MUNICIPAL BANKRUPTCY: A GUIDE FOR PUBLIC FINANCE ATTORNEYS

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of Bond Lawyers

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INTRODUCTION

A good plan in writing is to begin at the beginning. With that in mind, we want you to know what this Guide is and what it is not. It is not intended to be either a comprehensive treatise on the United States Bankruptcy Code, a complete compendium of the statutes that exist in all fifty states and comprise the authorization for or the alternatives to federal bankruptcy for municipalities, nor an exhaustive scholarly work on municipal insolvency.

It is, in a sense, a primer prepared for the bond practitioner in a fashion that we hope is useful and instructive. Nevertheless, to enhance value to bond lawyers and other attorneys, and contrary to the proverbial "fifty thousand foot view" afforded by many primers, we have provided footnotes and references to additional materials that may be of interest to the reader seeking more information than is provided here.

The material is organized so that the more general information is contained at the front of the volume, with additional details in the chapters that follow. We begin in Chapter One with a summary of state law alternatives to federal bankruptcy protection. This is intended to ensure that information on Chapter 9 is not presented in a vacuum, but rather in appropriate context with respect to our clients' options, alternatives and perhaps precursors to a Chapter 9 filing. Moreover, consideration of these alternatives is always the appropriate prologue to a decision to proceed under Chapter 9. This information should assist readers in preparing for and facilitating what could be somber discussions on the advantages and disadvantages of a municipal bankruptcy case.

Chapter Two will appeal to the historian in all of us. It includes a brief overview of the Bankruptcy Code (with emphasis on Chapter 9), its history and policies. We hope this provides a flavor of the Code to those lawyers who do not practice within it on a regular basis.

Next, we begin to address the specifics of municipal bankruptcy in Chapter Three, which covers the eligibility of a municipality to be a debtor under Chapter 9. This begins with the Code's definition of "municipality" and the five criteria that a municipality must satisfy in order to qualify as a Chapter 9 debtor. These eligibility standards are much more complex, and often more contentious, than the eligibility requirements for other chapters of the Code.

Chapter Four deals with items of particular interest to bond lawyers, *i.e.,* the treatment of a bond issue in a Chapter 9 proceeding. After a general description of the principal documents in a public finance transaction, the Guide addresses the very important issue of how bonds collateralized by revenue pledges are treated more favorably in Chapter 9 than are general obligation bonds. Moreover, important Chapter 9 provisions affecting preferences, the automatic stay and subordination are also addressed in this portion of the Guide.

The procedures for commencing a municipal bankruptcy case and many of the important case management aspects of the Chapter 9 case are described in Chapter Five of the Guide. These materials delve into some of the issues that are unique to Chapter 9 such as debtor operations during the course of the case: official committees, post-petition credit, the automatic stay, treatment of secured claims, including a discussion of Section 1111(b) of the Code, executory contracts and collective bargaining agreements. As is more specifically addressed, important Constitutional considerations give bankruptcy courts and creditors significantly less influence on the operations of a municipal debtor as compared to debtors under other chapters of the Code.

The plan of adjustment, which is the goal of the municipal debtor in bankruptcy, is the subject of Chapter Six. The plan of adjustment is first compared to a Chapter 11 plan of reorganization to further highlight some of the distinctions between Chapter 9 and traditional bankruptcy reorganizations. This is followed by an overview of the substantive and procedural requirements for the confirmation of the Chapter 9 plan and the effect of such a confirmation order.

Finally, dismissal of a Chapter 9 case is covered in Chapter Seven of this work. Since the Chapter 9 case cannot be converted to a case under another chapter of the Code, this can be a particularly important and relevant issue.

We close with some parting thoughts and our recommendations for further reading that you may find instructive if your intellectual appetite is not yet satiated. Also we note some of the significant issues of Chapter 9 that will likely be addressed in the days and years ahead by both courts and Congress. We do not intend for you to digest this volume in one sitting, or read it from cover to cover (though if you do, we are flattered, if not a little worried) but hope that it proves a helpful introduction to municipal bankruptcy law for public finance lawyers.

CHAPTER 1

MUNICIPAL FINANCIAL DISTRESS AND ALTERNATIVES TO BANKRUPTCY

While the primary focus of this work is Chapter 9 municipal bankruptcy, any effort to describe the availability, mechanics, advantages and disadvantages of Chapter 9 would fall short of its goal if it did not also address some of the most common reasons that require municipalities to undertake a Chapter 9 analysis, including consideration of alternatives to a bankruptcy filing. Bankruptcy "alternatives" are, almost by definition, creatures of state law and accordingly vary significantly from state to state. The intent of this chapter is not to address each and every one of these state laws, but rather to give you a flavor of the types of remedial options that may be viable alternatives of a Chapter 9 filing.

I. SOURCES OF FISCAL/FINANCIAL PROBLEMS AFFECTING MUNICIPALITIES

Municipal bonds, at least general obligation municipal bonds, are generally considered the second safest category of investments by the nationally recognized rating agencies, following securities issued by the United States government.[1] Municipalities, however, are not immune to the impact of national and regional economic downswings and their associated fiscal stressors. The three largest rating agencies each prepare reports on U.S. municipal bond ratings and defaults.[2] In 1988, a study by Enhance Reinsurance Co. of municipal bond defaults from the 1800's to the 1980's concluded that municipal defaults usually follow downswings in business cycles and are more likely to occur in high growth areas that borrow heavily. The study attributed defaults to the following factors: fluctuating land values, commodity booms and busts,

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[1] *2014 Annual U.S. Public Finance Default Study and Rating Transitions,* Standard & Poor's Ratings Services, a division of McGraw Hill Companies, May 5, 2015.

[2] *Ibid*.; *Default Risk and Recovery Rates on U.S. Municipal Bonds*, Fitch Ratings, January 9, 2007; and Moody's *US Municipal Bond Defaults and Recoveries, 1970-2013*, May 7, 2014.

cost overruns, financial mismanagement, unrealistic projections of the future and private purpose borrowing. The same factors contribute to current or recent examples of municipal financial distress. Before the City of Detroit's bankruptcy, Citizens Research Council of Michigan prepared an in-depth 74-page study of the financial position of the City[3] identifying many similar factors that have contributed to its declining financial position. While clearly not representative of all large urban areas, the factors highlighted by the study are illustrative of the challenges faced by municipal entities and may account for some of the concentration of financial distress in certain areas of the country. In its most recent default study, Moody's noted "When credit risk rises in a given region or state, severe stress and default are likely to occur in clusters."[4]

A. Common Sources of Financial Distress

On the revenue side, it is difficult to increase revenues during periods of economic crisis. Diminishing property tax values, statutory and constitutional property tax caps, increasing unemployment and declining manufacturing and construction activity each lead to decreasing property, income and excise tax revenues, even in communities which are politically able to increase the notional rate of these taxes. Areas with shrinking populations face further shortfalls in per capita shared revenues. On the expense side, the same economic factors lead to increasing per capita costs of government. States and municipalities toil under the burden of annual cost increases for negotiated health care benefits for employees and retirees. The budgets of governmental units that are bound by long term negotiated labor contracts that may have been negotiated utilizing unrealistically rosy projections, or with unsustainable wage or benefit provisions, are under unprecedented stress. Pension obligations, and in some states, constitutional protection of those obligations, can limit a municipality's attempts to contain

[3] *The Fiscal Condition of the City of Detroit*, Report 361, Citizens Research Council of Michigan, April 2010.

[4] Moody's Investors Service, *US Municipal Bond Defaults and Recoveries, 1970-2013,* May 7, 2014.

expenses. Finally, unanticipated one-time expenses, frequently associated with failed projects, projects with significant cost-overruns, adverse legal judgments or environmental remediation create fiscal challenges for governments that cannot be readily resolved with existing or accessible revenue sources.

B. Financial Distress vs. Financial Crisis

Financial distress is a common theme among almost all municipalities today. When, however, does distress become crisis, and what can be done about it? Insolvency is often defined as an inability to meet debts as they become due.[5] Accurately addressing actual or potential insolvency, once identified, requires an understanding of the particular causes of such insolvency for the municipality involved, as well as an understanding of potential solutions.

II. OPTIONS FOR MUNICIPALITIES OTHER THAN CHAPTER 9

As described in more detail in Chapter Two, the remedies available to states in their legislative approaches to financial intervention are limited by the Contract Clause of Article I, section 10 of the United States Constitution. Municipalities in some states, including those with structured financial oversight laws, have argued that state law remedies are not adequate in cases of extreme financial emergency.[6] This primer does not take a position on the wisdom of any particular municipality pursuing a state law remedy or a Chapter 9 bankruptcy case. Rather, we intend to provide bond practitioners with some basic information regarding these proceedings, so

[5] *See* 11 U.S.C. §101(32) which defines "insolvent" with respect to a municipality as "a financial condition such that the municipality is (i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due."

[6] The City of Hamtramck, Michigan (which previously emerged from a "financial emergency" during which time it had an Emergency Financial Manager under state law) unsuccessfully petitioned the State of Michigan to allow the city access to federal bankruptcy, having determined that its other remedies could not adequately address its particular financial situation. The *Report of the State Receiver in the Matter of the Receivership of Central Falls, Rhode Island*, issued by the State-appointed receiver of Central Falls on December 14, 2010, similarly posits that in the absence of state action, the state receiver would need to utilize a Chapter 9 bankruptcy to restructure the city's obligations. By voluntary petition filed August 1, 2011, the State-appointed receiver commenced a Chapter 9 case for the City of Central Falls, Rhode Island, Case No. 11-13105, in the United States Bankruptcy Court for the District of Rhode Island. On September 11, 2012, the court confirmed the Fourth Amended Plan of Debt Adjustment proposed by the receiver.

that they may further research any proceeding that may enable their clients to successfully persevere through the particular financial stresses they may be encountering.

A. Revenue Solutions; Bonding and Taxing

Solutions to a single budget stressor, such as an unexpected one-time expense, are generally available to municipalities and may consist of financing or tax solutions. With appropriate approvals (which vary from state to state), municipalities are often permitted to issue long term working capital financings under various scenarios. In addition, many state laws provide authorization for the imposition of taxes to fund a court ordered writ of mandamus or judgment to address certain financial crises. For example, a creditor filing suit against a municipality may be entitled a writ of mandamus that not only directs the governmental unit to pay its debt, but also to levy and collect taxes in an amount sufficient to pay the judgment.[7] Under such a judgment levy system, a municipality may be able to assess taxes it otherwise could not, in order to fund the judgment levy, thereby addressing in part the revenue shortfall. For example, Pennsylvania's Municipalities Financial Recovery Act, Act 47 of 1987, as amended, provides additional taxing authority to municipalities declared fiscally distressed, and brought within the Act 47 coordinator system.[8] In other states, municipalities may have no power to raise taxes without action of the state legislature or for reasons other than general operating purposes.

B. Negotiated Debt Modifications, Waivers and Forbearance Agreements

Before true cash insolvency is reached, a municipality will often default (with a lower case "d") on one or more covenants in its bond documents. This may or may not result in a payment default or other Event of Default (with a capital "D") under the bond documents. It will almost inevitably result, however, in the need for frank discussions with bondholders, indenture

[7] *See*, *e.g.*, Michigan Revised Judicature Act of 1961, as amended, Public Act 236 of 1961, MCL 600.6093 *et seq*.

[8] The Financially Distressed Municipalities Act, Pennsylvania Act 47 of 1987, P.L. 246, No. 47.

trustees, rating agencies, bond insurers and/or swap providers regarding the causes of the default and the municipality's plans for dealing with the situation.

If the crisis is expected to be short-lived, or a sustainable plan of resolving the crisis can be agreed upon, the parties to a bond transaction can generally enter into either a simple waiver agreement (most often used for a one-time covenant breach) or a more detailed forbearance and reservation of rights agreement, such as the ones entered into by Jefferson County, Alabama, with interested parties to certain of its financial transactions.[9]

Forbearance agreements on the municipal side, like their corporate kin, are generally heavily negotiated, and vary significantly from deal to deal. They often provide that during the specified forbearance period, creditors will forbear from their pursuit of any actions against the issuer, the collateral or other remedies provided under the bond documents, as long as the issuer achieves certain agreed-upon milestones. The forbearance agreement will typically include a "reservation of rights," whereby the creditors and/or the bond trustee expressly reserve all rights and remedies that they may have against the issuer and others under the bond documents or applicable law, with a recognition of the creditors' right of enforcement should the forbearance agreement milestones not be met, or if the forbearance period expires without resolution of the default.

A forbearance agreement can be (but is not always) an interim step to the workout or restructuring of one or more of an issuer's outstanding bond deals. Debt modifications can include changes to interest rates, principal forgiveness, changes in amortization, or early

[9] Jefferson County, Alabama Swap Forbearance Agreement and Standby Purchase Forbearance Agreements dated March 31, 2008 and subsequent amendments thereto found on the Jefferson County, Alabama "Investor Relations" webpage: http://jeffconline.jccal.org/investorrelations. The negotiations contemplated under these Jefferson County forbearance agreements did not succeed in preventing a chapter 9 filing, Case No. 11-05736, *In re: Jefferson County*, *Alabama*, in the United States Bankruptcy Court for the Northern District of Alabama. Among other things, all settlement proposals were conditioned upon legislation that was not forthcoming from the state legislature.

repayment and restructured reissuance.[10] As noted below, creditors cannot force municipalities into bankruptcy. Similarly, liquidation of a public issuer through the bankruptcy process is not an option for either the debtor or the creditor. Also, a variety of statutory or case law impediments may limit a creditor's enforcement of a remedy, even if that remedy might be available against a non-municipal debtor.

Accordingly, a municipality often has more negotiating leverage (or at least its creditors have less) than might originally be presumed, in connection with negotiation of a work-out or restructuring. Nevertheless, it will likely be difficult, painful and expensive under any scenario. For example, a municipal default normally will be highly publicized and may be politically charged. State sunshine laws hamper confidential negotiations. Press and public scrutiny complicate the development and approval of a structured settlement.

C. Structured State-Law Intervention Options

1. General State Imposed Oversight Mechanism

As described later in greater detail, a Chapter 9 municipal bankruptcy case may be duly commenced only upon the filing of a voluntary petition of a municipality that is authorized by state law. As more fully discussed in Chapter Three,[11] many states require some form of state or court-imposed oversight as either an alternative to, or a precursor of, authority to file a Chapter 9 petition. These statutes vary in the breadth of power given to the person or authority overseeing the municipality. For instance, under Pennsylvania's Municipalities Financial Recovery Act (also known as Act 47), once a fiscally distressed community is identified, an Act 47 coordinator is appointed and paid by the state. The Act 47 coordinator has general powers and authority to

[10] All of these modifications and a multitude of other arrangements raise complex questions under federal income tax laws applicable to municipal debt. That is an important, perhaps critical, element in evaluating modifications and restructuring options. It is also beyond the scope of these materials.

[11] *See* Chapter Three, Part II.A, Eligibility Requirements – Specific Authorization to be a Chapter 9 Debtor.

assist the community and require development of a recovery plan enabling it to remedy its fiscal distress. Contracts negotiated by the municipality prior to the commencement of the Act 47 proceeding are unaffected, but those negotiated under Act 47 cannot violate the terms of the recovery plan. The coordinator assists with implementation of the plan, but the governmental unit continues to be responsible for day to day operations. As of the date of this Third Edition, five of the ten largest cities in Pennsylvania are in some type of Act 47 or related oversight.

On December 15, 2010, the City of Harrisburg entered the Act 47 program, making it the twentieth Pennsylvania municipality to be subject to this program. As Harrisburg's Act 47 process continued into 2011, the city council rejected a recovery plan developed by the coordinator and a second plan developed by the mayor, new legislation at the state level restricted the ability of a financially distressed "city of the third class" (the class that applied to Harrisburg) to file a bankruptcy case for a specified period, and a majority of the Harrisburg city council nonetheless authorized the filing of a chapter 9 case, which was thereafter filed. In late 2011, the Bankruptcy Court dismissed the petition. *See In re City of Harrisburg, Pa*., Case No. 1:11-06938, in the United States Bankruptcy Court, Middle District of Pennsylvania, and particularly *Opinion* dated December 5, 2011, Bankruptcy Case Docket # 144, and the subsequent *Memorandum and Order* (Bankruptcy Case Docket #173) of the United States District Court, Middle District of Pennsylvania, in Case No. 1:12-CV-0130, on the appeal of the dismissal. On December 1, 2011, a state law receiver was appointed for the city. In May 2012, the United States Court of Appeals for the Third Circuit dismissed Harrisburg's appeal of the District Court's order affirming dismissal. Receivers continued to operate in Harrisburg until March 1, 2014, when the receivership was terminated. Harrisburg continues to operate under a "Harrisburg Strong Plan" with an Act 47 Coordinator.

Effective January 1, 2012, California Government Code Section 53760 provides that to be eligible to file for Chapter 9 protection, California municipalities must either complete a sixty-to-ninety-day mediation process or face an immediate financial crisis that threatens the health and welfare of its residents.

A similar system exists in Michigan, where the Governor can appoint an Emergency Manager (EM) for a municipality or school district with a "financial emergency."[12] The EM assumes the power and duties of the chief administrative officer and legislative body, and in addition, is the sole person authorized under state law to commence a Chapter 9 bankruptcy case for a municipality. EMs were recently operating twelve Michigan municipalities and five Michigan school districts.

2. State Imposed Control Schemes for Specific Municipalities

In some instances, the financial distress of a city or other state instrumentality is more severe than can be remedied with the type of oversight described above. For example, the 1975 financial crisis of the City of New York caused the State of New York and the federal government to become involved in debt restructuring, changes to wage and pension obligations and tax revisions. This intervention resulted in the creation of the Municipal Assistance Corporation (MAC) that was authorized to issue debt on behalf of the city, and the Financial Control Board (FCB), which assumed oversight of the city's financial matters. The FCB remains in place today. Similarly, in 1991, Philadelphia, Pennsylvania faced a severe financial crisis that led the Pennsylvania legislature to adopt the Pennsylvania Intergovernmental Cooperation Authority Act for Cities of the First Class,[13] creating a five member authority to oversee the city's financial management.

[12] Michigan Public Act 436 of 2012, the Local Financial Stability and Choice Act, which took effect March 28, 2013, replacing the Local Government and School District Fiscal Accountability Act, Public Act 4 of 2011.

[13] 53 P.S. §§12720.101 *et seq*.

3. State Appointed Receivers

Many states have some statutory authorization or requirement for the appointment of municipal receivers. Sometimes the legislation is specific to a particular community. In 1991, the State of Massachusetts adopted special legislation removing the City of Chelsea's mayor from office and appointing a receiver for the city. Other times, as in Pennsylvania, Michigan and Rhode Island,[14] the law provides for the discretionary appointment of a receiver following a determination of a certain level of financial distress or emergency. Such legislative measures are of particular interest in those states that do not authorize a municipality to pursue a Chapter 9 filing.

D. Judicial Receivers

1. Judicial Appointment of System or Project Receivers

Outside of the financing context, courts have long used the equitable remedy of the appointment of a receiver to reform public institutions such as schools and housing agencies.

Within the financing context, bond indentures for the financing of revenue producing projects such as sewer or water systems frequently provide, upon the occurrence of an event of default, for the right to request the appointment of a receiver to administer and operate the underlying system. This is generally a discretionary equitable remedy. In one recent example involving Jefferson County, Alabama, the indenture trustee sought the appointment of a receiver pursuant to court's equity powers based not only on applicable state statutes, but on a specific

[14] The Rhode Island Fiscal Stability Act, R.I. §45-9-1 et seq., provides for three stages of support for fiscally troubled Rhode Island cities, towns and fire districts. First, the director of revenue may appoint a fiscal overseer if any two of a series of negative credit events have occurred and are considered serious enough to threaten the fiscal well-being of the municipality, including deficit projections, failure to file required audits, ratings downgrades, inability to access credit markets or failure to respond to requests for financial information from the director of revenue or other designated governmental officials. Second, if the fiscal overseer reports that his powers are not sufficient and a budget commission should be appointed, the director of revenue may appoint a five-member budget commission with additional powers. Third, if the budget commission reports that it has concluded that its powers are insufficient to restore fiscal stability, the director of revenue may appoint a receiver with full executive powers, including the power to file a Chapter 9 petition in the name of the city, town or fire district.

provision in the indenture providing that the trustee was entitled following an event of default "as a matter of strict right, upon the order of any court of competent jurisdiction, to the appointment of a receiver." In that case, events of default occurred and continued under an outstanding bond indenture, as supplemented, causing the trustee to request the appointment of a receiver for the county sewer system. The Circuit Court of Jefferson County, Alabama granted the request and in September 2010, appointed a receiver to operate and administer the sewer system, with "full power and authority to effectively administer, operate and protect the System."[15] These powers expressly include the right to fix rates and charges, hire and fire system staff, and terminate or modify outstanding system contracts and enter into new ones. In general, a court-appointed receiver has no greater powers than the municipality. The sewer receiver faced the same legal and financial limitations as the County, including legal and practical limits to rate increases, federal environmental and employment mandates, state-law limits on hiring and contracting, and lack of support from the state legislature. The receiver did not raise rates and failed to broker a settlement and was divested of control by the County's bankruptcy filing.

2. Judicial Appointment of General or "Equitable" Receivers

Some states do not have statutory authorization for state law receiverships, but permit judicial or "equitable" receiverships to address situations of extreme municipal financial distress. In Michigan in 1986, prior to the adoption of a predecessor[16] to its current Local Financial Stability and Choice Act,[17] the Wayne County Circuit Court ordered the appointment of a

[15] Order of the Circuit Court of Jefferson County, Alabama dated September 22, 2010, in 01-CV-2009¬02318.00. *See also In re Jefferson County*, *Alabama*, 465 B.R. 243, 249 (Bankr. N.D. Ala. 2012) (The receiver and the receivership court have no interest in the property of the receivership estate other than holding the properties in *custodia legis*).

[16] Mich. Public Act 101 of 1988, as amended.

[17] Mich. Public Act 436 of 2012.

receiver for the City of Ecorse, and granted that receiver significant authority to address and resolve the financial distress that existed in that community.

More recently, in May of 2010, Central Falls, Rhode Island filed a petition (which was initially granted) with the Rhode Island Providence County Superior Court for appointment of a judicial receiver to oversee the affairs of the city. A temporary receiver was appointed, with broad oversight powers, including the authority to re-negotiate municipal contracts. The bond markets reacted negatively to this development, and state officials worried about the ripple effects that the receivership might have on other Rhode Island communities. Accordingly, the Rhode Island legislature adopted legislation[18] in June of 2010 prohibiting municipalities from seeking judicial receivership, and instead, prescribing a statutory mechanism of differing levels of fiscal oversight and, where appropriate, a state-appointed receiver. The Rhode Island statute applied retroactively to Central Falls, and therefore, the city withdrew its motion for appointment of a judicial receiver and the Rhode Island Director of Revenue appointed a statutory receiver for the city in July of 2010. In October of 2010, a Rhode Island judge upheld the constitutionality of the state legislation and its applicability to Central Falls.[19]

As the foregoing examples illustrate, the availability and scope of judicial receiverships for financially troubled communities is not entirely clear. Appointment of a receiver by a court is an equitable remedy, although in some instances a state statute may specifically govern the appointment of a receiver for a municipality. As a general rule, equitable remedies are permissible only when legal remedies are inadequate. Bondholder legal remedies include those provided in the bond documents. These remedies may include specific performance,

[18] The Act Relating to Cities and Towns: Providing Financial Stability, R.I. §45-9-1 *et seq*.

[19] Decision of the State of Rhode Island and Providence Plantations Superior Court filed October 18, 2010 in C.A. No. PB 10-5615, consolidated with C.A. No. PB 10-5672.

contractual remedies, a money judgment and a writ of mandamus (to force tax levies or other payment of claims). They may also include the right to request the appointment of a system receiver like the one in Jefferson County, Alabama. In states that have adopted some type of statutory fiscal oversight system, bondholders may or may not have rights under such laws. Moreover, in states that authorize issuers to commence a Chapter 9 case, bondholders have rights in receiverships pursuant to the bond documents or governing state law that may not be enforceable under the Code. A court's decision to either grant or deny an equitable remedy, such as appointment of a receiver, will vary significantly by state and be largely dependent upon the facts and circumstances of each case. In some states, such as Rhode Island, it may in fact not be available at all.

CHAPTER 2

AN OVERVIEW OF THE HISTORY, POLICIES AND STRUCTURE OF THE BANKRUPTCY CODE (WITH EMPHASIS ON CHAPTER 9)

I. UNITED STATES CONSTITUTIONAL PROVISIONS

Three federal constitutional provisions are critical in the operation, and indeed the existence, of the current version of Chapter 9 of the Bankruptcy Code. The most obvious is Article I, section 8, clause (4): "Congress shall have Power . . . To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States. . . ."[20] This power, which has such far reaching effects in the American economy in the twenty-first century, "was added late in the proceedings of the Constitutional Convention, after very little debate" and for almost a century was exercised by Congress only sporadically.[21]

For municipal bankruptcy legislation, two other constitutional provisions play important roles. First is the "Contract Clause" of Article I, section 10: "No State shall . . . pass any . . . Law . . . impairing the Obligation of Contracts . . . ."[22] Second is the Tenth Amendment: "All powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States, respectively, or to the People."[23]

Among its other consequences, the Contract Clause has meant that a *state* could not constitutionally enact laws for the discharge of the contractual liabilities (arising prior to enactment of the law) of an insolvent person. In 1819 *Sturges v. Crowninshield* held unconstitutional, under the Contract Clause, an 1811 New York law that "liberate[d] the person of the debtor, and discharge[d] him from all liability for any debt previously contracted, on his

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[20] U.S. CONST. art. I, §8, cl.4.

[21] Charles Jordan Tabb, *The History of Bankruptcy Legislation in the United States*, 3 Am. Bankr. Inst. L. J. 5, 13 (1995) (hereinafter, Tabb, History of Bankruptcy).

[22] U. S. CONST. art. I, §10.

[23] U.S. CONST. amend. X.

surrendering his property in the manner it prescribes."[24] Conversely, the Tenth Amendment has, sometimes in unexpected ways, also applied to *federal* legislation that affects, or could affect, states and municipalities.[25]

II. THE DEVELOPMENT OF BANKRUPTCY LEGISLATION FOR NON-MUNICIPAL DEBTORS

A. From 1800 to 1938[26]

In 1819, *Sturges* considered the power of a state to provide relief to debtors by way of a discharge of liability for debts incurred prior to the enactment of the state law, at a time when a federal bankruptcy statute was not in effect. The Court held New York's law was not a defense to a suit against the debtor on his note, as the law impaired the obligation of the debtor's contract under the Contract Clause.[27] Federal inaction on bankruptcy legislation and the enactment of peripheral state laws on insolvency, but not extending to a discharge of liabilities, set the basic pattern for about a century after the adoption of the Constitution, as Congress only sporadically enacted bankruptcy laws, usually in the wake of an economic crisis.[28] The first federal

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[24] *Sturges v. Crowninshield*, 17 U.S. 122, 197 (1819). By contrast, a state law permitting discharge of a debt contracted by a citizen of the state after the adoption of the law would not be invalid under the Contract Clause, as that state law would be part of the contract under which the debt arose, at least insofar as applied to debts owed to another citizen of the same state. *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213 (1827).

[25] *See discussion below on page 26 and also* David L. Dubrow, *Chapter 9 of the Bankruptcy Code: A Viable Option for Municipalities in Fiscal Crisis?*, 24 Urb. Law. 539 (1992) (hereinafter, Dubrow, *A Viable Option*) at 553. "It is not at all clear after *South Carolina* and *Garcia* that sections 903 and 904 [of Chapter 9 of the Bankruptcy Code], which are designed to protect state sovereignty, are constitutionally mandated."

[26] This summary of the history of "general" bankruptcy legislation draws on Tabb, *History of Bankruptcy*, and the historical review set out by Justice Sutherland in *Cont'l. Ill. Nat. Bk. v. Chicago*, *R.I.*, *& Pac. Ry. Co.*, 294 U.S. 648, 668-670 (1935) (referred to as *Rock Island* case). The *Rock Island* case upheld the constitutionality of the 1933 amendments that added §77 for railroad reorganizations to the 1898 Bankruptcy Act, described below.

[27] *Sturges*, 17 U.S. at 208. *Sturges* also commented on state laws modifying remedies for breach of contract: "Without impairing the obligation of the contract, the remedy may certainly be modified. . . . Imprisonment [for non-payment] is no part of the contract, and simply to release the prisoner does not impair its obligation." *Id*. at 201. Emergency legislation temporarily modifying redemption periods and requiring payment to the mortgagee of (at least a part of) the rental or income value of collateral was upheld as an exercise of state police powers in *Home Building & Loan Assn. v. Blaisdell*, 290 U.S. 398 (1934). And more recent decisions of the Supreme Court "have not relied on the remedy/obligation distinction, primarily because it is now recognized that obligations as well as remedies may be modified without necessarily violating the Contract Clause." *United States Trust Company v. New Jersey*, 431 U.S. 1 (1977), n. 17 at 19.

[28] *See generally*, Tabb, *History of Bankruptcy*, at 12-21.

bankruptcy law was adopted in 1800 in response to the financial panic of 1797 and was from the outset intended to be a temporary measure (with an expiration date in 1805), but was actually repealed in 1803.[29] The 1800 act was principally a "creditors' remedy" bill, with proceedings initiated by creditors and applying to a limited class of debtors. The act did allow for discharge of the debtor upon consent of a substantial proportion of the creditors – both in number and in amount of claims.[30]

The Panic of 1837 produced the Bankruptcy Act of 1841, also short-lived.[31] The 1841 Act included a then-startling innovation – the debtor could voluntarily seek relief.[32] And in 1867, Congress enacted a third federal bankruptcy law, one that lasted just over ten years.[33] By an amendment in 1874, the debtor, for the first time, could "propose terms of composition to his creditors to become binding upon their acceptance by a designated majority and confirmation by the judge."[34] These three early federal bankruptcy laws encountered, and substantially survived, constitutional challenges that asserted the laws were beyond the scope of the congressional power to enact laws "on the subject of bankruptcies," but each encountered opposition from a variety of political and business interests with the result that no "permanent" legislation was enacted.[35]

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[29] Act of April 4, 1800, c. 19, 2 Stat. 19; *repealed* Dec. 19, 1803, ch. 6, 2 Stat. 248.

[30] Tabb, *History of Bankruptcy*, at 14.

[31] Ch. 9, 5 Stat. 440 (1841), *repealed* by Act of March 3, 1843, ch. 82, 5 Stat. 614. *See*, Tabb, *History of Bankruptcy*, at 16-17.

[32] "[T]he act of 1841 took what then must have been regarded as a radical step forward by conferring on the debtor the right by voluntary petition to relieve himself of all future liability in respect of past debts. . . . [T]he act of 1841 and the later [federal bankruptcy] acts proceeded on the assumption that he might be honest but unfortunate. One of the primary purposes . . . was to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh'. . . ." *Cont'l. Ill. Nat. Bk. v. Chicago, R.I., & Pac. Ry. Co.*, 294 U.S. at 670. The 1841 Act also permitted involuntary petitions, as had been the standard procedure before then for commencing a bankruptcy case.

[33] Ch. 176, 14 Stat. 517, *repealed* by Act of June 7, 1878, ch. 160, 20 Stat. 99 (1878).

[34] *Cont'l. Ill. Nat. Bk. v. Chicago, R.I., & Pac. Ry. Co.*, 294 U.S. at 671. *And see* Tabb, *History of Bankruptcy*, at 21-22.

[35] *See generally*, Tabb, *History of Bankruptcy*, at 19-20.

Then, in 1898, Congress finally enacted a long-term bankruptcy statute that, with substantial revisions beginning in the 1930s, remained in effect until the enactment of the 1978 Bankruptcy Code.[36] This long-term successor came after "[t]he panics of 1884 and 1893 clearly exposed the need for some form of federal bankruptcy law. State laws were simply incapable of dealing with the financial problems created by these widespread calamities."[37] Not only did the 1898 Act enjoy a long legislative life, it also "ushered in the modern era of liberal debtor treatment in United States bankruptcy laws."[38] In addition to the historic legislative purposes of enforcing creditors' claims and (in varying degrees) providing for relief of the "honest but unfortunate debtor," the 1898 Act also reflected concern, from a number of quarters, with the fair and efficient administration of the bankruptcy court system:

> Much of the 1898 Act was directed not at debtor relief, but rather at facilitating the equitable and efficient administration and distribution of the debtor's property to creditors. . . . Creditors exercised significant control over the bankruptcy process through the power to elect the "trustee" . . . and creditors' committees.[39]

The *Rock Island* opinion of 1935 captured the development of federal bankruptcy legislation into the early 1930s, when it observed:

> The fundamental and radically progressive nature of these extensions becomes apparent upon their mere statement; but all have been judicially approved or accepted as falling within the power conferred by the bankruptcy clause of the Constitution. Taken altogether, they demonstrate in a very striking way the capacity of the bankruptcy clause to meet new conditions as they have been disclosed as a result of the tremendous growth of business and development of human activities from 1800 to the present day. And these acts, far-reaching though they be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed.[40]

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[36] Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended; *repealed* by P.L. 95-598, Nov. 6, 1978, eff. October 1, 1979.

[37] Tabb, *History of Bankruptcy*, at 23. This problem continues to the present day in the context of municipal insolvency; many creditors would prefer to limit municipalities' access to Chapter 9, but state law remains inadequate for dealing with municipal insolvency.

[38] *Id*. at 24.

[39] *Id*. at 25.

[40] *Cont'l. Ill. Nat. Bk. v. Chicago, R.I., & Pac. Ry. Co.*, 294 U.S. at 671.

As the Great Depression of the 1930s brought dramatic changes to the business world of the 1920s, Congress – and the states[41] - adopted a multitude of laws to alleviate the economic crisis. During the early 1930s, Congress amended the Bankruptcy Act by expanding protections for debtors both generally and in specific industry sectors.[42] At the end of the decade, the Chandler Act of 1938[43] rewrote, revised and updated the 1898 Act and provided the basic framework that lasted until 1978.

B. The Bankruptcy Code of 1978

The adoption of the Bankruptcy Reform Act of 1978 (which included the Bankruptcy Code and related jurisdictional provisions) and accompanying changes to the Rules of Bankruptcy Procedure in 1978 substantially altered the practice of bankruptcy law.[44] One of the major changes was an expansion of jurisdiction and powers of the bankruptcy court. Longstanding concerns about the role of bankruptcy judges in both the administration of bankruptcy estates and in the adjudication of disputes affecting those estates resulted in a change

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[41] In early 1934, the Supreme Court upheld the Minnesota Mortgage Moratorium Law against a challenge based on the contract clause and the due process and equal protection clauses of the Fourteenth Amendment. *Home Building & Loan Ass'n. v. Blaisdell*, 290 U.S. 398 (1934). Reaching back to *Sturges v. Crowninshield*, the Court distinguished the obligation of contracts, which a state could not alter, from the remedies, which could be modified so long as the change did not impair substantial rights. *Id*. at 430. *But cf*. *United States Trust Co.*, *supra* n. 24, on case law recognizing "that obligations as well as remedies may be modified without necessarily violating the Contract Clause." 431 U.S. at 19, n. 17.

[42] "The legislative onslaught began in 1933 with a law that made compositions more readily and widely available, authorized agricultural compositions, and permitted railroads to reorganize. Corporate reorganizations were sanctioned just a year later. Also in 1934, Congress introduced a reorganization law for municipalities. The Supreme Court overturned this law in 1936. Congress passed yet another version in 1937, which then was upheld by the Court. The Frazier-Lemke Act was passed in 1934, giving farmers greater ability to keep their farms. In 1935, the Supreme Court struck down this act on the ground that it violated the Fifth Amendment property rights of mortgagees. In just a few weeks Congress responded by passing a revised [Frazier-Lemke] amendment, which then survived judicial review. The railroad reorganization law was amended in 1935, as was the corporate reorganization section. In a crucial decision, the Supreme Court upheld the constitutionality of §77, the railroad reorganization section." Tabb, *History of Bankruptcy*, at 28.

[43] Chandler Act, Act of July 22, 1938, c. 575, 52 Stat. 883.

[44] The details of the changes made in 1978 are beyond this Primer. J. Ronald Trost & Lawrence P. King, *Congress and Bankruptcy Reform Circa 1977*, 33 Bus. Law. 489 (1977) gives a review of changes made and also changes dropped in the course of developing the Bankruptcy Code. The enactment process is covered, conversationally, in G. Ray Warner, et al., *Roundtable Discussion: Bankruptcy Reform: Then and Now*, 12 Am. Bankr. Inst. L. Rev. 299 (2004) and also in Klee, *Legislative History*. A practitioner's look is in Robert Chatz, et al., *An Overview of the Bankruptcy Code*, 84 Com. L. J. 259 (1979).

in the structure of bankruptcy courts and expanded jurisdiction for those courts. Much of the expanded jurisdiction for bankruptcy judges was later determined to be unconstitutional. The 1978 Code also began a pilot program for what is now the "United States Trustee" system within the Department of Justice to deal with administrative and oversight matters.

Some of the bankruptcy concepts under the 1898 Act remained in place: The new Bankruptcy Code retained "straight bankruptcy" in its Chapter 7 – Liquidation. The "reorganization chapters" (former Chapters X, XI, and XII) became Chapter 11 - Reorganization, and a new Chapter 13 – Adjustment of Debts of an Individual with Regular Income - was the successor to former Chapter XIII governing "wage earner plans." The statutory definitions moved, generally, into Chapter 1, and administrative provisions and avoidance power provisions applying to multiple types of cases appear in Chapters 3 and 5.

The Bankruptcy Code prescribes the types of "debtors" that can obtain relief under its various chapters. To proceed under Chapter 7 (liquidation) a "person"[45] must *not be* a railroad, an insurance company, a bank, a savings bank, or another of a long list of excluded entities (generally of a "financial" character).[46] A Chapter 11 debtor must be a "person" eligible to proceed under Chapter 7 *or* a railroad *or* a multilateral clearing organization.[47] A debtor under Chapter 13 must be an individual *with regular income* (or an individual with regular income and that individual's spouse) having debts and assets within a specified range.[48] A separate Chapter 12, enacted in 1986, is now available to a family farmer or family fisherman with regular

[45] *See* 11 U.S.C. §101 for the definition of "person" and 11 U.S.C. §109 for other limits on persons eligible to be debtors in Chapter 7 as well as in other Chapters. A "person" under §101(41) "includes individual, partnership, and corporation, but does not include government unit [defined in §101(27)]", except that under certain circumstances, certain governmental units are considered to be "persons." *See* 11 U.S.C. §101(41).

[46] *See* 11 U.S.C. §109(b) for the list of "persons" that may not proceed in Chapter 7. Sections 109(g) and (h) set out further restrictions on eligibility to be a debtor tied to instances of dismissal of a prior case and to required pre-petition credit counseling.

[47] 11 U.S.C. §109(d). This section excludes stockbrokers and commodity brokers from Chapter 11, even though those persons are eligible to be debtors in Chapter 7.

[48] 11 U.S.C. §109(e), again with an exclusion for stockbrokers and commodity brokers.

income, and Chapter 15 now applies to international bankruptcy proceedings.[49] The "core operational provisions" of Chapters 1, 3 and 5 generally apply to cases under any of the particular other chapters for a "type" of bankruptcy relief, but exceptions abound.

Since 1978 the Bankruptcy Code has been the subject of various amendments. One of the most important, because it addressed the constitutional infirmity over jurisdiction that had arisen during enactment of the Code in 1978, was the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA").[50] The Supreme Court had, in a complex set of opinions in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,[51] undone the jurisdictional structure of bankruptcy courts and bankruptcy judges under the Bankruptcy Reform Act of 1978.[52] In short, the Court concluded that the Bankruptcy Reform Act of 1978 unconstitutionally gave Bankruptcy Judges Article III jurisdiction without appointment as Article III judges having life tenure, and also applied that conclusion to the entire jurisdictional structure of bankruptcy courts under the Bankruptcy Reform Act of 1978, based on the view that Congress would (or should) rethink the jurisdiction of the bankruptcy courts comprehensively, rather than deal with only the specific jurisdictional dispute in *Marathon Pipe Line*.[53] After much political and

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[49] Chapter 12 is principally codified at 11 U.S.C. Chapter 12, §§1201, *et seq*., and Chapter 15 at 11 U.S.C. Chapter 15, §§1501, *et seq*.

[50] The Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333. A "practical perspective" on the Article I – Article III judicial debate is reported in Arthur Miller, et al, *Roundtable Discussion: Bankruptcy Reform: Then and Now*, 12 Am. Bankr. Inst. L. Rev. 299, 307 (2004) (Comments of Robert Feidler): "Our main goal was to get the [federal] judgeship bill. And who was our [Senate Judiciary] Chairman? Sen. James Eastland of Mississippi. Who did he hate most in life? Federal judges. He had one word of advice to his subcommittee Chairman, my boss, and that was this, 'You will not return from the bankruptcy conference with the House with any more Article III judgeships - I won't let such a bill pass.' There was no thoughtful jurisdictional [and] no constitutional theory applied. Simply, we will not, in addition to 155 Article III judgeships, add 250 bankruptcy Article III judgeships. End of story. That's how we got to that point over the status of bankruptcy judges with the House."

[51] 458 U.S. 50 (1982).

[52] These provisions were set forth in 28 U.S.C. § 1471 (1978), which has since been repealed.

[53] Walter J. Taggart, *The New Bankruptcy Court System*, 59 Am. Bankr. L.J. 231, 235: "[Justice Brennan] held the entire delegation of jurisdiction to the bankruptcy judges was unconstitutional. This unusual result was justified on the ground that Congress would prefer to redo the entire bankruptcy court system than to have bankruptcy courts operating with less than the pervasive jurisdiction the Congress had attempted to confer."

constitutional juggling, Congress enacted BAFJA to place jurisdiction of bankruptcy cases with the federal district court, and then permitted all bankruptcy cases and proceedings within the district court's bankruptcy jurisdiction to be referred to the bankruptcy court.[54] To deal with the constitutional limitations on the exercise of jurisdiction by bankruptcy judges as non-Article III judges, the BAFJA amendments next set out a potentially difficult-to-draw line between "core" and "non-core" proceedings to define the extent of the bankruptcy court's jurisdiction and powers over a referred bankruptcy case and proceedings in that case.[55]

In recent decisions, the United States Supreme Court has limited the authority of bankruptcy courts to rule on litigation involving state law. In *Stern* v. *Marshall*,[56] the Court held that bankruptcy courts do not have constitutional authority to issue final judgments on certain state law claims by debtors against third parties. In *Executive Benefits Insurance Agency* v. *Arkison*,[57] the Court clarified that bankruptcy courts may issue findings of fact and conclusions of law, for de novo review by district courts, on "core" claims that bankruptcy courts do not have authority to decide under *Stern*. In May 2015, the Court further clarified bankruptcy courts' authority in *Wellness Int'l Network, Ltd. v. Sharif*,[58] holding that, notwithstanding the limitations set forth in *Stern*, bankruptcy judges may adjudicate claims with the parties' express or implied

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[54] *See Id*., 59 Am. Bankr. L. J. at 239; and *see* Miller, et al., *Roundtable Discussion*, 12 Am. Bankr. Inst. L. Rev. 299.

[55] 28 U.S.C. §157(a) permits the referral of bankruptcy cases and proceedings in those cases to the bankruptcy judges for a district, and subsection (b) of §157 describes the powers of the bankruptcy judge in such a referred case over "core proceedings" and over those that are other than core proceedings. This distinction is reminiscent of the "summary-plenary" distinction used to define jurisdiction under the 1898 Bankruptcy Act. Municipal bankruptcy cases under Chapter 9 may offer some unusual issues as to core and non-core status of proceedings in a bankruptcy case. In *Stern v. Marshall*, 564 U.S. 2 (2011), the Supreme Court again applied Article III principles to limit a bankruptcy court's jurisdiction to render final decisions on a debtor's state law counterclaims to a creditor's claim (against the debtor) that was filed in bankruptcy court. These constitutional and statutory intricacies of bankruptcy court jurisdiction are well beyond the scope of this guide, but present issues that bond lawyers should be mindful of. For a recent application of *Stern* in a Chapter 9 case, *see In re City of Central Falls, Rhode Island*, 468 B.R. 36 (Bankr. D.R.I. 2012).

[56] 564 U.S. 2 (2011).

[57] 134 S. Ct. 2165, 189 L. Ed. 2d 83 (2014).

[58] 135 S. Ct. 1932 (2015).

"knowing and voluntary consent." Lower courts and practitioners still face uncertainty over bankruptcy courts' ability to rule on matters previously considered within bankruptcy jurisdiction, including which claims fit within *Stern*'s limitation on constitutional authority and what constitutes implied "knowing and voluntary consent" to a bankruptcy court issuing final orders.

Following the 1984 amendments, Congress made other substantive revisions of general application in The Bankruptcy Reform Act of 1994[59] and the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act.[60] Congress added Chapter 12, for family farmers and family fishermen, in 1986, and Chapter 15 on cross-border insolvency cases was part of the 2005 "BAPCPA" amendments.[61]

III. BASIC POLICIES OF (NON-MUNICIPAL) BANKRUPTCY LAWS

To oversimplify, we can identify several policies or goals that federal bankruptcy laws, as enacted from 1800 forward, have served in the case of non-municipal debtors:

A. Protection of Creditor Interests

In the early enactments, the protection of creditor interests took precedence. Cases were commenced only upon the petition of the creditors as an "involuntary proceeding" against the debtor, the granting of a discharge might require consent of creditors (by super-majority, if not unanimous, action), and grounds for denial of a discharge were often numerous. Although the Bankruptcy Code is less creditor-oriented, creditor protection is still a fundamental aspect of modern bankruptcy law, which promotes equality of treatment for creditors,

[59] Pub. L. 103-394, Oct. 22, 1994.

[60] Pub. L. 109-8, Apr. 14, 2005.

[61] The original enactment of Chapter 12 was in the Bankruptcy Judges, U.S. Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. 99-554, but it then had a sunset date of October 1, 1993; after numerous extensions or re-enactments, the 2005 BAPCPA amendments made Chapter 12 a permanent part of the Code. The Chapter 15 international bankruptcy provisions were enacted as Title VIII of the 2005 BAPCPA amendments.

discourages a "race to the courthouse" through piecemeal dismemberment of the estate, and encourages the maximization of asset values.

B. Relief of Debtors

Over time, the relief of debtors became an increasingly significant element of bankruptcy laws and policy. Concern for the relief of the "honest but unfortunate debtor" from the burden of oppressive debt is seen in the allowance of voluntary petitions, in the development of a composition process as an alternative to liquidation, and in the incremental reduction of grounds on which a discharge may be denied. The experience of the Great Depression in the 1930s also produced an expansion of bankruptcy relief to include reorganizations of large corporations (initially the railroads under §77 of the 1898 Bankruptcy Act as amended in 1933). Chapters 11, 12, and 13 now carry forward the reorganization and composition policies, as developed over time.

C. Fair and Efficient Management of the Bankruptcy Process

From the time of the 1898 Act, Congress has sought ways to provide all participants in the bankruptcy process, debtors and creditors alike, with as fair and efficient a system as possible, centralizing claims and litigation, reducing the costs borne by all and avoiding the opportunity for preferences and misconduct. These goals motivated, in part, the changes in the "stature" of bankruptcy courts seen in the Bankruptcy Reform Act of 1978 and the implementation of the United States Trustee program.[62]

Certainly these policies operate in a state of tension, and the relative emphasis among the policy options can be changed by Congress over time. And as we will note below, somewhat different constitutional principles and policy considerations operate in municipal bankruptcies.

[62] *See*, as an example of reforms made earlier to the "referee system," the comments of Gerald Smith in *Roundtable Discussion Bankruptcy Reform: Then and Now*, 12 Am Bankr. Inst. L. Rev. 299 at 306 (2004).

IV. THE DEVELOPMENT OF MUNICIPAL BANKRUPTCY LAWS

A. Legislation in the Shadow of the Contract Clause and the Tenth Amendment

1. The Short Journey from *Ashton* to *Bekins*

We have seen that the Contract Clause curtails *state* action to provide for a discharge of debts or to do more than is a permissible (however slippery that slope may be) modification. Hence, a state law that attempted to modify directly, and without bondholder consent, payment terms of outstanding bonds would face a federal constitutional challenge based on the Contract Clause.[63] Most state constitutions include similar provisions prohibiting impairment of contracts. The outcome of such a challenge would depend on a host of facts and constitutional analyses that we need not fully plumb.

In considering the constitutional boundaries of laws that attempt to alter contractual performance, modifications of secured and of unsecured bonds may present different concerns.[64] Also, the extent of the financial crisis facing the municipal issuer or the enacting state would bear on the degree to which that state could exercise its police power, and the extent of the "modification" would bear on the validity of the exercise of that power. *United States Trust*, which found the repeal of the statutory covenant at issue there to be invalid, observed that Supreme Court decisions "eschewed a rigid application of the Contract Clause to invalidate state

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[63] Compare *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U. S. 502 (1942), upholding the binding effect on non-consenting bondholders of a plan proposed under New Jersey state law and confirmed with approval from over 85% of bondholders and a state court, where the refunding bonds did not reduce the principal amount of the "unsecured" refunded bonds but extended payment periods and reduced interest, with *United States Trust Company v. New Jersey*, 431 U.S. 1 (1977), holding that legislative repeal of a covenant protecting holders of bonds issued by the Port Authority of New York and New Jersey violated the Contract Clause. *Faitoute* suggests that state laws could constitutionally affect more than "just remedies," at least with respect to unsecured municipal obligations, through the exercise of state police powers in an emergency situation. *United States Trust* shows some of the limits to the *Faitoute* position. For a careful look at the *Faitoute* and *United States Trust* decisions and their (in)consistencies, *see* Thomas R. Hurst, *Municipal Bonds and the Contract Clause: Looking Beyond United States Trust Company v. New Jersey*, 5 Hastings Const. L. Q. 25 (1978).

[64] Justice Frankfurter in *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942) at 509, described an unsecured municipal bond as "merely a draft on the good faith of the municipality in exercising its taxing powers." A lien, in contrast, has consistently been viewed as a property right entitled to protection under the due process clause of the Fifth Amendment to the United States Constitution. *But see* Tabb, *The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, available online at http://materials.abi.org/sites/default/files/2014/Mar/BankruptcyClause5thAmend.pdf.

legislation," and accepted the general principle for public contracts and debts that, "[a]s with laws impairing the obligations of private contracts, an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose."[65] More pointedly, Section 903 of the Bankruptcy Code establishes a statutory bar to the use of state law compositions to bind non-consenting bondholders to modifications of municipal debts.[66]

The Tenth Amendment presents other concerns about the use of federal bankruptcy law to affect municipal obligations. In 1936, the Supreme Court relied on the Tenth Amendment to hold the first federal municipal bankruptcy law, passed in 1934, to be unconstitutional in *Ashton v. Cameron County Water Improvement District No. 1*.[67] The Court then distinguished *Ashton* away two years later in *United States v. Bekins*,[68] holding a second Congressional effort in 1937 at municipal bankruptcy legislation to be constitutional when again challenged on Tenth Amendment grounds. The crucial issue, on which *Ashton* and *Bekins* diverged, was whether a federal bankruptcy law permitting a state-created district or municipality, through a voluntary case commenced with the consent (consent being measured in various ways over the years) of the affected state, to modify its obligations without consent of the holders of the obligations, constituted federal interference with sovereign powers that the states hold under the Tenth Amendment.[69]

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[65] *United States Trust*, 431 U.S. at 25.

[66] 11 U.S.C. §903(1)-(2). What now appears as clauses (1) and (2) in §903 began as a response enacted in 1946 to the prospect of state law composition law following *Faitoute*. *See* 6 *Collier on Bankruptcy* (*15th ed. Rev.*) (Alan N. Resnick & Henry J. Sommer, eds.) at 903-10 - 12, and H. R. Rep. 94-686 (1975) at 20 (quoting H. R. Rep. 2246 (1946) at 4): "Only under a Federal law should a creditor be forced to accept such an adjustment without his consent." Lawrence P. King, *Municipal Insolvency: Chapter IX, Old and New; Chapter IX Rules*, 50 Am. Bankr. L.J. 55 (1976) commented on the predecessor of §903 (1) and (2) in relation to *Faitoute*, with the observation that absent such a provision states could enact their own versions of Chapter IX (now Chapter 9). The application of a federal bankruptcy provision outside the bankruptcy context of course raises other questions of statutory construction.

[67] 298 U. S. 513 (1936).

[68] 304 U. S. 27 (1938).

[69] We can set aside for now the differences among types of entities such as political subdivisions, municipalities, agencies, and instrumentalities of a state, as the debtors in *Ashton* and *Bekins* were clearly within the coverage of the Acts of 1934 and 1937. That question does come back into play, for example, in the dismissal of the case of one of

The 1934 municipal bankruptcy statute, invalidated in *Ashton*, included provisions that targeted the Tenth Amendment issues, expressly limiting powers of the bankruptcy court and preserving state control over the political and governmental powers of the municipality.[70] In keeping with the federal invitation for state authorization of a municipal entity's filing, the State of Texas, where the Cameron County District was located, had adopted its own legislation declaring that "municipalities, political subdivisions, taxing districts, etc., might proceed under the Act of Congress approved May 24, 1934."[71]

The Supreme Court held that the 1934 Act did not satisfy the standard of the Tenth Amendment. It concluded that a federal law authorizing a federal judicial proceeding to alter the terms of municipal obligations (in that case, issued by a special purpose district), even with statutory provisions limiting interference in the bankruptcy proceedings with governmental and political powers and coupled with actual consent by the State of Texas for the district to proceed with the bankruptcy case, was inconsistent with the sovereignty reserved to the states by the Tenth Amendment.[72] The *Ashton* opinion has been criticized on its own federalism terms,[73] and, in a spirited response to that opinion, Congress promptly passed a new statute in 1937 doing exactly what it had done before, although with a somewhat less explicit statement as to the need for authorization by the state for the debtor to commence the case and with an exclusion (no

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the debtors in the Orange County bankruptcy case. *See In re County of Orange*, 183 B. R. 594, 599 (C. D. Cal. 1995), and footnote 94 below.

[70] Act of May 24, 1934, c. 345, §80, quoted in *Ashton*, 298 U.S. at 525-26. These provisions are essentially replicated in the Bankruptcy Code, 11 U.S.C. §§903 and 904.

[71] *Ashton*, 298 U.S. at 527.

[72] *See Id*. at 531-32. "The power 'to establish . . . uniform Laws on the subject of Bankruptcies' can have no higher rank . . . than the power 'to levy and collect taxes.' . . . We find no reason for saying that the one [taxation] is impliedly limited by the necessity of preserving the independence of the States, while the other [bankruptcy] is not. Accordingly, as application of the statutory provisions . . . might materially restrict respondent's control over its fiscal affairs, the trial court rightly declared them invalid." 298 U. S. at 530.

[73] "[T]he federalism-based reasoning of *Ashton* is impossible to defend." McConnell & Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. Chi. L. Rev. 425, 452 (1993).

longer in the law) of counties as eligible debtors.[74] In *Bekins*, the Court reversed the result in *Ashton* and upheld the validity of the 1937 law against the same challenge under the Tenth Amendment. With respect to the second law (virtually identical to the first passed in 1934), in support of its conclusion that the new statute met the requirements of the Tenth Amendment, the Court stated that, "Congress was especially solicitous to afford no ground for this objection" under the Tenth Amendment. Although the Court did not expressly overrule it, *Ashton* was no longer controlling.[75] The 1937 statute permitting voluntary municipal bankruptcy proceedings remained substantially unchanged (although renumbered to again be Chapter IX) until 1976.

2. The 1976 Upgrade to Chapter IX; Adoption of the Code

And so things remained, untouched for several decades. Even the revision projects looking toward the 1978 Bankruptcy Code paid little attention to then Chapter IX.[76] That is, according to Professor King, until 1975 when "[a]ll heads turned to New York City and some even read Chapter IX."[77] In April of 1976, just ahead of the 1978 Bankruptcy Code, Congress enacted new amendments to the long standing municipal bankruptcy law. "The amendment to Chapter IX was necessitated by a recognition that the version in existence did not serve the purposes for which it was intended. The fiscal crises in New York and other cities arising during the summer and fall of 1975 showed clearly that Chapter IX, as it existed in the Bankruptcy Act,

[74] Act of August 16, 1937, 50 Stat. at L. 653, chap. 647, 11 U. S. C. 401. *See* McConnell & Picker, *supra* n. 69, at 453. *See also*, Statements of Solicitor General Jackson, reproduced in *United States v. Bekins* at 1938 U.S. LEXIS 1094, p.5: "He [Representative Sumners, Chairman of the House Judiciary Committee] felt, however, it was not only the right, but the duty of Congress to present the question once more to this Court, since the decision, if allowed to stand, threatened grave impairment to the powers of the States, in that it forbade them to authorize their political subdivisions to enter into bankruptcy proceedings."

[75] 304 U.S. at 51-52.

[76] *See* Lawrence P. King, *Municipal Insolvency: Chapter IX, Old and New; Chapter IX Rules*, 50 Amer. Bankr. L. J. 55 (1976).

[77] *Id*. at 57.

was not realistically available to major public entities."[78] With such an upgrade to municipal bankruptcy law having been made in 1976, the 1978 Bankruptcy Code understandably incorporated into the new Code, by and large, the recently revised Chapter IX, but without adjustment of that existing framework to accommodate substantive changes the Code made to the other bankruptcy provisions that were "made applicable in Chapter 9", and thereby created further problems.[79]

3. The 1988 Municipal Bankruptcy Amendments

Problems arising out of merging the 1976 municipal amendments into the 1978 Code were noticeable during the late 1970s and early 1980s, as practitioners recognized that several provisions that were functional in the "business bankruptcy" world of Chapters 7 and 11 would have unintended consequences in municipal cases. The Senate Report accompanying the 1988 Bankruptcy Code amendments identified several examples, including the effect of Section 552 (limiting the post-petition extent of a security interest) on a pledge of revenues that secured a revenue bond issue, and the operation of new Section 1111(b)(2) on "deemed recourse" of secured debt, which could transform revenue bonds into general obligation bonds.[80] There were other logistical problems with the manner in which Chapter 9 would operate when linked to provisions of "general application," and the repeated credit crises for municipal and public issuers across the country made substantive revision necessary. By 1979, the city with the precipitating financial crisis was not New York. Cleveland, Ohio "needed additional financing, but lenders were unwilling to lend for a variety of reasons, including the incorporation into

[78] Lawrence P. King, *Municipal Insolvency: The New Chapter IX of the Bankruptcy Act*, 1976 Duke L. J. 1157 (1976), 1158. *See also*, H. R. Rep. 94-686, Dec. 1, 1975, and H. R. Conf. Rep. 94-938, Mar. 22, 1976, for more explanation of the 1976 amendments.

[79] *See*, S. Rep. 100-506 (1988), *Report to Accompany S. 1863*, reprinted in App. F, *Collier on Bankruptcy* (*15th ed. Rev.*) (Alan N. Resnick & Henry J. Sommer, eds.), App. Pt. 41(g)(ii)(A), at 41-113.

[80] *Id*. at 41-116, -119: ". . . Section 552(a) may permit general creditors of the municipality to seek payment from pledged revenues and prohibit the specified payment of pledged revenues to the bondholders. . . . Section 1111(b) can be interpreted as converting revenue bondholders from creditors with rights to certain specific revenues into general creditors with a claim against the full faith and credit of the municipality."

Chapter 9 of the general [b]ankruptcy concept of Section 552 of the Bankruptcy Code."[81] Substantive revisions were finally enacted in 1988, producing substantially the current Chapter 9.[82]

B. Mixing Bankruptcy Policy and Municipal Bankruptcy Policy

As noted earlier in this chapter, two of the principal policies of bankruptcy law are the protection or preservation of creditors' rights and, in tension with that, the relief of the debtor from financial burdens which may take the form of reorganization and continuation of the debtor and the modification of its obligations. In Chapter 1, we outlined some of the state law remedies available to the creditors of municipal issuers and also covered some of the legal and practical limits of those remedies under state law.[83] Put another way, the general bankruptcy policy of enforcing (or perhaps better stated, respecting), creditors' remedies will be less influential in municipal bankruptcy law if those remedies are of limited utility in the first instance, when applied in a state lawsuit against the municipality, than if those remedies were highly effective and creditors would have reason to strongly oppose any displacement of them.[84] This is reflected in the assessment of municipal bankruptcy policies in some articles on the topic.

> What is the goal of the municipal bankruptcy laws? Although cities are legally classified as municipal corporations, the purposes of federal municipal bankruptcy laws resemble individual bankruptcy more than corporate bankruptcy: municipal

[81] *Id*. at 41-144.

[82] For an analysis of the policies and purposes underlying the 1988 Municipal Bankruptcy Amendments, with a particular emphasis on the status of "special revenues," see *In re Jefferson County, Alabama*, 465 B.R. 243, 282-84 (Bankr. N.D. Ala. 2012).

[83] Indeed, the lack of effective state law remedies was one of the factors that led to the 1934 and 1937 municipal bankruptcy bills and from there to the current Chapter 9. *See*, Dubrow, *A Viable Option*, 24 Urb. Law. at 547-48: "In essence, the [House] Committee saw a mutuality of interest between creditors and an insolvent municipality. Without a federal law, creditors and the debtor were at an impasse to neither's advantage," citing H. R. Rep No. 517, 75th Cong., 1st Sess., relating to the 1937 municipal bankruptcy bill.

[84] *See* Dubrow, *supra* n. 23, 24 Urb. Law. at 539, quoting H. R. Rep. 517: "This bill is intended to remove an impasse and the committee believes that it will be welcomed by debtors and creditors alike." *And see* Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B. U. L. Rev. 633 (2008), 647: "In the municipal context, however, even if the creditors receive a favorable judgment against a locality, their ability to enforce the judgment is very limited." *See also*, Robert H. Frelich, *Municipal Debt Adjustment: Historical Perspectives on a Current Crisis*, 7 Urb. Law. ix (1978).

> bankruptcy is based on the idea of the fresh start rather than the efficient reconfiguration of assets. The theory of Chapter 9 is that the burden of debt service, if sufficiently high, will affect the taxpayers of a city as it would a debt-ridden individual: it will sap initiative and depress money generating activity. The debt-ridden individual will cease to work if all the gains go to the creditor; the taxpayers of a city will cease to pay taxes if rates are too high and the citizens get none of the benefit. In both contexts, bankruptcy is premised on the idea that the debtor will become more productive if freed from the burden of debt, but the law presumes that the debtor will survive bankruptcy in essentially the same form that it went in.[85]
>
> * * *
>
> The underlying policy justification for Chapter 9 is different than the justification for bankruptcy law regulating corporations due to the fundamental differences between corporations and municipalities . . . . [L]iquidation is not an option for a municipality. Municipalities must continue to operate to provide essential services to the public. Consequently the policy justification pertaining to the liquidation of corporations does not generally apply to the adjustment of municipal debt. . . . The role of the market is not to put "unprofitable" municipalities out of business.
>
> The fundamental policy goal underlying municipal bankruptcy law is to provide a legal context for distressed municipalities to be able to address their financial problems in a manner with enables them to provide essential public services rather than to collapse. [M]unicipal bankruptcy law is primarily designed to aid the debtor in its efforts to resolve its financial problems so as to be able to effectively serve the public. . . [U]nder Chapter 9 creditors have fewer tools to intervene in the reorganization process than do creditors under Chapter 11.[86]

V. APPLYING THE CODE IN A CHAPTER 9 CASE

Now that we know where Chapter 9 came from, how does it work? How does the Bankruptcy Code carry out the principles of providing a federal "adjustment of debts" that state laws could not accomplish under the Contract Clause, while preserving state control over the affected municipalities and without otherwise violating the Tenth Amendment (or at least not raising paralyzing concerns)?[87] How does the Bankruptcy Code use provisions and definitions of general application in a Chapter 9 case, and what special rules are in place for Chapter 9 cases

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[85] McConnell & Picker, *When Cities Go Broke*, 60 U. Chi. L. Rev. at 469.

[86] Dubrow, *A Viable Option*, 24 Urb. Law. at 546-47, footnotes omitted.

[87] *Id*., 24 Urb. Law. at 553. "It is not at all clear after *South Carolina* and *Garcia* that sections 903 and 904, which are designed to protect state sovereignty, are constitutionally mandated."

given the complexities of public finance law and the various ways public borrowings are structured?

The issues previously addressed require that many provisions of the Code that are designed for general application may not be applied in a Chapter 9 case. To determine what "general" provisions apply in Chapter 9, we first look to paragraphs (f) and (g) of Section 103 entitled "Applicability of chapters." Those provisions state (i) that "[e]xcept as provided in section 901 of this title" only Chapters 1 and 9 apply in a case under Chapter 9, and further (ii) that subchapters I, II, and III of Chapter 11 apply only to a case under Chapter 11 "[e]xcept as provided in section 901 . . ."[88] Put another way, Chapters 1 and 9 do apply in a Chapter 9 case, and some provisions of Chapter 11 may apply in a Chapter 9 case. Section 901(a) is a specific list of the provisions of Chapters 3, 5, and 11 that apply in Chapter 9 cases.[89] For ease of reference, we will look at the specifically "incorporated" provisions applicable to Chapter 9 cases substantially in our discussion of the specific Chapter 9 provisions where they operate.[90] From this general overview, we will turn to the specifics of Chapter 9 in the following chapters.

[88] 11 U.S.C. §103 (f) and (g).

[89] Sections 301, 344, 347(b), 349, 350(b), 361, 362, 364(c), 364(d), 364(e), 364(f), 365, 366, 501, 502, 503, 504, 506, 507(a)(2), 509, 510, 524(a)(1), 524(a)(2), 544, 545, 546, 547, 548, 549(a), 549(c), 549(d), 550, 551, 552, 553, 555, 556, 557, 559, 560, 561, 562, 1102, 1103, 1109, 1111(b), 1122, 1123(a)(1), 1123(a)(2), 1123(a)(3), 1123(a)(4), 1123(a)(5), 1123(b), 1123(d), 1124, 1125, 1126(a), 1126(b), 1126(c), 1126(e), 1126(f), 1126(g), 1127(d), 1128, 1129(a)(2), 1129(a)(3), 1129(a)(6), 1129(a)(8), 1129(a)(10), 1129(b)(1), 1129(b)(2)(A), 1129(b)(2)(B), 1142(b), 1143, 1144, and 1145 of this title apply in a case under this chapter.

[90] This primer does not generally address issues related to the importation of other general bankruptcy concepts such as statutory and equitable mootness which have been raised in *Jefferson County* appellate litigation.

CHAPTER 3

ELIGIBILITY OF MUNICIPALITY FOR BANKRUPTCY PROTECTION

I. DEFINITION OF MUNICIPALITY

Municipalities may voluntarily[91] file petitions under Chapter 9 of the Bankruptcy Code. This is the only source of bankruptcy relief for municipalities. The law does not allow for involuntary cases against municipalities. The Bankruptcy Code broadly defines a "municipality" as a "political subdivision or public agency or instrumentality of a State."[92] Political subdivisions can include counties, parishes, cities, townships, towns and villages. Public agencies or instrumentalities are "state-sponsored or controlled" authorities, boards, commissions, districts, and independent corporations that raise revenues through taxes (*e.g.*, public improvement districts, school districts) or user fees (*e.g.*, public utility boards and bridge and highway authorities).[93] Applying the definition of municipality requires care in analysis of the statutory definition and of the character of the particular debtor seeking to proceed under Chapter 9. This is particularly illustrated in three bankruptcy court decisions. The court in the 1995 *Orange County* case found that one of the debtors, an investment pool operated by the county, did not meet the "municipality" definitional requirements of Section 101(40), a decision that has received criticism.[94] The debtor in *In re New York City Off-Track Betting Corp*., a public benefit corporation operating a pari-mutuel betting system, was determined by the court, and conceded by creditors, to be a "municipality" that could proceed in Chapter 9.[95] And finally, after a thorough review of cases on the meaning of "municipality" in *In re Las Vegas Monorail*

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[91] 11 U.S.C. §§109(c)(1), 303, 901(a); *see also United States v. Bekins*, 304 U.S. 27, 51 (1938).

[92] 11 U.S.C. §101(40).

[93] H. Slayton Dabney, Jr., et al, *Municipalities in Peril: The ABI Guide to Chapter 9*, 15 (2010).

[94] *Compare In re County of Orange*, 183 B. R. 594, 599 (C. D. Cal. 1995) with *2 Collier on Bankruptcy* (*16th ed.*) (Alan N. Resnick & Henry J. Sommer, eds.), ¶109.04[3][b], p. 109-26, and fns. 22-24. Also note the definition of "governmental unit" found in 11 U.S.C. §101(27).

[95] 427 B.R. 256, 265-66 (Bankr. S.D. N.Y. 2010).

Company, the court held that the debtor was *not* a municipality for purposes of Chapter 9.[96] States are not municipalities by definition; they are neither included nor contemplated in the definition of a municipality.[97] "State" is defined to expressly include the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under Chapter 9 of this title."[98] Thus, a State may not be a debtor in a Chapter 9 case.

In re Las Vegas Monorail Co.,[99] analyzed whether a private, non-profit corporation that owned and operated a public transportation system was a state instrumentality. When the debtor filed under Chapter 11, a creditor moved to dismiss the case, arguing the debtor was a municipality eligible to file only under Chapter 9. The debtor had declared itself an instrumentality in a tax certificate, but the court found the declaration did not control the eligibility determination because "instrumentality" has a different meaning for tax purposes and the debtor did not make the declaration in connection with the bankruptcy. The debtor lacked the traditional powers of government, such as eminent domain, taxing authority or sovereign immunity, so the court examined whether the debtor had a public purpose and the necessary level of state control, focusing particularly on day-to-day activities. Although the debtor offered a public service traditionally supplied by government, private corporations often provide public services in areas such as transportation, utilities and education. The state's control over the debtor was strategic and periodic rather than operational and constant. The debtor ran its day to

[96] 429 B.R. 770 (Bankr. D. Nev. 2010).

[97] Two hearings were held by subcommittees in the U.S. House of Representatives in February, 2011, on the question of adding "state" to the definition of "municipality." *See*, *e.g.*, NABL Government Affairs News of February 4, 2011, at http://www.nabl.org/newsroom/1103.

[98] 11 U.S.C. §101(52). In addition, as noted in *2 Collier on Bankruptcy* (*16th ed.*) (Alan N. Resnick & Henry J. Sommer, eds.), ¶ 101.52 at p. 101-205: "The inclusion of the District of Columbia and Puerto Rico within the meaning of state does not apply for purposes of determining eligibility for a Chapter 9 bankruptcy. This limitation has the effect of preventing political subdivisions, agencies and instrumentalities of the District of Columbia and Puerto Rico from being debtors in Chapter 9 cases."

[99] 429 B.R. 770 (Bankr. D. Nev. 2010).

day business without the direct oversight of the state, whose power over the debtor was a matter of regulation rather than control.[100] Moreover, the state generally did not treat non-profit public benefit corporations as municipalities.[101] Accordingly, the debtor did not exhibit the characteristics of a municipality and was eligible for chapter 11.

II. ELIGIBILITY REQUIREMENTS

Section 109(c) prescribes five eligibility standards for a Chapter 9 debtor.[102] An entity[103] qualifies as a Chapter 9 debtor if it:

> 1. is a municipality;
>
> 2. is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;
>
> 3. is insolvent;
>
> 4. desires to effect a plan to adjust such debts; and
>
> 5. [the municipality]
>
> (a) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;
>
> (b) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;
>
> (c) is unable to negotiate with creditors because such negotiation is impracticable; or

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[100] *Id.* at 797-98.

[101] *Id.* at 799-800.

[102] The debtor bears the burden of proof on proving eligibility. *In re Jefferson County, Alabama*, 469 B.R. 92, 99 (Bankr. N.D. Ala. 2012). *In re New York City Off-Track Betting Corp.*, 427 B.R. 256, 264 (Bankr. S.D. N.Y. 2010).

[103] "Entity" is defined at 11 U.S.C. §101(15), and that term includes a "governmental unit," defined in 11 U.S.C. §101(27). A municipality is a governmental unit, but not all governmental units are municipalities.

(d) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.[104]

A. Specific Authorization to be a Chapter 9 Debtor

State law must specifically authorize a municipality to file for bankruptcy.[105] States take different approaches as to how they authorize a municipality to file for bankruptcy.[106] Some states, like Idaho, grant a municipality direct access to bankruptcy protection and do not place restrictions on its filing. In Idaho, any "taxing district" is authorized, without restriction, to file a bankruptcy petition.[107]

Many states place preconditions on its authorization of a Chapter 9 filing. They may only allow particular municipalities to file or allow filing only in certain circumstances. Montana, for example, allows a "local entity" to file for bankruptcy, but specifically excludes counties from this definition.[108] Some states give a state appointed official or body the power to approve a filing. In Connecticut, a municipality cannot file without the governor's prior consent.[109] A Pennsylvania municipality must obtain the written approval of the State Department of Internal Affairs.[110] California, which used to permit direct access to bankruptcy by its municipalities,

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[104] 11 U.S.C. § 109. "A chapter 9 petitioner must satisfy each of the mandatory provisions of § 109(c)(1)-(4), and one of the requirements under §109(c)(5) to be eligible for relief under the Code." *In re Boise County*, 2011 WL 3875639*6 (Bankr. D. Idaho) (Sept. 2, 2011); *see also Int'l. Ass'n. of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo)*, 408 B.R. 280, 289 (9th Cir. BAP 2009).

[105] 11 U.S.C. §109(c)(2). Some courts have held "that the authorization must be written, 'exact, plain, and direct with well-defined limits so that nothing is left to inference or implication.'" *In re New York City Off-Track Betting Corp.*, 427 B.R. 256, 267 (Bankr. S.D. N.Y. 2010); *see also In re Jefferson County*, *Alabama*, 469 B.R. 92, 2012 WL 715635 (Bankr. N.D. Ala, 2012).

[106] *See* the appendix at the end of this Primer for a survey of state laws authorizing municipal bankruptcy.

[107] Idaho Code §67-3903.

[108] Mont. Code. Ann. §7-7-132.

[109] Conn. Gen. Stat. Ann. §7-566.

[110] 53 P.A. Cons. Stat. Ann. §5571.

now requires communities to undergo a mediation except in cases of immediate financial crisis.[111]

Lastly, some states have enacted "municipal distress statutes" containing "bankruptcy" procedures that parallel federal bankruptcy laws.[112] New York and Pennsylvania both have municipal distress statutes. New York's statute created an Emergency Financial Control Board and authorizes the municipality or the board to file a petition in the New York Supreme Court for approval of a repayment plan.[113] Pennsylvania's Municipalities Financial Recovery Act[114] provides:

- The criteria for identifying distress;
- The powers and duties of the Department of Community and Economic Development in assisting a community to alleviate its distressed status;
- A procedure for declaring a municipality as distressed and subsequently authorizing the appointment of a distressed municipality coordinator;
- A requirement that a distressed municipality develop a fiscal plan to remedy its distress status;
- The option for a distressed municipality to formulate its own fiscal plan;
- A requirement that the state withhold all nonessential state funds when a distressed municipality refuses to adopt a fiscal solvency plan; and
- Authorization for a distressed municipality to file under Chapter 9.[115]

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[111] Effective January 1, 2012, California Government Code Section 53760 provides that to be eligible to file Chapter 9, California municipalities must either complete a sixty-to-ninety-day mediation process or face an immediate financial crisis that threatens the health and welfare of its residents.

[112] Public Law Research Institute, *Municipal Bankruptcy: State Authorization Under the Federal Bankruptcy Code*, http://gov.uchastings.edu/public-law/docs/plri/muniban.pdf (last visited August 23, 2015).

[113] N.Y. Local Fin. Law §§85.00–85.90, Title 6-A, Art. 11, Ch. 33-A, N.Y. Cons. Laws.

[114] 53 P.S. §§11701.101 *et seq*.

[115] Pennsylvania General Assembly, Local Government Commission, Pennsylvania Legislator's Municipal Deskbook 185-86 (3rd ed. 2006).

Twenty-one states have no authorizing statute and therefore do not allow municipalities to file bankruptcy. Many states limit, to varying degrees, access. Georgia is currently the only state to expressly prohibit a municipality from filing for bankruptcy.[116] Municipalities in the twenty-one states without an authorization statute must seek the enactment of a statute specifically authorizing that particular municipality to file for bankruptcy. This is a difficult and time-consuming process that puts a major roadblock in front of a municipality's ability to seek bankruptcy protection. The exact scope of the authorizing statute, as well as other state laws in effect at the time of adoption of the authorizing statute, can make a difference in eligibility determinations. In the Detroit bankruptcy, the Bankruptcy Court noted that the state had a bankruptcy authorizing statute when it enacted the constitutional protections in 1986, but also noted that it did not take any steps in 1963 to protect pensions from bankruptcy, and accordingly concluded that the pensions were merely contractual obligations under Michigan law.[117]

B. Insolvency

The term "insolvent" as used in Section 109(c) is defined in 11 U.S.C. §101(32). That definition for municipalities differs from the "balance sheet tests" of insolvency applied, when the term is relevant, to most other entities and partnerships. Municipal insolvency is defined as a "financial condition" in which a municipality is:

1. generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or
2. unable to pay its debts as they become due.[118]

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[116] GA. CODE ANN. §36-80-5.

[117] In re *City of Detroit,* Case No. 13-53846 *Opinion Regarding Eligibility*, pp. 75-80; see also Chapter 6 herein.

[118] 11 U.S.C. §101(32)(C). The insolvency tests are applied as of the time of the filing. *In re Hamilton Creek Metro. Dist.*, 143 F.3d 1381, 1384 (10th Cir. 1998).

Part one of the definition looks to current, general nonpayment of debts as they become due.[119] Part two of the definition is an equitable, prospective test looking to inability to pay in the near future.[120] A municipality's projections of insolvency must be based on the current or upcoming fiscal year.[121] Merely an anticipated inability to pay debts in later years does not satisfy the definition of insolvency. Furthermore, bankruptcy courts have found that a municipality does not meet the insolvency requirement if it is merely economically distressed or, although distressed, remains in a favorable cash position.[122] Upon the filing of an objection to a Chapter 9 petition, Section 921(c) provides that the municipality bears the burden to prove its insolvency.[123] Under both components of the definition, insolvency should be determined as of the petition date.[124]

C. Desire to Effect a Plan

A municipality must "desire to effect" a debt adjustment plan.[125] There is no specific test that a municipality must fulfill to satisfy this requirement.[126] This is essentially a good faith requirement–the municipality must demonstrate it wants to put a plan in place through Chapter 9. Having such a plan in place is not a precondition to filing. In determining whether this

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[119] *Hamilton Creek*, 143 F.3d at 1384; *see also In re Town of Westlake*, *Texas*, 211 B.R. 860, 864 (Bankr. N.D. Tex. 1997).

[120] *Id*.

[121] *In re Pierce County Housing Authority*, 414 B.R. 702, 711 (Bankr. W.D. Wash. 2009); *In re City of Vallejo*, 408 B.R. 280 (B.A.P. 9th Cir. 2009); *In re City of Bridgeport*, 129 B.R. 332 (Bankr. D. Conn. 1991).

[122] In re *Boise County*, 465 B.R. 156, 172-73 (Bankr. D. Idaho 2011) (county with surplus funds and borrowing capacity failed to show inability to pay debts and failed to demonstrate reserves were restricted or unavailable to pay judgment debt); *In re Hamilton Creek Metro Dist*., 143 F.3d 1381, 1386 (10th Cir. 1998) (debtor not eligible for relief simply because it was severely economically distressed); *In re City of Bridgeport*, 129 B.R. 332, 337 (Bankr. D.Conn.1991) (unbalanced budget not sufficient to establish insolvency); see also *In re City of Vallejo*, 408 B.R. 280, 290-291 (B.A.P. 9th Cir.) (analyzing debtor's ability to pay general obligations when due where restrictions apply to use of certain funds).

[123] 11 U.S.C. §109(c)(3). *See In re Valley Health Sys.*, 383 B.R. 156, 161 (Bankr. C.D. Cal. 2008) ("The burden of establishing eligibility under § 109(c) is on the debtor.").

[124] *See In re Slocum Lake Drainage Dist. of Lake City*, 336 B.R. 387, 391 (Bankr. N.D. Ill. 2006).

[125] 11 U.S.C. §109(c)(4).

[126] *In re New York City Off-Track Betting Corp.*, 427 B.R. at 272; *In re City of Vallejo*, 408 B.R. 280, 295 (B.A.P. 9th Cir. 2009).

requirement is met, the bankruptcy court will not look "behind the petition" for an improper purpose.[127] Rather, it will look at the financial situation of the debtor and whether the case serves the purpose of Chapter 9.[128] A court will find that a municipality does not, in good faith, seek to adjust its debts if it filed only to "buy time or evade creditors."[129] Courts that have analyzed this requirement have held that a written declaration of the debtor stating its intent to affect a plan, combined with actual efforts to negotiate and prepare a plan, fulfill this requirement.[130]

D. Negotiation with Creditors; Impracticability

The municipality must show that it satisfies at least one of the "creditor negotiation" tests of Section 109(c)(5), which include requirements that the municipality has made efforts to negotiate with its creditors regarding the impairment of their claims or that such an effort is impracticable.[131] The purpose of this requirement is to show that the municipality has attempted to find ways to avoid filing for bankruptcy and that Chapter 9 is its last resort.[132] Courts have read this section in conjunction with the "desire to effect a plan" requirement to conclude that a municipality must actually engage in negotiations concerning the possible terms of the plan.[133] Nevertheless, "[c]ourts agree . . . that no formal complete plan is required for negotiations."[134] An outline, term sheet or similar writing is satisfactory.[135]

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[127] *In re Sullivan County Reg'l Refuse Disposal Dist.*, 165 B.R. 60, 81 (Bankr. D. N.H. 1994).

[128] *Id*.

[129] *See In re City of Vallejo*, 408 B.R. 280, 295 (9th Cir. B.A.P. 2009).

[130] *See e.g. In re Pierce County Housing Auth.*, 414 B.R. 702, 710 (Bankr. W.D. Wash. 2009).

[131] 11 U.S.C. §109(c)(5), (A) – (D).

[132] *Sullivan County*, 165 B.R. at 82.

[133] *In re Cottonwood Water and Sanitation Dist.*, 138 B.R. 973, 975 (Dist. Colo. 1992); *but cf. 2 Collier on Bankruptcy* ¶109.04[3][(e)][ii] (To require that pre-filing negotiations include a proposed plan "is an overly restrictive view").

[134] *In re New York City Off-Track Betting Corp.*, 427 B.R. at 274, quoting *In re City of Vallejo*, 408 B.R. at 297.

[135] *See In re City of Vallejo*, 408 B.R. at 297 ("[W]e emphasize that while a complete plan is not required, some outline or term sheet of a plan which designates classes of creditors and their treatment is necessary"); *see also In re*

There are four alternative ways to satisfy these requirements of Section 109(c)(5). First, the debtor may obtain the agreement to a plan for adjustment from a majority of the creditors that the debt adjustment plan will impair.[136] Second, it may demonstrate that it attempted to negotiate terms of a plan with the creditors in good faith and was unable to reach an agreement.[137] When a municipality did not acknowledge all of its creditors and liabilities in its plan, never utilized its assessment powers, and failed to present a realistic repayment plan in a timely manner, this requirement was not met.[138] The mere presentation of a "take-it-or-leave-it" plan to creditors without discussing the material terms is insufficient to meet this requirement.[139] The municipality must express a willingness to compromise and make a good-faith effort to use available revenues to resolve its financial crisis.[140]

Third, the municipality may demonstrate that negotiations are impracticable.[141] One way to prove this is by demonstrating that there are a large number of claimants and no practical way to negotiate with them individually or through a representative.[142] In *In re Villages at Castle Rock Metropolitan District No. 4*, for example, the debtor had four classes of bondholders but negotiated only with one class.[143] The court found that the "creditor negotiation" requirement was met because negotiating with all of the classes of bondholders would have been

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Mendocino Coast Recreational and Park Dist., 2012 WL 1431219 *2 (Bankr. N.D. Cal.) (The proposal of a plan in concept does not require specific references to provisions of the Bankruptcy Code).

[136] 11 U.S.C. §109(c)(5)(A). When a majority of creditors have accepted a plan, bankruptcy may be necessary to bind the non-accepting minority.

[137] 11 U.S.C. § 109(c)(5)(B).

[138] *Sullivan County*, 165 B.R. at 78.

[139] *In re Ellicott School Building Authority*, 150 B.R. 261, 266 (Dist. Colo. 1992).

[140] *Id.*; *Sullivan County*, 165 B.R. at 83.

[141] 11 U.S.C. §109(c)(5)(C). Impracticality of negotiations requires a fact-sensitive analysis that must be addressed on a case-by-case basis. *In re City of Vallejo*, 408 B.R. at 298.

[142] *In re City of Vallejo*, 408 B.R. at 297-98.

[143] *In re Villages at Castle Rock Metro Dist. No. 4*, 145 B.R. 76, 85 (D. Colo. 1990).

impracticable.[144] This conclusion was also reached by the Bankruptcy Court in Detroit, which concluded that the City did *not* negotiate in good faith, but referenced Section 109(c)(5)(C) of the Code, and concluded that such negotiations were impracticable, stating "It is impracticable to negotiate with a group that asserts that their position is immutable," and further that "[n]egotiations with retirees and bondholders were impracticable due to the sheer number of creditors, and because many of the retirees and bondholders have no formal representatives who could bind them, or even truly negotiate on their behalf."[145]

Negotiations might also be impracticable because a municipality must act to preserve its assets.[146] In *In re County of Orange*, local agencies deposited their excess funds in the debtor county's treasury, which were commingled in an investment fund.[147] The fund had hundreds of participants and accounts.[148] The fund could not meet the lenders' demand for additional collateral. Liquidation of the lender's portfolio was threatened, thus prompting the Chapter 9 filing.[149] Negotiations were impracticable as the fund "had no time to enter into negotiations with its participants before acting to protect its portfolio assets."[150]

Finally, a municipality can satisfy the fifth requirement by proving a creditor may attempt to gain a transfer of assets that would be avoidable as a preference.[151] Such a situation may exist when a municipality demonstrates that a creditor is seeking a transfer that would unfairly

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144 *Id*.

145 In re *City of Detroit, Eligibility Opinion*, *supra* at fn. 117, pp. 124-125.

146 *In re Valley Health Syst.*, 383 B.R. 156, 163 (Bankr. C.D. Cal. 2008).

147 *In re County of Orange*, 183 B.R. 594, 607 (Bankr. C.D. Cal. 1995).

148 *Id*. at 608.

149 *Id*.

150 *Id*.

151 11 U.S.C. §109(c)(5)(D).

disadvantage other creditors. Examples include a demand for collateral or a setoff of funds. A municipality can file for Chapter 9 without negotiations to prevent this from occurring.

Not all municipalities will meet the eligibility requirements for a Chapter 9 debtor. In extreme instances, it has taken a year or more for a municipality to establish it is eligible for Chapter 9.[152] Other cases have only taken a few months.[153] If a creditor objects to the filing, the municipality bears the burden of proving it is eligible by a preponderance of the evidence.[154] In making this determination, the court should "provide access to relief in furtherance of the Code's underlying policies."[155] If the court concludes that the filer is ineligible, it must dismiss the case.[156]

A case may also be dismissed if the petition is not filed in good faith, so the municipality should be prepared to prove it filed the petition in good faith, apart from the good faith negotiation component of the eligibility requirements.[157] The "good faith" requirement for a municipality's petition is not defined by the Code and there is no legislative history for Section 921(c) on this issue.[158]

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[152] *Vallejo*, *supra*; *Hamilton Creek*, *supra*.

[153] *Valley Health Syst.*, *supra*; *In re New York City Off-Track Betting Corp.*, 427 B.R. 256 (Bankr. S.D. N.Y. 2010); *City of Bridgeport*, *supra*.

[154] *See Valley Health Syst.*, 383 B.R. at 161; *Vallejo*, 408 B.R. at 289, 289 n.14; *Sullivan County*, 165 B.R. at 75.

[155] *Vallejo*, 408 B.R. at 289 (quoting *Valley Health Sys.*, 383 B.R. at 161).

[156] *See County of Orange*, 183 B.R at 599.

[157] 11 U.S.C. § 921(c). Dismissal for lack of good faith is permissive, but not mandatory. *In re Pierce County*, 414 B.R. at 714.

[158] *In re County of Orange*, 183 B.R. at 608.

CHAPTER 4

THE BOND ISSUE IN CHAPTER 9

I. GENERAL OBLIGATION BONDS VERSUS REVENUE BONDS

As all public finance practitioners appreciate, there are significant differences between general obligation bonds and revenue bonds.[159] This distinction continues, and may be magnified, in a Chapter 9 case. Although it may seem elementary to many readers, we will review some of the basic concepts of public finance as prologue to the treatment of municipal bonds in a Chapter 9 case. The characteristics of any general obligation ("GO") bond are determined by applicable state or local law. The precise source and security for payment of general obligation bonds varies considerably from issuer to issuer depending on state or local law; therefore, it is impossible to generally summarize characteristics of all general obligation bonds.

Contrary to the common assumption, general obligation bonds may be supported by a pledge of the issuer's full faith and credit *and/or* the issuer's taxing power. For example, general obligation bonds of California local governments are supported by a pledge of their taxing power, but not by the full faith and credit. In contrast, general obligation warrants of Alabama local governments are not supported by a pledge of their taxing power.

The concept of a full faith and credit obligation is consistently used among the states, but the specific attributes of any individual full faith and credit obligation will undoubtedly vary among different states. It may be difficult for an issuer to detail the attributes of its full faith and credit obligation, as constitutional, statutory, case law and other state law tends to recite the plain language of the term rather than provide a definition of the term.

[159] For a general discussion of the differences in general obligation bonds and revenue bonds in Chapter 9, *see* NABL's *General Obligation Municipal Bonds: State Law, Bankruptcy and Disclosure Considerations* (August 2014).

Although it is difficult to attempt to fit all general obligation bonds into just a few conceptual boxes, it may be useful to think about general obligation bonds in three broad categories based on whether and to what extent the taxing power of the issuer is pledged:

- Unlimited tax general obligation bonds ("UTGOs"),
- Limited tax general obligation bonds ("LTGOs"), and
- General obligations payable from the issuer's general fund ("GFGOs").

The risk of default by the issuer of GOs is generally perceived by the capital markets to be lower than for revenue bonds.

Revenue bonds are payable exclusively from a specific revenue source. Accordingly, revenue bonds are particularly appropriate to finance the construction or expansion of revenue producing public works projects such as public utilities, airports and toll roads. These revenue sources are generally pledged as security for the payment of the revenue bonds.

Because revenue bonds are not supported by the taxing powers or the full faith and credit of an issuer, revenue bonds are deemed to have a greater risk of default. Upon such a default, the bondholders have no claim upon the non-pledged revenues or assets. Revenue bonds are therefore often rated lower than GOs, and a particular issuer's revenue bonds often have a higher interest rate than its GO bonds.

Outside of a Chapter 9 case, GO bonds are often required to be paid as a "first budget priority." Inside a Chapter 9 case, however, payment priorities are determined in part by the Code and by the debtor. Contrary to the norms of the capital markets, in a Chapter 9 bankruptcy case, revenue bonds, as secured obligations, often receive treatment that is superior to the

treatment afforded to single-barrel GOs, which may be treated as unsecured debt.[160] This inversion of credit quality expectations is discussed in greater detail below.

Similarly, in certain situations, industrial development revenue bonds, or other so-called private activity bonds may be issued by a governmental agency on behalf of a private sector business for the construction or acquisition of qualifying capital assets by the business. These bonds are generally repaid by the benefited private sector business and may be secured by the company's real estate, improvements and equipment, as well as certain credit enhancements such as a letter of credit.[161]

II. THE BOND DOCUMENTS

The mass of documents produced by bond lawyers is legendary among attorneys, underwriters and the other participants in the bond issuance process. Of great importance in Chapter 9 cases are those documents that describe the obligations of the issuers to bondholders, the collateral, if any, that secures those obligations, and the powers and remedies afforded to bondholders should the issuer default.

The bond resolution, or indenture, includes many of the terms of the contract between the issuer of the bonds and the bondholders. The indenture prescribes, among other things, the form of the bonds, the rates of interest, the security for the bonds, the times for payment and the terms of any applicable calls or conversions.

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[160] Note, however, that on the eve of the Central Falls, Rhode Island bankruptcy, the Rhode Island state legislature enacted legislation creating a statutory lien on a municipality's property tax revenues as security for GO bonds. R.I. Gen. Laws § 45-12-1(a). It should be noted that Central Falls had a nominal amount of general obligation debt which was not impaired under the confirmed plan and that the validity of the Rhode Island statute was not the subject of a judicial determination in the proceedings. In addition, in the Detroit bankruptcy, the treatment of UTGO bonds was called into question. The parties ultimately settled the dispute on terms that treated these bonds more like revenue bonds than LTGO bonds.

[161] Revenue bonds issued by a non-municipal debtor may not enjoy the same protection in Chapter 11 that municipal revenue bonds enjoy in chapter 9. *See Las Vegas Monorail* and Chapter 5 herein.

In most municipal bond issues, the interest of the bondholders is represented by a trustee who administers the funds and property that are subject to the indenture. The parties to the indenture are the issuer and the trustee. The indenture contains provisions that grant to the trustee certain powers to enforce the indenture terms on behalf of the bondholders. The "prudent man" standard is the generally recognized standard of care for indenture trustees once a default has occurred or is anticipated; prior to such an occurrence, the indenture trustee's duties are generally governed by the detailed provisions in the indenture.[162] Most indentures include provisions which permit bondholders to compel the trustee to take certain actions, and in particular circumstances, to remove the trustee.

Another document that should be carefully considered in a Chapter 9 case is the authorizing resolution. This term encompasses certain resolutions of the issuer which include, among other things, a description of the nature of the bond (*e.g.*, GO or special revenue), the issuer's duties to bondholders and the bondholders' rights with respect to the security for the bonds, if any. These documents also set forth the issuer's authorization to issue and sell the bonds. In some jurisdictions, these terms and issuer authorization are addressed in a bond ordinance rather than a resolution.

III. PAYMENT CONSIDERATIONS IN CHAPTER 9

A. Revenue Pledges

Bonds secured by "special revenues" (as defined by the Bankruptcy Code)[163] receive favorable treatment in Chapter 9 cases because they continue to be secured by the liens established at the outset of the bond transaction.[164] Section 902(2) of the Bankruptcy Code

[162] *See generally*, *Schwarcz*, *Bond Defaults and the Dilemma of the Indenture Trustee*, 59:4 Ala. L. Rev. 1037 (2008).

[163] 11 U.S.C. §902(2).

[164] 11 U.S.C. §928.

defines special revenues as revenues derived from (1) the operation or ownership of transportation or utility projects, (2) special excise taxes, (3) incremental taxes attributable to a special project, (4) certain municipal functions and (5) taxes levied to finance a specific project.[165] Section 928(a) specifically provides that special revenues received by a municipal debtor after the commencement of a Chapter 9 case remain subject to a prepetition pledge.[166] This is a significant exception to Section 552(a), which provides that property the debtor acquires after filing bankruptcy is not subject to any lien resulting from a pre-petition security agreement, notwithstanding an after-acquired property provision in the grant of the security interest. Another advantage to the holders of revenue bonds is that Section 922 provides that the automatic stay imposed by Section 362(a) does not stay the application of pledged revenues to the payment of the bond indebtedness.[167] Municipal debtors have argued that while pledged revenues held or received by an indenture trustee can continue to be applied by the trustee to pay down bond debt without court approval, a municipal debtor is not required by the Code to turn over special revenues to the trustee during the chapter 9 case despite the retention of the trustee's security interest in such revenues.[168] The bankruptcy court in *Jefferson County* rejected this argument and ruled Section

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[165] 11 U.S.C. §902(2).

[166] *See In re County of Orange*, 179 B.R. 185 (Bankr. C.D. Cal. 1995) where the court reasoned as follows:

> Prior to 1988, when a municipality filed Chapter 9, a risk existed that §552(a) could strip revenue bondholders of their liens on post-petition property of the debtor. Code §928 was enacted to remedy this problem by making §552(a) inapplicable to revenue bonds. Section 928 was narrowly crafted to apply only to special revenue bonds. Congress could have made §928 applicable to all municipal bonds, but it chose to limit its application.

179 B.R. at 191-92 (footnotes omitted).

[167] 11 U.S.C. §922(d) provides: "Notwithstanding section 362 of this title and subsection (a) of this section, a petition filed under this chapter does not operate as a stay of application of pledged special revenues in a manner consistent with section 927 of this title to payment of indebtedness secured by such revenues."

[168] *In re Jefferson County, Alabama*, 465 B.R. 243, 285-286. (Bankr. N.D. Ala. 2012). Note, however, that in *Jefferson County*, the Bankruptcy Court concluded that the debtor could not deduct funds from its operating revenues for the purpose of establishing a reserve for professional fees, depreciation, amortization, and capital expenditures because the indenture did not contemplate those deductions. See Chapter 5 herein.

922(d) required the debtor to pay over net revenues during the life of the case.[169] In either event, the trustee does not need stay relief to apply net revenues in its possession whether the trustee obtains possession before or after the debtor files chapter 9. Further, if a municipal debtor chooses to turn over special revenues (which, in some cases, may help facilitate the debtors' ultimate exit from bankruptcy and future access to the capital markets), it can do so without first obtaining court approval or notifying other creditors. Similarly, a municipality may elect to pay or not pay unsecured debt, including GOs, after the commencement of the Chapter 9 without first obtaining court approval.[170]

As of the date of this paper, some State Legislatures, including California, have taken action to create state law statutory lien protection which is intended to also constitute statutory lien protection under the Bankruptcy Code.[171] Statutory liens do not constitute consensual liens (security interests) under the Bankruptcy Code[172] but are not subject to the same express protections as bonds backed by "special revenues" under Section 928.

B. Gross Pledge versus Net Pledge

The revenues pledged as security for revenue bonds may be subject to either a gross pledge or a net pledge. A gross pledge in an indenture requires the issuer to first apply revenues to the bond issue debt service costs. Once the pledged revenues are used for that purpose, operating costs may be paid from the balance. Conversely, a net pledge allows the issuer to first

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[169] For a discussion of "special revenues," the "pledge" of those revenues, and the implications of 11 U.S.C. §§362(a) and 922(d) on those funds, see generally *In re Jefferson County, Alabama*, which is discussed further below in chapter 5.

[170] 11 U.S.C. § 904(2) provides: "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 . . . any of the property or revenues of the debtor".

[171] See for example, California's Senate Bill 222, now enacted as § 15251 of the California Education Code, applicable to certain school district general obligation bonds, and Michigan's Public Act 17 of 2015, amending 117.36a, applicable to certain home rule city financial recovery bonds.

[172] 11 U.S.C. § 101(53).

pay operating expenses from the projects receipts prior to any payment for the benefit of bondholders. However, this distinction is of little consequence during the pendency of a Chapter 9 of the issuer since Section 928(b) provides that a lien on special revenues is subject to the payment of operating expenses, even if the revenues are subject to a gross pledge.[173]

C. Preference Exception

Section 926(b) provides that a transfer of property of the debtor to or for the benefit of a bondholder on account of a bond (either GO or revenue) is not subject to avoidance as a preference pursuant to Section 547.[174] Bondholders therefore are generally exempt from the threat of preference liability with respect to pre-petition payments on account of bonds.

D. Preservation of Nonrecourse Status

Section 927 suspends the operation of Section 1111(b) and prevents the creation of a recourse claim by the holders of revenue bonds should the dedicated revenues prove to be insufficient.[175] Thus revenue bonds will remain nonrecourse obligations throughout a Chapter 9 case. In the absence of Section 927, it might be possible for a revenue bond issue to become a GO bond issue, raising major issues with respect to debt limitations and authority to incur a general obligation debt under state law.

E. Automatic Stay Exception

As addressed hereafter in greater detail,[176] the filing of a Chapter 9 petition results immediately in the imposition of a stay against most actions against the municipality and its

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[173] "Any such lien on special revenues, other than municipal betterment assessments, derived from a project or system shall be subject to the necessary operating expenses of such project or systems, as the case may be." 11 U.S.C. §928(b).

[174] "A transfer of property of the debtor to or for the benefit of any holder of a bond or note, on account of such bond or note, may not be avoided under 547 of this title." 11 U.S.C. §926(b).

[175] "The holder of a claim payable solely from special revenues of the debtor under applicable nonbankruptcy law shall not be treated as having recourse against the debtor on account of such claim pursuant to section 1111(b) of this title." 11 U.S.C. §927.

[176] *See* Chapter 5, Section VII, *infra*.

properties. Nevertheless, a Chapter 9 petition does not stay the application of special revenues that are pledged as security.[177] This exception is subject to the provision made in Section 928(b) for the payment of necessary operating expenses.

F. Subordination

The provisions of Section 510 of the Bankruptcy Code, which deal with the enforceability of subordination agreements, are incorporated into Chapter 9 via Section 901. Accordingly, contractual and equitable subordination apply in Chapter 9. Without limitation, agreements subordinating termination claims and other swap obligations to the payment of bond debt should be enforceable in Chapter 9.

[177] 11 U.S.C. §922(d).

CHAPTER 5

COMMENCEMENT OF THE CHAPTER 9 CASE AND PRE-CONFIRMATION CONSIDERATIONS

Because the eligibility requirements of 11 U.S.C. §109 require a prospective Chapter 9 debtor to have either (i) obtained the agreement of a majority in amount of the creditors of each class, or (ii) negotiated in good faith with creditors and failed to obtain an agreement of creditors holding a majority in amount of each class, or (iii) determined that negotiation with creditors is impracticable, or (iv) reasonably believed that a creditor may attempt to obtain a transfer that is avoidable under §547, the timing of filing a Chapter 9 petition often will be tied to the municipality's inability to achieve a consensual restructuring of its debt, or to a sudden event affecting the municipality's cash flow (as in the *Orange County* case) and the need to obtain some of the protections of bankruptcy (*e.g.*, the automatic stay) pending confirmation of a Chapter 9 plan.

I. PROCEDURAL REQUIREMENTS FOR FILING

If the issuer is a "municipality" for purposes of the Code,[178] the Chapter 9 case is commenced by filing a short petition, a list of the creditors holding the 20 largest unsecured claims, and the filing fee.[179] While the official bankruptcy forms do not designate a particular format for a Chapter 9 petition other than the general short form petition used for all chapters, the magnitude of a Chapter 9 filing, coupled with some of the fact-specific eligibility requirements of Section 109(c) of the Bankruptcy Code, make it prudent for the Chapter 9 debtor to supplement the official form with pleadings and affidavits that establish the eligibility of the municipality to file for Chapter 9.

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[178] "Municipality" is defined as a "political subdivision or public agency or instrumentality of a State." 11 U.S.C. §101(40).

[179] 11 U.S.C. §§301, 901; Fed. R. Bankr. P. 1007(d). The amount of the filing fee is the same as that for Chapter 11 cases. 28 U.S.C. §1930(a)(2).

Proper authorization from the municipality's governing legislative body to commence a petition of course must be obtained prior to filing the petition. In the event a Chapter 9 debtor is an unincorporated tax or special assessment district that does not have its own officials, a Chapter 9 case may still be filed by the district's governing authority or board or body having authority to levy taxes or assessments to meet the obligations of such district.[180] Chapter 9 anticipates that the bankruptcy court will consider eligibility issues for a municipal debtor "before" an order for relief is entered, in contrast to the usual result under Section 301 of the Code, where the filing of a voluntary petition operates immediately as an order for relief.[181]

Unlike a Chapter 11 debtor that is required to file detailed schedules itemizing the debtor's assets and liabilities, a Chapter 9 debtor need only file a list of creditors (or schedule of liabilities) and designate whether a creditor's claim is disputed, contingent, or unliquidated, and a list of the twenty largest unsecured creditors, exclusive of insiders.[182] The creditor list shall be filed within such time as the court fixes.[183] The schedule of liabilities constitutes prima facie evidence of the validity and amount of each claim included therein, other than claims scheduled as disputed, contingent or unliquidated.[184] If a claim is not scheduled or is scheduled as disputed, contingent or unliquidated, a proof of claim must be filed within such time limit as the court may fix.[185] If a proof of claim is filed, it supersedes the listing for that creditor in the municipality's schedules and shall be deemed allowed unless there is an objection to the claim.[186] A creditor whose claim

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[180] 11 U.S.C. §921(a). *See also In re New York City Off-Track Betting Corp*. 427 B.R. 256 (Bankr. S.D.N.Y. 2010) (municipality authorized to file by governor's proclamation).

[181] 11 U.S.C. §921(d).

[182] 11 U.S.C. §924; Fed. R. Bankr. P. 1007 (a), (d). For a Chapter 9 debtor, the term "insider" includes an elected official or relative of an elected official. 11 U.S.C. §101(31)(d).

[183] Fed. R. Bankr. P. 1007(e).

[184] 11 U.S.C. §925; Fed. R. Bankr. P. 3003(b).

[185] Fed. R. Bankr. P. 3003(c). The debtor usually files a pleading early in the case to establish a bar date for filing claims. Creditors should monitor the docket to ascertain deadlines.

[186] Fed. R. Bankr. P. 3001(f) & 3003(c)(4).

is not listed in the schedule of liabilities but which otherwise has knowledge of the case may be barred from participating in distributions in a confirmed Chapter 9 plan if it fails to file a proof of claim.[187]

Section 901 incorporates Sections 501 and 502 of the Bankruptcy Code. Except for sections that obviously have no application in a municipal case (for example, allowance of equity interest, disallowance of claims for alimony, and gap claims in involuntary cases), the normal claims-filing and allowance process should apply in Chapter 9. Except for subsection (a)(2), Section 507 does not apply in Chapter 9. Accordingly, Chapter 9 cases include the filing and allowance of administrative expense claims (discussed below), but not the allowance of priority claims.[188]

An indenture trustee may file a claim on behalf of all known and unknown holders of securities or bonds represented by the trust indenture.[189] Because a municipality does not necessarily know the identity of the holders of publicly traded municipal bonds (or the beneficial owners of such bonds if held in street name), it is likely that the indenture trustee will represent bondholder interests and initial legal notices relating to a Chapter 9 case will be sent to the trustee. The filing of a proof of claim by an indenture trustee, however, does not preclude individual bondholders from filing proof of claims for amounts owed pursuant to their respective bonds. Depending on the provisions of the indenture, such separately filed claims may be disallowed as duplicative. In the absence of a power of attorney or other agency

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[187] *Nebraska Security Bank v. Sanitary & Improvement Dist. No. 7*, 119 B.R. 193 (D. Neb .1990). Section 944 of the Bankruptcy Code provides that confirmation of a plan discharges the debtor from all debts except those "owed to an entity that, before confirmation of the plan, had neither notice nor actual knowledge of the case." 11 U.S.C. § 944(c)(2). The language is unambiguous and discharges the claims of any creditor that had notice or actual knowledge of the case before confirmation of a plan, regardless of whether the creditor had specific notice of the bar date. *Nebraska Security Bank*, 119 B.R. at 195.

[188] This was an issue in the Detroit bankruptcy with respect to the allowance of senior and junior unsecured claims. The issue was ultimately resolved through mediation.

[189] 11 U.S.C. §501(a); Fed. R. Bankr. P. 3003(c)(5).

relationship, an individual bondholder may not file a claim on behalf of any other bondholder.[190] Similarly, the standing of insurers with respect to bonds not yet due is uncertain.

If a proposed plan requires a revision of assessments so that the proportion of special assessments or special taxes to be assessed against some real property will be different from the proportion in effect at the date that the petition is filed, the Chapter 9 debtor must also file a list of the names and addresses of all known holders of title, legal or equitable, to the real property that is adversely affected, unless upon motion and for cause shown, the court orders otherwise.[191]

In addition to filing the petition, the list of creditors and a list of the 20 largest creditors, a Chapter 9 debtor must also give notice of the case filing (and any subsequent dismissal of the case) through publication at least once a week for three successive weeks in a newspaper of general circulation in the district where the case is commenced and in such other newspapers having general circulation among bond dealers and bondholders as the court may designate.[192] The assignment of a bankruptcy judge to the Chapter 9 case is made by the chief judge of the court appeals for the circuit in which the case is pending.[193] Thus, in some circuits, a few bankruptcy judges become, through this assignment mechanism, familiar with the practices and issues unique to Chapter 9 cases.

II. MANAGEMENT OF THE DEBTOR

Post-petition management of a Chapter 9 municipality remains the same as prior to filing. Elected officials and legislative bodies continue to perform their duties which are necessary to the daily operation of the municipality. As noted previously, the federal constitutional concerns for state sovereignty and their control of municipalities have produced several Supreme Court

[190] *In re Standard Metals Corp.*, 48 B.R. 778 (Bankr. D. Colo.1985).

[191] Fed. R. Bankr. P. 1007(e).

[192] 11 U.S.C. §923. The debtor may seek court approval of its plan to meet publication requirements.

[193] 11 U.S.C. §921(b). Cases under other chapters of the Bankruptcy Code generally receive random assignment.

cases that illustrate, if not resolve, many of the historical problems with a federal law that affects state municipal governmental bodies, and their debts, contracts and revenues. Section 541 of the Bankruptcy Code does not apply in Chapter 9. Accordingly, municipal property remains the debtor's and does not become a part of a bankruptcy estate subject to direct judicial overnight and control. Sections 903 and 904 succinctly prescribe limits on the powers of the bankruptcy court to intervene in political or governmental matters or to affect the property and revenues (i.e., their expenditure) of a municipality, as well as the debtor's income producing property. Without limitation, the bankruptcy court has no power to overrule state law or relieve the municipality of compliance with governing state law.[194]

As a result of these constitutional and statutory limitations, a bankruptcy court's role in Chapter 9 is far more restricted than in cases under other chapters. Absent the consent of the municipality or unless the plan otherwise provides, the court may not interfere with any of the political or governmental powers of the municipality, the municipality's use of its property or revenues or enjoyment of its income producing properties.[195] The municipality is free to incur post-petition debt, borrow funds, and buy or sell property (subject to the rights of lien holders) without authorization of the court.[196] The debtor also has the power to pay pre-petition claims notwithstanding the application of Section 549 of the Bankruptcy Code.[197] Similarly, the authority of a state to control the exercise of the political or governmental powers of the

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[194] *See New York City Off–Track Betting Corp.*, 427 B.R. at 277-78 (debtor's Chapter 9 plan not feasible absent legislative action to alter state law on distribution of betting proceeds).

[195] 11 U.S.C. §904.

[196] Section 904 makes clear that the court *may* enter orders affecting the debtor's powers, property and revenues *if the debtor consents*. The debtor may consent to entry of such orders, including orders that limit the municipality's right to exercise powers otherwise protected by the Tenth Amendment, to facilitate settlements, provide extra security to lenders extending post-petition credit, or to expedite discovery or other litigation issues.

[197] *See In re Richmond Unified School Dist.*, 133 B.R. 221, 224 (Bankr. N.D. Cal 1991); *In re Sanitary & Improvement Dist. No. 7*, 96 B.R. 966, 972 (Bankr. D. Neb. 1989).

municipality is not impaired by Chapter 9.[198] In sum, the bankruptcy court has the power to grant or deny stay relief, confirm or not confirm the debtor's plan, approve or deny the assumption of contracts and leases, and to dismiss the case entirely for ineligibility, lack of good faith, or failure to achieve confirmation. Otherwise, the court's oversight role is limited. Specifically, the bankruptcy court cannot order municipalities to raise taxes or fees in Chapter 9.[199]

The inapplicability of Section 541 and the lack of an "estate" in Chapter 9 also affects the allowance and payment of administrative claims. In Chapter 11, the bankruptcy court is required to allow as administrative expenses the "actual and necessary costs of preserving the estate," which may include wage claims, the claims of vendors who supply goods and services to the debtor on credit and other operating expenses. Section 901 incorporates both 503(b), which provides for the allowance of administrative expense claims, and Section 507(a)(2), which grants priority to claims allowed as administrative expenses under Section 503(b); however, because there is no estate in Chapter 9, the bankruptcy court has no direct authority to allow as an administrative expense claim, or to direct the debtor to pay, general operating costs of employees and trade vendors.[200] Allowance of administrative expenses in Chapter 9 is limited to expenses incurred with the administration of the case itself, not the preservation or operation of the debtor's assets.[201] Although the court does not have authority to allow or order payment of

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[198] 11 U.S.C. §903.

[199] State law often prevents a municipal debtor from raising revenues in Chapter 9. *See, e.g., In re Jefferson County, Alabama*, 484 B.R. 427, 435 (Bankr. N.D. Ala, 2012) (debtor lacked "home rule" under State constitution and required action by State legislature to raise taxes); *In re Pierce County Housing Auth.,* 414 B.R. 702, 711-12 (Bankr. W.D. Wash. 2009)) (State law prohibited debtor from operating at a profit or raising rents above specified levels); *In re Town of Moffett*, Case No. 09-81814 (Bankr. E.D. Okla. 2009) (State Attorney General and Department of Public Safety impaired debtor's primary revenue source by declaring speed trap illegal).

[200] However, Section 366 applies in Chapter 9. Although utilities providing services to the municipality may not terminate service based on the debtor's bankruptcy or failure to pay a pre-petition claim, the utility may discontinue service if the debtor does not provide adequate assurance of payment for future service.

[201] *In re New York City Off–Track Betting Corp*., 434 B.R. 131, 141-142 (Bankr. S.D.N.Y. 2010).

administrative claims on an interim basis, payment of allowed administrative expenses may be a condition to confirmation under Section 943.

III. OFFICIAL COMMITTEES AND UNITED STATES TRUSTEE

Chapter 9 does not include a provision that specifically addresses the composition or function of official committees. Instead, Section 901 provides that sections 1102 and 1103, which govern the creations and powers of committees, are applicable in Chapter 9.[202]

Section 1102 requires the United States Trustee ("UST") to appoint an official committee of unsecured creditors "as soon as practicable after the order for relief."[203] Other committees of creditors may be appointed as the UST deems appropriate.[204] Likewise, on request of a party in interest, the court may order the appointment of additional committees "to assure adequate representation of creditors."[205] The determination of adequacy of representation focuses on whether different classes of debt are treated differently under a plan and require unique representation through additional committees.[206] Factors that a bankruptcy court may consider in deciding whether to grant motion for appointment of additional creditors' committees include: (1) the ability of an existing committee to function; (2) the nature of case; (3) standing and desires of the various constituencies; (4) ability of creditors to participate in the case even without their own official committees; (5) whether different classes may be treated differently under the plan and thus need representation; (6) motivation of movants; (7) the costs incurred by

[202] 11 U.S.C. §901(a). Section 1102 provides for at least one committee of unsecured creditors. Committees are the primary means of negotiation between the debtor and its unsecured creditors during the formulation of the plan. *See* H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 401 (1977). Section 1103 authorizes a committee to, among other things, consult with the debtor, investigate the business and financial condition of the debtor, participate in the formulation of a plan and employ legal counsel and other professionals.

[203] 11 U.S.C. §1102(a)(1).

[204] *Id*. In Detroit bankruptcy, the UST appointed a committee for retired city employees.

[205] 11 U.S.C. §1102(a)(2).

[206] H.R. Rep. No. 595, 95th Cong. 1st Sess. 401(1977); *In re Drexel Burnham Lambert Group, Inc.*, 118 B.R. 209, 212 (Bankr. S.D.N.Y. 1990).

appointing additional committees; and (8) tasks that the committee or separate committee is to perform.[207] Upon the entry of an order for the creation of additional committees, the UST is required to appoint such a committee.[208]

Once a committee is appointed, a party in interest may move to change the member composition if the court concludes that a change is required "to ensure adequate representation of creditors . . . ."[209] For example, retired employees of a municipal debtor may not hold in the aggregate a substantial portion of the claims against the debtor, but the court may conclude that a committee should include a representative of this creditor constituency.[210]

Although Sections 1102 and 1103 apply in cases under Chapter 9 and Chapter 11, the committee in a Chapter 9 case differs from a Chapter 11 committee in several important respects. First, as previously noted, a creditors' committee is appointed shortly after the entry of an order for relief.[211] As noted earlier, in Chapter 11 cases, the order for relief is entered upon the filing of a voluntary petition.[212] The creditors' committee, and perhaps other official committees, are therefore integral participants in many of the significant issues that are addressed in the early stages of a Chapter 11 case. Conversely, in a Chapter 9 case, the order for relief is not entered until the court determines that the eligibility requirements for Chapter 9 have been met.[213]

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[207] *In re Enron*, 279 B.R. 671, 685-686 (Bankr. S.D.N.Y. 2002).

[208] *Id*.

[209] 11 U.S.C. §1102(a)(2).

[210] 11 U.S.C. §1102(a)(4). If a creditor is a small business concern whose claims in the aggregate represent a disproportionately large portion of that business' annual gross revenue, then the court may order the trustee to increase the number of members on a committee to include that creditor. *Id*. For a definition of small businesses considered eligible for this exception, *see* The Small Business Act, 15 U.S.C. §632(a)(1).

[211] 11 U.S.C. §1102(a)(1).

[212] *See* 11 U.S.C. §301(b).

[213] 11 U.S.C. §§109(c), 903 and 921(d).

Accordingly, the threshold issue of eligibility for Chapter 9 relief is litigated without the participation of any official committees.[214]

Second, the Code does not specifically address the debtor's obligation to pay the fees and expenses of professionals retained by committees or to reimburse committee members for their expenses.[215] Section 901(a) does not incorporate Sections 327, 328, 329, 330 and 331, which govern court approval of retention and compensation of professionals. Outside of a Chapter 9 bankruptcy, Section 328 authorizes a committee, with court approval, to employ a professional person.[216] After notice and hearing, the court may award reasonable compensation and the reimbursement of actual, necessary expenses to "a professional person employed under Section 327 or 1103."[217]

Because Sections 328 and 330 do not apply to Chapter 9 cases, the debtor has no statutory obligation to pay the professionals employed by the official committees or to reimburse committee members for their expenses.[218] Nevertheless, the debtor may wish to agree to pay those expenses since a knowledgeable and well-represented committee can be an important and persuasive ally of the municipal debtor on many of the significant issues in the Chapter 9 proceeding, including the negotiation of the plan for adjustment. Moreover, to the

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[214] *See In re Colorado Centre Metro. Dist.*, 113 B.R. 25 (Bankr. D. Colo. 1990) (finding that a committee cannot be formed until after the court enters an order for relief pursuant to 11 U.S.C. §921(d)); *see also In re City of Vallejo*, 408 B.R. 280, 288 (9th Cir. 2009) (describing the eight day trial of whether the City of Vallejo was eligible for Chapter 9 relief).

[215] *In re East Shoshone Hosp. Dist.*, 226 B.R. 430, 432 (Bankr. D. Idaho 1998) (finding that nothing in Chapter 9 demonstrates that it would be appropriate for a court to enter an order approving a Chapter 9 debtor's employment of legal counsel).

[216] "The trustee, or a committee appointed under section 1102 of this title, with the court's approval, may employ or authorize the employment of a professional person under section 327 or 1103 of this title, as the case may be, on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis or on a contingent fee basis." 11 U.S.C. §328(a).

[217] 11 U.S.C. §330(a)(1).

[218] *See In re East Shoshone*, 226 B.R.430 (Bankr. D. Idaho 1998); *but see*, *In re Castle Pines North Metropolitan Dist.*, 129 BR 233 (Bankr. D. Colo. 1991) (holding that professional compensation is an administrative expense).

extent committee professional fees are allowed as an administrative expenses, the debtor may be required to pay them as a condition to confirmation.[219]

Once appointed, a committee is authorized to (i) consult with the municipality concerning the administration of the case, (ii) investigate the acts, conduct, assets, liabilities and financial condition of the municipality, (iii) participate in formulating a plan and advise its constituents with respect to a plan, (iv) collect and file acceptances or rejections of a plan, and (v) seek the appointment of a trustee or examiner.[220] Chapter 9 Committees have the powers and obligations of committees generally and, with the amendment to Section 1102(b)(3), are subject to certain access and disclosure obligations.[221] Although the usual rules of retention and compensation of professionals do not apply, those powers include the employment of counsel and other professionals to advise the committee.

Apart from the appointment of official committees, the UST plays a limited role in Chapter 9 cases. In Chapter 11, the UST plays a major role in supervising the administration of the case. In addition to monitoring fee applications, disclosure statements, plans and other pleadings, the UST requires the debtor to file monthly operating reports and conducts a meeting of creditors pursuant to Section 341, at which time the UST and creditors may question the debtor under oath regarding the debtor's conduct, property, finances and prosecution of the case. The UST has standing in Chapter 11 to object to pleadings and files its own motions to dismiss or convert the case to Chapter 7, or to appoint a Trustee or examiner in the Chapter 11 case if the debtor fails to

[219] 11 U.S.C. §943(b)(5). Section 943(b)(3) imposes an additional requirement that all amounts paid for services and expenses in the case or incident to the plan be disclosed and reasonable. This confirmation requirement is sometimes addressed in a plan or confirmation order by requiring professionals to apply for and be limited to compensation approved as reasonable by the court in a post-confirmation hearing. *See In re Corcoran Hospital District*, 233 B.R. 449, 452-53 (1999). See, also *Order Confirming Eighth Amended Plan for the Adjustment of Debts of the City of Detroit,* Document 8272 filed November 12, 2014 at 36.

[220] 11 U.S.C. §1103(c).

[221] *See* 11 U.S.C. §§1102(b)(3), 1103.

comply with the Bankruptcy Code, local rules, or the UST's own requirements. For the reasons discussed above, the UST performs none of these functions in Chapter 9.

IV. OBTAINING CREDIT UNDER SECTION 364

Section 901 makes *parts* of Section 364 on obtaining post-petition credit applicable in Chapter 9. Section 364(c) [obtaining unsecured credit with priority over administrative claims, with a lien on otherwise unencumbered assets, or with a junior lien on encumbered assets], Section 364(d) [obtaining secured credit with a senior or equal lien on encumbered assets], Section 364(e) [protection of good faith creditor against reversal on appeal of the validity of post-petition debt or priority of post-petition lien], and Section 364(f) [exclusion from securities laws for offer or sale in a §364 transaction of a security that is not an equity security] all apply in Chapter 9. Sections 364 (a) and (b), which address the debtor's authority to obtain unsecured credit, either in ordinary course or outside the ordinary course, do not apply in a Chapter 9 case.[222] By virtue of Tenth Amendment concerns and the requirements of Sections 903 and 904, the bankruptcy court does not approve or monitor the municipal debtor – even though it is a Chapter 9 debtor – in its incurring of unsecured debt or obtaining unsecured credit, at least until those transactions impact administrative priorities or involve liens on property.[223] However, the debtor may avail itself of the protections offered lenders by court approval under Section 364(c) – (f) to facilitate post-petition borrowing.

V. PRELIMINARY DISMISSAL ISSUES: BAD FAITH AND INELIGIBILITY

Once the petition is filed, the court, upon any objection to the petition, may dismiss the case if the petition does not meet the statutory requirements for filing or if it was not filed in

[222] 11 U.S.C. §901(a).

[223] For the same constitutional and statutory reasons that unsecured credit transactions of a municipal debtor do not require bankruptcy court approval, Section 363 on the use, sale or lease of property does not apply to the municipal debtor.

good faith.[224] For example, petitions may be dismissed for bad faith where the municipality failed to exercise assessment powers to resolve its financial problems, did not engage in considered debate of the decision to file and utilized Chapter 9 as a litigation tactic.[225] While "good faith" is not defined in the Code, courts addressing the question in Chapter 9 have relied on case law which has imposed a good faith requirement for filing under other chapters of the Bankruptcy Code. Factors considered have included an evaluation of a debtor's "financial condition, motives, and local financial realities."[226] Improper motives to delay creditors without benefiting them or to achieve results not intended by the Code may constitute bad faith.[227] Even when a case is filed in good faith, dismissal at inception is appropriate where other eligibility requirements are not met.[228] Determination of eligibility may take months, if not longer, and a contested matter regarding eligibility is a critical step in the case. A debtor may file a "Statement of Qualifications" with the petition to show – and to attempt to head off issues about –

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[224] 11 U.S.C. §§109(c) and 921(c). Creditors in the chapter 9 cases of Jefferson County, Alabama and City of Prichard, Alabama argued the Ala. Code § 11-81-3 authorized filing only by municipalities that have issued bonds rather than warrants or other types of debt. Both the Bankruptcy Court (on a motion to dismiss) and the Alabama Supreme Court (on certified question from the United States District Court) rejected this construction of the statute and ruled Alabama municipalities may file Chapter 9 regardless of the type debt. *See In re Jefferson County Alabama*, 469 B.R. 92 (Bankr. N.D. Ala. 2012); *City of Prichard v. Balzer*, 95 So. 3d 1 (Ala. 2012).

[225] *In re City of Vallejo*, 408 B.R. 280, 295 (B.A.P. 9th Cir. 2009) (municipality does not act in good faith if it files Chapter 9 only to delay or evade payments to creditors); In *re Sullivan County Regional Refuse Disposal Dist.*, 165 B.R. 60 (Bankr. D.N.H. 1994) (case dismissed despite insolvency and desire to effect plan where municipality failed to engage in good faith negotiations with other creditors, failed to give notice of financial troubles to anyone except largest creditor, and failed to negotiate a comprehensive plan outside of bankruptcy); *see In re Chillowee R-IV School Dist.*, 145 BR. 981 (Bankr. W.D. Mo 1992) (finding that it was not bad faith for school district to engage in prebankruptcy planning to file Chapter 9 to avoid payment of a judgment in favor of discharged teachers); *Matter of Jersey City Medical Center*, 817 F. 2d 1055 (3rd Cir. 1987) (plan filed in good faith and did not discriminate unfairly by grouping unsecured creditors in different classes); *see also In re New York City Off-Track Betting Corp.*, 427 B.R. 256 (Bankr. S.D.N.Y. 2010) (petition not in bad faith simply because automatic stay permitted avoidance of mandatory statutory distributions).

[226] *In re Sullivan County Regional*, 165 B.R. at 82, quoting *In re Villages of Castle Rock*, 145 B.R. 76, 81 (Bankr. D. Colo. 1990).

[227] *Id*. at 81.

[228] *In re Town of Westlake, Tex.*; 211 B.R. 860 (Bankr. N.D. Tex. 1997) (case dismissed where case was filed in good faith but debtor not insolvent and had no desire to effect plan to adjust debts).

eligibility.[229] Denial of a motion to dismiss for bad faith is interlocutory in nature and not appealable as a final order.[230]

VI. EMPLOYMENT OF PROFESSIONALS

Unlike Chapter 11, a Chapter 9 debtor may employ professionals without court approval. This eliminates supervision by the UST of the employment of counsel and approval of fees and eliminates potential or actual conflicts from preventing employment, subject to non-bankruptcy ethical considerations. Fees to be paid to professionals at or after confirmation must be disclosed and are reviewable for reasonableness in connection with confirmation of the plan.[231]

VII. AUTOMATIC STAY

A general policy of Chapter 9 is to give the municipal debtor relief from debt collection efforts in order to develop a plan to restructure its debts.[232] When efforts to restructure those debts outside of bankruptcy fail, the protection afforded by the automatic stay is often a motivating factor to file Chapter 9. Pursuant to 11 U.S.C. §§362(a) and 922(a), the filing of the Chapter 9 petition will operate as a stay of all litigation and debt collection activities against a municipality and its property.[233] This can be a significant benefit to a

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[229] *See*, *e.g.*, *In re New York City Off-Track Betting Corp.*, 427 B.R. 256, 272 (Bankr. S.D.N.Y. 2010); *In re City of Vallejo*, 408 B.R. 280, 295 (B.A.P. 9th Cir. 2009).

[230] *In re City of Desert Hot Springs*, 327 F.3d 930 (9th Cir. 2003).

[231] 11 U.S.C. §943(b)(3). 11 U.S.C. §§327-330, which regulate employment and compensation of professional in Chapter 11 cases, are not incorporated into Chapter 9.

[232] H.R. Rep. No. 595, 95th Cong., 1st Sess. 263 (1977).

[233] 11 U.S.C. §362(a) provides:

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of--
> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
> (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
> (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

municipality which may be facing foreclosure actions by bondholders or enforcement of judgments by creditors.[234] The automatic stays generally give the municipality breathing room from the enforcement of prepetition obligations. The stay, however, does not protect the municipality from ongoing legal duties to comply with applicable state and federal laws.

There are a number of statutory exceptions to the automatic stay, many of which are inapplicable to a municipality. Some exceptions that do apply, however, could be quite important. For example, if a municipality is a lessee of non-residential real property pursuant to a lease that terminated prior to a Chapter 9 filing, the automatic stay will not stay further action by the landlord to recover possession.[235] Similarly, if the municipality is subject to regulations by other governmental entities, then the automatic stay may not protect the municipality from regulatory enforcement actions.[236] One set of exceptions to the automatic stay permits certain

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(4) any act to create, perfect, or enforce any lien against property of the estate;
(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
(8) the commencement or continuation of a proceeding before the United States Tax Court concerning a corporate debtor's tax liability for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

For purposes of Chapter 9, "property of the estate" simply means property of the debtor. 11 U.S.C. §902(1). For an extensive discussion of property of a municipal debtor in a Chapter 9 case, *see In re Jefferson County*, *Alabama*, 465 B.R. 243, 260-87, 295-300 (Bankr. N.D. Ala. 2012)*, amended and superseded*, 474 B.R. 228 (Bankr. N.D. Ala., 2012).

[234] *See e.g.*, *In re City of Desert Hot Springs*, 327 F.3d 930 (9th Cir. 2003) (city filed Chapter 9 to avoid seizure of bank accounts and levy on city assets by judgment creditor); *In re Jefferson County*, *Alabama*, 465 B.R. 243, 260 (Bankr. N.D. Ala. 2012) (the automatic stays of §§362(a) and 922(a) "constitute one of the means by which this exclusive case and property jurisdiction is shielded from encroachment."). The *Jefferson County* court rules the stay applied to a pre-petition receiver appointed by a state court and divested the receiver of control of the County's sewer system. 465 B.R. at 249.

[235] 11 U.S.C. §362(10).

[236] For example, if the debtor is an educational institution, the stay will not stay any actions by an accrediting agency regarding the debtor's accreditation as an educational institution. 11 U.S.C. §362(b)(14) and (15). Similarly, the stay does not preclude the debtor from being excluded from participating in the Medicare program or other health program by the Secretary of Health and Human Services. 11 U.S.C. §362(b)(28). In *Jefferson County*, the debtor did not argue that the stay applied to ongoing litigation concerning consent decrees with the Environmental Protection Agency and the United States Department of Justice. On the other hand, a receivership was not a police

brokers and financial participants to exercise contractual setoff rights under various financial instruments and agreements, such as forward contracts, repurchase agreements and interest rate swap agreements.[237] Thus, to the extent a municipality has funds invested in these types of instruments or is a party to a contract or derivative within the categories excluded from the automatic stay, Chapter 9 will not stay the exercise of certain contractual rights by counterparties to those instruments.[238]

A creditor may file a motion for an order granting it relief from the stay.[239] The stay may be modified or terminated for "cause", including lack of adequate protection of an interest in property.[240] If the motion relates to specific property, relief may also be granted if the debtor does not have equity in the property and the property is not necessary to an effective reorganization.[241] Alternatively, the court has authority to provide for adequate protection of the creditor's interest in lieu of stay relief.[242] Should the adequate protection granted to a secured creditor who has been stayed with respect to its collateral prove to be inadequate, the creditor may have an allowed administrative claim to the extent that its protection is inadequate.[243]

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or regulatory action notwithstanding the receiver's status as an officer of the state court. The receivership was an enforcement remedy of private creditors and therefore was stayed. *See Jefferson County, Alabama*, 465 B.R. at 275.

[237] 11 U.S.C. §362(b)(6), (7), (17); *see also* 11 U.S.C. §§555, 556, 559, 560.

[238] Set off issues and particularly the intricacies of the forward, swap and derivative contract rules are discussed in *Interest Rate Swaps for the General Bond Practitioner: Basic Structures, Documentary and State Law Issues*, National Association of Bond Lawyers, (August 2009) (the portal website is http://www.nabl.org).

[239] 11 U.S.C. §362; Fed.R.Bankr. P. 4001(a).

[240] 11 U.S.C. §362(d)(1). Cause is not limited to lack of adequate protection and could be based on other factors such as bad faith. *See e.g. In re City of Desert Hot Springs*, 81 Fed. Appx. 113 (9th Cir 2003) (affirming denial of stay relief for lack of sufficient proof of bad faith without deciding whether motion should have been filed as a motion to dismiss).

[241] 11 U.S.C. §362(d)(2).

[242] *See In re County of Orange*, 189 B.R. 499 (C.D. Cal. 1995) (denying stay relief for noteholders after finding noteholders held statutory lien as security, and remanding to trial court for adequate protection of interest in post-petition tax revenues).

[243] 11 U.S.C. §922(c).

In addition to §362, 11 U.S.C. §922(a) imposes an automatic stay against (i) commencing or continuing legal actions against officers or inhabitants of a municipality that seek to enforce a claim against the municipality and (ii) enforcement of liens on or arising out of taxes or assessments owed to the municipality. For example, this extension of the stay prevents public officials from being named as defendants in mandamus actions to compel the collection of taxes or payment of debts. Significantly, the stay imposed by Section 922(a) is not subject to the exclusions listed in Section 362(b).[244]

Nevertheless, as addressed previously,[245] a Chapter 9 petition does not stay the application of pledged special revenues to the payment of indebtedness secured by such revenues so long as such application is consistent with the special revenue bond provisions of 11 U.S.C. §928.[246] This exception was specifically addressed in *In re Jefferson County, Alabama*,[247] where the bankruptcy court held that the automatic stays of sections 362(a) and 922(a) were inapplicable to pledged special revenues.[248] The court further explained that the exception applied to all the revenues in which the indenture trustee had been granted a lien, including those in the possession of the indenture trustee or the receiver on the date that the Chapter 9 case commenced, all that were controlled or possessed by the county as of that date, and the revenues subject to the lien that came into the possession of either the indenture trustee, the receiver or the county after the filing

[244] Thus, pursuant to §922(a), the exercise of a governmental unit's police and regulatory powers may be stayed as against individual officers and employees. *See Jefferson County, Alabama*, 465 B.R. at 260. By its terms, §922(a) prevents "(1) the commencement or continuation …[of an] action or proceeding against an officer or inhabitant of the debtor that seeks to enforce a claim against the debtor; and (2) the enforcement of a lien on or arising out of taxes or assessments owed to the debtor." 11 U.S.C. §922(a). As the opinion in the Jefferson County case illustrates, determining the scope of this unique Chapter 9 stay and then evaluating its interactions with provisions of §362 are surprisingly complex.

[245] *See* Chapter 4, Section III, *supra*.

[246] 11 U.S.C. §922(d). §922(d) erroneously refers to §927 instead of §928.

[247] 465 B.R. 243 (Bankr. N.D. Ala. 2012).

[248] *Id*. at 287.

date. Subject to the necessary operating expenses of the county's sewer system, all pledged special revenues were to be paid to the indenture trustee.[249]

VIII. ADEQUATE PROTECTION

Section 361 sets out ways in which "adequate protection" required by the Code, and "derived from the fifth amendment protection of property interests," is to be provided, when, for example, the Code's automatic stay of enforcement of remedies applies, or secured credit is obtained post-petition.[250] Adequate protection may be in the form of cash payment(s) when the automatic stay results in a decrease in the value of a creditor's interest in property, or in the form of replacement liens, or through "such other relief . . . as will result in the realization by such entity of the indubitable equivalent" of the entity's interest in the affected property.[251] Common situations in which adequate protection may be sought include the provision of compensation for loss arising from the operation of the automatic stay under Section 362 or provision of assurance of ultimate recovery of collateral values when post-petition credit is obtained and is secured with a lien of equal or senior rank to the protected interest.

IX. CHAPTER 5 AVOIDANCE POWERS

As with Chapter 3, not all provisions of Chapter 5 of Title 11 apply in a Chapter 9 case. The following comments highlight some of the special provisions affecting avoidance powers in Chapter 9 cases.

Under Section 901, the avoiding powers provided by Section 544 [powers of a state law creditor], Section 545 [avoidance of statutory liens], Section 547 [preferential transfers], and

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[249] *Id.*

[250] 11 U.S.C. §361. The constitutional element is noted in H. R. Rep. 95-595 accompanying H.R. 8200: "The concept [of adequate protection] is derived from the fifth amendment protection of property interests. *See Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935)." H. R. Rep. 95-595, Sept. 8, 1977, at 339, reprinted in App. C, *Collier on Bankruptcy* (*15th ed. Rev.*) (Alan N. Resnick & Henry J. Sommer, eds.), App. Pt. 4(d)(i), at App. Pt. 4-1470. *See generally 3 Collier on Bankruptcy* (*16th ed.*) (Alan N. Resnick & Henry J. Sommer, eds.) ¶361.02, at p. 361-4 – 9.

[251] 11 U.S.C. §361(3).

Section 548 [fraudulent transfers] are available to the municipal debtor. The operation of Section 547 is limited, however, by Section 926, which precludes use of Section 547 preference avoidance powers with respect to transfers of property of the debtor to or for the benefit of the holder of a bond or note and made on account of such bond or note.[252]

In a similar way, the avoidance power provided by Section 549(a)[253] with regard to post-petition transfers made by a debtor without court authorization is effectively limited by Section 904. Section 549(a) applies to, and permits the avoidance of, transfers that occur after commencement of the case without court approval or specific authorization under Title 11. Section 904, however, by its terms, precludes interference by the bankruptcy court with the property or revenues of the municipality or the municipality's use or enjoyment of its property. "Thus, every transfer of property by a municipality is authorized by the Bankruptcy Code, including payments of prepetition debt . . . . Thus section 549(a) has limited application, if any, to a Chapter 9 case."[254]

X. TREATMENT OF SECURED CLAIMS

A major principle of the Bankruptcy Code is equality of treatment between similarly situated creditors. To this end, the Code recognizes disparate treatment between secured and unsecured creditors. Consistent with this policy, secured creditors are deemed to be secured only in an amount equal to the value of their interest in the collateral that secures their claim.[255] If a claim is "undersecured," it is bifurcated into separate secured and unsecured claims, even if the secured claim would otherwise be deemed to be non-recourse outside of bankruptcy.[256]

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[252] *See* 11 U.S.C. §926(b).

[253] Sections 549(a), (c), and (d) are made applicable by Section 901(a).

[254] 6 *Collier on Bankruptcy* (*15th ed. Rev.*) (Alan N. Resnick & Henry J. Sommer, eds. 2005), ¶ 901.04[25].

[255] 11 U.S.C. §506(d).

[256] 11 U.S.C. §506(a)(1).

The ability to "strip down" a secured creditor's claim to the value of its collateral can be a powerful tool in a Chapter 9 case. As a result of the claims bifurcation provided by Section 506(a)(1), secured claims, other than claims based upon special revenue bonds, are deemed by 11 U.S.C. §1111(b) to be treated as recourse claims for purposes of a plan, unless (i) the class of which such claims are a part elects to waive its recourse unsecured claim and to be treated as a secured creditor under §1111(b)(2) (the "§1111(b)(2) election") or (ii) such class is in fact nonrecourse and the property is to be sold by the municipality in connection with case or as part of the plan.[257] The §1111(b)(2) election may be made by a class of secured creditors at any time prior to approval of the disclosure statement or such other time as the court may fix.[258] If a §1111(b)(2) election is made, the class so electing shall retain its lien on collateral and shall be entitled to receive a stream of payments over time at least equal to the creditor's total claim and having a present value equal to the present value of its collateral.[259] A class may not make the §1111(b)(2) election if (i) the interest of the class in the collateral is of inconsequential value or (ii) the class has recourse against the municipality and the collateral is to be sold through the plan or during the case.[260]

The mechanics of making the §1111(b)(2) election present unique problems for a class of bondholders. While an indenture trustee has a right to be heard in a Chapter 9 case,[261] and may have the right to file a proof of claim,[262] indenture trustees ordinarily do not have the power to vote

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[257] 11 U.S.C. §1111(b).

[258] Fed. R. Bankr. P. 3014. For purposes of determining class acceptance for purposes of §1111(b)(2), holders of claims representing two-thirds in dollar amount and more than one-half in number of the total class must vote to make the election.

[259] 11 U.S.C. §1129(b)(2)(A)(i); *General Elec. Credit Equities, Inc. v. Brice Rod. Devs.*, (*In re Brice Rd. Devs., L.L.C.*), 392 B.R. 274, 285(6th Cir. B.A.P. 2008); *First Fed. Bank of Cal. v. Weinstein* (*In re Weinstein*), 227 B.R. 284, 294 (9th Cir B.A. P. 1998).

[260] 11 U.S.C. §1111(b)(1)(B).

[261] 11 U.S.C. §1109 is made applicable to Chapter 9 by §901.

[262] 11 U.S.C. §501 is made applicable to Chapter 9 by §901.

for a plan or make the §1111(b)(2) election in the absence of an express power of attorney or delegation of such authority by the bondholders since the indenture trustee is not the true creditor. Ascertaining the identity of the true creditor is further complicated by publicly traded bonds in "street name" *i.e.*, typically in the name of a brokerage house or dealer who has purchased the bond for the account of a customer. To facilitate the prompt transfer of these bonds in a public market, registration of the bonds will usually remain in the name of the broker, who holds them as custodian for its customers. Moreover, the broker will typically hold the bonds in electronic form, rather than a physical certificate. Because the "street name" record holder of a bond is not usually the entity who is owed money by the debtor, the bankruptcy rules and the courts have recognized that the beneficial holders of the bonds, rather than the record holder, are the true parties in interest who may vote their claims for purposes of Section 1111(b)(2) or for voting on a plan.[263]

Although Section 1111(b) applies in Chapter 9, Section 927 provides that a claim paid solely from special revenues shall not have recourse against the debtor. Accordingly, if such claims are non-recourse, they will remain non-recourse.[264]

XI. EXECUTORY CONTRACTS AND UNEXPIRED LEASES

Section 365 of the Bankruptcy Code, which is made applicable to Chapter 9,[265] governs the circumstances in which a municipality may assume or reject an executory contract and,

[263] Fed. R. Bankr. P. 3017(e) requires the bankruptcy court to develop procedures for transmitting the disclosure statement and plan in Chapter 9 and 11 cases to the beneficial holders of stocks, bonds, debentures, and other securities of the debtor. *See In re City of Colorado Springs Spring Creek General Imp. Dist.*, 177 B.R. 684 (Bankr. D. Colo. 1995) (denying confirmation of pre-packaged Chapter 9 plan on various grounds, including failure to demonstrate that disclosure statement had been adequately disseminated to beneficial bondholders); *In re Tenn-Fla Partners*, 1993 WL 151346 (Bankr. W.D. Tenn 1993) (finding that beneficial bondholders were creditors entitled to vote on plan and make §1111(b)(2) election); *In re Southland Corp.*, 124 B.R. 211 (Bankr. N.D. Tex. 1991) (finding that the record holder of a debt security was not the owner of a claim or true creditor for purposes of voting on a plan).

[264] *See* Chapter 4, Section III for the treatment afforded special revenue bonds in a Chapter 9 case.

[265] 11 U.S.C. §901(a).

except as modified by Section 929, an unexpired lease. Section 365 is intended, in a case under any Chapter of the Code, to permit a trustee or debtor in possession to assume the advantages of beneficial contracts and to likewise reject burdensome contracts. By assuming favorable contracts, a debtor may be able to require otherwise reluctant parties to continue to do business with the debtor.[266] The ability to assume or reject contracts was provided to municipalities in the 1976 Municipal Bankruptcy Act, which was taken from similar powers in former Chapters X, XI and XII.[267]

A. Municipal Leases

Municipal leases are afforded special treatment in Chapter 9 because many municipalities, as lessees, rely upon lease financing structures in the acquisition and construction of public facilities and equipment. Sometimes lease financing is combined with revenue bond financing to make a revenue bond issue more marketable. Municipal lease transactions are usually conditioned upon the municipality agreeing to appropriate sufficient funds in its annual budget to make the rental payments and may have default or termination provisions which are triggered if the municipality fails to appropriate rent for such lease.

Section 929 provides that a lease to a municipality shall not be treated as an executory contract or an unexpired lease for purposes of Section 365 or 502(b)(6) solely because the failure to appropriate rent would give rise to a right to terminate by the other party.[268] This provision may preempt the application of state statutes that provide for the termination of municipal leases if a municipality fails to appropriate rent.[269] To the extent municipal leases are treated as

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[266] *In re Chateaugay Corp.*, 10 F.3d 944, 955 (2nd Cir 1993).

[267] *See* Lawrence P. King, *Municipal Insolvency: The New Chapter IX of the Bankruptcy Act*, 1976 Duke L. J. 1157, 1169.

[268] 11 U.S.C. §929.

[269] S. Rep. No. 506, 100th Cong. 2d Sess. 10-11 (Sept. 14, 1988).

financing transactions rather than true leases, the lessor's damages are not subject to the limitations on damages which are imposed on true real estate leases.[270] Moreover, with respect to such financing leases, the municipal debtor will not be required to comply with the sometimes burdensome cure requirements and post-petition performance duties imposed by Section 365 that are discussed in the following section.

B. Contracts and Leases Not Excluded by §929

With respect to the assumption of leases or executory contracts that are not excluded by Section 929, a municipality that desires to assume such a contract or lease must (i) cure, or provide assurance that it will promptly cure, any monetary defaults, (ii) compensate the other party to such contract or lease for any pecuniary losses caused by default and (iii) provide adequate assurance of future performance.[271] Non-monetary defaults that cannot be cured retroactively may be cured by future performance under the lease.[272] A municipality is obligated to perform all post-petition obligations under nonresidential leases arising from and after the entry of the order for relief pending assumption or rejection.[273] Similarly, the debtor must perform all obligations arising under non-consumer personal property leases from or after 60 days after the entry of the order for relief, until the lease is assumed or rejected, unless otherwise ordered by the court.[274] All unexpired leases and executory contracts involving personal property may be assumed or rejected at any time prior to confirmation of a plan, although the counterparty to such agreements may move the court for an order requiring assumption or rejection within a specified period of time.[275] Nonresidential leases in which the municipality is

[270] 11 U.S.C. §929; S. Rep. No 100-597, 100th Cong. 2d Sess. (4-5) (1988); *see also* 11 U.S.C. §502(b)(6).

[271] 11 U.S.C. §365(b)(1).

[272] 11 U.S.C. §365(b)(1).

[273] 11 U.S.C. §365(d)(3).

[274] 11 U.S.C. §365(d)(5).

[275] 11 U.S.C. §365(d)(2).

the lessee must be assumed or rejected within 120 days of the entry of the order of relief, provided, however, that the court may grant a single extension of an additional 90 days.[276]

The rejection of executory contracts or unexpired leases gives rise to claims for damages for breach of contract, which are treated as pre-petition general unsecured claims.[277] If rejection occurs after a prior assumption of such contract or lease by the debtor, the counterparty may have a breach of contract claim that is entitled to administrative claim status.[278] Damage claims arising from the rejection of unexpired leases of real property are limited to the rent for the remaining term, but not to exceed the greater of one year of rent or 15% of the remaining term of the lease but not to exceed 3 years of such term.[279]

XII. REJECTION OF COLLECTIVE BARGAINING AGREEMENTS AND PENSION BENEFIT PLANS

A. Collective Bargaining Agreements

Unexpired collective bargaining agreements are executory contracts that may be assumed or rejected by a Chapter 9 debtor, subject to court approval.[280] It is important to note that Section 901 *does not* import Section 1113 with the special rules on rejection of collective bargaining agreements into Chapter 9. That difference is significant in many municipal credit crises, as collective bargaining agreements entail substantial current and future costs to the municipality. While Chapter 9 does not incorporate some of the procedural and substantive requirements on the rejection of these contracts which are imposed upon a Chapter 11 debtor, the court must find that certain criteria are met before rejection may be ordered. A Chapter 9 debtor seeking to reject a

[276] 11 U.S.C. §365(d)(4). The court may grant additional extensions only with the prior written consent of the lessor.

[277] 11 U.S.C. §365(g)(1).

[278] 11 U.S.C. §365(g)(2)(A).

[279] 11 U.S.C. §502(b)(6).

[280] A recent and highly visible instance of the use of Chapter 9 for modification of labor agreements is the *City of Vallejo* Chapter 9 case in California. *See*, *IBEW v. City of Vallejo* (*In re City of Vallejo*), 432 B.R. 262, 2010 U.S. Dist. LEXIS 67598 (E.D. Cal.), June 14, 2010.

collective bargaining agreement must demonstrate that (i) the agreement is burdensome and hinders its ability to propose a viable plan for adjustment, (ii) a balancing of the equities favors rejection, and (iii) reasonable efforts to negotiate a consensual modification have been made and are not likely to produce prompt and favorable results.[281] In an appropriate case, some of the bankruptcy court's findings of Chapter 9 eligibility (*e.g.*, failing to obtain agreement with creditors after good faith negotiation) may form the basis for approving rejection of a collective bargaining agreement.[282]

B. Pension Benefit Plans

Pension benefit plans are often a significant liability for municipalities and may be a major influence in a decision to file Chapter 9. It is unclear whether the rejection of retirement plans is subject to the same standards as the rejection of collective bargaining agreements. Nevertheless, a plan for adjustment, as it relates to pension benefits, must satisfy the good faith standard. Unlike cases in Chapters 7 and 11, unsecured pension and retirement benefit claimants have no priority over general unsecured creditors in Chapter 9 proceedings.[283] If a Chapter 9 debtor is permitted to reject its pension plan agreements, retirees will be treated like other general unsecured creditors (for amounts not payable from funds held in an effective trust or as collateral) and future benefits are likely to be substantially reduced. While the number of reported decisions dealing with the rejection of pension plans is sparse, a threat of rejection provides a municipality with significant leverage in negotiations for the restructuring of these

[281] *In re City of Vallejo*, 403 B.R. 72 (Bankr. E.D. Ca. 2009), *aff'd*. 432 B.R. 262, 2010 WL 2465455 (E.D. Ca. June 14, 2010); *N.L.R.B. v Bildisco & Bildisco*, 465 U.S. 513, 521-26 (1984). A review of differing views on what Chapter 9 permits a municipal debtor to do in regard to its labor agreements is found in 6 *Collier on Bankruptcy* (*15th ed. Rev.*) (Alan N. Resnick & Henry J. Sommer, eds.) ¶901.04[9][a].

[282] *In re City of Vallejo*, 432 B.R. 262, 2010 WL 2465455 (E.D. Ca. June 15, 2010).

[283] *In re City of Prichard*, *Alabama*, No. 09-15000 (Bankr. S.D. Ala., March 10, 2010).

obligations. The Detroit eligibility opinion contained language on the debtor's ability to impair pensions as executory contracts.[284]

[284] In re *City of Detroit,* Case No. 13-53846 *Opinion Regarding Eligibility*, pp. 73-75; see also Chapter 6 *infra*.

CHAPTER 6

THE PLAN FOR ADJUSTMENT

The previous chapter addresses some of the issues dealt with at the beginning of a Chapter 9 case as well as various strategic and case management issues that the municipality and its creditors must be mindful of. This chapter extends that focus to the objective of Chapter 9 – the plan for the adjustment of the municipality's obligations to its creditors and the confirmation of that plan.

I. WHAT IS A PLAN FOR ADJUSTMENT?

A. Comparison of Plans in Chapter 9 and Chapter 11 Cases

Just as a plan of reorganization is the bulls eye of a Chapter 11 case in which reorganization is the target, so is the plan for adjustment in Chapter 9. Although the similarities between the Chapter 9 and Chapter 11 plans are numerous, there are significant differences.

The Chapter 11 debtor has the exclusive right to file a plan of reorganization for a defined period.[285] Thereafter, any party in interest can propose a Chapter 11 plan.[286]

In Chapter 9 cases only a municipal debtor can file a plan for adjustment.[287] This is designed to be consistent with the accommodation in Chapter 9 proceedings of governmental interests under the Tenth Amendment.

Many Chapter 11 plans provide for the liquidation of the debtor in possession rather than its reorganization, and Chapter 9, like Chapter 11, allows for liquidating plans. However, Chapter 9 neither provides for nor permits the liquidation of the municipality.[288] Most general

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[285] 11 U.S.C. §1121(b) ("Except as otherwise provided in this section, only the debtor may file a plan until after 120 days after the date of the order for relief under this chapter.").

[286] 11 U.S.C. §1121(c). For cause, the court may increase or reduce the debtor's exclusive period. *Id.* at §1121(d).

[287] 11 U.S.C. §941.

[288] *See also Newhouse v. Corcoran Irrigation Dist.*, 114 F.2d 690, 691 (9th Cir. 1940) (noting that the assets of a Chapter 9 debtor cannot be disposed of for the debtor's benefit), cert. denied, 311 U.S. 717 (1941). *Compare In re Natchez Regional Medical Center*, Case No. 14-01048-NPO (Bankr. S.D. Miss. 2014) (sale of essentially all assets

purpose governments cannot liquidate as a matter of state law. In deference to state law, Chapter 9 is unlikely to become a vehicle for the liquidation of general purpose governments, though it can and will continue to serve as a vehicle for liquidation plans for agencies and instrumentalities where consistent with state law. If a plan for adjustment is not confirmed, the Chapter 9 case is to be dismissed absent an extension of time to file a new or modified plan.[289]

As a result of the inability of creditors to force a municipal liquidation or otherwise to propose their own plan in the Chapter 9 case, the negotiating dynamic for the municipality and its creditors is noticeably different from the Chapter 11 bargaining environment.[290] Of course, this is experienced by the municipality and its creditors even before the Chapter 9 case is initiated, since eligibility for Chapter 9 requires, among other things, that the municipality has negotiated with its creditors in an effort to avoid the bankruptcy filing or meets another of the requirements of Section 109(c)(5).[291] With these distinctions in mind, we now consider the contents of the plan for adjustment.

B. Content of the Chapter 9 Plan

Section 1123 prescribes the contents of the Chapter 11 plan. Section 901 makes Sections 1122, 1123(a)(1) through (5), 1123(b) and 1123(d) applicable to the Chapter 9 case. A plan for adjustment must therefore:

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of public health authority to for-profit hospital operator); *In re West Jefferson Amusement and Public Park Authority*, Case No. 02-04303-BGC-9 (Bankr. N.D. Ala. 2002) (sale of essentially all assets of municipal amusement park authority to private company).

289 *See* 11 U.S.C. §930.

290 Since Sections 903 and 904 limit the bankruptcy court's power over Chapter 9 debtors, the court has minimal control over the municipality's finances, revenue, or property. *See In re New York City Off-Track Betting Corp.*, 434 B.R. 131, 140 (Bankr. S.D.N.Y. 2010) ("As a general matter, section 904 of the Bankruptcy Code places severe limits on the power of courts to compel any action from Chapter 9 debtors").

291 11 U.S.C. §109(c); *and see In re Hamilton Creek Metro. Dist.*, 143 F.3d 1381, 1386 (10th Cir. 1998) (holding that municipality was not eligible for Chapter 9 relief merely because it was economically distressed); *In re City of Bridgeport*, 129 B.R. 332, 334 (Bankr. D. Conn. 1991) (applying the requirements for Chapter 9 relief upon opposition from the municipality's creditors).

- Designate, subject to Section 1122, classes of claims, other than certain priority claims;[292]
- Specify any class of claims that is not impaired pursuant to the treatment proposed by the plan;[293]
- Specify the treatment proposed in the plan for each impaired class of claims;[294]
- Provide for the same treatment for each claim in a particular class of claims unless the holder of a particular claim has agreed to a less favorable treatment;[295] and
- Provide adequate means for the plan to be implemented.[296]

Although not required, a plan for adjustment may also:

- Impair or leave impaired any class of claims, whether secured or unsecured;[297]
- Assume, reject or assign any executory contract or unexpired lease;[298]
- Provide for the settlement or enforcement of any claim held by the debtor;[299]
- Provide for the sale of property of the debtor and the distribution of proceeds to creditors or the debtor;[300]
- Modify the rights of secured or unsecured creditors;[301] and
- Include any other provision that is not inconsistent with the applicable provisions of the Bankruptcy Code.[302]

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[292] 11 U.S.C. §1123(a)(1).

[293] 11 U.S.C. §1123(a)(2).

[294] 11 U.S.C. §1123(a)(3).

[295] 11 U.S.C. §1123(a)(4).

[296] 11 U.S.C. §1123(a)(5).

[297] 11 U.S.C. §1123(b)(1).

[298] 11 U.S.C. §1123(b)(2).

[299] 11 U.S.C. §1123(b)(3).

[300] 11 U.S.C. §1123(b)(4).

[301] 11 U.S.C. §1123(b)(5).

[302] 11 U.S.C. §1123(b)(6).

C. Filing the Plan

A plan for adjustment may be filed by the municipality with its Chapter 9 petition.[303] Otherwise, the plan must be filed in accordance with the schedule established by the court.[304]

D. Modification of the Plans

At any time prior to confirmation, the municipal debtor may modify its previously-filed plan.[305] Any such modification must comply with all relevant requirements of Chapter 9[306] and necessitates a determination as to whether the modification is "material," thereby requiring a revised disclosure statement and the resolicitation of votes.[307] A plan modification is effective immediately upon filing.[308]

E. The Disclosure Statement

Prior to soliciting votes to accept or reject its plan for adjustment, the municipal debtor must prepare a written disclosure statement that the court determines contains information adequate to allow a hypothetical creditor of each relevant class of claims to make an informed judgment when voting to accept or reject the plan.[309]

The role of the Disclosure Statement is akin to the role of an Official Statement in a new offering of municipal securities, and disclosure standards for it are established by rules adopted under the Bankruptcy Code.

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[303] The simultaneous filing of the petition and the plan may be appropriate in a number of circumstances. For example, pre-filing negotiations with creditors may result in agreements with all classes of impaired claims. Also, those negotiations may have been successful with some impaired classes, but reached an impasse with others. Of course, political inferences or civic morale may dictate that a plan be put forth as soon as possible, even if it is only a platform from which the municipality continues negotiations with its creditors.

[304] 11 U.S.C. §941.

[305] 11 U.S.C. §942.

[306] *Id*.

[307] A plan modification is not material unless it "so affects a creditor or interest holder who accepts the plan that such entity, if it knew of the modification, would be likely to reconsider its acceptance." *In re Am. Solar King Corp.*, 90 B.R. 808, 824 (Bankr. W.D. Tex. 1988) (chapter 11 case); *see also* 9 *Collier On Bankruptcy*, ¶3019.01 (15th ed. 1987).

[308] 11 U.S.C. §942.

[309] 11 U.S.C. §1125(a)(1).

The hearing to consider the disclosure statement and any objections to it may be held upon at least 28 days' prior written notice to the creditors and other parties in interest.[310] If the disclosure statement is approved, the court will establish the time in which the holders of impaired claims may vote to accept or reject the plan as well as the date of the confirmation hearing.[311] The debtor will then mail or cause to be mailed to all creditors (1) the plan or a court-approved summary of the plan, (2) the court-approved disclosure statement, (3) notice of the time in which creditors can vote to accept or reject the plan, (4) the time fixed by the court for filing objections to the confirmation of the plan, (5) a form of a ballot, and (6) such other information as the court may require.[312] With respect to bondholders, the disclosure statement must be sent to the beneficial holders of the bonds, and not merely the "street name" record holder or indenture trustee.[313]

[310] Fed. R. Bankr. P. 3017(a).

[311] Fed. R. Bankr. P. 3017(c).

[312] Fed. R. Bankr. P. 3017(d).

[313] Fed. R. Bankr P. 3017(e). The Advisory Committee Note to Rule 3017(e) indicates the rule is designed to insure that "the plan, disclosure statement, ballot and other materials . . . reach the beneficial holders of securities held in nominee name." *See In re City of Colorado Springs Spring Creek General Imp. Dist.*, 177 B.R. 684 (Bankr. D. Colo. 1995) (denying confirmation of pre-packaged Chapter 9 plan on various grounds, including failure to adequately disseminate disclosure statement to beneficial bondholders); *In re Pioneer Finance Corp.*, 246 B.R. 626 (Bankr. D. Nev. 2000) (Prepetition solicitation of pre-packaged Chapter 11 plan was inadequate where no evidence that beneficial holders of bonds had been solicited or that record holders of bonds were authorized to vote on behalf of beneficial holders).

II. CONFIRMATION OF THE PLAN

Confirmation of the plan for adjustment is the preeminent objective of the Chapter 9 case. Section 943 provides that the court "shall" confirm a plan if it satisfies certain criteria. Prior to entry of the confirmation order, the court must determine that all of the following criteria are satisfied.

A. Debtor Compliance

The debtor must comply with the applicable provisions of the Bankruptcy Code.[314] In the Chapter 9 case, this means Chapters 1 and 9 as well as other provisions of the Bankruptcy Code that are incorporated by Section 901.

B. Good Faith

The municipality must propose the plan for adjustment in good faith and not by any means that is forbidden by law.[315] As noted earlier in the context of eligibility as a Chapter 9 debtor, good faith is not defined by the Code and is determined by the court on a case-by-case basis, based upon the totality of the circumstances.[316] Factors that have been considered include: whether certain individuals or groups stand to receive a disproportionately large benefit as a result of confirmation,[317] whether the municipality properly disclosed all material information,[318]

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[314] 11 U.S.C. §1129(a)(2).

[315] 11 U.S.C. §1129(a)(3). If the court does not receive any objections calling into question the debtor's good faith, the court may make such determination without reviewing relevant evidence. Fed. R. Bankr. P. 3020(b)(2). Certain ratepayers in the Jefferson County case appealed the confirmation order on the grounds that the plan provides for sewer rate increases that allegedly are forbidden by state law.

[316] *See In re Mount Carbon Metro. Dist.*, 242 B.R. 18 (Bankr. D. Colo. 1999) (finding that good faith should be determined by examining the totality of the circumstances); *In re Matter of Metropolitan Realty Corp.*, 433 F.2d 676 (5th Cir. 1970) (finding that good faith implies honesty and a genuine desire to use the bankruptcy process to reorganize rather than for some unworthy purpose). S*ee also In re Southern Land Title Corp.*, 301 F. Supp. 379, 428 (Bankr. E.D. La. 1968) and Robert L. Ordin, *The Good Faith Principle in the Bankruptcy Code: A Case Study*, 38 Bus. Law 1795 (1983). Given the bookend requirements of good faith at both the commencement of the case and its consummate objective of confirmation, one can convincingly argue that the standard of good faith is implicit in all decisions and conduct of the municipal debtor.

[317] *See Town of Belleair v. Groves*, 132 F.2d 542 (5th Cir. 1942) (refusing to confirm the town's plan for adjustment because "property-owning bondholders would receive benefits, above and apart from the surrender price proposed for their bonds in which the other bondholders would not participate, and that such special benefits were substantial inducements toward approval of the plan"), *cert. denied*, 318 U.S. 769 (1943).

[318] *In re Wolf Creek Valley Metro. Dist.*, 138 B.R. 610 (Bankr. D. Colo. 1992). "Good faith requires a full disclosure of all material facts." *Id*. at 618.

whether the municipality seeks confirmation to impair the interests of the parties least willing to negotiate a settlement that would favor the municipality,[319] or whether there exists a legitimate reason for the municipality's refusal to raise taxes to avoid bankruptcy.[320]

C. Government Regulatory Approvals

Should a governmental regulatory commission have jurisdiction over the rates of the debtor for services, goods or otherwise after confirmation of the plan, any and all approvals for rate changes provided in the plan must be obtained or such rate change must be conditioned on such approval.[321]

D. Acceptance by Classes

At least one class of impaired claims must vote to approve the plan.[322] Holders of allowed claims or interests within each class are permitted to vote.[323] With respect to a class of bondholders, the beneficial holders of the bonds, rather than the "street name" record holder, are the persons entitled to vote.[324] Classes of unimpaired claims are deemed to have accepted the plan.[325] A class accepts the plan if the claims in the class vote, at least two-thirds in amount and more than one-half in number, to accept the plan.[326] Conversely, if the plan proposes that claims in a certain class will receive nothing, that class is deemed to have rejected the plan.[327] Even if

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[319] *Wright v. City of Coral Gables*, 137 F.2d 192, 195 (5th Cir. 1943) (finding that that it was not good faith to use Chapter 9 relief "to bludgeon into submission those whom the city had not been able to make settlements satisfactory to itself").

[320] *In re Corcoran Hosp. Dist.*, 233 B.R. 449, 459 (Bankr. E.D. Cal. 1999) (finding that raising the hospital district's assessment tax would be a "futile exercise" and that a failure to increase taxes was not an indication of a lack of good faith).

[321] 11 U.S.C. §1129(a)(6).

[322] 11 U.S.C. §1129(a)(8).

[323] 11 U.S.C. §1126(a).

[324] *In re Southland Corp.*, 124 B.R. 211 (Bankr. N.D. Tex. 1991) (beneficial holders of bonds, rather than record holders, were entitled to vote on Chapter 11 plan); *In re Tenn-Fla Partners*, 1993 WL 151346 (Bankr. W.D. Tenn 1993) (finding that beneficial bondholders had right to make §1111(b)(2) election and vote on Chapter 11 plan).

[325] 11 U.S.C. §1124(1).

[326] 11 U.S.C. §1126(c).

[327] 11 U.S.C. §1126(g).

less than all impaired classes accept the plan, confirmation by "cram-down" may be possible if at least one class of impaired claims accepts the plan, determined without consideration of acceptance cast by any insider of the debtor if the plan does not discriminate unfairly against nonaccepting classes and if fair and equitable with respect to those claims.[328] In the *Detroit* case, recoveries in classes the debtor had classified as unsecured ranged from 13% (Other Unsecured Claims class) to 74% (Unlimited Tax General Obligation Bond Claims class). The Bankruptcy Court held that despite the differences in respective recoveries, "such discrimination is fair in light of, among other things, (a) the circumstances of the City's chapter 9 Case, (b) the purpose of chapter 9, which is to adjust an insolvent municipality's debt so that it can provide adequate municipal services and (c) the Bankruptcy Court's conscience, as informed by the Bankruptcy Court's experience, education and sense of morality."[329] The Bankruptcy Court noted that substantial mission-based considerations justified the differential treatment of pension claims, and differential treatment among bondholder classes was the result of treatment is the result of arm's-length, intensely negotiated and reasonable settlements.

E. Plan Compliance

The plan must comply with the provisions of Chapter 9.[330] Since most of the confirmation requirements are contained in Section 1129 which is in Chapter 11, this requirement is seldom an obstacle to confirmation. The plan must also comply with those provisions of the Bankruptcy Code that are made applicable to Chapter 9 cases pursuant to 11 U.S.C. §§103(e) and 901.[331]

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[328] 11 U.S.C. §§1129(b) and (a)(10).

[329] *Order Confirming Eighth Amended Plan for the Adjustment of Debts of the City of Detroit*, Document 8272 filed November 12, 2014.

[330] 11 U.S.C. §943(b)(2).

[331] 11 U.S.C. §943(b)(1). *See In re Bamberg County Memorial Hospital*, 2012 WL 1890259 *5 (Bankr. D.S.C.).

F. Reasonable Payments are Disclosed

All amounts to be paid by the municipality for services or expenses in the case or incident to the plan must be reasonable and fully disclosed.[332] In Detroit, the Bankruptcy Court engaged a fee monitor, and relied heavily on the fee monitor's review of bills, on both the debtor and creditor sides, for professional services and expenses. At the end of the case, the Bankruptcy Court then ordered mediation of legal and consultant fees to be paid by the debtor.

G. No Legal Inhibition

The debtor must not be prohibited by law from taking any action necessary to implement the plan.[333] Though it can be used as a vehicle for contract impairment, a Chapter 9 plan cannot be confirmed as a means of avoiding the future application of state law or permitting a plan for adjustment to contradict applicable state law.[334]

H. Payment of Administrative Expenses

On the effective date of the plan, the holder of claims entitled to an administrative expense priority must be paid cash in the full amount of the allowed claim. The holders of a particular administrative claim may agree to less than full payment, payment other than cash, or payment after the effective date.[335]

I. Regulatory or Electoral Approval

Any regulatory or electoral approval under nonbankruptcy law that is required to carry out any provision of the plan must have been obtained or such provision of the plan is

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[332] 11 U.S.C. §943(b)(3).

[333] 11 U.S.C. §943(b)(4).

[334] *See In re Sanitary & Improvement Dist. No. 7*, 98 B.R. 970 (Bankr. D. Neb. 1989).

[335] 11 U.S.C. §943(b)(5). Accordingly, notwithstanding the lack of application of Sections 328 and 330 in Chapter 9 cases, the payment of administrative expenses, including those of professionals, committees, or indenture trustees, at or after confirmation, require disclosure and a favorable determination under §943(b)(3) for confirmation.

conditioned upon obtaining that approval.[336] This requirement is substantially the same as the requirement of Section 1129(a)(6) described in the preceding Item G.

J. Best Interests of Creditors and Feasible

The plan must be in the best interests of the creditors of the municipality.[337] In the context of Chapter 9, this means that the payments to creditors proposed by the plan are no less than what would be obtained through the dismissal of the case whereupon creditors would be free to exercise their nonbankruptcy remedies.[338]

In Detroit, the Bankruptcy Court concluded that outside of bankruptcy, the City would face several billion dollars in cumulative deficits, even if it attempted only to maintain then-current service levels. It noted the creditors' inability to compel the City to liquidate City-owned assets, and the City's inability to raise taxes, having reached what the Bankruptcy Court described as "tax saturation." In addition, it determined that the plan, and the negotiated settlements approved therein, including the "Grand Bargain" and the bondholder settlements, provided the only feasible vehicle for the City's ability to provide essential government services, concluding that "[w]ithout the ability to provide adequate levels of basic services, the City would be unable to reverse the exodus of residents and businesses from the City that has depleted the City's tax base, reduced land values and led to widespread abandonment and blight."[339]

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[336] 11 U.S.C. §943(b)(6).

[337] 11 U.S.C. §943(b)(7).

[338] "The best interests of creditors test was contained in former Chapter XI of the Bankruptcy Act. It was generally taken to mean that the payments under the plan to creditors would yield at least as much as would be received on a liquidation of the debtor's business and the distribution of the proceeds to creditors. In other words, the plan had to be better than the alternative . . . The same information does not work in a Chapter 9 case. A municipality cannot be liquidated . . . The court must find a middle ground [and] apply the test to require a reasonable effort by the municipality that is a better alternative to its creditors than dismissal of the case." *Collier on Bankruptcy* (*16th ed.*) (Alan N. Resnick & Henry J. Sommer, eds.), ¶943.03(7)(a) (footnote omitted).

[339] *Order Confirming Eighth Amended Plan for the Adjustment of Debts of the City of Detroit,* Document 8272, filed November 12, 2014 at 36.

Feasibility requires the debtor to demonstrate that it has or will have the ability to make the payments and perform the obligations required by the plan, yet maintain a level of operations necessary for its ongoing municipal duties. This may require the court to make a careful examination of the debtor's projected revenues and expenses. In Detroit, Judge Rhodes retained feasibility experts to advise the Bankruptcy Court.

III. EFFECT OF CONFIRMATION

The liabilities of the municipality, as "adjusted" by a confirmed plan, supersede the pre-petition contractual relationship between the municipality and its creditors. To the extent that the pre-petition rights of a creditor are altered by the plan, the plan for adjustment creates a new contract between the municipality and its creditors that binds both the municipality and the creditor, without regard to whether (i) the creditor filed a proof of claim or has a claim which is deemed filed, or (ii) the claim is allowed by the court, or (iii) the creditor has accepted the plan.[340]

Once the Chapter 9 plan for adjustment is confirmed, the municipality emerges from Chapter 9 protection and is required to fulfill its obligations to creditors under the terms of the plan. The municipality is discharged from all debts when (i) the plan is confirmed; (2) the debtor deposits with the disbursing agent any consideration to be distributed under the plan by such agent; and (3) the court has determined that any security to be distributed and any provision made to pay or secure payment of such obligations under the plan are valid.[341] The municipality, however, is not discharged of debts which are expressly excepted from discharge by the plan for

[340] 11 U.S.C. §944(a).

[341] 11 U.S.C. §944(b).

adjustment or the order confirming the plan or which are owed by the debtor to an entity that had neither notice nor actual knowledge of the case prior to confirmation of the plan.[342]

IV. RETENTION OF JURISDICTION

The bankruptcy court may retain jurisdiction of the municipality's case after confirmation for such period of time as is necessary to ensure the successful implementation of the plan.[343] The terms of the plan for adjustment may also provide for retention of jurisdiction over certain post-confirmation matters, such as correcting plan defects,[344] determining controversies, suits and disputes over the interpretation and enforcement of the plan, classification of claims and to hear matters that were pending on the confirmation date. Post-confirmation jurisdiction may also extend to determination of claim objections, motions to allow late filed claims, and the continuation of adversary proceedings commenced prior to confirmation.[345] While there is little case law addressing how long a court may retain jurisdiction post confirmation, some courts have indicated that jurisdiction is appropriate at least through the point that consummation of the plan has commenced, and the courts in both Jefferson County and Detroit retained jurisdiction for an extended period for certain matters.[346] Where a Chapter 9 debtor has failed to perform its

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[342] 11 U.S.C. §944(c). Bondholders that had actual notice of the Chapter 9 case but did not receive actual notice of a bar date to file proof of claims had claims which were discharged and were denied leave to file late claims. *Matter of Sanitary & Imp. Distr. No. 7*, *Lancaster County*, *Neb.*, 112 B. R. 990 (Bankr. D. Neb. 1990), *affirmed*, *Nebraska State Bank v. Sanitary & Imp Dist. No. 7*, 119 B.R. 193 (Neb 1990).

[343] 11 U.S.C. §945(a).

[344] *In re Wolf Creek Valley Metropolitan Dist. IV*, 138 B.R. 612 (D. Co. 1992), district court, in reviewing an appeal from a confirmation order, found that a plan provision which authorized retained jurisdiction of the bankruptcy court to consider plan modifications, provided the jurisdictional basis for court to approve a plan modification necessitated by surprise or mistake.

[345] *See* current 11th Circuit appellate litigation in *Jefferson County* regarding retained rate enforcement jurisdiction. *See also Matter of Sanitary & Improvement District No. VII*, 112 B.R. 990 (B.R. D. Neb. 1990), which found that bankruptcy court had post confirmation jurisdiction to determine that creditors had notice of bankruptcy case and were not entitled to file late claims even though they had no specific notice of the claims bar date. The court further noted that under §945(a), it was not divested of jurisdiction simply because the plan had been confirmed and a discharge granted.

[346] *See* current 11th Circuit appellate litigation in *Jefferson County* regarding retained rate enforcement jurisdiction. *See also In re Lake Grady Road & Bridge District*, 119 B.R. 853 (B.R. D. Fla. 1990), where the court noted that the plan itself had broad retention of jurisdiction provisions to determine all controversies, disputes, conflicts, or causes of action, whether or not subject to an action pending as of the confirmation date; s*ee also* George H. Hempel, *An Evaluation of Municipal Bankruptcy Laws & Procedures*, 28 J. Fin. 1339, 1344 (1973) (describing municipal

obligations under a confirmed plan, the court has post-confirmation jurisdiction to deny the debtor's motion to close the case and find that the plan has not been substantially consummated.[347]

bankruptcy of Fort Lee, New Jersey, where court exercised continuing jurisdiction over the debtor's plan for 40-year term of bonds issued under plan); 6 Collier on Bankruptcy ¶945.02 (16th ed. rev. 2015) (discussing Fort Lee case and congressional intent for continuing jurisdiction under §945(a) "to enable the effective implementation of a confirmed plan of adjustment").

[347] *Id*. at 857.

CHAPTER 7

DISMISSAL OF THE CHAPTER 9 CASE

The previous chapters address the commencement and administration of a Chapter 9 case, as well as the statutory requirements for plan confirmation. Of course, not all Chapter 9 cases realize a confirmed plan, resulting in one or more parties seeking a dismissal of the case. The provisions related to dismissal are outlined here.

I. STATUTORY PROVISIONS

Chapter 9 of the Bankruptcy Code contains a specific dismissal provision set forth in Section 930.[348] As Chapter 9 is available only to "municipalities" and such is the only chapter that a municipality may proceed under, Section 930 does not provide for conversion of the case to another chapter of the Bankruptcy Code.[349]

Section 930(a) permits the court, after "notice and a hearing,"[350] to dismiss a Chapter 9 case for "cause", which includes (i) want of prosecution, (ii) unreasonable delay by the debtor that is prejudicial to creditors, (iii) failure to propose a plan for adjustment within the time fixed under Section 941, (iv) failure to have a plan for adjustment accepted within a time fixed by the court, (v) the denial of confirmation of a plan and denial of additional time to file either a modification of the plan or another plan, and (vi) if the court has retained jurisdiction after confirmation, the occurrence of a material default by the debtor under the plan, or the termination of the plan by reason of the occurrence of a condition specified in that plan.[351] Section 930 makes clear that the list of causes is not exclusive, but "includes" the factors that are

[348] Dismissal provisions in other chapters that may be compared to Section 930 include Sections 707, 1112, and 1307.

[349] *See*, *e.g.*, §706 of Chapter 7, 11 U.S.C. §706, permitting conversion of a Chapter 7 case to a case under Chapter 11, 12 or 13.

[350] *See*, on the construction of "after notice and a hearing," 11 U.S.C. §102(1).

[351] 11 U.S.C. §930(a).

specifically described. The statute is permissive, as it states "the court may" dismiss for cause after notice and a hearing.

Nevertheless, Section 930(b) imposes an apparently mandatory dismissal in one circumstance: "The court *shall* dismiss a case under this chapter if confirmation of a plan under this chapter is refused."[352] This appears to cover, in mandatory terms, what would be optional under Section 930(a)(5), by which a case may dismissed when confirmation is *denied* and additional time to modify or file a new plan is also denied. The House and Senate proposed differing versions of what is now Section 930 during the course of enacting 1978 Code. *Collier's on Bankruptcy* comments: "Inclusion of both provisions, one in the permissive dismissal subsection and one in the mandatory dismissal subsection, was probably a legislative oversight. The House bill did not contain the mandatory dismissal provision, but contained the other provision in the permissive dismissal section. The Senate bill did not contain the denial of confirmation ground in its permissive dismissal provision, but contained the mandatory dismissal provision. Undoubtedly, both provisions were incorporated into the enacted version without consideration of their redundancy."[353]

Concern over the application of the "dismissal on refusal to confirm" provision and a suggestion to the bankruptcy courts on how to avoid the problem were expressed at the time of the 1976 municipal bankruptcy amendments:

> Unfortunately, section 98(b) provides that if confirmation is refused the court *must* dismiss the case. Such dismissal would take the petitioner out of the supervision of the court and probably put it back in the same position it was in before it filed. To obviate this result, a court should to the extent possible refrain from refusing confirmation but rather should put off a decision on the

[352] 11 U.S.C. §930(b), emphasis added.

[353] 6 *Collier on Bankruptcy* (*16th ed.*) (Alan N. Resnick & Henry J. Sommer, eds.), ¶930.03, text following n.2.

> confirmation issue and permit the filing of a modified plan in the hope that such a plan could be confirmed.[354]

In any event, counsel for the municipal debtor must take into account that dismissal is possible, if not likely, if confirmation of its plan is denied.

Section 349 of the Code prescribes the statutory effects of dismissal of a Chapter 9 bankruptcy case. Section 349(a) generally preserves the debtor's right to file a new petition for relief and to obtain a discharge in such later case, unless the court, for cause, orders otherwise. Also, unless the court otherwise orders, dismissal of a Chapter 9 case reinstates a variety of transfers and liens that have been avoided (for example, preferential transfers, fraudulent transfers, or avoided set offs), and vacates orders and judgments for the recovery or transfer of property in such instances, and revests property of the estate, meaning property of the debtor under Section 902(1), in the entity in which such property was vested immediately before the case was commenced. If a municipal debtor is considering, or facing, a dismissal motion under Section 930, counsel should carefully evaluate the effect of dismissal under Section 349.[355]

II. CASE LAW

As with most of Chapter 9, there is little case law that is instructive on Section 930, and the few reported cases on the issue do not lend themselves to a predictable pattern. A sense of how courts may respond to a motion for dismissal under Section 930 is provided in *In re Richmond Unified School District,* 133 B.R. 221 (Bankr. N.D. Cal. 1991), and *In re Sanitary & Improvement District #7,* 98 B.R. 970 (Bankr. D. Neb. 1989). The *District #7* opinion denied

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[354] Lawrence P. King, *Municipal Insolvency: The New Chapter IX of the Bankruptcy Act*, 1976 Duke L. J. 1157 (1976), at 1174.

[355] Note that §921(c) provides for dismissal if the debtor did not file the petition in good faith or the petition does not meet the requirements of Chapter 9. 11 U.S.C. §921(c). This provision looks to the debtor's satisfaction of eligibility and good faith requirements at the outset of the case, and may operate independently of §930. *See e.g.*, *Int'l. Ass. of Firefighters v. City of Vallejo*, 408 B.R. 280 (B.A.P., 9th Cir. 2009) and *In re County of Orange*, 183 B.R. 594 (Bankr. C.D. Cal. 1995).

confirmation of a plan for adjustment (actually the debtor's Fourth Amended and Substituted Plan, a plan caption that suggests a controversial and extended proceeding) over the objection of bondholders. The court nevertheless granted the debtor leave to file an amended or modified plan under Section 930(a)(5) rather than dismiss under Section 930(b), noting that there was a possibility of confirmation using "cram-down" powers.[356] Put another way, the court followed the suggestion of Professor King in 1976 to find a way to use the permissive rule of Section 930(a) and sidestep the mandatory dismissal rule of Section 930(b).

In *Richmond Unified School District*, the court dealt with a motion by the debtor, acting through its administrator (appointed by the State School Superintendent after a state court case in which powers of the district board passed to the superintendent), to dismiss the Chapter 9 case of the school district. The motion was opposed by several parties, including teachers' and employees' unions. The *Richmond* court held that a motion (effectively) by the municipal debtor for dismissal constituted "cause" for purposes of Section 930 and should be granted, as of right and without an evidentiary hearing.[357] This result can be seen, as the court there asserted, as a special application of the principle of federal non-interference embodied in Sections 903 and 904 when the debtor municipality seeks dismissal.[358]

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[356] *Sanitary & Improvement Dist. #7*, 98 B. R. at 975.

[357] *Richmond Unified Sch. Dist.*, 133 B.R. at 224: "[P]rior to confirmation and absent a clear waiver of its autonomy rights under section 904 . . . a Chapter 9 debtor's request for dismissal is "cause" for dismissal and [the debtor] is entitled to an order of dismissal without necessity of an evidentiary showing that dismissal would be in the best interest of creditors."

[358] *Id.*, 133 B.R. at 225: "Given these restrictions, precious little would be served by the continuation of a case that the debtor wishes dismissed before a plan has been confirmed."

CHAPTER 8

WHAT LIES AHEAD?

Municipal bankruptcy law is, in some respects, like the depths of the Mariana Trench in the Pacific Ocean. It has a long history, but there have been relatively few explorations. The bankruptcies in Detroit, Jefferson County and the California communities of Vallejo, and Stockton, in the last few years have provided a bit of a roadmap, and demonstrated the effectiveness, and in some instances, practical necessities of a Chapter 9. How often communities will continue to avail themselves of this vehicle is unclear.

Needless to say, the future of municipal bankruptcy law is uncertain. It is undeniable, however, that Chapter 9 is no longer of interest only to bankruptcy lawyer. As elected officials, county and municipal managers, budget officials, bond lawyers, financial advisors and capital markets address the problems they are facing now and may face in the future all such participants should become increasingly knowledgeable of what can and cannot be accomplished in Chapter 9.

CHAPTER 9

RECOMMENDATIONS FOR FURTHER READINGS

General Obligation Bonds: State Law, Bankruptcy and Disclosure Considerations, National Association of Bond Lawyers (2014),

Municipalities in Peril The ABI Guide to Chapter 9, Second Edition, American Bankruptcy Institute (2012).

Primer on Municipal Debt Adjustment; Chapter 9: The Last Resort for Financially Distressed Municipalities, Chapman and Cutler LLP (2012).

How City Finances Can Be Restructured: Learning from both Bankruptcy and Contract Impairment Cases, 88 AM.Bankr.L.J.41 (2014).

Avoiding and Using Chapter 9 in Times of Fiscal Distress, Orrick, Herrington & Sutcliffe LLP (2009).

STATE ENABLING STATUTES
(as of 8-1-2015*)

State	Form of Authorization	Scope of Authorization	Applicable Statute	Local Procedures
Alabama	*Direct Access*	Applies to "each county, city or town, or municipal authority organized under [§ 11-47-210]."	Ala. Code § 11-81-3	Municipality's governing body has the "power to take all steps and proceedings contemplated or permitted by [Chapter 9]." Ala. Code § 11-81-3.
Alaska	*Not Specifically Authorized*	N/A	N/A	N/A
Arizona	*Direct Access*	Applies to "taxing districts," as defined in the Bankruptcy Act of 1898. Ariz. Rev. Stat. Ann. § 35- 601.	Ariz. Rev. Stat. Ann. § 35-603	Taxing district must adopt a resolution authorizing the filing of the petition and authorizing its attorney (or appointed special counsel) to file the petition and to represent the taxing district in the bankruptcy proceedings. Ariz. Rev. Stat. Ann. § 35-604. Taxing district must file a certified copy of a resolution consenting to the plan of readjustment with the court before the plan can become effective. Ariz. Rev. Stat. Ann. § 35-606.
Arkansas	*Direct Access*	Applies to "taxing agencies or instrumentalities named in § 14-74-102."	Ark. Code Ann. § 14-74-103	Municipalities are authorized to institute bankruptcy proceedings "through their governing boards." Ark. Code Ann. § 14-74-103.

* Due to pending and future legislation, readers are urged to review the actual legislation as of a current date. As with any 50 state survey, this summary is provided for initial reference only. The "Form of Authorization" is categorized as "Direct" "Indirect" or "Not Specifically Authorized." The exact definition of "Indirect" varies by state but often means that access is conditioned in some way by State law or that State law provides only certain types of municipalities meeting certain criteria with access.

California	Indirect Access	Applies to a "local public entity," which has the same meaning as "municipality" in the Bankruptcy Code.	Cal. Gov't Code § 53760, as amended by AB 506	Municipalities are authorized to exercise powers if it (a) pursues a neutral evaluation process or (b) certifies a fiscal emergency jeopardizing health, safety or well-being and passes a resolution authorizing the filing after a public hearing. Cal. Gov't Code § 53760.
Colorado	Limited	Applies to "any insolvent taxing district." Colo. Stat. § 32-1-1403. Taxing district means a special district that is organized or acting under the Special District Act's provisions. Colo. [illegible] "irrigation or drainage district organized under the laws of the state of Colorado." [illegible] Ann. § 37-32-102.	Colo. Rev. 32-1-1403, 102.	**Taxing Districts**: The board of directors of the district must file the petition at a regular or special meeting. The board must publish notice and postcard or letter notification to property owners within the district and to the division of local government in the department of local affairs of the place, time, and date of such meeting and such proposed action. Postcard or letter notification must be mailed to the property owners within the district not less than ten days prior to the meeting. Colo. Rev. Stat. § 32-1-1403.5. **Irrigation or Drainage Districts**: The board of directors of such district must adopt a resolution authorizing the filing. Colo. Rev. Stat. § 37-32-103.
Connecticut	Indirect Access	Applies to municipalities, which means any town, city, borough, consolidated town and city, consolidated city and borough, any metropolitan district, any district, as defined in section 7-324, and any other political subdivision of the state having the power to levy taxes and to issue bonds, notes or other obligations. Conn. Gen. Stat. § 7-560(13).	Conn. Gen. Stat. § 7- 566	Municipalities must obtain the express prior written consent of the governor. If the Governor consents, he must submit explain his consent in a report to the Treasurer and the appropriate joint standing committee of the General Assembly. Conn. Gen. Stat. § 7-566.
Delaware	Not Specifically Authorized	N/A	N/A	N/A
District of Columbia	Not Specifically Authorized	N/A	N/A	N/A
Florida	Indirect Access	Applies to municipalities, taxing districts and political subdivisions.	Fla. Stat. § 218.01	Decision to file is "at the discretion of the [municipalities'] governing authorities" but requires separate approval of the Governor.

Georgia	Not Authorized	Counties, municipalities, etc., are not authorized to file petition for bankruptcy.	Ga. Code Ann. § 36-80-05	N/A
Hawaii	Not Specifically Authorized	N/A	N/A	N/A
Idaho	Direct Access	Applies to "any taxing district" as defined in the Bankruptcy Act of 1898. Idaho Code Ann. § 67- 3901.	Idaho Code Ann. § 67-3903	The taxing district must adopt a resolution authorizing the filing of the petition and authorizing its attorney to file the petition and to represent it in the bankruptcy proceedings. Idaho Code Ann. § 67-3904. Before the plan can become effective, the taxing district must file a certified copy of a resolution consenting to the plan of readjustment with the court. Idaho Code Ann. § 67-3906.
Illinois	Indirect Access	Applies to a "unit of local government," which means counties, municipalities (cities, villages, and incorporated towns), townships, special districts, etc., but does not include school districts. 50 Ill. Comp. Stat. 320/3(d); Ill Const. Art. 7, § 1.	50 Ill. Comp. Stat. 320/9(b)(4)	The Financial Planning and Supervision Commission must recommend that the unit of local government file a petition under Chapter 9. 50 Ill. Comp. Stat. 320/9(b)(4) but see also In re Slocum Lake Drainage Dist. Of Lake County, 336 B.R. 387 (Bank.N.D. 111 2006).
Indiana	Not Specifically Authorized	N/A	N/A	N/A
Iowa	Limited Direct Access	Applies to a city, county, or other political subdivision.	Iowa Code § 76.16A	Municipality may only file a petition if it is rendered insolvent "as a result of a debt involuntarily incurred." Iowa Code § 76.16A.
Kansas	Not Specifically Authorized	N/A	N/A	N/A
Kentucky	Indirect Access	Applies to any "taxing agency or instrumentality" as defined in the Federal Bankruptcy Act, as amended in 1940.	Ky. Rev. Stat. Ann. § 66.400	A county may not file the petition unless the proposed plan is first approved by the state local debt officer and the state local officer, as defined in Ky. Rev. Stat. Ann. § 68.001.

Louisiana	Indirect Access	Applies to "any parish, municipality, political subdivision, public board or public corporation, taxing district, or other agency of the state."	La. Rev. Stat. Ann. §§ 13:4741 and 39:619-620	Approval to file the petition is required from the State Bond Commission. La. Rev. Stat. Ann. § 13:4741. Approval of the petition and plan is also required by the Governor and state Attorney General. La. Rev. Stat. Ann. § 39:619-620.
Maine	Not Specifically Authorized	N/A	N/A	N/A
Maryland	Not Specifically Authorized	N/A	N/A	N/A
Massachusetts	Not Specifically Authorized	N/A	N/A	N/A
Michigan	Indirect Access	Applies to any "municipal government" or "school district" for which an emergency manager has been appointed. "Municipal government" means a city, a village, a township, a county, an authority established by law, or a public utility owned by a city, village, township, or county." MCL 141.1542.	MCL 141.1558	Emergency manager may recommend to the governor and the state treasurer that the local government be authorized to proceed under Chapter 9. Recommendation requires approval of the governor. MCL 141.1558.
Minnesota	Direct Access	Applies to a municipality as defined by the Code, as amended in 1996, "but limited to a county, statutory or home rule charter city, or town; or a housing and redevelopment authority, economic development authority, or rural development financing authority established under chapter 469, a home rule charter, or special law."	Minn. Stat. § 471.831	N/A
Mississippi	Not Specifically Authorized	N/A	N/A	N/A

Missouri	Direct Access	Applies to any municipality or political subdivision.	Mo. Ann. Stat. 427.100	N/A
Montana	Some Direct Access	Applies to a "local entity," which is defined as a "district created under title 7, chapter 12, a city, or a town." Counties are specifically excluded from this definition. Also applies to any "irrigation district."	Mont. Code Ann. §§ 7-7-132 and 85-7-2041	**Local Entities**: The local entity's legislative body must pass an ordinance or resolution declaring that it meets certain requirements. It must also accept the local entity's proposed plan for adjustment. Mont. Code Ann. § 7-7-132. **Irrigation Districts**: The board of commissioners or directors of the irrigation district may initiate and carry out the filing of the petition. Mont. Code Ann. § 85-7-2041.
Nebraska	Direct Access	Applies to "any county, city, village, school district, agency of the state government, drainage district, sanitary and improvement district, or other political subdivision of the State."	Neb. Rev. Stat. § 13-402	N/A
Nevada	Not Specifically Authorized	N/A	N/A	N/A
New Hampshire	Not Specifically Authorized	N/A	N/A	N/A
New Jersey	Indirect Access	Applies to any political subdivision, which is defined as a "county, municipality, school district or other political subdivision of this State."	N.J. Stat. Ann. § 52:27-40	Prior to filing the petition, the political subdivision must get the approval of the Municipal Finance Commission. N.J. Stat. Ann. § 52:27-40. An ordinance or resolution of the governing body of the political subdivision must authorize filing the petition. N.J. Stat. Ann. § 52:27-41. The Municipal Finance Commission must approve the readjustment plan. N.J. Stat. Ann. § 52:27-42. To get the Commission's approval of the petition, plan, or other papers to be filed in the court, the political subdivision must file a certified copy of a resolution of its governing body requesting its approval with the office of the Commission. N.J. Stat. Ann. § 52:27-45.
New Mexico	Not Specifically Authorized	N/A	N/A	N/A

New York	Indirect Access (Municipal Distress Statute)	Applies to "a municipality or its emergency financial control board." Municipality is defined as a "county, city, town, or village." N.Y. Local Fin. Law § 2.00.	N.Y. Local Fin. Law § 85.80	A municipality or its emergency financial control board may file under Chapter 9 in addition to or in lieu of filing in the New York Supreme Court under N.Y. Local Fin. Law § 85.30.
North Carolina	Indirect Access	Applies to "any taxing district, local improvement district, school district, county, city, town or village in the State."	N.C. Gen. Stat. § 23- 48	Local units must get the approval of the Local Government Commission of North Carolina before filing the petition.
North Dakota	Not Specifically Authorized	N/A	N/A	N/A
Ohio	Indirect Access	Applies to the taxing authority of any subdivision provided for in the Bankruptcy Code.	Ohio Rev. Code Ann. § 133.36	Approval of the Tax Commissioner is required before filing the petition.
Oklahoma	Direct Access	Applies to "debtor municipal corporation or political subdivision" of the state.	Okla. Stat. tit. 62, § 283.	N/A
Oregon	Indirect Access	Applies only to "any irrigation or drainage district of this state."	Or. Rev. Stat. § 548.705	Board of Directors or Board of Supervisors may file the petition.
Pennsylvania	Indirect Access (Municipal Distress Statute)	Applies to a political subdivision.	53 Pa. Cons. Stat. § 11701.261	The State Department of Internal Affairs must give written approval before filing. 53 Pa. Cons. Stat. § 5571. Certain conditions must be met before filing. 53 Pa. Cons. Stat. § 11701.261(a). The municipality may only file if authorized by a majority vote of its governing body. 53 Pa. Cons. Stat. § 11701.261(b). Upon filing, the municipality must comply with state requirements. 53 Pa. Cons. Stat. § 11701.262–263.
Rhode Island	Indirect Access	Applies to cities, towns and fire districts.	R.I. § 45.9.1 et. seq.	See Footnote 14.
South Carolina	Direct Access	Applies to "any county, municipal corporation, township, school district, drainage district or other taxing or governmental unit organized under the laws of the State."	S.C. Code Ann. § 6-1- 10	N/A

South Dakota	Not Specifically Authorized	N/A	N/A	N/A
Tennessee	Not Specifically Authorized	N/A	N/A	N/A
Texas	Direct Access	Applies to a municipality that has the power to incur indebtedness through the action of its governing body. Applies to a taxing district or other political subdivision that has the power to incur indebtedness either through the action of its governing body or through that of the county or municipality in which it is located.	Tex. Loc. Gov't Code Ann. § 140.001	N/A
Utah	Not Specifically Authorized	N/A	N/A	N/A
Vermont	Not Specifically Authorized	N/A	N/A	N/A
Virginia	Not Specifically Authorized	N/A	N/A	N/A
Washington	Direct Access	Applies to "any taxing district" as defined in the Bankruptcy Act of 1898.	Wash. Rev. Code § 39.64.040	Before filing the petition, the taxing district must adopt a resolution authorizing the attorney's filing of the petition and representation of the taxing district in court. Wash. Rev. Code § 39.64.050.
West Virginia	Not Specifically Authorized	N/A	N/A	N/A
Wisconsin	Not Specifically Authorized	N/A	N/A	N/A
Wyoming	Not Specifically Authorized	N/A	N/A	N/A