

# Client Alert

Current Issues Relevant to Our Clients

November 25, 2013

## Governing Law for Municipal Bankruptcy in Illinois<sup>1</sup>

Under current bankruptcy law, units of local government cannot voluntarily petition for municipal bankruptcy under Chapter 9 without express and specific authority from the state. Currently, with the exception of the Illinois Power Agency, the state of Illinois has not specifically authorized its municipalities or any other local governmental units to petition for Chapter 9 bankruptcy. Until such time as the State of Illinois legislature provides specific authority to units of local government to petition for municipal bankruptcy, no such petition will be permitted.

### Illinois Municipalities Have No Specific Authority to File for Chapter 9

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An Illinois municipality may not file for municipal bankruptcy unless it has specific authorization to do so from the state. Section 109(c)(2), Title 11, of the United States Bankruptcy Code requires that a municipality be “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 chapter.”<sup>2</sup> 11 U.S.C. § 109(c)(2).

Bankruptcy courts have strictly construed the “specifically authorized” language of § 109(c)(2). The authorization must be “exact, plain, and direct with well-defined limits so that nothing is left to inference or implication.” *In re Slocum*, 336 B.R. 387, 390 (Bankr. N.D. Ill. 2006) (quoting *In re County of Orange*, 183 B.R. 594, 604 (Bankr. C.D. Cal. 1995)); see also *In re Alleghany-Highlands Econ. Dev. Auth.*, 270 B.R. 647, 649 (Bankr. W.D. Va. 2001). A municipality attempting to petition for Chapter 9 bankruptcy must be able point to a particular state statute that gives specific authority to file for bankruptcy.

Due to the specific authorization requirement, general grants of authority, even when very broad, are insufficient for § 109(c)(2) purposes. See *In re Timberon Water and Sanitation Dist.*, No. 9-07-12142 ML, 2008 WL 5170581, at \*3 (Bankr. D.N.M., June 18, 2008) (“Given that the purpose of the amendment was to require specific authorization, that purpose would not be served if a municipality were able to rely on its general powers to create a specific authorization for itself”). As a consequence, although the Illinois Constitution has granted broad authority for home-rule units under Article VII, § 6(a),<sup>3</sup> this authority would not likely be construed by a bankruptcy court to authorize a home-rule municipality to file for municipal bankruptcy because the language is not specific enough to satisfy the requirement of § 109(c)(2). Therefore, home-rule units under the current law in Illinois would not likely be eligible to file for bankruptcy under § 109(c)(2).

At present, Illinois has specifically authorized only the Illinois Power Agency to file for Chapter 9 bankruptcy, under 20 Ill. Comp. Stat. Ann. 3855/1-20(b)(15).<sup>4</sup> Section 3855/1-20(b)(15) grants the Power Agency the authority to “file a petition under

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<sup>1</sup> The results of certain research by James Spiotto was used in the production of this memo. In addition, this memo relied, in part, on James E. Spiotto, Ann E. Acker, and Laura E. Appleby, *Municipalities in Distress: How States and Investors Deal with Local Government Financial Emergencies*, Chapman and Cutler LLP (2012).

<sup>2</sup> Under 11 U.S.C. § 101(40), “municipality” means a “political subdivision or public agency or instrumentality of a State.”

<sup>3</sup> Article VII, § 6(a), of the Illinois Constitution states that a home municipality may “exercise any power and perform any function pertaining to its government and affairs including, but not limited to, the power to regulate for the protection of the public health, safety, morals and welfare; to license; to tax; and to incur debt.” A “home-rule unit” means any county that has an elected chief executive officer or any municipality that has population of more than 25,000. *Id.*

<sup>4</sup> Additionally, section 3855/1-20(b)(14) authorizes the Power Agency to:

Chapter 9 of Title 11 of the United States Bankruptcy Code or take other similar action for the adjustment of its debts.” Illinois has no statute providing specific authorization to any other municipal entity. *See Slocum*, 336 B.R. at 391 (noting that specific authorization that would satisfy § 109(c)(2) does not presently exist in Illinois). Until such time as the State of Illinois legislature provides specific authority to units of local government to petition for municipal bankruptcy, no such petition will be permitted.

Only one Illinois bankruptcy court has considered the question of what authority, if any, Illinois has granted its municipalities to file for municipal bankruptcy under Chapter 9. In *Slocum*, an Illinois drainage district filed a Chapter 9 petition that was challenged by one of the district’s creditors. *Id.* at 388. The creditor filed a motion to dismiss the petition, arguing that the district was not specifically authorized to be a Chapter 9 debtor under any Illinois statute. *Id.* at 389. The district argued that it was eligible for Chapter 9 because the Illinois Drainage Code and the Illinois Public Water District Act had empowered commissioners of the district to, “in the corporate name of the district, contract, sue and be sued, plead and be implead, and do and perform all acts and things, whether express or implied, that may be reasonably required in order to accomplish the purposes of [the] Act.” *Id.* (quoting 70 ILCS 605/4-14 (2002)). The district also cited the Illinois Government Financial Planning and Supervision Act, 50 ILCS 320/1 *et seq.* (2002). One provision of this act empowers a commission and financial adviser appointed under the Act to recommend that a unit of local government file a Chapter 9 petition. *Id.* (citing 50 ILCS 320/9(b)(4) (2002)).

The bankruptcy court in *Slocum* concluded that the provisions cited by the district were “catch-all” provisions; these provisions alone did not specifically authorize the district to file for bankruptcy. *Id.* The court noted that the provision cited by the district in the Illinois Public Water District Act constituted only general authorization to manage the affairs of the municipalities subject to the Act, not the specific authorization required by § 109(c)(2) of the Bankruptcy Code. *Id.* at 391. As to the Illinois Local Government Financial Planning and Supervision Act, the court observed that there had not been a commission or financial adviser appointed that could have recommended that the debtor file a Chapter 9 petition. *Id.*

Even though Illinois has not specifically authorized units of local government to file for Chapter 9, some Illinois bankruptcy courts have entertained bankruptcy filings from Illinois municipalities, including *In re Village of Brooklyn*, Case No. 3-34272 (Bankr. S.D. Ill. Nov. 23, 2004) (confirmation plan) and *In re Village of Alorton*, Case No. 05-30055 (Bankr. S.D. Ill. Dec. 11, 2006) (confirmation plan). *See Spiotto et al., Municipalities in Distress?*, at p. 115. These courts likely took up the cases because there was no challenge to the municipalities’ eligibility to file for bankruptcy.<sup>5</sup> *Id.* In other Illinois municipal filings where objections were raised as to the municipalities’ authority to file, the courts have dismissed the cases due to a lack of specific authority to file under Illinois law. *See In re Slocum*, 336 B.R. 387 (Bankr. N.D. Ill. 2006); *In re Washington Park*, Case No. 09-31744 (dismissed in December 2010).<sup>6</sup>

## Illinois Government Financial Planning and Supervision Act

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The Illinois Local Government Financial Planning and Supervision Act, 50 ILCS 320/9(b)(4), allows for the establishment of a financial planning and supervision commission and authorizes that commission to recommend that a unit of local government

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negotiate and enter into agreements with trustees or receivers appointed by United States bankruptcy courts or federal district courts or in other proceedings involving adjustment of debts and authorize proceedings involving adjustment of debts and authorize legal counsel for the Agency to appear in any such proceedings.

<sup>5</sup> When a party challenges a debtor’s bankruptcy petition, the debtor then has the burden of establishing that it is in fact eligible to be a debtor under Chapter 9. *See In re Slocum*, 336 B.R. at 390.

<sup>6</sup> Washington Park has filed for Chapter 9 protection at least two times within the last ten years, in 2004 and 2009. Both cases were eventually dismissed by the bankruptcy courts. *See* Jim Suhr, *Judge throws Out Ill. Village’s Bankruptcy Case*, ASSOCIATED PRESS (January 10, 2011, 2:03 PM), available at <http://news.yahoo.com/judge-throws-ill-villages-bankruptcy-case-20110110-110319-519.html>; *see also* *Judge Denies Washington Park’s Bankruptcy Bid*, ASSOCIATED PRESS (January 11, 2011, 12:00am), available at [http://www.stltoday.com/news/local/illinois/judge-denies-washington-park-s-bankruptcy-bid/article\\_9db5faee-7ab1-5d6d-b29c-0938a11f7a00.html](http://www.stltoday.com/news/local/illinois/judge-denies-washington-park-s-bankruptcy-bid/article_9db5faee-7ab1-5d6d-b29c-0938a11f7a00.html). The 2004 case was dismissed when Washington Park briefly emerged from insolvency. *See* Suhr, *Judge Denies Washington Park’s Bankruptcy Bid*. The second case was dismissed in 2010 when the bankruptcy court found that Washington Park did not have the authority under Illinois law to file for municipal bankruptcy under Chapter 9. *See id.*; *see also In re Washington Park*, Case No. 09-31744 (dismissed in December 2010).

file a petition for bankruptcy under Chapter 9. Under 50 ILCS 320/4(a), any “unit of local government”<sup>7</sup> may, upon a two-thirds (2/3) vote of the members of its governing body, “petition the Governor for the establishment of a financial planning and supervision commission if the governing body of the unit of local government determines that a fiscal emergency, as defined in Section 3, exists or will exist within 60 days.” The Act applies only to units of local government that have a population under 25,000. *Id.* § 320/3(d).

Although the Local Government Financial Planning Supervision Act contains language providing that the commission may recommend that a unit of local government file for Chapter 9 bankruptcy, this language is likely not specific enough to satisfy the specific authority requirement of 11 U.S.C. § 109(c)(2). The pertinent provision of the Act allows only for the commission and financial adviser to recommend a Chapter 9 filing, not to authorize the municipality to actually file for bankruptcy under Chapter 9. As noted in *Slocum*, the specific authorization from the state must be “exact, plain, and direct with well-defined limits so that nothing is left to inference or implication.” *Slocum*, 336 B.R. at 390.

Moreover, the bankruptcy court in *Slocum* implied that this statute would not provide the specific authority to satisfy § 109(c)(2). In reference to the Act, the court contended that “[h]ad the Illinois General Assembly intended to specifically authorize this Debtor or other municipalities to seek relief under Chapter 9, it could have easily drafted appropriate legislation, but has not done so.” *Id.* at 391. The court further noted that “[i]ndependent research by the Court [had] not revealed any Illinois statute containing the specific authorization required by § 109(c)(2).” *Id.*

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## Conclusion

Under current bankruptcy law, units of local government cannot voluntarily petition for municipal bankruptcy under Chapter 9 without express and specific authority from the state. Currently, with the exception of the Illinois Power Agency, the state of Illinois has not specifically authorized its municipalities or any other local governmental units to petition for Chapter 9 bankruptcy. Until such time as the State of Illinois legislature provides specific authority to units of local government to petition for municipal bankruptcy, no such petition will be permitted.

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<sup>7</sup> The term “unit of local government” means “counties, municipalities, townships, special districts, and units, designated as units of local government by law, which exercise limited governmental powers or powers in respect to limited governmental subjects, but does not include school districts.” ILCS Const. Art. 7, § 1; 50 ILCS 320/3(d) (“‘Unit of local government’ shall have the meaning provided as specified in Article VII, Section 1 of the Illinois Constitution . . . .”)