

Chapter 9 Update

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1

Comparison of Chapter 9 to Chapter 11

2

Requirements for Confirming a Chapter 9 Plan of Adjustment

3

Municipal Bonds

4

Pension Obligations

5

Collective Bargaining Agreements

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Comparison of Chapter 9 to Chapter 11

Selected Issues	Chapter 9	Chapter 11
Case Commencement	Only a municipality can commence a case	Subject to specific qualifications, creditor may commence an involuntary case
Asset Sales	Court approval not necessary to use, sell or lease property	Debtor must receive court approval for disposition of assets, including sales of some or all assets
Professionals	Court permission not needed to retain professionals; no fee applications	Debtor must receive court permission to retain professionals, who must file fee applications
The Plan	Only the debtor may file a plan of adjustment (potential for case to stay in court longer)	After exclusive period ends or other conditions are met, any party in interest may file a plan
Confirmation	Best interests of creditors requires municipal debtor to make a reasonable effort to repay creditors, which may include maximizing the value of its primary, non-core assets	Best interests of creditors test requires creditors that have not accepted the plan to receive a distribution at least equal to what they would receive in a chapter 7 liquidation
Rejection of CBAs / Modification of Retiree Benefits	Section 365 applies; Sections 1113-14 do not Municipality enjoys greater latitude than chapter 11 debtor regarding modification or rejection of labor agreements	Debtor cannot unilaterally abrogate a CBA Section 1113 requires debtor to negotiate proposed modifications of CBA with the authorized representative of the employees; lengthy negotiation process and court approval necessary for rejection or modification of a CBA Section 1114 enumerates stringent requirements for modification/termination of retiree benefits
Conversion / Liquidation	Case may be dismissed for failure to make progress; no conversion or sale of all assets	Case may be converted to chapter 7 liquidation or result in sale of all assets and liquidating plan

Section 109(c) provides: “An entity may be a debtor under chapter 9 of this title if and only if such entity—

(1) is a municipality;

(2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable;
or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.”

11 U.S.C. § 109(c).

Section 943(b) provides: “The court shall confirm the plan if—

- (1) the plan complies with the provisions of this title made applicable by sections 103(e) and 901 of this title;
- (2) the plan complies with the provisions of this chapter;
- (3) all amounts to be paid by the debtor or by any person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable;
- (4) the debtor is not prohibited by law from taking any action necessary to carry out the plan;
- (5) except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that on the effective date of the plan each holder of a claim of a kind specified in section 507(a)(2) of this title will receive on account of such claim cash equal to the allowed amount of such claim;
- (6) any regulatory or electoral approval necessary under applicable nonbankruptcy law in order to carry out any provision of the plan has been obtained, or such provision is expressly conditioned on such approval; and
- (7) the plan is in the best interests of creditors and is feasible.”

11 U.S.C. § 943(b).

Types of Bonds

General Chapter 9 Treatment

General Obligation Bonds

Post-petition, a court may treat general obligation bonds without a statutory lien as unsecured debt and order a restructuring of the bonds. Payment on the bonds during the bankruptcy proceeding likely will cease. Prepetition, general obligation bonds are backed by the unlimited taxing power of the municipality (its “full faith and credit”) and are historically subject to conditions such as voter authorization or limitations on particular purposes.

General Obligation Bonds Plus Pledged Revenues

Assuming that the general obligation pledge is an actual pledge of revenue and to the extent that it may be classified as a statutory lien or special revenues, this secured issuance will be respected to the degree it is consistent and authorized under state law. A pledge of revenues that is not a statutory lien or special revenues may be attacked as not being a valid continuing postpetition lien under section 552 of the Bankruptcy Code.

Special Revenue Bonds

A pledge on special revenue bonds will survive a bankruptcy filing. Prepetition, a special revenue bond is an obligation to repay solely and only from revenues of a municipal enterprise (net of operations and maintenance costs) that are pledged to bondholders. The contemplated remedy for default often focuses on a covenant to charge rates sufficient to amortize the debt. Defaulted bondholders are expected to seek mandamus in court to require the municipal borrower to raise its rates.

Revenues Subject to Statutory Lien

Assuming the pledge is authorized under state law through a statutory lien, the Bankruptcy Court should respect that statutory lien. Thus, as long as the revenues are subject to a statutory lien, payments to the bondholders should be protected postpetition.

Are unfunded pension obligations the single largest problem facing municipalities today?

- Public pension funds are generally not covered by ERISA—*i.e.*, not subject to rigorous vesting and funding rules imposed by ERISA.
- The *Stockton* court left open what standard should be applied in rejecting a pension contract in chapter 9. It noted: "There is no reason to believe that the *Bildisco* standard would not apply to using chapter 9 to force changes in municipal pension plans."
- In Judge Rhodes' opinion regarding *Detroit's* chapter 9 eligibility, he noted: "The Court emphasizes that it will not lightly or casually exercise the power under federal bankruptcy law to impair pensions." Before this issue could ultimately be decided, the parties settled.

How can chapter 9 debtors modify or reject collective bargaining agreements with unions?

- Section 1113 does not apply to chapter 9 debtors. Instead, section 365 as informed by the Supreme Court's decision in *NLRB v. Bildisco & Bildisco*, governs whether a chapter 9 debtor may reject or modify a collective bargaining agreement.
- Under *Bildisco*, a debtor must establish that
 - (a) the labor agreement burdens the estate;
 - (b) after careful scrutiny, the equities balance in favor of contract rejection; and
 - (c) "reasonable efforts to negotiate a voluntary modification have been made, and are not likely to produce a prompt and satisfactory solution."



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