Who is Eligible for Chapter 9 Relief?[1]

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Chapter 9 bankruptcy relief was enacted originally in 1934 to provide financially distressed "municipalities" with protection from creditors in order to develop and negotiate a plan for adjustment of debt. Only a "municipality" may file for relief under Chapter 9, and only voluntarily, not forced in against its will. 11 U.S.C. § 109(c) and 11 U.S.C. §§ 303(a).

While this may seem clear-cut, numerous of the more recent Chapter 9 cases have gotten bogged down with eligibility issues and battles. There are 5 basic elements that must be proven in order for a political entity to be found eligible for remaining in chapter 9.

The term "municipality" is defined in 11 U.S.C. § 101(40) as a "political subdivision or public agency or instrumentality of a State." This is a broad definition and looks to the particular state's laws which help define what constitutes subdivisions, agencies, and instrumentalities of the state. The definition is broad enough to include cities, counties, school districts, public improvement districts, urban county governments, water districts, fire protection districts and other kinds of special purpose bodies that might be quasi- political bodies such as industrial parks, highway authorities and others. Title IX of KRS, entitled "Counties, Cities, and other Local Units" (KRS Chapters 65-109) will come into play in our Kentucky Bankruptcy Courts on definition analysis.

Assuming an entity crosses the "municipality" hurdle, § 109(c) sets forth the 4 additional eligibility requirements for Chapter 9:

- The municipality is "specifically authorized" in its own capacity to be a debtor under state law or a government office or organization is empowered under state law to authorize the municipality to be a debtor. Kentucky law requires state approval before certain types may file. KRS Ch 66.

- The municipality is insolvent. "Insolvency" is defined in 11 U.S.C. § 101(32)(C) as generally not paying its debts as they come due unless the debts are subject to a bona fide dispute, or unable to pay its debts as they become due. The question becomes—how long out in to the future may governing officials look on possible or probable inability to pay?

- The municipality "desires to effect a plan to adjust" its debts. This would be proven by good faith discussions and documenting efforts. Open records and executive session laws could become an issue.

[1] This article is a service for friends and clients of DelCotto Law Group PLLC. The opinions expressed in this article are intended for general guidance only and not as recommendations for specific situations. As always, readers should consult a qualified attorney for specific legal guidance. We are a debt relief agency. We help people file for bankruptcy relief.

- One of the following four options is shown by the chapter 9 debtor:

> (1) Has obtained the agreement of creditors holding at least a majority of the amount of claims in each class that the municipality intends to impair under a plan;
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> (2) Has negotiated in good faith with creditors but failed to obtain the agreement of creditors holding a majority of the amount of the claims of each class that will be impaired under a plan;
>
> (3) Is unable to negotiate with creditors because such negotiation is impracticable; or
>
> (4) Reasonably believes that a creditor may attempt to obtain a transfer that is preferential and avoidable under 11 U.S.C. § 547.

Unfortunately, the eligibility to even proceed in Chapter 9 can become an expensive battle in and of itself. Fights over proving "insolvency" often are evidentiary battles with multiple expert witnesses. Several published opinions show that the eligibility hurdle often is not met. *See, e.g., In re Boise County*, 2011 WL 3875639 (Bankr. D. Id. 2011) (dismissed Chapter 9 petition, holding that county was generally paying its debts as they came due and thus county did not prove the insolvency requirement).

The paradox is interesting to consider. Forward thinking governing officials attempting to address looming inabilities to pay in the future, which is often the case, such as underfunded pension obligations, or future one time capital needs, may have a difficult time if creditors are opposing current efforts to address future problems. Yet, voters and taxpayers often complain that their governing leaders will not address big tough issues that are looming on the horizon. Kicking the can down the road indefinitely is not really an adequate strategy for governing officials, or for anyone else for that matter, unless "delay" is thoroughly explored as one of all options, and intentionally and thoughtfully selected as the best option.

As with any other chapter of bankruptcy, few really *want* to file bankruptcy. It is expensive, court governed, time consuming, and creates numerous litigation opportunities over side issues. However, as with all other chapters of bankruptcy, politicians and other governmental officials, in order to satisfy their due diligence duties, should always evaluate and understand the pros and cons of Chapter 9 as one of the possible alternatives to address fiscal issues. One of the pluses of bankruptcy is that it brings all issues and interested groups to the table at the same time, in the same controlled forum, rather than piecemeal efforts that are stalled.

DelCotto Law Group's mission is to insist upon thorough analysis of options and risk as the first step in any decision-making process. It is impossible to explore and develop strategy and action steps without considering the pros and cons of all possible options. If you would like more information about Chapter 9 options and analysis, please contact Laura Day DelCotto or any of the other attorneys at DelCotto Law Group at (859) 231-5800 or visit our website at www.dlgfirm.com.