



BANKRUPTCY CLIENT ALERT

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Below from the Kutak Rock LLP bankruptcy group are summaries of two recent decisions relating to the Bankruptcy Code's provisions governing bankruptcy filings by municipalities.

Municipality Bankruptcy Filings under the Bankruptcy Code: *In re Las Vegas Monorail Company*, Case No. 10-10464 (Bankr. D. Nev. April 26, 2010) and *In re New York City Off-Track Betting Corp.*, 2010 WL 1027612 (Bankr. S.D.N.Y. Mar. 22, 2010)

In re Las Vegas Monorail Company

The United States Bankruptcy Court for the District of Nevada recently issued a decision addressing the scope of the Bankruptcy Code's definition of "municipality" in Section 101(40) of the Bankruptcy Code. *In re Las Vegas Monorail Company*, Case No. 10-10464 (Bankr. D. Nev. April 26, 2010).

The Las Vegas Monorail Company ("LVMC") owns and operates a monorail system in Las Vegas, Nevada. LVMC financed the monorail project with proceeds of bonds. Generally speaking, the Nevada Department of Business and Industry (the "Department") sponsored or issued bonds and loaned the bond proceeds to LVMC to operate the project. The bonds are revenue bonds payable solely from the revenues generated by LVMC and its project. The bonds were insured by a bond insurer. LVMC subsequently filed bankruptcy under Chapter 11 of the Bankruptcy Code and the bond insurer objected to LVMC's bankruptcy filing. The insurer argued that LVMC was not eligible to file bankruptcy under Chapter 11 of the Bankruptcy Code because LVMC constituted a "municipality" for purposes of the Bankruptcy Code.

Under Section 101(40) of the Bankruptcy Code, the term "municipality" is defined as a "political subdivision or public agency or instrumentality of a State." Whether an entity constitutes a "municipality" under the Bankruptcy Code is important for several reasons. In the LVMC case, for example, LVMC's eligibility to be a debtor under the Bankruptcy Code depends on whether LVMC constitutes a municipality or a private corporation for purposes of the Bankruptcy Code. An entity that constitutes a "municipality" under the Bankruptcy Code, and that meets certain conditions set forth in Section 109(c) of the Bankruptcy Code, is eligible to file bankruptcy only under Chapter 9 of the Bankruptcy Code. Municipalities are not eligible debtors under Chapter 7, 11 or 13 of the Bankruptcy Code. The conditions to a municipal bankruptcy filing under Section 109(c) of the Bankruptcy Code include, among other things, the condition that the municipality be "specifically authorized" by applicable state law to file bankruptcy. Thus, if an entity constitutes a municipality under the Bankruptcy Code and is not

specifically authorized by applicable state law to file bankruptcy, such entity would not be eligible to commence a case under the Bankruptcy Code.

As noted by the court in the LVMC case, “Nevada, along with a majority of States, has not specifically authorized its municipalities to file Chapter 9 bankruptcy.” Thus, if LVMC were determined to constitute a municipality under the Bankruptcy Code, LVMC’s Chapter 11 case would be dismissed and LVMC would not be an eligible debtor under Chapter 9 of the Bankruptcy Code. If, on the other hand, LVMC were held to constitute a private entity and not a municipality under the Bankruptcy Code, LVMC could be an eligible debtor under Chapter 11 of the Bankruptcy Code.

After examining the history and purpose of Chapter 9, the scope of “municipality” as defined under the Bankruptcy Code and its various amendments and related case law, the bankruptcy court concluded that LVMC was not a municipality for purposes of the Bankruptcy Code and thus was an eligible debtor under Chapter 11. The court reasoned that LVMC did not constitute either a “political subdivision” or a “public agency” of Nevada because, among other reasons, LVMC did not have traditional government attributes such as taxing authority or eminent domain power and did not engage in traditional government functions.

Much of the court’s discussion and analysis focused on whether LVMC constituted an “instrumentality” of Nevada. As described by the court, whether an entity constitutes an “instrumentality” of a state for purposes of the Bankruptcy Code depends on whether the entity serves a public function, whether the nature of state or municipal control over the entity includes the direct management of the entity’s finances (as opposed to general oversight or regulation of an entity’s operations) and whether the state categorizes or refers to the entity under state law as a municipal entity as opposed to a private entity. The court concluded that LVMC failed to satisfy these elements of an “instrumentality” of the State of Nevada. The court reasoned that LVMC’s finances were not directly subject to state or municipal control, the day-to-day operations of LVMC were vested in officers not selected by public officials and LVMC was able to incur debt other than debt relating solely to the bonds. The court further stated that LVMC was not created by Nevada legislation, but instead was incorporated under Nevada law as a nonprofit corporation, was treated by other public agencies in Nevada as a private entity and that LVMC’s operating funds were not based on the authority to impose taxes but instead were generated from fares paid by the general public.

The court was also not persuaded that LVMC should be considered a municipality based on the representation of LVMC in a tax certification delivered the bond financing to the effect that LVMC constituted an “instrumentality” of the State of Nevada. The court stated that a determination of LVMC’s status for tax purposes did not involve the same criteria as determining LVMC’s status as a municipality under the Bankruptcy Code, the tax certification of LVMC was for a purpose separate and distinct from LVMC’s status under the Bankruptcy Code and the determination of LVMC’s nature for tax purposes is not controlling for purposes of the Bankruptcy Code.

This case may be instructive in considering whether particular entities are municipalities for purposes of a bankruptcy filing and in considering the applicability of other provisions of Chapter 9 of the Bankruptcy Code.

The bond insurer objecting to LVMC's bankruptcy filing may appeal the bankruptcy court's order.

In re New York City Off-Track Betting Corp.

The recent case of *In re New York City Off-Track Betting Corp.*, 2010 WL 1027612 (Bankr. S.D.N.Y. Mar. 22, 2010), addresses the requirement under Section 109(c)(2) of the Bankruptcy Code that a municipality be "specifically authorized" to file bankruptcy under Chapter 9 of the Bankruptcy Code.

Prior to the Bankruptcy Code's amendment in October 1994, the Bankruptcy Code provided that a municipality could file bankruptcy under Chapter 9 of the Bankruptcy Code if such entity were "generally authorized" to be a debtor by state law or by a governmental officer or organization empowered by state law to authorize the entity to be a debtor under Chapter 9. The language "generally authorized" caused different results among courts as to whether a state in fact had authorized its municipalities to file bankruptcy. Some courts concluded that state statutes granting municipalities broad "necessary and proper" powers constituted sufficient authorization for municipalities to file bankruptcy under the Bankruptcy Code. Congress subsequently amended Section 109 of the Bankruptcy Code to specify that a municipality must be "specifically authorized" to file bankruptcy. Based on Section 109(c)(2) of the Bankruptcy Code, the conditions a municipality must satisfy to be eligible to file bankruptcy under Chapter 9 now include the condition that the municipality be:

... specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter.

The *In re New York City Off-Track Betting Corp.* case interpreted the language quoted above from Section 109(c)(2) that a municipality's bankruptcy filing must be specifically authorized by State law "or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor." In the *In re New York City Off-Track Betting Corp.* case, an entity constituting a municipality under the Bankruptcy Code filed a Chapter 9 bankruptcy case based solely on the authority provided in an executive order issued by the Governor of the State of New York. No state statute specifically authorized the municipal entity to file bankruptcy or specifically authorized the Governor to issue an executive order authorizing such filing.

Several creditors of the municipal debtor objected to the bankruptcy filing, asserting that the Governor's executive order constituted insufficient state authority to support the bankruptcy filing under Section 109(c)(2) of the Bankruptcy Code. The creditors asserted that the executive

order was insufficient to authorize the bankruptcy filing because the order was not based on a state statute providing the Governor with this specific authority.

The court held, however, that the Governor’s broad authority under state law included the power to issue executive orders, including the executive order specifically authorizing the municipal debtor in this case to file bankruptcy. As discussed by the court, Section 109(c)(2) of the Bankruptcy Code does not require that an authorizing order referred to therein be based on a state statute expressly granting the officer or organization specific authority to authorize a bankruptcy filing. Instead, the court reasoned, an order of a governmental officer or organization authorizing a municipality to file bankruptcy can comply with, and be effective under, Section 109(c)(2) of the Bankruptcy Code so long as such order is within the scope of such officer’s or organization’s general authority under state law.

Based on the *In re New York City Off-Track Betting Corp.* case, absent a state statute expressly prohibiting a bankruptcy filing by municipalities in a particular state (which includes within its scope the particular type of municipal debtor at issue), creditors or potential creditors of a municipal entity may not be able to determine based solely on a review of state statutes whether such municipal entity is specifically authorized to file bankruptcy. Instead, a governmental officer or organization with sufficient general authority under applicable state law may be able to authorize such a municipal entity to file bankruptcy at any time, which authorization may not require any amendment or modification of any state statute.

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