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ARTICLE

STATE BANKRUPTCY: SURVIVING A TENTH AMENDMENT CHALLENGE

DAVID E. SOLAN^{*}

When it becomes necessary for a state to declare itself bankrupt, in the same manner as when it becomes necessary for an individual to do so, a fair, open, and avowed bankruptcy is always the measure which is both least dishonourable to the debtor, and least hurtful to the creditor.¹

ABSTRACT

During February 2011 the prospect of creating a state-bankruptcy chapter burst into the national conversation. This debate largely centered on the necessity of state bankruptcy as a means of averting state bailouts, and leading commentators emphasized the need to tread gingerly on state prerogatives under the Tenth Amendment. The constitutionality of bankruptcy for states demands closer scrutiny, given that the Supreme Court's recent Tenth Amendment jurisprudence has evolved toward protecting state sovereignty.

The principles handed down from a pair of cases in the 1930s involving the constitutionality of municipal bankruptcy would likely support upholding a state-bankruptcy chapter that is carefully drawn to respect state sovereignty. Though highly relevant, these cases are not

^{*} J.D. 2011, Tulane University Law School; B.A. 2008, cum laude, Bucknell University. Special thanks to Professor Adam Feibelman for his helpful advice and suggestions. Thanks also to my friends and family for all their support, and especially to Danielle Solan for her insightful comments.

¹ ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 435 (Edwin Cannan ed., The Univ. of Chi. Press 1976) (6th ed. 1793).

dispositive, however, because the legal landscape has changed a great deal since the 1930s. Even a broad state-bankruptcy chapter would be constitutional, because recent Tenth Amendment jurisprudence does not preserve traditional state functions. The Court has already upheld many similar infringements on state sovereignty, such as the interference with state contractual obligations.

Assuming a state-bankruptcy chapter is constitutional, is it a good idea? The main justification expressed for the creation of a state-bankruptcy chapter is that it is necessary to avoid a massive federal bailout, because states are too big to fail. This justification concludes that the grim logic of bailouts applies to the states because they are significantly interconnected with the financial markets.

INTRODUCTION

The great bank bailouts of 2007 have become the most widely detested policy in a generation. At the time, Hank Paulson, Treasury Secretary in the Bush Administration, warned Congress that the failure to promptly pass a massive bank bailout would lead to an imminent collapse of the financial markets.² The country's major financial institutions—such as Citigroup, Bank of America, Wells Fargo and JPMorgan Chase—were so connected with one another that a failure of one could lead to a failure of all.³ In other words, these banks were “too big to fail.”⁴

Unwilling to risk a second Great Depression for the sake of standing on principle, members of Congress held their noses and voted to approve the Troubled Asset Relief Program (TARP).⁵ This \$700 billion bailout

² See *Financial Bailout Package Shifts Focus*, N.Y. TIMES DEALBOOK (Nov. 13, 2008, 8:05 AM), <http://dealbook.nytimes.com/2008/11/13/financial-bailout-package-shifts-focus> (“In September, Mr. Paulson went to Congress and urgently pressed for authority to spend as much as \$700 billion to unclog the nation’s financial pipelines by buying up unsellable securities from banks and other financial institutions.”).

³ See Cyrus Sanati, *Senator Seeks to Break Up Banks “Too Big to Fail”*, N.Y. TIMES DEALBOOK (Nov. 6, 2009, 1:08 PM), <http://dealbook.nytimes.com/2009/11/06/senator-seeks-to-break-up-banks-too-big-to-fail/>. The subtext for this debate was that the failure of one major financial institution could lead others to fail due to their interconnectedness. This is implied: “Senator Bernard Sanders, the Vermont independent, . . . introduced legislation on Friday that would force the Treasury Department to break up all financial institutions whose failure could cause a major disruption to the nation’s financial system. ‘If an institution is too big to fail, it is too big to exist,’ according to Mr. Sanders.” *Id.*

⁴ *Id.*

⁵ See Carl Hulse & David M. Herszenhorn, *Bank Bailout Is Potent Issue for Fall Elections*, N.Y. TIMES, July 10, 2010, www.nytimes.com/2010/07/11/us/politics/11tarp.html (noting that the Senate approved the bailout measure with a bipartisan vote of 74 to 25, and the House passed the bill 263 to 171, after initially rejecting it).

package was designed to rescue the banking system from collapse.⁶ Not long after, a wave of outrage spread over the nation, rooted in utter disgust that the same malefactors whose risky behavior nearly brought the economy crashing down were bailed out, leaving the taxpayers holding the bag.⁷ From this froth of outrage a new political power was born. The Tea Party, a loose federation of citizens incensed by the bank bailout, joined forces with conservative candidates to defeat incumbents who had voted for TARP.⁸ This coalition swept the Democrats out of power in the 2010 congressional elections, and the new leadership of the House of Representatives vowed to end the era of bailouts.⁹

Although it appeared the era of bailouts had come to an end, the financial services industry is not the only sector that is interconnected with the broader national economy; concern has grown that some large states, such as California and Illinois, teetering on the brink of insolvency, are also too big to fail. A report issued by the Center on Budget and Policy Priorities, a Washington research group, found that states collectively face more than \$140 billion in budget deficits in 2012.¹⁰ Even bleaker are the states' unfunded pension and health-care liabilities, which amount to \$3.5 trillion.¹¹ Moreover, since the states' debt burdens are interconnected with banking institutions, it is plausible that the collapse of a single large state could have damaging

⁶ See *id.*

⁷ See Jennifer Steinhauer, *Beware of Anger, Take Advantage of Anxiety*, N.Y. TIMES, Sept. 18, 2010, www.nytimes.com/2010/09/19/weekinreview/19steinhauer.html; Carl Hulse & David M. Herszenhorn, *Bank Bailout Is Potent Issue for Fall Elections*, N.Y. TIMES, July 10, 2010, www.nytimes.com/2010/07/11/us/politics/11tarp.html (“Democrats who voted for the bailout—which was championed by their own leaders along with President George W. Bush and Senator John McCain of Arizona, then the Republican presidential nominee—are now facing attacks from Republican challengers on the campaign trail. Republicans who voted for it are being accused of promoting big government and fiscal irresponsibility by Tea Party candidates and other conservatives. . . . In Iowa, the Democratic Senate challenger, Roxanne Conlin, said that voters resented the government aid to big banks . . .”).

⁸ Cf. Hulse & Herszenhorn, *Bank Bailout Is Potent Issue for Fall Elections*, N.Y. TIMES, July 10, 2010, www.nytimes.com/2010/07/11/us/politics/11tarp.html (stating that support for the bank bailouts was a factor in both the Republican primaries and the general election).

⁹ See David M. Herszenhorn, *Boehner Offers G.O.P. for 2010 Version of Change*, N.Y. TIMES, Oct. 31, 2010, www.nytimes.com/2010/11/01/us/politics/01boehner.html (quoting Speaker Boehner as stating “if you are tired of all the bailouts, if you are tired of all the stimulus spending. . . . remember what the president said: ‘That’s what elections are for.’”); Kate Zernike, *Tea Party Gets Early Start on G.O.P. Targets for 2012*, N.Y. TIMES, Jan. 29, 2011, www.nytimes.com/2011/01/30/us/politics/30teaparty.html.

¹⁰ See Alison Vekshin, *State Bankruptcy Weighed by Republicans Blocking Aid*, BLOOMBERG (Jan. 21, 2011, 2:18 PM), www.bloomberg.com/news/2011-01-21/u-s-state-bankruptcy-weighed-by-house-republicans-blocking-aid.html.

¹¹ See James Pethokoukis, *When States Go Bust*, WEEKLY STANDARD (Feb. 14, 2011), www.weeklystandard.com/articles/when-states-go-bust_541424.html.

repercussions for the national economy.¹² The European sovereign debt crisis reinforced the concern that a financial contagion can quickly spread among interconnected entities.¹³ If investors lose confidence in a state's ability to pay back its debts, the same pattern of financial contagion may occur, leading investors to demand sharply higher interest rates to buy the municipal debt of other states.¹⁴ This turn of events would increase the borrowing costs for states, placing an even greater burden on strapped state budgets.¹⁵ Against this backdrop, leading policymakers have proposed extending bankruptcy protection to states as a credible alternative to bailing out indebted states in a moment of crisis.¹⁶

The principles handed down from a pair of cases from the 1930s—*Ashton v. Cameron County Water Improvement Dist. No. 1*, and *United States v. Bekins*—involving the constitutionality of municipal bankruptcy would likely support upholding a state-bankruptcy chapter that is carefully drawn to respect state sovereignty. However, the resurgence of the Tenth Amendment in the Supreme Court's jurisprudence complicates the picture and calls for closer analysis. Ultimately, even in an era of

¹² *But see* David Skeel, *Give States a Way to Go Bankrupt*, WEEKLY STANDARD (Nov. 29, 2010), www.weeklystandard.com/articles/give-states-way-go-bankrupt_518378.html.

¹³ *See* Steven Erlanger & Rachel Donadio, *Beyond Greece, Europe Fears Financial Contagion in Italy and Spain*, N.Y. TIMES, July 19, 2011, www.nytimes.com/2011/07/20/world/europe/20europe.html; Graham Bowley, Christine Hauser & Nelson D. Schwartz, *Fear of Contagion Rocks Markets*, N.Y. TIMES, Nov. 9, 2011, www.nytimes.com/2011/11/10/business/daily-stock-market-activity.html; *Europe's Financial Contagion*, WASH. POST, www.washingtonpost.com/wp-srv/special/business/financial-crisis-in-europe/ (last updated Nov. 7, 2011) [hereinafter *Europe's Financial Contagion*, WASH. POST] (“The European debt crisis has already spread like a virus from Greece to Ireland and Portugal, and other countries are now at risk: Spain, and Italy are probable candidates for financial problems. Contagion also has much to do with actual economic links among countries. Researchers have identified financial ties in particular as responsible for the ‘fast and furious’ spread of crisis from one country to another.”).

¹⁴ *See generally* Erlanger & Donadio, *Beyond Greece, Europe Fears Financial Contagion in Italy and Spain*, N.Y. TIMES, July 19, 2011, www.nytimes.com/2011/07/20/world/europe/20europe.html; Bowley et al., *Fear of Contagion Rocks Markets*, N.Y. TIMES, Nov. 9, 2011, www.nytimes.com/2011/11/10/business/daily-stock-market-activity.html; *Europe's Financial Contagion*, WASH. POST, www.washingtonpost.com/wp-srv/special/business/financial-crisis-in-europe/ (last updated Nov. 7, 2011).

¹⁵ Erlanger & Donadio, *Beyond Greece, Europe Fears Financial Contagion in Italy and Spain*, N.Y. TIMES, July 19, 2011, www.nytimes.com/2011/07/20/world/europe/20europe.html; Bowley et al., *Fear of Contagion Rocks Markets*, N.Y. TIMES, Nov. 9, 2011, www.nytimes.com/2011/11/10/business/daily-stock-market-activity.html; *Europe's Financial Contagion*, WASH. POST, www.washingtonpost.com/wp-srv/special/business/financial-crisis-in-europe/ (last updated Nov. 7, 2011).

¹⁶ *See, e.g.*, Jeb Bush & Newt Gingrich, Op-Ed., *Better Off Bankrupt*, L.A. TIMES, Jan. 27, 2011, <http://articles.latimes.com/print/2011/jan/27/opinion/la-oe-gingrich-bankruptcy-20110127>.

heightened concern for state sovereignty, a well-drafted state-bankruptcy law would likely be found constitutional.¹⁷

Part I of this Article will analyze the constitutionality of a state-bankruptcy chapter by reasoning by analogy to a pair of cases from the 1930s involving the constitutionality of federal laws extending bankruptcy protection to municipalities. This Part argues that a state-bankruptcy law that honors the principles handed down by *Bekins* would pass constitutional muster. Part II will probe the main justification expressed for the creation of a state-bankruptcy chapter—that is, it is necessary to avoid a massive federal bailout because states, like major financial institutions, are too big to fail. Part III sheds light on the impact of this Tenth Amendment analysis on drafting considerations.

¹⁷ This Article fits within the literature discussing particular constitutional issues raised by bankruptcy legislation. While many scholars have discussed the constitutionality of particular aspects of the bankruptcy system, few have comprehensively explored the constitutionality of bankruptcy at great length. See Douglas G. Baird, *Bankruptcy Procedure and State-Created Rights: The Lessons of Gibbons and Marathon*, 1982 SUP. CT. REV. 25 (1983); Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 862-77 (2000); Erwin Chemerinsky, *Constitutional Issues Posed in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 571 (2005); S. Elizabeth Gibson, *Jury Trials in Bankruptcy: Obeying the Commands of Article III and the Seventh Amendment*, 72 MINN. L. REV. 967 (1988); Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605 (2008) [hereinafter Lipson, *Debt and Democracy*] (developing a comprehensive theory of bankruptcy's role in the constitutional order); Jonathan C. Lipson, *Fighting Fiction with Fiction—The New Federalism in (a Tobacco Company) Bankruptcy*, 78 WASH. U. L.Q. 1271, 1291-1339 (2000) [hereinafter Lipson, *Fighting Fiction*]; Jonathan C. Lipson, *First Principles and Fair Consideration: The Developing Clash Between the First Amendment and the Constructive Fraudulent Conveyance Laws*, 52 U. MIAMI L. REV. 247, 272-303 (1997); Thomas E. Plank, *Bankruptcy and Federalism*, 71 FORDHAM L. REV. 1063, 1076-89 (2002); Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487 (1996); James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973 (1983). But see Lipson, *Debt and Democracy*, 83 NOTRE DAME L. REV. at 616 n.38. This Article is limited to discussing the Tenth Amendment issues raised by the creation of a state-bankruptcy chapter, a discussion that focuses on state sovereignty. Although a related topic, sovereign immunity under the Eleventh Amendment presents interesting challenges for a state-bankruptcy chapter, it is outside the scope of this Article. Many articles have discussed how developments in sovereign immunity under the Eleventh Amendment impact bankruptcy. See, e.g., Adam Feibelman, *Federal Bankruptcy Law and State Sovereign Immunity*, 81 TEX. L. REV. 1381 (2003); Scott Fruehwald, *The Supreme Court's Confusing State Sovereign Immunity Jurisprudence*, 56 DRAKE L. REV. 253 (2008); Joseph Pace, *Bankruptcy As Constitutional Property: Using Statutory Entitlement Theory to Abrogate State Sovereign Immunity*, 119 YALE L.J. 1568 (2010); Martin H. Redish & Daniel M. Greenfield, *Bankruptcy, Sovereign Immunity and the Dilemma of Principled Decision Making: The Curious Case of Central Virginia Community College v. Katz*, 15 AM. BANKR. INST. L. REV. 13 (2007).

I. CONSTITUTIONALITY OF A STATE-BANKRUPTCY CHAPTER

Proponents of a state-bankruptcy chapter tend to assume its constitutionality; however, they often suggest that it must be narrowly drafted to uphold state sovereignty, “the Constitution’s protections against federal meddling in state affairs.”¹⁸ In *Give States a Way to Go Bankrupt*, Professor David Skeel argued that the “constitutionality of bankruptcy-for-states is beyond serious dispute.”¹⁹ At the same time, he cautioned that a state-bankruptcy chapter must “tread[] gingerly on state prerogatives” for it to be constitutional.²⁰ One cannot have it both ways, however: if a state-bankruptcy chapter is easily constitutional, then Congress has the liberty to draft a broad bankruptcy chapter. On the other hand, if a state-bankruptcy chapter is constitutionally questionable, then Congress’s drafting choices are constrained, such that a bankruptcy chapter must be narrowly drawn to avoid violating state sovereignty.²¹ This paradox calls for further explanation to parse out the constitutional problems raised by the creation of a state-bankruptcy chapter.

A. CONSTITUTIONAL FOUNDATIONS OF THE BANKRUPTCY CLAUSE

The U.S. Constitution grants Congress the power to make “uniform Laws on the subject of Bankruptcies throughout the United States.”²² Remarkably, the introduction of the Bankruptcy Clause near the end of the Constitutional Convention elicited little debate.²³ The only recorded comments were those expressed by Governor Morris, who stated, “this [is] an extensive [and] delicate subject.”²⁴ *The Federalist Papers* are equally terse, stating only that the bankruptcy power is so intimately

¹⁸ David Skeel, *Give States a Way to Go Bankrupt*, WEEKLY STANDARD (Nov. 9, 2010), www.weeklystandard.com/articles/give-states-way-go-bankrupt_518378.html.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² See U.S. CONST. art. I, § 8, cl. 4.

²³ See Lipson, *Debt and Democracy*, 83 NOTRE DAME L. REV. 605, 625 (2008) (stating that “[l]ittle is known” about the legislative history of the bankruptcy clause). On August 29, 1787, Pinckney proposed that Congress be given the power “[t]o establish uniform laws upon the subject of bankruptcies, and respecting the damages arising on the protest of foreign bills of exchange.” See 2 MAX FARRAND, RECORDS OF THE FEDERAL CONVENTION 447 (1911), available at <http://memory.loc.gov/ammem/amlaw/lwfr.html>.

²⁴ See FARRAND, RECORDS OF THE FEDERAL CONVENTION at 489. This Article was written in response to Sherman, who objected to granting Congress the power to punish bankrupts by death, as occasionally was the case under the laws of England. No further debate was recorded, and the Bankruptcy Clause was adopted by a 9-1 margin. *Id.*; see generally Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 12–13 (1995) (recounting the discussion of bankruptcy during the Constitutional Convention).

connected with the regulation of commerce “that the expediency of it seems not likely to be drawn in question.”²⁵ Notably, while ratifying the Constitution, the New York Convention proposed an amendment that would restrict the scope of the Bankruptcy Clause to merchants and traders.²⁶ The rejection of this amendment, however, suggests that the framers intended the bankruptcy power to extend beyond merchants.²⁷

The early judicial decisions recognized a broad conception of the bankruptcy power. As early as 1819, Chief Justice Marshall held in *Sturges v. Crowninshield* that Congress has broad discretion to define the scope of the bankruptcy power, and interpreted this power as extending to the broader realm of insolvency legislation.²⁸ Although “[a]lmost every [expansion of the bankruptcy power] has been hotly denounced in its beginnings as a usurpation of power,” these objections have receded over time.²⁹ Indeed, the history of the bankruptcy power shows “an expanding concept” leaving in its wake a “trail . . . strewn with a host of unsuccessful objections based on constitutional grounds against the enactment of various provisions, all of which are now regarded as

²⁵ See THE FEDERALIST NO. 42 (James Madison), available at http://thomas.loc.gov/home/histdox/fed_42.html.

²⁶ See 1 DEBATES IN THE SEVERAL STATE CONVENTIONS ON THE ADOPTION OF THE FEDERAL CONSTITUTION 330 (Jonathan Elliot ed., 2d ed. 1836), available at <http://memory.loc.gov/ammem/amlaw/lwled.html> (“That the power of Congress to pass uniform laws concerning bankruptcy shall only extend to merchants and other traders; and the states, respectively, may pass laws for the relief of other insolvent debtors.”).

²⁷ *Id.*

²⁸ *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 195 (1819) (opinion of Marshall, C.J.). Justice Marshall also observed that the bankruptcy power is “one on which the Legislature may exercise an extensive discretion.” *Id.* Contemporary scholars support this sweeping interpretation of the bankruptcy power. See Lipson, *Debt and Democracy*, 83 NOTRE DAME L. REV. at 633 n.1135 (citing Frank R. Kennedy, *Bankruptcy and the Constitution*, in BLESSINGS OF LIBERTY: THE CONSTITUTION AND THE PRACTICE OF LAW 131, 137-38 (1988) (“When the variety of the provisions enacted by Congress and the frequency and range of attacks on their constitutionality are considered, it must be concluded that the courts have indeed come close to permitting Congress complete freedom in formulating and enacting bankruptcy legislation.”)).

²⁹ *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 535 (1936) (Cardozo, J., dissenting); *id.* at 536 n.6 (“Thus, it was at first contended that, constitutionally, such a law must be confined to the lines of the English statute; next, that it could not discharge prior contracts; next, that a purely voluntary law would be nonuniform and therefore unconstitutional; next, that any voluntary bankruptcy was unconstitutional; next, that there could be no discharge of debts of any class except traders; next, that a bankruptcy law could not apply to corporations; next, that allowance of State exemptions of property would make a bankruptcy law non-uniform; next, that any composition was unconstitutional; next, that there could be no composition without an adjudication in bankruptcy; next, that there could be no sale of mortgaged property free from the mortgage. All these objections, so hotly and frequently asserted from period to period, were overcome either by public opinion or by the Court.” (quoting CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 9-10 (1935))).

perfectly orthodox features of a bankruptcy law.”³⁰ Moreover, nearly all of these bold expansions have received judicial approval as falling within the scope of the powers granted by the Bankruptcy Clause of the Constitution.³¹ The only momentary hitch in the road to continuous expansion occurred in 1936, when the Supreme Court struck down the Municipal Bankruptcy Act of 1934 in *Ashton v. Cameron County Water Improvement Dist. No. 1*.³² However, this decision was effectively overturned only two years later in *United States v. Bekins*.³³ For over seventy years since the *Bekins* decision, the constitutionality of a municipal-bankruptcy law has been well settled.

History shows that the Bankruptcy Clause extends to any debtors that are unable to meet their obligations.³⁴ Given the similarities between municipalities and states,³⁵ expanding bankruptcy relief to the states could be the next stage in the evolution of bankruptcy. In this sense, the Bankruptcy Clause has proven its flexibility in stretching to meet fresh challenges brought by the remarkable growth of American business activities. For example, it has not stood in the way of the country’s transformation from an agrarian economy to an industrial one.³⁶ Although many expansions of the Bankruptcy Clause were bold and far-reaching,³⁷ the courts have held that these expansions were within the limits of congressional power.³⁸ These decisions reflect the Bankruptcy Clause’s boundless potential to extend into new fields.

³⁰ See *id.* at 535.

³¹ See, e.g., *Hanover Nat’l Bank v. Moyses*, 186 U.S. 181, 186 (1902) (upholding the 1800 Act’s extension of the bankruptcy power beyond traders, and stating that the Bankruptcy Power “extends to all cases where the law causes to be distributed, the property of the debtor among his creditors; this is its least limit.” (quoting *In re Klein*, 42 U.S. (1 How.) 277, 281 (1843)); *Cont’l Ill. Nat’l Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry. Co.*, 294 U.S. 648, 670 (1935) (“The first [bankruptcy act, in 1800,] ignored the English law, which was confined to traders, as to include bankers, brokers and underwriters as well. The act of 1841 added merchants; and other additions have been made by later acts until now practically all classes of persons and corporations are included.”).

³² See *Ashton*, 298 U.S. at 530.

³³ *United States v. Bekins*, 304 U.S. 27, 49-50 (1938).

³⁴ See *Hanover*, 186 U.S. at 185; *Cont’l Ill. Nat’l Bank*, 294 U.S. at 662, 663 n.4.

³⁵ See Carol F. Lee, *The Federal Courts and the Status of Municipalities: A Conceptual Challenge*, 62 B.U. L. REV. 1, 56-57 (1982).

³⁶ See Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 11-12 (1995).

³⁷ See *id.* at 44-45 (recounting the major expansions of the bankruptcy clause over the years); *id.* at 46 (“Today, virtually any law that readjusts the respective rights between creditors and a financially distressed debtor falls within the ‘subject of bankruptcies.’”).

³⁸ See *Cont’l Ill. Nat’l Bank*, 294 U.S. at 670 (“The fundamental and radically progressive nature of these extensions becomes apparent upon their mere statement; but all have been judicially approved or accepted as falling within the power conferred by the bankruptcy clause of the Constitution.”).

The text of the Bankruptcy Clause does not limit the class of debtors that are subject to the bankruptcy power under strict constructionism.³⁹ Indeed, courts have held that Congress's power under the Bankruptcy Clause is "unrestricted and paramount."⁴⁰ The only existing limitation is that bankruptcy laws passed by Congress must be "uniform"; bankruptcy laws should "not be designed to help one debtor in a manner different from how other debtors are treated."⁴¹

Similarly, the Supreme Court does not require the exclusion of public debtors. On the contrary, the Court has determined that the Bankruptcy Clause extends to all categories of debtors unable to meet their obligations.⁴² In 1902, the Court endorsed the view that "[t]here is nothing in the nature or reason of such laws to prevent their being applied to any other class of unfortunate and meritorious debtors."⁴³ This example comports with other authority from the same period that reaffirmed the broad scope of the bankruptcy powers.⁴⁴ In sum, it appears that the bankruptcy power extends to all debtors, regardless of whether the debtor is an individual or an organization.

³⁹ See ERWIN CHEREMINSKY, CONSTITUTIONAL LAW 286 (3d ed. 2006). Interestingly, when it comes to methods of interpreting the bankruptcy clause, the Court has, in the past, appeared to embrace a hybrid of the "living Constitution" view and the strict constructionist view. See *Cont'l Ill. Nat'l Bank*, 294 U.S. at 668. In 1935, the Court remarked that the framers did not intend the powers of Congress under the Bankruptcy Clause to be limited to the English or Colonial law in force when the Constitution was adopted. *Id.* In other words, the framers intended the Bankruptcy Clause to expand over time to meet new commercial realities.

⁴⁰ See, e.g., *In re Delta Group*, 300 B.R. 918, 921 (E.D. Wis. 2003), *appeal dismissed*, 336 B.R. 405 (E.D. Wis. 2004) (citing *Int'l Shoe Co. v. Pinkus*, 278 U.S. 261, 265 (1929)).

⁴¹ See CHEREMINSKY, CONSTITUTIONAL LAW at 286 ("For example, in the *Regional Railroad Reorganization Act Cases*, the Court upheld a bankruptcy law that treated railroads in one part of the country differently than other areas The Court explained that the law was 'uniform' because all of the railroads covered by the law, and all of the creditors of these railroads were treated the same under the Act.").

⁴² See *Cont'l Ill. Nat'l Bank*, 294 U.S. at 670 (approving a formulation that the bankruptcy power extends to "any person's general inability to pay his debts." (quoting *Kunzler v. Kohaus*, 5 Hill 317, 321 (N.Y. 1843))).

⁴³ See *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 185 (1902) (quoting 3 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES (1st ed. 1833); see also *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 195 (1819) (opinion of Marshall, C.J.) ("[I]t is not easy to say, who must be excluded from, or may be included within, this description. It is, like every other part of the subject, one upon which the legislature may exercise an extensive discretion.").

⁴⁴ See *In re Klein*, 42 U.S. (1 How.) 277, 281 (1843) ("To what limits is [bankruptcy] jurisdiction restricted? I hold it extends to all cases where the law causes to be distributed the property of the debtor among his creditors: this is its least limit."); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 588 n.18 (1935) (same, quoting *In re Klein*, 42 U.S. at 281); *Cont'l Ill. Nat'l Bank*, 294 U.S. at 672-73.

B. CONSTITUTIONALITY OF MUNICIPAL BANKRUPTCY—EARLY CASES

The constitutionality of extending bankruptcy protection to municipalities was hotly contested in a pair of Supreme Court cases during the 1930s.⁴⁵ These early cases are important to the discussion of whether a state-bankruptcy chapter would be constitutional because they implicate the same set of issues—state sovereignty and federal power under the Bankruptcy Clause. Although under reigning jurisprudence it is well settled that the municipal-bankruptcy law is constitutional, it is possible that a state-bankruptcy chapter could be stricken down as an impermissible infringement upon state sovereignty. Such a law would be struck down if the sovereignty concerns relating to state bankruptcy were different and more pressing than those relating to municipal bankruptcy. While cities and states are separate governmental entities, the Court’s analysis of municipal bankruptcy has been premised on the status of municipalities as agents of the state.⁴⁶ As the states’ agents, municipalities act on their behalf and are subject to their control while carrying out local governmental responsibilities.⁴⁷ The states’ plenary power over municipalities is also expressed in the metaphor that municipalities are “creatures of the state,” and are thus separate entities that owe their existence to the state.⁴⁸ Under either metaphor, federal interference with a municipality constitutes interference with the state itself. While state bankruptcy would apply more directly to the state, analogous protections may satisfy the same sovereignty concerns.

1. *Ashton Decision*

Ashton was handed down in an economic climate not very different from that of modern America. The Great Depression ravaged the balance sheets of municipalities across the country. In 1934, congressional hearings revealed that 2,019 municipalities, counties, and

⁴⁵ In *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, the Court struck down the Municipal Bankruptcy Act of 1934 and held that extending the bankruptcy power to municipalities violated state sovereignty. 298 U.S. 513, 531-32 (1936). In the second case, *United States v. Bekins*, the Court upheld the constitutionality of a similar law, while declining to overrule *Ashton*. 304 U.S. 27, 45, 50-51 (1938) (noting that the question on appeal concerned the constitutionality of “the Act of August 16, 1937, amending the Bankruptcy Act by adding Chapter 10 providing for the composition of indebtedness of the taxing agencies or instrumentalities therein described.” (citation omitted)).

⁴⁶ See *Bekins*, 304 U.S. at 54 (describing a municipality as the state’s agency).

⁴⁷ See Carol F. Lee, *The Federal Courts and the Status of Municipalities: A Conceptual Challenge*, 62 B.U. L. REV. 1, 6-7 (1982).

⁴⁸ *Id.*

other governmental units were in default.⁴⁹ These municipalities could not turn to their respective states for relief, because the Contracts Clause of the U.S. Constitution prohibits the states from passing laws that impair the obligation of existing contracts.⁵⁰ Unwilling to ignore the plight of municipalities, Congress passed the Municipal Bankruptcy Act of 1934 (MBA), which provided a mechanism for the discharge of municipal debt.⁵¹ Well aware of the constitutional problems raised by permitting a federal court to exercise jurisdiction over an instrumentality of a state, Congress took care to draft the law to minimize infringements of state sovereignty, for example, by requiring a municipality to obtain state consent prior to being able to utilize the Act.⁵²

Despite such protections, within two years, the Supreme Court, in *Ashton*, found the MBA unconstitutional.⁵³ In that case, an insolvent water district, organized under the laws of Texas in 1914, sought to adjust its debt obligations under the MBA.⁵⁴ A minority of the district's bondholders, however, refused to go along with the plan and challenged the validity of the petition.⁵⁵ The trial court held that Congress overstepped its power when it authorized a federal court to adjust debt obligations of an instrumentality of a state.⁵⁶ The circuit court reversed, holding that Congress had properly exercised the bankruptcy power by extending bankruptcy protection to municipalities.⁵⁷ The Supreme Court held that the MBA unconstitutionally interfered with state sovereignty.⁵⁸

The *Ashton* Court reasoned that the power of Congress to enact uniform laws on bankruptcies did not extend to the political subdivisions of states, because such an extension unduly interfered with their fiscal autonomy.⁵⁹ To support its analysis, the Court drew a parallel to the taxing power of Congress.⁶⁰ The Bankruptcy Clause, like the power to lay and collect taxes, is "impliedly limited by the necessity of preserving

⁴⁹ See *Hearings Before a Subcommittee of the Senate Committee on the Judiciary on S. 1868 and H.R. 5950*, 73d Cong., 2d Sess. (1934); *Hearings Before the House Committee on the Judiciary on H.R. 1670, etc.*, 73d Cong., 1st Sess. (1933).

⁵⁰ U.S. CONST. art. I, § 10, cl. 1.; see *Sturges v. Crowninshield*, 17 U.S. (4 Wheat.) 122, 128 (1819) (holding that a state insolvency act could not relieve obligations incurred by the debtor before its passage).

⁵¹ See *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 523 (1936).

⁵² See S. REP. NO. 407, 73d Cong., 2d Sess., at 1 (1934).

⁵³ See *Ashton*, 298 U.S. at 530.

⁵⁴ *Id.* at 523.

⁵⁵ *Id.* at 523-24.

⁵⁶ *Id.* at 524.

⁵⁷ *Id.*

⁵⁸ *Id.* at 530.

⁵⁹ *Id.* at 530-31.

⁶⁰ *Id.* at 530.

independence of the states.”⁶¹ Likewise, the Court emphasized the importance of state sovereignty in the federal system, observing that “[t]he sovereignty of the state essential to its proper functioning under the Federal Constitution cannot be surrendered [or] taken away by any form of legislation.”⁶² The Court characterized the chief purpose of all bankruptcy legislation as interfering with the contractual relations of the parties by modifying the obligations of their contracts.⁶³ This purpose, the Court observed, could not be applied to states or to their political subdivisions.

Notably, the specter of extending the Bankruptcy Clause to sovereign states was in the forefront of the Court’s mind.⁶⁴ For example, the Court asked rhetorically, “If federal bankruptcy laws can be extended to respondent, why not to the state?”⁶⁵ The Court was apparently concerned with the slippery slope leading to bankruptcy for states, and it decided to thwart such expansion.⁶⁶ Accordingly, the Supreme Court struck down the MBA as unconstitutional because it could “materially restrict [the water district’s] control over its fiscal affairs.”⁶⁷

In his dissent, Justice Cardozo characterized the issue in narrow terms: “Is there power in the Congress under the Constitution of the United States to permit local governmental units generally, and irrigation or water improvement districts in particular, to become voluntary bankrupts with the consent of their respective states?”⁶⁸ Cardozo started

⁶¹ *Id.*

⁶² *Id.* at 531 (stating that it is impermissible for the federal government to “pass laws inconsistent with the idea of sovereignty”). “If obligations of states or their political subdivisions may be subjected to the interference here attempted, they are no longer free to manage their own affairs; the will of Congress prevails over them And really the sovereignty of the state, so often declared necessary to the federal system, does not exist.” *Id.*

⁶³ *Id.* at 530.

⁶⁴ *Id.* at 532. (Cardozo, J., dissenting). Notably, Justice Cardozo, in dissent, also suggested that he would view the extension of bankruptcy to states to be unconstitutional. *Id.* at 542 (“There is room at least for argument that within the meaning of the Constitution the bankruptcy concept does not embrace the states themselves.”). Cardozo reasoned that under the U.S. public laws, “a state is a sovereign or at least a quasi sovereign.” *Id.* “Not so a local governmental unit, though the state may have invested it with governmental power.” *Id.* at 541. As an example of an attribute of sovereignty that resides with states, Cardozo listed immunity from suit, which “belongs to the state alone by virtue of its sovereignty.” *Id.* at 543 (citing *Hopkins v. Clemson Agric. Coll.*, 221 U.S. 636, 645 (1911)). In other words, since states are considered sovereign, extending the bankruptcy power to them inherently interferes with their sovereignty.

⁶⁵ *Id.* at 530 (majority opinion).

⁶⁶ *Id.* (“If the state were proceeding under a statute like the present one, with terms broad enough to include her, apparently the problem would not be materially different. Our special concern is with the existence of the power claimed—not merely the immediate outcome of what has already been attempted.”).

⁶⁷ *Id.*

⁶⁸ *Id.* at 532 (Cardozo, J., dissenting).

his analysis by tracing the history of the bankruptcy power, noting that although it has steadily expanded over the years, “[a]lmost every change has been hotly denounced in its beginnings as a usurpation of power.”⁶⁹ Cardozo stated that the MBA was carefully drafted to avoid interfering with state sovereignty, and he conceded for the sake of argument that a more sweeping law might upset the balance between state and federal power.⁷⁰ He emphasized that the MBA did not provide for involuntary bankruptcy; therefore, the critical element of consent was preserved, which prevented the MBA from upsetting the balance of power between the federal government and the states.⁷¹ It thus appears that Cardozo would have drawn the constitutional line at involuntary bankruptcy, because such a law would lack the critical element of state consent; in Cardozo’s view, municipal bankruptcy would be constitutional so long as it takes place in a voluntary proceeding.⁷²

Importantly, Cardozo emphasized the practical necessity for the MBA.⁷³ Forbidding municipalities from entering into voluntary bankruptcy would mean they are “caught in a vise from which it is impossible to let them out.”⁷⁴ Since the Contracts Clause of the U.S. Constitution forbids states from offering a forum to rework contracts,⁷⁵ the states themselves cannot directly rescue their municipalities from financial ruin. In the absence of federal bankruptcy protection, the collective action problem dictates that “a small minority of creditors . . . will resist a [fair and reasonable] composition.”⁷⁶ Therefore, a municipal-bankruptcy chapter becomes necessary as a practical matter for some indebted municipalities to become solvent.

⁶⁹ *Id.* at 535.

⁷⁰ *Id.* at 538 (“The question is not here whether the statute would be valid if it made provision for involuntary bankruptcy, dispensing with the consent of the state and with that of the bankrupt subdivision. For present purposes one may assume that there would be in such conditions a dislocation of that balance between the powers of the states and the powers of the central government which is essential to our federal system.”).

⁷¹ *Id.* at 541.

⁷² *Id.* at 541-42.

⁷³ *Id.* (“To hold that this purpose must be thwarted by the courts because of a supposed affront to the dignity of a state, though the state disclaims the affront and is doing all it can to keep the law alive, is to make dignity a doubtful blessing. Not by arguments so divorced from the realities of life has the bankruptcy power been brought to the present state of its development during the century and a half of our national existence.”).

⁷⁴ *Id.*

⁷⁵ See U.S. CONST. art. I, § 10, cl. 1.; see generally J. Michael Veron, *The Contracts Clause and the Court: A View of Precedent and Practice in Constitutional Adjudication*, 54 TUL. L. REV. 117 (1979).

⁷⁶ *Ashton*, 298 U.S. at 541 (Cardozo, J., dissenting).

2. *Bekins Decision*

Congress responded to the *Ashton* Court's decision by amending the MBA in 1937.⁷⁷ The revision provided for a composition procedure similar to an agreement between a debtor and a majority of creditors, and it required the approval of a majority of creditors before a municipality could obtain a discharge of its debts.⁷⁸ In recognition of state sovereignty concerns, bankruptcy judges were given a passive role in the bankruptcy process, limited to determining whether an agreement was fair.⁷⁹ Notwithstanding minor drafting changes, the new law accomplished the same objective that the Court had firmly rejected in *Ashton*, namely the extension of the bankruptcy power to municipalities.⁸⁰

In *Bekins*, however, the Court retreated from its earlier position that state sovereignty presents a barrier to extending bankruptcy to municipalities. *Bekins* considered "the question of the constitutional validity of the [1937 Act], amending the Bankruptcy Act by adding chapter [X] providing for the composition of indebtedness of the taxing agencies or instrumentalities."⁸¹ The Court held that the 1937 Act was constitutional, finding that the voluntary composition of debts "was nothing less than 'the subject of the relations between an insolvent or non-paying or fraudulent debtor, and his creditors, extending to his and their relief.'"⁸² The Court reasoned that "[t]he statute is carefully drawn

⁷⁷ See Act of Aug. 16, 1937, §§ 81-84, 50 Stat. 653 (1937), available at HeinOnline. 11 U.S.C. §§ 401-404.

⁷⁸ See Giles J. Patterson, *Municipal Debt Adjustment Under the Bankruptcy Act*, 90 U. PA. L. REV. 520, 525 (1942) ("The Supreme Court of the United States not only had defined compositions, but it had enumerated the essential characteristics of them. A composition, it had said, was in the nature of a contract or agreement between the debtor and a majority of its creditors. In a proceeding for composition, the Court is limited to a determination of the fairness of that agreement; but for this it would not be necessary for the debtor to seek the intervention of the Court.").

⁷⁹ See *id.*

⁸⁰ See Daniel J. Goldberg, *Municipal Bankruptcy: The Need for an Expanded Chapter IX*, 10 U. MICH. J.L. REFORM 91, 94 (1977) (describing the revision as "virtually identical to its predecessor"); David L. Dubrow, *Chapter 9 of the Bankruptcy Code: A Viable Option for Municipalities in Fiscal Crisis?*, 24 URB. LAW. 539, 550 (1992) (describing the revision as a "slightly modified version").

⁸¹ *United States v. Bekins*, 304 U.S. 27, 45 (1938).

⁸² *Id.* at 47 (citing *Cont'l Ill. Nat'l Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry. Co.*, 294 U.S. 648, 673 (1935)). Echoing Cardozo's dissent in *Ashton*, the majority of the Court emphasized the practical necessity of extending bankruptcy to municipalities. *Id.* 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."). The Court stressed that states are obliged to cooperate with the federal government because a "[s]tate itself is powerless to rescue" its municipalities from financial ruin due to the Contracts Clause. *Id.*

so as not to impinge upon the sovereignty of the State.”⁸³ Congress had adequately responded to the concerns raised in *Ashton* by allowing the state to keep control of its fiscal affairs, and by authorizing the exercise of the bankruptcy power only when the state consents.⁸⁴

Whereas the *Ashton* Court envisioned a rigid federal system in which the powers of Congress cannot reach into spheres traditionally left to the states, even with the states’ consent,⁸⁵ the *Bekins* Court concluded that “[i]t is of the essence of sovereignty to be able to make contracts and give consents bearing upon the exertion of governmental power.”⁸⁶ This logic suggests that a municipal-bankruptcy chapter is consistent with federalism norms so long as states consent for their municipalities to participate. Furthermore, “the Tenth Amendment protected, and did not destroy, [a state’s] right to make contracts and give consents” to limit the exercise of its powers.⁸⁷ The Court went on to draw an analogy to the making of treaties, where “governments yield their freedom of action in particular matters in order to gain the benefits which accrue from international accord.”⁸⁸

The *Ashton* decision “came at the twilight of the traditional framework and the dual spheres model of federalism.”⁸⁹ It reflected the Court’s shift away from a rigid construction of state sovereignty under the Tenth Amendment, where there is a well-defined sphere of exclusive state dominance,⁹⁰ and toward the more flexible, modern approach. Under the former approach, a state-bankruptcy chapter would likely intrude into the separate sphere reserved for the states by the Tenth Amendment; under the latter approach, so long as a state consents to participate in the federal bankruptcy process, “[t]he State acts in aid, and not in derogation, of its sovereign powers.”⁹¹

⁸³ *Id.* at 51.

⁸⁴ *Id.* at 50-51 (“In enacting chapter 10 the Congress was especially solicitous to afford no ground for [the *Ashton* Court’s] objection.”).

⁸⁵ See *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 531 (1936) (“Neither consent nor submission by the states can enlarge the powers of Congress The sovereignty of the state essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation.”).

⁸⁶ *Bekins*, 304 U.S. at 51-52.

⁸⁷ *Id.* at 52.

⁸⁸ *Id.*

⁸⁹ See Carol F. Lee, *The Federal Courts and the Status of Municipalities: A Conceptual Challenge*, 62 B.U. L. REV. 1, 21 n.94 (1982).

⁹⁰ *Id.* at 6-7.

⁹¹ *Bekins*, 304 U.S. at 52.

3. *Applying Ashton and Bekins to State Bankruptcy*

The Court's shift from *Ashton* to *Bekins* was dramatic. In *Ashton*, the Court issued a sweeping holding that struck down the Municipal Bankruptcy Act on the grounds of protecting state sovereignty.⁹² Only two years later, in *Bekins*, the Court abruptly changed course and largely adopted Justice Cardozo's dissenting opinion in *Ashton* by emphasizing that federalism concerns are alleviated when the state gives its consent for municipalities to participate in the bankruptcy process.⁹³

Similarly, the inherent federalism conflict present with municipal bankruptcy would occur with state bankruptcy. In the context of municipal insolvency, the federalism conflict emanates from the fact that while states wield plenary power over their municipal subdivisions, the federal government is charged with promulgating a uniform system of bankruptcy.⁹⁴ As a result, the Court's discussion in *Ashton* and *Bekins* regarding how federalism principles apply to municipal bankruptcy sheds light on the application of federalism principles to state bankruptcy.⁹⁵ Although the portions of the two opinions discussing the constitutionality of extending bankruptcy protection to states are dicta, the Court's analysis of state sovereignty, though not binding on future courts, is instructive and should not be ignored.

The *Bekins* Court articulated a more flexible theory of state sovereignty than the rigid formalism expressed in *Ashton*. Had the *Bekins* Court adopted Justice Cardozo's reasoning that a local governmental unit is neither a sovereign nor a quasi-sovereign, the constitutionality of a state-bankruptcy chapter would be thrust into greater doubt, because such a distinction broadens the conceptual distance between municipalities and states.⁹⁶ Instead, the *Bekins* Court grounded its reasoning in the idea that state consent can override federalism concerns. For example, the Court noted that a state, like a country that enters into a treaty, has the power to give its consent to limit the exercise of its powers.⁹⁷

Notwithstanding its shift away from protecting state sovereignty, the *Bekins* Court articulated several guideposts that suggest when

⁹² See *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513 (1936).

⁹³ See *Bekins*, 304 U.S. 27.

⁹⁴ See Jonathan J. Spitz, *Federalism, States, and the Power to Regulate Municipal Bankruptcies: Who May Be a Debtor Under Section 109(c)*, 9 BANKR. DEV. J. 621, 621 (1993) (citing *City of Trenton v. New Jersey*, 262 U.S. 182 (1923); *Barnes v. District of Columbia*, 91 U.S. 540 (1875); U.S. CONST. art. I, § 8, cl. 4).

⁹⁵ See generally *Ashton*, 298 U.S. 513; *Bekins*, 304 U.S. 27.

⁹⁶ See *Ashton*, 298 U.S. at 542 (Cardozo, J., dissenting).

⁹⁷ See *Bekins*, 304 U.S. at 52.

municipal bankruptcy might run afoul of the Constitution.⁹⁸ The key requirements appear to be that a city cannot be forced to file for bankruptcy against its will, and that a bankruptcy judge cannot usurp a municipality's political decisionmaking authority.⁹⁹ These standards are relevant for determining the constitutionality of a state-bankruptcy chapter because both involve the limits of federal intrusion into state sovereignty.

Since the *Bekins* Court found that the municipal-bankruptcy law was sufficiently circumscribed so as not to impinge upon state sovereignty, a state-bankruptcy law that honors the *Bekins* principles would be equally sound.¹⁰⁰ However, the same bankruptcy law may not apply identically to municipalities and states, because they represent two different forms of sovereignty.¹⁰¹ Municipalities are endowed with some features of sovereignty, but not all.¹⁰² In contrast, states possess all aspects of sovereignty that they did not give up when they ratified the Constitution. Accordingly, a state-bankruptcy chapter would inherently risk a greater intrusion into state sovereignty than municipal bankruptcy.

Moreover, the "necessity" rationale articulated by the *Bekins* Court does not apply to states in the same way as it does to municipalities. The *Bekins* Court, mirroring Justice Cardozo's dissent in *Ashton*, emphasized that without municipal bankruptcy a "[s]tate . . . is powerless to rescue" its municipalities from financial ruin.¹⁰³ This is not the case with states themselves because, unlike a municipality, a state always has the option of defaulting on debt and refusing to pay creditors, much like a sovereign country.¹⁰⁴

⁹⁸ See *id.* at 51-52.

⁹⁹ See *id.* at 51.

¹⁰⁰ See David A. Skeel Jr., *States of Bankruptcy* 24 (U of Penn, Inst. for Law & Econ Research Paper No. 11-24) (July 30, 2011), available at <http://ssrn.com/abstract=1907774>.

¹⁰¹ See Carol F. Lee, *The Federal Courts and the Status of Municipalities: A Conceptual Challenge*, 62 B.U. L. Rev. 1, 3 (1982) ("Underlying the cases is a conceptual duality that has long characterized legal thinking about municipal subdivisions. The city is an intermediate entity, created by the sovereign state, exercising power over the citizenry, yet in form and dignity not equivalent to the state. According to the traditional doctrine, it derives a public, governmental character from the state and shares some of the state's powers and immunities.").

¹⁰² *Id.*

¹⁰³ See *Bekins*, 304 U.S. at 54.

¹⁰⁴ See, e.g., Robert M. Barnett, *Exchange Rate Arrangements in the International Monetary Fund: The Fund As Lawgiver, Adviser, and Enforcer*, 7 TEMP. INT'L & COMP. L.J. 77, 89-93 (1993); Derek W. Bowett, *Claims Between States and Private Entities: The Twilight Zone of International Law*, 35 CATH. U. L. REV. 929, 931-32 (1986); Enrique R. Carrasco & Randall Thomas, *Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539 (1996); Rainer Geiger, *The Unilateral Change of Economic Development Agreements*, 23 INT'L & COMP. L.Q. 73 (1974); Rory Macmillan, *The Next Sovereign Debt Crisis*, 31 STAN. J. INT'L L. 305, 353 (1995).

In summary, the principles expressed in *Bekins* will likely play a role in determining the constitutionality of any state-bankruptcy chapter. The Court contemplated the prospect of extending bankruptcy protection to states as it shaped the guideposts for when a municipal-bankruptcy chapter might violate sovereignty principles. Even assuming, however, that *Bekins* is good law today, an analysis of the constitutionality of a state-bankruptcy chapter must take into account the Court's evolving protection of state sovereignty.

C. STATE SOVEREIGNTY ISSUES

While *Ashton* and *Bekins* were decided on Tenth Amendment grounds, it is not prudent to simply grab the decisions from the shelf and apply them directly to the constitutionality of a state bankruptcy. For starters, the *Ashton* Court did not directly cite the Tenth Amendment to invalidate the MBA. Nevertheless, the Court's focus on state sovereignty supports such an interpretation of the Court's reasoning.¹⁰⁵ If a bankruptcy chapter was challenged on Tenth Amendment grounds,¹⁰⁶ it is plausible that the Court would come down squarely on the side of state sovereignty because this issue has been a primary concern for a majority of the current Court.¹⁰⁷

Over the course of American history, the Court has shifted between two different approaches as to whether the Tenth Amendment is a judicially enforceable limit on Congress's powers.¹⁰⁸ Insofar as the Court in the early 1930s, as represented by the *Ashton* decision, was fixated on defining rigid boundaries between the national and state

There is, however, a kind of "necessity" in both cases. States today, like municipalities in the 1930s, are grappling with dire financial troubles. See Alison Vekshin, *State Bankruptcy Weighed by Republicans Blocking Aid*, BLOOMBERG (Jan. 21, 2011, 2:18 PM), www.bloomberg.com/news/2011-01-21/u-s-state-bankruptcy-weighed-by-house-republicans-blocking-aid.html. States can always raise revenues to dig out of a financial crisis, but so can municipalities. Although a fear exists that if a municipality raises taxes, its citizens will move elsewhere, the same fear exists on the state level that citizens may "vote with their feet" in response to tax hikes. However, there is less justification for this fear on the state level; it is often more difficult to move out of the state than out of the municipality.

¹⁰⁵ See *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 531 (1936).

¹⁰⁶ The Tenth Amendment reads, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. CONST. amend. X.

¹⁰⁷ See David A. Skeel Jr., *States of Bankruptcy* 24 (U of Penn, Inst. for Law & Econ Research Paper No. 11-24) (July 30, 2011), available at <http://ssrn.com/abstract=1907774>.

¹⁰⁸ See ERWIN CHERMERINSKY, *CONSTITUTIONAL LAW* 312-13 (3d ed. 2006). Scholars tend to identify three main policy rationales behind federalism: "decreasing the likelihood of federal tyranny, enhancing democratic rule by providing government that is closer to the people, and allowing states to be laboratories for new ideas." *Id.*

governments,¹⁰⁹ the Tenth Amendment cases from that period have lost some of their force, because modernly the Court has not required such a strict separation.¹¹⁰ Between 1937 and the 1990s, the Court expressly rejected the position that the Tenth Amendment operates as an independent limit on the legislative power.¹¹¹ Instead, the Court has viewed the Tenth Amendment during this period as an unenforceable admonition that there must be authority in the Constitution before Congress can legislate.¹¹²

In the 1990s, by contrast, the Court revived the Tenth Amendment as a limit on congressional power in its anticommandeering cases, *New York v. United States*¹¹³ and *Printz v. United States*.¹¹⁴ In these cases, the

¹⁰⁹ See *Ashton*, 298 U.S. at 528 (“[There can] be no loss of separate and independent autonomy to the States, through their union under the Constitution.” (quoting *Texas v. White*, 74 U.S. 700, 725 (1868))). Some leading examples of cases discussing the concept of dual sovereignty are found in cases throughout the nineteenth and twentieth centuries. See *Indian Motor Cycle Co. v. United States*, 283 U.S. 570, 575 (1931) (“[I]t is an established principle of our constitutional system of dual government that the instrumentalities, means and operations whereby the United States exercises its governmental powers are exempt from taxation by the States . . . [and t]his principle is implied from the independence of the national and state governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system. . . . Where the principle applies it is . . . absolute.”); *Collector v. Day*, 78 U.S. (11 Wall.) 113, 124 (1870) (“The general government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres.”); *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 428-36 (1819) (describing the reciprocal immunity from taxation of the state and federal governments); *New York v. United States*, 326 U.S. 572, 594 (1946) (Douglas, J., dissenting) (“The notion that the sovereign position of the States must find its protection in the will of a transient majority of Congress is foreign to and a negation of our constitutional system. There will often be vital regional interests represented by no majority in Congress. The Constitution was designed to keep the balance between the States and the nation outside the field of legislative controversy.”). The Federalist Papers as well reflect dual sovereignty ideas. See THE FEDERALIST NO. 39, at 256 (James Madison) (Jacob E. Cooke ed., 1961) (“[T]he proposed Government cannot be deemed a national one; since its jurisdiction extends to certain enumerated objects only, and leaves to the several States a residuary and inviolable sovereignty over all other objects.”); THE FEDERALIST NO. 81, at 548 (Alexander Hamilton) (Jacob E. Cooke ed., 1961) (“It is inherent in the nature of sovereignty, not to be amenable to the suit of an individual without its consent.”).

¹¹⁰ See Note, *Municipal Bankruptcy, the Tenth Amendment and the New Federalism*, 89 HARV. L. REV. 1871, 1873 (1976) (describing “the demise of the nineteenth century notion of dual sovereignty”). This theory has been explained in John H. Clough, *Federalism: The Imprecise Calculus of Dual Sovereignty*, 35 J. MARSHALL L. REV. 1 (2001); Lipson, *Fighting Fiction*, 78 WASH. U. L.Q. 1271 (2000); William E. Thro, *That Those Limits May Not Be Forgotten: An Explanation of Dual Sovereignty*, 12 WIDENER L.J. 567, 569 (2003) (“[The dual sovereignty] theory views the Constitution as dividing sovereignty between the States and the National Government, vesting specific powers in both sovereigns, and forbidding one sovereign from interfering with the other sovereign’s exercise of its powers.”).

¹¹¹ See, e.g., *Garcia v. San Antonio Metro. Transit Auth.*, 469 U.S. 528, 552-53 (1985) (adopting the rationale that the political process is sufficient to safeguard state sovereignty).

¹¹² *Id.*

¹¹³ *New York v. United States*, 505 U.S. 144 (1992).

Court struck down federal legislation that required the states to address issues of national concern. These cases held that Congress may not “commandeer” states or coerce them into carrying out federal policy.¹¹⁵ In *New York*, the Court struck down a federal law requiring state governments to clean up their nuclear wastes,¹¹⁶ as such actions impermissibly “commandeer[ed]” the states to enact laws.¹¹⁷ In *Printz*, the Court held that a provision of the Brady Handgun Control Act, which required local law enforcement officers to conduct background checks prior to issuing firearm permits, was unconstitutional.¹¹⁸ As in *New York*, the Court explained that Congress may not force states to implement federal policy.¹¹⁹ These cases have made it clear that the Court will use the Tenth Amendment to restrain the power of the federal government.¹²⁰

Under an expansive reading of the Tenth Amendment, perhaps the Court might return to the *Ashton* conception of state sovereignty and strike down state bankruptcy on the grounds that such legislation permits federal judges too much authority to meddle in state affairs.¹²¹ Even with the recent shift toward protecting state sovereignty, the Court has not required a strict separation between the federal and state governments in the same way that it adhered to the dual sovereignty theory in the past.¹²² The Court has not held that the Tenth Amendment reserves a zone of activities for exclusive state control. Instead, recent decisions have made it clear that Congress cannot compel state legislative or

¹¹⁴ *Printz v. United States*, 521 U.S. 898 (1997). One scholar argues that the new federalism that emerged in the 1990s is a different form, the “etiquette of federalism.” Alfred R. Light, *Lifting Printz Off Dual Sovereignty: Back to a Functional Test for the Etiquette of Federalism*, 13 BYU J. PUB. L. 49, 49 (1998) (citing *United States v. Lopez*, 514 U.S. 549, 580, 583 (1995) (Kennedy, J., concurring)).

¹¹⁵ See Samuel L. Bufford & Erwin Chemerinsky, *Constitutional Problems in the 2005 Bankruptcy Amendments*, 82 AM. BANKR. L.J. 1, 24 (2008).

¹¹⁶ *New York*, 505 U.S. at 149.

¹¹⁷ *Id.* at 175.

¹¹⁸ *Printz*, 521 U.S. at 902.

¹¹⁹ *Id.* at 935.

¹²⁰ See Katherine A. Connolly, *Who’s Left Standing for State Sovereignty, Private Party Standing to Raise Tenth Amendment Claims*, 51 B.C. L. REV. 1539, 1541 (2010).

¹²¹ However, this result may be unlikely, considering that the federal government is already deeply involved in state affairs in other areas, such as Medicaid funding obligations, tax policy, and welfare restrictions. See David A. Skeel Jr., *States of Bankruptcy* 24-25 (U of Penn, Inst. for Law & Econ Research Paper No. 11-24) (July 30, 2011), available at <http://ssrn.com/abstract=1907774>.

¹²² See, e.g., *United States v. Comstock*, 130 S. Ct. 1949, 1962 (2010); Edward S. Corwin, *The Passing of Dual Federalism*, 36 VA. L. REV. 1 (1950). However, some scholars have argued that “the concept of a state sovereignty constitutionally immune from excessive federal impairment has never been wholly abandoned where regulation affects the operations of the state itself rather than merely displacing its authority to regulate private conduct.” See Note, *Municipal Bankruptcy, the Tenth Amendment and the New Federalism*, 89 HARV. L. REV. 1871, 1873 (1976).

regulatory activity.¹²³ This distinction, as far as it goes, would seem to permit bankruptcy legislation so long as it is entirely voluntary and the states retain authority to manage their own legislative affairs.

Moreover, the prospects for upholding a state-bankruptcy chapter also benefit from the wide berth given to Congress's exercise of power under the Bankruptcy Clause. The Court has seldom stricken down bankruptcy legislation on other constitutional grounds.¹²⁴ In the single case¹²⁵ in which the Court struck down bankruptcy legislation on Tenth Amendment grounds, its reasoning was based in concerns over protecting state sovereignty, the very same rationale used to strike down laws exceeding the scope of the Commerce Clause. Indeed, Professor Lipson argues that "[i]n the case of vertical relations, bankruptcy appears to be an exception to the Rehnquist Court's robust protection for states from federal judicial power."¹²⁶ Since it is a distinct constitutional clause, it therefore would be reasonable for the Court to apply the Tenth Amendment dissimilarly to the bankruptcy power. The animating theme of constitutional interpretation of the Bankruptcy Clause is "bankruptcy exceptionalism": courts often treat the bankruptcy power differently than other clauses.¹²⁷ For example, in another bankruptcy context, the Court has held that the Bankruptcy Clause trumps state sovereignty concerns.¹²⁸

¹²³ See *New York v. United States*, 505 U.S. 144, 149 (1992); *Printz*, 521 U.S. at 902. Specifically, those decisions held that Congress may not "commandeer" states or coerce them into implementing federal policy.

¹²⁴ See *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 71 (1982) (Article III); *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 532 (1936) (encroachment on state sovereignty); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 601-02 (1935) (Takings Clause).

¹²⁵ See *Ashton*, 298 U.S. at 530.

¹²⁶ See Lipson, *Debt and Democracy*, 83 NOTRE DAME L. REV. 605, 637-38 (2008). Specifically, in *Central Virginia Community College v. Katz*, the Court held, in a 5-4 decision, that a state's sovereign immunity does not apply to a suit in bankruptcy court to avoid a preferential transfer received by the state. 546 U.S. 356, 373-78 (2006). Sovereign immunity is embodied in the Eleventh Amendment, which precludes suits "in law or equity, commenced or prosecuted against one of the United States by Citizens of another State." U.S. CONST. amend. XI. Professor Lipson argues that a reasonable inference would be that *Katz* could form the basis for a bankruptcy power unchecked by the First, Fifth, or any other Amendments. See Lipson, *Debt and Democracy*, 83 NOTRE DAME L. REV. at 643. This decision carved out a special exception to the states' sovereign immunity for bankruptcy matters, and "strongly smacks of exceptionalism." *Id.* at 644.

¹²⁷ See Lipson, *Debt and Democracy*, 83 NOTRE DAME L. REV. at 611.

¹²⁸ See *Cent. Va. Cmty. Coll.*, 546 U.S. at 378.

II. “TOO BIG TO FAIL” AND OTHER POLICY REASONS FOR STATE BANKRUPTCY

Much like the last major expansion of the bankruptcy statutes to municipalities, spurred by the financial troubles of the Great Depression, so too has the recent Great Recession spurred the need for another expansion of the Bankruptcy Code. Creating a new state-bankruptcy chapter could be the next stage in the bankruptcy evolution. Once thought of as a far-fetched idea, the creation of a state-bankruptcy chapter is now taken seriously by both policymakers¹²⁹ and legal scholars.¹³⁰ The growing desire to avoid another round of massive federal bailouts has made bankruptcy for states more attractive.

In 2007, the bank bailouts were seen as necessary to avert a financial crisis. The Bush Administration argued that if a large financial institution defaulted, then creditors would lead a panicked “run” on the banks. Since banks are so interconnected with one another, a failure of one could lead to a failure of all, creating an immediate financial crisis.¹³¹ It soon came to pass that people, who were struggling themselves during hard economic times and cutting back on their personal budgets, viewed these bailouts with disgust.

The prospect of bailing out big-spending states, such as California and Illinois, is nearly as hated as the decision to bail out the banks. In response to a question addressing the possibility of providing federal assistance to insolvent states, the Senate Republican Minority Leader declared, “There will be no bailouts, I can tell you that. No bailouts.”¹³² It is questionable, however, whether Congress could resist the mounting political pressure to do nothing if bailing out an insolvent state was necessary to avert a financial meltdown. This is the problem of institutions that are deemed “too big to fail.” If a default by a large financial institution is guaranteed to bring down the economy, it is reasonable to bail out the institution. This kind of market contagion took place in the recent financial crisis, when the loss of investor confidence

¹²⁹ See, e.g., Jeb Bush & Newt Gingrich, Op-Ed., *Better Off Bankrupt*, L.A. TIMES, Jan. 27, 2011, <http://articles.latimes.com/print/2011/jan/27/opinion/la-oe-gingrich-bankruptcy-20110127>.

¹³⁰ See David A. Skeel Jr., *States of Bankruptcy* 24 (U of Penn, Inst. for Law & Econ Research Paper No. 11-24) (July 30, 2011), available at <http://ssrn.com/abstract=1907774>.

¹³¹ Steven L. Schwarcz, *A Minimalist Approach to State “Bankruptcy”*, 59 UCLA L. REV. 322, 325 (2011).

¹³² See Andy Sullivan & Lisa Lambert, *Senate Leaders Eye Option of State Bankruptcy*, REUTERS, Jan. 25, 2011, www.reuters.com/article/2011/01/25/us-usa-states-bankruptcy-senate-idUSTRE70066220110125.

in the market for mortgage-backed securities set off a loss of confidence in the broader market for all rated debt securities.¹³³

The same grim logic appears to apply to states. Several states are teetering on the edge of insolvency.¹³⁴ Financially strapped states have responded to multi-billion-dollar budget deficits by turning to austerity measures, tax increases, and renegotiation of union contracts.¹³⁵ A growing consensus has emerged that states will need debt relief.¹³⁶

Some form of debt relief will be needed if a state's debt burden becomes so overwhelming that reasonable efforts to reform the state's fiscal affairs are doomed to fail. In this situation, a federal bailout becomes necessary to avoid default.¹³⁷ Some scholars have suggested that certain states are "too big to fail" based on the high degree of interconnectedness with the economy.¹³⁸ The fear is that a state default would trigger a market contagion with systemic consequences.¹³⁹ Such a contagion could occur if the loss of investor confidence with one indebted state undermines such confidence in the debt of all states with shaky balance sheets, leading to a collapse of the broader market.¹⁴⁰ This collapse in one market may undermine confidence in related markets, say for corporate bonds markets.¹⁴¹

Creating an orderly mechanism for providing debt relief to states would "reduce the inevitable political pressure on the federal government to bail out defaulting states."¹⁴² Although congressional leaders contend that no bailouts will occur on their watch, it is doubtful that they would

¹³³ See Schwarcz, *A Minimalist Approach to State "Bankruptcy"*, 59 UCLA L. REV. at 324-25.

¹³⁴ See Alison Vekshin, *State Bankruptcy Weighed by Republicans Blocking Aid*, BLOOMBERG (Jan. 21, 2011), www.bloomberg.com/news/2011-01-21/u-s-state-bankruptcy-weighed-by-house-republicans-blocking-aid.html.

¹³⁵ See, e.g., NAT'L GOVERNORS ASS'N & NAT'L ASS'N OF STATE BUDGET OFFICERS, THE FISCAL SURVEY OF STATES 8 (Fall 2010) ("In fiscal 2010, the actions taken most consistently were targeted cuts [in the state workforce], which were put in place by 33 states, as well as across the board cuts, which were utilized by 26 states To eliminate fiscal 2011 budget gaps, 35 states are using specific, targeted cuts [in the state workforce], while 25 states have employed across the board cuts. Another method being used by 19 states is to reduce aid to localities while 13 states made use of their rainy day funds.").

¹³⁶ See Schwarcz, *A Minimalist Approach to State "Bankruptcy"*, 59 UCLA L. REV. at 324 (citing *State and Municipal Debt: The Coming Crisis?: Subcomm. on TARP, Fin. Servs., and Bailouts of Pub. & Private Programs of the H. Comm. on Oversight and Gov't Reform*, 112th Cong. (2011) (opening statement of Rep. Patrick Chairman, H. Comm. on Oversight and Gov't Reform) (observing that the "vast majority of states now find themselves in a fiscal straightjacket").

¹³⁷ See *id.*

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

refuse if economists advise that a state bailout is necessary to avert a financial meltdown. It is one thing to publicly oppose the idea of bailouts in the abstract. It is quite another, however, to sit by when headlines are declaring that a state's impending default will send the whole country into another Great Depression. On the other hand, the debate over raising the debt ceiling demonstrated that congressional leaders are quite willing to engage in a high-stakes game of chicken. These leaders may have a point; "[i]f a federal bailout were to occur, the resulting moral hazard . . . and too-big-to-fail dilemma would likely dwarf that of financial institutions, which are at least somewhat disciplined by the threat of being liquidated."¹⁴³

Some scholars have argued that the "too big to fail" problem does not apply to states.¹⁴⁴ They argue that bondholders are the states' most important creditors, and they cannot pull their funding in the same way that a bank's short-term creditors can.¹⁴⁵ On the other hand, it is reasonable to fear that a host of state bond defaults would destabilize the financial markets. State and municipal debt is widely interconnected with the banks, as banks own more than \$229 billion in state and municipal bonds.¹⁴⁶

Likewise, a state's default on its debts threatens more than its own ability to borrow at low interest rates; it threatens the banks as well, which hold large amounts of state municipal bonds. Therefore, a state default could mean that banks will suffer huge losses.¹⁴⁷ Additionally, there is further potential for a financial crisis, because municipal debt is viewed as a "safe" investment.¹⁴⁸ A municipal bond crisis would endanger one of the few "safe" investments available, and this is particularly troublesome given the fragile state of the economy.¹⁴⁹

¹⁴³ *Id.*

¹⁴⁴ See David A. Skeel Jr., *States of Bankruptcy* 24 (U of Penn, Inst. for Law & Econ Research Paper No. 11-24) (July 30, 2011), available at <http://ssrn.com/abstract=1907774>.

¹⁴⁵ *Id.* Moreover, the bond market is already starting to discount the possibility of a default by California. *Id.*

¹⁴⁶ See James Pethokoukis, *When States Go Bust*, WEEKLY STANDARD (Feb. 14, 2011), www.weeklystandard.com/articles/when-states-go-bust_541424.html.

¹⁴⁷ *Id.*

¹⁴⁸ See David A. Skeel Jr., *States of Bankruptcy* 4 (U of Penn, Inst. for Law & Econ Research Paper No. 11-24) (July 30, 2011), available at <http://ssrn.com/abstract=1907774>.

¹⁴⁹ See Nicole Gelinis, *The Market Won't Fix States' Woes*, BOSTON GLOBE, Jan. 23, 2011, www.boston.com/bostonglobe/editorial_opinion/oped/articles/2011/01/23/the_market_wont_fix_states_woes/.

III. IMPACT OF TENTH AMENDMENT ANALYSIS ON DRAFTING CONSIDERATIONS

The federal municipal-bankruptcy regulations are drafted in a way that is sensitive to federalism concerns.¹⁵⁰ These regulations walk a tightrope between the congressional power to establish uniform bankruptcy regulations and the state power reserved under the Tenth Amendment.¹⁵¹ Such federalism concerns are manifested in a number of ways. First, section 109(c) of the Bankruptcy Code provides that a municipality can file for Chapter Nine relief only if it is “generally authorized to be a debtor . . . by State law.”¹⁵² Second, only a voluntary debtor may initiate Chapter Nine proceedings. Involuntary petitions are not allowed, to avoid infringements of state sovereignty.¹⁵³ Third, the bankruptcy judge’s role in the Chapter Nine process is very limited.¹⁵⁴ The bankruptcy court’s role is generally limited to overseeing the implementation of the plan, as opposed to interfering with the entity’s property or revenues.¹⁵⁵

Upon closer inspection, however, it is unclear whether the Constitution requires these restrictions, much less whether they reflect good bankruptcy policy. Determining the scope of the bankruptcy power has taken on new urgency in the debate over creating a state-bankruptcy chapter, because such restrictions may hamper the effectiveness of a new bankruptcy regime. To the extent that federalism concerns restrict the breadth of relief that can be offered to states, such a chapter would become less effective.

The question becomes whether the drafting choices that would be required to avoid constitutional problems would reduce the effectiveness of a state-bankruptcy chapter. Leading scholars have suggested that a state-bankruptcy chapter must provide for the bankruptcy court to have limited powers.¹⁵⁶ Otherwise it risks running afoul of federalism norms enshrined in the Constitution. However, narrowly drafting the state-

¹⁵⁰ See Jonathan J. Spitz, *Federalism, States, and the Power to Regulate Municipal Bankruptcies: Who May Be a Debtor Under Section 109(c)*, 9 BANKR. DEV. J. 621 (1993).

¹⁵¹ *Id.* at 629-30.

¹⁵² *Id.* at 627 (citing 11 U.S.C. § 109(c)(2) (1988)). Moreover, Congress’s federalism concerns are further illustrated by § 943(b)(6), which provides that the municipal debtor must obtain for its reorganization plan “any regulatory or electoral approval necessary under applicable nonbankruptcy law in order to carry out any provision of the plan.” *Id.* at 632.

¹⁵³ *Id.* at 626.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* (citing 11 U.S.C. § 904 (1988)).

¹⁵⁶ See David A. Skeel Jr., *State Bankruptcy from the Ground Up* 20 (Univ. of Penn. Research Paper No. 382 (2011), available at http://lsr.nellco.org/upenn_wps/382).

bankruptcy chapter might drain the chapter of all its potential benefits. If the Constitution places few constraints on the powers of a bankruptcy court, is a state-bankruptcy chapter still worthwhile? These are the questions that policymakers must face as they decide how to implement a state-bankruptcy chapter.

CONCLUSION

The leading proponents of a state-bankruptcy chapter have tended to assume that bankruptcy for states would be easily constitutional, while at the same time expressing concerns that such a chapter could unconstitutionally infringe state sovereignty. While the sovereignty issues involved with municipal bankruptcy are not identical to those with state bankruptcy, as long as the principles handed down by the *Bekins* court are honored, a federal law that extends bankruptcy protection to states should pass constitutional muster. However, whether the *Bekins* decision is still good law is up for debate, given the resurgence of the Tenth Amendment in the Supreme Court's jurisprudence. In the event that the Tenth Amendment constrains the drafting choices of policymakers, the effectiveness of the resulting state-bankruptcy chapter may be diminished. Nonetheless, the normative strengths and practical benefits of a state-bankruptcy chapter argue in favor of moving forward to the next stage in the bankruptcy evolution.