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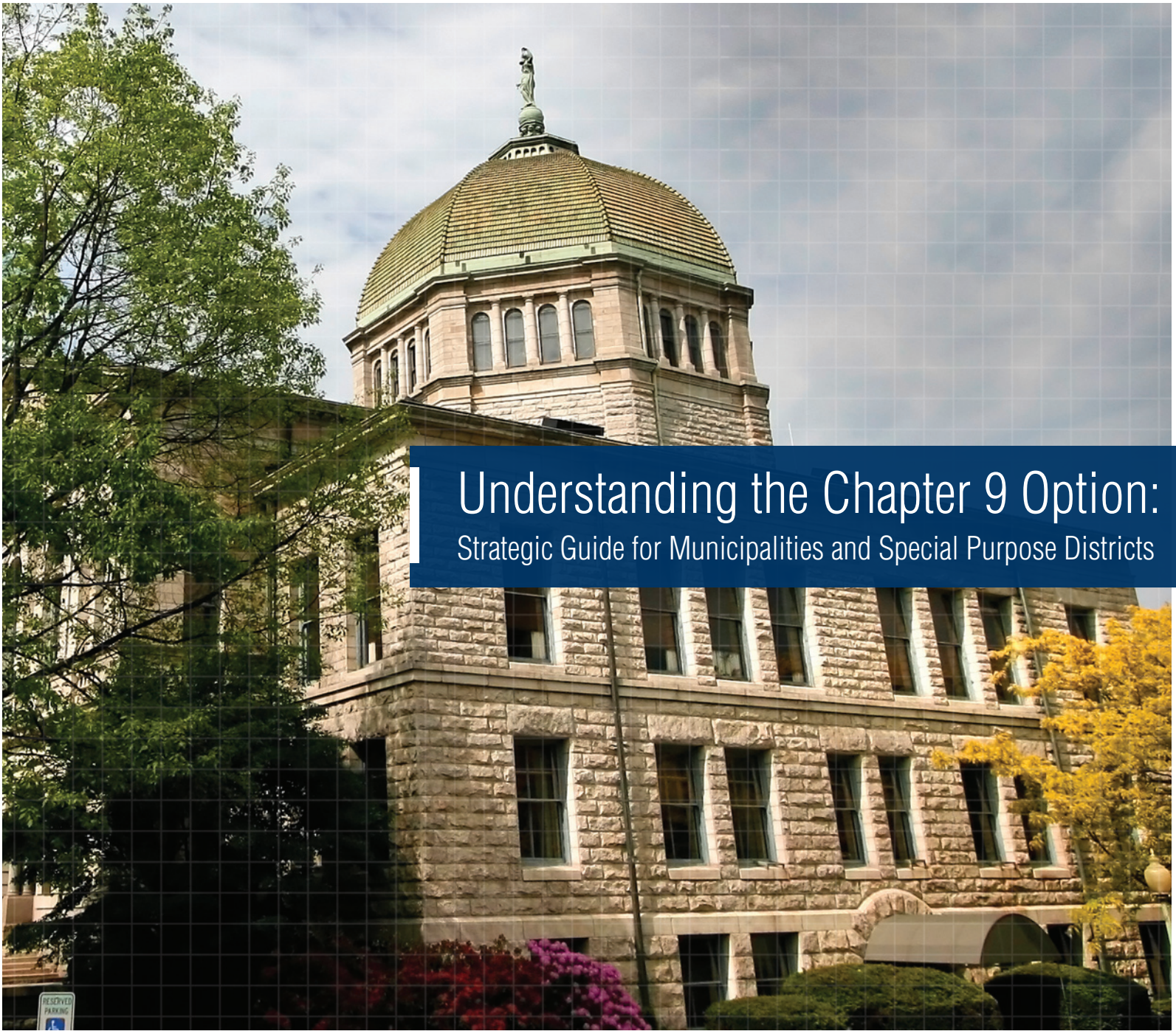

Understanding the Chapter 9 Option:

Strategic Guide for Municipalities and Special Purpose Districts

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Understanding the Chapter 9 Option:
A Strategic Guide for Municipalities and Special Purpose Districts

PREFACE

This Chapter 9 Guide is written for government officials and staff in municipalities and other local special purpose authorities and districts who are confronting financial challenges and assessing their options. I had several goals in mind when writing the Guide, but permit me to clearly state from the outset that I did not prepare the Guide wishing to encourage municipal or other special purpose local authorities to file Chapter 9. I am certainly not urging it as the go-to solution for local governments when dealing with their fiscal imbalances, and it is my view that resorting to Chapter 9 should only be employed if doing so becomes a necessity.

As the Guide will make clear, there are several reasons for local public officials to avoid filing a Chapter 9 case if they can otherwise successfully accomplish a long term solution to their fiscal difficulties. Since the Guide was not written to motivate local governments in the first instance to seek Chapter 9 protection, why did I write it and why should local officials and their senior staff want to learn more about Chapter 9?

First, let me suggest that if a municipality is facing serious financial problems and hopes to accomplish a workable plan for its long term financial stability without resorting to the judicial process, it will need to convincingly raise during the negotiation process the prospect that, should a consensual plan not be achieved, the filing of a Chapter 9 might become necessary. The anecdotal evidence clearly suggests that major creditor constituencies will be unwilling to make meaningful debt relief concessions to local governments unless they fear that Chapter 9 might produce a judicially imposed solution that is less favorable than that which could be garnered through a consensual plan. No means exist, other than Chapter 9, to obtain debt relief to which creditors will not agree. To be convincing in its threat, a local government will need to understand how the Chapter

9 process works, that it will qualify to file if that were to become necessary, and how the provisions of the Bankruptcy Code could allow it to obtain debt relief from its creditors over their objection. It will also need to understand the actions it will have needed to take to maximize its revenues and control its expenses before seeking bankruptcy protection, because proof of having done so is a condition that it must demonstrate upon filing. Since these revenue maximization steps are likely the same undertakings that creditors would expect the municipality to undertake before they were to agree to a consensual out-of-court resolution, a community's threat of a Chapter 9 filing will be credible if it is in the process of comprehensively solving its financial challenges through belt tightening measures and is implementing revenue increasing plans.

Second, I prepared the Guide to counter considerable misinformation that Chapter 9 cannot be an effective means of resolving a municipality's fiscal distress. While I am not encouraging Chapter 9 as the preferred response to fiscal distress, I want to allay the fears that appear common in the financial press that Chapter 9 cannot provide a viable solution if a consensual out-of-court settlement cannot be reached and filing for bankruptcy becomes necessary. I think that much of the negativity surrounding Chapter 9 is quite intentional. Major creditors, including notably bondholders, unions and retirees, do not want their discussions with financially struggling local governments and special authorities to be conducted with Chapter 9 standing as the likely alternative to a consensual out-of-court resolution for the reasons previously referenced. Local officials have been led to believe that using Chapter 9 will put their jobs at risk, their credit ratings will be ruined for decades to come, that collective bargaining agreements and retiree benefits are entirely insulated from modification, and that creditors will never be required against their will to grant debt relief if the local government has the legal ability to impose higher taxes to solve its operational shortfalls.

Let me address the specter of negativity surrounding Chapter 9's utility by initially acknowledging that our experience with Chapter 9 is admittedly quite limited. In the past 70 years, only slightly more than 40 political subdivisions have sought protection under Chapter 9; and only another 500 plus special districts and authorities have resorted to Chapter 9 to resolve their fiscal problems. Judicial rulings on key issues have been sparse, and even where an issue has been adjudicated, there was no appeal; and little comfort can

be taken that such lower court rulings will be universally adopted as the appropriate interpretation. While definitive conclusions on certain fundamental issues cannot be provided, the very fact that uncertainty exists may alone be motivation for both a local community and its creditors to reach agreement on debt relief rather than having a determination on key issues made by a bankruptcy court.

Apart from the fact that uncertainty regarding judicial interpretation of significant Chapter 9 issues will likely motivate all parties to reach a consensual agreement either before or after a Chapter 9 filing, I do believe that Chapter 9 can provide a financially troubled local government that requires debt relief with a meaningful prospect that a court will approve the relief it needs over creditor objections. As a general observation, I see no trend in the cases to suggest that bankruptcy courts will be inhospitable to Chapter 9 cases. To the contrary, I believe that local governments should assume that they will be given fair treatment, and that bankruptcy courts will be inclined to fulfill their goal of helping those who come before them achieve a workable resolution. In the Guide, I extensively discuss how a plan can qualify for court approval even where there exists material creditor opposition, and what a municipality will need to do to increase the likelihood of judicial approval of its plan.

With the benefit of those general observations, I wish to briefly counter the common misperceptions about Chapter 9 that I identified earlier. The proposition that collective bargaining agreements with a municipality's unions are insulated from modification is simply untrue. Indeed, the statutory criteria for justifying the need to make changes to the terms of a labor contract are considerably easier to satisfy in a Chapter 9 case than those that a for-profit business must meet to warrant similar relief. It is also the case that a municipality may modify retiree benefits in its plan, provided doing so is deemed necessary to bring about a stable financial future for the local government. Recent state legislation attempting to preclude such retiree adjustments will be constitutionally challenged for years to come; and, for now, retiree constituencies should be willing to agree to a compromise that avoids the risk that the court will rule the state law prohibiting modification of retiree benefits unconstitutional, thereby subjecting the retirees to larger cuts than they could have negotiated.

And then there is the bondholder argument that they should not be forced to take haircuts on the debt they are owed if the Chapter 9 government can increase taxes to bridge the shortfall between its revenues and expenses. But having reviewed the few judicial decisions in this area, they take, as I would have expected, a more sensible and rational approach, and only require additional taxes where doing so will not be frustrative of the goal of making the local government financially viable. To rule otherwise as a blanket proposition would render the utility of Chapter 9 illusory; because if higher taxes were always the requirement, there could never be debt relief -- the very purpose of Chapter 9.

I address all these misperceptions more fully in the Guide, and with respect to the critical issue of whether a plan can be confirmed over creditor objections, I believe the Guide's discussion is the most extensive on this subject to date, and that it meaningfully describes the comprehensive steps a local government should be expected to take to be best positioned to obtain debt relief in an adversarial context.

In sum, I am not suggesting that Chapter 9 will be successful in every instance; what I am advancing, however, is that if a Chapter 9 case is professionally orchestrated from the very inception of creditor negotiations and well before the actual filing, and provided the municipality has done all within its power to belt tighten and find additional revenues with which to operate, judicial approval of a plan that provides a viable solution to a financially troubled municipality is realistic to assume.

Let me lastly respond to concerns raised about the possible adverse impact that a Chapter 9 filing might have on the job security of public officials and on a municipality's future credit rating. First, Chapter 9 does not permit a bankruptcy court to remove elected or appointed officials. Its role is not to tamper with the government's team. As to job retention following a Chapter 9 case, there is no evidence to suggest that elected public officials will not be returned to office or appointed officials not reappointed merely because they made the decision to file Chapter 9. Stated more affirmatively, if government officials are not seen as the cause of the fiscal crisis and are perceived to have acted responsibly and in a balanced fashion toward creditor constituencies during a case, and a court-approved plan fixing the municipality's financial problems is accomplished, their reelection or

reappointment is much more likely than if they simply failed to file Chapter 9 when no other solution could solve the community's financial difficulties.

Nor should there be concern that a municipality's use of Chapter 9 to solve its financial problems will preclude it from meaningful access to the credit markets. There is simply no evidence to indicate that communities that obtain confirmation of a plan through Chapter 9 will be unable to gain access to the credit markets in the future. Necessarily, when a local government is facing significant financial distress, it will have no access to the bond market. Only by fixing its problems with a long term viable plan where revenues will exceed expenses, can a municipality hope to again access the credit markets. If Chapter 9 becomes necessary, it will be because creditors were unwilling to cooperate and reach a plan consensually. At that point, approval of a Chapter 9 plan is the only solution and, as such, becomes the sole means by which a municipality can hope to reestablish its credit worthiness -- justified by a court approved plan that affords the community the ability to achieve a balanced and stable set of income and expense projections.

I hope you benefit from The Guide. I prepared it in plain speaking terms. I have purposefully not cited code provisions or case authorities. My goal was to prepare a easily readable discussion, not for lawyers, but for public officials and their staff, and to make sure that the Guide would tackle and candidly evaluate the key issues about Chapter 9 that an official would want to fully understand. While the Guide is not filled with legalese, I candidly address the thorny unresolved issues that stand at the heart of Chapter 9, so you can be familiar with the opportunities as well as the uncertainties of the Chapter 9 process.

Thank you for your interest and I wish you the best in addressing your government's financial challenges.

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I. INTRODUCTION

As municipalities and other local governmental special purpose districts and authorities address increasing fiscal pressures, elected government officials, ombudsmen, managers, and other senior staff have been increasingly asking whether solutions potentially offered under Chapter 9 of the Bankruptcy Code, among the many options being considered, might afford an opportunity for resolution of their financial challenges. Because relatively little is known about the possible advantages of Chapter 9 and how, in meaningful ways, it might provide protection to governments and their officials when compared to the risks attendant to the corporate world's Chapter 11 equivalent process, it has not traditionally been considered when officials in the past explored how best to solve their financial difficulties. Not infrequently, too, misconceptions about the Chapter 9 process have led decision makers to veer away from considering it when, in fact, advantages of Chapter 9 will often significantly outweigh the risks of pursuing such an approach.

This Guide is intended to provide a hands-on sense about the Chapter 9 process, directly raising and answering some of the hard questions about how typical challenges faced by municipalities are likely to be resolved if determined in a judicially-supervised Chapter 9 setting. In that sense, this Guide is specifically designed to both demystify what Chapter 9 can and cannot accomplish and to remove common misapprehensions about Chapter 9 that come from an unfamiliarity with the opportunities that it may afford to financially-strained municipalities.

Unquestionably, a voluntary, consensual, and "out-of-court" resolution of a local government's financial challenges is ideal, and nothing in this Guide is intended to suggest to the contrary. Plainly, it is preferable for local governments to forge a plan to solve their present and future cash shortfalls through an agreement negotiated among the government, its creditor constituencies, and other important interest groups; and that

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approach is strongly encouraged and endorsed. Indeed, as will be discussed in more depth below, a best efforts attempt to resolve a local government's financial issues through an agreed-upon solution is a precondition under the Bankruptcy Code to a municipality's right to even seek Chapter 9 protections. Moreover, in many states that authorize their local governments to file for such protection, a concerted consensual resolution effort is also a state law requirement that must be sufficiently satisfied before a local government will be authorized by its state to file for Chapter 9 relief.

Perhaps the most significant point to be made in this Guide, however, is that the likelihood of achieving an agreed-upon consensual plan to restructure a local government's obligations and to provide a long-term solution for its financial challenges will be seriously diminished if the myriad creditor constituencies with which the government must fashion acceptable solutions do not believe that there is some meaningful risk that their rights and recoveries may be impaired through a Chapter 9 process beyond the concessions to which they are being asked to consensually agree. While in a limited set of circumstances a creditor's risks of a more adverse resolution than that which would be consensually acceptable to the government might arise because the creditor is exposed to unique contractual obligations or subject to damage claims that might arise in litigation, there is no mechanism -- other than a court-approved plan achieved through Chapter 9 -- that puts creditors with valid claims at risk of receiving less than their contractual rights. *Distilled, what that means is that a critical component in the tool box of governments facing insolvency and the need to restructure their financial affairs for the long run is preparedness of their officials to candidly discuss with their significant creditor constituencies the possibility of seeking a court-imposed solution to its financial difficulties through a Chapter 9 imposed plan if an agreed out-of-court solution cannot be accomplished.*

In considering Chapter 9 as a possible restructuring method and how a municipality might employ even raising the prospect of seeking Chapter 9 relief with its creditors, it

should be recognized that preparing for a Chapter 9 alternative, and putting it on the table as a potential resolution tool if an agreement with the government's major constituencies cannot be achieved through consent, will not meaningfully increase a municipality's resolution costs. First, Chapter 9 preparedness may well expedite a municipality's ability to reach an out-of-court accord with its creditors as well as produce meaningful financial savings. But also, as will be demonstrated below, the prudent and well-managed steps that a local government would appropriately pursue in its effort to achieve a viable consensual solution of its financial troubles without resorting to the judicial process are essentially the same best practices that it would want to pursue if Chapter 9 were actually being explored as an alternate possibility if voluntary agreements are not reached.

Necessarily, this Guide cannot answer all possible questions nor, of course, is it intended to express an opinion about the viability of Chapter 9 for any specific local government. Rather, it is designed to address what appear to be the most prevalent concerns that local governments, special districts, or authorities have raised about the utility and potential benefits of seeking relief under Chapter 9 as a means of resolving their financial difficulties.

II. WHAT LOCAL GOVERNMENT OFFICIALS NEED TO KNOW ABOUT CHAPTER 9

This Guide will address the most common questions raised by local government officials about the Chapter 9 process. Included among the topics to be explored in the Guide are:

What governmental entities can qualify under the Bankruptcy Code as a Chapter 9 debtor? Is it true that in addition to actual political subdivisions, such as cities, counties and towns, state or locally created authorities or districts are also eligible to file for Chapter 9 protection?

Must the state also enact legislation authorizing its municipalities or special authorities to file Chapter 9 before a filing is permitted under the Bankruptcy Code?

What efforts must a local government have undertaken to consensually resolve its financial concerns before seeking Chapter 9 relief?

Need a local government be insolvent in order to file, and how is such insolvency sufficiently proven?

Is it true that the bankruptcy court cannot displace elected or appointed local officials or force the government to pursue a specific set of actions?

How long may the Chapter 9 process take, and will a government be afforded sufficient time to accomplish its restructuring goals?

Does the filing of a Chapter 9 operate as an injunction against creditor actions to enforce their rights; how long can the automatic injunction stay in effect; and what must a creditor prove to lift the injunction against actions it wishes to take?

Can the government successfully rid itself of the burdens of long-term inefficient or overpriced contracts; how must the claims arising from such termination be treated under a court-approved plan?

Does the municipality's right to reject burdensome contracts in Chapter 9 also extend to its collective bargaining agreement obligations and, if so, what must a municipality prove to be so entitled?

How may the potential right to reject bargaining agreements help a municipality negotiate acceptable new agreements?

Is it true that a Chapter 9 municipality can operate its affairs on a "business as usual" basis, decide how best to use its available revenues, sell or lease its assets and enter into contracts during the Chapter 9 process, without the requirement that it first seek and obtain court approval?

Are the rights of holders of general obligation bonds different from the rights of those holding revenue bonds secured by specific assets; and how might those differences materially impact a court-approved adjustment of the municipality's obligations?

Will a bankruptcy court give effect to a state law that puts the repayment of general obligation bond indebtedness ahead of all other general unsecured obligations?

Does Chapter 9 limit or encourage the government's rights to look to public or private partnerships or transactions as a means of improving its fiscal strength?

Is a government's underfunding of its retiree benefit obligations something that a Chapter 9 process can meaningfully address? What effect will be given in a Chapter 9 bankruptcy to state laws that attempt to preclude the modification of a municipality's pension plan obligations to retirees?

Can a municipality obtain court approval of a plan of adjustment that modifies the terms of its financial obligations; does that even include the possible reduction of what it owes its creditors; must the creditors vote in favor of the plan to obtain the court's approval?

Is it true that creditors cannot file their own plan, but that the right to do so is conferred only on the Chapter 9 municipality?

Does every class of creditors, by the majority vote of its members, need to approve the municipality's plan of adjustment for the plan to be judicially confirmed?

Is it true that a majority of similarly classified creditors can bind dissenting members of the class to the terms of a municipality's restructuring plan?

What if some classes of creditors vote to oppose the municipality's plan? Since the ultimate goal of Chapter 9 is to reduce or modify the pre-filing contractual rights of the municipality's creditors, can a municipality nonetheless successfully obtain judicial confirmation of a plan that is opposed by one or more creditor classes?

To obtain court approval of a plan that pays objecting creditor classes less than their full contractual claims, what steps must the municipality have undertaken to reduce its operating costs and to maximize its revenues?

Can a plan of adjustment that does not provide equal treatment to all unsecured creditor groups nonetheless be confirmed; how so?

If a government's right to impose or increase local property or sales taxes is not constitutionally or statutorily precluded, will proposing to do so be a condition to obtaining plan confirmation; or can a court determine whether additional taxes should be a requirement based in each case on assessing the adverse impact that increased taxes would have on the plan's long term feasibility?

III. ELIGIBILITY AND PRECONDITIONS TO FILING:

A. What Local Governments Are Eligible to File Chapter 9? The Bankruptcy Code authorizes "municipalities" to file for protection under Chapter 9. Despite the general perception that the term "municipalities" only encompasses cities, towns, counties, and other political subdivisions that govern citizens in a specific geographic area and elect their officials by popular vote, the Code's definition is considerably broader; it also permits a "public agency or instrumentality of a State" to file for such relief. Most courts, though not all, have given broad meaning to the permission for agencies or instrumentalities of a state to file, and have allowed filings by special purpose districts, authorities, and agencies, whether directly created by the state or by a political subdivision of the state, such as a county or city (provided the state authorizing statute, discussed below, permits the filing by such authorities or instrumentalities). Thus, in states that authorize their special districts or authorities to file for bankruptcy protection, instrumentalities that were created to construct, operate, and maintain revenue-generating activities that provide services to the public in exchange for fees -- such as toll road authorities, hospitals, stadiums, gardens and parks, school districts, industrial development districts, waste and water and sewage treatment authorities -- are eligible to file under Chapter 9.

B. State Authorization: Even if the local government satisfies the definition of a "municipality" rendering it eligible under *federal* law to file for Chapter 9 protection, the Bankruptcy Code further requires that *state* law specifically authorize a municipality's filing. Approximately half the states permit some or all types of municipalities to file for relief under Chapter 9. One state expressly precludes a filing by its municipalities, while most of the rest of the states have no legislation either authorizing or prohibiting a Chapter 9 filing.

The state authorization requirement under the Bankruptcy Code has generally been interpreted as satisfied in states where general legislation has been enacted that authorizes

all or specific types of municipalities to file for Chapter 9 protection. Where such broad legislation has been enacted, the prevailing view is that there is no need to obtain further specific authorization for a particular municipality to file for Chapter 9 relief. Instead of conferring the authority for municipalities to file by statute, states may confer the authorization function on a governmental officer or organization to determine. Moreover, even in states where general legislation permitting a filing has not been previously enacted, the Bankruptcy Code will deem a specific municipality authorized to seek Chapter 9 protection if the state legislature were to enact "special legislation" authorizing its proposed filing.

Since state authorization is required, municipalities in states that have neither adopted legislation permitting their municipalities to file Chapter 9 cases, nor conferred the filing authorization function on a government officer or organization to determine, cannot seek such protection[1]. Of those states that permit filings, some do so broadly, while others limit the filing of Chapter 9 to actual political subdivisions, but not to other types of special purpose local governments. Of those states that authorize all or limited types of municipalities to file, some impose no additional precondition to a filing; others have conditioned the right to file on obtaining additional approvals from special state commissions or the like whose responsibility it is to determine whether a municipality has met the additional state-law established criteria justifying the legitimate need for it to seek Chapter 9 protection. Since states can preclude a municipality from filing altogether, there is little doubt that they have the power to condition a municipality's right to file Chapter 9 based on satisfying additional state-imposed conditions.

C. To Be Eligible for Chapter 9, a Municipality Must Be Insolvent: A municipality's insolvency is not determined by whether its assets exceed its liabilities, but will be based solely on whether its available cash flows are sufficient to satisfy its existing obligations. To be insolvent, therefore, a municipality must be able to demonstrate either

[1] *While a discussion of the specific laws enacted by each of the states that address the right of their local governments to seek bankruptcy protection is beyond the scope of this Guide, McKenna Long & Aldridge has analyzed the laws of all states and would be pleased to provide additional information regarding the "authorization" statutes and criteria adopted in a particular state. Please contact the author of this Guide if you would like such additional information.*

that it is not currently paying its obligations as they become due or, even if currently able to do so, based on realistic projections, it will soon be unable to pay its obligations as they become due. Insolvency is apt to be a contested issue, and a municipality should expect to have developed substantial proof of its insolvency or anticipated insolvency before filing for Chapter 9 protection.

D. As a Condition to Seeking Chapter 9 Relief, a Municipality Must Show That Good Faith Negotiations with Its Principal Creditors Has Failed to Result in an Agreement to a Feasible Plan: The Bankruptcy Code encourages municipalities to make a serious effort to achieve a consensual out-of-court agreement among its significant creditors sufficient to provide a feasible solution to its financial problems. To assure that such an effort has been undertaken, absent extreme and unique circumstances where conducting such negotiations can be shown to have been impracticable, a municipality in the early days of its case must sufficiently satisfy the court that despite its good faith efforts, a workable consensual plan to solve its financial distress could not be achieved without resorting to Chapter 9. How a municipality demonstrates compliance with the good faith efforts test will, of course, differ in every situation; but, importantly, as indicated at the outset of this Guide, the prudent and comprehensive financial steps taken by a municipality to build consensus and agreement among its creditor constituencies in an effort to achieve a consensual out-of-court restructuring will essentially be the same types of showings that the municipality will be expected to make at the outset of its Chapter 9 case.

IV. LIMITED BANKRUPTCY COURT POWERS AND RIGHTS TO INTERFERE IN THE MUNICIPALITY'S DECISION MAKING:

A. Generally: Unlike Chapter 11 -- the provisions governing business bankruptcies -- a bankruptcy court's authority and powers when dealing with a municipality are quite circumscribed and limited. The goal of Chapter 9 is for the municipality to obtain court approval of a plan of adjustment that will provide a long-term solution to its financial concerns, and the bankruptcy court is conferred the right to determine whether the municipality's plan meets the requirements that Congress has mandated for permitting an adjustment in its financial obligations. *Importantly, therefore, the court is entitled to look at the entirety of the actions taken by the municipality both before and during the Chapter 9 case when assessing the bona fides of its plan. That being so, a Chapter 9 municipality ought to comport itself accordingly, keeping the court's ultimate control over approval of the municipality's adjustment plan well in mind. Nonetheless, the bankruptcy court is not given significant means to condition, preclude, or mandate that a municipality take or refrain from taking any specific action during the pendency of its case.* Thus, as a general proposition, when a municipality files for Chapter 9 protection, unlike a Chapter 11 business seeking to reorganize, it can essentially operate on a "business as usual" basis, free of court or creditor intervention.

The constraints placed on a court's powers to direct a municipality's affairs are not because Congress failed to envision that there might be prudent reasons for a court to exercise some controls or limits on a municipality's course of actions. Rather, though our bankruptcy laws and the powers conferred on bankruptcy courts are protected and guaranteed under the Constitution, those powers must be tempered and balanced against the competing need to afford equal dignity to the Constitutional right of the states and their municipalities to govern themselves. This balance is struck, on the one hand, by Chapter 9's conferral on bankruptcy courts of the power to decide whether or not to approve a plan

of adjustment while, on the other hand, precluding the courts from interfering with the right of a Chapter 9 municipality to manage its operations and develop its financial plans.

> *"… the court is entitled to look at the entirety of the actions taken by the municipality both before and during the Chapter 9 case when assessing the bona fides of its plan."*

That said, an additional observation about the limitation of the court's powers to direct the municipality's affairs is merited: while a court cannot direct a municipality's actions, it has the ability, indirectly, to affect how a municipality acts during the case by forming impressions that are either critical or supportive of the municipality's actions or inactions; and, since the court has the power to ultimately approve or reject the municipality's plan of adjustment, a municipality will be well-advised to take due notice of the court's reactions to various steps taken or proposed to be taken by the municipality during the Chapter 9 process, and to incorporate the sense of the court's views in developing a balanced plan of adjustment.

B. A Court May Not Displace Elected or Appointed Officials; But What Is the Practical Effect on the Ability of Those Officials to Be Reelected or Reappointed? In Chapter 11, a business debtor is often concerned that a court, whether prompted by creditor requests or on its own initiative, might decide to displace the debtor's management by appointing an independent trustee to run the debtor's affairs if it finds that the debtor's management has acted in a materially imprudent fashion in the past or is not capable of accomplishing the debtor's restructuring goals. *There is no such correlative power given to courts under Chapter 9; and, as such, elected and appointed officials need not be concerned that whatever creditor backlash or frustrations the filing of Chapter 9 might generate, creditor leverage against public officials and their restructuring goals cannot be obtained by threats to have them removed and replaced.* As a corollary proposition, while a bankruptcy court has the power to appoint an independent examiner to investigate and report to the court and creditors on certain designated affairs of a Chapter 11 business debtor, it has no similar statutory right to appoint an examiner in Chapter 9.

While elected officials should be comforted by the fact that a bankruptcy court has no power to displace them, they may be concerned that public opinion following resorting

to the Chapter 9 process may put their reelection at risk. Similarly, those holding appointed offices in special districts and the like may have fears that public opinion could sway decision makers not to reappoint them. There is no meaningful anecdotal evidence to suggest that the mere filing of a Chapter 9 case will put public officials at reelection or reappointment risk. In reality, whether elected officials are positively perceived by the public following resort to Chapter 9 will depend on many factors beyond merely the decision to seek bankruptcy protection.

> *"… elected and appointed officials need not be concerned that whatever creditor backlash or frustrations the filing of Chapter 9 might generate [as] creditor leverage against public officials and their restructuring goals cannot be obtained by threats to have them removed and replaced."*

Paramount among the considerations of the electorate or decision makers will be their perception of whether their elected or appointed officials were the cause of the financial distress that resulted in the filing or whether the local government's fiscal problems were due to actions taken or not taken by previous administrations. The electorate and those responsible for appointed public officials will also assess whether Chapter 9 in their opinion could have been avoided, whether they perceive the Chapter 9 process to have been fairly handled with due consideration of the rights and needs of all constituencies and if the Chapter 9 filing ultimately resulted in a viable long-term solution for the municipality's financial difficulties. In the final analysis, if Chapter 9 is the only realistic solution, it is more likely that public officials will be returned to office if they properly utilize that approach to provide a workable solution than they would if, in response to their government's serious problems, those officials fail to avail themselves of the Chapter 9 remedy.

C. Decision Making During Chapter 9 Is Essentially Left to Government Officials, Free of Court Supervision or Creditor Objections: In contrast with Chapter 11, where only routine day-to-day business activities of a debtor need not be submitted for court approval, Chapter 9 permits a municipality to undertake a vast array of activities without the obligation that it first seek court approval. Not only is judicial authorization

not required, *a bankruptcy court is expressly precluded from interfering with a municipality's property, whether it is the use of any of its assets, or a new lease or the sale of them; nor can it control the municipality's management decisions including either the retention or termination of employees*. Not only does the bankruptcy court not need to be consulted before making such decisions, creditor constituencies cannot be heard to object on such matters. As such, a debtor municipality, unlike a Chapter 11 business debtor, should not be concerned that creditor groups might attempt to complain and object about the government's business decisions as an indirect means to pressure the municipality's officials into fashioning a plan of adjustment that is more favorable to them than is otherwise appropriate.

"… a bankruptcy court is expressly precluded from interfering with a municipality's property, whether it is the use of any its assets, or a new lease or the sale of them; nor can it control the municipality's management decisions including either the retention or termination of employees."

D. The Retention and Compensation of Professionals Is Exclusively Within the Municipality's Control: In Chapter 11 cases, the bankruptcy court must approve the retention of outside professionals that a debtor chooses to engage, whether they be turnaround professionals, accountants, financial advisors, or counsel. Not so in Chapter 9, where all such decisions can be made free of judicial intervention. This non-intervention principle also applies to the rates charged by professionals and the amount of the actual fees that the municipality incurs in effecting its restructuring goals. While the municipality may need to make those matters publicly available in compliance with sunshine laws or because it otherwise seems prudent, all decisions about fees to be paid are solely the municipality's to determine, though the court may consider the totality of the professional fees incurred by the municipality when considering confirmation of its plan of adjustment.

V. THE AUTOMATIC STAY: A BREATHING SPELL THAT AFFORDS TIME TO DEVELOP A COMPREHENSIVE PLAN

A. Generally: Aside from other material benefits that Chapter 9 confers on a municipality, the mere filing of a Chapter 9 case automatically stops creditors and other parties, who in the absence of the filing could have done so, from taking or initiating action that could have adversely impacted the municipality's operations. *Like Chapter 11 debtors, a Chapter 9 municipality is protected by what is known as the "automatic stay", conferred from the very moment it files, that insulates it from a broad host of activities or actions that if not enjoined could have had a detrimental impact. Importantly, the municipality need take no action whatsoever to be entitled to these automatic protections.* In essence, the filing grants the municipality a comprehensive injunction without it having to satisfy what a party normally seeking an injunction would have to establish -- namely, how the particular action would have materially and adversely affected the municipality and, often more challenging to prove, that the municipality's rights are contractually or equitably superior to those of the adverse party that the municipality seeks to enjoin.

As discussed below, this automatic injunction is not permanent and can potentially be lifted by the court under certain circumstances at the urging of an adverse party against whom the injunction applies. But the stay is vital; it affords the municipality a breathing spell in which to formulate and negotiate a workable financial resolution to its distress, precluding aggressive creditors or other interested parties from setting the agenda by either taking harmful actions or by compelling the municipality to grant it inappropriate or unrealistically favorable terms in exchange for their agreement not to exercise such remedies.

B. What Actions Are Automatically Enjoined? Without addressing here every possible scenario, all suits against the municipality are stayed, and creditors are enjoined from enforcing any judgment they have against the municipality. Actions to place liens on municipal properties or to obtain the possession of the municipality's assets are stayed. Not infrequently, bondholders who are not being paid threaten not only to bring suit to enforce their right to payment but, in addition, to compel the issuer to take some affirmative action that can provide a source for payment on the bonds whether that action, for example, might be to enjoin payments to others such as employees, or to compel the municipality to raise funds through additional taxation. Unquestionably, all these troublesome courses of creditor action are automatically stayed by the Chapter 9 filing.

> *"Like Chapter 11 debtors, a Chapter 9 municipality is protected by what is known as the "automatic stay", conferred from the very moment it files, that insulates it from a broad host of activities or actions that if not enjoined could have had a detrimental impact. Importantly, the municipality need take no action whatsoever to be entitled to these automatic protections."*

C. Are There Certain Actions that Are Not Stayed when a Municipality Files a Chapter 9? Since the Bankruptcy Code is not intended to limit the right of a government to exercise its legitimate interest in preserving the rights of those whom it is authorized to protect, *certain actions that a governmental body other than the Chapter 9 debtor, such as the state, the federal government, or another local government, might wish to take against or affecting the Chapter 9 municipality may not be automatically enjoined.* It is beyond the scope of this Guide to examine all the possible types of governmental action against the municipality that might not be stayed; but, generally, a municipality is protected by the stay unless the other government can satisfy the Chapter 9 bankruptcy court that the health and welfare of its constituents will be threatened if the municipality's behavior is not enjoined. Disputes between governmental bodies regarding the respective rights to protect those they serve produce a complex balancing of considerations, and for this reason a determination of how that balance would be struck in any particular case requires an

analysis of specific facts and the implications of granting or denying injunctive protections that are unique to each situation.

D. Under What Circumstances, Short of a Comprehensive Restructuring, Can Those Who Are Automatically Stayed Successfully Have the Injunction Against Them Lifted? While the stay protecting the municipality is conferred automatically, creditors and other adversely-affected parties do have the right to request that the bankruptcy court lift the injunction thereby permitting the aggrieved creditor or other affected party to take the action that the automatic stay inhibited. In assessing whether in any specific case to grant a creditor's request that the injunction be lifted as to specified conduct, the court should act in a timely fashion. But unlike Chapter 11, and in order to afford the municipality a longer period to address a multitude of issues, the court is not compelled to adjudicate the request to lift the stay on an expedited basis.

"While no precise rule of thumb can be stated, the party requesting relief is likely to prevail if it can show superior legal rights to any contrary assertions raised by the municipality and can also demonstrate that the harm it will suffer by keeping the injunction in place is meaningfully greater than the adverse impact on the municipality if the stay is lifted."

After affording the municipality time to respond and holding a hearing on any request that the automatic injunction be lifted, the court should grant the request to lift the injunction if the requesting party can prove "cause". Generally speaking, courts find "cause" if the justifications for lifting the stay to protect the legitimate interests of the requesting party are found to outweigh the benefits to the municipality of keeping the stay in place. As such, cases turn on the particular merits of each situation. *While no precise rule of thumb can be stated, the party requesting relief is likely to prevail if it can show superior legal rights to any contrary assertions raised by the municipality and can also demonstrate that the harm it will suffer by keeping the injunction in place is meaningfully greater than the adverse impact on the municipality if the stay is lifted.*

E. Creditor Requests to Lift the Stay to Permit Foreclosure: Often, a creditor moves for relief from the automatic stay so it can proceed with efforts to foreclose on security interests in real property or other assets that the municipality has contractually granted to the creditor as the means to protect the creditor's right to repayment of its loans to the municipality. Financial institutions seeking to recover on defaulted loans, by foreclosure on the assets that secured the financing, frequently will seek relief from the stay so they can sell the collateral and reduce or pay off the debt they are owed.

When relief from the automatic stay is for the purpose of permitting foreclosure, a significant burden is imposed on the requesting creditor. In order to prevail, the creditor must not only show that the municipality lacks any equity in the property sought to be foreclosed -- i.e., the debt owed exceeds the fair value of the municipality's asset in question -- but, more difficult to prove, also establish that the property is not needed by the municipality to accomplish its continuing duty to provide services to its citizens. For this reason, and though every situation is different, a municipality is likely in a better position to resist foreclosure-premised requests to lift the automatic stay than "for profit" debtors in Chapter 11, thus allowing the municipality additional time to formulate a comprehensive plan to readjust its debts through a court-approved plan.

VI. UNIQUE TREATMENT OF REVENUE BONDS IN CHAPTER 9

Where a debtor municipality owns assets that generate designated "special revenue" earmarked both to pay operating expenses associated with the use of the asset as well as interest and principal on the borrowings -- typically revenue bond financings -- the rights of the municipality's creditor may in certain respects be better, and in other respects materially less so, than had the financing been extended to a for profit business. First, in respect to revenue bond holders, the filing of Chapter 9 does not enjoin the application of pledged special revenues to the payment of revenue bond debt secured by the revenues, though the municipality is entitled to retain as much of the special revenues as needed to pay expenses attributable to the operation and maintenance of the revenue generating assets in question. Thus, holders of revenue bonds can receive payments on the indebtedness owed to them during the pendency of a Chapter 9 case to the extent net special revenues are available to pay them. While the municipality usually controls the special revenues and need not remit them to revenue bondholders during the case, it may not use such special revenues, whether generated before the filing or (as distinct from Chapter 11) after the filing, for any purpose other than making payment on the bonds. Thus, typically, a municipality would remit the net special revenues to the revenue bondholders because, by a specified bankruptcy provision applicable only in Chapter 9, under no circumstance may any such special revenues be diverted to paying any of the municipality's general operating expenses.

While the foregoing rules unique to revenue bonds favor the bondholders, in a different respect municipal revenue bondholders are treated less favorably than the municipality's non-special revenue secured creditors or any secured creditors of a for profit borrower would be treated. In the case of for profit borrowers, where assets securing a loan are found by a court to be of a value less than the indebtedness owed, the secured creditor's claim is split; the portion of the debt equal to the current value of the

asset is treated as secured, and for a plan to be confirmed, a new modified debt and repayment schedule for that portion of the debt is required. The balance of the debt -- the under-secured portion -- is treated as an unsecured obligation and, in respect to that portion of the obligation, the creditor is entitled to receive distributions under a plan equal in percentage to that being paid to other general unsecured creditors. Notably, in Chapter 11, this treatment of the under-secured portion of the debt must be provided to the creditor even where the creditor at the loan's inception was given no direct contractual recourse against the debtor to recover any under-secured portion of its claim from the debtor's unencumbered assets or funds but, rather, was contractually entitled to look solely to the income stream of the special project as the only source of funds from which to satisfy its claim.

"This unique aspect of Chapter 9, which precludes secured creditor recourse absent the municipality's express contractual agreement to permit recourse when the loan was first made, could prove to be extremely important to a municipality's ability to achieve a confirmed plan of adjustment."

In contrast, however, in Chapter 9 cases, if the holder of a claim was contractually entitled to be paid solely from the "special" revenues generated by the municipality's use of the special purpose asset, and the creditor from the loan's inception did not also receive a separate contractual agreement from the municipality to repay any shortfall from its general coffers, the under-secured portion of the claim of the special purpose financing creditor is entitled to no treatment under any plan. *This unique aspect of Chapter 9, which precludes secured creditor recourse absent the municipality's express contractual agreement to permit recourse when the loan was first made, could prove to be extremely important to a municipality's ability to achieve a confirmed plan of adjustment.*

VII. FINANCING THE MUNICIPALITY'S OPERATIONS DURING THE CHAPTER 9 CASE

A. Use of the Municipality's Current Revenues: Generally speaking, a municipality can use any of its revenues to fund operations except, as discussed above, those "special" revenues that have been earmarked exclusively for the repayment of secured financing. No court permission to use other than "special revenue" is required. Thus, with respect to any funds other than those defined as special revenues, even if by agreement or legislation they were to be used solely for earmarked purposes or to make payment on a secured loan, a municipality may use the funds other than for those designated purposes provided that, if challenged, the municipality can prove that the purpose for the earmarking will not be compromised or jeopardized or, in the case of a secured loan, the lender's rights to repayment of its loan are adequately protected.

B. A Chapter 9 Municipality Is Precluded from Drawing Down As-Yet-Unfunded Loan Proceeds: As is true with any business bankruptcy, the filing of a Chapter 9 terminates any obligation of a secured or unsecured lender to permit a Chapter 9 municipality to draw down on unfunded loan proceeds even if the municipality was not in default on the particular loan prior to filing for bankruptcy protection. A lender may, however, choose to permit such a borrowing with additional protections as it may require to be conferred by order of the court; but this consent to allow further drawings is entirely discretionary, and a municipality should assume that a lender will not agree to do so unless appropriately authorized by all the participants in the loan and even then only if it is in the lender's best interests to do so.

C. A Chapter 9 Debtor Can, However, Obtain Credit During Its Proceedings; *Unsecured* Credit Can Be Incurred Without Need of Court Approval, and *Secured* Financing Can Be Obtained with Court Authorization: A municipality's entitlement to

obtain credit and the conditions for doing so depend on whether the proposed credit is unsecured or secured.

1. *Unsecured Credit from Vendors or Service Providers:* After a municipality files for protection, it is nonetheless able to incur debt on an *unsecured* basis, generally for the payment of goods and services, and it need not obtain court approval to do so. It can pay for such goods and services as well without court authorization. Accordingly, ordinary daily business transactions can continue as if there were no Chapter 9 pending. Additionally, to induce the flow of credit after the filing, credit extended by third-party vendors during a Chapter 9 has the status of an "administrative expense," meaning that such claims have priority entitling them to repayment superior to the claims arising from all pre-filing unsecured debts, including GO bond indebtedness. That priority makes post-filing credit easier to obtain. Moreover, because a Chapter 9 debtor will not have to pay claims for most goods and services that were provided prior to the filing until such time as a plan is approved, the municipality will likely have some increased liquidity with which to pay for post-filing goods and services.

That said, sometimes a debtor desires to pay critical vendors their pre-filing claims because not doing so may result in the vendor not providing post-filing goods or services. To pay such pre-filing unsecured claims necessary to assure the municipality's receipt of critically necessary post-filing goods or services, a municipality can seek court approval to promptly pay such claims rather than under a plan upon a showing that alternative sources of comparable goods or services are not available or other proof that the failure to pay for the pre-fling goods or services promptly and in full could seriously impair the municipality's efforts to achieve a confirmable plan of adjustment. Of course, keeping critical vendors current prior to a filing is the safest course to avoiding the risk that a court might not approve post-petition payments to them.

2. *Other Unsecured Borrowings*: Aside from a local government's ability to obtain credit from vendors, it may need cash to meet its operating expenses, though the Chapter 9 filing itself will relieve the need to pay significant bond interest during the case, and this alone may solve the government's short-term liquidity problems. If funding is still needed, loans secured by assets, discussed next, may be a possible solution. But if a municipality

does not have assets that would justify a secured loan, and it must look to obtain unsecured financing, can it hope to successfully do so?

Generally, the bond markets will not be a source available to an insolvent entity until it succeeds in its restructuring and has sufficiently stable credit to attract capital. In the interim, while a Chapter 9 case is pending, the likely source of any borrowing is apt to come from commercial banks or other secured lenders. The Code provides the basis upon which such a lender might be willing to extend credit. Because loans made after the filing of a Chapter 9 case have the status of an "administrative expense," they stand at a higher priority as to their right to repayment than do pre-filing creditors, whether they be general obligation bondholders or other unsecured creditors. Because any restructuring plan that the municipality proposes must provide that its administrative expenses will be paid in full before any distributions to unsecured can be permitted, new post-filing lenders may be amenable to provide funding to a municipality during its Chapter 9 case sufficient to meet operating shortfalls.

Chapter 9 debtors are permitted to incur new unsecured loan obligations, and *may* be able to do so without court approval. However, because this aspect of the Bankruptcy Code has not been sufficiently tested, a post-filing lender might require that the municipality obtain the court's approval of the proposed loan in order to assure that it will be granted administrative expense status. In that setting, a court would need to determine whether permitting the unsecured loan with administrative priority jeopardizes the rights of existing creditors, or whether authorizing the bridge financing improves the prospects that those creditors in the final analysis will receive a greater percentage repayment of what they are owed than if the loan were not approved.

3. *Secured Credit*: Sometimes a Chapter 9 debtor is in need of obtaining more significant levels of financing, but financial institutions are unwilling to make such a loan unless granted a security interest in certain of the municipality's assets. Though generally a municipality will not be permitted to grant a new lender a superior lien on assets previously pledged to secure a pre-filing loan from another creditor, it can, with court approval and after notice to creditors and a hearing, grant junior liens on previously collateralized assets (except the assets of special project revenues that may not be further pledged to collateralize a junior indebtedness) or, as would more typically be the case, on

otherwise not previously pledged assets. Affording such a lien in exchange for new credit will be permitted by a court provided that the municipality can demonstrate that it was neither able to obtain credit on less imposing terms nor could it obtain the financing without affording security to the new lender. If it is pledging a junior lien to a new lender on collateral pledged previously to a superior lender, the municipality must also satisfy the court that the rights of the senior lien holder will not be jeopardized.

VIII. ASSUMPTION OR REJECTION OF THE MUNICIPALITY'S EXISTING CONTRACTS

A. General Principles: One benefit that Chapter 9 affords is the ability for a municipality to potentially restructure its existing contractual relationships. Executory contracts -- those where both parties to it have as yet uncompleted obligations -- can, with court approval, be assumed by the municipality if they are favorable, while those that are no longer economically favorable can be rejected. In exercising its oversight, a court will generally defer to the municipality's business judgment, thus affording it relatively broad discretion in how it restructures its contractual relationships.

Generally, there is a period of time either established by the Court or, for certain types of contracts, by the Bankruptcy Code, in which a municipality will need to decide whether to assume its contracts or reject them, but courts will usually accommodate a debtor's request to be afforded additional time where good cause is shown for such allowance.

B. Assumption of Contracts: A municipality will need to decide whether or not to assume the entirety of an existing contract. A debtor cannot choose to assume portions of a contract, keeping those elements favorable to it, but rejecting other provisions. If a municipality assumes a contract, the municipality is then bound to the terms of the contract once it emerges from bankruptcy. In order to assume a contract, a municipality will generally need to cure any existing defaults, and provide adequate assurance that it will continue to perform its obligations under the contract in the future; but, importantly, if it cures any existing defaults and proves to the court that it will prospectively be able to perform its duties under the contract, the other party cannot terminate the contract as it could have were there to have been no bankruptcy. Past due and unpaid obligations are typical of the defaults that can be cured. Pending the municipality's decision to assume or reject a particular contract, the other party must continue to perform its obligations even if

there were prior defaults by the municipality, provided the municipality pays currently for the reasonable value of the benefits of the contract that it is being provided.

C. Rejection of Executory Contracts: Where existing municipal contracts are burdensome to a municipality because the costs exceed current market conditions for similar goods or services, or where circumstances otherwise make the continued performance of the municipality's obligations under the contract ill-advised or inappropriate given its financial conditions and limited resources, the Bankruptcy Code provides a means for rejecting such burdensome contracts. If a municipality rejects a contract, it terminates any further obligation to perform its contractual obligations, whether those obligations consist of payments or other contractual duties. If the court approves the municipality's proposed rejection of a contract, which in most cases it will, the other party to the contract will be entitled to a damage claim resulting from the municipality's permitted breach of the contract. Though the municipality will be exposed to a damage claim if it rejects a contract, paying the damages may cost it considerably less than the drain on its resources were the municipality to continue its performance of the contract.

"… a municipality's threat to reject a contract can often aid its ability to lever a negotiated modification of the contractual terms with the counterparty who might prefer to grant modifying concessions than face the loss of the contract in its entirety."

While, as noted earlier, a local government cannot reject a portion of a contract while seeking to affirm the rest of it, *a municipality's threat to reject a contract can often aid its ability to leverage a negotiated modification of the contractual terms with the counterparty who might prefer to grant modifying concessions than face the loss of the contract in its entirety*.

Additionally, the Bankruptcy Code limits the measure of damages for certain types of executory contracts that are rejected. For example, leases of real property and certain employment contract obligations are so limited by provisions in the Bankruptcy Code. Moreover, damage claims arising from a contract's rejection may be limited by state law

principles. Illustratively, certain types of claims for contractual breach, such as arising from the termination of a real property lease, require the non-breaching parties to mitigate their damages by attempting to release the properties subject to the lease.

D. Rejection of Collective Bargaining Agreements: Collective bargaining agreements, like other contracts, can be rejected by a municipality under certain conditions, starting an entirely new round of negotiations and the possibility that the damage claims of union members arising from the bargaining agreement's rejection will not be paid in full under the municipality's plan of adjustment. Here, too, the threat that a municipality will decide to reject a bargaining agreement can often facilitate a consensual modification that avoids the union's risk that it will be rejected.

The right of a municipality to reject a collective bargaining agreement is broader than the similar right of a Chapter 11 business debtor to do so. The ability of a business debtor to reject a collective bargaining agreement was significantly circumscribed by an amendment to the Bankruptcy Code that established elaborate conditions to effecting such a rejection, but this amendment does not apply to municipal bankruptcies. Additionally, the ability to reject a collective bargaining agreement conferred by the Bankruptcy Code has been held to override any contrary limitation on the right to reject a bargaining agreement that state laws may impose on a municipality. For a municipality to reject a collective bargaining agreement, it will need to demonstrate to the court that: (i) the agreement burdens its ability to achieve a workable plan of adjustments; (ii) it has engaged in reasonable effort to negotiate a voluntary modification of the bargaining agreement, but those efforts have been unavailing; and (iii) weighing all the competing circumstances, the balance of the equities favors the municipality's need to reject the agreement over the union's right to insist that the municipality perform its obligations under the agreement for its term. The last of the three criteria will undoubtedly require a court to consider everything the municipality is undertaking in its efforts to reorganize; and what the municipality might be willing to offer to the union members under a new contract if the bargaining agreement is rejected is apt to be a factor that the court will consider in deciding whether to permit rejection. Also likely to be considered by the Court in determining whether to permit rejection of a bargaining agreement is what percentage of

the aggregate damages arising from the rejection is to be paid to union members under the municipality's adjustment plan, and over what period of time they are to be paid.

E. Rejection Of Retiree Benefit Plan Obligations: Of significant concern to municipalities and, of course, those of its prior employees covered by existing pension plans, is whether and to what extent a Chapter 9 debtor can reject its pension plan funding obligations, giving rise to a damage claim in favor of the retirees. If it were able to do so, but also amendable to offering a less lucrative new plan, the difference in benefits between the existing and newly proposed plan would give rise to a damage claim in favor of the retirees equal in status to the claims of all other unsecured obligations of the municipality, including amounts owed on general obligation bonds. How such a retiree damage claim might be treated relative to other unsecured creditors is discussed below in the section that addresses plan confirmation issues.

However, some states have recently enacted legislation that protects retiree benefits from being modified by local governments that contracted to provide them. Whether these state laws will be given enforcement in a Chapter 9 context remains uncertain. Our federal courts, which will decide this issue, must weigh whether such state laws should be given efficacy despite the fact that if enforced it could significantly impede a Chapter 9 municipality from achieving a workable restructuring plan. As yet, there are insufficient precedents from which to determine how this issue will ultimately be resolved, and it is apt to be years before there is a uniform view.

The legal issue posed by these anti-dissolution statutes involves competing constitutional considerations. On the one hand, states that adopt such insulating protections will argue that doing so to protect their citizens is a right reserved to the states under the broad prerogative to manage their affairs conferred by the Tenth Amendment. Municipalities that seek to modify the rights of retirees in order to accomplish a sound restructuring of its obligations will argue, however, that state statutes that inhibit any modification of retiree benefits frustrate the protections that the Bankruptcy clause of the U.S. Constitution conferred on a debtor to afford it a fresh start.

For now, because the judicial outcome of this issue remains uncertain, there is much for both the retirees and financially distressed municipalities to lose by asking a Chapter 9 judge to decide the outcome of this issue. In this setting, there is considerable justification

for municipalities and their retirees to agree to a consensual resolution of these claims, whether that resolution were to occur before a municipality ever sought Chapter 9 protection or after such a filing.

IX. THE GOAL OF A CHAPTER 9 FILING -- ACHIEVING A CONFIRMED PLAN OF ADJUSTMENT

A. Confirming a Plan; Strategies for Securing the Time that Is Needed: There is no precise time by which a municipality must seek to obtain confirmation of its restructuring goals once it files for bankruptcy protection. That said, a Chapter 9 debtor should be expected to work diligently toward that goal and demonstrate progress and prodigious efforts if it expects to garner support from the bankruptcy court that will permit it a reasonable amount of time necessary to comprehensively address all its financial problems and attempt, as best as possible, a consensual agreement among its creditors and other affected constituencies. Municipal distress produces a complicated and extensive set of matters, involving numerous constituencies. For this reason, history teaches that efforts to achieve a judicial resolution will likely take a year, and possibly much longer. This is true even if, as the Code contemplates, significant pre-filing efforts were made to accomplish a consensual plan to avoid the Chapter 9 filing.

Relatively early in a Chapter 9 case, it is likely that the court will set a date by which it expects the debtor to file and then seek confirmation of its plan. While the court has the flexibility to modify the dates as it deems appropriate and to do so based on evolving considerations, it will be advisable in most cases to request from the court, at the outset of the case, a fairly extensive amount of time to complete its plan, justifying the time requested by describing the myriad matters that will need to be addressed and resolved before a plan can be meaningfully negotiated.

Though no specific timetable for completing a restructuring plan exists, a municipality should anticipate that as negotiations with its major creditors likely get more strained before a compromise is hopefully reached, discontent creditors may be inclined to request that the bankruptcy court dismiss the bankruptcy, not because doing so would afford a realistic solution for anyone including the creditors, but simply as leverage from

which the requesting creditors would hope to negotiate favorable concessions. Since the two-prong criteria that the court is to use in determining whether grounds for dismissal exist are either the debtor's failure to obtain confirmation of its plan within the time set by the court or an "unreasonable delay" in the municipality's process for seeking plan confirmation, the debtor should proactively establish status-reporting requirements with the court and then comply with them, thereby keeping the court fully and consistently advised of developments; and, if delays are being experienced, periodic updates should include explanations why certain matters are taking longer than earlier anticipated. By following that approach, justifications for why more time is needed to complete a municipality's restructuring do not arise in response to a creditor's motion for dismissal, but instead occur as part of candid progress reporting to the court throughout the case. This should minimize any judicial misimpression that the municipality, as may be urged by disgruntled creditors, is guilty of foot-dragging.

B. Only a Chapter 9 Debtor May File a Plan: In Chapter 11, business debtors are given an exclusive period to propose a plan. Unless the period is extended for good cause, the exclusive right of a debtor to file a plan expires after 120 days, and creditors can propose competing or alternative plans. No similar right to file competing plans is afforded to creditors in Chapter 9. Because a municipality need not be concerned that creditors can propose their own plans, a Chapter 9 municipality has more control over the plan process than does a business debtor in Chapter 11, which will often be confounded by the distractions and risks of court confirmation of a competing plan.

C. Appointment and Role of the Creditors' Committee: In a Chapter 9 case, a committee of unsecured creditors will be appointed by the United States Trustee -- an agency that operates under the United States Department of Justice. Usually the committee will consist of 5 to 7 of the largest unsecured creditors, though there is flexibility to appoint a committee that is composed of representatives holding diverse types of unsecured claims. The committee, though conferred no specific voting powers on a plan, is intended to provide the municipality with an organized and centralized forum to whom it is to provide detailed data and with whom to generally negotiate plan provisions. However, just as is the case with specific creditors, the committee has no power to compel the municipality to take or refrain from taking specific action or to formulate a plan containing certain specified

creditor-friendly provisions. While a Chapter 9 municipality is not obligated to pay for professionals retained by a committee, it may choose to do so to engender creditor cooperation leading to a consensual plan.

D. The Ultimate Goal: Confirmation of a Feasible Plan of Adjustment that Works for the Long Term: Simply put, the reason a municipality should seek Chapter 9 relief is because it has failed, despite robust effort, to accomplish a workable out-of-court solution. It therefore files Chapter 9 because it needs a bankruptcy court to approve a plan, perhaps over some creditor opposition, which seeks to reduce or materially modify in some respects its current and long-term obligations. *A municipality's plan should seek to accomplish adjustments to creditor claims that best assure that its comprehensive restructuring proposal is feasible -- meaning not only that the plan will work in the near term, but also that it will provide for a stable future and as permanent a solution as possible to the municipality's financial challenges.*

"A municipality's plan should seek to accomplish adjustments to creditor claims that best assure that its comprehensive restructuring proposal is feasible -- meaning not only that the plan will work in the near term, but also that it will provide for a stable future and as permanent a solution as possible to the municipality's financial challenges."

Not surprisingly, securing the court's blessing of a proposed plan will be dependent on meaningful financial proof that the proposed modifications of creditor claims, coupled with operational cost-cutting and, where possible, the generation of increased revenues, will make the municipality's near-term return to fiscal health "feasible" and, as far in the future as can be reasonably projected, will allow the municipality to fulfill its responsibilities to its citizenry without requiring further judicial intervention.

E. To Be Confirmed, the Municipality Must Prove that Creditors Will Receive More Under the Proposed Plan than What They Would Receive if the Plan Were Denied and the Bankruptcy Dismissed: Known as the "best interests" test, every Chapter 9 plan proponent must prove to the bankruptcy court that all creditors will receive

more under the plan than the amount which they would likely receive were the case dismissed and creditors left to fend for themselves. Evidence to prove this requirement is apt to be developed almost naturally from the Chapter 9 negotiation process itself. It will be the extraordinarily rare Chapter 9 case where a municipality is unable to prove that its creditors will obtain greater recoveries through the plan than if the case were to be dismissed. Simply observed, in a setting where a municipality, upon dismissal of its Chapter 9 case, would find itself in a "free fall" crisis, with no means of establishing its financial stability, it is hard to conceive how creditors could argue that such an environment would likely allow them to obtain superior recoveries to those offered by the plan.

"… there is little likelihood that a court would not approve a consensual plan that was accomplished by the debtor's utilization of the bankruptcy process to hammer out the needed compromises."

F. A Feasible Plan Will Be Confirmed if All Creditor Classes Vote in Favor of It; Creditor Class Acceptance of a Plan By the Vote of Less than All Its Members: There is certainly nothing controversial about the proposition that a court will almost invariably confirm a workable plan if all creditor groups whose rights are to be impaired vote to approve it. While creditor acceptance may have been unattainable absent the pressure created by the Chapter 9 filing, *there is little likelihood that a court would not approve a consensual plan that was accomplished by the debtor's utilization of the bankruptcy process to hammer out the needed compromises.*

But, as will more likely be the case, the inability to obtain nearly unanimous support for the terms of a feasible plan from each of the municipality's creditor classes will frequently necessitate resort to Chapter 9. *Chapter 9 facilitates acceptance of a plan by the municipality's various creditor classes by permitting the approving vote of materially less than all the creditors of a particular class to be sufficient to bind all members of that class of creditors.* Sometimes the mere number and dollar value of dissenting members in a creditor class makes the cost of paying their hold-out demands in an amount sufficient to achieve an out-of-court resolution too high; in yet other situations, absent bankruptcy rules that allow majority voting to bind a class, a contractual requirement that the debtor obtain

the consent of all or a very substantial super-majority of constituent creditors in a class to bind all the class members to a treatment of their claims, renders achieving class consent too unwieldy or untenable. Such is frequently the situation encountered with bondholder claims where contractual provisions specify that modification of the bondholders' rights in any material fashion require unanimity or super-majority approval.

Approval by a creditor class in Chapter 9, however, is satisfied if both greater than 50% of the number of creditors in the class (that have voted) so vote, and also that greater than two-thirds of the aggregate dollar amount of claims voting have so voted. In sum, by availing itself of this provision of the Bankruptcy Code, a municipality may be able to obtain support of its plan by all its creditor classes, even though a minority number of creditors in one or more classes oppose it in a setting where, absent using the power of a bankruptcy court to bind dissenting votes, those dissenters could have frustrated the achievement of a broadly-supported plan.

G. The Plan Must Be Supported by at Least One Accepting Class of Creditors:

What if one or more classes vote in required majorities against a plan? Can it nonetheless be confirmed over the objection creditor class objections? The answer is "yes," provided the debtor satisfies two important conditions.

First, Congress has mandated that for a plan to be confirmed, *at least one class of creditors whose contractual rights have been modified by the plan must accept the plan.* Considerable law has developed regarding whether a grouping of creditors into a particular class is appropriate, and most of the controversy has surrounded challenges to whether a class created by the debtor that later votes to accept the plan was appropriately grouped together or was artificially constructed so the debtor could achieve compliance with the "at least one assenting class" requirement. Here is not the place to explore the nuances of classification; it is sufficient to observe as a generality that a grouping of creditors in a distinct class will survive challenge if there is a legitimate rationale for separately grouping its constituents apart from other creditors, even though the other creditors are of equal rank in terms of their distribution rights.

> *"... at least one class of creditors whose contractual rights have been modified by the plan must accept the plan."*

H. "Cram Down": Approval and Confirmation of a Plan of Adjustment over the Objection of Creditor Classes: Secondly, even if a municipality gains the support of at least one assenting class of creditors, more is required to confirm a plan over the objection of one or more creditor classes than voting on it. *It is the power of a court to confirm a Chapter 9 plan, even though it was objected to by one or more creditor classes, that provides the vehicle by which a municipality can hope to lever a consensual agreement among its creditors, either achieving it without ever resorting to Chapter 9 or, if a filing becomes necessary, then resulting from the Chapter 9 process itself.* This power, universally known as *"cram down,"* provides a very real incentive for creditors to consensually agree to a proposed treatment of their claims, rather than face the risk that worse terms could be imposed on them were a court to approve a cram down plan containing less favorable recoveries.

"It is the power of a court to confirm a Chapter 9 plan, even though it was objected to by one or more creditor classes, that provides the vehicle by which a municipality can hope to lever a consensual agreement among its creditors, either achieving it without ever resorting to Chapter 9 or, if a filing becomes necessary, then resulting from the Chapter 9 process itself."

I. The Two Conditions that a Municipality Must Satisfy to "Cram Down" a Plan over Dissenting Classes: Provided that at least one class of impaired creditors approves the plan and the plan comports with all the requirements for confirmation including, but not limited to, satisfying the "feasibility" and "best interests" tests discussed above, a court is permitted to override creditor class opposition to the plan proposed by a municipality *even if numerous groups of creditors oppose it* (i.e., utilize its "cram down" powers) if the plan: (i) is found to be *"fair and equitable"* and (ii) to *"not discriminate unfairly"* with respect to any class of creditors that the plan proposes to impair. Satisfaction of these two additional "cram down" requirements is often hotly disputed by opposing creditor classes.

J. Dissenting Members of a Class Cannot Be Heard to Challenge the Municipality's Compliance with the Cram Down Requirements: Importantly, however, and as a threshold matter, if a class of creditors votes to approve the plan (with the required statutory majorities for class approval discussed above), none of its class members can be heard to challenge the plan as not being fair and equitable or unfairly discriminatory. In essence, the approving vote of the class quiets the voice of any of its dissenting members to challenge the municipality's satisfaction of the cram down requirements. The ability to win over a class and preclude cram down objections by class members who opposed the plan is often a very effective tool for the debtor and removes the likelihood that dissident voices of a few can frustrate the will of the majority.

"… if a municipality can satisfy the "fair and equitable" requirement, it can actually compromise certain of its contractual obligations and otherwise materially modify the repayment of its debts over time."

K. Satisfying the "Fair and Equitable" Requirement Generally? No principle is more critical to the viability of a Chapter 9 restructuring plan that is opposed by one or more creditor classes than whether the provisions of the plan can satisfy the requirement that they be "fair and equitable." This "fair and equitable" rubric is also central to the confirmability of Chapter 11 cases, and relevant teachings about how the "fair and equitable" standard can be satisfied in a Chapter 9 setting can be derived from the extensive body of Chapter 11 decisions. That said, certain aspects of the "fair and equitable" analysis in the context of a Chapter 9 case will necessarily be different than those applicable in a Chapter 11 setting; and why that is so is explored more fully below.

As a preliminary matter, a municipality should start with the assumption that complying with the "fair and equitable" requirement will likely be the most challenging aspect of a Chapter 9 case. That said, however, *if a municipality can satisfy the "fair and equitable" requirement, it can actually compromise certain of its contractual obligations and otherwise materially modify the repayment of its debts over time.* In that sense, aside from a consensual agreement among constituencies, there is no method under our system of laws

that can achieve the lasting and significantly beneficial results that a confirmed Chapter 9 plan of adjustment can provide to a financially-challenged municipality.

L. Application of the "Fair and Equitable" Principle in the Municipal Bankruptcy Context: "Fair and equitable" in its most basic form, and when applied to "for profit" enterprises, means that a plan must comport with the *absolute priority rule* requirement that senior creditors recover in full before junior creditors receive any distribution. As relates to the priority treatment of senior creditors to junior ones, Chapter 9 is essentially no different than Chapter 11. This means that creditors holding a security interest in certain municipal assets are entitled to be paid in full from the use or sale of the assets securing their claims, before other junior creditors are entitled to participate in the right to realize from the security to satisfy any of what they are owed. Hence, unless secured creditors are paid in full, unsecured creditors can only look to non-encumbered assets to pay their claims.

A related proposition is that unsecured creditors, by contract with one another, may agree that their claims are to be superior to others. Absent any such agreement, all unsecured creditors will be on the same footing, except for a few isolated types of creditors that the Bankruptcy Code has afforded priority status.

Recently, however, one state has adopted legislation that attempts to elevate the right of municipal general obligation bonds to a priority recovery status superior to that of all other unsecured creditors. Other states may follow, hoping that if such legislation were to be enforceable it would protect the state and other local governments who are not themselves facing financial difficulties from being exposed to the risk that their credit ratings might be adversely affected merely because a municipality in the state sought to propose a plan that would not repay its general obligation bondholders in full. It is much too early to assess whether such state statutes that attempt to insulate general obligation bondholders from debt reduction plans will survive federal law challenges. It is currently unclear whether such laws will be struck down as either contrary to affording a beleaguered municipality a viable bankruptcy restructuring option, or on the basis that this statute attempts to unfairly adjust the rights of other already existing creditors who had entered into their agreements before the bond priority statue was enacted.

A further fair and equitable concept applicable to Chapter 11, but not found in the Chapter 9 setting, is that unsecured creditors must be paid in full under the terms of the plan if the plan also proposes any distributions to any pre-filing equity holders. Since municipalities by their nature do not have equity interests holders, does that render superfluous the "fair and equitable" principle insofar as protecting unsecured creditors, or may the "fair and equitable" requirement place limits the circumstances in which a court is permitted to approve debt modifications that reduce the contractual claims of unsecured creditors?

As might be reasonably expected, "fair and equitable" ought to mean something different in a municipality setting where equity holders do not exist. The limited body of case law suggests that *a municipality's compliance with the "fair and equitable" principle will require that it demonstrate that its plan is balanced, and that the municipality has done all that it reasonably could to increase revenues and cut costs before resorting to a plan containing proposed debt reductions and other contractual modifications as a means of solving its financial difficulties.* This reasoning is also why, even where troubled for-profit companies are restructuring but paying nothing under their plan to prior equity holders, a creditor may nonetheless challenge a plan as lacking "fairness or equity" if the plan does not maximize the amount of debt that can reasonably be paid to unsecured creditors.

"… a municipality's compliance with the "fair and equitable" principle will require that it demonstrate that its plan is balanced, and that the municipality has done all that it reasonably could to increase revenues and cut costs before resorting to a plan containing proposed debt reductions and other contractual modifications as a means of solving its financial difficulties."

M. How Can a Municipality Prove to a Court that Its Plan Satisfies the "Fair and Equitable" Requirement? So what must a municipality prove in order to persuade a bankruptcy court that its plan is fair and equitable to the various classes of unsecured creditors sufficiently so that it should be approved even when doing so might be over

material creditor opposition? Unquestionably, throughout its Chapter 9 case, the debtor will have been expected to have taken all steps reasonably available to it to find ways to better maximize both the generation of revenues and the conservation of its resources. Guided by counsel, experienced turnaround professionals, and often financial advisors, a municipality will need its staff and senior officials to explore all means available, on the one hand, to look for new or increased sources of additional revenue and, on the other hand, implement measures to reduce the near-term and future operating costs of the municipality. Indeed, much of this undertaking will likely have occurred even before the municipality found it necessary to seek Chapter 9 protection.

> *"[For its plan to be confirmed]… what the court will need to be persuaded is that the municipality has made a well-conceived and balanced effort to achieve a resolution, and that its adjustment plan imposes on creditors no more than is realistically necessary to make it feasible from its inception and into the future."*

Among the action items that a municipality would likely need to pursue include: (i) a comprehensive review of its existing contracts to look for inefficiencies and savings; (ii) the possible need to terminate certain contracts that are burdensome; (iii) whether and to what extent modifications to its collective bargaining agreements should be negotiated; (iv) payroll cost savings through possible reductions in force, reduced compensation, the modification of retiree benefits, or some combination of these containments; (v) the sale or lease of specified municipal assets; (vi) outsourcing or privatizing certain of the municipality's previously provided functions; (vii) the consolidation of services with other nearby municipalities; and (viii) the securing of grants or other financial support from either or both federal and state programs.

In the final analysis, a court will be motivated to approve a plan of adjustment if it believes that the municipality has made a very serious and persistent effort to achieve a consensus among the principal constituencies of creditors. In a setting where, despite best efforts, a consensual plan cannot be forged among the creditor constituencies, every

disgruntled class of creditors will have their own self-serving opinion about why its treatment under the municipality's plan is unfair; that is to be anticipated, and the court can be expected to take a tempered view of those protestations. *But, what the court will need to be persuaded is that the municipality has made a well-conceived and balanced effort to achieve a resolution, and that its adjustment plan imposes on creditors no more than is realistically necessary to make it feasible from its inception and into the future.*

Shaping the process to best assure that the court sees the municipality in a favorable light when the time comes for plan approval considerations is the "art of the deal" and why a municipality should retain professionals to assist them in the process from the outset. This advance planning will clearly affect the court's views about whether the municipality and its officials have acted in a prudent and responsible manner, even perhaps more so than the arguments advanced in the context of specific litigation over whether to approve the plan.

N. Need a Municipality Propose New or Additional Taxes as an Element of Its Plan in Order to Satisfy the "Fair and Equitable" Requirement? One consideration impacting the confirmability of the plan not addressed above, but which merits separate discussion, is whether increased or new taxes need to be part of the municipality's methods for achieving a fair and equitable resolution justifying confirmation of its adjustment plan. Initially, it should be observed that not all municipalities have the power to tax. Even political subdivisions that have that power may be constitutionally or statutorily limited from imposing new forms of tax or from raising the rate of taxation. For example, in regard to real property taxes, many states cap the millage rate. In yet other states, the ability to impose a higher millage rate must be approved by a vote of the affected citizenry.

But the ultimate "fair and equitable" question remaining for those municipalities that have the legal right to raise revenues from new or additional taxation, whether or not doing so might require voter approval, is: must a court require a municipality to raise taxes if it has the legal right to impose them, or may a court approve an adjustment plan that does not contemplate doing so? This question is not sufficiently resolved by the courts such that a definitive and absolute answer can be provided. However, while judicial guidance is limited, it seems that certain rational observations about imposing the requirement that a municipality "tax its way out" of its financial difficulties leads to

principles that make sense out of Chapter 9 and fulfill the intent of Congress to afford a viable remedy to financially-troubled local governments.

Consider the following: Some might argue that bankruptcy courts ought not compel municipalities to increase taxes as a required step to remedy their financial distress before acceding to confirm a plan that proposes to pay creditor claims less than in full. But even those who so advocate would likely agree that situations might exist where imposing additional taxes would not be entirely unwarranted or unjustified. Stated differently, Chapter 9 might arise where the municipality should be expected to shoulder part of the financial shortfalls by raising taxes while, in other settings, expecting the municipality to do so would entirely frustrate the very reason for it seeking bankruptcy protection in the first place, essentially rendering Chapter 9 an illusory tool. There may in fact be times when raising taxes, making the city noncompetitive, will adversely affect its long-term revenues; thus the future of the municipality, including its economic development plan, should also be considered.

What this all suggests, of course, is that whether and, if so, to what extent a bankruptcy court ought to require a municipality to impose new or incremental taxes, where doing so would not be prohibited by state law, should be determined on a case-by-case basis; and as the law develops in this area, it is anticipated that courts will adopt a flexible approach, neither automatically precluding nor, on the other hand, requiring new taxes as part of the solution to a municipality's financial distress.

O. How Should a Municipality Determine Whether Additional Taxes Should Be a Component of Its Adjustment Plan? What then should a Chapter 9 municipality be expected to do when facing the question of whether its proposed plan of adjustment should contain a taxation increase component where doing so is not precluded by state law? One approach, perhaps, would be for the municipality to simply propose its plan without a tax increase component and see if that will be accepted by the court over creditor objections. That approach assumes that if the municipality's "no new taxes" plan, which it seeks to confirm over creditor class objections, is rejected by the bankruptcy court, it will have a "second bite at the apple" before the court would consider dismissal of the case. A more prudent approach to addressing the tax increase issue might be to first have a comprehensive market study conducted. The study could, for example, assess the local

economic climate, the tax rates of neighboring municipalities, the job market and current level of employment in the locale, prospects for growing the local population and for attracting new businesses, and the current level of real estate property values in the community relative to historic levels. Then, from this combined data, the municipality could justifiably determine whether, given all the competing considerations, any tax increase, after exploring both the type of tax (e.g., property, sales, or point of earnings taxes) as well as the extent of the new or increased amounts, makes sense as a rational and long-term approach to fixing the municipality's financial difficulties.

If the municipality can realistically conclude that increasing taxes is more likely to exacerbate its financial strains and be counter-productive to the goals that prompted the need in the first place to seek approval of a Chapter 9 plan of adjustment then, with that analysis in hand, it will best positioned to fend off creditor challenges to its plan from the outset. By being proactive in first assessing the set of issues prompted by the consideration of new or increased taxes and then reporting its conclusions to the court and creditor constituencies, the municipality can materially reduce the prospect that the bankruptcy court will draw a negative perception about the willingness of the municipality to explore all options; and the debate will turn instead to a more productive and less incendiary one about the conclusions the municipality reached. This approach will likely engender a fair outcome for all parties arising from a good faith consideration of all relevant factors in a setting where the decision about whether and to what extent any new or increased taxes should be imposed will be tested against the court's desire to confirm a plan that provides the municipality with a feasible plan that works in the long term.

P. The "Not Discriminate Unfairly" Requirement Generally: In addition to satisfying the "fair and equitable" test to obtain court approval to "cram down" a plan over creditor class objections, as between or among the various impaired classes of creditors that have voted to oppose the plan. The Bankruptcy Code contains no language defining what distinctions in treatment would be deemed "unfair." There is no question that creditor groups can be provided with distinct forms of distributions from the debtor that vary from what another creditor group might receive, provided that the value of what is being offered to each group is approximately the same for creditor groups of equal rank. Thus, for example, a group of unsecured GO bondholders might be paid over time with

notes at a stated interest rate, while vendors might be paid over a considerably shorter period. If both creditor classes are found to be of equal rank, which likely would be the case, then the fact that each class is to be paid differently is not objectionable provided the present value of the payments to each class as a percentage of their entire claims is found to be approximately equal.

But if a debtor were to propose to treat one class more favorably in percentage recovery terms than another class, would that be "unfair" discrimination? Stated differently, not all discriminations between classes are inherently precluded; only those that are "unfair" cannot be permitted. When, then, can a discriminatory treatment be justified and confirmable over creditor class objections, and when is the disparate treatment too "unfair" to be permitted?

Q. What Types of Discriminatory Treatment Among Classes Would Be Deemed to Be "Unfair"? Recognizing that not every discriminatory treatment will be seen as necessarily "unfair," courts seem to have adopted several guiding principles in determining whether a particular discrimination will be tolerated. In addition to finding that the plan cannot be consummated without the proposed discriminatory treatment, and that the degree of discrimination in the plan is directly proportional to the rationale, a court should only approve the disparate treatment if there is a business or economic justification for separate classification and treatment of groups of unsecured creditors. While different treatment may be permitted where a group of creditors agrees to provide some benefit to the debtor commensurate with the improved treatment that the class of creditors is to receive under the plan, it is less clear whether an improved treatment of one creditor class over another of equal rank can be approved where not permitting the difference in treatment might hamper the reorganization. It is in this respect that an open issue exists as to whether a municipality can provide relatively better treatment, for example, to employees under a rejected collective bargaining agreement in respect to their rejection claims or to retiree pension claimants than to holders of general obligation bonds based on the argument that not doing so would significantly hamper the local community's ability to be economically viable insuring the municipality's long term financial integrity. If this concept were to have any realistic prospect of success, the municipality would need to develop sufficient financial analyses to support their assertions.

There is also a distinct legal concept, currently the subject of conflicting judicial views, that might justify different treatment among similarly ranked groups of creditors. Labeled the "gifting" principle, the notion is that if a creditor group, such as revenue bond holders, with superior contractual rights to the discriminatorily to be favored groups were willing to allow some of the economic benefits to which it is entitled to pass to a junior ranking group, that creditor-funded discrimination in treatment ought not be disallowed because the different treatment arises through a voluntary "gift" from the senior creditor rather than from the debtor affording preferential treatment to a class of creditors. This rationale for discriminatory treatment remains currently in flux and not definitively resolved by the courts.

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Concentrating in the representations of secured creditors, lenders, investors, and committees, Mark S. Kaufman has also represented debtors in significant Chapter 11 cases, including as lead counsel of one of the nation's most significant utility bankruptcies. Mr. Kaufman is Co-Chair of the Municipal Recovery & Restructuring Practice at McKenna, has served as President of the Bankruptcy Section of the Atlanta Bar Association, and is a Director and recently served as Chairman and President of the Southeastern Bankruptcy Law Institute in 2007 and 2008 respectively. He also chaired Georgia's Bankruptcy Bench and Bar Conference.

Mr. Kaufman has received several recognitions, including being named to the 2006 through the current 2011 Editions of *Best Lawyers in America*, where he is featured for bankruptcy and creditors' rights law. Mr. Kaufman has also been recognized as one of only 430 lawyers to have a biography in the 2011 Edition of the *International Who's Who of Insolvency and Restructuring Lawyers*. Chambers USA has included him (from 2003-current) in their *Client's Guide to America's Leading Lawyers for Business*, recognizing Mr. Kaufman's achievements in its bankruptcy and creditors' rights section. Mr. Kaufman is also listed in the 2011 Edition of *Who's Who in America* and the 2011 Edition of *Who's Who in the World*. Mr. Kaufman earned his Juris Doctorate, *cum laude*, from Harvard Law School and a Bachelor of Science with high distinction from Cornell University.

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