Monorail, Monorail, Monorail

Chapter 9 and Restructuring Issues Relating to Municipal Authorities

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The Simpsons episode "Marge vs. The Monorail"[1] details a litany of municipal project disasters in Springfield, the eponymous family's hometown. Among these failures are a huge pile of tires, a massive escalator that leads to nowhere, and a toothpick skyscraper unwisely located next to a giant magnifying glass. At the heart of the episode, though, is one of the most famous fictional municipal project failures in history: a doomed investment in public transit known as the Springfield Monorail. While comically exaggerated by design, the episode provides a prescient warning to municipalities looking to engage in special infrastructure development, particularly in light of the unique issues that accompany common, special-purpose financing structures for such projects known as "municipal authorities."

In the episode, flush with cash from an environmental fine levied against the city's richest resident, Springfield's population falls sway to huckster monorail salesman Lyle Lanley. Lanley weaves a tale of clean, inexpensive mass transit, "cushy jobs" for the town's residents and a self-perpetuating source of redevelopment. Marge Simpson, the Simpson family's level-headed matriarch, opposes the purchase, arguing instead for a modest investment in the city's roads, but the project is approved nonetheless. While construction of the Springfield Monorail is underway, Marge visits the nearby town of North Haverbrook, which had embarked on a similar monorail project. Marge finds an economic wasteland, the monorail inoperative, residents denying that a monorail ever existed, and the city's good fortunes completely wasted on a special project gone awry. The Springfield Monorail turns out, similarly, to be a colossal failure. Though the episode aired almost 20 years ago, the Springfield Monorail mirrors real world blunders occurring in many American communities. The task of addressing the legal issues accompanying often misguided municipal projects is tedious and would never capture the attention of any media audience.

A real-world version of Springfield would likely have utilized a quasi-municipal authority—or similar entity—to finance and manage the monorail. Where a city's financial fortunes are tied up with a municipal authority or any other type of quasi-municipal entity and the underlying project proves unsuccessful, what options does the city or project have to restructure? The Bankruptcy Code contains traps for the unwary project planner. Municipal authorities occupy a disfavored status under

the Bankruptcy Code. Not only are they often unable to access the more conventional restructuring tools of Chapter 11 of the Code, but in many instances they are unable to avail themselves of either Chapter 9 or state-level restructuring benefits. This situation can lead taxpayers indirectly to pay for municipal projects for which they were assured no taxes would be used. Understanding the pitfalls of financing special projects in advance can help a governmental entity to structure its projects to maintain eligibility for bankruptcy remedies and to spread risk among those best able to bear it, be they taxpayers or lenders. Realistically, however, legislative reform of either the Bankruptcy Code or some state "home rule" statutes may be necessary to address this problem fully.

This article discusses the treatment of municipal authorities under the Bankruptcy Code and suggests solutions on how most efficiently to address certain roadblocks and ensure access to a supervised restructuring process. Part I of this article begins with a brief overview of the relevant portions of municipal finance, including summaries of how and why a city may use a municipal authority to finance special projects. Part II summarizes the Bankruptcy Code's treatment of quasi-governmental entities such as municipal authorities, including an overview of recent developments in the area, and highlights the problem caused by differing interpretations of the term "municipality." Part III discusses some legislative and strategic solutions to the problem.

What Is a Municipal Authority?

The term "authority" or "municipal authority" generally refers to any special-purpose, quasi-governmental unit that serves as an alternative vehicle to accomplish public purposes, often in the realms of public transportation, water supplies, sewage systems, airports, and parks. It commonly covers entities of various designations, such as commissions or districts. In 2002, the U.S. Census Bureau noted 1,885 municipal authorities in Pennsylvania alone, many of the largest being sewage and parking districts in major metropolitan areas. The primary distinguishing feature of an authority, as distinct from an agency, is the authority's ability to issue debt instruments denominated as tax-exempt "revenue bonds."

A revenue bond is a municipal bond, issued by a public entity that is not supported or repaid from tax revenues but, rather, is repaid from revenues received from operation of the public utility or property over which the authority has control.[2] For instance, the State of Idaho's Department of Commerce issues "Industrial Revenue Bonds," which effectively offer businesses fixed-rate financing for industrial improvements that the Department believes will increase the general tax base. The Department sells the bonds, then loans the proceeds to a business looking to make a major improvement. The bonds are then repaid, not from taxes—which could be politically unpopular—but from the business's own revenues. When a special-purpose authority—as distinct from a state governmental department—is involved, there is no taxation power whatsoever, and the full faith and credit of government to pay is not triggered. Construction and management of a particular project or asset is undertaken without resort to public coffers; moreover, management of the authority, while overseen by the municipality, is usually handled by public officials through intermediaries. Because a municipal authority does not have taxation power, its operations are more closely akin to a private corporation than those of pure governmental units. Like other municipal obligations, revenue bonds take advantage of Section 103 of the Tax Code, which makes interest on municipal bonds nontaxable. Thus, revenue bonds issued by public authorities present an appealing investment alternative for governmental units and investors: they are, at least at the outset, politically nonconfronttional, and are an attractive, tax efficient, and ideally stable investment opportunity for the private parties that purchase the bonds.

Access to Bankruptcy Courts for Municipal Authorities

The status of municipal authorities as the primary conduits of municipal finance works remarkably well as long as the underlying project generates a sufficient stream of income to cover its liabilities. Although not common, revenue bonds have defaulted. For example, if a city has financed a sports stadium with revenue bonds and the local sports team relocates to a different city, default is all but assured. Similarly, if ridership on a public transportation project, such as a monorail, fails to meet projections, the operating entity may be unable to meet its liabilities and a

default will ensue. With general obligation bonds, a municipality can--and, in some cases, must--levy taxes in order to meet debt payments. By contrast, revenue bonds are subject to shifts in business fortune.

In the event of a default, some sort of nonjudicial restructuring of the debt will likely be attempted. Depending on the depth of the project's failure and the value of the collateral at stake, however, bankruptcy or a state-supervised restructuring process may be the only alternatives to maintain the asset's viability. In some cases, though, the combination of restrictions drafted into the Bankruptcy Code and similar limitations in state statutes renders access to banruptcy courts unfeasible or ultimately ineffective. These problems are compounded when the governmental entity has a direct financial stake in the restructuring. For instance, if the City of Springfield had guaranteed revenue bonds issued by its monorail authority, the city could find its financial future tied directly to the authority's. In such instance, there must be a clear path to a restructuring for both the governmental entity and the authority: dealing with only one or the other will either ignore the root cause of the problem or fail to prevent serious harm to the municipality. Consequently, taxpayers may end up footing a bill for a project that was supposed to have been self-sufficient, but is not because of the existence of a cross-guarantee.

Access to Chapter 11: Is a Municipal Authority a "Governmental Unit"?

Chapter 9 of the Bankruptcy Code is open to only authorized governmental units. Section 109 provides generally that an entity may be a debtor under Chapter 9 only where the entity "is a municipality" and "is specifically authorized... to be a debtor under [Chapter 9] by State law."[3] Conversely, neither a municipality nor any other "governmental unit" may be a debtor under any other chapter of the Bankruptcy Code. Chapter 7 is restricted to "persons," a term which excludes "governmental units."[4]

Current law generally considers municipal authorities to be "governmental units," which the Bankruptcy Code bars from filing a Chapter 11 petition. The policy behind restricting municipalities from participating in bankruptcies arises from a legislative compromise to balance sovereignty of the states and the Contracts Clause of the Constitution. The Supreme Court, finding the statute was an unconstitutional impairment of the states' sovereignty over their subdivisions, including municipalities, held unconstitutional a predecessor to Chapter 9 that permitted municipalities to file for relief without specific authorization of their state legislature. By the same token, however, the U.S. Constitution forbids a state from creating any law that "impair[s] the Obligation of Contracts."[5] Thus, any municipal restructuring must occur under the auspices of the federal bankruptcy system in order to compromise the debt.

Various requirements in Chapter 9 further demonstrate this tension, as the Bankruptcy Code imposes stringent requirements on even a permissible municipal restructuring. Even to enter the bankruptcy system, the governmental entity must demonstrate that it has support of creditors and actually desires to effectuate a workable plan of reorgnization.[6] Similarly, the legislative history behind Chapter 9 suggests that the plan of reorganization include tax increases, where applicable, instead of merely restructuring debt obligations. Because a governmental entity cannot liquidate, creditors are entitled to the "going concern value" of their claims, which is intended to be higher than the liquidation value would be, in light of the governmental entity's ability to raise taxes.[7] Additionally, a governmental debtor that refuses to raise taxes may find itself kicked out of bankruptcy altogether, as courts have found that the Code's requirement that a municipality be "insolvent" to be eligible for Chapter 9 relief includes consideration of the governmental unit's ability to raise taxes.[8]

By contrast, Chapter 11, which is designed for corporate reorganizations, is much more flexible. There are practically no barriers to entry, and reorganization is open to almost any entity other than a governmental entity. Where a quasi-governmental authority is sufficiently independent from the state or its subdivisions, the doctrines requiring state authorization and resort to Chapter 9 do not apply, and the authority may file under the more flexible provisions of Chapter 11. A recent decision from the Bankruptcy Court for the District of Nevada—*In re Las Vegas Monorail Co.*[9]—explored the extent of Chapter 11 eligibility for public authorities. Simultaneously, however, the *Las Vegas Monorail* case illustrated that the determination of eligibility for Chapter 11 can be an unpredictable,

fact-specific inquiry. Certain aspects of the *Monorail* decision also point to an institutional failing in the municipal restructuring system: a municipal authority can find itself without recourse to *any* restructuring process, including the less lenient Chapter 9 or a state-sponsored restructuring process.

Springfield's is not the only famous monorail failure. In 2000, the City of Las Vegas formed as a private, nonprofit corporation, the Las Vegas Monorail Company (LVMC), which was the beneficiary of a revenue bond issuance designed to help produce a monorail public transportation system between casinos on the Las Vegas strip. The monorail was and is a fiasco. Once completed, the monorail's ridership was well below expectations, causing a default and an ensuing bankruptcy under Chapter 11 of the Bankruptcy Code. The insurer of the monorail's bonds, Ambac Assurance Corporation, contended that the monorail was a "governmental unit" such that the Chapter 11 bankruptcy could not proceed. The State of Nevada does not permit its subdivisions to file for Chapter 9, meaning Ambac's tactic was to propel the monorail completely out of the bankruptcy system and into Nevada's own "elaborate... scheme of regulation for local municipalities."[10]

Though the question of LVMC's "governmental unit" status was in theory a simple application of statutory analysis, Bankruptcy Judge Markell undertook an exhaustive review of the jurisprudence, legislative intent, and plain meaning of these definitions, which may serve as the primary standard for future analyses.[11] He developed a three-part test for determining whether an entity is a "governmental unit": (1) "whether the entity has any of the powers typically associated with sovereignty, such as eminent domain, the taxing power or sovereign immunity," or only a "public purpose," if the former, then the entity is a municipality; (2) if the entity has only a "public purpose," then the court examines "the level of control... on the entity's activities in furtherance of that purpose" by the state, municipality, or other purely governmental entity; and (3) whether the state's "own designation and treatment of the entity" indicates that the entity is a municipality or instrumentality.[12]

The court found that LVMC did not exercise traditional state power, and the level of state control did not rise to that of a "municipality" under the Bankruptcy Code. The court drew a distinction between entities that provide a "traditional governmental function" and those activities that merely assist the larger public purpose while being subject to state regulation. For instance, a taxi com_-pany undoubtedly assists a municipality with the traditional public function of public transportation; however, even extensive regulation would not suffice to call a taxi company an "instrumentality" of the state. Similarly, while a public school district is undoubtedly a state instrumentality, charter schools help to fill that function and are heavily regulated but are not instrumentalities of the state. Similarly, because the LVMC did not "operate in place of the State" but, rather, was "simply subject to [extensive] regulation," LVMC could not rise to the level of control required by the Bankruptcy Code's definition of "municipality."[13] Additionally, because Nevada's statutory definition of "local government" makes the power to tax the sine qua non of municipality status, LVMC would not be considered a municipality from the state's perspective.[14] Based on application of its three factors, the bankruptcy court found that the LVMC was not a municipality and could there-fore be a debtor under Chapter 11.[15]

While the *Las Vegas Monorail* decision is instructive to those who may be planning the bankruptcy restructuring of quasi-governmental entities generally, its intersection with municipal authorities as such was limited. *In dicta*, Bankruptcy Judge Markell described the history of the bankruptcy treatment for public and quasi-public entities that issued revenue bonds. Prior to 1946, municipal bankruptcy was strictly limited to entities that were capable of levying taxes. Under the 1937 Act,[16] an eligible municipal petitioner must have been a "taxing" agency or instrumentality. In 1946, Congress removed the "taxing" language from all parts of the eligibility requirement, ostensibly to accommodate entities, other than those with the power to tax, that issue revenue bonds. The House and Senate Reports regarding the 1946 amendments specifically stated that the 1937 Act did not "adequately cover what [are] known as revenue bonds" and the "new type of municipality known as an authority."[17] However, Bankruptcy Judge Markell noted that this change created a "negative inference" away from municipality designation for any entity that falls short of a paradigm authority, such as where an

authority is lent bond proceeds from the city and does not issue the bonds itself.[18]

Based on the language in the House and Senate Reports, Judge Markell assumed that such quasi-governmental authorities likely will qualify as municipalities for bankruptcy purposes. This is a well-founded assumption, based as it is on a large swath of existing case law.[19] However, the eligibility test established by *Las Vegas Monorail* is inherently fact-specific and may ultimately create more uncertainty, particularly where jurisdictions place more emphasis on any one factor of the test. In *Las Vegas Monorail*, Ambac cited to a decision from the Ninth Circuit Court of Appeals holding that a federal court should look to state-level definitions in determining eligibility for bankruptcy protection.[20] Though Judge Markell ultimately rejected this approach, other courts may emphasize the "state treatment" factor over other factors.

Moreover, in certain jurisdictions, the level of control exerted by a governmental entity is the threshold for entry into bankruptcy. In *In re Ellicott School Building Authority*,[21] the court stated flatly that the authority in question was not a municipality, largely because the State of Colorado did not exercise sufficient "control" over the authority's operations. Although the Elliott School Building Authority was structured as a nonprofit corporation, similar to the LVMC, it had the requisite power of a municipal authority: the ability to raise revenue through issuance of limited obligation bonds and thus, under the most basic application of the 1946 bankruptcy law amendments, it should have been considered eligible for municipal bankruptcy reorganization.

By attempting to establish a multifaceted test for determining what constitutes a "municipality," the *Las Vegas Monorail* decision has opened the issue of Chapter 11 eligibility to complex and possibly contradictory factual inquiries. Of the three factors, the only one that is at all simple to apply is the state definition of municipality. Beyond that, there are infinite combinations of levels of control and varying public purposes behind the creation and organization of the multitude of public authorities. Moreover, different jurisdictions may likely have opinions on when an entity is acting as an "instrumentality" of the state versus having a mere public purpose, which means that even if its creators take steps to ensure that a project entity may access Chapter 11, it may be impossible to guarantee such an outcome. Also, a project entity without access to Chapter 11, depending on the applicable state law, may have no supervised reorganization process available at all.

Access to Chapter 9: The Problem of State Authorization

Unpredictability is one problem specific to municipal authorities: functional breakdown is another. In some situations, an authority may be completely deprived of any ability to restructure debt, either as a Chapter 11 debtor, Chapter 9 debtor, or under a state rehabilitation scheme. Consider for instance, that instead of merely purchasing the monorail, the City of Springfield decided to form a municipal authority to issue revenue bonds and support the monorail project. Assume that, in doing so, it used a common municipal authority structure (not a nonprofit corporation or any other variation) and that the mayor and city council of Springfield appointed the board members to over-see certain substantial operations of the Springfield Monorail Authority. Assume further that Springfield is located in a state[22] that has a restructuring statute identical in every way to Pennsylvania's Financially Distressed Municipalities Act—or "Act 47" as it is more commonly called—and that, like Pennsylvania, the state does not have any other statute that would separately permit a municipality to file for bankruptcy. Under these circumstances, if the Springfield Monorail Authority were to default on its debt obligations, it would have absolutely no access to a reorganization process, either under state law, Chapter 9, or Chapter 11 of the Bankruptcy Code.

Under the Bankruptcy Code, if an authority is deemed a "governmental unit" that may not file a Chapter 11 petition, it also may be unable to file for the Chapter 9 protections afforded to "municipalities." To address concerns over protecting state sovereignty, the Bankruptcy Code provides that a municipality may not file for bankruptcy protection unless it is specifically authorized to do so by specific state law.[23] Very few states generally permit their municipalities to make a filing. As of the most recent count, only 14 states provide any sort of specific authorization for their cities to pursue Chapter 9 relief.[24] Some states permit Chapter 9 filings for municipalities but do not permit

their major metropolises to file. Philadelphia, for instance, may not make a bankruptcy filing.[25]

More commonly, states impose their own restructuring systems on municipalities as either a replacement or complement to a federal bankruptcy. Under Pennsylvania's Act 47 a municipality may bring a Chapter 9 proceeding only in limited circumstances where there is imminent jeopardy to health and safety or services for its citizens, or where a state-appointed coordinator recommends it as necessary. Also, even under those circumstances, the state-appointed coordinator may maintain strong control over the bankruptcy proceeding and the municipality's eventual restructuring. Many state reorganization statutes, including Act 47, do not include municipal authorities or their equivalents in the list of entities capable of invoking the protections of a state-sponsored restructuring.

In this situation, the hypothetical Springfield Monorail Authority has no access to any sort of supervised restruc-uring under the Bankruptcy Code. Under the *Las Vegas Monorail* test, the Springfield Monorail Authority would be deemed a "governmental unit": it fills a public function, is a paradigm "municipal authority" rather than a corporation, and is subject to control and direction by a the local municipality. Therefore, it would have no independent right to file a bankruptcy petition under Chapter 11. Furthermore, as a "governmental unit," the Bankruptcy Code would permit a Chapter 9 filing only where there is specific state authorization, and as indicated above, Pennsylvania and many other states do not permit such filings.

Under a more uniform, consistent system, reorganization for the Springfield Municipal Authority would at least still be possible under some sort of state structure. In many states, however, this is simply not the case. If Springfield were in Pennsylvania, for instance, Act 47 would not define the Springfield Monorail Authority as a "municipality" eligible for state-sponsored reorganization. That Act lists certain, specific entities that are considered "municipalities," including any "county, city, borough, incorporated town, township, and home rule municipality" is eligible for Act 47 relief.[26] Municipal authorities are conspicuously absent from this provision, and the Springfield Monorail Authority could therefore not pursue reorganization under the Pennsylvania statutory scheme.

The absence of any supervised reorganization structure could present a massive dilemma should the City of Springfield be at all linked to the revenue bonds issued by the Springfield Monorail Authority. If, for instance, Springfield had guaranteed the Authority bonds, it has no way to compel the Authority to seek any sort of protection for the monorail. Not only is the City barred from invoking the automatic stay of Bankruptcy Code § 362 by the requirements of Act 47, it has no basis even under the emergency provisions of Act 47 to extend bankruptcy protection to the Authority entity itself. Without the protection of the automatic stay, the Authority's secured creditors would seize assets and, in all likelihood, eventually sell them to a new operator. In doing so, the municipality suffers: it endures a hit to its credit rating, loses a revenue stream from the asset, surrenders control over management of the project, and in some cases may find itself without important public infrastructure in which it was invested.

The only practical way to prevent an unsupervised liquidation and free-for-all seizure of the Authority's assets is for the governmental entity that oversees the Authority to assume the debts and take back any assets. Pennsylvania's Municipal Authorities Act permits this very result. However, unless the city has guaranteed the revenue bonds, there is very little incentive for a municipality to do so. Moreover, taking back the asset generally it is not an efficient or effective solution for a company simply looking to reorganize. By assuming the debt, the governmental unit shifts the burden of financial risk away from the authority's bondholders and over to taxpayers, who were assured from the get-go that tax revenues would not be used to pay for the project.

Practical Concerns and Solutions

In order to navigate the issues explored above and to ensure that some sort of restructuring procedure is in place, a city or other governmental subdivision must make a series of complex structuring choices. First, the city or project planners must determine how to structure the entity that will control the investment, whether by way of a conventional municipal authority or otherwise. Secondly, before a city makes any sort of financial commitment, it must assess bankruptcy

options and ensure there is a proper endgame. Otherwise, the city may severely restrict its options and negotiating leverage in the event of a default. The city is likely to meet resistance from the lenders and credit markets, which will naturally want to eliminate its eligibility for bankruptcy relief so as to facilitate their foreclosure remedies—remedies that may not be in the public interest.

The first question invokes a strategic issue for the city. In structuring the project entity, the city must determine whether it will be content to have that entity enter a Chapter 9 bankruptcy, either as part of the city's own restructuring or on its own merits. In Chapter 9, the application of the traditional "fair and equitable" or "cram down" power is unclear. Congress required that the creditors of a Chapter 9 debtor must be provided with the going concern value of their claims, which seems to call for a straightforward valuation of the underlying collateral, since the authority's debt generally is nonrecourse. Unlike Chapter 11, the legislative history then goes on to explain that going concern value contemplates a "comparison of revenues and expenditures taking into account the taxing power and the extent to which tax increases are necessary and feasible."[27] The resulting calculation must also yield a return to creditors that is greater than the liquidation value of the collateral assets. The exercise of Chapter 9 cram down power, then, plainly contemplates that the bankruptcy court conduct an inquiry into the authority's ability to raise taxes to fill part or perhaps all of the difference between the discounted cash flow value of the underlying project and the amount of the debt secured by the project liens and security interests. The range of results of such an inquiry could theoretically be anywhere from a finding that raising taxes is not "feasible" to a ruling that tax increases must fully make up the difference between the discounted cash flow value of the asset and the full amount of the debt. In the latter case, the nonrecourse debt may have been converted into a limited recourse obligation through the Chapter 9 process, despite that the city and its constituents were supposed to have been shielded by the terms of the nonrecourse obligations themselves.[28]

In all likelihood, Chapter 11 is the preferable restructuring scheme for any sort of municipal authority or other project entity. Not only is it flexible, but access to Chapter 11 gives the authority the potential to invoke the "fair and equitable" (cramdown) power of that chapter of the Code. Moreover, by following the tests described in the *Las Vegas Monorail* decision, a developer can help to ensure that the entity will not fall into the legislative black hole described above in Part II in the context of the Springfield Monorail Authority.

To ensure that the project entity may be a Chapter 11 debtor, the developers should adhere as closely as feasible to the standards set forth in *Las Vegas Monorail*. For instance, the project entity should not be an "authority" entity but, rather, a nonprofit private corporation formed in compliance with applicable state laws. However, using non-profit corporations as issuers may make qualifying for favorable tax treatment more difficult. The *Las Vegas Monorail* decision reveals a structure that will work, though: the government may lend proceeds of a bonds issuance to the project entity, thereby ensuring that interest on the bonds will be free from taxation under 26 U.S.C.A. § 103.

Before embarking on any revenue bond finance, the city should review the applicable statutes to determine whether the local law will consider the new authority or corporation to be a "municipality" for bankruptcy or other purposes. Because the *Las Vegas Monorail* standards are inherently fact-specific, it would be wise to consider the test as a sliding scale. For instances where the project entity is or is likely to be a "municipality" for bankruptcy purposes, steps should be taken in the organizational documents to make the project entity subject to less governmental oversight or control, so that the project entity may have access to Chapter 11.

If one or more governmental units are asked to guarantee the bonds,[29] planning becomes more complicated. Because the city's financial future will be impacted by the success or failure of the underlying project—say, for instance, where a city has itself guaranteed bonds meant to support a revenue-producing asset like a monorail, a power plant, or even a golf course—the governmental unit will want to ensure both that it has proper control over the asset and authority, but also that it will be able to

coordinate any debt restructuring with that of the project entity. Because of the need for joint administration, the project entity may benefit most from being eligible for Chapter 9. Under these circumstances, the *Las Vegas Monorail* factors should be analyzed to determine whether the project entity is a paradigm municipal authority, with control placed squarely in the hands of the governmental unit that has guaranteed the project.

If a municipal authority fails and the governmental unit that guaranteed the bonds or other debt cannot meets its obligations, the only practical way for the municipality to place the authority's assets into bankruptcy protection is through a statutory assumption mechanism. In some jurisdictions, such as Pennsylvania, a city retains the authority to assume all obligations under the authority bond issuance and thereby take ownership of the underlying asset. This course may be the only practical option in instances where a particular authority has multiple tasks—for instance, if the same entity governs both Springfield's monorail and its waterworks. This is a risky strategy, as taking on a large amount of debt could negatively affect the city's relations with its other, general creditors and its public employee unions, and the possibility of undoing a sale of assets from a city to its authority can negatively affect a city's credit rating profile.[30] However, assuming the obligations of the authority's bond issuance may be the only option for a city to protect the project entity's assets from foreclosure and to ensure a bankruptcy filing properly addresses a significant cause of the city's financial woes.

Recourse to bankruptcy is not without costs, however. If an authority is able to access bankruptcy protections, bondholders or other lenders may demand certain additional protections, including restrictions on the use of revenue proceeds or requirements to raise usage rates charged by the authority. Lenders and bondholders understandably will want to insulate the project entity from any other entities operated under a common authority. The local governmental unit, thus, may be forced to surrender input or control over the operation and direction of the project entity. Likewise, lenders and bondholders may demand more draconian default remedies if a bankruptcy option is permitted.

Beyond strategic concerns, the situation of municipal authorities and their quasi-governmental cousins begs some serious inquiry into how the Bankruptcy Code's requirements for municipalities are meant to function, particularly in a world of complex municipal financing structures. State laws have significant impact on a city's ability to restructure, and statutes passed in a different era and economic climate should not now leave a quasi-governmental entity without restructuring protection, as in the Springfield Monorail Authority hypothetical given above. Where states allow their governmental units to enter bankruptcy, most municipal authorities will be relegated to Chapter 9, despite the fact that many municipal authorities are more akin to conventional businesses. Only certain municipal authorities—particularly those that perform nontraditional government functions—may access Chapter 11 under the *Las Vegas Monorail* test, which may not be uniformly applied across jurisdictions.

Federal and state legislators ought to consider whether making Chapter 11 reorganization more broadly available to municipal authorities offers a better alternative than the present, byzantine combination of federal and state laws that leave some entities unable to restructure at all. Opening Chapter 11 to municipal authorities generally could require substantial legislative amendment and would overturn long-standing precedent that considers Chapter 9 the only bankruptcy remedy available, if any. New legislation could be considered that would either codify the eligibility factors outlined in the *Las Vegas Monorail* decision or expand the availability of Chapter 11 reorganization to a broader array of municipal authorities. Predictability would do much to ensure that municipal authorities, their investors, governmental units, and the taxpayers impacted by such authorities, can accurately assess their bankruptcy options when structuring a revenue bond issuance and when preparing for a judicial or nonjudicial restructuring procedure.

Endnotes

[1] *The Simpsons: Marge vs. the Monorail* (Fox television broadcast, original air date Jan. 14, 1993). This episode seems particularly prescient given the recent spate of municipal financial difficulties, including the bankruptcy of the Las Vegas Monorail Company. See generally Part II of this article.

[2] This financing structure is also often referred to as "special obligation debt"—as opposed to "general obligation debt," which is payable from tax revenues. For a detailed analysis and description of special obligation debt, see Morrison, *The Insolvency of Public Entities in the United States, 50 Am. J. Comp. L. 567 (2002).*

[3] Additionally, the section requires that the municipality be "insolvent," must "desire[ ] to effect a plan to adjust [its] debts," and meets certain requirements related to restructuring negotiations prior to filing.

[4] Compare *11 U.S.C.A. § 109(b)* ("[A] person may be a debtor.") (emphasis added) with *11 U.S.C.A. § 101(41)* ("The term 'person' includes individual, partnership, and corporation, but does not include governmental unit."). The term "governmental unit" includes a "municipality" or any "instrumentality of... a State [or] a municipality."). Chapter 11 incorporates the same requirements as Chapter 7. See 11 *U.S.C.A. 109(d)* ("[A] person that may be a debtor under chapter 7 of this title... may be a debtor under chapter 11 of this title.").

[5] *U.S. Const. art. I, § 10, cl. 1.*

[6] See *11 U.S.C.A. § 109(c)* ("An entity may be a debtor under chapter 9 of this title if and only if such entity... (3) is insolvent; (4) desires to effect a plan to adjust such debts; and (5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter; (B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority; (C) is unable to negotiate with creditors because such negotiation is impracticable; or (D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.").

[7] See *S. Rep. No. 95-989*, 9th Cong., 2d Sess. 113 (1978) (stating that "going concern value" contemplates "a comparison of revenues, and expenditures, taking into account the taxing power and the extent to which tax in-creases are both necessary and feasible").

[8] See *In re Sullivan County Regional Refuse Disposal Dist., 165 B.R. 60, 83, 25 Bankr. Ct. Dec. (CRR) 471 (Bankr. D. N.H. 1994)* ("Municipalities that wish to come into bankruptcy under Chapter 9 in my judgment must, at a minimum, demonstrate that before filing they either used their assessment or taxing powers to a reasonable extent, or in their pre-petition negotiations have committed to the use of those powers as part of the comprehensive and appropriate work out of their financial problems. If they have undertaken that endeavor in good faith, and nevertheless have failed to reach an accommodation with their creditors, they then may be entitled to Chapter 9 relief if they are otherwise qualified.").

[9] *In re Las Vegas Monorail Co., 429 B.R. 770 (Bankr. D. Nev. 2010).*

[10] *Las Vegas Monorail, 429 B.R. at 783* (citing Nev. Rev. Stat. §§ 354.655-.725).

[11] Judge Markell's decision is the subject of a pending appeal. As of the time of this writing, the parties have finished briefing, but the District Court for the District of Nevada has not yet issued a decision. Ambac Assurance Corp. requested certification for direct appeal to the U.S. Court of Appeals for the Ninth Circuit.

[12] *Las Vegas Monorail, 429 B.R. at 788.*

[13] See *Las Vegas Monorail, 429 B.R. at 797.*

[14] See *Las Vegas Monorail, 429 B.R. at 799* (citing Nev. Rev. Stat. § 354.474.1(a)) ("'Local government' means every political subdivision or other entity which as the right to levy or receive money from ad valorem or other taxes or any mandatory assessments, and includes, without limitation, counties, cities, towns, boards, school districts and other districts").

[15] *See Las Vegas Monorail, 429 B.R. at 800* ("[E] xamination reveals a concern not with regulation of matters of public interest, but a concern with the separateness and sovereignty of States, as exemplified through laws affect-ing traditional public functions and the public fisc. LVMC does not exhibit any of these characteristics to the extent required under the Bankruptcy Code or the caselaw interpreting it.").

[16] Act of August 17, 1937, Pub. L. No. 302, 50 Stat. 653 (1937).

[17] See H.R. Rep. No. 2246, 79th Cong., 2d Sess. 2-3 (1946); S. Rep. No. 1633, 79th Cong., 2d Sess. 2 (1946).

[18] See *Las Vegas Monorail, 429 B.R. at 779* ("This structure and purpose created a negative inference that entities such as LVMC were also to be considered municipalities; otherwise, the legislation could have been easily extended to the entities to whom the public financing was lent, or from whom project revenues were to be re-ceived.").

[19] See, e.g., E*x parte York County Natural Gas Authority, 238 F. Supp. 964 (W.D. S.C. 1965)*, order modified, *352 F.2d 78 (4th Cir. 1965)* (finding authority was a municipality based on level of control exerted by State); *Matter of North and South Shenango Joint Municipal Authority, 14 B.R. 414, 8 Bankr. Ct. Dec. (CRR) 195, 5 Collier Bankr. Cas. 2d (MB) 276, Bankr. L. Rep. (CCH) P 68378 (Bankr. W.D. Pa. 1981)*, order rev'd on other grounds, *80 B.R. 57 (W.D. Pa. 1982) (looking to the intent of the statute).*

[20] See *Security Bldg. & Loan Ass'n v. Spurlock, 65 F.2d 768 (C.C.A. 9th Cir. 1933)* (adopting Arizona's definition of "building and loan association" to determine that petitioner was not a "building and loan association" for the purposes of bankruptcy eligibility).

[21] *In re Ellicott School Bldg. Authority, 150 B.R. 261, 23 Bankr. Ct. Dec. (CRR) 1551, 81 Ed. Law Rep. 170 (Bankr. D. Colo. 1992).*

[22] Notably, no one knows in which state the Simpson family's town is located.

[23] The authorization power is normally reserved to legislatures. However, in a recent decision, the Bankruptcy Court for the Southern District of New York found that a governor's executive order would satisfy the authorization requirement. See *In re New York City Off-Track Betting Corp., 427 B.R. 256, 267-68 (Bankr. S.D. N.Y. 2010)* (addressing a "direct and unambiguous order" from the governor of New York for a quasi-governmental entity to file a Chapter 9 petition). The Off-Track Betting Corp. decision was appealed, but the appeal was dismissed as moot when the bankruptcy court dismissed the underlying bankruptcy. See Stipulation and Order for the Dismissal of Appeal and Motion to Dismiss, *In re N.Y. Off-Track Betting Corp., No. 10-03958 (S.D.N.Y. February 14, 2011), ECF No. 9.*

[24] Freyberg, *Municipal Bankruptcy and Express State Authorization to Be a Chapter 9 Debtor: Current State Approaches to Municipal Insolvency and What Will States Do Now?, 23 Ohio N.U. L. Rev. 1001, 1008-09 (1997).*

[25] See Act 47 § 261. Pennsylvania does not permit its largest municipality even to participate in its own re-structuring process. As a "municipality of the

first class," Philadelphia may not be participate in Act 47 or Chapter 9 bankruptcy. See Pennsylvania Intergovernmental Cooperation Act, Section 708 of Act 1991, June 5, P.L. 9, No. 6.

[26] See Act 47 *§ 103*. Similarly, as quoted in *Las Vegas Monorail*, Nevada's definition of municipality relied on the entity's ability to levy taxes. This hypothetical would operate the same way under a system like Nevada's, which also involves a complex state-sponsored municipal restructuring scheme in lieu of Chapter 9 bankruptcy.

[27] *S. Rep. No. 95-989*, 95th Cong., 2d Sess. 113 (1978) (emphasis added).

[28] See *11 U.S.C.A. § 927* ("The holder of a claim payable solely from special revenues of the debtor under applicable nonbankruptcy law shall not be treated as having recourse against the debtor on account of such claim pursuant to section 1111(b) of this title").

[29] It is highly unusual for a municipality to guarantee the debt of a public authority, but such transactional structures are not unprecedented. The City of Harrisburg, Pennsylvania, for example, has guaranteed certain of the debts of its public authority. See McNichol, Harrisburg, Pennsylvania, Council Told to Consider Bankruptcy, Bloomberg (Apr. 27, 2010), available at http:// www.bloomberg.com/news/2010-04-27/pennsylvania-s-capital-told-to-consider-chapter-9-bankruptcy-protection.html ("Harrisburg, the capital of Pennsylvania, the sixth-most populous U.S. state, has guaranteed payments on $282 million in bonds on the incinerator, run by the Harrisburg Authority. The payments on the bonds and on a working-capital loan this year add up to four times the amount the city collects in property taxes each year, budget documents show.").

[30] In fact, following the City of Harrisburg's entry into state reorganization process, due in part to a failed incinerator project, Moody's Investors Service downgraded approximately $86 million in bonds unrelated to The Harrisburg Authority's default on bonds for a public incinerator. See Fosenberg and Varghese, Moody's Downgrades $86 Million in Harrisburg-Related Bonds, Dow Jones Daily Bankruptcy Review, January 20, 2011, at 7. Moody's downgraded $69.42 million water revenue refunding bonds issued by The Harrisburg Authority, as well as $16.28 million in revenue bonds issued by the Harrisburg Parking Authority. for unrelated water revenue refunding bonds issued by The Harrisburg Authority and $16.28 million in bonds from the Harrisburg Parking Authority. See Fosen-berg and Varghese, Dow Jones Daily Bankruptcy Review, January 20, 2011, at 7. Moody's expressed concern that the bonds are susceptible to Harrisburg's overall financial ailments and that the authorities or their assets "could be drawn into the workout plan for the city's financial distress." Fosenberg and Varghese, Dow Jones Daily Bankruptcy Review, January 20, 2011, at 7.

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