Chapter 9 of the U.S. Bankruptcy Code: "Municipal Bankruptcy"

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Summary

As cities and states have experienced varying degrees of financial difficulties in recent years, "municipal bankruptcy" has been mentioned relatively often in the popular press. The term is somewhat misleading, both in the word "municipal" and in the word "bankruptcy."

Many people think only of cities when they hear the word "municipal." Upon learning that in the context of the U.S. Bankruptcy Code the term means more than just cities, some think that states may use the provisions of the Bankruptcy Code for municipal debtors: chapter 9. However, states are currently not eligible to be debtors under the Bankruptcy Code. The Code's definition of "debtor" includes only persons and municipalities. Its definition of "municipality" includes cities and counties as well as other political subdivisions, public agencies, and instrumentalities of a state. However, a municipality may not file under chapter 9 unless specifically authorized to do so by its state. To be eligible for chapter 9, a municipality must be insolvent.

Chapter 9 is titled "Adjustment of Debts of a Municipality." The Bankruptcy Code does not provide for the liquidation of a municipality's assets and distribution thereof to the creditors. Instead, it provides a legal mechanism through which municipalities may be protected from the claims of their creditors as they attempt to develop and negotiate a plan to adjust their debts. In this way, chapter 9 has similarities to chapter 11 reorganizations. However, a municipality retains more control in a chapter 9 case than does the debtor in a chapter 11. The oversight and involvement of the bankruptcy court is quite limited. The court cannot interfere with the municipality's political or governmental powers, its property or revenues, or its use or enjoyment of its income-producing property.

There are only a few sections of the Bankruptcy Code that were specifically written in chapter 9; however, many other sections of the Code are explicitly made applicable to a chapter 9 case. Among these is § 365, which allows executory contracts to be assumed or rejected in a bankruptcy proceeding. Collective bargaining agreements (CBAs) are executory contracts. The expense incurred in meeting the obligations of CBAs may be a substantial budget consideration for many municipalities. While chapter 11 includes a section that specifically addresses the standards that must be met before a court can allow rejection of a CBA, no such section exists in chapter 9. Instead, based on two chapter 9 cases (*In re County of Orange, California* and *In re City of Vallejo, California*) it appears that municipalities may reject CBAs if they meet the less stringent standards established in *National Labor Relations Board v. Bildisco and Bildisco*.

Although of current interest, chapter 9 is a provision of the Bankruptcy Code that is rarely used. Since 1979, the number of chapter 9 filings per year has averaged less than 10. Most of those have been by small government agencies such as municipal utilities, school districts, or single-purpose entities.

Although chapter 9 has provided significant relief in the two major cases named above, it is not a panacea for a municipality's financial problems. It can be a lengthy and expensive procedure. Additionally, the debtor's ability to adjust debts, particularly pension or general obligation debt, may be limited by the state's constitutional or statutory restrictions since a plan of adjustment cannot require the municipality to take an action that is not lawful.

Contents

Appendixes

Contacts

Chapter 9[1] of the U.S. Bankruptcy Code[2] provides a legal mechanism through which municipalities may be protected from their creditors as they attempt to develop and negotiate a plan to adjust their debts. Although chapter 9 was enacted as part of the Bankruptcy Code pursuant to Congress's power under Article I, § 8, clause 4,[3] municipal bankruptcies are different from the bankruptcies of individuals and businesses. There is no provision for liquidation of a municipality's assets to satisfy creditors, there is no "bankruptcy estate," and the bankruptcy court has limited authority over the conduct of the municipality during the pendency of the case. Furthermore, creditors do not have the ability to file a petition for the municipality—an "involuntary case." Many of these limitations are in the code to preserve the states' autonomy under the Tenth Amendment to the U.S. Constitution.[4]

The recent recession has caused fiscal distress for states and municipalities as well as for individuals and businesses. In 2009, there were more filings by municipalities under chapter 9 of the Bankruptcy Code than in 2007 and 2008 combined.[5] Despite this seemingly dramatic increase in chapter 9 filings, chapter 9 is, and has been, a relatively seldom used provision of the Bankruptcy Code,[6] generally averaging fewer than 10 filings per year. Many of those filings have been by small government agencies such as municipal utilities, school districts, or single-purpose entities (e.g., a hospital or convention center).[7]

Reports of significantly decreased revenues and increased expenses in both cities and states as well as predictions of a significant number of municipal bond defaults in the coming years[8] have sparked interest in municipal bankruptcy, as well as calls for allowing states to use the Bankruptcy Code as a means of adjusting their own debts. Under the current Bankruptcy Code, there is no provision that would allow states to file for bankruptcy protection; however, less than 100 years ago, municipalities were not eligible to file for bankruptcy protection. A brief legislative history is provided in the **Appendix**.

[1] 11 U.S.C. §§ 901-943.

[2] 11 U.S.C. §§ 101 *et seq*.

[3] "The Congress shall have Power … To establish … uniform Laws on the subject of Bankruptcies throughout the United States."

[4] "The 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."

[5] Statistics for the first three quarters of 2010 showed the same number of chapter 9 filings (6) as in the same period in 2009; however, only one filing was reported for the last quarter of 2010, resulting in fewer filings for the 2010 calendar year than for 2009, when 12 cases were filed. United States Courts, *Bankruptcy Statistics* at http://www.uscourts.gov/Statistics/BankruptcyStatistics.aspx.

[6] There were approximately 241 chapter 9 bankruptcies filed between 1979 and 2010. *See* United States Courts, *Bankruptcy Statistics* at http://www.uscourts.gov/Statistics/BankruptcyStatistics.aspx (showing 7 chapter 9 filings in calendar year 2010; New Generation Research, The 1994 Bankruptcy Yearbook and Almanac 28 (1994) (showing 29 cases filed between July 1, 1979, and June 30, 1987); and New Generation Research, The 2010 Bankruptcy Yearbook and Almanac 21 (20th ed. 2010) (showing 206 chapter 9 cases filed in calendar years 1988 – 2009).

[7] New Generation Research, The 2006 Bankruptcy Yearbook and Almanac 20 (16th ed. 2006).

[8] Nelson D. Schwartz, *A Seer on Banks Raises a Furor on Bonds*, B1, 7 New York Times (Feb. 8. 2011) (reporting Meredith Whitney's prediction of "a spate of municipal bond defaults").

Who Can File Under Chapter 9?

Only municipalities may file under chapter 9 of the Bankruptcy Code,[9] and it is the only chapter under which a municipality may file even if that municipality is incorporated.[10] Not all municipalities can file. A municipality must be specifically authorized by its state to file under chapter 9.[11] The municipality must be insolvent[12] and must be willing to negotiate a plan to adjust its debts.[13] It generally must also show that it has negotiated in good faith with its creditors.[14]

Challenges to an entity's eligibility to file under chapter 9 are a prime area for litigation by creditors following a chapter 9 filing. The municipality carries the burden of proving that it is eligible to file under chapter 9. If it is not, then the case will be dismissed. Litigation of challenges to chapter 9 eligibility can be a time-consuming process.[15]

Most people, hearing the term "municipality," probably think of cities and towns. However, under the Bankruptcy Code, the term encompasses a broader variety of entities. Section 101(40) of the Bankruptcy Code states that the term "means political subdivision or public agency or instrumentality of a State." Thus, although states are not included in the definition, counties are, since counties, like cities, towns, villages, etc., are political subdivisions of a state. Public agencies or instrumentalities of a state include such entities as school districts, water districts, and highway authorities.[16]

Since 1994, municipalities have only been eligible to file under chapter 9 if they were specifically authorized to do so by their states.[17] Not all states authorize their municipalities to file under chapter 9. Georgia law explicitly prohibits the state's municipalities from filing.[18] Iowa restricts chapter 9 authorization to those municipalities that become insolvent as a result of an involuntarily incurred debt.[19] In 14 states, municipalities must get approval from a state authority

[9] *See* 11 U.S.C. § 303 (limiting involuntary cases to those file under chapter 7 or 11).

[10] *See* 11 U.S.C. § 109(b), (d)-(f) (limiting chapter 7, 11, 12, and 13 to persons).

[11] 11 U.S.C. § 190(c)(2).

[12] 11 U.S.C. § 109(c)(3).

[13] 11 U.S.C. § 109(c)(4).

[14] 11 U.S.C. § 109(c)(5).

[15] H. Slayton Dabney, Jr. *et al*, *Municipalities in Peril: The ABI Guide to Chapter 9* 35 (Amer. Bankr. Inst. 2010).

[16] Recently, the Las Vegas Monorail, which filed under chapter 11, was challenged by creditors as being ineligible for chapter 11 because it was a municipality and municipalities may only file under chapter 9. The bankruptcy court held that it was *not* a municipality and, therefore, was not eligible to file under chapter 9. Case No. BK-S-10-10464-BAM, "Order Regarding AMBAC's Motion to Dismiss" (Bankr. D. Nev. Apr. 26, 2010).

[17] *See,* In re Slocum Lake Drainage District, 336 B.R. 387 (Bankr.N.D.Ill. 2006)(holding that the debtor drainage district was not specifically authorized to file a chapter 9 under Illinois law); In re County of Orange, 183 B.R. 1995 (Bankr.C.D.Ca. 1995). Orange County and a consolidated investment fund, the "Orange County Investment Pool" or OCIP, filed separate chapter 9 petitions. Although the County was permitted to file, the bankruptcy court held that the OCIP was not specifically authorized to file chapter 9.

[18] "No county, municipality, school district, authority, division, instrumentality, political subdivision, or public body corporate created under the Constitution or laws of this state shall be authorized to file a petition for relief from payment of its debts as they mature or a petition for composition of its debts under any federal statute providing for such relief or composition or otherwise to take advantage of any federal statute providing for the adjustment of debts of political subdivisions and public agencies and instrumentalities." Ga. Code Anno. 36-80-5(a).

[19] Iowa Code § 79.16A.

before filing a chapter 9 petition.[20] Twenty-three states have no law addressing authorization to file under chapter 9; therefore, unless a specific law were passed by the state explicitly authorizing their filing, municipalities in those states would be unable seek protection under chapter 9.[21]

Simply being a municipality that is authorized by its state to file under chapter 9 is not sufficient for being an eligible chapter 9 debtor. The municipality must also be insolvent. Insolvency in a municipal bankruptcy is determined on a cash flow basis rather than being defined as the condition where liabilities exceed assets; Section 101(32)(C) defines "insolvent" as the financial condition of either generally not paying undisputed debts as they become due or the inability to pay debts as they become due. However, fiscal distress is not sufficient if the municipality has the means of either increasing revenue or reducing costs.[22]

To be eligible for chapter 9 protection, an insolvent municipality must be filing for such protection in good faith. Although a municipality is no longer required to submit a plan of adjustment with its bankruptcy petition, it must evidence a desire to implement a plan of adjustment rather than filing under chapter 9 in an attempt to either evade or delay payments to its creditors. Unless it has reason to believe that a creditor may attempt to get an avoidable transfer, the municipality generally must show that it has negotiated with its creditors in good faith or that it is impractical to do so prior to filing the petition.

What Are the Benefits of Chapter 9 for the Municipal Debtor?

The Automatic Stay

The automatic stay goes into effect when the chapter 9 petition is filed. The stay generally prevents both the initiation and continuation of collection actions by creditors against the municipality. A creditor may, however, ask the bankruptcy court to provide relief from the stay, which the court shall grant in certain circumstances.[23]

Chapter 9 provides that the stay does not apply to application of pledged special revenues to the debt secured by those special revenues.[24] Additionally, the stay will not prevent creditors from challenging the municipality's eligibility to file for chapter 9 protection.

[20] Congressional Budget Office Economic and Budget Issue Brief, *Fiscal Stress Faced by Local Governments* 9, Dec. 2010.

[21] *Id.*

[22] *See* In re Hamilton Creek Metro. Dist., 143 F.3d 1381,1386 (10th Cir. 1998); In re City of Bridgeport, 132 B.R. 85, 92 (Bankr. D. Conn. 1991).

[23] 11 U.S.C. § 362(d).

[24] 11 U.S.C. § 922(d). Reference to § 927 in § 922(d) is understood by commentators to be an error and intended as a reference to § 928. *See* H. Slayton Dabney Jr., *Municipalities in Peril: The ABI Guide to Chapter 9* 64 (Amer. Bankr. Inst. 2010).

Postpetition Financing

Filing for chapter 9 does not automatically eliminate the financial stress a municipality is experiencing. The municipality may need additional funds to provide services or to pay for expenses incurred in the administration of the chapter 9 case. By its incorporation of Section 364(c),[25] chapter 9 provides the municipality with the ability to acquire debt that either has priority over administrative expenses or is secured by a lien on the municipality's property. However, some states will not allow their municipalities to borrow to cover operating expenses. Furthermore, unless the lender were to agree otherwise, the entire debt would need to be repaid by the effective date of the plan of adjustment, otherwise the plan could not be confirmed.[26]

Retention of Control

There are several ways in which the municipal debtor retains control in a chapter 9 case.

No Trustee

Generally, there is no trustee in a chapter 9 case. In this way it is similar to a chapter 11. However, in a chapter 9 case, if a creditor so requests, the court may appoint a trustee for the limited purpose of pursuing a cause of action using certain avoidance powers,[27] such as fraudulent or preferential transfers, when a debtor has refused to do so. In a chapter 11, if a trustee is appointed, the trustee takes the place of the debtor in possession, with the same powers and duties. Generally, a trustee is appointed in a chapter 11 case only "for cause" such as fraud, dishonesty, incompetence, or gross mismanagement.[28]

No Bankruptcy "Estate"

Municipal property, including income other than special revenues, remains under the control of the municipality to use as it chooses. It does not become part of an estate that cannot be disposed of without the consent of the bankruptcy court.

Limited Involvement or Oversight by the Bankruptcy Court

In a municipal bankruptcy, the municipality retains autonomy in most things. The bankruptcy court cannot interfere with the municipality's political or governmental powers, its property or revenues, or its use or enjoyment of its income-producing property.[29]

The municipality in chapter 9 remains subject to control by the state.[30] The bankruptcy court's involvement is generally limited to a few areas. It may determine whether the municipality is

[25] 11 U.S.C. § 901(a).

[26] 11 U.S.C. § 943(b)(5).

[27] These powers are found in 11 U.S.C. §§ 544, 545, 547, 548, 549(a), 550.

[28] 11 U.S.C. § 1104(a)(1).

[29] 11 U.S.C. § 904.

[30] 11 U.S.C. § 903. However, having authorized its municipality to file under chapter 9, the state may not "cherry pick" what it likes about chapter 9; it must accept the chapter in its totality. In re County of Orange, 191 B.R. 1005, 1021 (continued...)

eligible to file under chapter 9[31] and may dismiss cases when appropriate.[32] Approval of assumptions or rejections of executory contracts[33] and confirmation of the municipality's plan of adjustment are also within the purview of the bankruptcy court.[34]

Assumption and Rejection of Executory Contracts

Chapter 9 includes § 365 among the sections of the Bankruptcy Code that are applicable in a municipal case.[35] As a result, the municipality, with the approval of the court, may assume executory contracts that are beneficial to the municipality and reject those that are too burdensome.[36] Generally, the standard bankruptcy courts use in approving a debtor's assumption or rejection of an executory contract is the business judgment rule, a standard that generally defers to the debtor's judgment as to what is best for its operations. However, in evaluating assumption or rejection of a collective bargaining agreement (CBA), the courts use a higher standard.

In a chapter 11 bankruptcy, rejection of a CBA is subject to the requirements of § 1113 of the Bankruptcy Code. This section requires that three conditions be met before a court can grant a motion to reject a CBA: (1) the debtor must meet the requirements of 11 U.S.C. § 1113(b)(1) by (a) presenting a proposal that both treats all parties equitably and proposes changes necessary for reorganization,[37] and (b) providing the bargaining unit's representative with information needed to evaluate the proposal;[38] (2) the representative must have refused to accept the debtor's proposal without good cause;[39] and (3) "the balance of equities [must] clearly favor[] rejection."[40] Section 1113, which is not among the Bankruptcy Code sections named in § 901(a) as applicable in chapter 9, was added to the Bankruptcy Code following the U.S. Supreme Court's 1984 holding in *National Labor Relations Board v. Bildisco and Bildisco*.[41] *Bildisco* held that rejection of a CBA required a higher standard than the business judgment rule, but its requirements were not as stringent as those of § 1113.

Under the *Bildisco* standard, a CBA may be rejected only if the court finds that the agreement is burdensome to the debtor and that, after balancing the equities, rejection is favored. This is the standard generally used for rejecting a CBA in chapter 9.

(...continued)

(Bankr. C.D. Cal. 1996).

[31] 11 U.S.C. § 921.

[32] 11 U.S.C. §§ 921, 930.

[33] 11 U.S.C. § 365(a) (applicable in chapter 9 through § 901(a)).

[34] 11 U.S.C. § 943(b).

[35] 11 U.S.C. § 901(a).

[36] However, municipal leases may not be treated as an executory contract or unexpired lease simply because it may be terminated if the municipality fails to pay rent. 11 U.S.C. § 929.

[37] 11 U.S.C. § 1113(b)(1)(A).

[38] 11 U.S.C. § 1113(b)(1)(B).

[39] 11 U.S.C. § 1113(c)(2).

[40] 11 U.S.C. § 1113(c)(3).

[41] 465 U.S. 513 (1984).

In 1995, the bankruptcy court overseeing the Orange County, CA, chapter 9 case found that the standards established by the *Bildisco* decision were applicable when a municipality wanted to reject a CBA, but that those standards had not been met nor had the county established the necessity for unilateral abrogation of its employee CBAs.[42] Recently the city of Vallejo, CA, was successful in rejecting CBAs in its chapter 9 case, with both the bankruptcy court[43] and the district court[44] finding that the *Bildisco* standard was applicable in the case. The district court, ruling in an appeal by the International Brotherhood of Electrical Workers, Local 2376, found that the *Bildisco* standard had been met.[45]

Avoidance Powers

Sections 547 and 548 of the Bankruptcy Code are applicable in chapter 9 cases; therefore, the municipality can avoid (or "clawback") fraudulent transfers and preferential transfers. One exception to the latter is transfers to bondholders.[46]

Adjustment of Debts

In a chapter 9 case, only the debtor has the right to file a plan of adjustment.[47] This is in contrast to chapter 11 reorganizations, in which the debtor initially has the exclusive right to file a plan of reorganization, but with the passage of time, may lose that exclusivity.[48] In a chapter 9 case, if the plan is not filed with the petition, the court may determine a date by which the plan must be filed.

To be confirmed, a plan generally must be accepted by each class of impaired creditors.[49] However, chapter 9 incorporates the "cramdown" provision in chapter 11, thereby allowing confirmation if at least one class of impaired creditors accepts the plan and the plan "does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted the plan."[50]

Special revenue bonds are generally protected from adjustment in chapter 9.[51] General obligation bonds do not enjoy such protection under bankruptcy law; however, a municipality's ability to adjust those debts may be limited by state law. To be confirmed, a plan cannot require the municipality to take an action that is prohibited by law.[52] This provision may also limit a municipality's ability to adjust its existing pension obligations through chapter 9. Many states

[42] In re County of Orange, 170 B.R. 177, 184 (Bankr. C.D. Cal. 1995).

[43] In re City of Vallejo, 403 B.R. 72 (Bankr. E.D. Cal. 2009).

[44] 432 B.R. 262, 272 (E.D. Cal. 2010).

[45] *Id.*

[46] 11 U.S.C. § 926(b).

[47] 11 U.S.C. § 941.

[48] 11 U.S.C. § 1121.

[49] 11 U.S.C. § 1129(2)(8) (applicable in chapter 9 through § 901(a)).

[50] 11 U.S.C. § 1129(b)(1). The standards imposed by these "terms of art," though not fully tested in chapter 9, are supported by a large body of judicial case law and cannot be viewed as conferring unfettered discretion upon a court in applying them.

[51] 11 U.S.C. § 928.

[52] 11 U.S.C. § 943(b)(4).

have either constitutional or statutory constraints regarding both general obligation debts and pensions.[53]

Section 943 directs the court to confirm a plan *if* it complies with the requirements of the Bankruptcy Code; the expenses incurred in connection with the case and the plan of adjustment are disclosed and are reasonable; the debtor is not legally prohibited from taking actions necessary to carry out the plan; holders of administrative claims receive cash equaling their claims, unless they agree otherwise; the debtor has, or will, obtain any regulatory or electoral approval required under nonbankruptcy law for carrying out the plan; and the plan is both feasible and in the best interest of creditors.

Notable Chapter 9 Cases

As stated before, municipalities rarely file for bankruptcy protection. Although New York City experienced significant financial difficulty in 1975, it did not file for bankruptcy. Instead, the state created a financial watchdog: the New York City Emergency Financial Control Board, which held veto power over the city's budget until 1986.[54] In 1991, the city of Bridgeport, CT, filed under chapter 9, but its case was dismissed after its eligibility to file was challenged by creditors. The court found that state law authorized the city to file, but found that it was not insolvent.

In recent years, there have been two notable chapter 9 filings: Orange County, CA; and the city of Vallejo, CA.

Orange County, California

On December 6, 1994, Orange County, CA, filed under chapter 9. Its debt adjustment represents the largest municipal bankruptcy filing to date. The county was overseer of the Orange County Investment Pool (OCIP), comprising its funds and those belonging to a wide variety of additional municipal entities, such as school and irrigation districts. The county treasurer engaged in a high-risk investment strategy involving reverse repurchase agreements or "repos." The OCIP's $7.5 billion in investment equity was leveraged into $20 billion. The success of the investment strategy depended upon declining interest rates. When interest rates began to rise and creditors demanded increased collateral, the county's financial liquidity plummeted.[55] It filed under chapter 9 and instituted many lawsuits against its investment bankers and others. A plan of adjustment became effective in June 1996. In February 2000, the presiding bankruptcy judge closed the case by approving the distribution of $816 million in litigation proceeds.[56]

[53] *See e.g., State Constitutional Protections for Public Sector Retirement Benefits.* Available at http://www.ncpers.org/Files/News/03152007RetireBenefitProtections.pdf.

[54] Joshua Brustein, *The Fiscal Crisis After 30 Years*, Gotham Gazette, Oct. 10, 2005. Available at http://www.Gothamgazette.com/article//2051010/200/1612.

[55] Philippe Jorion, *Big Bets Gone Bad: Derivatives and Bankruptcy in Orange County* (Academic Press 1995).

[56] Daniel Yi, *Judge OKs Payments Ending O.C. Bankruptcy*, L.A. Times, Feb. 3 2000, at B3. The distribution provided "near total" recovery for many of the agencies that lost money in the OCIP; schools recovered an average of 97.7%; cities and public agencies, 94.4%; and the County, 87 cents on the dollar.

Vallejo, California

Prior to filing under chapter 9 on May 23, 2008, the city of Vallejo attempted to resolve its financial issues by "reducing the number of its employees, cutting funding and services not controlled by contract, and severely reducing or completely cutting off funding for various community services … as well as infrastructure."[57] It also "retained a consultant to identify potential sources of new and additional revenue, and implemented these recommendations where possible."[58] However, its ability to generate new revenues was limited by California law.[59]

Through negotiations, the city was able to temporarily reduce employee costs, arriving at interim agreements to modify the collective bargaining agreements (CBAs) with its police and firefighters.[60] The city was not successful in its attempts to negotiate long-term modifications to its CBAs with any of the four unions representing its employees. Prior to the expiration of the interim agreements, the city filed under chapter 9 and froze all employee compensation at its pre-petition level.[61] This enabled the city to benefit from the interim agreements beyond their stated expiration dates as well as avoid upcoming salary increases provided for in the CBAs. It also filed a motion to reject its CBAs.[62] Ultimately, the city was able to renegotiate all but one of its CBAs. The court allowed the city to reject the remaining CBA, using the *Bildisco* standard.

The city's plan of adjustment[63] was filed January 18, 2011, along with its disclosure statement.[64] In the plan the city proposes paying its unsecured creditors less than the full amount of their claims. Estimates are that the claims would be paid between 5% and 20%. The disclosure statement prepared by the city must be approved by the court before the creditors have the opportunity to vote on the city's plan of adjustment.

Recent Developments

Boise County, Idaho

On March 1, 2011, Boise County, ID, filed a chapter 9 petition.[65] Reportedly the impetus for the filing was a judgment against the county for $4 million. The annual budget for the county, which

[57] In re City of Vallejo, California, Case No. 2008-26813, *Disclosure Statement with Respect to the Adjustment of Debts* 6-7, Jan. 18, 2011. Available at http://www.ci.vallejo.ca.us/uploads/853/836.pdf.

[58] *Id.* at 7.

[59] *Id.* at 6.

[60] *Id.* at 7.

[61] *Id.* at 8.

[62] A copy of this motion and its supporting documents as well as many other key documents are available at http://www.ci.vallejo.ca.us/GovSite/default.asp?serviceID1=744&Frame=L1.

[63] The plan is available at http://www.ci.vallejo.ca.us/uploads/853/01182011%20-%20Plan%20of%20Adjustment.pdf.

[64] The disclosure statement is an explanatory document provided to creditors and required to be approved by the court. Its purpose is to provide sufficient information about the proposed plan to allow creditors to make an informed decision when they vote to accept or reject the plan.

[65] *Boise County, Idaho, Files for Ch. 9 Protection After $4 Million Judgment*, BNA Bankruptcy Law Reporter, Mar. 10, 2011. Available at http://news.bna.com/bbln/BBLNWB/split_display.adp?fedfid=19954527&vname=bkynotallissues&wsn=500214000&searchid=13991907&doctypeid=1&type=date&mode=doc&split=0&scm=BBLNWB&pg=0.

does *not* include the city of Boise, is less than $9.5 million.[66] The judgment came as the result of a suit by Alamar Ranch, LLC, which asserted that its efforts to obtain a conditional use permit had been improperly blocked.[67] Taxpayers in the county had opposed the proposed development—a residential treatment facility for 72 boys. Ultimately, the county was found to have violated the Fair Housing Act. After the judgment, the county attempted to negotiate a lower amount that it could afford, but was unsuccessful.

Harrisburg, Pennsylvania

Harrisburg considered filing under chapter 9,[68] but ultimately its mayor, who opposed bankruptcy, chose to pursue a state-offered program for distressed cities.[69] December 15, 2010, Harrisburg, PA, was accepted into the state's "distressed cities" program, also known as Act 47. The program was started in 1987. Harrisburg is the 20th municipality in the program. Many have remained in the program for more than a decade.

The city qualified for the program after missing $10.5 million in payments for bonds related to an incinerator project. It also had a junk-bond credit rating and lawsuits to force it to postpone paying operating expenses (including payroll) in favor of meeting debt obligations as well as a more than $19 million projected deficit in 2015. Some believe that chapter 9 would be a better alternative for the city than the state program and are considering appealing the state's decision to admit the city into its program.

Jefferson County, Alabama

Jefferson County, AL, is the most populous county in Alabama. Most of the city of Birmingham is within its boundaries. It has been experiencing financial difficulties for several years. While there has been speculation about its filing for bankruptcy, it has not done so. If it does, it is believed that it would be the largest municipal bankruptcy in history.[70]

Jefferson County's financial troubles are due in part to the recession, but also due to a $3.2 billion debt load attributable to sewer bonds with a floating interest rate and a downgrading of those bonds to junk status in 2008 by both Moody's Investors Service and Standard and Poor's due to the projected inability of the county to meet interest payments on the debt.[71] Most recently, the

[66] One source states that the annual budget is about $9.3 million; *id.*; another estimates it at $9.5 million; *Small Idaho County Files for Bankruptcy*, Wall Street Journal, Mar. 3, 2011.

[67] Alamar Ranch, LLC v. County of Boise, 2009 WL 3669741, 1 (D. Idaho 2009).

[68] *Harrisburg, Pa., Seeks Bankruptcy Attorneys*, Reuters, Oct. 8, 2010. Available at http://www.reuters.com/article/2010/10/08/us-pennyslvania-harrisburg-idUSTRE69761720101008.

[69] Romy Varghese and Kelly Nolan, *Harrisburg Enters Pennsylvania's Distressed-Cities Program*, Wall Street Journal, Dec. 15, 2010. Available at http://online.wsj.com/article/SB10001424052748704828104576021462978168284.html.

[70] *Jefferson County's Financial Woes Increase When Alabama Court Voids Occupational Tax*, Associated Press, Mar. 16, 2011. Available at http://www.therepublic.com/view/story/e8af07d8fed54bc9a5be704b4d9e9ebc/AL—Jefferson-County-Tax#.

[71] Bob Sims, *Update: Jefferson County Finances Take Another Hit*, Mar. 4, 2008. Available at http://blog.al.com/spotnews/2008/03/update_jefferson_county_financ.html.

county has lost a source of revenue after the Alabama Supreme Court found the county's occupational tax unconstitutional for lack of sufficient notice.[72]

[72] Barnett Wright, *Alabama Supreme Court Rules Jefferson County's 2009 Occupational Tax Illegal*, Mar. 17, 2011. Available at http://blog.al.com/spotnews/2011/03/alabama_supreme_court_rules_je.html; Barnett Wright, "State Supreme Court Rules Jefferson County Occupational Tax Unconstitutional," Mar. 16, 2011. Available at http://blog.al.com/spotnews/2011/03/state_supreme_court_rules_jeff.html.

Appendix. Legislative History of Municipal Bankruptcy

In 1934, legislation was enacted as "emergency temporary aid" for insolvent municipalities whose revenues had dropped during the Great Depression.[73] The provisions were modified slightly[74] by legislation enacted in April 1936 and were extended to January 1, 1940.[75] Two years and one day after the original legislation was enacted, the U.S. Supreme Court, in a 5 to 4 opinion, found it to be unconstitutional.[76]

The next year, 1937, new legislation was enacted that established a new chapter of the Bankruptcy Code.[77] The legislation expanded the definition of "municipality," but continued to require the entity to have the power to tax.[78] The constitutionality of the new law was challenged, but the U.S. Supreme Court found the provisions to be constitutional,[79] noting that a federal provision for municipal bankruptcy was needed because adequate relief could not be provided by the states due to the constitutional prohibition on enacting any law that would impair contracts.[80] This legislation was also enacted as a temporary provision and was due to expire on June 30, 1940.[81] It was extended for two years in 1940[82] and for four more years in 1942.[83] In 1946, the provisions were amended[84] and made permanent.[85]

Among the changes made in 1946 was the removal of "taxing" as an adjective in the lengthy definition of "municipality."[86] This change allowed the definition of "municipality" to include public agencies[87] that were authorized to either construct or acquire revenue-producing utilities and that issued bonds to finance those public improvements—revenue bonds, whose source of repayment was revenue from the utility that had been constructed or acquired.[88]

[73] P.L. 73-251, 48 Stat. 798.

[74] P.L. 74-515, 49 Stat. 1203.

[75] P.L. 74-507, 49 Stat. 1198.

[76] Ashton v. Cameron County Water Improvement District, 298 U.S. 513 (1936).

[77] P.L. 75-302, 50 Stat. 653.

[78] P.L. 75 302, 50 Stat. 653, 654.

[79] United States v. Bekins, 304 U.S. 27 (1938).

[80] The "Contracts Clause" states that "[n]o State shall … pass any … Law impairing the Obligation of Contracts." U.S. Const. art. I, § 10, cl. 1. Many states' constitutions include similar prohibitions.

[81] P.L. 75-302, 50 Stat. 653, 659 (creating § 84 of the Bankruptcy Act of 1898). The courts retained jurisdiction over "any proceedings initiated by filing a petition … on or prior to June 30, 1940. *Id.*

[82] P.L. 76-669, § 4, 54 Stat. 667, 670.

[83] P.L. 77-622, 56 Stat. 377.

[84] P.L. 79-481, 60 Stat. 409.

[85] P.L. 79-481, § 2, 60 Stat. 409, 416.

[86] P.L. 79-481, 60 Stat. 409 (amending § 81).

[87] These public agencies go by a variety of names such as "authorities," commissions," or "districts."

[88] H.Rept. 2246, at 2-3 (1946); S.Rept. 1633, at 2 (1946). However, some states limit the municipality authorized to file under chapter 9 to those that have the power to tax. *E.g.* Arizona, Ariz. Rev. Stat. § 35-603; Idaho, Idaho Code § 67-3903; Washington, Wash. Rev. Code § 39.64.040.

In the wake of New York City's 1975 financial crisis, the provisions for municipal bankruptcy were again revised. The existing provisions were believed to contain procedural obstacles that made them inadequate for the reorganization of a major municipality.[89] In 1976, chapter IX of the Bankruptcy Act of 1898 (as amended) was amended to revise sections 81 through 83 and add sections 84 through 98.[90] The revisions eliminated the need to have a plan of adjustment approved by the majority of creditors before the petition could be filed. Filing of the petition then triggered the automatic stay, providing protection from litigation of creditors' claims against the debtor. The revisions also extended to municipal debtors some provisions available to other debtors and allowed them to reject executory contracts with the approval of the court.

Two years later, when Congress enacted the Bankruptcy Reform Act of 1978,[91] establishing the current Bankruptcy Code, the 1976 revisions were incorporated into chapter 9.[92] Since 1978, Congress has amended chapter 9 several times. In 1988, Congress passed amendments generally concerned with the definition of municipal "insolvency"; the rights of creditors as general obligation bondholders and special revenue bondholders; and the status of municipal financing leases.[93] Section 109(c)(2) of the Bankruptcy Code was amended in 1994[94] to require that municipalities be "specifically authorized" by state law to be a debtor under chapter 9. Previously, the authorization under state law needed only to be general.

The primary way in which the Bankruptcy Prevention and Consumer Protection Act of 2005[95] changed chapter 9 directly was by amending § 901[96] to make applicable in chapter 9 several additional sections from chapter 5 of the Bankruptcy Code, most of which involved exceptions to the automatic stay. An additional subsection from chapter 11[97] was also added to the sections of chapter 11 that are applicable in chapter 9.

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[89] One of these obstacles was a requirement that, before it could file a bankruptcy petition, the municipality draft a plan of adjustment and get consent to that plan by at least 51% of its creditors. *Bankruptcy Act of* 1898, § 83. This meant that before enjoying the protection of bankruptcy's automatic stay on litigation, the municipality must find at least a majority of its creditors—many of whom might be individual bondholders—and propose a plan of adjustment that might require lengthy negotiation and revision before possibly being agreed to by the required 51% of creditors. Only at that point could the municipality file its petition and be protected from lawsuits by creditors.

[90] P.L. 94-260, 90 Stat. 315 (1976).

[91] P.L. 95-598, 92 Stat. 2549.

[92] P.L. 95-598, § 101, 92 Stat. 2549, 2621 – 25.

[93] P.L. 100-597m 102 Stat. 3028, 3028 – 30.

[94] P.L. 103-394, § 402, 108 Stat. 4106, 4141.

[95] P.L. 109-8, 119 Stat. 23.

[96] "Applicability of other sections of this title."

[97] 11 U.S.C. § 1123(d), which requires that the amount needed to cure a default must be determined according to the underlying agreement and nonbankruptcy law *if* the plan includes a proposed cure of the default.

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