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Municipal Bankruptcies

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Disclaimer

The various sections of this outline were prepared by individuals that often have differing perspectives on the many issues addressed in the outline given the diverse parties these individuals and their firms represent in the Puerto Rico Title III cases and other matters. Therefore, it should not be assumed that each contributing individual subscribes to each position advanced in the outline. Further, the views and opinions expressed in this outline and during the accompanying presentation are those of each individual presenter and nothing in this outline or the accompanying presentation represents the position of any party's client, or necessarily reflects any firm's position on the merits of any particular matter in any case.

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- I. Municipal Bankruptcies**
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Key Jurisdictional Differences In Sovereign Bankruptcies

- **Tenth Amendment / Federalism Concerns**
- **Reservation of State Power to Control Municipalities**
- **Court may not enter order interfering with Debtor's property or revenue**
- **Sole remedy for failure to confirm Plan of Adjustment is dismissal of case**
- **Circumscribed Court Oversight**
 - ▶ No Debtor in Possession
 - ▶ No Property of the Estate
 - ▶ No restrictions on Debtor's use of property
 - ▶ Court approval of settlements and compromises not required
 - ▶ No Court approval of administrative expenses, including professionals

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U.S. v. BEKINS, 304 U.S. 27 (1938)

Constitutional Underpinnings for chapter 9

- **Constitutional Basis – Uniform Laws on Bankruptcy**
 - ▶ Upholding Chapter X of the Bankruptcy Act (now chapter 9 of Bankruptcy Code), which is limited to voluntary proceedings for the composition of debts of state taxing agencies and instrumentalities.
 - ▶ The fact that a municipal debtor could not be subject to liquidation did not limit Congress' invocation of the Bankruptcy Clause of the U.S. Constitution over municipal debt readjustments.
 - ▶ A state can consent to its municipalities using federal law to adjust its debts without violating 10th Amendment
- **Constitutional Limitations – 10th Amendment of U.S. Constitution (Powers not delegated to the U.S. are reserved to the States)**
 - ▶ No limitations on powers of the States or their municipalities in the exercise of their sovereign rights and duties.
 - ▶ No interference with the fiscal or governmental affairs of a political subdivision is permitted.
 - ▶ No involuntary proceedings
 - ▶ No control over municipal debtor's property or revenues

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Limitations On Court's Authority

Bankruptcy Code Sections 903 and 904

- **Section 903:**

- ▶ This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but—
 1. a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and
 2. a judgment entered under such a law may not bind a creditor that does not consent to such composition.

- **Section 904:**

- ▶ Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—(1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property.

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Limitations On Court's Authority (Cont'd)

PROMESA Sections 303

- **Section 303:**

- ▶ Subject to the limitations set forth in subchapters I and II of this chapter, this subchapter does not limit or impair the power of a covered territory to control, by legislation or otherwise, the territory or any territorial instrumentality thereof in the exercise of the political or governmental powers of the territory or territorial instrumentality, including expenditures for such exercise, but whether or not a case has been or can be commenced under this subchapter--
 1. a territory law prescribing a method of composition of indebtedness or a moratorium law, but solely to the extent that it prohibits the payment of principal or interest by an entity not described in section 109(b)(2) of Title 11, may not bind any creditor of a covered territory or any covered territorial instrumentality thereof that does not consent to the composition or moratorium;
 2. a judgment entered under a law described in paragraph (1) may not bind a creditor that does not consent to the composition; and
 3. unlawful executive orders that alter, amend, or modify rights of holders of any debt of the territory or territorial instrumentality, or that divert funds from one territorial instrumentality to another or to the territory, shall be preempted by this chapter

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Limitations On Court's Authority (Cont'd)

PROMESA Sections 305

- **Section 305:**

- ▶ Subject to the limitations set forth in subchapters 1 and 2 of this chapter, notwithstanding any power of the court, unless the Oversight Board consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—
 1. any of the political or governmental powers of the debtor;
 2. any of the property or revenues of the debtor; or
 3. the debtor's use or enjoyment of any income-producing property.

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Impact Of Limitation On Court's Authority On Creditor Rights

- **Section 363 inapplicable to chapter 9 cases**

- ▶ Chapter 9 does not prevent a municipal debtor from paying pre-petition claims because debtor can use its money as it wishes
- ▶ Court unable to interfere with how debtor uses its property or revenues
- ▶ Court approval not required for use of cash collateral or transactions outside the ordinary course of business
- ▶ Debtor can settle claims without court approval (i.e., No Bankruptcy Rule 9019 approval)
 - Debtor can choose to seek approval of settlements or use of its property by consenting to court interference with property or the plan so provides

- **Section 541 inapplicable to chapter 9 debtor. As such, no property of the estate or turnover of property of estate**

- **Creditor's leverage significantly reduced in municipal bankruptcy:**

- ▶ No ability to file involuntary petition
- ▶ No ability to terminate exclusivity
- ▶ No competing plans of adjustment
- ▶ No ability to convert the case to a liquidation
- ▶ No non-consensual derivative standing

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Relevance of State Constitution

- **Detroit decision**

- ▶ While the Michigan state constitution provides that accrued pensions cannot be reduced, Judge Rhodes held that the Supremacy Clause of the United States Constitution requires that federal bankruptcy law provisions authorizing impairment of municipal debts and obligations take precedence over this conflicting Michigan constitutional provision.

- **Treatment under PROMESA**

- ▶ What does it mean to “respect” lawful priorities
 - Section 201(b)(1)(N) requires that certified Fiscal Plan respect the relative lawful priorities or lawful liens, as may be applicable, in the constitution, other laws, or agreements of a covered territory or covered territorial instrumentality in effect prior to June 30, 2016.
- ▶ Reviewability of Fiscal Plan
 - There shall be no jurisdiction in any United States district court to review challenges under Commonwealth constitution to the Oversight Board’s certification determinations under this chapter.

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In Chapter 9 Bankruptcy, What is the Impact of Congress’s Decision to not Incorporate the Bankruptcy Priority Scheme into Chapter 9

- **In chapter 9, only section 507(a)(2) is incorporated into the chapter 9 case. All the other bankruptcy priorities are not incorporated into the chapter 9 case.**

- ▶ Some of the priorities are plainly inapposite to a chapter 9 case. For example, claims for domestic support obligations (507(a)(1)), gap period involuntary expenses (507(a)(3)), and deposits for household items (507(a)(7)) would not arise in a municipal bankruptcy case
- ▶ Other priorities, such as employee wages (507(a)(4)), contributions to employee benefit plans (507(a)(5)), and certain prepetition taxes (507(a)(8)) could arise in a municipal bankruptcy case but the priorities for such claims are not incorporated into the chapter 9 case.
- ▶ The impact of not including such priorities into chapter 9 is that such claims would be treated as general unsecured claims under the Plan of Adjustment, and thus subject to impairment as with any other prepetition general unsecured claim.

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Can Constitutional Claims be Discharged in Bankruptcy?

- **State or Territorial constitutional claims can be discharged**

- ▶ The Supremacy Clause and Bankruptcy Clause of the U.S. Constitution operate “to cause federal bankruptcy law to trump state laws, including state constitutional provisions, that are inconsistent with the exercise by Congress of its exclusive powers to enact uniform bankruptcy laws.” *In re City of Stockton*, 526 B.R. 35, 50 (Bankr. E.D. Cal. 2015).
- In the City of Detroit’s bankruptcy, the court upheld a non-consensual third-party release of claims under the Michigan Constitution over the objections of pensioners who argued that the Michigan Constitution required the state to assume responsibility of any underfunding of municipal pensions. The court approved a settlement in the city’s plan of adjustment, pursuant to which the state would make a monetary contribution and, in exchange, each pension holder (even those who did not consent) were forced to release the state from all liabilities arising from or related to, among other things, the Michigan Constitution. *In re City of Detroit*, 524 B.R. 147, 171, 174 (Bankr. E.D. Mich. 2014).
- ▶ Similarly, claims under territorial constitutions may also be dischargeable in a plan confirmed under PROMESA, which was enacted pursuant to the Territorial Clause of the U.S. Constitution.

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Can Constitutional Claims be Discharged in Bankruptcy? (Cont’d)

- **Federal Constitutional claims that rely on 42 U.S.C. § 1983 to provide cause of action can be discharged**

- ▶ Not all constitutional provisions themselves establish a right to damages (*e.g.*, the Fourteenth Amendment).
- ▶ Congress enacted 42 U.S.C. § 1983 to create a cause of action for individuals who suffer violations of their constitutional rights.
 - ***The statute itself does not create substantive rights.***
- ▶ In *Detroit*, the court held that it does not pose a constitutional problem to impair a claim for compensation under Section 1983. *See Detroit*, 524 B.R. at 264 (approving plan that would treat creditors who were plaintiffs in pending lawsuits under Section 1983 as unsecured creditors and discharge their claims against the debtor under chapter 9’s general discharge provision).

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Can Constitutional Claims be Discharged in Bankruptcy? (Cont'd)

• U.S. takings clause claims

- ▶ Claims can be brought directly under the Fifth Amendment's Takings Clause, which provides that "private property [shall not] be taken for public use, without just compensation." U.S. Const. amend. V.
- ▶ The Supreme Court has repeatedly held that the bankruptcy power is subject the Fifth Amendment's prohibition against taking private property without just compensation. *See, e.g., U.S. v. Sec. Indust. Bank*, 459 U.S. 70 (1982).
- ▶ In *Detroit*, the bankruptcy court certified to the U.S. Attorney General the question whether Chapter 9 is unconstitutional if it allows for the discharge or impairment of creditors' claims for just compensation arising under the Fifth Amendment. The U.S. Attorney General submitted a brief in response, stating the following:
 - "Congress's constitutional bankruptcy power, Art. I, § 8, cl. 4, 'is subject to the Fifth Amendment's prohibition against taking private property without compensation.' *U.S. v. Sec. Indust. Bank*, 459 U.S. 70, 75 (1982). Accordingly, a bankruptcy court may not direct or authorize that less than just compensation may be paid for the taking of property, whether that is through direct condemnation or inverse condemnation." (Case No. 13-53846, Dkt. No. 6664).
 - The Attorney General noted, however, that the bankruptcy court could avoid such constitutional questions through the discretion afforded to it under Section 944(c)(1) of the Bankruptcy Code, which gives the court sufficient equitable flexibility to exclude just compensation claims from discharge.

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Can Constitutional Claims be Discharged in Bankruptcy? (Cont'd)

• U.S. takings clause claims (cont'd)

- ▶ The *Detroit* bankruptcy court adopted the Attorney General's reasoning, and held that certain creditors' existing / pending Takings Clause claims were not dischargeable under the city's proposed plan of adjustment.
 - The city argued that the objecting creditors were unsecured creditors whose right was merely to collect payment, which does not constitute a property interest. The court rejected this argument, stating that:
 - "The taken property here is not the creditors' unsecured claim in bankruptcy.... [U]nder the Fifth Amendment, the owner of private property must be justly compensated if that property was taken for public use, whenever and wherever that taking occurred. If confirmed, the plan would deny that just compensation. The plan would allow the City to impair the property owners' constitutional claim for just compensation after the City took their private property. That violates the Fifth Amendment." *Detroit*, 524 B.R. at 270.
- ▶ However, in December 2018, the Ninth Circuit dismissed the appeal of a creditor whose claim originally arose from a takings claim as equitably moot. *In re City of Stockton, Ca.*, 909 F.3d 1256 (9th Cir. 2018)
 - After holding that the appeal was equitably moot, the court stated that the creditor's underlying theory—that the Takings Clause exempts his unsecured claim from reorganization—was not viable on the record.
 - According to the court, under California state law, the creditor had waived all claims and defenses to the condemnation, and therefore was simply a holder of an unsecured monetary damages claim. When Stockton filed for bankruptcy, the creditor did not possess a cognizable property interest, and never asserted anything but an unsecured proof of claim. His claim was therefore subject to adjustment.
 - Notably, the majority did not cite to the *Detroit* decision, nor to the Attorney General's brief submitted in the *Detroit* bankruptcy.
 - The dissent opined that the constitutional claim for just compensation should have been exempted from discharge, noting that "the majority's contrary approach is at odds with the only other federal court that has addressed this question," citing the *Detroit* decision. *Id.* at 1274, n.7.

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Can Constitutional Claims be Discharged in Bankruptcy? (Cont'd)

• U.S. contracts clause claims

- ▶ As an initial matter, a bankruptcy plan (whether confirmed under the Bankruptcy Code or PROMESA) does not itself violate the U.S. Constitution's Contracts Clause, which provides that "[n]o **State**...shall pass any...Law impairing the Obligations of Contracts...." U.S. Const. art. IV, § 10 (emphasis added).
 - The U.S. Contracts Clause does not forbid **Congress** from passing any laws that impair contract rights, and both the Bankruptcy Code and PROMESA were passed by Congress.
- ▶ The U.S. Contracts Clause, "so far as it can be said to confer upon or secure to any person any individual rights, does so only indirectly and incidentally. It forbids the passage by the states of laws such as are described. If any such are nevertheless passed by the legislature of a state, they are unconstitutional, null, and void." *Carter v. Greenhow*, 114 U.S. 317, 322 (1885).
 - No court has expressly addressed the issue of whether an individual or entity would lose its ability to seek to nullify a State law that violates the U.S. Contracts Clause by operation of a bankruptcy discharge.

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Potential U.S. Liability

Takings Claims

- **Tucker Act (28 U.S.C. § 1491) requires takings claims against the United States must be filed in the U.S. Court of Federal Claims**
- **Current PROMESA-related cases in the U.S. Court of Federal Claims**
 - ▶ ERS Litigation (*Altair Global Credit Opportunities Fund (A), LCC et al. v. United States* (17-970C))
 - On July 19, 2017, ERS Bondholders filed a complaint against the United States claiming that the Oversight Board's involvement in the creation and adoption of "Joint Resolution 188" violated the Takings Clause because the resolution diverts funds allegedly pledged for payment on the ERS Bonds without giving the bondholders any compensation.
 - ▶ BAN Litigation (*Puerto Rico BAN (VL) LLC et al. v. United States* (19-482))
 - On April 1, 2019, PRIFABAN holders filed a complaint against United States claiming that the Oversight Board's budget and fiscal plan violated the Takings Clause by diverting revenues allegedly pledged to BAN holders without compensation.
 - ▶ Both cases are based on the premise that the Oversight Board is a federal entity.

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Background – Oversight Board as a Federal Entity

- **First Circuit appointments clause decision (Case No. 18-1671)**

- ▶ Holders of Puerto Rico general obligation bonds brought suit against the Oversight Board, arguing that the members of the Board were appointed in violation of the U.S. Constitution's Appointments Clause.
 - Appointments Clause (U.S. Const. art. 2, § 2, cl. 2) mandates that principal officers of the United States must be appointed by the President **with the advice and consent of the Senate** (board was appointed from a slate provided to President Obama by congressional leadership).
- ▶ The Title III Court (Swain, J.) ruled against plaintiffs, holding that the Oversight Board was a territorial entity, not a federal entity. See Case. No. 17-BK-3283 (Dkt. 3503).
- ▶ The First Circuit (Torruella, J.) **REVERSED**, holding that the members of the Oversight Board **are** U.S. officers that should have been appointed pursuant to the requirements in the Appointments Clause.

- **Impact of decision**

- ▶ If the decision stands, the Oversight Board will be considered a federal entity, and parties may assert that the actions taken by the Board can be attributed to the United States government.

- **Appeal**

- ▶ The Oversight Board announced on Feb. 28, 2019 that it will file a petition for certiorari from the Supreme Court.

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Direct Claims against the United States

GM and Chrysler Cases

- ***Colonial Chevrolet Co., Inc. et al., v. United States*, (Consol. Nos. 10-647C, 11-100C, & 12-900C)**

- ▶ GM and Chrysler dealers sued the United States for coercing GM and Chrysler into cancelling franchise agreements with the plaintiffs as a prerequisite to receiving much-needed federal aid during the 2008-09 financial crisis.
- ▶ Federal government moved to dismiss the complaints, and Court of Claims denied motion.

- **Federal Circuit decision (Consol. Nos. 13-5019 & 13-5020)**

- ▶ On April 7, 2014, the Federal Circuit **AFFIRMED** the Court of Claims' decision.
- ▶ The Federal Circuit held that the dealers' contractual rights contained in franchise agreements constitute property interests, and that the United States' conditioning of federal aid on the manufacturers' cancellation of the franchise agreements may constitute a taking under the Fifth Amendment.

- **Impact**

- ▶ The GM and Chrysler cases seem to open the door for direct U.S. liability under the Takings Clause should the U.S. condition disaster relief funding for the Commonwealth on the impairment of creditor rights.
 - The Federal Circuit's holding that the United States' conditioning of federal aid to a third party on that third party first impairing a plaintiff's contractual rights amounts to coercion such that the third party's impairment may amount to a taking opens the door for Puerto Rico creditors to allege takings occurred as a result of the United States' potential conditioning of disaster funding upon the impairment of creditor rights.
- ▶ This gives creditors a separate avenue for bringing takings claims against the United States government.

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Equitable Mootness

- “[A] prudential doctrine under which the district court may dismiss a bankruptcy appeal when, even though effective relief could conceivably be fashioned, implementation of that relief would be inequitable. *In re Charter Commc’ns, Inc.*, 691 F.3d 476, 481 (2d Cir. 2012).
- Rationales: to preserve the finality of reorganizations and protect third-party expectations on a plan.
- Requires courts to balance the importance of finality in bankruptcy cases against the appellant’s right to review and relief.

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Balancing Test

- **Standard for applying equitable mootness: 3 factors**
 - (i) Whether a stay from consummation of the plan has been obtained
 - (ii) Whether the plan has been “substantially consummated”
 - (iii) Whether the relief requested would affect the rights of parties not before the court or the success of the plan

In re Manges, 29 F.3d 1034, 1039 (5th Cir. 1994).

- **Other circuits have adopted substantially similar tests.**

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Application in Municipal Bankruptcies

- 6th, 9th, 11th Circuits have held that equitable mootness is applicable in chapter 9 cases, in addition to chapter 11 cases.

- ▶ *In re City of Stockton, California*, 909 F.3d 1256 (9th Cir. 2018) (dismissing an appeal from an unstayed chapter 9 plan of confirmation order as equitably moot).
- ▶ *In re City of Detroit, Michigan*, 838 F.3d 792, 803 (6th Cir. 2016) (“The fact that the debtor is a municipality, with state sovereignty, rather than a business enterprise does not reduce the municipal debtor’s rights in bankruptcy.”; “[T]he interests of finality and reliance . . . apply with greater force to the City’s chapter 9 Plan, which affects thousands of creditors and residents.”)

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Application in Municipal Bankruptcies (Cont’d)

- *Bennett v. Jefferson City, Alabama*, 899 F.3d 1240, 1250 (11th Cir. 2018), *reversing Bennett v. Jefferson City, Alabama*, 518 B.R. 613 (N.D. Ala. 2018), *cert. denied sub nom. Bennett v. Jefferson City, Alabama*, 139 S. Ct. 1305 (2019). (“[T]he doctrine [of equitable mootness] is driven by its principles rather than any particular codification or arbitrary limitation Indeed, in ways these principles will sometimes weigh more heavily in chapter 9 context precisely because of how many people will be affected by municipal bankruptcies.”)

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Outlook in Puerto Rico

- No court in the 1st Cir. has considered whether equitable mootness applies in chapter 9 cases.
- All circuit courts (6th, 9th, and 11th Circuits) that have considered the issue have held that equitable mootness applies to chapter 9 cases in addition to chapter 11 cases.
- This issue may be particularly relevant in Puerto Rico's PROMESA Title III cases:
 - (i) given the inter-connectedness of the debtors, reversal of confirmed plan may impact settlement with other debtors;
 - (ii) new securities have been and will be issued under the plans, which when issued will make unscrambling the plans nearly impossible.

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II. Pension Treatment in Municipal Restructurings

Nature of Pension Benefits

- **Accrued benefits are a vested contractual right in the form of deferred compensation rather than a government gratuity or a unilateral employee expectation.**
 - ▶ *Bayron Toro v. Serra*, 119 D.P.R. 605, 19 P.R. Offic. Trans. 646 (1987)
 - The court rejected the “archaic notion that pensions are State gratuities” and held that members of a government retirement system have a vested contractual right that begins when the employee joins the system. *Id.* at 660.
- **Vested pension benefits can be “property interests.”**
 - ▶ *Board of Regents v. Roth*, 408 U.S. 564, 566-67 (1972).
 - The Constitution protects interests “already acquired in specific benefits” and “upon which people rely in their daily lives.”
 - ▶ *Russell v. Dunston*, 896 F.2d 664, 669 (2d Cir. 1990).
 - Termination of contractual right to a pension is a deprivation of property.
- **Whether pensions can be classified as claims subject to modification under a plan may turn on state law.**
 - ▶ In *Detroit*, the court based its treatment of pension rights as claims on the contractual nature of the interest under Michigan law. See *In re City of Detroit, Michigan*, Case No. 13-53846 (TJT) (Bankr. E.D. Mich.), Opinion on Eligibility [ECF No. 1945].

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Pension Classification in Bankruptcy

- **Pension benefits are accrued claims and typically placed in one or more separate classes from other creditors’ claims.**
- **Other post-employment benefit (“OPEB”) claims are not generally viewed as entitled to the same legal protections as pensions. They are usually classified and treated differently, often receiving recovery on par with general unsecured creditors.**

	Pension Recovery in Bankruptcy	Retiree OPEB (i.e., Health Care) Recovery in Bankruptcy
Stockton, California	100%	1%
Detroit (Police & Fire)	100% of pension; 45% of COLA	11%
Detroit (General)	95.5% of pension; 0% COLA	11%
San Bernardino, Calif.	100%	1%

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Pension Claim Calculation

- **Under section 502(b), a bankruptcy court determines the amount of a claim.**
 - ▶ Under § 502(b), the bankruptcy court shall determine the amount of pension liability in “lawful currency of the United States as of the date of the filing of the petition.”
- **It is not clear that pension claims must be discounted to net present value.**
 - ▶ *In re Oakwood Homes Corp.*, 449 F.3d 588, 595 (3d Cir. 2006) (“[Section] 502(b) speaks in terms of determining the “amount” of a claim “as of” the petition date. However, given that the remainder of the Bankruptcy Code uses the term “value, as of” to signify discounting to present value, and “amount” and “value” are not synonymous, we cannot say that § 502(b) clearly and unambiguously requires discounting to present value in all situations.”).
 - ▶ *In re City of Stockton*, 542 B.R. 261, 287 (B.A.P. 9th Cir. 2015) (persuaded by “careful analysis and interpretation of § 502(b)” of *Oakwood Homes*; no discount of healthcare benefit claims to present value in chapter 9 context).
- **If the claim is discounted, recent case law indicates that the PBGC’s approach or a similar annuity-like discount rate is appropriate, not a prudent-investor rate.**
 - ▶ *In re U.S. Airways Grp., Inc.*, 303 B.R. 784, 798 (Bankr. E.D. Va. 2003) (ERISA and PBGC provide acceptable method of calculating claim, and court’s equitable powers and implementation of prudent-investor rate or some alternative is not necessary to avoid unfair result).
 - ▶ *In re Durango Georgia Paper Co.*, No. 02-21669, 2017 WL 221785 (Bankr. S.D. Ga. Jan. 18, 2017) (same).
 - ▶ *But see PBGC v. CF & I Fabricators of Utah, Inc.*, 150 F.3d 1293, 1297–1298 (10th Cir. 1998) (affirming bankruptcy court’s use of the “prudent-investor” valuation method) (ERISA case); *CSC Indus. v. Belfance*, 232 F.3d 505, 509 (6th Cir. 2000) (same).

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III. Municipal Bankruptcies: Confirming a Plan of Adjustment

Important Differences between Chapter 9 / PROMESA and Chapter 11

Plan Confirmation Context

- The “primary purpose of debt restructure for a municipality is not future profit, but rather continued provision of public services.” Mt. Carbon Metro. Dist., 242 B.R. 18, 34 (Bankr. D. Colo. 1999)
- Municipalities cannot be sold or liquidated. In re Richmond Unified Sch. Distr., 133 B.R. 221 (Bankr. N.D. Cal. 1991)
- Municipalities have no equity holders. In re Corcoran Hosp. Dist., 233 B.R. 449 (Bankr. E.D. Cal. 1999)
- No ability for creditors to propose a competing plan

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Confirmation Requirements

- **Section 943(b) of the Bankruptcy Code provides standards for confirmation of a plan of adjustment for a municipal debtor.**
- **Court “shall” confirm the proposed plan if:**
 - 1) The plan complies with the provisions of [the Bankruptcy Code] made applicable by sections 103(e) and 901;
 - 2) The plan complies with the provisions of this chapter;
 - 3) All amounts to be paid by the debtor or by 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)(2) 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 an provision of the plan has been obtained, or such provision is expressly conditioned on such approval; and
 - 7) The plan is in the best interest of creditors and is feasible.

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Confirmation Requirements (Cont'd)

- Even if creditors support the proposed plan, the court “has an independent obligation” to ensure it satisfies the statutory confirmation requirements. In re Valley Health System, 429 B.R. 692 (Bankr. C.D. Cal. 2010).
- If the confirmation requirements are met, confirmation is mandatory. Id.

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943(b)(1): Comply with Other Relevant Provisions of the Bankruptcy Code

- **Section 901 incorporates many of the confirmation requirements of chapter 11, including sections 1122 (classification), 1123 (contents of a plan), and 1129 (confirmation requirements)**
 - ▶ § 1122 – Classification. As a general rule, the same requirements that apply in chapter 11 apply in chapter 9 (i.e., legal nature of claim is determined vis-a-vis the debtor; no gerrymandering; and there must be a business or economic justification for separate classification). Therefore, differences among circuits in their application of these rules will likely control more than any difference between chapter 9 and chapter 11.
 - In Stockton, the 9th Circuit BAP upheld the classification the unsecured claim of Franklin, a bondholder, together with all other unsecured claims, with the result that Franklin's claim was swamped by the class's overall vote in support of the plan. City of Stockton, California, 542 B.R. 261 (B.A.P. 9th Cir. 2015)
 - ▶ § 1123 – Contents of a Plan. section 1123 requires the plan to designate (under section 1122) various classes of claims, to identify the classes that are impaired, and to specify the treatment of impaired classes. Section 1123 also requires that a plan provide the same treatment to all members of a class (unless the holder of a particular claim agrees to less favorable treatment)
 - These requirements apply equally in chapter 9 as in chapter 11.
- **§ 1129(a)(3) – Proposed in Good Faith and not by Means Forbidden by Law. Courts have generally looked to cases decided under chapter 11 or chapter 13 in interpreting the requirement of good faith. In re Pierce County Housing Authority, 414 B.R. 702 (Bankr. W.D. Wash. 2009).**
 - ▶ In Pierce, plan restrictions precluding a creditors' committee from investigating potential sources of recovery – including from third parties – and choosing its own counsel were inconsistent with a true desire to modify debt by maximizing creditor recovery and, therefore, were not in good faith

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943(b)(7): Best Interests of Creditors and Feasibility

- **Feasibility:** a “[c]hapter 9 plan is feasible where it offers a reasonable prospect of success and is workable.” *In re Hardeman County Hospital Dist.*, 540 B.R. 229 (Bankr. N.D. Tex. 2015) (citations omitted)
- **In broad strokes, a feasibility analysis in chapter 9 is similar to the analysis in chapter 11: both ask whether the plan promises too much. The different nature and purpose of chapter 9, however, creates important differences**
 - ▶ Because primary goal of chapter 9 is the continued provision of municipal services, a debtor must show “a probability that it will be able to” make payments contemplated by the plan and also that “it can continue to provide public services while” making those payments. *In re Mount Carbon Metropolitan Dist.*, 242 B.R. 18 (Bankr. D. Col. 1999).
 - ▶ This makes feasibility “particularly difficult” for a chapter 9 debtor when the plan contemplates long-term repayment. *Id.*
 - ▶ This is exacerbated by the complexity of municipal debt and its connection to provided services, as well as by the fact that economic forecasting tends to be extremely long-term (frequently 40 years).
 - ▶ In Detroit, the court interviewed and appointed an independent expert “as its expert witness on feasibility.” The expert was tasked with determining whether the plan was feasible and “whether the assumptions that underlie the City’s cash flow projections and forecasts regarding its revenues, expenses and plan payments are reasonable.” *In re City of Detroit*, 524 B.R. 147 (Bankr. E.D. Mich. 2014)

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943(b)(7): Best Interests of Creditors and Feasibility (Cont’d)

- **A chapter 9 plan will not be considered feasible where required payments cannot be made from available funds (i.e., payments are proposed to be made from unavailable funds).**
 - ▶ See *City of Colorado Springs, Spring Creek Gen. Improvement Dist.*, 177 B.R. 684 (Bankr. D. Col. 1995) (payments that would require Trustee to make payments other than as provided in Trust Agreement could not be made).

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943(b)(7): Best Interests of Creditors and Feasibility (Cont'd)

• Best Interests of Creditors: The Test

- ▶ Best interests of creditors in chapter 9 is measured differently than the liquidation analysis of chapter 11.
- ▶ Some courts have noted that the best interests requirement in chapter 9 is “generally regarded as requiring that a proposed plan provide a better alternative for creditors than what they already have. This is often easy to establish,” especially in light of the fact that creditors “often have little possibility of being repaid, especially when the municipality’s debt burden is too high to be retired by taxes.” In re Mount Carbon Metropolitan Dist., 242 B.R. 18, 34 (Bankr. D. Col. 1999). Indeed, the best interests test has been described as a floor, requiring only that the debtor make a reasonable effort at payment of creditors. *Id.*
- ▶ In practice, this means that: a municipality is not expected to sell its assets; that the right to compel a municipality (through a mandamus proceeding) to increase its taxes is an empty right to litigate; that a municipality cannot be operated for the benefit of its creditors; and, ultimately, that the focus of the best interests test should be what a municipality could reasonably pay its creditors while continuing to operate and serve its citizens

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943(b)(7): Best Interests of Creditors and Feasibility (Cont'd)

• Best Interests of Creditors: Which Creditors?

- ▶ Creditors have asserted that the best interests test has not been satisfied because they, as individual creditors, would have done better if the case had been dismissed
- ▶ Certain courts have rejected this argument:
 - Detroit: “Confirmation may not be denied simply because some creditors may do better upon dismissal. The plain language of the statute compels this result. The Court finds that the plan is in the best interests of the creditors as a whole.” 524 B.R. at 217.
 - Stockton: “We conclude that the “best interests” test in chapter 9 considers the collective interests of all concerned creditors in a municipal plan of adjustment rather than focusing on the claims of individual creditors.” 542 B.R. at 286.
 - Hardeman: “The Plan is in the best interests of Creditors because it provides Creditors, as a whole, with a better alternative than dismissal of the chapter 9 Case and indeed provides all that Creditors can reasonably expect under the circumstances.” 540 B.R. at 241.

38

943(b)(7): Best Interests of Creditors and Feasibility (Cont'd)

- **Best interests of creditors and PROMESA section 314(b)(7)**

- ▶ Section 943(b)(7) says simply that plan shall be confirmed if it “is in the best interests of creditors and is feasible.”
- ▶ PROMESA expands on this, providing that best interests of creditors “shall require the court to consider whether available remedies under the non-bankruptcy laws and constitution of the territory would result in a greater recovery for the creditors than is provided by such plan.”
 - Is this different than the test under chapter 9?
 - Perhaps not. PROMESA may simply codify the test developed judicially in chapter 9 cases.
 - For example, in Detroit the court engaged in a lengthy analysis of what state law remedies would be available if the case were dismissed, and whether those remedies would provide a better result than the plan. 524 B.R. 147.

39

Cramdown

Unfair Discrimination

- **1129(b) is incorporated into chapter 9**

- ▶ Cramdown in chapter 11 requires that a plan can be confirmed over the objection of non-accepting class if the plan does not discriminate unfairly and is fair and equitable
 - Unlike the best interests of creditors test (which Congress rewrote for chapter 9), the unfair discrimination test in chapter 9 is taken directly from chapter 11
 - Nonetheless, in Detroit the court rejected three unfair discrimination standards, and concluded that “fairness is a matter of relying upon the judgment of conscience.” 524 B.R. at 256.
 - As applied to chapter 9, this results in “a more flexible standard of unfair discrimination.” Detroit, 524 B.R. at 256.

40

Cramdown (Cont'd)

Unfair Discrimination

- **Justifications for discrimination**

- ▶ In Detroit, the court held that it was fair to discriminate in favor of pension claims because
 - There was a “substantial mission-related justification” to do so, as maintaining relationships with employees (past and present) aided in the city’s mission of providing services to residents and visitors. 524 B.R. at 257.
 - This reasoning is reminiscent of justifications to favor (for example) trade creditors over other creditors in chapter 11
- ▶ Mason v. Paradise Irrigation Dist., 326 U.S. 536, 543 (1946), upheld favorable treatment for the underwriter that made “the [exit] refinancing possible” because it “gives something of value for the preferred treatment which it receives.”

41

Cramdown (Cont'd)

Unfair Discrimination

- **Fair and equitable is the statutory codification of the absolute priority rule**
- **In chapter 9, the absolute priority rule remains in effect for secured creditors (i.e., cramdown requirements of 1129(b)(2)(A)(i)-(iii) must be met)**
- **One court has held that because municipalities have no equity or shareholders, the “absolute priority rule provides unsecured creditors with no protection.” In re City of Detroit, 524 B.R. at 260.**
- **This does not mean that the fair and equitable requirement does not apply to crammed down unsecured creditors.**
 - ▶ The requirement that the plan be fair and equitable “includes” the absolute priority rule. 11 U.S.C. 1129(b)(2); see also Detroit, 524 B.R. at 260.

42

Cramdown (Cont'd)

Fair and Equitable in Chapter 9

- **Colliers takes the position that a chapter 9 plan is fair and equitable if it provides creditors “all that they can reasonably expect under the circumstances.” 6 Collier on Bankruptcy P 943.03 (16th 2019)**
 - ▶ In determining what can reasonably be expected, courts need not take into account future inflation, and the debtor's ability to pay is not based upon the debtor's financial condition after the probable success of the plan or the advent of more fortuitous times. Nor is it reasonable that all taxes should go to payment of debt, and the debtor must still have adequate revenues to continue its operations. *Id.*
- **Plan must be devoid of any misconduct or overreaching, and must be openly arrived at. City of Avon Park, 311 U.S. 138 (1940). This, at the very least, may require full disclosure of all of the benefits and recoveries a creditor will receive under a plan**

43

Cramdown (Cont'd)

Fair and Equitable in Chapter 9

- **Detroit was the first chapter 9 case decided under the Bankruptcy Code to consider application of the fair and equitable rule. 6 Collier on Bankruptcy P 943.03 (16th 2019).**
 - ▶ The court ruled that, in addition to absence of misconduct or overreaching, the court must determine whether there are “circumstances in the case that suggest to the court's conscience that it is fair and equitable to impose the plan on the dissenting creditors against their stated will?” 524 B.R. at 261.
 - This test looks a lot like the test stated by the Detroit court for testing whether any discrimination is unfair
 - ▶ A significant consideration in Detroit was the overwhelming majority of plan support and the fact that the dissenting classes themselves dissented only by a slim majority.

44

Cramdown and PROMESA Section 314(c)

Confirmation for Debtors with a Single Class of Claims

- **PROMESA section 314(c) requires court to confirm a plan if (i) all claims are “substantially similar under” PROMESA section 301(e), (ii) has only one class and that class is impaired, and (iii) was not accepted by that class IF**
 - ▶ The plan is fair and equitable and does not discriminate unfairly with respect to such impaired class
 - This eliminates cramdown requirement that the plan include at least one impaired accepting class
 - ▶ PROMESA section 301(e) directs the Oversight Board (but not the court) that, in applying classification rules of section 1122 of the Bankruptcy Code, it should “consider” whether claims are secured or have priority over other claims
 - Is this different than classification rules under chapter 11?
 - What does it mean to “consider”?
 - Does “priority” refer to priority under bankruptcy law or non-bankruptcy law?
 - ▶ How are the unfair discrimination and fair and equitable requirements applied to a single class plan? Does this contemplate separate recoveries for creditors within the same class?

45

Additional Confirmation Requirement

Professional Fees

- **943(b)(3) requires that “all amounts to be paid by the debtor or any other person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable”**
 - ▶ The most obvious application of this rule is to professional fees
 - ▶ After recognizing a split in the caselaw, the Detroit court held that even though the statute refers to amount “to be” paid, it also applies to payments already made. 524 B.R. at 208
 - Section 943(b)(3) is not incorporated into PROMESA

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IV. Key Differences from Chapter 11 and Chapter 9

Chapter 9 / PROMESA

Chapter 9

- **Provides for chapter 11-type reorganization cases for a municipal debtor**
 - ▶ A "municipality" may file for relief under chapter 9 if it meets eligibility requirements under 11 U.S.C. § 109(c).
 - ▶ "Municipality" is defined as a "political subdivision or public agency or instrumentality of a State," but does not include states. 11 U.S.C. § 101(40).
 - Includes cities, counties, townships, school districts, public improvement districts and revenue-producing bodies that provide services paid for by users rather than by general taxes (such as bridge authorities, highway authorities, and gas authorities)
- **Does not include states**
- **Authorized by 26 states. Other states have no authorization statutes, and at least one, Georgia, explicitly prohibits municipal bankruptcy filings.**

PROMESA

- **2016 US federal law that provides for chapter 9-like cases for U.S. territories**
 - ▶ Applies not only to municipalities but to "State", i.e., Commonwealth
 - ▶ While written more broadly, at present applies only to Puerto Rico (not U.S. Virgin Islands)
- **Court approved "consensual" Title VI restructuring or chapter 9-like Title III**
 - ▶ Puerto Rico and many of its public corporations are the subject of Title VI and Title III cases

PROMESA / Title III

- **PROMESA provides for:**

- ▶ Appointment of an Oversight Board that acts as an entity within the territorial government for which it is established. 48 U.S.C. § 2121
 - Purpose is to provide a method for a covered territory to achieve fiscal responsibility and access to capital markets
- ▶ Formulation of a fiscal plan that is not subject to court order, which must:
 1. Provide for estimates of revenues and expenditures in conformance with agreed accounting standards,
 2. Ensure the funding of essential public services,
 3. Provide adequate funding for public pension systems, and
 4. Provide for the elimination of structural deficits. 48 U.S.C. § 2141.
- ▶ A process for restructuring debt under Title III of PROMESA
- ▶ Expedited procedures for approving critical infrastructure projects

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Chapter 11 / PROMESA

Chapter 11

- **Twin Goals: Rehabilitation AND Protection of creditors against inequitable treatment**
- **Can be commenced involuntarily by creditors to protect their rights**
- **If rehabilitation does not maximize value, a business can be liquidated**

PROMESA

- **Can only be commenced voluntarily by debtor (or at the request of government in the case of Title III)**
- **Creditor key protection is challenging “eligibility” which provides:**
 - ▶ An entity may be a debtor under chapter 9 only if such entity has negotiated in good faith with creditors (with exception). 11 U.S.C. § 109(c).
 - ▶ For Oversight Board to issue a restructuring certification under PROMESA section 206(a)(1), the entity must have made good-faith efforts to reach a consensual deal with creditors.
- **Under PROMESA, debtors’ eligibility cannot be challenged within 120 days after a case is commenced under Title III. 48 U.S.C. § 2164.**
- **Rehabilitation is the only alternative, i.e. liquidation is not an option**

50

Chapter 9 / Title III – Role of Debtor

- **Chapter 9 is a voluntary process intended to protect sovereignty. It is structured to permit the debtor to continue to perform government functions and retain control.**
 - ▶ Due to the severe limitations placed upon the power of the bankruptcy court in chapter 9 cases (required by the Tenth Amendment and the Supreme Court's decisions in cases upholding municipal bankruptcy legislation), the bankruptcy court generally is not as active in managing a municipal bankruptcy case as it is in corporate reorganizations under chapter 11. See *Ashton v. Cameron County Water Improvement Dist. No. 1*, 298 U.S. 513, 532 (1936); *United States v. Bekins*, 304 U.S. 27, 54 (1938)
- **No “estate” is created by the commencement of a chapter 9 / Title III. The debtor continues to act as debtor, not on behalf of an estate**
- **Section 363 does not apply in chapter 9 / Title III. See PROMESA section 301(a), which does not incorporate Bankruptcy Code section 363. Section 363 is also not incorporated into chapter 9.**
 - ▶ Debtor has significant latitude to pay any prepetition creditor at any time (and outside the plan)
 - This can create inequality of creditor distribution not typical in a chapter 11
 - ▶ Debtor may sell assets without court approval. See 11 U.S.C. § 904; 48 U.S.C. § 2165.

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Chapter 9 / Title III – Debtor Control

- **Under chapter 9 and Title III, the debtor or the Oversight Board (as Debtor's representative) has the freedom to:**
 - ▶ Determine whether and when a bankruptcy case will be filed.
 - ▶ File a plan of adjustment during a virtually perpetual exclusive period. 48 U.S.C. § 2172; 11 U.S.C. § 941 (There is no provision in chapter 9 to allow creditors to move to terminate exclusivity or to propose a competing plan if the debtor is incapable of filing its own confirmable plan.)
- **A court may set a deadline for the debtor or the Oversight Board to file a plan of adjustment, although the court has not set any such deadline in the pending Title III cases**
 - ▶ However, in the City of Detroit chapter 9 case, the city filed a voluntary petition for relief on July 18, 2013 and the Bankruptcy Court set a deadline of March 1, 2014 for the city to file a plan. See *First Order Establishing Dates and Deadlines*, U.S. Bankr. E.D. Mi. (Aug. 2, 2013).
- **No examiner or trustee can be appointed (except a trustee for the purpose of pursuing avoidance actions under limited circumstances)**

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Chapter 9 / Title III – Creditors’ Leverage

Bond Structures

- **Special Revenue Bonds: A type of secured bond protected under chapter 9 / Title III**
 - ▶ Typically non-recourse and secured by a stream of revenue flowing from a project
 - ▶ Must fit into Bankruptcy Code definition to receive protections.
 - 5 categories of special revenues listed in section 902(2) of the Bankruptcy Code.
 - Congress intended to “define special revenues to include the revenues derived from a project or from a specific tax levy, where such revenues are meant to serve as security to the bondholders.” H.R. Rep. No. 100-1011, at 6-7 (1988).
 - The legislative history provides examples of “special revenues” including: (a) receipts from the operation of water, sewage, waste or electric systems, (b) highway or bridge tolls, (c) user fees, (d) special excise taxes, including hotel / motel taxes, alcoholic beverage taxes, meal taxes and license fees, and (e) proceeds from project financing.
 - ▶ Not cut off under section 552 of Bankruptcy Code
 - Claims secured by a pledge of “special revenues” are excluded the application of section 552 of the Bankruptcy Code, which cuts off liens on property acquired by the debtor post-petition. 11 U.S.C. § 928(a).
 - But subject to netting under Bankruptcy Code section 928(b), which transforms “gross” pledges into “net” pledges, subject to the debtor’s necessary operating expense. 11 U.S.C. § 928(b).
 - ▶ Typically structured so fully secured by future revenue stream
 - ▶ Section 922(d) provides that the filing of a petition “does not operate as a stay of application of pledged revenues . . . to payment of indebtedness secured by such revenues.”
 - First Circuit recently held that sections 928(a) and 922(d) of the Bankruptcy Code “permit, but do not require, continued payment during the pendency of the bankruptcy proceedings.”

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Chapter 9 / Title III – Creditors’ Leverage (Cont’d)

Bond Structures

- ▶ Liens secured by statutory lien:
 - Certain bonds (including certain “general obligation” recourse bonds) may be secured by a statutory lien
 - A statutory lien, as defined under the Bankruptcy Code and incorporated into Title III, is a “lien arising solely by force of a statute on specified circumstances and conditions. . . .” 11 U.S.C. § 101(53) (emphasis added). The “essence” of a statutory lien is the lack of need for an agreement or judgment to create the lien. See *Peaje Investments LLC v. Puerto Rico Highways & Transp. Auth.*, Nos. 17-2165, 17-2166, 17-2167, 899 F.3d 1, 5–11 (1st Cir. Aug. 8, 2018) (“[A] statute can create a lien outright or it can establish that a lien will attach automatically upon an identified triggering event other than an agreement to grant the lien.”).
 - This lien is also not cutoff by Section 552 of the Bankruptcy Code.
 - Whether over- or under-secured will depend on the extent of the credit enhancement provided by the statutory lien

Note: General obligation bondholders in Detroit and Puerto Rico have asserted secured claims based on the “pledge of full faith and credit” supporting the bonds. This argument was rejected in the Detroit chapter 9 case.

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Creditor Leverage – Access to Capital Markets

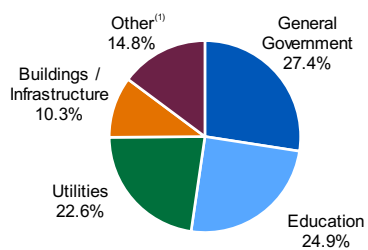
- The most important leverage point for creditors in Title III / chapter 9 is the need for municipal entities to access the capital markets

55

Long Term Municipal Issuance Use of Proceeds

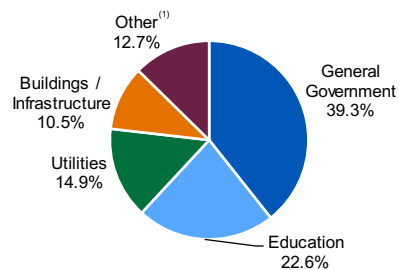
- Financing for General Government, Education and Utilities are the primary reasons municipalities have historically issued debt

2018



Total Issuance: \$320.6BN

Total Outstanding



Total Outstanding: \$3.6TN

Source: SIFMA Municipal Bond Credit Report Fourth Quarter 2018.
 (1) Includes medical, housing and elderly care / retirement

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State Reference Security Trading Yield History



Source: Pricing per Bloomberg as of April 21, 2019.
 (1) Illinois G.O. cash-pay 5.00% due 2025 (452152XUJ0).
 (2) Connecticut G.O. cash-pay 5.00% due 2025 (207722JQ47).
 (3) New Jersey G.O. cash-pay 5.00% due 2026 (546039VQ).

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New Jersey

• Situation overview

- ▶ New Jersey is facing significant financial challenges due to high pension obligations and its struggle to raise revenues.
- ▶ Governor Murphy recently unveiled a strategic plan focused on building a stronger and fairer economy in New Jersey.
- ▶ In February, Governor Murphy took the first steps towards a plan leveraging major state assets to stabilize New Jersey's severely underfunded pension system.

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New Jersey – Revenues and Expenditures (\$MM)

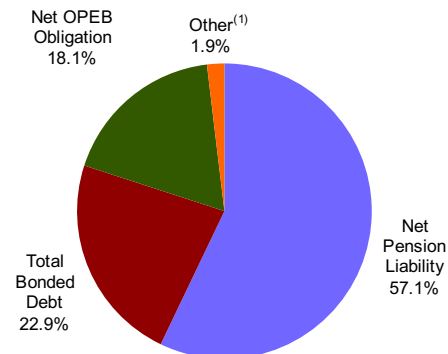
Summary of Revenues and Expenditures			
	2015	2016	2017
Revenues:			
Taxes	\$30,876	\$30,722	\$32,191
Federal and Other Grants	16,089	15,738	15,938
Licenses and Fees	1,460	1,466	1,529
Services and Assessments	3,089	3,219	3,019
Component Units and Port Authority	682	477	641
Investment Earnings	8	20	75
Other	1,278	1,171	1,469
Total Revenues	\$53,483	\$52,813	\$54,861
Expenditures:			
Public Safety and Criminal Justice	(3,283)	(3,303)	(3,211)
Physical and Mental Health	(14,267)	(14,244)	(14,904)
Educational, Cultural and Intellectual Development	(16,399)	(17,191)	(17,718)
Community Dev. And Environmental Management	(2,533)	(2,388)	(2,274)
Economic Planning, Development and Security	(6,480)	(6,244)	(6,283)
Transportation Programs	(2,742)	(2,749)	(2,617)
Government Direction, Management and Control	(6,588)	(7,119)	(7,175)
Special Government Services	(349)	(344)	(345)
Capital Outlay	(253)	(136)	(187)
Debt Service	(1,843)	(2,046)	(2,092)
Total Expenditures	(\$54,737)	(\$55,764)	(\$56,806)
Surplus (Deficit)	(\$1,255)	(\$2,951)	(\$1,945)
<i>% of Revenues</i>	<i>-2.3%</i>	<i>-5.6%</i>	<i>-3.5%</i>

Source: New Jersey FY2017 CAFR.

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New Jersey – Long-Term Obligations (\$MM)

Obligations as of June 30, 2017	
	Amount
Bonds:	
General Obligation	\$2,040
Revenue Bonds, Net ⁽²⁾	20,715
Installment Obligations, Net ⁽²⁾	17,825
Tobacco Settlement Financing, Net ⁽²⁾	3,184
Other Bonds ⁽³⁾	2,337
Total Bonded Debt	\$46,101
Long-Term Obligations:	
Net Pension Liability	\$115,114
Total Bonded Debt	46,101
Net OPEB Obligation	36,494
Other Long-Term Liabilities ⁽¹⁾	3,826
Total Long-Term Obligations	\$201,534



Source: New Jersey FY2017 CAFR.

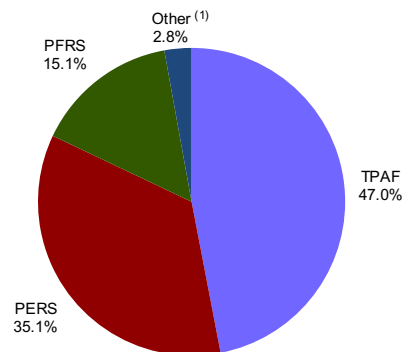
(1) Includes loans payable, compensated absences, capital leases, compensated absences, deposit fund contracts and other liabilities.

(2) Net of unamortized interest in CABs.

(3) Includes capital leases, certificates of participation and unamortized premium.

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New Jersey – Net Pension Liability (\$MM)



Net Pension Liability as of June 30, 2016 ⁽²⁾					
	TPAF	PERS	PFRS	Other ⁽¹⁾	Total
Total Pension Liability	\$101,747	\$85,770	\$49,402	\$6,672	\$243,591
Fiduciary Net Position	(22,718)	(26,762)	(23,985)	(1,883)	(75,348)
Net Pension Liability	\$79,029	\$59,008	\$25,417	\$4,789	\$168,243
Funding Ratio	22.33%	31.20%	48.55%	28.22%	30.93%

Source: New Jersey FY2017 CAFR. TPAF = Teachers' Pension and Annuity Fund, PERS = Public Employees' Retirement System, PFRS = Police and Firemen's Retirement System, CPFPPF = Consolidated Police and Firemen's Pension Fund, JRS = Judiciary Retirement System, POPF = Prison Officers' Pension Fund, SPRS = State Police Retirement System.

(1) Includes CPFPPF, JRS, POPF and SPRS.

(2) FY2017 net pension liability breakdown not provided.

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Illinois

• Situation overview

- ▶ Illinois is the worst-rated state in the municipal market.
- ▶ The poorly funded public pension system along with other financial challenges have sparked several downgrades over the years.
- ▶ Pension reform is critical to the financial future of Illinois. Lawmakers are currently considering a pension proposal, which will probably feature a voluntary pension buyout program.

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Illinois – Revenues and Expenditures (\$MM)

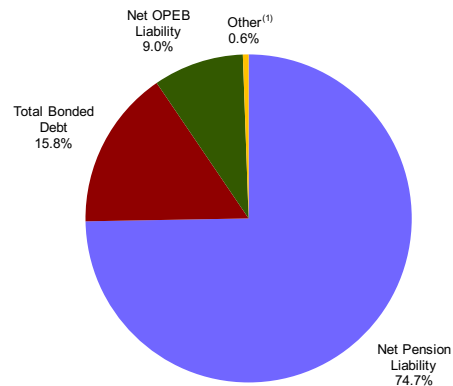
Summary of General Fund Revenues and Expenditures			
	2015	2016	2017
Revenues:			
Income Taxes	\$16,653	\$13,510	\$12,824
Sales Taxes	7,827	7,903	8,048
Public Utility Taxes	1,048	1,012	981
Medical Providers Assessment Taxes	1,412	1,376	1,546
Other Taxes	2,354	2,361	2,347
Federal Government	11,097	11,068	11,231
Licenses and Fees	619	636	645
Interest and Other Investment Income	32	40	54
Other Taxes	1,133	1,170	1,513
Total Revenues	\$42,175	\$39,076	\$39,188
Expenditures:			
Health and Social Services	(22,614)	(21,876)	(23,310)
Education	(13,987)	(13,277)	(13,809)
General Government	(1,983)	(2,095)	(1,959)
Employment and Economic Development	(145)	(98)	(118)
Transportation	(569)	(572)	(555)
Public Protection and Justice	(2,604)	(2,579)	(2,652)
Environment and Business Regulation	(197)	(138)	(166)
Debt Service for Principal	(2)	(2)	(2)
Debt Service for Interest	(1)	(1)	(0)
Capital Outlays	(67)	(39)	(53)
Total Expenditures	(\$42,169)	(\$40,675)	(\$42,624)
General Fund Surplus (Deficit)	\$6	(\$1,599)	(\$3,436)
<i>% of Revenue</i>	<i>0.0%</i>	<i>-4.1%</i>	<i>-8.8%</i>

Source: Illinois FY2017, FY2016 and FY2015 CAFRs.

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Illinois – Long-Term Obligations (\$MM)

Obligations as of June 30, 2017	
	Amount
Bonds:	
General Obligation Bonds	\$24,751
Special Obligation Bonds	2,533
Revenue Bonds	1,068
Plus: Premiums / Discounts	609
Total Bonded Debt	\$28,960
Other Long-Term Liabilities:	
Net Pension Liability ⁽²⁾	\$137,386
Net OPEB Liability	16,485
Other ⁽¹⁾	1,041
Total Other Long-Term Liabilities	\$154,911
Total Primary Government Liabilities	\$183,872



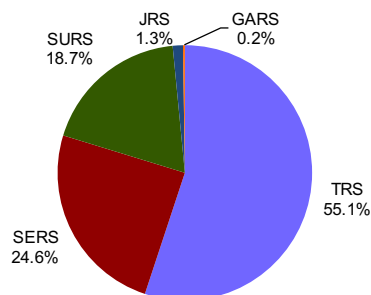
Source: Illinois FY2017 CAFR.

(1) Includes pollution remediation obligation, auto liability, certificates of participation and capital lease obligations.

(2) Net of liquidated liabilities.

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Illinois – Net Pension Liability (\$MM)



Net Pension Liability as of June 30, 2016⁽¹⁾

	TRS ⁽²⁾	SERS	SURS ⁽³⁾	GARS	JRS	Total
Total Pension Liability	N/A	\$49,184	N/A	\$374	\$2,638	N/A
Fiduciary Net Position	N/A	(15,039)	N/A	(49)	(840)	N/A
Net Pension Liability	\$76,334	\$34,145	\$25,965	\$325	\$1,797	\$2,122
Funding Ratio	N/A	30.58%	N/A	13.13%	31.86%	

Source: Illinois FY2017 CAFR. GARS = General Assembly Retirement System. JRS = Judges' Retirement System. SERS = State Employees' Retirement System. TRS = Teachers' Retirement System. SURS = State Universities Retirement System.

(1) FY2017 net pension liability breakdown not provided.

(2) TRS is an administrator of a cost-sharing multiple-employer defined benefit pension plan. As a non-employer contributing entity, at June 30, 2017, the primary government reported a liability of \$76.281 billion for its proportionate share of the collective net pension liability for the TRS plan.

(3) SURS is an administrator of a cost-sharing multiple-employer defined benefit pension plan. At June 30, 2017, as a non-employer contributing entity, the primary government reported a net pension liability of \$25.965 billion.

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Connecticut

• Situation overview

- ▶ Recently, there have been signs of fiscal progress.
- ▶ Under the 2019-2020 budget plan, the state is projected to contribute \$45.6 million to pay off GO debt.
- ▶ Hartford's issuer ratings was upgraded from B2 to B1 in March due to lean government spending and new cost-saving labor contracts.

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Connecticut – Revenues and Expenditures (\$MM)

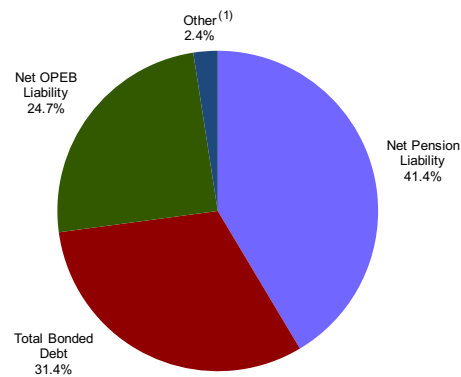
Summary of General Fund Revenues and Expenditures			
	2016	2017	2018
Revenues:			
Taxes, Net of Refunds	\$15,155	\$15,056	\$17,065
Casino Gaming Payments	266	270	273
Licenses, Permits and Fees	297	275	306
Other	366	523	416
Federal Grants	1,302	1,325	1,143
Refunds of Payments	(60)	(44)	(61)
Operating Transfers In	451	447	449
Operating Transfers Out	(62)	(58)	(58)
Transfer to BRF - Volatility Adjustment	-	-	(1,471)
Transfer to/from the Resources of the General Fund	67	(91)	136
Total General Fund Revenues	\$17,781	\$17,703	\$18,199
Expenditures:			
Legislative	(\$74)	(\$67)	(\$64)
General Government	(627)	(585)	(648)
Regulation and Protection	(289)	(274)	(260)
Conservation and Development	(195)	(181)	(181)
Health and Hospitals	(1,766)	(1,190)	(1,163)
Transportation	-	-	-
Human Services	(3,102)	(3,625)	(4,292)
Education, Libraries and Museums	(5,122)	(5,004)	(5,025)
Corrections	(1,463)	(1,397)	(1,382)
Judicial	(598)	(552)	(529)
Non Functional	(4,686)	(4,888)	(5,067)
Total General Fund Expenditures	(\$17,921)	(\$17,763)	(\$18,611)
General Fund Surplus (Deficit)	(\$140)	(\$60)	(\$412)
<i>% of Revenue</i>	<i>-0.8%</i>	<i>-0.3%</i>	<i>-2.3%</i>

Source: Connecticut FY2018, FY2017 and FY2016 CAFRs.

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Connecticut – Long-Term Obligations (\$MM)

Obligations as of June 30, 2018	
	Amount
Bonds:	
General Obligation	\$18,763
Transportation	5,540
Plus: Premiums	1,919
Total Bonded Debt	\$26,223
Other Long-Term Liabilities:	
Net Pension Liability ⁽²⁾	\$34,566
Net OPEB Liability	20,591
Other ⁽¹⁾	2,036
Total Other Long-Term Liabilities	\$57,194
Total Primary Government Liabilities	\$83,417



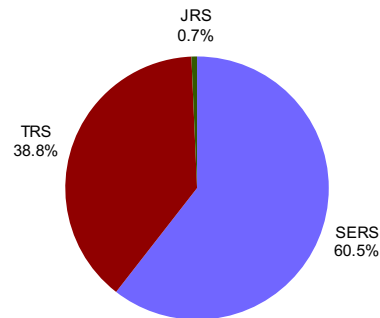
Source: Connecticut FY2018 CAFR.

(1) Includes workers' compensation, non-exchange financial guarantees, compensated absences, claims and judgments, landfill post closure care, capital leases, contracts payable & other and liability on interest rate swaps.

(2) Excludes net pension obligations allocated to component units.

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Connecticut – Net Pension Liability (\$MM)



Net Pension Liability as of June 30, 2017 ⁽¹⁾				
	SERS	TRS	JRS	Total
Total Pension Liability	\$33,053	\$30,637	\$448	\$64,138
Fiduciary Net Position	(11,982)	(17,134)	(210)	(29,326)
Net Pension Liability	\$21,071	\$13,503	\$238	\$34,812
Funding Ratio	36.25%	55.93%	46.88%	45.72%

Source: Connecticut FY2018 CAFR. SERS = State Employee Retirement System. TRS = Teachers' Retirement System. JRS = Judicial Retirement System. FY2018 net pension liability breakdown not provided.

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V. Title VI

Overview of Title VI

- Title VI of PROMESA allows voluntary “Qualifying Modifications” of bond debt (or other financial debt) through a collective action mechanism that binds dissenting creditors to an agreement reached with a super-majority of creditors.
- The Title VI process was successfully used to restructure the debt obligations of the Government Development Bank of Puerto Rico in the total amount of over \$4.5 billion.

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Voluntary Agreements

- If a “Voluntary Agreement” (i.e., a Restructuring Support Agreement) exists between a government issuer and a bondholder group, the Oversight Board must certify that the agreement conforms to the issuer’s certified fiscal plan and provides for a sustainable level of debt (or is limited to an extension of principal and interest payments for one year).
- Thereafter, the Oversight Board must certify the Voluntary Agreement as a “Qualifying Modification” under either the “Voluntary Agreement Process” or “Consultation Process.”
 - ▶ Under the Voluntary Agreement Process, to obtain Oversight Board certification, each creditor in a class or “Pool” must be offered the same consideration and the RSA must be executed by a majority of bondholders.
 - ▶ Under the Consultation Process (i.e., where there is no consensus from a majority of bondholders), the Oversight Board must also find that the proposed modification is in the best interests of the creditors and is feasible.

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Classification of Claims

- **Bond Claims are classified in separate Pools based upon whether they are**

- ▶ General obligations subject to issuer's "full faith and credit,"
- ▶ Secured,
- ▶ Senior or junior in priority,
- ▶ Senior or subordinated, or
- ▶ Guaranteed by the Commonwealth.

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Solicitation and Certification

- **After certification as a Qualifying Modification, the agreement is solicited to all bondholders for their approval.**
- **The Qualifying Modification is approved if:**
 1. At least a majority of the principal amount in each Pool votes in favor, and
 2. Of those who actually vote, at least 2/3 vote in favor
- **The Qualifying Modification only becomes effective after the Oversight Board certifies that the voting requirements have been met and the District Court enters an order approving that the Qualifying Modification satisfies the requirements of Title VI.**

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Distinctions from Title III

- Expedited process with limited judicial review;
- No creditors' committee appointed;
- Can only restructure financial debt; and
- A modification can be proposed by the Commonwealth or a designated public entity or such entity's bondholders (i.e., no per se exclusivity for the Government).