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Corporate Bankruptcy Panel

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MUNICIPAL RESTRUCTURING

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MS. MOLS: I will introduce our moderator for our first panel, Mr. Gary Marsh. Gary is a partner at the Atlanta office of McKenna, Long, and Aldridge and is chair of McKenna's national bankruptcy practice. He focuses on bankruptcy workouts and debtor creditor law. Gary graduated cum laude from American University and received his J.D. here at Emory University School of Law. Gary is an adjunct faculty member here, teaching bankruptcy law. He is also a fellow of the American College of Bankruptcy. Thank you for joining us Gary.

MR. MARSH: Thank you. Welcome everybody. It's my honor and pleasure to be here today and to be the moderator of this panel. Unfortunately, many municipalities all over the country are experiencing financial distress, and I believe this chapter of the bankruptcy system will be, and is currently being, tested tremendously by this crisis over the next years. There are a number of municipalities that are in bankruptcy now and, I believe, more to come. Whether the bankruptcy system can help solve that problem for all concerned, time will tell. Our panel will hopefully explain in detail the chapter 9 process, which is continuing to evolve, and its stake in most municipal bankruptcy cases, or the interest of bondholders, current employees, former employees, the municipality itself, and the public interest. The best thing I did for the program was to assemble this "dream team" of municipal restructuring experts. I don't think you could find a better group of people to talk about this subject today. All of them are active in current cases, including the City of Stockton, California; Jefferson County, Alabama; and the City of Harrisburg,

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Pennsylvania. At the very end is Patrick Darby. He is a partner at Bradley Arant Boult Cummings, and he represents Jefferson County in its chapter 9 case as debtor's counsel. He has represented debtors and creditors in other chapter 9 cases. Patrick is a fellow of the American College and adjunct professor of Business Bankruptcy Law at Cumberland, and is listed in Chambers, Best Lawyers and *Superlawyers*. Right here to my right is Mark Kaufman. Mark concentrates on representing secured creditors, lenders, investors, committees, and debtors. Mark has represented debtors in significant cases, including one of the nation's most significant utility bankruptcies. He is co-chair of our firm's municipal recovery and restructuring practice. He is listed in Chambers and Best Lawyers as one of the top bankruptcy lawyers, and Mark is currently representing the Court and Governor-appointed receiver for the city of Harrisburg. Next is Marc Levinson. Marc is a partner at Orrick, Herrington & Sutcliffe in its Restructuring Group. He is nationally recognized for his capabilities in complex reorganizations and restructurings. In 2009, Marc was named one of American Lawyer's "Dealmakers of the Year" for his role in the bankruptcy case of the largest California city to ever seek chapter 9 relief. He is also ranked in Chambers as one of the top restructuring lawyers in California, and Marc is currently bankruptcy counsel for the City of Stockton. And right next to me is Eric Schaffer. Eric is a partner at Reed Smith practicing in the area of commercial restructuring and bankruptcy. He has represented secured and unsecured creditors in major bankruptcy cases involving a wide range of industries. Eric has been a featured panelist on the subject of corporate trust defaults at meetings of the American Bankers Association and American Bar Association. He also is a fellow in the American College and is listed in Chambers, and he is representing the trustee of the largest unsecured creditor group in the Jefferson County, Alabama case, which is pending now.

I just wanted to make a disclaimer. Our presentation today is educational and for discussion purposes. Since there are active proceedings that all of my panelists are involved in, none of the views expressed have anything to do with any of their clients or positions they may or may not take in court. We were going to focus our discussion on eligibility to file bankruptcy, the differences between chapter 9 and chapter 11, the plan, process, confirmation, and cram down, and the way unions and employees and pensions are treated in chapter 9. With that, I wanted to start with eligibility and sort of pose to Marc Levinson: I'm a municipality. I've got financial trouble. I've heard chapter 9 might be a good option for me. I heard you were the best lawyer in California to talk to. Am I eligible to file? What do I need know about that?

MR. LEVINSON: In order to file a chapter 11 case, all you need is a computer and someone to sign the petition. Once you've filed the petition you're eligible—an order for relief is entered. Not so in chapter 9. In addition to being a person eligible for chapter 9, you have to be able to satisfy five separate elements that are laid out in statute in §109(c) of the Bankruptcy Code. The first one is you have to be a municipality. Well, what is that? If you look at § 101 of the Bankruptcy Code, you will find a definition for the word and some of it is fairly obvious. If you're a city of your county, you're a municipality. If you're a state, you are not. So even though I live in a bankrupt state, it is ineligible for bankruptcy relief. But there are a lot of gray areas of semi-governmental entities, and in order to find out whether those are municipalities, you look at case law. We've had a number of examples recently in Las Vegas and in New York where you're doing something that is neither fish nor fowl, but for our purposes today we will be talking mostly about cities like Harrisburg, Stockton, or counties like Jefferson, which are clearly eligible for bankruptcy. If you're a municipality you're ineligible for relief under any other chapter. Next, you have to be authorized by the law of your state, and to the best of my knowledge there's only one state that expressly says our municipalities are ineligible for bankruptcy and that's Georgia. There are twenty-five other states that have no laws on the books about eligibility for chapter 9, and the theory is if you're in one of those states, Nevada for example, you need to either get a law passed or have the governor issue an executive order or whatever state law would deem sufficient to authorize the municipality to file a bankruptcy case. Then there are some states, like California used to be, that just said, if you're a municipality you're eligible. Some states limited the filing to irrigation districts. Some limit it to filing, but only to deal with debts that are involuntarily incurred rather than debts that are consensually incurred, and that takes into consideration those cases where there's a whopping judgment against the city for excessive force by the police or housing discrimination or stiffing a developer, which is what happened recently in the City of Mammoth Lakes in California. California law changed effective January of 2012 because of me and the City of Vallejo case. When we filed the City of Vallejo case, as we will discuss later, you had the ability to reject agreements, and one of those agreements that we rejected—actually four of the agreements we rejected—were with the unions. In California, the unions have a lot of say in the Legislature. In fact, it's a wholly-owned subsidiary of labor. A law was passed that required mediation prior to the filing of a bankruptcy case unless there was such an emergency that the municipality could file without the need to go through the mediation process. Why is state

law required to bless the chapter 9 filing? And that's for you, Con. Law students, because of the Tenth Amendment that reserves power to the states. Back in the 1930's, the predecessor to today's chapter 9 was struck down by the U.S. Supreme Court because it was too much interference by the federal courts in the handling of the affairs and the property of instrumentality of the state. Congress then reworked the law to require, among other things, the consent of the state. So, if indeed you are in a municipality in Georgia, unless the state changes the law, you are simply ineligible for chapter 9. If you're a municipality in Las Vegas, in Nevada, you have the state legislature. If you're in Iowa you can only go there, again, if you want to deal with your involuntarily incurred debts. I'm going to talk a little bit later about the Tenth Amendment and how it pervades chapter 9. It is the main reason that chapter 9 is so very, very different than chapter 11 because of the fear of Congress and because of the constitutional requirement of the federal court telling the municipality how to run itself.

MR. KAUFMAN: One of the issues in regards to eligibility in terms of municipalities is to what extent the state ought to have a significant role, and actually not just be a way station that says something about "have you done the requisite steps," but actually supplants and takes some control over the operation either through an emergency manager or receiver. That is fraught with some serious issues both under state law and potentially issues of the Voting Rights Act because one of the questions that has come up in some states where there's been an attempt is whether there is some dilution of minority voting strength in violation of the '65 Voting Rights Act. But even beyond that, there's a tension between home rule and the power of the state to delimit cities, and it all is organic and dependent on how state law works in reference to whether the cities have independent power. One of the reasons why this phenomenon is growing, and Michigan is an example—Pennsylvania, Rhode Island, and other states are looking at this as well—is the extent to which there are issues impacting the financial integrity of the state or other cities. There is some concern whether that is legitimate or not—that governments are going to have higher exposure in terms of the rate they have to pay for a municipal creditor. The state has to pay in a significant way if cities were to run renegade in terms of filing, and to some extent states are trying to look at that and say well, to the extent I can impose some constraints and controls, it may mitigate the prospect of the state or other cities being penalize because certain cities are going to have problems. There are a host of issues yet unsettled in that whole area. The only final thing I would say about it is to the extent that that there is a supplanting of local government, the question

is whether the government actually is a little bit happy about it because they don't want to be the heel on the neck of labor or retirees and they can repose that obligation on the state to be more disciplined, maybe they would have a protection and cover for that so they don't have to do the hard work. At least right now, if you look around the country, and the number of cities where the threat exists, there's a lot of protesting about whether that's real or just designed to make the voters be understanding. But it's a significant set of issues, and to some extent by having a state, through emergency manager or receiver or whatever you may want to call it, taking control of the dynamics of how the negotiations go could be vastly different than at the local level.

MR. DARBY: Well, municipalities by definition are units of the state. They are agencies or instrumentalities of the state government so when one of those gets into financial distress, it is appropriate for the state to take steps to address it. And a lot of municipalities lack home rule: they don't have the ability to raise taxes or alter their own revenues and are wholly dependent on state legislature for substantive steps to address financial distress. So the tension you see, I think, is that some states are trying to take up the role and say, "we're the state, we're here, we're going to try to fix this." But it's also an alternative for the state to say, "if you get in financial distress, take it to a bankruptcy judge." That's what some states have done—about half the states—and I think that's fine because, for reasons we'll get into later, a bankruptcy judge or the federal government through a bankruptcy judge can do things with contractual obligations that the state legislature cannot do. State legislatures cannot pass laws abrogating contracts, but under the bankruptcy clause in the Constitution, the federal government can do that because that's what bankruptcy is: abrogation of contracts. But I would just add on—the variety of state statutes addressing eligibility, they're really all over the place, are impenetrable-they're very difficult to read. The Alabama statute, which we litigated in the Jefferson County case, was enacted in the 1930's and, we came to learn, over the years had been altered, not by the legislature, but by the codifier. The compiler of the Code had taken some liberties in how they edited statute and as a result it was very difficult to read. And the statute referred to the governing body of a municipality that is authorized to issue bonds, which in the 1930's were the preferred financing mechanism for municipal finance. Now, for the past fifty years or so, the preferred mechanism in Alabama for issuing public debt is not called a bond, it is called a warrant. The primary difference being that issuance of bonds requires a vote of the people, and the issuance of warrants does not. So most debt in Alabama these days is warrants instead of bonds, and the reference to bonds in the statute led some of our creditors to

argue that we weren't authorized to file chapter 9 at all because we had issued no bonds; we had only issued warrants. And we had to get that sorted out and finally prevailed in front of the Alabama Supreme Court. But it's the type of issue you can get into depending on your locality and depending on what the statute says; it is rarely clear or straightforward. It rarely just says municipalities may file chapter 9, period. And it is a very odd interplay of state and federal law so that our eligibility to be in bankruptcy was ultimately decided by the Alabama Supreme Court.

MR. MARSH: Thanks Patrick. I've read there's tremendous litigation over eligibility and people trying to keep municipalities out of bankruptcy. Eric, as a creditor lawyer, why are the creditors trying to keep municipalities out of bankruptcy? Are they afraid of the bankruptcy courts?

MR. SCHAFFER: Let me say preliminarily, a theme that I've heard from all these debtor lawyers to my right is that chapter 9 is inherently political. In chapter 11 we deal with facts, we deal with law; in chapter 9, you better know your politics. You better know your history. It's a deep overlay. Now why would a creditor say, we would rather not be in bankruptcy? You always have to start with, who is the creditor, and what are its interests? If you happen to be in Jefferson County and you have a lien on sewer revenues you might say, "I'd rather not be tied into the bankruptcy process, where there are so many other competing interests, when I have the ability to pursue my rights and remedies under state law, to go and perhaps seek a receiver for the sewer system in Jefferson County, and use that process to try and increase the rates—increase the value of my collateral." Now, an unsecured creditor might say, "bankruptcy is a great thing because otherwise there's just not enough to go around and I'm not going to have a seat at the table." If you are an unsecured bondholder, under state law you may have a right to pursue a writ of mandamus requiring taxes to be raised. But again, in so many of these states, you may find limits on the ability to force taxes to be raised. So, as a general obligation creditor, you may say, "bankruptcy is a good thing if there's no ability to pay me otherwise."

MR. KAUFMAN: I think Eric is dressing it a little bit up to make it look more like it's all warranted. In fact, as a debtor lawyer, the observation is it's the best leverage they have to try to negotiate something. We have very uncharted territory as to substantively what comes out, and whether a plan (and under what basis) can be confirmed over creditor objection. There are a host of these issues as to thresholds, including, "has state law been met." The other two that

Marc may want to further address for a few minutes, are issues about whether good-faith efforts to negotiate with your creditors have been satisfied. It's an issue he may not want to talk much about because he has four days of litigation coming up scheduled in the next month in Stockton, but he can talk about it in concept. And the other is whether or not you're insolvent, which has a set of issues unto itself. The point is that those issues look to be the right kinds of things that a creditor can use to try to negotiate early on.

MR. LEVINSON: Bankruptcy for a municipality is always the last and worst option. What you want to do is cut a deal outside of bankruptcy. All of us, and I have been doing chapter 11 work for 30 plus years, you're always trying to avoid bankruptcy, if at all possible. When you are in bankruptcy, it's out-of-control. Everybody gets to weigh in on what you ought to do: the attorney fees are challenged, if you want to go sell your assets that's challenged. You've also got some bankruptcy judge who may or may not get it—may or may not agree with you. So you're always better off solving your problems yourself without having to resort to courts. But when you're out of options, as was Vallejo, as was Stockton, and you didn't have enough money to make your payroll, you have to file. It's musical chairs, the music has stopped, there are not enough chairs to go around and something has to give. What happened with both Vallejo and Stockton that is before bankruptcy they did all these things that they should have done. They reduced the workforce to the extent possible and sometimes under collective bargaining. You guys know what unions are in Georgia?

MR. DARBY: They think they know what unions are, but they don't live in California, so they don't really.

MR. LEVINSON: Well, we know unions and many contracts have what are called minimum staffing requirements, which means you have to have X number of firefighters on call at any given time. You have to have so many on this kind of a truck, and so many on that kind of a truck, and outside of bankruptcy you don't have the power to simply say, no. If you do and say, "well we're not going to staff it that way," you get thrown into court and you lose—as you should because that's what the contract provides. In bankruptcy, you can do that, and that's what we did in the Vallejo case. But again, you always try to avoid bankruptcy, if at all possible. It's better for everybody, for the creditors and the debtor. Forces overtake you, and as Mark said, or Patrick said, or one of them, this is an inherently political process. But I don't feel sorry for the lenders because they loan to the political process. They loan to

people who are running cities and making these bad decisions. You know, the argument was made in Vallejo, and it's being made in Stockton today, that the city made these incredibly bad decisions. In Vallejo the bankruptcy judge said, bankruptcy is full of people who made bad decisions. People don't wind up here by accident, and when you're dealing with politicians, they make bad decisions. They build arenas that they can't afford. They hire police that they can't afford to pay. They promise pensions that they can afford to pay. They give other postemployment benefits to retirees they can't afford to pay. And then you get to the point when they can't pay. What you do? I view bankruptcy as something that's good for all sides because what it does is it keeps a municipality functioning such that it can provide a city for its residents, and it can provide services for the residents, and it can provide some income to pay the creditors. But what's coming out here is that state law is very, very important, perhaps even more so than in chapter 11. You have to look to see, first off, whether the state authorizes it, and then second, you have to look at things like, how do you raise taxes? Can you appoint a receiver? In California, the superintendent of schools for the state can appoint receivers for school districts, and the receiver comes in, displaces the elected school board, and makes fiscally sound decisions, at least on paper, certainly more so than the elected officials. That remedy is not available in California for cities. Maybe it should be, but it's not. The cities are still run by the city councils. Every state—again—the entry of whether the state permits the filing is different in every state. There is a truly outstanding American Bankruptcy Institute book that Patrick and I co-wrote, with three others that just came out in its second edition, and there is a terrific chart that neither of us wrote, somebody else did, that compiles the law of every state. So if you're called upon to opine on whether you can file a chapter 9 case in Nebraska or something like that, this can save you some time and you can look at that chart. But it is very, very different in every other state, and you have to know how you raise revenue in the state. In California, since the voters can pass initiatives—and do frequently—we have severe limitations on the ability of a local government to raise taxes. In fact, you can't do it without a vote of the people. That causes endless grief. Some people say, well, if the city doesn't want to tax itself out of the problem, then to heck with it. But if you require two-thirds of the voters to approve an initiative and sixty percent vote in favor of it, are you going to penalize the sixty percent and let the forty percent kill the city? That's the problem that falls to the lawyers for the creditors and the debtor to try to resolve. Because you just can't walk away and let the city fail. Let me get back to the eligibility requirements and stop preaching. In order to qualify for

chapter 9, the city has to be—the municipality has to be—insolvent. You look to the Bankruptcy Code definition of insolvency, and it's different for municipalities than for private entities and that's because the balance sheet doesn't really matter. You can't go out and liquidate and sell a park—sell city hall. It just doesn't work. So you look strictly to cash flow. Does the municipality have the cash to pay its bills now or in the near future? The cases have interpreted the "near future" to mean the next fiscal year. Both in Stockton and Vallejo, the cases were filed on the cusp of the new fiscal year when the city would be unable to pay its bills. Insolvency is a big fight, and we're fighting that in Stockton now, as Mark said, we're going to have a four-day trial at the end of March and one of the key issues is: is the city insolvent? Could it pay its bills? We believe that it is—the creditors, I think, believe that it is—but they're fighting us anyway.

MR. KAUFMAN: I think one issue that will be fascinating over time—Marc alluded to the fact that if you're not insolvent now, maybe in the next twelve months you will be. It seems to me there are two issues that come up that are warranting further litigation. One is, if I have a city that it's inevitable that the liabilities are going to be increasing—tax revenues are dropping, there is OPEB liability or post-employment benefits problems—to the extent you can see the inevitability of that, the fact that you wait until the year before rather than starting to deal with it earlier seems to me problematic. So I think there's some worthy litigation there. The other competing consideration, if you talk to creditor lawyers, is "am I insolvent if I have, theoretically, the opportunity to go out and do some kind of further financing to make my way." And Eric, you may want to comment about that, because that can be some argument that creditors would make in the context where you had a city, maybe not Stockton or any specific city, but a city that may still have some capacity to borrow even though it's borrowing for the inevitability that it's still going to hit the cliff at some point.

MR. SCHAFFER: I think that just highlights the political nature of this. We're in an environment now where there aren't too many people that are actively looking to raise taxes. Maybe California is an exception; maybe it's the rule. But it's hard to get people together to agree on something. You want to raise money? Well, who is paying, and who is it going to?

MR. MARSH: Patrick, have you litigated the good faith requirement or how would a municipality prove it negotiated in good faith with its creditors prior to commencing a bankruptcy?

MR. DARBY: Well, it's tricky. Marc may have more actual experience than I do in that. You actually have to show factually that you met with people and discussed a potential resolution of the debt. One legal issue is: do you have to negotiate the specific plan that you intend to put forward in chapter 9, which, if that's the standard, it makes negotiation practically impossible because the municipality has to come and put its best deal on the table and then there's nothing to negotiate because they can't move any further off that. Jefferson County had engaged in a three and a half year period of intense negotiation with several of its creditors. We had not negotiated with every single creditor, but there were a few creditor voices who spoke up and said, well, but that three and a half years, they didn't really mean it, they weren't really doing it in good faith. They were sort of ignored, even by the other creditor groups. I think it's factual and when all else fails, tell the truth. Go out, try to cut your deal, try to do the best you can, and it's a necessary exercise for the reasons Marc says: if you can settle it outside of chapter 9, you should. But municipalities will have limitations on their ability to deliver promises that chapter 11 lawyers are not used to. It took us a long time in Jefferson County to convince certain creditors of ours that we can't raise taxes. We're not negotiating with you. The state constitution will not allow us to raise taxes. We will have to go to the legislature, and that's a whole different realm of negotiations to get those guys into the fold of your plan.

MR. LEVINSON: The good-faith negotiation requirement originally stems from the Bankruptcy Act in the '30s, actually the Bankruptcy Act of 1898, that permitted chapter 9's (or what was then chapter 10 I believe, but what is now chapter 9) only when you had a plan and you had the votes and you needed chapter 9 in order to bind the minority. The best thing about chapter 11 is that the majority can bind the minority so long as you play by the rules. So you couldn't file a chapter 9 case unless you already had the votes, but you just didn't get 100%, because the trust indentures always require 100% to change the interest rates and things like that. That's been relaxed, and in the Vallejo case we thought we satisfied the good-faith negotiation test because what we did was we proved that we spent all of our time trying to stay out of bankruptcy and we got in only when there was no alternative. We also proved at the trial level that negotiations were really impracticable, which is another prong that you can satisfy. There are four separate prongs: two of the most prominent are those of § 109(c)(5). It was impracticable because what we needed there was to get relief from the postretirement health benefits, and there were hundreds, if not thousands, of Vallejo retirees, and we couldn't get them all in a room, and we certainly couldn't bind them, because as Patrick said,

under the Contract Clause, a state can't alter contracts. You need to do that through the bankruptcy court, which then can take advantage of the bankruptcy power given to the federal courts. So we proved both of those. On appeal, we won on the practicality issue, but the Bankruptcy Appellate Panel disagreed with us and the bankruptcy judge on the good-faith negotiation and said, trying to stay out of bankruptcy is laudable, but it doesn't satisfy the statute. You have to come up with at least a term sheet—and that was the term they used, a term sheet—given to your creditors. So with that in mind in Stockton, we came out with a 790-page document, which we called "the ask," fifty pages of which were text. It dealt with every single creditor. Many of the creditors didn't like what it said about them, but it dealt with them. The rest was financial data that I couldn't understand because I was an English major. We're fighting over that in bankruptcy court now, about whether that satisfied the good faith requirement, but I'm confident that we will win on that issue.

MR. DARBY: I'll ask Eric and I'll ask all of you this thought. Is it a viable strategy for a creditor who sees a chapter 9 coming, and doesn't want a chapter 9, and wants to position itself for an eligibility fight—is it a credible strategy for that creditor simply to refuse to negotiate on the theory that if they're not negotiating, if the creditor is not negotiating, then the debtor is not engaged in good faith negotiations?

MR. LEVINSON: I pointed out the irony of the creditors' positions on it at a hearing about a month ago—that only the debtor is required to act in good faith. I didn't want to imply that the creditors didn't, but they didn't. But there's no requirement that the creditors act in good faith. It's only the debtor. In fact, Patrick, that's what happened in the City of Mammoth Lakes case, which never should have been a chapter 9 in the first place. It was a two-party dispute. It was the city and a developer. A California state court found that the city had stiffed the developer on this big development project by changing the ground rules, and the developer got this huge judgment of like fifty million dollars for the city with an annual general fund revenue of about ten or twelve million dollars. It was serious, and that turned into a fight, as sometimes these litigations can, and they couldn't settle. So they started this required mediation process under the new California law, but you can't force someone into mediation, and the creditor didn't participate.

MR. KAUFMAN: I think if you're in a situation where you get to a city early enough, it's inherent in what you want to do—accomplish a deal—that you're going to flesh out the terms of the plan. And as long as you have enough

running room to have that process then you might as well go through the exercise out of court. If it can achieve the result, then you don't have to go in assuming you can deal with this retiree problem and get in sufficient people to sign-on. But at a minimum you check the box that you've gone through the good faith and it's going to be inherently necessary to engage in that in any event in the chapter proceedings. So it seems to me while people may want to posture about it from a litigation standpoint, most prudent people, like Marc, are going to do as much as they can pre-bankruptcy to actually engage with the creditors and try to negotiate something as can be possible given the exigencies. Because, to some extent, there are circumstances where you get to the situation late, and there's not enough time. Save for that, then you ought to go through an orderly process of negotiating as best you can and that hopefully will be salutary, and if it's not, you've checked the box on the eligibility.

MR. SCHAFFER: I think it's entirely appropriate that the goodfaith requirement be focused on the municipality, on the would-be debtor, because the creditor may have a much broader view of the world, a broader agenda, if you will. As the debtor, you only care about one municipality. As a creditor, I may care about my entire portfolio of municipal bonds or insurance policies, and if I decide that Marc Levinson comes in and he's got an awfully good story to tell, and I immediately give him twenty percent relief, how much is that going to cost me across my entire portfolio? So it should focus on the debtor's good faith.

MR. DARBY: I think that's a fair point because that will be your starting point for the next negotiation. You're going to start at twenty percent off. In fairness to the creditors, there is also extreme difficulty. A lot of chapter 9, or a lot of restructuring plans, will require action by the state legislature, and all of our negotiations have involved that. When you're sitting at a table with creditors and saying, "well, I understand you want that, but I have to go to the legislature for that and they may not give it to me." The creditors are in a jam. They're going to say, "well if the legislature doesn't want to do it, or they're going to want to re-trade, how can I commit to anything?" It's a problem for creditors because if they jump right to their bottom line, the state legislature will want to re-trade. The state legislature will want to say, "I'll pass you this law but I want some extra concessions." So it's very difficult for anybody to get to their final number.

MR. MARSH: I think I understand eligibility, so I think I know how to get into bankruptcy now. So I'm in bankruptcy. I'm in a chapter 9. Is that the same

as chapter 11 or what's different about it? Marc Levinson, what's the critical difference?

MR. LEVINSON: All the differences stem from the Tenth Amendment and the inability of the court to control the property or the operations of the debtor. That's codified in Bankruptcy Code § 904. When you're doing a chapter 9 case, the first thing you do when you look at the Bankruptcy Code is you look at § 901, which tells you what sections of the Bankruptcy Code apply. And it's § 103(f), I think, that tells you that chapter 1 applies, so the definitions apply and all that other kind of stuff. But § 109 or § 901(a) tells you what sections apply and those of you who are chapter 11 jocks will know that some of the things that aren't there speak loudly. Why is it that the court can't tell the debtor how to use or sell or lease its property? Because, again, that would violate § 904 and violate the Tenth Amendment—you would be telling the debtor how to spend its money. Section 541 doesn't apply. There is no estate. You don't create a separate estate. Section 549 kind of applies, but § 549 (post-petition transfers), looks back to other provisions of the Bankruptcy Code. And the other provision of the Code is § 904 that says you can do what you want. Which means, you can pay prepetition debt in bankruptcy. We have done that. We did that in Vallejo and we're doing that in Stockton—this really ticks off the creditors who we're not paying, but the city has the right to do that. The most important, and best one though, is that § 327 doesn't apply. So I could be an interested lawyer, and be hired by the city. The judge doesn't stick his nose into my attorney's fees. Again, it would be the court telling the city how to spend its money, who to hire—can't do that. Obviously, the state rules of professional responsibility still apply, so I have to worry about things like conflict and the like, but § 327 does not apply. Professionals are not governed by the court because, again, that would be the court interfering with the way the city decides to run itself. The U.S. Trustee has a much more limited role in chapter 9 and, in fact, just about the only thing the U.S Trustee can do is appoint a committee. The interesting thing is that the debtor doesn't have to pay for the committee's professionals. What's happened in virtually all the chapter 9 cases and certainly happened in Vallejo, happened in Orange County. I don't know, Patrick, is it your case too? You have a committee?

MR. DARBY: We do not. Could have.

MR. LEVINSON: It's that the debtor cuts a deal with the committee that the U.S. Trustee appoints, and tries to reach some sort of agreement on capping the fees or something like that. That's what we did in Vallejo, again, that's what

happened in other cases as well because, I'm a big believer in creditors' committees and you need someone to speak for these masses of people. You just don't want them all flocking into court, and so, having them represented is a good thing. But the interesting quirk is that § 1103 talks about committees and says that a committee is appointed on the entry of an order for relief. Well, if eligibility is challenged, there's no order for relief until eligibility is decided. So in Stockton, we've been rolling along here since June 28th; we're having a trial on eligibility at the end of March. We won't get a ruling until the end of March or early April, so there can be no official committee. A number of people have come up to us and asked if the city would pay for their counsel as unofficial committees, and we have said no. After we obtain our order for relief there likely will be a committee formed of retirees, which we support because there are 2,400 retirees in Stockton, half of whom receive healthcare benefits, and they need a voice. They really need a voice because we've stopped paying healthcare benefits, and saved the city $600 million because of that. But there will be an official committee, but again that's a very, very big difference between chapter 9 and chapter 11.

MR. KAUFMAN: The point that Marc just made about stopping paying the retiree health care benefits is one of those prerogatives that again is consistent with the notion that the city, during the pendency of the case—certainly before adjudication and then subsequent, assuming that eligibility is granted—has the prerogative to decide what to do. Whether that's good and healthy or not is an open question, but that's been litigated. I think that's going to be the consistent pattern. More recently, Marc just had a case that litigated the question of whether a settlement disputed under § 9019 (for bankruptcy people) is something that applies in a chapter 9. Judge Klein in the Stockton case said no, it doesn't apply, harkening back essentially to the history of § 9019, but also to Tenth Amendment concepts. And so, you're in a situation where there are a lot of prerogatives given to the city. The question is whether, at the end of the day, those prerogatives, when taken, are prudent. Because ultimately, at some juncture, the court (while it has limited power), ultimately has the power to confirm a plan. So all of these things that are done interstitially, end up being in the optics of whether the debtors exercise good faith and acted appropriately in the prosecution of its claims.

MR. DARBY: It's been said, as just a rule of thumb, a bankruptcy judge can do a very limited number of things in chapter 9. The judge can find eligibility or not. The judge can dismiss the case even if the debtor is eligible. The judge can approve the rejections of contracts under § 365, and the judge can confirm

or not confirm a plan. Now that's a lot, but a lot of the interim stuff, as Marc said, is in the hands of debtor—but it will come back to haunt the debtor if the debtor doesn't act right. But on a deeper level, to the chapter 11 lawyers out there, we're all chapter 11 lawyers in our day jobs. By the way, it sounds great. You don't have to file fee applications, you don't have to file employment applications, don't have to file motions to sell under § 363. You can just sell your property. But that freedom has a deeper cost, which I think a lot of chapter 11 lawyers take for granted and don't really realize how much they value it. chapter 11, if nothing else, is an exit strategy. There's always a way out. You go in, you try to reorganize. If that doesn't work, sell the business. If you can't do that, you can always convert to chapter 7 and you're out; you're done. There is no exit strategy like that in chapter 9 because municipal government cannot go away. Now, I did file a liquidating chapter 9 plan years ago for a public park; an amusement authority that happened be a municipality under state law. But a city or town can't go away. And this has enormous ramifications, and it also cuts back the other way on the politics. There's no easy way out for the politicians who run the municipality by filing chapter 9. You can't file chapter 9 and just let the bankruptcy judge sort it out.

MR. SCHAFFER: Patrick, what I think is one of the frustrating things for the bankruptcy court is: what ability do you have to shape the process? You can certainly tell people what you think ought to be done, but at the end of the day, what's the alternative to working through chapter 9, hopefully toward a confirmation? It's dismissal. And what does that mean?

MR. DARBY: It either means nothing or it means chaos. Because you're either going to revert to state law and all creditors are going to try to come and cut their best deal with no central oversight in the political chaos. Or it's going to be that the creditors' remedies under state law are so limited that it's sort of stasis.

MR. KAUFMAN: It sort of gets back to the issue of whether the creditors actually like the haven the chapter proceeding provides. Because, as Patrick was alluding to, to the extent you're in a situation where the city doesn't have the prerogative of taxing more, as a practical matter, and you're in a situation where the option is trying to exercise remedies, as a political matter, going and saying, "I'm going to take your first dollars of tax and use it to pay me, the bondholder, in a state court proceeding where that means fire and police protection and the lights of the city aren't going to be dealt with effectively" is problematic and maybe in theory existing. But, I think you can count on your

hands the state court judges who are political appointees or just living in the city, who are going to be amenable to turning the lights out on the city in favor of making sure some bondholders are being paid. So the process of trying to actually work it through ultimately gives a lot of leverage to the debtor, as it probably should, because these cities can't go away. But as a practical matter, it's probably better than the alternative result of just having a dismissal, and then you're back to the chaos.

MR. DARBY: Just to finish the point, nothing becomes easier politically because you're in chapter 9. In fact, in a lot of ways it becomes a lot harder. A federal judge is not going to answer these difficult questions for you. You're going to have to come up with the answer, whatever it is.

MR. LEVINSON: In both Vallejo and Stockton, the city councils that guided in Vallejo's case and are guiding in the Stockton case, the people involved in the bankruptcy case were not the people who created the problem. They were people that, for whatever reason, decided to run for office when the cities were in extremis to try to fix it. It's not an easy job for them at all. And it's really, and don't you feel sorry—well, I do want you to feel sorry for Patrick and me. This is tough stuff because, as Mark or Patrick said, the city doesn't go away. It's going to be there. What keeps me awake at night is thinking what happens if chaos does ensue? What if you can't fix this problem? What's going to happen? Nobody really knows, and I don't want it to happen under my watch to the city. The other thing that's really hard about representing a city is that, at least in Stockton's case, there are 300,000 bankruptcy experts who know more about it than I do. They and the City Council are willing to second guess you at any time. It's very different representing a city and a private debtor, where you're talking to a board of directors that presumably are somewhat sophisticated in business matters. Because they are politicians, they're just different from the business people were used to dealing with as chapter 11 lawyers. The real serious negotiations or decisions are made in public. California has a Sunshine Act, I assume most states do, where the important deliberations happen in public; where the politicians facing the public, have stacked the room and they're piled out into the hallway and the vestibule, and they're on TV. And people get up and give speeches, and it's just a hard way to make a living. On the other hand, chapter 9 is just so very exciting because everything is new. It's been around since the 30's, as I said, but all the issues are new. In the Stockton case alone, we've had four published opinions already, two of them dealing with this Bankruptcy Code § 904 and the power of the court. We're lucky we have a very smart judge who likes to write, and

writes well. So, we'll have a number of opinions that will help clarify the law at least in this judge's mind, but it's an exciting area of practice and, as Mark said earlier, it's not going away. The reason that these cities have these massive unfunded retirement liabilities, at least in California—I can't speak to other states—is that cities promised their workers lifetime retirement health, and usually at very, very high rates. That made sense if you put the money aside to fund it, so when the retiree retired, some money would have been put aside for him or her in a fund that would presumably be earning some sort of a return, and would pay for the retirement benefits, both pension on one side and health on the other. But what cities did was they made the promises but they didn't put the money aside. It became what's called "pay-go"—you pay-as-you-go. So we're at the point in Stockton where we have almost as many retirees as we do current employees. And as people grow older and live longer and have lifetime retirement health benefits and pension benefits, the problem gets worse because you're paying out of your active general fund for people who were no longer providing services to the city. And yet, in many cases, gave their lives to the city on the basis of a promise. And if you think rejecting those contracts is fun, it's not.

MR. DARBY: This is a very difficult issue for the retirees. They made a deal, and the city made a deal. But it's a rational question for a taxpayer, you know, if I'm a young guy, married, moved my wife and kids, why should I pay higher taxes to pay for the retirement of a fifty-two-year old policeman who rendered service to the city twenty-five years ago? It's a tough issue, and the idea of just raising taxes, there is no political will for that, but it's not a wholly illegitimate complaint from the taxpayer.

MR. KAUFMAN: The pay-as-you-go scenario that started back in the fifties, well before you had the hockey stick growth. And that's happening much more precipitously in the last ten years of unprecedented growth in healthcare costs. So, the notion was that you could fund this with a very small part of your funding obligation. And, you didn't have many retirees yet. You could kick the can. And then the cost seemed to be something easily manageable. For most cities in America that are on this "pay-go," it's inevitable they're going to reach a crunch and they're going to have to renegotiate it. Whether we're going to start getting modeling of cities after cities doing this so that there's some conformity and their people get used to or not, is unknown. And complicating it are retirees. While during their employ they were represented by the collective bargaining units, they are not any longer. And so they're largely just a mass of people that you have to sort of coalesce. The difficulty of

trying to do that out of court is problematic, and renders what could be solution-based through a non-court scenario something you might have to take through court or do sort of a pre-pack chapter 9 in order to accomplish it.

MR. SCHAFFER: All of this really feeds into thinking about how you get to a confirmation. Patrick says, "if I've got a young family, do I really want to spend more to bail out the city, the county, for mistakes that were made for the best of reasons, ten, twenty, thirty years ago?" Chapter 9 may be the only chapter where your greatest sources of revenue can vote with their feet. And when you get to the confirmation process, when you start foreshadowing best interests of creditors, what do we do to maximize the value for creditors in the case of my clients? I want to have the greatest recovery I can. If I'm secured, if I've got some sort of a priority, that's wonderful, but in terms of just maximizing the size of the pie before you start trying to slice it up, you have to think about what the tax rates are—assuming you can raise taxes—that will maximize the available assets before you start to see your sources of revenue walking away.

MR. DARBY: There is elasticity in taxation as with anything else. It would be extraordinary if I filed a chapter 11 for a failing business and the judge asked me, "what's your plan," and my plan was, "well, I'm going to raise my prices by fifty percent." Nobody would think that that's a viable business plan for a failing business, and it's not for an entity that gets its revenue from taxes.

MR. MARSH: Why don't we turn to confirmation? Go ahead Marc.

MR. LEVINSON: Let me just mention one other important difference from chapter 11 is the automatic stay. The automatic stay does apply in chapter 9. But there's a weird twist in Bankruptcy Code § 922, and that is that the stay applies to city officials and to residents. The reason for that is, at least in California, the way that you enforce a judgment against the local government is you get a writ of mandate from the court, compelling the person who writes the checks for the city to pay you. I believe that the law in many other states is the same way. So the automatic stay applies to those people as well. It's a very important factor, and I'll tell you it was very important to the City Council in Vallejo in filing the case because when they realized that they couldn't legally, under California law, pay the first payroll, that was their alternative; somebody coming in when the payroll wasn't paid or the bondholders weren't paid, getting a judgment—getting a writ—and subjecting them to personal liability. So the automatic stay is a very important feature.

MR. MARSH: Thanks Marc. Mark Kaufman, I'm in the confirmation world. Can a chapter 9 debtor confirm a plan and not pay its creditors in full? Can I do that?

MR. KAUFMAN: In a sense that's the ultimate question, because if you're in chapter 9, as Marc Levinson said earlier, you're in there because you haven't been able to affect an out of court workout either because you've got some problem of getting requisite numbers of retirees to sign on, or the bondholders of the bargaining units aren't compliant, and so you go in. And so the ultimate question, and the ultimate power of the bankruptcy court, while it may not have a lot of control over how you handle the matter during the pendency of the case, ultimately has the trump card of saying, "I'm either going to confirm a plan or not." Now, aside from the fact that saying, "I'm not going to confirm it and dismissal is the option," the likelihood is that at some point people conform to how the court reacts—and if you have to do it again, you might. The question is, when you get down to it, and you propose a plan that says, "I'm not going to tax my taxpayer more, but I want some haircuts on either bond debt or the retirees or the collective bargaining units," those creditors say, "listen, you've made these agreements, why don't you just execute a plan that requires more tax?" So the first question is, under state law, "can you get that accomplished?" Or, under various laws in different states, that power to vote for more taxes is reposed in the people and even then if the people say no, what does that mean for the bankruptcy judge, because then the bankruptcy judge says, well, the people have said no, but I think the answer ought to be yes. They voted with their pocketbook. I'm looking at fairness. And so, in a way, I think the best prospect of getting a plan confirmed over creditor objection is to be able to say, "Have I acted equitably in the interest of all constituencies throughout the pendency of the case?" And that's my behavior pattern and whether I've done things right and made pacts with the devil or not, that's going to have some impact on how the court sees things and, whether I've looked at every opportunity to maximize revenue and reduce expenses, other than taxes. And, you know, maybe there's some public-private partnership or other way I can raise some revenue. And then, apart from that, is the city, like Stockton, a city that can actually handle the notion of more taxes, or is it so impoverished that it can't? And there has yet to be developed law on this area. We're talking about uncharted territory, essentially, as what kind of metrics you'd want to utilize to prove the incapacity—or if you're the creditor—the capacity of the particular city given its demographics, the history, what the real estate values have done to increase or deteriorate over time. What are going to be the requisites that are going to lead a court to believe that taxing is not a

solution?—that it's counterproductive? That, as Eric was saying before, people can walk with their feet and move out of town? Those are the uncharted areas. One other thing I'd add is, there is no notion as to what "fair and equitable" truly means in a chapter 9 and it is almost a question of truth. What does fair and equitable mean in the broad context of dealing with cities with all these competing interests of the people who live in the city, and the various creditors, and the expectation of the bargaining unit, employees, and the retirees? It's highly complex. And because it is, one of the advantages for affecting a consensual deal right now is we don't have laws established on the most critical issue: when and under what circumstances can you cram? And so whether you're the monoline creditors who were in most of these—who were the insurer of most of the bond debt—or you're the collective bargaining players, you're in virtually every one of these cities. The same unions are there, the same monoline players are there, and they're very concerned that what happens in "city A" could happen elsewhere. So the implications there is that people want to look for a potential compromise as opposed to turning a card that could then have a ripple effect profoundly throughout the whole portfolio of tens of billions, or hundreds of billions.

MR. DARBY: Fair and equitable in chapter 11 does not mean fair and equitable. That's the first thing you've got to get over. There is nothing fair about it; there's nothing equitable about it. It's a name for a very objective test. We all know what it means. We all know how it works. But I think what Mark is saying is that fair and equitable in chapter 9 means "fair and equitable," like what it says in the *Webster's* dictionary. That is not objective. That is subjective, and how that applies in any case is anybody's guess.

MR. SCHAFER: One thing that's interesting, Mark—you alluded to state law. Confirmation is one of the few areas where I think the Bankruptcy Code—the bankruptcy court actually—does have some power to depart from and escape the strictures of state law. There may be a state law that says bondholders have to get paid in full. There may be caps on millage rates. But if the bankruptcy court is stuck with whatever state law is, then the entire chapter 9 process makes no sense. There is not a huge amount of case law here, but I think that it's reasonably well accepted that, if there's anything the bankruptcy court can do, it's to modify state law when it comes to treatment, to escape from absolute provisions that say these creditors must be paid.

MR. KAUFMAN: The growing question that is certainly ultimately going to make it to the Supreme Court are a series of dynamics where states are

attempting to say, "this particular constituency is the sacred cow in my state." We had the situation in Rhode Island where they said bondholders unquestionably have to be paid first. There are some *ex post facto* questions about what that means when it's a new piece of legislation. But you then say, "wait a second, I'm going to chapter 9 and I've already got my hands tied behind my back in the sense that if I'm going to constrain or impose, I've got to go to the bargaining units, or to the retirees or some other contractual parties, as opposed to bondholders." In other states, they try a different approach: "I'm going to make sacred the retirees. My gosh, these people depended upon this, how can I set them out to have some risk of having their contractual right modified?" The question is supremacy and you get into the question of—well, we already understood the concept of the Tenth Amendment, and you're deferring to states with regard to a lot of gatekeeping and controls and the powers of the city. And you're not going to abrogate those powers because of the Tenth Amendment. And now we're coming along and saying, almost a 180-degree opposite way, when it comes to how rights should be treated, if you want access to the bankruptcy court and you want to utilize the principles, why should state law that preordains that some group is supreme relative to others stand against the principles of the Bankruptcy Code. If you're accessing, you have to play by the bankruptcy rules. This is uncharted territory. There's a little bit of case law that Marc can talk to, that has happened in California, but you know, a bankruptcy court here and there may have made a determination favorable to the notion that the bankruptcy court reigns supreme on this issue. But it's uncharted territory, by and large, when you look across the nation and say, "how is this actually going to come out?" Until we have authority by circuit courts and maybe higher than that, this is going to be persistent. And I will say one other thing about it. To the extent you're strangle-holding the bankrupt, whether it's a state running it or a city doing it by these constraints that say you can't touch this or that, it's almost a recipe for disaster. People can't get their heads around the notion of saying, "this group of people ought to be protected," or, "these claims ought to be protected, but everybody else ought to suffer." And if you're going to actually effect some kind of "fair and equitable" plan, whatever it means, at the end of the day, avoiding saying, "this is a protected, sacred cow," I think has a much better prospect of making the chapter 9 process work.

MR. DARBY: It's unworkable too. If you just have a law, you can pass a law that says, the city must pay its retirees. But that doesn't generate the funds to do it. Laws don't change reality. But from a policy standpoint, you can see the sense of what Mark is saying, which is, if the state wants to have a protected

cow, like bondholders or pensioners, then it's easy. They can tell their municipalities, don't file chapter 9. That's how they control that. But once they're going to let their municipalities into chapter 9, they're going to have to accept the rules that the bankruptcy court plays by. If the state is not going to fix it itself, and wants to defer to the federal court, then the rules that apply in federal court have to apply. I think that makes sense.

MR. LEVINSON: We fought and won that battle in the Vallejo case because, early on in the case, we filed a motion to reject the four executory contracts that were the labor agreements. The unions fought us on that, saying among other things, that under California law you had collective bargaining agreements. And there were good reasons for having collective bargaining agreements. There was good reason to foster labor peace, etc., etc. And, therefore, you had to look to state law as to whether or not a contract could be rejected. The bankruptcy judge, quoting from the Orange County decision, said you can't cherry pick the provisions of the Bankruptcy Code that apply. That, as Patrick said—or Mark just said—the state is the gatekeeper. You're either in bankruptcy or not. But once you're in, you're in. And he ruled, therefore, that § 365 governed because § 1113, which you know governs collective-bargaining agreements in chapter 11, does not apply in chapter 9 cases. So the bankruptcy judge ruled, and he was affirmed on appeal by a district judge, so we have two published opinions on that. This will come up again in Stockton as well if we can't make peace with the monoline insurers. And so far, we've actually made peace with one. But we are still fighting with some others, and will be testing the outer boundaries of the fair and equitable rule. One thing that is clear though, is that the Bankruptcy Code provides in § 943 that the court shall confirm the plan if any regulatory or electoral approval is necessary under applicable law, and bankruptcy law, in order to carry out a provision of the plan that has been obtained, or if such provision is expressly conditioned. This provision is expressly conditioned on such approval. In other words, if California law requires the people to vote on a new tax, the plan can't get around that. You have to go to the people. The problem we face in California, because the enlightened voters have passed Prop. 13 and Prop. 218, is that in order to raise revenue through a sales tax or a property tax, you have to go to the people. If you want to raise a property tax, you needed a two-thirds vote. That's very, very difficult to get—very difficult. In the city of Davis, which Katie knows is the very school-oriented place where I live, we pass school bonds all the time; it's a university town. And we still only get sixty-eight, sixty-nine, seventy percent. But most of those revenues don't pass because it's so difficult to get two-thirds. If you want to raise a sales tax, there are two

options the city can pursue. One, it can go the people and say, "I want to raise a sales tax and I'm not going to tell you how to spend the money." If you do that, you only need fifty percent plus one of the vote. If you want to raise sales tax and spend it in a particular way, "I want to spend it to hire more police," or "I want to spend it to build a fire station," you need a two-thirds vote.

MR. DARBY: That seems a little counterintuitive. Is that your point?

MR. LEVINSON: I didn't vote for it. But the fact of the matter is, that's what I have to live with. And the monoline insurers who knowingly loaned to a city in this state did when they issued their insurance policies. But it makes it very difficult in a chapter 9 case to deal with that. Stockton will go to voters. And, in fact, with materials we filed in court, we've shown the polling data. Because first you hire these polling people to ask all manner of questions to try to figure out whether you've got a chance. And the problem is, if you say, "just trust us, we're gonna spend the money, we're still in chapter 11 or chapter 9," the voters are going to intuit that some of that money is going to go to the creditors. Well, they don't want to pay the creditors; they want to put more police back on the streets. Stockton has the lowest ratio of police officers to residents of any city over 100,000 in the state of California, and we want to put more police back on the street. But if we do that, we have to get a two-thirds vote, which is very difficult. So it is, in a word, a conundrum.

MR. SCHAFFER: One of the things that's interesting, when we start talking about what is fair and equitable, is that the bondholders will typically have a pledge of the full faith and credit of the municipality. Now what does that mean? There are cases that say you have to raise taxes to the greatest extent possible. Maybe it means that you've got an equitable lien. It's not entirely clear what it means, but it certainly taps into this whole theory of equity. And once you've given me this pledge of your full faith and credit, equity demands something more than saying, "wow, there's just not enough to go around."

MR. KAUFMAN: I was starting to feel bad for Eric for a minute until the full faith and credit argument came up. I think there's an argument when it comes to the cities that say I'm not going to tax because "I don't want this money to go to pay the Wall Street bondholders who lent me the money." I like Marc's best argument, which is monolines and the bondholders who underwrote it with the taxpayers and may not agree to higher taxes, so they have to be stuck with it. The countervailing argument, before we get to full faith and credit, is that at some point the bankruptcy court can say, "okay I'll call your bluff." "I have the power to look at fair and equitable on the one hand, and yes, the

taxpayers said no, but I can dismiss the case. You're move." I'm not saying that that's what I'm going to do, but just to say that in a city that can, meaning it has the financial capacity to impose upon the taxpayers because they're not at death's door in terms of paying a few more dollars, then in that kind of city, you know, I could see a bankruptcy court saying, "I'm not going to just have your vote of no define whether I'm going to now be cabin to have to confirm plan." That's why in cities which don't have that real capacity, I would double up and say, not only did the vote not happen, but as a practical matter, those people voted prudently because they knew better than you court—or anybody else's—that it's anathema for the city to start trying to tax its way out, because it's going to be counterproductive. We're going to have people leave, and the city will even be worse for it. To Eric's point on full faith and credit—fortunately for Eric, I think it does mean something relative to what his rights may be as to other creditors. Perhaps there may be some ordained notion that it has some supremacy relative to other creditors, if there's an obligation of full faith and credit. Otherwise, however, if you're saying full faith and credit means tax your way out, that's true under state law. But it's like another contract that chapter 9 says I have to cram that down. So it's just another contractual obligation that I'm going to say, "I understand what you're saying, but you know, I'm looking at a practicality and whether it's paying you the existing amount of your debt, or exercising full faith and credit obligations to go tax more, it's supplanted by what's needed to be fair and equitable and I'm doing a cramdown and that's just another claim."

MR. LEVINSON: The full faith and credit really applies to what are called "GOs." Those are unsecured of government obligation bonds. We don't have any of those in Stockton. We didn't have any in Vallejo, so those issues will not be decided by those courts. There is a concept in chapter 9 that has been around for a long time that is called the death spiral, and what that means is that you can only raise taxes so much until people can no longer pay the taxes, and you reach a point of diminishing returns. We don't know what that is. In Stockton, we may find out. But this is a city with unemployment at twenty percent, and it was one of the nation's leaders in housing foreclosures because it rode the housing bubble and was right at the top when it burst. A couple of years ago, the average house price in Stockton was about $450,000. It's now $150,000. So there's a point where you just can't raise taxes and people pay them, so what's the use? A sales tax is always tough because it hits the poorest the hardest because they have to buy provisions to eat and the like. So, it's a really difficult issue.

MR. DARBY: Marc Levinson and I sat on a panel a couple of years ago at the National Association of Bond Lawyers. They made the mistake of inviting some bankruptcy guys to speak to them—and that's a very genteel group—and we were a little rough around the edges for that crowd, I think. It got off to a bad start when we discussed this full faith and credit business. And the bankruptcy lawyers kind of looked at each other and said, "that's an unsecured claim." In the municipal finance world, full faith and credit generally has been taken to be the gold standard. Whereas a special revenue pledge, a pledge of special revenues, was taken to be something lesser, because then all you've got is a pledge of this revenue stream. You don't have the full faith and credit of the municipality. But to a bankruptcy lawyer, we immediately thought, well, the one is unsecured, and the other is secured. And when you're in bankruptcy, you want the secured claim; you don't want the unsecured claim.

MR. SCHAFER: Unless you're unsecured and there's the ability to pay unsecured claims, in which case full faith and credit may be as good or better.

MR. DARBY: Right. That's the dissonance right there, which is traditionally public finance has been based on the assumption that a certain project, with a certain defined revenue stream, that may fail. Your incinerator may fail, your sewer system may not be able to generate enough revenue, but the municipality itself is always going to have the capacity to pay its debts. And that's the dissonance right there, which is sort of the brave new world we're in.

MR. KAUFMAN: By the way, the bond market doesn't recognize this dissonance. I happened to have attended the bond-buyer conference a couple days ago. And as we're sitting, talking about this, there are cities around the United States that are listing, and you have this OPEB impending problem. They're saying, "hey, everything is great, we're going to issue the same amount of bonds as last year. We're going to do refunding, meaning recapitalizing the same bonds and we'll have $400 billion of work for this next year, isn't this great?" And even in the context where occasionally somebody talks about some problems, it overrides. They're in a warm fuzzy way, saying everything is good and by the way, municipal bond rates, because otherwise the borrowing rates are so low, are down to a couple digits—2%, 2.5%, 3% around the country—and everybody's just assuming this is going to go on forever. It's interesting to watch that community in a mindset that it's going to be forever, and full faith and credit will prevail, and all will be good.

MR. MARSH: Thank you. I want to thank the panelists, and hope everybody learned something.