

POLITICAL SUBDIVISIONS AND BANKRUPTCY

BANKRUPTCY

Chapter 9 of the United States Bankruptcy Code provides for the reorganization of municipalities, including cities and towns, as well as villages, counties, taxing districts, municipal utilities, and school districts. The original municipal bankruptcy legislation was enacted in 1934 during the Great Depression; however, the Supreme Court found it to be an improper interference with the sovereignty of the states. Congress enacted a revised Municipal Bankruptcy Act in 1937, which was upheld by the Supreme Court. There have been fewer than 500 municipal bankruptcies filed since the Act was enacted in 1937. In order for a municipality to file for bankruptcy under Chapter 9, the municipality must be specifically authorized to be a debtor by state law, governmental officer, or organization empowered by the state law to authorize such a designation. Since the legislature has not so authorized, North Dakota cities are not eligible to file for protection under Chapter 9.

REMEDIES FOR BANKRUPTCY

In the 1974 North Dakota Supreme Court Case, *Kitto v. Minot Park District*, the court provided that the drafters of the state constitution took great care to spell out the specific powers and limitations applicable to the state, municipalities, and other political subdivisions. North Dakota law does not grant authority for local governments to file for bankruptcy protection. In the event of default, North Dakota Century Code Section 40-35-15 provides that the holders of any issue of revenue bonds, or a trustee thereof, may enforce such person's rights against the municipality and its governing body and compel such municipality or governing body to perform and carry out their duties and obligations. Bondholders may also require the municipality and governing body to account as if they were the trustees or enjoin any acts or things which may be unlawful or in violation of the rights of bondholders. Finally, bondholders may bring suit upon the bonds.

Section 40-35-16 provides that general obligation bondholders can petition a court for the appointment of a receiver; however, North Dakota law does not expressly allow for the appointment of a receiver during financial distress. Section 40-35-17 provides the powers and duties of a receiver of undertaking to include taking possession of the undertaking and excluding the municipality, its governing body, officers, agents, and employees. Upon cure of default, the court has the discretion to direct the receiver to surrender the possession of the undertaking to the municipality. Section 40-35-19 provides a receiver shall act under the direction and supervision of the court by which the receiver was appointed.

Following the oil boom of the 1980s, the cities of Belfield and Gladstone defaulted on special assessment debt carrying an unlimited tax pledge. Belfield levied a deficiency tax to meet its obligations; however, it proved to be an unaffordable burden on taxpayers which resulted in the city defaulting on \$1.9 million in debt. In July 1991, bondholders accepted a settlement of 55 percent of the principal with no back interest. Belfield paid the settlement through a combination of the deficiency levy and a \$150,000 grant from the state. After Gladstone defaulted in 1985, the city received a \$100,000 grant from to state to help retire the special assessment debt. A revenue bond default would negatively affect a city's bond rating; however, the city's future bonds may still be marketable with a lower rating and higher interest rate. Because many city bonds are sold to local banks or state agencies without being rated, a lower bond rating may ultimately have a limited impact.