



CHAPTER 1

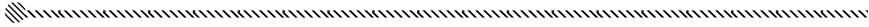
WHAT IS CHAPTER 9?

The U.S. Constitution grants to Congress the exclusive right to make laws about bankruptcy. Each state has various laws that govern creditor rights and remedies, and most have enacted legislation regarding the liquidation of businesses, including the appointment of a receiver to take control of the assets of a failing business. Bankruptcy, even the bankruptcy of local governments, is, however, a matter of federal law.

The federal bankruptcy law is codified in title 11 of the U.S. Code and is commonly referred to as the “Bankruptcy Code.”⁴ Congress enacted the current Bankruptcy Code in 1978. Before then, bankruptcy in this country was governed by a law that was enacted in 1898 and substantially revised in 1938. The Bankruptcy Code modernized the 1938 Bankruptcy Act, emphasizing reorganization and rehabilitation of debtors as opposed to straight liquidation.

The Bankruptcy Code is divided into several chapters. Chapters 1, 3 and 5 contain administrative and general provisions that, in

4 Unless otherwise noted, all statutory references are to sections of the U.S. Bankruptcy Code, 11 U.S.C. §§ 101, *et. seq.*



general, apply to every type of bankruptcy case. Chapter 15 has special rules for debtors that are also the subject of international bankruptcies or insolvency proceedings. Chapters 7, 9, 11, 12 and 13 provide for different types of bankruptcy cases for different types of debtors.

Chapters 7 and 13 are the most commonly used forms of personal bankruptcy. In chapter 7, an individual can obtain a discharge of all of his or her debts. An independent trustee becomes the owner of the debtor's assets (subject to certain exemptions) and sells them for the benefit of creditors. Individual chapter 7 debtors generally get a "fresh start" free of their old obligations, save for most tax debts, willful torts such as fraud and conversion, and a few additional debts. In chapter 13, individuals with regular income propose a plan to repay their creditors over time. A chapter 13 debtor obtains a discharge upon completion of the repayment plan, even if creditors are not paid in full.

Chapter 11 is generally designed for business debtors. In chapter 11, the debtor, with certain exceptions, remains in possession and control of its business and assets and proposes a plan to restructure its debts. A typical plan pays a reduced amount to creditors over time. An individual may file a chapter 11 case, but almost all opt for chapter 13 if they are within the income and debt eligibility limits, which is better crafted to deal with individual debtors.

Chapter 12 is for family farmers and commercial fishermen.

Chapter 9 is the part of the Bankruptcy Code that applies to the adjustment of the debts of a municipality. Chapter 9 has few operating provisions of its own. Rather, it specifies which provisions of chapters 3, 5 and 11 apply in a municipality bankruptcy case. Chapter 9 most closely resembles chapter 11, though with several key differences. This booklet frequently emphasizes the differ-

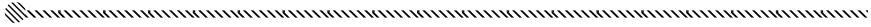
ence between chapter 9 and the more familiar provisions of chapter 11 to illustrate how municipality bankruptcy works. Chapter 4 of this *Guide* includes an overview of the differences between chapter 9 and chapter 11.

Because of the limits imposed by the Tenth Amendment to the U.S. Constitution and the reservation to the states of sovereignty over their own internal affairs, a bankruptcy court is limited in its ability to control the outcome of a municipality bankruptcy. The municipality is in control, and creditors have little recourse but to seek dismissal of the bankruptcy case or vote to reject the plan of adjustment proposed by the debtor. Similarly, a municipality debtor cannot liquidate its assets under chapter 9; it can only restructure its debts.

A municipality can be relieved of debt obligations (or discharged) in a chapter 9 case.⁵ Similar to a chapter 11 debtor, however, a municipality debtor is not entitled to the “fresh start” that allows an individual chapter 7 debtor, for example, to simply walk away from debt. In other words, a municipality debtor cannot, simply by filing bankruptcy, reduce debts to zero or make debt disappear.

The goal of a chapter 9 debtor is to file and confirm a plan of adjustment. This term is explained in more detail below, but in short, a plan of adjustment is much like a plan of reorganization in chapter 11, with a few critical distinctions. Under the right circumstances, a municipality may be able to obtain court approval of a plan that does not pay all debts in full. These circumstances are very complicated and are likely to be litigated vigorously. Without limitation, a plan that pays some creditors less than they are owed must be “fair and equitable” to creditors and must be proposed

5 11 U.S.C. § 944(b).



by the municipality in good faith.⁶ These terms can mean different things, depending on the circumstances, but at a minimum the debtor must put forth a good-faith effort to repay creditors.

When a chapter 9 plan of adjustment is confirmed, the debtor's obligations thereunder replace all of the municipality's former debts and obligations.⁷ Instead of the debtor's prebankruptcy contracts and agreements, the plan now controls whom, when and how much the debtor must pay. That said, the debtor can reaffirm some of its old contracts and agreements under the plan. The plan can alter some of the rights of creditors, but cannot alter other rights. This is what a discharge amounts to in chapter 9: The debtor's old obligations are replaced with a new set of obligations, defined by the plan of adjustment, on the effective date of the plan. What that means in practice will vary greatly from case to case.

6 11 U.S.C. § 1129.

7 11 U.S.C. § 944.