

2015

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Recommended Citation

MaryJane Richardson, *The Disguise of Municipal Bonds: How a Safe Bet in Investing Can Become an Unexpected Uncertainty During Municipal Bankruptcy*, 37 *CAMPBELL L. REV.* 187 (2015).

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ABSTRACT

When revenue is low, municipalities often use general obligation or special revenue bonds to meet their budgetary needs. In issuing bonds, municipalities promise to repay bondholders; however, when a municipality files for Chapter 9 bankruptcy, repayment may be prolonged or even precluded. Special revenue bond repayment is subject to the “necessary operating expenses” of the municipality, as established by 11 U.S.C. § 928. However, the Bankruptcy Code leaves this phrase undefined. This Comment attempts to assign meaning to this phrase through an analysis of the Jefferson County, Alabama, bankruptcy. This Comment further identifies factors that investors should consider before purchasing municipal bonds to ensure a return on investment.

INTRODUCTION

In 2008, the housing and subprime mortgage crises caused one of the most significant recessions this country has ever seen.¹ The mortgage crisis “slowed consumer spending, increased unemployment, and restricted credit markets,”² negatively affecting economic health all the way down to individual communities.³ State and local governments experienced massive budget gaps due to weak tax collections.⁴ States saw some of the

1. See CHRISTINE R. MARTELL & ADAM GREENWADE, BUECHNER INST. FOR GOVERNANCE, AN ANALYSIS OF LOCAL GOVERNMENT FINANCE (2013), <http://www.ucdenver.edu/academics/colleges/SPA/spaweb/Documents/Martell%20Brief%20BIG%20Fin.pdf> (outlining the effects of the housing and subprime mortgage crisis of 2008 on the consumer and credit markets, unemployment rates, and local government).

2. *Id.*

3. Michael F. Thompson, *State Revenue Collection Through the Great Recession*, IND. BUS. REV., Fall 2013, at 8.

4. Phil Oliff et al., *States Continue to Feel Recession’s Impact*, CTR. ON BUDGET & POL’Y PRIORITIES 1 (June 27, 2012), <http://www.cbpp.org/files/2-8-08sfp.pdf> (“The budget gaps result principally from weak tax collections. The Great Recession that started in 2007 caused the largest collapse in state revenues on record.”).

lowest collected revenues in history,⁵ ultimately reaching an all-time low in 2010.⁶

Because the primary revenue source for local governments is property tax, local governments are typically more resistant than states to fluctuations in the economy, and they may see smaller decreases in tax-revenue collection during an economic downturn. Property tax constitutes almost 80% of local tax collection, with income and sales taxes comprising much smaller percentages.⁷ During the recession, however, falling home prices led to lower tax values, leaving local governments with a significantly diminished source of revenue.⁸

In response to the recession, many local governments implemented measures to reduce spending. Local governments instituted “hiring and pay freezes, pay cuts, layoffs, furloughs, early retirement incentives, and buyouts.”⁹ For the debt already incurred, local governments “renegotiate[d] debt, delay[ed] or cancel[ed] projects and contracts, and ma[de] cuts to . . . infrastructure repairs, libraries and senior services.”¹⁰

As revenue and federal aid decreased, demand for public services increased.¹¹ Local governments spent a substantial amount of money providing social, economic, and health services.¹² Financially distressed municipalities resorted to restructuring their finances, particularly through bankruptcy.¹³ Filing for bankruptcy protection can help to relieve some of

5. *Id.*

6. *Id.*

7. Jiri Jonas, *Great Recession and Fiscal Squeeze at U.S. Subnational Government Level* 15 (Int’l Monetary Fund, Working Paper No. 12/184, 2012), available at <https://www.imf.org/external/pubs/ft/wp/2012/wp12184.pdf>.

8. *Id.* at 11.

9. Joshua Franzel, *The Great Recession, U.S. Local Governments, and e-Government Solutions*, PM MAG., Sept. 2010, <http://webapps.icma.org/pm/9208/public/pmplus1.cfm?author=Joshua%20Franzel&title=The%20Great%20Recession%2C%20U.S.%20Local%20Governments%2C%20and%20e-Government%20Solutions>.

10. *Id.*

11. Jonas, *supra* note 7, at 10 (“The Great Recession had a severe impact on state and local government finances At the same time, the recession ‘automatically’ increased demand for a range of state-provided services . . .”).

12. Oliff et al., *supra* note 4, at 1 (explaining that “[t]he vast majority of these [budget] shortfalls have been closed through spending cuts and other measures in order to meet balanced-budget requirements”). Moreover, “[t]o the extent these shortfalls are being closed with spending cuts, they are occurring on top of past years’ deep cuts in critical public services like education, health care, and human services.” *Id.*

13. David A. Skeel Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677, 684 (2012) (outlining six benefits of state bankruptcy and undercutting the common objections to it).

the municipality's financial strain, but it can cause stress and uncertainty for bondholders.¹⁴

This Comment provides a brief overview of Chapter 9 municipal bankruptcy. Part I discusses the history of municipal bankruptcy and outlines the prerequisites for filing. Part II discusses two types of municipal bonds, as well as their benefits and risks to both municipalities and bond purchasers. Part III explores the effect of a bankruptcy filing on municipal bonds by examining the recent municipal bankruptcy filing of Jefferson County, Alabama, and how it handled special revenue bond claims. Finally, Part IV highlights factors for investors to consider before purchasing municipal bonds, in light of the *Jefferson County* Chapter 9 bankruptcy.

I. MUNICIPAL BANKRUPTCY

Municipal bankruptcy originated in the mid-1930s as a way for Congress to extend bankruptcy relief to municipalities.¹⁵ Congress recognized that state and municipal governments needed access to bankruptcy protection, especially after the financial crisis of the Great Depression, which was felt by every level of government.¹⁶ Between 1929 and 1937, there were approximately 4,700 defaults by governmental entities.¹⁷

To expand bankruptcy protection, however, Congress had to be mindful of the Tenth Amendment's reservation of the states' right to sovereignty over their internal affairs, including how states handle debt acquisition and payment.¹⁸ To extend bankruptcy protection while also

14. See *infra* notes 71–76, 91–115 and accompanying text.

15. See Rachael E. Schwartz, *This Way to the Egress: Should Bridgeport's Chapter 9 Filing Have Been Dismissed?*, 66 AM. BANKR. L.J. 103, 114–15 (1992). Specifically, federal law did not provide for municipal bankruptcy until 1934. *Id.* at 114.

16. See *id.* at 114–15 (explaining that the first federal bankruptcy legislation was a direct byproduct of the Great Depression); see also Joseph M. Witalec & Mark G. Douglas, *Chapter 9 Descends Into the Sewer to Clean Up*, JONES DAY 2 (Mar.–Apr. 2012), http://www.jonesday.com/files/Publication/c2b8d4fd-416f-4747-a330-f3b49d1a15bb/Presentation/PublicationAttachment/bbe7f15d-1a64-4bc3-b41dbcc48af5311a/Jefferson%20County%20chapter%209%20BRR%20Mar_Apr%202012.pdf (providing that Congress's decision to implement the new federal municipal bankruptcy law was “[u]shered in during the Great Depression to fill a vacuum that previously existed in both federal and state law”).

17. JAMES E. SPIOTTO, CHAPMAN & CUTLER LLP, PRIMER ON MUNICIPAL DEBT ADJUSTMENT 3 (2012), available at http://www.afgi.org/resources/Bankruptcy_Primer.pdf.

18. See U.S. CONST. amend. X (“The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.”); see also Witalec & Douglas, *supra* note 16, at 2 (suggesting that federal

respecting Tenth Amendment rights, Congress created a separate chapter of the federal Bankruptcy Code: Chapter 9.¹⁹ Chapter 9 allows a municipality to adjust its debts in ways similar to private debtors,²⁰ but limits the powers of bankruptcy courts over the debt-adjustment process.²¹

Under Chapter 9, political subdivisions can reorganize or adjust their debts.²² The process of reorganizing under Chapter 9 includes “extending debt maturity dates, reducing principal or interest due on prior debts, or refinancing existing debts with new loans or municipal bonds.”²³ A municipality can file for Chapter 9 relief only if authorized to do so under state law.²⁴

Once a municipality has been authorized to file a Chapter 9 petition, the municipality must meet three eligibility requirements. First, the municipality must be insolvent.²⁵ According to the Bankruptcy Code, a municipality is insolvent if it is unable to pay its current debts when they

municipal bankruptcy law is limited by the Tenth Amendment’s reservation of certain states’ rights and the Supreme Court’s striking of the first bankruptcy law as unconstitutional in 1936).

19. Municipal Bankruptcy Act of 1934, ch. 345, 48 Stat. 798, *invalidated by* Ashton v. Cameron Cnty. Water Improvement Dist. No. 1, 298 U.S. 513, 531 (1936). Chapter 9 was created through an amendment to the uniform system of bankruptcy laws that applied throughout the United States. The amendment’s purpose was to help with the “national emergency caused by increasing financial difficulties of many local governmental units.” *Id.* § 78, 48 Stat. at 798; *see also* Schwartz, *supra* note 15, at 114–15.

20. *See* 11 U.S.C. § 901 (2012) (indicating that several sections of Chapter 11 on reorganization of an individual’s debt, including sections concerning information that must be included in the readjustment plan and how to reorganize debt, apply to Chapter 9 municipal bankruptcy).

21. *Id.* §§ 903–904 (limiting the power of the court to prevent it from interfering with any political or governmental powers of the municipality).

22. *Id.* § 901.

23. Paul Mignano, *Was GM a Municipality? Chapter 9 of the Bankruptcy Code and the Definitional Limit of “Government Instrumentality,”* 8 N.Y.U. J.L. & BUS. 529, 535 (2012).

24. 11 U.S.C. § 109(c)(2).

For instance, section 23-48 of the North Carolina General Statutes provides that “any taxing district, local improvement district, school district, county, city, town or village” may file for Chapter 9 bankruptcy with the “approval of the Local Government Commission of North Carolina.” N.C. GEN. STAT. § 23-48 (2013).

Similarly, Pennsylvania’s authorization statute requires a city of “the first class” to get authorization from the governor before filing for Chapter 9 bankruptcy. *See* 53 PA. CONS. STAT. ANN. § 12720.101 (West 2014). A city of “the first class” under Pennsylvania’s structure is one that has a population of one million people or more. *Id.*

Other states require less oversight. For example, in the State of Washington, any taxing district may file for protection under Chapter 9 as long as it adopts a resolution to authorize the filing. *See* WASH. REV. CODE § 39.64.050 (2014).

25. 11 U.S.C. § 109(c)(3).

become due, or if it is generally not paying its undisputed debts as they become due.²⁶

Second, the municipality must “desire[] to effect a plan to adjust [its] debts.”²⁷ Finding that a municipality has the “desire” to adjust its debts is a highly subjective determination of intent.²⁸ Bankruptcy courts have found different forms of proof to be sufficient;²⁹ generally, the municipality must show “prepetition efforts to develop and implement a plan to avoid bankruptcy, even if that plan eventually fails.”³⁰

The third eligibility requirement concerns the municipality’s readjustment plan—the municipality’s proposed method of satisfying or discharging creditors’ claims.³¹ This eligibility requirement may be satisfied in one of four ways. First, the municipality can obtain the “agreement of creditors holding at least a majority in amount of the claims of each class that [the municipality] intends to impair under a plan.”³² Second, even if the municipality fails to obtain the agreement of the creditors, it may meet its eligibility requirement if it has negotiated with those creditors in good faith.³³ Finally, if such negotiation would be impracticable,³⁴ or if the municipality “reasonably believes that a creditor may attempt to obtain” a preference under 11 U.S.C. § 547,³⁵ the municipality may be deemed to have fulfilled its obligation. If all three of the eligibility requirements are met, the municipality can file a petition for Chapter 9 bankruptcy, along with a proposed debt-reorganization plan.³⁶

26. *Id.* § 101(32)(C).

27. *Id.* § 109(c)(4).

28. *In re City of Detroit*, 504 B.R. 97, 171 (Bankr. E.D. Mich. 2013) (engaging in an in-depth evaluation of Detroit’s “desire,” through a discussion of potential ulterior motives as well as the possibility of impairing pensions).

29. *Compare In re Cnty. of Orange*, 183 B.R. 594, 607 (Bankr. C.D. Cal. 1995) (proposing a comprehensive settlement agreement, among other steps taken that demonstrated efforts to resolve claims which satisfied § 109(c)(4)), with *In re Sullivan Cnty. Reg’l Refuse Disposal Dist.*, 165 B.R. 60, 76 (Bankr. D.N.H. 1994) (holding that a postpetition submission of a draft plan of adjustment met the requirements of § 109(c)(4)).

30. Mignano, *supra* note 23, at 536.

31. 6 COLLIER ON BANKRUPTCY ¶ 900.02[2][d], at 900-22 to -23 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2014).

32. 11 U.S.C. § 109(c)(5)(A).

33. *Id.* § 109(c)(5)(B).

34. *Id.* § 109(c)(5)(C).

35. *Id.* § 109(c)(5)(D).

36. Lauren M. Wolfe, Comment, *The Next Financial Hurricane? Rethinking Municipal Bankruptcy in Louisiana*, 72 LA. L. REV. 555, 565 (2012) (citing 11 U.S.C. § 109(c)(5)).

Once a municipality files a Chapter 9 bankruptcy petition, the bankruptcy court issues an automatic stay,³⁷ halting all actions to enforce claims for debt, including enforcement of liens on taxes owed.³⁸ Although the stay and plan of adjustment under Chapter 9 are beneficial to a municipality, the effect on bondholders is considerably less favorable.³⁹

II. MUNICIPAL BONDS

A local government's ability to meet its obligations varies based on the services that its residents need, as well as the amount of revenue that it collects. Tax revenue is one of the largest sources of revenue for most state and local governments.⁴⁰ During an economic downturn, tax revenues decline, forcing local governments to operate with less funding.⁴¹ Adding to the financial strain, most state and local governments are required by law to maintain balanced budgets.⁴² This requirement places a restriction on spending that makes it difficult for governments to pay for day-to-day operations, public services, and the maintenance and upkeep of infrastructure.⁴³ Further, state and local governments are required to provide "basic infrastructure, education, and health and safety services at

37. 11 U.S.C. § 922(a).

38. *Id.*

39. Famose T. Garner, Comment, *Putting the Honest Back in "Honest but Unfortunate Debtor": A Debtor's Duty to Report a Beneficial Change in Circumstances*, 47 HOUS. L. REV. 105, 130 (2010) (explaining that some debtors have abused the Code as a means of avoiding debt repayment, and that under the current laws, a debtor does not have to report a beneficial change in income, providing a "head start" instead of a "fresh start" for the debtor).

40. Indeed, taxes accounted for almost 40% of local-government revenues in 2011. See Christine Sgarlata Chung, *Government Budgets as the Hunger Games: The Brutal Competition for State and Local Government Resources Given Municipal Securities Debt, Pension and OBEP Obligations, and Taxpayer Needs*, 33 REV. BANKING & FIN. L. 663, 676 (2014) [hereinafter Chung, *Hunger Games*].

41. These periods of decreased revenue often correspond with a need to expand community services. See CONG. BUDGET OFFICE, ECONOMIC AND BUDGET ISSUE BRIEF: FISCAL STRESS FACED BY LOCAL GOVERNMENTS 2 (2010), http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/120xx/doc12005/12-09-municipalities_brief.pdf.

42. Peter Molk, Comment, *Broadening the Use of Municipal Mortgages*, 27 YALE J. ON REG. 397, 398 (2010) (citing CONN. GEN. STAT. ANN. § 12-122 (West 2008) (requiring municipalities to set taxes to balance budgets); Ronald K. Snell, *State Balanced Budget Requirements: Provisions and Practice*, NAT'L CONF. ST. LEGISLATURES, <http://www.ncsl.org/research/fiscal-policy/state-constitutional-and-statutory-requirements-fo.aspx> (last updated Mar. 2004) (noting that forty-nine states have balanced-budget requirements)).

43. Chung, *Hunger Games*, *supra* note 40, at 671–74 (discussing the tension between state and local governments' obligations to provide public services with limited revenue).

all times,”⁴⁴ which means that certain budget cuts or downsizing are not always possible.⁴⁵

With restricted funding and balanced-budget requirements, local governments have to resort to other sources of funding, mainly by issuing municipal bonds.⁴⁶ A municipal bond is defined as “a type of interest-bearing debt instrument issued by state or local governments to fund certain types of financial needs.”⁴⁷ Historically, municipalities issue two types of bonds: general obligation bonds and special revenue bonds.⁴⁸ The difference between the two types of bonds is the type of collateral used to secure payments of interest and principal, and the types of risk that the bonds carry.⁴⁹ The two types of bonds are discussed in more detail below.

A. *General Obligation Bonds*

General obligation bonds are debt instruments issued by state and local governments to raise funds for public projects.⁵⁰ A general obligation bond is a tool used by municipalities to raise money for projects and services that will not provide a source of revenue, such as roads, bridges, parks, and equipment.⁵¹ State and local law determine how general obligation bonds are secured and what funds are used for their repayment.⁵² Typically, general obligation bonds are secured by the municipality’s “full faith and credit,”⁵³ meaning that the municipality has committed to use all available revenue resources through its general revenue powers to pay the principal and interest of the bond.⁵⁴ Essentially, the municipality promises

44. *Id.* at 672.

45. *Id.*

46. *Id.* at 683.

47. Arthur Flynn, Note, *The Life and Premature Death of BABS: A Proposal to Reinstate the Subsidized Taxable Municipal Bond*, 6 BROOK. J. CORP. FIN. & COM. L. 673, 676 (2012) (citing BLACK’S LAW DICTIONARY 76 (3d pocket ed. 2006)).

48. *Id.* at 677 (citing Randle B. Pollard, *Who’s Going to Pick Up the Trash?—Using the Build America Bond Program to Help State and Local Governments’ Cash Deficits*, 8 PITT. TAX REV. 171, 178 (2011)).

49. *See id.* at 677 n.39 (citing Pollard, *supra* note 28, at 178–79).

50. *Id.* at 676–77.

51. *Id.*; *see also* MOODY’S INVESTORS SERV., SPECIAL COMMENT: U.S. MUNICIPAL BOND DEFAULTS AND RECOVERIES, 1970-2011, at 2 (2012), <http://www.nhhefa.com/documents/moodysMunicipalDefaultStudy1970-2011.pdf> (stating that general obligation bonds are sold to fund projects that improve the physical infrastructure of a municipality).

52. NAT’L ASS’N BOND LAWYERS, GENERAL OBLIGATION BONDS: STATE LAW, BANKRUPTCY AND DISCLOSURE CONSIDERATIONS 13 (2014), http://www.nabl.org/uploads/cms/documents/GENERAL_OBLIGATION_MUNICIPAL_BONDS.pdf.

53. *Id.* at 2.

54. *Id.* at 2–3.

to use its power to levy taxes in order to meet the general obligation bonds when they become due.⁵⁵ The taxing power used to meet this obligation varies depending on the municipality's laws.⁵⁶ Some municipalities may secure general obligation bonds with property taxes,⁵⁷ which allows the municipality to raise property taxes if other sources of revenue are insufficient to pay for the general obligation debt.⁵⁸

General obligation bonds are considered the best investment among municipal bonds.⁵⁹ Because they are secured by full faith and credit, investors are ensured that their bonds will be repaid, even if the municipality has to raise its taxes.⁶⁰ A municipality's ability to raise its taxes to repay general obligation bonds lowers the occurrence of defaults and lowers the risk of loss to investors.⁶¹

General obligation bonds are beneficial to a municipality as well, but are limited in their ability to help with the municipality's need for additional funding. Many municipalities have a statutory cap on the amount of debt that the municipality is allowed to incur, and general obligation bonds typically count toward this cap.⁶² Considering the recent recession, the maximum amount that can be borrowed may be much less than the amount that the municipality needs. When the municipality reaches its

55. KROLL BOND RATINGS, NOT ALL G.O. BONDS ARE CREATED EQUAL 3-4 (2013), <http://www.treasurer.ca.gov/cdiac/seminars/2014/20140205/kroll.pdf> (defining general obligation bonds, which, depending on the level of government that issues the bond, can be secured by a limited or an unlimited property tax rate, the general fund, or by guaranteed debt and discussing the corresponding taxing power that comes with each type of general obligation bond as well as what risks these bonds pose on the issuing local government's credit rating).

56. *Id.*

57. *Id.*

58. *Id.* at 3.

59. See Christine Sgarlata Chung, *Municipal Securities: The Crisis of State and Local Government Indebtedness, Systemic Costs of Low Default Rates, and Opportunities for Reform*, 34 CARDOZO L. REV. 1455, 1465, 1469 (2013) [hereinafter Chung, *Municipal Securities*] (arguing that regulations are concerned with risk and municipal markets, but that the risks to issuers and taxpayers should be instead regulated by federal securities laws).

60. *Id.* at 1469 ("Although default rates tend to be higher for revenue bonds, issuers' obligation to tap dedicated revenues has kept default rates (and thus investor losses) in relative check.").

61. *Id.* at 1470. General obligation bonds are used "to finance public facilities that do not produce revenues, or when it is thought to be inappropriate to levy fees for use as a matter of public policy." *Id.* at 1466.

62. For example, Illinois prohibits any municipality with a population of less than half a million people from incurring a total debt exceeding "8.625% of the value of the taxable property" within that municipality. 65 ILL. COMP. STAT. 5/8-5-1 (2012).

debt limit, it must look for other forms of financing, such as special revenue bonds.⁶³

B. Special Revenue Bonds

Special revenue bonds are debt instruments that are issued to fund public works and infrastructure projects that are designed to improve the municipality.⁶⁴ Under the Bankruptcy Code, “special revenue” includes any receipts, special excise taxes, or other revenues derived from projects or systems of the municipality that are primarily used to provide transportation, utility, and other services that are owned, operated, or disposed of by the municipality.⁶⁵ For example, projects that may be built or improved with special revenue bonds include toll roads and sewer systems.⁶⁶ Although the revenues received are part of general taxes levied by the municipality, this revenue is attributable to the improvements of the financed project.⁶⁷

Special revenue bonds are secured “only by the revenue stream generated from a distinct source, usually the underlying project the bonds are used to finance.”⁶⁸ Since these bonds are self-funded by an identifiable revenue stream that is not based on the municipality’s usual tax collections, such as property and income taxes, special revenue bonds do not count toward a municipality’s statutory debt limit.⁶⁹ Because these bonds have a limited revenue source and, thus, carry a higher risk of default, the bonds

63. Molck, *supra* note 42, at 399. Molck suggests:

Many municipalities have ceilings on the amount of debt they can incur. Typically, general obligation bonds count toward this ceiling, but [special] revenue bonds do not. Revenue bonds thus offer an important form of financing if municipalities approach or break through their debt ceiling. Because pure revenue bonds are self-funded by an identified revenue stream, they do not count as debt

Id.

64. Mignano, *supra* note 23, at 537 (“Special revenue bonds remain secured and serviced during the pendency of the [C]hapter 9 case. These special revenue bonds are often distributed in order to fund public works such as hospitals, stadiums, or other public infrastructure projects.”).

65. 11 U.S.C. § 902(2) (2012).

66. Chung, *Municipal Securities*, *supra* note 59, at 1466; SPIOTTO, *supra* note 17, at 29 (defining “special revenues” and providing examples of each of the five types of special revenues as set out in 11 U.S.C. § 902(2)).

67. SPIOTTO, *supra* note 17, at 29.

68. Molck, *supra* note 42, at 399.

69. *Id.* at 399–400.

incur higher interest rates.⁷⁰ The higher interest rates and the security of the project itself appeal to investors.⁷¹ Despite the higher risk of default, investors will see the link between how their money is used to improve the municipality and repayment of the special revenue bonds, increasing their confidence in purchasing these bonds.⁷²

III. MUNICIPAL BANKRUPTCY'S EFFECT ON MUNICIPAL BONDS

When a municipality files for Chapter 9 bankruptcy, what once seemed to be a good investment can become a significant loss for bondholders. General obligation bondholders and special revenue bondholders are given different priority,⁷³ which determines whether the bondholders will receive payment on their investment in the municipality during the stay and after the municipality readjusts its debt.⁷⁴

General obligation bonds are treated as part of the municipality's "general debt."⁷⁵ Those who have been issued general obligation bonds are treated as general unsecured creditors during the bankruptcy process.⁷⁶ After a municipality has filed for bankruptcy and a stay has been placed on all payments to creditors, payments on bonds will be stayed as well.⁷⁷ Creditors holding special revenue bonds, however, fare much better than those who hold general obligation bonds during a Chapter 9 bankruptcy.

70. Chung, *Municipal Securities*, *supra* note 59, at 1466 n.37 (quoting ROBERT L. BLAND, *A BUDGETING GUIDE FOR LOCAL GOVERNMENT* 171 (2007)).

71. *Id.*

72. *Id.*

73. Priority determines which creditor, or class of creditors, gets paid first and how much they get repaid. See Richard M. Hynes & Steven D. Walt, *Pensions and Property Rights in Municipal Bankruptcy*, 33 *REV. BANKING & FIN. L.* 609, 613 (2014) ("Creditors with claims having equal priority share equally in proportion to their claims." (citing *Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 667 (2006); *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941); H.R. REP. NO. 95-595, at 177-78 (1977))). As explained above in this Comment, the Bankruptcy Code grants some creditors higher priority than others. Secured creditors, such as special revenue bondholders, are given higher priority than general, unsecured creditors, like general obligation bondholders—meaning, special revenue holders will be paid before general obligation bondholders. *Id.*

74. 11 U.S.C. § 928 (2012); see Mignano, *supra* note 23, at 537 ("General obligation bondholders are treated as general creditors, holding claims to be redeemed in the bankruptcy process. Special revenue bonds remain secured and serviced during the pendency of the [C]hapter 9 case.").

75. 11 U.S.C. §§ 552, 928(a); S. REP. NO. 100-506, at 4-5 (1988).

76. 11 U.S.C. § 928; Mignano, *supra* note 23, at 537; SPIOTTO, *supra* note 17, at 32.

77. SPIOTTO, *supra* note 17, at F-3.

Special revenue bonds remain secured and are paid during the pendency of a Chapter 9 bankruptcy case.⁷⁸ The Bankruptcy Code, in a sense, rewards investors who have helped fund projects that will improve the municipality through providing these bonds with priority.⁷⁹ The Code provides that any prepetition pledge or obligation terminates upon the filing of a Chapter 9 bankruptcy petition, but only as to property acquired after the filing of the petition.⁸⁰ However, rights to proceeds of the property subject to the lien, such as the project securing special revenue bonds, are not terminated.⁸¹ In the case of special revenue bonds, “the security interest in ‘special revenues’ remains valid and enforceable even though such revenues are received after a Chapter 9 filing.”⁸² Thus, special revenue bondholders continue to receive payment on those bonds, despite the bankruptcy filing.⁸³

Although special revenue bondholders receive priority, repayment of these bonds can still be uncertain. Repayment of special revenue bonds is subject to § 928(b), which exempts the “necessary operating expenses” of the project or system that was financed by the bonds.⁸⁴ However, the Bankruptcy Code does not explicitly define which costs are “*necessary* operating expenses” of a municipal project.⁸⁵ Consequently, the phrase is open to subjective interpretations, “ranging from something that is absolutely needed to something that is needed, but not essential.”⁸⁶

Since “necessary operating expenses” has not been defined in the Bankruptcy Code, municipalities must look to other sources, such as legislative history, to determine what expenses will receive priority over all other payments to creditors and bondholders. The legislative history of Chapter 9 suggests that “necessary operating expenses” are those expenses that are “necessary to keep the project or system going and producing special revenues.”⁸⁷ Prepetition operating expenses may qualify as

78. 11 U.S.C. § 928; Mignano, *supra* note 23, at 537.

79. Mignano, *supra* note 23, at 537.

80. SPIOTTO, *supra* note 17, at 26.

81. *Id.* Although the Bankruptcy Code does not directly define what constitutes “proceeds,” and the term has not been addressed in case law, amendments to the Code provide clarity as to what the term “proceeds” includes. *Id.*

82. *Id.* at 27.

83. *Id.*

84. 11 U.S.C. § 928(b) (2012).

85. *See id.* §§ 101, 928(b) (emphasis added).

86. Bank of N.Y. Mellon v. Jefferson Cnty. (*In re* Jefferson Cnty.) (*Jefferson II*), 474 B.R. 725, 752 (Bankr. N.D. Ala.), *amended*, 482 B.R. 404 (Bankr. N.D. Ala. 2012).

87. F COLLIER ON BANKRUPTCY, *supra* note 31, app. pt. 41(g)(ii)(A), at 41-130 (providing the legislative history of the 1988 amendments to the Bankruptcy Code).

“necessary operating expenses,” but the legislative history reflects that a court can ultimately determine whether these prepetition expenses are truly necessary for the purpose of generating special revenues.⁸⁸

The lack of guidance from the Code as to what constitutes a “necessary operating expense” has recently led to litigation and, as a result, has provided an interpretation of the term. Analysis of the recent litigation can provide investors with insight as to what constitutes a “necessary operating expense,” helping them to make better investment decisions the next time they have the opportunity to purchase special revenue bonds.

A. *Municipal Bankruptcy in Jefferson County, Alabama*

The *Jefferson County* bankruptcy resulted from the loss of a large part of the county’s tax revenue, which exacerbated the municipality’s immense preexisting debt.⁸⁹ In March 2011, the Supreme Court of Alabama struck down a business license and occupation tax as improperly implemented by the state’s legislature.⁹⁰ Along with this loss of revenue, which amounted to approximately \$50 million,⁹¹ Jefferson County was facing almost \$4 billion of previously incurred debt.⁹² Most of the debt came from borrowing money in the late 1990s and early 2000s in the form of special revenue bonds to finance the construction and repair of the county’s sewer system.⁹³

The Jefferson County sewer system had drastically grown in size, with the county acquiring over twenty sewer systems from the local governments of both small towns and large cities.⁹⁴ The county acquired the sewers without first determining the condition of these systems, most of which were improperly maintained.⁹⁵ Using special revenue bonds to make the appropriate repairs to the newly enlarged sewer system caused the county to sink further into debt, and prevented spreading the costs of the repairs

88. *See id.*

89. *In re Jefferson Cnty. (Jefferson I)*, 474 B.R. 228, 236 (Bankr. N.D. Ala. 2012).

90. *Jefferson Cnty. v. Weissman*, 69 So. 3d 827, 844–45 (Ala. 2011) (holding that the tax was improperly advertised because the legislature failed to publish four consecutive weekly notices in the affected counties before introducing the bill).

91. *Updates from the State House*, LEGIS. UPDATE (Birmingham Bus. Alliance, Birmingham, Ala.), Apr. 1, 2011, at 1, <http://www.birminghambusinessalliance.com/uploads/PDFs/BBALegislativeUpdate.Newsletter.Issue5.pdf>.

92. *Jefferson I*, 474 B.R. at 237.

93. *Id.*

94. *Id.*; *see also* Robin Smith, *Southern Discomfort: An Examination of the Financial Crisis in Jefferson County, Alabama*, 10 HOUS. BUS. & TAX L.J. 363, 365 (2010).

95. *Jefferson I*, 474 B.R. at 237; *see also* Smith, *supra* note 94, at 366.

across everyone in the county⁹⁶ in the form of taxes, fees, assessments, and general obligation bonds.⁹⁷ Instead, the sewer bonds were to be repaid by the revenues of a sewer system that was in desperate need of repair.⁹⁸

The county soon realized that the sewer-system revenue would not cover the payments that had become due on the special revenue bonds. By February 2008, Jefferson County had defaulted on the warrants.⁹⁹ Two months later, the county could not make principal payments on the bonds.¹⁰⁰ By April, the county and the bondholders had entered into an agreement of forbearance of special revenue bond payments.¹⁰¹ After years of trying to restructure the debt by laying off hundreds of employees, closing facilities, eliminating overtime, and cutting work hours,¹⁰² Jefferson County filed for Chapter 9 bankruptcy in November 2011.¹⁰³

Despite the bankruptcy filing, the county was still required to make payments on the special revenue bonds with the returns that the sewer system generated during the bankruptcy stay.¹⁰⁴ However, a dispute arose between a trustee of the special revenue bondholders and the county.¹⁰⁵ The trustee and the county disagreed as to which expenses should be considered “necessary operating expenses.”¹⁰⁶ The county wanted to use

96. *Jefferson I*, 474 B.R. at 238.

97. *Id.* at 238–39.

98. *Id.* at 239 (“When sewer usage charges increase beyond a point, the ability of the county to obtain revenue from other sources for other purposes is constrained . . . the payment of increasing sewer charges takes monies from its residents that might otherwise have been available via taxes, assessments, fees, or other means.”); *see also* David A. Rosenzweig & Stanford G. Ladner, *The Latest in Jefferson County*, LAW360 (July 12, 2012, 7:27 AM), <http://www.law360.com/articles/359720/the-latest-in-jefferson-county>.

99. *Jefferson I*, 474 B.R. at 241.

100. *Id.*

101. *Id.*

102. *Id.* at 244–45.

103. Voluntary Petition, *In re Jefferson Cnty.*, No. 11-05736-TBB9 (Bankr. N.D. Ala. Nov. 9, 2011); *see also* Lawrence A. Larose & Robert J. Gayda, Chadbourne & Parke LLP, Treatment of Special Revenue Bonds in Chapter 9: Where Are We After *In re Jefferson County, Alabama?*, Presentation at the American Bankruptcy Institute 2014 Annual Spring Meeting, in *Business Track: Municipal Bankruptcies*, AM. BANKR. INST., Apr. 2014, 213, 214, <http://materials.abi.org/sites/default/files/2014/Apr/MunicipalBankruptcies.pdf>.

104. *Jefferson II*, 474 B.R. 725, 730 (Bankr. N.D. Ala.), *amended*, 482 B.R. 404 (Bankr. N.D. Ala. 2012).

105. *Id.*

106. The parties disagreed as to “what expenditures for the County’s sewer system [were] payable ahead of payments to those lenders who/which secured payment of interest and principal owed” to the special revenue bonds. *Bank of N.Y. Mellon v. Jefferson Cnty. (In re Jefferson Cnty.) (Jefferson III)*, 482 B.R. 404, 408 (Bankr. N.D. Ala. 2012); Rosenzweig & Ladner, *supra* note 98.

\$4.5 million of the sewer revenue each month to pay for professional fees consisting primarily of attorney's fees relating to the bankruptcy proceedings and negotiations with bondholders, as well as for depreciation and amortization, and for future operating expenses and capital expenditures.¹⁰⁷ The trustee argued that these were not "necessary operating expenses" because under the contract governing the trustee's duties, only the expenditures incurred and for which payment is due in the current month constituted expenditures that could be taken from the sewer-system revenues.¹⁰⁸

To resolve the conflict between the trustee and Jefferson County, the United States Bankruptcy Court for the Northern District of Alabama had to determine the meaning of "necessary operating expenses."¹⁰⁹ In doing so, the court first looked to the legislative history of the 1988 amendments to the Bankruptcy Code, which created the "necessary operating expenses" exception.¹¹⁰ The court noted that when reviewing the legislative history of a statute, it is important to determine the purpose of the statute.¹¹¹ Further, the court explained that the legislative history reflected Congress's desire to ensure special "revenue bondholders receive the benefit of their bargain with the municipal issuer [and that] they will have unimpaired rights to the project revenues pledged to them."¹¹² However, the report of the United States House of Representatives Committee on the Judiciary indicated that the pledged revenues for special revenue bonds are not to be affected by a stay of bankruptcy as long as it is consistent with the amendments to the Bankruptcy Code, including the "necessary operating expenses"

107. *Jefferson III*, 482 B.R. at 409–10; Rosenzweig & Ladner, *supra* note 98.

108. *Jefferson III*, 482 B.R. at 410, 414.

109. *Id.* at 431; *see also* Rosenzweig & Ladner, *supra* note 98.

110. 11 U.S.C. § 928(b) (2012) ("Any such lien on special revenues, other than municipal betterment assessments, derived from a project or system shall be subject to the necessary operating expenses of such project or system, as the case may be."); H.R. REP. NO. 100-1011, at 8 (1988), *reprinted in* 1988 U.S.C.C.A.N. 4115, 4122 ("New subsection 928(b) ensures that in the case of project financing . . . or system financing . . . the lien on special revenues will be subordinate to the necessary operating expenses of the project or system.").

111. *Jefferson III*, 482 B.R. at 432; Witalec & Douglas, *supra* note 16 ("According to the [*Jefferson County*] court, excerpts from the legislative history of amendments to the Bankruptcy Code in 1998 . . . were intended to preserve creditors' liens on municipal special revenues that might otherwise be avoided . . .").

112. S. REP. NO. 100-506, at 12 (1988) ("[T]he [1988] amendments insure that revenue bondholders receive the benefit of their bargain with the municipal issuer, namely, they will have unimpaired rights to the project revenue pledged to them.").

exception.¹¹³ Thus, the court concluded, “Congress contemplated leaving a pledge of special revenues unaffected unless it is at odds with the policies” in the Bankruptcy Code’s exception.¹¹⁴

According to the Senate Report, a policy of the amendments was that special revenues be used to “keep the system or project operating followed by payment of interest and principal to lenders.”¹¹⁵ Keeping the system or project operating includes funds necessary to both repay the bondholders and to deliver services to customers.¹¹⁶ According to the House Report, “payment of operating expenses—those necessary to keep the project or system going—must be protected so that the project or system can be maintained in good condition to generate the [revenue] to repay bondholders.”¹¹⁷ After reviewing the legislative records, the court indicated that the perimeter of “necessary operating expenses” includes expenses that are “expended to keep the system or project operating in the sense that . . . [it] is kept in good repair and generating the special revenues, not improvements or enhancements,” as well as those that are “directly related to the project or system.”¹¹⁸ Necessary operating expenses also include “some, but not all operating expenses, which flow from § 928(b) being a minimum standard” and those that are “being paid, which is different from those that may be incurred and paid in a later time period.”¹¹⁹ Overall, the consideration of what would constitute “necessary operating expenses” should be, “whether the contracted for pledge allows the system during the pendency of the municipal bankruptcy to continue to operate, be in good condition, and generate revenues for debt repayment. It is not that it is the

113. *Id.* at 11 (“The automatic stay should specifically be inapplicable to application of [pledge revenues for secured bonds].”); *Jefferson III*, 482 B.R. at 434; *see also* Witalec & Douglas, *supra* note 16, at 5 (“However, [§] 922(d) excludes certain acts from the scope of the stay under [§] 922(a) by providing that ‘[n]otwithstanding [§] 362 of this title and subsection (a) of this section, a petition filed under this chapter does not operate as a stay of application of pledged special revenues in a manner consistent with [§] 927 of this title to payment of indebtedness secured by such revenues.’” (quoting 11 U.S.C. § 922(d))).

114. *Jefferson III*, 482 B.R. at 434.

115. *Id.*; S. REP. NO. 100-506, at 22.

116. *Jefferson III*, 482 B.R. at 437; S. REP. NO. 100-506, at 22.

117. *Jefferson III*, 482 B.R. at 437; H.R. REP. NO. 100-1011, at 8 (1988), *reprinted in* 1988 U.S.C.C.A.N. 4115, 4122.

118. *Jefferson III*, 482 B.R. at 437.

119. *Id.*; *see* Larose & Gayda, *supra* note 103, at 218 (“[T]he Court found that ‘necessary operating expenses’ meant expenses necessary to keep the sewer system operating and to maintain it in good, not perfect, condition so that the system could generate revenue necessary to repay the Sewer Warrants and to provide service to the residents of the municipality.”).

best possible operation, the best maintained, or the best of any possible criteria.”¹²⁰

The *Jefferson County* court also noted that a bankruptcy court should avoid an item-by-item determination of what constitutes a “necessary operating expense.”¹²¹ What a system needs to remain in operation is a business judgment of the municipality and the lenders.¹²² That assessment should not be second-guessed by a bankruptcy court unless there is evidence of unreasonableness or certainty that the § 928(b) standard has not been met.¹²³ Bankruptcy courts should defer to the agreement between the parties as expressed in their contract.¹²⁴

The *Jefferson County* court noted the absence of a discussion of capital expenses and capital expenditures in both the House and Senate Reports.¹²⁵ The omission of capital expenses is significant in determining whether those expenses were to be included as part of “necessary operating expenses,” the court reasoned, because, just a few months prior to the House and Senate’s review of the proposed amendments to the Bankruptcy Code, these expenses had previously received a great deal of attention by the *Report on the National Bankruptcy Conference on Proposed Municipal Bankruptcy Amendments*.¹²⁶ The absence of a discussion on capital expenditures and expenses indicated that Congress did not intend for these expenses to be considered as “necessary operating expenses” of a project or system.¹²⁷

Overall, the court found that neither depreciation and amortization nor capital expenses and capital expenditures are “necessary operating expenses.”¹²⁸ The 1988 amendments were created to ensure that special revenues were used to pay the special revenue bondholders.¹²⁹ The county’s plan to take \$3.6 million per month would hinder this purpose.¹³⁰ Further, capital

120. *Jefferson III*, 482 B.R. at 441.

121. *Id.* at 440.

122. *Id.* at 441.

123. *Id.* at 442–43.

124. *Id.* at 443.

125. *Id.* at 438; *see also* S. REP. NO. 100-506 (1988); H.R. REP. NO. 100-1011 (1988), reprinted in 1988 U.S.C.C.A.N. 4115, 4122.

126. *Jefferson III*, 482 B.R. at 435 (“This National Bankruptcy Conference report was part of the floor speeches of the two members of Congress who introduced the bills in their respective chambers.”); *see also* 133 CONG. REC. S16229 (Nov. 12, 1987) (statement of Sen. DeConcini); 134 CONG. REC. H77 (Feb. 2, 1988) (statement of Rep. Edwards).

127. *Jefferson III*, 482 B.R. at 435.

128. *Id.* at 439; *see also* Larose & Gayda, *supra* note 103, at 216.

129. *Jefferson III*, 482 B.R. at 439; S. REP. NO. 100-506, at 5–7.

130. *Jefferson III*, 482 B.R. at 439.

expenses and expenditures are not the daily expenses required to keep the sewer system in operation during the time the county is in Chapter 9 proceedings.¹³¹ Finally, although depreciation and amortization are expenses, they were not *current* operating expenses that would keep the sewer system operating.¹³²

The court considered whether the county could deduct professional fees before making special revenue bond payments.¹³³ There were two types of professional fees and related costs at issue. The first type of professional fees are the “fees and costs directly related to the efficient and economical administration of the sewer system exclusive of those related to the county’s chapter 9 bankruptcy case,”¹³⁴ which all parties agreed were properly payable ahead of special revenue bond payments. The second type includes all other professional fees, mostly those related to the county’s Chapter 9 case, totaling over \$830,000 per month,¹³⁵ and which were disputed. The court explained that “legal services are never a frill or an extra; they are fundamental to the efficient development of a reorganization plan.”¹³⁶ Thus, the court held that the professional fees in *Jefferson County* were “necessary operating expense[s]” that could be paid prior to payment of special revenue bonds.¹³⁷

B. *Lessons Learned from Jefferson County*

Jefferson County can provide guidance to investors as to the type of bonds in which to invest and the information to consider prior to making that investment. In addition to looking at interest rates and the security backing the bonds, investors should consider how municipal bankruptcy can change the risk of their investment based on the type of security

131. *Id.*

132. *Id.*

133. Mark N. Berman, *A Crack in the Armor of the Special Revenue Bond*, BANKR. L. ALERT 3 (July 31, 2013), http://www.nixonpeabody.com/files/157872_Bankruptcy_Alert_31JULY2013.pdf (discussing the three *Jefferson County* decisions to explain the rights of special revenue bondholders, the indenture between the county and its bankruptcy trustee, and the risk to special revenue bondholders of losing priority to professional fees after the *Jefferson County* decisions).

134. *Jefferson III*, 482 B.R. at 409.

135. *Id.* at 410.

136. Bank of N.Y. Mellon v. Jefferson Cnty. (*In re Jefferson Cnty.*) (*Jefferson IV*), 503 B.R. 849, 900 (Bankr. N.D. Ala. 2013); *see also* Berman, *supra* note 132, at 4 (recognizing Chief Judge Bennett’s finding that professional fees are necessary expenses for § 928(b) purposes).

137. *Jefferson IV*, 503 B.R. at 902–03.

provided, the purpose of the bond, and the kinds of fees that are related to the bond.

First, investors should research the bond under consideration and understand the condition of the security, if the bond is secured. As *Jefferson County* illustrates, the condition of the security is an important indicator of a municipality's ability to honor its obligation after filing for bankruptcy.¹³⁸ This is especially true for special revenue bonds, which rely on the amount of revenue that is generated by the underlying project or system. If the special revenue bond-financed project is in poor condition and requires costly maintenance, the revenue that it generates will be needed for the maintenance and improvement of the project.¹³⁹ Upon filing for bankruptcy, this revenue will be used for that maintenance—a “necessary operating expense”—rather than paying back the bond.¹⁴⁰ Thus, although special revenue bondholders receive payments during a municipal-bankruptcy stay, this privilege may be undercut by high costs of improvement and maintenance of the secured project.¹⁴¹

Second, investors should consider the professional fees that will be needed for a project to maintain operations, including legal fees associated with potential bankruptcy filings. In a bankruptcy filing, both types of professional fees—operational maintenance and litigation—receive priority over special-resource bond payments.¹⁴² Litigation fees would likely cut into the funds available to make payments on special revenue bonds.¹⁴³ As for general obligation bonds, if a municipality is negatively affected by a downturn in the economy, it may have to provide more services, but with lower revenue collections, and may not be able to raise taxes high enough to cover its operational maintenance costs.

Third, special revenue bondholders should also find comfort in two main components of the *Jefferson County* court's interpretation of “necessary operating expenses.” The first component is that the court

138. See *supra* notes 80–87 and accompanying text.

139. See Berman, *supra* note 133, at 3 (discussing Chief Judge Bennett's finding that operating expenses included those funds necessary to maintain the sewer system in good enough condition so that it can generate revenue to repay bondholders and, obviously, to continue to provide services to the community).

140. *Id.*

141. See 11 U.S.C. § 928(b) (2012) (“Any such lien on special revenues, other than municipal betterment assessments, derived from a project or system shall be subject to the necessary operating expenses of such project or system, as the case may be.”).

142. *Jefferson IV*, 503 B.R. at 902–03 (finding that attorney's fees were necessary operating expenses).

143. As seen in *Jefferson County*, the litigation fees can be enormous. The attorney's fees in *Jefferson County* amounted to nearly three quarters of a million dollars *per month*. See *Jefferson III*, 482 B.R. 404, 410 (Bankr. N.D. Ala. 2012).

required the expenses to be *current* expenses.¹⁴⁴ The time limitation placed on municipal expenses prevents a municipality from deducting costs that may arise in the future in order to buffer any possible future negative consequences.¹⁴⁵ Special revenue bondholders, in turn, do not have to worry about expenses they cannot anticipate before the municipality files for bankruptcy.¹⁴⁶

As for the second component, the *Jefferson County* court required “necessary operating expenses” to be limited in scope.¹⁴⁷ Only the expenses that keep the project operating in good—not optimum—condition and generating revenue will be given priority over the special revenue bondholders’ claims. Although the municipality’s judgment receives deference,¹⁴⁸ evidence of unreasonable spending can be raised when there is a bankruptcy filing, forcing the bankruptcy court to review the legitimacy of the municipality’s priority claim and providing special revenue bondholders further protection of their claims.¹⁴⁹

Finally, despite the risks associated with special revenue bonds, potential bond investors should remember that the Bankruptcy Code favors special revenue bondholders. When Congress amended the Bankruptcy Code, it created unique privileges for special revenue bondholders to reward them for investing in a municipality.¹⁵⁰ All claims during a municipal bankruptcy case will be considered in light of this purpose and should earn these bondholders—and their priority claims—favor with the court.¹⁵¹

144. *Id.* at 439 (deciding that depreciation and amortization were expenses, but were not necessary operating expenses because they were not part of the day-to-day expenses needed to keep the sewer system functioning).

145. *Id.*

146. See Berman, *supra* note 133, at 4–5 (arguing that unless municipalities take care to draft concise definitions in their contracts with trustees as to what expenses can be paid out of project revenues, bondholders’ priority in repayment may be subject to the legal fees incurred by the municipality’s bankruptcy proceedings).

147. See *id.* at 3 (noting Chief Judge Bennett’s finding that funds needed to keep the sewer in good—but not perfect—condition were “necessary operating expenses”).

148. See *supra* notes 104–06 and accompanying text.

149. See *In re City of Detroit*, 504 B.R. 97, 171 (Bankr. E.D. Mich. 2013) (reviewing the petitioner’s subjective desire to restructure its debts before confirming the municipality’s bankruptcy plan).

150. S. REP. NO. 100-506, at 12 (1988); H.R. REP. NO. 100-1011, at 8 (1988), *reprinted in* 1988 U.S.C.C.A.N. 4115, 4122; SPIOTTO, *supra* note 17, at 23 (discussing Senate reports indicating that Congress wanted special revenue bondholders to be rewarded for investing in the municipality); see also *supra* note 95 and accompanying text.

151. S. REP. NO. 100-506, at 12; H.R. REP. NO. 100-1011, at 8, 1988 U.S.C.C.A.N. at 4122; SPIOTTO, *supra* note 17, at 26–28 (discussing Senate reports indicating that Congress intended to “[make] clear that revenue bondholders are entitled to receive the revenues

CONCLUSION

Municipal bonds, both general obligation bonds and special revenue bonds, are beneficial in helping municipalities find funding for their daily operations as well as revenue-generating projects. However, these bonds come with the risk that a financially distressed municipality will file for Chapter 9 bankruptcy. General obligation bonds do not have to be paid during the bankruptcy proceedings, while special revenue bonds enjoy continued investment and principal payments.¹⁵² The “necessary operating expenses” of projects financed by special revenue bonds, however, can overshadow the benefit of the continued payments of special revenue bonds during municipal-bankruptcy proceedings.

Although “necessary operating expenses” has not been defined in the Bankruptcy Code, the recent *Jefferson County* opinions provide insight into what Congress intended the phrase to mean. Operating and maintenance costs and professional fees, excluding capital and future expenses, are the only fees intended to take priority over special revenue bond payments. Investors can look to the *Jefferson County* bankruptcy to assess the risks they face when a municipality files for bankruptcy.

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pledged to them without any interference and on a timely basis”); *see also supra* notes 95–97 and accompanying text.

152. SPIOTTO, *supra* note 17, at 27.

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