How are Foreclosures, Bankruptcies and Delinquencies Affecting Your District?

Debt Workouts, Restructuring, Collections and other Solutions

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Assessed Value Calculations and Recession Projections

I. Taxing entities in Colorado will see a delayed impact from the economic and credit crisis the country is currently facing.

II. District tax revenues are determined by the district's total assessed valuation and its mill levy. Over the last several years, growth and construction coupled with the rising values of both residential and non-residential properties have generally caused a continuous increase in the total assessed valuation for special districts. This has enabled some districts to assess the same mill levy year after year and still generate increased tax revenues. The real estate market has been hit hard by the economy and the recession, which will likely affect a district's assessed valuation and its revenues. The decline in property valuations will start to impact the district budgeting process for 2010, and the full impact of the decline in values will be delayed to subsequent years of 2012 and beyond.

III. To better understand the delayed financial impact on special districts, it is important to review how property values are determined and how the county assessor determines the District's assessed valuation. By statute, property values are reassessed every two years, in odd-numbered years. To determine real property values, the county assessor evaluates property sales that closed within a set 18 month time period prior to the reassessment. For budget years 2008 and 2009, that period occurred from January 1, 2005 to June 30, 2006. The 2009 reassessment, which will impact budget years 2010 and 2011, is based upon sales from January 1, 2007 to June 30, 2008. In 2011, the assessor will again reassess all real property by examining property sales between January 1, 2009 and June 30, 2010. These values will impact budget years 2012 and 2013.

IV. Some analysts contend that Colorado housing prices remained strong for most of 2007 and the first half of 2008 and that the most significant impact will not be seen until the 2011 reassessment. Nonetheless, some counties are anticipating a decline of as much as 7-10% following the 2009 reassessment. As such, some districts may see an impact now; however, districts should anticipate seeing a larger impact following the 2011 reassessment when the property sales from 2009 are considered, as part of its 2012 budget.

Sample Mill Levy Calculation

(See Attached Chart)

Hypothetical Revenue Calculation

Based on 8% Decrease in Average Home Value

Limited Mill Levy District (35 Mill Limit)

District Assessed Value

	Average Home Value	Number of Homes	Actual Value	Assessed Value	% Change
2009 Assessed Value	250,000	1,000	250,000,000	19,900,000	-
2010 Assessed Value	230,000	1,000	230,000,000	18,308,000	8.00%

District Revenues

	Assessed Value	Mill Levy	Total Revenue	Difference from 2009	% Change
2009 Revenues	19,900,000	35.00	696,500	-	-
2010 Revenues	18,308,000	35.00	640,780	55,720	8.00%

ited Mill Levy District

District Assessed Value

	Average Home Value	Number of Homes	Actual Value	Assessed Value	% Change
2009 Assessed Value	250,000	1,000	250,000,000	19,900,000	-
2010 Assessed Value	230,000	1,000	230,000,000	18,308,000	8.00%

District Revenues

	Assessed Value	Mill Levy	Total Revenue	Difference from 2009	% Change
2009 Revenues	19,900,000	35.00	696,500	-	-
2010 Revenues	18,308,000	38.04	696,500	-	0.00%

* Assessed Value = 7.96% of the Actual Value for Residential property and 29% for Commercial Property

Implications of Limited vs. Unlimited Mill Levies

I. Limited Mill Levy vs. Unlimited Mill Levy

A. A special district's primary source of revenue is from property taxes.

1. Each taxing entity determines the revenue needed to operate the entity during the coming fiscal year. The required revenue is then divided by the total assessed value to determine the mill levy or tax rate for that entity.

EXAMPLE: Calculating the mill levy:

The assessor has determined that the total assessed value for the district is $100,000,000.

The district board determines the required property tax revenues needed for debt service to be $1,398,000.

$1,398,000/$100,000,000= 1.3980% or 13.98 mills

B. Colorado statutes contain a mechanism to limit the amount of mill levy imposed by a special district in order to protect taxpayers from excessive tax increases resulting from the underperformance of a development.

C. **Statutory Debt Limitation**: Section 32-1-1101(6), C.R.S. limits the amount of debt a special district can issue to the greater of two million dollars or fifty percent of the valuation for assessment of the taxable property in the special district, as certified by the assessor, except for debt which is:

1. Rated in one of the four highest investment grade rating categories by one or more nationally recognized organizations which regularly rate such obligations;

2. Determined by the board of any special district in which infrastructure is in place to be necessary to construct or otherwise provide additional improvements specifically ordered by a federal or state regulatory agency to bring the district into compliance with applicable federal or state laws or regulations for the protection of the public health or the environment if the proceeds raised as a result of such issue are limited solely to the direct and indirect costs of the construction or improvements mandated and are used solely for those purposes;

3. Secured as to the payment of the principal and interest on the debt by a letter of credit, line of credit, or other credit enhancement, any of which must be irrevocable and unconditional, issued by a depository institution:

a. With a net worth of not less than ten million dollars in excess of the obligation created by the issuance of the letter of credit, line of credit, or other credit enhancement;

b. With the minimum regulatory capital as defined by the primary regulator of such depository institution to meet such obligation; and

c. Where the obligation does not exceed ten percent of the total capital and surplus of the depository institution, as those terms are defined by the primary regulator of such depository institution; or

d. Issued to financial institutions or institutional investors.

D. **Statutory Limited Mill Levy Exception**: A special district may issue general obligation debt or other obligations which are either payable from a limited debt service mill levy, which mill levy shall not exceed fifty mills, or which are refundings or restructurings of outstanding obligations.

E. **Service Plan Limits**: A district's service plan may also contain limits to the mill levy imposed by the district.

F. The limited mill levy places the risk on the bondholders and the developer, instead of the district and the homeowners.

State Law Protections Regarding District Financial Responsibilities

I. **Introduction.** In the late 1970s and early 1980s, Colorado experienced substantial growth which could not adequately be served by existing infrastructure. In response to this significant growth and to address the infrastructure needs of their respective communities, cities and counties approved many Title 32 Special Districts. With the downturn in the economy in the late 1980s, many of these special districts which had issued large amounts of general obligation debt were unable to fulfill their debt service obligations, as was highly publicized at the time.

Title 32 Special Districts continue to serve as an important financing mechanism for public infrastructure and provide an effective means to facilitate development "paying its own way." The information below highlights the Colorado legislature's response to the events of the late 1980s with respect to special districts and highlights some of the statutory provisions or other protections which now limit and/or may govern special districts in order to protect homeowners or ultimate users of the public infrastructure funded by special districts.

II. **Legislative Restrictions:**

A. Limitation of Issuance of Debt (§ 32-1-1101(6), C.R.S.). The total amount of general obligation debt that a special district can issue shall not at the time of issuance exceed the greater of $2,000,000 or 50% of the assessed valuation of the taxable property within the special district, unless the mill levy is capped at 50 mills or less or the debt falls into certain other categories which limit risk to bondholders and/or homeowners, including debt that is secured by a letter of credit, issued to a financial institution or institutional investor, or rated in one of the four highest investment grade rating categories by a company such Moodys or Standard and Poor's.

B. Registration (§§ 11-59-101, *et seq.*, C.R.S.). Any issuance of bonds by a special district must be registered with the State Securities Commission, with the exception of certain types of issues which limit risk to bondholders and/or homeowners (e.g., private placement or credit-enhanced debt).

C. Limitation on Debt Authorization/Quinquennial Review (§§ 32-1-1101(2) and 1101.5(1.5), C.R.S.). A special district's ability to issue general obligation bonds is limited to a five year period of time from the date of the election authorizing the debt, or within 20 years if the bonds are found to be in material compliance with the district's financial plan as contained in the service plan. Counties and cities have the power to periodically require a special district to provide certain financial information regarding the district's debt and operation and maintenance and to limit the authority of the district to incur additional general obligation debt.

D. Notification

a. § 38-35.7-101, C.R.S. Requires every contract for the purchase and sale of residential real property to contain a disclosure statement in bold-faced type which in essence notifies the potential purchaser that property owners in special taxing districts may be placed at risk for increased mill levies and excessive tax burdens to service existing debt.

b. § 10-11-122, C.R.S. Requires title companies to provide, along with any title commitment issued for the sale of residential real property, a statement disclosing that the property may be located in a special taxing district and contact information as to how additional information regarding the district may be obtained.

c. Senate Bill 87, which was passed by the 2009 Colorado Legislature, places many new legal requirements on special districts in an effort to increase the "transparency" of special districts to the public.

E. Contract and Agreement Restrictions (§§ 32-1-1001(1)(d)(I) and (II), C.R.S.). Subsection (I) requires publication for proposed construction contracts for work or materials involving costs of $60,000 or greater. Subsection (II) prohibits contracts for work or material, including service contracts, between a district and an owner of 25% or more property located within the boundaries of the district, unless publication for bids occurs and the owner is the lowest responsible and responsive bidder.

F. Acquisition of Real Property Limitations (§ 32-1-1001(1)(f), C.R.S.). Prohibits special district board from paying more than fair market value and reasonable settlement costs for any interest in real property or paying for any interest in real property which must otherwise be dedicated for public use or the special district's use.

III. **Constitutional Restrictions on Local Government Financing** (Article X, Section 20 of the Colorado Constitution (TABOR)). Requires electorate approval for State and local governments to incur additional indebtedness or to increase taxes.

Overview of Foreclosures and How to Deal with Bank-owned Property

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Fee Collection Options for Past Due Accounts

I. Introduction. Special districts have the authority to impose fees, rates, tolls and charges for services, programs or facilities furnished by the special district. During times of economic recession, some special districts experience delinquencies in payment of fees which, depending upon the amount of unpaid/uncollected fees, can negatively impact the district's operation and maintenance capabilities and/or capacity for debt retirement.

II. Laws Governing Fee Collection

A. State of Colorado

1. **Section 32-1-1001(1)(j)(I), C.R.S.** gives special districts the authority to fix and from time to time to increase or decrease fees, rates, tolls, penalties, or charges for services, programs, or facilities furnished by the special district. Until paid, all such fees, rates, tolls, penalties, or charges constitute a perpetual lien on and against the property served, and any such lien may be foreclosed in the same manner as provided by Stare law for the foreclosure of mechanics' liens.

2. **Section 29-1-1101(2), C.R.S.** provides that "*Delinquency charg*e means a separate fee, fine, or penalty levied as a result of the late payment of an amount due. …"

3. **Section 29-1-1102, C.R.S.** provides that "(a) Notwithstanding any other provision to the contrary, no local government shall impose a delinquency charge except as provided in this section.

(b) No delinquency charge may be collected by a local government on any amount due that is paid in full within five days after the scheduled due date.

(c) No delinquency charge shall exceed the amount of fifteen dollars or up to five percent per month, or fraction thereof, not to exceed a total of twenty-five percent of the amount due, whichever is greater.

(d) No more than the amount set forth in subsection (3) of this section shall be collected by a local government on any amount due regardless of the period of time during which the amount due remains in default.

(e) In the event that an amount due is one of a series of payments to be made toward the satisfaction of a single fee, fine, penalty, or other charge assessed by a local government, no more than the amount set forth in subsection (3) of this section shall be collected by a local government on any one of such payments regardless of the period of time during which the payment remains in default.

(f) No interest shall be assessed on a delinquency charge.

(g) Nothing in this section shall be construed to prohibit a local government from charging interest on an amount due. In no event shall such interest be charged upon a delinquency charge or any amount other than the amount due. In no event shall any such interest charge exceed an annual percentage rate of eighteen percent or the equivalent for a longer or shorter period of time. The provisions of this subsection (7) restricting the charging of interest shall not apply to delinquent interest imposed after a tax lien is sold at a tax lien sale pursuant to article 11 of title 29, C.R.S.

(h) Nothing in this section shall be construed to prohibit a local government from recovering the costs of collection, including but not limited to disconnection or reconnection fees, reinstatement charges, or penalties assessed where fraud is involved."

4. **Section 32-1-1101(1)(e), C.R.S.** provides: "In addition to any other means provided by law, to elect, by resolution, at a public meeting held after receipt of notice by the affected parties, including the property owner, to have certain delinquent fees, rates, tolls, penalties, charges, or assessments made or levied solely for water, sewer, or water and sewer services, certified to the treasurer of the County to be collected and paid over by the treasurer of the county in the same manner as taxes are authorized to be collected and paid over pursuant to section 39-10-107, C.R.S. The governing body of said special district shall pay to the county in which the affected property of the special district is located, at least once a year, an amount which shall be just and reasonable compensation for the extra labor imposed by this paragraph (e) and an amount for the special district's proportion of the expense of advertising the sale of lands for said delinquent fees, rates, tolls, penalties, charges, or assessments in each year, said amounts to be certified to the governing body of the special district by the county treasurer. Any such fee, rate, toll, penalty, charge, or assessment shall total at least one hundred fifty dollars per account and shall be at least six months delinquent. The treasurer of the county is also authorized to charge and retain a penalty at the rate of thirty percent, or thirty dollars, whichever is greater, on the delinquent sum due and owing to defray the costs of collection.

B. (Federal) Fair Debt Collection Practices Act, **15 U.S.C. Section 1692[1] ("FDCPA")**

Fair debt collection practices laws seek to protect consumers from abusive practices by debt collectors. The FDCPA generally applies to attorneys who act as in-house counsel and who send letters or make telephone calls on behalf of their creditor employer/client. Such attorneys are required to send a validation notice containing information about the debt. (See 15 U.S.C. Section 1692g(a)). The notice must include a statement that if you

[1] The "Colorado Fair Debt Collection Practices Act" is located at Section 12-14-101, *et seq.*, C.R.S.

dispute the debt within 30 days of the notice, the debt collector will obtain and send verification of the debt. Careful reading of the FDCPA should be done to determine if it applies to attorney assistance with fee collection matters.[2]

III. Successful Collections Start with a Well-Drafted Resolution. Although not legally required to constitute a valid fee of the district, many districts memorialize the imposition of a fee in a resolution that is recorded against the property within the district. This generally serves to provide record notice of the fee to potential purchasers of property within the district. Occasionally, despite the fact that there is a recorded fee resolution in the County's real property records, title companies sometimes do not include such documents in the Schedule B-2 exceptions to a title commitment. Careful drafting of these resolutions can help to mitigate this issue.

A. Sample Resolution (*see Appendix 1*)

1. Title
2. Further Inquiry Provision
3. Legal Description

B. Boundary Changes

It is advisable to amend a fee resolution as boundary changes (i.e., inclusions or exclusions) are made within the District and record such amendment(s) to maintain clarity in the real property records of the County.

IV. Sample Procedure for Collection of Fees. It is advisable for a special district to adopt a policy governing fee collection in accordance with State and Federal law governing fee collection by governmental entities. Such a policy should address the following and a time frame for each step.

A. Initial District Invoice to User

B. Past Due Invoice

C. Potential Attorney Letter

D. Foreclosure of Lien under **Section 38-22-101, *et seq*., C.R.S.**

E. **Section 32-1-1101(1)(e), C.R.S.** *(See Above)*

V. Conclusion. Particularly in times of economic recession, special districts need to emphasize fee collection to secure a critical revenue stream for funding operations and debt service. The process starts with a well crafted fee resolution that is recorded in the real property records and is updated as needed. A district should have a fee collection policy in place that

[2] See "Fair Debt Collection: What Every Lawyer Should Know," 17 Colo.Law. 453 (1988).

prescribes timeframes and clear direction for district management and counsel to enhance the district's ability to obtain fee revenues.

APPENDIX 1

RESOLUTION
OF THE
BOARD OF DIRECTORS
OF
_____ METROPOLITAN DISTRICT
re
IMPOSITION OF FACILITIES FEES

WHEREAS, _____ Metropolitan District (the "District") is a quasi-municipal corporation and political subdivision of the State of Colorado duly organized and existing as a metropolitan district pursuant to Title 32, Colorado Revised Statutes; and

WHEREAS, the Board of Directors of the District (the "Board of Directors") is the governing body of the District; and

WHEREAS, the District is authorized to provide for various improvements, including water, sewer, streets, park and recreation, and other public improvements needed for the area, and all other necessary, incidental and appurtenant facilities for said improvements (the "Improvements"); and

WHEREAS, the District is authorized, pursuant to § 32-1-1001(1)(j) and (k), C.R.S., to impose and, from time to time, increase or decrease fees, rates, tolls, penalties or charges for services, programs, or facilities furnished by the District; and

WHEREAS, § 32-1-1001(1)(j), C.R.S., also provides that until paid, all such fees, rates, tolls, penalties or charges shall constitute a perpetual lien on and against the property served, which lien may be foreclosed in the same manner as provided by the laws of the State of Colorado for the foreclosure of mechanics' liens; and

WHEREAS, the District has determined that the Improvements to be provided by the District would be of benefit to the District, its residents and taxpayers, and therefore, to assist the District in defraying the costs of the Improvements, the District has established a fee for services and/or facilities provided by the District (the "Facilities Fee"), to be imposed upon property within the District as described in **EXHIBIT A** hereto, and upon such additional property which may be included into the District's boundaries from time to time.

NOW, THEREFORE, BE IT RESOLVED BY THE BOARD OF DIRECTORS OF _____ METROPOLITAN DISTRICT THAT:

Section 1. ***Facilities Fee***. There is hereby imposed a Facilities Fee on all residential property within the District in the amount of $5,000 per single family unit due at the issuance of a building permit.

The District may increase or decrease the amount of the Facilities Fee at the discretion of the District's Board of Directors.

The Facilities Fee is due and shall be paid prior to the issuance of a building permit. The Facilities Fee shall be paid to the District. The District may impose penalties for non-compliance as permitted by law. Upon collection of the Facilities Fee by the District and provision of an adequate legal description of the subject property, the District shall cause a release of its lien, applicable to the subject property. Without limiting the foregoing, a late charge on any past-due amounts shall accrue from the date due at a rate of fifteen dollars, or up to five percent per month, not to exceed twenty-five percent of the amount due, whichever is greater. Nothing herein shall prevent any party from prepaying the Facilities Fee at any time with the consent of the District.

Section 2. ***Modification/Future Events***. The Facilities Fee policy being adopted herein and the rate thereof have been established based on projected budgetary requirements of the District using various assumptions regarding the cost of improvements, bond issues and interest rates therefor, together with operations expenses and maintenance expenses. Actual costs may differ from projections and the District may determine to modify the Facilities Fee imposed hereunder based upon actual circumstances.

Section 3. ***Notification/Collection***. The appropriate officers, agents and/or employees of the District are hereby authorized to establish a system for notification of adoption of this Resolution, and collection of amounts due hereunder. Such notification shall provide for the recording of this Resolution or of an appropriate Notice of Facilities Fee upon the property to be charged.

Section 4. ***Status as Lien/Foreclosure***. Pursuant to § 32-1-1001(1)(j), C.R.S., the Facilities Fee shall, until paid, be deemed a perpetual lien against the property subjected to the Facilities Fee hereunder from and after the date of adoption of this Resolution by the Board of Directors of the District, which lien may, in the event of non-payment of the Facilities Fee as required in this Resolution, be foreclosed upon in the same manner as provided by the laws of the State of Colorado for the foreclosure of mechanics' liens. Upon payment of the appropriate Facilities Fee and a request by the party making the payment, the properties subject to such Facilities Fee shall be released from the lien thereof by the recording of a form of Release of Lien by the District.

Section 5. ***Inquiries Regarding Facilities Fee.*** Any inquiries regarding the imposition and collection of the Facilities Fee may be directed to District counsel at _____.

PASSED AND ADOPTED at a special meeting this _____ day of _____ _____, 2009.

_____
METROPOLITAN DISTRICT

[SEAL]

By: _____
President

Attest:

By: _____
Secretary

STATE OF COLORADO)
) ss.
COUNTY OF _____)

The foregoing instrument was acknowledged before this ____ day of _____, 2009 by _____, as President of _____ Metropolitan District, a quasi-municipal corporation and political subdivision of the State of Colorado.

Witness my hand and official seal.

My commission expires: _____

[S E A L]

_____
Notary Public

EXHIBIT A

[TO RESOLUTION OF BOARD OF DIRECTORS OF _____ METROPOLITAN DISTRICT RE IMPOSITION OF FACILITIES FEES]

THE PROPERTY

Basic Discussion of Foreclosure Process in Colorado and What it Means to Districts

I. In Colorado, lenders may foreclose on deeds of trust or mortgages using either a judicial or non-judicial foreclosure process.

A. **Judicial Foreclosures.**

1. A "judicial foreclosure" is a lawsuit brought to obtain a court order to foreclose a lien created by a mortgage document when no power of sale exists in the loan documents.

a. An action "in rem" as to the foreclosure and possession of the property and an action "in personam" with regard to any deficiency judgment.

i. An "in rem" action may be maintained without personal service of process. These actions may take place upon publication of the proceedings in a newspaper. *There are some foreclosures that may occur on property in your district without the actual knowledge of the owner or of the district and other lien holders.*

ii. However, no judgment against a person or entity can be entered without personal service (*in personam*).

b. *In our experience, districts are seldom served with process or included in a judicial foreclosure because the parties intend to pay past due fees, rates, tolls and charges but that is not always the case.*

i. *If the district is served with process it must participate in the judicial foreclosure proceedings to protect its interest, even if that interest is prior and superior to the interest being foreclosed.*

ii. *If the district is not served with process but becomes aware of the proceedings by some other means, we still recommend that the district make its interest known. Generally this will be done by a motion to intervene.*

2. **Non-Judicial or Public Trustee Foreclosures.**

a. The non-judicial or public trustee foreclosure is the typical process of foreclosure utilized in Colorado. It is a shortened process administered by a Public Trustee who is appointed for each

county. It is utilized whenever there is a "power of sale" in the loan documents.

b. The exercise of the "power of sale" is supervised by the public trustee process. The process begins when the attorney for the lender files the proper paperwork with the public trustee.

i. The Trustee then files a "Notice of Election and Demand" with the county clerk and recorder.

ii. Trustee schedules an auction date 110-125 days from the date of filing.

iii. The Notice of Election is published in the newspaper for five weeks.

iv. Borrower and other claimants of record are mailed the same notice along with in formation concerning the right to cure and the right to redeem.

c. The lender's attorney schedules a Court Hearing (called a Rule 20 hearing) to take place before the auction. The hearing will establish whether the lender has the right to foreclose and sell the property.

d. After the public auction, there is a short "Redemption Period." During this period junior lien holders may pay off the amount bid at auction plus allowed fees and costs. To receive redemption figures, an Intent to Redeem must be with the Trustee within 8 business days of the auction sale. Only junior lien holders whose liens were "of record" prior to the recording of the Notice of Election and Demand may be allowed to Redeem.

3. **Some additional ideas to consider in an economic environment dominated by foreclosures.**

a. Section 32-1-1001(1)(j)(1), C.R.S. provides that district fees, rates, tolls and charges constitute a perpetual lien against the property served until paid.

i. This provision is self-executing in that the lien exists if the obligation exists.

ii. However, the judicial and non-judicial foreclosure processes depend substantially on the county's real property records. *Accordingly, any substantial fee, rate, toll or charge*

imposed by the district should be the subject of a properly recorded document whether it is district wide or pertains only to a single property.

b. If your district is served with process in a judicial foreclosure proceeding you should get these documents to your attorney immediately as you must participate in the proceeding in some form to protect your lien rights.

c. You may receive a Notice of Right to Redeem a property in the mail. This notice will provide very little information and may seem insignificant. However, your receipt of it is notice that someone believes you have a lien right that may be affected by the proceedings. Follow-up on these notices and forward them to your attorney as quickly as possible as the deadlines are short.

d. Bank foreclosures result in the property being added to the banks "Real Estate Owned" (REO). The lender's goal is to resell the property for the best possible price. Because of the importance of district services and district lien rights, the district will almost always be paid its fees, rates, tolls or charges. Eventually the bank will assign a realtor or other person to care for the property while it is in REO and to offer it for sale. The District should consider:

i. Advise the lender's REO department of fees, rates, tolls and charges owed.

ii. Advise the realtor, caretaker or trustee of the same.

iii. Consider recording something to ensure that any title company is aware of the district before the property is resold.

iv. You will likely be paid at the closing by the new owner.

II. A district may utilize a foreclosure process to collect its fees, rates, tolls and charges.

A. Section 32-1-1001(1)(j)(1), C.R.S. provides that, until paid, fees, rates, tolls and charges shall constitute a perpetual lien on and against the property served, and any such lien may be foreclosed in the same manner as provided by the laws of this state for the foreclosure of mechanic's liens.

B. Mechanic's liens are foreclosed under the provisions of § 38-22-101, *et seq.* C.R.S. Unfortunately, this statute contains both the substantive law of mechanic's liens and the procedural rules for their foreclosure. A careful analysis must be made to separate out the procedural elements that apply to the foreclosure of a special district perpetual lien.

C. The rules found in the mechanic's lien statute are very technical and contain very specific deadlines that should be addressed by an attorney. Even though these technical rules and deadlines would likely not effect the validity of a perpetual lien that remains in place until paid, compliance is necessary to avoid complicating the foreclosure proceedings, providing additional arguments to the party being foreclosed and precluding the need for costly argument over such issues. Accordingly, we urge that such foreclosures be preceded by the lien statements and other pre-court proceedings listed in § 38-22-109, C.R.S.

Issues and Concerns Under the United States Bankruptcy Code

I. In difficult economic times, contractors, customers, developers and those others who may have obligations to your district may be filing for bankruptcy protection. Bankruptcy protection is provided in various forms under the United States Bankruptcy Code found at 11 U.S.C. Chapters 1 through 15.

II. There are various forms of bankruptcy defined in the statute and each has its own rules and related procedures. Accordingly, only generalizations can be provided here.

III. A district is concerned that bankruptcy filings may affect its revenues which are received from ad valorem taxes and/or from fees, rates tolls and charges assessed under §32-1-1001(1)(j)(I), C.R.S.

A. Bankruptcy and a*d valorem* tax receipts.

1. The accumulation of bankruptcy filings in a district, along with an increase in lender foreclosures will effect future values and result in declining revenues.

2. The priority and collection of property tax revenues is well protected in the bankruptcy code.

a. Tax liens associated with ad valorem taxes can not be subordinated to other liens in the bankruptcy court.

b. Bankruptcy judges can no longer reassess the amount of ad valorem taxes owed by the debtor after the period for appealing such taxes has expired.

B. Bankruptcy and Fees, Rates, Tolls and Charges.

1. Unfortunately, liens arising from nonpayment of district fees (Fee Liens) are treated as non-ad valorem tax liens and can be subordinated to senior liens and various unsecured claims.

a. District fees create a perpetual lien that can be foreclosed in the same manner as mechanic's liens. § 32-1-1001(1)(j)(I), CRS. However, once a debtor is in bankruptcy, the Code dictates priority and supersedes state law.

b. As an example, Section 724(d) treats all statutory liens for District utility charges as though they were tax liens. Since fees are not ad valorem taxes, which are explicitly and narrowly removed from the subordination requirements, the liens that result from District fees are

subordinated as non-ad valorem tax liens. Such liens may be subordinated to all "senior" liens and other administrative priorities. Code §724(b).

2. The general rule in bankruptcy is that a valid lien will pass through a bankruptcy unaffected. However, in reorganizations §1141(c) provides an exception. That exception is very difficult to understand based upon the statutory language, but, the courts have stated the rule as:

> "Where a plan does not expressly preserve a lien, a lienholder may lose it after confirmation of the plan, provided that the lienholder participated in the reorganization and its property was dealt with by the plan."
>
> See, *260 Gregory LLC v. Black Hawk/Central City Sanitation District*, 77P.3d 841, at 844 (Colo. App. 2003).

3. Given the difficulty in applying the preceding language and the varying provisions of the Bankruptcy Code, the practical question is: What steps must be taken to preserve the district's claim and lien rights?

a. Listed creditors in a bankruptcy proceeding will receive a form entitled "Proof of Claim." A copy of a proof of claim form is provided below.

(i) Upon receipt of the form, you should immediately consult your district counsel and possibly bankruptcy counsel.

(ii) If advised to complete and submit the form:

(aa) note the amount in section 1;

(bb) under section 4. you will note that the security is real estate; and

(cc) the "basis for perfection" should be completed by inserting Colorado Revised Statutes, Section 32-1-1001(1)(j).

b. Return the completed form as provided in the instructions. This is your entry into and access to the case and the numerous filings that will occur thereafter.

c. Without the proper filing of this form, you will not be included in proceedings and may find the district's rights affected with little or no knowledge on your part.

d. Provide copies of all subsequent notices and filings to appropriate counsel as soon as they are received. Numerous proceedings following the notice may require your participation.

Official Form 10 -- US Bankruptcy Court

B 10 (Official Form 10) (12/08)

UNITED STATES BANKRUPTCY COURT	**PROOF OF CLAIM**
Name of Debtor:	Case Number:

NOTE: *This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A request for payment of an administrative expense may be filed pursuant to 11 U.S.C. § 503.*

Name of Creditor (the person or other entity to whom the debtor owes money or property):	❒ Check this box to indicate that this claim amends a previously filed claim.
Name and address where notices should be sent: Telephone number:	**Court Claim Number:**_____ (*If known*) Filed on:_____
Name and address where payment should be sent (if different from above): Telephone number:	❒ Check this box if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy of statement giving particulars. ❒ Check this box if you are the debtor or trustee in this case.
1. Amount of Claim as of Date Case Filed: $_____ If all or part of your claim is secured, complete item 4 below; however, if all of your claim is unsecured, do not complete item 4. If all or part of your claim is entitled to priority, complete item 5. ❒ Check this box if claim includes interest or other charges in addition to the principal amount of claim. Attach itemized statement of interest or charges.	**5. Amount of Claim Entitled to Priority under 11 U.S.C. §507(a). If any portion of your claim falls in one of the following categories, check the box and state the amount.** Specify the priority of the claim. ❒ Domestic support obligations under 11 U.S.C. §507(a)(1)(A) or (a)(1)(B). ❒ Wages, salaries, or commissions (up to $10,950*) earned within 180 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier – 11 U.S.C. §507 (a)(4). ❒ Contributions to an employee benefit plan – 11 U.S.C. §507 (a)(5). ❒ Up to $2,425* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use – 11 U.S.C. §507 (a)(7). ❒ Taxes or penalties owed to governmental units – 11 U.S.C. §507 (a)(8). ❒ Other – Specify applicable paragraph of 11 U.S.C. §507 (a)(__). **Amount entitled to priority:** $_____ **Amounts are subject to adjustment on 4/1/10 and every 3 years thereafter with respect to cases commenced on or after the date of adjustment.*
2. Basis for Claim: _____ (See instruction #2 on reverse side.)	
3. Last four digits of any number by which creditor identifies debtor: _____ **3a. Debtor may have scheduled account as:** _____ (See instruction #3a on reverse side.)	
4. Secured Claim (See instruction #4 on reverse side.) Check the appropriate box if your claim is secured by a lien on property or a right of setoff and provide the requested information. **Nature of property or right of setoff:** ❒ Real Estate ❒ Motor Vehicle ❒ Other **Describe:** **Value of Property:$_____ Annual Interest Rate_____%** **Amount of arrearage and other charges as of time case filed included in secured claim,** **if any: $_____ Basis for perfection: _____** **Amount of Secured Claim: $_____ Amount Unsecured: $_____**	
6. Credits: The amount of all payments on this claim has been credited for the purpose of making this proof of claim. **7. Documents:** Attach redacted copies of any documents that support the claim, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, judgments, mortgages, and security agreements. You may also attach a summary. Attach redacted copies of documents providing evidence of perfection of a security interest. You may also attach a summary. (*See instruction 7 and definition of "redacted" on reverse side.)* DO NOT SEND ORIGINAL DOCUMENTS. ATTACHED DOCUMENTS MAY BE DESTROYED AFTER SCANNING. If the documents are not available, please explain:	

Date:	**Signature:** The person filing this claim must sign it. Sign and print name and title, if any, of the creditor or other person authorized to file this claim and state address and telephone number if different from the notice address above. Attach copy of power of attorney, if any.	**FOR COURT USE ONLY**

Penalty for presenting fraudulent claim: Fine of up to $500,000 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 3571.

INSTRUCTIONS FOR PROOF OF CLAIM FORM

The instructions and definitions below are general explanations of the law. In certain circumstances, such as bankruptcy cases not filed voluntarily by the debtor, there may be exceptions to these general rules.

Items to be completed in Proof of Claim form

Court, Name of Debtor, and Case Number:
Fill in the federal judicial district where the bankruptcy case was filed (for example, Central District of California), the bankruptcy debtor's name, and the bankruptcy case number. If the creditor received a notice of the case from the bankruptcy court, all of this information is located at the top of the notice.

Creditor's Name and Address:
Fill in the name of the person or entity asserting a claim and the name and address of the person who should receive notices issued during the bankruptcy case. A separate space is provided for the payment address if it differs from the notice address. The creditor has a continuing obligation to keep the court informed of its current address. See Federal Rule of Bankruptcy Procedure (FRBP) 2002(g).

1. **Amount of Claim as of Date Case Filed:**
State the total amount owed to the creditor on the date of the Bankruptcy filing. Follow the instructions concerning whether to complete items 4 and 5. Check the box if interest or other charges are included in the claim.

2. **Basis for Claim:**
State the type of debt or how it was incurred. Examples include goods sold, money loaned, services performed, personal injury/wrongful death, car loan, mortgage note, and credit card. If the claim is based on the delivery of health care goods or services, limit the disclosure of the goods or services so as to avoid embarrassment or the disclosure of confidential health care information. You may be required to provide additional disclosure if the trustee or another party in interest files an objection to your claim.

3. **Last Four Digits of Any Number by Which Creditor Identifies Debtor:**
State only the last four digits of the debtor's account or other number used by the creditor to identify the debtor.

3a. Debtor May Have Scheduled Account As:
Use this space to report a change in the creditor's name, a transferred claim, or any other information that clarifies a difference between this proof of claim and the claim as scheduled by the debtor.

4. **Secured Claim:**
Check the appropriate box and provide the requested information if the claim is fully or partially secured. Skip this section if the claim is entirely unsecured. (See DEFINITIONS, below.) State the type and the value of property that secures the claim, attach copies of lien documentation, and state annual interest rate and the amount past due on the claim as of the date of the bankruptcy filing.

5. **Amount of Claim Entitled to Priority Under 11 U.S.C. §507(a).**
If any portion of your claim falls in one or more of the listed categories, check the appropriate box(es) and state the amount entitled to priority. (See DEFINITIONS, below.) A claim may be partly priority and partly non-priority. For example, in some of the categories, the law limits the amount entitled to priority.

6. **Credits:**
An authorized signature on this proof of claim serves as an acknowledgment that when calculating the amount of the claim, the creditor gave the debtor credit for any payments received toward the debt.

7. **Documents:**
Attach to this proof of claim form redacted copies documenting the existence of the debt and of any lien securing the debt. You may also attach a summary. You must also attach copies of documents that evidence perfection of any security interest. You may also attach a summary. FRBP 3001(c) and (d). If the claim is based on the delivery of health care goods or services, see instruction 2. Do not send original documents, as attachments may be destroyed after scanning.

Date and Signature:
The person filing this proof of claim must sign and date it. FRBP 9011. If the claim is filed electronically, FRBP 5005(a)(2), authorizes courts to establish local rules specifying what constitutes a signature. Print the name and title, if any, of the creditor or other person authorized to file this claim. State the filer's address and telephone number if it differs from the address given on the top of the form for purposes of receiving notices. Attach a complete copy of any power of attorney. Criminal penalties apply for making a false statement on a proof of claim.

DEFINITIONS

Debtor
A debtor is the person, corporation, or other entity that has filed a bankruptcy case.

Creditor
A creditor is a person, corporation, or other entity owed a debt by the debtor that arose on or before the date of the bankruptcy filing. See 11 U.S.C. §101 (10)

Claim
A claim is the creditor's right to receive payment on a debt owed by the debtor that arose on the date of the bankruptcy filing. See 11 U.S.C. §101 (5). A claim may be secured or unsecured.

Proof of Claim
A proof of claim is a form used by the creditor to indicate the amount of the debt owed by the debtor on the date of the bankruptcy filing. The creditor must file the form with the clerk of the same bankruptcy court in which the bankruptcy case was filed.

Secured Claim Under 11 U.S.C. §506(a)
A secured claim is one backed by a lien on property of the debtor. The claim is secured so long as the creditor has the right to be paid from the property prior to other creditors. The amount of the secured claim cannot exceed the value of the property. Any amount owed to the creditor in excess of the value of the property is an unsecured claim. Examples of liens on property include a mortgage on real estate or a security interest in a car.

A lien may be voluntarily granted by a debtor or may be obtained through a court proceeding. In some states, a court judgment is a lien. A claim also may be secured if the creditor owes the debtor money (has a right to setoff).

Unsecured Claim
An unsecured claim is one that does not meet the requirements of a secured claim. A claim may be partly unsecured if the amount of the claim exceeds the value of the property on which the creditor has a lien.

Claim Entitled to Priority Under 11 U.S.C. §507(a)
Priority claims are certain categories of unsecured claims that are paid from the available money or property in a bankruptcy case before other unsecured claims.

Redacted
A document has been redacted when the person filing it has masked, edited out, or otherwise deleted, certain information. A creditor should redact and use only the last four digits of any social-security, individual's tax-identification, or financial-account number, all but the initials of a minor's name and only the year of any person's date of birth.

Evidence of Perfection
Evidence of perfection may include a mortgage, lien, certificate of title, financing statement, or other document showing that the lien has been filed or recorded.

INFORMATION

Acknowledgment of Filing of Claim
To receive acknowledgment of your filing, you may either enclose a stamped self-addressed envelope and a copy of this proof of claim or you may access the court's PACER system (www.pacer.psc.uscourts.gov) for a small fee to view your filed proof of claim.

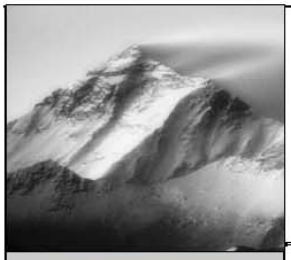
Offers to Purchase a Claim
Certain entities are in the business of purchasing claims for an amount less than the face value of the claims. One or more of these entities may contact the creditor and offer to purchase the claim. Some of the written communications from these entities may easily be confused with official court documentation or communications from the debtor. These entities do not represent the bankruptcy court or the debtor. The creditor has no obligation to sell its claim. However, if the creditor decides to sell its claim, any transfer of such claim is subject to FRBP 3001(e), any applicable provisions of the Bankruptcy Code (11 U.S.C. § 101 *et seq.*), and any applicable orders of the bankruptcy court.

Facilitating Bond Workouts to Avoid Potential Defaults

Prepared and Presented by:

Marybeth Jones, Brownstein Hyatt Farber Schreck LLP
Michael Lund, Piper Jaffray - Denver

August 27, 2009



	Moody's	Standard & Poor's	Fitch Ratings
Ambac	(Caa2) Developing Outlook	(CC) Negative Outlook	NR
Assured Guaranty (1)	(Aa2) Rating Under Review	(AAA) Negative Outlook	(AA) Negative Watch
Berkshire Hathaway Inc.	(Aa1) Affirmed/Stable	(AAA) Negative Outlook	NR
CIFG	(Caa2) Rating Under Review	(CC) Negative Watch	NR
FSA (1)	(Aa3) Rating Under Review	(AAA) Negative Outlook	(AA+) Negative Watch
mbia	(B3) Negative Outlook	(BBB) Negative Outlook	NR
national public finance guarantee (2)	(Baa1) Developing Outlook	(A) CreditWatch Developing	NR
Syncora Guarantee (3)	(Ca) Developing Outlook	(R) Regulatory Supervision	NR
Radian	(Ba1) Stable Outlook	(BBB-) CreditWatch Negative	NR
FGIC	Rating Withdrawn	NR	NR
ACA Capital	NR	NR	NR

Source: Rating Agency Reports
(1) AGC has agreed to purchase FSA, pending rating affirmation
(2) National Public Finance Guarantee (formerly MBIA of IL)
(3) Syncora Guarantee (formerly XL Capital Assurance)

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I. From the investor and insurer's perspective

A. Not a set process, but rather taken case by case.

B. Talk to investor or insurer early.

II. Who do you talk to?

A. Finance team participants

1. Underwriter or financial advisor

2. Trustee

3. Bond Counsel

4. District Counsel

III. Investor contacts

A. Insured Bonds

1. Who is the insurer? (See ratings handout)

2. Insurer’s options or willingness to participate may be limited until there is an actual default.

3. Insurance Company will (should) make payments.

4. Insurance Company may have other enforcement provisions.

B. Uninsured Bonds

1. How many bondholders?

2. Is there a major bond holder?

IV. What will be some of the first questions?

A. Is the District in compliance with its Bond documents?

B. Financial Status of the District.

C. Is there a Debt Service Reserve Fund or Surplus Fund?

1. Has it already been used to make a payment?

2. When will the District actually miss a principal or interest payment?

D. Are there other sources of revenue or cash available to the District?

E. Is this problem temporary or permanent?

1. What is the short term vs. long term outlook?

2. What needs to happen for the District to perform?

F. What are the limits on the Debt?

1. Is there a maximum term?

2. What is the maximum repayment amount that was voted?

V. Different buyers have different motives

A. Original buyer or purchased the bonds at or near par:

1. May be more concerned about return of principal rather than absolute investment return.

2. May be more informed about the history of the District and the likelihood of it recovering.

3. Has the District followed the bond covenants and provided timely disclosure?

4. Once the bonds default they are harder to trade.

5. What is the price of the bonds? Has the investor already lost substantial value?

B. Distressed buyer that purchased the bonds for cents on the dollar

1. More interested in the return on his investment rather than on the outstanding principal amount.

2. May be more interested in potential gains if the District recovers.

Typical Default Provisions in Bond Documents

I. **Limited Mill Levy**

A. **Events of Default**. Typical events of default:

1. the special district defaults in the performance or observance of any of the Indenture covenants, agreements, or conditions and fails to remedy the same after notice thereof; or

2. the special district declares bankruptcy; or

3. the special district fails to impose the required mill levy or to remit to the trustee, when required, any property taxes, specific ownership taxes or other amounts due and owing.

B. **Remedies**. Typical remedies of the trustee (on behalf of the bond owners):

> by mandamus, or other suit, action or proceeding at law or in equity, enforce all rights of the bonds owners, and require the special district to carry out any agreements with or for the benefit of the bond owners including all of its rights under the Indenture to require the special district to impose the required mill levy and collect and remit all amounts due and owing thereunder, and to perform its or their duties or enforce any lien or foreclose on any property subject to any lien created under state law or the bond documents, provided that any such remedy may be taken only to the extent permitted under the applicable provisions of the bond documents to the extent permitted by law;
>
> bring suit upon the bonds;
>
> by action or suit in equity require the special district to account as if it were the trustee of an express trust for the bond owners; or
>
> by action or suit in equity enjoin any acts or things which may be unlawful or in violation of the rights of the bond owners.

II. **Unlimited Mill Levy**

A. Events of Default. Typical events of default:

> Nonpayment of the principal of the Bonds when due; or
>
> Nonpayment of the interest on any Bonds when due; or

the special district defaults in the performance or observance of any of the Indenture covenants, agreements, or conditions and fails to remedy the same after notice thereof; or

the special district declares bankruptcy.

Remedies. Typical remedies of the trustee (on behalf of the bond owners):

by mandamus, or other suit, action or proceeding at law or in equity, enforce all rights of the bonds owners, and require the special district to carry out any agreements with or for the benefit of the bond owners, and to perform its or their duties or enforce any lien or foreclose on any property subject to any lien created under state law or the bond documents, provided that any such remedy may be taken only to the extent permitted under the applicable provisions of the bond documents to the extent permitted by law;

bring suit upon the bonds;

by action or suit in equity require the special district to account as if it were the trustee of an express trust for the bond owners; or

by action or suit in equity enjoin any acts or things which may be unlawful or in violation of the rights of the bond owners.

III. Other Credit Documents

A special district with debt secured by a letter of credit, bond insurance or other credit facility should review the underlying credit documents for possible covenant defaults which may result in a default.

EXAMPLES:

A material adverse change occurs: if, in Bank's reasonable discretion, the business, operations or financial condition of a person, entity or property has changed in a manner which would materially impair the value of Bank's security for the obligations of the special district under the credit documents, prevent timely payment of the obligations of the special district under the credit documents or otherwise prevent the applicable person or entity from timely performing any of its material obligations under the credit documents.

the special district declares bankruptcy;

failure to maintain debt service coverage ratios;

failure to file annual financial information; or

failure to maintain required reserves or operations and maintenance accounts.

Chapter 9 (Municipal) Bankruptcy as a Last Resort

Prepared and Presented by:

Marybeth Jones, Brownstein Hyatt Farber Schreck LLP

Chapter 9 Municipal Bankruptcy

I. Generally

A. CHAPTER 9: The chapter of the Bankruptcy Code providing for reorganization of municipalities (which includes cities and towns, as well as villages, counties, taxing districts, municipal utilities, and school districts).

B. In the more than 60 years since Congress established a federal mechanism for the resolution of municipal debts, there have been fewer than 500 municipal bankruptcy petitions filed. Although chapter 9 cases are rare, a filing by a large municipality can— like the 1994 filing by Orange County, California—involve many millions of dollars in municipal debt.

II. Purpose of Municipal Bankruptcy

A. The purpose of chapter 9 is to provide a financially-distressed municipality protection from its creditors while it develops and negotiates a plan for adjusting its debts.

B. Reorganization of the debts of a municipality is typically accomplished either by extending debt maturities, reducing the amount of principal or interest, or refinancing the debt by obtaining a new loan.

C. Although similar to other chapters in some respects, chapter 9 is significantly different in that there is no provision in the law for liquidation of the assets of the municipality and distribution of the proceeds to creditors. The functions of the bankruptcy court in chapter 9 cases are generally limited to approving the petition (if the debtor is eligible), confirming a plan of debt adjustment, and ensuring implementation of the plan. As a practical matter, however, the municipality may consent to have the court exercise jurisdiction in many of the traditional areas of court oversight in bankruptcy, in order to obtain the protection of court orders and eliminate the need for multiple forums to decide issues.

III. Eligibility

A. Only a "municipality" may file for relief under chapter 9. 11 U.S.C. § 109(c).

B. The term "municipality" is defined in the Bankruptcy Code as a "political subdivision or public agency or instrumentality of a State." 11 U.S.C. § 101(40).

Definition includes cities, counties, townships, school districts, public improvement districts and revenue-producing bodies that provide services

which are paid for by users rather than by general taxes, such as bridge authorities, highway authorities, and gas authorities.

C. Section 109(c) of the Bankruptcy Code sets forth four additional eligibility requirements for chapter 9:

the municipality must be *specifically* authorized to be a debtor by State law or by a governmental officer or organization empowered by State law to authorize the municipality to be a debtor;

the municipality must be insolvent, as defined in 11 U.S.C. § 101(32)(C);

the municipality must desire to effect a plan to adjust its debts; and

the municipality must either:

obtain the agreement of creditors holding at least a majority in amount of the claims of each class that the debtor intends to impair under a plan in a case under chapter 9;

negotiate in good faith with creditors and fail to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that the debtor intends to impair under a plan;

be unable to negotiate with creditors because such negotiation is impracticable; or

reasonably believe that a creditor may attempt to obtain a preference

IV. Commencement of the Case

A. Municipalities must voluntarily seek protection under the Bankruptcy Code. 11 U.S.C. §§ 303, 901(a). They may file a petition only under chapter 9.

B. A case under chapter 9 concerning an unincorporated tax or special assessment district that does not have its own officials is commenced by the filing of a voluntary "petition under this chapter by such district's governing authority or the board or body having authority to levy taxes or assessments to meet the obligations of such district." 11 U.S.C. § 921(a).

C. A municipal debtor must file a list of creditors. 11 U.S.C. § 924. Normally, the debtor files the list of creditors with the petition. However, the bankruptcy court has discretion to fix a different time if the debtor is unable to prepare the list of creditors in the form and with the detail required by the Bankruptcy Rules at the time of filing. Fed. R. Bankr. P. 1007.

V. Assignment of Case to a Bankruptcy Judge

A. One significant difference between chapter 9 cases and cases filed under other chapters is that the clerk of court does not automatically assign the case to a particular judge. "The chief judge of the court of appeals for the circuit embracing the district in which the case is commenced [designates] the bankruptcy judge to conduct the case." 11 U.S.C. § 921(b). This provision was designed to remove politics from the issue of which judge will preside over the chapter 9 case of a major municipality and to ensure that a municipal case will be handled by a judge who has the time and capability of doing so.

VI. Notice of Case/ Objections/ Order for Relief

A. The Bankruptcy Code requires that notice be given of the commencement of the case and the order for relief. 11 U.S.C. § 923. The Bankruptcy Rules provide that the clerk, or such other person as the court may direct, is to give notice. Fed. R. Bankr. P. 2002(f).

B. The notice must also be published "at least once a week for three successive weeks in at least one newspaper of general circulation published within the district in which the case is commenced, and in such other newspaper having a general circulation among bond dealers and bondholders as the court designates." 11 U.S.C. § 923. The court typically enters an order designating who is to give and receive notice by mail and identifying the newspapers in which the additional notice is to be published. Fed. R. Bankr. P. 9007, 9008.

C. The Bankruptcy Code permits objections to the petition. 11 U.S.C. § 921(c). Typically, objections concern issues like whether negotiations have been conducted in good faith, whether the state has authorized the municipality to file, and whether the petition was filed in good faith. If an objection to the petition is filed, the court must hold a hearing on the objection. *Id.* The court may dismiss a petition if it determines that the debtor did not file the petition in good faith or that the petition does not meet the requirements of title 11. *Id.*

D. If the petition is not dismissed upon an objection, the Bankruptcy Code requires the court to order relief, allowing the case to proceed under chapter 9. 11 U.S.C. § 921(d).

VII. Automatic Stay

A. The automatic stay of section 362 of the Bankruptcy Code is applicable in chapter 9 cases. 11 U.S.C. §§ 362(a), 901(a). The stay operates to stop all collection actions against the debtor and its property upon the filing of the petition. Additional automatic stay provisions are applicable in chapter 9 that prohibit actions against officers and inhabitants of the debtor if the action seeks to enforce a claim against the debtor. 11 U.S.C. § 922(a). Thus, the stay prohibits a creditor from bringing a mandamus action against an officer of a municipality on account of a prepetition debt. It also prohibits a creditor from bringing an action

against an inhabitant of the debtor to enforce a lien on or arising out of taxes or assessments owed to the debtor.

B. Section 922(d) of title 11 limits the applicability of the stay. Under that section, a chapter 9 petition does not operate to stay application of pledged special revenues to payment of indebtedness secured by such revenues. Thus, an indenture trustee or other paying agent may apply pledged funds to payments coming due or distribute the pledged funds to bondholders without violating the automatic stay.

VIII. Proofs of Claim

A. In a chapter 9 case, the court fixes the time within which proofs of claim or interest may be filed. Fed. R. Bankr. P. 3003(c)(3). Many creditors may not be required to file a proof of claim in a chapter 9 case. For example, a proof of claim is deemed filed if it appears on the list of creditors filed by the debtor, unless the debt is listed as disputed, contingent, or unliquidated. 11 U.S.C. § 925. Thus, a creditor must file a proof of claim if the creditor's claim appears on the list of creditors as disputed, contingent, or unliquidated.

IX. Court's Limited Power

A. Sections 903 and 904 of the Bankruptcy Code are designed to recognize the court's limited power over operations of the debtor.

B. Section 904 limits the power of the bankruptcy court to "interfere with – (1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property" unless the debtor consents or the plan so provides. The provision makes it clear that the debtor's day-to-day activities are not subject to court approval and that the debtor may borrow money without court authority. In addition, the court cannot appoint a trustee (except for limited purposes specified in 11 U.S.C. § 926(a)) and cannot convert the case to a liquidation proceeding.

C. The court also cannot interfere with the operations of the debtor or with the debtor's use of its property and revenues. This is due, at least in part, to the fact that in a chapter 9 case, there is no property of the estate and thus no estate to administer. 11 U.S.C. § 902(1). Moreover, a chapter 9 debtor may employ professionals without court approval, and the only court review of fees is in the context of plan confirmation, when the court determines the reasonableness of the fees.

D. The restrictions imposed by 11 U.S.C. § 904 are necessary to ensure the constitutionality of chapter 9 and to avoid the possibility that the court might substitute its control over the political or governmental affairs or property of the debtor for that of the state and the elected officials of the municipality.

E. Similarly, 11 U.S.C. § 903 states that "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 the municipality, including expenditures for such exercise," with two exceptions – a state law prescribing a method of composition of municipal debt does not bind any non-consenting creditor, nor does any judgment entered under such state law bind a nonconsenting creditor.

X. Role of the U.S. trustee/bankruptcy administrator

A. In a chapter 9 case, the role of the U.S. trustee (or the bankruptcy administrator in North Carolina or Alabama) is typically more limited than in chapter 11 cases. Although the U.S. trustee appoints a creditors' committee, the U.S. trustee does not examine the debtor at a meeting of creditors (there is no meeting of creditors), does not have the authority to move for appointment of a trustee or examiner or for conversion of the case, and does not supervise the administration of the case. Further, the U.S. trustee does not monitor the financial operations of the debtor or review the fees of professionals retained in the case.

XI. Role of Creditors

A. The role of creditors is more limited in chapter 9 than in other cases. There is no first meeting of creditors, and creditors may not propose competing plans. If certain requirements are met, the debtor's plan is binding on dissenting creditors. The chapter 9 debtor has more freedom to operate without court-imposed restrictions.

B. In each chapter 9 case, however, there is a creditors' committee that has powers and duties that are very similar to those of a committee in a chapter 11 case. These powers and duties include selecting and authorizing the employment of one or more attorneys, accountants, or other agents to represent the committee; consulting with the debtor concerning administration of the case; investigating the acts, conduct, assets, liabilities, and financial condition of the debtor; participating in the formulation of a plan; and performing such other services as are in the interest of those represented. 11 U.S.C. §§ 901(a), 1103.

XII. Intervention/Right of Others to be Heard

A. When cities or counties file for relief under chapter 9, there may be a great deal of interest in the case from entities wanting to appear and be heard. The Bankruptcy Rules provide that "[t]he Secretary of the Treasury of the United States may, or if requested by the court shall, intervene in a chapter 9 case." Fed. R. Bankr. P. 2018(c). Further, "[r]epresentatives of the state in which the debtor is located may intervene in a chapter 9 case." *Id.* In addition, the Bankruptcy Code permits the Securities and Exchange Commission to appear and be heard on any issue and gives parties in interest the right to appear and be heard on any issue in a case. 11 U.S.C. §§ 901(a), 1109. Parties in interest include municipal

employees, local residents, non-resident owners of real property, special tax payers, securities firms, and local banks.

XIII. Powers of the Debtor

A. Due to statutory limitations placed upon the power of the court in a municipal debt adjustment proceeding, the court is far less involved in the conduct of a municipal bankruptcy case (and in the operation of the municipal entity) while the debtor's financial affairs are undergoing reorganization. The municipal debtor has broad powers to use its property, raise taxes, and make expenditures as it sees fit. It is also permitted to adjust burdensome non-debt contractual relationships under the power to reject executory contracts and unexpired leases, subject to court approval, and it has the same avoiding powers as other debtors. Municipalities may also reject collective bargaining agreements and retiree benefit plans without going through the usual procedures required in chapter 11 cases.

B. A municipality has authority to borrow money during a chapter 9 case as an administrative expense. 11 U.S.C. §§ 364, 901(a). This ability is important to the survival of a municipality that has exhausted all other resources. A chapter 9 municipality has the same power to obtain credit as it does outside of bankruptcy. The court does not have supervisory authority over the amount of debt the municipality incurs in its operation. The municipality may employ professionals without court approval, and the professional fees incurred are reviewed only within the context of plan confirmation.

XIV. Dismissal

A. As previously noted, the court may dismiss a chapter 9 petition, after notice and a hearing, if it concludes the debtor did not file the petition in good faith or if the petition does not meet the requirements of chapter 9. 11 U.S.C. § 921(c). The court may also dismiss the petition for cause, such as for lack of prosecution, unreasonable delay by the debtor that is prejudicial to creditors, failure to propose or confirm a plan within the time fixed by the court, material default by the debtor under a confirmed plan, or termination of a confirmed plan by reason of the occurrence of a condition specified in the plan. 11 U.S.C. § 930.

XV. Treatment of Bondholders and Other Lenders

A. Different types of bonds receive different treatment in municipal bankruptcy cases. General obligation bonds are treated as general debt in the chapter 9 case. The municipality is not required to make payments of either principal or interest on account of such bonds during the case. The obligations created by general obligation bonds are subject to negotiation and possible restructuring under the plan of adjustment.

B. Special revenue bonds, by contrast, will continue to be secured and serviced during the pendency of the chapter 9 case through continuing application and payment of ongoing special revenues. 11 U.S.C. § 928. Holders of special revenue bonds can expect to receive payment on such bonds during the chapter 9 case if special revenues are available. The application of pledged special revenues to indebtedness secured by such revenues is not stayed as long as the pledge is consistent with 11 U.S.C. § 928 [§ 922(d) erroneously refers to § 927 rather than § 928], which insures that a lien of special revenues is subordinate to the operating expenses of the project or system from which the revenues are derived. 11 U.S.C. § 922(d).

C. Bondholders generally do not have to worry about the threat of preference liability with respect to any prepetition payments on account of bonds or notes, whether special revenue or general obligations. Any transfer of the municipal debtor's property to a noteholder or bondholder on account of a note or bond cannot be avoided as a preference, *i.e.*, as an unauthorized payment to a creditor made while the debtor was insolvent. 11 U.S.C. § 926(b).

XVI. Plan for Adjustment of Debts

A. The Bankruptcy Code provides that the debtor must file a plan. 11 U.S.C. § 941. The plan must be filed with the petition or at such later time as the court fixes. There is no provision in chapter 9 allowing creditors or other parties in interest to file a plan. This limitation is required by the Supreme Court's pronouncements in *Ashton*, 298 U.S. at 528, and *Bekins*, 304 U.S. at 51, which interpreted the Tenth Amendment as requiring that a municipality be left in control of its governmental affairs during a chapter 9 case. Neither creditors nor the court may control the affairs of a municipality indirectly through the mechanism of proposing a plan of adjustment of the municipality's debts that would in effect determine the municipality's future tax and spending decisions.

XVII. Confirmation Standards

A. The standards for plan confirmation in chapter 9 cases are a combination of the statutory requirements of 11 U.S.C. § 943(b) and those portions of 11 U.S.C. § 1129 (the chapter 11 confirmation standards) made applicable by 11 U.S.C. § 901(a). Section 943(b) lists seven general conditions required for confirmation of a plan. The court must confirm a plan if the following conditions are met:

> the plan complies with the provisions of title 11 made applicable by sections 103(e) and 901;
>
> the plan complies with the provisions of chapter 9;

all amounts to be paid by the debtor or by any person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable;

the debtor is not prohibited by law from taking any action necessary to carry out the plan;

except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that on the effective date of the plan, each holder of a claim of a kind specified in section 507(a)(1) will receive on account of such claim cash equal to the allowed amount of such claim;

any regulatory or electoral approval necessary under applicable nonbankruptcy law in order to carry out any provision of the plan has been obtained, or such provision is expressly conditioned on such approval; and

the plan is in the best interests of creditors and is feasible.

XVIII. 11 U.S.C. § 943(b).

A. Section 943(b)(1) requires as a condition for confirmation that the plan comply with the provisions of the Bankruptcy Code made applicable by sections 103(e) and 901(a) of the Bankruptcy Code. The most important of these for purposes of confirming a plan are those provisions of 11 U.S.C. § 1129 (*i.e.*, § 1129(a)(2), (a)(3), (a)(6), (a)(8), (a)(10)) that are made applicable by 11 U.S.C. § 901(a). Section 1129(a)(8) requires, as a condition to confirmation, that the plan has been accepted by each class of claims or interests impaired under the plan. Therefore, if the plan proposes treatment for a class of creditors such that the class is impaired (*i.e.*, the creditor's legal, equitable, or contractual rights are altered), then that class's acceptance is required. If the class is not impaired, then acceptance by that class is not required as a condition to confirmation. Under 11 U.S.C. § 1129(a)(10), the court may confirm the plan only if, should any class of claims be impaired under the plan, at least one impaired class has accepted the plan. If only one impaired class of creditors consents to the plan, plan confirmation is still possible under the "cram down" provisions of 11 U.S.C. § 1129(b). Under "cram down," if all other requirements are met except the § 1129(a)(8) requirement that all classes either be unimpaired or have accepted the plan, then the plan is confirmable if it does not discriminate unfairly and is fair and equitable.

B. The requirement that the plan be in the "best interests of creditors" means something different under chapter 9 than under chapter 11. Under chapter 11, a plan is said to be in the "best interest of creditors" if creditors would receive as much under the plan as they would if the debtor were liquidated. 11 U.S.C. § 1129(a)(7)(A)(ii). Obviously, a different interpretation is needed in chapter 9 cases because a municipality's assets cannot be liquidated to pay creditors. In the

chapter 9 context, the "best interests of creditors" test has generally been interpreted to mean that the plan must be better than other alternatives available to the creditors. *See* 6 COLLIER ON BANKRUPTCY § 943.03[7] (15th ed. rev. 2005). Generally speaking, the alternative to chapter 9 is dismissal of the case, permitting every creditor to fend for itself. An interpretation of the " best interests of creditors" test to require that the municipality devote all resources available to the repayment of creditors would appear to exceed the standard. The courts generally apply the test to require a reasonable effort by the municipal debtor that is a better alternative for its creditors than dismissal of the case. *Id.*

C. Parties in interest may object to confirmation, including creditors whose claims are affected by the plan, an organization of employees of the debtor, and other tax payers, as well as the Securities and Exchange Commission. 11 U.S.C. §§ 901(a), 943, 1109, 1128(b).

XIX. Discharge

A. A municipal debtor receives a discharge in a chapter 9 case after: (1) confirmation of the plan; (2) deposit by the debtor of any consideration to be distributed under the plan with the disbursing agent appointed by the court; and (3) a determination by the court that securities deposited with the disbursing agent will constitute valid legal obligations of the debtor and that any provision made to pay or secure payment of such obligations is valid. 11 U.S.C. § 944(b). Thus, the discharge is conditioned not only upon confirmation, but also upon deposit of the consideration to be distributed under the plan and a court determination of the validity of securities to be issued.

B. There are two exceptions to the discharge in chapter 9 cases. The first is for any debt excepted from discharge by the plan or order confirming the plan. The second is for a debt owed to an entity that, before confirmation of the plan, had neither notice nor actual knowledge of the case. 11 U.S.C. § 944(c).

C. At any time within 180 days after entry of the confirmation order, the court may, after notice and a hearing, revoke the order of confirmation if the order was procured by fraud. 11 U.S.C. §§ 901(a), 1144.

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Kim J. Seter *(ksseter@svwpc.com)* earned his Juris Doctorate from George Washington University in 1984 and graduated magna cum laude from Western State College of Colorado with a Bachelor of Arts degree in English and Economics in 1980. Mr. Seter was the recipient of the Rockefeller Scholarship for the study of comparative political and economic systems at Georgetown University and obtained a Masters Degree in the fall of 1981. Mr. Seter has more than 25 years of experience in tax, commercial, construction, securities and municipal litigation before administrative agencies and all federal, state and local courts. In recent years, Mr. Seter's practice has concentrated on the general representation of, and litigation for, municipal entities. Mr. Seter now serves as general counsel to local government entities.

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