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BANKRUPTCY - PENNSYLVANIA

In re City of Chester

United States Bankruptcy Court, E.D. Pennsylvania - March 14, 2023 - B.R. - 2023 WL 2504708

City, through receiver appointed under Pennsylvania's Municipalities Financial Recovery Act, filed Chapter 9 petition. Certain elected city officials and holder of city-issued bond objected.

The Bankruptcy Court held that:

- City was specifically authorized to file its voluntary petition by a governmental officer empowered by Pennsylvania state law, as required to be eligible for Chapter 9 relief;
- City was insolvent, as required to be eligible for Chapter 9 relief;
- City desired to effect a plan to adjust its debts, as required to be eligible for Chapter 9 relief;
- City negotiated in good faith with those of its major creditor constituencies with which it was practical to negotiate, as required to be eligible for Chapter 9 relief; and
- City filed its voluntary petition in good faith.

City was a "political subdivision" of Pennsylvania and, thus, a "municipality" within the meaning of the Bankruptcy Code, for purposes of determining its eligibility for relief under Chapter 9; the oldest city in the state, city maintained a fire department with approximately 61 sworn personnel and a police department with approximately 83 sworn officers, and had the ability to tax its residents.

Under Pennsylvania law, city, through receiver appointed under Pennsylvania's Municipalities Financial Recovery Act, was specifically authorized to file its voluntary bankruptcy petition, as required to be eligible for Chapter 9 relief; Secretary of Pennsylvania Department of Community and Economic Development (DCED) authorized receiver to commence a municipal debt adjustment action in writing, and receiver subsequently consulted with Municipal Financial Recovery Advisory Committee (MFRAC) regarding city's financial problems, such that receiver followed all procedural requirements of Act for initiating a municipal debt adjustment action.

Elected city officials did not have standing to object to city's eligibility to be a debtor under Chapter 9 of the Bankruptcy Code; officials did not have "personal stake" in outcome of controversy and were not creditors of city or able to assert an equitable claim against the bankruptcy estate.

City was insolvent, as required to be eligible for Chapter 9 relief, where city had current and long-term inability to pay its debt obligations as they came due; city's prolonged financial distress satisfied both "generally not paying its debts as they become due" and "is unable to pay its debts as they become due" prongs of the Bankruptcy Code's definition of "insolvent," as city was currently unable to fund, and historically had been unable to fun, its substantial obligations under pension funds established for city employees, which were unconditionally owed and presently enforceable, over $100 million remained due and owing under the pension plans, which city lacked resources to pay, in addition to other substantial debt obligations, city's baseline general fund projections showed deficits of $46.5 million to $16.3 million over upcoming five-year period, and city was in state of "bona fide financial distress" unlikely to be resolved absent bankruptcy.

City desired to effect a plan of adjustment, as required to be eligible for Chapter 9 relief; there was no evidence that city filed its bankruptcy petition with ulterior motive such as evading creditors, city, through receiver appointed under Pennsylvania's Municipalities Financial Recovery Act, attempted to resolve claims with its creditors for months prior to filing petition, but to no avail, city submitted a memorandum of law in support of its eligibility to be a debtor with its voluntary petition which stated that city was "presently developing a plan of adjustment[ ] and [was] seeking mediation with its major constituencies to expedite and mediate a path towards such a plan," city requested mandatory mediation at outset of case, further confirming its desire to expeditiously effect a plan of adjustment, and receiver made pre- and postpetition efforts to implement city's recovery plans.

City negotiated in good faith with those of its major creditor constituencies with which it was practical to negotiate, as required to be eligible for Chapter 9 relief; city engaged in well-documented meetings with its unions and made numerous attempts at follow-up communication prior to filing its petition, city had a constructive meeting and attempted to follow up with one group of bondholders, city made multiple unsuccessful attempts to negotiate with second bondholder and negotiated in good faith even though the parties ultimately could not reach consensual resolution outside of bankruptcy, and it was impracticable for city to negotiate with its approximately 268 retirees, given the volume of potential retiree claims and their lack of centralized representation prepetition.

In context of determining whether a municipality negotiated with creditors in good faith for purposes of Chapter 9 eligibility, the creditor's response, and the amount of time the creditor has to respond, may be factors; if creditor has had a relatively short time to respond to municipality's offer to negotiate, lack of detail in the opening communication might weigh against municipality rushing to file, while on the other hand, where creditor has been apprised of the possibility of a debt adjustment and declined to respond after a reasonable period of time, or where creditor has explicitly responded with a refusal to negotiate, its position as an objector is significantly weakened.

In context of determining whether a municipality negotiated with creditors in good faith for purposes of Chapter 9 eligibility, it is impossible to negotiate with a "stonewall," that is, a creditor whose position has remained virtually unchanged over a period of time, and a municipality is not required to wait until it has reached an impasse after extensive prepetition negotiations to invoke the subject provision of the Bankruptcy Code.

City filed its voluntary Chapter 9 petition in good faith; financial problems that city had faced for decades were of type contemplated by, and meant to be addressed in, a Chapter 9 filing, city's decision to file voluntary petition and its pursuit of plan of recovery in the face of "crippling liabilities" and insufficient revenue to meet current and future liabilities was consistent with Chapter 9's objective of providing protection to a financially distressed municipality from creditors while it develops a plan to adjust its debts, city had been and remained insolvent despite its receiver's efforts to cut expenses and find sources of funding, city's prepetition negotiations with creditors to avoid bankruptcy had not been fruitful and Chapter 9 appeared to be the only viable option, and city's residents, who were burdened by high taxes while facing diminishing essential services, would be prejudiced by denial of Chapter 9 relief.

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