YALE LAW & POLICY REVIEW

Bankruptcy and the Public-Private Divide

*Laura N. Coordes**

The Bankruptcy Code draws a firm line between "municipalities" and other entities. In reality, numerous entities exist that could be categorized somewhere between a purely public municipality and a private entity. This incongruence between theory and practice creates two primary sets of problems. First, when a "blended entity" seeks to file for bankruptcy, the relief it receives from the bankruptcy system, if any, may be practically inappropriate or constitutionally suspect. Second, blended entities' use of the bankruptcy system creates uncertainty, which parties and courts can capitalize on to exploit gaps in the law.

This Article is the first to take an in-depth look at blended entities and the problems that ensue when they attempt to use a bankruptcy system that does not contemplate their existence. In doing so, it contributes to the larger debate about the usefulness of the current Bankruptcy Code in light of manipulation of the bankruptcy laws, and it exposes a core weakness arising from the Code's inability to recognize the blended nature of many of the entities that form the backbone of the U.S. economy and provide services the public has come to rely on in everyday life.

* Professor of Law, Arizona State University Sandra Day O'Connor College of Law. For helpful comments and discussions, I thank all the participants at the State and Local Government Law Works in Progress Workshop, especially Richard Briffault, Kaitlin Caruso, Nestor Davidson, Andrew Elmore, David Schleicher, Rich Schragger, and Nadav Shoked. I am also indebted to ASU colleagues past and present, especially Victoria Sahani and Justin Weinstein-Tull, and to all participants at the University of Arizona Faculty Workshop.

INTRODUCTION

The Bankruptcy Code draws a firm line between "municipalities" and other entities, offering different avenues of relief to each. Entities the Code defines as "municipalities" must file for bankruptcy using chapter 9, a chapter designed to balance local entities' need for federal government intervention with the Tenth Amendment's reservation of power to the states.[1] Other entities file for bankruptcy using chapters 7 or 11[2]—chapters that lack chapter 9's Tenth Amendment-related restrictions.[3]

In theory, the dividing line between a municipality and a non-municipality is clear;[4] the Bankruptcy Code even defines "municipality" for its purposes.[5] In practice, the divide is not so simple. Many entities blend public and private features.[6] These "blended" entities don't easily or predictably sort into a particular Code chapter. In other words, bankruptcy law is based on the false premise that clear boundaries exist between the public and the private. Whereas the law attempts to group entities into distinct buckets, in reality, entities fall along a spectrum, and the line between public and private entities is difficult to pinpoint in practice, if it exists at all.

Given the generally broad accessibility of bankruptcy law, it is tempting to ignore or downplay this mismatch of the law with reality. Yet, blended entities are ubiquitous and important, as they provide the American public

1. 11 U.S.C. § 109(c) (2018) (denoting eligibility for chapter 9); *id.* § 101(40) (defining "municipality" as a "political subdivision or public agency or instrumentality of a State").

2. Family farmers and family fishermen are eligible to file chapter 12 bankruptcy, and individuals are eligible to file under chapter 13. *Id.* § 109(e)-(f). However, these debtors are not the focus of this Article.

3. *See id.* § 109(b) (denoting eligibility for chapter 7); *id.* § 109(d) (denoting eligibility for chapter 11).

4. *See id.* § 101(41) (explaining that a "person," which includes partnerships and corporations, does not include "governmental unit").

5. *Id.* § 101(40) ("The term 'municipality' means political subdivision or public agency or instrumentality of a state.").

6. *See* Gerald E. Frug, The City: Private or Public? 2 (Mar. 13, 2017) (unpublished working paper) [hereinafter Frug, Private or Public], https://lsecities.net/wp-content/uploads/2017/03/FrugGE-2017-The-city-private-or-public-2.pdf [https://perma.cc/3DCC-PT37] ("[I]t has become harder and harder to articulate what we mean when we use the word 'public' to describe city governments.").

with some of its most basic necessities.[7] They offer critical services such as education[8] and medical care.[9] They transport the public from one location to the next.[10] They range in size, form, and function from a small, rural sewer district to a massive city transit authority. And they are growing in number as state and local governments find the creation of special districts increasingly attractive and as the federal government contemplates an increasing role for public-private partnerships.[11]

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7. *See* Richard L. Epling, Kerry A. Brennan & Kent P. Woods, *Monorail, Monorail, Monorail: Chapter 9 and Restructuring Issues Relating to Municipal Authorities*, 20 NORTON J. BANKR. L. & PRAC. 225, 226-27 (2011) (defining "municipal authority" as a "quasi-governmental unit that serves as an alternative vehicle to accomplish public purposes," including supplying water and sewage systems).

8. *See generally* Matthew A. Bruckner, *Special Purpose Municipal Entities and Bankruptcy; The Case of Public Colleges*, 36 EMORY BANKR. DEVS. J. 341 (2020) (discussing the challenges of classifying and aiding public institutes of higher education in the bankruptcy context).

9. *See generally* Diane Lourdes Dick, *Public Hospital Bankruptcies and an Evolving Functional Interpretation of the Bankruptcy Code*, BANKR. L. LETTER, Aug. 2019, at 1 (discussing public healthcare organizations).

10. *See generally* Epling, Brennan & Woods, *supra* note 7, at 226-27 (including entities that supply public transportation in the definition of "municipal authority").

11. *See, e.g.*, Ivan L. Kallick, Randall Keen & Jacob Itzkowitz, *Municipal Bankruptcy in the Time of COVID-19*, PUB. MGMT., Aug. 1, 2020, at 33, 37 (observing that, in California, "the budgetary constraints of Proposition 13 have pushed numerous municipal functions into special districts"); Am. Counts Staff, *Are There Special Districts in Your Hometown? From Municipalities to Special Districts, Official Count of Every Type of Local Government in 2017 Census of Governments*, U.S. CENSUS BUREAU (Oct. 29, 2019), https://www.census.gov/library/stories/2019/10/are-there-special-districts-in-your-hometown.html [https://perma.cc/S5BQ-RJ7C] (explaining the growth of various types of special districts, such as multifunction districts); Frank Beckers & Uwe Stegemann, *A Smarter Way to Think About Public-Private Partnerships*, MCKINSEY & CO. (Sept. 10, 2021), https://www.mckinsey.com/capabilities/risk-and-resilience/our-insights/a-smarter-way-to-think-about-public-private-partnerships [https://perma.cc/S8XT-FR7G] (observing that public-private partnerships "have become an increasingly popular way to get major infrastructure projects built"); Fernando J. Rodriguez Marin, Nicolai J. Sarad & Liam P. Donovan, *Infrastructure Investment and Jobs Act: Selected Changes Impacting*

Furthermore, blended entities matter because of their intimate interactions with other important entities, such as local governments. The financial health of a blended entity impacts the financial health of the local government—the city, town, county, etc.—in which it is located, and vice versa.[12] Many local governments are struggling, too. For example, New York City faces gutted tax revenue due to empty office buildings, as some employers have delayed return-to-office policies after the COVID-19 pandemic.[13] Blended entities support our cities in their growth and critical functions. If they fail, our cities and towns may not be far behind.[14]

Thus, blended entities provide or enhance many of the most essential features of our everyday life: utilities, transportation, health care, and education, to name only a few.[15] Stunningly, as critical as these institutions

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Public-Private Partnerships, BRACEWELL (Nov. 23, 2021), https://www.bracewell.com/resources/infrastructure-investment-and-jobs-act-selected-changes-impacting-public-private [https://perma.cc/KRM2-JK54] (discussing the "expansion of the public-private partnership ("PPP") model in the transportation, social infrastructure and broadband sectors").

12. *See, e.g.*, Michelle Kaske, *NYC's Transit Debt Is as Big and Complex as the Subway Itself*, BLOOMBERG (Dec. 20, 2023), https://www.bloomberg.com/news/articles/2023-12-20/the-aging-nyc-subway-is-big-and-complicated-so-is-its-debt [https://perma.cc/FQ3U-4889] ("The MTA system is essential for the functioning of New York's economy, and where New York's economy goes, so goes the country.").

13. Adam Tempkin, *NYC's Empty Office Buildings Could Gut Tax Revenue: Barclays*, BLOOMBERG L. (July 27, 2021), https://news.bloomberglaw.com/bankruptcy-law/nycs-empty-office-buildings-could-gut-tax-revenue-barclays [https://perma.cc/MH55-R8PA] (noting New York City's increasing reliance on property taxes).

14. *See* Michael A. Francus, *Disaggregating State Bankruptcy*, 171 U. PA. L. REV. 1589, 1600-03 (2023) (claiming that state debt is primarily composed of debt from special-purpose entities).

15. *See* DAVID SCHLEICHER, IN A BAD STATE: RESPONDING TO STATE AND LOCAL BUDGET CRISES 9 (2023) (observing the United States's reliance on "states and local governments to build and maintain most of our civic infrastructure"); Brian Highsmith, *Averting Local Fiscal Crises—and Resolving the "Trilemma"—by Centralizing Infrastructure Funding*, SLOG L. BLOG (June 27, 2023), https://www.sloglaw.org/post/averting-local-fiscal-crises-and-resolving-the-trilemma-by-centralizing-infrastructure-funding [https://perma.cc/7PSE-7CXF] ("[O]ur federalism design *uniquely* places the primary responsibility for funding . . . infrastructure, and other public services, on fiscally-constrained subnational governments.").

are, bankruptcy law does not recognize their blended nature, meaning they may lack access to a bankruptcy safety net in the event of financial distress or failure. Even when they can access bankruptcy relief, it is frequently ill-suited to meet their needs.[16] Thus, blended entities are "bankruptcy misfits."[17] While the failure of a blended entity, particularly a small one, may not make the headlines, this issue illustrates that the structure of the Code can be incongruous with reality.[18]

This incongruity may well be exposed further in coming years as blended entities grow in number and scope. For example, the Environmental Protection Agency recently released a proposed regulation for per- and polyfluoroalkyl substances ("PFAS"), the "forever chemicals" that take decades to break down, in drinking water.[19] If the proposed rules go forward, water systems—one type of blended entity discussed in this Article—will be required to expend billions of dollars collectively to remove PFAS and other prohibited substances from the nation's drinking water.[20] This expense will come on top of other increased costs "such as replacing lead service lines, upgrading cybersecurity, replacing aging infrastructure, and assuring sustainable water supplies."[21] This is just one example of

16. Although nonbankruptcy alternatives are sometimes available to these entities, as Professors Mitu Gulati and Richard C. Schragger document, many of these entities do not contemplate receiving relief from those alternatives either. Mitu Gulati & Richard C. Schragger, *Do Investors Care About Municipal Debtors' Access to Bankruptcy? Evidence From Bond Disclosures*, 50 FORDHAM URB. L.J. 657, 664 (2023).

17. Laura N. Coordes, *Reorganizing Healthcare Bankruptcy*, 61 B.C. L. REV. 419, 423 (2020) (describing "bankruptcy misfits" as debtors whose goals and purposes "do not mesh well with the Bankruptcy Code's . . . existing statutory framework").

18. Of course, the existence of blended entities raises concerns outside the bankruptcy setting as well. *See* Frug, Private or Public, *supra* note 6, at 12 ("We should pay attention to what we are creating."). However, the goal of this Article is to explore the particular salience of this problem in the context of bankruptcy as a stark example of the way the Code's structure fails to reflect reality.

19. *PFAS Regulations: What You Need to Know*, BLACK & VEATCH https://www.bv.com/perspectives/new-proposed-epa-regulations-on-pfas-what-water-utilities-need-to-know [https://perma.cc/9TBM-R6UX].

20. *Id*. (estimating an annual cost of over $3.8 billion to remove forever chemicals to meet the levels required by the Environmental Protection Agency).

21. *Id*.

increased financial pressure on a blended entity, which may lead to an increase in bankruptcy filings.

This Article explores what a "local government" is for bankruptcy purposes and analyzes the consequences of the mismatch between the Code's structure and the needs of blended entities in distress. Previous scholarship has explored the failure of particular subsets of blended entities, such as special-purpose municipalities,[22] institutes of higher education,[23] and public hospitals.[24] However, the full extent to which blended entities present challenges to the bankruptcy system has not yet been mapped, a surprising gap given the ubiquity and importance of blended entities. Examining the breadth of blended entities and their treatment in bankruptcy reveals both that bankruptcy law may need to be changed in order to work for these entities[25] and that these entities create problems for the law when they seek bankruptcy relief. Notably, this Article contends that a safety net for blended entities likely involves greater respect for state government treatment of these entities than the Code currently provides.

The need for bankruptcy law to recognize blended entities goes beyond the question of whether and how such entities may file for bankruptcy relief and impacts other aspects of the Bankruptcy Code.[26] As blended entities continue to proliferate, an exploration of the ways in which the law could adapt to recognize their existence is warranted.

As it now stands, bankruptcy is a poor fit for many blended entities. Yet, blended entities are also a poor fit for bankruptcy. This Article demonstrates that a blended debtor's difficulties with bankruptcy threaten the predictability, certainty, and coherence of bankruptcy law. The Bankruptcy Code's very design rejects the possibility that an entity could simultaneously be governmental and nongovernmental. Federalism

22. *See* Epling, Brennan & Woods, *supra* note 7.

23. *See* Bruckner, *supra* note 8.

24. *See* Dick, *supra* note 9.

25. *See, e.g.*, *id*. (discussing how courts and parties apply a "functional" interpretation of the Bankruptcy Code in hospital chapter 9 bankruptcies).

26. *See, e.g.*, L. Katherine Good, *3rd Circuit Narrowly Construes Police Power Exception to Automatic Stay*, DEL. BUS. CT. INSIDER (Jan. 18, 2012), https://www.potteranderson.com/insights/publications/3rd-Circuit-Narrowly-Construes-Police-Power-Exception-to-Automatic-Stay [https://perma.cc/EK5C-S88B] (describing a Third Circuit decision in which the court had to determine whether certain entities were "governmental units" capable of utilizing an exception to the bankruptcy automatic stay).

necessitates that the Code engage in this line-drawing,[27] and thus, Constitutional concerns underlie the creation of chapter 9, the Code's separate chapter for governmental entities. Yet, these concerns appear to be swept under the rug without much of a second thought in some of the blended bankruptcy cases seen to date.[28]

This Article's study of blended entities makes two further contributions. First, it identifies that blended entities' use—and misuse—of the bankruptcy system parallels activity that has recently been decried in large chapter 11 bankruptcy practice. As the Article describes in more detail,[29] although some blended entities may be denied bankruptcy relief altogether, others do access the bankruptcy system. When they do, the law in practice often differs substantially from the law on the books, creating opportunities to exploit legal gaps in ways that echo what policymakers and some scholars have criticized in the chapter 11 context.[30] By showing that these problems exist beyond chapter 11, this Article contributes to the literature suggesting that the Bankruptcy Code may need to be adjusted to better align theory with practice.

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27. *See* Clayton P. Gillette & David A. Skeel, Jr., *Governance Reform and the Judicial Role in Municipal Bankruptcy*, 125 YALE L.J. 1150, 1166 (2016) (noting that "Congress designed Chapter 9 to avoid interference with state sovereignty"); S. Todd Brown, *Constitutional Gaps in Bankruptcy*, 20 AM. BANKR. INST. L. REV. 179, 181 (2012) ("[Q]uestions concerning the constitutionality of the adjudication of disputes under the Code predate its enactment."). More broadly, concerns about overlap between public and private have long dominated constitutional-law discussions. *See, e.g.*, Larry Alexander, *The Public/Private Distinction and Constitutional Limitations on Private Power*, 10 CONST. COMMENT. 361 (1993).

28. *See infra* Part III.

29. *See infra* Part III.

30. *See, e.g.*, Lynn M. LoPucki, *Chapter 11's Descent into Lawlessness*, 96 AM. BANKR. L.J. 247 (2022) (discussing ultrafast chapter 11 cases and alleging that bankruptcy courts in those cases ignore the Bankruptcy Code and Bankruptcy Rules); Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. 101, 105 (2022) (discussing the "weaponiz[ation]" of bankruptcy through "aggressive and coercive restructuring techniques"); *Oversight of the Bankruptcy Code, Part I: Confronting Abuses of the Chapter 11 System: Hearing Before the Subcomm. on Antitrust, Com. & Admin. L. of the H. Comm. on the Judiciary*, 117th Cong. 132 (2021) (statement of Adam J. Levitin, Professor of Law, Georgetown University Law Center) (highlighting "six problematic developments in chapter 11").

Second, state and local government scholars have long recognized that the divide between the public and the private is porous.[31] By examining the implications of this porous divide for bankruptcy law, this Article brings together bankruptcy scholarship and state and local government scholarship in this area. Uniting these two lines of scholarship results in a better understanding of how blended entities came to be, how they work, and how they can best address their financial distress.

The Article proceeds as follows. Part I explains the Bankruptcy Code's design, focusing on why chapter 9 of the Code differs from other chapters and why eligibility for chapter 9 renders an entity necessarily ineligible for relief under other chapters. Part II defines blended entities, providing examples to showcase the breadth and depth of their existence and their importance to American society. Part III analyzes what happens when a blended entity files for bankruptcy and highlights two related problems: (1) the functional problem of blended entities attempting to use bankruptcy laws that ignore a key aspect of the entity's identity, and (2) the contribution of these problems to the broader problems with the Bankruptcy Code that have been the subject of scholarly debate. Part IV maps out some possible ways to address the problems identified and, in particular, suggests that greater examination of and deference to state law characterizations of blended entities would both allow for better sorting of these entities in bankruptcy and respond to the federalism concerns underlying chapter 9's creation. Part V offers a brief conclusion, emphasizing that the gap between law and practice should be addressed to better align bankruptcy law with the reality of ubiquitous and varied blended entities.

I. THE (THEORETICALLY) UNCROSSABLE LINE

Eligibility for bankruptcy depends on being eligible for one or more chapters of the Bankruptcy Code. Each chapter, in turn, has its own eligibility rules, which depend on what type of entity (or person) the debtor is. Thus, it is critical to define and classify the debtor to know which chapter(s) the debtor is eligible for.

The Bankruptcy Code separates municipal debtors from other types of debtors and assumes that an entity will either fall within the Code's definition of "municipality" or not. Furthermore, chapter 9 of the Code, the

31. *See, e.g.*, Frug, Private or Public, *supra* note 6; Gerald E. Frug, *The City as a Legal Concept*, 93 HARV. L. REV. 1059 (1980) [hereinafter Frug, *The City as a Legal Concept*]; Max Schanzenbach & Nadav Shoked, *Reclaiming Fiduciary Law for the City*, 70 STAN. L. REV. 565 (2018).

chapter providing for the process of municipal debt adjustment, may not be used in conjunction with other reorganization or liquidation chapters. If an entity is a municipality, its only option under the Code is chapter 9. Thus, the Bankruptcy Code sorts debtors into categories and assumes that the classification of an entity as a "municipality" will be determinable.

This Part begins by discussing the design of the Bankruptcy Code, emphasizing chapter 9's conceptual separation from the other chapters. It then explains how chapter 9 developed and why separate provisions for municipal debtors are necessary from the perspective of the Supreme Court, Congress, and the Constitution.

A. Chapter 9 Stands Alone

An entity's journey through bankruptcy begins with chapter choice. Chapters 7, 9, 11, 12, 13, and 15 of the Bankruptcy Code each provide distinct paths through the bankruptcy process, each with its own eligibility requirements.

Chapters 12, 13, and 15 are chapters of specialized application and are not the focus of this Article. Chapter 12 provides a special process receptive to the needs of family farmer and family fisherman debtors.[32] Chapter 13 applies only to individuals (i.e., human beings),[33] while chapter 15 facilitates cross-border restructurings.[34]

By contrast, chapters 7 and 11 have much wider applicability. Chapter 7, which provides a liquidation procedure, is available to any "person" (defined as including business entities) except for railroads and certain types of banks and insurance companies.[35] Chapter 11, which provides a reorganization procedure, is available to railroads, all those eligible to file under chapter 7 (except for stockbrokers and commodity brokers), and certain banks and clearing organizations.[36] Notably, this means that most "persons," as defined in the Bankruptcy Code, have a choice between chapters 7 (liquidation) and 11 (reorganization) when they file for bankruptcy.

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32. 11 U.S.C. §§ 1201-1232 (2018).

33. *Id.* §§ 1301-1330.

34. *Id.* §§ 1501-1532.

35. *Id.* § 109(b). In relevant part, the Code defines "person" as including "individual, partnership, and corporation" but not "governmental unit." *Id.* § 101(41).

36. *Id.* § 109(d).

Chapter 9 provides the process for municipal debt adjustment. Unlike chapter 7, chapter 9 does not provide an avenue for a municipality to liquidate. Instead, the chapter 9 process is more akin to a chapter 11 reorganization in the sense that both processes, in general,[37] contemplate the continuation of the debtor's existence at the end of the proceeding. As in chapter 11, a municipal debtor proceeding under chapter 9 will receive a discharge of its debts upon confirmation of a plan of adjustment.[38] However, there are numerous differences between chapters 9 and 11: For example, unlike a chapter 11 debtor, a chapter 9 debtor, that is, a "municipality," cannot be put into bankruptcy involuntarily (i.e., by its creditors).[39] In addition, the court in a chapter 9 case has limited powers and cannot interfere with the debtor's property, revenues, or governmental powers.[40] Unlike in a chapter 11 case, the court may not appoint a trustee or examiner to run or investigate a municipal debtor.[41] As in a chapter 11 case, a creditors' committee may be appointed in a chapter 9 case, but unlike in chapter 11, creditors in chapter 9 cannot file a competing plan of adjustment for the debtor.[42] As discussed in Part B, these differences are largely due to limitations on Congress's power over state entities, such as municipalities.

Chapter 9 also has the strictest eligibility requirements in the Bankruptcy Code. Only an entity that meets the Code's definition of a "municipality" may file for chapter 9.[43] The Code defines "municipality" as a "political subdivision or public agency or instrumentality of a State."[44] In addition to being a municipality as defined in the Code, debtors seeking to use chapter 9 must meet four other eligibility criteria: (1) the municipality must be specifically authorized to be a chapter 9 debtor under state law; (2) the municipality must be insolvent; (3) the municipality must desire to effect a plan to adjust its debts; and (4) the municipality must meet one of

37. It is, of course, possible to use chapter 11 to sell all of a debtor's assets via a § 363 sale; however, the main purpose of chapter 11 is reorganization.

38. 11 U.S.C. § 944 (2018).

39. *Id.* § 303.

40. *Id.* § 903.

41. *Id.* § 1104.

42. *Id.* §§ 901(a), 941, 1102, 1103.

43. *Id.* § 109(c).

44. *Id.* § 101(40).

the criteria in § 109(c)(5), which often means it must have negotiated in good faith with its creditors prior to filing.[45]

Notably, although the Bankruptcy Code defines "municipality," the definition is sparse, leaving much to court interpretation. For example, the Bankruptcy Code does not define the terms "political subdivision," "public agency," or "instrumentality," leaving courts to determine what those terms mean. The only other defined term in the definition of "municipality" is the term "State," which, for chapter 9 eligibility purposes means the 50 U.S. states.[46]

Thus, only "municipalities" (that otherwise meet the eligibility requirements) are eligible to file for chapter 9. Scholars and commentators typically further classify these municipalities into two sub-types: general-purpose municipalities, including cities, towns, and counties; and special-purpose municipalities, including public service districts (such as water, sewer, garbage, and the like), government-run businesses (such as public hospitals), and public schools.[47] Although general-purpose municipal bankruptcies usually receive the most scholarly and public attention, most chapter 9 bankruptcies involve special-purpose entities.[48]

Because municipalities are only eligible to file under chapter 9 when an entity files for bankruptcy, a threshold question is whether it qualifies as a "municipality." In many cases, this question is easy to answer. This Article's focus, however, is on those cases where the answer to this threshold question is difficult.

B. Why Separate Chapter 9?

An understanding of why municipal debtors receive separate treatment under the Bankruptcy Code begins with the U.S. Constitution. The Tenth Amendment provides that "powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States

45. *Id.* § 109(c)(2)-(5).

46. *Id.* § 101(52).

47. *See, e.g.*, Aurelia Chaudhury, Adam J. Levitin & David Schleicher, *Junk Cities: Resolving Insolvency Crises in Overlapping Municipalities*, 107 CAL. L. REV. 459, 469-70 (2019) (describing and differentiating between general-purpose and special-purpose municipalities).

48. Vincent S.J. Buccola, *The Logic and Limits of Municipal Bankruptcy*, 86 U. CHI. L. REV. 817, 823 (2019) ("[T]hose municipalities that do file are disproportionately 'special purpose' entities.").

respectively, or to the people."[49] The reason for a separate chapter and categorization for municipalities is grounded in federalism, or the balance of power between the federal government and the states.

As a federal remedy provided by the Constitution's Bankruptcy Clause,[50] bankruptcy offers a distinct benefit to states and their political subdivisions: the ability to impair contractual obligations on a nonconsensual basis. The Contract Clause of the Constitution prohibits states from impairing the obligation of contracts.[51] Federal bankruptcy law, however, explicitly allows debtors to impair contractual obligations. [52] Because the Contract Clause only prohibits *states* from impairing contractual obligations, bankruptcy does not run afoul of that clause.

There is, however, a tension when it comes to municipal bankruptcy in particular: The ability to access bankruptcy can provide a distinct benefit to municipalities, but subjecting a municipality, a state entity, to federal bankruptcy law threatens to intrude too much into a state's power to regulate its own affairs.

Supreme Court decisions in chapter 9's infancy reflect this tension. When Congress first attempted to provide a bankruptcy mechanism for the adjustment of municipal debts in the 1930s, the Supreme Court struck down the resulting law in *Ashton v. Cameron County Water Improvement District* on the grounds that the fiscal problems of municipalities were strictly state problems "not subject to control or interference" via the federal government through bankruptcy law.[53] However, just a few years later, the Court upheld Congress's second attempt at a municipal bankruptcy law in *United States v. Bekins*.[54] In doing so, the Court acknowledged that federal bankruptcy offers a distinct remedy that states themselves are unable to

49. U.S. CONST. amend. X.

50. *Id.* art. I, § 8, cl. 4 (providing that Congress shall have power to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States").

51. *Id.* art. I, § 10.

52. 11 U.S.C. § 365 (2018).

53. Ashton v. Cameron Cnty. Water Improvement Dist., 298 U.S. 513, 528 (1936).

54. 304 U.S. 27, 54 (1938).

offer to their municipalities: the ability to nonconsensually impair contractual obligations.[55]

Simultaneously, the Court recognized the potential concern of unfettered federal (bankruptcy) law interfering with state and local law.[56] However, the Court in *Bekins* was persuaded that limitations in what was then called Chapter IX, coupled with the need for state authorization before a municipality could access Chapter IX, sufficiently assuaged these concerns.[57] Specifically, the Court in *Bekins* articulated three aspects of chapter 9 that it deemed critical to the protection of state autonomy in bankruptcy: (1) limitation of municipal bankruptcy to voluntary proceedings (i.e., only the debtor-municipality can commence a bankruptcy case); (2) a state's consent to its municipalities entering chapter 9; and (3) restraint from interference with fiscal and governmental affairs.[58]

Municipal bankruptcy law was thus developed and refined in response to concerns about undue federal interference with state powers. To be eligible for chapter 9 relief, a municipality must be "specifically authorized, in its capacity as a municipality or by name," by the state in which it is located, to file for relief.[59] Notably, however, at the time of the *Bekins* decision, *specific* state authorization for municipal bankruptcy was not required; rather, the municipality simply had to be authorized to carry out

55. *Id.* at 51 ("There is no hope for relief through statutes enacted by the States, because the Constitution forbids the passing of State laws impairing the obligations of existing contracts. Therefore, relief must come from Congress, if at all."); *see Ashton*, 298 U.S. at 531 ("The Constitution was careful to provide that 'No State shall . . . pass any Law impairing the Obligation of Contracts.'").

56. *See Bekins*, 304 U.S. at 54 ("The bankruptcy power is competent to give relief to debtors in such a plight and, if there is any obstacle to its exercise in the case of the districts organized under state law it lies in the right of the State to oppose federal interference."); Thomas Moers Mayer, *State Sovereignty, State Bankruptcy, and a Reconsideration of Chapter 9*, 85 AM. BANKR. L.J. 363, 371 (2011) (noting that, despite the Court never explicitly basing its opinions on the Tenth Amendment, "numerous lower court decisions and commentators assume that municipal bankruptcy implicates Tenth Amendment concerns").

57. *See Bekins*, 304 U.S. at 54 (noting that when a State authorizes the use of municipal bankruptcy, "[t]he State acts in aid, and not in derogation, of its sovereign powers").

58. *Id.* at 47-50.

59. 11 U.S.C. § 109(c)(2) (2018).

whatever procedures were necessary for an effective reorganization.[60] However, Congress subsequently amended the bankruptcy laws, first to require that a municipality be "generally authorized" by state law to file bankruptcy, and then, in 1994, to require that a municipality be "specifically authorized" to do so.[61] The specific authorization requirement currently in place makes it much harder for municipalities to access bankruptcy relief.[62] At least one commentator has argued that the switch to a specific authorization requirement was based on "flawed evidence" and "undermined the original intent of Chapter 9."[63] Furthermore, *Bekins* itself does not mandate that consent be "specific."[64]

In addition to a state authorization requirement, provisions in chapter 9 itself preserve the state's control over its municipalities by explicitly acknowledging that chapter 9 does not "limit or impair" a state's power to control its municipalities with respect to political or governmental powers[65] and that the bankruptcy court may not interfere with those powers or with the debtor's property or revenues.[66] Finally, chapter 9 only allows voluntary bankruptcy, meaning that creditors cannot force a municipality into bankruptcy.[67]

60. *See* Nicholas B. Malito, *Municipal Bankruptcy: An Overview of Chapter 9 and a Critique of the "Specifically Authorized" and "Insolvent" Eligibility Requirements of 11 U.S.C.A. § 109(c)*, 17 NORTON J. BANKR. L. & PRAC. 517, 522 (2008) (observing that the municipal bankruptcy law approved by the *Bekins* Court did not include any provision requiring state approval for municipal bankruptcy and that, instead, municipalities "merely had to be 'authorized by law' to carry out all procedures necessary for an effective reorganization under" the predecessor to chapter 9).

61. *Id*.

62. *See* Laura N. Coordes, *Gatekeepers Gone Wrong: Reforming the Chapter 9 Eligibility Rules*, 94 WASH. U. L. REV. 1191, 1227 (2017) ("[S]pecific authorization more often bars an otherwise eligible municipality's entry into bankruptcy than facilitates it.").

63. Malito, *supra* note 60, at 534.

64. *See* United States v. Bekins, 304 U.S. 27, 49 (1938) (dismissing as "immaterial" the omission of a provision from chapter IX that would have required a state governmental agency to approve of the municipal bankruptcy filing).

65. 11 U.S.C. § 903 (2018).

66. *Id.* § 904.

67. *Id.* § 303 (2018) (providing that involuntary cases may only be commenced under chapters 7 or 11 of the Code).

Thus, bankruptcy law provides for separate treatment of municipal debtors because Congress cannot interfere with the states' sovereign powers as guaranteed by the Tenth Amendment to the U.S. Constitution.[68] The Supreme Court has recognized the requirement of,[69] and Congress has accordingly placed, limitations on bankruptcy courts' powers in chapter 9 out of respect for state sovereignty and the consequent need for limited federal (bankruptcy) interference in the restructuring of a municipality, which is a creature of the state in which it is located. Congress and the Court have thus deemed separation of municipal bankruptcy necessary in order to preserve the balance of power between the states and the federal government.

Chapter 9, therefore, treads a narrow line, allowing municipalities to access the federal bankruptcy regime to overcome the constitutional limitation on states' abilities to impair contracts,[70] but limiting what the federal government and bankruptcy courts can do in a municipal bankruptcy case out of respect for state sovereignty.[71] For these reasons,

68. *See* Ashton v. Cameron Cnty. Water Improvement Dist., 298 U.S. 513, 525-26 (1936); *Bekins*, 304 U.S. at 51 (1938); *see also* 11 U.S.C. § 903 (2018) ("This chapter does not limit or impair the power of a State to control . . . a municipality . . . .").

69. *Ashton*, 298 U.S. at 513; *Bekins*, 304 U.S. at 27.

70. S. REP. NO. 75-911, at 3 (1937) ("[T]he Constitution forbids the passing of State laws impairing the obligations of existing contracts."); *see also* H.R. REP. NO. 75-517, at 3 (1937) (same). In *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), the Supreme Court upheld a New Jersey law that permitted municipal debt to be adjusted upon the agreement of the municipality and 85% of its creditors. However, Congress subsequently overruled *Faitoute* and expressly prohibited laws such as the one in New Jersey that nonconsensually adjusted creditors' debts. H.R. REP. NO. 79-2246, at 4 (1946); 11 U.S.C. § 903 (2018). Since then, courts have interpreted the Contracts Clause as prohibiting state municipal bankruptcy laws. *See, e.g.*, *In re* City of Detroit, 504 B.R. 97, 144 (Bankr. E.D. Mich. 2013).

71. *Chapter 9: Municipal Bankruptcy Relief*, NAT'L BANKR. REV. COMM'N, https://govinfo.library.unt.edu/nbrc/report/22chapte.html [https://perma.cc/MA3K-X2EA]; *see also* Joshua Santangelo, *Bankrupting Tribes: An Examination of Tribal Sovereign Immunity as Reparation in the Context of Section 106(a)*, 37 EMORY BANKR. DEVS. J. 325, 343 (2021) ("Sovereign immunity protects a government from in personam liability; it is a protection of a governmental structure's integrity, not of a governmental structure's property. Bankruptcy is a proceeding in rem; people file for bankruptcy in order to have the in personam liability of debtors dismissed, and the debt

the Bankruptcy Code's structure is blind to the possibility of blended entities—an entity is either a municipality for purposes of bankruptcy law, or it is not. Indeed, given the history of chapter 9's development and the Court's pronouncements in *Bekins*, it seems clear that there must be a line drawn between municipal and nonmunicipal entities when it comes to the provision of bankruptcy relief because federal bankruptcy relief for municipalities must account for the additional considerations of the Tenth Amendment.

In summary, the Bankruptcy Code, in combination with a constellation of Supreme Court decisions, congressional legislation, and the Constitution, assumes that the question of whether an entity is a municipality must be answerable and provides different treatment to entities depending on the answer. In reality, however, blended entities challenge the notion that the line between municipal and nonmunicipal can be clearly delineated.

II. THE BLENDED ENTITIES

In many cases, debtors are easy to categorize. An individual is a flesh-and-blood human being. Although a business may take many forms—and entity choice is undeniably important—a business debtor is often easy to categorize precisely because its creators choose a form for it when they create it.

A significant and growing group of entities does not fit neatly into categories, however. These entities blend governmental (or public) and nongovernmental (or private) features, making it difficult to classify them as either "municipalities" or nonmunicipal businesses for bankruptcy purposes.

Imagine a spectrum running from governmental entities to private entities. General-purpose municipalities, such as cities, towns, and counties, are at the governmental end. At the private end are private corporations,

levied only against property that they may own. For this reason, bankruptcy proceedings may be filed against a governmental structure without destroying its sovereign immunity."); Coordes, *supra* note 62, at 1209 ("Specifically, chapter 9 strikes a careful balance: the requirement from the Constitution and Congress that bankruptcy law and the nonconsensual impairment of contracts must come at the federal level is reconciled in chapter 9 with the Tenth Amendment mandate that local government access to federal bankruptcy relief be determined by the states. This balance is struck through the chapter 9 eligibility requirements, and particularly through the requirement that states must authorize their municipalities to file for bankruptcy.").

partnerships, and other business entities that do not have a formal relationship with the government. The entities falling between those two extremes are what this Article terms "blended entities."[72]

There are numerous ways in which entities can blend public and private aspects. Consequently, this Part provides a nonexhaustive typology of some forms that blended entities may take, with the goal of providing sufficiently representative examples to enable the reader to recognize blended entities in whatever form they may appear. Though each blended entity may be created differently from the next, they all defy easy categorization under bankruptcy law.

A. Special-Purpose Municipalities

Special-purpose municipalities are perhaps the quintessential blended entities. Although not separately defined in the Bankruptcy Code, special-purpose municipalities, which include special districts and special authorities, are government entities that perform functions also attributable to private businesses.[73] In this way, they differ from purely

72. Although blended entities are hybrid in nature, I have not chosen to describe them using the term "hybrid entities" because "hybrid entity" has a specific, and different, meaning in corporate, healthcare, and tax law. *See Benefit Corporations & Hybrid Entities Under the Law*, JUSTIA (Oct. 2024), https://www.justia.com/business-operations/starting-your-own-business/business-ownership-structures/benefit-corporations-hybrid-entities [https://perma.cc/8682-K764] ("Benefit corporations are one type of the business model now known as a 'hybrid entity.'"); Christopher D. Hampson, *Bankruptcy & the Benefit Corporation*, 96 AM. BANKR. L.J. 93, 142 (2022) ("The benefit corporation is just the latest innovation, yet perhaps one of the most important ones, because it creates a truly hybrid form."); *Becoming a Hybrid Entity: As Defined by the HIPAA Privacy Rule*, NETWORK FOR PUB. HEALTH L. 1, https://www.networkforphl.org/wp-content/uploads/2020/01/Becoming-a-Hybrid-Entity-As-Defined-by-the-HIPAA-Privacy-Rule-4-23.pdf [https://perma.cc/CZ56-DA9L] (discussing what it means to be a hybrid entity under the Health Insurance Portability and Accountability Act); Andrew Mitchel, *Hybrid Entities and Reverse Hybrid Entities*, ANDREW MITCHEL LLC: INT'L TAX BLOG (July 27, 2010), https://www.andrewmitchel.com/blog/2010_07_hybrid-entities-and-reverse-hybrid-entities [https://perma.cc/L8F5-DE8Z] (defining "hybrid entities" in the context of U.S. tax law).

73. *See* Abbye Atkinson, *Making Public Debt a Public Good*, JUST MONEY (Sept. 16, 2021), https://justmoney.org/a-atkinson-making-public-debt-a-public-good

governmental general-purpose municipalities, such as cities, towns, and counties.

Special-purpose municipalities are abundant and difficult to classify. According to the 2002 Census of Governments, "Numerous single-function and multiple-function districts, authorities, commissions, boards, and other entities, which have varying degrees of autonomy, exist in the United States. The basic pattern of these entities varies widely from state to state. Moreover, various classes of local governments within a particular state also differ in their characteristics." [74] Examples of special-purpose municipalities include public improvement districts (including waste disposal districts, water and sewer treatment districts, and public transit), public school districts, and public hospitals, although this list is by no means exhaustive.[75]

Special-purpose municipalities may be dissolved by the general-purpose municipality in which they are located, providing yet another indicator that they are different from general-purpose municipalities, which typically do not dissolve.[76] In general, special districts have a "shorter lifespan and higher turnover" than their general-purpose counterparts.[77] For example, the 2017 Census of Governments added more than 1,500 special districts from 2012 and removed approximately 1,260 that are no longer operating.[78] Thus, many special districts are governmental entities formed for a particular (i.e., "special") and sometimes limited purpose.

To further complicate matters, special-purpose municipalities differ amongst themselves, not just from general-purpose municipalities.[79] Indeed, they "vary substantially from one another in terms of revenue

[https://perma.cc/G9BU-F2ZY] ("Viewed through this lens, municipal debt is no more than another for-profit business.").

74. U.S. CENSUS BUREAU, DEP'T OF COM., GC02(1)-1, GOVERNMENT ORGANIZATION: 2002 CENSUS OF GOVERNMENTS 10 (Dec. 2002), https://www2.census.gov/programs-surveys/gus/tables/2002/gc021x1.pdf [https://perma.cc/7J6T-MS8D].

75. *See* Bruckner, *supra* note 8, at 354 (describing certain types of special-purpose municipalities).

76. *But see generally* Michelle Wilde Anderson, *Dissolving Cities*, 121 YALE L.J. 1364 (2012) (providing an in-depth examination of the dissolution of cities and towns, which is rare).

77. Am. Counts Staff, *supra* note 11.

78. *Id.*

79. Michelle Wilde Anderson, *The New Minimal Cities*, 123 YALE L.J. 1118, 1132 (2014).

sources, service obligations, and financial conditions."[80] Thus, even as we differentiate special-purpose entities from their general-purpose counterparts, they are sufficiently different from each other that it can be difficult to classify them into a single separate group.

The form and structure of local governments—particularly their delegation of local functions to special districts—has always been a focus of public debate.[81] This is partly because special districts provide some of society's most basic and important services, such as healthcare, fire protection, and education. If you send your children to public school, have your trash picked up from your house, or have visited a public hospital, you have likely interacted with a special-purpose municipality.[82]

A recent dispute over whether to sell a water authority in Pennsylvania highlights the sometimes confusing nature of special-purpose entities. The city of Chester, Pennsylvania has filed for chapter 9 bankruptcy and is contemplating the privatization of its water authority, intending to sell it to a private company.[83] However, the water authority itself is opposed to the sale and had previously rejected an unsolicited offer from the same private company to purchase it.[84] There is an ongoing dispute in the courts over who owns and has the rights to sell the water authority: Does the water authority have sufficient autonomy to decide whether its assets may be sold, or is the city of Chester the entity that can make that decision? [85]

In September of 2021, a Pennsylvania court ruled that Chester is the sole owner of the water authority; however, the water authority appealed that decision to the state's supreme court.[86] The dispute was ongoing when Chester filed for bankruptcy, and the bankruptcy filing halted the state court litigation, leaving the question unanswered.[87]

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80. *Id.*

81. *Id.* at 1214.

82. *See id.* at 1220 ("[S]pecial districts can provide everything from sanitation systems to waste management.").

83. Hadriana Lowenkron, *Bankrupt Pennsylvania City Pushes to Sell Water System to Raise Cash*, BLOOMBERG (Dec. 22, 2022), https://www.bloomberg.com/news/articles/2022-12-22/bankrupt-pennsylvania-city-pushes-to-sell-water-system [https://perma.cc/LAY5-KYAX].

84. *Id.*

85. *Id*.

86. *Id*.

87. *Id*.

The dispute in Chester raises significant questions about the nature and powers of the water authority. Is the water authority merely an asset that the city can simply sell on its own? Or is it a separate entity with independent ownership and the autonomy to determine whether its assets can be sold?

Similar questions have arisen with respect to the Delaware County Regional Water Quality Control Authority ("DELCORA"), which treats wastewater for over 40 municipalities in two Pennsylvania counties.[88] In 2019, DELCORA entered into an asset purchase agreement with a private company and created a trust in which to place the proceeds of the transaction.[89] However, in May of the following year, the Delaware County Council filed a complaint against DELCORA, arguing that the entity had exceeded its authority when it created the trust.[90] These proceedings have been stayed upon the request of Chester's receiver, and the issue of whether DELCORA has the authority to sell itself and distribute the proceeds remains undecided.[91] Although Part III will discuss various issues surrounding the classification of special-purpose entities in bankruptcy, these examples illustrate that, when it comes to special-purpose municipal entities, questions about what these entities are and the extent of their authority and autonomy exist outside of bankruptcy as well.

Special-purpose municipalities are numerous, varied, and not clearly defined. Because of this variance in form and function, many special-purpose municipalities look and act more like private businesses than an arm of the government, even though they are subject to government ownership and sometimes treated as governments. However, special-purpose municipalities are not the only entities that raise questions over where they fall along the governmental-private spectrum. The following sections highlight other entities that may raise the same or similar issues.

88. Kathleen E. Carey, *Bankruptcy Situation in Chester the Key Component in Water, Sewer Authority Sales*, DEL. CNTY. DAILY TIMES (May 7, 2023), https://www.delcotimes.com/2023/05/07/bankruptcy-situation-in-chester-the-key-component-in-water-sewer-authority-sales [https://perma.cc/9NWF-KSYZ].

89. *Id*. The trust was intended to "provide payments to customers to assist with future bills." *Id*.

90. *Id*.

91. *Id*.

B. Government-Created or Government-Run Businesses

At times, a government may create or run a business itself. This is sometimes referred to as a "public benefit corporation." Broadly speaking, there are two main types of public benefit corporations.[92] Traditionally, a public benefit corporation is formed when the government creates an entity to serve a specific public need, such as healthcare or education.[93] In this sense, the United States Postal Service (the "USPS"), discussed below, can be considered a public benefit corporation because the U.S. government established it to serve the specific public need for mail delivery.[94] The Metropolitan Transportation Authority (the "MTA"), established by the New York State government for transportation purposes, also falls into this category and is discussed further below. These entities blur the line between public and private and are considered blended entities for purposes of this Article. The second type of public benefit corporation arises solely under state law. A public benefit corporation formed under state law is in the private sector[95] and would not be considered a blended entity for purposes of this Article.

At the federal level, the most notable example of a struggling public benefit corporation (of the first type) is the USPS. The USPS is part business, part public service.[96] Although the USPS is a federal government agency, it is not publicly funded and is designed to be self-sufficient, much like a private business.[97] The USPS also competes with other private businesses, such as United Parcel Service ("UPS") and FedEx.[98] At the same time, because the USPS is a government agency, it is subject to extensive

92. Stacey Supina, *Exploring the Basic Features of Public Benefit Corporations*, STAR TRIB. (Feb. 8, 2019), https://www.startribune.com/exploring-the-basic-features-of-public-benefit-corporations/505593312 [https://perma.cc/9QFA-Y77Q].

93. *Id.*

94. *Id.*

95. *Id.*

96. Tim Levin, *Congress Established the US Postal Service as Both a Business and a Service. That May Be Its Fatal Flaw.*, BUS. INSIDER (Aug. 28, 2020), https://www.businessinsider.com/usps-congress-established-us-postal-service-usps-service-fatal-flaw-2020-8 [https://perma.cc/V4T4-ZHLA].

97. *Id.*

98. *Id.*

governmental rules and regulations, including restrictions on rate increases and a mandate to deliver to every address in the country.[99]

In recent years, the USPS has encountered significant financial difficulties. Yet, as a result of its blended status, it lacks a clear option for addressing those difficulties absent direct congressional action.[100] Such congressional action came in May of 2021, in the form of a bipartisan bill removing the requirement that the USPS fund $5 billion a year in retiree healthcare expenses while simultaneously requiring that the USPS increase accountability to its customers.[101] In creating this bill, lawmakers sought to remove structural barriers to reduce the USPS's $188.4 billion in liabilities, while mandating that the USPS improve performance outcomes through better accountability to customers for on-time mail delivery.[102] This bill, the Postal Service Reform Act, was signed into law in the spring of 2022 to address the USPS's financial difficulties.[103]

Congressional action was the only way to address the USPS's financial problems because, as I have written previously, the USPS, in both form and function, falls somewhere in between a government agency and a private business.[104] Due to its blended status, and due to the fact that it is a federal entity, it lacks access to bankruptcy as a safety net; yet, this same blended

99. *Id.*

100. *See* Monique Beals, *USPS Testing Paycheck Cashing, Other Financial Services*, HILL (Oct. 4, 2021), https://thehill.com/policy/finance/575227-usps-testing-paycheck-cashing-other-financial-services [https://perma.cc/2UNA-HGJA] (describing how the USPS has begun to offer some financial services at a few locations with the aim of potentially reviving postal banking so that it can "achieve financial sustainability and service excellence").

101. Jacob Bogage, *Senators Reach Bipartisan Deal to Overhaul USPS Finances, Tighten Accountability Requirements*, WASH. POST (May 19, 2021), https://www.washingtonpost.com/business/2021/05/19/usps-senate-bipartisan-agreement [https://perma.cc/AJ84-6LVY].

102. *Id.*

103. Press Release, Comm. on Oversight & Gov't Reform, President Biden Signs Comer, Maloney, Peters, Portman's Postal Service Reform Act into Law (Apr. 6, 2022), https://oversight.house.gov/release/president-biden-signs-comer-maloney-peters-portmans-postal-service-reform-act-into-law [https://perma.cc/W9FU-LCDR].

104. Laura N. Coordes, *A Path Forward for the Postal Service*, 37 EMORY BANKR. DEVS. J. 581 (2021).

status prohibits it from pursuing efficiency-based reforms the way a struggling private business might.[105]

Although the USPS is not the equivalent of, for example, a special-purpose municipality, it is a blended entity. In part, because the USPS blends public and private functions, those tasked with addressing the USPS's financial difficulties have struggled to articulate a viable relief mechanism for the USPS when it encounters financial difficulties.[106] In 2020, the Government Accountability Office asked the National Bankruptcy Conference to examine possible bankruptcy options—including a bespoke bankruptcy provision—for the USPS.[107] If the USPS were a fully private entity, as some scholars have urged, it could become financially self-sufficient using tools of innovation available to all private businesses.[108] By contrast, if the USPS was fully a part of the federal government, it could be funded with taxpayer dollars and would not need to be independently self-sufficient.[109] However, Congress has made the USPS into a blended entity by requiring it to be fully self-sufficient while restricting its use of tools available to private businesses because, for example, the USPS is still required to comply with government mandates. The creation of a business funded independently from the government yet hamstrung by government rules and requirements has both exacerbated the USPS's financial problems and has prevented it from accessing the traditional avenues of relief: bankruptcy for private businesses and taxpayer funds for governmental entities.

The USPS's financial struggles might best be left to Congress because the USPS is not a state entity and, therefore, would not qualify as a

105. *Id*. at 581 (arguing that the USPS's lack of clear structural identity "poses innumerable problems, including and especially the lack of a readily available safety net").

106. *Id*. at 587 ("In practice, the USPS is a hybrid, sharing characteristics with both governmental agencies and private businesses. . . . [T]he USPS's lack of ready classification makes it difficult, in turn, to assess or design options for its financial relief.").

107. *Id*. at 591-92 (describing this request and the results of the National Bankruptcy Conference's assessment).

108. *Id*. at 588 (describing examples of such innovation as "finding new goods and services to offer and coming up with new ways to deliver those goods and services").

109. *Id*. at 589 (noting that the Post Office was, at one time, "a taxpayer-subsidized cabinet-level agency").

"municipality" under bankruptcy law. However, state-level public benefit corporations exist as well. An example is New York's MTA.

The MTA was created as a public-benefit corporation under New York state law.[110] It is a corporate entity that exists separately and apart from New York State and has no taxing power.[111] Despite this, in common parlance, it is frequently referred to as a "public authority,"[112] and it is fairly easy to see why. As can be observed from the MTA's website, the MTA is responsible for "developing and implementing a unified mass transportation policy" for New York City and its surrounding counties.[113] Its subsidiaries and affiliates are also public benefit corporations, and the Governor appoints its Board with the advice and consent of the State Senate.[114]

Like the USPS, the MTA has faced financial difficulties in recent years.[115] Also, like the USPS, it lacks a clearly defined safety net wherein it can resolve these problems. The MTA received $14.5 billion of COVID-19 relief from Congress, but it expected to use this all up by 2024, at which point it could face a $3.5 billion two-year shortfall due to a post-pandemic drop-off in subway riders.[116] In late 2021, the New York State Comptroller characterized the MTA as running on "borrowed time."[117]

110. *The Related Entities*, MTA 1, http://web.mta.info/mta/compliance/pdf/MTA-Creation-Structure.pdf [https://perma.cc/5YL8-MBXW].

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.* at 2.

115. Kaske, *supra* note 12 (asserting that the MTA "has to simultaneously service its existing financial debt while spending billions of dollars more on infrastructure").

116. David Harrison, *Transit Got Billions in Covid-19 Relief from Congress, but Deficits Still Loom*, WALL ST. J. (Aug. 22, 2021), https://www.wsj.com/articles/transit-got-billions-in-covid-19-relief-from-congress-but-deficits-still-loom-11629624605 [https://perma.cc/9SAZ-WDC5].

117. Mischa Wanek-Libman, *New York State Comptroller's Annual Report Says MTA Financial Outlook in Precarious Balance*, MASS TRANSIT (Sept. 30, 2021), https://www.masstransitmag.com/management/article/21240455/new-york-state-comptrollers-annual-report-says-mta-financial-outlook-in-precarious-balance [https://perma.cc/UUG9-BSMB].

The MTA is not alone in facing financial difficulty: Many US public transit systems have faced the challenge of wooing back riders after the COVID-19 pandemic.[118] As public authorities like the MTA increasingly assume responsibility for infrastructure, including transit, it will become critical to sort out where these entities fall on the spectrum of public and private to ensure a safety net for them in the event of financial distress or failure.[119] Currently, however, there are no clear answers as to what these entities are or what infrastructure is needed to deal with their financial challenges.

C. Tribal Corporations

Just like entities created by state or federal governments, tribal corporations may have both public and private aspects. Using Section 17 of the Indian Reorganization Act, tribes can form corporations separate from the tribal government yet wholly owned by the tribe.[120] These so-called "Section 17 corporations" may issue tax-exempt bonds if their proceeds finance essential government services.[121] Thus, these corporations have features of both a private business (in the sense that they are separate from tribal government) and a public one (through their ability to issue tax-exempt bonds and provide essential government services).

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118. Skylar Woodhouse, *US Public Transit Systems Face Credit Downgrades as Riders Stay Away*, BLOOMBERG (June 6, 2023), https://www.bloomberg.com/news/articles/2023-06-06/transit-systems-face-downgrades-as-us-riders-aren-t-returning [https://perma.cc/D4A7-W6FU]; Kaske, *supra* note 12 (describing financial pressures on Boston's transit agency and the Chicago Transit Authority).

119. Charles D. Jacobsen & Joel A. Tarr, *Ownership and Financing of Infrastructure: Historical Perspectives* 10 (World Bank Pol'y Rsch., Working Paper No. 1466, 1995), https://documents1.worldbank.org/curated/ru/624581468765619582/112512322_20041117163030/additional/multi0page.pdf [https://perma.cc/5CCN-PNC5] (observing that "publicly owned and subsidized transit systems continue to dominate the field of urban transit").

120. DIV. OF ECON. DEV., U.S. DEP'T OF INTERIOR, TRIBAL ECONOMIC DEVELOPMENT PRINCIPLES AT A GLANCE SERIES: CHOOSING A TRIBAL BUSINESS STRUCTURE 3-4, https://www.bia.gov/sites/bia.gov/files/assets/as-ia/ieed/bia/pdf/idc1-032915.pdf [https://perma.cc/R3X7-7UW2].

121. *Id.* at 4.

Tribally chartered organizations are another form of blended entity. These organizations are formed pursuant to tribal law.[122] Some tribal corporations are tax-exempt if they operate as an "integral part" of the tribe.[123] Like Section 17 corporations, tribally chartered organizations may be able to issue tax-exempt bonds if their proceeds finance government-related services.[124]

In previous work, I have examined in detail how tribal corporations straddle the line between government and private business.[125] Like any other sovereign nation, tribes may form their own entities to perform business and other functions.[126] Like municipalities formed by states, entities formed by tribal governments may be considered instrumentalities or political subdivisions or agencies of the tribe.[127] Of course, tribes may also form wholly separate business entities under federal, state, or tribal law.[128] As I have written elsewhere, instrumentalities, political subdivisions, and agencies of the tribe would likely be ineligible for chapter 9 bankruptcy, since they are not instrumentalities of a "state" but rather of a sovereign tribal government.[129] Yet, the point remains: In practice, it may be difficult to precisely define what type of tribal entity—private or public—one is dealing with.

A current debate over tribal sovereign immunity, while not the focus of this Article, nevertheless sheds light on the question of the law's treatment of tribal entities. In *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin*,[130] the Supreme Court held that tribes do not have sovereign immunity from bankruptcy. In that case, LendGreen, the lending subsidiary of the Lac Du Flambeau Band of Lake Superior Chippewa Indians, issued a

122. Karen J. Atkinson & Kathleen M. Nilles, *Tribal Business Structure Handbook*, OFF. OF INDIAN ENERGY & ECON. DEV., at III-6 (2008), https://www.irs.gov/pub/irs-tege/tribal_business_structure_handbook.pdf [https://perma.cc/TXN7-QW4Y].

123. *Id.*

124. *Id.* at III-7.

125. *See* Laura N. Coordes, *Beyond the Bankruptcy Code: A New Statutory Bankruptcy Regime for Tribal Debtors*, 35 EMORY BANKR. DEVS. J. 363 (2019).

126. Atkinson & Nilles, *supra* note 122, at I-4.

127. *Id.*

128. *Id.*

129. Coordes, *supra* note 125, at 376-77.

130. 599 U.S. 382 (2023).

payday loan to the debtor, Coughlin.[131] After Coughlin filed chapter 13 bankruptcy, LendGreen continued its efforts to collect on the loan, asserting that tribal sovereign immunity exempted it from bankruptcy's automatic stay, which would otherwise prohibit such efforts.[132]

In *Coughlin*, no one questioned that LendGreen, a lending agency, was synonymous with the Lac du Flambeau tribe. Instead, the only question was whether the tribe, LendGreen included, had sovereign immunity for purposes of the bankruptcy regime's automatic stay. As Nathalie Martin has observed, the bankruptcy court's holding in *Coughlin* was based on the premise that "the entire conglomerate of lenders was immune from the automatic stay, even though only one was a tribe."[133] Martin posits that the real issue in the case is "whether the tribe was the actual lender involved or whether the true lender was another party not entitled to immunity."[134] She contends that in most cases, "tribes will rarely be the true lender in credit transactions,"[135] and she points out that courts have developed tests for determining whether an entity can claim sovereign immunity.[136] As government-run businesses,[137] tribal lenders raise questions not only about sovereign immunity but also about their status as tribal or private entities. Thus, while the Court's decision in *Coughlin* resolved questions regarding tribes' sovereign immunity in bankruptcy law, it did not address the perhaps more difficult questions of which types of tribal businesses are synonymous with tribes or whether tribal businesses may be debtors in bankruptcy.

As discussed, tribal corporations will never constitute "municipalities" under the Bankruptcy Code because they are not creatures of "State" governments. Nevertheless, tribal corporations are blended entities, and their blended nature creates a similar uncertainty as to how to address their financial distress.

131. *Id*. at 385.

132. *Id.* at 385-86.

133. Nathalie Martin, *Brewing Disharmony: Addressing Tribal Sovereign Immunity Claims in Bankruptcy*, 96 AM. BANKR. L.J. 145, 149 (2022).

134. *Id.*

135. *Id.* at 164.

136. *Id*. at 171.

137. *Id*. at 170 ("Tribes run numerous forms of businesses for the benefit of their communities.").

D. Nonprofit Organizations

At first glance, private, nonprofit organizations may clearly appear to fall within the wholly private end of the public-private spectrum. However, these organizations increasingly carry out tasks once performed by governments, causing at least one commentator to question whether they should be considered "municipalities" for bankruptcy purposes.[138] This question is not merely theoretical and has arisen in the case of *In re Seven Counties Services, Inc.*[139] That case concerned a nonprofit established by an individual but later recognized by the Commonwealth of Kentucky as a regional mental health board. The nonprofit, Seven Counties, contracted with Kentucky to operate mental health facilities in the state. When the nonprofit filed for chapter 11 bankruptcy, the Kentucky Employees Retirement System ("KERS"), in which Seven Counties participated, argued that Seven Counties was a governmental unit and ineligible to file chapter 11 bankruptcy. The bankruptcy court ultimately held that Seven Counties was nongovernmental and could reorganize under chapter 11 of the Code, but only after an exhaustive and detailed examination of the debtor encompassing over 30 pages.[140]

Although the court in *Seven Counties* ultimately concluded that the nonprofit debtor was not a governmental unit, it is possible that, in the future, courts could conclude that nonprofits that carry out tasks traditionally performed by governments could be blended entities. This is because chapter 9's legislative history indicates that Congress intended to define the term "governmental unit" broadly.[141] Although thus far, it appears that this term's broad reach does not include independent, private

138. D. Nicholas Panzarella, *Determining the Meaning of "Instrumentality" in the Bankruptcy Code* 2 (St. John's Univ. Bankr. Rsch. Libr., Working Paper No. 17, 2015), https://scholarship.law.stjohns.edu/cgi/viewcontent.cgi?article=1169&context=bankruptcy_research_library [https://perma.cc/7GFY-W6JN] ("Therefore, the question is whether such non-profits are 'persons,' eligible to pursue chapter 7, 11, 12, or 13 bankruptcy, or 'municipalities,' restricted to filing under chapter 9.").

139. 511 B.R. 431 (Bankr. W.D. Ky. 2014).

140. *Id*. The bankruptcy court's decision as to Seven Counties' nongovernmental status was later affirmed on appeal, although the district court reversed in part and remanded on other grounds. Ky. Emps. Ret. Sys. v. Seven Cntys. Servs., Inc., 550 B.R. 741 (W.D. Ky. 2016).

141. Panzarella, *supra* note 138, at 4.

nonprofits (even if they work closely with a government, and even if, as in the *Seven Counties* case, they participate in the government's pension system)[142] the status of private, nonprofit organizations brings to the forefront the question of how broad a net should be cast by the definition of "governmental unit."[143] As one commentator explains, "[a]s the use of government contracts develop and change [sic] to include corporate complexities that did not exist or were not contemplated when the Bankruptcy Code was enacted in 1978, the question of the scope of the term 'governmental unit' is likely to become litigated more frequently."[144] The number of private nonprofits carrying out tasks traditionally performed by governments has, in fact, grown significantly over the years.[145] Consequently, it is not possible to confidently assert that these entities are not blended.

Relatedly, certain public-private partnerships ("PPPs") involving nonprofits may also constitute blended entities. Often, a public-private partnership is funded through a bond issued by a nonprofit corporation acting on behalf of a state or municipal government.[146] The hybrid status of the issuer creates an advantage in that the issuer has a "sufficient nexus to a state or municipal government to satisfy federal tax criteria for the issuance of tax-exempt municipal debt" yet is sufficiently distinct from such government to "escape otherwise applicable state law restrictions on the incurrence of debt."[147]

Due to their hybrid status, debt issuers in these types of PPPs may or may not be considered "municipalities" for purposes of bankruptcy law, and

142. *Id.* at 12.

143. Elizabeth L. Gunn, *Escaping the Net of a Governmental Unit Classification*, AM. BANKR. INST. J., Mar. 2019, at 14, 14.

144. *Id.* at 56.

145. *See, e.g.*, David M. Halbfinger, *City Sets Up a Corporation to Oversee Its Tech Projects*, N.Y. TIMES (Aug. 23, 2012), https://www.nytimes.com/2012/08/24/nyregion/new-york-city-sets-up-nonprofit-corporation-to-oversee-tech-projects.html [https://perma.cc/S2W3-PT5H] (describing a new quasigovernmental entity, formed as a nonprofit by New York City, to take over some of the responsibilities of the city's Department of Information Technology and Telecommunications).

146. William W. Kannel, *Checking-In Chapter 9, Chapter 11 or Ineligible?*, MINTZ 1 (Feb. 23, 2018), https://www.mintz.com/mintz/pdf?id=23211 [https://perma.cc/H65Z-N7W8].

147. *Id.*

the rise of PPPs threatens to exacerbate the already blurred line between municipalities and their private counterparts. If and when these issuers file for bankruptcy, it is unclear whether they should be eligible for chapter 9 or chapter 11 relief.[148]

As the U.S. increasingly relies on public-private partnerships to finance public projects—and as these partnerships become debt issuers—it will be increasingly critical to understand the distinctions among governmental units that may not file for bankruptcy per state law, municipalities that are eligible only for chapter 9, and other types of entities that will be eligible for chapter 11. If these distinctions cannot be untangled, issuers of PPP debt may avoid using bankruptcy altogether. For example, projects that use "conduit" or "special revenue" financing may have both public and private aspects, making it difficult to determine whether the entity relying upon that financing is eligible for chapter 9 or 11 of the Bankruptcy Code.[149]

The distinction between public and private is theoretically straightforward, and this straightforwardness is reflected in the Bankruptcy Code's structure. In practice, however, the distinction is markedly less clear. As long as the line between public and private is blurred, bankruptcy law's application to blended entities will be uncertain.[150]

E. Cooperatives and Utilities

As a final example, cooperatives and utilities may straddle the line between the public and the private. A cooperative is an organization owned and controlled by those who also consume its end products.[151] Municipal utilities are those that a state or local government owns and operates to

148. *Id.* (noting that "bondholders can be lulled into a false sense of security thinking their issuer cannot file bankruptcy under Chapter 9, only to find out that the issuer is Chapter 11 eligible").

149. *An Overview of Chapter 9 of the Bankruptcy Code: Municipal Debt Adjustments*, JONES DAY (Aug. 15, 2010) [hereinafter *An Overview of Chapter 9*], https://www.jonesday.com/en/insights/2010/08/an-overview-of-chapter-9-of-the-bankruptcy-code-municipal-debt-adjustments [https://perma.cc/3N56-7VPB].

150. *See* Brown, *supra* note 27, at 184 (noting that "public/private dichotomy questions . . . until answered, may continue to plague bankruptcy practice").

151. Rocky Weber, *What Is a Cooperative?*, UNIV. OF NEB.-LINCOLN, https://ncdc.unl.edu/what-cooperative [https://perma.cc/Q5C2-K6U9].

provide public services such as electricity, water, gas, and phone service.[152] Several bankruptcies involving cooperatives and utilities have recently highlighted interesting facets of these entities, which raise questions as to whether they might be considered blended entities.

For example, after Brazos Electric Power Cooperative Inc. filed chapter 11 bankruptcy in Texas, the bankruptcy judge commented that the case should be treated more like a municipal bankruptcy than a corporate chapter 11, due in part to pending state legislation that would have allowed Brazos to securitize costs it incurred during Winter Storm Uri.[153] Similarly, the California state government was heavily involved in—and impacted by—the recent chapter 11 case of the Pacific Gas & Electric Company, an investor-owned utility.[154] The state's intense interest and involvement in the case highlights the state's close relationship with this entity. Finally, the Texas Supreme Court recently held that ERCOT, the state's power grid operator, had immunity against fraud claims and allegations of overpricing during Winter Storm Uri, even though ERCOT is a private corporation overseen by a government agency.[155]

Most recently, the question of the status of Hawaiian Electric Industries Inc. has arisen after property owners in Maui sought to hold the utility accountable for damage they incurred after fires devastated Maui in August of 2023. Property owners there argue that inverse condemnation, which allows property owners to sue governments for damages, applies in this

152. Scotty Hendricks, *What Are Municipal Utilities and Why Are They Suddenly Popular?*, BIG THINK (Nov. 26, 2019), https://bigthink.com/the-present/municipal-electricity-utility [https://perma.cc/5ERT-5YTL].

153. Jeremy Hill, *Brazos Electric Judge Says Lawmaker Help May Not Be Best Option*, BLOOMBERG L. (May 18, 2021), https://news.bloomberglaw.com/bankruptcy-law/brazos-electric-judge-says-lawmaker-help-may-not-be-best-option [https://perma.cc/ME8X-6MC6].

154. For a full discussion of this involvement, see Jared A. Ellias & George Triantis, *Government Activism in Bankruptcy*, 37 EMORY BANKR. DEVS. J. 509 (2021). *See also* KATHERINE BLUNT, CALIFORNIA BURNING: THE FALL OF PACIFIC GAS & ELECTRIC—AND WHAT IT MEANS FOR AMERICA'S POWER GRID 202 (2022) ("Suddenly, [PG&E's] bankruptcy threatened the entire state [of California].").

155. Lauren Castle, *Texas Justices Find ERCOT Immune in Winter Storm Suits*, LAW360 (June 23, 2023), https://www.law360.com/articles/1692203/texas-justices-find-ercot-immune-in-winter-storm-suits [https://perma.cc/M2RV-Z5LC].

instance and allows them to sue Hawaiian Electric, a private utility.[156] Whether their argument succeeds depends on whether Hawaiian Electric is held to function like a government agency.[157] "Hawaiian Electric is a private utility but it gets to operate as a quasi-governmental entity" because it supplies electricity to the public.[158] Hawaiian Electric is thus subject to governmental regulation over certain aspects, such as the rates it sets.[159] Although inverse condemnation has seen some success with respect to California utilities, it is not yet clear whether this argument will succeed in Hawaii.[160] Nevertheless, this issue illustrates Hawaiian Electric's status as a blended entity.

Common interest communities ("CICs") are yet another example of entities that straddle the line between the public and the private.[161] Because of this, as Scott Pryor has pointed out, bankruptcy law does not provide an effective means of addressing their financial distress.[162] In a CIC, a private association is responsible for the provision of certain public goods.[163] Although CICs fall in between public and private, they are by no means alone.[164] Yet, CICs that have filed for bankruptcy have experienced difficulty confirming plans that would allow them to exit bankruptcy proceedings. Certain of the Bankruptcy Code's plan confirmation requirements, such as the requirement that creditors receive at least as much as they would in a liquidation (the "best interests test") and the requirement that creditors with higher priority claims be paid in full before lower-priority creditors receive any payment (the "absolute priority rule"), make sense in the context of a plan for a private business, but, as Pryor explains, work special

156. Joel Rosenblatt, *Maui Fire Lawyers Eye Tactic that Got Californians $13.5 Billion*, BLOOMBERG L. (Aug. 22, 2023), https://news.bloomberglaw.com/environment-and-energy/maui-fire-lawyers-eye-tactic-that-got-californians-13-5-billion [https://perma.cc/BS9C-GHY9].

157. *Id*.

158. *Id*.

159. *Id*.

160. *Id*.

161. *See* C. Scott Pryor, *Nine into Eleven: Accounting for Common Interest Communities in Bankruptcy*, 33 EMORY BANKR. DEVS. J. 455, 459 (2017) ("CICs occupy a peculiar middle space between private entities and public ones.").

162. *Id*. at 462 (arguing that the Code "should be amended to do so").

163. *Id*. at 459.

164. *But see id.* at 470 (describing the "unique middle space occupied by CICs").

hardships for CICs because of CICs' structure and the constellation of state laws that may apply to them.[165] Thus, although direct questions about bankruptcy eligibility for CICs have yet to arise in practice, these entities clearly fall somewhere in the middle of the public-private spectrum.

* * *

To varying extents, all of the entities discussed in this Part blend public and private forms and functions. All of the entity types examined above are connected to government in ways that private businesses are not: they may be formed by the government, or they may be able to take advantage of special rules for governments, such as the ability to issue tax-exempt bonds. Yet, each of these entities also engages in activities traditionally associated with private business as well. Blended entities are truly a diverse and growing group.

Why do so many blended entities exist in so many forms? The answer lies, at least in part, in history: The earliest forms of municipal governments were actually corporate forms, and municipal governments began as corporations.[166] It took many years for the public/private distinction between municipalities, on the one hand, and private corporations, on the other, to develop, and as just discussed, the distinction remains blurry in many instances.[167]

Blended entities also represent an attempt to attain the ultimate flexibility: They may act like a government when it is advantageous to do so (i.e., for tax or financing reasons), and they may act like a private entity when it is advantageous to do so. In many instances, blended entities are the product of the privatization of public goods and services, a trend that has existed since the 1980s.[168]

For these reasons, classifying blended entities is quite difficult, as many entities have relationships with the state without necessarily turning into

165. *Id*. at 470-76.

166. Zachary D. Clopton & Nadav Shoked, *Suing Cities*, 133 YALE L.J. 2539, 2592 (2024) ("Historically, municipal governments were corporations or corporation-like entities."); *see also* Frug, *The City as a Legal Concept*, *supra* note 31, at 1082 ("[B]efore the nineteenth century, there was no distinction in England or in America between public and private corporations, between businesses and cities.").

167. Frug, *The City as a Legal Concept*, *supra* note 31, at 1082.

168. *See* John B. Goodman & Gary W. Loveman, *Does Privatization Serve the Public Interest?*, HARV. BUS. REV., Nov.-Dec. 1991, at 26, 26 ("This newfound faith in privatization has spread to become the global economic phenomenon of the 1990s.").

"governmental units," while many others seemingly take advantage of attributes and benefits traditionally only provided to or associated with governments.

The line between public and private is likely to become even blurrier with time. The Supreme Court stopped trying to determine which government functions are "traditional" in the 1985 case *Garcia v. San Antonio Metropolitan Transit Authority*.[169] In *Garcia*, the Court overruled a previous decision, *National League of Cities v. Usery*, which held that Congress could not enforce federal Fair Labor Standards Act requirements against the states "in areas of traditional governmental functions."[170] The Court in *Garcia* found that trying to demarcate "traditional governmental functions" was both unworkable and inconsistent with federalism principles.[171] Judges sitting in bankruptcy cases have similarly considered whether an entity has traditional government attributes or engages in traditional government functions when assessing whether an entity is a "governmental unit."[172] Yet, just as the Supreme Court has recognized the difficulty of categorizing "traditional government functions," courts using this concept to demarcate the line between governmental and nongovernmental have found it impossible to apply with precision.

Of course, bankruptcy law is not the only area of law that draws a firm line between the public and the private. Indeed, the law generally treats "public" entities differently from "private" ones.[173] This disparate treatment makes some intuitive and even practical sense: public entities are creatures of the state in which they are located, while private entities are beholden to their members. [174] However, these practical distinctions break down

169. 469 U.S. 528 (1985).

170. 426 U.S. 833, 852 (1976).

171. *Garcia*, 469 U.S. at 531.

172. *See* Laura E. Appleby, James Heiser, Scott A. Lewis & Franklin H. Top III, *Sixth Circuit Weighs in on the Meaning of "Governmental Unit*," 15 PRATT'S J. BANKR. L. 49, 50-51 (2019) (noting that *In re Las Vegas Monorail Co.*, 429 B.R. 770 (Bankr. D. Nev. 2010)), and *In re Lombard Public Facilities Corp.*, 579 B.R. 493 (Bankr. N.D. Ill. 2017), are instances where courts have invoked the "traditional governmental functions" question).

173. Schanzenbach & Shoked, *supra* note 31, at 569 (noting that the "disparate legal treatment of public and private entities is grounded in seemingly important practical distinctions between the entities").

174. *Id.*

whenever a public entity behaves like a private entity by transacting rather than governing and vice versa.[175]

Max Schanzenbach and Nadav Shoked describe a phenomenon of "a wave of outsourcings of services, public-private partnerships, privatizations of city assets, and sophisticated financial dealings . . . sweeping the nation's cities." [176] Although the factual gap between the public and the private is shrinking every day, the legal gap remains.[177] According to the authors, a "public" city may even be treated as a private entity in some areas of the law.[178]

Given the (increasing) number of blended entities, should our bankruptcy laws acknowledge this blending? At the time the modern Bankruptcy Code was created in the 1970s, nonprofits were not playing as significant a role in the provision of public services as they do today.[179] PPPs were much rarer.[180] Thus, in many respects, bankruptcy law has not caught up with the reality of a growing number of blended entities.

The next Part explains how and why a bankruptcy filing by a blended entity creates problems and why blended entities are bankruptcy misfits.[181]

III. BANKRUPTCY PROBLEMS FOR BLENDED ENTITIES

Blended entities are numerous and varied, and the line between public and private has become blurred, if it ever was clear. Yet, bankruptcy law

175. *Id.* at 569-70.

176. *Id.* at 570.

177. *Id.* at 571.

178. *Id.* at 573.

179. Alan J. Abramson, *History of the Nonprofit Sector Part 2: A (Very) Brief History of the U.S. Nonprofit Sector*, INDEP. SECTOR 1 (Mar. 2019), https://independentsector.org/wp-content/uploads/2019/04/IS-class-summary-part2-final.pdf [https://perma.cc/2E9Q-K9CW] ("Nonprofit service organizations grew especially in and after the 1960s as government contracted with nonprofits to deliver services rather than providing services directly itself through government agencies.").

180. *A Brief History of Public Private Partnerships*, LORMAN (July 19, 2018), https://www.lorman.com/resources/a-brief-history-of-public-private-partnerships-16968 [https://perma.cc/9J4M-L326] ("The first public private partnership state legislation in the United States was in 1989 in California, followed by Virginia in 1995.").

181. *See* Coordes, *supra* note 17, at 423 (defining and describing "bankruptcy misfits").

remains as rigid as ever in its distinction between the public and the private, even though that distinction does not match reality. This mismatch between law and practice, in turn, creates numerous practical problems, affecting both the bankruptcy system and the blended entities that use (or attempt to use) it.

Because blended entities are notoriously difficult to categorize, uncertainty exists as to whether a blended debtor has filed in the correct Code chapter and, sometimes, as to whether that debtor is eligible for bankruptcy relief at all. Because bankruptcy law does not recognize blended entities, the more "blended" an entity is—i.e., the more it intertwines public and private features—the less the Bankruptcy Code is equipped to do for it.

Thus, when blended entities do use the bankruptcy process, judges sometimes apply a "functional" approach. Although such an approach has practical benefits, it threatens bankruptcy's legal foundations. A functional approach can also create uncertainty and open the door to manipulation of bankruptcy law and the possibility that the law will become incoherent.

This Part reviews these problems, focusing primarily on examples of special-purpose municipalities because several types of special-purpose municipalities have filed for bankruptcy and encountered difficulties while using the bankruptcy system.

A. Blended Entities are Bankruptcy Misfits

Many blended entities are "bankruptcy misfits": the relief the Bankruptcy Code is designed to provide does not meet the needs of the particular entity.[182] Notably, courts are asked to apply the Code's definition of a "municipality" to a wide range of entities that differ substantially. And of course, bankruptcy law does not recognize that many of the existing entities are neither wholly governmental nor wholly private. The structure of the Code presupposes a clear divide between a government entity and a private business, whereas, in reality, such a clear divide simply does not exist.[183]

This structural problem makes blended entities difficult to classify in the bankruptcy regime. Although the Bankruptcy Code defines "municipality" as a "political subdivision or public agency or

182. *See* Coordes, *supra* note 17, at 431-34 (applying the bankruptcy-misfit concept to healthcare debtors).

183. 11 U.S.C. § 101(41) (2018) (defining "person" to exclude governmental units).

instrumentality of a State,"[184] there is little consensus or understanding about when and whether blended entities, such as special districts, fall within that definition.[185] Nor is there a great deal of case law on this topic because "parties do not often litigate over whether a particular entity is a municipality."[186] Even when they do, the courts that hear these disputes are not always clear about how they have reached a decision.[187] Consequently, it is possible that a bankruptcy court could find that an entity in one of the categories described in Part II is not, in fact, a "municipality" for purposes of chapter 9 eligibility or that an entity not listed above does qualify as a "municipality" under bankruptcy law.

A few examples will suffice to illustrate this point. In *In re Ellicott School Building Authority*,[188] the bankruptcy court held that the debtor authority, established as a nonprofit under Colorado law for the sole purpose of issuing debt for the construction of a new school, was not a municipality eligible for chapter 9. Similarly, in *In re Las Vegas Monorail Co.*,[189] the bankruptcy court held that the debtor at issue was not a municipality despite explicit language in bond documents identifying the monorail's owner and the issuer as an "instrumentality of the State of Nevada . . . controlled by the Governor."[190] Notably, the court also held that the Internal Revenue Service's classification of the debtor as a municipality was irrelevant to determining whether the debtor was a municipality for purposes of bankruptcy law.[191] In Florida, the Campbellton-Graceville Hospital Corporation filed for chapter 11 even though it was created

184. *Id.* § 101(40).

185. *See* Dick, *supra* note 9, at 10 (observing that whether an entity is a "municipality" is more complex than simply observing how the state classifies it); Bruckner, *supra* note 8, at 356-66 (examining the case law); Gulati & Schragger, *supra* note 16, at 666 ("Determining the background law often requires a legal judgment about which entities are allowed by local law to file for bankruptcy as well as an assessment of the nature of the debt being issued. It is not that these determinations cannot be made, but rather that these judgments can and do result in litigation.").

186. Bruckner, *supra* note 8, at 354.

187. *See id.* at 366 ("Only three cases appear to squarely address whether a debtor is a public agency, and none provide much analysis.").

188. 150 B.R. 261 (Bankr. D. Colo. 1992).

189. 429 B.R. 770 (Bankr. D. Nev. 2010).

190. *Id*. at 774.

191. *Id*. at 791-92.

pursuant to Florida law and had been previously treated as a political subdivision in other judicial proceedings.[192]

Professor Matthew Bruckner has synthesized the existing case law on whether a particular entity qualifies as a "municipality" for purposes of accessing chapter 9 bankruptcy. He has also surmised that the analyses in the case law are less than crystal clear.[193] Recall that under the Code's definition, a "municipality" can be a "political subdivision," a "public agency," or an "instrumentality" of a state. Bruckner observed that courts rely on three factors when determining whether an entity is a political subdivision of a state: "(i) the label assigned to an entity by its creator; (ii) the statutes or regulations governing the formation of such entities; and (iii) the powers possessed by the entity in question."[194] When considering whether an entity is an "instrumentality" of a state, courts primarily focus on whether the entity is subject to control by a public authority,[195] although they may also look at why the state is exercising control over an entity, or the extent of the state's control, and specifically whether it is directed toward the debtor's day-to-day operations.[196] Finally, when considering whether a debtor is a "public agency," Bruckner observes that courts primarily consider legislative intent and/or revenue generation.[197] Despite these trends, if they may, in fact, be called trends at all,[198] there remains no clear test for when a blended entity will constitute a municipality for bankruptcy purposes, and the factors courts consider are numerous and varied. Arguably, these tests cannot help but be convoluted: Differences in state law and differences among different blended entities themselves mean any simple test would go awry.[199]

192. Gulati & Schragger, *supra* note 16, at 669-70.

193. Bruckner, *supra* note 8, at 366 (describing the case law on whether an entity is an instrumentality of a state as "limited and somewhat muddled").

194. *Id*. at 356.

195. *Id.* at 360.

196. *Id.* at 362-63.

197. *Id.* at 366.

198. *Id*. at 354 (describing the case law as a whole as "sparse").

199. *See* Gulati & Schragger, *supra*, note 16, at 669 ("[C]ases suggest that whether an entity is a 'municipality' for purposes of state and/or federal law will often need to be determined on a case-by-case basis, dependent in many instances on the nature of the entity, its ability to tax, and the level of control exercised by the government over its operations.").

Professor Diane Dick's study of public hospital bankruptcies found that "[i]n most hospital chapter 9[cases], the debtor self-identifies as a municipality," but the question of whether an entity is, in fact, a "municipality" is complex and involves more than simply looking at the state's classification or the debtor's self-identification.[200] In other words, "[t]he line is blurred."[201] In most cases, however, the hospital debtor gets around the confusion by simply choosing a chapter under which to file and hoping that no one will object.[202]

The existing scholarship focusing on subsets of blended entities indicates that these entities are bankruptcy misfits. They are difficult to classify because the Code simply does not contemplate the existence of entities that blend governmental and nongovernmental features. Although the courts have, at times, developed tests to attempt to sort these entities into one chapter or another, the tests are convoluted, fact-specific, and produce few general principles that can be carried forward to future cases.

Blended entities' misfit status thus results in a lack of clarity. When it is unclear what sort of relief will be available to a financially distressed entity, or whether bankruptcy relief will be available at all, creditors and investors cannot analyze their risk in lending to or investing in this entity in advance.[203] If it is not clear whether an entity is a "municipality," it is equally unclear whether that entity is specifically authorized by its state to file for bankruptcy.[204] If an entity's creditors and rating agencies do not know whether the entity can file for bankruptcy, its credit risk may rise, making it more difficult for the entity to issue debt and increasing the cost of servicing that debt.[205] Thus, uncertainty as to whether an entity qualifies as a "municipality" for bankruptcy purposes increases uncertainty as to whether

200. Dick, *supra* note 9, at 12.

201. *Id.* at 13.

202. *Id.*

203. Gulati and Schragger, however, have noted that investors may not care about access to bankruptcy relief. Gulati & Schragger, *supra*, note 16, at 663 ("Our findings could indicate that investors in this market do not care enough about bankruptcy access to demand disclosure, or do not think it is important—despite empirical findings indicating that bankruptcy access affects the price of debt.").

204. Michael J. Deitch, *Time for an Update: A New Framework for Evaluating Chapter 9 Bankruptcies*, 83 FORDHAM L. REV. 2705, 2708 (2015).

205. *Id.* at 2731.

that entity will be specifically authorized to use chapter 9.[206] Outside of bankruptcy, if we cannot determine what relief (if any) an entity is eligible for ex ante, the entity may be seen as a less attractive investment.

Within bankruptcy, the lack of clarity regarding blended entities takes two forms. First, there is a lack of clarity with respect to chapter choice for blended entities. Second, and relatedly, it may not be clear whether a blended entity belongs in the bankruptcy regime to begin with. The *Las Vegas Monorail* case illustrates both forms.

In 2010, after the Las Vegas Monorail Company filed chapter 11, one of its bond insurers, Ambac Assurance Corp., moved to dismiss the bankruptcy, arguing that the Monorail was a "municipality" and therefore belonged in chapter 9.[207] Effectively, however, a conclusion that the Monorail belonged in chapter 9 would deny the Monorail access to bankruptcy entirely, as the Monorail was not specifically authorized under Nevada law to access chapter 9.[208] Thus, the court's decision would determine not just which Code chapter the Monorail could use but whether the Monorail could access bankruptcy relief at all.

Ambac's argument was based on the idea that the Monorail was an "instrumentality" of Nevada because (1) the Governor controlled the Monorail; (2) the Monorail had identified itself as an "instrumentality" when obtaining tax-exempt status for its bonds; and (3) the state issued the bonds, and the local government had granted the Monorail several exemptions based on its "instrumentality" status.[209] The bankruptcy court, however, denied Ambac's motion and held that the Monorail could remain in chapter 11. After an exhaustive examination of all of the circumstances, the court found that the Monorail was a private, nonprofit corporation and that its certification as an "instrumentality" for tax purposes did not change the fact that it was organized as a private, nonprofit under Nevada law.[210]

In re Lombard Public Facilities Corporation[211] is another example of what can happen when it is unclear whether a debtor is eligible for chapter 9 or chapter 11. The Village of Lombard, Illinois had incorporated the debtor, a public facilities corporation, because the Village itself lacked the authorization to borrow the money it needed to complete a construction

206. *Id.* at 2732.

207. *In re* Las Vegas Monorail Co., 429 B.R. 770, 774 (Bankr. D. Nev. 2010).

208. *Id*. at 782.

209. *Id*. at 774.

210. *Id*. at 800.

211. 579 B.R. 493 (Bankr. N.D. Ill. 2017).

project consisting of a convention hall and hotel.[212] Before filing for bankruptcy, the debtor had unsuccessfully claimed to be a governmental unit for tax purposes.[213] When it filed for bankruptcy, however, the debtor chose to file chapter 11, and the court ultimately held that the debtor was eligible to do so.[214] In briefings filed with the court, both sides extensively discussed the case of *In re Las Vegas Monorail*.[215] Ultimately, however, the *Lombard* court did not rely extensively on the *Monorail* case, likely because the situation of the *Lombard* debtor was sufficiently different from the *Monorail* debtor.[216] Like in the *Monorail* case, however, uncertainty surrounding Lombard's case caused delay and expense as parties fought over the debtor's bankruptcy eligibility and chapter choice.

A lack of clarity about what exactly a blended entity is can slow down a case and waste resources. Consider the example of the water authority in Chester, Pennsylvania, discussed above. The City of Chester has asked that various courts identify the water authority and determine the identity of those with authority to make decisions on the entity's behalf.[217] This has slowed down Chester's bankruptcy proceedings.[218] Similarly, in the *Seven Counties* case discussed in Part II.D, an entire court proceeding took place

212. *Id.* at 495.

213. *Id.* at 496.

214. *Id.* at 497 (finding that objecting parties "have failed to show that the Debtor is not a separate entity [from the municipality] for purposes of eligibility to be a debtor under chapter 11").

215. Kannel, *supra* note 146, at 2-3 (discussing the arguments of the debtor and the movants).

216. *Id.* at 3 ("The Bankruptcy Court neither ignored, nor adopted, the Monorail Case, yet was clearly influenced by it.").

217. Michael Klein, *Selling Chester Water Authority Assets: The Latest on Litigation Efforts by The City of Chester*, WATER NEWS SOURCE, Winter 2021, at 34, 34-35 (describing the uncertainty about whether Chester can dissolve the water authority and sell the water system without the concurrence of other counties).

218. This dispute was ongoing as this Article went to print. *See* Alex Wolf, *City of Chester Seeks Water Utility Documents Amid Sale Dispute*, BLOOMBERG L. (Dec. 5, 2024) https://news.bloomberglaw.com/bankruptcy-law/city-of-chester-seeks-water-utility-documents-amid-sale-dispute [https://perma.cc/QGA3-K27U] (noting that the court overseeing Chester's bankruptcy "recently permitted an appeal to the Pennsylvania Supreme Court to decide whether the city and state-appointed receiver Michael Doweary have a right to seize and sell [the water authority's] assets").

simply to determine the identity of the blended entity and the relief it was entitled to. Finally, even when we know that a blended entity cannot file for bankruptcy, as with the USPS, it can be challenging to figure out a viable path for relief if the entity's identity blends public and private aspects.[219]

In sum, the lack of clarity about a blended entity's status leads to uncertainty about whether that entity belongs in bankruptcy, which chapter the entity should file under, and what can be done with it once it is in bankruptcy.

B. Lack of Access or Misclassification

Some blended entities may fall into a bankruptcy gap and lack access to any sort of relief under the Bankruptcy Code. Lack of access to bankruptcy, by itself, may not be a problem if there is an alternative safety net. But in many cases, these entities appear to have no safety net at all.

For example, as discussed above, the USPS is ineligible to file for bankruptcy.[220] A lack of clarity as to what, exactly, the USPS is contributes to uncertainty about what relief might be available to it.[221] Because the USPS lacks access to bankruptcy relief, Congress—and taxpayers—are left to address the USPS's financial difficulties.

Similarly, as discussed above, many tribal corporations are ineligible for bankruptcy relief.[222] It is difficult to categorize these entities since the extent to which they may be equated with the tribes that created them is unclear.[223] The result is that tribal corporations are functionally excluded from bankruptcy while lacking any other alternative for financial relief.[224]

Even for some special-purpose entities, classification is a struggle. These entities do not fit neatly into either the public or the private box and

219. *See* Jory Heckman, *USPS Reform Law Sought to Ease Financial Burdens. A Year Later, What's Changed?*, FED. NEWS NETWORK (Apr. 10, 2023), https://federalnewsnetwork.com/workforce/2023/04/usps-reform-law-sought-to-ease-financial-burdens-a-year-later-whats-changed [https://perma.cc/DP4S-MGX9] (illustrating the difficulties in crafting reforms for the USPS).

220. Coordes, *supra* note 104, at 591.

221. *Id.* at 587 ("[T]he USPS's lack of ready classification makes it difficult, in turn, to assess or design options for its financial relief.").

222. Coordes, *supra* note 125, at 390.

223. *Id.* at 377.

224. *Id.* at 368.

risk being classified as municipalities in states that bar chapter 9 access, making them ineligible for bankruptcy relief. Such was the case with the Las Vegas Monorail, described above; had the court not determined the Monorail was eligible for chapter 11, the Monorail would not have been able to access bankruptcy under chapter 9.[225]

Professor Dick's study of public hospital bankruptcies similarly concluded that public hospitals that lack state authorization to file under chapter 9 may find themselves without access to bankruptcy protection at all.[226] In *In re Hospital Authority of Charlton County*, the court struggled to classify the hospital authority and analyzed the authority's eligibility under both chapter 9 and chapter 11.[227] The court found the hospital ineligible to file under chapter 9 due to lack of state authorization but also ineligible to file under chapter 11 because the hospital was a "governmental unit."[228] The court concluded, "The reality is that not every entity is entitled to relief from its debts through bankruptcy. Some entities, like the Hospital Authority, may not be eligible for chapter 9 or chapter 11 relief."[229]

The *Charlton County* case illustrates that some entities are ineligible for bankruptcy because of where they are located, rather than what they are. This "geographic ineligibility" creates uneven application of the law. Geographic ineligibility exists out of respect for state sovereignty, yet on a practical level, it is difficult to square with reality. If we cannot tell what an entity is ex ante (i.e., if we cannot tell that an entity is clearly a municipality ex ante), why should the state have any expectations with respect to bankruptcy relief for that entity? Further, bankruptcy courts have determined that a state's classification of the municipality is not by itself determinative of what the municipality is for bankruptcy purposes.[230] This

225. *In re* Las Vegas Monorail Co., 429 B.R. 770 (Bankr. D. Nev. 2010).

226. Dick, *supra* note 9; *see* Harold L. Kaplan, *Chapter 9 and Municipal Health Care Bankruptcy: A Collision and Evolution of Bankruptcy Code Provisions*, *in* CHAPTER 9 BANKRUPTCY STRATEGIES: LEADING LAWYERS ON NAVIGATING THE CHAPTER 9 FILING PROCESS, COUNSELING MUNICIPALITIES, AND ANALYZING RECENT TRENDS AND CASES 87, 89 (2011) ("Depending on the state, a municipal health care entity may be ineligible or limited in its access to federal bankruptcy relief . . . .").

227. *In re* Hosp. Auth. of Charlton Cnty., No. 12-50305, 2012 WL 2905796 (Bankr. S.D. Ga. July 3, 2012).

228. *Id.* at *1.

229. *Id.* at *9.

230. *See, e.g.*, *Las Vegas Monorail*, 429 B.R. at 798-99 (rejecting the contention that a state's characterization of an entity should be given "controlling effect" when determining whether the entity qualifies for chapter 9 or chapter 11).

suggests that state sovereignty concerns may be lessened in the special-purpose municipality context.

The lack of access to bankruptcy relief seems particularly strange and startling for blended entities with purely private counterparts. Bankruptcy is readily available to restructure the debts of private hospitals and universities, but relief is frequently denied to their public counterparts.

Furthermore, if bankruptcy courts minimize the state's own classification of the entity, they may reach conclusions that are contrary to those made by insurers, creditors, and others that have interacted with the municipality pre-petition. For example, in *In re Ellicott School Building Authority*,[231] the court held that the authority was not a municipality, even though "under the most basic application" of chapter 9, it should have been eligible for municipal bankruptcy.[232] Although the court found that the State of Colorado did not exercise sufficient "control" over the authority, the authority was able to issue limited obligation bonds to raise revenue, giving it, according to observers, "the requisite power of a municipal authority."[233]

Ellicott School Building Authority illustrates that blended entities are sometimes misclassified: that is, they are required to file under one chapter of the Bankruptcy Code when it is reasonably apparent that they belong in another. Contrary to what might be expected, most parties do not seem to care whether a blended entity is filing in the "correct" chapter. This stands in sharp contrast to the bankruptcies of general-purpose municipalities, such as cities, towns, and counties, where litigation over the debtor's eligibility can last for months.[234] It also flies in the face of the Code's careful delineation of public and private bankruptcy options.

Misclassification is also a problem in public hospital bankruptcies. Diane Dick has observed that many public hospitals do not meet the Code's definition of a "municipality" and therefore do not belong in chapter 9.[235] Nevertheless, in many instances, the debtor merely self-identifies as a

231. 150 B.R. 261 (Bankr. D. Colo. 1992).

232. Epling, Brennan & Woods, *supra* note 7, at 231.

233. *Id.*

234. *See generally* Coordes, *supra* note 62.

235. Dick, *supra* note 9, at 10 ("As a preliminary matter, it may be that many public hospital debtors do not actually belong in chapter 9 in the first place, because they do not meet the definition of 'municipality.'").

municipality, and no-one objects.[236] Similarly, some public hospital debtors have filed in chapter 11 when it seems reasonably clear that they belong in chapter 9.[237] Others have multiple owners and operators, making it difficult to determine with any real certainty whether the hospital qualifies as a "municipality" because it is unclear which owners and operators "count" for the purpose of answering that question.[238] For example, *In re Adair County Hospital District* was a consolidated case of the hospital district and a nonprofit corporation the district had incorporated.[239] Although both entities filed under chapter 9, it was "not clear whether either or both truly qualified as a 'municipality.'"[240]

The *Las Vegas Monorail* case, discussed above, further illustrates the complexity of an eligibility decision for blended entities and provides a clue as to why many creditors may not want to waste resources raising an eligibility objection for a blended debtor.[241] The inquiry can be fact-intensive, complicated, and difficult to predict. Furthermore, once a judge determines a blended debtor's eligibility for one chapter or another, that decision is unlikely to produce binding precedent, both because blended entities differ significantly from each other and because bankruptcy courts lack the power to bind other courts outside of the district in which they are located. Consequently, fact-specific tests for eligibility may limit their future applicability and may not be worth litigating.[242]

Relatedly, in states that do not authorize municipal bankruptcy, Professor Bruckner has concluded that public colleges, universities, and other higher education institutions will not be eligible for bankruptcy.[243] Without access to bankruptcy relief or other state-created mechanisms to

236. *See id.* at 12 (discussing *In re Surprise Valley Health Care District*, No. 18-20070 (Bankr. E.D. Cal. May 30, 2018), where "the debtor simply stated that it is a municipality because it is a 'local public entity' under California law").

237. *See id.* at 13 ("For instance, Campbellton-Graceville Hospital Corporation filed for chapter 11 bankruptcy in 2017, even though it was legislatively created by the State of Florida as a public entity, possessed numerous governmental attributes, and had previously been recognized as a political subdivision in judicial proceedings.").

238. *See id.*

239. *See id.*

240. *Id.*

241. *In re* Las Vegas Monorail Co., 429 B.R. 770 (Bankr. D. Nev. 2010).

242. Epling, Brennan & Woods, *supra* note 7, at 229-31.

243. Bruckner, *supra* note 8, at 344.

help them address financial difficulties, these entities "suffer unnecessarily," harming those they serve and employ.[244] More broadly, a lack of bankruptcy relief, coupled with a lack of developed and viable alternatives to bankruptcy, can harm blended entities, their employees, and the communities they serve.

When entities blend public and private features, it is unclear whether and how they can address debt overhang and other financial problems.[245] If these entities are determined to be municipalities, they may be unable to access bankruptcy relief if the states in which they are located have not authorized their municipalities to use chapter 9.[246] But, as the *Ellicott* and *Monorail* cases show, it is not always clear that these entities *will* qualify as municipalities because there is no clear, easy-to-apply test to determine this question. The resulting lack of clarity means that creditors of these entities cannot assume that they will have—or not have—access to bankruptcy relief.[247]

This means that taxpayers must bear the burden of any bankruptcy gap. In other words, if the government and private parties create an entity, believing it will be eligible for bankruptcy, and the entity is later found by a court to be ineligible for all available bankruptcy relief, taxpayers will end up paying for the projects the entity is responsible for—when the entire purpose of creating the entity in the first place was to take the burden off of taxpayers.[248] Because the Bankruptcy Code provides a strict either-or test for a debtor's eligibility for chapters 9 and 11, and because entry into chapter 9 is further restricted by the state authorization requirement, many blended entities may be unable to access any bankruptcy relief at all.[249]

Of course, if a blended entity looks and acts sufficiently like a private business, it may be eligible for chapter 11. But there is no easy test to

244. *Id.* at 345.

245. Brian Lohan, Maja Zerjal Fink & Jeffrey Messina, *The 'Quasi-Instrumentality' Question: Chapter 9, Chapter 11, or Neither?*, BLOOMBERG L. (Feb. 11, 2021), https://news.bloomberglaw.com/bankruptcy-law/the-quasi-instrumentality-question-chapter-9-chapter-11-or-neither [https://perma.cc/8MM3-6K2C].

246. *Id.*

247. *Id.*

248. *See* Epling, Brennan & Woods, *supra* note 7, at 226 ("This situation can lead taxpayers indirectly to pay for municipal projects for which they were assured no taxes would be used.").

249. *Id.*

determine when a blended entity is "sufficiently" like a private business, and even though "many municipal authorities are more akin to conventional businesses" than to governments, many of these authorities may be prohibited from accessing chapter 11 relief.[250] When Congress created municipal bankruptcy, it did not contemplate (and arguably could not have foreseen) today's complex municipal capital structures and the blending of public and private that many of today's quasi-municipal entities represent.[251] Reality has simply outpaced the Bankruptcy Code.

Of course, lack of access to bankruptcy relief is not a problem for every blended entity. In particular, in the states that *do* authorize their municipalities to file for bankruptcy relief, blended entities should be able to access bankruptcy in some form, even if they (and their creditors) cannot predict exactly which chapter will provide relief. However, when a quasi-governmental entity is created and unknowingly falls into a bankruptcy gap, the costs of that blended entity's financial distress may be passed on to taxpayers.

Misclassification and lack of access are only part of the story; as the next section shows, blended entities also risk receiving inappropriate relief through the bankruptcy process.

C. Inappropriate Relief: Bankruptcy's Wild West

While serious, lack of access to bankruptcy relief is not a problem for all blended entities. Some can and do access bankruptcy. However, in many cases, the relief these entities receive through the bankruptcy system has problematic aspects. Diane Dick, studying this phenomenon in the case of public-hospital bankruptcies, has described judges in these cases as using a "functional" interpretation of the Bankruptcy Code.[252] This subsection describes some of the ways in which the bankruptcies of blended entities can go awry.

Professor Dick notes that courts and parties in blended-hospital cases apply a "functional" interpretation of the Bankruptcy Code, which focuses less on chapter 9's distinguishing features and more on the practical reality that the parties to a typical hospital chapter 9 are working to achieve—in

250. *Id.* at 237.

251. *See id.* ("[S]tatutes passed in a different era and economic climate should not now leave a quasi-governmental entity without restructuring protection.").

252. Dick, *supra* note 9, at 3.

essence, a business restructuring.[253] This functional approach begins at the eligibility stage: Dick notes that once state authorization for a chapter 9 filing is received, "courts and parties appear more willing to take an expansive view of chapter 9's remaining eligibility requirements," at least when it comes to hospital debtors.[254]

Dick further explains that parties may actually expect to achieve a set of goals (i.e., a business restructuring) that are incompatible with the form of relief offered in chapter 9.[255] Specifically, she points out that many public hospital debtors essentially advance liquidation plans.[256] For example, in *In re Surprise Valley Health Care District*, the court approved a § 363 sale for the hospital, even though § 363 does not apply in chapter 9.[257] In addition, many public hospital debtors are using bankruptcy to liquidate, in contravention of one of chapter 9's primary goals.[258] Thus, many public hospital debtors are using chapter 9 to achieve case outcomes that were likely never intended by Congress and that may even conflict with the basic goals of the bankruptcy chapter they are using.[259] Importantly, this doesn't happen in a vacuum: Hospital chapter 9s are laying down legal precedent that may be applied to other, more politically complex chapter 9s, including those involving cities and counties.[260]

Liquidation is not supposed to be available to municipalities, considering their political sovereignty.[261] A core reason underlying the lack of a liquidation remedy is that "preservation of the public goods and services provided by the debtor outweigh[s] the interests of creditors in

253. *Id.*

254. *Id*. at 6.

255. *Id*. at 12.

256. *Id.* at 11 (citing *In re Natchez Regional Medical Center*, No. 14-01048 (Bankr. S.D. Miss. June 5, 2014) where the debtor's plan "contemplated the sale of the community hospital and a subsequent distribution of available proceeds and any remaining assets to creditors").

257. *Id*.; *In re* Surprise Valley Health Care Dist., No. 18-20070 (Bankr. E.D. Cal. May 30, 2018).

258. Dick, *supra* note 9, at 11.

259. *Id*.

260. *Id*. at 12.

261. Pryor, *supra* note 161, at 477 ("The irreducible political sovereignty of municipalities eliminates liquidation as a means of resolving chapter 9 bankruptcies.").

repayment through liquidation."[262] Nevertheless, liquidation via a § 363 sale may, in practice, preserve the goods and services provided by the debtor if the buyer continues to provide those services.

Thus, it is not the case that a chapter 9 debtor can never sell its assets;[263] however, because § 363 is not incorporated into chapter 9, we should be wary of relief that recreates what is provided by that section in a chapter 9 case. Even beyond disguised § 363 sales, however, a larger point looms: why bother to separate chapter 9 bankruptcy if the rules and guardrails incorporated into that chapter are so easily ignored?

In short, even when chapter 9 bankruptcy is available to blended entities, it may provide only limited or ill-suited relief to the problems these entities face. As described above, some courts have addressed this problem through a more "functional" approach to chapter 9. Although practically valuable, the question, of course, is whether such a functional approach is legally appropriate.

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The Bankruptcy Code's current inability to recognize blended entities creates numerous problems for these entities. They may lack access to bankruptcy relief, a critical safety net. Even if they can access bankruptcy, the process is fraught with confusion—as to which chapter they belong in, as to the types of relief available to them, and, if they end up in chapter 9, as to whether that more limited form of relief will adequately serve their needs.

The cases reviewed in this Part thus far also show a breakdown between theory and practice. In theory, the Bankruptcy Code and the Constitution dictate that a clean line be drawn between governmental and nongovernmental entities. In practice, courts and parties can blur this line or cast it aside. This breakdown causes problems, not just for blended entities in practice, but for the bankruptcy laws that exist to assist them.

262. *Id*. at 481-82.

263. Jay Bender, *Chapter 9 Cases with Debtors Other than Cities, Counties and Towns*, BRADLEY (June 2015), https://web.archive.org/web/20230609080449/https://www.bradley.com/insights/publications/2015/06/chapter-9-cases-with-debtors-other-than-cities-c__ [https://perma.cc/MQQ8-CHA4] (discussing other ways in which chapter 9 debtors may sell assets).

D. Problems for Bankruptcy Law

Just as blended entities' use of the Bankruptcy Code presents problems for the entities in practice, when blended entities use bankruptcy, their use exposes issues with the law of bankruptcy and particularly the law of chapter 9. In particular, the difficulty of classifying blended entities exposes a gap in the law, requiring courts to engage in fact-intensive and often lengthy exercises to determine whether a blended entity belongs in chapter 9 or chapter 11. As I have previously written, problems such as these, which occur when determining an entity's eligibility for bankruptcy relief, rack up costs and impede an entity's progress in the case.[264] Although, as noted in Part II, courts have issued decisions on blended entity eligibility for bankruptcy, these decisions have not effectively plugged the gap in the law because the fact-intensive tests used to reach these decisions hold little precedential value.

Problems with classifying blended entities contribute to the *ad hoc* nature of chapter 9, which in turn makes chapter 9 bankruptcy a less attractive safety net. Scholars have already criticized chapter 9 for generating a "hodge-podge of judge-made law," and this "hodge-podge" is only likely to compound in the context of blended entity bankruptcy.[265] As discussed above, bankruptcy court decisions largely do not dictate the outcomes of other municipal bankruptcies. [266] Uncertainty concerning debtor identity compounds the already existing uncertainty that characterizes the current chapter 9 process.[267]

If the law cannot predictably classify an entity, debtors and creditors consequently cannot reliably predict whether the entity may file for chapter 9 or chapter 11 bankruptcy.[268] As previously discussed, this means that it may be riskier to lend to these entities.[269] Even if credit markets remain

264. Coordes, *supra* note 62, at 447.

265. Juliet M. Moringiello, *Decision-Making and the Shaky Property Foundations of Municipal Bankruptcy Law*, 12 BROOK. J. CORP. FIN. & COM. L. 5, 7 (2017).

266. *Id*.

267. *Id*. ("The patchwork nature of municipal bankruptcy law gives little guidance.").

268. Deitch, *supra* note 204, at 2731.

269. *See, e.g.*, Jiwon Lee, David Schoenherr & Jan Starmans, *The Economics of Legal Uncertainty* 16-17 (Eur. Corp. Governance Inst. L. Working Paper No. 669/2022, 2024), https://ssrn.com/abstract=4276837

stable, however, the lack of certainty with respect to blended entities creates other gaps in the law.

The tests that bankruptcy courts rely upon to sort out eligibility, such as the test found in *Las Vegas Monorail*, are inherently fact-specific and may ultimately create more uncertainty than they resolve.[270] The lack of a clear and consistent entry test creates uncertainty about who (or what) can use which aspects of the Bankruptcy Code. If creditors do not know whether their borrowers are eligible for bankruptcy relief—or whether they are eligible for relief under a particular chapter—the cost of credit may rise.[271]

Bankruptcy becomes less useful if there is uncertainty about who can use it. This is compounded in the context of chapter 9, because, as critics have pointed out, the chapter 9 process itself is ad hoc and uncertain.[272] If the bankruptcy process becomes fraught with uncertainty, bankruptcy's purpose as a safety net is not served.[273] In a system that may already be too expensive for many special-purpose municipalities, [274] the expenses accompanying the process of filling gaps in the law may put bankruptcy even further out of reach for many blended entities.

Legal uncertainty can create many concerns,[275] both within and outside of the chapter 9 process. The lack of clarity concerning the classification and treatment of blended entities in bankruptcy injects further uncertainty into a process, chapter 9, that is already characterized by significant variation

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[https://perma.cc/RT7M-VA9R] (finding that legal uncertainty reduces the size of credit markets); Uri Weiss, *The Regressive Effect of Legal Uncertainty*, 2019 J. DISP. RESOL. 149, 152 (observing that legal uncertainty transfers wealth from parties with weak bargaining power to parties with strong bargaining power).

270. Epling, Brennan & Woods, *supra* note 7, at 229-31.

271. *See* Kannel, *supra* note 146, at 3 ("Knowing whether your borrower is eligible for relief under the federal Bankruptcy Code and if so under what chapter is an important part of [knowing your borrower generally].").

272. Buccola, *supra* note 48, at 854 (describing municipal bankruptcy as "an unpredictable, ad hoc, and expensive to deliver subsidy mechanism").

273. *See generally id.* (criticizing the uncertainty in municipal bankruptcy).

274. Frederick Tung, *After Orange County: Reforming California Municipal Bankruptcy Law*, 53 HASTINGS L.J. 885, 911 (2002) (noting that, "for some municipalities, the complexity and expense of municipal bankruptcy may make it a poor device for handling financial crisis").

275. *See* Steven L. Schwarcz, *The Inequities of Equitable Subordination*, 96 AM. BANKR. L.J. 29, 30 (2022) (observing that "uncertainty reduces fairness and increases the cost of credit").

even with respect to non-blended entities. This, in turn, makes the bankruptcy process even less appealing for those who are considering it.[276]

Gaps in the law also create opportunities for exploitation. Scholars have observed such exploitation in large chapter 11 cases and even within subchapter V of chapter 11. Such exploitation occurs in the context of blended entities as well: Many blended entities proceed to file bankruptcy using chapter 11, ignoring the fact that they should be classified as a "municipality" or ignoring that they have represented themselves, either under other law or to their creditors, as being municipalities.

This phenomenon can be observed with respect to public-private partnerships. Public-private partnerships are often created in order to gain tax advantages. [277] For this to happen, the clear language of the documentation and the parties' expectations often is that the partnership is a municipality. [278] These entities attempt to be a municipality for tax purposes but a private entity for bankruptcy purposes.

Jay Bender has suggested that blended entities are different enough from general-purpose municipalities such that a liquidating plan would be acceptable for these debtors and adds that state law should be used to evaluate a chapter 9 debtor's actions.[279] In other words, if the state accepts, for example, a liquidation plan, then a state entity such as a municipality should be able to create such a plan in chapter 9. From a practical standpoint, Bender may be correct. However, the law provides no basis for this conclusion, as the Bankruptcy Code does not currently provide a liquidation option for municipalities. The current law does not distinguish between a hospital or amusement park, for whom we might think that liquidation is an acceptable outcome, and a city or county. Put differently, an entity that represents that it is a municipality, either under other law or to its creditors, arguably has no means to liquidate under bankruptcy law, even though, in practice, a state may be perfectly willing to liquidate such an entity.

At the same time, it may be difficult to invoke the law to tamp down on practices that may be problematic from a legal standpoint. A variant of this may be seen in subchapter V bankruptcy cases. Christopher Bradley writes, "Many debtors ignore the fact that they should be 'small business' debtors

276. Moringiello, *supra* note 265, at 7 (observing that chapter 9's "patchwork nature" fails to "give comfort to the market that municipal bankruptcy law was originally developed to protect").

277. *An Overview of Chapter 9*, *supra* note 149.

278. *Id*.

279. Bender, *supra* note 263.

and simply proceed under the standard chapter 11. Sometimes they get caught. But mostly, no one objects."[280] This is because "the debtor benefits from considerable informational and evidentiary advantages concerning questions about its own finances. In most cases, this access gives the debtor an all but insurmountable advantage over any objector." [281] The same phenomenon is occurring, for the same basic reasons, in the chapter 9 context with blended entities: many blended entities simply proceed under the chapter of their choosing, and objecting to an entity's chapter choice may be a losing battle.

More generally, the Bankruptcy Code lacks guiding principles for what a hybrid case should look like. It sets out general principles for municipal debtors but fails to distinguish between a municipal debtor that looks like a city and one that looks like a private business. Debtors can exploit this gap in the law to facilitate outcomes that are legally unacceptable, even as they may be practically beneficial.

Relatedly, many blended entities appear as if they belong in chapter 9 but are exploiting uncertainty about their features to file for chapter 11 and, sometimes, to receive relief only available in chapter 11. This use of the law challenges the principle, articulated in Part I, that it is constitutionally necessary for chapter 9 and chapter 11 to have distinct boundaries.

If it is difficult to figure out which entities are eligible for chapter 9 and how a chapter 9 bankruptcy is supposed to work, it is little wonder that few entities overall are enticed to use it. For example, Professors Gulati and Schragger found that the barriers to a municipal bankruptcy filing were "numerous" and that predicting whether a given entity would ultimately be deemed eligible to file for chapter 9 was speculative because "bankruptcy is inconsistently applied." [282] As the lines between public and private get blurrier, there is a real risk that bankruptcy law will apply incoherently at best or not at all at worst with respect to a growing number of entities, thereby depriving those entities of an important safety net and depriving this area of bankruptcy of clear and consistently applied law.

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Problems with blended entities illustrate that the law on the books—the Bankruptcy Code—sometimes does not reflect reality. The above analysis also suggests that chapter 9 itself is a "misfit" within bankruptcy

280. Christopher G. Bradley, *The New Small Business Bankruptcy Game: Strategies for Creditors Under the Small Business Reorganization Act*, 28 AM. BANKR. INST. L. REV. 251, 263 (2020).

281. *Id*. at 266.

282. Gulati & Schragger, *supra* note 16, at 684-85.

law. Chapter 9 was created as a separate set of rules intended to reflect the fundamental differences between municipalities and nongovernmental entities. Yet, in practice, chapter 9's rules are manipulated, downplayed, or even outright ignored. What, if anything, should be done to address these problems? The next Part explores some options.

IV. PROPOSALS

This Part begins by asking whether the problems identified in the previous Part are worth addressing, given the prevailing narrative that chapter 9 works well for special-purpose municipalities. After arguing that the status quo is indeed problematic, this Part proceeds by presenting a range of possible options for reform, beginning with modifications to bankruptcy law and continuing with broader ideas.

A. Should These Problems Be Addressed?

As expressed in the academic literature, the prevailing wisdom is that bankruptcy works well for special-purpose entities,[283] or at least better than it works for the larger, general-purpose municipalities that have received the bulk of scholarly attention.[284] However, the literature also recognizes that scholars and practitioners have, to date, not been overly focused on blended or other special-purpose entities.[285] Moreover, recent studies that focus on certain types of special-purpose entities have

283. *See* Jack Zarin-Rosenfeld, *Water Bankruptcy Through the Bankruptcy Code*, 57 U.C. DAVIS L. REV. 1435, 1441 (2023).

284. *See, e.g.*, Michael A. Francus, *Death, Bankruptcy, and the Public Hospital*, 41 YALE J. ON REGUL. 524 (2024); Daniel J. Freyberg, Comment, *Municipal Bankruptcy and Express State Authorization to Be a Chapter 9 Debtor: Current State Approaches to Municipal Insolvency–and What Will States Do Now?*, 23 OHIO N. U. L. REV. 1001, 1024 (1997) (claiming that chapter 9 has been effective for special districts).

285. James L. Tatum III, *Detroit's Bankruptcy and Market Reentry*, 37 EMORY BANKR. DEVS. J. 65, 67 (2020) (observing that although special districts make up the majority of municipal bankruptcies, neither market analysts nor bankruptcy experts focus on them); *see* ADVISORY COMM'N ON INTERGOVERNMENTAL RELS., THE PROBLEM OF SPECIAL DISTRICTS IN AMERICAN GOVERNMENT 75 (1964), https://library.unt.edu/gpo/acir/reports/policy/a-22.pdf [https://perma.cc/VL99-BE2B] ("Frequently, no unit of general government within a State or a locality is fully aware of the various aspects of special district activity.").

identified problems with addressing their financial distress and with their use of bankruptcy. For example, Matthew Bruckner's study of special-purpose municipalities and bankruptcy noted that when special-purpose entities span multiple boundaries, "residents' ability to prevent or remedy financial distress is limited," and "neither creditors nor the state are necessarily better situated to prevent or remedy" these entities' financial distress.[286] And Diane Dick's study of public hospital bankruptcies notes that "these cases challenge conventional understandings of the distinctions between municipal debt adjustment . . . and commercial restructuring."[287]

Even accepting the argument that bankruptcy works reasonably well for special-purpose entities, there are reasons to be concerned about the problems raised by this Article. First, blended entities are growing in number and type as the line between public and private becomes increasingly blurred. And these entities will need viable safety nets. As just one example, in May of 2021, the *Carolina Journal* reported that over 100 towns, counties, water, and sewer districts in North Carolina were on a state "watch list" due to financial management problems.[288] Municipalities, in all of their various forms, "are structurally dependent on debt."[289] It is, therefore, critical to provide a viable safety net for blended entities, not least because they must exist to serve a public or quasi-public purpose.[290] In many cases, bankruptcy was designed to be that safety net.

Second, there are long-held reasons for keeping chapter 9 and governmental entities separate from other chapters and other entities. As discussed, federalism requires respect for states' authority to govern their own affairs.[291] The Supreme Court decisions that shaped chapter 9 into what it is today referenced the Tenth Amendment, indicating the

286. Bruckner, *supra* note 8, at 345.

287. Dick, *supra* note 9, at 3.

288. Andrew Dunn, *N.C. Towns Face Insolvency as Financial Oversight Falls Short*, CAROLINA J. (May 14, 2021), https://www.carolinajournal.com/news-article/more-n-c-towns-face-insolvency-as-financial-oversight-falls-short [https://perma.cc/Y7JW-SBRM].

289. Atkinson, *supra* note 73.

290. Mitu Gulati & Robert K. Rasmussen, *Puerto Rico and the Netherworld of Sovereign Debt Restructuring*, 91 S. CAL. L. REV. 133, 148 (2017) ("At a fundamental level, the municipal corporation needs to continue in existence so as to fulfill its public purpose.").

291. Connor Fitch, *Chapter 9's Constitutional Timebomb or: How I Learned to Stop Worrying and Love the Uniformity Requirement*, 47 S. ILL. U. L.J. 353, 353 (2023).

importance of federalism to the design of chapter 9.[292] Recall that in *Ashton v. Cameron County Water Improvement District*, the Court proclaimed that a municipal bankruptcy regime interfered with states' control over their political subdivisions, even as it acknowledged that states themselves lack bankruptcy powers.[293] In *United States v. Bekins*, the Court acknowledged that states need access to federal bankruptcy relief for their municipalities if they wish to impair existing contractual obligations. At the same time, the Court insisted that such access come with state authorization and that the process allows states to retain control of their fiscal affairs.[294] Thus, turning a blind eye to blended entities' "functional" use of the Bankruptcy Code ignores the foundations upon which chapter 9 of the Bankruptcy Code was built.

In practice, of course, it is not so simple: there is no clear-cut way to sort blended entities into one chapter of the Code or another. Often, there is little time to sort this out. Indeed, chapter 9 authorizations often come hastily, in the form of emergency declarations, last-minute asks and approvals, and so on.[295] The tests for sorting blended entities are convoluted and do not easily translate to precedent for other decisions due to the uniqueness of special-purpose entities and variances in state laws.[296] Consequently, it is easy to ignore the question of whether an entity has filed in the correct chapter, either because no one bothers to object or because the answer is not easily ascertainable.

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292. *Id*. at 357.

293. 298 U.S. 513, 530 (1936) ("Accordingly, as application of the statutory provisions now before us might materially restrict respondent's control over its fiscal affairs, the trial court rightly declared them invalid.").

294. United States v. Bekins, 304 U.S. 27 (1938).

295. *See* Gulati & Schragger, *supra* note 16, at 671 ("When push comes to shove and fiscal crises hit, states tend to deal with local fiscal emergencies in an ad hoc manner through the legislative adoption of special laws."); Scott Bauer, *Milwaukee Faces Bankruptcy, Police Cuts if Aid Deal Can't Be Reached*, AP NEWS (May 23, 2023), https://apnews.com/article/wisconsin-local-government-aid-shared-revenue-milwaukee-057935eea10b53736547a8e12c2e4a33 [https://perma.cc/5WH2-C44K] (discussing how Wisconsin state law does not allow for its cities to declare bankruptcy, meaning that if a city were to run out of money, the state legislature would have to vote to allow the city to file for bankruptcy).

296. *See* Bruckner, *supra* note 8.

If there are indeed good constitutional reasons to ensure the separation of governmental bankruptcies from nongovernmental bankruptcies,[297] it seems that there should be a greater focus on ensuring that blended entities are, indeed, filing in the correct chapter. Yet, this does not happen in practice, and there are several reasons why.

First, blended entities simply don't file for bankruptcy very often.[298] However, they file more frequently than general-purpose governments, and given their sheer number, filings could easily increase in the future.[299]

Second, even when blended entities file for bankruptcy, existing practice indicates that few care about how they are classified or what they do in bankruptcy. This makes chapter 9 proceedings the "wild west" of the bankruptcy frontier, especially when it comes to special-purpose entities.

Finally, special-purpose entities do not work like their general-purpose counterparts. Their capital structures differ, and there are often fewer political and practical concerns about what happens to them as compared to a general-purpose governmental entity.[300] For example, using chapter 9 to sell a hospital to a private buyer seems less objectionable than "selling" or privatizing an entire city, town, or county. Put differently, special-purpose entities often look and act more like businesses in chapter 11 than they resemble their general-purpose counterparts in chapter 9.[301] Yet, existing law forbids the placement of special-purpose entities in chapter 11. And, of course, special-purpose entities often differ from each other and

297. For a discussion of these reasons, see *supra* Part I.

298. Gulati & Schragger, *supra* note 16, at 690 ("[A] vanishingly small number of municipalities and state instrumentalities actually file for Chapter 9 when they are in distress, even in states that allow it.").

299. *See, e.g.*, Deena Winter, *Minneapolis School District on Brink of Insolvency, State Involvement*, MINN. REFORMER (June 12, 2023), https://minnesotareformer.com/2023/06/12/minneapolis-school-district-on-the-brink-of-insolvency-state-involvement [https://perma.cc/KWE8-7PR2] (discussing how the Minneapolis School District is approaching insolvency).

300. *See Special Briefing: Avoiding Municipal Distress*, VOLCKER ALL. (May 18, 2023), https://www.volckeralliance.org/events/special-briefing-avoiding-municipal-distress [https://perma.cc/4NZ3-73XY] (describing how cities are service-delivery organizations that face particular challenges).

301. Buccola, *supra* note 48, at 861 (differentiating the capital structures of special-purpose municipalities from general-purpose municipalities).

their general-purpose counterparts, making any lump-sum treatment of these entities extraordinarily difficult.[302]

In short, we should not be deceived by the assertion that some blended entities tend to fare well in bankruptcy. As described above, not all blended entities have access to bankruptcy. As the case of *In re Hospital Authority of Charlton County* shows,[303] some bankruptcy courts have determined that some blended entities may simply lack access to the provisions of the Bankruptcy Code. Yet, if non-blended entities, such as municipalities and private entities, can access bankruptcy relief, it is not clear why blended entities should lack such access if they are in financial distress.

Those blended entities that do file for bankruptcy often succeed in bankruptcy precisely because they can manipulate the process to achieve their goals, possibly in contravention of the Constitution and the Code. This manipulation threatens the structure and legitimacy of the Bankruptcy Code and should not be ignored.

B. Bankruptcy Solutions

What, if anything, can be done to make sure that blended entities are not bankruptcy misfits? The analysis above reveals two primary problems concerning blended entities and bankruptcy. First, blended entities do not fit within the Code's existing structure. Second, the bankruptcy process for these blended entities is often haphazard. This subsection overviews a menu of possible options to address each of these problems.

One option would be to develop a chapter or subchapter of the Bankruptcy Code that specifically addresses blended entities. Eligibility for this chapter or subchapter could depend on a functional test that asks whether the entity's creditors could functionally liquidate it.[304] If yes, the

302. *See, e.g.*, Alex Wolf, *PREPA Worker Union Sues to Block New Fortress Unit Contract*, BLOOMBERG L. (June 16, 2023), https://news.bloomberglaw.com/bankruptcy-law/prepa-worker-union-sues-to-block-new-fortress-unit-contract [https://perma.cc/UBQ5-YCPK] (describing the resistance of the union to a private takeover of Puerto Rico's power-generation assets and allegations that the deal gives away too much public funding without adequate assurances that the private operator will be a good steward of those public assets).

303. *See supra* Section III.C.

304. *See* Anderson, *supra* note 79, at 1190 (noting that chapter 9 is not geared toward dissolution but rather reorganization—"to enable a financially

entity could be eligible for these new Code provisions. Creating a new section of the Bankruptcy Code for blended entities would serve as a direct legal acknowledgment of these entities' existence and the unique nature of blended entity bankruptcies.

However, given the potential for constitutional challenges, creating a new chapter or subchapter would require substantial effort for entities that do not file that often. Furthermore, because blended entities differ so significantly from each other, it is not clear that a single subchapter would adequately capture their varied needs. As noted, the complexity and expense of chapter 9 preclude it from being a panacea, especially for smaller entities. [305] Nevertheless, allowing blended entities to use a specific subchapter or chapter of the Bankruptcy Code that pulls elements from both chapter 9 and chapter 11 could be valuable, as this new restructuring option would recognize the existence and complexity of blended entities.

A related alternative for special-purpose municipalities is to provide for a single bankruptcy process involving the municipality and its instrumentalities or sub-entities.[306] At least some special-purpose entities are designed to coordinate among municipalities. Just as the formation of blended entities results from creativity, Congress could think creatively about new restructuring options for cities and special districts, including more flexible mechanisms for dissolution, merger, and consolidation.[307] This "group bankruptcy" option would recognize the intertwined nature of government and business; however, as the situation involving the city of Chester, discussed above, indicates, this approach could also give rise to questions and concerns about who holds decision-making power for the group, and the extent of control any one member of the group has over others.

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distressed city to continue to provide its residents with essential services . . . while it works out a plan to adjust its debts and obligations.").

305. Tung, *supra* note 274, at 911.

306. *See* Chaudhury, Levitin & Schleicher, *supra* note 47, at 477 (describing how these entities are all overlapping and interconnected and contending that "Chapter 9 doctrine and other types of responses thus need to develop solutions that address coordination problems among overlapping local governments").

307. *See* Anderson, *supra* note 79, at 1210 (describing the "shrinking cities movement," in which land-use planners seek to "rightsiz[e] their physical landscapes to fit declining populations" (quoting Joseph Schilling & Jonathan Logan, *Greening the Rust Belt: A Green Infrastructure Model for Right Sizing America's Shrinking Cities*, 74 J. AM. PLAN. ASS'N 451, 453 (2008)).

Yet another option is to refine the test for chapter 9 eligibility. For example, Congress could define "municipality" more clearly in the Bankruptcy Code or make "blended entity" a defined term. To more clearly define "municipality," Congress could define each of the components of the "municipality" definition, providing a roadmap to what exactly qualifies as a "public agency," "political subdivision," and "instrumentality." Another option is to include a sorting test within the statute itself. For example, in cases involving the eligibility of certain entities for tribal sovereign immunity, courts have developed the multi-factor "arm of the tribe test" to determine whether the entity in question is so closely related to the tribe that it is, in fact, eligible for tribal sovereign immunity.[308] A similar test could be developed for use in bankruptcy law to determine whether a blended entity is so closely related to a government that it is eligible for chapter 9 bankruptcy. Or perhaps blended entities could be presumed eligible for chapter 11 unless the state exercises a veto.

A potential drawback of these efforts is that complicating eligibility for chapter 9 may needlessly delay access to bankruptcy for some blended entities.[309] In addition, given the variation in both state law and blended entities themselves, the development of a clear sorting test may be particularly challenging. The fact that blended entities blur the line between governmental and nongovernmental entities suggests that bright-line answers to their eligibility may simply not exist. The state-veto option is therefore a potentially more elegant solution, as it reduces complexity, accounts for federalism concerns, and provides a simple mechanism for sorting without resorting to a bright-line test of the entity's features.

The existence of blended entities makes a case for states to increase their municipalities' access to chapter 9. Recent research has indicated that investors do not place importance on access to bankruptcy for municipalities.[310] If true, this raises questions about whether state limits on

308. *See, e.g.*, McCoy v. Salish Kootenai Coll., 334 F. Supp. 3d 1116, 1120, 1124 (D. Mont. 2018) (utilizing Ninth Circuit's five-factor arm of the tribe test to determine that a college was an arm of the tribes in question). The Ninth Circuit's test requires an examination of "(1) the method of creation of the economic entities; (2) their purpose; (3) their structure, ownership, and management, including the amount of control the tribe has over the entities; (4) the tribe's intent with respect to the sharing of its sovereign immunity; and (5) the financial relationship between the tribe and the entities." *Id*. at 1120 (citing White v. Univ. of Cal., 765 F.3d 1010, 1025 (9th Cir. 2014)).

309. *See* Coordes, *supra* note 62, at 1231 (discussing the harms of prolonged eligibility battles).

310. Gulati & Schragger, *supra* note 16, at 664.

municipal bankruptcy access are doing anything more than needlessly denying municipalities access to a tool that could help them.[311] If states are willing to increase access to chapter 9 for blended entities, this could help alleviate the lack-of-access problem described above.

Increased access to chapter 9 would be aided through reversion to the authorization rule in place prior to 1994, which allowed general authorization for municipal bankruptcy. Although the Supreme Court in *Bekins* stressed that state authorization was important for municipal debtors, the particulars of the state authorization requirement (e.g., general vs. specific) were not discussed.[312] Consequently, there do not appear to be constitutional barriers to returning to a requirement that allows states to generally authorize their municipalities to be eligible for bankruptcy.

If a state-veto option is not utilized, bankruptcy judges could still give more deference to a state's characterization of the blended entity. Although bankruptcy courts have stated that a state's classification of the entity is not determinative of whether the entity is a municipality for bankruptcy purposes, [313] deference to state law respects the federalism concerns underlying chapter 9's creation.[314] Thus, bankruptcy courts could rely more heavily on the lines the state itself has drawn between governmental and nongovernmental entities by asking, for example, whether the entity in question is subject to state open meetings laws, state ethics codes, or state requirements of indemnity and public defense. This approach embraces the fact that blended entities are so varied that no single functional test will provide predictability. Putting the onus on the state to decide better aligns the eligibility process with the federalism concerns that animated chapter 9. It also clearly delineates roles: The state categorizes blended entities, and bankruptcy law treats them according to the state's categorization.

The above discussion has provided several options for fashioning a bankruptcy-specific solution to the problems financially distressed blended entities present. Although several of these options contemplate changes to the structure of the Bankruptcy Code, such changes may be necessary and desirable given the growing presence of blended entities in U.S. public life. At the very least, the process for classifying blended entities should show greater deference to state treatment of these entities while being

311. *Id*.

312. *See* Mayer, *supra* note 56, at 375.

313. *See supra* Section III.B.

314. *See supra* Section I.B.

responsive to the federalism concerns that drove the creation of chapter 9 in the first place.

C. Non-Bankruptcy Safety Nets

Even an expanded chapter 9 will not help every blended entity. Part of the solution may also involve developing entity structures with a safety net in mind. This safety net may or may not include bankruptcy, but it would help clarify whether and how it does. As we increasingly blur the public and the private, it is critical to consider how to deal with the failure and financial distress of entities with significant public importance. We need a robust system to supplant the status quo, which largely consists of an *ad hoc* smattering of bailouts coupled with a handful of bankruptcies that apply the law "functionally" rather than in accordance with legal principles.

Put differently, entities should not be created without ensuring that a safety net exists for them. It would be fairly easy for states to turn blended entities into either clearly government or clearly non-government entities.[315] The safety net for an entity does not necessarily have to include bankruptcy, but if it does, those creating the entity should be clear about chapter choice—which would, in turn, clarify whether and how bankruptcy is supposed to work.

Not all entities need to be eligible for bankruptcy relief, but denial of bankruptcy relief ought to be done deliberately and carefully. In other words, bankruptcy need not be the solution to every entity's financial distress, but *some* relief ought to be available. Bankruptcy might not be worth the cost for every entity, but every entity should have a backup plan. If they don't, and if they fail, there is a risk of contagion as well as a risk that basic public services will cease to exist. Imagine the United States without a Postal Service or New York City without the MTA.

Although it is always possible for the federal or state government to provide a bailout when bankruptcy is not an option, the pros and cons of a bailout must be discussed on a case-by-case basis and the tradeoffs made clear. For example, during the pandemic, America's states and cities received hundreds of billions of dollars from the federal government in an unprecedented move to stave off fiscal crisis.[316] Although this infusion of

315. Francus, *supra* note 14, at 1608 ("For example, if state law creating the entity uses the magic words 'body politic and corporate,' that suffices.").

316. Amanda Albright & Shruti Singh, *Cities Awash in Rescue Cash Seek to Use It to Pay Down Debts*, BLOOMBERG (July 16, 2021), https://www.bloomberg.com/

money did prevent a glut of bankruptcies, it also contributed to a long-term spike in inflation.

Any solution involves tradeoffs, and there is no simple or straightforward way to comprehensively address the myriad issues that financially distressed blended entities present. That said, continuing to follow the status quo comes with its own set of costs, a set that grows daily as blended entities expand in number and type.

CONCLUSION

This Article has exposed a gap between legal expectations and reality. Bankruptcy law was written with the expectation that the entities seeking to use the bankruptcy system would fit neatly and entirely into defined categories. In reality, entities blend public and private components, defying easy categorization.

A mismatch between law and practice is not necessarily problematic if there is a consistent sorting mechanism—if bankruptcy law provided a way to sort blended entities easily and conveniently, and if the provided relief were consistent with both the entity's needs and legal principles. But bankruptcy law lacks such a mechanism, and establishing one has been challenging due to variation in both entity types and state laws. Consequently, blended entities that file for bankruptcy risk ending up with inappropriate relief or, in some cases, no relief at all.

It is time to begin narrowing the gap between law and practice. Although it is unlikely that this gap will disappear completely, bankruptcy law can adapt to better recognize and account for blended entities. Without some adaptation, we risk generating further uncertainty, facilitating manipulation, and fostering incoherence in the law. Although most blended entities receive little attention when they attempt to use the bankruptcy system, their very existence threatens the integrity of the Bankruptcy Code's structure and the efficiency of its functions. Bankruptcy law can do better for the providers of our most essential public goods and services.

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news/articles/2021-07-16/cities-awash-in-rescue-cash-seek-to-use-it-to-pay-down-debts [https://perma.cc/5XTK-D2NB].