
BANKRUPTCY - KENTUCKY

Kentucky Employees Retirement System v. Seven Counties Services, Inc.

United States Court of Appeals, Sixth Circuit - August 24, 2018 - F.3d - 2018 WL 4042666

Kentucky Employees Retirement System (KERS) filed complaint seeking determination that debtor, as tax-exempt nonprofit employer that operated mental health facilities in Kentucky, was "governmental unit" that was statutorily barred from seeking Chapter 11 relief, to enjoin debtor from seeking to withdraw from KERS, and to require debtor to continue to contribute to KERS.

The United States Bankruptcy Court dismissed complaint and granted debtor's motion to reject its alleged contract with KERS, and KERS appealed. The United States District Court affirmed in part and reversed in part, and appeal was taken.

The Court of Appeals held that:

- Employer was not state instrumentality, weighing in favor of conclusion that it was not statutorily disqualified from filing Chapter 11 petition;
- Kentucky's statutory empowerment of employer to oversee administration of mental health services did not weigh in favor of conclusion that employer was subject to state control and therefore statutorily disqualified from filing Chapter 11 petition; and
- Question had to be certified to Kentucky Supreme Court of whether participation by employer as department in and its contributions to Kentucky Employees Retirement System were based on contractual or a statutory obligation.

Unpublished case from Court of Appeals panel could provide support for proposition that tax-exempt nonprofit employer, like its predecessor, should be given benefit of access to Chapter 11 proceedings; although statutory scheme was different in prior case, it did not explain its reasoning, and it was not binding, subsequent panel was required to not read Bankruptcy Code to erode past bankruptcy practice absent clear indication that Congress intended such departure.

Tax-exempt nonprofit employer that operated mental health facilities in Kentucky was "instrumentality" of Commonwealth of Kentucky, weighing in favor of conclusion that it was subject to state control and therefore statutorily disqualified from filing Chapter 11 petition, since employer's work of providing safety net of mental health care served public purpose.

Kentucky did not in normal course of events choose leadership of tax-exempt nonprofit employer that operated mental health facilities in Kentucky, weighing against conclusion that employer was subject to state control and therefore statutorily disqualified from filing Chapter 11 petition; although Kentucky had power to do so in emergency situations, board and officers of employer were selected internally without input from state government and lone state official who attended some board meetings, as governmental liaison, did not have any vote and was excluded from executive sessions.

Kentucky did not govern operations of tax-exempt nonprofit employer that operated mental health facilities in Kentucky through enabling statute, and Kentucky did not fund it through mechanism that normally was reserved for public entities, weighing against conclusion that employer was subject to state control and therefore statutorily disqualified from filing Chapter 11 petition; although employer was subject to governmental regulation and recognition, being subject to regulation was not synonymous with functioning pursuant to enabling statute, employer undertook projects unrelated to its role as regional provider of mental health services, and it never took even limited step of making request for tax even if it had ability to do so.

Kentucky’s ability to withdraw its recognition of tax-exempt nonprofit employer that operated mental health facilities in Kentucky, as community mental health center (CMHC), and thereby render it ineligible for main service provision contract did not weigh in favor of conclusion that employer was subject to state control and therefore statutorily disqualified from filing Chapter 11 petition; although withdrawal of recognition would create financial difficulties because that contract accounted for more than 20% of annual revenue, CMHC had to take or fail to take certain actions listed in statute to trigger those consequences, and employer would not thereby cease to exist.

Tax-exempt nonprofit employer that operated mental health facilities in Kentucky was not state instrumentality, weighing in favor of conclusion that it was not statutorily disqualified from filing Chapter 11 petition, since Commonwealth of Kentucky did not create employer, Kentucky did not in normal course of events choose employer’s leadership, Kentucky did not govern its operations through enabling statute, Kentucky did not fund it through mechanism that normally was reserved for public entities, and Kentucky could not unilaterally destroy it.

Kentucky’s statutory empowerment of tax-exempt nonprofit employer that operated mental health facilities in Kentucky, as community mental health center (CMHC), to oversee administration of mental health services did not weigh in favor of conclusion that employer was subject to state control and therefore statutorily disqualified from filing Chapter 11 petition, since complying with regulations for special purpose governmental entities was not same as being special purpose governmental entity, and overseeing was not same as making policy.

Question had to be certified to Kentucky Supreme Court of whether participation by tax-exempt nonprofit employer that operated mental health facilities in Kentucky, as community mental health center (CMHC), as department in and its contributions to Kentucky Employees Retirement System were based on contractual or a statutory obligation, since key problem was one of Kentucky law and Kentucky Supreme Court previously had accepted certification of questions that apply Kentucky law to facts, Kentucky Supreme Court’s decision on issue could be determinative, precedent from Kentucky courts was not available to provide clear guidance in answering question, decision could have significant impact on fiscal health of Kentucky public pension system, and final resolution of case depended on Kentucky Supreme Court’s determination.

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