



## Municipal Restructuring Alert

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November 2010

### Chapter 9 Update: Continued Financial Woes for Cities and Municipalities

#### City of Harrisburg, PA

According to an October 5, 2010 article in *The Wall Street Journal* entitled "Harrisburg Faces Deepening Woes," author Romy Aarghese explains that Mayor Linda Thompson has applied to have the City of Harrisburg, Pennsylvania "declared a distressed municipality under a state oversight program known as Act 47" through which a coordinator is appointed to work with the distressed municipality to prepare a plan directed toward financial recovery. The State Department of Commercial and Economic Development conducted a hearing on October 20, 2010 to consider whether to accept the City into Pennsylvania's Act 47 program. According to an Internet article authored by Eric Veronikis, the City's Mayor, Linda Thompson, testified, as did certain City Council members, the President and CEO of the Harrisburg Regional Chamber and Capital Region Economic Development Corp. David Black, Neil Grover on behalf of Debt Watch Harrisburg and others. According to Mr. Veronikis, Mr. Black opined that Act 47 would facilitate the establishment of a financial recovery plan that has to date eluded the City Council. Mr. Veronikis stated that a motion to dismiss the Act 47 petition made on behalf of Debt

Watch Harrisburg was denied. Mr. Veronikis further stated that other interested parties supported the filing of a Chapter 9 bankruptcy filing instead, suggesting that it was too late in the day to effectively use Act 47. According to Mr. Veronikis, the State Department of Commercial and Economic Development has 30 days to decide whether to accept the City into the Act 47 program.

The state legislature enacted Act 47 in 1987 to ensure that a city or municipality continue to provide needed services to its citizens. As of July 19, 2010, nineteen other cities, townships and boroughs were within its scope. The City's financial woes have been widely reported in the media. The focus of the article was the possibility that Moody's Investors Services might cut the ratings of \$68 million in water refunding bonds and \$18 million in parking revenue bonds. The issuing authorities transfer funds to the City of Harrisburg. This fact, according to Mr. Aarghese, quoting Moody's, "brings into question whether parking or water system financial operations could be weakened or disrupted, even temporarily, by continued stress at the city, including actions that could be taken by an Act 47 coordinator or a federal bankruptcy judge."

The Mayor's spokesman, Chuck Ardo, stated that "[w]e don't believe the city filing for a distressed determination under [[Pennsylvania] Act 47 or even Chapter 9 bankruptcy filing should negatively impact the [Harrisburg Authority and Harrisburg Parking Authority] from operations and credit risk perspectives." Regardless, it continues to be the case that the City of Harrisburg may well seek protection under Chapter 9 of the Bankruptcy Code, although Governor Rendell has expressed his opinion that a bankruptcy filing is not a preferred option. In that regard, Mr. Aarghese notes that "some city politicians continue to view a [Chapter 9] bankruptcy filing as the best option" to deal with the City's financial woes, generally, and a substantial (\$288 million) debt regarding a guarantee issued by the City concerning a troubled incinerator project, specifically. While Harrisburg is hardly the only city or municipality facing financial distress, it continues to be the subject of ongoing litigation concerning its guarantee and a potential Chapter 9 bankruptcy filing.

#### Jefferson County, AL

On September 22, 2010, an Alabama circuit court judge appointed John Young as the Receiver for the Jefferson County,

Alabama sewer system. In its order, the court explained that a Chapter 9 filing was not “a feasible alternative. Jefferson County, in order to progress, must have access to capital markets.” According to an article in the Wall Street Journal authored by Kelly Nolan, Mr. Young will serve as chief executive of a newly formed Delaware limited liability company that will oversee the County’s sewer system. Birmingham, Alabama’s largest city, is located in Jefferson County. Bank of New York Mellon Corp. (BONY), the trustee in charge of collecting bond payments and protecting bondholders’ interests, sued Jefferson County in 2008 and asked for the appointment of a receiver. According to Ms. Nolan, BONY alleged that Jefferson County mismanaged the sewer system while accumulating in excess of \$515 million in payment defaults. The crux of the problem facing the County is \$3.2 billion in debt resulting from “soured derivatives products” referred to as “interest rate swaps.” Ms. Nolan explained that “[f]or some time now, Jefferson County officials have been trying to steer clear of what would be the largest municipal bankruptcy in U.S. history.”

Mr. Young was quoted by the *Dow Jones Daily Bankruptcy Review* as stating that “[a]t a high level, it’s all about restructuring the debt and getting the creditors as whole as we possibly can, while minimizing rate increases for the county’s customers.” Mr. Young stated that a Chapter 9 bankruptcy filing should be used as a last resort only. He explained that such a filing could hamper economic growth and the county’s ability to borrow for various projects, as well as the ability to borrow by other cities and municipalities within the State.

## City of Prichard, AL

By Order dated August 31, 2010, Bankruptcy Judge William S. Shulman dismissed the City of Prichard, Alabama’s Chapter 9 bankruptcy case based upon an Alabama statute providing that only municipalities that have issued refunding or funding bonds under Article 9, Chapter 21, are eligible to seek bankruptcy protection.

This is the construction placed on the applicable statute by the group of retirees that moved to have the City’s Chapter 9 case dismissed. The statute provides, in relevant part, that “[t]he governing body of any county, city or town, or municipal authority organized under Article 9, Chapter 47 of this title *which shall authorize the issuance of refunding or funding bonds* may exercise all powers deemed necessary...for the execution and fulfillment of any plan or agreement for the settlement, adjustment, refunding, or funding of the indebtedness of the county, city or town, or municipal authority... not inconsistent with the provisions of law relating to the issuance of refunding or funding bonds.” The movants, who had not been paid retirement benefits due them since September, 2009, noted that the schedules and disclosures made by the City of Prichard, Alabama in connection with its (second) bankruptcy filing did not reflect outstanding issuance of refunding or funding bonds and, therefore, there was no statutory basis for the bankruptcy filing. The City disagreed with the movants’ construction of the applicable statute; however, the bankruptcy court agreed with the movants. The day after the bankruptcy case was dismissed, the movants filed a class action lawsuit against the City based upon the unfunded pension payments.

The legal ruling by the court, now the subject of an appeal to the United States District Court for the Southern District of Alabama, is narrow in scope and, in the absence of similar statutory language, will not even be persuasive authority in states other than Alabama that allow cities and municipalities the option to file for bankruptcy protection. ■

- i DECD staff recommends distressed status for Harrisburg (Central Penn Business Journal, Oct. 20, 2010, 9:01 p.m.)
- ii Receiver Named for Jefferson County, Ala. (WSJ.com, Sept. 22, 2010, 5:54 p.m.)
- iii Ala. Code § 11-81-3.
- iv Ala. Code § 11-81-3 (Italics Added).



**Paul Avron** is a member of Berger Singerman’s Business Reorganization Team. Paul focuses his practice

primarily in the areas of corporate reorganization, bankruptcy law, creditors’ rights and appellate litigation, both state and federal. He can be reached at 561-893-8703 or pavron@bergersingerman.com

*\*Courtesy of Berger Singerman’s Business Reorganization Team with offices in Fort Lauderdale, Miami, Boca Raton and Tallahassee.*

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