

# COMMENTS

## STATE BANKRUPTCY, COVID-19, AND THE UNITED STATES TRUSTEE PROGRAM: THE EXECUTIVE BRANCH'S ROLE IN THE OVERSIGHT OF A STATE'S FINANCIAL RESTRUCTURING

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## INTRODUCTION

COVID-19 turned 2020 on its head. It caused state governments to implement lockdowns and quarantines, put many businesses out of commission, tanked the global economy, and forced Congress to pass federal spending bills providing aid to state economies.<sup>1</sup> In its wake, many states had, or came close to having, their credits downgraded.<sup>2</sup> Between February and April 2020, major rating agencies bumped the Alaska, Connecticut, Hawaii, Illinois, New Jersey, and New York state municipal bond ratings from an investment grade to negative watches.<sup>3</sup> At the beginning of the pandemic, Illinois was only weeks away from insolvency as it continued to spend more than it brought in,<sup>4</sup> and California's state and local unfunded liabilities amounted to \$1.5 trillion.<sup>5</sup> Because states' deficit spending is currently unsustainable, intervention is vital to protect the national economy.<sup>6</sup>

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1. See Stephanie Segal & Dylan Gerstel, *The Global Economic Impacts of COVID-19*, CTR. FOR STRATEGIC & INT'L STUD. (Mar. 10, 2020), <https://www.csis.org/analysis/global-economic-impacts-covid-19> (predicting drops in nations' gross domestic product, revenue from tourism industries, price of oil, and low-yielding interest rates).

2. But see Kyle Glazier & Lynne Funk, *How the Coronavirus Is Impacting Perceptions of Municipal Credit, Ratings*, BOND BUYER (Apr. 23, 2020, 3:00 PM), <https://www.bondbuyer.com/news/municipal-participants-question-ratings-value-amid-coronavirus> (reporting that major credit rating agencies have recently downgraded the credit ratings of several states, while acknowledging perceived weaknesses of the municipal bond rating system generally).

3. See *id.* Since April 2020, all state bonds have recovered with Illinois's rating being the lowest at BBB- (a negative rating). See Susan S. Corson, *U.S. State Ratings and Outlooks: Current List*, S&P GLOB. (Dec. 11, 2020, 5:29 PM), <https://www.spglobal.com/ratings/en/research/articles/190319-u-s-state-ratings-and-outlooks-current-list-1738758> (reflecting that as of December 11, 2020, all state municipal bonds had a rating of BBB- or higher, which is generally considered an investment grade rating).

4. See Adam Schuster, *Illinois Moves Closer to Becoming First 'Junk' State with Negative Credit Outlook*, ILL. POL'Y (Apr. 12, 2020), <https://www.illinoispolicy.org/illinois-moves-closer-to-becoming-first-junk-state-with-negative-credit-outlook/> (reporting that Illinois was close to becoming the first state ever to reach "junk" status).

5. Marc Joffe & Edward Ring, *California's State and Local Liabilities Total \$1.5 Trillion*, CAL. POL'Y CTR. (Jan. 3, 2019), <https://californiapolicycenter.org/californias-state-and-local-liabilities-total-1-5-trillion-2/>.

6. See Steven Pearlstein, *What the \$2 Trillion Coronavirus Bailout Is Really Going to Cost*, WASH. POST (Apr. 5, 2020, 3:24 PM), <https://www.washingtonpost.com/business/2020/04/05/what->

In response to the economic downturn occasioned by COVID-19, Congress enacted various spending bills. Congress first passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which created a Coronavirus Relief Fund that provided \$150 billion for state and local governments to alleviate the “necessary” expenses incurred from the virus.<sup>7</sup> Following that, Congress passed the Paycheck Protection Program and Health Care Enhancement Act as an addition to the CARES Act.<sup>8</sup> This bill amounted to \$484 billion, which included provisions to bailout hospitals and businesses—but nothing for state and local governments.<sup>9</sup> The Federal Reserve created the Municipal Liquidity Facility in April 2020 to purchase municipal bonds.<sup>10</sup> This program constructively bails out state and local governments by buying out municipal bonds from states in need.<sup>11</sup> However, the Federal Reserve cannot invest in municipalities with a bond rating that is below investment grade, making this program unhelpful to states in trouble since they are unable to receive government aid through this program.<sup>12</sup>

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2-trillion-coronavirus-bailout-is-really-going-cost/ (pointing out that Congress is able to fund relief packages by increasing the money supply and inflating the value of the dollar).

7. MATTHEW D. DICKERSON & ALISON WINTERS, AMERICANS FOR PROSPERITY, FEDERAL BUDGET ASSISTANCE FOR STATE & LOCAL GOVERNMENTS 1, 6 (2020), [https://mk0xituxemaua.aa56cm7.kinstacdn.com/wp-content/uploads/2020/05/Report\\_FederalBudgetAssistance.pdf](https://mk0xituxemaua.aa56cm7.kinstacdn.com/wp-content/uploads/2020/05/Report_FederalBudgetAssistance.pdf).

8. Paycheck Protection Program and Health Care Enhancement Act, H.R. 266, 116th Cong. (2020); *see also* Press Release, U.S. Dep’t of the Treasury, SBA and Treasury Release Paycheck Protection Program Loan Forgiveness Application (May 15, 2020), <https://home.treasury.gov/news/press-releases/sm1010> (providing that Congress passed the Paycheck Protection Program bill in response to COVID-19).

9. Andrew Taylor et al., *Trump Signs \$484 Billion Measure to Aid Employers, Hospitals*, PBS NEWSHOUR (Apr. 24, 2020, 2:44 PM), <https://www.pbs.org/newshour/economy/trump-signs-484-billion-measure-to-aid-employers-hospitals..>

10. *See generally* BD. OF GOVERNORS OF THE FED. RESRV. SYS., MUNICIPAL LIQUIDITY FACILITY 1 (2020), <https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20200811a1.pdf> (providing the terms of the Municipal Liquidity Facility (Facility) and setting out its purpose).

11. *See id.* (describing how the Facility supports lending by purchasing notes from U.S. states and the District of Columbia); *see also* FAQs: *Municipal Liquidity Facility*, FED. RESRV. BANK OF N.Y., <https://www.newyorkfed.org/markets/municipal-liquidity-facility/municipal-liquidity-facility-faq> (Oct. 5, 2020) [hereinafter *FAQs*] (emphasizing that the purpose of this program is to restore faith in the municipal bond market); *What Are Municipal Bonds and How Are They Used?*, TAX POL’Y CTR. BRIEFING BOOK, <https://www.taxpolicycenter.org/briefing-book/what-are-municipal-bonds-and-how-are-they-used> (May 2020) (defining municipal bonds as bonds that “primarily [] pay for large, expensive, and long-lived capital projects”).

12. *See* *FAQs*, *supra* note 11 (requiring “eligible notes” from states, cities, or counties to be at least BBB-/Baa3 as of April 8, 2020); *see also* Glazier & Funk, *supra* note 2 (demonstrating that

Senator Minority Leader Mitch McConnell is calling for a consideration of state bankruptcy, so now, following the pitfalls of COVID-19, states will likely need to restructure their debt or figure out a way to pay it off.<sup>13</sup>

Under the Tenth Amendment, state sovereignty allows states to choose whether to file for bankruptcy or default on their debts.<sup>14</sup> No state has ever filed for bankruptcy and Congress has not amended the U.S. Code to include it.<sup>15</sup> In recent years, Puerto Rico, the District of Columbia (D.C.), and Detroit, Michigan have been on the verge of bankruptcy.<sup>16</sup> All entities filed due to insurmountable debt and the freedom that restructuring would provide them.<sup>17</sup> Currently, the U.S. Department of Justice's (DOJ's) U.S. Trustee Program (USTP) oversees bankruptcy proceedings to make certain that entities filing for bankruptcy follow relevant regulations and laws throughout the process.<sup>18</sup>

This Comment argues that federal oversight is an essential mechanism to ensure the successful financial restructuring of states. Part I of this Comment explains the current U.S. Code provisions and the benefits of state bankruptcy, the constitutional hurdles that must be addressed to allow for it, and why the DOJ's USTP should oversee state bankruptcy. Part II examines how Puerto Rico, D.C., and Detroit have handled restructuring, and the assistance the USTP provides. Part III recommends and asserts that Congress should expand the USTP's statutory powers to allow states to utilize its expertise and federal data and permit the USTP to monitor for fraud and abuse during both the restructuring process and the oversight period.

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some states were classified as “negative watch” and in need of bailout, but would not qualify as eligible notes under the Facility). *But see* Corson, *supra* note 3 (showing that as of December 2020, all state bonds were rated BBB- or higher, making the bonds investment grade again).

13. Jordain Carney, *McConnell Sparks Bipartisan Backlash with State Bankruptcy Remarks*, HILL (April 23, 2020, 5:48 PM), <https://thehill.com/homenews/senate/494406-mcconnell-sparks-bipartisan-backlash-with-state-bankruptcy-remarks>.

14. *See* David E. Solan, *State Bankruptcy: Surviving a Tenth Amendment Challenge*, 42 GOLDEN GATE U. L. REV. 217, 233–34 (2012) (discussing the sovereign nature of the states, and whether they can file for bankruptcy or default on their debt).

15. Brendan Cole, *Has a State Ever Gone Bankrupt?*, NEWSWEEK (Apr. 25, 2020, 7:58 AM), <https://www.newsweek.com/bankruptcy-mitch-mcconnell-coronavirus-states-crisis-1500013>.

16. Jon Bouker, *The D.C. Revitalization Act: History, Provisions & Promises*, in BUILDING THE BEST CAPITAL CITY IN THE WORLD app. 1, at 81–83 (2008); Mary Williams Walsh, *Puerto Rico Declares a Form of Bankruptcy*, N.Y. TIMES (May 3, 2017), <https://www.nytimes.com/2017/05/03/business/dealbook/puerto-rico-debt.html> (discussing bankruptcy in Puerto Rico and Detroit).

17. *Infra* Part II.

18. *About the Program*, U.S. DEP'T OF JUST., <https://www.justice.gov/ust/about-program> (Dec. 6, 2019).

## I. THE CURRENT STATE OF THE U.S. CODE

Allowing states to restructure debt creates long-lasting financial health without the influence of state and local elections or creditors.<sup>19</sup> In the midst of COVID-19, bankruptcy allows states to alleviate financial strain without a government bailout.<sup>20</sup> Although the U.S. Code does not provide for state debt restructuring, there are strong constitutional foundations for it, demonstrated by the actions of all three branches of government.<sup>21</sup> The USTP is the best entity to oversee state bankruptcy because it would provide guidance through lessons learned and offer federal data to inform states on best practices for debt restructuring, while also monitoring for fraud and abuse.<sup>22</sup>

### A. Bankruptcy in the U.S. Code

Congress implements “uniform Laws on the subject of Bankruptcies” as derived from Article 1, Section 8 of the U.S. Constitution.<sup>23</sup> In 1978, Congress created the Bankruptcy Code (U.S. Code) to provide a set of rules, processes, and official forms for parties to use in bankruptcy courts throughout the country.<sup>24</sup> Filing for bankruptcy allows a municipality or commercial enterprise to either discard or reorganize and repay debt.<sup>25</sup> When corporations are bankrupt, they typically file under Chapter 7 or Chapter 11.<sup>26</sup> Chapter 7 bankruptcy liquidates an individual’s or a business’s assets to satisfy obligations to their creditors, and in the case of a business,

19. See David A. Skeel, Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677, 683–84 (2012) (stating that a major contributor to state debt is political actors who enact policy to get reelected without long-term planning).

20. David Frum, *Why Mitch McConnell Wants States to Go Bankrupt*, ATLANTIC (Apr. 25, 2020), <https://www.theatlantic.com/ideas/archive/2020/04/why-mitch-mcconnell-wants-states-go-bankrupt/610714/>.

21. See Skeel, *supra* note 19, at 684 (discussing several alternative justifications for debt restructuring within the constitutional separation of powers).

22. See *infra* Part III (summarizing the benefits of the U.S. Trustee Program’s (USTP’s) involvement).

23. U.S. CONST. art. I, § 8, cl. 4; *Process - Bankruptcy Basics*, U.S. CTS. [hereinafter *Process*], <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/process-bankruptcy-basics> (last visited Mar. 2, 2021).

24. *Process*, *supra* note 23.

25. See *Bankruptcy*, U.S. CTS., <https://www.uscourts.gov/services-forms/bankruptcy> (last visited Mar. 2, 2021) (explaining broadly the reasons an entity would file for bankruptcy).

26. See Steve Nitz, *The Different Chapters of Bankruptcy Explained*, NFCC: BLOG (Sept. 22, 2017), <https://www.nfcc.org/resources/blog/different-chapters-bankruptcy-explained/> (stating how Chapter 7 and Chapter 11 bankruptcy are used by corporations).

the entity no longer exists post-bankruptcy.<sup>27</sup> If a state were to file for bankruptcy, liquidation would not be a feasible option because the state's resources belong to the taxpayer.<sup>28</sup> Chapter 11 bankruptcy allows the debtor to remain in control of its operations but forces the entity to reorganize its debt to create long-term financial stability.<sup>29</sup>

Chapter 9 bankruptcy allows for the reorganization of municipalities,<sup>30</sup> similar to Chapter 11.<sup>31</sup> Here, entities reorganize by extending debt maturities, reducing the amount of principal or interest, or refinancing the debt by obtaining a new loan.<sup>32</sup> A bankruptcy judge or special taxpayer must approve a municipality's bankruptcy plan before it goes into effect. Once approved, the party cannot alter the plan in any way, ensuring that a federal court does not infringe on the state's sovereignty over internal affairs.<sup>33</sup> Typically, there is an oversight board that the state creates to oversee the municipality's restructuring process.<sup>34</sup> State oversight ensures that the restructuring process is proceeding as planned and allows the state to cut funding to the municipality, if needed, to enforce conditions of the bailout.<sup>35</sup> Detroit restructured under this chapter in 2013.<sup>36</sup>

27. *See id.* (explaining the parameters of Chapter 7).

28. *See Chapter 9 - Bankruptcy Basics*, U.S. CTS., <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-9-bankruptcy-basics> (last visited Mar. 2, 2021) (“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.”).

29. *See Nitz, supra* note 26 (“Chapter 11 . . . allow[s] a business to come out of bankruptcy as a healthy business.”).

30. Municipalities include counties, cities, towns, and public companies (e.g., state hospitals, municipal utilities, and school districts). *See Process, supra* note 23.

31. *Id.*

32. *Id.*

33. *Id.*

Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with – (1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property.

11 U.S.C. § 904.

34. Daniel Gill, *State Bankruptcies May Be Legal if System Structured Correctly*, BLOOMBERG L. (Apr. 23, 2020, 3:37 PM), <https://news.bloomberglaw.com/bankruptcy-law/state-bankruptcies-may-be-legal-if-system-structured-correctly>.

35. *See id.* (acknowledging that in state bankruptcy, the federal government could not make the same threats to state funding under the Tenth Amendment); *see also infra* Part II.B (using D.C. as a case study in federal financial oversight).

36. *Infra* Part II.C.

State bankruptcy benefits states in six primary ways.<sup>37</sup> First, creating a framework for states to restructure gives states bargaining power in pre-bankruptcy negotiations, especially collective bargaining agreements,<sup>38</sup> which would not be possible without the threat of bankruptcy.<sup>39</sup> Looming pressure from a potential bankruptcy suit may make it easier to restructure bond debt outside of bankruptcy altogether.<sup>40</sup> Second, bankruptcy alleviates the financial burden caused by political agency costs or conflicts of interest between politicians' incentives and their constituencies.<sup>41</sup> State bankruptcy would allow the restructuring committee to consider the long term effects of its decisionmaking without politicians risking their electability.<sup>42</sup>

Third, outlining the process of state bankruptcy would provide a clear and cohesive prioritization of the states' financial obligations.<sup>43</sup> Clear prioritization will help both bond and pension holders have a better idea of how safe their investments are and better inform their financial decisions.<sup>44</sup> Fourth, the process authorizes the state to restructure pension obligations that may be too generous and cancel contracts that cannot be adjusted normally.<sup>45</sup> Fifth, bankruptcy allows for more equitable treatment of creditors, ensuring that constituents would not take on all of the consequences of a state's insolvency.<sup>46</sup> Finally, most insolvent states are not looking at a short-term

37. See Skeel, *supra* note 19, at 689–706 (listing the benefits state bankruptcy can offer).

38. See *id.* at 689 (providing examples of unionized employee groups, like teachers and first responders).

39. *Id.* at 689–90.

40. *Id.*

41. See *id.* at 690–94 (discussing two recent examples of political agency costs, the first being politicians' temptation to finance expenditures by borrowing, which allows them to reap the benefits and leaves successors to pay off the cost, and the second being their dependence on state pension holders' votes in upcoming elections, both of which could be curbed through state bankruptcy).

42. See *id.* at 691–92 (explaining the potential political backlash of negotiating a state's pension program). But see *id.* at 683–84 (stating also that two plausible objections are “(1) that states already have adequate tools to address their financial distress, as evidenced by the measures that have been taken in [some states], and (2) that bankruptcy might create contagion in the bond markets, making it difficult for even fiscally responsible states to borrow money,” but that both are less compelling than they appear).

43. See *id.* at 694–701 (listing the ways the bankruptcy framework can clarify and benefit areas of state finances).

44. See *id.* (stating that public prioritization of debt provides data to government pension holders and bondholders to see their priority ranking and know how safe their money is).

45. *Id.* at 701.

46. See *id.* at 702–04 (explaining that fairness cannot always be achieved through bankruptcy, but it is more likely to achieve fairness than other measures).

liquidity problem and therefore, restructuring, as opposed to a bailout, would have more lasting effects.<sup>47</sup>

Notwithstanding these reasons, the U.S. Code does not include a provision for state bankruptcy.<sup>48</sup> State bankruptcy would give the states more power to negotiate the current structure of their debt, allowing the state to spend less money and save more to use in emergencies, like COVID-19.<sup>49</sup> Today, it is more likely that states consider bankruptcy to avoid further government bailouts, and Congress must amend the U.S. Code to reflect that.

### *B. Discussion of the Constitution as it Relates to State Bankruptcy*

The strong constitutional foundations for a state bankruptcy provision allow for Congress to add it to the U.S. Code.<sup>50</sup> For Congress to amend the U.S. Code in this way, two constitutional provisions must be examined—the Tenth Amendment and the Contracts Clause.

Under the Tenth Amendment, states have the authority to handle their internal affairs and choose whether to file for bankruptcy or default on their debts.<sup>51</sup> In 1938, in *United States v. Belkins*,<sup>52</sup> the Supreme Court considered whether it was constitutional for Congress to dictate the parameters for municipal bankruptcy under Chapter 9.<sup>53</sup> Ultimately, the Court held that this

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47. *Id.* at 704–06; *see also* Anna Gelpern, *Sovereign Debt: Now What?*, 41 YALE J. INT'L L. ONLINE, Fall 2016, at 45, 73–81 (discussing Greece's sovereign debt in the context of the European Union and the International Monetary Fund's interest in bailing out Greece to ensure there was not a domino effect of debt in Europe that followed).

48. This is primarily because of constitutional hurdles that need to be addressed. *Infra* Part I.B; *see also* Ted Barrett & Manu Raju, *McConnell Thinks Bankruptcy, Not More Federal Money, Might Be Best for State and Local Governments*, CNN (Apr. 23, 2020, 9:15 AM), <https://www.cnn.com/2020/04/22/politics/mitch-mcconnell-state-local-government-aid-bankruptcy/index.html> (highlighting Senator McConnell's recent support for state bankruptcy amidst COVID-19 bailouts).

49. *See* Skeel, *supra* note 19, at 689–706 (identifying the benefits of state bankruptcy).

50. *See* Solan, *supra* note 14, at 222 (stating that the constitutionality of state bankruptcy is beyond dispute; the question is how broadly Congress can draft it that calls for closer constitutional examination); *see also id.* at 223 (recalling that, during the drafting of the Constitution, the framers shot down a proposal to limit bankruptcy to merchants and traders, suggesting that the framers intended Congress's bankruptcy power to go beyond private enterprises).

51. U.S. CONST. amend. X; *see also* Solan, *supra* note 14, at 234 (clarifying that if creditors try and collect on their debts, the state cannot be forced into a bankruptcy hearing, unlike in private bankruptcy).

52. 304 U.S. 27 (1938).

53. *Id.* at 51; *see also* Andrew B. Dawson, *Beyond the Great Divide: Federalism Concerns in Municipal Insolvency*, 11 HARV. L. & POL'Y REV. 31, 43 (2017) (summarizing the history of conflict between federalism and municipal bankruptcy).

was a permissible exercise of congressional authority; however, the filing could only occur with the state's consent and that it is "the right of the state to oppose federal interference."<sup>54</sup>

Therefore, states' filing for bankruptcy should be voluntary, and the revision to the U.S. Code should reflect that.<sup>55</sup> As seen in Chapter 9 cases, federal courts have little to do with the restructuring process to preserve the states' sovereign power.<sup>56</sup> In response to federalism concerns, the USTP's proposed services in a state's restructuring would be optional and serve a more technical function—providing recommendations, without explicit instructions, and mechanisms to monitor for fraud and abuse.<sup>57</sup>

Under the Contracts Clause, "[n]o state shall . . . pass any . . . Law impairing the Obligation of Contracts . . ."<sup>58</sup> This clause makes it unconstitutional for states to interfere with private contracts.<sup>59</sup> However, bankruptcies typically allow for the cancellation or alteration of contracts.<sup>60</sup> In 1976, the Supreme Court in *U.S. Trust Co. of New York v. New Jersey*<sup>61</sup> evaluated this Clause in the context of a contractual agreement between the parties to provide subsidized transportation for New Jersey citizens.<sup>62</sup> The Court determined that a state cannot refuse to meet legitimate financial obligations out of preference but can break a contract to protect "the general welfare of the people" and "respect the 'wide discretion on the part of the

54. See *Belkins*, 304 U.S. at 53–54 ("[T]he State acts in aid, and not in derogation, of its sovereign powers."); see also *In re City of Detroit*, 504 B.R. 191, 244 (Bankr. E.D. Mich. 2013) ("*Belkins* makes it clear [] that with state consent, the adjustment of municipal debts does not impermissibly intrude on state sovereignty.").

55. See Solan, *supra* note 14, at 235–36 (recalling that the Supreme Court since the 1990s has "revived the Tenth Amendment as a limit on congressional power" and that recent cases have made it clear that it is meant to restrain the federal government's power).

56. See *Chapter 9 - Bankruptcy Basics*, *supra* note 28 (explaining that in Chapter 9 bankruptcy, the judge's role is limited to approving or denying the restructuring plan).

57. See Solan, *supra* note 14, at 237 (arguing that since Congress cannot dictate a state's regulatory or legislative activity, the Court would "permit bankruptcy legislation so long as it is entirely voluntary and the states retain authority to manage their own legislative affairs"); *infra* Part III (expanding on the role the USTP would play in the process).

58. U.S. CONST. art. I, § 10.

59. See Skeel, *supra* note 19, at 707 (stating that ordinarily states cannot alter existing contracts).

60. See Gill, *supra* note 34 (noting that the Supreme Court accepted the alteration of contracts in municipal bankruptcies during the Great Depression, and that the Contracts Clause "only prohibits states from altering contract rights" but an amendment in the U.S. Code allowing for bankruptcy would be federal and not in violation of the clause).

61. 431 U.S. 1 (1977).

62. *Id.* at 3.

legislature in determining what is and what is not necessary.”<sup>63</sup> The Supreme Court held that “the Contract Clause does not prohibit the States from repealing or amending statutes generally, or from enacting legislation with retroactive effects.”<sup>64</sup> There can also be a “substantial impairment” for the state to get out of a contractual obligation.<sup>65</sup> The impairment must be “reasonable and necessary to fulfill an important public purpose.”<sup>66</sup>

There is leeway for states to cancel or break their contracts where restructuring debt would likely fulfill “an important public purpose” or contribute to the welfare of its citizens.<sup>67</sup> State bankruptcy contributes to the welfare of its citizens by restructuring programs to allow future lawmakers to provide more and better public goods and services, ensuring payment of state government workers’ pensions, and making the state’s bond a better investment to further bolster the state’s economy.<sup>68</sup> In the midst of a public health crisis, such as COVID-19, it is paramount that citizens have proper access to healthcare, neighborhood sanitation, and government pension money.<sup>69</sup> Therefore, if a state breaks a contract for the purpose of bankruptcy

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63. *Id.* at 16 (quoting *E.N.Y. Sav. Bank v. Hahn*, 326 U.S. 230, 232–33 (1945)); HEATHER POOLE, OFF. OF LEGIS. RSCH., STATE BANKRUPTCY, 2020-R-0074, at 2 (2020), <https://www.cga.ct.gov/2020/rpt/pdf/2020-R-0074.pdf>; *see also* *In re City of Detroit*, 504 B.R. 191, 236 (Bankr. E.D. Mich. 2013) (quoting *United States v. Bekins*, 304 U.S. 27, 51 (1938)) (“[T]he Constitution forbids the passing of State laws impairing the obligations of existing contracts. Therefore, relief must come from Congress, if at all.”).

64. *U.S. Trust Co. of New York*, 431 U.S. at 17.

65. *See* Steven L. Schwarcz, *A Minimalist Approach to State “Bankruptcy”*, 59 U.C.L.A. L. REV. 322, 336 (2011) (citing *Energies Rsr. v. Kan. Power & Light Co.*, 495 U.S. 400, 411–12 (1983)) (stating the Court’s longstanding threshold).

66. *Id.*

67. *See U.S. Trust Co. of New York*, 431 U.S. at 25–26 (holding that states are able to pass amendments or laws that break its contracts so long as it serves an important public purpose or contributes to the welfare of its citizens).

68. *See* Kate Waldo & Luigi Zingales, *Capitalism’t: Coronavirus—the State Bankruptcy Debate*, CHI. BOOTH REV. (May 1, 2020), <https://review.chicagobooth.edu/economics/2020/article/capitalism-t-coronavirus-state-bankruptcy-debate> (stating that state insolvency leads to layoffs of government employees, smaller pension funds, and cutbacks on public services).

69. *See* Jamie S. King, *Covid-19 and the Need for Health Care Reform*, NEW ENG. J. MED., June 25, 2020, at e104(1), <https://www.nejm.org/doi/pdf/10.1056/NEJMp2000821?articleTools=true> (describing the challenges associated with access to health care during COVID-19); Suhail Baht, *Complaints of Missed Trash Pickup Surge as Garbage Piles up at Home*, CITY (Sept. 27, 2020, 8:08 PM), <https://www.thecity.nyc/2020/9/27/21458755/nyc-missed-trash-pickups-garbage-piles-sanitation> (noting the increased volume of trash pickup during the pandemic); Michael R. Glass & Sean H. Vanetta, *The Next Covid-19 Victim? Public Pension Funds*, WASH. POST (Apr. 17, 2020, 6:00 AM), <https://www.washingtonpost.com/outlook/2020/04/17/next-covid-19-victim->

and that contract creates a “substantial impairment” to that goal, then the state should further examine that contract for amending.<sup>70</sup> Congress must amend the U.S. Code because of its strong constitutional foundations and ability to create lasting financial stability to the state.

### C. Introduction of the United States Trustee Program's Role

Once Congress revises the U.S. Code to include a form of state bankruptcy, the question remains as to how the restructuring process will take place and under whose authority. The governor and other state officials will evaluate their financial statements, begin the restructuring process to avoid problems like the ones seen in Puerto Rico and D.C., and preserve their sovereignty over internal affairs.<sup>71</sup> However, federal involvement throughout the process would be a helpful mechanism to ensure the restructuring plan's authors follow relevant laws and, once implemented, state officials carry out the plan in the agreed upon way.<sup>72</sup> The USTP is a natural fit to fulfill the oversight role because of the program's supervision of commercial enterprise reorganization and specialized data and expertise, which would ensure that the state has access to a full range of information.<sup>73</sup>

The USTP's current role in bankruptcy is to provide decentralized and semiautonomous administration of the bankruptcy laws and handle all of the bankruptcy judges' former administrative duties.<sup>74</sup> Its mission is to “promote the integrity and efficiency of the bankruptcy system for the benefit of all stakeholders.”<sup>75</sup> The program has twenty-one regions with ninety-one field

public-pension-funds/ (noting how the financial meltdown due to COVID-19 has “exposed the fragility of public pension systems”).

70. See Schwarcz, *supra* note 65 (confirming that a “substantial impairment” could break a contractual obligation).

71. See Solan, *supra* note 14, at 236–37 (clarifying that Congress cannot dictate a state's regulatory or legislative activity under the Tenth Amendment); see also *infra* Part IIA (discussing the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA)).

72. See Kris Maher, *Detroit Released from State Oversight*, WALL ST. J. (Apr. 30, 2018, 5:22 PM), <https://www.wsj.com/articles/detroit-released-from-state-oversight-1525123337> (showing that Detroit's oversight board was effective in carrying out the approved restructuring plan); *About the Program*, *supra* note 18 (defining the USTP's current role in Chapters 7, 11, and 13); see also Solan, *supra* note 14, at 237 (asserting that the Court would permit bankruptcy legislation “so long as it is entirely voluntary and the states retain authority to manage their own legislative affairs”).

73. See *About the Program*, *supra* note 18 (outlining the USTP's structure and authority).

74. *Id.*; see also Sarah Rudolph Cole, *Obligations of the United States Trustee's Office Under the Administrative Procedure Act*, 5 J. BANKR. L. & PRAC. 371, 372 (1996) (highlighting the administrative duties of the USTP). See generally 28 U.S.C. § 586 (USPT's governing statute); 11 U.S.C. § 101 (same).

75. *About the Program*, *supra* note 18.

office locations nationwide, with its executive office located in Washington, D.C.<sup>76</sup> Currently, the USTP appoints and supervises private trustees who administer Chapters 7, 12 and 13 bankruptcies or act as a trustee in those cases where no private individual can be found.<sup>77</sup> The USTP also prevents fraud and abuse through the enforcement of the U.S. Code and, when appropriate, refers matters for criminal prosecution.<sup>78</sup> The USTP ensures that bankruptcy estates are correctly administered, appoints and convenes creditors' committees in Chapter 11 reorganization, reviews disclosure statements, and makes certain that cases follow the U.S. Code's procedural guidelines.<sup>79</sup> In these cases, the USTP does not mediate disputes between two parties, but investigates and brings forth actions when a creditor, debtor, or attorney abuses the system.<sup>80</sup>

Serving as a "watchdog" for fraudulent claims and activity is another major role of the USTP.<sup>81</sup> The U.S. Code's United States Trustees Chapter requires the USTP to notify the U.S. Attorney's Office of potential criminal offenses and assist in trial.<sup>82</sup> The number of criminal referrals made by the USTP each year evidences this function's importance.<sup>83</sup> In 2018, it made 2,257 bankruptcy and bankruptcy-related criminal referrals.<sup>84</sup> The most common referrals that the USTP makes are for tax fraud, false oath or statement, concealment of assets, bankruptcy fraud scheme, and identity theft or use of false or multiple security numbers.<sup>85</sup>

Under the relevant provisions, the USTP is currently not responsible for overseeing Chapter 9 bankruptcy.<sup>86</sup> The USTP's oversight role should expand into state bankruptcy. The many USTP field offices<sup>87</sup> provide a structure to gather data on relevant regions and begin to understand the root of its financial

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76. *Id.*

77. *Id.*; see also Nitz, *supra* note 26 (defining Chapter 12 as bankruptcy designed for "family farmers" and "family fisherman" that allows debtors to payback creditors over a three- to five-year-period, and defining Chapter 13 as bankruptcy for an individual that allows her to pay back all or part of her debt).

78. *About the Program*, *supra* note 18.

79. *Id.*

80. *Id.*

81. *Id.*

82. See Daniel J. Morse, *Recent Developments in the Law Regarding Bankruptcy Crimes*, in NORTON ANN. SURV. BANKR. L. pt.3, § 1 (2019 ed.), Westlaw 2019 NRTN-ASBL 33 (discussing fraudulent activity in cases that the USTP currently has oversight powers in); see also 28 U.S.C. § 586(a)(3)(F) (establishing the USTP's prosecutorial process).

83. Morse, *supra* note 82.

84. See *id.* § 2 (providing the most current annual statistics).

85. *Id.*

86. For the USTP's governing statutes, see 28 U.S.C. § 586; 11 U.S.C. § 101.

87. See *About the Program*, *supra* note 18 (noting that there are twenty-one regions nationwide).

issues.<sup>88</sup> Expanding the USTP's oversight would allow it to challenge a state's reorganization plan in an informed way and better understand whether the state's proposed restructuring committees are engaging in fraudulent activity.<sup>89</sup>

State bankruptcy needs an entity to ensure no fraud or abuse takes place and provide access to specialized regional data not otherwise available.<sup>90</sup> The current role of the USTP is vital, but it is even more essential in state bankruptcy when taxpayers' money and state employees' pension funds are on the line.<sup>91</sup> Thus, it is critical for states to allow the USTP to have oversight during its restructuring process.

## II. CASE STUDIES IN GOVERNMENT OVERSIGHT OF THE RESTRUCTURING OF TERRITORIAL, DISTRICT, AND MUNICIPAL DEBT

By examining the modern-day restructuring of American territories, districts, and municipalities, it becomes easier to understand how a state's restructuring would function. States considering filing for bankruptcy should identify mistakes in their oversight and restructuring process and learn from them. Examples of modern day restructuring of this kind include Puerto Rico's restructuring as a result of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) in 2017; D.C.'s restructuring by Congress beginning in 1995; and Detroit's Chapter 9 restructuring in 2013—the largest Chapter 9 restructuring to date.<sup>92</sup>

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88. See U.S. TR. PROGRAM, U.S. DEP'T OF JUST., 1 UNITED STATES TRUSTEE PROGRAM POL'Y & PRACS. MANUAL 1, 12–13 (2015) [hereinafter USTP POL'Y & PRACS. MANUAL], [https://www.justice.gov/ust/file/volume\\_1\\_overview.pdf/download](https://www.justice.gov/ust/file/volume_1_overview.pdf/download) (providing that each field office supervises the administration of cases and trustees; acts as a liaison to the legal community, the public, the U.S. Department of Justice (DOJ), and other federal agencies; and is staffed by a Bankruptcy Analyst, who “determine[s] the financial viability of the business,” and a Legal Data Technician, who works with data for complex case management and reporting, among other valuable positions).

89. See *id.* (listing the various roles of the DOJ field offices related to bankruptcy data collection, which would assist in determining whether restructuring committees are engaged in fraudulent activity).

90. See *id.* (reporting the functions the field offices serve and the roles that contribute data that would be beneficial to a state during restructuring); Morse, *supra* note 82 (analyzing the high quantity of fraud and abuse crimes that occur annually under the USTP's current authority).

91. See generally *What Are Municipal Bonds and How Are They Used?*, *supra* note 11 (explaining that the Pension Benefit Guaranty Corporation, a federal entity, covers a portion of the risk of nonpayment of employee benefits).

92. See Walsh, *supra* note 16 (noting that Puerto Rico's \$123 million debt far exceeded Detroit's \$18 million debt in 2013).

A. *Puerto Rico as a Case Study in Territorial Bankruptcy*

Under PROMESA in 2017, Puerto Rico became the first territory to file for bankruptcy.<sup>93</sup> Congress enacted PROMESA in 2016 as a response to Puerto Rico's financial insolvency and inability to file for bankruptcy under Chapter 9 provisions because the Commonwealth is not a municipality.<sup>94</sup> The Bill created a structure similar to Chapter 9 bankruptcy provisions in recognition that Puerto Rico is not part of a state and should be treated as a sovereign.<sup>95</sup>

PROMESA was widely criticized, mostly because of the financial oversight board created by the statute.<sup>96</sup> The board has wide-ranging powers to "approv[e] budgets and fiscal plans, . . . veto debt issuances[,] and determine which projects [got] funded and which [did not]."<sup>97</sup> The members of this board are not chosen by residents; rather, the President appoints and removes members for three-year terms, which impedes the territory's leaders and constituents from having control during the restructuring process.<sup>98</sup> The board consists of seven voting members;<sup>99</sup> only one member is required to either reside or conduct business in Puerto Rico to be eligible.<sup>100</sup> The governor serves as an ex-officio member of the board, but is limited in influence.<sup>101</sup> The board must submit an annual report to the President, Congress, and Puerto Rico's governor and legislators, which outlines progress made, assistance provided by the board, recommended changes to the governing laws, and the ways its funds have been spent, as well as quarterly reports on Puerto Rico's cash flow.<sup>102</sup>

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93. *Id.*

94. *Id.*; see also *Chapter 9 - Bankruptcy Basics*, *supra* note 28 (explaining the guidelines for Chapter 9 bankruptcy and that only a municipality may file for relief under Chapter 9).

95. See Walsh, *supra* note 16 (noting that many bankruptcy lawyers and public finance experts watched this case closely to see if it could eventually be applied to insolvent states). Compare PROMESA, 48 U.S.C. § 2146 (showing the provisions of Congress's Act to restructure Puerto Rico's debt), with *Chapter 9 - Bankruptcy Basics*, *supra* note 28 (defining Chapter 9 bankruptcy for municipalities).

96. Gillian B. White, *Puerto Rico's Problems Go Way Beyond Its Debt*, ATLANTIC (July 1, 2016), <https://www.theatlantic.com/business/archive/2016/07/puerto-rico-promesa-debt/489797/>.

97. *Id.* For the explicit powers granted under the Act, see PROMESA §§ 2101–2241.

98. *Id.* § 2121(e).

99. *Id.* § 2121(e)(1)(A).

100. *Id.* § 2121(e)(2)(D).

101. *Id.* § 2121(e)(3).

102. See *id.* § 2148 (outlining the mandatory reporting requirements).

Today, Puerto Rico's financial problems persist.<sup>103</sup> There have been pension cuts, elimination of workers' protections, public school closures, and staff reductions at police stations in violent areas.<sup>104</sup> One of the harsher critiques of PROMESA has been the board's inability to understand Puerto Rico's financial needs, comparing the current system to colonialism.<sup>105</sup> Many Puerto Rican constituents feel misrepresented by the leaders who chair the board.<sup>106</sup> Because of this, many of the board's solutions could not fix the territory's financial problems and create financial longevity.<sup>107</sup> The USTP understands the intricacies and uniqueness of the states that file because of the data that it collects in its field offices and its general expertise on the subject.<sup>108</sup> Due to the local nature of its field offices, the USTP is familiar with the problems that states face and utilizes the data available to them through the DOJ and other federal agencies.<sup>109</sup>

States considering bankruptcy can learn from the board's shortcomings by recognizing the importance of creating an oversight entity consisting of leaders from the region who are familiar with its financial intricacies and have access to real data about the region and national economic trends.<sup>110</sup> Utilizing knowledge of state leaders allows local needs to be represented, and bolstering these leaders with federal data and support provides them with a broad outlook

103. See Jill Dolan, *After the Storm: Hurricanes Irma and Maria and Puerto Rico's Debt Restructuring*, 43 DEL. J. CORP. L. 347, 365–66 (2019) (commenting that the oversight board may have been tasked with the impossible, and citing criticism from bondholders and members of Congress).

104. Luis Vega-Ramos, *Time to Undo the United States' Failed Promesa to Puerto Rico*, HILL (May 3, 2019, 9:15 AM), <https://thehill.com/blogs/congress-blog/politics/441945-time-to-undo-the-united-states-failed-promesa-to-puerto-rico>.

105. See *id.* (highlighting the importance of involvement from local leaders to avoid policy that worsens the territory's financial state).

106. See Dolan, *supra* note 103, at 365 (observing public criticism and logistical errors in the restructuring process); Vega-Ramos, *supra* note 104 (criticizing Puerto Rico's Fiscal Oversight Board); Walsh, *supra* note 16 (defining PROMESA broadly).

107. See Vega-Ramos, *supra* note 104 (discussing the Board's continual failure to fulfill its obligations under PROMESA and its subsequent financial toll on Puerto Ricans).

108. See USTP POL'Y & PRACS. MANUAL, *supra* note 88, at 12–13; *U.S. Trustee Regions and Offices*, U.S. DEP'T OF JUSTICE, <https://www.justice.gov/ust/us-trustee-regions-and-offices> (Feb. 3, 2021) (listing the location of every field office, which exists in every state and territory, except Alabama and North Carolina).

109. See USTP POL'Y & PRACS. MANUAL, *supra* note 88, at 12 (explaining the role of field officers serving as liaisons to the local legal community, the general public, the DOJ, and other government agencies).

110. See Dolan, *supra* note 103 (observing public criticism and logistical errors in the restructuring process); Vega-Ramos, *supra* note 104 (criticizing the "political control" over Puerto Rico and outlining lessons learned); Walsh, *supra* note 16 (examining PROMESA broadly).

on the national backdrop.”<sup>111</sup> One aspect of PROMESA that should be carried into state bankruptcy is the mandatory reporting function, which would allow Congress to track the progress of the restructuring process to prepare for potential federal legislative or financial assistance.<sup>112</sup>

Puerto Rico’s restructuring process demonstrates the thin line between federalism concerns and the necessity of oversight. Last year, the Supreme Court ruled on five consolidated cases questioning the legality of PROMESA, the way it appoints its board members, and the federal government’s ability to weigh in on Puerto Rico’s affairs.<sup>113</sup> The Court ruled that it was constitutional for the board members to be appointed by the President without Senate approval because the appointments clause in the Constitution “does not restrict the appointment of local officers that Congress vests with primarily local duties.”<sup>114</sup> Regarding the second issue, the Court ruled that the committee could make decisions for Puerto Rico’s restructuring process because the authority was accepted by Puerto Rican law.<sup>115</sup> Although the federal government created the board, the issues discussed are local; therefore, the board’s decisionmaking power is constitutional.<sup>116</sup>

In Justice Sotomayor’s concurring opinion, she wrote that similar to a state, Puerto Rico is an “autonomous political entity” and that the board exists “in a twilight zone of accountability, neither selected by Puerto Rico itself nor subject to the strictures of the Appointments Clause.”<sup>117</sup> To determine whether a presidential appointment requires Senate approval, the Court established a test that evaluates whether the appointment duties are of a local nature.<sup>118</sup> If the appointment duties are of a local nature, then

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111. See USTP POL’Y & PRACS. MANUAL, *supra* note 88, at 12–13 (reporting the resources within every field office, which would be helpful to states during restructuring).

112. See PROMESA, 48 U.S.C. § 2148 (explaining the mandatory reporting requirements); Bouker, *supra* note 16, at 81–82 (establishing that congressional involvement in D.C.’s restructuring was imperfect but ultimately led to a federal bailout, solving D.C.’s problem).

113. See Amy Howe, *Opinion Analysis: After a Long Wait, a Unanimous Court Upholds Puerto Rico Oversight Board*, SCOTUSBLOG (June 1, 2020, 12:36 PM), <https://www.scotusblog.com/2020/06/opinion-analysis-after-a-long-wait-a-unanimous-court-upholds-puerto-rico-oversight-board/> (elaborating on the consolidation of the following cases: *Fin. Oversight & Mgmt. Bd. for Puerto Rico v. Aurelius Inv., LLC*; *Aurelius Inv., LLC v. Puerto Rico*; *Off. Comm. of Debtors v. Aurelius Inv., LLC*; *U.S. v. Aurelius Inv., LLC*; *UTIER v. Fin. Oversight & Mgmt. Bd. for Puerto Rico*).

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

Congress is not required to approve it.<sup>119</sup> This ruling is positive for advocates of state bankruptcy because the Court treated Puerto Rico like a state and upheld the constitutionality of the restructuring process and the federal government's role in the oversight and restructuring process.<sup>120</sup>

*B. The District of Columbia as a Case Study in Federal Financial Oversight*

In 1995, similar to Puerto Rico, D.C. reached a point of financial insolvency that it could not remedy alone.<sup>121</sup> Its deficit reached \$722 million and its municipal bonds were at “junk” level ratings.<sup>122</sup> As a result of this deficit, the District could not pay its vendors nor provide basic city services to its residents, causing many to relocate to Maryland and Virginia.<sup>123</sup> In response, Congress passed the District of Columbia Financial Responsibility and Management Assistance Act of 1995, which created the District of Columbia Financial Control Board.<sup>124</sup>

Congress created the Control Board to balance D.C.'s budget, and required it to ensure efficient and effective deliverance of services to residents, timely payment of debts, increased access to capital markets, long-term economic vitality and operational efficiency, and a repaired relationship between D.C. and the federal government.<sup>125</sup> Congress gave the Control Board broad, sweeping powers “traditionally reserved for the city government.”<sup>126</sup> The Board had four years to create a balanced budget for D.C., which would then need to stay balanced for another four years before the Control Board would

119. *See id.* (stating that the Constitution “does not restrict the appointment of local officers that Congress vests with primarily local duties”).

120. *Id.*

121. Bouker, *supra* note 16, at 82.

122. *Id.* at 81.

123. *See id.* (exposing that the migration of D.C. residents, amounting to 22,000 households in five years, only contributed to D.C.'s financial misfortune, as it took away a chunk of its tax revenue); *see also* Yesim Sayin Taylor, *Twenty Years After the Revitalization Act, the District of Columbia Is a Different City*, D.C. POL'Y CTR. (Dec. 19, 2017), <https://www.dcpolicycenter.org/publications/twenty-years-revitalization-act-district-columbia-different-city/> (finding that this migration accounted for 12% of the District's population).

124. *History of OCFO*, DC.GOV, <https://cfo.dc.gov/page/history-ocfo> (last visited Mar. 2, 2021).

125. Bouker, *supra* note 16, at 82. For all of the regulations governing the Control Board, *see* District of Columbia Financial Responsibility and Management Assistance Act of 1995, H.R. 1345, 104th Cong. (1995).

126. Bouker, *supra* note 16, at 82 (approving the annual budget, writing D.C.'s financial plan, spending or borrowing under D.C.'s authority, approving and removing the Mayor's appointments to key positions, reviewing all active and future contracts, and, on specific occasions, vetoing laws passed by D.C.'s council).

disassemble.<sup>127</sup> Once created, the Board took over all contracting authority to overhaul the District's approval procedures, repaired all emergency vehicles, privatized city functions to cut costs, and rejected Council-approved expenditures that they believed would contribute to a deficit.<sup>128</sup> Although the Council and the District's mayor took steps to demonstrate fiscal responsibility, the Board became more aggressive over time—even going so far as to revoke most of the school board's powers and appoint its own superintendent to oversee the system.<sup>129</sup> When the Board's first twenty months were over, even with the budget cuts, members admitted that they had managed little progress.<sup>130</sup>

If the Control Board had collaborated with D.C. representatives to determine the restructuring plan, it might have realized that slashing government programs would not fix its insolvency problem without creating new revenue streams.<sup>131</sup> Since D.C. is not a state, the sweeping power of the Control Board is constitutional.<sup>132</sup> However, if D.C. was treated as a state and the Board worked in conjunction with the Mayor's office, primarily offering its expertise and recommendations while ensuring that no one was abusing the system, the District may have become solvent sooner by attacking macro problems in its financial structure.<sup>133</sup> This could also have been accomplished by separating the Board's actions into two phases—the restructuring phase and the oversight phase.<sup>134</sup> The restructuring phase would have forced the Board to see the structural issues with D.C.'s balance sheet and think holistically about how to continue to fund essential government programs while ending contracts that are contributing to insolvency.<sup>135</sup>

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127. *See id.* (conceding that the sweeping powers were granted because of this timeline and goal).

128. *Id.* at 83.

129. *Id.*

130. *See id.* (resulting in Congress's and stakeholders' discussion of alternative remedies).

131. *See id.* at 82–83 (discussing the immediate actions taken by the Board with little planning, and the Board's ultimate success coming from a federal bailout); Dawson, *supra* note 53, at 33 (emphasizing the importance of acknowledging “root causes” of the insolvency and the interdependence of financial [debt] and operational [services] restructuring); *infra* Part III.E (demonstrating the value of a restructuring committee).

132. *See* Bouker, *supra* note 16, at 82 (highlighting the power granted to the Board by Congress).

133. *See* Solan, *supra* note 14, at 235–36 (illustrating that federal involvement in state bankruptcy should be optional and recommendation-based to be considered as constitutional); *see also* Dawson, *supra* note 53, at 32–33 (criticizing Chapter 9 because it only governs the municipality's financial cuts while ignoring the services those cuts take away and that restructuring should evaluate the “root causes” of insolvency).

134. *See infra* Parts III.E, III.F (defining the role of each phase).

135. *See* Bouker, *supra* note 16, at 83–85 (explaining the financial structure of D.C.).

The structural issues of D.C.'s finances stem from the foundational lack of revenue from taxpayers and lack of federal payouts given to states.<sup>136</sup> The Board asserted that every U.S. city is supported by its state and a network of other cities and counties, which allows the city to lessen its burdens by sharing powers and responsibilities with other entities.<sup>137</sup> D.C. does not have this network of support.<sup>138</sup> One stark depiction of this is the way that D.C. funds Medicaid.<sup>139</sup> All states fund the cost of Medicaid to its cities, with the exception of New York City, which contributes to 25% of the Medicaid expense of its citizens.<sup>140</sup> D.C. is made to contribute 50% of its Medicaid expense.<sup>141</sup>

In 1997, Congress passed the Revitalization Act in response to the Control Board's inability to correct D.C.'s financial troubles.<sup>142</sup> Under this Act, the District forfeited its annual federal funding, and the federal government agreed to fix the Medicaid funding problem and assume all of D.C.'s debts, underfunded employee pensions, and courts and prison management.<sup>143</sup> Then in 2005, Congress passed the Omnibus Authorization Act, which further strengthened the power of D.C.'s Office of the Chief Financial Officer (OCFO) by appropriating more funds, responsibilities, and personnel to the office.<sup>144</sup> The OCFO acts as an oversight body independent from the Mayor's office, and is responsible for regular audits of the District and certification that

136. *See id.* (highlighting that D.C. had less revenue than states but the same expenditures).

137. *See id.* (quoting former President Clinton, who referred to this as “‘not quite’ syndrome,” as D.C. is “‘not quite a State, not quite a city, not quite independent, not quite dependent’”).

138. *Id.* at 85.

139. *Id.*

140. *Id.*

141. *See id.* (finding that the taxpayer to Medicaid recipient ratio in D.C. is 2:1, compared to Maryland's and Virginia's 4:1 ratio).

142. *See id.* at 95, 109 (outlining the Revitalization Act, which assumed the District's \$5 billion unfunded pension liability and resulted in the dissolution of the Control Board); Taylor, *supra* note 123 (summarizing the reasoning behind the Revitalization Act). For the full text of the Act, see National Capital Revitalization and Self-Government Improvement Act of 1997, H.R. 1963, 105th Congress (1997).

143. *See* Taylor, *supra* note 124 (highlighting the provisions in the Revitalization Act that contributed to D.C.'s solvency, and stating that D.C. is responsible for pension obligations after 1997).

144. *See* Bouker, *supra* note 16, at 95, 108–09 (reviewing the Revitalization Act, which allowed the Office of the Chief Financial Officer (OCFO) to enter into private contracts for the collection of taxes, provided access to the U.S. Department of the Treasury to liquidate its deficit, and eliminated some of the District's mandatory payments, resulting in a stable and solvent financial status for D.C. and subsequently reasserted the OCFO power and independence after the Control Board dissolved); *History of OCFO*, *supra* note 124 (stating the name and summary of the Revitalization Act).

its revenue is used to the benefit of D.C.'s "long-term financial, fiscal, or economic health."<sup>145</sup>

Twenty years later, when evaluating the financial state of the District, it is apparent that the Revitalization Act accomplished its purpose.<sup>146</sup> Employment went up 25% between 1997 and 2017, and since the Great Recession, D.C.'s economic growth has been stronger than the nation and the metro area.<sup>147</sup> The upward trend began after the federal government assumed the District's debt, which gave its balance sheet a fresh start.<sup>148</sup> State bankruptcy would allow states a similar opportunity by determining weak points in its balance sheets and solutions that lead to long-term growth.<sup>149</sup> The USTP would help the state's restructuring committee identify weak points in the balance sheet and national trends that may be contributing to the state's problems while working with the state's leaders and acting as technical support.<sup>150</sup> The USTP's reporting function would put Congress on notice to the financial problems of the state, which is especially important if a bailout proves to be inevitable.<sup>151</sup>

### C. *Detroit as a Case Study in Municipal Bankruptcy*

Unlike Puerto Rico and D.C., Detroit could file for bankruptcy under Chapter 9 because it is a municipality.<sup>152</sup> Detroit's filing is the largest Chapter 9 bankruptcy to date, with liabilities totaling over \$18 billion.<sup>153</sup> Detroit filed under guidance from a state-appointed emergency manager, which called for \$1.7 billion to improve services over the next decade and cut \$7 billion in

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145. 2005 District of Columbia Omnibus Authorization Act, H.R. 3508, 109th Cong. §§ 101, 306 (2006).

146. See Taylor, *supra* note 123 (showing the economic growth of the District through statistics and financial statements).

147. See *id.* (establishing that the District has seen growth in jobs, population, and incomes, with much of the growth coming from private sector employers moving into the District due to its booming economy).

148. See generally *id.* (summarizing D.C.'s economic growth between 1997 and 2017).

149. See Dawson, *supra* note 53, at 33 (emphasizing the importance of identifying "root causes" of insolvency, not just debt); Skeel, *supra* note 19, at 701 (recognizing the benefits of a state's restructuring).

150. *Infra* Part III.

151. See PROMESA, 48 U.S.C. § 2148 (stating the mandatory reporting requirements); Bouker, *supra* note 16, at 95 (linking congressional involvement in D.C.'s restructuring to a successful federal bailout).

152. See *Chapter 9 - Bankruptcy Basics*, *supra* note 28 (explaining that only a municipality may file for relief under Chapter 9, and the definition of municipality as a "political subdivision or public agency or instrumentality of a State").

153. Maher, *supra* note 72.

liabilities.<sup>154</sup> The plan enabled the city to balance its budget with surpluses over the next three years.<sup>155</sup> The plan formed the Detroit Financial Review Commission (FRC) to ensure that the local government complied with the recommended practices, to approve budgets, and to approve contracts greater than \$750,000.<sup>156</sup> In 2018, Detroit's balance sheet was positive, and the FRC was released from its oversight position.<sup>157</sup>

The FRC consisted of five members, appointed by the governor, and six ex-officio members.<sup>158</sup> The ex-officio members were the State Treasurer, who served as the chairperson, the State Budget Director, the Mayor and City Council President of the City of Detroit, and the Superintendent and School Board Chairperson of the Detroit Public Schools Community District.<sup>159</sup> The members all served without pay in four-year terms.<sup>160</sup> The state of Michigan released the FRC of its oversight position after the conclusion of the current term, which indicates the FRC's success.<sup>161</sup>

Notwithstanding the FRC's successes, it also had its shortcomings. In 2019, a routine audit revealed that Detroit's public school district mismanaged the school's finances.<sup>162</sup> The FRC, with the Detroit School Board, was responsible for approving and overseeing the financial practices of the school.<sup>163</sup> The audit identified the school district's accounting error because of the systems in place under FRC, but also believed that the problem resulted from the school district's underfunded accounting department.<sup>164</sup> This demonstrates the importance of routine audits, as well as how oversight boards can fall short. The USTP would not only identify problems like this through regular auditing; it would also have the experience

154. *See id.* (explaining that the plan required and received approval from state legislators).

155. *Id.*

156. *Id.*

157. *See id.* (distinguishing that the oversight committee will exist through its remaining term as an inactive organization, as long as the city remains stable).

158. *About the Detroit Financial Review Commission (FRC)*, MICH. DEP'T OF TREASURY, [https://www.michigan.gov/treasury/0,4679,7-121-1751\\_51556\\_77310--,00.html](https://www.michigan.gov/treasury/0,4679,7-121-1751_51556_77310--,00.html) (last visited Mar. 2, 2021); MICH. DEP'T OF TREASURY, DETROIT FIN. REV. COMM'N BYLAWS 1 (2016), [https://www.michigan.gov/documents/treasury/Detroit\\_FRC\\_Bylaws\\_480596\\_7.pdf](https://www.michigan.gov/documents/treasury/Detroit_FRC_Bylaws_480596_7.pdf).

159. *About the Detroit Financial Review Commission (FRC)*, *supra* note 158.

160. MICH. COMP. LAWS § 141.1635 (2014).

161. Maher, *supra* note 72.

162. Tom Gantert, *State Oversight Fails as Auditors Scorch Detroit Schools' Accounting*, MICH. CAPITOL CONFIDENTIAL (May 9, 2019), <https://www.michigancapitolconfidential.com/state-oversight-fails-as-auditors-scorch-detroit-schools-accounting>.

163. *Id.*

164. *Id.*

and expertise to know which functions serve a critical purpose in the prevention of fraud and abuse.<sup>165</sup>

When a state files for bankruptcy, the USTP would fill the same role as the governor and his staff in Detroit, and the state would benefit from the resources and oversight of the federal government.<sup>166</sup> While this is not a perfect analogy, given the co-sovereign relationship between states and the federal government, the expertise and information provided by the USTP would serve as a great resource to states during this process. On top of the support provided to states by the USTP, the USTP would also alert Congress to the needs of the state to better evaluate if it needs to pass legislation or bailout the state.<sup>167</sup> This function would manage tensions between the coequal sovereigns.<sup>168</sup>

Detroit's FRC demonstrates the need for oversight throughout the entire restructuring process. The issues that arose in 2019 with the school district would not have been brought to light without a routine audit.<sup>169</sup> Creating a mechanism to ensure that the state is following all federal laws and guidelines secures the long-term financial health of the state and draws attention to any practices that need to be reformed.<sup>170</sup> If a municipality's reorganization requires state oversight, then state reorganization demands federal oversight. The USTP is essential to ensure that no fraud or abuse occurs throughout the restructuring process.

### III. MAKING THE CASE FOR UNITED STATES TRUSTEE PROGRAM'S ROLE IN STATE BANKRUPTCY

For a state to be successful in its restructuring, it will need the USTP's expertise and oversight. The USTP will offer a technical support function to states that is entirely optional, but will be vital to the state's success. To implement this program, Congress must add a state bankruptcy provision to

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165. See *infra* Part III (highlighting proposed mechanisms to monitor for fraud and abuse).

166. See Maher, *supra* note 72 (focusing on the state relationship with the municipality during restructuring); *About the Detroit Financial Review Commission (FRC)*, *supra* note 158 (defining the specific roles the state government fills).

167. This mechanism is similar to the one outlined in PROMESA, 48 U.S.C. § 2148. See *supra* Part II.A (emphasizing the proposed mandatory reporting function).

168. See BOUKER, *supra* note 16, at 83–85, 89 (establishing congressional involvement in D.C.'s restructuring, leading to a federal bailout and fixing D.C.'s problem; while this specific structure would be unconstitutional between a state and the federal government, the concept of keeping Congress informed would prove useful in a state's restructuring process).

169. Gantert, *supra* note 162.

170. See Morse, *supra* note 82 § 2 (reporting the annual volume of fraud and abuse that occurs in private bankruptcy).

the U.S. Code and expand the USTP's role. The state will set up a restructuring committee, and once the restructuring plan is approved, the state will create an oversight committee. The USTP will offer recommendations throughout the restructuring process based on past experience, expertise, and data from its field offices and other executive agencies. The USTP will also put mechanisms into place to prevent fraud and abuse from occurring. Finally, the USTP will provide semiannual reports to Congress, the President, and the Attorney General to ensure that the federal government is aware of a potential bailout or future legislation down the road.

#### A. *Expanding the USTP's Statutory Authority*

The statutory power of the USTP should extend into state bankruptcy proceedings to provide oversight through the approval of the state's restructuring process and by monitoring the process for fraudulent activity.<sup>171</sup> Democratic leaders today have seen the ways that federal oversight, advocated for by Republican leaders, has hurt the restructuring process in PROMESA and under D.C.'s Control Board.<sup>172</sup> However, the proposed changes will offer oversight—as opposed to full control—during the restructuring process and primarily serve as a technical function for state support. This legislation will benefit both parties' goals. It achieves the Republican Party's goal of reducing the likelihood of a federal bailout by offering states a way to restructure its debts.<sup>173</sup> It serves the Democratic Party by addressing state revenue concerns and ensuring the long-term funding of Medicaid and other state benefit programs that are currently underfunded.<sup>174</sup> Therefore, it seems that if a member of Congress drafts

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171. See 28 U.S.C. § 586(a); 11 U.S.C. § 101 (showing current statutory powers given to the USTP).

172. See Bouker, *supra* note 16, at 82 (evaluating how the predominately Republican Congress passed the Act that created the Control Board); 28 U.S.C. § 586(a) (showing how Congress has limited the USTP's current statutory powers to establish panels of private trustees, perform Title 11 duties, supervise the administration of cases, handle monies received in its role as trustee, and compile reports at the order of the Attorney General); see also 11 U.S.C. § 101 (providing definitions for terminology found in statutes involving U.S. Trustee powers).

173. See Barrett & Raju, *supra* note 48 (showing Senate Majority Leader McConnell's support for state bankruptcy to prevent bailouts).

174. See Doug Sword, *Democrats' Virus Rescue Plan Would Help McClatchy*, *Other Papers*, ROLL CALL (Apr. 29, 2020, 2:41 PM), <https://www.rollcall.com/2020/04/29/democrats-virus-rescue-plan-would-help-mcclatchy-other-papers/> (asserting that House Democrats want the next COVID-19 relief package to help with unfunded pensions, such as for newspapers, and other government programs).

the proposed legislation a way that explicitly respects state sovereignty, Congress would approve.

Once Congress creates a bankruptcy chapter that allows a state to restructure, it must amend the USTP's role as it currently stands to include this new chapter. The USTP's mission in state bankruptcy is to serve as technical support to the state, offering recommendations based on expertise and past experiences, as well as access to federal data while monitoring for fraud and abuse throughout the process. This support will be optional for a state, and the state's government would be the decisionmaker, ensuring that the state's constituents' interests are represented.<sup>175</sup>

### B. *The USTP's Oversight Role*

The USTP's role in monitoring fraudulent activity is especially crucial because the crimes that can and do occur in Chapter 7 and 13 bankruptcy have the potential to arise in state bankruptcy cases.<sup>176</sup> It becomes even more critical that the USTP prosecute this type of fraudulent activity in state bankruptcy cases because taxpayers', state pension fund holders',<sup>177</sup> and municipal bondholders' money is at stake.<sup>178</sup> If the USTP finds that fraudulent activity is occurring during the restructuring process, it will report the activity, as it does in personal and commercial enterprise cases, by opening a case and prosecuting through the resources and power of the DOJ.<sup>179</sup>

To monitor for fraudulent activity, the USTP will implement routine auditing of top state agencies, and review case information, petitions, schedules,

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175. See *supra* Parts II.A, II.B (demonstrating the pitfalls of restructuring when local players are not involved).

176. See Gantert, *supra* note 162 (noting that a routine audit identified fraud and abuse in Detroit's restructuring); Morse, *supra* note 82 (quantifying annual fraud and abuse crimes that occur in private bankruptcy).

177. State pension fund holders include teachers, first responders, sanitation workers, and other government employees. *Public Pensions - Frequently Asked Questions*, NAT'L PUB. PENSION COAL., <https://protectpensions.org/learn/pensions-frequently-asked-questions/> (last visited Mar. 2, 2021).

178. See John M. Broder, *Five Officials in San Diego Are Indicted over Pensions*, N.Y. TIMES (Jan. 7, 2006), <https://www.nytimes.com/2006/01/07/us/five-officials-in-san-diego-are-indicted-over-pensions.html> (recounting the San Diego pension abuse scandal, which occurred as a result of bad accounting practices that left pension funds underfunded, as an example of the effect bankruptcy crimes have on the areas constituents).

179. *Report Suspected Bankruptcy Fraud*, U.S. DEP'T OF JUSTICE, <https://www.justice.gov/ust/report-suspected-bankruptcy-fraud> (Nov. 8, 2018).

statements, and tips from whistleblowers regularly.<sup>180</sup> The goal of these mechanisms is to both prosecute and prevent fraud and abuse.

### C. *The USTP's Expertise Function*

The USTP's expertise function exists primarily to support the states throughout the process by providing states with lessons learned from past bankruptcies, providing recommendations from knowledge acquired in the field office, and allowing the states access to its federal databases to demonstrate trends in the regional and national market.<sup>181</sup>

This expertise will primarily stem from the USTP's field offices due to its current organizational structure.<sup>182</sup> In addition to providing this information to the states, the field officers will collect data and report on the systems and practices used in state restructuring to allow for better recommendations in the future.

### D. *The USTP's Mandatory Reporting Function*

The USTP should model its reporting function after the mandatory reporting function in PROMESA and the Inspector General Act of 1978.<sup>183</sup> The USTP will provide a semiannual report to the relevant chairs of Congress's financial and oversight committees,<sup>184</sup> the President, and the

180. See NOREEN CLANCY & STEPHEN J. CARROLL, IDENTIFYING FRAUD, ABUSE, AND ERROR IN PERSONAL BANKRUPTCY FILINGS 10 (2007), <https://www.ncjrs.gov/pdffiles1/nij/grants/218848.pdf> (listing the methods used in personal and commercial enterprise bankruptcy to identify fraud and abuse).

181. Since its inception in 1978, the USTP has been collecting data on bankruptcy in various regions and serving in an oversight function regularly within its jurisdiction. See USTP POL'Y & PRACS. MANUAL, *supra* note 88, at 11–16 (reporting the role that the field offices play in current bankruptcy proceedings and their access to the local legal community, the public, and the DOJ and other federal agencies; data on the financial viability of the business; and data for complex case management).

182. *Id.* at 7–13 (outlining how USTP officials at every level of the organization conduct analyses of local policies and regulations, and advise on their revision and implementation).

183. See PROMESA, 48 U.S.C. § 2148 (expressing the mandatory reporting requirements); Inspector General Act of 1978, Pub. L. 95-452 § 5, 92 Stat. 1101, 1103–04 (codified as amended at 5 U.S.C. app.) (outlining the Inspector General's mandatory reporting requirements, which include annual and semiannual reports).

184. These committees include the House of Representatives' Financial Services Committee and Oversight and Reform Committee, the Senate's Budget and Finance Committees, and the Joint Economic Committee. See *Committees of the U.S. Congress*, CONGRESS.GOV, <https://www.congress.gov/committees> (last visited Mar. 2, 2021) (listing all congressional committees and their duties).

Attorney General. The report will outline significant problems, abuses, or deficiencies relating to any active state bankruptcy restructurings or oversight process, as well as active suits against bad actors and the evidence of the violations. Under PROMESA, the report shall provide all financial statements of the relevant states to outline the progress made since the last report, account for any USTP assistance, and give recommended changes to the governing laws.

This service will keep Congress, the President, and the Attorney General aware of the state's progress. This benefits the state by allowing it to both act independently from the federal government and to alert the federal government to any activity that might require action from Congress.<sup>185</sup>

### *E. Creating Restructuring Committees*

When a state determines whether to restructure, it will establish a committee to begin analyzing its finances, set the state up logistically to begin the process, and ultimately carry out the restructuring plan. While the USTP is the focus of this Recommendation, there is also value in local lawmakers' role in implementing the restructuring plan, as seen in Puerto Rico, D.C., and Detroit.<sup>186</sup> Therefore, the governor of the relevant state shall create a commission consisting of local community leaders, corporations, and state agency heads to offer a fairer representation of the creditors' and constituents' voices.<sup>187</sup>

Although stakeholders and constituents have competing interests, forming a restructuring committee with representatives from the private and public sector will reflect the public's differing concerns and create a balanced approach to prioritizing debt.<sup>188</sup> Allowing state and federal actors to work together also emphasizes the importance of the federal government's recognition of the state's sovereignty.<sup>189</sup> The USTP may offer recommended guidelines and outlines of what restructuring should look like based off its data and lessons learned from past restructuring, but will not make these mandatory to preserve the state's sovereignty. The restructuring plan will then go to the

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185. Examples of this would be a federal bailout or legislation that may benefit the state.

186. See *supra* Parts II.A, II.B, and II.C (demonstrating clear incidences where the involvement of local lawmakers in the restructuring process contributed to the success of implementation and, conversely, where restructuring plans failed due to the lack of local input and perspective).

187. See Bouker, *supra* note 16, at 81, 100 (highlighting the success of D.C.'s restructuring once the mayor's office became involved); Dolan, *supra* note 103, at 365–66 (recognizing the need for local involvement on the PROMESA board); Maher, *supra* note 72 (citing the success of Detroit's oversight board, which consisted of local city council members).

188. See Bouker, *supra* note 16, at 81–83, 86 (identifying local criticism of the Control Board); Vega-Ramos, *supra* note 104 (pointing out local PROMESA criticism).

189. See *supra* Part I.A (emphasizing the importance of state sovereignty).

bankruptcy judge for approval to ensure that the plan follows relevant laws, does not lead to fraudulent activity, and contributes to the financial longevity of the state.<sup>190</sup>

The USTP will effectively carry out this role by utilizing its field officers, who are aware of the finances, population, and politics of the state. These officers will not spearhead the restructuring plan, but will ensure the process is not fraudulent and that the state is making informed decisions through the data provided by the USTP.<sup>191</sup> Further, these field officers will be well versed in local politics and the financial and social context of the state, so that they have a full comprehension of the players and process of the restructuring.<sup>192</sup>

#### F. *Establishing Oversight Committees*

After a bankruptcy judge approves the restructuring plan, the governor of the relevant state should form an oversight committee, like the one in Detroit.<sup>193</sup> However, this oversight committee will also have representatives from the USTP to continue to monitor the committee's implementation of the restructuring plan to ensure that there is no ongoing fraudulent activity and that the state carries out the restructuring plan as approved by the bankruptcy judge and the USTP in the first stage.<sup>194</sup> The field agents working for the USTP will provide continuity in the oversight process due to their involvement throughout the restructuring process. This would also offer the committee specialization and expertise as they have dealt with similar issues on the private side of bankruptcy.

### CONCLUSION

As we look to the future, insolvent states will need a more long-term solution than the typical government bailout—especially in times dictated by a virus with no indication of when its spread will slow.<sup>195</sup> Thus, the creation of state

190. See 11 U.S.C. § 904 (granting the bankruptcy judge the authority to approve or deny a plan, but not revise it).

191. See *supra* Parts I.C, II.A (noting the importance of protecting against fraud and abuse).

192. See *supra* Part II.B (explaining how the lack of local knowledge in D.C. led to sweeping budget cuts that adversely affected the community, but had little effect on the District's financial struggles).

193. See *supra* Part II.C (explaining how Detroit used an apolitical oversight committee to ensure compliance with recommended practices).

194. Monitoring activities occur in Chapter 9 bankruptcy too. See Cole, *supra* note 74, at 380.

195. See Thomas J. Zemetis & Geoffrey E. Buswick, *As COVID-19 Grips U.S. State Finances, Some Budget Debates Will Continue Well Beyond the Deadline*, S&P GLOB. (June 29, 2020, 7:09 PM), <https://www.spglobal.com/ratings/en/research/articles/200629-as-covid-19-grips-u-s-state->

bankruptcy is vital to states' livelihood. As leaders begin to discuss what this means for the states and our nation as a whole, they must understand the importance of building an optional oversight instrument into the plan. Oversight will ensure that state bankruptcy accomplishes its goals—achieving financial longevity for states to prosper and making sure government programs adequately protect constituents.

To accomplish this goal, Congress must first expand the USTP's statutory power to include the oversight of state bankruptcy. Second, the USTP will play a role in the state restructuring process by providing optional guidelines and recommendations to the restructuring committee while also monitoring the process for fraud and abuse. Once the restructuring plan is approved, the USTP will continue this role into the oversight committee to ensure relevant and agreed upon practices from the restructuring plan are followed and, again, monitoring for fraud and abuse. Finally, the USTP will gather data and information on relevant practices to better advise other states that decide to file. The USTP will play a crucial role in guaranteeing the long-term financial success of the state for its investors, taxpayers, and pension holders.

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[finances-some-budget-debates-will-continue-well-beyond-the-deadline-11550876](#) (highlighting how COVID-19 has contributed to states' budgeting by deferring tax revenue and reducing economic activity).