Historical and Legal Strength of State and Local Government Debt Financing

In Good Times and Bad Times
Financial Challenges Past, Present and Future

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I. In the Beginning – The Big Question

Why Buy State and Local Government Debt in the U.S.A.?
INTRODUCTION

Present global economic conditions have increased the possibility that many Sovereigns will experience significant cash flow problems and ensuing financial crisis (e.g., Greece, Portugal, Spain, Italy, Ireland, Latvia, Ukraine, Romania, etc.).

The Sovereign crisis must be addressed to avoid damaging the Financial Market and to ensure that the perception of sovereign debt (including state and local governments in the U.S.A.) not face unfriendly credit markets going forward.

The problems facing Sovereigns are not new. The ability of states and municipalities in the U.S.A. to be able to meet financial challenges and successfully resolve them provides a guide as to workable solutions for other Sovereigns to follow.

This presentation studies past problems faced by troubled sub-sovereigns in the United States. The lessons learned by these sub-sovereigns will help us develop financing structures to avoid and lessen the negative effects of financial distress to the States and the sub-sovereigns.
II. A Proud History of State and Local Government Financing

Prior to 2000 and the Dawn of this Century, State and Local Government Financing funded the most sophisticated Public Works System in the World, including:

- 3,866,000 Miles of Roadways
- 565,000 Bridges
- 1,000 Public mass transit systems
- 16,000 Airports
- 25,000 Miles of in coast and intercostals waterways
- 70,000 Dams
- 900,000 Miles of pipe in water systems
- 15,000 Waste water treatment plants

while at the same time assuring the funding of operation and infrastructure of the States, Cities, Towns and Villages of the largest economy in the World.
II. A Proud History of State and Local Government Financing (cont’d)

In fact, it has been the increased issuance of State and Local Debt that has helped stimulate the Local, State and National economy during economic recessions. This increased issuance of Debt by State and Local Governments has funded increased governmental financing and infrastructure improvements that create jobs for the unemployed, business opportunities for local businesses, demand for goods, and increased GDP Growth and employment, which lead to increased tax revenues.
II. A Proud History of State and Local Government Financing (cont’d)

YES – There is a correlation between the Increased Issuance of State and Local Debt during Economic Downturns and the following increased employment and GDP Growth.
In Economic Downturns, Increased Issuance of State and Local Bonds Is Followed by Increases in Employment and GDP Growth
In Economic Downturns, Increased Issuance of State and Local Bonds Is Followed by Increases in Employment and GDP Growth

U.S. Economic Trends, 1949-2009 (year-on-year % change):

Bars indicate recessions; width indicates thickness

State and local bond issuance (3-year moving avg.) year-on-year growth rate (%)
Real GDP year-on-year growth rate (%)
Employment year-on-year growth rate (%)
II. A Proud History of State and Local Government Financing (cont’d)

We are presently going from a significant economic downturn:

— With unemployment over 9% for many months, state and local governments will feel the effects of the following:
  — Lower Sales Tax Collection
  — Lower Real Estate Tax Collection
  — Lower Personal Income Tax Collection

— We have all seen this before and, in the past, issuances of state and local government debt financing have helped stimulate the way to increased employment and economic growth.

Remember the Industrial Revenue Bonds, Recovery Zone Economic Development Bonds and other forms of financing and all of their efforts to increase business opportunities on the state and local level that have successfully led to past recoveries. Other similarly related state and local government financing may this time be just what is necessary to encourage economic growth and job creation.
II. A Proud History of State and Local Government Financing (cont’d)

But we will never forget that there are economic cycles, and good times will be followed by bad times.

State and local governments have not only survived but have improved and grown through all these past downturns while continuing to provide ever increasing governmental services.
II. A Proud History of State and Local Government Financing (cont’d)

- State and Local Government Debt has also Grown in the USA
  - USA: State and Local Government
    - The Debt of State and Local Governments has more than doubled in the last 10 years, from $1.197 Trillion in 2000 to $2.8 Trillion at the end of 2010.
    - This does not include over $1 Trillion of Unfunded Pension Liabilities and OPEB of over $700 Billion plus the needed debt financing over the next five years to bring infrastructure up to acceptable standards of $2.5 Trillion.
III. Default Statistics

Default Rate for Rated Municipal Bonds is Significantly Lower than Rated Corporate Bonds.

According to Moody’s, between 1970-2007, there were 54 Rated Municipal Bond Defaults compared to 1,707 Rated Corporate Defaults. 78% of the Rated Municipal Defaults were in the healthcare and housing project finance sectors. The median recovery rate for Rated Municipal Issuers was .85¢ and $1.00. In 2009, Defaulted Rated Bonds and Loan Recoveries ranged from 54% first lien Bank loans, 37.5% Senior Secured Bonds, 37.78% Senior Unsecured Bonds, 22.4% Senior Subordinated Bonds and 34.3% for all Bonds.

According to S&P, between 1986-2008, there were 39 Rated Municipal Defaults compared to 1,604 Rated Corporate Defaults.


Will any U.S. state become the next Greece or one of the PIIGS (Portugal, Italy, Ireland, Greece and Spain)?

- The per capita GDP of each of California, Texas, Florida, New York, Illinois and New Jersey (certain “Major U.S. States”) is higher than Portugal, Greece, Italy and Spain.
- The percentage of debt to revenue ratio is lower for Major U.S. States than Portugal, Italy and Greece.
- The percentage of debt to GDP is lower for certain Major U.S. States than Spain, Ireland, Portugal, Greece and Italy.
- Market perception can be different than reality. Look at Credit Default SWAPs (“CDS”) for certain Major U.S. States and the PIIGS, where Italy, Spain, Ireland, Portugal have lower CDS spreads than New Jersey, New York, California and Illinois.
III. GDP of Selected U.S. States and European Countries

Billions of 2009 USD

Source: US Bureau of Economic Analysis; OECD.
III. GDP per capita of Selected U.S. States and European Countries

Thousands of 2009 USD

Source: US Bureau of Economic Analysis; US Census Bureau; OECD.
III. Debt-to-Revenue Ratio of
Selected U.S. States and European Countries (2008 figures)

Source: US Bureau of Economic Analysis; US Census Bureau; Eurostat; OECD.

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III. Debt-to-GDP Ratio of
Selected U.S. States and European Countries (2008 figures)

Source: US Bureau of Economic Analysis; US Census Bureau; Eurostat; OECD.
III. Credit Default Swap Spreads (bps) of Selected U.S. States and European Countries

Source: Bloomberg (February 8, 2011).
III. Default Statistics (cont’d)

- Comparing Chapter 11 Corporate Organization Filings to Chapter 9 Municipal Debt Adjustment Filings shows a more drastic comparison of the strength and credit quality of Municipal Bond Debt. In 2009 and 2010, there were over 11,000 Chapter 11 Corporate reorganizations filed each year. Since 1937, there have only been 620 Chapter 9 cases filed, most of which have been small special tax district and entities that did not issue municipal bonds.
III. Default Statistics (cont’d)

Corporate Bankruptcy Filing Trends (1985 set equal to 1)

Source: Administrative Office of the U.S. Courts
III. Default Statistics (cont’d)

High Yield Bond Issues and Bankruptcy Assets of Public Companies that Filed Bankruptcy

Source: Thomson Financial
III. Default Statistics (cont’d)

FREQUENCY OF MUNICIPAL BANKRUPTCIES • 1937-2011
(as of 2/7/2011)

* Since passage of the Bankruptcy Code.
III. Default Statistics (cont’d)

CHAPTER 9 FILINGS BY YEAR • 1980-2011
(as of 2/7/2011)
CHAPTER 9 FILINGS BY STATE • 1980-2011
(as of 2/7/2011)

III. Default Statistics (cont’d)
CHAPTER 9 FILINGS BY REGION • 1980-2011
(as of 2/7/2011)
III. Default Statistics (cont’d)

Corporate Bankruptcies – Trend Towards Acceptance of Default and Bankruptcy (Reorganization)

- Increase with less acceptance. Increased more than 5 times between 1950-1989.
- Since 1983 average of over 15,000 per year Chapter 11 (Corporate Restructurings).
III. Bankruptcy Filings (cont’d)

Bankruptcy Filing Trends (1985 set equal to 1)

Source: Administrative Office of the U.S. Courts
III. Municipal Defaults (cont’d)

Frequency of Municipal Defaults

Less than 10,000 defaults since 1839 for over 50,000 municipal and state entities.

There were 6,195 defaults between 1839-1969 consisting of:

- 727 counties and parishes.
- 1,911 incorporated municipalities.
- 313 unincorporated municipalities.
- 1,372 school districts.
- 1,872 special purposes districts.

(4,770 default between 1929-1937).
III. Defaults by Governmental Bodies During the Period of 1929-1937

<table>
<thead>
<tr>
<th>Type of Government Unit</th>
<th>Number in Default</th>
<th>Percentage of Total Number in Default</th>
<th>Indebtedness of Defaulting Unit (in $ millions $)</th>
<th>Percentage of Debt in Default</th>
</tr>
</thead>
<tbody>
<tr>
<td>Counties</td>
<td>417</td>
<td>13.7</td>
<td>$360</td>
<td>15.1</td>
</tr>
<tr>
<td>Incorporated Municipalities</td>
<td>1,434</td>
<td>8.3</td>
<td>$1,760</td>
<td>19.9</td>
</tr>
<tr>
<td>Towns Organized townships</td>
<td>88</td>
<td>.4</td>
<td>$10</td>
<td>2.9</td>
</tr>
<tr>
<td>School Districts</td>
<td>1,241</td>
<td>.9</td>
<td>$160</td>
<td>7.8</td>
</tr>
<tr>
<td>Reclamation, levee irrigation, and drainage districts</td>
<td>944</td>
<td>28.2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other special districts</td>
<td>644</td>
<td>12.4</td>
<td>$400</td>
<td>25.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,770</strong></td>
<td><strong>2.7</strong></td>
<td><strong>$2,690</strong></td>
<td><strong>17.7</strong></td>
</tr>
</tbody>
</table>

III. Default Statistics (cont’d)

Frequency of Municipal Defaults (cont’d)

1944–1970 — only $450 million Bonds Defaults (most Toll Roads and Bridges).

Between 1937 and Present 620 Municipal Debt Adjustment – Bankruptcy – Chapter 9 Filings.

IV. What Are the Traditional Causes of State and Local Government Debt Default?
IV. Traditional Causes of Default

Traditional Causes of Municipal Bond Defaults in U.S.A.

1. **Economic Depression:**
   - 1837 - Mobile.
   - 1843 - Bridgeport.
   - 1857 - Chicago-Philadelphia.
   - 1860s - Civil War Debts — 13 States Repudiate Reconstruction and War Debt.
   - 1873 - Mobile.
   - 1877 - Pittsburgh.
IV. Traditional Causes of Default (cont’d)

Traditional Causes of Municipal Bond Defaults in U.S.A. (cont’d)

2. Non Essential Services:
   – Railroad Station (with no railroad).
   – Real Estate speculation.
   – Refuse burning facilities.
   – Large housing developments on Guam.

3. Feasibility of Projects and Industries:
   – Ranger Texas.
   – WPPSS.
IV. Traditional Causes of Default (cont’d)

Traditional Causes of Municipal Bond Defaults in U.S.A. (cont’d)

4. Fraud:
   – Irrational Investment Strategies – Orange County.

5. Mismanagement.

6. Unwillingness to pay:
   – 13 States in 1860s.
   – WPPSS.
   – Orange County.

7. Natural and Man Made Disasters:
   – South Tucson, Arizona – Tort Liability.
   – 1900 Galveston, Texas – Hurricane.
   – 9/11/01 attack on NYC.
IV. Traditional Causes of Default (cont’d)

<table>
<thead>
<tr>
<th>Year Range</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1900-1943</td>
<td>Average default rate of 1.7%.</td>
</tr>
<tr>
<td>1944-1965</td>
<td>1/10 of 1%.</td>
</tr>
<tr>
<td>1970</td>
<td>Over $1 Billion Dollars of Default.</td>
</tr>
<tr>
<td>1987</td>
<td>$21.4 Billion of Corporate Debt Default.</td>
</tr>
<tr>
<td>1991</td>
<td>$26.5 Billion of Corporate Debt Default.</td>
</tr>
<tr>
<td>1993</td>
<td>$7 Billion of Corporate Debt Default.</td>
</tr>
<tr>
<td>2008</td>
<td>Assets in Bankruptcy increased to $1.2 Trillion with Lehman’s $639 Billion of assets in Bankruptcy and Washington Mutual’s $325 Billion (almost triple any other year in recent history).</td>
</tr>
</tbody>
</table>
V. Some Proximate Causes of Municipal Defaults

Coming Attractions
Income vs. Property Taxes

The Issue of Proposition 13-Type Legislation and Tax Cap –
California and its progeny.

Sales Tax – Florida and others.

New York – Income tax (State - City).

Tax exemption for not-for-profits – (Real Property and Income).

Artificial restriction on revenues.

Will Proposition 13 Survive by 2025?

Reduced Property Tax Revenue – the Bursting of the Housing and
Commercial Real Estate Bubble.
The Problem of Infrastructure and who will pay for it?

In 1980 - On $1 on highway construction spending.

72¢ Federal 28¢ State.

Now just the reverse.

$2-3 Trillion of Infrastructure Improvements over next 5 years.

The Hidden Deficit?

$280 Billion + to upgrade highway.

$70 Billion + to upgrade bridges.

$12 Billion + to upgrade mass transit.
Extraordinary Personnel Growth and Future Pension Crisis (Mortgaging Your Grandchildren)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of State Employees</th>
<th>Number of Local Employees</th>
<th>Percentage of State of All Government Employees</th>
<th>Percentage of Local of All Government Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>2,755,000</td>
<td>7,392,000</td>
<td>21.1</td>
<td>56.7</td>
</tr>
<tr>
<td>1997</td>
<td>4,732,608</td>
<td>12,000,608</td>
<td>24.2</td>
<td>61.4</td>
</tr>
<tr>
<td>Percent Increase from 1970</td>
<td>71.8%</td>
<td>62.3%</td>
<td>14.7%</td>
<td>8.3%</td>
</tr>
</tbody>
</table>

Pension obligation for Municipal Workers do not have priority in Bankruptcy no protection for Deferred Compensation:
– Demand for Funding Now.
– Orange County Cut Thousands to Balance Budget.

State and Local Government Employees have grown between 1946 – 2008 by 12.7 million employees, faster than the rate of growth in population. In 1946, there were 2.3 State and Local Government Employees per 100 citizens. In 2008, that number was 6.5. Are we less effective? (Grandfather State and Local Government Spending Report by Michael Hodges).
V. Some Proximate Causes of Municipal Defaults (cont’d)

On the State and Local Government Side Unfunded Pensions and

On Federal Side Unfunded Social Security

- 12% of the USA’s Workforce Are State and Local Government Workers Whose Pensions Are Underfunded by Over $1 Trillion and Whose Post-Retirement Health Care Liabilities (OPEB) Could Range from $300 - $700 Billion.

- Social Security Is $35 Trillion Underfunded. Medicare, Medicaid and Social Security Represent 40% of the Federal Budget in 2005 and 8% of GDP. By 2011 They Are Projected to Be 11% of GDP and by 2020-2040 the Projection Is 16% of GDP. Federal Tax Revenues Are Only 18% of GDP — So Much for a Balanced Federal Budget.
V. Some Proximate Causes of Municipal Defaults (cont’d)

WARNING Another Bubble to Burst

  - Worldwide and USA Federal.
  - The National Debt of All Countries in the World Has Doubled in the Last Ten Years to a Peak of $55 Trillion of Which the U.S.A. Represents approximately $13.0 Trillion. How Long Can Anyone Defy Gravity?
V. Some Proximate Causes of Municipal Defaults (cont’d)

Decline of Urban Areas

- Surfing the Internet.
- Virtual office - Telecommuting probably less than 10% today, but what if it is 25% or more tomorrow?

  Decrease intercity tax payer (head tax, income tax, parking, sales, gasoline taxes).

Flight from the Rustbelt to the Funbelt

- Movement from Industrial States.
- New office environments.
- Effect on 30 year Bond and taxes.
V. Some Proximate Causes of Municipal Defaults (cont’d)

Newly Discovered Tenth Amendment!

Who pays for it — the States Do?
No more unfunded mandates?
Welfare.
Medicare Medicaid.
Public Safety-Crime.
Child care.
Schools.
V. Some Proximate Causes of Municipal Defaults (cont’d)

THE GATHERING STORM: HAS IT PASSED?
IS THIS ONLY THE LULL BEFORE A BIGGER STORM?
WHAT TO EXPECT IN THE FUTURE?

- **USA: State and Local Government Debt Bubble**
  - The Debt of State and Local Government has also almost doubled in the last 10 years, from $1.197 Trillion in 2000 to $2.8 Trillion in the fourth quarter of 2010.
  - This does not include over $1 Trillion of Unfunded Pension Liabilities and OPEB of over $300-$700 Billion plus the needed debt financing of debt funding over the next five years to bring infrastructure up to acceptable standards of $2.5 Trillion.
VI. Chapter 9: Who Can File and Who Does File?

Answer: Very Few for Most Part Special Tax Districts and Small Municipalities That Do Not Issue Public Bond Debt.
To be a Debtor in a Chapter 9, an entity must be:

- An entity that is a municipality;
- Specifically authorized under State law to be a Debtor. Fifteen States have Statutory Provisions in which the State specifically authorizes filing (AL, AZ, AR, CA, ID, KY, MN, MO, MT, NE, NY, OK, SC, TX, WA), another nine States authorize a filing conditioned on a further act of the State, an Elected Official or State entity (CT, FL, LA, MI, NJ, NC, OH, PA, RI) Three states (CO, OR and IL) grant limited authorization, two states prohibit filing (GA) but one of them (IA) has an exception to the prohibition. The remaining 21 are either unclear or do not have specific authorization;
- Insolvent;
- Willing to effectuate a plan; and
- Either have obtained the agreement of creditors holding majority amount of the claim of each class that the municipality intends to impair or have attempted to negotiate in good faith, but was unable to do so or it was impractical to negotiate with creditors or a creditor is attempting to obtain a preference.
General Analysis of State Specific Authorization for Municipalities to File a Chapter 9 Case

The following are statutory provisions in which states have authorized Chapter 9 filings for certain governmental entities:

15 States that specifically authorize municipal bankruptcies:
- Ala. Code 1975 § 11-81-3
- Ark. Code Ann. § 14-74-103
- Cal. Gov’t Code § 53760
- Idaho Code Ann. § 67-3903
- Ky. Rev. Stat Ann. § 66.400
- Mo. Ann. Stat. § 427.100
- Mont. Code Ann. § 7-7-132
- Neb. Rev. St. § 13-402
- N.Y. Local Finance Law § 85.80
- S.C. Code Ann. § 6-1-10
- Tex. Loc. Gov’t Code § 140.001
- Wash. Rev. Code § 39.64.040

9 States that conditionally authorize municipal bankruptcies:
- Fla. Stat. Ann. § 218.01
- Mich. Comp. Laws § 141.1222
- Ohio Rev. Code Ann. § 133.36
- R.I. Gen. Laws § 45-9-7

3 States with limited authorization:
- Colorado has enacted legislation specifically authorizing its beleaguered special taxing districts to file a petition under Chapter 9. Section 32-1-1403 of the Colorado revised statutes states that "any insolvent taxing district is hereby authorized to file a petition authorized by federal bankruptcy law and to take any and all action necessary or proper to carry out the plan filed with said petition…" (CRS § 37-32-102 (Drainage & Irrigation District))
- Oregon permits Irrigation and Drainage Districts to file (Or. Rev. Stat. § 548.705)

2 States prohibit filing but one has an Exception:
- Iowa generally prohibits filing Chapter 9 (Ia. Code Ann. § 76.16) but allows filing for insolvency caused by debt involuntarily incurred not covered by insurance proceeds (Ia. Code Ann. § 76.16A)
- Georgia prohibits the filing of Chapter 9 Bankruptcy (Ga. Code Ann. § 36-80-5)

The 21 Remaining States are either unclear or do not have specific authorization.
General Analysis of State Specific Authorization for Municipalities to File a Chapter 9 Case

- 16 States that specifically authorize municipal bankruptcies
- 9 States that conditionally authorize municipal bankruptcies
- 3 States with limited authorization
- 2 States prohibit filing, but one has an exception (Iowa)
- Remaining 21 States are either unclear or do not have specific authorization so there is no specific authorization
General Analysis of Chapter 9 (cont’d)

What is a Municipality?


An “entity” includes a person, estate, trust, governmental unit, and United States Trustee.


An “governmental unit” means United States, State, Commonwealth, District, Territory, municipality, foreign state, department, agency, or instrumentality of the United States (but not a United States trustee while serving as a Trustee), a State, a Commonwealth, a District, a Territory, a municipality, or a foreign state or other foreign or domestic government.


A “municipality” means political subdivision or public agency or instrumentality of a state.
Interested Parties in Chapter 9

- The municipality.
- Bondholders or their Trustees.
- Landowners and other Tax Payers.
- Unsecured (Trade) Creditors (Unsecured Creditors Committee).
- The State.
- Unions.
- Judgment and other Secured Creditors.

Issue

- How are professionals paid for?
Steps to File for Chapter 9

- State and local law is followed to document proper authorization.
- Voluntary petition is filed in the Federal District Court where municipality is located.
- The chief judge of the Court of Appeals for the district where case commenced designates the judge to hear the case.
- Commencement of the case constitutes an “order for relief” (this is clarified in new Bankruptcy Bill).
- After notice and hearing, the Court may dismiss the petition if the Debtor did not file the petition in good faith or if the petition does not meet the requirements of the title.
General Analysis of Chapter 9
Unlike a Chapter 11 (cont’d)

- In Chapter 9, only the Debtor can file the case.
- In Chapter 9, only the Debtor can file the plan of debt adjustment.
- In Chapter 9, there is no Section 1113 criteria for sharing information with employee representatives or workers or any process of information sharing prior to rejection of union or employment contracts.
- In Chapter 9, there is no limitation on damages on real estate leases held by a Trustee for a Municipal Building Authority (real estate lease).
- In Chapter 9, municipal bond and note payments made pre-petition, even within 90 days of the filing, are not preferential.
- In Chapter 9, there are no priorities for pre-petition wages, benefits, accrued vacation and health care benefits. There is no $11,725 per employee priority claim.
General Analysis of Chapter 9

Limitation on the Bankruptcy Court (cont’d)

- The Bankruptcy Court in a Chapter 9 proceeding cannot interfere with the government and affairs of the municipality.
- Other than the lack of revenues to pay creditors, municipal services are provided and determined as to whether they will be provided by the governmental body, not by the Bankruptcy Judge.
- Unlike Chapter 11, the municipality can sell its assets, incur debt and engage in governmental affairs without necessarily having to obtain the approval of the bankruptcy court.
VII. Chapter 9 – Where Is Your Sting?

Answer: With Proper Credit Analysis and Structuring There Is None!
How Is Municipal Debt Treated in a Chapter 9 Proceeding? (Priority of Payment)

Summary of Chapter 9 Priorities

<table>
<thead>
<tr>
<th>TYPE OF CLAIM</th>
<th>EXPLANATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Obligations secured by a statutory lien to the extent of the value of the collateral.</td>
<td>Debt (Bonds, Trans, Rans) issued pursuant to statute that itself imposes a pledge. (There may be delay in payments due to automatic stay - unless stay is lifted - but ultimately will be paid.)</td>
</tr>
<tr>
<td>2. Obligations secured by Special Revenues (subject to necessary operating expenses of such project or system) to the extent of the value of the collateral.</td>
<td>Special Revenue Bonds secured by any of the following: (A) receipts derived from the ownership, operation, or disposition of projects or systems of the debtor that are primarily used or intended to be used primarily to provide transportation, utility, or other services, including the proceeds of borrowings to finance the projects or systems; (B) special excise taxes imposed on particular activities or transactions; (C) incremental tax receipts from the benefited area in the case of tax-increment financing; (D) other revenues or receipts derived from particular functions of the debtor, whether or not the debtor has other functions; or (E) taxes specially levied to finance one or more projects or systems, excluding receipts from general property, sales, or income taxes (other than tax-increment financing) levied to finance the general purposes of the debtor. There should be no delay in payment since automatic stay is lifted under Section 922(d).</td>
</tr>
</tbody>
</table>

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a Chapter 9 incorporates Section 506(c) of the Bankruptcy Code which imposes a surcharge for preserving or disposing of collateral. Since the municipality cannot mortgage city hall or the police headquarters, municipal securities tend to be secured by a pledge of a revenue stream. Hence, it is seldom a surcharge will be imposed. (But see Nos. 3 and 4)
b Chapter 9 incorporates Section 364(d) of the Bankruptcy Code which permits a debtor to obtain post-petition credit secured by a senior or equal lien on property of the estate that is subject to a lien if the prior lien holder is adequately protected.
c A Pledge of Revenues that is not a Statutory Lien or Special Revenues may be attacked as not being a valid continuing Post-Petition Lien under Section 552 of the Bankruptcy Code.
How Is Municipal Debt Treated in a Chapter 9 Proceeding? (Priority of Payment) (cont’d)

<table>
<thead>
<tr>
<th>TYPE OF CLAIM</th>
<th>EXPLANATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Secured Lien based on Bond Resolution or contractual provisions that does not meet test of Statutory Lien or Special Revenues to the extent perfected prepetition, subject to the value of prepetition property or proceeds thereof.</td>
<td>Under language of Sections 522 and 958, liens on such collateral would not continue postpetition. After giving value to the prepetition lien on property or proceeds, there is an unsecured claim to the extent there is recourse to the municipality or Debtor. You may expect the creditor to argue that pursuant to Section 904, the Court cannot interfere with the property or revenues of the Debtor, and that includes the grant of security to such secured creditor.</td>
</tr>
<tr>
<td>4. Obligations secured by a municipal facility lease financing.</td>
<td>Under Section 929 of the Bankruptcy Code, even if the transaction is styled as a municipal lease, a financing lease will be treated as long-term debt and secured to the extent of the value of the facility.</td>
</tr>
<tr>
<td>5. Administrative Expenses (which would include expenses incurred in connection with the Chapter 9 case itself.)</td>
<td>Pursuant to Section 943, all amounts must be disclosed and be reasonable for a Plan of Adjustment to be confirmed.</td>
</tr>
</tbody>
</table>

*These expenses strictly relate to the costs of the Bankruptcy. Because the Bankruptcy Court cannot interfere with the government and affairs of the municipality, general operating expenses of the municipality are not within the control of the Court, are not discharged and will remain liabilities of the municipality after the confirmation of a plan or dismissal of the case.*
### How Is Municipal Debt Treated in a Chapter 9 Proceeding? (Priority of Payment) (cont’d)

<table>
<thead>
<tr>
<th>TYPE OF CLAIM</th>
<th>EXPLANATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Unsecured Debt includes:</td>
<td></td>
</tr>
<tr>
<td>A. Senior Unsecured Claims with benefit of subordination paid to the extent of available funds (without any obligation to raise taxes) which include any of B, C, D, or E below.</td>
<td>Secured by the “full faith and credit” of the issuing municipality. Postpetition, a court may treat general obligation bonds without a statutory lien or Special Revenues pledge as unsecured debt and order a restructuring of the bonds. Payment on the bonds during the bankruptcy proceeding likely will cease.</td>
</tr>
<tr>
<td>B. General Obligation Bonds.</td>
<td>Vendors, suppliers, contracting parties for goods or services. Payment will likely cease for prepetition goods or services.</td>
</tr>
<tr>
<td>C. Trade.</td>
<td>These do not enjoy any priority, unlike in a Chapter 11.</td>
</tr>
<tr>
<td>D. Obligations for Accrued but Unpaid Prepetition Wages and Pensions and other Employee Benefits.</td>
<td>Any debt subordinated by statute or by contract to other debt would be appropriately subordinated and paid only to the extent senior claims are paid in full. Senior debt would receive pro rata distribution (taking unsecured claim and subordinated claim in aggregate) attributable to subordinated debt until paid.</td>
</tr>
<tr>
<td>E. Unsecured portion of secured indebtedness.</td>
<td></td>
</tr>
<tr>
<td>F. Subordinated Unsecured Claims.</td>
<td></td>
</tr>
</tbody>
</table>

e  Section 503(b)(9) provides for a priority claim to be paid on Confirmation of a Plan for the value of goods provided prepetition within 20 days of the Petition Date.

f  Chapter 9 does not incorporate Section 1113 of the Bankruptcy Code, which imposes special provisions for the rejection of collective bargaining agreements (making the standard less restrictive, i.e., “impairs ability to rehabilitate”), or Sections 507(a)(4) and (5), which give a priority (before payment of unsecured claims) to wages, salaries, commissions, vacation, severance, sick leave or contribution to pension plans of currently $11,725 per employee.
The Role of Special Revenues

- Many municipal bonds are revenue bonds secured by a pledge of revenues derived from the project or a special tax levy.
- Section 552 of the Bankruptcy Code generally provides that property acquired post-petition is not subject to a lien resulting from any security interest created pre-petition.
- Section 928 of the Bankruptcy Code, one of the Municipal Bankruptcy Amendments, renders Section 552(a) inapplicable to revenue bonds secured by “special revenues.”
- The security interest in “special revenues” remains valid and enforceable even though such revenues are received after a Chapter 9 filing.
- Subsection (b) of Section 928 provides that in the case of project or system financing, the bondholders’ lien on “special revenues” is subject to necessary operating expenses of the project or system. Thus, these expenses can be put in front of bondholder claims.
The Role of Special Revenues (cont’d)

“Special revenues” means—

(A) receipts derived from the ownership, operation, or disposition of projects or systems of the debtor that are primarily used or intended to be used primarily to provide transportation, utility, or other services, including the proceeds of borrowings to finance the projects or systems,

(B) special excise taxes imposed on particular activities or transactions,

(C) incremental tax receipts from the benefited area in the case of tax-increment financing,

(D) other revenues or receipts derived from particular functions of the debtor, whether or not the debtor has other functions, or

(E) taxes specifically levied to finance one or more projects or systems, excluding receipts from general property, sales, or income taxes (other than tax-increment financing) levied to finance the general purposes of the debtor.
This problem, however, has been addressed by the Municipal Bankruptcy Amendments. Section 927 of the Bankruptcy Code provides that the holder of a claim payable solely from “special revenues” of the debtor shall not be treated as having recourse against the debtor on account of such claim pursuant to Section 1111(b). The legislative history for this section recognizes that many municipal obligations are, by reason of constitutional, statutory or charter provisions, payable solely from special revenues and not from the full faith and credit of the municipality. This amendment leaves these legal and contractual limitations intact without otherwise altering the provisions with respect to nonrecourse financing. Thus, according to the Senate Report, this section avoids the potential conversion of revenue bonds into general obligation bonds.
Recent Court Test of Special Revenues / Statutory Lien Concepts

- The 1988 municipal bankruptcy amendment recognizing the post-petition effectiveness of a lien on special revenues brought needed clarity to municipal finance.
  - Absent such clarification, a risk had existed that a lien on special revenues could be avoided under Bankruptcy Code Section 552(a), effectively turning a revenue bond into a general obligation bond.
- Subsequently, given consideration of the 10th amendment to the U.S. Constitution reserving power to the States, the Orange County Bankruptcy produced a decision recognizing that liens created by a force of state statute, as opposed to a lien created by agreement of the parties, would survive a Chapter 9 filing.
- Few court rulings have dealt with such concepts.
However, the Bankruptcy Court in the Eastern District of California has recently entered an Order in a Chapter 9 case that, for the first time, applies these principles to a financing secured by a special pledge of ad valorem property taxes.

In the Chapter 9 case of In re Sierra Kings, an insurance company bondholder held municipal securities of a municipal health care district issued for the purpose of financing the renovation of the hospital. The bond resolution provided that as security for the payment of the bonds, there should be levied, in addition to all other taxes, a continuing, unlimited ad valorem tax while the bonds were outstanding, sufficient to pay the principal of and interest on the bonds when due and that such ad valorem taxes should not be used for any other purpose and should not be paid to the District for any other use. The lien was established in accordance with Chapter 4 of Division 23 commencing with Section 32300 of the California Health and Safety Code and the Enabling Resolution of the District.
The Sierra Kings Court has entered an order approving the agreement between the District and the bondholder (1) reaffirming the statutory lien on the ad valorem taxes levied or collected for the payment of the bonds and the related funds and accounts, (2) granting a replacement lien on such ad valorem taxes and such funds and accounts and (3) recognizing such ad valorem taxes as “special revenues” as defined in 11 U.S.C. § 902(2)(e) of the Bankruptcy Code.

The Reaffirmation Agreement between the District and the bondholder is incorporated into the court order. This constitutes judicial recognition that bonds, notes and other obligations which have pledged to their payment tax revenues which are “Special Revenues” or are the subject of a “statutory lien” shall be paid on time on their scheduled payment date without any interference from the Bankruptcy proceeding. In other words, the automatic stay imposed by the Chapter 9 proceeding and the Plan of Adjustment shall not interfere with the payment of the collected tax revenue or the obligations. This means that, as collected, the taxes will be paid on time without interference of the Bankruptcy proceeding to satisfy scheduled payments on the Bonds when due, and nothing in the Chapter 9 proceeding, including the Plan of Adjustment, will interfere with that.
How Is Municipal Bond Debt Treated in a Chapter 9 Proceeding?

### Summary of Basic Treatment of Bonds and Notes in Chapter 9

<table>
<thead>
<tr>
<th>TYPE OF BONDS/NOTES</th>
<th>BANKRUPTCY EFFECTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Obligation Bonds</td>
<td>Post-petition, a court may treat general obligation bonds without a statutory lien as unsecured debt and order a restructuring of the bonds. Payment on the bonds during the bankruptcy proceeding likely will cease. Pre-petition, general obligation bonds are backed by the unlimited taxing power of the municipality (its &quot;full faith and credit&quot;) and are historically subject to conditions such as voter authorization, limitations on particular purposes, or debt limitation to a percentage of assessed valuation on the power of municipal entities to incur such debts.</td>
</tr>
<tr>
<td>General Obligation Bonds plus Pledged Revenues</td>
<td>Assuming that the general obligation pledge is an actual pledge of revenue and to the extent that it may be classified as a Statutory Lien or Special Revenues, this secured issuance will be respected to the degree it is consistent and authorized under state law. A Pledge of Revenues that is not a Statutory Lien or Special Revenues may be attacked as not being a valid continuing Post-Petition Lien under Section 552 of the Bankruptcy Code. This position may be questioned under Section 904 of the Bankruptcy Code given the prohibition that the Court not interfere with the Government Affairs or Revenues of the Municipality.</td>
</tr>
<tr>
<td>Special Revenue Bonds</td>
<td>A pledge on special revenue bonds will survive a bankruptcy filing. Pre-petition, a special revenue bond is an obligation to repay solely and only from revenues of a municipal enterprise (net of operations and maintenance costs) that are pledged to bondholders. The contemplated remedy for default often focuses on a covenant to charge rates sufficient to amortize the debt. Defaulted bondholders are expected to seek mandamus in court to require the municipal borrower to raise its rates.</td>
</tr>
<tr>
<td>Revenues subject to Statutory Lien</td>
<td>Assuming the pledge is authorized under state law through a statutory lien, the Bankruptcy Court should respect that statutory lien. Thus, as long as the revenues are subject to a statutory lien, payments to the bondholders should be protected post-petition.</td>
</tr>
</tbody>
</table>
How Is Municipal Bond Debt Treated in a Chapter 9 Proceeding? (cont’d)

G.O. Bond without any pledge of revenue or special constitutional priority can be treated like any other unsecured claim of vendors, workers, pension; however, in Medley, Florida in 1968, there was a distinction made to pay bond indebtedness on schedule and stretch out the payments to other unsecured creditors over a 10-year period since failure to make payment on the Bonds might cause the municipality to lose access to the market or to pay a significantly higher price for access that would justify a better treatment for bond indebtedness for the benefit of all.

As noted in *Faitoute Iron & Steel Co. et al. v. City of Asbury Park, N.J.*, 316 U.S. 502 (1942), discretion must be exercised in dealing with secured claims so that, while the Court recognized New Jersey’s Depression-era Municipal Finance Commission Act of 1931 could impair municipal debt, there was recognition that a secured claims, tax anticipation and revenue notes stand on an entirely different footing from other municipal obligations and, in relation to them, no claim is affected by the Municipal Finance Commission Act. The Plan adopted by Asbury Park paid general obligation bondholders a compromise payment (less in amount and a delay in payment).
Preference in Chapter 9

- The Municipal Bankruptcy Amendments not only address the problem of revenue bondholders, but actually provide assurance to holders of all municipal bond or note obligations. Section 926(b) of the Bankruptcy Code now provides that a transfer of property to the debtor to or for the benefit of any holder of a bond or note on account of such bond or note may not be avoided under Section 547. While this section refers to “bonds or notes,” there is nothing in the legislative history to support the view that this provision is limited only to instruments bearing such titles. The legislative intent appears to be that Section 926(b) should be applicable to all forms of municipal debt.
VIII. Other Issues in Chapter 9

Labor Issues

- Burdensome labor contracts can be rejected for cause (City of Vallejo)
- Unfunded pension liabilities are unsecured obligations and no priority for wages, vacation, pension or healthcare in Chapter 9

Non-Bonded Debt or Contracts

- No priority among unsecured claims unless they qualify as administrative
- In a Chapter 9 proceedings, the municipality may assume or reject an executory contract or unexpired lease
- Municipal lease financing presents issue of true vs. financing lease (United Litigation)

Priming of Bonded Debt by

- Necessary operating expenses

Priming of Unsecured Debt by

- Administrative claims

Duration of Chapter 9

- Long enough to accomplish objectives. In complicated actual city or county filing, measured in years

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VIII. Other Issues in Chapter 9 (cont’d)

Emergence from Chapter 9

- The Court must confirm a plan if all the requirements of § 943(b) are satisfied:
  1. the plan complies with the provisions of this title made applicable by sections 103(e) and 901 of this title;
  2. the plan complies with the provisions of this chapter;
  3. all amounts to be paid by the debtor or any person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable;
  4. the debtor is not prohibited by law from taking any action necessary to carry out the plan;
  5. except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that on the effective date of the plan each holder of a claim of a kind specified in section 507(a)(1) of this title will receive on account of such claim cash equal to the allowed amount of such claim;
  6. any regulatory or electoral approval necessary under applicable nonbankruptcy law in order to carry out any provision of the plan has been obtained, or such provision is expressly conditioned on such approval; and
  7. the plan is in the best interests of creditors and is feasible.
VIII. Other Issues in Chapter 9 (cont’d)

- New obligations arise under the plan and pre-confirmation obligations are discharged in accordance with the plan, the order confirming the plan and § 944(b).

- While the market typically views the filing for Chapter 9 as a substantial negative, if the filing is perceived to be the result of a problem that has been dealt with, as in Orange County, the market impact has not been permanent.
IX. Preferences in Chapter 9

- The Municipal Bankruptcy Amendments not only address the problem of revenue bondholders, but actually provide assurance to holders of all municipal bond or note obligations. Section 926(b) of the Bankruptcy Code now provides that a transfer of property to the debtor to or for the benefit of any holder of a bond or note on account of such bond or note may not be avoided under Section 547. While this section refers to “bonds or notes,” there is nothing in the legislative history to support the view that this provision is limited only to instruments bearing such titles. The legislative intent appears to be that Section 926(b) should be applicable to all forms of municipal debt.
X. Other Mechanisms of State and Local Debt Resolution of Financial Distress
State and Local Governments Have a History of Addressing and Solving Financial Distressed Situations

- If a particular state does not allow its municipalities to file a chapter 9 petition, the state may, through an Intergovernmental Cooperation Act or Refinancing Authority, step in and provide (a) bridge financing or refinancing of the troubled debt; (b) transfer certain services to other governmental agencies to reduce expenditures; (c) grant funds to the municipality to bridge the financial crisis; (d) loan funds to the municipality on terms that are realistic or payable out of state tax sources that can be offset; and/or (e) use intercept of state tax payable to the municipality to ensure essential municipal services. A particular state’s action will depend on the authority provided in the state’s statutes, whether bridge financing or refinancing of troubled debt.
State and Local Governments Have a History of Addressing and Solving Financial Distressed Situations (cont’d)

- The state courts may also be used to appoint a receiver to supervise the municipality’s board. Along with this, a court of equity or legislature could withdraw the municipality’s charter and liquidate its assets to distribute to creditors. This, of course, is the least politically acceptable resolution and would be a highly unlikely scenario. In any of these scenarios, a lender should enter the negotiations early to better protect its interests.

- Generally, Refinancing Authorities, Receiverships and Commissions do not deal with adjustment of debt but rather with providing funds for continued provision of municipal services (gratis or loans), refocusing municipal services to other governmental bodies and requiring a balanced budget going forward.
State and Local Governments Have a History of Addressing and Solving Financial Distressed Situations (cont’d)

- The State may, by state statute (Intergovernmental Cooperation Act or Refinance Authority), step in and provide:
  - Bridge financing or refinancing of troubled debt.
  - Transfer certain services to other governmental agencies to reduce expenditures.
  - Grant funds to the municipality to bridge the financial crisis.
  - Loan funds to the municipality on terms that are realistic or payable out-of-state tax sources that can be offset.
  - Use intercept of State tax payable to municipality to ensure essential municipal service.
State and Local Governments Have a History of Addressing and Solving Financial Distressed Situations (cont’d)

- Use of State Finance or Supervisory Board to provide Adult Supervision (such as Municipal Assistance Corporation for NYC in 1975, Chicago School Finance Authority 1978):
  - Require Balanced Budgets, provide economic discipline and reporting.
  - Issue debt in state name or separate entity to obtain market credibility and access.
  - Power to negotiate debt restructuring and quasi-judicial jurisdiction.
  - Review services or costs that can be transferred to other governmental bodies.
  - Right to intercept tax revenue and focus use on essential services and cost.
  - Power to authorize Chapter 9 if needed.
  - Monitor compliance with any restructuring plan.
  - Pennsylvania Act 47 Financially Distressed Municipalities Act. Twenty-five municipalities have been declared financially distressed since 1988 and only six have had the designation rescinded.
  - New York has Financial Control Boards.
  - Connecticut has a Commission to supervise balanced budget and financial status.
  - Ohio has a Local Fiscal Emergencies Act to deal with budget and accounting issues.
State and Local Governments Have a History of Addressing and Solving Financial Distressed Situations (cont’d)

- Use of state or court appointed receivers:
  - Provide Adult Supervision as Board.
  - Municipal receiverships go back to Fifth Century B.C. and the Greek town of Atarneus where a Greek banker took over administration due to a defaulted loan.
- Use of Court of Equity or legislature to withdraw charter of the municipal entity and liquidate assets and distribute to creditors.
- Unlike a corporation, it is very hard to liquidate a municipality or state and the least politically acceptable resolution.
The Structure for Oversight and Emergency Financing

- Local Governmental bodies experiencing financial distress often times are resolved by the resort to state created financing and oversight authorities with various degrees of formal oversight and control.

- Creation of a commission which later develops into a refinancing authority provides two basic advantages:
  - The new authority has financial credibility and access to capital markets if it has an assured source of revenue to pay debt service which is isolated from bankruptcy and other credit risk.
  - An independent authority can use a variety of fiscal tools to enforce fiscal discipline on the local government because it is removed from political pressure.
The Structure for Oversight and Emergency Financing (cont’d)

Needs of the Municipality

Responses by the State to a Financially Distressed Municipality

STATE

Policy Decision: Inactive or Active?

State Agencies or State Legislation dealing with Financially Distressed Municipalities

- Formulate Plan
- Appoint Coordinator or Commission or Finance Authority
- Require, Monitor, Restructure and Refinance
- Oversight & Standards
- Permit Federal Bankruptcy in Control Pre-Package Soft Landing

New Revenue Stream

Who Controls?

- Revenue to Municipality?
- Revenue/Tax to New Authority?
- Strong or Weak New Authority?

Short Term Legislation

- Subsidize or provide relief from annual budget deficit
- Temporary Cash Infusions (Funding and repayment?)
- Identify and grant new revenue (Secured Financing)

Longer Term Legislation

- Create Oversight and Financing Authority
- Finance Cumulative Deficit
- Provide Annual Financing
- Provide Discipline through Monitoring, Standards, and system of rewards and withholdings
- Merger, Restructuring and Refinancing
- Transfer Functions and Expenditures from Municipality to new Entity in Pre-Package Plan or Sale

- Provide Legislation
- Provide Money
- Provide Ongoing Discipline
Scenario for Successful Municipal Financial Oversight

1. Amend Balanced Annual Budget
2. New Revenue Sources
3. New HCP Refinance Authority
4. Allocation and Protection of New Revenue Sources to Cure Liquidity Problem
5. Creation of Deficit Financing/Oversight Authority
6. Moratorium
Virtually all States have some statutes providing for:

- Ability to refund.
- Appointment of receivers.
- Mandamus or remedies upon default to require payment of debt or levying taxes.
- Statutory liens or special revenues.

Active financial supervision or financial review (over half of the States):

At least 2 - Debt Advisory Commission.
At least 6 - Statutes providing for debt compromise or adjustment process and intercepts for payment.
At least 9 - Active technical assistance, grants, loans, budget review.
At least 10 - Financial control boards, refinance authorities and active outside supervision and review.
XI. Selected Case Studies

New York City

- Questionable Accounting Practices for 10 years prior to 1975.
- Lack of Funds to meet short-term Debt Obligations.
- Federal and State Bridge Financing.
- State Municipal Assistance Corporation.

Cleveland, Ohio

- Default on $15.5 million of Board Anticipation Notes.
- Large General Fund Deficit.
- Then current Bankruptcy Legislation increased concerns with respect to Bailout Financing.
- Amended Bankruptcy Code in 1988 to allow Special Revenue Financing protected from subsequent Bankruptcy Filing.
- State Bailout.
XI. Selected Case Studies (cont’d)

San Jose School District - California (1983)

Teacher Union Contract Dispute:

- Reduced Real Estate Tax Revenue.
- First major municipality to file for Bankruptcy since the Great Depression.
- Paid Interest to Bondholders During Bankruptcy.
- Ultimately settled with Teachers and Dismissed Bankruptcy.

Medley, Florida (1968)

- Small city of 350 residents.
- Filed for Bankruptcy Protection but promised to pay.
- Bondholders before other creditors.
Washington Public Power Supply System (WPPSS) – 1983

- Projected Demand for electric power in Pacific Northwest of U.S.A. did not materialize.
- Financing of Nuclear Power Plants 4 and 5 for $2.25 Billion had both legal and feasibility problems.
- Supreme Court of State of Washington holds Municipal Participants not obligated to pay – (6/15/83).
- Legal and Financial meltdown.
- Issue of lingering legal problem – need for clear, objective and validated statutory basis for financing.
- Necessity of legal validation.
XI. Selected Case Studies (cont’d)

The Colorado Special Districts

- Financing for infrastructure for Real Estate Developments – streets, sewers, utilities and the like.
- Over-Development and Lack of Demand.
- Wrong Economics – lack of feasibility.
- Municipal Debt Adjustment – Chapter 9 proceedings.
XI. Selected Case Studies (cont’d)

City of Bridgeport, Connecticut – 1991

- Financial distress of City due to business and residents leaving core city and reducing the tax base.
- State of Connecticut enacted special legislation to discipline financing and limit expenditures to actual revenue.
- Mayor disputes State’s effort and contests budget restraints files for Bankruptcy – Municipal Debt Adjustment.
- City elects new Mayor and works with State as Bankruptcy is dismissed on technical reason.
- Balanced budget enforced by State.
XI. Selected Case Studies (cont’d)


Operating Deficit of $200 Million:

- Refinancing and Bridge Financing as well as restructuring of operation and responsibilities.
- Statutory Authority for Emergency Financing and Restructuring:
  - State Authority.
  - Membership on Authority Board – representative.
- Compliance with Constitution Provision:
  - Ability to tax.
  - Ability to direct and oversight.
  - Ability to fund.
- Use of Intergovernmental Agreements and transfer of Service Obligation.
- Refunding of Past Obligations.
- Development of near Term and 5 year.
XI. Selected Case Studies (cont’d)

Financial Recovery Plan:

- Budget Development, Review and Approval.
- Collective Bargaining Agreement Review and Approval.
- Limit Availability of Federal Bankruptcy.
- Create New Revenue Sources.
- Intercept of State Revenue to City for proper disposition.
XI. Selected Case Studies (cont’d)

Orange County, California – 1994

- Fourth Largest County in U.S.A. by population.
- Annual Budget of $4 Billion.
- Unwise Leveraged investment policy to make up for increasing costs and limited revenue sources.
- Derivative Problem – reasonableness of municipal investment.
- Filed Bankruptcy and ultimately paid Bondholders in full (delay in payment).
XI. Selected Case Studies (cont’d)

City of Vallejo, California – 2008

- While case still pending, has already produced important ruling on Chapter 9 eligibility (insolvency determined by cash flow analysis).
- Motion to Reject Collective Bargaining Agreements met by unions agreeing to modifications of benefits given court ruling that the contracts can be rejected.
XI. Central Falls Problems Leads to Change in Rhode Island Receivership Law for Municipalities

- In 2010, Central Falls, a financially troubled Rhode Island town, sought a court-appointed receiver under the then-existing law.
- A judge appointed an outside lawyer as temporary receiver and gave him oversight over the town’s finances, including vendor contracts.
- State officials and others worried the move could have a ripple effect beyond Central Falls disrupting the municipal bond market and alarming rating agencies.
- As a result, a new bill was enacted that prohibits cities and towns in Rhode Island from entering judicial receivership and that calls on the State to intervene earlier when communities are in financial trouble.
- The new law introduces levels of state oversight for struggling municipalities.
Central Falls Problems Leads to Change in Rhode Island Receivership Law for Municipalities (cont’d)

- The first level allows the state director of revenue to appoint a fiscal overseer for communities in financial distress.
- The overseer would have the authority to review all proposed contracts, approve the annual budget and supervise expenditures. If the town is still unable to produce a balanced budget, the law authorizes the creation of a budget commission.
- And if problems still persist, the state can appoint a receiver, who besides having oversight of the city or town has authority to file for federal bankruptcy protection.
- The bill was written to apply retroactively so as to cover Central Falls.
Harrisburg, Pennsylvania Default Threatens G.O. Market

- In September of 2010, the Pennsylvania city announced it would miss a payment on general obligation bonds, which were insured by Assured.
- This followed an earlier default on conduit bonds for a failed incinerator project and sparked talk of widespread trouble in the municipal bond market, including general obligation bonds. These defaults continue.
- The Governor of Pennsylvania responded with an advance on state aid to meet the $3.3 million in bond payments.
- Harrisburg’s default would have increased borrowing costs or make credit unobtainable for other Pennsylvania municipalities and school districts, and jeopardize the city’s attempts to devise a recovery plan.
- Under the governor’s plan, Harrisburg will immediately receive three state grants for fire protection and pension assistance worth a total of $3.6 million that has been scheduled for later this year.
Harrisburg, Pennsylvania Default Threatens G.O. Market

- The early transfer enabled Harrisburg to meet a September 15 due date for its 1997 Series F bonds, which it had told a trustee August 30 it would skip. The state is also working with the city and private lenders to secure a short-term tax- and revenue-anticipation note for operating funds.
- If the city counsel does not agree on an asset sale or other plan to shore up Harrisburg’s finances, local decision-making will be taken over by the state through Pennsylvania’s Act 47 municipal recovery program or a bankruptcy court.
- The state will also give Harrisburg $350,000 in grants and a $500,000 loan to hire Chicago-based financial consultant Scott Balice Strategies LLC to develop options for financial recover, potentially including the sale and lease of assets such as parking garages and meters.
- The loan will be repaid if there is a sale of assets.
XII. What About Sovereign Debt Resolution Mechanism for the States?
XII. What About Sovereign Debt Resolution Mechanism for the States? (cont’d)

- Other Sovereign Debt Restructuring Mechanism (“SDRM”).
  - Composition of Creditors (Provide a Forum for Creditors to meet to reach consensus as to what can be paid and what should be forgiven).
  - Use of Contractual Restructuring Approval – The use of Collective Action Clauses where by a Majority or Super Majority of Creditors to that contract have the power to bind all holders to a debt restructuring and forgiveness. (Not a capital market acceptable provision) – Question of International enforceability.
  - Arbitration Clauses – Again arbitration does not have the transparency and creditor participation that Sophisticated institution may require. (Many questions, including who can pull the trigger – in voluntary arbitration and what law will govern.)
  - “Club” Approval – London Club or Paris Club but there is a question of whether it involves (and binds) all of the relevant parties especially in a more diverse world.
XII. What About Sovereign Debt Resolution Mechanism for the States? (cont’d)

- Bankruptcy Court for Sovereigns.
- Use – IFM – SDRM “Dispute Resolution Forum” – to verify and reconcile claims and possibly continue with Sovereign Debt Restructuring Court as a Sovereign Debt Tribunal with:
  - Independence.
  - Expertise.
  - Neutrality.
  - Certainty/Predictability.
  - Attempt to reach volition of parties.
  - Restructuring Plan must have vote of majority of creditors.
  - The ultimate hammer of a Sovereign Debt Tribunal deciding what the payout will be if Restructuring Plan cannot be approved.
The simple answer is NO!

Why?

- States have not asked for it or perceived they need it.
- No State has defaulted in payment of its obligations including G.O. Bonds, since its late 1800’s and repudiation of Debt incurred after the Civil War (except Arkansas in 1933 which defaulted on G.O. Bonds).
- States have weathered the financial storms since then including the Great Depression.
- Bankruptcy for States raises constitutional and practical problems.
  - Each State is a Sovereign and as such is not subject to the jurisdiction of another Sovereign such as the federal government.
    - It is not only a Tenth Amendment issue but also the nature of Sovereign.
Bankruptcy like Chapter 9 affects all creditor relationships – those that work and are desired to continue and those that are a problem.

- Why tip over good working relationship.

- Further Federal Bankruptcy Court cannot interfere with the revenues government and affairs of another Sovereign – § 904 of Chapter 9 – U.S. Supreme Court Decisions and Tenth Amendment.

- State Bankruptcy cannot provide interim financing or new revenues, new tax sources or an expeditious resolution of the major problem affecting the State.

- A State Bankruptcy will be an expensive and time consuming experience, expensive, intrusive into certain creditor relationships that should not be disturbed.
XII. Should States Be Authorized to File for Bankruptcy as a Sovereign Debt Resolution Mechanism (cont’d)

The discussion or existence of State Bankruptcy can cause concern or panic in the capital markets given the unprecedented threat of a State not honoring in full its obligations.

- The existence of a State Bankruptcy Option will cause a cloud or stigma on State access to the financial markets and increase borrowing costs.

- Compare 10 year U.S. Treasury Notes to Greek 10 year notes and the increased borrowing cost of almost 10% additional costs a year or the equivalent of almost pay twice the principal amount over 10 years.
XIII. State and Local Government Pension Underfunding – A Clear and Present Danger or Just Another Issue to Be Addressed?
XIII. Unfunded Pensions and OPEB

- Is New Jersey settlement with SEC on lack of full disclosure on unfunded pension liability a “wake up call” or the “first shoe to drop”?
- Is unfunded pension liability due to lack of accounting standards – (a GASB issue) or lack of mandated funding to actuarially required contribution?
- Are pension underfunding liabilities real debt obligations of the state or local government or just non-enforceable promises?
  - Illinois Legislation.
  - South Dakota, Colorado, Minnesota Legislation.
- How do unfunded pension liabilities rank in priority of payment in a Chapter 9 proceedings with special revenues, statutory liens, revenue pledge and G.O. debt? What about the Sierra King Health Care District order?
- Will pension underfunding cause an immediate default or Chapter 9 filing? Is it a slow death?
Can Pension Benefits and OPEBs Be Rolled Back or Reduced?

A. Different Approaches. States take different approaches in analyzing the pension rights of public employees and whether those rights can be modified. The chart set forth below summarizes some of these:

<table>
<thead>
<tr>
<th>Specific state constitution prohibiting impairment of public employee pensions</th>
<th>General constitutional prohibition against impairment of contracts (applicability to pensions depends on whether the courts view pensions as contractual obligations; also, states that do not have their own Contract Clause oftentimes rely on the Contract Clause of the U.S. Constitution):</th>
<th>State statute or case law prohibiting impairment of public employee pensions</th>
</tr>
</thead>
</table>
Can Pension Benefits and OPEBs Be Rolled Back or Reduced? (cont’d)

B. States that by Specific Constitutional Provisions Prohibit Impairment. In certain States, there are Constitutional prohibitions specifically preventing any reducing or eliminating of pension benefits - State Constitutions prohibit altering (reducing or eliminating) state and local governmental contractual obligations to employees for pension benefits — a “vested” right (See e.g., Illinois, New York, Michigan, etc.).

C. States that Prohibit Impairment on General Basis (General Constitutional Provisions). Some States rely on either the Federal or State Constitution language prohibiting the impairment of a contract in order to preclude a reduction in pension rights. These states include Georgia, Indiana, Oklahoma, Rhode Island and West Virginia.
D. Use of State Statutes to Protect Pension Rights. Some states have enacted statutory provisions which preclude local governments that establish pension and other post-employment benefits from diminishing or impairing those rights (See e.g., Connecticut, Massachusetts and Maine).

E. Generally, the Constitutional or Statutory Provisions Relate to Pension Rights as Compared to OPEBs. Some Courts have extended the protection against reduction in benefits to OPEBs and some have not:

1. Accordingly, changes of pension benefits can only be done voluntarily or through Court-ordered process.

2. Unions and employees generally do not easily agree to changes in pension benefits or OPEB:
   - Voluntarily change may only be possible if the situation is desperate and there is imminent loss of jobs and income, including benefits.
3. The analysis states have undertaken in determining whether OPEBs can be modified are instructive:

   a. A divided Michigan Supreme in *Studier v. Michigan Public School Employees’ Retirement Board*, 698 N.W. 2d 350 (Mich. 2005), determined that the term “accrued financial benefits” in the Michigan Constitution refers only to benefits that increase over time such as retirement benefits and not health insurance benefits which are not protected by State or Federal constitutions:

      i. The Michigan State Constitution provides:

         “The accrued financial benefits of each pension plan and retirement system of the State and its political subdivisions shall be a contractual obligation thereof and shall not be diminished or impaired thereby”.

      ii. The Michigan decision is in accord with earlier decisions in Colorado, Georgia and Tennessee. For example, Colorado has distinguished between quasi-pension type benefits protected from modification and ancillary benefits such as payments of health insurance premiums.
b. In 2003, Alaska's Supreme Court reached the opposite conclusion, namely, that a health benefit increase is constitutionally protected like retirement plans and cannot be changed and must be honored as a contractual obligation and cannot be reduced or eliminated without consent or just compensation. States that have sided with Alaska are New Jersey, Oklahoma, California and West Virginia.

c. Similarly, in *Calabro v. City of Omaha*, 247 Neb. 955, 531 N.W.2d 541 (1995), the Supreme Court of Nebraska considered whether the elimination of a supplemental cost-of-living benefit provided to plaintiffs by the City of Omaha unconstitutionally violated the firefighters' contract rights. The Court first determined that the supplemental cost-of-living benefit constituted a pension in which the plaintiffs obtained a vested, constitutionally protected contractual right because this supplemental benefit was directly related to the pension plan, and, in order to receive this benefit, the employee also had to qualify for the pension plan. The Court then determined that the elimination of this supplemental benefit resulted in the unconstitutional impairment of the plaintiffs' contract rights. Cases are now pending in Colorado and Minnesota over the constitutionality of laws that reduced the cost of living increase (e.g., Colorado from 3.5% to 2%).

d. By statute, the State of Maine distinguishes between those provisions of the public employee pension protected by the non-impairment clause and those that are not.
Can Pension Benefits and OPEBs Be Rolled Back or Reduced? (cont’d)

F. A Non-Impairment Law Is Not Intended to Stretch Pensions Beyond Their Elastic Limits.

Pensions can be and need to be changed, but within certain structures:

1. Right to modify must be clear in legislation, employment agreements and union contract (Rhode Island).

2. Adverse conditions which could lead to the failure of pension plans and the purpose of the legislation justify amendment (Vermont).

3. To balance adverse consequence of actuarially necessary changes to strengthen or improve the pension plan (Colorado, West Virginia).

4. Reasonable modifications that bear material relationship to theory of pension system and successful operation (Massachusetts).

5. Certain legislation that by its nature cannot bind successive legislation and can be changed (Georgia).

6. Contractual pension rights may be altered if changes are related to maintaining a healthy pension system as a whole. Changes that disadvantage members must be accompanied by comparable new advantages (California).
The Non-Impairment Laws Are Not All-Encompassing and Have Been Held Not to Reach:

- benefits that accrue in the future,
- reduction in mandatory retirement age,
- reduction in hours or salary,
- loss of benefits for non-compliance with the plan, and
- dismissal of public employee,

even though such may indirectly affect the pension benefits received.
H. Pension obligations can, in very extreme circumstances, be “discharged” where necessary to serve an important public purpose:

- If the state and local government can not fund pension obligations since there are not sufficient tax revenues to pay for essential government services and pay pension obligations.
- This is an inability (insolvency) not an unwillingness to pay.
- Pension obligations cannot be enforced if to do so would frustrate the essential purpose of the governmental body and sacrifice the required services it must provide.
- The U.S. Supreme Court has supported the ability of the state to set up municipal receiverships or other quasi-judicial mechanism to discharge obligations that cannot be paid given the dire financial condition and the need to continue governmental services for the financially embarrassed governmental body.
Can Pension Benefits and OPEBs Be Rolled Back or Reduced? (cont’d)

- In the case of Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502 (1942), the New Jersey Municipal Finance Act provided that a state agency could place a bankrupt local government into receivership. Under the law, similar to a Plan of Adjustment for a Chapter 9 municipal bankruptcy action, the interested parties could devise a plan that would be binding on non-consenting creditors if a state court decided that the municipality could not otherwise pay its creditors and the plan was in the best interest of all creditors. *Id.* at 504. After certain bondholders dissented, the court determined that the plan helped the city meet its obligations more effectively. *Id.* “The necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city’s debt is implied in every such obligation for the very reason that thereby the obligation is discharged, not impaired.” *Id.* at 511. The court then found that the plan protected creditors and was not in violation of the Contract Clause. *Id.* at 513. See also U.S Trust v. New Jersey, 431 U.S. 1, 25-28 (1997).
XIV. A Solution Is Required to Avoid the Inevitable Meltdown

If the problem of pension underfunding is not solved, competing interests will be aligned against each other:

- The Workers Demand for Full Funding Now. On the one hand, workers will insist that the pension obligations are in fact debt of the unit of State or local government and consider seeking a writ of mandamus to require the State or municipality to levy taxes or take other action to satisfy the debt obligation.

- The Demand to Invalidate Unjustified Pension Obligation. Taxpayers and other creditors, including the holders of the State or local government’s general obligation bonds, will seize on the debt argument. They will likely insist that in committing to make the pension and OPEB payments, the State or municipality violated state constitutional debt limitations which, under state law, such State or municipality does not have the power to violate, or the government has frustrated its fundamental purpose by threatening the ability to provide essential governmental services. As a consequence, any undertaking assumed in violation of state law is invalid. (It has already begun in California as the Superior Court of Sacramento, California has ruled in invalidating bonds issued under the State Pension Bond Act. See Pension Obligation Bonds Committed ex rel. California vs. All Persons Interested in the Matter of the Validity of the California Pension Obligation Bonds To Be Issued, No. 04AS04303 (November 15, 2005). This ruling was upheld on appeal to the California Court of Appeals, 152 Cal. App. 4th 1386, 62 Cal. Rptr. 3d 364 (2007).)
XIV. A Solution Is Required to Avoid the Inevitable Meltdown (cont’d)

- The Only Way Out Is Change. Given the dynamics, there likely will be no winners in this battle. Significantly increasing taxes can lead to a revolt on the part of the taxpayer if not a death spiral to State or local government. A real resolution is required, not a bailout. The urgency of the situation will be exacerbated by the retirement of the baby boomers. As noted, techniques to correct the situation include yearly Annual Required Contributions (ARC) at a level deemed actuarially sound, the transition from any pension plan that is not affordable or is doomed to fail (unsustainable defined benefit plans versus flexible plans where benefits can vary based on the affordable contribution by government and the variable contribution by employees that may vary the benefits), the freezing of current benefits and the adoption of new programs which specifically include the right to modify if necessary and require increased contributions by employees. Finally, the issuance of pension bonds with dedicated sources of payment pursuant to enabling legislation must be considered.
XV. The Use of a Public Pension Funding Authority to Solve the Severe Pension Underfunding Problem

A. Likewise given the Pension Underfunding Crisis, Public Pension Funding Authorities can provide a supervised forum to assist in determining critical issues such as:

- What contribution increases are necessary by both public employers and employees:
  - Can taxes be raised to fund pensions?
  - Are intercepts of state revenue necessary to provide a source of funding?
- Can the annual Actuarially Required Contribution ("ARC") for pension be made or is it unreasonable, unaffordable and not sustainable?
- Will continued funding of ARC cause the government to be unable to fund the costs of essential governmental services?
XV. The Use of a Public Pension Funding Authority to Solve the Severe Pension Underfunding Problem (cont’d)

- What cost-cutting measures are required to achieve sustainable and affordable benefits that do not interfere with providing essential government services:
  - What past employment benefits are affordable and what ones, if any, are not?
  - What adjustments to past employment benefits are mandated to avoid a government function meltdown or GFE?

- What is the minimum acceptable funding percentage for funding pension benefit (“Target Percentage”)?
B. The Public Pension Funding Authority ("Authority") would have jurisdiction over pension underfunding issues on a voluntary basis. Government and its workers desiring the supervised approach would be able to petition for the Authority’s determination that they qualify for assistance. Likewise, the Authority would have mandatory jurisdiction over governmental pensions if the Target Percentage of acceptable minimum funding is not reached or there is or in the Authority’s determination is an imminent threat of a GFE, the inability of the government to provide essential governmental services due to the annual cost of funding the ARC for pension and post-employment benefits. The Public Pension Funding Authority mission is to be the supervising forum for the determination of critical issues resulting from underfunded pension plans:

- Whether past employment benefits (pension and OPEB) are affordable and sustainable while paying the cost of essential governmental services.
XV. The Use of a Public Pension Funding Authority to Solve the Severe Pension Underfunding Problem (cont’d)

- What recommendations, if any, for tax increases by the government to provide additional funding?
- What recommendation of reduction in Pension or OPEB benefits are mandated in order to prevent a government function emergency or meltdown?
- Recommend tax increases to fund additional pensions contributions and require the local home rule units legislative body (city council, *et al.*) to consider a tax increase or have a non-home rule government have a referenda over a tax increase with full information available on the Authority’s determination of the recommendation of tax increases, the affordability of current and future pension costs and whether any pension costs adjustments are necessary.
- Determine whether an intercept of state tax revenue should be implemented to pay required benefit.
- Determine whether arbitration (voluntary or involuntary) should be engaged in.
XV. The Use of a Public Pension Funding Authority to Solve the Severe Pension Underfunding Problem (cont’d)

- Determine whether contributions are necessary from both public employees or employers.
- Determine what cost-cutting measure or adjustment of pension benefits are necessary to achieve affordable benefit and allow the continued funding of the cost of essential governmental services.
XVI. Chapman State Survey

Chapman and Cutler LLP is currently developing a 50 state survey summarizing for each state municipal bankruptcy authorization, default resolution mechanisms, remedies upon default, bondholder protections including statutory liens and special revenues.

While the survey is a work in progress and is being refined, the following summary for California, Illinois, Indiana, New York and Wisconsin is representative of the project.
Any county, city, district, public authority, public agency, or other entity, without limitation, that is a “municipality” as defined under the U.S. Bankruptcy Code, or that qualifies as a debtor under any other federal bankruptcy law applicable to local public entities may file a petition under chapter 9 of the U.S. Bankruptcy Code. Unless an entity is specifically identified above, it is not authorized to file a municipal bankruptcy petition.

Between 1980 and December 30, 2010, 38 entities in California have filed petitions under the municipal bankruptcy provisions of the Bankruptcy Code.

### Debt Default Prevention

**CALIFORNIA DEBT AND INVESTMENT ADVISORY COMMISSION**

The California Debt and Investment Advisory Commission provides technical assistance on debt issuance and public fund investments to local public agencies and professionals in the public finance field. The Commission serves as a clearinghouse for public debt issuance information and to assist state and local agencies with monitoring, issuing and managing debt.

Further, all public debt issuers in California are required to submit information to the Commission 30 days before the proposed sale date of the debt. No later than 45 days from the actual date of sale, issuers must submit a report on the final sale to the Commission, which includes, but is not limited to, the issuer’s name, type of sale, principal amount, type of debt instrument, sources of repayment, purpose of the financing, the issuance’s rating and the members of the finance team.

**DEBT LIMITATION**

No county, city, town, township, board of education or school district may incur debt exceeding in any year the income and revenue of that year, without a two-thirds vote. Debt may be incurred for public school purposes by majority vote.

The California Code contains further limitations, for instance for a school district or community college district the total amount of bonds issued for certain purposes as defined in the statute may not exceed 1.25 percent of the taxable property in the school district or community college district, or school facilities improvement district. For a county, the total amount of bonded indebtedness may not at any time exceed 5 percent of the taxable property in the county. If a water conservation, flood control, irrigation, reclamation or drainage works, improvements, or purposes, or the construction of select county roads is included in a proposition, the total indebtedness may exceed 5 percent, but cannot exceed 15 percent of the taxable property of the county.
Debt Default Prevention (cont’d)

| Mechanisms for Resolution After Default<sup>a</sup> | NEGOTIATIONS  
At least one provision of the California Code provides that if a district is in debt, it has no power to impair or destroy any of its indebtedness without bondholder consent. The district may make arrangements with creditors to surrender the indebtedness at less than par and may levy an assessment for bondholder payment.<sup>b</sup>  

| REFUNDING BONDS  
The governing body of certain municipal entities may issue refunding bonds to refund outstanding notes.<sup>c</sup> |

| Remedies on Default | RECEIVERSHIP  
In certain situations, the California law allows for the appointment of a receiver with respect to revenue bonds where a default has occurred.<sup>d</sup>  

| ACCOUNTING  
In certain situations on default, bondholders may bring a proceeding in any court of competent jurisdiction to require the authority in question to account as if it were a trustee of an express trust.<sup>e</sup>  

| BONDHOLDER ACTION  
In certain situations, bondholders may bring any appropriate suit on default.<sup>f</sup>  

| FORECLOSURE  
In certain situations generally involving special revenue bonds, bondholders may foreclose on a project when a default has occurred.<sup>g</sup>  

| INJUNCTIVE RELIEF  
In certain situations, California law authorizes bondholders to bring any action or suit in equity to enjoin any act that may be unlawful or violate the rights of bondholders.<sup>h</sup> |
### Remedies on Default (cont’d)

| **MANDAMUS** | In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection.  

**ANY OTHER REMEDIES** | Certain provisions of California law allow for provisions in any bond resolution to set forth the rights and remedies of holders of the bonds. |

### Other Bondholder Protections

| **SPECIAL REVENUE BONDS** | As provided by the section 922(d) of the U.S. Bankruptcy Code, payments to bondholders holding special revenue bonds would not be stayed on the filing of a municipal bankruptcy petition and payments to holders could continue. Whether an issuance would qualify as a special revenue bond depends on the provisions of the authorizing statute with respect to the bonds at issue.  

**SPECIAL TAX BONDS** | In certain situations, on approval of 2/3 of eligible voters voting, in the case of community facilities districts, the district may incur bonded indebtedness and establish or change appropriations limits. The proceeds of the bonds issued is pledged and committed to pay or repay the principal and interest on the bonds.  

**STATUTORY LIENS** | Were a municipal entity to file a petition under chapter 9 of the U.S. Bankruptcy Code, bondholders holding bonds to which statutory liens have attached would continue to receive payment on those bonds. For a statutory lien to apply, the authorizing law of the bond issue must contain such a lien. |
California Endnotes

i CAL. GOV'T CODE § 53760. California courts have determined that the term “municipality” should not be narrowly construed, although an entity under government control is not necessarily a municipality. In re County of Orange, 183 B.R. 595 (Bankr. C.D. Cal. 1996) (finding Orange County Investment Pool not a municipality eligible to file a Chapter 9 proceeding). The court described a “public subdivision” as “any county or parish or any city, town village, borough, township, or other municipality,” the common thread of which is “their ability to exercise various sovereign powers such as the power to tax, the power of eminent domain or the police power.” Id. at 602. Public agencies are “incorporated authorities, commissions, or similar public agencies organized for the purpose of constructing, maintaining and operating revenue producing enterprises.” Id. The U.S. Bankruptcy Code defines “municipality” as any political subdivision or political agency or instrumentality of a State.

Of the entities filing bankruptcy petitions, two were municipal utilities; four were cities, villages or counties; twenty-three were hospital or health care districts; three were school or education districts; five were special municipal districts; and one was unrelated to these areas.

A bill considered in the California legislature in 2010 would have provided that a local public entity may only file under federal bankruptcy law if it receives the approval of the California Debt and Investment Advisory Commission. This bill, Assembly Bill 155 was approved by the Senate Appropriations Committee on May 28, 2010 but was placed in the Senate Inactive File on June 14, 2010.

ii CAL. GOV. CODE §§ 8855 to 8859 (establishing California Debt and Investment Advisory Commission); CAL. GOV. CODE § 6586.7 (requiring reporting to the Commission by issuers under the Marks-Roos Local Bond Pooling Act of 1985); CAL. GOV. CODE § 53359.5 (reporting requirements).

iii CAL. CONST. art. XVI, § 18; CAL. ED. CODE § 15102 (school district); and CAL. GOV. CODE § 29909 (counties).

iv See CAL. VAT. CODE 50001 (Reclamation Districts).

v See, e.g., CAL. GOV’T CODE § 43720-43747. This provision applies to any city, except a city and a county, if the city has outstanding bond indebtedness or a judgment against it, or if any department, board, or special fund of the city has any outstanding bonds and the bonds were created for a purpose for which the city could have authorized and issued the bonds. The interest on the bonds cannot exceed 8 percent per year. Until the legislative body has sufficient amounts set aside to pay all principal and interest on the bonds as they become due, the legislative body must levy and collect a tax sufficient to make such payments. Another provision allows for local agencies, including any city, county, city and county, or any municipal or public corporation or district authorized to acquire, construct, own or operate an enterprise to issue refunding bonds. CAL. GOV’T CODE § 54660-54662 (Refunding Bonds for Revenue Bond Law of 1941). See also CAL. HAR. AND NAV. CODE § 3917 (Harbor Development Bond Law of 1958). In January 2011, the Town of Chowchilla, California defaulted on its January bond payment with respect to bonds issued to renovate its city hall. Chowchilla had in summer 2010, drawn down on its reserves to make an earlier bond payment. The town intends to draw on its reserves again to meet its January payment.

vi See, e.g., CAL. GOV. CODE § 15942 (State Building Construction Revenue Bonds); CAL. GOV. CODE § 91537 (Industrial Development Authorities); CAL. PUB. UTIL. CODE § 10.1 (West Bay Rapid Transit Authority Act); CAL. VAT. CODE § 36361 (California Water Districts); and CAL. VAT. CODE § 36364 (California Water Districts Action to Secure Payment of Revenue Bonds). The state’s code may be more expansive, and the statutory authority for each individual bond issuance should be reviewed before assessing whether a receiver may be appointed.
See, e.g., CAL. GOV. CODE § 15842 (State Building Construction Revenue Bonds); CAL. PUB. UTIL. CODE § 10.1 (West Bay Rapid Transit Authority Act); CAL. GOV. CODE § 54643 (Revenue Bond Law of 1941); and CAL. GOV. CODE § 67620 (San Francisco Bay Area Transportation Terminal Authority). The state’s code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing whether an accounting may be pursued.

See, e.g., CAL. GOV. CODE § 91537 (Industrial Development Authorities); CAL. GOV. CODE § 66540.48 (San Francisco Bay Area Water Emergency Transportation Response and Disaster Recovery Act); CAL. ED. CODE § 81960 (Community College Revenue Bond Act of 1961); CAL. ED. CODE § 90072 (The State University Revenue Bond Act of 1947); CAL. ED. CODE § 92491 (The State University Revenue Bond Act of 1947); CAL. GOV. CODE § 6569 (Joint Exercise of Powers: Power to Issue Revenue Bonds); CAL. GOV. CODE § 54643 (State Building Construction Revenue Bonds); CAL. GOV. CODE § 26370 (Revenue Bonds for County Improvements); CAL. GOV. CODE § 26470 (Revenue Bonds for County Incinerators); CAL. GOV. CODE § 50770 (Revenue Bonds for Public Improvements); CAL. ED. CODE § 81960 (Community College Revenue Bond Act of 1961); CAL. ED. CODE § 90072 (The State University Revenue Bond Act of 1947); CAL. ED. CODE § 92491 (The State University Revenue Bond Act of 1947); CAL. ED. CODE § 96074 (Revenue Bond Law of 1941); and CAL. ED. CODE § 67620 (San Francisco Bay Area Transportation Terminal Authority). The state’s code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing whether injunctive relief may be pursued.
California Endnotes (cont’d)

xii See, e.g., CAL. GOV. CODE § 15841 (State Building Construction Revenue Bonds, allowing bondholders to appoint a trustee to enforce rights of bondholders, including requiring board to collect moneys adequate to carry out the agreement); CAL. GOV. CODE § 91537 (Industrial Development Authorities); CAL. GOV. CODE § 66540.48 (San Francisco Bay Area Water Emergency Transportation Response and Disaster Recovery Act); CAL. PUB. UTIL. CODE § 10.1 (West Bay Rapid Transit Authority Act); CAL. ED. CODE § 17186 (California School Finance Authority); CAL. ED. CODE § 81960 (Community College Revenue Bond Act of 1981); CAL. ED. CODE § 90072 (The State University Revenue Bond Act of 1947); CAL. ED. CODE § 92491 (The State University Revenue Bond Act of 1947); CAL. ED. CODE § 94148 (California Educational Facilities Authority Act); CAL. GOV. CODE § 6659 (Joint Exercise of Powers: Power to Issue Revenue Bonds); CAL. GOV. CODE § 15444 (Health Facilities Financing Authority Act); CAL. GOV. CODE § 26370 (Revenue Bonds for County Improvements); CAL. GOV. CODE § 26470 (Revenue Bonds for County Incinerators); CAL. GOV. CODE § 50770 (Revenue Bonds for Public Improvements); CAL. GOV. CODE § 54642 (Revenue Bond Law of 1941); CAL. GOV. CODE § 54702.8 (Cities, Counties and Other Agencies: Employee Rental Housing); CAL. GOV. CODE § 64118 (California Transportation Financing Authority); CAL. GOV. CODE § 66540.48 (San Francisco Bay Area Water Emergency Transportation Response and Disaster Recovery Act); CAL. GOV. CODE § 67620 (San Francisco Bay Area Transportation Terminal Authority); CAL. GOV. CODE § 92308 (California Passenger Rail Financing Commission Act); CAL. HARB. & NAV. CODE APFX § 66 (San Diego Unified Port District & Humboldt Bay Harbor, Recreation and Conservation District); CAL. PUB. RESOURCES CODE § 26034 (California Alternative Energy and Advanced Transportation Financing Authority); CAL. PUB. RESOURCES CODE § 32205 (California Urban Waterfront Restoration Financing Authority Act); CAL. PUB. UTIL. CODE § 13106 (Municipal Utility District Act Electric System Improvements); CAL. PUB. UTIL. CODE § 30981 (Southern California Rapid Transit District); CAL. PUB. UTIL. CODE § 100492 (Santa Clara Valley Transportation Authority); CAL. PUB. UTIL. CODE § 102602 (Sacramento Transit District); CAL. PUB. UTIL. CODE § 103602 (San Mateo County Transit District); CAL. PUB. UTIL. CODE § 105262 (Sonoma-Marin Area Rail Transit District); CAL. PUB. UTIL. CODE § 120702 (Transit Development Boards); CAL. PUB. UTIL. CODE § 125716 (North County Transit District); CAL. PUB. UTIL. CODE § 132370.10 (Transportation Consolidation for San Diego); CAL. PUB. UTIL. CODE § 170082 (San Diego County Regional Airport Authority); CAL. STS. & HY CODE § 31171 (El Dorado County Toll Tunnel Authority Act); CAL. STS. & HY CODE § 35417 (Packing District Law of 1951); CAL. WAT. CODE § 11708 (Conservation, Development and Utilization of State Water Resources); CAL. WAT. CODE § 36360 (California Water Districts, bondholders holding at least 25% in outstanding unpaid bonds may bring an action to compel the district to fix and collect sufficient charges to pay the principal and interest on the bonds); and CAL. UNCOD. WATER DEER, Act 400 § 33 (Kings River Conservation District Act). It is possible that an aggrieved bondholder could pursue the writ even absent authorizing statutory law.

xiii See, e.g., CAL. ED. CODE § 90032 (State University Revenue Bond Act) and CAL. ED. CODE § 17184 (California School Finance Authority). The state’s code may be more expansive than the examples cited here, and the statutory authority for each individual bond issuance should be reviewed before assessing whether other remedies may be available to bondholders.

xiv See, e.g., CAL. GOV. CODE § 6540 to 6579.5 (Joint Exercise of Powers: Power to Issue Revenue Bonds); CAL. GOV. CODE § 54300 TO 54700 (Revenue Bond Law of 1941). These are examples of revenue bonds. The California state code is more expansive and an attorney should be consulted to examine any specific situation involving a default.

xv CAL. GOV. CODE § 53345 to 53365.7.

xvi For example, see In re Sierra Kings Health Care District, Case No. 09-19728 (Bankr. E.D. Cal September 13, 2010) (confirming the post-petition effectiveness of a municipality’s pledge of ad valorem taxes which qualifies as both a special revenue pledge or a statutory lien). The bond issuance in Sierra Kings was subject to a statutory lien pursuant to CALIFORNIA HEALTH & SAFETY CODE § 32300. Also, in 1983, the San Jose school district payment of bonds to bondholders was unaffected by a chapter 9 filing on July 1, 1983 due to CALIFORNIA EDUCATION CODE § 15250, which provided a tax pledge to bondholders collected by the county or tax collector to pay bondholders first.

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Illinois

| Municipal Bankruptcy Authority | Specific state authority to file a municipal bankruptcy petition only exists with respect to the Illinois Power Agency. With exception to the Illinois Power Agency, no other municipal entity in Illinois is authorized to file a municipal bankruptcy petition. Courts in Illinois have entertained municipal bankruptcy petitions, including *In re Village of Brooklyn*, Case no. 03-34272 (Bankr. S.D. Ill. Nov. 23, 2004) (confirmation of plan); *In re Village of Alorton*, Case no. 05-30055 (Bankr. S.D. Ill. Dec. 11, 2006) (confirmation of plan); but see *In re Slocum Lake Drainage Dist. of Lake County*, 336 B.R. 387 (Bankr. N.D. Ill. 2006) (finding no specific authority and dismissing); *In re Washington Park*, Case no. 09-31744 (dismissed Dec. 21, 2010 due to lack of authorization). The cases in which plans were confirmed likely were not dismissed because the municipal filing was not challenged.|
| Debt Default Prevention | DEBT LIMITATION
Various debt issuance provisions in the Illinois Code contain limitations on how much debt a particular municipal entity may issue. For instance, municipalities with less than 500,000 people may issue debt up to 8.625 percent of the total equalized assessed valuation of taxable property in the municipality. A school district for either grades kindergarten through eighth grade or ninth grade through twelfth grade may only issue bonds up to 6.9 percent of the taxable property in the district. Should a school district contain grades kindergarten through twelve, the district may issue bonds up to 13.8 percent of the taxable property in the district. Other debt limitations include: 2.875 percent of taxable property in counties with populations less than 500,000 and townships, schools or municipal corporations with populations less than 300,000, or park districts, but this 2.875 percent limit does not apply to schools for acquiring or improving a site, constructing, extending, improving and equipping school buildings or establishing a working cash fund; and 5.75 percent of the value of taxable property for fire protection districts. FINANCIALLY DISTRESSED CITY LAW
Under this provision, a financially distressed city may receive assistance from the Illinois Finance Authority, which may provide financial aid to the city so that it can provide basic municipal services, while permitting the distressed city to meet its obligations with creditors and bondholders. REFUNDING BONDS
In certain situations, a municipal entity may issue refunding bonds to refund and refinance outstanding debt. |
Illinois (cont’d)

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<th>Mechnisms for Resolution After Default</th>
<th>FINANCIAL PLANNING AND SUPERVISION</th>
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<td>Under the Local Government Financial Planning and Supervision Act, a local government with a population less than 25,000 and suffering a “fiscal emergency” in certain instances may upon 2/3 vote of the members of its governing body petition the Governor for the establishment of a financial planning and supervision commission in order to remove the “fiscal emergency.” A unit of local government may contract out of the provisions of the Local Government Financial Planning and Supervision Act.</td>
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<th>Remedies on Default</th>
<th>APPROPRIATE RELIEF</th>
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<td>In certain situations, a bondholder may obtain relief from an “appropriate civil action in the appropriate circuit court.”</td>
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RECEIVERSHIP
In certain revenue bond default situations, a receiver may be appointed to take possession and operate the project for which the bonds were issued.

FORECLOSURE
In certain situations, bondholders may foreclosure on a mortgage and seize and sell the underlying asset.

INJUNCTIVE RELIEF
In certain situations, bondholders may obtain injunctive relief to enjoin an action with respect to a bond issuance.

MANDAMUS
In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection.
### Illinois (cont’d)

<table>
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<tr>
<th>Other Bondholder Protections</th>
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Illinois Endnotes

i 20 ILL. COMP. STAT. 3855/1-20(b)(15) (specific authorization for Illinois Power Agency).

Pursuant to Illinois law, further, under the Local Government Financial Planning and Supervision Act, the financial planning and supervision commission has the power to recommend that the local government file a petition under Chapter 9 and to submit this recommendation to the state legislature. 50 ILL. COMP. STAT. 320/9(b)(4). The Illinois Code, however, does not include any provisions specifically authorizing a public entity, with exception to the Illinois Power Agency, to file a petition.

ii 65 ILL. COMP. STAT. 5/8-5-1 (municipalities less than 500,000). Certain exceptions to this provision exist, such as debt incurred for constructing a wastewater facility to comply with the Clean Water Act. This provision, further, does not apply to home rule municipalities. 105 ILL. COMP. STAT. 5/19-1 (school district for either grades kindergarten through eighth grade or ninth grade through twelfth grade); 105 ILL. COMP. STAT. 5/19-1 (School district contain grades kindergarten through twelve); 50 ILL. COMP. STAT. 405/1 (local governments including counties with populations less than 500,000 and townships, schools or municipal corporations with populations less than 300,000; 70 ILL. COMP. STAT. 705/12 (fire protection districts); and 70 ILL. COMP. STAT. 1205/6-2 (park districts).

These provisions have been provided as examples of statutory debt limitations under the Illinois State Code. The state code may be more expansive and an attorney should be consulted to examine any specific situation.

iii 65 ILL. COMP. STAT. 5/8-12-1 et seq. "Financially distressed City" means any municipality which is a home rule unit and which (i) is certified by the Department of Revenue as being in the highest 5% of all home rule municipalities in terms of the aggregate of the rate per cent of all taxes levied pursuant to statute or ordinance upon all taxable property of the municipality and as being in the lowest 5% of all home rule municipalities in terms of per capita tax yield, and (ii) is designated by joint resolution of the General Assembly as a financially distressed city." 65 ILL. COMP. STAT. 5/8-12-3.

A designation as "financially distressed city" shall last for 10 years until the city submits a balanced budget and proves its responsibility.

iv See, e.g., 65 ILL. COMP. STAT. 5/8-4-14 (allowing for refunding revenue bonds issued by municipalities with a population less than 500,000) and ILL. COMP. STAT. 1/130-12 (allowing for Water Supply and Sewerage System refunding bonds). The state’s code may be more expansive and the statutory authority for each bond issuance should be reviewed with respect to each proposed refunding bond issuance.

v 50 ILL. COMP. STAT. 320/1 et seq. "Local governments" include counties, cities, villages, incorporated towns, townships, special districts, and units of local government that exercise limited governmental powers, but not including school districts. "Fiscal emergency" includes the existence of any one or more of the following conditions: (1) the existence of a continuing default in the payment of principal and interest on any debt obligation for more than 180 days; (2) the failure to make payment of over 20% of all payroll to employees of the unit of local government in the amounts and at the times required by law where the failure has continued for more than 30 days after such time for payment, unless 2/3 of such employees agree in writing to such extension; (3) the insolvency of the unit of local government, being a financial condition that the unit is (A) generally not paying its debt as it becomes due unless they are the subject of a bona fide dispute or (B) unable to pay its debts as they become due." 50 ILL. COMP. STAT. 320/3.

In 1980, the Chicago Board of Education was placed under supervision of the state and in 1989, East St Louis was placed under state supervision.
Illinois Endnotes (cont’d)

vi See, e.g., 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act); 50 ILL. COMP. STAT. 455/6 (Medical Services Facilities Revenue Act); 50 ILL. COMP. STAT. 465/20 (Local Government Housing Finance Act); 65 ILL. COMP. STAT. 5/11-103-15 (Airports for Municipalities of Less than 500,000); 65 ILL. COMP. STAT. 5/11-119.1-6 (Joint Municipal Electric Power Agency bond documents may contain provisions allowing for appointment of receiver); 65 ILL. COMP. STAT. 5/11-119.2-6 (Joint Municipal Natural Gas Agencies’ bond documents may contain provisions allowing for appointment of receiver); and 65 ILL. COMP. STAT. 5/11-130-7 & 11/130-12 (Water Supply and Sewerage System bonds). The state’s code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether a receiver may be appointed.

vii See, e.g., 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act); 50 ILL. COMP. STAT. 455/6 (Medical Services Facilities Revenue Act); and 50 ILL. COMP. STAT. 465/20 (Local Government Housing Finance Act). The state’s code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether such a remedy is applicable.

viii See, e.g., 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act); 50 ILL. COMP. STAT. 455/6 (Medical Services Facilities Revenue Act); and 50 ILL. COMP. STAT. 465/20 (Local Government Housing Finance Act). The state’s code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether bondholders may pursue a foreclosure action.

ix See, e.g., 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act). The state’s code may be more expansive and the statutory authority for each individual bond issuance should be reviewed before assessing the availability of injunctive relief under the particular statute.

x See, e.g., 70 ILL. COMP. STAT. 2002-51 (Civic Center Code); 65 ILL. COMP. STAT. 5/11-48.3-11 (Municipal Zoo Authorities); 70 ILL. COMP. STAT. 503/ -535/ (Development Authorities); and 70 ILL. COMP. STAT. 2002-51; 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act); 50 ILL. COMP. STAT. 465/20 (Local Government Housing Finance Act); and 65 ILL. COMP. STAT. 5/11-103-15 (Airports for Municipalities of Less than 500,000). It is possible that an aggrieved bondholder could pursue the writ even absent authorizing statutory law.

xi See, e.g., 65 ILL. COMP. STAT. 58/4.1-11 (revenue bonds issued by municipalities paid by revenues from operation of utility system or revenue producing enterprise) and 65 ILL. COMP. STAT. 5/11-130-7 (Water Supply and Sewerage System bonds). These are examples of special revenue bonds. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.

xii See, e.g., 105 ILL. COMP. STAT. 5/1E-110 (creating statutory lien for Downstate School Finance Authority); 50 ILL. COMP. STAT. 445/6 (Industrial Building Revenue Bond Act, providing that a mortgage or deed of trust attaches without filing); and 65 ILL. COMP. STAT. 5/11-103-15 (Airports for Municipalities of Less than 500,000, establishing statutory mortgage lien). These are examples of statutory liens. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.
Indiana

| Municipal Bankruptcy Authority | Indiana does not specifically authorize municipalities to file for municipal bankruptcy under chapter 9 of the U.S. Bankruptcy Code. The Indiana legislature is currently considering a bill that would allow the state’s Distressed Unit Appeals Board to declare a municipality distressed, which would allow the state to financially take-over the municipality, appoint an emergency fiscal manager, and grant the municipality permission to file a municipal bankruptcy petition. Although Indiana does not specifically authorize its entities to file a municipal bankruptcy petition, between 1980 and December 30, 2010, one municipal entity has filed such a petition. This case was filed in 1989 before Congress greatly limited the ability of municipalities to file by requiring specific state authorization. |
| Debt Default Resolution Mechanisms | DEBT LIMITATION
A political subdivision may not become indebted in an amount in the aggregate that exceeds 2 percent of the latest adjusted value of taxable property determined for the political subdivision immediately preceding the incurring of the indebtedness. DISTRESSED POLITICAL SUBDIVISION PROTECTIONS
A Distressed Unit Appeals Board may assist in establishing a financial plan for any petitioning distressed political subdivision. The Board shall create a financial plan and is entrusted to take actions such as increasing property taxes in the political subdivision and reducing tax credits. REFUNDING BONDS
In certain situations, a municipal entity may issue refunding bonds to refund and refinance outstanding debt. |
| Mechanisms for Resolution After Default | RECEIVERSHIP
Scholars have indicated that receiverships could be created to manage projects when payment on bonds is refused. In addition, Indiana law includes receivership provisions. REDEMPTION BONDS
If a bond fund of a county or township is insufficient to pay bonds as of date of maturity together with interest, the board may enter into contract with owners of bonds for the issuance of redemption bonds. |
### Indiana (cont’d)

<table>
<thead>
<tr>
<th>Remedies on Default</th>
<th>ACCOUNTING</th>
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</table>
|                              | In certain default situations, bondholders may bring a proceeding in to require the authority in question to account as if it were a trustee of an express trust.  
|                              | FORECLOSURE |
|                              | In certain situations, bondholders may foreclose on a mortgage and seize and sell the underlying asset. |
|                              | INJUNCTION  |
|                              | In certain situations, an interested person may bring an action against a board to enjoin or mandate the board to act.  
|                              | MANDAMUS    |
|                              | In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection.  

<table>
<thead>
<tr>
<th>Other Bondholder Protections</th>
<th>SPECIAL REVENUE BONDS</th>
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|                             | As provided by the section 922(d) of the U.S. Bankruptcy Code, payments to bondholders holding special revenue bonds would not be stayed on the filing of a municipal bankruptcy petition and payments to holders could continue. Whether an issuance would qualify as a special revenue bond depends on the provisions of the authorizing statute with respect to the bonds at issue.  
|                             | STATUTORY LIENS        |
|                             | Were a municipal entity to file a petition under chapter 9 of the U.S. Bankruptcy Code, bondholders holding bonds to which statutory liens have attached would continue to receive payment on those bonds. For a statutory lien to apply, the authorizing law of the bond issue must contain such a lien. |
Indiana Endnotes

i  See Ind. S.B. 150 (introduced Dec. 23, 2010).

ii  IND. CODE § 36-1-15-6.  A “permitted excess of debt limitation” authorizes a political subdivision to incur debt that exceeds the maximum amount allowed “for the public protection and defense only”: (1) “in time of war, foreign invasion, or other great public calamity”; and (2) “upon petition of a majority of the property owners in number and value within the limits of the political subdivision.”  IND. CODE § 36-1-15-7.

In Lake County Council v. Allen, the county claimed that all debt incurred by the township in excess of 2 percent of its assessed valuation, Indiana’s debt limitation provision, was in violation of Article XIII, § 1, of the Indiana Constitution.  524 N.E.2d 771 (Ind. 1988).  Upon declaring the township “distressed” on March 25, 1986, the trustees thus sought protection under the Distressed Township Act of 1986.  Despite funding from the State of $7 million, the county refused to continue any plan claiming that poor relief was the obligation of the township and not the county.  Id.  The issue on appeal was whether poor relief was ultimately the responsibility of the county and thus governed by its constitutional debt limit rather than that of the township.  Id. at 771-72.  Affirming, the Court held that the county indeed has an affirmative obligation to fund the township poor relief, therefore upholding the validity of the liabilities resulting from the distress of the township.  The Court stated that “clearly, the Lake County Council had an affirmative duty” to fund the township, “whether it was to be reimbursed by the township or not.”  Both poor relief and the Distressed Township Act which set up a four-person team to manage the finances of the “distressed” township were constitutional exercises of state authority.

iii  IND. CODE §§ 6-1.1-20.3 to 6-1.1-20.3-5 (Distressed Political Subdivisions).  The Board conducts audits or reviews to determine whether the political subdivision is abiding by the financial plan.  These provisions apply only to a political subdivision expecting to have its property tax collections reduced by at least 5 percent in a calendar year as a result of a certain tax credit allowed under IND. CODE § 6-1.1-20.6 for that year.  A political subdivision includes any municipal corporation — a unit, school corporation, library district, local housing authority, fire protection district, public transportation corporation, local building authority, local hospital authority or corporation, local airport authority, special service district or other separate local governmental entity that may sue and be sued — and “special taxing districts” — a geographic area where a special tax may be levied and collected on an ad valorem basis on property to financing local public improvements that are: (1) not political or governmental in nature; and (2) of special benefit to the residents and property of the area.”  IND. CODE § 36-1-2-10.

Section 6-1.1-20.6 provides a credit to Indiana residents for excessive residential property taxes.  Specifically, a person is entitled to a property tax credit if the person’s property tax liability on the applicable real property exceeds the gross assessed value of the property that is the basis for the property tax determination for that year, including: their homestead (one percent); residential property (two percent); long term care property (two percent); agricultural land (two percent); nonresidential real property (three percent); or personal property (three percent).  IND. CODE § 6-1.1-20.6-7.5.  Calculations for these provisions, however, shall not include property taxes imposed after being approved by a voter referendum after 2009.  These provisions contain further limits based on whether the property in question is located in an “eligible county” as determined by the general assembly or not.  In an “eligible county,” property taxes imposed to pay debt service or make lease payments for bonds or leases entered into before July 1, 2008 shall not be considered for the purposes of calculating a person’s credit.

The governor of Indiana highlighted efforts of the Distressed Units Appeal Board for preventing a municipal bankruptcy in Gary, Indiana.  Jon Seidel, Daniels: Bankruptcy Law Needed in Case Cities Fail, Indiana Economic Digest (May 1, 2010).
Indiana Endnotes (cont’d)

v See, e.g., IND. CODE § 5-1-6-15 (Revenue Bond Refinancing). See, e.g., IND. CODE § 36-9-11.1-16 (allowing for appointment of receiver to enforce revenue bonds issued by Marion County) and IND. CODE § 5-1-4-20 (Hospital Bonding Authorities). The state’s code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether a receiver may be appointed.

vi See, e.g., IND. CODE § 5-1-7-1 (Redemption Bonds of Counties and Townships).

vii IND. CODE § 8-22-3-18.1(q) (Local Airport Authorities); IND. CODE § 5-1-6-15 (Revenue Bond Refinancing); and IND. CODE § 14-33-20-36 (Water Supply Districts). The state’s code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether an accounting may be sought.

viii See, e.g., IND. CODE § 36-9-36-47 (allowing for foreclosure of bonds issued in anticipation of collection of assessments with respect to lots or parcels of land) and IND. CODE § 5-20-2-9(c) (Housing Facilities). The state’s code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether foreclosure is an option for bondholders.

ix For instance, although not specifically contained in a particular provision authorizing the issuance of a bond, IND. CODE § 14-33-5-24 allows for a party adversely affected by an action committed or omitted by a board of a Conservancy District to petition a court with jurisdiction to enjoin or mandate the board to act. See also IND. CODE § 14-33-20-36 (Water Supply Districts).

x See, e.g., IND. CODE § 5-1-4-20 (Hospital Bonding Authorities); IND. CODE § 14-33-20-36 (Water Supply Systems); IND. CODE § 8-5-15-14 (Commuter Transportation Districts); IND. CODE § 8-22-3-18.1(q) (Local Airport Authorities); IND. CODE § 5-1-4-20 (Housing Facilities); IND. CODE § 8-15-2-16 (Operation Financing of Toll Roads); IND. CODE § 8-10-1-19 (Indiana Ports); IND. CODE § 5-1-6-15 (Revenue Bond Refinancing); IND. CODE § 14-14-1-41 (Recreational Development Corporation); IND. CODE § 14-33-5-24 (applicable to actions of Conservancy District boards). It is possible that an aggrieved bondholder could pursue the writ even absent authorizing statutory law.

xi See, e.g., IND. CODE § 8-1-5-2-24 (bonds issued to establish municipally owned utilities shall be payable from revenue of the utility). These are examples of special revenue bonds. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.

xii See, e.g., IND. CODE § 36-9-11.1-16 (establishing statutory lien on property acquired or improved from proceeds of bonds issued by Marion County for parking facilities). Note this is an example of a statutory lien. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.
Iowa

| Municipal Bankruptcy Authority | Iowa has no specific municipal bankruptcy authorization except that a city, county or other political subdivision may file a petition under chapter 9 of the U.S. Bankruptcy Code if it is rendered insolvent as a result of a debt involuntarily incurred. Between 1980 and December 30, 2010, no entity in Iowa has filed such a petition. |
| Debt Default Prevention | DEBT LIMITATION  
No county or other political or municipal corporation may incur debt in the aggregate exceeding 5 percent of the value of the taxable property within, as ascertained by the last state and county tax lists previous to incurring the indebtedness.  
REFUNDING BONDS  
In certain situations, a municipal entity may issue refunding bonds to refund and refinance outstanding debt. |
| Mechanisms for Resolution After Default | RECEIVERSHIP  
In most default situations, a receiver may be appointed to take possession and operate the project.  
MORATORIUM  
In certain revenue bond default situations, the defaulting municipality will be barred from entering into activities on its own, with exception to releasing property for some industrial activity. |
| Remedies on Default | MANDAMUS  
In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection. |
### Iowa (cont’d)

<table>
<thead>
<tr>
<th>Other Bondholder Protections</th>
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<tbody>
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<td>Were a municipal entity to file a petition under chapter 9 of the U.S. Bankruptcy Code, bondholders holding bonds to which statutory liens have attached would continue to receive payment on those bonds. For a statutory lien to apply, the authorizing law of the bond issue must contain such a lien.\textsuperscript{viii}</td>
</tr>
</tbody>
</table>
Iowa Endnotes

i Iowa Code § 76.16A. To file, the city, county or political subdivision must show that (1) all or a portion of such obligation will not be paid from available insurance proceeds and must be paid from a general tax levy increase; (2) that the general tax levy increase will result in a severe, adverse impact on its ability to exercise powers granted under applicable law, including without limitations providing necessary services and promoting economic development; (3) as a result of such obligation, it is unable to pay its debts as they become due; and (4) the debt is not an obligation to pay money to another city, county, other organized entity, or political subdivision. These provisions were intended to address situations in which a municipality has incurred a large judgment against it or similar liability, such as damages caused by natural disasters, and cannot provide necessary services without levying a tax that would result in a severe, adverse effect on the municipality.

ii Iowa Const. Art. XI, § 3. In a court decision, an Iowa court found that a park district was not a distinct municipality from the city in which the park district was located, but rather the district was an instrumentality of the city government. Thus, any bonds issued by the park district’s board were a debt of the city and fell within the city’s debt limit. Orvis v. Bd. of Park Comm’r of City of Des Moines, 56 N.W. 294 (Iowa 1893). In Fults v. City of Coralville, 666 N.W.2d 548 (Iowa 2003), the Iowa Supreme Court considered a challenge by property owners in a tax increment financing (“TIF”) district where the property owners contended that the TIF district’s issuance of bonds would cause the city to exceed its constitutional debt limits. Because the provisions establishing the TIF district did not contain a legally enforceable obligation for the city to continue bond repayment in the future, the court found that the debt was not considered constitutional debt. 666 N.W.2d at 556-57.

The Fults court relied on existing Iowa case law in which the court had found a city’s debt unconstitutional where “none of its resources or property can be taken for, or subjected to, the payment of any bond.” Id. (citing Interstate Power Co. v. Town of McGregor, 296 N.W. 770, 777 (1941)).

iii See, e.g., Iowa Code § 419.6 (applies to project bonds issued by counties and incorporated cities). Further, when refunding bonds are issued to pay on improvement bonds, the power to create liens on the property is preserved. Iowa Code § 384.68.

iv See, e.g., Iowa Code § 384.88 (applies to revenue bonds issued by “municipalities,” including a city utility, city enterprise, or combined city enterprise); Iowa Code § 28J.23 (Port Authority revenue bond); and Iowa Code 419.4 (county or incorporated city project bonds). The state’s code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether such a remedy is applicable.

v See, e.g., Iowa Code § 419.4 (applies to project bonds issued by counties and incorporated cities) and Iowa Code § 419.10 (payment of any revenue bond).

vi See, e.g., Iowa Code § 384.88 (applies to revenue bonds issued by “municipalities,” including a city utility, city enterprise, or combined city enterprise); Iowa Code § 28J.23 (Port Authority revenue bond); Iowa Code § 313A.20 (Intrastate Bridges under the Department of Transportation); and Iowa Code 419.4 (county or incorporated city project bonds). It is possible that an aggrieved bondholder could pursue the writ even absent authorizing statutory law. For example, in 1902, bondholders sued Sioux City, Iowa with respect to district improvement bonds the city issued from 1886-1891 for the paving, curbing and grading of roads. The bonds were meant to be repaid with assessments on certain properties. The court found that the special assessment bonds should be deemed the direct obligations of the city, because the city had not exercised due care in managing the funds. Hillhouse, A.M., MUNICIPAL BONDS: A CENTURY OF EXPERIENCE at 111 (New York: Prentice-Hall 1936). Further, in 1975, the Supreme Court of Iowa upheld the constitutionality of Iowa Code § 384.88 in Sampson v. City of Cedar Falls, 231 N.W.2d 609 (1975).
Iowa Endnotes (cont’d)

vii See, e.g., IOWA CODE § 313A.16 (bonds payable by pledge of tolls from bridges). These are examples of special revenue bonds. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.

viii See, e.g., IOWA CODE § 12.74; IOWA CODE § 12.84; IOWA CODE § 12.90; IOWA CODE § 12.91; and IOWA CODE § 12A.8. These are examples of statutory liens. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.
### Michigan

| Municipal Bankruptcy Authority | Under Michigan law, any city, village, township, county, authority established by law, or a public utility owned by a city, village, township, county or school district may file a petition under chapter 9 of the U.S. Bankruptcy Code if an emergency financial manager so approves. Specifically, an emergency financial manager, after giving notice to a local emergency financial assistance loan board, may authorize a local government to file a petition pursuant to the U.S. Bankruptcy Code, unless authorization is disapproved by the local emergency financial assistance loan board within 60 days after the notice has been received by the board. Pursuant to section 141.1241, any school district for which an emergency financial manager has been appointed may file a chapter 9 petition after the emergency financial manager has given written notice to the superintendent of public instruction. Unless an entity is specifically identified above, it is not authorized to file a municipal bankruptcy petition. Between 1980 and December 30, 2010, two municipal entities have filed petitions under chapter 9 of the U.S. Bankruptcy Code, including a hospital in 1992 and the Village of Merrill, Michigan in 1987. |
| Debt Default Prevention | **DEBT LIMITATION** The Michigan Constitution contains debt limits for cities, villages and counties. A county may not issue debt totaling more than 10 percent of its assessed valuation. The Michigan legislature may limit debt issued by cities and villages. **LOCAL GOVERNMENT FISCAL RESPONSIBILITY ACT** Should a local government request assistance or the treasurer inform the governor that he or she has conducted a preliminary review of a local government financial situation and has determined that certain conditions indicating a serious financial problem exist, the government must appoint a review team to undertake a local financial management review. Based on the review, the review team may recommend that an emergency financial manager be appointed, with broad powers to ensure the local government’s continued viability. **REFUNDING BONDS** In certain situations, a municipal entity may issue refunding bonds to refund and refinance outstanding debt. |

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**Michigan**

**Chapman and Cutler LLP**

Attorneys at Law • Focused on Finance®
### Michigan (cont’d)

<table>
<thead>
<tr>
<th>Mechanisms for Resolution After Default</th>
<th><strong>EMERGENCY FINANCIAL MANAGEMENT</strong></th>
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<tbody>
<tr>
<td></td>
<td>If a municipality fails to pay an installment of principal and interest on an outstanding municipal bond on or before its due date, the state treasurer or superintendent for public instruction can investigate the municipality’s fiscal affairs, consult with the governing body of the municipality and negotiate with the municipality’s creditors to develop a plan for financing, adjusting or compromising the outstanding, overdue bond.</td>
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<tr>
<td></td>
<td><strong>RECEIVERSHIP</strong></td>
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<tr>
<td></td>
<td>In certain default situations, Michigan law allows for the appointment of a receiver with respect to revenue bonds.</td>
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In November 2010, Michigan rejected a request for permission to file a municipal bankruptcy petition filed by the municipality of Hamtramck.

Pursuant to MICH. COMP. LAWS § 78.26, a village governed by the Home Rule Village Act may not incur indebtedness exceeding 10 percent of the assessed valuation of the real and personal property within the village subject to taxation.

If the governing body requests assistance, the resolution requesting assistance must identify the financial conditions making the request necessary. There are fifteen triggering events including: a written request by the governing body or chief administrative officer, or a major creditor with an undisputed claim remaining unpaid for at least six months and exceeding $10,000 or 1 percent the annual general fund budget of the local government; petition of 10 percent of voters voting in the last gubernatorial election; notification by the trustee, actuary, or 10 percent of beneficiaries of the municipality’s pension fund that the pension fund is deficient; notification that employees have either not been paid or that payment is seven or more days late; notice of a bond payment default or violation of a bond covenant; resolution from the state senate or house of representatives; a violation of the municipal finance act, the emergency municipal loan act, the uniform budgeting and accounting act, or the state revenue sharing act; failure to provide an adequate annual financial report or audit to the state treasurer; failure to distribute tax revenue, as required by law that has been collected for another taxing jurisdiction; or a court order of an additional tax levy without prior approval of the governing body.

In Flint City Council v. State of Michigan, 655 N.W.2d 604 (Mich. Ct. App. 2002), the state treasurer reported to the Governor that the City of Flint had a serious financial problem. The Governor appoint a financial review team to assess Flint’s financial situation and found a substantial general fund deficit. The review team also determined that Flint city officials demonstrated an inability “to accurately monitor revenue and expenditures throughout a given fiscal years and to amend city budgets accordingly.” As such, the review team recommended that the Governor appoint an emergency financial manager. The City appealed and the court found the Governor’s decision was supported.

A financial manager was also appointed for the city of Hamtramck. See Omer Kimhi, Reviving Cities: The Legal Remedies to Municipal Insolvency (N.Y.U. School of Law 2007) at 281

See, e.g., MICH. COMP. LAWS § 141.2802(1) (allowing any outstanding security that has been assumed in part by another municipality to be refunded by the municipalities as to their respective liabilities) and MICH. COMP. LAWS § 141.2609 (allowing refunding securities under the drain code of 1956). Municipalities may issue refunding bonds to refund all or any portion of funded indebtedness, but their issuance must be necessary such as to avoid a default. MICH. CIVIL JUR., Municipal and Public Bonds § 51 (2010).

The State has taken over the Detroit Public Schools; City of Pontiac; City of Escorce; Village of Three Oaks; City of Hamtramck; City of Highland Park; and the City of Flint. See Eric Scarsone, Local Government Financial Emergencies and Municipal Bankruptcy, Michigan Senate Fiscal Agency Issue Paper, available at http://www.senate.michigan.gov/sfa/publications/ issues/localgovfin/localgovfin.pdf (last visited October 11, 2010).
Michigan Endnotes (cont’d)

vi  See, e.g., MICH. COMP. LAWS § 141.110 (allowing for appointment of receiver with respect to revenue bonds). Under § 141.110, a receiver may be appointed to administer and operate any public improvement as long as its revenues are pledged to pay the principal and interest on the bonds at issue. The receiver may fix and charge rates and collect revenues sufficient for the payment of any bonds or obligations outstanding, but must act under the direction of the court. For instance, in Farmington Township v. Warrenville State Bank, 185 F.2d 260 (6th Cir. 1950), bondholders asked the court to appoint a receiver. The court appointed a receiver and found that the receiver was allowed to continue to charge a specified amount each year for water hydrant rentals to help the township repay the debt.

vii  See, e.g., MICH. COMP. LAWS § 41.347 (provides that bondholders representing in aggregate not less than 20% of entire outstanding bond issue by Township Water Supply and Sewage Disposal Services and Facilities may protect and enforce the statutory lien and compel performance of duties by officials of borrower); and MICH. COMP. LAWS § 331.8e(2) (provides that bondholders representing in aggregate not less than 20% of entire outstanding bond issue by Hospital Authority may protect and enforce the statutory lien and compel performance of duties by officials of borrower, including fixing sufficient rates to pay bonds). It is possible that an aggrieved bondholder could pursue the writ even absent authorizing statutory law.

viii  See, e.g., MICH. COMP. LAWS § 41.343 (revenue bonds for water supply and sewage disposal projects); MICH. COMP. LAWS §§ 125.667(5) & 125.709(2) (revenue bonds for housing facilities); and MICH. COMP. LAWS §§ 141.107(4) (Revenue Bond Act). These are examples of special revenue bonds. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.

ix  See, e.g., MICH. COMP. LAWS § 41.346 (establishing statutory lien on net revenues of water supply and sewage disposal project); MICH. COMP. LAWS §§ 125.667(5) & 125.709(2) (statutory liens for bonds issued by housing facilities); MICH. COMP. LAWS § 125.1666(2) (Downtown Development Authority bonds providing for statutory lien on tax increment revenues); MICH. COMP. LAWS § 141.108 (establishing statutory lien on net revenues under Revenue Bond Act); MICH. COMP. LAWS § 331.8e (establishing statutory lien on all net revenues on bonds issued by hospital authorities); and MICH. COMP. LAWS § 333.26220a(5) disposal site revenues subject to statutory lien under Low-Level Radioactive Waste Authority). These are examples of statutory liens. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.
### New York

| Municipal Bankruptcy Authority | A municipality or its emergency financial control board, the city of New York or the New York state financial control board may file a petition under chapter 9 of the U.S. Bankruptcy Code. “Municipality” is defined as “a county, city, town or village.” Unless an entity is specifically identified above, it is not authorized to file a municipal bankruptcy petition. Only one entity between 1980 and December 30, 2010, the New York Off-Track Betting Corporation, has filed a municipal bankruptcy petition. |
| Debt Default Prevention | DEBT LIMITATION
The New York Constitution contains certain limitations on local indebtedness based on the average full valuation of the taxable real estate of the municipal entity. The percentage limits include: Nassau County, 10 percent; all other counties, 7 percent; New York City, 10 percent; any other city with a population more than 125,000, 9 percent; cities with less than 125,000 in population, excluding education purposes, 7 percent; towns, 7 percent; villages, 7 percent; and school districts in cities with populations less than 125,000, for education purposes, 5 percent (but the city’s voters may vote to increase this amount with the consent of the state). MUNICIPAL ASSISTANCE CORPORATION
The Municipal Assistance Corporation was created by the New York legislature in 1975 to aid New York City in paying its debt. The Corporation will cease to exist one year after New York City pays off its liabilities and has been discharged. Specifically, the Corporation is an independent Corporation authorized to sell bonds to meet New York City’s borrowing needs. NEW YORK FINANCIAL CONTROL BOARD
The New York State Financial Control Board was created in September 1975 to give control powers to the Board with responsibilities to review and oversight the financial management of New York City and certain related public authorities. REFUNDING BONDS
In certain situations, a municipal entity may issue refunding bonds to refund and refinance outstanding debt. |
New York (cont’d)

<table>
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<th>Mechanisms for Resolution After Default</th>
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<td>In certain situations, if the holders of 25 percent in aggregate principal amount of bonds then outstanding so declare a default, they may appoint a trustee to protect their interests. ( ^{vi} )</td>
<td>In certain situations, bondholders have foreclosed on projects within the State of New York. ( ^{ix} )</td>
<td>As provided by the section 922(d) of the U.S. Bankruptcy Code, payments to bondholders holding special revenue bonds would not be stayed on the filing of a municipal bankruptcy petition and payments to holders could continue. Whether an issuance would qualify as a special revenue bond depends on the provisions of the authorizing statute with respect to the bonds at issue. ( ^{x} )</td>
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<td><strong>EMERGENCY FINANCIAL CONTROL BOARDS</strong></td>
<td><strong>MANDAMUS</strong></td>
<td><strong>STATUTORY LIENS</strong></td>
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<td>The New York legislature may create for any municipality outside of New York City an Emergency Financial Control Board. ( ^{vii} )</td>
<td>In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection. ( ^{x} )</td>
<td>Were a municipal entity to file a petition under chapter 9 of the U.S. Bankruptcy Code, bondholders holding bonds to which statutory liens have attached would continue to receive payment on those bonds. For a statutory lien to apply, the authorizing law of the bond issue must contain such a lien.</td>
</tr>
</tbody>
</table>
New York Endnotes

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i N.Y. LOCAL FIN. § 85.80. Municipality is defined as “a county, city, town or village.” As mentioned, only one entity between 1980 and December 31, 2010 in New York, the New York Off-Track Betting Corporation, has filed a municipal bankruptcy petition. While this entity was not specifically authorized by statute to file a petition, the governor of New York signed an executive order authorizing the filing. The bankruptcy court found that the governor had the power to issue such an order. In re New York Off Track Betting Corp., 427 B.R. 256 (Bankr. S.D.N.Y. 2010). The case, however, was dismissed in January 2011.

Under New York law, however, no municipality may file a petition for so long as its local ARRA bonds purchased by the state of New York municipal bond bank agency and secured by its pledge of tax revenues remain outstanding. N.Y. LOCAL FIN. § 85.80.

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ii N.Y. CONST. art. VIII, § 4.

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iv NY Unconsol. Ch. 22, § 5. According to the New York State Financial Control Board, “[t]he New York State Financial Control Board was created by the State legislature in September 1975 pursuant to the New York State Financial Emergency Act of the city of New York (the “Act”). The Act gives the Control Board powers and responsibilities to review and oversight with respect to the financial management of the New York City government and certain related public authorities. Among other things the Act requires the City to prepare and submit a ‘rolling’ four-year financial plan to the Control Board prior to the beginning of each City fiscal year and, to modify the plan as necessary from time to time to conform with standards set forth in the Act.

The board assumes control over the city’s finances and management during a ‘control period,’ which is declared when the city fails to meet its obligations. During a non-control period, the Control Board reviews the four-year financial plan at least quarterly, and must notify the City if a plan or modification to the financial plan does not conform to the Act’s standards. In addition, the Control Board must make a determination annually whether a new control period, under which the board’s suspended powers are reimposed, should be declared.” New York State Financial Control Board, http://www.fcb.state.ny.us/ (last visited Oct. 4, 2010).

A “control period” occurs if the city fails to pay debt service on any of its obligations when due or payable; incurs an operating deficit of more than $100 million in a fiscal year’ issues notes in violation of the Act; violates any provision of the act substantially impairing its ability to repay its notes or bonds or its ability to adopt or adhere to a balanced budget. N.Y. CLS Gen. Mun. § 2. The Act terminates when all bonds issued pursuant to it are refunded, redeemed, discharged or otherwise decreased.

In the case of Ropico, Inc. v. New York, 425 F. Supp. 970 (S.D.N.Y. 1976), the court discussed the creation of the New York City Emergency Financial Control Board and permitted a temporary extension of debt payments for the purpose of facilitating the City’s recovery.

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v See, e.g., N.Y. LOC. FIN. Titls 7 (applies to a municipality (any county, city, town or village), school district or district corporation and allows for refunding bonds). Under these provisions the refunding bonds must be for less than the present value of the principal and interest amount on the bonds to be refunded after deducting costs and expenses.
New York Endnotes (cont’d)

vi N.Y. PUB. AUTH. § 368 (New York State Thruway Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests); N.Y. PUB. AUTH. § 1390 (Ogdensburg Port Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests); N.Y. PUB. AUTH. § 1420-Q (Monroe Regional Parking Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests); N.Y. PUB. AUTH. § 1425-P (Hudson Parking Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests); and N.Y. PUB. AUTH. § 1983 (Battery Park City Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests). The previously listed provisions are a representative example of provisions contained in New York law.

vii See N.Y. LOCAL FINANCE LAW §§ 85.00 to 85.90. Under these provisions, the New York legislature may create an Emergency Financial Control Board for a municipality. Action may not be taken unless the municipality is due or overdue on a payment of a debt or obligation, demand for payment has been made and thirty (30) days has passed since service was demanded. If the municipality is unable to pay its bills as they mature, its Emergency Financial Control Board may petition a court for a temporary stay of claims for 90 days. Should the court grant such a petition, the municipality must also establish a repayment plan for its debts, providing for the eventual satisfaction of all debts and obligations. The stay will be extended for the period of time it takes the municipality to carry out the plan.

In November 1975, an Emergency Financial Control Board was put in place for the City of Yonkers. The Control Board terminated on December 31, 1978.

viii See, e.g., N.Y. PUB. AUTH. § 368 (New York State Thruway Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests); N.Y. PUB. AUTH. § 1390 (Ogdensburg Port Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests); N.Y. PUB. AUTH. § 1420-Q (Monroe Regional Parking Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests); N.Y. PUB. AUTH. § 1425-P (Hudson Parking Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests); and N.Y. PUB. AUTH. § 1983 (Battery Park City Authority if the holders of twenty-five percent in aggregate principal amount of bonds then outstanding so declare a default and appoint a trustee to protect their interests). The previously listed provisions are a representative example of provisions contained in New York law. The state’s code may be more expansive and the statutory authority for each bond issuance should be reviewed before assessing whether a receiver may be appointed.

ix Moody’s Investors Service, U.S. Municipal Bond Defaults and Recoveries, 1970-2009. In November 2003, the Cicero Land Development Corporation defaulted on approximately $15.3 million in debt. A foreclosure sale was held on the mortgages securing the obligations, generating $2 million. Bondholders recovered approximately 10.3% according to Moody’s. See also, N.Y. PUB. HOUS. § 75 (allowing for receivership and/or foreclosure with respect to public housing authority). The state’s code may be more expansive than the example cited here, and the statutory authority for each individual bond issuance should be reviewed before assessing whether foreclosure is an alternative.
New York Endnotes (cont’d)

See, e.g., N.Y. ENVTL CONSERV. § 34 (allowing mandamus for rapid transit bonds issued by cities). It is possible that an aggrieved bondholder could pursue the writ even absent authorizing statutory law.

See, e.g., N.Y. GEN. MUN. § 407 (providing for the granting of liens for revenue producing undertakings); N.Y. PUB. HOUS. § 47 (providing revenues pledge by municipal housing authorities for bonds immediately subject to lien on pledge). These are examples of special revenue bonds. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.
Wisconsin

| Municipal Bankruptcy Authority | Wisconsin does not specifically authorize its municipal entities to file a petition under chapter 9 of the U.S. Bankruptcy Code. Between 1980 and December 30, 2010, no municipal entity in Wisconsin has filed such a petition. |
| Debt Default Prevention | DEBT LIMITATION  
The Wisconsin Constitution includes debt limit provisions for counties, cities, towns, villages, school districts, sewage districts and other municipal corporations. Specifically, these entities’ debt, with certain exceptions, may not exceed 5 percent of the percentage of taxable property located in the entity equalized for state purposes as provided by the state legislature. Bonds issued for school purposes by cities may be issued up to an additional 10 percent; and bonds issued by school districts offering grades one through twelve may be issued up to 10 percent of the taxable property.  
DEFICIENCY PROTECTION FOR PUBLIC IMPROVEMENT BONDS  
If a local government issues public improvement bonds and if the local government determines there will be a deficiency in a bond fund for the ensuing calendar year, the municipality must make up the deficiency, up to its municipal debt limit.  
REFUNDING BONDS  
In certain situations, a municipal entity may issue refunding bonds to refund and refinance outstanding debt. |
| Remedies on Default | FORECLOSURE  
Certain provisions of Wisconsin law allow for a mortgage lien in relation to payment on project bonds.  
MANDAMUS  
In certain situations, bondholders or their trustee may bring a court action to compel the local governing body to perform a ministerial action that it has refused to undertake, such as refusing to collect taxes or fees where the underlying bond authorization requires such a collection. |
Wisconsin (cont’d)

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<tr>
<th>Other Bondholder Protections</th>
<th>SPECIAL REVENUE BONDS</th>
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<tbody>
<tr>
<td></td>
<td>As provided by the section 922(d) of the U.S. Bankruptcy Code, payments to bondholders holding special revenue bonds would not be stayed on the filing of a municipal bankruptcy petition and payments to holders could continue. Whether an issuance would qualify as a special revenue bond depends on the provisions of the authorizing statute with respect to the bonds at issue.</td>
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<tr>
<td></td>
<td>STATUTORY LIENS</td>
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<td></td>
<td>Were a municipal entity to file a petition under chapter 9 of the U.S. Bankruptcy Code, bondholders holding bonds to which statutory liens have attached would continue to receive payment on those bonds. For a statutory lien to apply, the authorizing law of the bond issue must contain such a lien.</td>
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</tbody>
</table>
Wisconsin Endnotes

i WIS. CONST. Art. XI, § 3. See also WIS. STAT. § 67.03 (establishing general limitations on indebtedness).

ii See, e.g., WIS. STAT. § 66.0619 (Public Improvement Bonds). Under Wisconsin law, the debt of any municipality shall not exceed 5% of the value of the taxable property locate in the municipality. WIS. STAT. § 67.03.

Note that this provision only applies to Public Improvement Bonds. Other issuances, such as the bond anticipation notes on which the City of Menasha Wisconsin defaulted on September 1, 2009 would not be affected by this provision. See Am. Bank v. City of Menasha, 2010 U.S. App. LEXIS 34345 (7th Cir. Nov. 29, 2010) (describing bond issuance). As background, the city of Menasha had issued bond anticipation notes to finance the conversion of a municipal power plant into a coal-fired, steam-generating facility intended to serve certain paper mills. The city paid the interest it owed on the notes, but only $1.4 million of the $24.2 million in principal it owed before the default. The city is currently involved in litigation over the default brought by bondholders. See Rick Romell, "City of Menasha Sued After Defaulting on Bonds," Journal Sentinel Online, Sept. 28, 2009, www.jsonline.com/business/62342647.html (visited Dec. 28, 2010).

iii See, e.g., WIS. STAT. § 66.0621 (refunding bonds for revenue bonds) and WIS. STAT. § 66.0623 (refunding village, town, sanitary and inland lake district bonds).

iv See, e.g., WIS. STAT. § 66.0621 (securing payment of revenue bonds). The state's code may be more expansive than the example cited here, and the statutory authority for each individual bond issuance should be reviewed before assessing whether bondholders could pursue a foreclosure action.

v See, e.g., WIS. STAT. § 182.34(9) (bondholders may bring suit at law or in equity by suit, action, mandamus or other proceeding to protect their rights with respect to turnpike project bonds). It is possible that an aggrieved bondholder could pursue the writ even absent authorizing statutory law.

vi See, e.g., WIS. STAT. § 62.185 (sewer district bonds are payable solely out of special sewer district tax); and WIS. STAT. § 67.16 (general obligation local improvement bonds providing that all collections must be placed with the treasurer of the local governmental unit in a special debt service fund designated and identified for the issue of the bonds). These are examples of special revenue bonds. The state code may be more expansive and an attorney should be consulted to examine any specific situation involving a default.
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