**Title:** Bankruptcy Tales (Part 1 of 2)

**Subtitle:**

**Meta Description:** Bankruptcy Tales (Part 1 of 2)

**Date:** 0-1-2012

**Author:** Joel R. Glucksman

**Formatted Content:**

Today’s Story -- Municipal Bankruptcy

Insolvents contemplating bankruptcy can have an exaggerated idea of the benefits to be gained. More to the point, they often fail to appreciate the down side. Municipalities are no different. In this connection, while we may never know exactly what the City Fathers of Vallejo, California discussed before deciding to file bankruptcy, we do know what occurred after Vallejo successfully emerged from bankruptcy court – and the view is not pretty.

First, a word about Chapter 9 of the United States Bankruptcy Code. This is the part of the Code which is applicable to public entities. It is restricted solely to a “municipality,” and this is defined as a “political subdivision or public agency or instrumentality of a State."

Entry into Chapter 9 is restricted, because it is not just an exclusive club but also one that provides far greater powers than are granted to non-municipality debtors. First of all, municipalities may not be involuntarily placed into bankruptcy. By contrast, three or more creditors may place a non-municipal debtor into bankruptcy against its will, as long as the proposed debtor is generally not paying its debts as they become due. Moreover, the powers of the bankruptcy court are limited in a Chapter 9 case. For example, §904 of the Bankruptcy Code states explicitly that the bankruptcy court may not interfere with the political or governmental powers of the municipal debtor, nor with any of its property or revenues, nor with the municipal debtor’s use or enjoyment of any income–producing property. Similar provisions do not exist for non-municipal debtors.

There are other distinctions. Non-municipal debtors who give the court sufficient cause may wind up with a bankruptcy trustee appointed by the court to take over their operations and manage their affairs, for the benefit of their creditors. Municipal debtors are not subject to such a remedy. Moreover, municipal debtors need not seek bankruptcy court approval to retain or pay professionals, whereas the fees of non-municipal debtors’ professionals (such as their lawyers) are subject to the bankruptcy court’s jurisdiction.

Of greater importance, a municipal debtor is not subject to the extensive and complicated requirements that a non-municipal debtor must fulfill in order to dissolve a union’s collective bargaining agreement. Municipal debtors may dissolve such agreements merely if they establish that: (i) the agreement burdens the municipal debtor, (ii) the equities balance in favor of allowing dissolution, and (iii) there are not prospects for the municipality and its union to reach a deal in the near future. Finally, and of equal significance, is the fact that only a municipal debtor may propose a plan for the adjustment of its debts. In a non-municipal bankruptcy, once the initial period of exclusivity terminates, any creditor or party in interest may propose a plan of reorganization.

In my next blog post, I'll discuss what happened to Vallejo after its bankruptcy case terminated.

**Raw Content:** <p style="text-align: center;" align="CENTER"><span style="text-decoration: underline;"><strong>Today’s Story -- Municipal Bankruptcy</strong></span></p>
<h3 style="text-align: left;" align="CENTER">Part 1</h3>
&nbsp;
<p style="text-align: left;" align="CENTER"><span style="text-align: left;">Insolvents contemplating bankruptcy can have an exaggerated idea of the benefits to be gained. More to the point, they often fail to appreciate the down side. Municipalities are no different. In this connection, while we may never know exactly what the City Fathers of <a href="http://www.ci.vallejo.ca.us/GovSite/">Vallejo, California</a> discussed before deciding to file bankruptcy, we do know what occurred <span style="text-decoration: underline;">after</span> Vallejo successfully emerged from bankruptcy court – and the view is not pretty.</span></p>
<p style="text-align: left;" align="CENTER">First, a word about <a href="http://en.wikipedia.org/wiki/Chapter\_9,\_Title\_11,\_United\_States\_Code">Chapter 9</a> of the United States Bankruptcy Code. This is the part of the Code which is applicable to public entities. It is restricted solely to a “municipality,” and this is defined as a “political subdivision or public agency or instrumentality of a State."</p>
<p style="text-align: left;" align="CENTER">Entry into Chapter 9 is restricted, because it is not just an exclusive club but also one that provides far greater powers than are granted to non-municipality debtors. First of all, municipalities may not be involuntarily placed into bankruptcy. By contrast, three or more creditors may place a non-municipal debtor into bankruptcy against its will, as long as the proposed debtor is generally not paying its debts as they become due. Moreover, the powers of the bankruptcy court are limited in a Chapter 9 case. For example, §904 of the Bankruptcy Code states explicitly that the bankruptcy court may not interfere with the political or governmental powers of the municipal debtor, nor with any of its property or revenues, nor with the municipal debtor’s use or enjoyment of any income–producing property. Similar provisions do <span style="text-decoration: underline;">not</span> exist for non-municipal debtors.</p>
<p style="text-align: left;" align="CENTER">There are other distinctions. Non-municipal debtors who give the court sufficient cause may wind up with a bankruptcy trustee appointed by the court to take over their operations and manage their affairs, for the benefit of their creditors. Municipal debtors are not subject to such a remedy. Moreover, municipal debtors need not seek bankruptcy court approval to retain or pay professionals, whereas the fees of non-municipal debtors’ professionals (such as their lawyers) are subject to the bankruptcy court’s jurisdiction.</p>
<p align="JUSTIFY">Of greater importance, a municipal debtor is not subject to the extensive and complicated requirements that a non-municipal debtor must fulfill in order to dissolve a union’s collective bargaining agreement. Municipal debtors may dissolve such agreements merely if they establish that: (i) the agreement burdens the municipal debtor, (ii) the equities balance in favor of allowing dissolution, and (iii) there are not prospects for the municipality and its union to reach a deal in the near future. Finally, and of equal significance, is the fact that only a municipal debtor may propose a plan for the adjustment of its debts. In a non-municipal bankruptcy, once the initial period of exclusivity terminates, any creditor or party in interest may propose a plan of reorganization.</p>
<p align="JUSTIFY">In my next blog post, I'll discuss what happened to Vallejo <span style="text-decoration: underline;">after</span> its bankruptcy case terminated.</p>