Educational Materials

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A Tale of Two Cities

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A Tale of Two Cities

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A Tale of Two Cities

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A Tale of Two Cities:

Chapter 9 Eligibility Issues

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Chapter 9 Eligibility Issues

The commencement of a voluntary bankruptcy case constitutes an order for relief pursuant to Bankruptcy Code § 301(b). However, Bankruptcy Code § 921(c) authorizes the court to dismiss the petition if, upon an objection, it determines that the petition was not filed in good faith or does not meet the requirements of the Bankruptcy Code. The latter test invokes Section 109(c), which enumerates the elements that must be satisfied in order for the debtor to be deemed eligible for chapter 9 relief. Thus, in chapter 9, the order for relief is entered only after the court determines that the petition should not be dismissed. Bankruptcy Code § 921(d).

Eligibility was heavily litigated in the City of Vallejo, Jefferson County, City of Detroit, City of Stockton and City of San Bernardino cases, and the following discussion explains each of the elements of section 109(c), as drafted and as interpreted by those courts as well as others. It also discusses the section 921(c) good faith requirement.

Bankruptcy Code § 109(c)(1) – The debtor must be a Municipality

Only a municipality is eligible for chapter 9 relief. The term "municipality" is defined in Bankruptcy Code § 101(40) to mean "political subdivision or public agency or instrumentality of a State."

A State (defined in Bankruptcy Code § 101(52)) is not a municipality, and thus is not eligible for chapter 9 relief.

Clearly, a city, county or a school district is a municipality. But the line is not always so easy to draw. Thus, after the Las Vegas Monorail filed a chapter 11 case, it faced a motion to dismiss that contended that the Monorail was a municipality and thus eligible under the Bankruptcy Code only for chapter 9 relief. In a lengthy opinion that looked to a series of factors for determining whether an entity was a municipality, the bankruptcy court concluded that the debtor was not one, and the case proceeded under chapter 11. In re Las Vegas Monorail Co., 429 B.R. 770 (Bankr. D. Nev. 2010).

The New York City Off-Track Betting Corporation was found to be a municipality. In re New York City Off-Track Betting Corp., 427 B.R. 256, 265-66 (Bankr. S.D.N.Y. 2010)("OTB"). The Orange County investment pool was not a municipality. In re County of Orange, California, 183 B.R. 594 (Bankr. C.D. Cal. 1995).

Bankruptcy Code § 109(c)(2) – The Municipality must be authorized by State law to be a chapter 9 debtor

Authorization is determined by reference to State law, which may be by statute (see, e.g., Cal. Govt. Code § 53760 et seq.) or by a governmental officer empowered to make the decision.

State authorization has been contested in a number of cases.

In re Jefferson County, 469 B.R. 92 (Bankr. N.D. Ala. 2012). Statute authorized filings by local governments that issued "bonds" but Jefferson County issued "warrants." The court determined that the County was eligible.

OTB. The Governor's executive order was authorized by the legislature even though that authorization was not crystal clear. 427 B.R. at 266-71.

In re City of Detroit, Michigan, 504 B.R. 97 (Bankr. E.D. Mich. 2013)("Detroit"). The filing was authorized under Michigan law regardless of whether the case would impact pension obligations, and the Governor was authorized by statute to approve the filing of the case. Id. at 162. The emergency manager was authorized to file the petition despite the fact that he is not an elected official. Id. at 161-62.

In re City of Harrisburg, 465 B.R. 744 (Bankr. M.D. Pa. 2011). The city was ineligible based on the court's reading of a Pennsylvania statute that prohibited cities of the "third class" from filing for chapter 9 relief – and Harrisburg was such a city.

In re City of Stockton, California, 475 B.R. 720 (Bankr. E.D. Cal. 2012). The first case to interpret the mandatory mediation provisions of Cal. Govt. Code § 53760 et seq., which became effective six months before the filing of the chapter 9 case. Absent compliance with the statute, a California municipality is not eligible for relief. Held: Stockton complied.

In re City of San Bernardino, California, 499 B.R. 776 (Bankr. C.D. Cal. 2013)("San Bernardino"). The debtor took advantage of the so-called emergency offramp alternative of Cal. Govt. Code § 53760.3, but the initial challenge to the debtor's action was not pursued by the objector.

Bankruptcy Code § 109(c)(3) – The debtor must be insolvent

"Insolvent" as it applies to municipalities is defined in Bankruptcy Code § 101(32)(C) to mean (i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due.

Cases interpreting the definition are fact intensive. In re City of Vallejo, California, 2008 WL 4180008 (Bankr. E.D. Cal. 2008)("Vallejo"), aff'd, Int'l Ass'n of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo)("Vallejo BAP"), 408 B.R. 280 (9th Cir. BAP 2013); In re Boise County, 465 B.R. 156 (Bankr. D. Idaho 2011); Detroit, 504 B.R. 97, 168-72; In re City of Stockton, California, 493 B.R. 772, 789 (Bankr. E.D. Cal. 2013)("Stockton").

The definition focuses on cash flow, as liquidation or fair market value is irrelevant in the case of a municipality, which is ineligible for chapter 7 or chapter 11 relief. So insolvency is proven by use of a cash flow analysis. Vallejo, 2008 WL 4180008, at *22; Stockton, 493 B.R. at 788-91.

The courts have interpreted the second prong – unable to pay its debts as they become due – as meaning that the municipality will be generally unable to pay its debts in the next succeeding fiscal year. Stockton, 493 B.R. at 788; Vallejo, 2008 WL 4180008, at *22, both citing In re City of Bridgeport, 129 B.R. 332, 337-38 (Bankr. D. Conn. 1991).

Bankruptcy Code § 109(c)(4) – The debtor must desire to effect a plan to adjust its debts

There is no bright line test, as intent is both subjective and proven largely by circumstantial evidence. Detroit, 504 B.R. at 171-72; Vallejo BAP, 408 B.R. at 295. Also, Stockton, 493 B.R. at 791-92, noting that certain drastic budget reductions left the debtor little option but to restructure its debts through chapter 9.

B. In San Bernardino, an objector sought to depose members of the City Council. Judge Jury opined that courts look only to the municipality's intent "as an entity" [citing In re Pierce County Hous. Auth., 414 B. R. 702, 710 (W.D. Wash. 2009)]. "The subjective intent of an individual councilmember is immaterial in determining whether a municipal body had the requisite intent or good faith." 499 B.R. at 788.

Bankruptcy Code § 109(c)(5) – The debtor must satisfy at least one of four additional requirements

Bankruptcy Code § 109(c)(5)(A). The debtor has obtained the consent of each impaired class of creditors

Bankruptcy Code § 109(c)(5)(B). The debtor has negotiated in good faith with its creditors but has failed to obtain the consent of a majority of each class that the municipality intends to impair in a chapter 9 plan of adjustment.

The debtor need not propose a full-blown plan of adjustment to its creditors prior to filing, but it should at least propose a term sheet. Vallejo BAP, 408 B.R. at 297. See also, In re Mendocino Coast Recreation & Park Dist., 2013 WL 5423788 (N.D. Cal. Sept. 27, 2013) (At a minimum, the negotiations must cover a plan of adjustment "in concept").

Pre-filing negotiations are a two-way street, and creditors that refuse to negotiate cannot later complain in good faith about the municipality's failure to obtain agreement on a term sheet. Stockton, 493 B.R. at 785.

Bankruptcy Code § 109(c)(5)(C). The debtor is unable to negotiate with creditors because negotiation is impracticable.

In the City of Vallejo case, negotiation was held to be impracticable because the bank that was the letter of credit provider for the city's public debt expressed its willingness to negotiate, but only if and when the city's labor organizations agreed to concessions. The unions refused to make any prepetition concessions and then unsuccessfully argued against the city's contention that negotiation was impracticable. Vallejo, 2008 WL 4180008, at *24; Vallejo BAP, 408 B.R. at 297-98.

The court in In re Valley Health Sys., 383 B.R. 156, 162–63 (Bankr. C.D. Cal.2008) opined: "There is nothing in the language of section 109(c)(5)(C) that requires a debtor to either engage in good faith pre-petition negotiations with its creditors to an impasse or to satisfy a numerosity requirement before determining that negotiation is impracticable under the specific facts and circumstances of a case."

Question: Is it possible (let alone practicable) for a municipality with hundreds if not thousands of creditors, including thousands of retirees with pension and other post-retirement benefits, to efficiently negotiate with such creditors (not to mention, bind such creditors) outside of bankruptcy? For example, the City of Stockton eliminated health benefits to over 1,100 retirees and their beneficiaries. Association of Retired Employees of the City of Stockton, et. al. v. City of Stockton, Calif. (In re City of Stockton, Calif.), 478 B.R. 8 (Bankr. E.D. Cal. 2012); Stockton, 493 B.R. at 794. How could it bargain with the 1,100, even though a responsible committee purported to represent their interests? See also, Detroit, 504 B.R. at 176-79.

Bankruptcy Code § 109(c)(5)(D). The debtor reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under the Bankruptcy Code.

Insolvent municipalities do not appear to have made much use of subsection (5)(D), but it is a helpful alternative that could be used when a creditor is about to obtain a judgment or attach a judgment lien – assuming judgment liens are available under applicable nonbankruptcy law – and the municipality did not have the time to satisfy one of the other subsections of § 109(c)(5). Under such circumstances, though, a court might conclude that negotiation of plan of adjustment was impracticable.

Invoking subsection (5)(D) if the imminent avoidable transfer is not material might be seen by a court as a dodge around the other subsections of § 109(c)(5), and the court might deem the filing not to have been made in good faith in violation of § 921(c).

Bankruptcy Code § 921(c) – The debtor must file the case in good faith

Good faith has been the subject of litigation in virtually each case in which eligibility has been contested, and each time the debtor was found to have filed in good faith.

The BAP concluded that "… the evidence must demonstrate that 'the purpose of the filing of the chapter 9 petition [was] not simply ... to buy time or evade creditors.'" Vallejo BAP, 408 B.R. at 295, quoted in OTB, 427 B.R. at 272.

Stockton. The objectors contended, among other things, that Stockton failed to negotiate in good faith prior to the filing of the petition because the city did not seek concessions from recipients of pension benefits (which are administered by CalPERS), and that it filed the petition in bad faith because it did not intend to seek concessions in chapter 9. The court noted that once the elements of § 109(c) have been met, there is a strong presumption of good faith. 493 B.R. at 794.

Detroit. Referring to and quoting the good faith portions of the decisions in the Stockton and OTB cases, the court looked to the following factors, and after applying the factors to the facts, concluded that the petition had been filed in good faith: (i) the City's financial problems are of a type contemplated for chapter 9 relief; (ii) the reasons for filing are consistent with the remedial purpose of chapter 9; (iii) the City made efforts to improve the state of its finances prior to filing, to no avail; and (iv) the City's residents will be severely prejudiced if the case is dismissed. 504 B.R. at 180.

San Bernardino. The objector argued that the city lacked good faith because, inter alia, it failed to engage in prepetition negotiations with its creditors. Concluding that the debtor took advantage of the Calif. Govt. Code § 53760.3 "emergency offramp" and that it was in financial distress – insolvency was not contested – the court granted summary judgment for the debtor. 499 B.R. at 789-91.

A Tale of Two Cities:

The Municipal Bond Market's Ambivalence Regarding Chapter 9

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The Municipal Bond Market's Ambivalence Regarding Chapter 9

Municipal Bond Market is large. $3.7 Trillion bonds outstanding at year-end 2013 and $334 billion borrowed during 2013 through 11,464 separate issuances.

Municipal Bonds have historically been extremely safe investments. From 2007-2013, according to Moody's, the number of defaults on rated debt averaged 5 per year.

Municipal Fiscal Distress is not uncommon. Current market practices and regulation have largely been in response to the challenges of fiscal distress – Many states recast their municipal borrowing laws following large scale defaults during the Great Depression and more recently the New York City Fiscal crisis of the 1970s led to wholesale changes in municipal financial disclosure and accounting rules and to a decided market preference for bonds secured by enterprise revenues or dedicated taxes rather than by the full faith and credit, general obligation of a municipality.

Municipal Fiscal Distress will continue to be present. The combination of anti-tax sentiment, increasing federal, state and judicial spending mandates, necessary investment in deteriorating and outdated infrastructure and the growing recognition that promised pension and health benefits to retired municipal employees are significantly underfunded are pressures that are unlikely to abate even as the economy recovers. Nevertheless, most municipalities have demonstrated that they will make tough choices and maintain fiscal balance.

In cases of severe municipal fiscal distress, relief has often come through local or state initiated processes outside of Bankruptcy. Only 12 States have granted unconditional authority for their municipal corporations to file under Chapter 9 while 25 States have specific programs to assist, and or intervene with their financially distressed municipalities.

State programs to assist distressed municipalities generally feature 3 components. 1) a means to alleviate imminent illiquidity through cash advances, temporary suspension of payments or secured market borrowings (typically against future state assistance); 2) development of a plan to re-establish long term fiscal balance through cost cutting, revenue enhancement and new revenue authority enforced through enhanced governance often in the form of an appropriately empowered financial oversight control board; and 3) a means to re-establish and maintain needed access to sources of external financing. State programs that address fiscal distress generally look to preserve access to the capital market, and therefore either seek to continue paying existing obligations or to stretch them out while providing enhanced security. Prominent examples are MAC for New York City, PICA for Philadelphia and the Chicago Schools Finance Authority.

While Chapter 9 filings remain infrequent, the municipal market recognizes the necessity of a defined means of addressing a true municipal fiscal emergency. In the event of an insufficiency of resources to pay currently due obligations, and in the absence of a state bail-out, the automatic stay available under Chapter 9 allows a municipality to continue providing essential services while it sorts out its difficulties and develops a longer term solution. Puerto Rico, ineligible under Chapter 9 and facing the imminent illiquidity of its electric utility this past June, adopted a local alternative to Chapter 9. The enactment of The Puerto Rico Fiscal Recovery Act however was viewed by the municipal market as a precursor to a wholesale restructuring and haircutting of the island's more than $70 billion of outstanding municipal bonds, resulting in significant across-the-board rating downgrades, a severe drop in the value of outstanding debt and greatly reduced market access.

Municipal Market's general concerns regarding the use of Chapter 9 relate to the fundamental nature of municipal finance. At its most basic, municipal governments exist in perpetuity to provide essential services relating to the health, safety and welfare of their citizens and are empowered to collect taxes and fees for service in order to fulfill their responsibilities. Municipal fiscal distress results from an insufficiency of current resources to meet current obligations, and not from long term liabilities exceeding the value of municipal assets. While meeting long term debt and accrued employee benefit obligations can be daunting, municipal assets, other than the power to tax, are generally of little assistance. In fact, most tangible municipal assets, public buildings, parks, streets and sidewalks present ongoing costs. So fundamentally, the municipal market believes that municipal fiscal distress should be addressed through cost cutting and revenue enhancement and not through a forced liquidation of assets or reduction in liabilities.

Municipal Market's specific concerns regarding the use of Chapter 9 relate to the treatment of various classes of Municipal debt. Most loans made to fiscally challenged municipalities are structured in ways which the market believes will survive Bankruptcy. If credit structures designed to survive distress are proven to be vulnerable, it will become increasingly more difficult for fiscally distressed municipalities to maintain access to credit markets which can lead to more debt defaults and greater use of Chapter 9. It is in this regard that the Municipal market in general, separate form directly affected creditors, have closely followed the still ongoing Chapter 9 proceeding in Detroit.

The municipal market largely accepts that Detroit has long been in a state of fiscal emergency and that attempting to right itself within the limited means at its disposal has proven futile and non-sustainable. All of the Detroit's bonded debt currently outstanding was issued post the 1967 riots which marked a significant milestone in the City's long-term economic and fiscal decline. In fact virtually all of Detroit's currently outstanding debt was issued in the last 15 years. Bond investors were repeatedly made aware of the uncertainties and risks inherent to the City's debt repayment obligations through bond document disclosures, annual financial filings and rating agency reports and downgrades. To maintain its credit market access during this period Detroit structured its debt issues with security features specifically designed to assure repayment, notwithstanding its deteriorating fiscal prospects. In almost all cases it further secured its bonded debt with third party financial guarantees, in the form of municipal bond insurance.

The outstanding Detroit bonded indebtedness and tentative settlement agreements that have received the greatest market attention are it's approximately:

$450 million General Obligation Unlimited Tax Bonds (ULT). These bonds are secured under a statutory lien on property taxes that can only be levied and collected to service the ULT bonds. Bond insurers have agreed to a settlement of 76%. Market participants believe these bonds are fully secured and that no reduction in payment is warranted.

$**240 million General Obligation, Limited Tax Bonds (LT), additionally payable directly by the state from withheld state aid.** Full payment not challenged. Market questions whether these bonds are being fully paid because of respect for the special protections afforded by the pledge of withheld state aid or out of a more pragmatic recognition that the state did not want to see its widely utilized distributable aid program tainted by Detroit.

$164 million General Obligation LT Bonds, without benefit of withheld state aid. Agreement reached for a 34% settlement, with a potential for more depending on the outcome of the City's challenge to the validity of its $1.45 billion of Pension Obligation Certificates of Participation. Market participants agree that these bonds are unsecured and generally understand the reasoning behind the agreement to settle.

$5.3 billion Enterprise Revenue Bonds issued for the City owned water and sewer utility. There has been no challenge to the repayment of the face value of the principal of these bonds but the City is attempting to execute a forced exchange for bonds bearing lower interest rates than the bonds currently provide. This would result in a substantial reduction in market value. The City has also attempted to gain benefit from the City's ownership of this regional utility through proposals to sell the utility, to have the utility make significant annual payments to the City and to relinquish certain bondholder call options. The proposed forced exchange and the taking of call options has led to across-the-board rating agency downgrades to junk bond levels resulting in a pronounced reduction in secondary market value, significant secondary market illiquidity and uncertainty about the utility's future borrowing costs and market access. Market believes that the utility's bonds are special revenue bonds within the context of the City's Chapter 9 filing and should be fully protected; that if the utility is sold, it must result in existing bonds being fully protected or otherwise completely redeemed; that revenues collected by the utility must be used in accordance with the bond indenture which directs the application of system revenues for system purposes and does not allow for payments to the City; and that there is no basis for changing or rescinding bond call provisions.

The City's $1.4 billion Pension Obligation Certificates of Participation, payable from Casino revenues and issued to bolster the City's Pension Funds. These bonds have been challenged by the City, outside of the bankruptcy, as being invalidly issued because the issuance exceeded the legal limitations that the State places on the issuance of municipal debt. This attempted debt repudiation has been closely followed by the market with alarm, as the validity of bond issues, as asserted by the issuer and attested to by the unconditional opinion of their bond counsel, are routinely relied upon. Municipal market participants have broadly expressed a belief that if the bonds are found invalid, then bond proceeds should be returned to investors.

Conclusion: The financial benefits to Detroit from its Chapter 9-related debt negotiations appear modest, aside from the potential windfall that would result from a successful repudiation of the Pension COPs, a challenge that could have been made irrespective of the Chapter 9 filing. From the perspective of the Municipal Market, a debt reduction totaling just over $200 million, producing an annual benefit approximating $15 million, is being achieved at a relatively high price. The challenges have created uncertainty around previously accepted debt security provisions, particularly the insulation of Special Revenue bonds, has raised hurdles for Detroit's eventual re-entry into the credit markets and is being questioned relative to the alternative approaches that may have led to state-assisted consensual debt restructurings that could have provided near term relief and the prospect of full repayment as the City works towards long term fiscal recovery. Municipal market observers are hopeful, but somewhat skeptical that with its emergence from Chapter 9, Detroit will be on the path to fiscal self-sufficiency.

A Tale of Two Cities:

Bildisco and Rejection of Collective Bargaining Agreements in Chapter 9

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***Bildisco* and Rejection of Collective Bargaining Agreements in Chapter 9**

- Bankruptcy courts generally follow the Countryman definition of executory contract: a contract where performance is due and owing by both parties to the agreement, such that non-performance by one party constitutes a material breach excusing the other party's performance.

- Provided there are ongoing performance obligations owed by both sides, a collective bargaining agreement ("CBA") generally qualifies as an executory contract.

- Section 365 of the Bankruptcy Code allows a trustee or debtor in possession (both are referred to below collectively as "debtor"), subject to court approval, to "reject" an executory contract of the debtor.

- Rejection of an executory contract is deemed to be a breach of the agreement that arose just before the petition date, giving rise to a prepetition claim for rejection damages. See § 502(g).

- Ordinarily, a debtor moving to reject an executory contract need only meet a "business judgment" standard.

- However, in *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 104 S. Ct. 1188, 79 L. Ed. 2d 482 (1984), the U.S. Supreme Court held that a debtor must meet a higher standard when it seeks to reject a CBA.

- In *Bildisco*, the chapter 11 debtor, a building supplies distributor, sought to reject a CBA negotiated with a labor union representing certain of the debtor's employees.

- As a preliminary matter, the Supreme Court held in *Bildisco* that the term "executory contract" as used in § 365(a) includes CBAs subject to the National Labor Relations Act. 465 U.S. at 516.

- The Court then held that the debtor could reject the CBA if it demonstrates the following: (1) the CBA burdens the estate; (2) after careful scrutiny, the equities balance in favor of rejecting the CBA; and (3) "reasonable efforts to negotiate a voluntary modification [of the CBA] have been made and are not likely to produce a prompt and satisfactory solution." 465 U.S. at 526.

- In addition, the Court held that a debtor does not commit an unfair labor practice when, after filing its petition, it unilaterally terminates or modifies a CBA before the bankruptcy court formally approves rejection of the agreement. 465 U.S. at 516-17.

- In the wake of *Bildisco*, Congress enacted section 1113 of the Bankruptcy Code, entitled "Rejection of collective bargaining agreements," which mandates higher standards for rejection of a CBA than those set forth in *Bildisco*.

- Section 1113 requires that a chapter 11 debtor take specific actions before moving to reject a CBA. To that end, a debtor must make a proposal to the authorized representative of the employees covered by the CBA which provides for "those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably[,]" and must also provide "such relevant information as is necessary to evaluate the proposal."

- Section 1113 further requires that the debtor meet "at reasonable times" with the employee representative "to confer in good faith in attempting to reach mutually satisfactory modifications of [the CBA]."

- However, while section 365, governing assumption and rejection of executory contracts, is incorporated into chapter 9 proceedings, <u>section 1113 is not</u>. *See* § 901 (Applicability of other sections of this title).

- In 2009, Judge McManus of the Bankruptcy Court for the Eastern District of California held that since section 1113 is not incorporated into chapter 9, the *Bildisco* standard, rather than section 1113, governs a chapter 9 debtor's motion to reject a CBA. *In re City of Vallejo*, 403 B.R. 72, 78 (Bankr. E.D. Cal. 2009), *aff'd* 432 B.R. 262 (E.D. Cal. 2010).

- Notably, since there is no bankruptcy estate in a chapter 9 case, Judge McManus found that under the first *Bildisco* prong (i.e., the CBA "burdens the estate"), "a municipal debtor must demonstrate that the collective bargaining agreement burdens its ability to reorganize by proposing and implementing a viable plan of adjustment." 403 B.R. at 78, n.2.

- Both Judge McManus and the District Court which affirmed him noted that Congress had considered incorporating a "section 1113-like provision" into chapter 9, but declined to do so. 403 B.R. at 78; 432 B.R. at 271.

- This deliberate omission provided further confirmation that section 1113 does not apply in chapter 9, and was not intended to overrule *Bildisco* as to chapter 9 cases. *See also In re City of Stockton, California*, 478 B.R. 8, 23 (Bankr. E.D. Cal. 2012) ("The judicial consensus is that *Bildisco* controls rejection of collective bargaining agreements in chapter 9 cases.")

A Tale of Two Cities:

Selected Confirmation Issues
and
Use of Mediation in Chapter 9 Cases

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[1] I want to thank my law clerk, Diane Bridge, for her assistance in the preparation of these materials.

Selected Confirmation Issues
and
Use of Mediation in Chapter 9 Cases

Confirmation of a chapter 9 plan of adjustment is governed by Bankruptcy Code § 943. Section 943(b) sets out seven requirements for confirmation, including that the plan comply with the provisions of the Code made applicable to chapter 9 cases by § 901.

Section 901 makes certain provisions of chapter 11 applicable to chapter 9 cases. The particular provisions that affect plan confirmation include § 1122 (classification of claims or interests), some of § 1123 (contents of plan), § 1124 (impairment of claims or interests), § 1125 (postpetition disclosure and solicitation), most but not all of § 1126 (acceptance of plan), § 1127(d) (modification of plan), § 1128 (confirmation hearing), and portions of § 1129(a) and (b). The effect of confirmation of a chapter 9 plan is governed by § 944.

Thus, many of the issues that arise in chapter 11 confirmations also arise in chapter 9. But the arguments may differ from traditional chapter 11 arguments either because the chapter 9 confirmation requirements differ from those in chapter 11, or because of the unique nature of a chapter 9 municipal debtor.

1. Compliance with applicable chapter 11 provisions

A. Section 943(b)(1) requires that a chapter 9 plan comply with provisions of the Code made applicable by § 901.

B. Classification

Section § 1122(a) applies in chapter 9: a plan may place a claim in a class only if it is substantially similar to other claims in the class.

i. As in chapter 11, questions arise about whether the substantially similar claims can be classified separately and therefore treated differently. The separate classification issues are often intertwined with arguments under the cramdown provisions that the plan not unfairly discriminate with respect to each nonconsenting impaired class. See In re Corcoran Hosp. Dist., 233 B.R. 449, 455 (Bankr. E.D. Cal. 1999) (explaining that issues about classification and treatment of classes must be viewed in light of the § 1129(b)(1) prohibition of unfair discrimination).

ii. The only priority in chapter 9 is for administrative expenses. § 901 (incorporating § 507(a)(2) but not other provisions of § 507).[2] Questions arise about whether state laws that prefer certain types of claims over other types of claims provide a basis for different classification. These may be stated in terms of priorities or subordination. Without any Code

[2] Under § 364(c), made applicable to chapter 9 by § 901, the court may, under certain circumstances during the case, authorize the debtor to obtain credit that has priority over administrative expense claims.

priorities other than administrative expense priority, are all unsecured claims substantially similar in chapter 9?

a. For example, state municipal finance law may make payment of bonds a first budget priority. Must (or may) the bondholders be separately classified from other general unsecured creditors based on state law?

Courts have applied the chapter 11 standard for separate classification to conclude that unsecured claims can be separately classified if there is a business and economic justification, or if creditors have different state law rights. E.g., Corcoran Hosp. Dist., 233 B.R. 449 (business and economic justification); In re Jersey City Medical Center, 817 F.2d 1055 (3d Cir. 1987) (separate classification of similar claims must be reasonable); In re Sanitary and Improvement Dist. 65 of Sarpy County, Nebr., 73 B.R. 205 (Bankr. D. Neb. 1986) (plan could classify claims of bondholders separately from warrantholders because bondholders had priority under state law).[3]

Debtors have argued that the Bankruptcy Code preempts state law priorities, while creditors have argued that preemption does not apply to allow the municipal debtor to ignore state law priorities. See In re County of Orange, 191 B.R. 1005, 1015-1018 (Bankr. C.D. Cal. 1996) (state law priorities that conflict with bankruptcy law are preempted).

b. State law may allow payment of bonds with dedicated payment streams, or may require payment of bonds with specially assessed taxes. This may provide a basis for separate classification and disparate treatment.

C. Good faith

Section 901 makes § 1129(a)(3) applicable to chapter 9 confirmations: the plan must have "been proposed in good faith and not by any means forbidden by law." § 1129(a)(3).

i. Courts may use a totality of the circumstances test to determine a chapter 9 municipality's good faith. In re Mount Carbon Metro. Dist., 242 B.R. 18, 39 (Bankr. D. Colo. 1999). The general rule is "that a Chapter 9 plan proposed in good faith must treat all interested parties fairly and that the efforts used to confirm the plan must comport with due process." *Id.*

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[3] On appeal to the District Court, the warrantholders argued that general unsecured claims were required to be placed in the same class, so the debtor could not choose to separately classify bondholders from warrantholders. The court, rather than consider whether claims were required to be classified together, stated the issue as whether the debtor was required to separately classify the two types of claims. It held that because, under state law, if tax revenues were insufficient to pay both, the warrantholders would be paid after bondholders, the bankruptcy court did not err in allowing the two types of claims to be classified separately. In re Sanitary and Improvement Dist. 65 of Sarpy County, Neb., 79 B.R. 877 (D. Neb. 1987). The court also said that the state law preference of bondholders over warrantholders was not a priority and so did not conflict with § 507. On appeal to the Eighth Circuit, the court certified the question of whether state law granted priority to bonds over warrants. After the Nebraska Supreme Court answered the question, "yes," the circuit affirmed the district court. In re Sanitary and Improvement Dist. 65 of Sarpy Count, Neb., 873 F.2d 209 (8th Cir. 1989).

ii. The totality of the circumstances must be viewed in light of the purpose of chapter 9, "which is to allow an insolvent municipality to restructure its debts in order to continue to provide public services." Id. at 41.

D. If there is an impaired class of claims, at least one impaired class must have voted to accept the plan. § 1129(a)(10), made applicable to chapter 9 by § 901.

i. Plan acceptances by insiders are not counted in determining whether there is an accepting class. § 1129(a)(10).

ii. Insiders of municipalities include the debtor's elected officials or a relative of the elected official, § 101(31)(D), and managing agents of the debtor. § 101(31)(F). If the municipality has only appointed, not elected, officials, those appointed officials may be considered insiders as managing agents. 6 Collier on Bankruptcy, ¶ 943.03[1][e] (16th ed. 2010).

2. Compliance with state law post-confirmation

A. Section 943(b)(4) precludes confirmation of a chapter 9 plan if the debtor is "prohibited by law from taking any action necessary to carry out the plan[.]"

B. Thus, any new bonds issued as a result of confirmation must comply with state municipal finance law. In re Sanitary and Improvement Dist. 7, 98 B.R. 970 (Bankr. D. Neb. 1989) (although bonds can be impaired in chapter 9, bonds issued pursuant to the plan must comply with state municipal law).

i. Many states impose limits on the taxing authority of its municipalities. Does compliance with state law include not exceeding any tax limitation?

3. Best interests of creditors and feasibility

A. Section 943(b)(7) requires that a plan be "in the best interests of creditors" and feasible.

B. Best interests of creditors

i. This requirement differs from § 1129(a)(7), the chapter 11 best interests test, which requires that the plan treat each impaired creditor better than it would be treated in a chapter 7 liquidation.

ii. Municipalities cannot be forced to liquidate. Therefore, it does not make sense to compare recovery under a chapter 9 plan to what creditors would receive in a chapter 7 liquidation. For municipalities that are hospital districts or similar entities, there is a possibility of a liquidating plan, because the assets can be sold. Liquidation cannot, however, be forced on the district. See § 904 (limiting power of the court to interfere with any political or governmental powers of the debtor or with its property or revenues).

For municipalities that are cities, however, liquidation is not possible. Although municipalities sometimes can be disincorporated, they cannot be liquidated and the proceeds used to pay creditors.

iii. Because treatment under the plan cannot be compared to liquidation, the best interests test to be applied in chapter 9 is whether treatment of creditors is better than the alternatives. Sanitary and Improvement Dist. 7, 98 B.R. at 974.

a. In chapter 9, creditors cannot propose a plan, cannot have a trustee appointed, and cannot force conversion to chapter 7. The only alternative to confirmation of a plan of adjustment is dismissal. § 930. That means that the court must consider what would happen under state law if the case were dismissed. 6 Collier on Bankruptcy ¶ 943.03[7][a] (16th ed. 2010). If a municipality's debt is too great to be retired by tax revenues, creditors often have limited avenues to getting paid. Thus, for many creditors, getting any payment at all under a plan is better than the alternative. In re Mount Carbon Metropolitan Dist., 242 B.R. 18, 34 (Bankr. D. Colo. 1999).

b. The best interests test has been described as a floor that requires "a reasonable effort at payment of creditors[.]" Id.

c. This has been articulated as requiring that the plan provides the potential for the greatest economic return. In re Barnwell County Hosp., 471 B.R. 849, 869 (Bankr. S.Ca. 2012).

d. Debtors will argue that the alternative, dismissal, will result in a chaotic race to the courthouse, so any plan that deals with all creditors will be better than that free-for-all.

iv. There is a question of whether to apply the better-than-the-alternative test creditor-by-creditor or to creditors as a whole.

a. Creditor-by-creditor: The argument is that the test should serve the same function in chapter 11 and chapter 9: protection of the dissenting minority of an accepting class. Collier on Bankruptcy at ¶ 943.03[7][a]. Looking at the best interests of creditors creditor-by-creditor would be consistent with chapter 11, where individual creditors need to receive more than they would in a liquidation, not just that all creditors as a whole will be better off.

b. But if the test is applied creditor-by-creditor, it could result in indirectly importing state law priorities into chapter 9. For example, if the creditor (e.g., bondholder) has a first budget priority under state law and state law requires the creditor to be paid before other unsecured creditors are paid, that creditor would arguably be better off outside chapter 9 than under a plan that impairs the claim.

c. On the other hand, if the test is to be applied as to creditors as a whole, with the argument that the race to the courthouse outside bankruptcy would cause chaos and unfairness to the slower creditors, nearly any plan would meet the test.

d. If the test is considered creditor-by-creditor, does it matter that the claim is secured by special revenues in a system that produces sufficient revenue to pay the claim? Holders of bonds secured by revenues from closed systems argue that, if the system generates sufficient revenue to pay the bonds according to their terms, they cannot be impaired. It would not be in best interest of the bondholders, they would argue, to receive impaired treatment under the plan, because outside bankruptcy they would be paid in full according to the bond terms.

e. Legislative history supports creditor-by-creditor approach, in that it incorporates the best interests test from pre-Code law, which was understood to apply to protect minority creditors from the vote of the majority. See Pub. L. No. 95-598, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. (1977) (reprinted in App. C, Collier on Bankruptcy, App. Pt. 4(d)(I) at 4-1547).

C. Feasibility

i. The primary purpose of restructuring the debt of a municipality is not future profit, but instead is the ability to continue to provide public services. In re Mount Carbon Metro. Dist., 242 B.R. 18, 34 (Bankr. D. Colo. 1999). Thus, for a municipal debtor to meet the feasibility standard, it "must demonstrate its ability to make the payments required under the plan and still maintain its operations at the level that it selects as necessary to continued viability of the municipality." 6 Collier on Bankruptcy at ¶ 943.03[7][b].

ii. While the "best interests" test "provides a floor for payments under the plan, the feasibility test provides the ceiling, and the debtor cannot be expected to pay more than is reasonably feasible." Id.

iii. The court must consider whether, based on reasonable projections of future revenues and future expenses, the debtor will be able both to "pay prepetition debt and provide future services at the level necessary to its viability as a municipality." Mount Carbon Metro. Dist., 242 B.R. at 35.

iv. As in chapter 11, feasibility is concerned with avoiding confirmation of visionary schemes. Id. The bankruptcy court in the City of Detroit case appointed a consultant who will opine whether the City's projections are reasonable and not overly optimistic.

4. Cramdown

If there is a nonconsenting class, the cramdown requirements of § 1129(b)(1) and parts of § 1129(b)(2) apply. § 901. Section 1129(b)(1) requires that the plan not discriminate unfairly and be fair and equitable with respect to each nonconsenting class of impaired claims.

A. Unfair discrimination

Unfair discrimination in chapter 9 does not differ from the same concept in chapter 11.

i. A plan unfairly discriminates if two classes of creditors have the same legal rights but get unreasonably different treatment. E.g., In re Amer. Trailer & Storage, Inc., 419 B.R. 412 (Bankr. W.D. Mo. 2009).

ii. What are reasonable bases for differing treatment?

a. Business, economic justifications

b. On-going relationships with the debtor

c. Settlements with creditors

d. Subordination agreements

iii. Courts differ on what test should be applied to determine whether discrimination in treatment of different classes is unfair.

a. Some courts apply a four-part test: "(1) whether the discrimination is supported by a reasonable basis; (2) whether the debtor can confirm and consummate a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) the treatment of the classes discriminated against." In re Aztec Co., 107 B.R. 585, 590 (Bankr. M.D. Tenn. 1989) (discussing different approaches).

b. Some courts distill the test to two factors: whether there is "a rational or legitimate basis for the discrimination" and whether the discrimination is "necessary for the reorganization." In re Crosscreek Apartments, Ltd., 213 B.R. 521, 537 (Bankr. E.D. Tenn. 1997) (discussing different approaches).

c. Professor Markell, before he became a bankruptcy judge, proposed a presumption test, which has been adopted by the bankruptcy court in the Eastern District of Michigan:

[A] rebuttable presumption that a plan is unfairly discriminatory will arise when there is: (1) a dissenting class; (2) another class of the same priority; and (3) a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.

In re Dow Corning Corp., 244 B.R. 705, 710 (Bankr. E.D. Mich. 1999).

The presumption can be rebutted:

The plan proponent could rebut the presumption of unfairness established by a significant recovery differential by showing that, outside of bankruptcy, the dissenting class would similarly receive less than the class receiving a greater recovery, or that the alleged preferred class had infused new value into the reorganization which offset its gain. The plan proponent could overcome the presumption of unfair treatment based on a different risk allocation by showing that such allocation was consistent with the risk assumed by the parties before bankruptcy.

In re Dow Corning Corp., 244 B.R. 696, 702 (Bankr. E.D. Mich. 1999).

d. No special chapter 9 test has been developed, so the chapter 11 cases provide some guidance.

iv. Does unfair discrimination provision even apply among classes of impaired secured claims? See In re Riddle, 444 B.R. 681, 686 (Bankr. N.D. Ga. 2011) ("[The prohibition on unfair discrimination] has little, if any, significance in the context of a secured claim. Because each secured creditor has collateral, repayment terms, and other rights that are unique to it, proper classification in a [] plan requires a separate class for each secured claim. The propriety of the treatment of a secured claim is not generally determined by reference to the treatment of other secured claims. Nothing requires that a plan provide treatment for every secured claim with the same maturity date, rate of interest, payment schedule, or any other term."), Accord In re Am. Trailer & Storage, Inc., 419 B.R. 412, 443 (Bankr. W.D. Mo. 2009) (every secured claim may be treated differently). But see In re BWP Transport, Inc., 462 B.R. 225 (Bankr. E.D. Mich. 2011) (applying presumption test to claims of unfair discrimination among classes of secured claims).

The statute does not distinguish between discrimination among classes of unsecured claims versus classes of secured claims. If secured claims in a particular class truly differ in some material way to secured claims in a different class, then discriminating might not be unfair. But if similar secured claims are separately classified and treated materially differently, the unfair discrimination prohibition should apply so the court can assure that the discrimination is not unfair.

v. Questions of unfair discrimination have been raised in municipal cases where labor and retirees are treated differently than other unsecured claims, in particular capital market claims. One issue is whether one compares labor and pension claims piece by piece (pensions, labor concessions, and other post-employment benefits such as medical coverage) or as a whole package (consider all of the cuts that have been taken by labor and retirees as a whole). It could be argued that each claim is distinct, and the fact that a particular individual such as a retiree may have claims in more than one class should not affect the weighing of fairness of treatment of one class as to another similar class.

Questions also arise about whether claims based on bonds that have first budget priority under state law can be treated the same as other general unsecured claims that do not enjoy those rights.

There are questions of fairness raised by differing treatment of different classes of capital markets claims. Different types of bonds may have different rights under state law, such as a right to payment from special funds, or the bonds may be essentially secured by leases of municipal property, or the debtor may have the ability to pay certain bonds from special funds, even if the bondholders do not have a right to such payment. Questions arise about whether it matters in assessing fairness that the financing mechanism for the bonds are leases, or that voters have or have not voted to approve the debt, or that state law allows but does not require special funds to be used to pay the debt.

B. Fair and equitable

i. In chapter 9, the fair and equitable requirement includes the requirements of § 1129(b)(2)(A), dealing with secured claims, and § 1129(b)(2)(B), dealing with unsecured claims. Section 1129(b)(2)(C) does not apply, because it deals with equity claims, which do not exist in municipal bankruptcies.

ii. Secured claims: Section 1129(b)(2)(A) requires that, with regard to classes of secured claims, the plan must provide that the holders retain their liens and that they receive the present value of their allowed claims, or that the collateral will be sold and the lien attached to the proceeds, or that the creditor gets the indubitable equivalent of the allowed amount of the secured claim.

a. Valuation is a big issue when dealing with many municipal assets. It can be difficult to put a value on a fire station, a park, or a public golf course, for example.

b. Sometimes municipal finance law does not allow municipalities to secure debt with collateral, so other mechanisms are used to effectively secure the debt. For example, long term leases are one form of municipal financing that is used in California. This leads to arguments about whether § 365, regarding assumption or rejection of unexpired leases, applies instead of § 1129(b)(2)(A). If § 1129(b)(2)(A) applies, issues arise as the nature of the collateral: is it a time-limited right to an asset, or a right to the asset in perpetuity?

iii. Unsecured claims: Section 1129(b)(2)(B) provides two options for classes of unsecured claims: They must either be paid in full or creditors holding claims junior must not be paid anything.

a. In chapter 11, this is called the absolute priority rule, which prohibits payment of junior claims unless all senior claims are paid in full. In chapter 9, where the only priority in the Code is for administrative expenses, there can be questions of what are "junior claims." Is an unsecured creditor, such as a holder of a general obligation bond, that has a payment priority under state law, senior to other general unsecured claims that do not enjoy that seniority under state law? The legislative history of the 1976 legislation says that priority for purposes of the absolute priority rule are determined according to state law. <u>See</u> H.R. Rep. No. 94-686, 94th Cong., 1st Sess. 32-33 (1977).

b. Because, in chapter 9, there are no equity holders, courts have said that the absolute priority rule has a different meaning:

I. For unsecured creditors, it means that the amount to be received is all that they can reasonably expect under the circumstances. <u>Lorber v. Vista Irr. Dist.</u>, 127 F.2d 628, 639 (9th Cir. 1942).

II. Question: why is the test different in chapter 9 than it is in chapter 11, when the statutory language is the same, with the exception of excluding equity claims? Why would § 1129(b)(2)(B)(ii) be included, if it were not contemplated that there would be junior claims that could receive a distribution unless senior claims are paid in full?

c. What does it mean that creditors must receive all that they can reasonably expect under the circumstances?

I. Cases from which this test is derived focused on whether the debtor had the realistic ability to increase revenue (through taxation) to pay more. See Lorber, 127 F.2d at 639; Lorber v. Vista Irr. Dist., 143 F.2d 282 (9th Cir. 1944) (considering whether there was sufficient evidence of the taxpaying ability of the district to support the district court's decision on remand that the plan represented all that the debtor irrigation district could reasonably pay).

II. Some creditors are arguing that this test requires that what they are getting under the plan compare favorably to what they would get under state law.

A. This argument is hard to reconcile with the fact that state law priorities do not apply in chapter 9. If a creditor has a state law priority, then it could always argue that it can reasonably expect to be paid in full before other unsecured creditors. The argument also conflates the "best interests of creditors" test of § 943(b)(7) with the "fair and equitable" requirement of § 1129(b)(1).

5. Constitutional considerations for confirmation

A. Without the municipality's consent or a provision in the plan, a court may not interfere with the municipality's political or governmental powers, its property or revenues, or its use or enjoyment of income-producing property. § 904.

B. This Code provision helps implement the Tenth Amendment's restriction on the ability of the federal government to interfere with state sovereignty. See In re City of Stockton, CA, 478 B.R. 8 (Bankr. E.D. Cal. 2012). Because municipalities are creatures of the state, the Tenth Amendment restrictions apply to federal government interference with a municipality's political or governmental powers.

C. The Tenth Amendment restrictions on federal interference with state sovereignty requires that only the debtor can propose a plan of adjustment. § 941; United States v. Bekins, 304 U.S. 27 (1938).

D. Thus, in considering whether to confirm a plan of adjustment, the court's power is limited to determine whether the requirements for confirmation have been satisfied. 6 Collier on Bankruptcy at ¶ 900.01[2]; In re Willacy County Water Control & Improvement Dist. No. 1, 36 F.Supp. 36, 39 (S.D. Tex. 1940).

E. If the court finds that the plan does not meet the statutory requirements for confirmation, and the court denies additional time to file an amended plan, the limits of the court's power require that the case be dismissed. § 930.

6. Special revenue issues

A. Special revenue debt gets special treatment in chapter 9.

B. Special revenues are defined in § 902(2) as receipts from ownership, operation, or disposition of projects or systems used to provide transportation, utility, or other services; special excise taxes on particular activities or transactions; tax increment receipts; other revenues derived from particular functions of the debtor; and taxes levied to finance particular projects or systems.

C. There is no automatic stay as to application of pledged special revenues. § 922(d).

D. There is a limit on recourse for special revenue debt. § 927.

E. Special revenues remain subject to prepetition liens, and are subject to necessary operating expenses. § 928. Issues arise about what are necessary operating expenses under the statute. See, e.g., In re Jefferson County, Ala., 503 B.R. 849 (Bankr. N.D. Ala. 2013).

F. Some creditors argue that debt secured by special revenues cannot be impaired, because special revenues are treated uniquely in chapter 9, and the legislative history of the 1988 amendments, Pub. L. No. 100-597, suggests that Congress intended debt secured by special revenues to be unimpaired. S.Rep. No. 100-506, at 12 (1988), Report to Accompany S. 1863 (reprinted in App. F, Collier on Bankruptcy, App. Pt. 41(g)(ii)(A) at 41-124. What is to be unimpaired, however, is the question. The Senate Report said:

Finally, the amendments insure that revenue bondholders receive the benefit of their bargain with the municipal issuer, namely, they will have unimpaired rights to the project revenue pledged to them.

Id. As the bankruptcy court explained in In re Jefferson County, Ala., 482 B.R. 404, 433-434 (Bankr. N.D. Ala. 2012), the "benefit of their bargain" is described as "solely the revenues from the project and never the full faith and credit of the municipality." The protections of pledged special revenues added in 1988 were added to address specific problems, including protecting the lien on special revenue streams in chapter 9. See § 928. However, that does not necessarily mean that modification of the contractual relationship between the parties is unavailable. Jefferson County, 482 B.R. at 434 n.17 ("This should not be read to mean that, if applicable, other sections of the Bankruptcy Code . . . not changed by the 1988 Amendments may not be available to modify the contractual relations between parties to municipal special revenue financing agreements.").

G. If debt secured by special revenues can be impaired, in what way can it be impaired? Section 1123(b)(1) (made applicable in chapter 9 through § 901) provides that a municipality may in its plan of adjustment impair any class of secured claims, provide for the adjustment of any claim belonging to the debtor, § 1123(b)(3)(A), or "modify the rights of holders of secured claims[.]" § 1123(b)(5).

H. A municipal debtor needs to analyze potential gain from impairment by considering whether the special revenues arise from a closed system, and revenues from the system may not, under state law, be used for anything outside the system.

7. Mediation of chapter 9 plans

A. Only the debtor can propose a plan of adjustment in chapter 9. § 941. If the plan cannot be confirmed, the only alternative is dismissal of the case. § 930. Further, chapter 9 cases often involve numerous creditor groups with diverse interests, including, e.g., labor groups and capital markets creditors.

B. Negotiation of a consensual plan of adjustment is particularly useful in chapter 9 for various reasons.

i. Chapter 9 is different from chapter 11, where the goal is to reorganize to pursue profit. A municipality, on the other hand, has to strike a balance between repaying debts and providing future public services.

ii. The Bankruptcy Code recognizes the importance of prepetition negotiation with creditors in chapter 9. One requirement for eligibility for chapter 9 relief is that the municipality has either obtained agreement of a majority of creditors in each proposed impaired class, it has negotiated in good faith with creditors but has been unable to obtain creditors' agreement, negotiation is impracticable, or the municipality reasonably believes that a creditor may attempt to obtain an avoidable transfer. § 109(c)(5).

iii. Forced liquidation of the municipality's assets is not an option.

iv. Debt cannot be equitized.

v. Chapter 9 case law is sparse, leading to uncertainty of outcomes if issues are litigated.

C. Mediation of chapter 9 cases raises some unique issues.

i. Open meeting laws may prohibit city officials from participating directly in the mediation sessions.

ii. Often, there are political dynamics at play that are not necessarily logical from a business perspective.

iii. Mediation by its nature is confidential, which can be at odds with the public's right to know what its governmental bodies are doing.

iv. The press is often interested in the case, making leaks a real problem.

v. The Tenth Amendment and § 904 limit the court's power to interfere with a municipality's political and policy choices. The court cannot appoint a mediator over the objection of the municipality to mediate a dispute that is not directly related to chapter 9 issues, such as determining eligibility, negotiating a plan of adjustment, or allowing a claim. In re Palm Drive Health Care Dist., Case No. 14-10510 (Bankr. N.D. Cal. May 16, 2014) (Jaroslovsky, J.). In that case, a health care foundation organized to support the hospital operated by the district sought to compel the district to mediate about its proposal for how to reopen the closed hospital. The foundation was not a creditor and had no standing to enforce any rights against the district. The court pointed out that, under § 105, the bankruptcy court has broad equitable powers, including the power to appoint a mediator. But that power is limited by § 904, prohibiting the court from interfering with the political or governmental powers of the debtor. Because the dispute that the foundation sought to resolve through mediation did not relate to any chapter 9 issues, the court concluded that it did not have the power to force mediation.

D. Mediation has been used recently in a number of chapter 9 cases involving cities.

i. Vallejo, CA:

a. The problem - labor and debt costs exceeded revenue that had been reduced by a recession. The City could not obtain sufficient concessions to balance its budget.

b. Used mediation to resolve labor disputes

ii. Town of Mammoth Lakes, CA:

a. The problem - large judgment against the Town.

b. Used mediation primarily to resolve issue of Town's obligation on a multi-million dollar judgment. State law required payment of the judgment over 10 years, at the most. The Town did not have the resources to make the payment within 10 years. State law did not contain any mechanism for extending the payment period or otherwise adjusting the debt to make it affordable for the Town. The Town dismissed the case after reaching settlement.

iii. Stockton, CA:

a. The problem - City's revenue had dropped precipitously due to the housing crash; property values had dropped by more than 50 percent, leading to lower assessed values and therefore lower taxes.

b. Used mediation to reach agreements with many different groups, including labor and pensioners.

c. A big issue is pension costs; the City has high unfunded liability for future pension payments. City decided not to reduce pensions, but reduced labor costs and other retirement liabilities (i.e. medical coverage for pensioners and their dependents).

d. Used mediation to reach agreements with the police union, most capital markets creditors, and a significant creditor. Issues included how to monetize certain assets that were subject to leases from the City, such as parking garages.

iv. San Bernardino, CA:

a. The problem - growing costs coupled with falling revenue.

b. On-going mediation. City has failed to pay pension obligations. The press has reported that CalPERS and the City have reached an interim agreement that will help form the basis of a consensual plan. "CalPERS has Interim Agreement in San Bernardino Bankruptcy Case," Sacramento Bee, June 18, 2014. The mediation is now turning to other creditors and labor.

v. Detroit, MI:

a. The problem - City population has declined by 2/3 over the last 30 years, leaving greatly reduced tax base. There is wide-spread blight, which both reduces tax revenue and increases burden on police and fire departments.

b. Mediation used on a wide scale.

I. Labor - negotiated many new labor contracts.

II. Pensions - negotiated a "Grand Bargain" that, if approved by pension creditors, will bring in more than $800 million from private foundations, the State of Michigan, and the Detroit Institute of Arts to help fund pension liabilities going forward, reducing the cuts in pensions that would otherwise occur. Also will result in preserving the art at the DIA for the City.

III. Capital markets - negotiated or attempted to negotiate settlements with various groups of bondholders, each with different rights under state law. Included bonds secured by special revenues from water and sewer, bonds approved by the voters for which there was a special tax assessment above the statutory and constitutional tax limit, bonds not approved by the voters and backed by the full faith and credit of the City, and certificates of participation, proceeds from which were used to partially fund the unfunded liability of the pension funds.