AN OVERVIEW OF CHAPTER 9 OF THE BANKRUPTCY CODE: MUNICIPAL DEBT ADJUSTMENTS
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>An Overview of Chapter 9 of the Bankruptcy Code: Municipal Debt Adjustments</td>
<td>3</td>
</tr>
<tr>
<td>Municipalities Face Myriad Financial Problems</td>
<td>3</td>
</tr>
<tr>
<td><strong>Elements of a Chapter 9 Case</strong></td>
<td>5</td>
</tr>
<tr>
<td>Eligibility to File</td>
<td>5</td>
</tr>
<tr>
<td>Rejection of Collective Bargaining Agreements</td>
<td>6</td>
</tr>
<tr>
<td>Tenth Amendment Limitations on Bankruptcy Court Power</td>
<td>8</td>
</tr>
<tr>
<td>No Bankruptcy Court Approval Needed to Use or Sell Assets</td>
<td>8</td>
</tr>
<tr>
<td>No Bankruptcy Court Approval Needed to Pay Professional Fees</td>
<td>9</td>
</tr>
<tr>
<td>Protection of Special Bond Revenues</td>
<td>9</td>
</tr>
<tr>
<td>Confirmation Requirements of a Plan of Adjustment</td>
<td>9</td>
</tr>
<tr>
<td>Impairment Under a Plan of Adjustment</td>
<td>10</td>
</tr>
<tr>
<td><strong>Pros and Cons of a Chapter 9 Filing and Practical Considerations</strong></td>
<td>11</td>
</tr>
<tr>
<td>The Market is Paying Attention</td>
<td>12</td>
</tr>
<tr>
<td>The Derivative Safe Harbors</td>
<td>12</td>
</tr>
<tr>
<td>Unfettered Access to Chapter 9 May Come to an End</td>
<td>12</td>
</tr>
<tr>
<td>No Clear Answers on Pension Liability</td>
<td>13</td>
</tr>
<tr>
<td>Eligibility for Chapter 9 Remains an Issue</td>
<td>13</td>
</tr>
<tr>
<td>Be Wary of One-Time Fixes</td>
<td>14</td>
</tr>
<tr>
<td><strong>Conclusion</strong></td>
<td>14</td>
</tr>
<tr>
<td><strong>Lawyer Contacts</strong></td>
<td>15</td>
</tr>
</tbody>
</table>
AN OVERVIEW OF CHAPTER 9 OF THE BANKRUPTCY CODE: MUNICIPAL DEBT ADJUSTMENTS

As attention shifts from the global financial crisis of 2008–2009 to the global sovereign crisis that currently is affecting much of Europe, lawmakers are scrambling to create new laws and regulations designed to stave off the next financial crisis. Meanwhile, a different threat quietly has been growing in America’s states, cities, towns, municipalities, and other political subdivisions. With each passing quarter, unsustainable budgetary shortfalls, record level unemployment, and deepening losses in financial markets threaten the ability of some municipalities to continue providing even the most basic of services to its constituents. Indeed, the problem has grown so severe in some areas that several well-known towns and cities, big and small, across the United States are openly discussing bankruptcy as an option, and dozens more are seen as viable candidates for a bankruptcy filing. Many of the corporate entities hit hardest by the financial crisis have used chapter 11 of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1532 (the “Bankruptcy Code”), to address the financial, operational, and legal problems that threatened their existence. However, municipalities hoping to avail themselves of the same well-developed body of law associated with chapter 11 will discover that they are not available to municipalities.

Rather, municipalities must resort to the little-used (and little-understood) chapter 9 of the Bankruptcy Code, a patchwork of federal laws that borrows concepts and particular sections from other chapters of the Bankruptcy Code to create a forum of “last resort” to allow a municipality to deal with its problems outside of the confines of otherwise applicable state law. While chapter 9 has only been used approximately 560 times since its creation, the devastating results of the most recent global financial crisis, coupled with several decades of municipal government practices that did not always address fiscal imbalances, suggest that chapter 9 of the Bankruptcy Code will become a much more utilized tool in the coming months and years.

This White Paper is intended to give municipalities and other interested parties a brief overview of some of the significant financial issues facing municipalities today, particularly the growing deficiencies in many public pension funds. This paper includes a description of the basic elements of a chapter 9 proceeding, including eligibility requirements, operations under bankruptcy supervision, and emergence from chapter 9 through a plan of adjustment. Finally, the pros and cons of a chapter 9 filing are examined, and a number of practical tips for municipalities considering such a course of action are provided.

MUNICIPALITIES FACE MYRIAD FINANCIAL PROBLEMS

The basic problems faced by municipalities are not difficult to identify. Similar to private entities, municipalities are in the midst of an extended cycle of declining revenues. Such shortfalls are to be expected in light of the reduced income and sales taxes that municipalities have been able to collect from citizens who have, themselves, experienced job losses and other significant financial hardships. Similarly, the declining value of real estate and the high rate of foreclosure have negatively affected property tax revenues. Moreover, in some cases, municipalities engaged in complex derivative transactions, such as interest rate swap agreements (primarily for the purpose of hedging against rising interest rates), only to discover now that such hedging devices require significant current payments and a costly final payment if terminated prior to their scheduled end date.

Compounding the problem is that the cost of issuing debt for a municipality is going up. The low interest rates

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2 See, e.g., Linda Deutsch, “Budget Crisis Puts LA Court System at Risk,” Associated Press, April 22, 2010 (reporting that the budget crisis has resulted in the closure of Los Angeles courthouses on the third Wednesday of every month and the laying off of 329 workers, with 500 more at risk later this year).
3 For example, recent media reports of municipalities considering chapter 9 have included Birmingham, Alabama; Detroit, Michigan; Harrisburg, Pennsylvania; Miami, Florida; and San Diego, California, as well as numerous others.
4 A comparison of certain of the central issues that arise in chapter 11 versus chapter 9 is set forth in Appendix A.
traditionally enjoyed by municipalities are rising, whether because of the general “tightening” of the credit markets as a result of the financial crisis or because investors are beginning to take notice of the confluence of factors currently threatening municipalities. In addition, the monoline insurance companies that provided relatively inexpensive credit enhancement for tax-exempt debt have completely disappeared from the market. Moreover, despite being traditionally considered a relatively “risk-free” investment, the larger public issuers now find that their debt is the subject of an increasingly robust market in credit default swaps—one of the vehicles many claim was the culprit for some of the worst problems during the height of the domestic financial crisis and, indeed, during the current crisis in Europe.

But perhaps the single largest problem facing municipalities today is the dramatic and growing shortfall in public pension funds—estimated to be between $1 trillion and nearly $4 trillion nationwide. In California alone, the shortfall could be as high as $500 billion.5 Unlike private pensions, public pensions are not regulated by the Employee Retirement Income Security Act of 1974 (“ERISA”) and, therefore, are not subject to the rigorous vesting and funding rules imposed by ERISA. See § 4(b)(1), 29 U.S.C. § 1003(b)(1). Similarly, public pension participants do not enjoy the insurance-like protection of the Pension Benefit Guaranty Corporation. Thus, municipalities have been left in a largely unregulated vacuum, free to make their own choices about vesting, benefits, qualifications, and funding. This unregulated atmosphere has resulted in several decades of increasingly rich benefits packages, largely as a result of negotiations with a municipality’s collective bargaining units, coupled with a less-than-rigid fiscal approach to paying for those benefits.

As a result of these issues, when times get tough (as they are now), there are few rules or oversight agencies ensuring—with a threat of severe penalties, fines, and other sanctions—that public officials adequately fund their public pension plans and refrain from diverting money intended to fund a public pension to other necessary public services.6

Moreover, the accounting practices employed by many municipalities have exacerbated the pension problem by incorporating unrealistic assumptions into contribution calculations.7 Indeed, some commentators have noted that, if required to adopt a more realistic set of assumptions—revising their current assumed return on pension investments from the current 8 percent to something more realistic—the magnitude of the current under-funding problem would undoubtedly increase.8 Thus, while current funding levels of public pensions may be sufficient to satisfy current obligations, the historical practices associated with public pensions suggest that a severe problem exists with respect to funding future obligations and that the true gravity of the problem has not yet been fully acknowledged or addressed.

Further complicating the public pension issue is that, in many cases, the benefits are considered to be virtually untouchable. For example, in California, public pension benefits are considered a “vested right.” See Kern v. City of Long Beach, 29 Cal. 2d 848 (1947); Betts v. Bd. of Admin., 21 Cal. 3d 859, 863 (1978). While case law on the issue has demonstrated that public pension benefits for active employees are subject to “reasonable modification” under certain fact-specific circumstances (see Abbott v. City of Los Angeles, 50 Cal. 2d 438, 453 (1958) (providing a two-part test for determining whether public pension plans may be modified)), public pension benefits for retirees are not subject to modification. See Terry v. City of Berkeley, 41 Cal. 2d 698, 702-03 (1953); Claypool v. Wilson, 4 Cal. App. 4th 646, 664

6 See Gina Chon, “States Skip Pension Payments, Delay Day of Reckoning,” The Wall Street Journal, April 9, 2010 (reporting that New Jersey Governor Chris Christie has proposed skipping a $3 billion payment to the state’s public retirement system after his predecessor, Jon Corzine, failed to pay most of a $2.5 billion obligation and allowed local governments to pay only 50 percent of their obligations).
7 See Gina Chon, “Gurus Urge a Bigger Pension Cushion,” The Wall Street Journal, March 29, 2010 (reporting that most public pension funds anticipate a rate of return of 8 percent per annum, which, critics argue, is excessive, particularly in the current environment).
8 The Governmental Accounting Standards Board (the “GASB”) has proposed bringing discount rates more in line with realistic yields that, along with other measures including reduced amortization periods, allegedly could double or triple the annual contributions required from governments. Id. The GASB received letters from 27 state treasurers and representatives of 61 pension systems opposing the proposed changes. See id.
(Ct. App. 1992). Accordingly, even in circumstances where benefits under a public pension are pitted against the basic needs of a municipality's population, certain states' laws make clear that the public pension benefits win. The historic legal protection afforded to pension plans and their beneficiaries has not inhibited certain municipalities from challenging such protection in current legal proceedings,9 and such legal challenges can be expected to increase as the situation for many municipalities becomes more dire.

ELEMENTS OF A CHAPTER 9 CASE

Should a municipality determine that it needs to consider a chapter 9 filing to address its financial problems, such as the ones described above, the entity will need to understand the basic steps and elements of a proceeding. The basic elements of a chapter 9 filing are described below.

Eligibility to File. As mentioned above, a municipality's access to the well-developed statutory and case law set forth in the Bankruptcy Code is quite limited. Unlike the traditional individual, corporate, or partnership debtor that has a largely unfettered right to choose from a variety of chapters of the Bankruptcy Code (i.e., chapters 7, 11, and 13), municipalities are eligible to seek protection only under chapter 9 of the Bankruptcy Code. Moreover, demonstrating eligibility under chapter 9 could be difficult, time-consuming, and hotly contested process that may prove to be too difficult in many instances. Ultimately, if a bankruptcy court determines that the debtor has not proven its eligibility to be a debtor under chapter 9, the bankruptcy court will dismiss the case.

As an initial matter, access to chapter 9 is limited to municipalities. A “municipality” is defined by section 101(40) of the Bankruptcy Code as a “political subdivision or public agency or instrumentality of a State.” Although not defined in the Bankruptcy Code, “public agencies or instrumentalities of a State” refers, in general, to any state-sponsored or controlled entity that raises revenues through taxes or user fees to construct or operate public projects. Accordingly, the definition of “municipality” includes certain obvious examples, such as cities, townships, and villages. While significantly all of the attention and commentary on chapter 9 focuses on the more obvious examples of a “municipality,” the reality is that the overwhelming majority of municipal debtors are not cities or towns, but rather involve a large group of less-obvious examples, such as school districts, hospitals, sanitary districts, irrigation districts, public utility boards, public improvement districts, and bridge and highway authorities. Moreover, because the formation and structure of these various entities often include public-private partnerships, special tax provisions, and other complex financial and organizational tools, the determination of whether such an entity constitutes a “municipality” is not always easy and may, in certain instances, be a focal point of interest for creditors and other parties that hope to keep a debtor from accessing chapter 9. Indeed, as illustrated in the recent case of In re Las Vegas Monorail (discussed in greater detail below), the parties' expectations regarding whether a particular entity constitutes a municipality do not always prove to be correct.10 Notably, states themselves do not qualify as municipalities and, therefore, are not eligible for chapter 9 relief.

Section 109(c) of the Bankruptcy Code also sets forth four other prerequisites, all of which are unique to chapter 9, that the potential municipal debtor must satisfy in order to obtain the protection of chapter 9 of the Bankruptcy Code.

First, the municipality must be specifically authorized by state law to file a bankruptcy case. As the bankruptcy court explained in In re County of Orange, 183 B.R. 594 (Bankr. C.D. Cal. 1995), courts construing this requirement have concluded that state law must provide express written authority for a municipality to seek chapter 9 relief and that the authority must be “exact, plain, and direct with well-defined limits so that nothing is left to inference or implication.” Id. at 604. States have taken widely divergent approaches in allowing municipalities to seek chapter 9 relief. For example,

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9 The city of San Diego, for example, has initiated a lawsuit against its retirement system alleging that, under the city's charter, city workers are liable for 50 percent of its pension funding shortfall. See Craig Gustafson, "San Diego Sues Its Pension System," San Diego Union Tribune, May 5, 2010.

10 See, e.g., In re Las Vegas Monorail Co., Case No. 10-10464 (Bankr. D. Nev. Apr. 26, 2010), appeal docketed, No. 2:10-cv-00678 (D. Nev. May 11, 2010) (holding that monorail was eligible for chapter 11 despite argument that monorail constituted a "municipality," and therefore was eligible only for chapter 9, based upon language of certain of the formation documents identifying monorail as an instrumentality of the state and significant control of state over the monorail.)
some states, such as California, have very broad statutes that give municipalities almost blanket authority to file. Other states place conditions on the right to file, such as approval by the governor or other political body. Approximately half of the states, however, do not permit municipalities to file at all, requiring instead that municipalities seeking chapter 9 protection ask the state legislature to pass a law authorizing a chapter 9 filing before they are permitted to commence a chapter 9 case. In some instances, such a requirement imposes a difficult, expensive, and time-consuming process before a municipality may access chapter 9.

Second, the municipality must be insolvent. Because of the difficulty in accurately valuing the assets of a municipality, the standard “balance-sheet test” for determining solvency generally is not employed. Rather, whether a municipality is insolvent is analyzed on a cash-flow basis, meaning that the municipal debtor generally is unable to pay its debts as they become due. Alternatively, insolvency can be demonstrated through past failures to pay outstanding debts. There is no affirmative requirement that a municipality “do more” to raise money, but the ability to raise taxes, reduce spending, or possess adequate cash reserves to meet current obligations may result in a finding by the bankruptcy court that the municipality is not “insolvent” and, thus, is ineligible for chapter 9.

Third, the municipality must desire to effect a plan to adjust its debts. The dictate that a municipality “desires to effect a plan to adjust” its debts requires that the purpose of the chapter 9 filing must not be simply to buy time or evade creditors. This requirement, however, does not require the municipality to have a plan in place and ready to go before or as soon as it files, nor does it require the debtor to agree to creditor demands that may result in short-term solvency but will lead to insolvency in the long term.

Fourth, the municipality must satisfy at least one of four of the following conditions: The municipality must: (a) have obtained the consent of creditors holding at least a majority in amount of claims in classes that will be impaired under the plan; (b) have failed to obtain such consent after negotiating with creditors in good faith; (c) be unable to negotiate with creditors because negotiation is “impracticable”; or (d) reasonably believe that a “creditor may attempt to obtain” a transfer that is avoidable as a preference. A debtor need satisfy only one of the disjunctive pre-filing requirements set forth above.

In addition to the four requirements of section 109(c) of the Bankruptcy Code, the municipality may also be required to prove it filed the petition in good faith. Section 921(c) of the Bankruptcy Code provides that, “the court, after notice and a hearing, may dismiss the petition if the debtor did not file the petition in good faith or if the petition does not meet the requirements of this title.” Factors that may be relevant in determining whether a chapter 9 petition has been filed in good faith include: (a) the debtor’s subjective beliefs; (b) whether the debtor’s financial problems can be addressed by chapter 9; (c) whether the debtor’s motivation for filing is consistent with the purposes of chapter 9; (d) the extent of the debtor’s prepetition negotiations, if practical; (e) the extent to which the debtor considered alternatives to chapter 9; and (f) the scope and nature of the debtor’s financial problems. Standing alone, a municipal debtor’s refusal to impose or raise assessments or to borrow funds is not sufficient to warrant a finding of bad faith. Dismissal of a chapter 9 case is the only option if the debtor does not seek chapter 9 relief in good faith or cannot confirm a plan; the assets of a chapter 9 debtor cannot be liquidated involuntarily.

Rejection of Collective Bargaining Agreements. One of the more powerful tools that a debtor possesses is the power to assume or reject executory contracts, and chapter 9 gives this power to municipalities in bankruptcy. As a result, a municipal debtor can determine which executory contracts it wishes to assume in the bankruptcy case and which contracts it wants to reject. While the non-debtor party to a contract will be entitled to damages for breach of any contract that is rejected in the bankruptcy case, such damages will be treated as general unsecured prepetition claims and, thus, likely will receive a significantly discounted recovery.

Because employee payroll compensation and other employee benefits typically make up a substantial portion of a municipality’s budget, some of the most significant contracts that a municipality must consider in any restructuring are collective bargaining agreements (“CBAs”) with its unionized workforce. Although section 1113 of the Bankruptcy Code has special procedures that must be followed before a chapter 11 debtor may reject a CBA, that provision of
the Bankruptcy Code does not apply in a chapter 9 case. Accordingly, a CBA is easier to reject in a chapter 9 case than in other chapters of the Bankruptcy Code. The United States Supreme Court, however, has imposed certain requirements on a debtor to reject a CBA that would apply to a municipality in chapter 9, including reasonable efforts by the municipality to resolve the contract issues prior to rejection and a consideration of the hardships of the rejection on employees.11

Two decisions by California courts provide clarification of the consequences of Congress’ decision not to incorporate section 1113 of the Bankruptcy Code into chapter 9. In Orange County, a coalition of county employee organizations sued the debtor to enforce their labor contracts and sought an emergency injunction preventing the debtor from conducting permanent layoffs.12 The chapter 9 debtor argued that it is entitled to make unilateral changes to its CBAs under Bildisco, because section 1113 is inapplicable in chapter 9 cases.13 The employee organizations countered that the debtor should be required to satisfy the strict standard for emergency modification of labor contracts provided for by California law, consistent with the balance of power between the federal government and the states embodied in sections 903 and 904 of the Bankruptcy Code.14

The bankruptcy court granted the injunction and held that, although the proper standard for rejection of the CBAs was that articulated by the Supreme Court in Bildisco,15 the debtor should also be required to satisfy the standard of California law “if not as a legal matter, certainly from an equitable standpoint.”16 The court agreed with the employee organizations that chapter 9 recognizes the delicate balance between state and federal interests and stated that, even under Bildisco, municipalities must view unilateral modification of their labor contracts as a last resort.17

In City of Vallejo, the municipal debtor moved to reject its CBAs less than one month after filing its petition for relief under chapter 9 of the Bankruptcy Code.18 Consistent with Orange County, the court held that section 1113 was inapplicable to a chapter 9 debtor’s rejection of CBAs and that the Bildisco standard should govern.19 The Vallejo court was less deferential to California state labor law than its predecessor, however. The court held that section 903 of the Bankruptcy Code permits states to “act as gatekeepers to their municipalities’ access to relief under the Bankruptcy Code.”20 When a state authorizes its municipalities to file for relief under the Bankruptcy Code, the court emphasized, “it declares that the benefits of chapter 9 are more important than state control over its municipalities.”21 This means that any state authorizing access to chapter 9 “must accept chapter 9 in its totality.”22 Consequently, if a municipality is authorized by the state to file a petition under chapter 9 of the Bankruptcy Code, it “is entitled to fully utilize 11 U.S.C. § 365 to accept or reject its executory contracts.”23 Furthermore, the bankruptcy court noted that, although no California law purported to impose pre-filing restrictions on a municipal debtor requiring it to comply with state labor laws, any such attempted limitation on section 365 of the

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12 In re County of Orange, 179 B.R. 177, 179 (Bankr. C.D. Cal. 1995).
13 Id. at 181.
14 Id. at 181-82.
15 The three-part test articulated in Bildisco requires a showing that: (a) the labor agreement burdens the estate; (b) after careful scrutiny, the equities balance in favor of contract rejection; and (c) “reasonable efforts to negotiate a voluntary modification have been made, and are not likely to produce a prompt and satisfactory solution.” Bildisco, 465 U.S. at 526.
16 Id. at 184.
17 Id.
19 Id. at 78.
20 Id. at 76.
21 Id.
22 Id.
23 Id.
Bankruptcy Code would be preempted pursuant to the Supremacy Clause and the Contracts Clause of the United States Constitution.24

After outlining a standard for rejection, the court stopped short of addressing the merits of the debtor’s motion.25 Instead, the court deferred ruling “to give the parties every opportunity” to reach a settlement.26 Despite a clear shifting of leverage from the unions to the debtor, one of the unions was unable to come to terms with the debtor, and, approximately five months after its initial decision on the matter, the court authorized rejection of the applicable CBA.27

Accordingly, City of Vallejo provides strong support for the proposition that a chapter 9 debtor should be able to reject its CBAs using the significantly less stringent test set forth in Bildisco, and without consideration of section 1113 of the Bankruptcy Code or otherwise applicable state law. The ramifications of the City of Vallejo ruling, however, may not be universally positive for the chapter 9 debtor. Rejection of an executory contract under section 365 of the Bankruptcy Code, for example, gives rise to an unsecured prepetition claim for damages against the debtor by operation of section 502(g) of the Bankruptcy Code. Bankruptcy courts authorizing rejection of CBAs under section 1113 of the Bankruptcy Code, on the other hand, do not agree on whether rejection gives rise to a claim for damages.28 Accordingly, although under City of Vallejo a chapter 9 debtor may more easily reject its CBAs than its chapter 11 counterpart, the consequences of rejection for the municipal debtor may prove to be a significant deterrent. Notwithstanding such distinctions, however, the City of Vallejo court has shifted the balance of power decisively in favor of the chapter 9 debtor with respect to CBA negotiations.

Tenth Amendment Limitations on Bankruptcy Court Power. The Tenth Amendment of the United States Constitution guarantees that certain powers will be reserved to the states with respect to the management of their affairs. Chapter 9 of the Bankruptcy Code recognizes this reservation of power and limits the bankruptcy court’s power to regulate the day-to-day activities and operations of a municipal debtor. For example, section 904 of the Bankruptcy Code states that, absent the consent of the municipality, the bankruptcy court may not interfere with (a) any political or government power of the municipality, (b) any property or revenue of the municipality, or (c) any income-producing property of the municipality.

As a result of these restrictions, the bankruptcy court is not able to take certain actions in a chapter 9 case that it can take in other bankruptcy cases. For example, a bankruptcy court cannot appoint a trustee to operate the municipality or allow a secured creditor to force the sale of assets to satisfy the secured creditor’s lien. In this regard, municipalities in bankruptcy enjoy a level of protection over their operations and property that other debtors do not have.

No Bankruptcy Court Approval Needed to Use or Sell Assets. Consistent with the limited role of the bankruptcy court resulting from the reservation of the state’s power in the Tenth Amendment, a municipality does not need the approval of the bankruptcy court to use, sell, or lease property during its chapter 9 case. By contrast, nonmunicipal debtors need court approval to take any action outside the ordinary course of business, such as selling assets or buying significant items.

Accordingly, if a municipality determines that it would like to buy or sell a piece of real estate or make a significant capital improvement to its roads or infrastructure, it may do so without needing to ask the bankruptcy court for authority or without following any of the other special procedures applicable

24 Id. at 76-77.
25 Vallejo, 403 B.R. at 78.
26 Id.
28 Cf. In re Blue Diamond Coal Co., 160 B.R. 574, 577 (E.D. Tenn. 1993) (stating that “when Congress enacted [section] 1113, it intended that no claim for damages for rejection of such an agreement would be allowed”) with Adventure Resources Inc. v. Holland, 137 F.3d 786, 798 n.17 (4th Cir. 1998) (stating that, if a CBA is rejected, “the resulting damages . . . constitute general, unsecured claims against the estate”).
to other debtors. Of course, nonbankruptcy state or federal laws that otherwise regulate the process that municipalities must follow to take such actions would still apply.

**No Bankruptcy Court Approval Needed to Pay Professional Fees.** Chapter 11 debtors may not retain or pay professionals to assist with the administration of a bankruptcy case without bankruptcy court authority. Municipal debtors, however, are not subject to such restrictions. As a result, a municipality may retain any professional(s) that it wants to assist with a chapter 9 case, and those professionals may be paid their customary fees without the need to file applications with the bankruptcy court and await court approval. One of the requirements for the confirmation of a plan of debt adjustment in chapter 9, however, is that all amounts paid by the debtor for services in connection with the plan have to be fully disclosed and reasonable. Accordingly, the bankruptcy court will have at least some oversight with respect to the payments made by a municipal debtor to professionals in connection with its consideration of such debtor’s plan of adjustment.

Another fee issue that may arise in a chapter 9 case is the payment of professionals that represent an official committee. Although chapter 9 incorporates the provision of the Bankruptcy Code that provides for the appointment of an official creditors’ committee, it does not incorporate the provision of the Bankruptcy Code that requires the debtor to pay the professional fees and other costs of an official committee. Accordingly, it is possible that any professionals retained by an official committee appointed in a chapter 9 case will not be entitled to payment by the municipality, and will only have recourse for payment to the members of the official committee. As a practical matter, however, a municipality may often agree to pay the professional fees of an official committee in order to facilitate the negotiation of a consensual plan of adjustment.

**Protection of Special Bond Revenues.** Chapter 9 of the Bankruptcy Code expressly provides protection to creditors holding liens on special project revenues of a municipal debtor. For example, municipalities often finance special projects, such as water and sewer plants, with bonds that are collateralized with the revenues and fees earned by such projects. Section 928 of the Bankruptcy Code states that the “special revenues” from these projects remain subject to the liens of the bondholders in the specific projects. Accordingly, these revenues must be used to fund the necessary operating expenses of the special project and may not be diverted to support the general obligations of the municipality.

This result is the opposite of what normally occurs in a bankruptcy. Pursuant to section 522(a) of the Bankruptcy Code, liens on future revenues generally terminate as of the date of the bankruptcy filing. Accordingly, a debtor normally is able to use these otherwise pledged revenues for its general purposes. A municipality will not be able to avail itself of these special revenues to fund its general expenses during a chapter 9 proceeding, however, as such revenues will remain subject to the liens of the bondholders in the special project.

**Confirmation Requirements of a Plan of Adjustment.** Ultimately, the goal of chapter 9 is for the municipality to emerge with a successful plan of debt adjustment. In a typical bankruptcy case, the debtor has a limited period of time during which it has the exclusive right to file and obtain approval of a plan of reorganization or liquidation, after which creditors or other parties in interest may propose their own plan(s). By contrast, in a chapter 9 case, only the municipality may propose a plan of adjustment. Moreover, it is not subject to any statutory time constraints relating to the filing and confirmation of a plan of adjustment, although the municipality will likely seek to exit chapter 9 as quickly as possible to escape the costs and burdens of the bankruptcy process.

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30 See, e.g., In re City of Pritchard, Alabama, Case No. 09-15000 (Bankr. S.D. Ala., March 10, 2010), appeal denied, No. 10-00012 (S.D. Ala. June 9, 2010) (unreported order granting application of official committee of unsecured creditors to retain counsel, but denying portion of application that sought to require municipal debtor to compensate committee’s counsel).

31 For example, in the chapter 9 case of the City of Vallejo, the U.S. Trustee, with the support of debtor, appointed an official committee of unsecured creditors made up primarily of retirees.
The plan of adjustment itself is simply a document that provides for the treatment of the various classes of creditors’ claims against the municipality. The debtor must prepare a disclosure statement that describes the plan and related matters, and the disclosure statement is sent with a ballot to all impaired creditors with an opportunity to vote on the plan. In order to be confirmed, the plan of adjustment must be accepted by one half in number and two thirds in amount of each class of claims that is impaired under the plan.

In addition to the voting requirements, chapter 9 contains several other requirements that a plan of adjustment must meet to be confirmed by the bankruptcy court. The requirements include the following: (a) the municipal debtor must not be prohibited by law from taking any action necessary to carry out the plan; (b) all postpetition administrative claims must be paid in full; (c) all regulatory and electoral approvals necessary to consummate the plan must have been obtained; and (d) the plan must be feasible. Importantly, the plan of adjustment must also be in the best interest of creditors. Because of the impossibility in determining the liquidation value of a municipal debtor, however, this test has been interpreted to mean that a chapter 9 plan of adjustment need only be “better than alternatives,” which is the dismissal of the chapter 9 case.

If a municipal debtor’s plan meets all of the confirmation requirements, except that it has failed to receive the support of an impaired class of creditors, the bankruptcy court can still confirm the plan through a “cram down” of the dissenting class(es). In order to accomplish such a cram down, the debtor must show that at least one impaired class has accepted the plan and that the plan is fair and equitable and does not discriminate unfairly among creditors. In chapter 11, the fair and equitable requirement is often called the “absolute priority rule” and requires the debtor to show that no class of creditors is receiving any distribution under the plan of adjustment on account of its claims unless all classes of claims senior to such class are paid in full. In chapter 9, however, the “fair and equitable” standard requires a slightly different interpretation because of the impossibility in valuing a municipality and the lack of equity interests in a municipality. As a result, a chapter 9 plan is considered “fair and equitable” if the amount to be received by the dissenting class is “all they can reasonably expect to receive under the circumstances.” This ability to “cram down” a dissenting class of creditors can be an important tool for a debtor, especially if it is facing a group of creditors that is being unreasonable in its willingness to compromise to reach a consensual plan.

If a plan of adjustment is not approved by the bankruptcy court, the bankruptcy court may dismiss the chapter 9 case, which means that the municipality would no longer be under the protections set forth in chapter 9. A bankruptcy court may also dismiss a chapter 9 case for a variety of other reasons, such as the failure of a debtor to prosecute the case, unreasonable delay, the non-acceptance of a plan by creditors, or a material default or termination of a plan.

**Impairment Under a Plan of Adjustment.** As described above, only approximately 560 municipalities have ever filed for bankruptcy protection under chapter 9, and the vast majority of those have been relatively small municipal instrumentalities, such as irrigation districts, public utility districts, waste-removal districts, and health care or hospital districts. As a result, there are relatively few examples of previous plans of adjustment to review to develop an understanding of how municipal debt may be treated in a chapter 9 filing. Nonetheless, existing case law provides limited guidance on the various methods municipalities have used to address their obligations.

Certain differences between chapter 9 and chapter 11 inject a significant amount of subjectivity into the confirmation of a chapter 9 plan (i.e., the “best interests of creditors” test and the “fair and equitable” test). Thus, impairment under a chapter 9 plan is not constrained by objective considerations of valuation or the “absolute priority rule,” but rather involves the particular facts and circumstances of the chapter 9 debtor. In many instances, this can mean that holders of unsecured obligations will be subject to significant impairment, such as the imposition of nonmarket rates of interest, extended repayment terms, less than full payment of principal and interest, and other reductions. For example, in the context of litigation claims or judgments against a municipality, a payment plan extending many years into the future, sometimes without interest, may be an acceptable method of adjustment. See, e.g., *In re Westfall Township*, Case No. 09-02736 (Bankr. M.D. Penn., March 2,
(approving plan of adjustment that reduced $20 million judgment to $6 million and paid judgment through quarterly payments over the course of 20 years, without interest); In re Village of Alorton, Case No. 05-30055 (Bankr. S.D. Ill. Dec. 11, 2006) (approving plan of adjustment that paid judgment through monthly payments over the course of 20 years, with payments beginning after five years).

Similarly, in the context of unsecured debt obligations (such as general obligation bonds), significant impairment is possible. See, e.g., In re City of Columbus Falls, Montana, Special Improvement District No. 25, 26, 28, 143 B.R. 750 (D. Mont. 1992) (approving plan that provided for less than full payment of general obligation bonds, holding that municipal debtor is empowered to impair prepetition general obligation bonds as long as other requirements of chapter 9 were met); In re Sanitary & Improvement Dist. #7, 98 B.R. 970 (Bankr. D. Neb. 1989) (explaining that general obligation bonds are general unsecured claims, subject to impairment); In re City of Camp Wood, Texas, Case No. 05-54480 (Bankr. W. D. Tex. June 13, 2007) (approving plan of adjustment that impaired prepetition general obligation bond debt through (a) a principal reduction, funded through a sale of assets; (b) a new 20-year amortization schedule; and (c) a new interest rate of 5 percent). Moreover, impairment is a possibility, even if the municipality has the ability to pay the obligation in full, through additional taxation or other measures. See Sanitary & Improvement Dist. #7, 98 B.R. at 974 (explaining that “[i]f a municipality were required to pay prepetition bondholders the full amount of their claim with interest ... and the [debtor] had no ability to impair the bondholder claims over objection, the whole purpose of Chapter 9 would be of little value.”).

However, notwithstanding the expanded strategies available to a chapter 9 debtor, there are limitations in what the debtor can do through a plan of adjustment. For example, to the extent new debt instruments are proposed to be issued to holders of prepetition debt, such new debt instruments must comply with applicable state law, pursuant to section 943(b)(4) of the Bankruptcy Code. See, e.g., Sanitary & Improvement Dist. #7, 90 B.R. at 974-75 (finding that plan of adjustment was not confirmable where “new bonds” issued to repay obligations on prepetition bonds were not in compliance with state law because redemption feature of bonds would allow debtor to redeem bonds for less than present value, in violation of state law and section 943(b)(4) of the Bankruptcy Code).

PROS AND CONS OF A CHAPTER 9 FILING AND PRACTICAL CONSIDERATIONS

A potential chapter 9 filing is a major decision for a municipality and should not be taken lightly. As described above, there are a number of potential advantages to filing a chapter 9 case, such as the ability to reject burdensome executory contracts (including CBAs) or to impose a plan of adjustment without securing the unanimous consent of all creditors. In addition, the automatic stay set forth in section 362 of the Bankruptcy Code applies in chapter 9, which means substantially all litigation and other creditor collection efforts against the debtor must stop. This gives the debtor a breathing spell to allow it time to develop a plan of adjustment to address its financial restructuring in a realistic and fair manner. In addition, chapter 9 provides a municipal debtor with a single forum in which to consolidate and address each of its various issues under the expert supervision of a bankruptcy judge.

A chapter 9 filing also comes, however, with some significant disadvantages that must be carefully considered. For example, there are significant out-of-pocket costs associated with retaining legal and financial professionals to administer the case, complying with reporting requirements, negotiating with creditors, and developing a plan of adjustment. A filing will also likely be a major distraction to elected officials and government personnel who must field questions about the filing and assist in the administration of the case. A filing could also damage the municipality’s financial ratings and make bond and other financings more difficult and expensive in the future. However, evidence suggests that, over the long term, a chapter 9 restructuring may actually improve a municipality’s standing with the financial markets. For example, in the seven years since Orange County’s chapter 9 bankruptcy, its bond rating has improved from junk status to “Aaa”—the highest rating offered by Moody’s Investor Services.
Other issues to consider are as follows:

**The Market is Paying Attention.** In light of continued uncertainty regarding the stability of the domestic recovery and significant and growing problems with the sovereign debt of countries like Greece, Portugal, and Spain, the marketplace remains in a state of great uncertainty. Moreover, market players are keenly aware of the problems facing municipalities and are prepared to react at even the slightest hint of further deterioration. For example, in April 2010, Moody’s Investor Services downgraded the City of Los Angeles credit rating from Aa3 to Aa2 based solely on a dispute between the mayor, the controller, and the city’s water and power department. Similarly, the City of Stockton, California, saw the cost of its debt immediately spike upon reports that certain of its city council members sought, in a public forum, additional information about chapter 9. Accordingly, credit downgrades, increased yields, and other negative consequences may result from even the discussion of a chapter 9 proceeding.

Notwithstanding these issues, the municipal bond market remains skeptical of widespread default. Indeed, with nearly $3 trillion in bonds outstanding spread out over tens of thousands of issuers and a historic default rate of approximately .03 percent, the market for high-grade municipal debt remains robust. Whether investor appetite will change if and when one or more municipalities seek relief in chapter 9 remains uncertain. However, with a current credit rating of Aaa, former chapter 9 debtor Orange County, California’s experience suggests that the credit markets will not remain closed forever, even after a bankruptcy filing.

**The Derivative Safe Harbors.** A strategy common in the private sector has grown in popularity in the public sector: the use of complex derivative transactions designed to hedge or otherwise protect against uncertainty in the marketplace. For example, some municipalities have entered into interest-rate swap agreements to hedge against rising interest rates. In some situations, these transactions have proven to be costly mistakes for municipalities and may provide further momentum for consideration of chapter 9. However, as private entities have discovered in connection with chapter 11 of the Bankruptcy Code, chapter 9 provides very little help in the context of derivatives. Specifically, section 901 of the Bankruptcy Code incorporates the so-called “derivative safe harbors” into chapter 9. In particular, sections 555, 556, 557, 559, 560, and 561 of the Bankruptcy Code (collectively, the “Safe Harbor Provisions”) constitute a collection of provisions that provide safe harbors to nondebtor counterparties in a variety of derivative and security contracts, including repurchase agreements, swap agreements, forward contracts, and master netting agreements. The Safe Harbor Provisions provide nondebtor counterparties to qualifying agreements with a bundle of rights, including the right to exercise contractual rights of termination and the netting of transaction termination values, as well as the ability to apply collateral to the amounts owed without regard to the automatic stay under section 362 of the Bankruptcy Code. Accordingly, chapter 9 likely will be of very little use to a municipality seeking to shed liabilities or unwind transactions related to derivative contracts covered by the Safe Harbor Provisions.

**Unfettered Access to Chapter 9 May Come to an End.** As described above, many states afford their municipalities largely unfettered access to chapter 9. However, as the current economic crisis results in an increasing number of municipalities suffering distressed financial conditions, it is possible that state legislatures could rethink this liberal approach. Whether due to the fears that a single municipality seeking chapter 9 relief could negatively affect the credit rating of an entire state or because of a strong labor lobby seeking to protect itself from a repeat of the decision in Vallejo, municipalities may find their right to avail themselves of chapter 9 curtailed. For example, in California, a bill that limits access to chapter 9 has been in various stages of the legislative process for nearly a decade. In particular, the California bill seeks to require municipalities to first seek approval from the California Debt and Investment Advisory Commission prior to seeking the federal debt adjustment relief presently available to them by local government decision—effectively ending the ability of a California municipality to unilaterally decide if and when to file for chapter 9 protection. While the California bill has been tabled for the near term, it is possible that similar restrictive legislative

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32 See California State Assembly Bill 155.
efforts could materialize in other states where access to chapter 9 is not currently materially restricted.  

No Clear Answers on Pension Liability. As set forth above, current and future pension liability constitutes one of the largest problems facing municipalities. Considered to be virtually untouchable in states that treat pension benefits as “vested rights” (and therefore not subject to unilateral amendment or termination based upon various Constitutional concerns), most efforts to reduce or modify these obligations outside of chapter 9 end in failure or, at best, with minute changes. The question remains, however, whether chapter 9 provides an opportunity to expand the circumstances under which the pension liability problems can be addressed. Few municipalities, if any, have truly tested these waters. For example, the chapter 9 case of the City of Vallejo—one of the most recent cases involving a chapter 9 debtor with significant pension issues—demonstrates that the political capital required to deal with this issue is extraordinarily high. While the City of Vallejo was successful in achieving relief from its burdensome CBAs and certain of its retiree medical benefits, the City of Vallejo has yet to meaningfully attempt to reduce its pension obligations, one of its largest budget items. In fact, although the City may propose definitive steps to reduce its pension obligations in connection with its forthcoming plan of adjustment, the City’s required pension contributions actually have increased during the pendency of its chapter 9 case.

In contrast, in the chapter 9 case of the City of Prichard, Alabama, the municipal debtor has expressed more willingness to address its pension liability problems, and the results to date have been positive for the municipality. In particular, prior to the filing of its chapter 9 petition, the City failed to make certain contributions to its pension plan and continued to withhold contributions on a postpetition basis. The retirees asserted that such contributions must resume as administrative priority expenses of the estate. Agreeing with the municipal debtor, the bankruptcy court determined that the obligation to make contributions to its pension plan, both unpaid prepetition amounts as well as ongoing postpetition amounts, were not entitled to administrative priority status but were, instead, general unsecured claims. See In re City of Prichard, Alabama, No. 09-15000 (Bankr. S.D. Ala., March 10, 2010). Cessation of these contributions has provided the City with a short-term victory, but it remains to be seen whether the City will be able to turn this into an important and lasting solution to its problems.

Ultimately, a number of strategies and arguments can be crafted to use the tools offered by chapter 9, such as the automatic stay, the power to assume and reject executory contracts, and the “plan of adjustment” mechanism, to reduce pension liability. These strategies and arguments, however, remain theoretical. Until and unless the issue truly is tested—a path upon which both the Cities of Vallejo and Prichard may find themselves—uncertainty will remain.

Eligibility for Chapter 9 Remains an Issue. The structure and purpose of many projects financed using so-called “conduit” or “special revenue” financing has, in some cases, blurred the line between a private entity, eligible for chapter 11, and a municipality, eligible only for chapter 9. As revenues for corporate entities continue to decrease across the country, forcing many corporations to consider restructuring alternatives for existing projects, the documentation and structures underlying these projects likely will be tested. While chapter 11 is, without question, the better alternative, these public-private projects often create such a link to a public purpose or body, usually to gain tax advantages, that the clear language of the documentation and the expectations of the parties often is that the project is, itself, a municipality. Thus, chapter 9 is the only alternative. However, as recent case law demonstrates, “eligibility” as a debtor is a complex question that is highly fact intensive.

For example, in a recent decision in In re Las Vegas Monorail Co., Case No. 10-10464 (Bankr. D. Nev. Apr. 26, 2010), a bankruptcy court found that, despite explicit language in the relevant documentation identifying the debtor as an “instrumentality” of the state—seemingly explicitly establishing itself as a municipality for purposes of chapter 9—such

33 In a related development, the Rhode Island state legislature recently passed legislation that prohibits Rhode Island’s cities and towns from filing for state court receivership. The decision was prompted by the City of Central Falls’ decision in May 2010 to enter receivership. See Eric Tucker, “RI Gov Signs Bill Barring Receivership for Cities,” Bloomberg Businessweek, http://businessweek.com/ap/financialnews/D9GB80V82.htm, accessed on August 4, 2010.
debtor was not actually a “municipality,” pursuant to applicable law. As a result, the bankruptcy court determined that the monorail was eligible to remain in chapter 11. Id. at 42.

In Las Vegas Monorail, the City of Las Vegas granted a franchise to a private entity to purchase and operate a public monorail system. A later expansion of the monorail was funded through the use of industrial revenue bond financing, facilitated by various departments of the State of Nevada. The related tax documents explicitly provided that the monorail’s private owner was “an instrumentality of the State of Nevada ... controlled by the Governor of the State of Nevada.” Id. at 4. The monorail filed for chapter 11 bankruptcy when it became unable to pay debt service on the bonds and its other expenses. Id. at 3. The insurer on the bonds, Ambac Assurance Corp. (“Ambac”), filed a motion to dismiss, arguing that based upon (a) the language of the documents and (b) Nevada’s significant control over the monorail, the monorail constituted a “municipality” and, therefore, was ineligible for chapter 11. Id. at 41. After a thorough examination of the history of chapter 9 and the various elements of determining “eligibility,” the bankruptcy court determined that the monorail was not a “municipality” under section 101 of the Bankruptcy Code, as it lacked many of the qualities of a municipality, such as the power to tax. Id. As a result, Ambac’s motion was dismissed. On May 10, 2010, Ambac filed its notice of appeal of the bankruptcy court’s decision to the District Court for the State of Nevada.

Las Vegas Monorail primarily demonstrates that determination of eligibility is not a simple matter, nor is it always consistent with expectations. However, Las Vegas Monorail also provides valuable insight into the strategies that distressed entities may seek to employ in the future. In particular, if Ambac is successful upon appeal, and the district court determines that the chapter 11 case must be dismissed because the monorail is a municipality, the only remaining option of the monorail company will be to seek relief under chapter 9. However, access to chapter 9 in the State of Nevada is extremely limited and requires the passage of a law specifically authorizing a filing under chapter 9. Dismissal of the chapter 11 case may therefore, in this case, be tantamount to denial of access to the Bankruptcy Code in its entirety. Accordingly, while the stakes certainly are high for Ambac—indeed, Ambac’s exposure is estimated to be $1.1 billion—the stakes are equally high for the debtor monorail company.

Be Wary of One-Time Fixes. Among the strategies being considered by municipalities experiencing financial distress is the sale of valuable assets or entry into long-term leases to raise cash. For example, both the City of Los Angeles, California, and the City of Harrisburg, Pennsylvania, have considered selling assets to raise cash to satisfy near-term budgetary shortfalls and other debt obligations. While these options may prove attractive in the short term by raising much-needed cash, caution should be exercised. A sale or long-term lease of valuable assets—likely at a distressed or reduced price—is unlikely to adequately address core problems and will, instead, represent little more than a short-term panacea while reducing the municipality’s collateral base.

CONCLUSION

Chapter 9 of the Bankruptcy Code offers many tools and strategies to a struggling municipality that are not available under otherwise applicable state law. In fact, seeking chapter 9 protection may be the only alternative for some municipalities facing unprecedented budget shortfalls and excessively burdensome pension and other obligations. Although rare in the past, the unprecedented impact of the global financial crisis and the global sovereign crisis suggests that chapter 9 of the Bankruptcy Code may become more widely known and used in the near future.
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<thead>
<tr>
<th><strong>APPENDIX A</strong>&lt;br&gt;Chapter 9 Versus Chapter 11 at a Glance</th>
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</thead>
<tbody>
<tr>
<td><strong>(In)voluntary</strong></td>
<td>Cannot be involuntary filing.</td>
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<tr>
<td><strong>Bankruptcy Judge Assigned to Case</strong></td>
<td>Chief Judge of the Court of Appeals for the Circuit designates the Bankruptcy Judge with time for and capability of handling the case.</td>
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<tr>
<td><strong>Role of Bankruptcy Court</strong></td>
<td>Limited function because of 10th Amendment. CAN: Bankruptcy Court approves petition, confirms plan of adjustment, and ensures implementation of the plan. CANNOT: The Bankruptcy Court may not become involved in the debtor’s day-to-day operations. Unless debtor consents or the plan so provides, the Bankruptcy Court may not “interfere” with (i) any of the political or governmental powers of the debtor, (ii) any of the property or revenues of the debtor, or (iii) the debtor’s use or enjoyment of any income-producing property. PRACTICAL MATTER: Debtor may consent to have the court exercise jurisdiction in many of the traditional areas of court oversight in bankruptcy in order to obtain the protection of court orders and eliminate the need for multiple forums to decide issues.</td>
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| **During a Bankruptcy Case: Can and Cannot Specific Examples** | DEBTOR CAN:  
- Incur additional debt.  
- Pay prepetition debt postpetition.  
- Use, sell, or lease its property.  
BANKRUPTCY COURT CANNOT:  
- Allow a secured creditor to force the sale of assets to satisfy the secured creditor’s lien.  
- Order reductions in expenditures or order an increase in taxes.  
- Supervise the amount of debt incurred postpetition.  
- Authorize administrative expense status for unsecured credit obtained postpetition or otherwise prime liens of creditors in violation of state law. | Debtor cannot incur additional debt, pay prepetition debt, or use/sell/lease its property without bankruptcy court approval. Bankruptcy Court may allow secured creditor to force a sale, must approve postpetition debt incurred, and may prime creditors/approve administrative expense status. |
| **Rule of U.S. Trustee** | No general supervisory authority in chapter 9 other than appointment of creditors’ committee. Municipal debtor is not subject to the reporting requirements and other general duties of a chapter 11 debtor. No first meeting of creditors | General supervisory authority in chapter 11 including appointment of creditors’ committees, enforcing reporting requirements, and organizing/supervising first meeting of creditors. |
| **Legislative Authority to File** | Chapter 9 filing must be specifically authorized under state law. | No such requirement. |
| **Eligibility to File for Chapter 9** | Must file a Statement of Qualifications under section 109(c) of the Bankruptcy Code; eligibility can be challenged; filing may be dismissed.  
- Must be a municipality.  
- State law must authorize the filing.  
- Must be insolvent as of the date of filing the petition.  
- Must “desire to effect a plan” to adjust debts.  
- Must show one of the following four requirements: (a) obtained the agreement of creditors holding at least a majority in amount of the claims of each class than the municipality intends to impair under a plan; (b) negotiated in good faith with creditors but failed to reach an agreement; (c) unable to negotiate with creditors because impracticable; or (d) reasonably believes that a creditor may attempt to obtain an avoidable preference. | No such eligibility requirement; no such insolvency requirement. |
## Good Faith Requirement

Dismissal of petition required if no finding of good faith. Factors include:
- Debtor's subjective beliefs.
- Whether the debtor's financial problems can be addressed by chapter 9.
- Extent of debtor's prepetition negotiations, if practical.
- Extent to which the debtor considered alternatives to chapter 9.
- Scope and nature of debtor's financial problems.
- Standing alone, debtor's refusal to impose/raise assessments or to borrow funds is not sufficient to warrant a finding of bad faith.

## Filings Accompanying Petition

- Good Faith Requirement: Dismissal of petition required if no finding of good faith. Factors include:
  - Debtor's subjective beliefs.
  - Whether the debtor's financial problems can be addressed by chapter 9.
  - Extent of debtor's prepetition negotiations, if practical.
  - Extent to which the debtor considered alternatives to chapter 9.
  - Scope and nature of debtor's financial problems.
  - Standing alone, debtor's refusal to impose/raise assessments or to borrow funds is not sufficient to warrant a finding of bad faith.

## Notice of Case

Notice must be given to such persons as the court may direct, plus notice must be published at least once a week for three successive weeks in at least one newspaper of general circulation. Creditors can file objections to the petition.

## Intervention; Right of Others to Be Heard

Secretary of the Treasury of the United States, a representative of the state in which the debtor is located, and the Securities and Exchange Commission may intervene in a chapter 9 case.

## Treatment of Bonds

Special revenue bondholders have an advantage over general obligation bondholders in chapter 9 cases because bonds secured by special revenue will have continued access to the revenue stream securing debt service payments:
- Prepetition security interest in special revenue bonds is maintained postpetition.
- Special revenue bonds are subject to the necessary operating expenses of the underlying project.
- Chapter 9 debtor can pay special revenue bonds postpetition to satisfy postpetition amounts of principal and interest coming due under bonds secured by the special revenues.
- Secured creditor can apply special revenues to amounts due or coming due under bonds; automatic stay does not generally apply.
- Bondholders with claims payable solely from special revenues do not have recourse claims against the debtor.
- General revenue bonds are treated as any other unsecured claim.

## Retention of Professionals

- No Bankruptcy Court approval is required to retain or pay professionals.
  - Need to file, as part of the confirmation, amounts paid by debtor for services/expenses, which must be found to be reasonable.
  - Payment of professionals that represent a creditors' committee is uncertain; technically not required, but done as a practical matter.
  - Approval is required to retain and pay professionals; official creditors' committee advisory fees are required to be paid by debtor.

## Preferences

Same as in chapter 11, except that a transfer of property by a municipality to or for the benefit of bondholders on account of such bond may not be avoided as a preference (section 926(b)).

Payments to or for the benefit of creditors on account of an antecedent debt made within 90 days (one year if insider) of petition date and while debtor is insolvent can be avoided by debtor as preferential payments and must be paid back to the estate (subject to defenses).