

Federal Judicial Center

Chapter 9 Roundtable

September 29, 2016

Chapter 9 vs. Chapter 11

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Commencement of the Case

Chapter 9

- Municipalities cannot be put into chapter 9 involuntarily.
 - Only a municipality can initiate a chapter 9 case. Section 303 of the Bankruptcy Code,¹ which provides for the commencement of involuntary cases, is not applicable in chapter 9.
 - A chapter 9 case cannot be converted to one under another chapter.
- Chapter 9 debtors are not required to file schedules or statement of financial affairs.
 - Pursuant to section 924, a chapter 9 debtor is required to file a list of creditors.
 - Under section 925, any claim listed on the list of creditors is a proof of claim deemed filed under section 501, unless listed as contingent, disputed or unliquidated.
 - No reporting requirements.

Chapter 11

- Involuntary cases permitted.
 - A chapter 11 case can be converted to one under chapter 7.
- Debtor required to file schedules and statement of affairs
 - Under section 1111(a), no proof of claim required unless debt is listed in schedules as contingent, disputed or unliquidated.
 - Debtor must submit quarterly statements of disbursements and make other disclosures. (Rule 2015).

¹ All references to sections of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.*, are shown as § ____ or Section ____.

Commencement of the Case (cont.)

Chapter 9

- Publication of the notice of commencement of the case.
 - Section 923 requires publication of a Notice of Commencement for three consecutive weeks in a local newspaper and in a newspaper having general circulation among bond dealers and bond holders.
 - The notice must provide a date by which objections to eligibility must be filed.
- Bankruptcy judge is assigned by the Chief Judge of the Circuit rather than by the clerk of the bankruptcy court. § 921(b).

Chapter 11

- ✘ Not required.
- Judge selected at random.

Eligibility Requirements

Chapter 9

- Must be a municipality (political subdivision or public agency or instrumentality of a State). § 109(c)(1).
- Legislative Authority.
 - Municipality must be specifically authorized under state law to be a chapter 9 debtor. § 109(c)(2).
 - Approximately half of the states have legislation providing some form of authorization. California Government Code § 53760 *et seq.*
 - Certain of these statutes contain limitations as to the type of entity that may file, and some require further approval from the state or a state official prior to any filing.

Chapter 11

- Sole eligibility requirement relates to nature of the debtor (such as railroads and persons eligible to be chapter 7 debtors). § 109(d).

Eligibility Requirements (cont.)

Chapter 9

- Insolvency.
 - Debtor bears the burden of proving that it is insolvent as of the petition date. § 109(c)(3).
 - A municipality is insolvent if it is (i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute, or (ii) unable to pay its debts as they become due. § 101(32)(C).
 - The “generally not paying its debts as they become due” test requires a factual analysis of what payments have been missed and their relation to the municipality’s overall financial position.
 - In determining whether the municipality is unable to pay its debts as they become due, courts look at the cash flow of the municipality rather than using a balance sheet test.
 - The court will look to the municipality’s fiscal condition in the near future, as opposed to two or more years down the road.

Chapter 11

- ✘ No insolvency requirement.

Eligibility Requirements (cont.)

Chapter 9

- Must desire to effect a plan to adjust its debts. § 109(c)(4).
- Good faith requirements.
 - A municipality must show that it either:
 - Has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that the municipality intends to impair under a plan,
 - Has negotiated in good faith with creditors but failed to reach an agreement,
 - Is unable to negotiate with creditors because negotiations are impracticable, or
 - Reasonably believes that a creditor may attempt to obtain an avoidable preference. § 109(c)(5).
 - A bankruptcy judge also may dismiss a chapter 9 petition if the debtor did not file the petition in good faith. § 921(c).
- In the event of an appeal from the entry of an order for relief, the bankruptcy court may not delay any proceeding in the chapter 9 case, nor may any court issue a stay. § 921(e).

Chapter 11

- ✘ No statutory good-faith filing requirement.
- ✘ No chapter 11 equivalent.

Limitations on the Power of the Court

Chapter 9

- Because of limitations imposed by the Tenth Amendment to the U.S. Constitution on Congress' power over the states, the Bankruptcy Code provisions with respect to municipality debtors place significant restraints on the powers of a federal bankruptcy court to interfere with the operations of a municipality.
- State maintains its powers to control municipalities, subject to specific Bankruptcy Code provisions (such as the power to reject contracts). § 903.
- Absent consent by the debtor, the court may not interfere with (i) any of the political or governmental powers of the debtor, (ii) any of the property or revenues of the debtor, (iii) the debtor's use or enjoyment of any income-producing property. § 904.
 - A chapter 9 debtor does not need court approval to use, sell or lease property, including cash collateral (section 363 is not incorporated into chapter 9).
 - The debtor maintains complete control of most of its financial affairs and operations (in bankruptcy, a municipality will still need freedom to operate and provide services to citizens).
- Court cannot appoint an examiner or a trustee (except relating to the recovery of avoidable transfers [§ 926(a)], and that may not be constitutional).

Chapter 11

- ✘ Chapter 11 debtors subject to § 363.
- ✘ Trustee or examiner may be appointed.

Limited Role of U.S. Trustee (and Bankruptcy Administrator in Alabama and North Carolina)

Chapter 9

- The U.S. Trustee has no general supervisory authority in a chapter 9 case (reason being that it would be an improper interference with the political and financial affairs of the municipality debtor).
 - Does not examine the debtor at a meeting of creditors -- there is no meeting of creditors.
 - Does not have the authority to move for appointment of a trustee or examiner or for conversion of the case.
 - Does not monitor the financial operations of the debtor or review the fees of professionals retained in the case.
- The U.S. Trustee's most important role in chapter 9 cases is to appoint a creditors committee or other committee(s).

Chapter 11

- The U.S. Trustee plays an active role in overseeing the bankruptcy case.
- Conducts first meeting of creditors.
- Appoints members of official committees.
- May move for appointment of a trustee or examiner.
- May move to convert the case.
- Monitors financial operations and fee requests from estate professionals.

Case Administration

Chapter 9

- Chapter 9 does not create an estate.
 - Section 541 is not incorporated into chapter 9.
 - Section 902(1) defines “property of the estate” to mean “property of the debtor.”
- Retention of Professionals.
 - Sections 327 through 331 of the Bankruptcy Code are not applicable in a chapter 9 case. Therefore, the debtor does not need court approval to retain professionals, and any professionals retained by the debtor need not satisfy the requirements that they be disinterested or not hold or represent an interest adverse to the estate.
 - The debtor does not need court authorization to pay professionals during the course of the bankruptcy case. The only provision of chapter 9 governing the compensation of professionals provides as a confirmation requirement that all amounts to be paid by the debtor or by any person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable. § 943(b)(3).

Chapter 11

- Commencement of the case creates an estate.
- Sections 327 through 331 apply.

Case Administration (cont.)

Chapter 9

- Automatic stay.
 - The Bankruptcy Code automatic stay provisions apply in chapter 9.
 - Section 922(a) adds automatic stay provisions that prohibit actions against officers and inhabitants of the debtor if the action seeks to enforce a claim against the debtor.
 - Prohibits a creditor from bringing a mandamus action against an officer of a municipality on account of a prepetition debt.
 - Prohibits a creditor from bringing an action against an inhabitant of the debtor to enforce a lien on or arising out of taxes or assessments owed to the debtor.
 - Section 922(d) limits the applicability of the stay.
 - Chapter 9 petition does not operate to stay application of pledged special revenues to payment of indebtedness secured by such revenues.
 - An indenture trustee or other paying agent may apply pledged funds to payments coming due or distribute the pledged funds to bondholders without violating the automatic stay.

Chapter 11

- Automatic stay applies only to the debtor and its property.

Case Administration (cont.)

Chapter 9

- Committees.
 - Creditors committee has powers and duties similar to those of a committee in a chapter 11 case.
 - Cannot be appointed until after the entry of the order for relief, which may take months in a chapter 9 case in which eligibility is challenged.
 - Debtor cannot be ordered to pay the professionals employed by a committee, but generally, an agreement is reached.
- Right to be heard more expansive in chapter 9.
 - Section 1109 applies
 - Bankr. Rule 2018(c) provides that:
 - The Secretary of the Treasury of the United States may, or if requested by the court shall, intervene in a chapter 9 case.
 - Representatives of the state in which the debtor is located may intervene in a chapter 9 case with respect to matters specified by the court.

Chapter 11

- Order for relief occurs on the petition date in a voluntary chapter 11.
- Committee's retained professionals paid *pari passu* with debtors' professionals.

Case Administration (cont.)

Chapter 9

- Dismissal.
 - Court may dismiss a chapter 9 petition if it concludes the debtor did not file the petition in good faith or if the petition does not meet the requirements of chapter 9.
 - Court also may dismiss the petition for cause, including:
 - Lack of prosecution
 - Unreasonable delay by the debtor that is prejudicial to creditors
 - Failure to propose or confirm a plan within the time fixed by the court
 - Material default by the debtor under a confirmed plan or
 - Termination of a confirmed plan by reason of the occurrence of a condition specified in the plan. § 930.

Chapter 11

- Court may convert to chapter 7 or dismiss as specified in § 1112.

Avoidable Transfers

Chapter 9

- Bankruptcy Code avoidance powers are applicable.
- In chapter 9 cases, however, a transfer of property by a municipality to or for the benefit of a bondholder on account of such bond may not be avoided as a preference. § 926(b).

Chapter 11

- Bankruptcy Code avoidance powers are applicable.

Assumption or Rejection of Executory Contracts and Unexpired Leases

Chapter 9

- Section 365 applies in chapter 9 cases
- Collective bargaining agreements
 - Section 1113 does not apply in chapter 9 cases.
 - A municipality debtor thus enjoys greater latitude than a chapter 11 debtor with respect to modification or rejection of labor agreements.
 - The bankruptcy court should permit rejection if the debtor demonstrates that the CBA burdens the debtor, that, after careful scrutiny, the equities balance in favor of rejection, and that the prospects of reaching a deal in the near future are not good.
- Section 1114 does not apply in chapter 9 cases.

Chapter 11

- A chapter 11 debtor cannot unilaterally abrogate a CBA.
 - Section 1113 requires a chapter 11 debtor to negotiate proposed modifications of a collective bargaining agreement with the authorized representative of the employees covered by such agreement.
 - During this process, many steps are required of the debtor and court approval is necessary for debtor rejection or modification of a collective bargaining agreement.
- Section 1114 enumerates the stringent ground rules for treatment of retiree benefits.

Special Revenues

Chapter 9

- Obligations secured by a lien on special revenues retain such lien post-petition in chapter 9. However, the security interest is subject to the necessary operating expenses of the project involved. § 928(b).
- The holder of a claim payable solely from special revenues does not have recourse against the debtor. § 927. This prevents the conversion of revenue bonds into general obligation bonds.

Chapter 11

- A creditor with a nonrecourse claim may, under certain circumstances, be treated as having recourse against the debtor. § 1111(b).

Plan of Adjustment

Chapter 9

- Only the debtor may file a plan for adjustment of debts -- creditors may not propose and file competing plans.
- The Bankruptcy Code does not fix a specific deadline by which the debtor must file a plan. If a plan is not filed with the petition, the debtor shall file such plan at such later time as the court fixes. § 941.

Chapter 11

- Creditors may file a plan after termination of exclusivity.
- A trustee may file a plan because such appointment terminates exclusivity.

Plan of Adjustment (cont.)

- Plan content and confirmation requirements in chapter 9 cases are similar to those applicable in chapter 11 cases.
 - At least one class of impaired claims must vote to accept the plan.
 - A class accepts a plan if the plan is accepted by holders of at least two-thirds in amount and a majority in number of claims within that class actually voting.
 - Each class of claims that is impaired under the plan must accept it. However, if all requirements for confirmation are satisfied except that acceptance has not been received by all impaired classes, the court nevertheless shall confirm the plan if it does not discriminate unfairly and is fair and equitable with respect to each impaired class that has not accepted the plan – cramdown.
 - The debtor must have obtained any regulatory or electoral approval necessary under applicable nonbankruptcy law to carry out any provision of the plan of adjustment. § 943(b)(6).
 - The plan of adjustment must be “in the best interests of creditors and [be] feasible.” § 943(b)(7). Note that the language differs from § § 1129(a)(7)(A) and (11).

Discharge

Chapter 9

- A municipality debtor receives a discharge of all debts as of the time when: (1) the plan is confirmed; (2) the debtor deposits any consideration to be distributed under the plan with the disbursing agent appointed by the court; and (3) the court determines that securities deposited with the disbursing agent will constitute valid legal obligations of the debtor and that any provision made to pay or secure payment of such obligations is valid. § 944(b).
- A municipality debtor is not discharged from any debt (i) excepted from discharge by the plan or the order confirming the plan, or (ii) owed to an entity that, before confirmation of the plan, had neither notice nor actual knowledge of the case. § 944(c).

Chapter 11

- Confirmation of a plan discharges a debtor from most debts that arose before the date of confirmation. § 1141(d). After confirmation, the debtor is required to make plan payments and is bound by the provisions of the plan.

Discharge of Third Parties

Chapter 9

- § 524(e) not incorporated into chapter 9 by § 901(a).

Chapter 11

- § 524(e) - Discharge of debtor does not affect debts or liabilities of third parties.