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Of Standing and Stonewalling: Chester, Pennsylvania Bankruptcy Sheds New Light on Chapter 9 Eligibility Requirements - Cadwalader

On March 14, 2023, Judge Ashely M. Chan of the U.S. Bankruptcy Court for the Eastern District of Pennsylvania (the "***Court***") ruled that the City of Chester, Pennsylvania (the "***City***" or "***Chester***") was eligible for municipal bankruptcy relief under Chapter 9 of the Bankruptcy Code, specifically overruling objections that challenged Chester's authority under state law to file for Chapter 9 relief and whether the City negotiated with its creditors in good faith.1 The decision provides useful insight into some of the finer points of Chapter 9 eligibility and, like prior decisions concerning Chapter 9 eligibility, it confirms that Section 109(c)'s "good faith" negotiation requirement is a flexible standard left to the discretion of the court and that the court may consider the conduct of creditors in prepetition negotiations.

BACKGROUND

Chester is the oldest city in Pennsylvania. The City is located near Philadelphia and has a population of around 30,000 residents. Following the loss of its manufacturing base, the City suffered a steep decrease in revenues and population. Over time, the City accumulated multi-million dollar deficits, which in 1995 led to its designation as a "distressed city" under Pennsylvania's comprehensive state law for dealing with municipal distress – the Municipalities Financial Recovery Act, generally referred to as "***Act 47***." Under Act 47, if a municipality is determined to be in financial distress, then the Pennsylvania Secretary of Community and Economic Development (the "***Secretary***") must appoint a coordinator to prepare and administer a plan designed to relieve the municipality's financial distress.2

Despite decades of state supervision under Act 47, the City's financial situation continued to deteriorate, and in April 2020, the Governor of Pennsylvania declared a fiscal emergency for the City.3 Following the declaration of such a fiscal emergency, Act 47 authorizes the Governor to direct the Secretary to file a petition in state court to appoint a receiver for the distressed municipality. On June 1, 2020, the Secretary petitioned a state court for appointment of a receiver for the City, and on June 22, 2020, the court appointed Michael Doweary (the "***Receiver***") as receiver. Thereafter, the Receiver took various cost-saving measures, but those efforts were unable to improve the City's financial situation.

The Receiver also undertook negotiations with the City's major creditor constituencies in an effort to obtain debt relief for the City. At the time of the Receiver's appointment, the City's capital structure included two major bond issuances, consisting of (i) two series of "2017 Bonds" issued directly by the City, secured by certain casino and other revenues, and held entirely by a single financial firm – Preston Hollow Community Capital ("***Preston Hollow***") – and (ii) one series of unsecured "2021 Notes" issued by the Delaware Valley Regional Planning Commission on behalf of the City, and held by a more disparate group of bondholders. The City also had significant liabilities to both its current and former employees, including (i) current employees subject to collective bargaining agreements and represented by various unions, and (ii) retired employees entitled to benefits from the City's

underfunded pension funds, but not benefiting from any centralized or organized representation (the "***Retirees***"). Between 2020 and 2022, the Receiver attempted to negotiate concessions from various creditors (including the bondholders and unions), but was not able to reach an agreement with any of these constituencies.

Given the City's deteriorating financial condition and the Receiver's failure to obtain concessions from key creditors, the Receiver ultimately filed a Chapter 9 petition in the Court on November 10, 2022. Before filing the Chapter 9 petition, the Receiver obtained the requisite written authorization from the Secretary. Two major objections were filed to the City's eligibility for Chapter 9 relief, one by the City's mayor and City Council (the "***Elected Officials***"), and one by bondholder Preston Hollow. The Elected Officials argued that the City lacked authority under state law to file for Chapter 9 relief, while Preston Hollow claimed that the City did not negotiate in good faith with its creditors prior to filing for bankruptcy.

Continue reading.

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