

**RECENT STOCKTON CA AND JEFFERSON COUNTY AL CASES DISCUSS  
CONSTITUTIONAL UNDERPINNINGS OF CHAPTER 9<sup>1</sup>**

**By: Laura Day DelCotto (Copyright © 2012)**  
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Two separate cases decided in August 2012, one relying on the other, reaffirm the overall policy goals of the Bankruptcy Code in Chapter 9 settings.

The first case, decided August 6, 2012, came from the bankruptcy court in the *In re City of Stockton, Cal.*, chapter 9 case. 2012 WL 3193588 (Bankr. E.D. Cal. 2012). The retired city employee association sought an injunction to prohibit the city from implementing the city council's reduction of retiree health benefit payments. Judge Klein turned it into a constitutional law decision implementing the Contracts Clause and the Bankruptcy Clause of the Constitution. In short, the California Bankruptcy Court held that the Bankruptcy Clause can and does eclipse rights under the Contracts Clause all the time, and nothing changes about that in chapter 9. Without deciding whether the retired employees health benefits program was a "vested property interest," and even assuming that it was, those contracts could be "impaired" and thus completely changed in a Chapter 9 proceeding. The Court held that the Bankruptcy Clause of the United States Constitution gives Congress the express power to legislate uniform laws of bankruptcy that always result in impairment of contracts. Nothing is different in a Chapter 9 proceeding.

The *Stockton* decision also was used to give a primer — to reiterate a number of the key provisions of Chapter 9, and the lack of certain other Chapter 11 Bankruptcy Code provisions which are available in those cases but not in chapter 9. The court held that once a Chapter 9 is filed, there could be no "cherry picking" of which sections do or do not apply.

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In the second case, decided on August 28, 2012, the United States District Court for the Northern District of Alabama affirmed a decision by the bankruptcy court in the Jefferson County, Alabama Chapter 9 case. That case involved Jefferson County's decision to close a local hospital and cut off indigent care funding. The court quoted extensively from the *City of Stockton, Cal.* case. The court stated that the "purpose" of filing a Chapter 9 bankruptcy is to make "the funds of every department of the (governmental entity) subject to the bankruptcy court's authority." The court affirmed the bankruptcy court's decision denying relief from the automatic stay to allow state court proceedings regarding the funding of and the use of the county funds earmarked for operating the hospital. Those matters were properly before the Bankruptcy Court, and would not move outside in to state court proceedings.

As municipalities continue to wrestle with funding limitations, the chapter 9 cases already pending are only now beginning to result in a handful of published decisions on the merits of certain issues. These cases will be watched closely by those exploring and investigating the possibility of Chapter 9 as one of the available options to be considered.

For more information about this topic or how we could help to resolve your financial issues, please contact Laura Day DelCotto at [ldelcotto@dlgfirm.com](mailto:ldelcotto@dlgfirm.com) or any of the other attorneys at DelCotto Law Group.