Published on *The National Law Review* https://natlawreview.com

Chapter 9: An Rx for Health Care Districts and Public Hospital Authorities?

Article By:

Timothy R. Casey

Four (4) recent chapter 9 cases by a public health care district in the Northern District of California and by local hospital authorities in Kentucky, Oklahoma and Texas—raise the issue whether chapter 9 may increasingly be seen as a means for public hospitals facing financial distress to restructure (or adjust) their debts. Since the beginning of 2003, seventeen (17) health care districts and hospital authorities have sought to adjust their debts through chapter 9 proceedings.[1] Seven (7) of those cases have been filed since June 1, 2011. Of the seventeen health care district and hospital authority chapter 9 debtors who have filed since the beginning of 2003, eleven (11) successfully confirmed a plan of adjustment, one was dismissed as being ineligible to file for chapter 9, one was dismissed after nearly nine (9) years of chapter 9 protection for failure to prosecute, and four others were either recently filed or have not yet confirmed a plan. Further highlighting the possibility of an increase in chapter 9 filings by public hospital authorities and health care districts is a recent letter to Congress from the National Rural Hospital Association, warning that a proposed recommendation contained in an August 15, 2013 report by the Office of the Inspector General of the Department of Health and Human Services could cause many rural hospitals to lose their designation as critical "necessary providers," which in turn would result in those hospitals no longer being eligible to receive preferential (i.e., 101%) Medicare reimbursements.[2]

Reasons for Filing

In their pleadings filed with the bankruptcy court these seventeen entities cite a wide range of reasons for the financial distress which led them to seek to adjust their debts through chapter 9 of the Bankruptcy Code over the last decade. Several indicated that they were small rural or suburban hospitals that faced immense financial pressures, including frequent changes to and/or reductions in government and insurance reimbursement rates, service populations with a significant number of uninsured or underinsured persons resulting in substantial charity care and bad debt expenses, the cost of complying with new regulatory requirements, and an inability to generate sufficient patient volumes to be able to invest in updated equipment and technology and to attract and retain specialists and other staff. At least two entities noted the loss of financial assistance from the county governing body, while two others cited the failure or frustration of ballot initiatives to authorize a bond issuance or the sale of a distressed health care entity or a hospital district tax to provide a consistent revenue stream. Others cited poor management or aggressive plans for expansion that were ultimately unsustainable because of inadequate revenues. For still others, consequences arising from the termination of a management agreement—either the resulting claims of the terminated management entity or a drop-off in billing and collections because of the health care provider's own lack of expertise in an area previously handled by the management entity—were noted as reasons contributing to the filing of a chapter 9 petition. Only one entity cited obligations to employees under current collective bargaining agreements as a reason for seeking chapter 9 protection.

This article examines some of the ways in which chapter 9 differs from chapter 11, the traditional chapter for business reorganizations, and how those differences may translate into advantages or disadvantages for health care districts and public hospital authorities contemplating chapter 9 bankruptcy.

Chapter 9 affords several advantages to a would-be municipal debtor:

- No provision for creditors to file an involuntary bankruptcy petition against a municipality
- No provision for creditors to file a competing plan of adjustment
- Less onerous procedure and more-lenient legal standard for rejecting collective bargaining agreements
- Limitations on the authority of Bankruptcy Courts to interfere with political or governmental powers, property or revenues, or income-producing property of chapter 9 debtors
- Subordination of lien on special revenues to necessary operating expenses of the project or system

But Chapter 9 also involves several burdens that a Chapter 11 debtor would not face:

- More burdensome eligibility requirements
- Continuation of indenture trustee and/or bondholders' liens on special revenues acquired by the debtor postpetition
- More difficult to cram down confirmation of plan of adjustment over objection of secured creditors

Eligibility for Chapter 9

In general an entity must meet a higher standard for eligibility under chapter 9 of the Bankruptcy Code. Section 109(c) of the Bankruptcy Code sets forth the criteria that an entity must meet in order to be a debtor under Chapter 9:

1. entity must be a municipality;
2. entity must be specifically authorized, in its capacity as a municipality or by name, to be a debtor under Chapter 9 by State law or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under Chapter 9;

3. entity must be insolvent;

4. entity must desire to effect a plan to adjust its debts; and

5. entity must either (a) have obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under Chapter 9, (b) have negotiated in good faith with creditors and have failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under Chapter 9, (c) be unable to negotiate with creditors because such negotiation is impracticable, or (d) reasonably believe that a creditor may attempt to obtain a transfer that is avoidable as a preference under section 547 of the Bankruptcy Code.

11 U.S.C. § 109(c). As noted in a recent decision in *In re City of Stockton*, “Chapter 9 is unique among voluntary Bankruptcy Code cases in that a municipality must litigate its way to the order for relief before restructuring its debt. . . . . Such a proceeding is like a qualifying round in a competition; success leads only to the main event – the process of achieving a viable plan of adjustment” (*In re City of Stockton, California*, 493 B.R. 772, 776 (Bankr. E.D. Cal. 2013). A number of courts have held that “§109(c)’s eligibility requirements [should be construed broadly in order] in to provide access to relief in furtherance of the [Bankruptcy] Code’s underlying policies.” *See*, *In re Valley Health Sys.*, 383 B.R. 156, 163 (Bankr. C.D. Cal. 2008), *Int’l Ass’n of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo),* 408 B.R. 280, 289 (9th Cir. BAP 2009), *In re Pierce County Housing Auth.*, 414 B.R. 702,710 (Bankr. W.D. Wash, 2009), *In re Suffolk Regional Off-Track Betting Corp. d/b/a Suffolk OTB*, 462 B.R. 397 (Bankr. E.D.N.Y. 2011).

The Entity Must Be a Municipality

The first eligibility requirement for an entity seeking to be a debtor under Chapter 9 is that such entity be a municipality. Pursuant to section 101(40) of the Bankruptcy Code the term “municipality” means a political subdivision or public agency or instrumentality of a State. The Bankruptcy Code does not define the terms “political subdivision,” “public agency” or “instrumentality” of a state.

Municipality Must Be Specifically Authorized to Be a Debtor

The second eligibility requirement is that the municipality must be specifically authorized in its capacity as a municipality or by name, by state law or by a governmental officer or organization empowered by state law to make such authorization, to be a debtor under Chapter 9. Currently, eleven (11) states provide blanket authorization for municipalities to file for Chapter 9.[3] Sixteen (16) states have authorized municipal bankruptcy filings subject to certain conditions.[4] Such conditions include: written consent of the governor and/or other state officials (Connecticut, Kentucky, Louisiana, Ohio, Pennsylvania), limitation upon the types of municipal entities that may file for Chapter 9 (Colorado, Idaho, Illinois, Oregon), requirement that the filing entity have adopted a resolution authorizing the filing (Idaho, Montana, Washington), written approval by the governor after adoption of a resolution by a majority of the governing body of the local government declaring a financial emergency to exist and indicating that the emergency jeopardizes the health, safety and welfare of residents (Michigan),[5]prior oversight by a specially-appointed financial planning commission or emergency manager, which may then recommend a chapter 9 filing (Illinois and Michigan (approval of the governor also required)[6]), limitation upon the type of debt that can be adjusted in chapter 9 (Iowa, Pennsylvania), and pre-approval by a permanent state commission that has responsibility for local governments or municipal finance (New Jersey, New York, North Carolina). Rhode Island permits a receiver appointed by the state director of revenue to file a chapter 9 petition on behalf of the city or town for which it acts as receiver.[7] Georgia specifically prohibits municipalities from filing for Chapter 9, while twenty-one (21) other states provide no specific authorization for municipal bankruptcies, which means, that municipalities in those states are ineligible to file.[8] If a municipality is not specifically authorized to be a debtor, it is ineligible to be a debtor under chapter 9, and chapter 11 is likely to be unavailing also. To be eligible for chapter 11, an entity must be "a person that may be a debtor under chapter 7." 11 U.S.C. § 109(d). And governmental units are specifically excluded from the definition of "person" in Bankruptcy Code section 101. As the Bankruptcy Court in *In re Hosp. Auth. of Charlton County* explained:

The reality is that not every entity is entitled to relief from its debts through bankruptcy. Some entities . . . may not be eligible for chapter 9 or chapter 11 relief. "Congress did not intend that the Bankruptcy Code could solve all problems, least of all the financial problems of governmental units." (internal citations omitted)

Thus, some health care districts and hospital authorities seeking to restructure or adjust their debts may be faced with a conundrum. Without specific authorization, they are ineligible to file under chapter 9, while as "governmental entities" they are also ineligible to file under chapter 11. Such entities may simply be unable to avail themselves of the federal bankruptcy laws and may need to resort instead to state laws providing for the appointment of a receiver or for an assignment for the benefit of creditors or to legislative or administrative solutions to address their financial distress, such as appropriations from the state legislature or changes in reimbursement formulas.

Municipality Must Be Insolvent

The third eligibility requirement is that the municipality be insolvent. Insolvent as defined in the Bankruptcy Code, means, with reference to a municipality, that the municipality is (i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute, or (ii) unable to pay its debts as they become due.[9] The court overseeing the *City of Stockton* chapter 9 bankruptcy recently addressed the insolvency eligibility requirement for putative municipal debtors at some length. The *Stockton* court noted that three types of insolvency inform the analysis of §109(c)(3), i.e., the insolvency eligibility requirement: cash insolvency, budget insolvency and service delivery insolvency.[10] *In re City of Stockton*, 493 B.R. 772, 788 (Bankr. E.D. Cal. 2013).
The *Stockton* court concluded that "when a municipality lacks the funds to pay its contractual obligations within the current or next succeeding fiscal year, it is unable to pay its debts as they become due within the meaning of § 101(32)(C)," which is cash insolvency. *Id.* at 789. The court emphasized that "a municipality need not be actually out of cash before it is cash insolvent" and that a municipality may be cash insolvent, thus satisfying the insolvency requirement for filing for chapter 9, even though the municipality's projections indicate that the point at which it would actually run out of cash may "be after the next succeeding fiscal year." *Id*. at 788. According to the *Stockton* court, while cash insolvency is the controlling chapter 9 criterion for insolvency, budget insolvency (longer-term and persistent budget imbalance) and service delivery insolvency (focusing on the municipality's ability to pay for all the costs of providing services at the level and quality required for health, safety and welfare of the community) also inform a trier of fact's "assessment of the relative degree and likely duration of cash insolvency." *Id*. at 789. Service delivery insolvency is evidence that cash insolvency is "not a mere technical insolvency," while budget insolvency is probative of the fact that "insolvency would persist without realignment of revenues and expenses." *Id*. at 791.

Municipality Must Desire to Effect a Plan of Adjustment

The provisions of Chapter 9 limit the authority that a Bankruptcy Court may exercise over a municipal debtor. This limitation derives ultimately from the Tenth Amendment to the United States Constitution. Section 903 of the Bankruptcy Code states that Chapter 9 "does not limit or impair the power of a State to control by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of the municipality, including expenditures for such exercise." And Section 904 of the Bankruptcy Code states that "[n]otwithstanding any power of the [Bankruptcy Court], unless the debtor consents or the plan so provides, the [Bankruptcy 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." Thus courts have held that municipal debtors do not need Bankruptcy Court authorization to retain counsel or other professionals[11] nor do municipal debtors need specific court approval to pay the fees and expenses of retained professionals, although Section 943(b)(3) requires that in order for a plan of adjustment of debts to be confirmed, "all amounts to be paid by a debtor or by any person for services or expenses in the case or incident to the plan" be fully disclosed and reasonable.

Municipality Must Have Negotiated with Creditors Prior to Filing

To satisfy this eligibility requirement, a municipal debtor must demonstrate (1) approval of a plan of adjustment prior to the bankruptcy filing by a majority of creditors whose claims the municipal debtor proposes to impair pursuant to said plan of adjustment, (2) that it negotiated in good faith with its creditors but was unable to obtain approval of a plan of adjustment prior to the bankruptcy filing, (3) that it did not negotiate with its creditors because such negotiations were "impracticable" or (4) that it did not negotiate with its creditors because it reasonably believed that a creditor might seek to obtain a preferential payment or transfer from the municipality. The court in *In re City of Stockton* recently ruled that section 109(c)(5)(B)'s "good faith" negotiation requirement applies to both the putative municipal debtor as well as its creditors.[12]

While the issue of eligibility has been hotly contested in several chapter 9 cases, particularly in the cases of some of the more prominent municipalities that have sought protection under chapter 9 in recent years (e.g., City of Detroit, City of San Bernardino, City of Stockton, City of Harrisburg, PA, Jefferson County, AL), eligibility was challenged in only three (3) of the seventeen (17) chapter 9 cases involving health care districts and hospital authorities filed since 2003.[13] In only one of those cases, was the challenge fatal; with respect to the other two, in one case, the court overruled an indenture trustee's objection to eligibility and in the other case, the debtor and the objector entered into a stipulation that resolved several disputes between the parties and resulted in the withdrawal of the eligibility objection. The particular eligibility criteria that were challenged in these cases were: lack of specific authorization to be a debtor under chapter 9 (*In re Hosp. Auth. of Charlton County*), failure to prove that the debtor was unable to negotiate with creditors prior to filing because such negotiation would have been impractical (*In re Valley Health Sys.*), and failure to prove that the entity was insolvent, that the entity desired to effect a plan of adjustment and that the petition was filed in good faith (*In re Mendocino Coast Health Care District*).

Bankruptcy Court's Limited Authority Over Chapter 9 Debtors

Both the Tenth Amendment to the U.S. Constitution and Sections 903 and 904 of the Bankruptcy Code limit the authority that Bankruptcy Courts can exercise over chapter 9 debtors and act to protect state sovereignty. The Tenth Amendment states that "The Powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."[14] Section 903 of the Bankruptcy Code provides:

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 of the Bankruptcy Code provides:

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.

The Bankruptcy Court presiding over the chapter 9 case of City of Stockton, California recently interpreted Section 904's limitations on the courts' authority as follows:

[The section's] preambular language . . . is so comprehensive that it can only mean that a federal court can use no tool in its toolkit – no inherent authority power, no implied equitable power, no Bankruptcy Code § 105 power, no writ, no stay, no order – to interfere with a municipality regarding political or governmental powers, property or revenues, or use or enjoyment of income-producing property. . . . . In short, the § 904 limitation on the court's authority is absolute, with only the two exceptions stated in § 904: consent; and provision in a plan of adjustment. *In re City of Stockton*, 478 B.R. 8, 20 (Bankr. E.D. Cal., 2012).

The limited authority of the Bankruptcy Courts in chapter 9 cases is further reflected in the fact that Section 901 of the Bankruptcy Code sets forth a discrete list of seventy-one (71) other provisions of the Bankruptcy Code that are applicable to cases under chapter 9. Among the Bankruptcy Code provisions that are not included in Section 901's list are §§ 327, 328, 330 and 331 relating to the retention, employment and compensation of professional persons. Accordingly, Bankruptcy Courts have held that court authorization is not required in order for a chapter 9 debtor to retain professional persons.[15] In addition, municipal debtors may generally pay prepetition vendors and suppliers, use, lease or sell property, obtain new secured or unsecured financing, and conduct other transactions outside of the ordinary course of business all without Bankruptcy Court approval.

Some municipal debtors have even argued that Congress' deliberate exclusion of § 331 from the ambit of chapter 9 and the broad limitations on a Bankruptcy Court's authority to interfere with a municipal debtor's political or governmental powers, its property or revenues and its use and enjoyment of any income-producing property bar the Bankruptcy Court from compelling chapter 9 debtors to pay compensation to committee professionals. At least two courts, however, have concluded that they had the statutory authority to order a chapter 9 debtor to pay the legal fees and expenses of a creditors' committee as administrative expenses under a confirmed plan. These courts have reasoned that section 943(b), which governs the requirements for confirmation of a chapter 9 plan, requires a court to confirm a chapter 9 plan if the plan provides for payment of section 507(a)(2) claims on the effective date, that the inclusion of section 507(a)(2) in section 943(b) necessarily implies that administrative claims under section 503(b) be afforded priority, that administrative expenses under section 503(b) include compensation and reimbursement awarded under section 330(a), that section 330(a) provides for the allowance and award of fees and expenses incurred by professionals employed pursuant to section 1103, and, finally, that sections 1102 and 1103 are made applicable to chapter 9 bankruptcy cases pursuant to section 901(a).[16]

Treatment Afforded to "Special Revenues" in Chapter 9

In a chapter 11 case, property acquired by the estate or the debtor after the petition date is not subject to liens created by security agreements entered into by the debtor before the petition date. 11 U.S.C. § 552(a). In a chapter 9 case, however, *special revenues*collected or received by the debtor after the petition date continue to be subject to prepetition liens. Specifically, section 928(a) states:

Notwithstanding section 552(a) of this title and subject to subsection (b) of this section, special revenues acquired by the debtor after the commencement of the case shall remain subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case.

"Special revenues" are defined in section 902 of the Bankruptcy Code and encompass, among other things, "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."[17] In the case of public hospitals and health care districts, this typically refers to the gross revenues or net revenues generated by such entities that are used to repay the special revenue bonds issued to finance significant capital projects by such hospitals and health care entities. Thus the special revenues referred to in sections 902 and 928 of the Bankruptcy Code have special application to public health care entities because revenue bonds are frequently used as a means of financing health care projects. By contrast, the other major type of debt issued by municipalities—general obligation bonds, which are payable from the general revenues of a municipality rather than from the revenues generated by a specific project and are backed by the full faith and credit of the municipality—do not enjoy the special treatment afforded by section 928(a).[18]

Section 928(a)'s extension of lien rights is limited, however, by section 928(b), which states that "any such lien on special revenues [referred to in Section 928(a)], other than municipal betterment assessments, derived from a project or system shall be subject to the necessary operating expenses of such project or system, as the case may be." In other words, section 928(b) subordinates bondholders' or indenture trustee's continuing lien on postpetition special revenues to a debtor's "necessary operating expenses." The term "necessary operating expenses" is not defined in the Bankruptcy Code. The legislative history, however, suggests that the term is to be construed narrowly.[19] Given the right of chapter 9 debtors to access and use postpetition special revenues for "necessary operating expenses," some secured creditors, including bondholders and indenture trustees, may seek adequate protection (as defined in section 361 of the Bankruptcy Code) in order to protect against the diminution of the value of their collateral from and after the petition date.

Finally, section 922(c) of the Bankruptcy Code includes an important exception to the Bankruptcy Code's automatic stay provision, which exception allows special revenues to continue to be applied to the payment of principal and interest on public bond debt during the pendency of a chapter 9 case. Thus indenture trustees can continue to apply pledged funds to principal and interest and to make distributions to bondholders without violating the automatic stay.

Rejecting Collective Bargaining Agreements

The Bankruptcy Code generally allows a debtor to reject burdensome executory contracts, which according to the widely accepted definition of Professor Vern Countryman are contracts "under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach, excusing performance of the other."[20] In most cases, a collective bargaining agreement between a debtor and a labor union would be classified as an executory contract.[21] A chapter 11 debtor wishing to reject a collective bargaining agreement with a labor union must satisfy the requirements of section 1113 of the Bankruptcy Code, which sets forth the procedural prerequisites that a debtor must meet before being able to reject a collective bargaining agreement as well as the legal standard that the debtor must meet in order for a court to authorize rejection of a collective bargaining agreement. Prior to moving to reject or modify a collective bargaining agreement, the debtor must make a proposal to the employees' representative detailing the need for the modification of the agreement in order to effect a reorganization and assure fair and equitable treatment to all creditors, the debtor and all affected parties. The debtor must provide information necessary to evaluate the debtor's proposal, including balance sheets, profit and loss statements and projections of income and expenses. The Bankruptcy Court may authorize rejection only if it finds that the debtor fulfilled the requirements of section 1113 and that the employees' representative failed to accept the proposal without good cause. Section 1113 makes rejection of a collective bargaining agreement difficult, costly and time consuming.

A chapter 9 debtor, however, does not have to satisfy the requirements of section 1113 because section 1113 has not been made applicable to chapter 9 cases. A chapter 9 debtor seeking to reject a collective bargaining agreement does not need to satisfy the prerequisites set forth in section 1113 and need only satisfy a more-lenient legal standard "that the collective bargaining agreement burdens the estate, and that, after careful scrutiny, the equities balance in favor of rejection of the labor contract."[22] In *Orange County Employees Ass'n v. County of Orange (In re Orange County)*, the Bankruptcy Court held that Congress had deliberately chosen not to make the requirements for rejecting collective bargaining agreements contained in section 1113 applicable to chapter 9 debtors. The Bankruptcy Court also held, however, that the municipal debtor could not unilaterally abrogate the seniority and grievance provisions of its collective bargaining agreements, except as a "last resort," and that California state law imposed an obligation on the municipal debtor "to communicate, meet, confer and negotiate with its employees regarding changes to the terms and conditions of their employment."[23]

More recently, the Mendocino Coast Health Care District was able to modify its employment agreement with the United Food and Commercial Workers (the "UFCW") during the course of the health care district's chapter 9 proceeding after the parties had unsuccessfully attempted to renegotiate the contract prior to the bankruptcy filing. After filing a motion to reject the employment agreement, the debtor ultimately entered into a stipulation with the UFCW that provided for consensual modifications to the employment agreement.[24] According to the recitals contained in the stipulation, the debtor provided the union with proposed modification of the employment agreement that would permit the debtor to successfully confirm a plan of debt adjustment, provided the union with financial and other relevant information necessary to evaluate the proposal, and met with authorized representatives of the UFCW to confer in good faith in attempting to reach mutually satisfactory modifications to the employment agreement. Approximately three weeks thereafter, the debtor and the UFCW entered into an agreement to consensually modify the employment agreement.[25] While Mendocino Coast Health Care District as a chapter 9 debtor was clearly subject to a less exacting legal standard in seeking to reject its collective bargaining agreement with the UFCW, the recitals to the stipulation suggest that the debtor undertook to fulfill some of section 1113's procedural requirements that apply to chapter 11 debtors.

Confirming a Plan of Adjustment

In chapter 9 a debtor proposes and solicits acceptances for a plan of adjustment of debts. The plan of adjustment may be filed contemporaneously with the petition or at such later time as the court may fix. There is no statutory deadline for a debtor to file a plan of debt adjustment in a chapter 9 case, unlike chapter 11 where a debtor has only a 120-day exclusive period (which period may be extended for cause) in which to file a plan before other parties in interest may file a plan. In a chapter 9 case, only the debtor may file a debt adjustment plan; there is no provision for creditors to file competing or alternative plans.

Confirmation of a chapter 9 debt adjustment plan requires that a debtor satisfy the seven criteria set forth in section 943, the first of which is that the debt adjustment plan comply with the other provisions of the Bankruptcy Code made applicable to chapter 9 by sections 103(e) and 901. The other criteria are:

1. the plan complies with the provisions of chapter 9,

2. 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 (in other words, that the plan provide for the payment of administrative claims),

3. the debtor is not prohibited by law from taking any action necessary to carry out the plan,

4. 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 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;

5. 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

6. the plan is in the best interest of creditors and is feasible.

11 U.S.C. § 943. Other provisions of section 1129 (which sets the requirements that chapter 11 debtors must satisfy in order to confirm a plan) made applicable to chapter 9 debtors through section

9.01 include the requirement that the plan of adjustment be proposed in good faith and not by any means forbidden by law, that at least one class of impaired claims shall vote to accept the plan, and that the debtor may cram down a plan over a dissenting class of creditors if the plan complies with the other confirmation requirements of the Bankruptcy Code and does not discriminate unfairly and is fair and equitable with respect to such dissenting class of creditors. The continuing lien provisions of section 928(a), however, make it more difficult for a health care district or hospital authority debtor to cram down a plan of adjustment over the objections of a class of bondholders having a security interest in the special revenues. Lastly, unlike chapter 11 debtors, chapter 9 debtors are not required to prove that confirmation of a proposed plan is not likely to be followed by the need for further financial reorganization.

Conclusion

For health care districts and hospital authorities that operate public hospitals, a chapter 9 filing involves a higher bar of eligibility, although the empirical data suggest health care districts and hospital authorities may perhaps be less likely to have their eligibility contested than other chapter 9 debtors. Once their eligibility to proceed under chapter 9 has been established, however, health care districts and public hospitals (and municipal debtors generally) enjoy several distinct advantages, including greater deference from the courts, particularly with respect to the municipal debtor's political or governmental powers, its property or revenues and its use or enjoyment of income-producing property, less interference from creditors, greater latitude in rejecting burdensome collective bargaining agreements and an ability to use postpetition special revenues to meet necessary operating expenses despite an indenture trustee's continuing lien on such postpetition special revenues.

---

[1] These seventeen are: Coalinga Regional Medical Center, Case No. 03-bk-14147 (E.D. California), Indian Valley Health Care District, Case No. 03-bk-32839 (E.D. California), Watonga Hospital Trust Authority, Case No. 04-bk-10415 (W.D. Oklahoma), Tri-City Mental Health Center, Case No. 04-bk-13167 (C.D. California), West Contra Costa Healthcare District, Case No. 06-bk-41774 (N.D. California), Palm Drive Health Care District, Case No. 07-bk-10388 (N.D. California), Valley Health System, Case No. 07-bk-18293 (C.D. California), Natchez Regional Medical Center, Case No. 09-bk-00477 (S.D. of Mississippi), Sierra Kings Health Care District, Case No. 09-bk-19728 (E.D. California), Lost Rivers District Hospital, Case No. 10-bk-40344 (D. of Idaho), Bamberg County Memorial Hospital, Case No. 11-bk-03877 (District of S.C.), Barnwell County Hospital Case No. 11-bk-06207 (District of S.C.), Hospital Authority of Charlton County, Case No. 12-bk-50305 (S.D. Georgia), Mendocino Coast Health Care District, Case No. 12-bk-12753 (N.D. California), Pauls Valley Hospital Authority d/b/a Pauls Valley Hospital, Case No. 13-bk-10791 (W.D. Oklahoma), Hardeman County Hospital District d/b/a Hardeman County Hospital, Case No. 13-bk-70103 (N.D. Texas), and Adair County Hospital District, Case No. 13-10939 (W.D. Kentucky).

[2] See letter from National Rural Hospital Association to The Hon. Harry Reid, et al., August 15, 2013, available athttp://www.ruralhealthweb.org/go/left/government-affairs/response-to-2013-oig-cah-report.

[3] Alabama (Ala. Code § 11-81-3); Arizona (Az. Rev. Stat. § 35-603); Arkansas (Ark. Code § 14-74-103); California (Cal. Gov. Code § 53760); Florida (Fla. Stat. s. 218.01); Minnesota (Minn. Stat. § 471.831); Missouri (Mo. Rev. Stat. § 427.100); Nebraska (Neb. Code § 13-402); Oklahoma (Okla. Code § 62-283); South Carolina (S.C. Code § 6-1-10); and Texas (Tex. Stat. § 140.001).

[4] http://www.governing.com/gov-data/state-municipal-bankruptcy-laws-policies-map.html.

[5] Local Financial Stability and Choice Act of 2012 (MCL § 141.1566).

[6] *Id*. § 141.1558.

[7] Rhode Island G.L. § 45-9-7.

[8] While Nevada has no specific provisions authorizing municipal bankruptcy, the state does permit the Nevada Tax Commission to provide Technical Financial Assistance to municipalities and, in certain circumstances, to take control of or dissolve local governments.

[9] 11 U.S.C. § 101(32)(C).

[10] This is contrasted with the "balance-sheet insolvency" test used elsewhere in the Bankruptcy Code, which is a financial condition where liabilities exceed assets. *See, e.g.*, 11 U.S.C. § 548(a)(1)(B).

[11] *In re East Shoshone Hospital District*, 226 B.R. 430 (Bankr. D. Idaho 1998).

[12] *In re City of Stockton*, 493 B.R. at 793.

[13] For one of the cases (*In re Coalinga Regional Medical Center*), case documents are no longer available on PACER. The docket, which is still available on PACER, does not indicate any challenges to the debtor's chapter 9 petition.

[14] U.S. Const., amend. X.

[15] *In re East Shoshone Hospital District*, 226 B.R. 430 (Bankr. D. Idaho 1998).

[16] *In re Castle Pines North Metro. Dist.*, 129 B.R. 233, 234 (Bankr. D. Colo. 1991); *In re Pauls Valley Hospital Auth.*, Case No. 13-10791-SAH (Bankr. W.D. Okla.), Jul. 18, 2013, at 9-10. The*Pauls Valley* court, in its finding of "strong statutory support" for the payment of the fees and expenses of committee professionals as part of plan confirmation, went on to state that "[i]t makes little sense to provide for a committee's existence but not also provide for its operation which will necessarily involve the employment and payment of professionals." *Id*. at 11.

[17] Also included in section 902(2)'s definition of "special revenues" are (1) special excise taxes imposed on particular activities or transactions, (2) incremental tax receipts from the benefited area in the case of tax-increment financing, (3) other revenues or receipts derived from particular functions of the debtor, whether or not the debtor has other functions, and (4) 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.

[18] *See, In re County of Orange*, 179 B.R. 185, 192 (Bankr. C.D. Cal.) *aff'd and remanded*, 189 B.R. 499 (C.D. Cal. 1995).

[19] Necessary operating expenses are operating expenses which are necessary to keep the project or system going and producing special income. . . . . Subsection (b) sets forth a minimum standard for paying operating expenses ahead of debt service where revenues are pledged. It is not intended to displace any broader standard contained in the terms of the pledge or applicable non-bankruptcy law. The operating expenses are to be necessary and directly related to the project or the system generating the special revenues and are not the expenses of the public medical facility generally or for other systems or projects. Pub. L. 100-597.

[20] See Vern Countryman, Executory Contracts in Bankruptcy, 57 Minn.L.Rev. 439, 460 (1973).

[21] See *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984).

[22] *Id*. 526. This legal standard was articulated by the U.S. Supreme Court in *Bildisco*. It was in response to the *Bildisco* case that Congress enacted section 1113.

[23] *Orange County Employees Ass'n v. County of Orange*, 179 B.R. 177, 184 (Bankr. C.D. Cal. 1995).

[24] *See* Stipulation Between Mendocino Coast Health Care District and United Food and Commercial Workers 8 Golden State for Assumption of *Memorandum of Understanding*, as Amended, and Order Thereon, entered June 21, 2013 (Dkt. No. 140) (*In re Mendocino Coast Health Care District*, Case No. 12-12753, N.D. Cal.).

[25] *Id*. at 2-3.

Daniel Northrop *also contributed to this article*.

National Law Review, Volume III, Number 287