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Bankruptcy Judges Share Insight on Chapter 9 Eligibility.

This October, Judge Steven Rhodes of the U.S. Bankruptcy Court in Detroit will preside over a trial on whether the city of Detroit was eligible to file for Chapter 9 bankruptcy protection last month.

In setting an early trial on eligibility and also keeping a mediator on call as disputes arise, Judge Rhodes is following in the footsteps of the judges who oversaw prior municipal bankruptcy cases. Speaking Saturday in San Francisco at the American Bar Association's annual conference, two of those judges said Judge Rhodes appears to be taking a page from both of their books.

To file for Chapter 9, the debtor must meet several criteria: It must be a municipality, it must be insolvent and it must have authorization to file, among other issues. The long list of factors and the debates in each case over whether those factors are met make Chapter 9 very different from other chapters of the Bankruptcy Code.

"Eligibility is a huge thing in [Chapter] 9, and in other chapters, it just sort of happens," said Duane Morris LLP restructuring partner Ron Oliner, who is representing San Bernardino's police officers in the California city's ongoing Chapter 9 case.

Not only does determining eligibility pose a challenge to the distressed municipality and the creditors arguing otherwise, but it also challenges the judge overseeing the case. Is that an issue that is tackled right out of the gate, or, because so much evidence is required, do you give both sides plenty of time to make their case?

Take Stockton, Calif. The city filed for Chapter 9 protection last summer, and Judge Christopher Klein didn't set a trial to determine the city's eligibility for municipal bankruptcy until the following spring.

"My rationale, and I don't apologize for it at all, is that if you think about Chapter 11 as a negotiating model…successful Chapter 11 plans are fundamentally consensual," he said. "Given the restrictions that are in Chapter 9, it's the Chapter 11 negotiating model on steroids."

He appointed a mediator, fellow bankruptcy judge Elizabeth L. Perris, whom he said "worked very long and hard" to establish the facts surrounding the city's bankruptcy filing, including its insolvency. That "vastly simplified" the trial, said Judge Klein, who ultimately found that the city was eligible for municipal bankruptcy protection.

"All those months of time were spent in very extensive and intensive exchanges of information so that people could get on the same page," Judge Klein said. "That exchange of information is going to have to occur in any case."

Judge Klein was the first person that Judge Frank Bailey said he called when he was appointed to oversee Central Falls, R.I.'s Chapter 9 case. Instead of waiting to determine the city's eligibility for bankruptcy protection, Judge Bailey resolved the question within months of its Chapter 9 filing. The city was in and out of bankruptcy in little over a year.

Judge Rhodes in Detroit, according to Judge Bailey, is taking a page from both Stockton and Central Falls rulebooks by scheduling a fast-approaching trial on eligibility and also lining up a mediator, U.S. District Judge Gerald Rosen, should one be needed.

“Compared with other cases, will be remarkably fast,” Judge Klein predicted.

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