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United States: Chapter 9 Municipal Bankruptcy—Utilization, Avoidance, and Impact

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Introduction

As a result of the global trend of decentralization and increased subnational[1] fiscal autonomy, the restructuring and discharge of subnational debt has emerged as a critical issue. Due to the 2008–09 economic crisis and the declining fiscal conditions facing U.S. municipalities,[2] and to certain municipal financial practices related to funding of pension obligations,[3] municipal bankruptcy has become a relevant and much discussed issue in the arena of municipal finance. The importance of the issues and the risks associated with municipal insolvency are increasingly recognized.[4]

In the United States, Chapter 9 of the U.S. Bankruptcy Code[5] for municipalities[6] has long been established although rarely used. However, past experience may not be an accurate predictor of the future.[7] Observers speculate that future Chapter 9 filings may be driven by municipal pension and health care liabilities. Press accounts indicate that these liabilities may reach crisis levels for many municipalities.[8] During the past two years, there been considerable media attention and market concern about the prospect of municipalities filing for protection under the provisions of Chapter 9 of the U.S. Bankruptcy Code.[9]

The increased interest in Chapter 9 and its recent use or consideration in several high-profile cases has resurrected interest in its provisions.[10] This chapter assesses the current state of Chapter 9 municipal bankruptcy and its use and impact on municipalities facing severe fiscal distress.

Prior to the enactment of Chapter 9 in 1937, the only remedies available to creditors when a municipality was unable to pay the creditors were for the creditors to pursue an action of mandamus[11] and compel the municipality to raise taxes or to seize its accounts. The general rule is that "public property" dedicated to a public use is not subject to debt foreclosure. In practice, very little property falls into the "proprietary" category. This argument may also apply to funds in the public treasury accounts to be applied to public purposes.[12] These remedies were largely ineffective and, in particular, created an environment that induced individual creditors to *race to the courthouse* to file separate mandamus suits. Creditors that might be disposed to negotiate a settlement were dissuaded if any creditor refused to agree to a settlement and *held out* for full payment, called the *holdout problem*. During the Great Depression, these remedies proved ineffective.

The fundamental objective underlying the enactment of Chapter 9 is to provide a distressed municipality court protection from creditors, while it develops and negotiates a plan for adjusting its debts in a manner that enables it to continue to provide essential services.[13] A municipality, unlike a private corporation, is not created to generate profits but to provide public services to its residents, and it has an obligation to continue to provide these services even when facing economic difficulties.

Approximately 600 municipal bankruptcy petitions have been filed through 2011.[14] Most of these filings were by small, special-purpose districts such as water and sewer districts or small rural municipalities.[15] There were only 252 municipal bankruptcy filings between 1980 and 2011.[16] This compares to 51,259 business filings under Chapters 7 and 11 in 2010 alone.[17] A Chapter 9 filing for municipal bankruptcy by a general purpose municipality is a relatively rare event.[18] Default on debt appears to be equally rare. A study by Moody's Investors Services found that only three general purpose governments rated by Moody's had defaulted on long-term bonds in 30 years.[19,20]

Municipal bankruptcies are less frequent. As a result of the lack of judicial precedents interpreting the provisions of Chapter 9, many issues relating to the application of Chapter 9 are also not fully developed. Notwithstanding the shortage of case experience, in recent years there have been several significant cases that have enhanced the ability to assess the potential impact of Chapter 9,[21] the impact of municipalities seeking to avoid a Chapter 9 filing by negotiating with their creditors, and the impact of using the threat of a Chapter 9 filing as leverage in such negotiations.[22]

This chapter is organized as follows. Section two presents an overview of Chapter 9, with a focus on key elements of Chapter 9 that are shaped by the unique federal structure of the United States. Section three reviews the use of Chapter 9 and focuses on selected cases. Section four analyzes the impact of Chapter 9 and assesses the benefits and limitations of Chapter 9. Section five concludes and points to future areas of research.

Chapter 9: An Overview

Much of the structure of Chapter 9 is shaped by two federal constitutional constraints: the Contracts Clause[23] and the Tenth Amendment to the U.S. Constitution.

The Contracts Clause prohibits the states from passing laws that impair, that is, interfere with, existing contracts. Therefore, states cannot pass laws that would adjust a municipality's debt obligations, in effect impairing the creditors' interests in the debt obligation contracts. This constitutional restriction does not apply to the federal government.[24]

The Tenth Amendment to the U.S. Constitution reserves certain powers to the states regarding the management of their internal affairs. Chapter 9 must balance a bankruptcy court's power to restructure municipal debts with the sovereignty of a state and its municipal entities' ability to control their own affairs. As a result, the bankruptcy court plays a much more limited role in Chapter 9 than in the bankruptcy proceedings of private entities.[25] Although Chapter 9 contains many provisions similar to other chapters of the Bankruptcy Code applying to private entities, Chapter 9 is significantly different. For example:

- Creditors cannot force an involuntary filing, submit their own Plan for the Adjustment of Debts, move for the appointment of a trustee, or contest the decisions of the municipality regarding its property and revenues.[26]

- There is no provision in the law for liquidation of the assets of a municipality and distribution of the proceeds to creditors.
- The bankruptcy court cannot impose taxes.[27]
- The bankruptcy court generally is not as active in managing a municipal bankruptcy case as it is in corporate reorganizations under Chapter 11.[28]
- A municipality must be *specifically authorized* by the state to file for Chapter 9 Bankruptcy.[29]

In addition, state laws governing the activities and finances of municipalities cannot be interfered with. Chapter 9 is respectful of not interfering with a state's control over its municipalities by reserving to the state the power to control its municipalities and limiting the jurisdiction and powers of the Bankruptcy Court.[30]

Eligibility

A *municipality* may only use Chapter 9 of the Bankruptcy Code[31] *and* only a *municipality* may file for relief under Chapter 9.[32] In addition, Chapter 9 requires that the municipality must[33]:

- Be specifically authorized by state law to be a debtor
- Be *insolvent*[34]
- Desire to effect a plan to adjust its debts
- Engage in certain prefiling efforts to work out its financial difficulties. The debtor must have reached agreement toward a plan or must have failed to do so despite *good faith* negotiations, or such negotiation must be *impracticable*.[35]

The threshold for seeking bankruptcy protection is higher for a municipality than for a private business entity filing a Chapter 11 petition. In addition, a municipal debtor is subject to fewer constraints in its operations, and the court's role and powers are far more limited. The bankruptcy court cannot take over the governance of the debtor. Nor can the court interfere with the municipality's political or governmental powers or with its properties or revenues. The court cannot order a reduction in expenditures, an increase in taxes, or sales of property.

Due to these limitations on the court's jurisdiction over a municipality, some have argued that Chapter 9 may be used too easily by municipalities since they receive protection from creditors and the creditors are subject to debt adjustment pursuant to a Plan of Adjustment proposed by the municipal debtor, while at the same time the court cannot substantially interfere with municipal affairs, thus creating a moral hazard of abusing the Chapter 9 process. To counter this possibility, Chapter 9 provides for the dismissal of any petition not filed in *good faith*. This *good faith* requirement has been interpreted to mean that the municipal debtor must be attempting to effect a speedy, efficient reorganization on a feasible basis and to prevent the municipal debtor from attempting to unreasonably deter and harass its creditors.[36] Such good faith negotiations must be wary of preferring certain creditors over others, as in the event of bankruptcy such preferred arrangements may be voided. The voiding of preferred arrangements and the recovery of preferred payments, coupled with transparency, public access, and "sunshine," have substantially reduced the problem of nontransparent prefiling negotiations.

The intention to counter moral hazard, or abuse of the protection, also lies behind many other provisions: the insolvency test, for example, is designed to protect creditors and avoid abuse when less drastic remedies are available. The potential moral hazard of a debt adjustment procedure that is too easily available by not inflicting significant penalties on municipal affairs seems to be effectively countered by the stringent eligibility requirements and evidenced by the low use of Chapter 9 by municipalities.

Definition of municipality. The term *municipality* is defined as "a political subdivision or public agency or instrumentality of a State."[37] The definition is broad enough to include cities, counties, townships, school districts, and public improvement districts. It also includes revenue-producing bodies that provide services that are paid for by users rather than by general taxes, such as bridge authorities, highway authorities, and water and sewer authorities.[38]

Although this is a broad definition that clearly includes general purpose municipalities and special service districts, it is not without limitation. In the Orange County bankruptcy, the court held that the Orange County Investment Pool (OCIP) was an instrumentality of Orange County and not of the state; therefore the Investment Pool was not eligible to file under Chapter 9 as a municipality.[39] In addition, a recent case involving the Las Vegas Monorail Company's[40] filing for reorganization under Chapter 11 was challenged by Ambac Assurance Corporation, which had issued a guarantee of the Las Vegas Monorail's outstanding bonds.[41] Ambac argued that the Las Vegas Monorail was a "public instrumentality" of the state of Nevada and as such could only file pursuant to Chapter 9.[42] Although the interest on the Las Vegas Monorail's bonds was exempt from federal income taxation as a public instrumentality of the state, Ambac's motion was denied by the Bankruptcy Court of the District of Nevada.[43] The judge argued that although the Las Vegas Monorail Company had expressly acknowledged itself as an "instrumentality of the state of Nevada" for obtaining the tax exemption on its debt and that it was a company controlled by the Governor of the state of Nevada, the term "public instrumentality" of Chapter 9 was vague and that the Las Vegas Monorail Company did not have sufficient municipal qualities and characteristics to be considered a municipality within the meaning of Chapter 9.[44]

This case demonstrates that the determination of eligibility is not a simple matter and may vary among states.[45] For example, in a case involving New York City's Off-Track Betting Corporation (OTB) filing under Chapter 9, the court found that OTB was a *municipality* since it is a public benefit corporation "created by the State for the general purpose of performing functions essentially governmental in nature."[46]

The eligibility determination is critical because it may be more beneficial for a municipality to have one of its special purpose entities to proceed under Chapter 9 than it would be to proceed under Chapter 7 or Chapter 11. This is because Chapter 9 is more restrictive of creditor rights, reflecting the need to preserve essential public services.

State authorization. A municipality must be specifically authorized by the state to file for Chapter 9 bankruptcy.[47] This requirement of state authorization derives from the Tenth Amendment principle that the federal government may not interfere with states' internal governance. Chapter 9 must respect states' sovereignty over their political subdivisions. While Chapter 9 offers a municipal bankruptcy process, the state authorization requirement leaves to each state the final say over whether and which of its political subdivisions may have access to this process.[48]

A state has significant interests related to its municipalities' filing pursuant to Chapter 9. For example, a state may be concerned that, among other things, the impact of such a filing would limit the access of other municipalities in the state to the credit markets by lowering credit ratings in the state and increasing borrowing costs of all municipalities within the state.[49] However, such state interests do not necessarily coincide with the interests of the municipality. In addition, the state may be a creditor of the municipality. The requirement of state authorization may not be in the best interests of a financially distressed municipality.

States have approached the authorization requirement in several ways. In some states, there is a broad statute that grants filing authority to all municipalities. However, many states—including California, which until recently had such broad authorization[50]—limit which entities can file and under what circumstances, or require special approval of state authorities to permit a filing.[51] Twenty-three states prohibit their municipalities from filing pursuant to Chapter 9.[52] (See table 8.1.)

Table 8.1 State Authorization of Chapter 9 Bankruptcy

Chapter 9 eligible		Chapter 9 ineligible	
Alabama	Missouri	Alaska	New Mexico
Arizona	Montana	Delaware	North Dakota
Arkansas	Nebraska	Georgia	Oregon
California	New Jersey[a]	Hawaii	South Dakota
Colorado	New York	Indiana	Tennessee
Connecticut[a]	North Carolina[a]	Kansas	Utah
Florida	Ohio[a]	Maine	Vermont
Idaho	Oklahoma	Maryland	Virginia
Illinois[a]	Pennsylvania[a]	Massachusetts	West Virginia
Iowa	Rhode Island[a]	Mississippi	Wisconsin
Kentucky	South Carolina	Nevada	Wyoming
Louisiana[a]	Texas	New Hampshire	
Michigan[a]	Washington		
Minnesota			

Sources: Laughlin 2005; Spiotto 2008.[53]

a. States that conditionally authorize municipal bankruptcy.

Insolvency. A municipality must be *insolvent*.[54] Only municipalities filing in Chapter 9 face a statutory requirement of a determination of insolvency. However, because municipal assets are not subject to seizure or liquidation, insolvency of a municipality is not determined by examining its balance sheet but rather is based on cash flow. A municipality either must not be paying its debts when due or must be unable to pay such debts when they become due in the future.[55]

Determination of a municipality's insolvency requires a comprehensive cash flow analysis of factors including multiyear cash flows, available reserves, ability to reduce expenditures or borrow, and legal options to postpone debt payments. The municipality is expected to continue to operate and provide at least a minimal level of services.

A municipality's taxing capacity also enters into the analysis of insolvency. Although a municipality need not exercise its taxing authority to the fullest extent to be insolvent, a failure to consider any reasonable tax increase may lead a court to conclude that the *good faith* requirement (discussed under Eligibility) has not been met. In a case involving Bridgeport, Connecticut, the court held that the city, which had chronic financial problems, a US$16 million annual deficit, and the highest effective tax rates in the state, was not insolvent because it had not exhausted its financing power and, therefore, could not demonstrate that it would run out of funds in the next fiscal year.[56]

Commencement of Chapter 9: Automatic Stay and Revenue Bond Preference

One of the most important and immediate advantages of a Chapter 9 filing is the protection from legal actions that might be taken by creditors.[57] The automatic stay prohibits the continuation of creditors' lawsuits and the exercise of remedies against a debtor until the creditor obtains relief from the stay.[58] This protection provides the municipality with a period of time to deal with its financial crisis and to conduct negotiations without having to deal with legal claims of creditors.

Different types of bonds receive different treatment in municipal bankruptcy cases. General obligation bonds are treated as general debt in Chapter 9 cases. During the period of the automatic stay the municipality is not required to make payments on general obligations bonds. The obligations created by general obligation bonds are subject to negotiation and possible restructuring under the Plan of Adjustment.

Special revenue bonds,[59] by contrast, will continue to be secured and serviced to the extent that special revenues are available after the payment of the operating expenses of the project or system from which the revenue is derived.[60,61] Such revenues may be applied to payments coming due on special revenue bonds without violating the automatic stay.[62]

Although general obligation debt constituting the full faith and credit of a municipality may be generally viewed as the best credit a municipality can offer a creditor, in a Chapter 9 proceeding, debt secured by a single, limited, special revenue, having a protected status from impairment, may have a preferred credit status.

Plan of Debt Adjustment

Chapter 9 provides the municipal debtor with a means to refinance or reduce its debt and to obtain relief from burdensome contractual obligations, such as collective bargaining agreements. At the time a municipal debtor files for Chapter 9,[63] it must file a disclosure statement and a plan for the adjustment of its debts. The disclosure statement and the Plan of Adjustment are sent to the creditors for a vote. The Plan of Adjustment is proposed by the municipal debtor and submitted to the court and must be *fair and equitable* and *in the best interests of the creditors.*[64]

Executory contracts. The Plan of Adjustment may include, and the court may approve, the assumption or rejection of executory contracts.[65] The municipal debtor can assume unexpired leases and executory contracts that are beneficial and reject those that are burdensome.[66] For many municipalities the financial obligations associated with labor agreements and pensions are a substantial source of the financial distress. (For example, see the discussion of Vallejo, California, later.) Labor agreements and pension obligations are subject to an assumption or rejection in Chapter 9.[67,68]

Debt adjustment. In addition to the automatic stay, a significant benefit of Chapter 9 is that the bankruptcy court has the power to approve the Plan of Adjustment over the objection of creditors so long as the requisite majorities of creditors holding similar claims have approved the Plan and so long as the Plan does not discriminate among holders of similar claims.[69] In order to be confirmed, the Plan of Adjustment must be accepted by one-half in number and two-thirds in amount of each class of claims that is impaired under the Plan of Adjustment.[70] This provision was one of the primary motivations behind the enactment of Chapter 9.[71,72]

The Plan of Adjustment can impair the rights of holders of secured and unsecured debt. A vote of a majority of each class of debtor will bind dissenting creditors in that class. Notwithstanding a rejection by a class, if at least one impaired class approves the plan, the court may confirm the plan, forcing creditors to go along with a plan they have not accepted.

The bankruptcy court's role is limited to the acceptance or rejection of the plan. However, the court must still determine that the plan is *fair and equitable*, *feasible*, and *in the best interests of the creditors*.[73] Feasibility of a plan would be based on the expectation that the municipality is capable of carrying out the plan.[74] The *best interests of the creditors* is a more ambiguous standard. The test has been interpreted to mean that the plan must be better than other alternatives available to the creditors. In a Chapter 9 case, the alternative would be dismissal of the case, leaving a chaotic situation in which every creditor must fend for itself. An issue of some ambiguity is the extent to which the best interests test requires a municipality to raise taxes in order to meet debt obligations. The Supreme Court has held that the fairness of a plan cannot be evaluated without specific findings on a district's ability to pay bonds with tax revenues.[75] Determining the point to which taxes can be effectively raised is difficult. At some point tax increases will result in a decreasing collection rate, causing a decline in tax revenues.[76] In addition, the Plan of Adjustment must comply with state law that may be different in each state. For example, in the recent Chapter 9 filing by Central Falls, Rhode Island, a provision of a recent Rhode Island law providing that bondholders are to be paid first became a contentious issue with other creditors such as the pension funds and labor unions.[77]

Bankruptcy Courts: Restricted Powers

Chapter 9 is designed to recognize state sovereignty and the court's limited power over operations of the municipal debtor[78] by restricting the power of the bankruptcy court to interfere with:

- Any of the political or governmental powers of the municipality
- Any of the property or revenues of the municipality

- The municipality's use or enjoyment of any income-producing property unless the municipality consents or the plan so provides.

These provisions clearly provide that the municipality's day-to-day activities are not subject to court approval and that the debtor may borrow money without the court's approval.[79] In addition, the court cannot appoint a trustee (except for limited purposes[80]) and cannot convert the case to a liquidation proceeding.[81, 82]

If the Chapter 9 proceeding fails to produce a Plan of Adjustment acceptable to the bankruptcy court, the case will be dismissed and the relationship between the municipality and its creditors will continue as before the Chapter 9 filing, with whatever remedies are available to the municipality and its creditors under state law. Dismissal of the case without the approval of a plan puts the municipality in a difficult situation, because the municipality remains unable to pay its debts and is now without the protection of the automatic stay. The power of the bankruptcy court to reject the plan and force the municipal debtor and creditors into the maelstrom and unpredictability of litigation is the only, although substantial, leverage that the bankruptcy court has in Chapter 9.

Use of Chapter 9

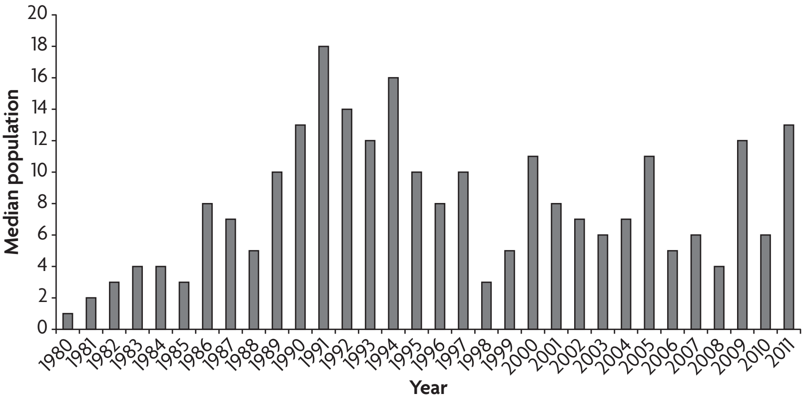
Statistics on Chapter 9 Use

There were approximately 600 municipal bankruptcy filings from 1937 to 2011.[83] For bankruptcy practitioners, this number is small, and the use of the law is often described as "rare." For example, in 2010 there were only 6 Chapter 9 filings compared to 56,282 business bankruptcy filings.[84]

As shown in figure 8.1, from 1980 to 2011, there were 252 Chapter 9 petitions filed, or about eight filings annually. The annual number of filings peaked in 1990 at 18, while there was only one filing in 1980, the lowest number.

One crucial feature of Chapter 9 use is that most filings are not by general purpose municipalities, but by municipal utilities, special purpose districts, and other types of municipalities. From 1980 to 2007,

Figure 8.1 Annual Chapter 9 Filings, 1980–2011



Sources: 1980–2010 data are from the American Bankruptcy Institute, http://www.abiworld.org; 2011 data are based on cases recorded at http://www.pacer.gov.

only 17.5 percent of Chapter 9 filings were from general purpose municipalities—cities, villages, or counties—while 61.8 percent were from utilities and special purpose districts.[85] Other Chapter 9 filers were mainly schools, public hospitals, and transportation authorities.[86] Only four of the 13 Chapter 9 filings in 2011, for instance, are from general purpose municipalities, including Boise County, Idaho; the city of Central Falls, Rhode Island; the city of Harrisburg, Pennsylvania; and Jefferson County, Alabama.[87]

From 1980 to 2007, more than 60 percent of filings were concentrated in four states: California, Colorado, Nebraska, and Texas. Nebraska had 39 Chapter 9 filings from 1980 to 2007, the highest number, followed by Texas with 33 filings, and California and Colorado, with 22 filings each.[88]

Close scrutiny reveals that most general municipalities that filed for Chapter 9 tend to be small entities. Based on cases recorded in Public Access to Court Electronic Records (PACER), the population median is 1,305 for those that filed, and more than 75 percent had a population of less than 10,000.[89] This fact, coupled with the frequently observed state involvement in the fiscal distress of large municipalities, may support the hypothesis that states tend to aid big municipalities and would not allow them to go broke.

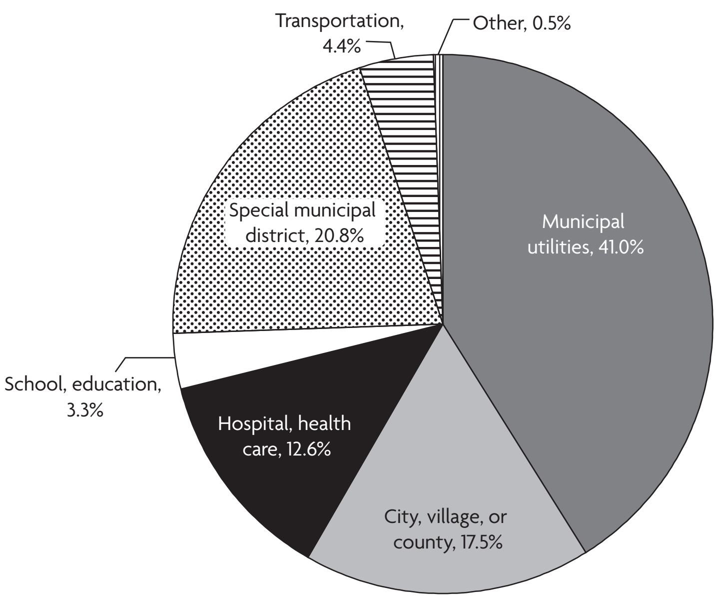
Five general purpose municipalities filed under Chapter 9 twice, but refiling is rare for other types of municipalities.[90] Three of the five refilings occurred in 2009, highlighting the impact of the recession on local government finances and the potential for revisiting Chapter 9 by previous filers (see figure 8.2).[91]

From 1937 to April 2012, 162 of 636 of the Chapter 9 filings, or approximately 26 percent, have been closed or dismissed without a plan of adjustment being filed. Since 1980, 81, or approximately 31 percent, have been dismissed or closed without a plan of reorganization of the filings (Spiotto 2012).

Selected Chapter 9 Cases

Below are brief descriptions of important Chapter 9 cases, of recent municipal experience with Chapter 9, and of municipalities considering Chapter 9. They illustrate different origins of Chapter 9 filing and reflect applications of the Chapter 9 framework.

Figure 8.2 Chapter 9 Filings by Type of Municipality, 1980–2007



Source: Spiotto 2008.

Until 2010, Orange County, California, was the largest municipal bankruptcy in the United States. However, Jefferson County, Alabama, which filed for bankruptcy in 2011, is now the largest to file a petition under Chapter 9. Both municipalities experienced fiscal distress as a result of the use of certain derivative debt instruments. Vallejo, California, is an example of a municipality financially burdened by labor agreements and pension obligations in the face of continuing economic decline. Harrisburg, Pennsylvania, the state capital, is experiencing financial distress as a result of a guaranty that it issued on the debt of a local authority used to build an incinerator. Westfall, Pennsylvania's financial distress was the result of a one-time liability judgment, and its Chapter 9 experience appears to have been efficient and effective.

Orange County, California. Orange County, California, was one of the fastest growing, richest counties in the United States and, as mentioned, was, at the time, the largest municipality in U.S. history to file for Chapter 9 bankruptcy, in 1994.[92]

At the time of its bankruptcy, the county was the fifth-most-populous county in the United States, with 2.5 million residents, had a budget that exceeded US$3.7 billion, and employed about 18,000 people.[93]

As a result of the restrictions imposed by the California Constitution[94] on the ability of local governments to raise local tax revenues, and the increasing demand for high-quality public services, public officials have been tempted to search for creative solutions to these challenges.[95] The County Treasurer was in charge of the OCIP, which invested funds of Orange County and of more than 200 other local public agencies including 31 cities, regional transportation agencies, local school districts, local water agencies, sanitation districts, and many small local agencies. The OCIP had assets of US$7.6 billion in 1994 that were invested in derivative instruments and high-yield long-term bonds. In addition, the OCIP borrowed US$2 for every US$1 on deposit, creating total liabilities of US$20.6 billion. As a result of market conditions that devalued OCIP investments, by November 1994, the OCIP had lost US$1.64 billion.

Awareness of the situation caused many Wall Street firms to commence legal actions to seize collateral, that is, the remaining assets of the OCIP. Orange County filed for Chapter 9 in December 1994 to avail itself of the automatic stay protection of Chapter 9. The filing did not stop the creditors' legal proceedings against the OCIP assets held as collateral by banking institutions, but it froze OCIP funds, preventing withdrawals and causing severe distress for Orange County and the local agencies that had invested their funds with it.

Both Orange County and the OCIP filed for Chapter 9 bankruptcy. The OCIP filing was rejected by the bankruptcy court based on a determination that it was not a *municipality* pursuant to Chapter 9 (see the discussion on Eligibility). Orange County initially submitted a Plan of Adjustment (Plan A) that called for an increase of one-half percent in the sales tax. Such an increase was subject to voter approval pursuant to California law, in effect requiring voter approval of Plan A. Voters overwhelmingly rejected the increase. Orange County then developed Plan B, which was substantially based on forbearance by the local public agencies that had invested in the OCIP and their willingness to seek reimbursement of their investment losses from the results of litigation by Orange County against the banking institutions and other professionals involved with the OCIP.[96]

Plan B also provided for refinancing the outstanding county debt. This was accomplished in June 1996 while Orange County was still in bankruptcy, through the issuance of US$880 million in 30-year bonds that were insured by a municipal bond insurer. This refinancing permitted Orange County to exit Chapter 9 by the end of June 1996.

Much of the impact of Plan B was felt after Orange County exited from bankruptcy.[97] This huge amount of debt for Orange County prevented the county from borrowing for other purposes, and the transfer of certain revenue sources to the payment of the debt put substantial stress on the Orange County budget. The Orange County budget constraints, together with an US$850 million shortage for local public agencies that had invested in the OCIP, resulted in severe budget cutbacks by Orange County and the investor local public agencies. Many of the local public agencies[98] that were OCIP investors were deliverers of public services, such as school districts, utilities, and health care and other social services. Most of the resulting budget cuts were in public protection, general government services, and community and social services. The impact fell disproportionately on the poor[99] since they are more dependent on county government programs. There were large budget cuts in social service agencies that serve the poor and cuts in basic infrastructure and transportation programs, and user fees for services were increased.[100]

The Orange County bankruptcy was precipitated by a risky investment strategy rather than a shortage of tax revenues and increased spending. The county emerged from Chapter 9 18 months later, in June 1996, and at that time sold US$880 million of insured bonds needed to refinance its debts. From the perspective of the current county treasurer, bankruptcy was beneficial; Orange County was insolvent and bankruptcy allowed it to reduce its debt to an affordable level and begin a path to sound fiscal health. Just two years after filing, it had access to the lending markets, and seven years after filing it had an AA bond rating. The downside was the risk to its reputation.[101]

The Orange County bankruptcy was both orderly and quick. Within 18 months, a Plan of Adjustment had been adopted that called for full repayment of creditors' claims (excluding lost interest and the forbearance of the shortfall to the local public agencies, which would be paid to the extent of amounts recovered as a result of litigation against the banking institutions and other professionals involved in the OCIP). This probably would not have been possible without the automatic stay on litigation and the financial relief provided by the suspension of payments to creditors during the stay.[102] Chapter 9 appears to have been sufficiently flexible to accommodate the operational needs of the county and the interests of its creditors.[103]

City of Vallejo, California. Vallejo, a community of 120,000, is the largest California city, by population, ever to file for Chapter 9 bankruptcy, and the only general purpose municipality to do so in California since 2001. Vallejo's finances have long been dominated by the costs of its labor agreements, and its distress was caused not by a debt issue but by a budget issue, that is, a long-term structural imbalance that was the result of a declining economic base, decreased revenues from property and sales taxes, cuts in funds from the state, and labor contracts that were out of line with the city's budget realities.[104] This trend was exacerbated by the recent economic slowdown. A large part of Vallejo's fiscal problems had to do with diminishing revenue; city tax collections plummeted from US$83 million during 2007–08 to US$65 million during 2010–11, a result of the recession and the housing bust. Housing values have fallen an astonishing 67 percent.[105]

Pension liabilities and financial obligations per labor contracts are by far Vallejo's largest debt. Prior to filing for Chapter 9, Vallejo had negotiated with several of its labor unions but was unable to reach an agreement. Vallejo filed for Chapter 9 bankruptcy in May 2008.[106]

Vallejo submitted a Plan of Adjustment it deemed feasible at the time and sought to adjust its labor contracts. The labor unions challenged the right of the bankruptcy court to approve a plan that abrogated their collective bargaining agreements. The court ruled that such executory labor contracts can be voided in a Chapter 9 proceeding.[107] Since the court decision, Vallejo has negotiated contracts with three of its four labor unions.[108]

During the bankruptcy proceedings, Vallejo continued to make all payments on its non-General Fund obligations (including water revenue bonds, tax allocation bonds, and assessment and improvement district bonds) on time and in full. The majority of this debt, approximately US$62 million, consisted of water revenue bonds, which were paid from the net revenues of the city's water enterprise. Payments on General Fund debt service, however, were paid at less than contractual rates.

During the Chapter 9 proceedings, the city's finances continued to deteriorate.[109] The feasibility of the original Plan of Adjustment diminished over time and municipal officials had to renegotiate further concessions from its unions.[110]

After spending three years and five months in Chapter 9 proceedings, the bankruptcy judge approved Vallejo's revised five-year Plan of Adjustment and its exit from Chapter 9 in November 2011.

Vallejo has closed fire stations; cut funding to senior centers, libraries and public works; eliminated minimum staffing requirements for the fire department; and sought new sources of revenue. Among other changes, city workers now contribute more to their health insurance, pension benefits are reduced for new employees, and pension contributions by current workers are increased. Pension benefits for current retirees were not changed.[111] The Plan does not adjust debt that is secured by designated revenue sources, such as water revenue bonds, and it restructures the debt owed to unsecured creditors, which will receive between 5 and 20 percent of their claims over two years.[112]

Unlike Orange County, Vallejo's bankruptcy process has not been quick, and unlike Orange County, where the distress was precipitated by a one-time event, the financial distress of Vallejo is based on structural fiscal imbalance, which was exacerbated by the economic decline. The Chapter 9 process does not seem to be as effective at resolving this type of fiscal distress. The process took more than three years at a cost of approximately US$9.5 million in legal fees.[113] Despite its limited effectiveness, bankruptcy has enabled the control of wage cost and pension liabilities, which account for more than three-quarters of Vallejo's General Fund spending.[114] However, Vallejo continues to face fiscal challenges.

Jefferson County, Alabama. Jefferson County, Alabama's most populous county, which includes Birmingham,[115] filed for Chapter 9 bankruptcy in November 2011 and has become the largest municipal bankruptcy in U.S. history. The filing is to resolve the overindebtedness of the county's sewer system—a special purpose vehicle. The sewer system, since inception in 1994, has suffered a structural imbalance in revenue and expenditure. The city resorted to structured financial products to reduce debt service obligations. However, the 2008–09 global financial crisis destabilized the market for such debt instruments.

The county began a sewer restoration and rehabilitation program in 1994. That effort, initially estimated to cost US$1 billion, grew into a US$3.2 billion project to rebuild and expand the system.[116] Jefferson County issued US$3.2 billion in bonds to finance the project.

The county's bankruptcy filing represents that sewer rates in Jefferson County increased 400 percent. In an attempt to reduce debt service costs while limiting increases in tariffs, the county swapped its long-term fixed higher interest rate into a short-term variable rate by entering into interest rate swap agreements. The 2008–09 financial crisis destabilized the market for such debt instruments, resulting in increased debt service largely as a result of financial market illiquidity.[117] In 2008, Jefferson County defaulted on its sewer debt payments, which resulted in an acceleration of the debt.[118]

The county had also been hurt by the loss of an occupational tax that brought in 44 percent of its discretionary revenue. The state Supreme Court ruled the tax unconstitutional in 2011, and the county has laid off hundreds of employees as a result.[119]

Unlike the city of Harrisburg, Pennsylvania (see below), where the state of Pennsylvania moved swiftly to intervene in the city's financial situation, the state of Alabama has resisted providing any assistance to Jefferson County.[120]

Jefferson County had been considering filing for bankruptcy pursuant to Chapter 9 for several years.[121] In lieu of such filing, it reached a forbearance agreement[122] with creditors in 2009 while it negotiated with creditors.[123] The governor and a majority of council members supported the negotiation of the debt in lieu of Chapter 9 filing because they wanted to avoid the "stigma" of bankruptcy. However, the possibility of a Chapter 9 filing and the desire of both the county and creditors to avoid Chapter 9 was part of the dynamic of these negotiations,[124] which revolved around[125]:

- Writing down a significant portion of the sewer debt
- Restructuring the remaining debt at fixed rates
- Limiting sewer rate increases to the rate of inflation.[126]

However, in November 2011, the negotiations were suspended and the county filed for Chapter 9 bankruptcy. This bankruptcy proceeding will raise several legal issues relating to Chapter 9, including but not limited to the issue of application of special revenues, pledges, and statutory liens, which have real significance to the municipal market.

Harrisburg, Pennsylvania. Debt issued by a special purpose vehicle for an incinerator plant was guaranteed by the city of Harrisburg, Pennsylvania, the capital of the state. Projections for the construction and operation of the plant were not met and forecasts of the revenues that would be generated were overly optimistic. As a result, the special purpose vehicle defaulted on its debt, and the guaranty of Harrisburg was activated. In 2010, Harrisburg owed US$68 million in interest payments, US$3 million more than its entire annual budget.[127]

Harrisburg sought forbearance by its principal creditor[128] for time to negotiate a settlement.[129] The mayor resisted filing for Chapter 9;

however, the governor has vowed that the state will not bail out the city, and the city controller considered Chapter 9 bankruptcy the city's best option.[130] The option of Chapter 9 bankruptcy was part of the dynamic of the negotiations with creditors.

Notwithstanding the negotiation efforts, on October 11, 2011, the Harrisburg city council authorized the filing for Chapter 9 bankruptcy amidst discord among state officials, the city council, and the mayor. In November 2011, the bankruptcy filing was dismissed by the court as not having been properly authorized by Harrisburg.[131] The dismissal leaves the state to move forward on its takeover of the city's finances. The state governor has asked a state judge to appoint a receiver for the city pursuant to state intervention procedures for municipalities in fiscal distress.[132]

Westfall, Pennsylvania. Westfall, Pennsylvania, with a population of 2,400 and an annual budget of US$1.5 million, faced an unusual US$20 million expense from a legal judgment obtained by a property developer whose civil rights were violated. Westfall tried to negotiate with the developer, who was willing to reduce the debt some, but not enough for the township to be able to pay.[133] In April 2009, the township learned that the developer planned to file a mandamus order to force Westfall to make the payments. On April 10, 2009, Westfall filed for bankruptcy.[134]

The Plan of Adjustment submitted by Westfall and approved by the bankruptcy court reduced the claim to US$6 million to be paid over 20 years with no interest. To pay the US$6 million legal settlement owed to the housing developer, township officials increased property tax rates on the community's residents by 48 percent—a rate that will drop gradually over the 20-year repayment period. Westfall's attorney believes that the developer agreed with the plan because the judge might have crammed down a less favorable plan if there was a fight in bankruptcy court. The judge cannot cram down a plan unless at least one class of creditors agrees to the plan. In Westfall's case, even though it was only one developer who was owed money, Westfall owed three other parties smaller sums. They all agreed to the plan even though the developer initially did not. Before Westfall filed for bankruptcy, it was known that at least one class of creditor would likely go along with the plan.[135]

The financial distress precipitated by a one-time event was effectively dealt with by the Chapter 9 proceeding.

Prichard, Alabama. Prichard, which is located outside of Mobile, has a population of 25,000—half the population it had 50 years ago. It is a classic case of a dying city, owing to, among other things, the closure of a military base, the shift in business and commerce to Mobile suburbs, and declining property values. Only the poorest citizens in the Mobile area live in Prichard, which has created challenging social problems. Housing infrastructure and law enforcement became serious problems.[136]

In October 1999, Prichard filed for Chapter 9 bankruptcy when it was unable to pay US$3.9 million in delinquent bills. In addition, Prichard admitted that it had not made payments into its employees' pension fund for years and had withheld taxes from employees' paychecks, but had not submitted the withholdings to the state and federal governments.

In the years following the bankruptcy filing, Prichard made some progress enhancing social, financial, and technological growth, as well as economic development. Its 2001 budget predicted a 4 percent increase in revenue over its 2000 budget, and the city exited from bankruptcy in 2001.

Although Prichard had some success in revising its budget, so that it no longer operated at a deficit, it was not able to meet its pension obligations. Prichard filed for Chapter 9 bankruptcy for the second time on October 27, 2009, eight years after exiting the previous Chapter 9 filing. In its filing, Prichard claimed a US$600,000 deficit in the prior fiscal year's US$10.7 million budget. In addition, it owed a US$16.5 million payment to its pension fund under the earlier Chapter 9 settlement. Prichard was being sued by its pensioners for failure to make pension payments for six months, and filed for Chapter 9 to "stay" those proceedings.[137]

On August 31, 2010, the bankruptcy court rejected Prichard's filing for Chapter 9 protection on a technical interpretation of the requirement for Alabama's consent for municipalities to file for Chapter 9. The court ruled that only municipalities with bonded debt may file. Prichard does not have any outstanding bonds. Prichard has filed an appeal of this decision.[138]

Impact of Chapter 9

Although Chapter 9 continues to be rarely used by municipalities,[139] there has been a marked increase in both interest in Chapter 9 by financially distressed municipalities and concern by creditors and rating agencies about municipalities filing for Chapter 9.[140] A number of factors may contribute to the scarcity of cases. They include:

- The threshold requirements for Chapter 9 eligibility are substantial, including the prohibition and limitations by states for a municipality to file for Chapter 9.[141]
- Municipalities are not exposed to some risks that lead private creditors to seek bankruptcy protection; for example, their assets are not subject to seizure.
- Municipalities are concerned about the stigma effect of bankruptcy on their ability to borrow and the cost of such borrowing, and the public perception of the municipality.
- Municipal officials may be wary of the political stigma of a bankruptcy filing, that is, constituents may link the bankruptcy to officials' policies and behaviors.[142]
- State intervention programs exist in some states, which could be effective in the sense that states could force tough fiscal adjustment-tax increases and service cuts that cannot be imposed by the court in a Chapter 9 proceeding.[143]
- The process is expensive.

In addition, it is apparent that the availability of Chapter 9 to municipal debtors has an impact on the dynamic of forbearance by, and negotiations with, creditors.[144] Chapter 9 may have a substantial impact in its avoidance, even if rarely used. Even when used, it is clear that Chapter 9 is perceived as a last resort to deal with a municipality's financial distress after all other options have been explored, including available state remediation.

An analysis of Chapter 9 must recognize the following basic, unique principles not common to other chapters of the Bankruptcy Code that put the municipal debtor in an advantageous position:

- Municipalities are not subject to liquidation or strict judicial control.
- The Plan of Adjustment is proposed by the municipal authority.

- The municipal authority does not need judicial permission to exercise governmental functions.

Pros and Cons of Chapter 9 Bankruptcy

Fiscally distressed municipalities may turn to a number of options short of default or bankruptcy to put their fiscal house in order. These include (a) cutting expenditures, (b) raising taxes, (c) postponing payment of obligations, (d) drawing down reserves, (e) renegotiating debt obligations to reduce or defer payments, and (f) borrowing from government entities or commercial lenders.[145]

However, Chapter 9 bankruptcy may benefit a municipal debtor in several ways:

- It provides immediate relief by "staying" the municipality's obligation to make payments on debt other than special revenue bonds; that is, it stops the run on municipal funds.
- It provides immediate relief from legal actions being pursued by creditors.
- It provides a means of obtaining long-term relief, including reduction in debt and other obligations, which will bind a dissenting minority if a majority of creditors consent.
- It may protect a municipality and its residents from untenable levels of taxation by blocking creditor lawsuits from seeking to force officials to raise taxes to support debt service.
- Since postfiling borrowing to support a municipality's operations is given a higher priority than prefiling borrowings, it may in some cases facilitate new borrowing.
- It provides the ability to renegotiate contract agreements and pension plans.
- It provides a municipal debtor with a single forum in which to consolidate and address each of its various issues under the expert supervision of a bankruptcy judge.

A Chapter 9 filing also comes with potentially significant costs including costs associated with retaining legal and financial professionals to administer the case, complying with court requirements, and negotiating with creditors. Moreover, any municipality engaged in a Chapter 9 proceeding faces the unpredictability innate in legal proceedings. This unpredictability may be a substantial factor in Chapter 9, a result of the uncertainty owing to limited case law relating to the interpretation of its provisions.

One of the most cited reasons to avoid Chapter 9 has been the alleged "stigma" of bankruptcy and the need of a municipality to have access to the credit markets that would arguably be limited, or available at an increased cost, by the stigma of bankruptcy.[146] Access to credit is a serious issue for a municipality faced with major infrastructure needs. It affects not just creditworthiness but the perception of life in the city and the economic vitality of the city for years to come.[147]

However, distressed municipalities have been able to gradually return to the credit markets. For example, New York City returned to the credit markets six years after its fiscal crisis, and Cleveland returned five years after its 1978 default.[148] Orange County was able to access the credit markets almost simultaneously with its exit from Chapter 9, 18 months after filing for Chapter 9.[149]

This experience raises the question of whether the stigma of bankruptcy is exaggerated by creditor interests fearing debt adjustment or loss of control over the debt adjustment process. Is it the bankruptcy procedure more than the fiscal distress that may increase future borrowing costs? That is, is the impact of Chapter 9 worse than the impact of default? If and when Jefferson County determines to return to the credit markets, will it be treated less favorably as a result of a Chapter 9 filing than as a result of its default and negotiated debt adjustment with its creditors? A Chapter 9 filing is not the cause of the fiscal problem but the result of not being able to resolve them any other way. Orange County's experience may indicate that a municipality's putting its financial house in order is more important to accessing credit markets than the process used to achieve financial well-being.[150]

Can Chapter 9 Save Fiscally Stressed Municipalities?

If the primary objective of a financial distress mechanism is to provide a process to develop a solution to the financial difficulties of a municipality that can be sustained over time, the effectiveness of Chapter 9 may depend on the underlying causes of the financial distress. The cases seem to indicate that many of the Chapter 9 filings are by municipalities that have experienced one-time events, for example, Orange County's use of strategic investments, and Westfall Township's liability for a legal judgment to a property developer. The Chapter 9 process seems to have been effective in these cases by providing a mechanism for debt adjustment and protection from legal proceedings. These municipalities have exited from Chapter 9. Orange County has since accessed the credit markets and currently enjoys an AA credit rating.[151]

In contrast, Vallejo's financial distress is the result of systemic budget distress, and notwithstanding concessions made by some of its creditors, it remained in Chapter 9 for more than three years as its fiscal condition continued to deteriorate and it incurred substantial administrative and legal costs.[152]

In addition, there is some evidence that the municipalities that have filed more than once for Chapter 9 did so as a result of systemic budget problems. For example, the city of Mack's Creek, Missouri, filed for Chapter 9 in 1998, then for a second time in 2000, and contemplated bankruptcy again in 2004.[153] The city of Prichard, Alabama, filed for Chapter 9 in 1999, exited from Chapter 9 in 2007, and filed for Chapter 9 again in 2009 (see section on Prichard). Without addressing the cities' core problems, the Chapter 9 process seems to have little impact on reversing the structural fiscal decline without debtors undertaking sustained fiscal consolidation.

Many of the potential remedies for systemic fiscal distress relate to the political and governmental management of municipalities that a court in Chapter 9 procedures is restricted from interfering with. Chapter 9 procedures do not operate in such a manner as to be able to force reform, facilitate reorganization, impose taxes, cut expenditures, or enable other interventions that may interfere with state sovereignty. The role of state intervention procedures and the active participation of market players may have more authority to impose such changes than Chapter 9.[154]

Fiscal stress related to a one-time problem appears to be more susceptible to resolution through the debt adjustment procedures of Chapter 9. Fiscal stress related to ongoing structural deficits is more difficult since Chapter 9 has limited impact on solving the underlying structural problems. Although Chapter 9 can facilitate fiscal adjustment, it lacks the authority to compel budgetary decisions that are under the purview of the executive and legislature.

Conclusion

The design of the Chapter 9 legal structure is specific to the U.S. legal system and is largely determined by the need to comply with the Tenth Amendment to the U.S. Constitution. However, the issues and objectives of a legal framework to resolve financial distress are common across many countries, that is, the public nature of municipalities, the interest in the functioning of local government autonomy, safeguarding essential public services and the assets that provide such services, transparent procedures, the interests of creditors, and functioning subsovereign capital markets. Strategic default by municipalities is a potential risk. The effective design of the insolvency procedure can deter strategic default but also allow a debt adjustment with less risk for moral hazard. The issues of maintaining essential services and assets and limited interference with the authority of democratically elected local officials must be dealt with in any public entity insolvency procedure. This represents a delicate balance of interests. The economic reality is that if creditors are not treated fairly in an insolvency proceeding, they may severely limit their lending to the municipal sector.

In addition, the U.S. Chapter 9 system is based on a respected, independent, and competent judiciary that has the authority to reject a municipality's Plan of Adjustment. This role of the judiciary in many countries may not be appropriate given the development of a country's judiciary. Other jurisdictions have relied on more administrative procedures or a combination of administrative and judicial procedures.[155]

In the municipal sector, bankruptcy is considered a remedy of last resort. However, when all other options have been exercised and have failed, it is useful to have access to this process. Municipal bankruptcy is not a perfect solution for a municipality's fiscal problems, but it can provide breathing room while other long-term options are pursued, and can provide the important element of debt adjustment. Municipalities must continue functioning, and temporary or partial relief from debt obligations can make a difference, particularly when the cause of the financial distress is a one-time event.

Chapter 9 appears to be less effective in providing a solution to municipalities facing long-term, endemic problems involving erosion of the tax base, loss of manufacturing jobs, and a decaying infrastructure, all of which will require substantial funding and significant structural changes that go beyond the scope of Chapter 9.

Notwithstanding this limitation, insolvency proceedings and debt adjustment are legitimate tools in a regulatory framework of subnational debt management and should be considered by municipalities experiencing financial distress. Limitations and implications must be carefully evaluated, notwithstanding the advantages of suspending legal actions by creditors, debt adjustment, reducing the holdout problem, and access to new financing. An insolvency system such as Chapter 9 is an important part of a regulatory framework of subnational financial management that strengthens ex-ante borrowing regulation. As shown by Liu and Waibel (2009), ex-ante rules for debt procedures are not sufficient without an ex-post insolvency mechanism that manages efficient debt workout and facilitates fiscal adjustment.

Notes

The findings, interpretations, and conclusions expressed in this work are those of the authors and do not necessarily reflect the views of The World Bank, its Board of Executive Directors, the governments they represent, or any other institutions with which the external authors may be affiliated.

1. Subnational refers to all tiers of governments and public entities below the federal government or central government. This chapter focuses on insolvency of municipalities in the United States. In broader terms, municipal bonds in the United States include bonds issued by states, local governments, and special purpose vehicles of states or local governments. For the purpose of Chapter 9, subnational governments applies only to local governments that are political subdivisions of states. Therefore, this chapter refers solely to municipalities, that is, local governments.
2. Moody's U.S. Public Finance, *Moody's Assigns Negative Outlook to U.S. Local Government Sector*, 2009.
3. A substantial problem facing municipalities today is the shortfall in public pension funds—estimated to be between US$1 trillion and nearly US$4 trillion nationwide. In California alone, the shortfall could be as high as US$500 billion. Howard Bornstein, Stan Markuze, Cameron Percy, Lisha Wang, and Moritz Zander, "Going for Broke: Reforming California's Public Employee Pension Systems," SIEPR Policy Brief, April 2010, at 2.
4. Council of Europe Recommendation No. 96 (3) "the consequences of financial difficulties among local authorities should be made clear, for example in a municipal bankruptcy code."

5. Municipal Bankruptcy is covered by Chapter 9 of the United States Bankruptcy Code (11 U.S.C. Sec. 901 et seq.).
6. See discussion below as to the definition of municipalities that are eligible to file pursuant to Chapter 9.
7. Robin Jeweler, *Municipal Reorganization: Chapter 9 of the U.S. Bankruptcy Code*, Congressional Research Service, March 8, 2007.
8. See, for example, Gary Kaplan and Joel Moss, "Distressed Cities See No Clear Path: Health, Pension Obligations Threaten Fiscal Crisis," *National Law Journal*, March 6, 2006, at S1; Mary Williams Walsh, "Once Safe, Public Pensions Are Now Facing Cuts," *New York Times*, Nov. 6, 2006 at A1; and "Paying Health Care From Pensions Proves Costly," *New York Times*, Dec. 19, 2006 at A1. Estimates of public pension liabilities for states and local governments range from US$1 trillion to US$3 trillion. "The $2 Trillion Hole," by Jonathan Laing, *Barrons*, March 15, 2010.
9. *Municipal Bankruptcy—A Story in Search of a Trend?*, by Chris Hoene, March 13, 2010; The Official Blog of the National League of Cities; "The Perils of Considering Municipal Bankruptcy, Special Report," January 27, 2010, *Fitch Ratings*; "Muni Threat: Cities Weigh Chapter 9," *Wall Street Journal*, February 18, 2010.
10. Recent filings by Central Falls, Rhode Island; Harrisburg, Pennsylvania; and Jefferson County, Alabama and have raised the profile of Chapter 9 as an option for municipalities in fiscal distress. See Paul Maco et al. (2011). International legal scholars have suggested that the principles of Chapter 9 may be appropriate for sovereign bankruptcies. See Raffer, "Internationalizing U.S. Municipal Insolvency; A Fair, Equitable and Efficient Way to Overcome Debt Overhang," 6 *Chicago Journal of International Law* 361 (2005).
11. A *mandamus* is a court order obliging public officials to take a certain course of action. For a description of mandamus, see McConnell, Michael W. and Randall C. Picker, "When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy," *University of Chicago Law Review* Vol. 60, No. 2 (Spring, 1993) pp. 425–495.
12. The general rule is that "public property" dedicated to a public use is not subject to debt foreclosure. In practice, very little property falls into the "proprietary" category. This argument may also apply to funds in the public treasury accounts to be applied to public purposes. See McConnell, *supra*, note 11 p. 431, 433, 444.
13. House Report No. 95-595, 95th Congress, 1st Session 263 (1977), U.S. Code Cong. & Admin. News 1978 pp. 5787, 6221.
14. Authors' estimation based on "Bankruptcy Basics" (2006) by Administrative Office of the United States Courts and the American Bankruptcy Institute. 2007 U.S. Census. http://www.abiworld.org/; and Public Access to Court Electronic Records, http://www.pacer.gov. 1980–2010 data are from the American Bankruptcy Institute, http://www.abiworld.org; 2011 data are based on cases recorded at http://www.pacer.gov. For statistics covering up to April 2012, see Spiotto (2012). According to the 2007 U.S. Census, there are 89,476 local

governments, which include those that are prohibited by state law from filing under Chapter 9.

15. See figure 8.2. Special Purpose Districts are independent governmental units that exist separately from general purpose local governments such as county and municipal governments for a specified purpose such as airports, cemeteries, conservation, electric power, fire protection, gas utility, highways, hospitals, irrigation, libraries, mass transit, parking facilities, parks, sewerage, solid waste, stadiums, water ports, and water supply.
16. Data for 1980–2010 are from the American Bankruptcy Institute; data for 2011 are based on cases recorded at http://www.pacer.gov.
17. United States Courts, http://www.uscourts.gov.
18. "Muni Threat: Cities Weigh Chapter 9; *Wall Street Journal*, February 18, 2010. See McConnell and Picker, "When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy", *University of Chicago Law Review* 60(2)(Spring): 425–95 (1993). A general purpose municipality is an administrative subdivision governing general municipal functions, as opposed to a special-purpose district which has a defined and limited purpose.
19. "Municipal Bankruptcy in Perspective, A Joint Report from the Bureau of Governmental Research and the Public Affairs Research Council of Louisiana," April 2006.
20. In 1988, a study by Enhance Reinsurance Co. looked at historical patterns of municipal defaults from the 1800s to the 1980s and concluded that municipal defaults usually follow downswings in business cycles and are also more likely to occur in high-growth areas that borrow heavily. Following the 1873 Depression, when more than 24 percent of the outstanding municipal debt was in default, the greatest number of defaults occurred in the South, the fastest growing region at the time. Factors that caused defaults included fluctuating regional land values, commodity booms and busts, cost overruns and financial mismanagement, unrealistic projections of the future, and private-purpose borrowing. The report also said that since World War II, revenue bonds have been a new source of default, largely because actual revenues were less than projected revenues.
21. For example, Orange County, California, which at the time of its Chapter 9 filing was the largest municipal bankruptcy in U.S. history.
22. "Alabama County Brainstorms," *Wall Street Journal*, July 2, 2010.
23. U.S. Constitution Article 1, 8, 10.
24. State programs that deal with municipalities experiencing financial distress, while having many tools to affect municipal financial affairs, may not impair the outstanding obligations to creditors without a substantial governmental interest (for a review of state programs dealing with financially distressed municipalities, see chapter 14 by Liu, Tian, and Wallis in this volume). The Supreme Court laid out a three-part test for whether a law violates the Contracts Clause in Energy Reserves Group v. Kansas Power & Light 459 U.S. 400

(1983). First, the state regulation must substantially impair a contractual relationship. Second, the State "must have a significant and legitimate purpose behind the regulation, such as the remedying of a broad and general social or economic problem." 459 U.S. at 411–13. Third, the law must be reasonable and appropriate for its intended purpose. Only once has the alteration of a municipal bond contract been sustained by the Supreme Court. In Faitoute Co. v. Asbury Park, 316 U.S. 502 (1942), the Court sustained a New Jersey statute authorizing state control over insolvent municipalities. The plan involved an exchange of securities for new bonds with an extended maturity and a lower interest rate. In response to this decision, however, Congress amended the bankruptcy law to proscribe state laws addressing composition of indebtedness from becoming binding on nonconsenting creditors. See 11 U.S.C. § 903. Allowing each state to enact its own version of Chapter 9 of the Bankruptcy Code would frustrate the constitutional mandate of uniform bankruptcy laws. See H. Rept. 686, 94th Cong., 2d Sess. 19, *reprinted in* 1976 U.S. CODE CONG. & ADM. NEWS 539, 557.

25. Section 904 of the Bankruptcy Code provides that absent the consent of the municipality, the bankruptcy court may not interfere with (a) any political or government power of the municipality, (b) any property or revenue of the municipality, or (c) any income-producing property of the municipality.
26. For a thorough discussion of such limitations see David L. Dubrow, "Chapter 9 of the Bankruptcy Code: A Viable Option For Municipalities in Fiscal Crisis?," 24 *The Urban Lawyer* 3, 548 (Summer 1992), p. 552.
27. "The levying of taxes is not a judicial act … it is an act of sovereignty to be performed only by the legislature," Merriweather, 102 U.S. at 515.
28. The functions of the bankruptcy court in Chapter 9 cases are generally limited to approving the petition (if the debtor is eligible), confirming a plan of debt adjustment, and ensuring implementation of the plan.
29. 11 U.S.C. § 109(c).
30. It is a result of such Tenth Amendment considerations that a Chapter 9 filing of an insolvent municipality may only be accomplished as a "voluntary" act of the municipality, and, unlike private entities, a municipality's creditors may not force it into a Chapter 9 filing. In the 2011 Chapter 9 filing by Central Falls, Rhode Island, a provision of a recent Rhode Island law providing that bondholders are to be paid first (limiting the bankruptcy court's authority) became a contentious issue with other creditors such as pension funds and labor unions. See "Pensions Chopped but Investors Paid," *Wall Street Journal*, December 20, 2011, p. C1.
31. Unlike the traditional individual, corporate, or partnership debtor that has a largely unfettered right to choose from a variety of chapters of the Bankruptcy Code (that is, chapters 7, 11, and 13).
32. Id.
33. Id.

34. As defined in 11 U.S.C. § 101(32)(C).
35. 11 U.S.C. § 109(c).
36. Frederick Tung, *After Orange County: Reforming California Municipal Bankruptcy Law*, 53 HASTINGS L.J. 885, 907 (2002).
37. 11 U.S.C. § 101(40).
38. 11 U.S.C. Sec 101 (4). A state is not a municipality for purposes of Chapter 9.
39. In re County of Orange; Orange County Investment Pools, 183 B.R. 605 (Bankr. Ct. C.D. Cal. 1995). On May 10, 2010, Ambac appealed the decision.
40. Created under the nonprofit corporation law of the state of Nevada.
41. Ambac's liability for such bonds was estimated to be US$1.16 billion; Reuters, January 14, 2010. Ambac believed its position as a creditor would be stronger in a proceeding pursuant to Chapter 9 rather than Chapter 11.
42. Municipalities as defined in Chapter 9 are ineligible from filing under Chapter 11.
43. Decision of the District of Nevada Bankruptcy Court, April 27, 2010.
44. Id.
45. In addition, *instrumentality* will be determined by each state's laws and can produce varying results.
46. In re New York Off-Track Betting Corp. (NYC OTB). March 22, 2010, the Bankruptcy Court for the Southern District of New York.
47. 11 U.S.C. § 109(c).
48. See Tung, *supra* note 36.
49. The argument is that allowing one municipality to file signals that the state will not bail out other municipalities if they get into financial distress, and this in turn raises municipal borrowing costs within the state. Michelle J. White, "Sovereigns in Distress: Do They Need Bankruptcy?", *Brookings Papers on Economic Activity*, I: 2002. In addition, the rating of the state could be negatively impacted, as illustrated in the case of Bridgeport, Connecticut.
50. California Government Code S. 53760 (1995).
51. For example, in Connecticut, the Governor must approve a Chapter 9 filing. In Louisiana, a Chapter 9 filing must have the prior consent of the Governor, the Attorney General, and the State Bond Commission. Pennsylvania liberally grants authorization to file Chapter 9, but the effect of filing Chapter 9 automatically triggers the appointment of a state plan coordinator and subjects the municipality to state procedures that act concurrently with federal bankruptcy law. 53 P.S. 11701.261-1170.263 (1995).
52. Source: See note 53. Twenty-two states are silent on the issue, and this silence cannot meet the requirement of "specifically authorize." Georgia specifically prohibits the Chapter 9 filings. In these states, a Chapter 9 filing needs special legislation to be authorized.
53. While the table is based on Laughlin (2005) and Spiotto (2008), we incorporate the new development in which Rhode Island adopted a new law, An Act Relating to Cities and Towns-Providing Financial Stability, on June 11, 2010,

which gives the state-appointed receiver the authority to file under Chapter 9. It is worth noting that the issue of state authorization is changing rather than static. The information, accurate as of August 2010, is subject to rapid change. California, for example, recently modified the procedure of its Chapter 9 filing. For recent development in states' authorization, see Spiotto (2012).

54. As defined in 11 U.S.C. § 101(32)(C).
55. Id.
56. In re City Of Bridgeport, 129 B.R. 332, 335 (Bankr. D. Conn. 1991). The court found that the city had access to a US$27 million bond fund and cited this as an additional reason for not meeting the "insolvency" test. See Rachael E. Schwarz, "This Way To Egress: Should Chapter 9 Filing Have Been Dismissed?," 66 *American Bankruptcy Law Journal* 103 (1992); Dorothy A. Brown, "Fiscal Distress and Politics: The Bankruptcy Filing of Bridgeport as a Case Study in Reclaiming Local Sovereignty," 11 *Bankruptcy Developments Law Journal* 626 (1994–95).
57. 11 U.S.C. Sec. 901.
58. The stay prohibits a creditor from bringing a mandamus action against an officer of a municipality on account of a prepetition debt. It also prohibits a creditor from bringing an action against an inhabitant of the debtor to enforce a lien on or arising out of taxes or assessments owed to the debtor. Additional automatic stay provisions are applicable in Chapter 9 that prohibit actions against officers and inhabitants of the debtor if the action seeks to enforce a claim against the debtor. 11 U.S.C. § 922(a).
59. Many municipalities have separate enterprises that are owned or operated by the municipality but are not separate legal entities. Such systems are typically treated as separate accounting units and are paid in the form of fees and charges for services. Such systems are typically financed by debt obligations payable from the system revenue, and in many cases this is the sole source of payment. Such revenues are treated as "special revenues." Special revenues are defined in Section 902(c) as (a) receipts derived from projects or systems primarily used for transportation, utility, or other services; (b) special excise taxes imposed on particular activities or transactions; (c) incremental tax receipts in a tax increment financing; (d) other revenues or receipts derived from particular functions of the debtor; and (e) taxes specifically levied to finance projects or systems (excludes general property, sales, or income taxes levied to finance the general purposes of the debtor.
60. Section 922(d) of title 11 limits the applicability of the stay.
61. 11 U.S.C. § 928.
62. Bondholders have been recognized as having the right to receive those revenues and to block diversion of those revenues to other purposes including general obligation bonds. *Matter of Sanitary and Improvement District No. 7,* 98 Bankr 970, 974 (D Neb 1989).
63. Or at a later time agreed to by the court.
64. 11 U.S.C. § 941.

65. Contracts that are yet to be performed.
66. 11 U.S.C. § 365.
67. Sections 1113 and 1114 of Chapter 11 restricting the ability to reject collective bargaining agreements and to restructure pension obligations do not apply to Chapter 9.
68. In re City of Vallejo, 403 B.R. 72 (51 Bankr. Ct. Dec 2009).
69. See 11 U.S.C. §1126.
70. Often referred to as *cramdown*, 11 U.S.C. 901 (a).
71. See McConnell, *supra,* note 11.
72. The U.S. Supreme Court upheld the constitutionality of Chapter 9's debt adjustment authority in U.S. v. Bekins, 304 U.S. 27 (1938).
73. 11 U.S.C. 941 (b).
74. See below for a discussion of how the feasibility of Vallejo's plan changed due to increasing deterioration of its financial condition during the two-year period it has been in Chapter 9 bankruptcy.
75. In an early irrigation district case, the Ninth Circuit Court of Appeals required a showing that the taxing power was inadequate to raise taxes to pay debt. See *Fano v. Newport Heights Irrigation District*, 114 F2nd 563 (9th Cir. 1940).
76. In addition, increased rates can dampen economic activity.
77. *Supra*, note 31.
78. Sections 903 and 904 of the Bankruptcy Code.
79. 11 U.S.C. § 903 states that "chapter [9] 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 the municipality."
80. Specified in 11 U.S.C. § 926(a).
81. Moreover, a Chapter 9 debtor may employ professionals without court approval, and the only court review of fees is in the context of plan confirmation, when the court determines the reasonableness of the fees.
82. The restrictions imposed by 11 U.S.C. § 904 are necessary to ensure the constitutionality of Chapter 9 and to avoid the possibility that the court might substitute its control over the political or governmental affairs or property of the debtor for that of the state and the elected officials of the municipality.
83. Authors' estimation based on "Bankruptcy Basics" (2006) by the Administrative Office of the United States Courts and the American Bankruptcy Institute; and http://www.pacer.gov. The U.S. Congress amended Chapter 9 in 1937, and the amended law was upheld by the Supreme Court in 1938.
84. United States Courts, http://www.uscourts.gov. For statistics covering up to April 2012, see Spiotto (2012).
85. See Spiotto, James E. (2008) "Chapter 9: "The Last Resort for Financially Distressed Municipalities," in *Handbook of Municipal Bonds*, ed. by Sylvan G. Feldstein and Frank J. Fabozzi. Since 1980, 49 of the 265 Chapter 9 filings have been traditional local governments, towns, cities, villages, and counties (Spiotto 2012).

86. Id.
87. See cases recorded at http://www.pacer.gov.
88. See Spiotto 2008.
89. The authors collected 217 Chapter 9 filings recorded at http://www.pacer.gov, which cover the period starting from 1981. Forty-two filings are by general purpose municipalities. Some filings may be missing since some filings may not be recorded in PACER, and some recorded filings do not give information on the filer. The population data are from the 2000 U.S. Census. We counted those entities that filed twice only once to calculate the median population.
90. Id. See cases recorded at http://www.pacer.gov. The 42 Chapter 9 filings of general purpose municipalities comprise 37 entities and 5 entities that filed twice. These 5 entities include (a) City of Macks Creek, Missouri, filed in 1998 and 2000; (b) City of Prichard, Alabama, filed in 1999 and 2009; (c) City of Westminster, Texas, filed in 2001 and 2004; (d) Town of Moffett, Oklahoma, filed in 2006 and 2009; and (e) Village of Washington Park, Illinois, filed in 2004 and 2009.
91. *Supra,* note 89. See cases recorded at http://www.pacer.gov.
92. A petition for Chapter 9 protection was filed on December 6, 1994.
93. The rest of this section draws mainly from Baldassare (1998).
94. The California Constitution limits local and city control over most tax and many fee revenue sources. Proposition 13 sets property tax rates and caps on the annual growth of parcel assessed valuations. Sales tax rates are also controlled by the state Bradley-Burns Act, with the exception that the local electorate can vote to self-assess at a greater rate for specific or general programs. Fees, assessments, and any new or increased taxes are subject to the constraints of Proposition 218. Fees can be assessed and used only to recover the actual cost of service, and assessments and taxes require property owner approval, voter approval, or both.
95. See Baldassare 1998.
96. See Baldassare 1998, p. 4. The county sued a dozen or more securities companies, advisors, and accountants. Merrill Lynch settled with Orange County, California, for US$400 million to settle accusations that it sold inappropriate and risky investments to Orange County. The county lost US$1.69 billion. The county was able to recover about US$600 million in total, including the US$400 million from Merrill Lynch.
97. The plan provided for the refinancing of outstanding debt, forbearance by the investor local public agencies, and diversion of certain revenue sources to secure the refinancing debt. The impact on the county budget was not a result of the Plan of Adjustment; rather, the impact was felt after Orange County exited from bankruptcy with a substantial debt burden and fewer revenue sources available for the budget.
98. Thirty-one cities, regional transportation agencies, local school districts, local water agencies, sanitation districts, and many small local agencies. See Baldassare (1998), p. 9.

99. See Baldassare (1998), p. 131.
100. Id. p. 179. The social program cuts included (a) a 50 percent reduction in child abuse prevention programs, (b) elimination of a program for the homeless, and (c) closure of a prenatal clinic and 15 clinics for children. The basic infrastructure cuts included cuts in funds for beaches, flood control, harbors, parks, and redevelopment projects.
101. http://www.PennLive.com, May 16, 2010, interview with Chris Street, Treasurer of Orange County, California.
102. White, *supra,* note 49. Orange County raised funds for the plan by laying off workers, selling some assets and cutting expenditures, and issuing new bonds. It attempted to raise its local sales tax, but voters rejected the proposed increase. See "Orange County Adopts Plans To Get Out of Bankruptcy," *New York Times*, December 22, 1995, p. D2.
103. "In the Orange County financial crisis, the bankruptcy forum appears to have provided an appropriate and efficient judicial mechanism for its resolution. The County *qua* municipality remained in control of its 'political' affairs, that is, the operation of government and the provision of public services, while the County *qua* debtor was free to pursue both litigation and negotiated settlement with its creditors. The uniquely binding effect of a Chapter 9, federally confirmed reorganization plan coupled with the inherent limitations creditors face in dealing with a municipal debtor may promote consensus towards an achievable composition of debt." See Jeweler, *supra* note 7.
104. For the years preceding 2008, the City of Vallejo had difficulty balancing its contractual commitments in its General Fund with its General Fund revenues. For fiscal years 2005–06, 2006–07, and 2007–08, General Fund expenditures exceeded revenues by US$3 million to US$4 million per year, resulting in a reduction of General Fund reserves. At the time of the bankruptcy filing, projections were that the city's General Fund reserves would be depleted by June 30, 2008 and that in fiscal year 2008–09, General Fund expenses could exceed General Fund revenues by US$16 million, meaning that the city could not meet its obligations and was technically insolvent. The city was unable to reach agreements with its primary creditors (employee labor associations) that would ensure ongoing General Fund solvency. See official website http://www.ci.vallejo.ca.us/GovSite/default.asp?serviceID1=712&Frame=L1.
105. "For Vallejo, Bankruptcy isn't exactly a fresh start," *The Bay Citizen*, January 23, 2011.
106. "Tough Budget Arithmetic Puts Vallejo in Bind," *Wall Street Journal*, July 15, 2010. http://www.ci.vallejo.ca.us/GovSite/default.asp?serviceID1=712&Frame=L1.
107. In re City of Vallejo, 403 B.R. 72 (51 Bankr. Ct. Dec 2009).
108. The agreements saved the city over US$6 million in General Funds through June 30, 2010. After attempts to facilitate an agreement between the city and the International Brotherhood of Electrical Workers failed, the United States

Bankruptcy Court upheld the city's motion to reject their labor contract. http://www.ci.vallejo.ca.us/GovSite/default.asp?serviceID1=712&Frame=L1. Much of the savings in the renegotiated union contracts come from severe workforce reductions: the police department is down to 90 sworn officers from 155 in 2003, and the fire department was slashed from 122 people and 8 firehouses to 70 people and 5 firehouses. See "For Vallejo, Bankruptcy isn't exactly a fresh start," *The Bay Citizen*, January 23, 2011.

109. *Wall Street Journal*, July 15, 2010. "As Vallejo slogs through its third year of bankruptcy, city officials are giving police a blunt choice; forgo a pay raise agreed to in January 2009" (agreed to in bankruptcy eight months after they filed for bankruptcy protection in May 2008).
110. Id. "What was feasible in January 2009 does not seem feasible 18 months later."
111. Pension plans for retirees and current city employees, including one that allows police officers to retire at 50 with as much as 90 percent of their pay, remain untouched. The city chose not to test whether the attempt to change the existing pensions would be allowed even in bankruptcy, and so remains responsible for some US$195 million in unfinanced pension liabilities. "For Vallejo, Bankruptcy isn't exactly a fresh start," *The Bay Citizen*, January 23, 2011.
112. http://www.huffingtonpost.com/2011/11/02/vallejo-bankruptcy-ends-after-three-years_n_1072;usactionnews.com/2011/01/Vallejo-bankruptcy-plan-offers-unsecured-creditors-5-20jpm.
113. blog.al.com/birmingham-news-stories/2011/11/jefferson_county_among_several.html.
114. May 25, 2008, www.cbs13.com news report, "Vallejo Facing Uncertain Road After Bankruptcy."
115. 665,000 residents.
116. http://www.al.com, published Monday, September 27, 2010. The county entered a consent decree in 1996, agreeing to fix the sewer system after the Cahaba River Society and individuals successfully sued in federal court to show that the county was illegally polluting area creeks and rivers with untreated waste.
117. www.CNNMoney.com May 28, 2010.
118. Shelley Sigo, "JeffCo Has 1st Missed Payment; Defaults on $46 million of Accelerated Principal," *The Bond Buyer*, July 9, 2009, at 1.
119. "Largest Municipal Bankruptcy Filed," *Wall Street Journal*, November 10, 2011.
120. www.articles.businessinsider.com/2011-10-23/wall-street/30312613_1_jefferson-county-sewer.
121. "The Chapter 9 Filing Would Be for All of Jefferson County, Not Just the Sewer System." www.al.com, published Monday, September 27, 2010.
122. Pursuant to which the creditors will not pursue legal remedies during negotiations.
123. JPMorgan bankers were among the financial advisers who persuaded county officials in 2002 to replace traditional fixed-rate bonds with notes having

floating interest rates, including auction-rate securities whose terms are set through periodic bidding.

124. "Largest U.S. Municipal Bankruptcy Looms in Alabama," Joe Mysak, http://www.Bloomberg.com, April 11, 2010.
125. "Alabama County Brainstorms," *Wall Street Journal*, July 2, 2010.
126. According to attorney Jeffrey Cohen, "Raising the rates [that] are already the second or third highest in the country will scare away new business. The businesses that can leave, will leave and frankly the people who are going to have the biggest burden are the homeowners." www.al.com, published, Monday, September 27, 2010.
127. http://www.CNNMoney.com, May 28, 2010.
128. Assured Guaranty, guarantor of the defaulted bonds.
129. "Harrisburg Seeks 'Least Worst' Path," *Wall Street Journal*, April 28, 2010.
130. http://www.CNNMoney.com, May 28, 2010; http://www.PennLive.com, May 16, 2010.
131. "Harrisburg Bankruptcy Filing Voided," *Wall Street Journal*, November 25, 2011.
132. "Judge Rejects Harrisburg Bankruptcy Move," *Wall Street Journal*, November 25, 2011.
133. www.PennLive.com, May 19, 2010.
134. Id.
135. Comments of Westfall Attorney J. Gregg Miller, www.PennLive.com, May 19, 2010.
136. *Financial Distress and Municipal Bankruptcy: The Case of Prichard Alabama*, by Douglas J. Watson, et al., July 1, 2005.
137. *The Deal Magazine*, March 19, 2010.
138. This ruling has no impact on Chapter 9 itself and would be limited to the requirements for municipalities in Alabama to use Chapter 9.
139. And almost never used by large cities such as New York, Cleveland, and Detroit. Large cities have persuaded their states to intervene and provide financial relief. The states of New York and Ohio were heavily involved in their cities' resolution of financial distress, and Michigan has shown no hesitation in its assistance to Detroit.
140. *Supra*, note 11.
141. See State Authorization above.
142. In the case of Bridgeport, the mayor who filed for Chapter 9 lost reelection, defeated by the new mayor whose position was against the filing, *supra,* note 57.
143. See chapter 14 by Liu, Tian, and Wallis in this volume.
144. For example, like Vallejo, Los Angeles is suffering from weak revenue at the same time that the cost of its pensions and other retirement benefits are rising. Former mayor Richard Riordan has said, "The threat of bankruptcy is really the only way you're going to get them to make major changes." Former mayor Richard Riordan said those factors put the government of the second-largest

U.S. city on track to declare bankruptcy between now and 2014. Riordan sees bankruptcy as a necessary tactic for squeezing concessions from the city's public employee unions. It could also pave the way for 401(k) retirement accounts for new city workers instead of defined pension benefit plans with escalating costs, he said. http://articles.latimes.com/2010/may/08/opinion/la-oe-morrison-20100508, May 8, 2010.

145. See *supra*, note 19, "Municipal Bankruptcy in Perspective," A Joint Report from the Bureau of Governmental Research and the Public Affairs Research Council of Louisiana, April 2006.
146. Raphael, Richard J., Friedland, Eric, Laskey, Amy R., and Doppelt, Amy S. "The Perils of Considering Municipal Bankruptcy." Fitch Ratings, Public Finance, January 27, 2010, indicating even the discussion of the possibility of filing is a negative credit factor.
147. Mark Baldassare, president and CEO of the Public Policy Institute of California and author of *When Government Fails: The Orange County Bankruptcy*, University of California Press, Berkeley, CA, a joint publication with the Public Policy Institute of California.
148. www.Ohiohistorycentral.org.
149. *Supra*, note 95.
150. For example, within seven years of Orange County's Chapter 9 bankruptcy, its bond rating has improved from junk status to "Aaa"—the highest rating offered by Moody's Investor Services.
151. Fitch Ratings.
152. *Supra*, note 111.
153. Wes Johnson, "Should Mack's Creek Exist?", *Springfield News Leader*, October 16, 2004 at 1A.; and data from the federal judiciary's case management files (http://www.pacer.gov).
154. For a review of state intervention, see chapter 14 by Liu, Tian, and Wallis in this volume.
155. See Liu and Waibel 2010.

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