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Is the § 943(b)(7) Feasibility Requirement Feasible? Why Congress Should Clarify Its Chapter 9 Bankruptcy Plan Requirements

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ABSTRACT

As the number of municipal bankruptcy filings increases, areas of confusion within the Bankruptcy Code are becoming more apparent. One point of ambiguity is what Chapter 9's "feasibility" requirement entails. This question is significant because all municipalities must satisfy the feasibility requirement before courts will confirm their bankruptcy plans. This Comment answers that question through an analysis of § 943(b)(7)'s historical roots, and relevant case law, as well as a comparative discussion of Chapter 9 and Chapter 11 standards. Ultimately, this Comment proposes that Congress codify the Mount Carbon decision to provide clarity and predictability for municipalities.

INTRODUCTION

As the rate of municipal bankruptcy filings continues to climb in the aftermath of the Great Recession,[1] the issues that accompany these filings are becoming more prevalent. The typical Chapter 9 case presents many issues that are unique to municipal bankruptcy, such as determining how bond creditors will be compensated,[2] and whether states will even allow municipalities to file for relief under Chapter 9,[3] as well as issues that are

1. *See* Arthur R. O'Keeffe, *Muni Bond Defaults, Bankruptcies and Bondholder Protections*, BNY MELLON WEALTH MGMT. 2 (2013), http://www.bnymellonwealthmanagement.com/Resources/documents/perspectives/fullhtml/muni-bond-defaults.pdf (explaining that while there were seventy-one, ninety-five, and sixty-nine municipal bankruptcy filings during the 1980s, 1990s, and 2000s, respectively, there were thirty-one filings between 2010 and 2012 alone).

2. *See, e.g.*, *In re* Mount Carbon Metro. Dist., 242 B.R. 18, 25 (Bankr. D. Colo. 1999) (evaluating the municipality's plan to compensate creditors "with a combination of cash and Exchange Bonds").

3. *See* 11 U.S.C. § 903 (2012) ("[Chapter 9] does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality."); *see also* O'Keeffe, *supra* note 1, at 3 (graphically illustrating that twelve states specifically authorize, twelve conditionally authorize, and two states prohibit municipal bankruptcy filings).

related to bankruptcy more generally, such as how to prioritize creditor claims.[4] The Detroit bankruptcy, the largest municipal bankruptcy filing in United States history,[5] demonstrates the pervasiveness of such issues, and has led to a wealth of analysis related to Chapter 9 filings, which, prior to Detroit's filing in July 2013 had been largely undiscussed by the legal community. This is perhaps because of the relative infrequency of Chapter 9 filings in comparison to other bankruptcy filings,[6] or because before 2013, no municipality of Detroit's size had invoked the protection of Chapter 9.

Whatever the reason for the lack of discussion regarding Chapter 9 issues, it is clear that substantive issues, such as how repayment priorities will be determined and whether states will sanction municipal bankruptcy filings, have been the most targeted subjects of scholarly review. Unfortunately, the practical issues have been largely overlooked. One practical—and often glossed-over—issue is the question of what hurdles municipalities must overcome for courts overseeing their bankruptcy filings to confirm their bankruptcy plans.[7] Congress enumerated the requirements for judicial confirmation of municipal bankruptcy plans in 11 U.S.C. § 943,[8] and courts are precluded from approving such plans if they do not comport with the statutory criteria.[9] Included among the confirmation requirements is the mandate that municipal bankruptcy plans be "in the best interests of creditors and [also be] *feasible*."[10] But what does it mean for a plan to be feasible?

4. *See, e.g.*, *In re* Cnty. of Orange, 191 B.R. 1005, 1013 (Bankr. C.D. Cal. 1996) (holding that a state statute establishing priority for non-county participants in a trust fund for which Orange County was trustee was preempted by federal bankruptcy law).

5. Zack A. Clement & R. Andrew Black, *How City Finances Can Be Restructured: Learning from Both Bankruptcy and Contract Impairment Cases*, 88 AM. BANKR. L.J. 41, 42 (2014).

6. The website of the federal judiciary shows the infrequency of Chapter 9 filings. Chapter 9, 12, and 15 filings collectively accounted for less than one-tenth of 1% of all bankruptcy petitions filed. *See U.S. Bankruptcy Courts*, U.S. CTS., http://www.uscourts.gov/Statistics/JudicialBusiness/2013/us-bankruptcy-courts.aspx (last visited Jan. 21, 2015).

7. "Practical," as it is used here, is not meant to suggest that confirmation requirements are not "substantive" issues. The distinction between "substantive" and "practical" issues is meant to underscore the fact that a wealth of academic analysis has focused on doctrinal issues traditionally associated with bankruptcy, while only a small amount of that analysis has focused on the prerequisites for bankruptcy plan confirmation.

8. 11 U.S.C. § 943.

9. *Id.*

10. *Id.* § 943(b)(7) (emphasis added).

Section 943(b)(7)'s feasibility requirement is different from any provision found in Chapter 11's bankruptcy plan requirements.[11] In fact, Chapter 11 never explicitly mentions feasibility. Because Congress has not explained what it means for a plan to be feasible for the purposes of Chapter 9, municipalities seeking relief cannot be sure what they need to include in their plans in order to attain confirmation and avoid dismissal.[12] It is clear that further guidance is needed regarding the requirements for confirmation—especially the feasibility requirement. Municipalities, already strapped for cash, simply cannot afford the expense of constantly altering their plans to comport with the courts' varying interpretations of what is required to achieve confirmation. Further, municipalities cannot afford to risk dismissal of their Chapter 9 filings for failure to have their plans confirmed within the applicable time limits.[13]

This Comment illustrates why it is necessary for Congress to clarify its Chapter 9 feasibility requirement for bankruptcy plans. Part I traces § 943(b)(7)'s origins in an attempt to ascertain what meaning Congress attached to the term "feasibility." Part II explores the case law interpreting the § 1129(a)(7) feasibility requirement, as well as the case law interpreting the § 943(b)(7) feasibility requirement. Part III compares the feasibility standards of Chapter 9 and Chapter 11, underscoring the principal differences between the two provisions. This Comment concludes by accentuating the lack of guidance that municipalities have when seeking to construct feasible bankruptcy plans, and urging Congress to provide ailing municipalities with statutory guidance by clearly delineating which aspects of Chapter 9 bankruptcy plans are essential to demonstrating feasibility.

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11. The most closely analogous feasibility requirement in Chapter 11, § 1129(a)(11), provides that:

> [A bankruptcy] court shall confirm a plan only if . . . [c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

Id. § 1129(a)(11).

12. Section 930 allows courts to dismiss Chapter 9 cases for, among other things, "unreasonable delay by the debtor that is prejudicial to creditors," "failure to propose a plan within the time fixed under [§] 941," "not [being] accepted within any time fixed by the court," and "denial of confirmation of a plan under [§] 943(b) . . . and denial of additional time for filing another plan or a modification of a plan." *Id.* §§ 930(a)(2)–(5). Additionally, the statute provides that a court "*shall dismiss*" a case filed under Chapter 9 if confirmation of a bankruptcy plan is refused. *Id.* § 930(b) (emphasis added).

13. *See id.* § 941 (allowing the court to affix a deadline for the filing of a satisfactory bankruptcy plan).

I. TRACING THE ORIGINS OF § 943(b)(7)

The requirements for confirmation of municipal bankruptcy plans in § 943(b), including the feasibility requirement, can be traced to section 83(e)[14] of the 1937 Municipal Bankruptcy Act (the 1937 Act) and section 94(b)[15] of the 1976 Municipal Bankruptcy Act (the 1976 Act).[16] Sections 83(e) and 94(b) of the 1937 and the 1976 Acts, respectively, are derived from legislation promulgated by Congress in 1934,[17] which authorized municipalities to file for bankruptcy.[18] To effectively understand the rationale underlying the Chapter 9 feasibility requirement, it is necessary to trace the provision back to its inception.

This Part first examines the backdrop against which Congress passed the 1934 Act. Next, this Part examines the original requirements for confirmation of municipal bankruptcy plans set forth in the 1937 Act, particularly focusing on the language giving rise to § 943(b)(7) in its current form. Finally, this Part traces the development of that language through the 1976 and 1978 amendments to the Bankruptcy Code,[19] to the current language of § 943(b)(7) that is applicable to the confirmation of Chapter 9 plans.

A. The 1934 Act

Congress enacted the 1934 Municipal Bankruptcy Act in response to an anomaly presented by the Great Depression.[20] As a result of market depression, many rural taxpayers were unable to farm their land profitably.[21] Taxpayers were unable to pay the real property taxes levied by their governing municipalities—the municipalities that taxpayers relied on for vital irrigation and drainage services.[22] As the Depression advanced, the decrease in tax revenue inevitably affected the ability of municipalities

14. Act of Aug. 16, 1937, ch. 657, § 83(e), 50 Stat. 653, 658, *amended by* Act of Apr. 8, 1976, Pub. L. No. 94-260, 90 Stat. 315.

15. Act of Apr. 8, 1976, § 94(b), 90 Stat. at 323–24 (current version at 11 U.S.C. § 943(b) (2012)) (amending Chapter IX of the Bankruptcy Act to provide by voluntary reorganization procedures for the adjustment of the debts of municipalities).

16. 6 COLLIER ON BANKRUPTCY ¶ 943.LH[2], at 943-29 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2014).

17. *See* 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 (1936).

18. *Id.*

19. The Bankruptcy Code is the name commonly given to Title 11 of the United States Code, and is the primary source of United States bankruptcy law.

20. *See* 6 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 900.LH[1], at 900-25.

21. *Id.* (citing *Ashton*, 298 U.S. at 533–34 (Cardozo, J., dissenting)).

22. *Id.*

to satisfy their bond obligations.[23] Tax foreclosures did not provide municipalities with additional revenue to pay their creditors; there was no market for the land, since few could afford to buy the foreclosed property.[24]

The bond creditors seeking a return on their investments had only one remedy available: an action for mandamus against the officers of the municipalities.[25] An action for mandamus, if granted by a court, would require the municipal officers to levy higher taxes in an effort to raise enough revenue to cure their bond defaults and allow continued payments on outstanding bonds.[26] Ironically, the bond creditors' liberal use of the mandamus remedy perpetuated the problem, as taxpayers were unable to meet their existing tax obligations, much less the tax hikes resulting from the mandamus orders.[27] Additionally, the higher taxes resulted in more property foreclosures, which further depleted municipal revenues.[28]

This vicious cycle presented many vexing problems for the defaulting municipalities. With no way to raise sufficient revenue, how would the municipalities attain relief from the demands of their creditors? Raising tax rates would not solve the problem, as the rural population could not bear the burden of the existing taxes. Turning to the capital markets was also not an option, as issuing more bonds would simply exacerbate the existing problem of massive debt and hurl the municipalities further into insolvency. Even more problematic, the states were constitutionally forbidden from assisting the municipalities in their struggle to return to solvency, as restructuring municipal debt in the manner of a commercial reorganization would run afoul of the Tenth Amendment's[29] prohibition against states impairing obligations of contract.[30] How were the

23. *See, e.g.*, Vallette v. City of Vero Beach, 104 F.2d 59, 61 (5th Cir. 1939) (involving the City of Vero Beach, Florida, which incurred debt during the state's financial boom and was subsequently unable to levy taxes at a rate high enough to cover its defaults because the appropriate rate would have been "very oppressive," if at all recoverable).

24. 6 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 900.LH[1], at 900-25 (citing Ouerbacker v. Henderson Cnty., 126 F.2d 309, 313 (4th Cir. 1942); Luehrmann v. Drainage Dist. No. 7, 104 F.2d 696, 700 (8th Cir. 1939)).

25. *Id.* (citing Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 510 (1942); H.R. REP. NO. 75-517 (1937)).

26. *Id.*

27. *Id.* ¶ 900.LH[1], at 900-25 to -26 (citing United States v. Bekins, 304 U.S. 27, 48–49 (1938); Ashton v. Cameron Cnty. Water Dist. No. 1, 298 U.S. 513, 533–34 (1936) (Cardozo, J., dissenting)).

28. *Id.*

29. U.S. CONST. art. I, § 10.

30. 6 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 900.LH[1], at 900-25 to -26 (citing *Bekins*, 304 U.S. at 48–49; *Ashton*, 298 U.S. at 533–34 (Cardozo, J., dissenting)).

municipalities to continue providing vital community services, while also paying their outstanding debts?

Congress came to the aid of the reeling municipalities by passing the first municipal bankruptcy legislation in 1934,[31] which added Chapter 9 to the Bankruptcy Code.[32] Chapter 9, entitled "Provisions for the Emergency Temporary Aid of Insolvent Public Debtors and to Preserve the Assets Thereof and for Other Related Purposes,"[33] helped bond creditors, who were recovering little, if any, on their original investments, and municipalities, which were struggling to maintain viability.[34] Congress's stated purpose for promulgating the Act was to provide a means for distressed cities, counties, and minor political subdivisions to adjust their finances, under judicial control, so that both the municipalities and their creditors could benefit.[35]

In passing the 1934 Act, Congress also promulgated the initial requirements for confirmation of municipal bankruptcy plans, including the language that formed the foundation for today's § 943(b)(7): "[T]he judge shall confirm the plan if satisfied that . . . it is fair, equitable, and for the best interests of the creditors, and does not discriminate unfairly in favor of any class of creditors."[36] The requirements of judicial confirmation in the 1934 Act were remarkably similar to the language found in Chapter 9 of the Bankruptcy Code today.[37] Despite Congress's good-faith effort to draft the 1934 Act in a manner that would not infringe upon the sovereignty of the states, the Supreme Court struck down the Act as unconstitutional in 1936 by a slim majority vote in *Ashton v. Cameron County Water District*.[38]

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31. Municipal Bankruptcy Act of 1934, ch. 345, 48 Stat. 798, *invalidated by Ashton*, 298 U.S. 513.

32. 6 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 900.LH[2], at 900-26.

33. Municipal Bankruptcy Act of 1934, 48 Stat. at 798.

34. *See* 6 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 900.LH[2], at 900-26.

35. H.R. REP. NO. 73-207, at 1 (1933).

36. 11 U.S.C. § 943(b)(7) (2012) (incorporating language from section 80(e) of the 1934 Act).

37. *See id.* § 943.

38. Ashton v. Cameron Cnty. Water Dist. No. 1, 298 U.S. 513, 531–32 (1936). The Court explained its rationale as follows:

> Like any sovereignty, a State may voluntarily consent to be sued; may permit actions against her political subdivisions to enforce their obligations. Such proceedings against these subdivisions have often been entertained in federal courts. But nothing in this tends to support the view that the Federal Government, acting under the bankruptcy clause, may impose its will and impair state powers—pass laws inconsistent with the idea of sovereignty.
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> . . . .

B. The 1937 Act

Despite the Supreme Court's decision in *Ashton*, Congress passed the revised Municipal Bankruptcy Act in 1937,[39] which enacted Chapter 10 of the Bankruptcy Act.[40] The 1937 Act altered certain provisions of the 1934 Act,[41] while retaining the requirements of fairness and equity.[42] More importantly, the Supreme Court upheld the 1937 Act as a valid exercise of Congress's use of the bankruptcy clause in *United States v. Bekins*.[43] With the *Bekins* decision, municipal bankruptcy, including the precursor to § 943(b)(7), became a mainstay in the Bankruptcy Code.[44]

> The difficulties arising out of our dual form of government, and the opportunities for differing opinions concerning the relative rights of State and National Governments are many; but for a very long time this court has steadfastly adhered to the doctrine that the taxing power of Congress does not extend to the States or their political subdivisions. The same basic reasoning which leads to that conclusion, we think, requires like limitation upon the power which springs from the bankruptcy clause.

Id.

39. Act of Aug. 16, 1937, ch. 657, 50 Stat. 653, 658 (current version codified in scattered sections of 11 U.S.C.).

40. *See* 6 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 900.LH[3], at 900-27 (citing H.R. REP. NO. 75-517, at 2 (1937)).

41. *See id.* ("The primary differences between Chapter IX and Chapter X were a change in the number of consents needed for confirmation of a plan (reduced from 75 to 66 ⅔ percent) and a modest increase in the protection of the states' sovereignty.") (citations omitted).

42. *See* Act of Aug. 16, 1937, § 83(e), 50 Stat. at 658 ("[T]he judge shall . . . enter an interlocutory decree confirming the [bankruptcy] plan if [she is] satisfied that . . . it is *fair, equitable, and for the best interests of the creditors* and does not discriminate unfairly in favor of any creditor or class of creditors.") (emphasis added).

43. United States v. Bekins, 304 U.S. 27, 51 (1938). The Court stated:

> [T]he Committee's points are well taken and . . . Chapter X is a valid enactment. The statute is carefully drawn so as not to impinge upon the sovereignty of the State. The State retains control of its fiscal affairs. The bankruptcy power is exercised in relation to a matter normally within its province and only in a case where the action of the taxing agency in carrying out a plan of composition approved by the bankruptcy court is authorized by state law.

Id.

44. The 1937 Act was set to expire; however, Congress passed several amendments to the Act extending its expiration date. 6 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 900.LH[3], at 900-28. Municipal bankruptcy became a permanent part of the Bankruptcy Code in 1946, when Congress removed the expiration date of Chapter X by amendment. *See* Act of July 1, 1946, Pub. L. No. 79-481, § 2, 60 Stat. 409, 416.

C. *The 1976 and 1978 Amendments*

In 1976, Congress again altered the Municipal Bankruptcy Act,[45] this time eliminating the "best interests of creditors" language.[46] Additionally, Congress included the term "feasible" for the first time among the confirmation requirements for bankruptcy plans.[47]

Congress acted again in 1978, amending the Municipal Bankruptcy Act to reincorporate the "best interests of creditors" language it had omitted just two years earlier, and removing the "fair and equitable" requirement.[48] The feasibility requirement survived, with only a slight revision.[49] That revision reads: "The court shall confirm the plan if . . . the plan is in the best interests of creditors and is feasible."[50] While Congress has amended Chapter 9 several times since the 1978 Act,[51] the substantive language on feasibility has been left untouched.[52]

D. *What Did Congress Intend for "Feasibility" to Encompass?*

The convoluted history of the Chapter 9 confirmation requirements presents an important question: exactly what meaning did Congress attach to "feasibility?" After all, Congress initially implemented the "fair and equitable" requirement, with no mention of feasibility. The legislative history of the 1976 Act provides some insight into Congress's intent in including the feasibility requirement.[53]

While Congress had never before 1976 explicitly used the term "feasible" in the confirmation section of the Municipal Bankruptcy Act, the House Report accompanying the bill indicates that the confirmation requirements were "copied from [the 1937 Act's requirements] with minor

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45. Act of Apr. 8, 1976, Pub. L. No. 94-260, 90 Stat. 315 (current version codified in scattered sections of 11 U.S.C.).

46. Finding that the "fair and equitable" language in the statute inherently encompassed the "best interests of creditors" language, Congress determined the inclusion of the latter in the statute to be superfluous. *See* H.R. REP. NO. 94-686, at 14 (1975), *reprinted in* 1976 U.S.C.C.A.N. 539, 551 (omitting any reference to "best interests of creditors").

47. Act of Apr. 8, 1976, § 94(b), 90 Stat. at 323 (requiring the court to confirm the plan if it "is fair and equitable and feasible").

48. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 943(b)(6), 92 Stat. 2549, 2624 (current version at 11 U.S.C. § 943(b)(7) (2012)).

49. *Id.*

50. *Id.*

51. There were subsequent amendments to the Municipal Bankruptcy Act in 1988, 1994, and 2005; however, none of these amendments affected the feasibility requirement in § 943(b)(6).

52. *See* 11 U.S.C. § 943(b)(7).

53. H.R. REP. NO. 94-686, at 32 (1976), *reprinted in* 1976 U.S.C.C.A.N. 539, 570.

style, but no substantive changes."[54] One might assume that if Congress perceived no substantive changes to the confirmation requirements, it must have considered feasibility to encompass the omitted "best interests" language. The comments go on to state, however, that feasibility means that based on the petitioner's past and projected tax revenues, there is a reasonable prospect that the petitioner will be able to make the payments required by the plan.[55]

The conspicuous absence of any reference to the debt owed to municipal creditors as a basis for whether the plan is feasible dispels the theory that Congress considered the "best interests of creditors" and feasibility standards to be synonymous. Thus, it appears that Congress, by including the feasibility language in the statute, intended municipalities seeking the protection of Chapter 9 to project the payment they could reasonably expect to make on their outstanding bonds based on their historic and projected revenue levels. These projections, in order to be feasible, would also have to leave sufficient operating cash in the municipalities' general funds for them to continue functioning. But what, exactly, would municipalities have to demonstrate through these projections to establish the feasibility of their plans?

The 1976 Act's legislative history provides some insight regarding what Congress did *not* intend the feasibility requirement to encompass. House members offering supplemental views on the Act[56] wrote that they were "encouraged by the additional requirement of 'feasibility' which is new in the context of municipal bankruptcy[,] but which has a well defined meaning in Chapters X and XI dealing with corporate reorganizations and arrangements."[57] They expressed concern, however, that Congress had declined to "make perfectly clear the congressional intent to require that a plan for adjustment of municipal indebtedness . . . be in balance within a reasonable period of time after confirmation of the plan."[58] In expressing such concern, the legislators noted that the distinction drawn between "feasibility" and "budget-balancing" was "disturbing."[59] The congressmen concluded by noting that while both the Committee and Subcommittee had

54. *Id.*

55. *Id.*

56. *Id.* at 55, 1976 U.S.C.C.A.N. at 575. These views concurred in part and dissented in part, from the views of the majority. *Id.*

57. *Id.* at 59, 1976 U.S.C.C.A.N. at 579. Additionally, Congress explicitly mentions *Kelley v. Everglades Drainage District*, 319 U.S. 415 (1943), which interpreted the feasibility requirement in Chapter 11 to be instructive to Chapter 9's new feasibility requirement. *See id.* (discussing *Kelley*).

58. H.R. REP. NO. 94-686, at 60, 1976 U.S.C.C.A.N. at 580.

59. *Id.*

rejected an amendment to expressly state the congressional intent for municipal debtors to balance their budgets within a reasonable time to achieve confirmation, they still wanted such an amendment to again be offered on the floor of Congress.[60] Congress's refusal to make explicit its desire for municipal bankruptcy plans to be balanced as a condition precedent to judicial confirmation demonstrates that Congress did not intend the Chapter 9 feasibility requirement to encompass budget-balancing. Congress had considered the possibility on multiple occasions, and each time had decided against it.[61]

The 1976 Act's legislative history as it relates to Congress's intent regarding the feasibility requirement provides several important insights. First, it appears Congress intended the municipalities seeking Chapter 9 protection to demonstrate feasibility by showing that their proposed plans could be carried out based on their projections of available future revenue, taking into account both expenses and the proposed payments under their plans, as well as the amount necessary to continue providing municipal services to their citizenry.[62] Second, Congress intended Chapter 9's feasibility requirement to mirror that of Chapter 11.[63] Finally, Congress did *not* intend for feasibility to include a requirement that municipalities balance their budgets in order to attain plan confirmation.[64] If Congress did not intend feasibility to function as a requirement that municipalities balance their budgets, what meaning could such a requirement possibly have?

II. HOW DO COURTS INTERPRET THE FEASIBILITY REQUIREMENT?

While the legislative history of the 1976 Act provides insight into the meaning that Congress attached to feasibility,[65] the history provides no further guidance on what is practically required for municipalities seeking relief under Chapter 9 in order to demonstrate plan feasibility, and thereby attain confirmation under § 943(b). As such, it is necessary to look at how courts have interpreted the feasibility requirement in both Chapter 9 and in Chapter 11. Because the legislative history of the 1976 Act explicitly provided that the feasibility requirement, as it appears in § 943(b)(7), was

60. *Id.*

61. *Id.* at 59–60, 1976 U.S.C.C.A.N. at 580 (noting that this type of amendment was considered in committee and subcommittee, and was rejected in each, but that it "may again be offered on the Floor").

62. *Id.* at 59, 1976 U.S.C.C.A.N. at 579.

63. *Id.*

64. *Id.* at 60, 1976 U.S.C.C.A.N. at 580.

65. *See supra* notes 53–64 and accompanying text.

fashioned from Chapter 11's feasibility requirement,[66] that chapter is the starting point of the analysis. Thus, a brief inventory of the instructive case law on Chapter 11's feasibility requirement is first in order, followed by an examination of the instructive case law interpreting Chapter 9's analogous standard.

A. Chapter 11

Feasibility in Chapter 11 is governed by 11 U.S.C. § 1129(a)(11).[67] That statute provides that "[t]he court shall confirm a plan only if . . . [c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor[,] . . . unless such liquidation or reorganization is proposed in the plan."[68] There is no expression of feasibility in the statute, yet it is widely regarded as imposing a feasibility requirement on Chapter 11 bankruptcy plans.[69] Courts have interpreted this requirement in a variety of ways.[70]

In *Kane v. Johns-Manville Corp.*,[71] the United States Court of Appeals for the Second Circuit interpreted whether Johns-Manville Corporation, the debtor, had proposed a feasible bankruptcy plan under Chapter 11.[72] In that case, the debtor, a large miner of asbestos and manufacturer of insulating materials, filed for Chapter 11 bankruptcy in anticipation of future asbestos-related liability.[73] Because a number of health studies linked asbestos to respiratory disease, the debtor had become the target of a growing number of products-liability lawsuits.[74] Estimating potential liability of approximately $2 billion, the debtor anticipated insolvency.[75]

Because the debtor in *Kane* filed to reorganize based on projected future liability, its bankruptcy plan's treatment of potential future claimants was an important consideration in determining whether the proposed plan was feasible under § 1129(a)(11).[76] The court held that "the feasibility

66. *See* H.R. REP. NO. 94-686, at 32, 1976 U.S.C.C.A.N. at 570.

67. 11 U.S.C. § 1129(a)(11) (2012).

68. *Id.*

69. 7 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 1129.02[11], at 1129-51 to -52 (analyzing 11 U.S.C. § 1129(a)(11) under the title "Feasibility").

70. *Id.* ¶ 1129.02[11], at 1129-52.

71. Kane v. Johns-Manville Corp., 843 F.2d 636, 649–50 (2d Cir. 1988). It is important to note that this was not a municipal bankruptcy case; this was a commercial bankruptcy case filed under Chapter 11 of the Bankruptcy Code.

72. *See id.* at 639.

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

standard [in Chapter 11] is whether the plan offers a reasonable assurance of success."[77] The court went on to emphasize that the plan's success need not be guaranteed; the debtor is only required to demonstrate that the proposed plan, based on "reasonable and credible projections of future earnings," is unlikely to cause the debtor to invoke further proceedings for relief under Chapter 11.[78]

The Tenth Circuit also considered the feasibility requirement under § 1129(a)(11) in *In re Pikes Peak Water Co.*[79] In that case, Pikes Peak, a company in the business of water sales, had taken out loans from Travelers Insurance to fund its operations and to purchase acreage.[80] Pikes Peak's operations did not yield enough water to service its debt to Travelers, so the parties renegotiated the loans, consolidating them into a more affordable arrangement for Pikes Peak.[81] Shortly thereafter, Pikes Peak again defaulted on its loans, and Travelers instituted foreclosure proceedings on the land that secured the loans it had previously made to Pikes Peak.[82] Pikes Peak subsequently filed for Chapter 11 bankruptcy.[83]

In evaluating the debtor's plan under § 1129(a)(11), the court stated that the purpose of this section is to prevent confirmation of bankruptcy plans that make unachievable promises to creditors and equity security holders.[84] Additionally, the court stated that "[i]n determining whether [a plan] is feasible, the bankruptcy court has an obligation to scrutinize the plan carefully to determine whether it offers a reasonable prospect of success and is workable."[85]

These judicial interpretations[86] show that to establish feasibility under § 1129(a)(11), a debtor must illustrate that its proposed bankruptcy plan evidences a reasonable likelihood that the debt reorganization will enable it

77. *Id.* at 649 (citing Prudential Ins. Co. v. Monnier (*In re* Monnier Bros.), 755 F.2d 1336, 1341 (8th Cir. 1985); *In re* Wolf, 61 B.R. 1010, 1011 (Bankr. N.D. Iowa 1986)).

78. *Kane*, 843 F.2d at 649 (quoting *In re* Johns-Manville Corp., 68 B.R. 618, 635 (Bankr. S.D.N.Y. 1986)).

79. Travelers Ins. Co. v. Pikes Peak Water Co. (*In re* Pikes Peak Water Co.), 779 F.2d 1456, 1460 (10th Cir. 1985).

80. *Id.* at 1457.

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.* at 1460 (quoting Pizza of Haw., Inc. v. Shakey's, Inc. (*In re* Pizza of Haw., Inc.), 761 F.2d 1374, 1382 (9th Cir. 1985)).

85. *Id.* (quoting Prudential Ins. Co. v. Monnier (*In re* Monnier Bros.), 755 F.2d 1336, 1341 (8th Cir. 1985)).

86. The two cases outlined by the author in the above paragraphs were included because they are representative of Chapter 11 interpretations of the feasibility requirement. *See* 7 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 1129.02[11], at 1129-52.

to return to solvency, while making the required payments to creditors and continuing its viability as a company. A plan's prospect of success is the capstone of the Chapter 11 feasibility analysis, and it is with this understanding that this Comment turns to the case law interpreting Chapter 9's feasibility requirement.

B. Chapter 9

Although Chapter 9 does not explicitly incorporate § 1129(a)(11) into its requirements for confirmation, the legislative history behind § 943(b)(7) suggests that Congress intended the same rationale for feasibility in Chapter 11 be used to determine whether municipal bankruptcy plans under Chapter 9 are feasible.[87] The courts interpreting the requirement, however, have taken a different approach.[88] Of the case law interpreting § 943(b)(7)'s feasibility requirement, the *Mount Carbon*[89] decision provides the greatest insight into what the feasibility requirement entails in Chapter 9, and it is that decision that best exhibits the difference between Congress's intent and the courts' interpretations.

In re Mount Carbon Metropolitan District involved a municipal district, Mount Carbon, which developed principally as a water and sanitation district and consisted mostly of undeveloped land.[90] The district eventually became a metropolitan district, and was thus required to adopt a service plan.[91] Mount Carbon's service plan resolved to expand the district's authority, providing for the construction of street improvements, safety protection, recreational facilities, parks, and other improvements over a number of years.[92] The service plan anticipated that "obligations [would be] ongoing and [would] become more important and costly to perform as the District . . . developed."[93] Because Mount Carbon lacked sufficient water and infrastructure to develop the district in accordance with the service plan, it eventually became unable to comport with the goals it had set for itself in the plan.[94] Moreover, its efforts to develop its lands in accordance with the service plan had driven Mount Carbon deep into

87. *See* H.R. REP. NO. 94-686 (1976), *reprinted in* 1976 U.S.C.C.A.N. 539.

88. *See In re* Mount Carbon Metro. Dist., 242 B.R. 18, 32 (Bankr. D. Colo. 1999) ("Although it is tempting to simply borrow the Chapter 11 feasibility analysis, such convenience would overlook differences in the language of the applicable Code sections as well as in the origin and purpose of each type of reorganization.").

89. *See id.* at 18.

90. *Id.* at 23.

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.* at 24.

insolvency, with the municipality eventually reporting less than $200 in cash, despite having approximately $58 million of debt.[95] Mount Carbon eventually filed a petition for Chapter 9 bankruptcy. Several creditors objected to the proposed bankruptcy plan, arguing, among other things, that the plan was not feasible pursuant to § 943(b)(7).[96]

Before analyzing whether the plan was feasible, the *Mount Carbon* court considered the meaning of § 943(b)(7)'s feasibility requirement.[97] After noting the absence of instructive case law interpreting Chapter 9's feasibility requirement, the court stated that "[a]lthough it is tempting to simply borrow the Chapter 11 feasibility analysis, such convenience would overlook differences in the language of the applicable [Bankruptcy] Code sections as well as in the origin and purpose of each type of reorganization."[98] The court set out the different purposes for Chapters 9 and 11, taking care to note that while Chapter 11 can be used by a solvent entity as a tool to restructure its affairs for business reasons, "[t]he purpose of reorganization under Chapter 9 is to allow municipalities . . . to adjust their debts through a plan voted on by creditors and approved by the [b]ankruptcy [c]ourts."[99] After pointing out this difference, the court posed the following question: "[W]hat must be feasible—only repayment of pre-petition debt or repayment of debt in conjunction with provision of continued governmental services?"[100]

The court eventually determined that bankruptcy plans must *both* allow the debtor to repay its prepetition debt and continue to provide essential governmental services in order to meet the feasibility standard of Chapter 9, noting that "[t]he primary purpose of debt restructure for a municipality is not future profit, but rather continued provision of public services."[101]

In sum, the *Mount Carbon* decision set forth two basic elements for a municipal bankruptcy plan to be considered feasible: (1) the plan must enable the municipality to pay prepetition debt and provide for public services at a level that will enable it to continue functioning as a viable municipality; and (2) the plan must not be merely a "visionary scheme,"

95. *Id.*
96. *Id.* at 31.
97. *Id.* at 31–35.
98. *Id.* at 31.
99. *Id.* at 32–33.
100. *Id.* at 34.
101. *Id.* at 34–35 ("The Court must, in the course of determining feasibility, evaluate whether it is probable that the debtor can both pay pre-petition debt and provide future public services at the level necessary to its viability as a municipality.").

and must be objectively workable by the municipality.[102] The court made clear that, with respect to the former element, it would not make sense to confirm a plan that did not allow the municipal debtor to return to solvency.[103] With respect to the latter element, the municipality must generate "reasonable income and expense projections" in order to demonstrate that the proposed bankruptcy plan is workable based on those projections.[104]

III. COMPARING THE FEASIBILITY STANDARDS OF CHAPTER 9 AND CHAPTER 11

The legislative history of the 1976 Act, the first act to explicitly mention feasibility among the requirements for judicial confirmation, evidenced the congressional desire that the feasibility requirement in Chapter 11 would inform the analysis of how feasibility would be interpreted in Chapter 9.[105] Congress, however, failed to anticipate the practical difficulties of letting a commercial bankruptcy standard determine municipal bankruptcy issues. Contrary to what Congress intended, two separate feasibility standards have developed over time, with the Chapter 9 standard requiring municipal debtors to demonstrate more than Chapter 11 commercial debtors to establish the feasibility of their bankruptcy plans.[106]

Feasibility in Chapter 9 has a similar meaning to that in Chapter 11—that the plan is financially sound and likely to be carried out—but also carries with it an additional component.[107] "The debtor must establish that, after all proposed spending cuts, revenue increases and payments to creditors proposed in the plan, the municipality will still be able to serve its citizens at a level it determines to be appropriate . . . ."[108] The Chapter 9 feasibility standard, like the standard employed in Chapter 11 cases,

102. *Id.* at 35 (quoting Travelers Ins. Co. v. Pikes Peak Water Co. (*In re* Pikes Peak Water Co.), 779 F.2d 1456, 1460 (10th Cir. 1985)).

103. *Id.* at 34; *see also* Lorber v. Vista Irrigation Dist., 127 F.2d 628, 638 (9th Cir. 1942) ("To afford the plan of payment proposed the District must be in a position to proceed as a going District and for this reason its cash on hand cannot be too greatly depleted." (quoting Moody v. James Irrigation Dist., 114 F.2d 685, 689 (9th Cir. 1940))).

104. *In re Mount Carbon*, 242 B.R. at 35 ("[I]f performance of a Chapter 9 plan is based upon deferred payments, projections of future income and expenses must be based upon reasonable assumptions and must 'not be speculative or conjectural.'" (quoting Ames v. Sundance State Bank (*In re* Ames), 973 F.2d 849, 851 (10th Cir. 1992))).

105. H.R. REP. NO. 94-686, at 32 (1975), *reprinted in* 1976 U.S.C.C.A.N. 539, 570.

106. *See, e.g.*, *In re Mount Carbon*, 242 B.R. at 18.

107. Clement & Black, *supra* note 5, at 49.

108. *Id.* (citing *In re* Corcoran Hosp. Dist. 233 B.R. 449, 453–54 (Bankr. E.D. Cal. 1999); *In re Mount Carbon*, 242 B.R. at 36–38).

prevents debtors from confirming plans that promise creditors more than can possibly be attained.[109] Unlike commercial debtors filing under Chapter 11, however, municipal debtors cannot be liquidated; therefore, they must "have adequate cash flow to make the payments to creditors set out in the plan and 'still have adequate revenues to continue operations.'"[110]

CONCLUSION

Considering the legislative history behind the 1976 Act, the judicial interpretations of Chapter 11, and the judicial interpretations of Chapter 9 collectively, it is possible to piece together what Chapter 9 municipal bankruptcy plans must *accomplish* in order to attain confirmation under § 943(b). Municipalities understand that their bankruptcy plans must be workable, and that this requires a practical analysis of whether they can accomplish what their plans require while continuing providing governmental services.[111] But what should such plans *actually include* in order to be feasible under § 943(b)(7)?[112] It appears that current and future revenue projections are cornerstones of all bankruptcy plans, but Congress has provided little guidance as to what the projections must show in order to evidence a municipality's ability to have enough revenue left over, after making all payments contemplated under the plan, to continue serving its citizenry.

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109. *In re Mount Carbon*, 242 B.R. at 35 (citing Travelers Ins. Co. v. Pikes Peak Water Co. (*In re* Pikes Peak Water Co.), 779 F.2d 1456, 1460 (10th Cir. 1985)).

110. Clement & Black, *supra* note 5, at 49 (quoting 6 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 943.03[1][f][i][B], at 943-16).

111. *In re Mount Carbon*, 242 B.R. at 35.

112. A leading bankruptcy treatise provides some insight on the factors that municipalities should consider when formulating bankruptcy plans. *See* 7 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 1129.02[11], at 1129-52. These factors include:

> (1) the adequacy of the debtor's capital structure; (2) the earning power of its business; (3) economic conditions; (4) the ability of the debtor's management; (5) the probability of the continuation of the same management; and (6) any other related matters which determine the prospects of a sufficiently successful operation to enable performance of the provisions of the plan.

Id. (internal citations omitted). Not all of these factors, however, will be relevant to the feasibility analysis in the municipal bankruptcy context; therefore, the factors above do not constitute an exhaustive list of factors municipalities must consider in coming up with feasible plans. *See In re Mount Carbon*, 242 B.R. at 32 ("Although it is tempting to simply borrow the Chapter 11 feasibility analysis, such convenience would overlook differences in the language of the applicable Code sections as well as in the origin and purpose of each type of reorganization.").

The convoluted history of § 943(b)(7) relegates municipal efforts to construct feasible bankruptcy plans to a guessing game in large part. Ascertaining exactly what Congress meant by requiring plans to be feasible is no easy task, yet municipalities must proffer plans that comport with § 943(b)(7), or risk losing the relief made available to them under Chapter 9.[113] The judiciary's role in interpreting the feasibility requirement is limited to determining whether municipal debtors' revenue and expense projections are reasonable forecasts and whether debtors will be able to make the payments necessitated by their plans based on those projections.[114] As a result of this limited role, the judiciary's guidance for municipalities on the feasible construction of their plans has been extremely vague: their plans should (1) "offer[] a reasonable prospect of success and [be] workable";[115] and (2) show "it is probable that the debtor can both pay pre-petition debt and provide future public services at the level necessary to its viability as a municipality."[116]

These standards leave more questions than answers. What defines a "reasonable prospect of success?" What does it mean for a plan to be "workable?" What level of service provision constitutes "viability as a municipality?" While it is desirable to have flexibility in the standards for feasibility, the Bankruptcy Code currently provides no guidance on what it means for a Chapter 9 plan to be feasible. Municipalities, therefore, must turn to the largely undeveloped case law to determine whether their plans meet this amorphous feasibility requirement.

Requiring municipal debtors to fashion feasible bankruptcy plans absent more explicit guidance is unreasonable. Debtors seeking Chapter 9 relief are not in a position to alter their plans multiple times in order to comport with the courts' interpretations of what is required to achieve confirmation, and cannot afford to risk dismissal for failure to have their plans timely accepted.[117] Congress should remedy this problem by clarifying the Chapter 9 feasibility requirement, including language setting out exactly what is required of municipalities in order to comport with this standard.

The *Mount Carbon* decision analyzed in Parts II and III of this Comment provides useful guidance on the goals of feasibility in Chapter 9,

113. *See* 11 U.S.C. § 930 (2012).

114. 6 COLLIER ON BANKRUPTCY, *supra* note 16, ¶ 943.03[7](b), at 943-27.

115. Travelers Ins. Co. v. Pikes Peak Water Co. (*In re* Pikes Peak Water Co.), 779 F.2d 1456, 1460 (10th Cir. 1985) (quoting Prudential Ins. Co. v. Monnier (*In re* Monnier Bros.), 755 F.2d 1336, 1341 (8th Cir. 1985)).

116. *In re Mount Carbon*, 242 B.R. at 34–35.

117. *See* 11 U.S.C. § 941 (allowing the court to affix a deadline for the filing of a satisfactory bankruptcy plan).

as well as a clear picture of how feasibility should be applied in the municipal bankruptcy context. Congress, therefore, could easily solve the problem presented by simply codifying the *Mount Carbon* decision in the Bankruptcy Code. By codifying *Mount Carbon*, Congress would simultaneously lend predictability to an unclear standard and underscore the purpose of Chapter 9 reorganizations—the continued viability of the municipality.

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