

Memorandum of the Ad Hoc Committee on Emergency Fiscal Management

Prepared by:
Patrick L. Anderson,
Principal & CEO
Anderson Economic Group LLC

1.0 Purpose of the Committee

1.1 Concerns of the Committee

The group agreed that a legal authority does not exist for the state to make expenditures without a budget for the 2007-08 fiscal year, and that any “shutdown” or a failure to properly adopt a budget and operate within the Constitution will have serious long-term and negative effects on the State of Michigan. Every participant agreed that it is in the best interest of the State that a budget be adopted, and signed by the Governor, prior to Friday, the last business day of this fiscal year.

The group could only hope to identify stop-gap, short-term measures. These measures would minimize, but not eliminate, the damage that a shutdown would cause to the state's reputation, to businesses conducting commerce in the state, to citizens relying on government services, to creditors of the state, and to state employees. Every member of the group wanted the state governor and legislature to agree on a set of appropriation bills that would allow for the proper operation of the government, even if that meant not achieving political objectives of the various parties.

1.1.1 Limited Objectives of Committee

The committee had the following limited objectives:

1. Outline one or more approaches to manage a “shutdown” of the state government due to a lack of an enacted budget for the 2007-2008 fiscal year;
2. Identify necessary steps to avoid the chaos that might otherwise arise;

3. Provide a court, court-appointed receiver, governor, creditors of the state, and other persons with guidance in event of shutdown.

1.2 Issues Outside the Purpose of the Committee

The following items were outside the purpose of the committee, and are not part of this memorandum:

1. Suggest tax or budget priorities for the state government,
2. Propose a budget or establish a plan for the operation of the state government, or
3. Otherwise do the legislature's or governor's jobs.

1.3 People Consulted in the Work of the Committee

Although this memorandum was drafted by one individual, it represents the work of over a dozen individuals and their organizations. These organizations represent a cross-section of the state's important stakeholders in the business, nonprofit, consulting, higher education, elementary and secondary education, and health and human services fields. In addition to these individuals, we received very helpful input from former and current state government officials.

Members of the committee that provided input into this memorandum are recognized in "Appendix VI: Selected Individuals Consulted in the Work of the Committee" on page 20. Given the very short time frame, we were able to consult with only a small group of individuals, and did not ask their affiliated organizations to formally endorse all the findings in this memorandum.

2.0 No Legal Basis for Expenditures Without Appropriation Act

The first issue we considered was the legal basis, or lack thereof, for the state government to operate in a fiscal year for which there was no properly adopted budget.

2.1 No Basis for Expenditures Without Appropriation

We concluded, consistent with the conclusion of a recent memo by the House Fiscal Agency head Mitch Bean, that the 1963 Constitution of the State of Michigan provides no authority to spend money except pursuant to an appropriation. "Appropriation" bills are the essence of a budget, and no "budget" (set of appropriation bills) has yet been adopted for the FY 2008 year.

We also concluded that there was no exception in the Constitution for "essential" services, and indeed no definition of what "essential" services were. Principal and interest payments on bonded indebtedness are not even excluded from the blanket requirement that all expenditures of the state be made pursuant to an appropriation act.

The following section of the Constitution establishes this quite clearly:

- Article IX section 17 states: “No money shall be paid out of the state treasury except in pursuance of appropriations made by law.”

Other sections require appropriation bills to be passed including a statement of estimated revenues that exceed expenditures; require the governor to reduce expenditures below the appropriated levels when estimated revenues are insufficient; and require any deficit in one year to be met with the first appropriation in the next.

Selected sections of the state Constitution are reprinted in “Appendix I: Key State Constitutional Provisions” on page 12.

2.2 Legal Expenditures to Fulfill Obligations Pursuant to Lawful Appropriations

We observed that the prohibition on expenditures without an appropriation did not mean that obligations incurred previously, and subject to an appropriation act lawfully passed, could not be fulfilled beyond a fiscal year for which a budget had been adopted.

In particular:

- Expenditures could be made to fulfill contracts that were funded in prior-year budgets.
- Refunds from overpayments on taxes, provided claims were made in the prior fiscal year, could be made.
- Principal and interest payments that were pledged, and funded in a prior fiscal year, could be made.
- State employees could be paid for the portion of their work period that fell within an appropriation for a prior fiscal year. It appears that state employees in different branches of government, and under different employment agreements, have varying payroll periods. It also appears that many employees have payroll periods that overlap fiscal years.

3.0 Practical Limitations on Expenditures Under Emergency Conditions

3.0.1 State not “bankrupt” initially

We note below, in “Bankruptcy, Insolvency, and Operation Without Budget” on page 9, that the state will have substantial cash reserves, and substantial debts, beyond the current fiscal year. Furthermore, at least at the beginning of a “shutdown,” it will not be technically “bankrupt,” and may or may not be “insolvent.”

The state will have cash on hand after the close of the current fiscal year, at least in some funds. Under whatever auspices it operates without a lawful appropriation, it will have the practical ability to make some payments out of the existing cash balances it possesses.

3.0.2 Serious practical limitations on payments during emergency operations

However, there are serious practical limitations that must be recognized in any emergency financial plan. These practical limitations include:

1. Expenditures can only be made from cash on hand. That cash on hand will be supplemented by tax payments and other forms of revenue, to the extent the taxpaying public has confidence the state will return to normal operations soon.
2. Lenders will be extremely reluctant to purchase bonds or notes from the state, and will also be reluctant to lend money to its authorities and subdivisions. Indeed, some lenders may demand repayment ahead of the normal schedule for their outstanding loans to the state. Any legal action against the state, or attempt to enforce payment on a claim, would further aggravate this difficulty.
3. The state officials responsible for ordering payments; and state employees that make payments, collect, administer, deposit, or account for state funds; must be ordered to work. Furthermore, they must agree to work, and (except for perhaps a handful of officials) must be paid for their work.
4. The request to perform these duties must arise from a plausible authority, which must pledge that these individuals will not be punished in the future for their actions under an emergency financial operation.

3.0.3 Emergency plans must address practical limitations

Any emergency plan must address these practical limitations. The options described below, address these, though none address them completely or satisfactorily.

4.0 Options for Operating Without Appropriations

4.1 Option 1: Continuation Budget

The Constitution does not provide for expenditures under a “continuation budget.” A “continuation” budget is a political label placed on appropriation acts that reflect, by common agreement, the political judgements made when the prior appropriation acts were passed, or some modification of those. It is designed to fulfill the constitutional requirements for appropriations during a temporary period during which a full fiscal year’s budget is enacted.

Regardless of the political label, properly enacted appropriations (including a statement of expected revenues and expenditures) provide the constitutional authorization to expend money. A budget con-

sisting of such appropriation acts is, therefore, preferable to any other option lacking full constitutional authority.

There are risks and defects of “continuation” budgets. Among them are the hasty manner in which they are assembled; the possibility that their drafting does not allow the governor the line-item veto power provided by the Constitution; and the shaky basis for concluding that such a budget would be balanced. However, even with these defects, such a “budget” is more lawful, and likely to suffer from far fewer practical difficulties, than any of the other options we will consider.

4.2 Option 2: Executive Orders Declaring Financial Emergency and Establishing Emergency Financial Operating Authority

4.2.1 Lack of enacted appropriation forces a dilemma

Without a continuation budget, or the appropriations bills sufficient to authorize expenditures in a new fiscal year, state officers do not have constitutional authority to expend money for operations in that year.

This leaves these officers with an awful choice: live strictly within the financial portions of the Constitution, and risk the chaos that would result if all state employees stopped working; or assert other authority to act to protect the health, welfare, property, and livelihoods of the citizens. The fact that one or more of these state officers are, at least partially, responsible for the “shutdown” does not change the fact of the dilemma, nor diminish the need to protect the public.

4.2.2 “Emergency” provision in Constitution limited to attacks by enemies

The Constitution authorizes “continuity” of government in times of emergency, but such emergencies are described as attacks on the United States. Clearly, the state’s financial emergency is not caused by attacks by foreign powers. Furthermore, there is no lack of continuity in state officers or the legislature.

4.2.3 State’s Own Financial Emergency Law

Guidance on the notion of operating to protect the health and welfare of the citizens is provided by the state’s own financial emergency law. The state adopted the Local Government Fiscal Responsibility Act as Act 72 of 1990. The first two sections of the Act (compiled at MCL 141.1201 and following) read as follows:

Sec. 1. This act shall be known and may be cited as the “local government fiscal responsibility act.”

Sec. 2. The legislature hereby determines that the public health and welfare of the citizens of this state would be adversely affected by the insolvency of units of local government, including certain school districts, and that the survival of units of local

government is vitally necessary to the interests of the people of this state to provide necessary governmental services. The legislature further determines that it is vitally necessary to protect the credit of the state and its political subdivisions and that there is a valid public purpose for the state to take action and to assist a unit of local government in a fiscal emergency situation to remedy this emergency situation by requiring prudent fiscal management. The legislature, therefore, determines that the authority and powers conferred by this act constitute a necessary program and serve a valid public purpose.

Note that the law applies to “units of local government.” However, the law provides significant guidance and precedent. In particular: the legislative determination that the health and welfare of the citizens could be adversely affected by insolvency; the public purpose to remedy a fiscal emergency through “prudent financial management;” the process for declaring a financial emergency; the process of appointing an emergency manager; the powers of that manager; and option of seeking of federal bankruptcy protection.

4.2.4 Possible Executive Orders by Governor

If the state fails to properly adopt a budget, and further fails to adopt a “continuation” budget, the Governor may be required to declare an emergency and establish an emergency financial operating plan.

The following executive orders (or executive directives) could accomplish this:

1. Declare a financial emergency. Without such a declaration, any “emergency” authority would have little or no validity.
2. Establish an emergency financial operating plan, to protect the lives, property, health, and general welfare of the people of the state. This plan must assert the principles and authority under which it will operate, and designate a public body to approve expenditures during a financial emergency. The State Administrative Board, which consists of Constitutional officers and has a Constitutional history that extends back as least as far as the 1908 Constitution, and a statutory authority that extends back at least 80 years, is the proper body for this purpose. See “Note on the State Administrative Board” on page 18.
3. Assure creditors and taxpayers that the state has cash reserves, is not “bankrupt,” and will operate under emergency authority for limited purposes. Further assert that all tax laws remain in effect and that taxes will be collected during a financial emergency.
4. Authorize temporary and automatic extensions of registrations, permits, and licenses. Note that almost all adult citizens of the state, and most employers in the state, are required by various state and federal laws (including laws from other states) to hold or show a valid license in order to conduct business, make purchases, or travel.

The state’s Local Government Fiscal Responsibility Act could serve as a model, and as precedent, for the steps requested in these executive orders or directives. “Appendix IV: Possible Executive Orders”

on page 17 lists elements that could be included in the statements establishing such a plan using executive powers.

4.3 Option 3: Bankruptcy

4.3.1 Bankruptcy, Insolvency, and Operation Without Budget

The State government has failed in recent years to operate within certain Constitutional budget requirements. These failures include the expenditures of money beyond appropriated amounts in FY 2006, and in the expenditures beyond the anticipated revenues in the current (FY 2007) fiscal year. However, neither of these conditions necessarily mean the state is insolvent, without cash reserves, or bankrupt.

In particular, the state was solvent (meaning able to meet its financial obligations) at least through the close of the last fiscal year. It may, or may not, be solvent in all funds at the end of the current (FY 2007) fiscal year. It is almost certain that it will have significant amounts of cash on hand, in at least some funds, at the close of the current fiscal year. Technically speaking the state will not be “bankrupt” until and unless it is declared bankrupt. Insolvency is normally a prerequisite for bankruptcy, but some organizations operate when insolvent for some time before becoming “bankrupt.”

Nomenclature aside, it is important to note that the State will have all of the following at the close of the current fiscal year:

- Substantial cash reserves--at least in some funds.
- Exhausted reserves in other funds, meaning a zero balance. Some funds may even have a negative balance.
- A stream of cash flowing into its coffers from tax revenue and other sources.
- Significant explicit debts and other obligations, some of which result from operations (and pursuant to appropriations) from prior fiscal years.
- Constitutionally-established funds with dedicated revenues, and restrictions on expenditures from those funds. These include the natural resources trust fund, the transportation fund, and the School Aid Fund.

Operating without a budget means, among other things, that there is no fully lawful authorization to determine which obligations are met, in what order, and from what sources of cash.

4.3.2 Chapter 9 Bankruptcy

Although rarely discussed, the federal bankruptcy code does deal with state and local governments. Chapter 9 of the Code provides for relief from creditors for a “municipality” while it develops and negotiates a plan to adjust its debts. A “municipality” is broadly defined as any subdivision of a state:

The term “municipality” is defined in the Bankruptcy Code as a “political subdivision or public agency or instrumentality of a State.” 11 U.S.C. § 101(40). The definition is broad enough to include cities, counties, townships, school districts, and public improvement districts. It also includes revenue-producing bodies that provide services which are paid for by users rather than by general taxes, such as bridge authorities, highway authorities, and gas authorities.

[US Courts, “Bankruptcy Basics,” see complete citation below.]

Because the federal government of the United States is created by the states, and not the states by the federal government, there are serious US Constitutional impediments to the federal government controlling state functions. For this reason, the powers of a bankruptcy court under the federal law are more limited, and the entry requirements more strict, than for individuals and businesses.

The Administrative Office of the United States Courts prepares a “Bankruptcy Basics” publication, which describes Chapter 9 as follows:

Purpose of Municipal Bankruptcy

The purpose of chapter 9 is to provide a financially-distressed municipality protection from its creditors while it develops and negotiates a plan for adjusting its debts. Reorganization of the debts of a municipality is typically accomplished either by extending debt maturities, reducing the amount of principal or interest, or refinancing the debt by obtaining a new loan.

Although similar to other chapters in some respects, chapter 9 is significantly different in that there is no provision in the law for liquidation of the assets of the municipality and distribution of the proceeds to creditors. Such a liquidation or dissolution would undoubtedly violate the Tenth Amendment to the Constitution and the reservation to the states of sovereignty over their internal affairs. Indeed, due to the severe limitations placed upon the power of the bankruptcy court in chapter 9 cases (required by the Tenth Amendment and the Supreme Court's decisions in cases upholding municipal bankruptcy legislation), the bankruptcy court generally is not as active in managing a municipal bankruptcy case as it is in corporate reorganizations under chapter 11. The functions of the bankruptcy court in chapter 9 cases are generally limited to approving the petition (if the debtor is eligible), confirming a plan of debt adjustment, and ensuring implementation of the plan. As a practical matter, however, the municipality may consent to have the court exercise jurisdiction in many of the traditional areas of court oversight in bankruptcy, in order to obtain the protection of court orders and eliminate the need for multiple forums to decide issues.

[Administrative Office of the United States Courts, “Bankruptcy Basics, 3d edition” (April 2006); found at: <http://www.uscourts.gov/bankruptcycourts/bankruptcybasics.html>]

A plain reading of Chapter 9 reveals at least two criteria that would exclude the State of Michigan from being subject to a bankruptcy proceeding. First, it is a state, not a “subdivision” of a state. Second, it would have to adopt a law, or proclaim itself, to be subject to Chapter 9. It has adopted such a law: the

Local Government Fiscal Responsibility Act. However, this act applies only to local governments. See “State’s Own Financial Emergency Law” on page 7, and “Appendix II: Federal Bankruptcy Law” on page 13.

4.3.3 Bankruptcy as a remote possibility

Unfortunately, should the State become visibly insolvent, and should creditors become unable to receive payment for their obligations, those creditors may demand a federal court take jurisdiction. Should the State, at that time, be operating without Constitutional authority, it is possible one or more state officials—or a state body—may proclaim the state bankrupt and seek relief under Chapter 9. As we note below, there are many potential creditors of the state.

The committee believed that Chapter 9 was a remote possibility, at least in the first month of a shut-down. However, it remains a possibility if the state was not capable of paying its bills, and operated without Constitutional authority for an extended time.

The following additional information is contained in the Appendix:

- “Appendix II: Federal Bankruptcy Law” on page 13.
- “Possible Creditors of the State” on page 16.

5.0 Appendices

5.1 Appendix I: Key State Constitutional Provisions

Article IV §31 General appropriation bills; priority, statement of estimated revenue. Sec. 31. The general appropriation bills for the succeeding fiscal period covering items set forth in the budget shall be passed or rejected in either house of the legislature before that house passes any appropriation bill for items not in the budget except bills supplementing appropriations for the current fiscal year's operation. Any bill requiring an appropriation to carry out its purpose shall be considered an appropriation bill. One of the general appropriation bills as passed by the legislature shall contain an itemized statement of estimated revenue by major source in each operating fund for the ensuing fiscal period, the total of which shall not be less than the total of all appropriations made from each fund in the general appropriation bills as passed.

Article IV §51 Public health and general welfare. Sec. 51. The public health and general welfare of the people of the state are hereby declared to be matters of primary public concern. The legislature shall pass suitable laws for the protection and promotion of the public health.

Article V, §1 Executive power. Sec. 1. The executive power is vested in the governor.

Article IX, §17 Payments from state treasury. Sec. 17. No money shall be paid out of the state treasury except in pursuance of appropriations made by law.

Article IX, Sec. 14. To meet obligations incurred pursuant to appropriations for any fiscal year, the legislature may by law authorize the state to issue its full faith and credit notes in which case it shall pledge undedicated revenues to be received within the same fiscal year for the repayment thereof. Such indebtedness in any fiscal year shall not exceed 15 percent of undedicated revenues received by the state during the preceding fiscal year and such debts shall be repaid at the time the revenues so pledged are received, but not later than the end of the same fiscal year.

Article IX §29 State financing of activities or services required of local government by state law.

Sec. 29. The state is hereby prohibited from reducing the state financed proportion of the necessary costs of any existing activity or service required of units of Local Government by state law. A new activity or service or an increase in the level of any activity or service beyond that required by existing law shall not be required by the legislature or any state agency of units of Local Government, unless a state appropriation is made and disbursed to pay the unit of Local Government for any necessary increased costs. The provision of this section shall not apply to costs incurred pursuant to Article VI, Section 18.

Article IX, §39 Continuity of government in emergencies. Sec. 39. In order to insure continuity of state and local governmental operations in periods of emergency only, resulting from disasters occurring in this state caused by enemy attack on the United States, the legislature may provide by law for

prompt and temporary succession to the powers and duties of public offices, of whatever nature and whether filled by election or appointment, the incumbents of which may become unavailable for carrying on the powers and duties of such offices; and enact other laws necessary and proper for insuring the continuity of governmental operations. Notwithstanding the power conferred by this section, elections shall always be called as soon as possible to fill any vacancies in elective offices temporarily occupied by operation of any legislation enacted pursuant to the provisions of this section.

Article IX, §32 Suit to enforce sections 25 to 31. Sec. 32. Any taxpayer of the state shall have standing to bring suit in the Michigan State Court of Appeals to enforce the provisions of Sections 25 through 31, inclusive, of this Article and, if the suit is sustained, shall receive from the applicable unit of government his costs incurred in maintaining such suit.

5.2 Appendix II: Federal Bankruptcy Law

5.2.1 Chapter 9 of the Bankruptcy Code

The National Bankruptcy Review Commission report of 1997 summarizes this part of federal law as follows:

CHAPTER 9: MUNICIPAL BANKRUPTCY RELIEF

Chapter 9 of title 11 provides relief for municipal entities, defined as a “political subdivision or instrumentality of a state.”(2414) Chapter 9 is a rarely used part of the Bankruptcy Code. Only 141 Chapter 9 cases have been filed since 1980.(2415) The Commission's Chapter 9 Proposals are technical in nature and attempt to fill statutory gaps that have been brought to light in recent Chapter 9 cases, most notably the one involving Orange County, CA.

DISCUSSION

Municipal bankruptcy relief is a relatively recent addition to the federal bankruptcy scheme. For more than one hundred and forty years after the adoption of the Constitution, no municipal bankruptcy legislation existed either on the federal or state level.(2416) Debt restructuring legislation could not exist on the state level, because states are prohibited from impairing contract obligations under the Contracts Clause of the Constitution.(2417) Federal legislation relating to municipal bankruptcy was similarly hamstrung by Tenth Amendment considerations of state sovereignty.

It was not until the early 20th century that overwhelming economic crises demanded that this legislative vacuum be filled. The land development boom of the 1920s followed by the depression of the 1930s sent over 2,019 municipalities, counties and other governmental units into default on their obligations.(2418) In response, Congress enacted Chapter IX as temporary emergency legislation to help these municipalities restructure their debt.(2419) This emergency relief was held unconstitutional by the Supreme Court in *Ashton v. Cameron County Water Dist.* finding that Chapter IX impermissibly interfered with a state's sovereignty.(2420) The constitutional faults were remedied(2421) and Congress' second attempt to provide temporary municipal

bankruptcy relief was upheld.(2422) Congress extended the sunset provision twice before making Chapter IX a permanent part of the Bankruptcy Act in 1946.(2423)

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Substantive Bankruptcy Code Provisions Applicable in Chapter 9

Chapter 9 debtors do not have access to all of the substantive provisions of the Bankruptcy Code. Section 901 lists the Code sections and subsections that are applicable in Chapter 9, including, in relevant part:

- * Adequate protection (11 U.S.C. § 361);
- * Automatic stay (11 U.S.C. § 362 as supplemented by section 922);
- * Obtaining postpetition credit on a superpriority or priming lien basis (11 U.S.C. § 364(c) & (d));
- * Executory contracts (11 U.S.C. § 365);
- * Allowance of claims or interests and administrative expenses (11 U.S.C. §§ 502, 503);
- * Administrative expense priorities (11 U.S.C. § 507(a)(1));
- * Avoidance powers (11 U.S.C. §§ 544-548);
- * Creation and powers of creditors' committees (11 U.S.C. §§ 1102 & 1103);
- * Classification of claims and interests (11 U.S.C. § 1122);
- * Relevant provisions relating to the contents of a municipal debtor's plan (11 U.S.C. § 1123(a)(1) -(b));
- * Impairment of claims or interests (11 U.S.C. § 1124);
- * Postpetition disclosure and solicitation (11 U.S.C. § 1125);
- * Provisions regarding acceptances of a plan (except those governing acceptances of interestholders of the debtor) (11 U.S.C. § 1126 (a), (b), (c), (e), (f), and (g));
- * Deemed acceptance or rejection of plan as modified unless notification of change within time set by the court (11 U.S.C. § 1127(d));
- * Confirmation requirements for municipalities are as follows:
 - o The proponent must comply with the applicable provisions of title 11 (11 U.S.C. § 1129(a)(2));
 - o The plan has been proposed in good faith and not by any means forbidden by law (11 U.S.C. § 1129(a)(3));
 - o Governmental regulatory commission with jurisdiction over the rates of the debtor has approved any rate change in the plan or such rate change is conditioned on such approval (11 U.S.C. § 1129(a)(6));
 - o Each class of claims and interests has either accepted the plan or is not impaired under the plan (11 U.S.C. § 1129(a)(8));

o If any classes are impaired under the plan, at least one impaired class has accepted the plan (11 U.S.C. § 1129(a)(10));

o Cramdown of secured and unsecured claims (11 U.S.C. § 1129(b)(1)(a), (b)(2)(A) & (b)(2)(B)).

While Chapter 9 debtors do not enjoy the full range of relief and powers offered by the Bankruptcy Code, the above list indicates a careful application of only those provisions that are necessary to complete a municipal restructuring while balancing the state sovereignty concerns.

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Notes:

2414 11 U.S.C. § 101(40) (1994).

2415 Administrative Office of the United States Courts, Statistics Division, (Oct. 9, 1997).

2416 For a complete discussion of the municipal creditors' remedies that were available prior to 1933, see Mike W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 713 PLI/COMM. 35 (March 1995).

2417 *Id.* at 39-40, citing *Hanover Nat'l Bank v. Morses*, 186 U.S. 181, 188 (1902) (“[Congress's power under the Bankruptcy Clause includes the power to discharge the debtor from his contracts and legal liabilities, as well as to distribute his property. The grant to Congress involves the power to impair the obligations of contracts, and this the States were forbidden to do.”)

2418 *Ashton v. Cameron County Water Improvement District*, 298 U.S. 513, 533-34 (1936) (Cardozo, J., dissenting) (citing the “breadth and depth” of the municipal fiscal crises).

2419 The Bankruptcy Act of 1898, 30 Stat. 544 was amended to include Chapter IX, titled Provisions for the Emergency Temporary Aid of Insolvent Public Debtors and to Preserve the Assets Thereof and for Other Related Purposes. See 48 Stat. 798 (1934).

2420 *Ashton*, 298 U.S. 532 (holding that Chapter IX of the Bankruptcy Act was unconstitutional; Congress' enactment of a municipal debt restructuring statute impermissibly abridged a state's sovereignty).

2421 Chapter IX was redesignated as Chapter X by the Municipal Corporation Bankruptcy Act, Pub. L. No. 302, 75th Cong., 1st Sess., 50 Stat. 653 (1937). The principal differences between the two were a reduction in the number of consents needed for confirmation of a plan, from 75% to 66.66%, and a small expansion of protection for states' sovereign immunity.

2422 *United States v. Bekins*, 304 U.S. 27 (1938) (holding the Municipal Corporation Bankruptcy Act constitutional under both the Fifth and the Tenth Amendments).

[University of North Texas Law Library; found at: <http://govinfo.library.unt.edu/nbrclreport/22chapte.html>]

5.2.2 Possible Creditors of the State

All the following are possible creditors (people to whom the state owes money) that could attempt to enforce their claims against the state.

1. Citizens that are promised any license, registration, or other item necessary for the conduct of their business.
2. Business or individual taxpayers who have overpaid and are due refunds.
3. Contractors of the state. Contractors with claims to be paid from funds dedicated to specific funds, for work consistent with those funds, would probably be given precedence. An example is highway repair and construction contractors with contracts to be paid from the Transportation Fund, which has money from the gas tax dedicated to it by Constitution.
4. Employees that have contracts without explicit “appropriation risk” clauses.
5. Purchasers of state bonds, notes or other evidences of indebtedness.
6. Purchasers of bonds issued by the State Building Authority or other authorities that have the implied guarantee of the state.
7. Purchasers of bonds from municipalities and other subdivisions of the state, where the state has either an implicit guarantee, or has Constitutional obligations to provide certain funding to the debtor.
8. The State Building Authority, and other landlords who have rented facilities to state agencies.
9. School districts, cities, and municipalities that have payments due, under Constitutional guarantees such as revenue sharing and “Headlee” guaranteed payments. Note that promises made in budget negotiations; statements in “State of the State” or other documents; and budget targets are not Constitutional guarantees.

5.2.3 Authorization for Emergency Financial Manager to Seek Protection Under Chapter 9

Section 22 of the Local Government Fiscal Responsibility Act provides for local governments to seek protection under the federal bankruptcy code, and authorizes an emergency financial manager to authorize a bankruptcy petition and become a “debtor” under the bankruptcy code.

Sec. 22. (1) After giving written notice to the local emergency financial assistance loan board, the emergency financial manager may authorize the local government to proceed under title 11 of the United States Code, 11 U.S.C. 101 to 1330, unless this authorization is disapproved by the local emergency financial assistance loan board within 60 days after the notice has been received by the board. This section empowers the local government for which an emergency financial manager has been appointed to become a debtor under title 11 of the United States Code as required by section 109 of title 11 of the United States Code, 11 U.S.C. 109.

See “State’s Own Financial Emergency Law” on page 7.

5.3 Appendix III: Selected State Operations that Generate Positive Cash Returns

The following are examples of state operations that generate positive cash returns to the state government. Note that the cash produced by these programs are dedicated by law or Constitution, and diversion of any of these funds would be contrary to those provisions of law or Constitution.

1. The State Lottery
2. Regulation of casinos and collection of casino tax revenue
3. Secretary of State offices
4. Tolls from the Mackinac Bridge
5. Liquor distributed from state-designated agents.
6. Collection activities, including regular account maintenance, of the Department of Treasury. This includes Sales Use and Withholding and other activities.
7. Issuance of hunting and fishing permits.

Note the discussion in the text regarding the Article IX section 17 prohibition on expenditures made without a state appropriation act.

Note the discussion in the text regarding the Article IX section 17 prohibition on expenditures made without a state appropriation act.

5.4 Appendix IV: Possible Executive Orders

The following are elements of possible executive orders, or executive directives, that could be issued by the Governor to declare a financial emergency; establish and emergency financial operating plan; assure creditors and taxpayers; and authorize temporary and automatic extensions of registrations, permits, and licenses.

5.4.1 Declaration of Emergency and Establishment of Emergency Financial Operating Plan

The following are elements of a possible executive order, or executive directive.

1. Declare a financial emergency. Note that no appropriations acts have been properly enacted, in violation of Article IV section 31. Note that regular operations of the state cannot continue given the restriction of Article IX section 17 on any expenditure without an appropriation act.
2. Assert authority of governor under Article V, section I to act as executive during this financial emergency. Note the continuity of all state officers and the legislature, as required under Article IX section 39.
3. Note that Article IV Section 51 states “the public health and general welfare of the people of the state are hereby declared to be matters of primary public concern.”

4. Given this imperative, and to protect the lives, property, public health, and general welfare of the people of the state, declare that the state will follow an emergency financial operating plan during the time period in which no properly enacted appropriation acts, for the government operations in question, authorize government expenditures for the current fiscal year.
5. Authorize the State Administrative Board to approve payments during emergency conditions, only to the extent such expenses are necessary to protect the lives, property, public health, and general welfare of the people of the state. See “Note on the State Administrative Board” on page 18.
6. Restate or affirm other relevant recent directives and orders, such as:
 - Reductions in expenditures, executive order 2007-3.
 - Collecting Revenue Payable to the State of Michigan, directive 2007-15.

5.4.2 Note on the State Administrative Board

The existence of a state administrative board that approved bonds and major expenditures within the state government extends at least as far back as the 1908 Constitution. The current statute establishing the board’s authority dates from 1921:

STATE ADMINISTRATIVE BOARD (EXCERPT); Act 2 of 1921

17.1 State administrative board; membership; powers and duties.

Sec. 1. There is hereby created a board to be known and designated as the state administrative board of the state of Michigan. The state administrative board shall be composed of the governor, who shall act as chairperson, the lieutenant-governor, the secretary of state, the state treasurer, the attorney general, the director of the state transportation department, and the superintendent of public instruction, and shall possess the powers and perform the duties provided in this act.

...

Sec. 3. The state administrative board shall exercise general supervisory control over the functions and activities of all administrative departments, boards, commissioners and officers of the state, and of all state institutions:...

The authority of the Board to enforce budget restrictions was recently noted in Executive Directive 2007-18, Moratorium on Service Contracts and Use of Temporary Employees. The Directive described the authority of the Board as follows:

In exercising general supervisory control over the functions and activities of all administrative departments, boards, commissioners, and officers of the state, and of all state institutions, as required under Section 3 of 1921 PA 2, MCL 17.3, the State Administrative Board shall monitor compliance with the requirements of this Directive.

5.4.3 Other Directives: Extension of Permits and Registrations

1. Direct department directors to approve automatic and temporary extensions of licenses, permits, and registrations.
2. Authorize the Secretary of State to take actions necessary to extend licenses and registrations of drivers, automobile dealers and manufacturers.
3. Declare that all employees of the state and its subdivisions should consider any license, permit, or registration that was subject to an automatic or temporary extension should be considered valid during that time period. Request that other state and federal authorities similarly respect these extensions.

5.4.4 Other Directives; Assurance for Creditors and Taxpayers

1. Assure citizens that the state is not “bankrupt” and has cash reserves, which are sufficient only to operate minimal services.
2. Assure possible creditors of the state that the legislature and governor are working towards a properly-enacted state budget.
3. Assert that all tax laws remain in effect. Assert that the state will collect taxes such as: sales, use and withholding; single business tax; the state education tax (property tax); and other taxes.
4. Assert that all Constitutionally required allocations of state tax revenue to local governments will be made pursuant to lawfully enacted appropriation acts.
5. Note that state employees charged with collecting taxes and accounting for public moneys remain employed under emergency financial operating plan.

5.5 Appendix V: Individuals that could serve as an emergency financial manager

The Local Government Fiscal Responsibility Act provides for an emergency financial manager to be appointed in certain circumstances. Similar appointments occur in some federal bankruptcy proceedings. Should the State at some point need such a manager, it could seek such assistance from the following individuals.

- Former state treasurers or acting treasurers
- Former emergency financial managers of Michigan municipalities
- Retired state officials with significant financial experience
- Experts in financial management with prior government experience

In addition, the Southeastern Michigan region has a number of turnaround management firms with considerable experience with private sector bankruptcy and the management of troubled firms that are not in bankruptcy and seek to avoid it. These firms include BBK Ltd., AlixPartners, Mackinac Partners, McTevia & Associates, Conway & Associates, and others. These experts could also be available to the state, its subdivisions, and creditors of the state.

Note that these persons have not requested any nomination for such a responsibility, and may not accept a request if one was made for their services.

5.6 Appendix VI: Selected Individuals Consulted in the Work of the Committee

The following individuals supported the efforts of the committee and agreed to be recognized for their work:

- Robert LaBrandt, Michigan Chamber of Commerce
- Michael Boulus, Presidents Council, State Universities of Michigan
- Earl Ryan, Citizens Research Council of Michigan
- Craig Thiel, Citizens Research Council of Michigan
- Ray Telman, Middle Cities Education Association
- Alex Rosaen, Anderson Economic Group
- Patrick Anderson, Anderson Economic Group

The author of this memorandum also wishes to thank numerous others that provided very helpful input.

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The address of the main office of Anderson Economic Group LLC is: 1555 Watertower Place, East Lansing MI 48823; <http://www.andersoneconomicgroup.com>.