Municipal Bankruptcies: A Horse of a Different Color

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Erica M. Ryland
Mark G. Douglas

The devastating consequences of the Great Recession for businesses and individuals alike continue to dominate U.S. and world news headlines, as governments around the globe struggle to implement or extend programs designed to jump-start stalled economies and attempt to gauge the health of financial institutions deemed "too big to fail" or otherwise critical to long-term prospects for recovery. Less visible yet increasingly prominent amid the carnage wrought among financial institutions, automakers, airlines, retailers, newspapers, homebuilders, homeowners, and the enduringly unemployed is the plight of U.S. cities, towns, and other municipalities. A reduction in the tax base caused by plummeting real estate values and a high incidence of mortgage foreclosures, questionable investments in derivatives, underfunded pension plans and retiree benefits, and escalating costs (including the higher cost of borrowing due to the meltdown of the bond mortgage industry and the demise of the $200 billion market for auction-rate securities beginning in mid-2007) have combined to create a maelstrom of woes for U.S. municipalities.

One option available to municipalities teetering on the brink of financial ruin is chapter 9 of the Bankruptcy Code, a relatively obscure legal framework that allows an eligible municipality to "adjust" its debts by means of a plan of adjustment that is in many respects similar to the plan of reorganization that a debtor devises in a chapter 11 case. However, due to constitutional concerns rooted in the Tenth Amendment's preservation of each state's individual sovereignty over its

internal affairs, the resemblance between chapter 9 and chapter 11 is limited. One significant difference pertains to a municipal debtor's ability to modify or terminate labor contracts with unionized employees. Another distinction lies in the absence of an "estate" consisting of a municipal debtor's assets that is subject to administration in a chapter 9 case. Both of these issues were highlighted in rulings recently handed down by a California district court and a New York bankruptcy court. In *In re City of Vallejo, California*, the district court affirmed a bankruptcy court ruling that section 1113 of the Bankruptcy Code, which delineates the circumstances under which a chapter 11 debtor can reject a collective bargaining agreement, does not apply in chapter 9, such that it would appear to be easier for a municipal debtor to reject a labor agreement. In *In re New York City Off-Track Betting Corporation*, the bankruptcy court denied a creditor's motion to compel the immediate payment as an administrative expense of sums the municipal debtor was obligated to pay under applicable New York law, ruling that because there is no bankruptcy estate in a chapter 9 case, there can be no expenses of administering the estate allowed under section 503(b) of the Bankruptcy Code.

Municipal Bankruptcy Law

Ushered in during the Great Depression to fill a vacuum that previously existed in both federal and state law, federal municipal bankruptcy law suffered from a constitutional flaw that endures in certain respects to this day—the Tenth Amendment reserves to the states sovereignty over their internal affairs. This reservation of rights caused the U.S. Supreme Court to strike down the first federal municipal bankruptcy law as unconstitutional in 1936, and it accounts for the limited scope of chapter 9, as well as the severely restricted role that the bankruptcy court plays in presiding over a chapter 9 case and in overseeing the affairs of a municipal debtor.

The present-day legislative scheme for municipal debt reorganizations was implemented in the aftermath of New York City's financial crisis and state government bailout in 1975, but chapter 9 has proved to be of limited utility thus far. Few cities or counties have filed for chapter 9 protection. The vast majority of chapter 9 filings have involved municipal instrumentalities, such as irrigation districts, public utility districts, waste-removal districts, and health-care or hospital districts. In fact, according to the Administrative Office of the U.S. Courts, fewer than 600 municipal bankruptcy petitions have been filed in the more than 60 years since Congress established a federal mechanism for the resolution of municipal debts. Fewer than 250 chapter 9 cases have been filed since the current version of the Bankruptcy Code was enacted in 1978.

Access to chapter 9 is limited to municipalities. A "municipality" is defined by section 101(40) of the Bankruptcy Code as a "political subdivision or public agency or instrumentality of a State." Section 109(c) of the Bankruptcy Code sets forth other prerequisites to relief under chapter 9:

- A state law or governmental entity empowered by state law must specifically authorize the municipality (in its capacity as such or by name) to file for relief under chapter 9;
- The municipality must be insolvent;
- The municipality must "desire[] to effect a plan" to adjust its debts; and
- The municipality must either: (a) have obtained the consent of creditors holding at least a majority in amount of the claims in each class that will be impaired under the municipality's intended plan; (b) have failed to obtain such consent after negotiating with creditors in good faith; (c) be unable to negotiate with creditors because negotiation is "impracticable"; or (d) reasonably believe that a "creditor may attempt to obtain" a transfer that is avoidable as a preference.

Prior to 1994, the authorization requirement had been construed to require general authority, rather than specific authorization by name, for a municipality to seek chapter 9 relief. However, the Bankruptcy Reform Act of 1994 amended section 109(c)(2) to require that a municipality be "specifically authorized" to be a debtor under chapter 9. As the bankruptcy court explained in *In re County of Orange* in 1995, courts construing the amended provision have concluded that state law must provide express written authority for a municipality to seek chapter 9 relief and that the authority must be "exact, plain, and direct, with well-defined limits, so that nothing is left to inference or implication."

No other chapter of the Bankruptcy Code includes insolvency among the criteria for relief. "Insolvency" in the context of chapter 9 eligibility does not refer to balance-sheet insolvency. Instead, it requires a showing that as of the filing date, the debtor either: (i) is generally not paying its undisputed debts as they become due; or (ii) is unable to pay its debts as they become due.

The dictate that a municipality "desires to effect a plan to adjust" its debts requires that the purpose of the chapter 9 filing must not be simply to buy time or evade creditors. A debtor need satisfy only one of the disjunctive prefiling negotiation prerequisites set forth in section 109(c)(5), all of which are unique to chapter 9. These requirements were inserted by Congress to prevent capricious chapter 9 filings.

Chapter 9 is also the only chapter of the Bankruptcy Code that expressly incorporates a good-faith filing requirement. Section 921(c) states that "[a]fter any objection to the petition, the court,

after notice and a hearing, may dismiss the petition if the debtor did not file the petition in good faith or if the petition does not meet the requirements of this title." If the court does not dismiss the petition under section 921(c), it "shall" order relief under chapter 9. Notwithstanding its permissive language for dismissal ("may dismiss"), section 921(c) has been construed as requiring the dismissal of a petition filed by a debtor that is ineligible for relief under chapter 9. Dismissal of a chapter 9 case is the only option if the debtor is ineligible—the assets of a chapter 9 debtor cannot be liquidated involuntarily.

Constitutional Compromises

Section 903 of the Bankruptcy Code expressly reserves to the states the power to control municipalities that file for chapter 9 protection, with the caveat—and the significant limitation—that any state law (or judgment entered thereunder) prescribing a method of composition of indebtedness among a municipality's creditors is not binding on dissenters. Section 904 further provides that unless the debtor consents or the plan so provides, the court may not "interfere" with any of the debtor's "political or governmental powers," any of the debtor's property or revenues, or the use or enjoyment of its income-producing property. Thus, unlike a chapter 11 debtor, a municipal debtor is not restricted in its ability to use, sell, or lease its property (section 363 does not apply in a chapter 9 case), and the court may not become involved in the debtor's day-to-day operations. Also, unlike in a case under chapter 7, 11, 12, or 13 of the Bankruptcy Code, a municipal debtor's assets do not become part of the debtor's bankruptcy estate upon the filing of a chapter 9 petition.

Control of a municipal debtor under chapter 9 is not subject to defeasance in the form of a bankruptcy trustee (although state laws commonly provide a mechanism for transferring control

of the affairs of a distressed municipality). A trustee, however, may be appointed to pursue avoidance actions (other than preferential transfers to or for the benefit of bondholders) on behalf of the estate if the debtor refuses to do so. A municipal debtor is not subject to the reporting requirements and other general duties of a chapter 11 debtor.

A chapter 9 debtor enjoys many of the rights of a chapter 11 debtor in possession but is subject to few of the obligations. Pursuant to section 901, many provisions contained elsewhere in the Bankruptcy Code are expressly made applicable to chapter 9 cases. These include, among others, the provisions with respect to the automatic stay; adequate protection; administrative priority or secured postpetition financing; executory contracts; administrative expenses; a bankruptcy trustee's "strong arm" and avoidance powers; financial contracts; the formation of official committees; and most, but not all, of the provisions governing vote solicitation, disclosure, and confirmation of a chapter 11 plan. As discussed in more detail below, the incorporated provisions do not include section 1113, which spells out the circumstances under which a debtor can reject a collective bargaining agreement, or section 541, which provides that an estate consisting of all of the debtor's property is created upon the filing of a bankruptcy petition.

As with chapter 11, the raison d'être of chapter 9 is the confirmation of a plan (either consensual or otherwise), but with one significant difference noted earlier—a municipal debtor may not be liquidated in chapter 9. Only the chapter 9 debtor has the right to file a plan, and indeed is obligated to file a plan, either with its petition or within such time as the court directs. The plan confirmation standards are comparable to those under chapter 11.

If the debtor cannot confirm a plan, the only option available to the court (and creditors) is dismissal of the chapter 9 case. Under section 930, the court may dismiss a chapter 9 case for "cause," which includes unreasonable delay by the debtor that is prejudicial to creditors, failure to propose or obtain confirmation of a plan, or material default under a plan after it has been confirmed. If the court refuses to confirm the debtor's plan (either on the first attempt or after giving the debtor additional time to modify the plan or propose a new one), it "shall" dismiss the chapter 9 case. Dismissal is required in that circumstance even if the debtor is clearly insolvent and the creditors would be better off if the chapter 9 case were not dismissed.

Rejection of Labor Contracts in Bankruptcy

Section 365 of the Bankruptcy Code allows a bankruptcy trustee or chapter 11 debtor in possession to assume or reject most kinds of contracts or agreements that, as of the bankruptcy-filing date, are "executory" in the sense that both parties to the contract have a material continuing obligation to perform. For most kinds of contracts, the bankruptcy court will authorize assumption or rejection, provided it is demonstrated that either course of action represents an exercise of sound business judgment.

Until 1984, courts struggled to determine whether the same standard or a more stringent one should govern the decision to reject a collective bargaining agreement. The U.S. Supreme Court answered that question in 1984, ruling in *NLRB v. Bildisco & Bildisco* that a labor agreement can be rejected under section 365 if it burdens the estate, the equities favor rejection, and the debtor made reasonable efforts to negotiate a voluntary modification without any likelihood of producing a prompt satisfactory solution. The court also held (by a five-to-four majority) that the debtor did not need to follow the contract modification procedures set forth in the National Labor

Relations Act because, for purposes of that act, a collective bargaining agreement in bankruptcy is "no longer immediately enforceable, and may never be enforceable again."

Congress changed that later the same year, when it enacted section 1113 of the Bankruptcy Code in response to a groundswell of protest from labor interests. Section 1113 provides that the court "shall" approve an application to reject a bargaining agreement only if:

- The debtor makes a proposal to the authorized representative of the employees covered by the agreement;
- The authorized representative has refused to accept the debtor's proposal without good cause; and
- The balance of the equities clearly favors rejection of the agreement.

The provision ensures that a chapter 11 debtor-employer cannot unilaterally rid itself of its labor obligations and instead mandates good-faith negotiations with the union before rejection may be approved. To that end, section 1113 carefully spells out guidelines for any proposal presented by the debtor to the authorized labor representative. Underlying these guidelines is the premise that all parties must exercise their best efforts to negotiate in good faith to reach mutually satisfactory modifications to the bargaining agreement and that any modification proposal must treat all creditors, the debtor, and other stakeholders fairly. Each proposal must be based on the most complete and reliable information available and must "provide[] for those necessary modifications in the employees['] benefits and protections that are necessary to permit the reorganization of the debtor."

Section 1113 Inapplicable in Chapter 9

Section 1113, however, does not apply in chapter 9 cases—it was conspicuously omitted from the list of Bankruptcy Code provisions incorporated into chapter 9 under section 901. Although the reason for the omission is unclear, commentators have suggested that Congress excluded the provision due to constitutional concerns, opting to leave to the states, when authorizing municipalities to resort to chapter 9, the decision as to whether and under what circumstances a collective bargaining agreement with a municipal debtor can be modified. In 1991, Congress considered adding a provision to chapter 9 that would have required a municipal debtor to exhaust state labor law procedures before rejecting a collective bargaining agreement. However, the proposed bill, denominated the Municipal Employee Protection Amendments of 1991, H.R. 3949, 102 Cong. (1991), died in committee and was never enacted into law. Thus, Congress has not enacted legislation expressly dictating which standard would apply (*i.e.*, the standard in section 1113 or the less restrictive requirements in section 365) if a municipal debtor were to attempt to reject a collective bargaining agreement.

Orange County

The California bankruptcy court presiding over the chapter 9 case of Orange County, California, purported to answer that question in 1995. With a population exceeding 2.8 million, Orange County filed the largest chapter 9 case in U.S. history in 1994 after more than $1.6 billion in losses in its investment pools precipitated an acute and immediate financial crisis. Facing a projected budget shortfall of approximately $172 million, the management council appointed to devise cost-cutting measures recommended that many of the rights of county employees under various memoranda of understanding specifying wages, hours and terms, and conditions of employment be eliminated. Ten county-employee organizations that had formed a coalition to oppose the resolution sued the county in state court to enforce the labor contracts. That litigation

was later removed to the bankruptcy court, which conducted a hearing on the coalition's emergency request for an injunction preventing permanent employee layoffs.

The bankruptcy court granted the injunction. Orange County argued that the Supreme Court's ruling in *Bildisco* gives a municipal debtor the flexibility to make unilateral changes to its collective bargaining agreements because section 1113 does not apply in chapter 9 cases. The coalition countered that state rather than federal law should apply, consistent with the dictates of sections 903 and 904 of the Bankruptcy Code, and that California statutory and case law provides a mechanism by which municipalities and its employees are to negotiate and resolve their differences. The coalition argued that under the California Supreme Court's 1979 ruling in *Sonoma County Organization of Public Employees v. County of Sonoma*, a municipality must satisfy a four-part test before impairing employees' rights under a bargaining agreement on the basis of an emergency:

(1) a declared emergency must be based on an adequate factual foundation;

(2) the agency's action must be designed to protect a basic social interest and not benefit a particular individual;

(3) the law must be appropriate for the emergency and obligation; and

(4) the agency decision must be temporary, limited to the immediate exigency that caused the action.

The bankruptcy court in *County of Orange* concluded that "*Bildisco* applies in Chapter 9 since Congress has had numerous opportunities to limit its effect by incorporating § 1113 into Chapter 9." Even so, the court emphasized, this does not mean that a municipality in bankruptcy can unilaterally breach a collective bargaining agreement with its unions without limitations. According to the bankruptcy court, "any unilateral action by a municipality to impair a contract

with its employees must satisfy ... [the *Sonoma*] factors if not as a legal matter, [then] certainly from an equitable standpoint." The court explained that *Bildisco* does not excuse a municipality from complying with applicable state law. Although unilateral action may be justified in an emergency, the court concluded, Orange County, having declared an emergency, was obligated to satisfy the *Sonoma* factors before taking steps to modify, breach, or terminate its collective bargaining agreements: "Chapter 9 recognizes the interests of the state and a proper balance between state and federal interests. This balance requires that when modifying contractual rights under municipal collective-bargaining agreements, municipalities must view unilateral action as a last resort."

City of Vallejo

Bankruptcy judge Michael S. McManus of the U.S. Bankruptcy Court for the Eastern District of California rejected this approach in *City of Vallejo* in 2009. Vallejo, a city located in Solano County, California, with 117,000 residents, filed for chapter 9 protection on May 23, 2008, after the deficit in its general operating fund ballooned to $17 million due to significantly decreased revenues from property taxes, sales taxes, assessments, and fees. Less than one month afterward, Vallejo moved to reject collective bargaining agreements with four groups of unionized employees: police officers, firefighters, electrical workers, and administrative and managerial personnel. The city and two of the affected unions ultimately reached a settlement, leaving rejection motions pending with respect to the bargaining agreements with the firefighters and electrical workers. According to the City of Vallejo, the standard for rejection articulated by the Supreme Court in *Bildisco* governed its request for relief because section 1113 does not apply in chapter 9 cases.

After closely examining the constitutional underpinnings and legislative history of chapter 9, Judge McManus ruled that "section 1113 is not applicable in chapter 9 cases, and a chapter 9 debtor is not required to comply with it in order to reject an executory collective bargaining agreement." According to the judge, Congress enacted section 903 to harmonize two competing interests: "reservation of powers to the states and the supremacy of federal bankruptcy law." Together with the Bankruptcy Code's provisions governing eligibility to be a debtor, he explained, section 903 permits states "to act as gatekeepers to their municipalities' access to relief under the Bankruptcy Code." When a state authorizes its municipalities to file for chapter 9 relief, Judge McManus emphasized, "it declares that the benefits of chapter 9 are more important than state control over its municipalities." This means that any state authorizing access to chapter 9 "must accept chapter 9 in its totality" rather than cherry-picking some provisions and discarding others. As such, the judge concluded, if a municipality is authorized by a state to file a chapter 9 petition, the municipality "is entitled to fully utilize 11 U.S.C. § 365 to accept or reject its executory contracts."

Judge McManus found that the California statute authorizing chapter 9 relief for California municipalities provides the "broadest possible state authorization for municipal bankruptcy proceedings." Moreover, he concluded that no California law imposes prefiling limitations or postfiling restrictions requiring compliance with public-sector laws. Judge McManus ruled that a municipal debtor's decision to reject a collective bargaining agreement is governed not by California labor law but by section 365 of the Bankruptcy Code. Furthermore, he noted, any California law that purported to superimpose California labor laws onto section 365 would be unconstitutional by operation of the Bankruptcy Clause (Art. I, § 8, cl. 4), the Supremacy Clause

(Art. VI, § 1, cl. 2), and the Contracts Clause (Art. VI) of the U.S. Constitution. Judge McManus flatly rejected the assertion that *Sonoma* or any state labor law provides the standard controlling rejection of Vallejo's collective bargaining agreements, explaining that any such laws are preempted by section 365.

Despite his conclusion that neither section 1113 nor California labor law applied to Vallejo's motion to reject its two remaining bargaining agreements, Judge McManus deferred his ruling on the merits of the motion "to give the parties every reasonable opportunity" to reach a settlement and issued an order in April 2009 directing the parties to mediate the dispute. Following mediation, the union representing Vallejo's firefighters agreed to the rejection of its labor agreement, but no settlement was reached with the electrical workers' union. In August 2009, the bankruptcy court issued a formal ruling granting Vallejo's motion to reject its collective bargaining agreement with the electrical workers, who were represented by the International Brotherhood of Electrical Workers ("IBEW"). In the decision, Judge McManus reiterated his previous conclusions regarding the standard governing rejection of a bargaining agreement in a chapter 9 case. He also found that the evidence in the case before him satisfied the *Bildisco* standard. The IBEW appealed.

The District Court's Decision in *City of Vallejo*

The California district court denied the appeal and affirmed the bankruptcy court's August 2009 ruling. The legislative history of chapter 9 and the California statute authorizing municipalities to petition for bankruptcy, district judge John A. Mendez explained, "support [Vallejo's] argument that municipalities are intended to have broad authority to reject contracts and reorganize pursuant to Chapter 9, without regard to state labor laws." Judge Mendez flatly rejected the

IBEW's contention that the bankruptcy court improperly concluded that Vallejo was authorized to reject the bargaining agreement without looking to state law standards for mid-term modification or termination of public employment contracts. State labor laws, he concluded, are preempted by federal bankruptcy law for the reasons articulated by the bankruptcy court.

Judge Mendez also declined to fault the bankruptcy court's conclusion that *Bildisco* establishes the standard for rejection due to the inapplicability of section 1113 in chapter 9 cases. "[I]t is Congress, not the Court," he wrote, "which should decide whether to incorporate a Section 1113-like provision into Chapter 9." In the absence of such legislation as well as any case law directly on point, Judge Mendez concluded that "the Court finds *Bildisco* and *In re County of Orange* to be persuasive authorities for analyzing and determining the appropriate standard for a municipality to reject a CBA during Chapter 9 bankruptcy."

Finally, Judge Mendez ruled that the bankruptcy court's evidentiary rulings and findings on the three prongs of the *Bildisco* test were not in error. Among other things, he determined that the bankruptcy court did not err by focusing its inquiry on the insolvent general fund, rather than Vallejo's finances as a whole, in concluding that the IBEW bargaining agreement burdened Vallejo's ability to reorganize. Judge Mendez also refused to second-guess the bankruptcy court's conclusion that the balance of equities favored rejection of the contract, given the court's findings that, among other things, plunging revenues threatened Vallejo's survival; little, if anything, remained for the city to cut from its labor expenses; and further reductions in the funding of services threatened Vallejo's ability to provide for the basic health and safety of its residents.

New York City OTB

Another important concept excluded from the scope of municipal bankruptcies—the estate—was a central element of the New York bankruptcy court's ruling in *New York City OTB*. New York City Off-Track Betting Corporation ("OTB") is a public benefit corporation, established and governed by the New York Racing, Pari-Mutuel Wagering and Breeding Law (the "Racing Law"), that operates an off-track parimutuel betting system within New York City. OTB was created in 1971 to earn money from horse-betting activities and halt illegal wagering and bookmaking on horse races. It is operated by a board of directors appointed by the Governor of New York State, which took over the company in 2008 after Mayor Michael Bloomberg threatened to shut it down because of losses to the city.

OTB has been beset by economic problems for many years. Part of its financial malaise is caused by the Racing Law, which obligates OTB to distribute certain percentages of the pool of total bets OTB receives on a race to the state, local governments, horse-breeding funds, and certain racetracks. These "commissions" are payable both for races on New York tracks within OTB's region as well as for other New York tracks and out-of-state races that are simulcast by OTB and for which it accepts bets. OTB has lobbied the New York State Legislature without success for five years to alter the Racing Law's mandatory distributions in a way that would allow the company to erase enormous annual operating deficits.

Although the Racing Law provides the formulae for calculating commissions, neither the statute nor applicable regulations issued by the Racing and Wagering Board specify when the payments must be made. Cash-flow problems prompted OTB to slow the pace of commission payments

during the five-year period leading up to its bankruptcy filing. OTB filed a chapter 9 petition in December 2009 in New York. At the time of the filing, OTB was five months in arrears on the payment of “indirect commissions” to certain New York tracks for simulcast races outside of its region, although it was current in paying “direct commissions” to tracks for races within its region.

After the chapter 9 filing, OTB was able to pay both direct and indirect commissions with a one-month lag but stopped making indirect commission payments after three months and announced its intention to cease operating in April 2010 due to cash-flow problems. Instead of closing its doors, however, OTB elected to remain operating while the New York State Legislature debated a solution to its financial woes. It was able to do so by suspending the payment of indirect commissions.

Two of the tracks that were owed direct and indirect commissions aggregating approximately $8.5 million filed a motion seeking a court order obligating OTB to pay the outstanding amounts immediately, in part because indirect commissions payable after OTB’s chapter 9 filing are “actual, necessary costs and expenses of preserving the estate” entitled to administrative-expense treatment under section 503(b) of the Bankruptcy Code. According to the racetracks, OTB was obligated to comply with applicable nonbankruptcy law even though it was a chapter 9 debtor, and the commissions, which were vital to the tracks’ ability to continue operating and for the New York State harness-racing industry as a whole, clearly qualified for administrative priority.

Bankruptcy judge Martin Glenn denied the motion. Explaining at the outset that sections 903 and 904 severely restrict a bankruptcy court's discretion to interfere with a chapter 9 debtor's operations or property, Judge Glenn rejected the track's contention that the court, notwithstanding these statutory restrictions, was authorized to rule on all of the issues raised by the dispute because OTB had implicitly given its consent. According to Judge Glenn, OTB had consented only to whether the indirect commissions were administrative expenses and whether they must be paid on the schedule requested by the tracks.

Judge Glenn then ruled that the commissions were not administrative expenses. He explained that section 503 of the Bankruptcy Code, which contemplates the creation of administrative expenses for "the actual, necessary costs and expenses of preserving the *estate*," applies to chapter 9 debtors by operation of section 901(a). However, chapter 9 does not incorporate section 541 of the Bankruptcy Code, which provides for the creation of a bankruptcy "estate." As such, Judge Glenn ruled:

> Because a chapter 9 debtor's property remains its own and does not inure into a bankruptcy estate as provided by section 541 of the Bankruptcy Code, there can be no administrative expenses "for the actual and necessary costs of preserving the estate" as contemplated by section 503(b)(1)(A) of the Bankruptcy Code.

According to Judge Glenn, this interpretation has been adopted by several other bankruptcy courts and is consistent with the views expressed by leading commentators. Moreover, he emphasized, it is supported by the policies inherent in chapter 9, which "is permeated with dual sovereignty concerns," including respect for the sovereignty of state entities that "substantially constrains the Court's powers when dealing with a chapter 9 debtor." Even a municipal debtor's consent to the court's determination of issues pertaining to the debtor's statutorily and

constitutionally protected sovereignty over its operations is not sufficient to overcome these constraints. The court, Judge Glenn explained, simply has no discretion in this area.

Finally, Judge Glenn concluded that neither the Racing Law nor its accompanying regulations specified when commission payments were supposed to be disbursed. Given, among other things, the predominance of state law and policy in deciding that question, he accordingly determined that the circumstances called for the court to abstain from adjudicating the issue. The judge modified the automatic stay to allow the parties to commence a proceeding before the Racing and Wagering Board to resolve the issue. He also chastised that board, the Racing Commission, and the New York State Legislature for repeatedly failing to address the enduring problems in the racing industry, commenting that he had the discretion under section 930(a)(2) to dismiss OTB's chapter 9 case for cause, including "unreasonable delay by the debtor that is prejudicial to creditors."

Outlook

Taken together, *City of Vallejo* and *New York City OTB* are a primer on the limitations of chapter 9 and, more specifically, the delicate constitutional compromise that lawmakers reached when enacting a municipal bankruptcy law in 1978. Chapter 9's very title—"Adjustment of Debts of a Municipality"—is a telling testament to the marked differences between chapter 9 and chapters 7, 11, 12, and 13 of the Bankruptcy Code, where the court and stakeholders in the case have a much greater degree of control over the debtor and its affairs and property.

Depending on the circumstances, *City of Vallejo* should not necessarily be viewed as a positive development in all respects for municipal debtors, although the ruling would appear to make it

much easier to reject a bargaining agreement in chapter 9 than in chapter 11. In pre-section 1113 cases, courts recognized that rejection of a collective bargaining agreement under section 365 created an unsecured prepetition claim for damages by operation of section 502(g). Courts applying section 1113 disagree as to whether rejection of a labor agreement gives rise to any claim for damages, principally because section 502(g) refers to contract rejection under section 365, but not under section 1113. Thus, while it may be easier for a municipality to reject a collective bargaining agreement under section 365, the consequences of rejection may be less palatable.

The ruling in *New York City OTB* is notable principally because it highlights another important distinction between chapter 9 and chapter 11. Those who provide goods and services to chapter 9 debtors should be aware that, although applicable nonbankruptcy law (*e.g.*, state law or perhaps 28 U.S.C. § 959) may be interpreted to require a municipal debtor to satisfy its postpetition obligations, the operating expenses of a municipal debtor are not entitled to administrative priority.

In re City of Vallejo, California, 403 B.R. 72 (Bankr. E.D. Cal. 2009), *aff'd*, 432 B.R. 262 (E.D. Cal. 2010).

In re New York City Off-Track Betting Corporation, 434 B.R. 131 (Bankr. S.D.N.Y. 2010).

In re County of Orange, 179 B.R. 177 (Bankr. C.D. Cal. 1995).

NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984).

Sonoma County Organization of Public Employees v. County of Sonoma, 591 P.2d 1 (1979).

In re Valley Health Sys., 429 B.R. 692 (Bankr. C.D. Cal. 2010).

In re JZ L.C.C., 371 B.R. 412 (Bankr. 9th Cir. 2007).