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Editor-in-Chief & Board of Editors

Subnational Insolvencies and Chapter 9 of the United States Bankruptcy Code: History of Chapter 9 and Its Operation in the City of Detroit's Debt Adjustment Case—Part I

Patrick E. Mears*

In this first part of a two-part article, the author discusses the constitutional framework underpinning Chapter 9 of the Bankruptcy Code, insolvent municipalities and their stakeholders prior to the advent of Chapter 9, the Great Depression and the enactment of Chapter 9, and the structure of Chapter 9 and its operation. The second part of the article, which will appear in an upcoming issue of Pratt's Journal of Bankruptcy Law, *will focus on the City of Detroit's Chapter 9 case.*

Chapter 9 of the United States Bankruptcy Code, first enacted in the throes of the Great Depression in 1934, created insolvency proceedings in which financially troubled municipalities in the United States could seek judicial confirmation of plans for the "adjustment" of municipal debts. Chapter 9 was the first such legislation ever enacted by a sovereign state and has been resorted to by American municipalities throughout the years, especially in times of severe economic hardship. Prior to Chapter 9's enactment and its signing into law by President Franklin Delano Roosevelt, there existed no national legal mechanism to reorganize the finances of troubled cities and other municipalities, *e.g.*, water districts, school districts and counties. The various states were (and remain) constitutionally prohibited from enacting legislation compromising municipal debt in the absence of the consent of these creditors, meaning that "hold-out" creditors could always sabotage a voluntary restructuring of these obligations by enforcing their remedies under applicable law. In these circumstances, the federal government stepped in and authorized these debt adjustment plans under Congress' constitutional power to enact uniform bankruptcy laws.

The vast scale of economic and human suffering wrought by the Great Depression finally spurred the United States Congress into enacting the predecessor of current Chapter 9, labeled the "Wilcox Act" after its Congres-

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sional sponsor, which legislation authorized federal courts to approve debt adjustment plans for troubled municipalities over the objections of hold-out creditors. Although this act was voided as unconstitutional in 1936 by the United States Supreme Court on federalism grounds, Congress promptly enacted curative laws that were subsequently validated by that same court in 1938.

Since the enactment of this curative legislation in 1937 through September, 2013, municipalities had commenced 651 Chapter 9 cases. Until the World Financial Crisis of 2008, few of these cases involved cities of significant size.[1] However, after the collapse of Lehman Brothers in September, 2008, the floodgates opened; large cities like Harrisburg, Pennsylvania and San Bernardino, California filed Chapter 9 petitions with bankruptcy courts, leading to the largest municipal insolvency case ever commenced in the United States, that of the City of Detroit, Michigan (the "City"), which was initiated in July, 2013. Fifteen months later, the United States Bankruptcy Court for the Eastern District of Michigan (the "Court") confirmed the City of Detroit's Eighth Amended Chapter 9 Plan of Debt Adjustment (the "Plan") that provides payments to classes of unsecured claims ranging from 13 percent to 74 percent of their allowed claims. While some City assets will be transferred to third parties under the Plan, other properties will remain with the city, most notably its extensive and valuable art collection and Belle Isle, a large island park in the Detroit River that is presently leased to the State of Michigan. Confirmation of the Plan was announced by the Court on November 7, 2014 after numerous settlements were entered into by the City and a number of creditor classes, which settlements were thereafter incorporated into the Plan. Five days later, the Court entered its order confirming the Plan (the "Confirmation Order").

THE CONSTITUTIONAL FRAMEWORK UNDERPINNING CHAPTER 9 OF THE BANKRUPTCY CODE

The United States Constitution, written and promulgated by the Philadelphia Constitutional Convention in 1787 and ratified by the 13 states of the American Union in 1790, embodies the principle of federalism—governance

[1] The City of Bridgeport, Connecticut, then (and still) the most populous city in that state, commenced a Chapter 9 case in 1991, which was later dismissed by the bankruptcy court on the ground that the city was not "insolvent" within the meaning of section 109(c)(3) of the Bankruptcy Code. *In re City of Bridgeport*, 129 B.R. 332 (Bankr. D. Conn. 1991). In 1975, New York City narrowly averted filing a Chapter 9 petition by means of a bailout coordinated by the State of New York and the U.S. Congress. *See generally* Donna E. Shalala and Carol Bellamy, *A State Saves a City: The New York Case*, 1976 Duke L.J. 1118 (1976).

powers are parceled out separately between the national government and the various states. Article I of the Constitution grants to the national government various enumerated powers which are that government's special and exclusive reserve. Included among these enumerated powers are the power to "lay and collect Taxes," to "provide for the common Defense and general Welfare of the United States," to "coin Money" and to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." The Constitution also grants to the national government implied powers—the power to make "all Laws which shall be necessary and proper for carrying into Execution" all enumerated powers vested in the national government.[2]

To the various states and the American people themselves were reserved all powers not delegated in the Constitution to the national government and not prohibited by that document to the states. One of the powers that the Constitution prohibited the states from exercising was the power to impair "the Obligation of Contracts."[3]

In the course of American legal history, these constitutional powers and prohibitions were further defined and refined by the federal courts of the United States and, in particular, by the Supreme Court. The national government, unlike the states, was declared to have the power to impair contractual obligations of its citizens, particularly through the exercise of the federal power to enact uniform bankruptcy laws.[4] This power permitted Congress, in the context of insolvency legislation, to permit federal courts to enter orders and judgments discharging debtors from liability for their debts and to confirm debt adjustment plans reducing amounts required to be paid by debtors to their creditors.[5]

As will be discussed, the predecessor statutes to Chapter 9 of the Bankruptcy

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[2] The constitutional doctrine of implied powers of the national government was first articulated by Chief Justice John Marshall in *McCulloch v. Maryland*, 17 U.S. 316 (1819). *See also United States v. Butler*, 297 U.S. 1 (1936).

[3] This constitutional prohibition on state powers in Article 1, Section 10, Clause 1, is not absolute. The impairment must be substantial in order to trigger judicial review and, during this review, courts must determine (i) whether a significant and legitimate public purpose exists to justify the impairment; and (ii) whether the impairment is reasonable and necessary. *See, e.g.*, *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400 (1983).

[4] *See, e.g.*, *Ashton v. Cameron County Water Improvement District No. 1*, 298 U.S. 513, 530 (1936), where the Supreme Court stated that the "especial purpose of all bankruptcy legislation is to interfere with the relations between the parties concerned—to change, modify, or impair the obligation of their contracts."

[5] *See, e.g.*, *Assoc. of Retired Emples. v. City of Stockton (In re City of Stockton)*, 478 B.R. 8 (Bankr. E.D. Cal. 2012) (Klein, B.J.).

Code were drafted and enacted by Congress with respect for the doctrine of federalism in the Constitution. While Chapter 9, as a uniform bankruptcy law, may impair contractual obligations of debtor municipalities owing to their creditors, these federal statutory provisions may not interfere with the powers reserved to the states and, by extension, to municipalities without their consent.

INSOLVENT MUNICIPALITIES AND THEIR STAKEHOLDERS PRIOR TO THE ADVENT OF CHAPTER 9

As a nation that adopted after its foundation capitalism as its economic creed, the United States has been subject to business cycles throughout its history. During these cycles, the national economy expands and contracts, with some contractions being especially severe, *e.g.*, the Panics of 1837, 1857, 1873, and 1893, the Great Depression of 1929 and the World Financial Crisis of 2008. Before the enactment of Chapter 9, insolvent municipalities could not obtain debt relief—neither states nor municipalities could enact laws providing for the nonconsensual discharge of previously incurred indebtedness, being barred by the constitutional prohibition against state laws impairing the obligation of contracts.

Prior to the enactment of the Wilcox Act in 1934, creditors of insolvent municipalities could attempt to collect under applicable state law from their municipal debtors sums that were past due on contractual and other obligations, including bond indebtedness. These remedies included

- seizure of municipal property;
- appointment of a receiver to oversee municipal affairs;
- seizure of property of municipal inhabitants;
- state assumption of municipal debt;
- the imposition of liens on future municipal revenues; and
- imposition of new taxes through creditor-initiated mandamus actions.[6]

Before 1934, the most effective creditors' remedy to collect unpaid municipal debt under state law was the issuance of a writ of mandamus by a court requiring the defaulting municipality to impose new taxes to pay the petitioning creditors' claims.[7] The United States Supreme Court best summarized the legal underpinnings of this mandamus remedy in its *Meriwether*

[6] *See generally* Michael W. McConnell and Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 427–50 (1993) (hereinafter cited as "McConnell & Picker").

[7] *See, e.g.*, *Maryland Casualty Co. v. Leland*, 214 N.C. 235, 199 S.E. 7 (1938).

decision involving the imposition of a receivership by the Tennessee state legislature on the City of Memphis to collect its unpaid bond obligations:

> When creditors are unable to obtain payments of their judgments against municipal bodies by execution, they can proceed by *mandamus* against the municipal authorities to compel them to levy the necessary tax for that purpose, if such authorities are clothed by the legislature with the taxing power; and such tax, when collected, cannot be diverted to other uses.[8]

Although this was the most effective creditors' remedy in these circumstances, it had serious practical drawbacks. The invocation of the remedy by one creditor would often cause other, similarly situated creditors to commence similar actions, thereby starting a race to the courthouse. Second, raising tax rates to cover these mandamus obligations often led to significant defaults by taxpayers. In addition, sales of property to pay unpaid taxes often had the deleterious effect of causing the market for these properties to weaken or collapse.[9]

THE GREAT DEPRESSION AND THE ENACTMENT OF CHAPTER 9 OF THE BANKRUPTCY CODE

The Great Depression, Its Impact on Municipal Finance, and the Wilcox Act

The Great Depression originated in the United States on October 29, 1929, commonly known as "Black Tuesday," with the stock market crash. The economic malaise that resulted from the crash quickly spread throughout the world and lasted until World War II. The impact of this disaster on cities and other municipalities in the United States became especially severe by the Spring of 1933, when the United States Congress conducted hearings on the proposed "Wilcox Act," the immediate predecessor of present Chapter 9 of the Bankruptcy Code. By the mid-1930s, 10 percent of municipal bond issues were in default.[10] Included in the ranks of these defaulting municipalities were:

- Cook County, Illinois;
- Detroit, Michigan;

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[8] *Meriwether v. Garrett*, 102 U.S. 472, 518 (1879).

[9] McConnell & Picker at 448–449.

[10] Hearings Before the Committee on the Judiciary, House of Representatives, on H.R. 1670, H.R. 3083, H.R. 4311, H.R. 5267, and H.R. 5009 (Serial I), 73d Cong. 1st Sess., at pp. 107–110.

- Asheville, North Carolina;
- Miami, Florida;
- Charleston, South Carolina; and
- Mobile, Alabama.

The sponsor of this proposed statute, Representative J. Mark Wilcox of Florida, argued that national legislation permitting a federal court to confirm an enforceable composition plan for a troubled municipality was the only practical and efficient means to reorganize these debtors. Because states were prohibited by the constitutional prohibition against impairing contractual obligations and because holdout creditors could scuttle consensual repayment plans offered by municipalities to their creditors, a federal law providing for adjustment of municipal debts was necessary. Representative Wilcox in these hearings described the "holdout problem" as follows:

> Unless you have in this act a provision authorizing the court to stay suits for the payment of creditors, you would be confronted immediately with this situation, which is the situation we are trying to remedy. A substantial number of creditors, realizing the necessity for adjustment, and willing to work out a plan of adjustment, would come into court and consent to the working out of a plan. In the meantime, unscrupulous creditors, seeking to obtain an unfair advantage of the majority, would immediately file a mandamus action against the city, requiring it to pay over to these unscrupulous creditors any funds on hand, and the unscrupulous minority, who had no desire to help work out a plan of readjustment, would immediately get paid, while the other fellow would get nothing.[11]

The Wilcox Act was drafted with acute attention being given to federalism concerns. Section 80(k) of the Act provided that nothing in this legislation would be "construed to limit or impair the power of any State to control, by legislation or otherwise, any political subdivision thereof in the exercise of its political or governmental powers." In addition, the judge administering the insolvency proceeding was prohibited from interfering with any of the political or governmental powers of the municipality or with any of its property or revenues necessary for essential governmental purposes unless the plan of debt adjustment permitted such interference. Creditors of the municipality were permitted to vote on the debt adjustment plan and, in order for the judge to

[11] Statement of Hon. J. Mark Wilcox, Hearings Before the Committee on the Judiciary, House of Representatives, on H.R. 1670, H.R. 3083, H.R. 4311, H.R. 5267 and H.R. 5009 (Serial 1), 73rd Cong., 1st Sess., at pp. 165–166 (1933).

consider confirmation of the plan, a designated majority of creditors was required to approve the plan.[12]

The *Ashton* and *Bekins* Decisions of the Supreme Court

In 1936, the United States Supreme Court had the opportunity to address the constitutionality of the Wilcox Act and found it wanting. In *Ashton v. Cameron County Water Improvement District No. 1*,[13] the United States Supreme Court held on a 5-4 vote of the Justices that the Wilcox Act violated the reservation of rights and powers to the states by the Tenth Amendment to the Constitution. However, the Court's majority opinion in *Ashton* neglected to specify the provisions of the Wilcox Act that failed to pass constitutional muster. Accordingly, one legal commentator observed at the time that

> [t]he majority [of the Court] held that under the American system of dual sovereignty, Congress has no power to interfere with a state's control over its own subdivisions, counties, municipalities, etc. The opinion did not indicate what particular provisions of the Act would interfere with the state's control; rather, its conclusion seems to have been due to a fear of the consequences that might follow a decision that the Act was valid.[14]

After the *Ashton* decision, Congressman Wilcox and other members of Congress collaborated on the drafting of a new municipal insolvency statute that they hoped would alleviate the Supreme Court's concerns. The result of this effort was the creation of proposed legislation very similar to the Wilcox Act. This new legislation, however, would permit municipalities to commence proceedings seeking a "composition" of indebtedness and required prior state authorization before a municipality could file an insolvency petition with a federal court. This new statute, which has since evolved into the current Chapter 9 of the Bankruptcy Code, was enacted by Congress and signed into law by President Roosevelt in 1937.[15] One year later, the Supreme Court upheld this act against a constitutional challenge in *United States v. Bekins*. In

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[12] *See generally*, *Ashton v. Cameron County Water Improvement District No. 1*, 298 U.S. 513 (1936) for an analysis of the Wilcox Act (hereinafter cited as *Ashton*). *See also*, Edward J. Dimock, *Legal Problems of Financially Embarrassed Municipalities*, 22 Va. L. Rev. 39 (1935).

[13] 298 U.S. 513 (1936). *See also* George H. Dession, *Municipal Debt Adjustment of the Supreme Court*, 46 Yale L.J. 199 (1936).

[14] Giles J. Patterson, *Municipal Debt Adjustments under the Bankruptcy Act*, 90 U. Pa. L. Rev. 520, 523 (1942).

[15] *See generally*, Note, *The New Federal Municipal Debt Re-Adjustment Act*, 24 Va. L. Rev. 181 (1937); Forrest R. Black, *Has Congress Circumvented the Ashton Decision?*, 23 Am. Bar Assoc. J. 683 (1937).

its opinion, the Court found that the legislation was "carefully drawn so as not to impinge upon the sovereignty of the State."[16]

The 1938 statute, as later amended, was adopted by Congress to be a permanent part of United States bankruptcy law. This legislation was amended over time and in 1978, a revised version was incorporated as Chapter 9 of the Bankruptcy Reform Act of 1978.[17] A further amendment, requiring the specific authorization by a state to permit a Chapter 9 filing, was added by Congress in 1994 and additional changes to the statute were made in 2005.

STRUCTURE OF CHAPTER 9 AND ITS OPERATION

In General

The Chapter 9 provisions of the Bankruptcy Code are found at 11 U.S.C. §§ 901-946 and consist of only 20 sections. Section 109(c) of the Bankruptcy Code sets forth the eligibility requirements that a municipality must satisfy in order to commence and maintain a Chapter 9 case. Section 901(a) incorporates a list of other bankruptcy provisions from other Code chapters as being applicable in Chapter 9 cases, some of which will be discussed in this article. Section 901(b) posits a rule of construction—that defined terms incorporated into Chapter 9 from other sections of the Code continue to have those meanings "unless such term is otherwise defined" in section 902 of Chapter 9. Certain of the national bankruptcy rules, formally known as the Federal Rules of Bankruptcy Procedure, apply directly in Chapter 9 cases, *e.g.*, Bankruptcy Rule 3018, which prescribes voting procedures on Chapter 9 plans.

Filing of Chapter 9 Petitions and Eligibility to File

Chapter 9 cases generally proceed along the following lines. After a "municipality"[18] is "specifically authorized" by applicable state law or a "governmental officer or organization empowered by State law" to commence a Chapter 9 case,[19] the municipality will normally file a Chapter 9 petition in the federal district in which it has its principal assets/principal place of business.[20] No involuntary petitions against municipalities may be filed.

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[16] *United States v. Bekins*, 304 U.S. 27, 51 (1938).

[17] 11 U.S.C. § 901, *et seq.*

[18] 11 U.S.C. § 101(40) defines the term, "municipality" as a "political subdivision or public agency or instrumentality of a state." This category includes cities, counties, special assessment districts and municipal facilities, *e.g.*, hospitals and airports.

[19] 11 U.S.C. § 109(c)(2).

[20] 28 U.S.C. § 1408(1).

After the Chapter 9 petition is filed by a debtor, parties in interest in the Chapter 9 case may object to the petition and seek its dismissal and the bankruptcy court will conduct a hearing on the objection.[21] If the bankruptcy court finds that the debtor failed to file the petition in good faith or the debtor does not satisfy the eligibility requirements in section 109(c) of the Bankruptcy Code,[22] the judge may dismiss the Chapter 9 petition.[23] If the petition is not so dismissed, the bankruptcy court is required to enter an order for relief under Chapter 9.[24]

Powers of the Bankruptcy Court in Chapter 9 Cases

The power of a bankruptcy court to affect a Chapter 9 debtor's political or governmental powers, the debtor's property or its revenues, or the debtor's use or enjoyment of any income-producing property is severely circumscribed by section 904 of the Bankruptcy Code. This may be done only if the debtor consents to such interference or if the Chapter 9 plan so provides. In addition, Chapter 9 does not limit the power of a state "to control, by legislation or otherwise, a municipality . . . in the exercise of the [municipality's] political or governmental powers" subject to two very limited exceptions.[25] These limitations on the powers of the federal judiciary were inserted into Chapter 9 as a result of the federalism concerns of the United States Supreme Court as expressed in its *Ashton* decision previously discussed. As a consequence, the municipality's governing entities retain the power in most instances to conduct

[21] 11 U.S.C. § 922(c).

[22] The eligibility requirements that must be met by a Chapter 9 debtor are the following:

(a) The debtor is a municipality;

(b) The debtor is specifically authorized by state law or by an officer of the state to be a Chapter 9 debtor;

(c) The debtor is insolvent;

(d) The debtor desires to affect a debt-adjustment plan; and

(e) The debtor (i) has secured the agreement of creditors holding a majority in amount of claims in each class to be impaired under the plan; (ii) has negotiated in good faith with creditors and has failed to obtain agreement from the aforesaid classes of creditors; (iii) was unable to negotiate with creditors because the negotiation was impracticable; or (iv) believes that a creditor may attempt to secure a voidable preference.

11 U.S.C. § 109(c).

[23] *Id. See In re City of Harrisburg, Pennsylvania*, Case No. 11-06938 (Bankr. M.D. Pa. Dec. 2, 2011), and *In re City of Bridgeport*, 129 B.R. 332 (Bankr. D. Conn. 1991), for examples of bankruptcy court opinions dismissing Chapter 9 cases on eligibility grounds.

[24] 11 U.S.C. § 922(d).

[25] 11 U.S.C. § 903.

"business as usual" during a Chapter 9 case.

Filing of List of Creditors and Proofs of Claim

Upon the filing of a voluntary Chapter 9 petition, an injunction is automatically imposed by Sections 362 and 922 of the Bankruptcy Code prohibiting debt collection and lien enforcement actions against the municipality and its property. This automatic stay specifically extends also to protect officers and inhabitants of the debtor where the claim sought to be enforced is against the municipality.[26] The holders of claims in a Chapter 9 case are typically a diverse lot and include special revenue bondholders, general obligation bondholders, bond insurers, employees, beneficiaries of municipal pension funds, utility suppliers, lessors of equipment and trade creditors. Bond insurers hold contingent claims against the debtor to the extent that claims have not been made and satisfied from the policies. Finally, Section 922(c) excepts from the automatic stay the application of pledged "special revenues" against the debtor's bond obligations.[27]

Municipal debtors are required to file with the bankruptcy court clerk a list of creditors, including a list of the holders of the 20 largest unsecured claims.[28] Proofs of claim will be deemed filed in a Chapter 9 case if the claims appear on this list, provided that those claims are not listed as disputed, contingent or unliquidated.[29] Proofs of claim in Chapter 9 cases must be filed before the deadline date and time that the bankruptcy court fixes.[30] A proof of claim that is properly and timely filed will "supersede any scheduling of that claim," including a listing that the claim is either disputed, contingent or unliquidated.[31] Proofs of claim may be objected to on the grounds listed in Section 502 of the Bankruptcy Code and according to the procedures specified in Bankruptcy Rule 3007.

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[26] It is likely that this protection specifically granted to municipal inhabitants is an attempt to override antiquated laws of certain states (primarily those of New England) that permit recovery of municipal debts from a village or city's citizens. *See* the discussion of these state laws in McConnell & Picker.

[27] The term, "special revenues," is defined in section 902(2) of the Code. These typically consist of a stream of revenues derived from a bonded municipal project, *e.g.*, a water or sewer system. Liens in special revenues granted prior to the commencement of a Chapter 9 case will automatically continue post-bankruptcy subject to being surcharged for the project's "necessary operating expenses." 11 U.S.C. § 928.

[28] 11 U.S.C. § 924; Bankruptcy Rules 1007(a)(1), 1007(d).

[29] 11 U.S.C. § 925.

[30] Bankruptcy Rules 3003(c)(1), (2) and (3).

[31] Bankruptcy Rule 3003(c)(4).

Administrative Powers of the Chapter 9 Debtor

Section 901 of the Bankruptcy Code specifically incorporates sections provisions of other sections in the Code that grant to debtors the powers (i) to assume, assign and reject executory contracts;[32] (ii) to obtain post-petition financing;[33] and (iii) to provide adequate assurance of payment to utility providers.[34]

Avoidance Powers of the Chapter 9 Debtor

Chapter 9 debtors are granted the power to avoid and recover:

- unperfected liens and security interests under 11 U.S.C. § 544;
- certain statutory liens under 11 U.S.C. § 545;
- voidable preferences under 11 U.S.C. § 547;
- fraudulent transfers under 11 U.S.C. § 548; and
- certain post-petition transfers under 11 U.S.C. §§ 549(a), (c), and (d).

In the event that the debtor refuses to pursue a claim for avoidance and recovery under these provisions, the court may appoint a trustee to take this action.[35] Nevertheless, a transfer of property of the municipality to or for the benefit of a bondholder or noteholder on account of these instruments may not be avoided as a preference.[36]

The Chapter 9 Plan and Disclosure: Their Filing, Function, and Contents

In General

The Chapter 9 plan of debt adjustment is the keystone of all Chapter 9 cases; it is the device by which an insolvent municipality restructures its indebtedness and facilitates its "fresh start." Only the debtor municipality may propose such a plan; unlike Chapter 11, no third-party plans are allowed. There are no fixed time limits for filing a plan with the bankruptcy court except that the judge may fix a date by which a plan must be filed.[37] The municipality's failure to meet

[32] 11 U.S.C. § 365. *See also* 11 U.S.C. § 929 limiting the applicability of this provision to municipal leases where the lease is subject to termination "in the event the debtor fails to appropriate rent."

[33] 11 U.S.C. §§ 364(c), (d), (e) and (f).

[34] 11 U.S.C. § 366.

[35] 11 U.S.C. § 926(a).

[36] 11 U.S.C. § 926(b).

[37] 11 U.S.C. § 941.

such a deadline may cause the Chapter 9 case to be dismissed.[38]

Contents of the Plan

Section 901 of the Bankruptcy Code incorporates a number of Chapter 11 sections that specify what information and provisions must be and may be inserted in a Chapter 9 plan.[39] Thus, a plan must designate classes of secured and unsecured claims and describe the treatment of any "impaired" class.[40] With respect to each claim in a designated class, the plan must treat them similarly unless the holder of a claim consents to less favorable treatment. The plan must also provide "adequate means for the plan's implementation," which may include the municipality's (i) retention of all or a portion of its property; (ii) a sale of all or a part of its properties subject to or free and clear of liens; and (iii) extensions of maturity dates or interest rates of outstanding securities. The plan may leave certain classes of claims as "unimpaired."

The Disclosure Statement

Municipalities typically file with the bankruptcy court a "disclosure statement" at the same time as they file their plan. A disclosure statement is a document that explains the operation of the plan after its confirmation and its treatment of creditors' claims.[41] The information in the statement must be of a nature to "enable . . . a hypothetical investor of the relevant class to make an informed judgment about the plan."[42] This information must also be "of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records."[43]

After the municipality files its proposed disclosure statement, the bankruptcy court will schedule a hearing to determine whether it may be sent to all parties in interest along with the plan, for voting on the plan. Parties in interest are entitled to file objections to the adequacy of information contained in the disclosure statement, which objections will be ruled upon by the court at a hearing.[44] If the bankruptcy court approves the disclosure statement, it will be

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[38] 11 U.S.C. § 941.

[39] These incorporated provisions are Sections 1122, 1123(a)(1)–(5), 1123(b), and 1123(d).

[40] The concept of "impairment" is contained in Section 1124 of the Bankruptcy Code and is also incorporated into Chapter 9 cases. 11 U.S.C. § 901.

[41] 11 U.S.C. §§ 901, 1125.

[42] 11 U.S.C. § 1125(a)(1).

[43] *Id.*

[44] Bankruptcy Rule 3017.

served upon all parties in interest along with copies of (i) the plan, (ii) an order approving the disclosure statement and fixing the date, time and place of the confirmation hearing, (iii) a ballot for voting on the plan, and (iv) any other information required by the bankruptcy court.[45]

Confirmation of the Chapter 9 Plan

Voting on the Plan

Creditors holding "allowed" claims, *i.e.*, scheduled claims not characterized as "disputed, contingent or unliquidated" and not subject to a pending objection, are entitled to vote to accept or reject the proposed Chapter 9 plan. Ballots must be completed and signed by the creditor and received by the balloting agent prior to a court-established deadline in order to be counted.[46] Voting is by class; the ballots are tabulated in accordance with the plan's classification of the underlying claims. An impaired class of claims will be deemed to have accepted the plan if creditors holding more than one-half in number and at least two-thirds in amount of the allowed claims actually voting vote to accept the plan.[47] Unimpaired classes of claims and the claims themselves are conclusively presumed to have accepted the plan. The municipality is not required to solicit their acceptance of the plan.[48]

Hearing on Confirmation of the Chapter 9 Plan and Objections to Confirmation

As previously stated, the bankruptcy court's order approving the disclosure statement will typically contain the date, time and place of the hearing on confirmation. Parties in interest may object to confirmation; the deadline for filing and service of these objections will also normally be contained in this order.[49] Because of the potential of complex issues of fact and law that will be addressed in Chapter 9 confirmation hearings, the bankruptcy court will often enter detailed scheduling orders prescribing deadlines and procedures to be followed prior to and during these hearings. Lawyers for the municipality and objecting parties in interest will typically prepare for this evidentiary hearing with great diligence.

Confirmation Standards

Section 943 of the Bankruptcy Code sets forth standards that must be

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[45] Bankruptcy Rule 3017(d).

[46] Bankruptcy Rule 3018(a).

[47] 11 U.S.C. §§ 901, 1126(c).

[48] 11 U.S.C. § 1126(f).

[49] 11 U.S.C. §§ 901, 1128; Bankruptcy Rule 3017(d).

satisfied by the debtor at the confirmation hearing in order for the plan to be confirmed. These standards are as follows:

- The plan must comply with the provisions of the Bankruptcy Code made applicable to Chapter 9 cases by Code Sections 103(e) and 901. Thus, the plan must have been proposed in "good faith" and must be accepted by the vote of at least one impaired class of claims.[50] In addition, the Chapter 9 plan must not "discriminate unfairly" and must be "fair and equitable" with respect to each class of impaired claims that has voted to reject the plan.[51] A Chapter 9 plan will be deemed "fair and equitable" with respect to dissenting, impaired classes of claims if the amounts distributed to these classes is "all they can reasonably expect to receive under the circumstances."[52]
- The plan must comply with the provisions of Chapter 9.[53]
- The plan must fully disclose all sums to be paid by the debtor or by any person for expenses or services in the case or incident to the plan. In addition, these sums must be "reasonable."[54]
- The debtor must not be prohibited by applicable law from taking any action "necessary to carry out the plan."[55]
- Unless the holder of a particular claim agrees otherwise, the plan must provide that all holders of administrative expense claims must receive on the plan's effective date on account of those claims, cash in an amount equal to their allowed amounts.[56]
- Any regulatory or electoral approval required under applicable non-bankruptcy law in order to carry out a plan's provision must have been obtained or such provision must be expressly conditioned upon the

[50] 11 U.S.C. §§ 901, 1129(a)(3), 1129(a)(10). *See, e.g.*, *In re Jersey City Medical Center*, 817 F.2d 1055, 1058–1060 (3d Cir. 1987).

[51] 11 U.S.C. §§ 901, 943(a)(7), 1129(b)(1). *See, e.g.*, *American United Mutual Life Ins. Co. v. City of Avon Park, Florida*, 311 U.S. 138 (1940); *In re Jersey City Medical Center*, 817 F.2d 1055, 1060–1062 (3d Cir. 1987).

[52] 6 Collier on Bankruptcy ¶ 943.03[1][f][i][B] (16th ed. 2012). *See also In re Corcoran Hospital District*, 233 B.R. 449, 458–59 (Bankr. E.D. Cal. 1999); *Lorber v. Vista Irrigation District*, 127 F.2d 628, 639 (9th Cir. 1942).

[53] 11 U.S.C. § 943(a)(2).

[54] 11 U.S.C. § 943(a)(3).

[55] 11 U.S.C. § 943(a)(4).

[56] 11 U.S.C. § 943(a)(5).

granting of that approval.[57]

- The plan must be in the "best interests of creditors."[58] Unlike a Chapter 11 business reorganization debtor, a municipality cannot be liquidated under Chapter 9. Thus, the "best interests of creditors" test operative in Chapter 11 cases, in which a dissenting impaired class of claims must receive under a Chapter 11 plan at least as much as it would receive in a hypothetical liquidation of the debtor in a Chapter 7 case, does not apply in Chapter 9. Case law indicates that the Chapter 9 best interests test may be satisfied if these creditors will receive under the Chapter 9 plan more than they would receive outside of bankruptcy if the Chapter 9 case would be dismissed.[59]
- Finally, the Chapter 9 plan must be "feasible," *i.e.*, there is a reasonable chance that the provisions of the plan will be timely performed upon and after confirmation.[60]

Notice and Effect of Confirmation

In the event that the bankruptcy court confirms the Chapter 9 plan at the confirmation hearing, the court will enter an order memorializing that action, notice of which will be served upon all parties in interest in the Chapter 9 case. The terms of the plan will be binding upon the debtor and all creditors.[61] In addition, the debtor will be discharged from its debts when (i) the plan is confirmed, (ii) the debtor deposits the consideration required by the plan with the disbursing agent; and (iii) the court determines that any security deposited with the agent constitutes a valid obligation of the debtor and that the obligation to pay over the deposit is valid.[62] This discharge, however, will not relieve the debtor of liability for any debts (a) excepted from discharge in the plan or confirmation order; or (b) owed to a creditor who lacked actual knowledge or notice, before confirmation of the plan, of the pendency of the Chapter 9 case.[63]

Dismissal of Chapter 9 Cases

Section 930 of the Bankruptcy Code permits a bankruptcy court to dismiss

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[57] 11 U.S.C. § 943(a)(6).

[58] 11 U.S.C. § 943(a)(7).

[59] *See, e.g.*, *Kelley v. Everglades Drainage District*, 319 U.S. 415 (1943); *In re Sanitary Improvement District No. 7*, 98 B.R. 970, 974 (Bankr. D. Neb. 1989).

[60] 11 U.S.C. § 943(a)(6). *See, e.g.*, *In re Sanitary Improvement District No. 7*, *supra* at 975.

[61] 11 U.S.C. § 944(a).

[62] 11 U.S.C. § 944(b).

[63] 11 U.S.C. § 944(c).

a Chapter 9 case "for cause." The category of "cause" includes, among other things, an unreasonable delay by the debtor to the prejudice of creditors, denial of confirmation of a plan and material default of a creditor under a confirmed plan.