Nos. 14-1208; 14-1209; 14-1211;
14-1212; 14-1213; 14-1214 & 14-1215

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re CITY OF DETROIT, MICHIGAN,

Debtor.

On Direct Appeal from the United States Bankruptcy Court for the Eastern District of Michigan, Bankruptcy Case No. 13-53846
(Hon. Steven W. Rhodes)

BRIEF OF *AMICUS CURIAE* CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM IN SUPPORT OF APPELLANTS URGING REVERSAL

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CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

CORPORATE DISCLOSURE STATEMENT

The California Public Employees' Retirement System ("CalPERS") is a governmental agency of the State of California, which performs the sovereign function of administering the State's public pension system. *See* Cal. Gov't Code § 20002 (CalPERS "is a unit of the Government Operations Agency"). Because CalPERS is a governmental party, it is not required to file a Corporate Disclosure Statement. *See* Fed. R. App. P. 26.1(a). In addition, given that CalPERS is an arm of the State of California, no Corporate Disclosure Statement is required under the Sixth Circuit Rules. *See* 6 Cir. R. 26.1.

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INTERESTS OF *AMICUS CURIAE*

The California Public Employees' Retirement System ("CalPERS") is the largest State-run pension system in the United States, and one of the largest sovereign pension funds in the world. It is an arm of the State of California. *See* Cal. Gov't Code § 20002. It currently administers the pensions for nearly 1.7 million current and former public employees, who are drawn from over 3000 California public employers.[1] It has been involved in at least five chapter 9 bankruptcies in California, and is currently involved in the second and third largest municipal bankruptcies in United States history--the cities of Stockton and San Bernardino.

The CalPERS system was created during the Depression, and serves two primary objectives: "to induce persons to enter and continue in public service, and to provide subsistence for disabled or retired employees and their dependents." *Wheeler v. Bd. of Admin. of PERS*, 25 Cal. 3d 600, 605 (1979). *See also* Beth Almeida, *DB Pensions: The Real Deal*, Journal of Pension Benefits (Aspen 2010) (explaining three major benefits of defined benefit plans, including retention and recruitment of talented employees).[2]

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[1] *See* Facts at a Glance, April 2014, https://www.calpers.ca.gov/eip-docs/about/facts/facts-at-a-glance.pdf (last visited April 30, 2014).

[2] http://www.nirsonline.org/index.php?option=content&task=view&id=415 (last visited Apr. 28, 2014).

The administration of public pension funds, especially when administered by an arm of the State like CalPERS, is a sovereign function in which "the Federal Government should not interfere." *Feinstein v. Lewis*, 477 F. Supp. 1256, 1261 (S.D.N.Y. 1979) (quoting ERISA's legislative history), *aff'd* 622 F.2d 573 (2d Cir. 1980). *See also Hightower v. Tex. Hosp. Ass'n*, 65 F.3d 443, 448 (5th Cir. 1995). CalPERS and its relationship with public employers and employees is governed by California statutes and the California Constitution. *See generally* Cal. Gov't Code § 20000 *et seq.* & Cal. Const. art. XVI, § 17. Once a city elects to participate in CalPERS, it is bound by all of the statutory provisions governing the system and the decisions of CalPERS' Board. *See* Cal. Gov't Code § 20506.

CalPERS provides retirement benefits to employees through a three-way structure: (1) the municipality has a "contract"[3] with CalPERS, triggering the application of statutes and other laws governing the provision of pension benefits through CalPERS; (2) the public servant has an employment contract with the municipality that includes pension benefits; and (3) CalPERS has a fiduciary responsibility to provide and protect the pension benefits of its employee members. CalPERS administers a prefunded, defined benefit program, whereby its members' employees are entitled to a pre-determined amount of benefits upon retirement. CalPERS' member employers determine compensation for their employees, and

[3] This "contract" is not of the same character as a commercial contract. *Jasper v. Davis*, 164 Cal. App. 2d 671, 675 (1958).

CalPERS' Board and actuarial staff in turn determine the contribution rates and ultimate benefits based on statutory formulas and actuarial calculations. Impairment of obligations to the CalPERS system by a municipality in bankruptcy could increase the financial burden on the other members of the system and may threaten the actuarial soundness of the system as a whole.

The decision below was the first of its kind, determining that a municipality can impair the rights of a public pension system in bankruptcy despite express State law prohibitions to the contrary. While significant differences exist between CalPERS and the pension systems at issue on appeal, the decision below raises issues that are of critical importance to CalPERS and its 1.7 million members.[4] CalPERS authorized the filing of this Brief.

SUMMARY OF ARGUMENT

The bankruptcy court's conclusion that, once a State authorizes one of its subdivisions to file for chapter 9, that State's laws and constitution no longer control the actions of the municipal debtor is wrong on several levels. *First*, it was not absolutely necessary to the determination of whether the Detroit was eligible for relief and therefore constitutes an improper advisory opinion. *Second*, the decision nullifies section 903 of the Bankruptcy Code (the "Code"), which

[4] No person other than CalPERS or its counsel authored this brief in whole or in part, or contributed money intended to fund its preparation and submission. *See* Fed. R. App. P. 29(c)(5).

expressly preserves a State's laws governing its creatures notwithstanding the filing of a chapter 9 petition. In doing so, the court misconstrued the Tenth Amendment and the limitations it places on a State's ability to "consent" to violations of State laws and constitutional provisions. *Finally*, the court improperly created a presumption in favor of eligibility in interpreting the good faith filing requirement of 11 U.S.C. § 921(c).

ARGUMENT

I. The Constitutional Question of Whether Pensions Could Be Impaired, Consistent with the Tenth Amendment, Should Have Been Avoided.

This Court should vacate that portion of the bankruptcy court's opinion determining that pensions could be impaired in a manner consistent with the Tenth Amendment. *In re City of Detroit*, 504 B.R. 97, 145-54 (Bankr. E.D. Mich. 2013). Both the United States and the City urged that this claim was not ripe below, *see id.* at 140; nevertheless, the court improperly rendered an advisory opinion on the matter. Whether viewed through the lens of avoidance of constitutional questions or ripeness, the result is the same: the court improperly issued an advisory opinion on a constitutional question of the highest order.

Federal courts lack the power under Article III to issue advisory opinions, and this prohibition is as old as the Judiciary itself. *Hayburn's Case*, 2 U.S. 408 (1792); *Flast v. Cohen*, 392 U.S. 83, 97 n.14 (1968). The "'judicial Power' is one to render dispositive judgments," not advisory opinions. *Plaut v. Spendthrift*

Farm, Inc., 514 U.S. 211, 219 (1995) (quotations omitted). In this case, the court rendered a dispositive judgment--Detroit was eligible for relief. This should have ended the matter because it was unnecessary to rule on the Tenth Amendment as-applied challenge. It did so, because, in its view, "if the Tenth Amendment [as-applied] challenge to chapter 9 is resolved now, the parties and the Court can focus on whether the City's plan" can be confirmed. *Detroit*, 504 B.R. at 141.

In essence, the bankruptcy court decided a constitutional question, not because it was unavoidable, but because it believed that putting the issue behind it would facilitate negotiations and the administration of the case. This was not appropriate. "It is not the habit of the court to decide questions of a constitutional nature *unless absolutely necessary to a decision of the case*." *Burton v. United States*, 196 U.S. 283, 295 (1905) (emphasis added); *see also Ashwander v. TVA*, 297 U.S. 288, 346-47 (1936) (Brandies, J., concurring); *Adams v. City of Battle Creek*, 250 F.3d 980, 986 (6th Cir. 2001). *Cf. Clark v. Martinez*, 543 U.S. 371, 380-81 (2005) (explaining doctrine of constitutional avoidance in interpreting statutes). Here, it was not "absolutely necessary" to decide the question of whether the Tenth Amendment, as applied, prohibited the impairment of constitutionally protected pension benefits. That decision should have been left for another day.

Even assuming the issue was constitutionally ripe, a dubious proposition given that there was no certainty that pension rights would actually be impaired in

the plan ultimately presented to the bankruptcy court,[5] the court was duty-bound to avoid, not confront, this significant constitutional question. A desire to move the case along cannot overcome the prohibition against Federal courts issuing advisory opinions and requiring them to avoid constitutional questions. Because it was improper for the court to opine on this issue at the eligibility stage, that portion of the court's opinion should be vacated.

Vacation of this aspect of the eligibility decision is important to *amicus* because such a precedent can be, and has been, misconstrued for the broad proposition that *all* pensions are subject to impairment in chapter 9. This is too simplistic a view. Significant differences exist between the pension systems at issue in this case and CalPERS. While the pensions systems here are municipal run and created by the Detroit City Charter, the CalPERS system is a created by State law and is run by an arm of the State of California. Thus, impacts on the CalPERS system have a statewide, not only local, effect. Most notably, States and their arms enjoy sovereign status, while municipalities do not. *Ysursa v. Pocatello Educ. Ass'n*, 555 U.S. 353, 362 (2009) (affirming municipalities are not

[5] Subsequent events demonstrated why such a ruling was unnecessary. The City's plan has been amended since it was initially filed and will certainly be amended again before it is presented for confirmation. Various news sources report that the parties have reached agreement relating to pensions. *See, e.g.*, Nathan Bomey, *et al.*, *Detroit pension leaders, city reach landmark deal on retiree cuts*, *available at* http://www.freep.com/article/20140415/NEWS01/304150090/Detroit-bankruptcy-pension-deal-Kevyn-Orr (last visited Apr. 30, 2014).

sovereigns).[6] Accordingly, if this Court determines that it was proper for the bankruptcy court to reach this issue and affirms the court, *amicus* requests that this Court issue a narrow holding, taking into account the differences between State-run pension plans and municipal-run pension plans, given the different role States and municipalities play in our constitutional plan.

II. Section 903 of the Code and the Supreme Court's Recent *Bond* Decision Highlight the Flaws in the Court's "Consent" Analysis.

The nub of the bankruptcy court's conclusion regarding "consent" is that once a State authorizes its municipalities to file for chapter 9, municipal debtors are freed from the strictures of any State law that may impede a municipality's ability to restructure its debts. *Detroit*, 504 B.R. at 161. This conclusion rests on two fundamentally incorrect premises: (1) Section 903 of the Code means nothing; and (2) federalism only protects the States and States alone. The fact that a State may have authorized its subdivision to *file* for chapter 9 does not mean that it relinquishes all control over its creature and issues its creature a license to violate State laws that may inconvenience the reorganization process. Both section 903 and the Tenth Amendment prevent this.

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[6] Sovereign immunity highlights this difference. The Ninth Circuit has determined that CalPERS is entitled to sovereign immunity. *Kaplan v. CalPERS*, 221 F.3d 1348, 2000 WL 540932, at *1 (9th Cir. May 3, 2000) (affirming dismissal on Eleventh Amendment grounds); *see also Arya v. CalPERS*, 943 F. Supp.2d 1062, 1071-72 (E.D. Cal. 2013) (same). Municipalities, however, are not entitled to sovereign immunity. *Alden v. Maine*, 527 U.S. 706, 756 (1999).

A. Section 903 of the Code Protects State Sovereignty.

Although not central to its analysis, the bankruptcy court's decision includes overly-simplistic language regarding the import of section 903. *Detroit*, 504 B.R. at 161 (quoting *In re City of Stockton*, 478 B.R. 8 (Bankr. E.D. Cal. 2012)).[7] This language should be repudiated. It undermines what section 903 seeks to accomplish and, in turn, casts a shadow upon the constitutionality of chapter 9.

Section 903 expressly maintains a State's control over and governance of its municipalities. The provision has substantive meaning and independent force. It was placed into chapter 9 to alleviate the constitutional tension that exists when an instrumentality of the Federal Government is called upon to assist a municipality in readjusting its debts. Without the State law controls put in place by the plain terms of section 903, a municipal debtor would be free to violate any State law it chooses because 11 U.S.C. § 904 severely restricts a court's ability to interfere with the actions of a municipal debtor.[8] Any reading of section 903 that does not respect

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[7] The *Stockton* passage relied on by the bankruptcy court is *dictum*. Indeed, the Stockton court made that precise point, noting it was not bound by its off-the-cuff remarks about the import of section 903 in its decision addressing the limitations of section 904 on the court's power. *See* Attachment A (transcript).

[8] Section 904 provides: "Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with--(1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property."

the right of a State to control its municipalities ignores the delicate balance Congress attempted to strike in crafting municipal bankruptcy legislation.

Given the structure of our Nation's constitutional design, and the control States have over their municipalities, "any federal debt relief legislation affecting municipalities must be sufficiently narrow in scope to avoid intrusion by the federal courts on the sovereign power of the states." *In re Richmond Unified Sch. Dist.*, 133 B.R. 221, 224 (Bankr. N.D. Cal. 1991). Section 903 reflects this by protecting the rights of States *qua* States by allowing States to control the affairs of their political subdivisions even while such subdivisions are in chapter 9.

Entitled "Reservation of State power to control municipalities," section 903 provides:

> *This chapter does not limit or impair the power of a State to control, by legislation or otherwise*, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, *including expenditures for such exercise*, but—
>
> (1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and
>
> (2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.

Section 903 (emphasis added). Thus, section 903 honors the long-standing tradition that municipalities are merely instrumentalities of the State, to which a "State may withhold, grant or withdraw powers and privileges as it sees fit."

Ysursa, 555 U.S. at 362 (2009) (quotations omitted). *See also Ashton v. Cameron Cnty. Water Improvement. Dist. No. 1*, 298 U.S. 513, 529-30 (1936); *Sinas v. City of Lansing*, 170 N.W.2d 23, 25 (Mich. 1967).

Simply because a municipality seeks chapter 9 protection, the State is far from powerless to control the affairs of its own instrumentalities during the bankruptcy proceeding. Section 903 preserves such control because it is an express limit on a municipality's ability to consent to the interference of the Federal court in the internal affairs of a municipal debtor. *In re New York City Off-Track Betting Corp.*, 434 B.R. 131, 141 (Bankr. S.D.N.Y. 2010) ("The ability of a chapter 9 debtor to consent under section 904 is limited by section 903 of the Bankruptcy Code and federalism concerns."); *see also In re Jefferson Cnty.*, 484 B.R. 427, 463 (Bankr. N.D. Ala. 2012); *In re City of Harrisburg*, 465 B.R. 744, 755 (Bankr. M.D. Pa. 2011).

To preserve the constitutionality of chapter 9, section 903 provides that any State law or agency governing the relationship between a municipality and its parent State prior to entering into chapter 9 continues to control the actions of the municipality notwithstanding the filing of a chapter 9 petition. Although a court cannot interfere with the debtor's use of its property by virtue of section 904, the State *can*--"by legislation or otherwise," including "expenditures." Given the limitations imposed on courts by section 904, without section 903's explicit

reservation of state control a municipal debtor would be free to violate any and every State law merely by filing a chapter 9 petition. Unless section 903 constrains it, a municipal debtor, freed from court oversight of its property and revenues by section 904, would become a lawless entity because State law defines entirely the powers, duties and rights of municipalities.

This construction of the meaning and effect of section 903 is consistent with the legislative history surrounding section 903 and its precursor. From the outset, Congress was aware that municipal bankruptcy laws created significant potential for interference in State affairs; thus, the first such law contained a provision similar to section 903. *Ashton*, 298 U.S. at 526 (quoting Section 80(k)). Legislative history from the 1934 Act explains that this language was put into the law "as a further limitation upon Federal power and in respect for the rights and responsibilities of the States[.]" S. COMM. ON THE JUDICIARY, REP. NO. 407, at 2 (1934) (Attachment B).[9] Similar language was carried over into the 1937 Act, which the Court upheld in *United States v. Bekins*, 304 U.S. 27 (1938).[10]

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[9] For ease of reference, *amicus* attaches all of the cited legislative history.

[10] *Ashton* and *Bekins* must be viewed in their historical context because "the two cases were decided a year on either side of the Court's famous 1937 'switch in time'--mak[ing] it hard to say how they would fit into contemporary federalism jurisprudence." Emily D. Johnson & Ernest A. Young, *The Constitutional Law of State Debt*, 7 DUKE J. CONST. L. & PUB. POL'Y 117, 157 (2012).

In 1946, subparts (1) and (2) were added to section 903 in an effort to overrule *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), where the Court upheld a state bankruptcy (composition) law regarding municipal bonds against Contract and Supremacy Clause challenges. At that time, Congress did not amend the operative language of section 903 that is relevant to this appeal. Congress's stated concern in adding subparts (1) and (2) was one of uniformity. H.R. REP. NO. 94-686, at 19 (1975), *reprinted in* 1976 U.S.C.C.A.N. 539, 557 (discussing prior legislative history of § 83(i)) (Attachment C). Thus, section 903's primary language, and its application, did not, at least in Congress's eyes, raise any uniformity or Supremacy Clause concerns.[11]

In the 1970s, Congress reworked federal bankruptcy laws, culminating in the creation of the Bankruptcy Code in 1978. The legislative history of section 903's precursor notes the original understanding of the provision:

> It is to prevent the statute or the court from interfering with the power constitutionally reserved to the State by the Tenth Amendment. . . . *Any State law that governs municipalities or regulates the way in which they may conduct their affairs controls in all cases. Likewise, any State agency that has been given control over any of the affairs of a municipality will continue to*

[11] This makes sense given the "uniformity clause" is a limitation on Congress, not the States. *In re Applebaum*, 422 B.R. 684, 692 (9th Cir. BAP 2009) (citing *Ry. Labor Executives' Ass'n v. Gibbons*, 455 U.S. 457, 469 (1982); *see also generally In re Schafer*, 689 F.3d 601, 608-612 (6th Cir. 2012). It also makes sense in the context of the Supremacy Clause because section 903 is part of the Code and therefore reigns supreme if in actual conflict with a State law.

> *control the municipality in the same way, in spite of a Chapter IX petition.*

H.R. REP. NO. 94-686, at 19 (emphasis added). Thus, Congress intended that under section 903, State laws and constitutional provisions continued to control the actions of a municipal debtor during a chapter 9 proceeding.

During this same period, Congress was acutely aware of the Court's decision in *National League of Cities v. Usery*, which held there are certain "attributes of sovereignty" that "may not be impaired by Congress, not because Congress may lack an affirmative grant of legislative authority to reach the matter, but because the Constitution prohibits it from exercising the authority in that manner." 426 U.S. 833, 845 (1976).[12] Based on the Court's "developing ideas of Federalism," Congress re-affirmed its commitment to State sovereignty by including section 903 in the Code. H.R. REP. NO. 95-598, at 262-64 (1978), *reprinted in* 1978 U.S.C.C.A.N. 4717, 6220-22 (Attachment D).

Under the plain terms of section 903 and its legislative history (dating back to its inception), the States retain control over their political subdivisions even during a chapter 9 case. State control is so absolute that the legislative history indicates that "withdrawal of State consent at any time will terminate the case[.]"

[12] Although *Usery* was overruled in part by *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 531 (1985); its holding is still important because it provides the backdrop against which Congress was legislating.

H.R. REP. NO. 94-686, at 8, *reprinted in* 1976 U.S.C.C.A.N. 539, 545 (Attachment E). The form of control that States retain over their subdivisions varies.

For example, California has expressly chosen to control its municipalities in chapter 9 by preventing municipalities from rejecting their relationship with CalPERS under 11 U.S.C. § 365. *See* Cal. Gov't Code § 20487. Likewise, Michigan has chosen to control its political subdivisions by making it unconstitutional to diminish or impair accrued pension benefits and by requiring that those benefits be annually funded. *See* Mich. Const. art. IX, § 24 ("Pension Clause"). This is a point that has been well articulated by Michigan's chief legal officer. *See, e.g.*, Dkt. No. 481 (main case). The fact that a municipality is in bankruptcy does not alter the State's control over the municipality vis-à-vis the Pension Clause or, for example, Cal Gov't Code § 20487. Congress did not intend to provide municipal debtors with a license to ignore State laws governing their conduct simply because those laws may make it harder for them to adjust their debts. Such adjustment cannot be done at the expense of State law. Section 903 of the Code makes this clear.

The bankruptcy court equated State consent to file for bankruptcy under 11 U.S.C. § 109(c)(2) with the remarkable notion that a State cedes all control over its charge during a chapter 9 case. Why would Congress place section 903 into the

Code if it did not want it to have any independent force and meaning? Surely, it cannot be that one of the constitutional underpinnings of chapter 9 means nothing.

Bekins upheld the constitutionality of the revised law precisely because it protected State control over its municipalities. "The statute is carefully drawn so as not to impinge upon the sovereignty of the State. . . . The bankruptcy power is exercised . . . *only* in a case where the action of the taxing agency *in carrying out a plan of composition* approved by the bankruptcy court is authorized by *state law*." 304 U.S. at 51 (emphasis added). The Court determined that "the exercise of the federal bankruptcy power *in dealing with a composition of the debts* of the irrigation district, upon its voluntary application and *with the State's consent*," did not violate the essential sovereignty of the State. *Id.* at 49 (emphasis added). The State must do more than simply consent to a municipality's filing of its bankruptcy petition in order to satisfy this essential underpinning of the constitutionality of chapter 9. *Bekins* made it clear that the *scope* of the State's consent includes State consent to the terms of the municipality's plan for adjustment of debts. And section 903 is the reflection in the Code of this important principle.

Reading section 903 as having no independent force or meaning and as being merely co-extensive with section 109(c)(2), as the bankruptcy court did, violates at least three rules of statutory construction.

First, it renders section 903 meaningless surplusage. *TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001).

Second, it fails to read the statute as a whole. *Corley v. United States*, 556 U.S. 303, 314 n.5 (2009). Section 109(c)(2) specifically addresses State consent to *authorize a filing*, but does not address the interplay between State law and control reflected in section 903 *after* a petition is filed. If Congress only sought to limit State control at the incipient stage of its grant of authority to file a bankruptcy petition, it would not have included section 903 in the Code. These provisions must be read in conjunction with one another. Moreover, section 903 must also be read in the context of chapter 9 as a whole. Sections 109(c)(2), 903 and 904 all reflect a healthy respect for State sovereignty and State law. The final safeguard of State sovereignty is 11 U.S.C. § 943(b)(4), which requires, as a condition of confirmation of a plan, that "the debtor is not prohibited by law from taking any action necessary to carry out the plan." As explained, this means State law.

The bankruptcy court did not address these issues of statutory construction. Instead, it adopted simplistic *dictum* that "[a] state cannot rely on the § 903 reservation of state power to condition or to qualify, i.e. to 'cherry pick,' the application of the Bankruptcy Code provisions that apply in chapter 9 after such a case has been filed." *Detroit*, 504 B.R. at 161 (citation & quotation omitted). But

generally applicable State laws do not constitute "cherry picking."[13] They are the essence of what governs a municipal debtor during the pendency of bankruptcy under section 903. They are also the final hurdle to plan confirmation under section 943(b)(4). Putting a pejorative label on State laws does not justify a failure to adhere to criteria that Congress has commanded the courts to respect in chapter 9. Bankruptcy courts may feel that their authority is lessened by the limitations of sections 903 and 943(b)(4), in comparison to the broad authority they enjoy under other chapters of the Code. And so it is. But it is the will of Congress and must be given effect.

The decision below ignores State sovereignty by placing the desire to make it easier for a municipal debtor to reorganize above the sovereign interests of Michigan in having its organic laws respected. If such laws, like the Pension Clause, cannot be viewed as the State controlling "a municipality" in the

[13] When authorizing its municipalities to file for chapter 9, a State understands that it continues to control that municipality under section 903. Thus, any accusation of "cherry picking" by seeking to enforce the plain terms of section 903 is puzzling. In this sense, the alternate holding in *Mission Independent School District v. Texas*, 116 F.2d 175 (5th Cir. 1940), is wrong. The opinion fails to mention the precursor to section 903. Nonetheless, *Mission Independent* does not apply on its own terms. At issue was whether Texas could exempt bonds it held "as an investment" in order to obtain a "better right to repayment" than other bondholders in "the same class." *Id.* at 178. Texas was a market participant and held the bonds as means to generate revenue. In sharp contrast, pensions are not held by any governmental entity "as an investment" for gains to the State's coffers.

"exercise" of its "political or governmental powers" "including expenditures for such exercise," it is hard to imagine what, if anything, section 903 accomplishes.

Third, merging 903 and 109(c)(2) raises serious constitutional concerns because it elevates a State's subdivision above compliance with State law, the very source of its existence. Courts must construe statutes in a manner that avoids, not creates, constitutional issues. *Zadvydas v. Davis*, 533 U.S. 678, 689 (2001). Not only is it "fairly possible," *id.*, that Congress intended to allow States to retain control over their subdivisions while in bankruptcy, it is expressly so stated in section 903. If the bankruptcy court is correct, and the Pension Clause crumbles in chapter 9, then the entirety of chapter 9 is called into constitutional doubt because the very concerns at the heart of *Ashton* and *Bekins--States'* control over their political subdivisions and *States'* ability to control their fiscal affairs--is lost.

Congress did not envision that chapter 9 would become a haven for municipalities that seek to ignore and break State laws and constitutional provisions in order to adjust their debts. Without the control section 903 provides for through State law, a municipal debtor would be free to violate any and every State law once it filed a chapter 9 petition. If construed otherwise, the whole *raison d'être* of section 903--a healthy respect for State control over their creatures and a State's fiscal affairs--is lost and the constitutionality of chapter 9 as a whole is thrown into constitutional doubt.

B. The Supreme Court's *Bond* Decision Undercuts the Bankruptcy Court's Theory of Consent.

The bankruptcy court's theory of "consent" is at odds with Supreme Court federalism decisions. Even if there was any doubt about what the Court meant in *New York v. United States*, 505 U.S. 144 (1992), such doubt has been laid to rest by *Bond v. United States*, 131 S. Ct. 2355 (2011), where the Court made clear that the Tenth Amendment, at its heart, protects individuals.

In *New York*, the Court held: "State officials thus *cannot* consent to the enlargement of the powers of Congress beyond those enumerated in the Constitution." 505 U.S. at 182 (1992) (emphasis added). This pronouncement followed on the heels of the acknowledgment that federalism, at its core, was designed "for the protection of individuals." *Id.* at 181. Despite the clarity of the Court's language, the bankruptcy court said the Court did not really mean what it said. *Detroit*, 504 B.R. at 149 ("states *can* 'consent to the enlargement of the powers of Congress beyond those enumerated in the Constitution.") (emphasis added) (quoting *New York*).

Inherent in the bankruptcy court's understanding of the Tenth Amendment is the view that rights emanating from the Amendment belong to the States and to the States alone. Not only did *New York* reject this view, but the Court recently unanimously rejected an identical argument that "States and States alone" can assert a challenge that "state sovereignty" has been violated under the Tenth

Amendment. *Bond*, 131 S. Ct. at 2363. The Court made clear that Tenth Amendment "rights in this regard do not belong to a State." *Id.* at 2364. "Fidelity to principles of federalism is not for the States alone to vindicate." *Id.*; *see also United States v. Felts*, 674 F.3d 599, 607 (6th Cir. 2012) (discussing *Bond*). Remarkably, despite its direct application, the court never addressed *Bond*.

In light of *Bond*, the bankruptcy court's dismissal of certain "puzzling language in *New York*" is just plain wrong. 504 B.R. at 148-49. *New York*, when read in light of *Bond*, could not be clearer: Because federalism's protections are not designed solely to protect the States alone, those rights cannot be consented away by the State.[14] How can a State give something away that it does not solely possess? The answer is: It cannot. It is far too simplistic to say that Michigan, or any other State, by authorizing one of its creatures to file for chapter 9, consented away the enforcement of State statutory and constitutional law protecting individuals to benefit a single, financially distressed municipality.

Even assuming the protections of federalism could be consented away, the real answer lies in the scope of such consent. The bankruptcy court assumed the

[14] While State consent is important, if consent to *filing* was the be-all and end-all, *Ashton* would not have struck down the law, where Texas authorized the filing. 298 U.S. at 527 (1936). Likewise, *Bekins* would not have upheld the law on its face because the law did not require "approval of the petition by a governmental agency of the State." 304 U.S. at 49. *See also* Giles J. Patterson, *Municipal Debt Adjustment Under the Bankruptcy Act*, 90 U. PA. L. REV. 520, 531 (1942) (noting *Bekins* reaffirmed *Ashton* regarding the no-interference principle).

scope of consent was exceedingly broad, but nothing supports this conclusion. In fact, clues to the scope of such consent can readily be found in the authorization statute and the actions of Michigan's chief legal officer.

Nothing in the authorization law provides any "clear declaration" or "unequivocal" expression that Michigan consented to have its constitution displaced based on the needs of a single debtor. That is the test employed in determining whether sovereign immunity, which *can* be waived, has been waived. *Sossamon v. Texas*, 131 S. Ct. 1651, 1658 (2011). Unlike sovereign immunity, federalism's protections cannot be waived by a State given those protections are not the "States and States alone." *Bond*, 131 S. Ct. at 2363. Thus, the test to determine whether a State consented away enforcement of its laws and constitutional provisions that protect individual rights should be stricter, not less strict, than in the sovereign immunity context. Indeed, the idea that Michigan impliedly "consented" to a violation of its Pension Clause has been expressly refuted by Michigan's chief legal officer. *See* Dkt. No. 481 (main case). Because nothing supports the bankruptcy court's broad view of "consent" it should be rejected.

"Federalism, central to the constitutional design, adopts the principle that both the National and State Governments have elements of sovereignty the other is bound to respect." *Arizona v. United States*, 132 S. Ct. 2492, 2500 (2012). This

simple principle answers this case. Allowing a municipal debtor to ignore the plain dictates of State laws and constitutional provisions designed to ensure the integrity of pension benefits simply because it filed for bankruptcy is a grave intrusion upon the sovereignty of the States and is not supported by section 903 of the Code or the Supreme Court's view of federalism. Consequently, if this Court reaches this question, it must reverse the bankruptcy court on this point.

III. Congress Mandates Strict Compliance With Eligibility Criteria and No Presumption In Favor of Eligibility Exists.

Unlike other sections of the Code, a municipal petitioner must satisfy certain criteria before being determined eligible for relief. Under 11 U.S.C. § 109(c), an entity can be a debtor "if and only if" it satisfies certain requirements. 11 U.S.C. § 109(c)(1)-(5)(A)-(D). In addition, 11 U.S.C. § 921(c) requires a petition be filed "in good faith." The burden is on the municipality to show good faith. *In re City of Bridgeport*, 129 B.R. 332, 334 (Bankr. D. Conn. 1991). Here, the bankruptcy court determined that the "good faith" requirement *must* be construed to advance the "broad remedial purposes" of the Code and that if the section 109(c) factors are satisfied, then a "strong presumption in favor of" relief arises. *Detroit*, 504 B.R. at 180 (quotation omitted). Not only does this "strong presumption" lack textual support, it improperly flips the burden of good faith onto the objectors. This legal error should be corrected.

Reliance upon the so-called "broad remedial purposes" of the Code was doubly wrong because it created an extra-statutory presumption in favor of eligibility that can be met whenever a petitioner shows it is financially distressed. The Supreme Court has rejected such purpose-driven statutory construction.

> Additionally, and most impermissibly, the Court of Appeals relied on its understanding of the broad purposes of [the act] . . . . But no legislation pursues its purposes at all costs. Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice--and it frustrates rather than effectuates legislative intent simplistically to assume that *whatever* furthers the statute's primary objective must be the law.

Rodriguez v. United States, 480 U.S. 522, 525-26 (1987) (per curiam) (emphasis in original); *see also OfficeMax, Inc. v. United States*, 428 F.3d 583, 593-94 (6th Cir. 2005). The Supreme Court has referred to the invocation of such "purposes" as the "last redoubt of losing causes" because "[e]very statute proposes, not only to achieve certain ends, but also to achieve them by particular means--and there is often a considerable legislative battle over what those means ought to be." *Dir., Office of Workers' Comp. Programs, Dep't of Labor v. Newport News Shipbuilding & Dry Dock Co.*, 514 U.S. 122, 135 (1995). Congress chose to require municipal petitioners to have filed their petitions in good faith and the plain language of section 921(c) creates no presumption, let alone a "strong" one, in favor of a municipal petitioner.

In rejecting similar reasoning, the Supreme Court concluded that "the Bankruptcy Code . . . is not a remedial statute" in the sense that it is designed to protect and secure specific interests. *Florida Dep't of Revenue. v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 51 (2008); *In re Flores*, 735 F.3d 855, 861 (9th Cir. 2013) (en banc); *In re Dumont*, 581 F.3d 1104, 1111 (9th Cir. 2009); *Myers v. TooJay's Mgmt. Corp.*, 640 F.3d 1278, 1286 (11th Cir. 2011). Thus, the court's invocation of the "broad remedial purposes" of the Code was improper.

Unlike other chapters of the Code, chapter 9 is distinctive in imposing specific hurdles a municipal petitioner must overcome to obtain relief, one of which is that a petition be filed in good faith. The good faith requirement is not a mere formality. "Congress consciously sought 'to limit accessibility to the bankruptcy court' by municipalities." *In re Cottonwood Water & Sanitation Dist., Douglas Cnty.*, 138 B.R. 973, 979 (Bankr. D. Colo. 1992) (quoting legislative history). A municipal debtor must show that it both needs and is deserving of such protection. *See, e.g., In re Suffolk Reg'l Off-Track Betting Corp.*, 462 B.R. 397, 414 (Bankr. E.D.N.Y. 2011) ("[C]hapter 9 petitions should be viewed 'with a jaded eye.'") (quotation omitted). Although always inappropriate, broadly construing the Code in favor of a debtor is even less appropriate in chapter 9.

The first municipal bankruptcy law was declared unconstitutional because it invaded State sovereignty by allowing a federal court too much control over a

municipal debtor, a creature of the state. *Ashton*, 298 U.S. at 529-31 (1936). Thus, a constitutional tension exists in chapter 9 that exists nowhere else under the Code. For this reason, courts lack basic controls over the debtor in chapter 9. *See* § 904. A court's control over a municipal debtor is "strictly limited to disapproving or to approving and carrying out a proposed composition." *Leco Props. v. R.E. Crummer & Co.*, 128 F.2d 110, 113 (5th Cir. 1942). Therefore, the eligibility requirements, including good faith, must have real meaning and force. *In re Sullivan Cnty. Reg'l Refuse Disposal Dist.*, 165 B.R. 60, 82 (Bankr. D.N.H. 1994).

While chapter 9 provides some creditor protections, such protection is considerably less than provided elsewhere in the Code. *In re City of Desert Hot Springs*, 339 F.3d 782, 789 (9th Cir. 2003); *see also* Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 355-360 (2010) (same). For example, chapter 9 debtors "may borrow and spend money without court authority," and only the debtor can propose a plan of adjustment. *Desert Hot Springs* at 789 (quotation omitted). As one court recognized in rejecting the very same broad interpretation employed below, the eligibility factors serve as a form of "creditor protection" that is otherwise absent from chapter 9 and giving them force helps level the "playing field." *Cottonwood*, 138 B.R. at 979.

While some courts have concluded that the eligibility requirements must be broadly construed to effectuate chapter 9's purposes, such construction is contrary to the Supreme Court's decision in *Piccadilly* and other Circuit Court decisions, which all reject the notion that the Code reflects a singular, overriding purpose that drives statutory construction. As the Tenth Circuit recognized: "Chapter 9 does not offer relief to a municipality simply because it is economically distressed." *In re Hamilton Creek Metro. Dist.*, 143 F.3d 1381, 1387 (10th Cir. 1998).[15] Congress envisioned that municipal debtors would come to bankruptcy with clean hands by expressly including a good faith filing requirement. Here, despite the fact that the bankruptcy court acknowledged there is "some substantial truth" in the claim that

[15] While there is *dictum* in *Hamilton Creek* supporting a "broad" interpretation, 143 F.3d at 1384, reliance on it is improper for several reasons.

First, it predates the Supreme Court's *Piccadilly* decision and is contrary to other, more recent, Circuit Court cases.

Second, the court relied on *Sullivan County* for the proposition, which in turn cited *In re City of Bridgeport*, 128 B.R. 688 (Bankr. D. Conn. 1991) and *In re Pleasant View Utility District of Cheatham County Tenn.*, 24 B.R. 632 (Bankr. M.D. Tenn. 1982). *Sullivan County*, 165 B.R. at 73. The relevant statements in *Sullivan County* involved the question of whether the term "generally authorized" in former § 109(c)(2) should be broadly or narrowly construed. *Id.* The other courts concluded, based on the legislative history of that particular section, that Congress intended the "generally authorized" requirement to be read expansively. *Bridgeport*, 128 B.R.at 695; *Pleasant View*, 24 B.R. at 638. These cases are no longer good law on this point because in 1994 Congress amended § 109(c)(2) to require specific authorization. *See In re County of Orange*, 183 B.R. 594, 604 (Bankr. C.D. Cal. 1995).

Finally, even applying a "broad construction," the court determined that the debtor did not meet the insolvency requirement, affirming dismissal of the case. *Hamilton Creek*, 143 F.3d. at 1387.

the City did not file in good faith, *Detroit*, 504 B.R. at 187, it nonetheless concluded that the objectors had not overcome the extra-statutory "strong presumption" of a good faith filing. Exactly what the result would have been had the court not improperly injected its own notions of Congress's purposes into the analysis is unknown, but this Court should review this finding with a "jaded eye."

CONCLUSION

Amicus curiae respectfully requests that this Court REVERSE and/or VACATE certain portions of the opinion consistent with the foregoing arguments.

Dated: May 1, 2014

Respectfully Submitted,

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

The undersigned hereby certifies that:

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6,817 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii); and,

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in proportionally spaced typeface using Microsoft Office Word in Times New Roman.

Dated: May 1, 2014

Respectfully Submitted,

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By: s/ *Michael K. Ryan*
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Attorneys for California Public Employees' Retirement System

ADDENDUM OF UNPUBLISHED DISPOSITIONS AND ATTACHMENTS REFERENCED IN CALPERS' *AMICUS* BRIEF

221 F.3d 1348, 2000 WL 540932 (C.A.9 (Cal.))
(Table, Text in WESTLAW), Unpublished Disposition
(Cite as: 221 F.3d 1348, 2000 WL 540932 (C.A.9 (Cal.)))

H

NOTICE: THIS IS AN UNPUBLISHED OPINION.

(The Court's decision is referenced in a "Table of Decisions Without Reported Opinions" appearing in the Federal Reporter. Use FI CTA9 Rule 36-3 for rules regarding the citation of unpublished opinions.)

United States Court of Appeals, Ninth Circuit.
Gene KAPLAN, Plaintiff-Appellant,
v.
CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM; California Board of Administration of Pers; State of California, as administrator of Pers and as plaintiff's employer; James E. Burton, Chief Executive Officer, in that person's official and individual capacity; Chris Nishioka, Supervisor, Pers Benefit Services Division; Supervisor, Pers Benefit Application Services Division; Liaison, Pers Legal Office; Supervisor, Pers Legal Office; Supervisor, Pers Appeals Division, Defendants-Appellees.

No. 99-15295.
D.C. No. CV-98-01246-CRB.
Submitted April 17, 2000.[FN2]

FN2. The panel unanimously finds this case suitable for decision without oral argument. *See* Fed. R.App. P. 34(a)(2). Accordingly, appellant's request for oral argument is denied.

Decided May 3, 2000.

Appeal from the United States District Court for the Northern District of California, Charles R. Breyer, District Judge, Presiding.

Before KOZINSKI, RYMER, and FISHER, Circuit Judges.

MEMORANDUM [FN1]

FN1. This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as may be provided by 9th Cir. R. 36-3.

*1 Gene Kaplan appeals pro se from the district court's dismissal of his civil rights action, which alleged various constitutional and statutory violations related to the determination of his state retirement benefits. We have jurisdiction pursuant to 28 U.S.C. § 1291. We review the dismissal of claims under Fed.R.Civ.P. 12(b)(6) de novo. *See Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1295 (9th Cir.1998). The applicability of Eleventh Amendment immunity is reviewed de novo. *See Doe v. Lawrence Livermore Nat'l Lab.*, 131 F.3d 836, 838 (9th Cir.1997). We affirm.

To the extent Kaplan contends the district court erred in dismissing his claims based on alleged violation of the Age Discrimination in Employment Act ("ADEA"), 29 U.S.C. § 621, et seq ., his contention is without merit. The Eleventh Amendment bars Kaplan's ADEA claims. *See Kimel v. Florida Bd. of Regents*, 120 S.Ct. 631, 650 (2000); *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996).

We affirm the district court's dismissal of Kaplan's remaining claims for the reasons stated in the district court's September 3, 1998 Memorandum and Order.

AFFIRMED.

C.A.9 (Cal.),2000.
Kaplan v. California Public Employees' Retirement System
221 F.3d 1348, 2000 WL 540932 (C.A.9 (Cal.))

END OF DOCUMENT

ATTACHMENT A

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

---oOo---

In re:	)Case No. 12-32118-C-9
	)
CITY OF STOCKTON, CALIFORNIA,	)Chapter 9
	)
Debtor.	)DCN: OHS-5, OHS-6
	)

---oOo---

BEFORE THE HONORABLE CHRISTOPHER M. KLEIN, JUDGE OF THE UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF CALIFORNIA, AND ON JANUARY 30, 2013.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

CONTINUED MOTION FOR ORDER (1) RULING THAT APPROVAL OF SETTLEMENT AGREEMENT IS NOT REQUIRED UNDER RULE 9019 OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE; OR ALTERNATIVELY (2) APPROVE SETTLEMENT AGREEMENT WITH CHRISTOPHER HALLON and MOTION TO ASSUME LEASE OR EXECUTORY CONTRACT

---oOo---

APPEARANCES:

(See pg. 2)

Reported by: VICKI L. BRITT, RPR, CSR No. 13170

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---oOo---

WEDNESDAY, JANUARY 30, 2013 AT THE HOUR OF 10:00 A.M.

BEFORE THE HONORABLE CHRISTOPHER M. KLEIN

---oOo---

THE COURT: This is the time set for hearing on two motions in the City of Stockton Chapter 9 case; a motion for a ruling regarding a proposed settlement and a larger question relating to settlements generally, and then, second, a motion to assume a lease or executory contract.

Let's start with entries of appearance, beginning with counsel in the courtroom.

MR. LEVINSON: Good morning, Your Honor. On behalf of the City of Stockton, Marc Levinson, Patrick Bocash and John Killeen of Orrick, Herrington & Sutcliffe. Also in the courtroom is John Luebberke, the City Attorney for the City of Stockton.

MR. JOHNSTON: Good morning, Your Honor. Jim Johnston of Jones Day on behalf of the Franklin High Yield Tax-Free Income Fund and Franklin California High Yield Municipal Fund.

MR. BJORK: Good morning, Your Honor. Jeff Bjork from Sidley Austin on behalf of Assured Guaranty.

MR. WALSH: Good morning, Your Honor. Matthew Walsh with Winston & Strawn on behalf of National Public Finance Guarantee Corporation.

MR. GEARIN: Good morning, Your Honor. Michael

the merits of the Hallon settlement.

Your Honor, I am going to -- we did have a discussion on how to deal with the effect of section 903 of the Bankruptcy Code, which really is the section of the code that deals with the state's retained powers over its municipality while it is in chapter 9. And those issues aren't before you here today. We did want them before you because there's been prior discussion of section 903 in the *ARECOS* decision.

THE COURT: You didn't like that discussion I take it?

MR. GEARIN: We'd like an opportunity to fully address those matters before you, and imagine we will get to those at plan confirmation. But we do think that 903 has --

THE COURT: Well, I'll help you out a little bit, they were dicta. I confess, they were dicta, in which I was attempting to explain it so the decision would be understandable. Discussion of 903 is not a narrow holding.

MR. GEARIN: I understand and thank you for that. Your Honor, we do think 903 has an important role in chapter 9. And we think that as Mr. Levinson points out, state law continues to govern and to control the municipality during the course of the chapter 9.

So, for example, the public disclosure laws and the need to have settlements come before in open meetings,

specifically held -- maybe it was dicta -- but you wrote the words -- that section 904 poses no bar or impediment to the application of the --

THE COURT: I was making a holding regarding 904. CalPERS' worry was about what I said about 903. I agree what I said about section 903 was dicta. I didn't say that what I said about 904 was not a holding. As a matter of fact, I think it's probably the square holding.

MR. JOHNSTON: Well, I believe that holding is dispositive of the City's argument. If I read it correctly, you held that section 904 poses no bar or impediment to the application of the incorporated provisions of the Bankruptcy Code in chapter 9. And that by voluntarily commencing this case, the City and state have consented to the operation of those provisions.

THE COURT: Well, that may be a little -- the point of that pencil needs to be sharpened a little bit. If that's what you think I actually said in context, then Mr. Levinson is saying, judge, you've got to sharpen the point of that pencil.

MR. JOHNSTON: And I would love for you to educate me. And maybe this isn't the time or place for it, but that at least is the logical import of the conclusions reached in the retiree decision.

And I think that leads directly to the conclusion

MR. JOHNSTON: But assume it's true. Assume that at the time they say that, that is the best they can do, in part because they took a material part of their assets and paid it to other creditors before confirmation, that is not an adjustment of debt regime that's provided for in chapter 9. That's not the way I would submit that the statute works.

THE COURT: Well, you're arguing against confirmation. And if I agreed with you, then I'd say, I'm sorry, Mr. Levinson. Your plan of adjustment is not confirmed. Go back and take another swing at the pitch.

MR. JOHNSTON: And if we get to that point, we will. The gravamen of the argument today is that the creditors who aren't the favored 95 percent in this hypothetical shouldn't be put in the position of that being their only remedy. This is the chapter 4 adjustment of debts of a municipality. It's a two-way street, not a one-way street. The creditors have protections afforded to them by the statute and they're entitled to be heard on that. That's where we come out, Your Honor.

THE COURT: Okay. Anything else?

MR. JOHNSTON: I have some remarks on section 903. I don't know if you want to hear them or not.

THE COURT: Not particularly. I'm not going to decide this on section 903. I already conceded that my

discussion of 903 in the retired employees case was, I think, unquestionably dictum, that I included to provide my view of the landscape. And that if I was presented with a square 903 decision, that I would not be bound by it. I'm not even bound by the retired employees decision I entered.

Remember, a decision by a trial judge does not bind other trial judges anywhere. It doesn't even bind the state trial judge in another matter. So I'm free to change my mind and be better educated.

MR. JOHNSTON: And I would just say for the record, we categorically disagree with the way that CalPERS interprets section 903. In the context of a motion like this --

THE COURT: Well, I understand that you and CalPERS are not friends. On another front, I'll be hearing all about your disagreements.

MR. JOHNSON: And in the context of this motion, 903 is not remotely called into question. There's no issue of state control. The State of California has not directed the City to settle with Mr. Hallon; has not directed the City to pay Mr. Hallon any amount. It's just not implicated. So I think I'm safe to leave it at that for now and note our disagreement on the bigger picture issues.

THE COURT: Well, the City hasn't argued that 903 controls the analysis. CalPERS has said, please don't talk

more about 903 until you need to, judge, and you've said don't talk about 903 until you need to. And I've already said what I said about 903 is just talking.

MR. JOHNSTON: Unless you have anything further for me?

THE COURT: I have nothing further. Do any of your colleagues want to bat cleanup?

MR. BJORK: Yes, Your Honor. I guess we're into the afternoon by now. Jeff Bjork from Sidley Austin on behalf of Assured Guaranty.

Just one additional point to make. 3003 authorizes you to fix a bar date.

THE COURT: That's a rule.

MR. BJORK: That's a rule. And I believe it's incorporated by virtue of chapter 9 in terms of 924, 925 and the like. The debtor has taken in compliance with the provisions applicable in chapter 9 the step to file a list of creditors and identify those creditors or those claims that it disputes.

If you set a bar date, and disputed creditors by operation of the code and the rules would be forced to file claims, 502 says any party in interest can object to those claims. So we've been in hypothetical land, but let's just take this hypothetical one step further.

If that's where we were, a bar date established,

ATTACHMENT B

Calendar No. 436

73D CONGRESS, 2d Session } SENATE { REPORT No. 407

TO AMEND THE BANKRUPTCY ACT—MUNICIPAL INDEBTEDNESS

FEBRUARY 28 (calendar day, MARCH 5), 1934.—Ordered to be printed

Mr. NEELY, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany H.R. 5950]

The Committee on the Judiciary, having had under consideration the bill (H.R. 5950) to amend an act entitled "An act to establish a uniform system of bankruptcy throughout the United States", approved July 1, 1898, and acts amendatory thereof and supplementary thereto, report the same favorably to the Senate and recommend that the bill do pass.

The purpose and effect of this legislation are set out in House Report 207, which accompanied this bill in the House of Representatives, and which is hereby adopted as the report of the Committee on the Judiciary of the Senate, as follows:

The controlling purposes of the bill are to provide a forum where distressed cities, counties, and minor political subdivisions, designated in the bill as "taxing districts", of their own volition, free from all coercion, may meet with their creditors under the necessary judicial control and assistance in an effort to effect an adjustment of their financial matters upon a plan deemed mutually advantageous. If a plan is agreed upon by the taxing district and its creditors holding two thirds in amount of the claims of each class of indebtedness, and if the court is satisfied that the plan is workable and equitable, it may confirm the plan, and the minority creditors are bound thereby.

The general plan of this bill, as may be seen from the foregoing, is substantially that of the bills amendatory of the Bankruptcy Act dealing with railroads and dealing with corporations, which have been approved by the House.

THE CONSTITUTIONAL POWERS AND DUTIES OF CONGRESS

The following quotation is taken from an opinion given by the Attorney General April 21, 1933:

"Approaching the question whether Congress may enact any form of bankruptcy legislation applicable to municipalities, it should be borne in mind that Congress alone can effectively act. The Constitution prohibits the States from enacting any law 'impairing the obligation of contracts', and this prohibition

covers a law discharging insolvent debtors from liabilities incurred prior to its passage." (*Sturges* v. *Crowninshield*, 4 Wheat. 122.)

The committee concurs in this opinion, and is convinced that because of this limitation upon the power of the States contained in the Federal Constitution the States do not possess the power necessary effectively to deal with the situation which exists with regard to bankrupt taxing districts.

In the hearings before the committee it was disclosed that as of date March 25, 1933, there were scattered among 41 States, 805 cities, counties, taxing districts, etc., designated in this bill as "taxing districts," which were in actual default with the number now well above 1,000, with many others threatened with default.

The committee is also convinced that a large majority of holders of the obligations of these taxing districts desire the enactment of this proposed legislation.

The committee has also taken into consideration, and regards of great importance, the public necessity of making it possible for cities, by mutual and effective agreement with their creditors, so to adjust their existing indebtedness as to carry forward without too hurtful a diminution the discharge of their governmental duties of fire, police, and sanitary protection, and education, and meet the increased burden incident to caring for those who must seek public assistance in order to live.

THIS BILL DOES NOT EXTEND THE FEDERAL JURISDICTION OVER THE STATES OR OVER ANY OF THEIR SUBDIVISIONS

These defaulting taxing districts may now be sued by nonresidents in Federal courts as a private person may be sued for debt, and by mandamus may be compelled to levy the necessary tax to meet past due obligations, and their officers may be sent to jail for contempt if they refuse to proceed to the levy and collection of the necessary taxes.

This bill would suspend the exercise of that Federal power during the reasonable time provided by the bill while a new plan possible of being carried out is in process of formulation.

This bill does not permit a taxing district to be forced into court. Only upon its own initiative and petition can a taxing district become subject to the jurisdiction of the bankruptcy court under this bill.

The bill is not only temporary, made so by a specific limitation of 2 years, but it is also specifically provided that as soon as the final decree is entered in any case the Federal court before which the readjustment has been effected shall immediately cease all jurisdiction, leaving the parties to their present and ordinary remedies with reference to all matters connected with the plan which may later come into controversy. As a further limitation upon Federal power and in respect for the rights and responsibilities of the States, it is provided as follows:

"(l) Nothing contained in this chapter shall be construed to limit or impair the power of any State to control by legislation or otherwise any political subdivision thereof in the exercise of its political or governmental powers, including expenditures therefor and including the power to require the approval by any governmental agency of the State of the filing of any petition hereunder and of any plan of readjustment, and whenever there shall exist or shall hereafter be created under the law of any State any agency of such State authorized to exercise supervision or control over the fiscal affairs of all or any political subdivisions thereof, and whenever such agency has assumed such supervision or control over any political subdivision, then no petition of such political subdivision may be received hereunder unless accompanied by the written approval of such agency and no plan of readjustment shall be put into temporary effect or finally confirmed without the written approval of such agency of such plans."

This bill insofar as its coercive features are concerned is directed solely against the nonconsenting minority holding out, often, for its pound of flesh against the judgment of two thirds of the other creditors and against a taxing district unable to pay according to the present terms of its existing indebtedness, and in a sense holding out against the court of bankruptcy charged by the terms of the bill that before it may approve it, the judge must hear objections to the plan and find that the plan is fair and equitable.

The mechanics of the bill are substantially those of the two amendments to the Bankruptcy Act which are familiar to the House and which have been approved by the House.

MINORITY VIEWS

A minority of the Senate Judiciary Committee, to which was referred H.R. 5950, to amend the Bankruptcy Act of 1898, as amended and supplemented, feels that such bill ought to be rejected.

The recommendation that such bill be rejected is based upon two propositions: First, that said bill is unconstitutional; second, that the policy of enacting such legislation is ill-advised.

In support of the position taken by said majority of said subcommittee, it is respectfully submitted that the constitutionality of said bill has been the subject of prolonged and highly controversial discussion. It is the opinion of the undersigned that the weight of the authorities is to the effect that the bill is unconstitutional.

It is proposed by this legislation that any municipality or other political subdivision of any State, including any county, city, borough, village, parish, town, or township, unincorporated tax or special assessment district, and any school, drainage, irrigation, levee, sewer or paving, sanitary, port, improvement, or other districts may file petitions in courts of bankruptcy stating that the taxing district is insolvent or unable to meet its debts as they mature and that it is desirous of effecting a plan of readjustment of its debts upon the basis of its capacity to pay. Subject to numerous conditions contained in the bill, the judge of the United States district court may approve or disapprove the petition and the plan for refunding the debts of the petitioning municipality. If the plan be approved, the final decree of said court shall discharge the taxing district from those debts and liabilities dealt with in the plan and upon such confirmation the provisions of the plan and of the order of confirmation shall be binding upon (1) the taxing district, and (2) all creditors, secured or unsecured, whether or not affected by the plan, and whether or not their claims shall have been filed or evidenced, and if filed or evidenced, whether or not allowed, including creditors who have not, as well as those who have, accepted it. It is submitted that the grant of above powers to a court of bankruptcy is an interference with the powers, rights, and privileges of the sovereign States.

It is academic to suggest that the political units named in the bill are subdivisions of and agencies of the State. Such subdivisions and agencies are created by the State to carry out, in given localities, the business and functions of the State. Their authority is limited to the powers granted them under the constitution of the State, its statutes or by charter. Such powers must be exercised in strict compliance with such grants of power. Upon no other theory could the delegation of the power to tax, being a legislative function, be delegated to such political units.

By this bill, the Federal courts are empowered to revise and recast the debts and obligations of the subordinate governmental agencies of the States. They are empowered to alter and nullify the laws

theretofore enacted by the States and the ordinances of the States' subordinate governmental agencies exercising the power of taxation. It proposes to discharge the municipality and its officers from the duty imposed by State law to levy taxes to pay the debts and obligations of the municipality. These tax levies once fixed become liens which should not be interfered with nor nullified by Federal governmental action.

The opinion of the Attorney General's office rendered to the Judiciary Committee of the House attempts to draw a distinction between the proprietary and public capacities of a municipality and concludes as follows:

> In my opinion the private or proprietary capacity of a municipality is sufficiently distinct and definite to bring it within the purview of the bankruptcy power of Congress where the State, as the representative of the municipality's governmental functions, has given its consent.

It developed at the hearings that there is no recognized or uniform line of cleavage determining when a municipal unit is acting in a private or proprietary capacity and when it is functioning in a public or governmental capacity. Such distinction is purely of judicial origin to relieve the harsh rule denying recovery against municipalities for negligence of inferior officers and servants in the performance of duties connected with certain public activities. It has no application to the income, property, contracts, debts, bonds, appropriations, or tax levies for such public activities.

It is impossible to envisage a sovereign State as subject to bankruptcy courts. The power of the States and their subordinate governmental agencies to borrow money, incur obligations, and fix tax levies is essentially a function of the sovereign States, legislative in nature, and cannot be delegated to the judicial branches of the States, much less to the judicial branches of a foreign sovereignty.

In view of the above facts, the undersigned are of the opinion that the Federal Government is without power or authority to exercise jurisdiction over or interfere with the sovereign States or their subdivisions and agencies as provided in H.R. 5050.

THE POLICY OF THE BILL

After thorough public hearings and investigation, the undersigned are of the further opinion that, in the ground of policy as well as legality, the bill ought to be rejected.

As set out in the report of the committee on commercial law and bankruptcy of the American Bar Association, which report was unanimously adopted by the association at its annual meeting in 1933—

> The inevitable results of the operation of municipal bankruptcy must be to depress the market for municipal securities and seriously impair the credit of cities in sound financial position.

To this opinion we subscribe. Even proponents of this legislation have been candid enough to admit that the passage of either of the bills under discussion would affect the credit of solvent cities, would act as a drag on the sale of municipal securities and might demand a higher rate of interest on such securities. In all probability only a comparatively small percent of municipalities will take advantage of the provisions of the bills if enacted, yet the presence of the law on

the statute books would, in the opinion of the undersigned, cost investors and solvent municipalities millions of dollars.

Municipal securities have always been considered gilt edge investments. They have ranked second only to the obligations of the Federal and State Governments. Probate courts have for generations authorized and directed guardians, trustees and administrators to invest the trust funds under their control in municipal securities. The American Legion Endowment Fund Corporation now has approximately four and one-half million dollars invested in the bonds of municipalities and other political units. The capital of this corporation was contributed by public spirited citizens all over the United States for the purpose of creating an income which is expended solely for the rehabilitation and child welfare work in connection with the veterans of the World War. The officers of this fund are strongly opposed to the passage of this legislation. The funds of scores of fraternal insurance orders are similarly invested and such fraternal orders have gone on record as opposed to the bill.

The testimony taken at the hearings did not develop the fact that this legislation was necessary to avoid universal repudiation of municipal debts. While no witness seemed possessed of very accurate information on the subject, it was stated by the different witnesses that from 250,000 to 400,000 taxing districts would be potentially subject to this legislation. It is further safe to assume that approximately 2,000 of such units are in default in the payment of principal or interest or both on their obligations at this time. It is further agreed that there are outstanding approximately $20,000,000,000 of such municipal securities. In the face of such facts it surely cannot be argued that legislation of this character is universally demanded.

The most insistent demand for this legislation comes from cities which were overdeveloped during boom days when real-estate prices were pyramided and unreasonable and wholly unwarranted public improvements were projected upon such pyramided values. While it is palpable that such cities are at this time seriously involved, it is the duty of the State to come to the relief of such communities rather than to involve the faith and credit of the tens of thousands of solvent municipalities throughout the entire country by the passage of such Federal legislation as is here demanded. It is quite evident from the decision in the case of *Home Building & Loan Association* v. *Blaisdell*, rendered by the Supreme Court of the United States on January 8, 1934, that the State, through proper legislation, may declare such moritoria as may afford temporary relief to certain of its political subdivisions. It may also provide for direct relief to such municipalities and other political subdivisions. If this be true, we question the propriety of the Federal Government entering into the legislation contemplated by the bills under consideration.

Many reliable parties in interest have very frankly and fearlessly expressed themselves as opposed to this legislation. Among such opponents, may we cite the following:

1. American Bar Association.
2. American Bankers Association.
3. Chamber of Commerce of the United States.
4. National Fraternal Congress, representing fraternal societies with 8,000,000 members.
5. National Association of Credit Men, representing 20,000 manufacturing, wholesaling, and banking institutions.

6. Pennsylvania Fraternal Congress.
7. Ohio Chamber of Commerce.
8. Tacoma Chamber of Commerce.
9. Pennsylvania Fraternal Congress, having a constituency of 36 fraternal societies.
10. Polish Association of America, Milwaukee.
11. Junior Order of American Mechanics, Philadelphia.
12. New England Fraternal Congress.
13. Maryland Fraternal Congress.
14. Wisconsin Fraternal Congress.
15. Western Catholic Union, Peoria, Ill.
16. Degree of Honor Protective Association, St. Paul.
17. Ben Hur Life Association, having $8,000,000 in municipal bonds, Crawfordsville, Ind.
18. Association of Indiana Legal Reserve Life Insurance Companies, having $27,000,000 invested in municipal securities.
19. Ancient Order of United Workmen, having $10,500,000 invested in municipal bonds, Newton, Kans.

As aforesaid, on the ground of policy as well as legality, the undersigned members of said Judiciary Committee feel that said bill ought to be rejected.

FREDERICK VAN NUYS.
DANIEL HASTINGS.
FELIX HEBERT.
PAT MCCARRAN.

O

ATTACHMENT C

interpret it as they have done in the past consistent with the purposes of Chapter IX and the powers of the court.

SECTION 83

The purpose of section 83, copied from present section 83(i), is the same as that of section 82(c). It is to prevent the statute or the court from interfering with the power constitutionally reserved to the State by the Tenth Amendment. This section makes it clear that the chapter may not be construed to limit or impair the power of the State to control, by legislation or otherwise, any municipality, political subdivision or public agency or instrumentality in the exercise of its governmental functions. Any State law that governs municipalities or regulates the way in which they may conduct their affairs controls in all cases. Likewise, any State agency that has been given control over any of the affairs of a municipality will continue to control the municipality in the same way, in spite of a Chapter IX petition.

The proviso in current section 83(i), retained here, prohibiting state composition procedures was enacted in response to, and overruled the holding of the Supreme Court in, *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942).[4] In that case, the court upheld a New Jersey statute that permitted a binding composition of a municipality's debts upon the acceptance of a plan by 85% of the municipality's creditors. The composition dealt only with unsecured obligations, and the state statute prohibited reduction in the principal amount of the outstanding obligations. The Court refused to go beyond the facts of the case, holding only that the Contracts Clause of the Constitution did not prohibit that particular composition.

The proviso is retained for the same reason it was enacted by Congress:

> State adjustment acts have been held to be valid, but a bankruptcy law under which the bondholders of a municipality are required to surrender or cancel their obligations should be uniform throughout the [United] States, as the bonds of almost every municipality are widely held. Only under a Federal law should a creditor be forced to accept such an adjustment without his consent. H.R. REP. No. 2246, 79th Cong., 2d Sess. 4 (1946).

SECTION 84

Section 84 is derived in part from current section 81. It sets the eligibility requirements for relief under Chapter IX. The entity that files must be a political subdivision or public agency or public instrumen-

4. 62 S.Ct. 1129, 86 L.Ed. 1629.

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tality of a State. This is not meant to be limiting language, but rather is meant to be a description of general categories that cover all of the various entities now listed in section 81 of current law. The bill also omits any limiting reference to the manner by which the indebtness of the entity is payable. The intention of these two changes is to broaden the applicability of Chapter IX as much as possible. The entity must not be prohibited from filing by state law. The reference to a prohibition by state law recognizes a limitation frequently expressed in the

ATTACHMENT D

In my judgment, the provisions of the statute as it is being amended, with reference to fair plans and the approval thereof, the participation of the SEC, the optional character of the appointment of an independent trustee, are far superior to the present Chapter X, to the present combination of Chapters X and XI, and to limited proposals by the SEC, which in my opinion, do not recognize the extent to which the insights of 40 years ago are not responsive to today's needs.

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CHAPTER 6. ADJUSTMENT OF DEBTS OF A MUNICIPALITY

I. Introduction

A procedure for the adjustment of the debts of a financially distressed municipality has been a permanent part of the Bankruptcy Act since 1937.[1] The troubles of the depression drove many municipal units to default on their obligations. Because existing laws did not provide a procedure for the relief of hard-pressed municipalities, Congress responded to their plight with the enactment of a Municipal Bankruptcy Act.[2] The original legislation was declared unconstitutional by the Supreme Court,[3] but a later enactment [4] was upheld,[5] and remained a part of the Bankruptcy Act, with minor amendments, until last year. In the 94th Congress, major amendments to the municipal bankruptcy laws were made [6] as a result of the deteriorating financial plight of several of the larger cities, most notably New York, Yonkers, and Detroit.[7] The amendments adopted last year went far to modernize then existing procedure, which was "hopelessly archaic and unworkable for all but the smallest entities." [8] The Committee Report that accompanied the bill enacted last year explained the need for a municipal bankruptcy procedure,[9] and it is not necessary to repeat those considerations here.

The municipal bankruptcy law passed last year was adopted while the reforms proposed by H.R. 8200 were under consideration. Thus, many of the provisions in last year's amendments are derived in large part from the work of the Commission on the Bankruptcy Laws and the Subcommittee on Civil and Constitutional Rights.[10] The need for substantive revision this year is not great, and H.R. 8200 carries over substantially intact many of the reforms adopted last year. The changes that have been made fall into two categories. First, the municipal debt adjustments chapter, chapter 9 of proposed title 11, is conformed generally with the revisions in reorganization law contained in the bill. Current chapter IX is based largely on current chapter X of the Bankruptcy Act. The new chapter 9 is brought into conformity with proposed chapter 11, governing reorganizations generally. The changes resulting from this include changes in the financial rules for confirmation of a plan, and changes in some procedures.

The second basis for change from the bill adopted last year is the recent decision of the Supreme Court in *National League Cities* v.

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[1] Act of August 16, 1937, c. 657, 50 Stat. 654.
[2] Act of May 24, 1934, c. 345, 48 Stat. 798.
[3] *Ashton* v. *Cameron County Water Improvement District No. 1*, 298 U.S. 513 [56 S.Ct. 892, 80 L.Ed. 1309.] (1936).
[4] Act of August 16, 1937, c. 657, 50 Stat. 654.
[5] *Bekins* v. *United States*, 304 U.S. 27 (1938).
[6] Pub. L. No. 94-260, April 8, 1976.

[7] *See* H.R. REP. No. 94-686, 94th Cong., 1st Sess. 4 (1975).
[8] *Id.*
[9] *Id.*
[10] *Id.* at 5.

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Usery.[11] In that case, the Court enunciated a stronger policy of Federalism and States' rights than had been stated since the first Municipal Bankruptcy Act was held unconstitutional in 1936.[12] In deference to developing ideas of Federalism, this bill takes greater care to insure that there is no interference in the political or governmental functions of a municipality that is proceeding under chapter 9,[13] or of the State in its power to control its municipalities.[14]

II. GENERAL DESCRIPTION

Chapter 9 provides a workable procedure so that a municipality of any size that has encountered financial difficulty may work with its creditors to adjust its debts. Though the chapter is proposed as part of the bankruptcy code and is proposed under the bankruptcy power,[15] the term "bankruptcy" in its strict sense is really a misnomer for a chapter 9 case. Chapter 9 provides essentially for Federal court protection, and supervision of a settlement between the debtor municipality and a majority of its creditors. A municipal unit cannot liquidate its assets to satisfy its creditors totally and finally. Therefore, the primary purpose of chapter 9 is to allow the municipal unit to continue operating while it adjusts or refinances creditor claims with minimum (and in many cases, no) loss to its creditors.

The general policy underlying the municipal debt adjustments chapter is the same as that underlying the reorganization chapter: the chapter gives the debtor a breathing spell from debt collection efforts in order that it can work out a repayment plan with its creditors. There are two major differences from general reorganization law: first, the law must be sensitive to the issue of the sovereignty of the States; second, a municipality is generally not a business enterprise operating for profit, and there are no stockholders. These differences dictate some limitations on the court's powers in dealing with a municipal debt adjustment, and some modifications of the standards governing the proposal and confirmation of a plan.

Thus, the powers of the court are subject to a strict limitation—that no order or decree may in any way interfere with the political or governmental powers of the petitioner, the property or revenue of the petitioner, or any income-producing property. The purpose of this limitation derives from *Ashton* v. *Cameron Water Improvement District No. 1*,[16] which held the first Municipal Bankruptcy Act unconstitutional on the basis of infringement of State sovereignty. This limitation was included in the second Act, and was relied upon in *Bekins* v. *United States*,[17] which upheld the second municipal adjustments statute. The Court quoted extensively from the Committee Report on this point:[18]

> In *Ashton* v. *Cameron County District*, *supra*, the court considered that the provisions of Chapter IX authorizing the

[11] 426 U.S. 833 [96 S.Ct. 2465, 49 L.Ed.2d 245.] (1976). *See* Note, *Municipal Bankruptcy, the Tenth Amendment and the New Federalism*, 89 HARV. L. REV. 1871 (1976).
[12] Ashton v. Cameron County Water Improvement District No. 1, 298 U.S. 513 [56 S.Ct. 892, 80 L.Ed. 1309.] (1936).

[33] H.R. 8200, 95th Cong., 1st Sess. § 101 (proposed 11 U.S.C. 904).
[34] *Id.* (proposed 11 U.S.C. 903).
[35] U.S. CONST. art. I, § 8, cl. 4.
[36] 298 U.S. 513 (1936).
[37] 304 U.S. 27 [58 S.Ct. 811, 82 L.Ed. 1137.] (1938).
[38] *Id.* at 48-51 (footnotes omitted).

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bankruptcy court to entertain proceedings for "readjustment of the debts" of "political subdivisions" of a State "might materially restrict its control over its fiscal affairs," and was therefore invalid; that if obligations of States or their political subdivisions might be subjected to the interference contemplated by Chapter IX, they would no longer be "free to manage their own affairs."

In enacting Chapter [IX] the Congress was especially solicitous to afford no ground for this objection. In the report of the Committee on the Judiciary of the House of Representatives, which was adopted by the Senate Committee on the Judiciary, in dealing with the bill proposing to enact Chapter [IX], the subject was carefully considered. The Committee said:

". . .

"The Committee on the Judiciary is not unmindful of the sweeping character of the holding of the Supreme Court above referred to [in the *Ashton* case], and believes that H.R. 5969 is not invalid or contrary to the reasoning of the majority opinion . . .

"The bill here recommended for passage expressly avoids any restriction on the powers of the States or their arms of government in the exercise of their sovereign rights and duties. No interference with the fiscal or governmental affairs of a political subdivision is permitted. The taxing agency itself is the only instrumentality which can seek the benefits of the proposed legislation. No involuntary proceedings are allowable, and no control or jurisdiction over that property and those revenues of the petitioning agency necessary for essential governmental purposes is conferred by the bill. . . ."

We are of the opinion that the Committee's points are well taken and that Chapter [IX] is a valid enactment. The statute is carefully drawn so as not to impinge upon the sovereignty of the State. The State retains control of its fiscal affairs.

The Supreme Court and the Courts of Appeals have made it very clear that the jurisdiction of the court "is strictly limited to disapproving or to approving and carrying out a proposed composition."[39] The bill follows these holdings and retains the limitation on the court's power, especially in light of the more recent decision of the Supreme Court in *Usery* stressing the concept of non-interference by the Federal Government with State governmental powers.[40]

[39] Ledo Properties v. R. E. Crummer & Co., 128 F.2d 110, 113 (5th Cir. 1942).
[40] 426 U.S. 833 (1976).

ATTACHMENT E

The filing of the petition operates as an automatic stay of all actions, judicial or otherwise, and of the commencement or continuation of any action which seeks to enforce a lien against the petitioner, its property, its officers, or its inhabitants. This feature is new as well. It gives the petitioner the breathing spell it may need to get back on its feet financially, and the time it needs to negotiate and develop a plan of adjustment with its creditors.

The filing of a petition also makes unenforceable certain contractual provisions, such as those that terminate or modify, or permit a party to a contract other than the petitioner to terminate or modify, the contract for the reason that the petitioner is insolvent or has filed a petition for relief under the Bankruptcy Act. These clauses, known generally as ipso facto clauses, are often found in the commercial context. Their existence and enforceability may severely hamper a successful reorganization or arrangement proceeding under Chapter X or XI, so they are made unenforceable in those chapters. It is unknown how widespread such clauses are in the municipal context, because they are usually included only when there is some suspicion on the part of one contracting party that the other may become insolvent, and seldom is such an occurrence found in the municipal context. Nevertheless, it is felt that their existence could be detrimental to a successful municipal adjustment, and they are made unenforceable in Chapter IX in the same way as in Chapter X and XI—only if past defaults in performance are cured and adequate assurance of future performance is provided. This gives protection to the other contracting party, who may have entered into the contract relying on the petitioner's credit, which, after a filing, is markedly reduced.

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[13] S. Rep. No. 2094, 85th Cong., 2d Sess., 3805 (1958); *see* 8 *Collier, Bankruptcy* 4.06[6], at 390 (14th rev. ed. 1975).

[page 8]

After the filing of the petition, the court must give notice to the petitioner's creditors. The notice is by publication, and by mailing to those creditors whose addresses are known. Notice is also given to the Securities and Exchange Commission, and to the State in which the petitioner is located. The notice to the S.E.C. is designed to allow it to participate in an investor protection role. The municipal bond market is sufficiently interstate in character, involving investors in much the same way that the corporate bond market does, that it is felt that the S.E.C. may have an investor protection role to play in municipal adjustments the same as it does in corporate reorganizations.

The state is formally notified for two reasons. First, because the language of the eligibility section, section 84, allows an entity to file if the state has not prohibited it; and because withdrawal of State consent at any time will terminate the case, it is felt that the State should formally be put on notice so that it may object if it does not wish its subdivisions to proceed under a Chapter IX. Second, if the State does permit the municipality to proceed, the State is notified in order that it may participate with the municipality in formulating and implementing a plan of adjustment in a case in which the petitioner is unable to effect a feasible plan without the State's assistance. The intent is to make the proceeding a cooperative one with the State involved to the extent necessary to make the petitioner's plan success. full.

CERTIFICATE OF SERVICE

I hereby certify that on this 1st day of May, 2014, I emailed the foregoing to the Case Manager, who will then docket and cause electronic service to the parties and interested parties.

s/ Michael K. Ryan
Michael K. Ryan

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