The Aftermath of Bankruptcy: Legislative Reform -- State and Federal

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Legislative Solutions in the Orange County Chapter 9 Case

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Federal-State Dualism in Chapter 9

Unlike private sector bankruptcies under Chapters 7, 11, 12 and 13 of the Bankruptcy Code, the bankruptcy case of a public agency under Chapter 9 provides a unique opportunity for active legislative involvement in the conduct and outcome of the case. This opportunity arises principally because of the interplay in a Chapter 9 case between two constitutional mandates. On the one hand, as instrumentalities of a state, Chapter 9 debtors necessarily enjoy substantial freedom from federal interference. This freedom derives from the Tenth Amendment to the Constitution, which provides that "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." U.S. Const., amend. X. According to the Supreme Court, the Tenth Amendment determines the boundary between state and federal authority.

On the other hand, only federal law can overcome the constitutional prohibition on the impairment by states of the obligation of contracts. U.S. Const., art. I, § 10, cl. 1. Thus, the powerful debt restructuring tools under the Bankruptcy Code--such as the automatic stay, the avoidance of transfers, the rejection of contracts and the disallowance of claims--are available exclusively in federal court.

As a result of the tension between these two constitutional imperatives, Chapter 9 was carefully crafted by Congress to accommodate both the reserved sovereign rights of the states and the debt adjustment powers of federal law. This accommodation is reflected both in certain unique provisions of Chapter 9 and in the omission of selected bankruptcy provisions from Chapter 9.

First, the eligibility of a municipality to seek federal relief is committed to the exclusive control of each state. Although many states permit Chapter 9 cases, some with detailed pre-conditions or prior consent, other states expressly prohibit the bankruptcy option. Moreover, even if authorized under state law, only the municipality can file a case or propose a plan of adjustment; involuntary proceedings and creditor plans are not permitted. In October 1994, Congress amended the Bankruptcy Code to require that municipalities be "specifically authorized" under state law to file a petition under Chapter 9. 11 U.S.C. § 109(c)(2). Previously, a municipality was eligible if it was "generally authorized" to file for bankruptcy under state law. By amending the eligibility statute, Congress has expressly invited each state to revisit the types of local agencies that may seek federal relief.

Second, Chapter 9 is designed to permit, if not encourage, active state involvement in the post-bankruptcy affairs of the municipality. Section 903 of the Bankruptcy Code, for example, provides that (with certain limited exceptions) the provisions of Chapter 9 do 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 such municipality, including expenditures for such exercise." Bankruptcy Rule 2018 also permits the state to freely intervene in any Chapter 9 case "with respect to matters specified by the court." And section 943(b)(6) prohibits confirmation of a plan of adjustment unless the debtor has obtained any electoral approval necessary to carry out the plan.

Third, other provisions of Chapter 9 render certain municipal decisions largely immune from court review or creditor scrutiny. Section 904 generally prohibits the bankruptcy court from interfering, "unless the debtor consents or the plan so provides," with any of the debtor's political or governmental powers, property or revenues, or use or enjoyment of income-producing property. In addition, section 363 of the Bankruptcy Code, concerning the use or sale of property, is omitted from Chapter 9, as are sections 327 and 330 (concerning the employment and compensation of professionals), and section 1107 (concerning reporting duties). A Chapter 9 case may neither be commenced involuntarily by creditors nor converted to another case under the Bankruptcy Code. Moreover, the bankruptcy court may not appoint a trustee to manage or control the debtor (except in very limited circumstances to pursue avoidance actions) or compel a liquidation of municipal assets. The sole effective remedy for disgruntled creditors is dismissal of the case.

These unique Chapter 9 provisions were frequently invoked in the Orange County case. Section 904, in particular, was cited by the County as a formidable constraint on creditors' remedies. Although the County routinely sought court approval for many actions taken in the case, it seldom missed the opportunity to remind potential objecting parties that, under section 904, it likely could proceed with the planned action absent court approval. In one reported opinion, the bankruptcy court held that it lacked the ability to compel interim payments to professionals without the County's consent.

Orange County Legislative Solutions

Partly in reaction to the limited authority of the bankruptcy court, and partly in dissatisfaction with the County's aggressive treatment of creditors, many creditors sought to resolve their disputes in a second forum--the California Legislature. Throughout the case, members of the Legislature were very receptive to the concerns of the County and its creditors and, perhaps more importantly, the interests of other cities and municipalities within the state and their respective creditors and bondholders. In many respects, since the County is an instrumentality of the state, the state bore certain responsibility for the County's predicament. Indeed, one of the Legislature's first actions was to reform the investment guidelines for County treasurers. See Statutes of 1995, Chapter 784. Ultimately, the legislative forum proved to be as important as the bankruptcy forum in crafting the means for implementation of the County's recovery plan.

Although there were many traditional bankruptcy issues that received, or merited, legislative attention in the Orange County case, four issues in particular seem to have generated the most interest. They are: (1) the eligibility of a public body in California to file a Chapter 9 case; (3) the ability of the state to divest the public body of its powers to govern and re-delegate those powers to a trustee; (3) the impact of California's debt limitation provisions on the satisfaction of claims in the bankruptcy case; and (4) the impact of bankruptcy law on pledges of tax revenues to secure municipal borrowings.

☞ Eligibility to File ☜

A municipality must meet fairly stringent eligibility requirements in order to commence a Chapter 9 case. The eligibility requirements are set forth in a five-prong test under section 109(c) of the Bankruptcy Code.[1] This test was recently construed in an opinion by Judge Ryan dismissing the Orange County Investment Pools case, In re County of Orange, 183 B.R. 594 (Bankr. C.D. Cal. 1995). Judge Ryan dismissed the pools case mainly because the pool was not a municipality since it lacked traditional attributes of sovereignty, such as the police power, the power to tax or the right of eminent domain.

One of the five eligibility requirements is specific, state-by-state authorization to file a Chapter 9 case. The pre-1994 version of this requirement permitted a municipality to file if it was "generally authorized" under state law. Case law was split over whether the authority to file could be inferred from the delegation by some states of traditional "home rule" powers to their municipalities (e.g., to issue debt, control finances or sue and be sued), or whether more detailed, express permission was necessary. The amendment was intended to clarify this uncertainty, particularly after the dispute between state and local officials in Connecticut concerning the legitimacy of the City of Bridgeport filing. According to Judge Ryan's opinion in County of Orange, courts may "no longer find the requisite authorization for the filing by implication." Id. at 604.

California law presently permits "any taxing agency or instrumentality" of the state to file a petition and "prosecute to completion all proceedings permitted" under the former Bankruptcy Act of 1898. Cal. Gov't Code § 53760. The statute refers to the definition of "taxing agency or instrumentality" contained in the Act. Section 53760 has not been amended since it was enacted in 1949.

The existing statute is plainly outdated and, thus, merits amendment on purely technical grounds. In addition, a number of substantive developments in the Orange County case have prompted the California Legislature to re-examine the eligibility threshold for federal bankruptcy relief. Under the amended version of Section 109(c), each state may now specifically authorize a local agency "in its capacity as a municipality or by name" to be a debtor under Chapter 9. The statute also permits the state to create a gatekeeper "empowered by state law to authorize such entity to be a debtor." Various states currently use a gatekeeper to regulate entry to Chapter 9. Connecticut requires the prior written consent of the governor and New Jersey requires the prior approval of a municipal finance commission. Kentucky requires the pre-approval of a proposed plan by certain state officers before a county may file and Pennsylvania has a detailed list of bankruptcy triggers.

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[1] **See Attachments**: Blacklined text of Section 109(c) of the Bankruptcy Code reflecting 1994 amendments.

A bill recently introduced by State Senator Kopp (SB 349) would require prior legislative approval before the commencement of a Chapter 9 case in California and, in addition, would permit the Governor to appoint a state trustee to "oversee" the municipality.[2] Senator Kopp's bill proposes the establishment of the Local Agency Bankruptcy Committee comprised of the state Treasurer, Controller and Director of Finance. The committee would be empowered to permit or deny a Chapter 9 filing "under the terms and conditions that the committee may impose." The trustee, if appointed, would also be authorized to assume additional "specific powers" as indicated by the Governor.

Given the extraordinary proliferation of local agencies in California,[3] the Legislature has also focused its attention on whether certain special or limited purpose entities should be authorized to impair their contractual obligations in federal bankruptcy courts. For example, a pending bill sponsored by State Senator Calderon (SB 1993) would prohibit the newly-formed California Earthquake Authority from filing a Chapter 9 case. The bill, which would render the authority operational, provides that the "authority is not and shall never be authorized to become a debtor in a case under the United States Bankruptcy Code or to make an assignment for the benefit of creditors or to become the subject of any similar case or proceeding." The bill further prohibits any interference with the "full and timely payment of principal, interest and premiums on revenue bonds of the authority" or "any pledge or assignment of revenues as security for those payments."

A possible corollary for withholding the benefits of federal relief for selected agencies is the assumption, by the state, of responsibility for the fiscal health of that agency and the protection of its creditors. To the extent the state is unwilling, or financially unable, to assume this responsibility, it may be more tolerant of a liberal filing threshold. Even if the state lowers the barriers to access to Chapter 9, it may still retain the ability to intervene in the conduct of the bankruptcy case by appointing a trustee over the municipal debtor.

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[2] **See Attachments**: Senate Bill 349, Senator Kopp, amending California's eligibility statute.

[3] According to some estimates, California has over 7,000 local government agencies, many with redundant service areas and overlapping bureaucracies. A bill that was chaptered into law last year provided certain benefits to over 100 distinct types of "public bodies" created under California law, ranging from "**A**" (air pollution control districts) to "**Z**" (zones of any public body). Orange County alone has over 150 local bodies comprised of approximately 85 special districts and 65 cities and school boards. Another bill recently introduced by Assembly Members Pringle and Baugh (AB 2109) would provide, subject to electoral approval, for the consolidation of twenty-five separate Orange County special water districts into a single entity--the "Orange County Water and Sanitation District." Many of these special water districts have only a handful of customers, successors to the huge "ranchos" and citrus groves that covered the area in the late 1800s.

☞ Imposition of State Trustee ☜

Under section 903 of the Bankruptcy Code, the state retains the power to control, by legislation or otherwise, a municipality that has commenced a Chapter 9 case. Moreover, it is a fundamental precept of municipal law that local agencies, created by the state, exist principally as instrumentalities for (a) the orderly exercise of state functions and (b) the convenient delivery of state services. In California, the fragmentation of state subdivisions has been carried to an unprecedented extreme. Yet, notwithstanding the phenomenal growth of public agencies, the state retains plenary control over their duties and powers. For example, according to the California constitution, the "Legislature shall provide for county powers" and "shall prescribe uniform procedures for city formation and provide for city powers." Cal. Const. art. XI, § 1(b), § 2(a). Even charter cities and counties would remain subject to state control. Although a charter is deemed to supersede the general laws adopted by the Legislature, the "provisions of a charter are the law of the State and have the force and effect of legislative enactments." Cal. Const. art. XI, § 3(a).

Local agencies, thus, are creatures of only limited and enumerated powers. Based on this precept, it seems indisputable that the state may, at its pleasure, modify or withdraw any delegated powers and exercise them directly. Indeed, existing California law requires the appointment of a state administrator to exercise the powers and responsibilities of the governing board of an insolvent school district. This administrator has the authority to "implement substantial changes in the district's fiscal policies and practices, including, if necessary, the filing of a petition under Chapter 9 of the federal Bankruptcy Act for the adjustment of indebtedness." Cal. Educ. Code § 41325(c). See also In re Richmond Unified School Dist., 133 B.R. 221 (Bankr. N.D. Cal. 1991) (rejecting the argument that the appointment of an administrator divesting the school board of authority violated state law and reaffirming the court's inability to interfere with the school district's management).

A recent bill introduced by Assembly Member McDonald (AB 2415) would clarify the scope of the state administrator's authority. The bill provides that "it is the intent of the Legislature that the duly elected local governing board [of the school district] retain its designated powers with regard to the nonfiscal operations of the school district. It is also the intent of the Legislature that the appointed administrator have the power to stay or rescind decisions of the governing board."

Despite this seemingly fundamental principle of municipal governance, the trusteeship issue was the subject of extraordinary legislative and local political debate in both the Orange County bankruptcy case and the Los Angeles County budget crisis. In the Los Angeles County crisis, a bill was proposed in August 1995 that would have created the California Intergovernmental Cooperation Authority. The authority would have been established to assist Los Angeles County to solve its budgetary problems and "achieve and maintain access to the capital markets." To that end, the authority was granted extensive financial powers and, in particular, the ability to craft a financial recovery plan for the

county. If the county violated any provision of the plan, the authority was empowered to "assume all of the legal rights, duties and powers of the board of supervisors." Although this bill was not enacted, its detail and breadth are indicative of the Legislature's extensive powers over the affairs of its municipal entities.

The trusteeship legislation in Orange County was resisted by many parties. The County initially viewed the legislation as an encroachment on the powers of its officials and their sole accountability to the electorate. Cities and districts within (and without) the County also reacted negatively to the potential trustee's ability to direct the conduct of the Chapter 9 case. Ultimately, with the support of the official creditors' committee, the Legislature enacted a powerful set of laws permitting the state to appoint a trustee over both the county <u>and</u> its local agencies to further the timely confirmation of a plan.[4]

The Orange County legislation specifies the conditions for the appointment of a trustee and further provides, in accordance with accepted principles of municipal law, that "all powers granted to the county board of supervisors shall be withdrawn and delegated to the trustee." In recognition of the fact that the County's day-to-day affairs are probably beyond the scope of the trustee's purpose and expertise, the legislation further authorizes the trustee to retain or re-delegate specified powers to the board of supervisors, as necessary or appropriate to the "most effective action for resolving the pending case."

Perhaps the most important feature of the legislation is the trustee's authority to assume and exercise certain powers of the (over 200) local agencies asserting claims against the County based on losses derived from the failure of the County's investment pool. Specifically, the trustee would have the ability to vote, on behalf of the affected local agencies, to accept or reject the County's plan of adjustment and subordinate or otherwise restructure their claims against the County. Although seemingly broad, these powers are limited in scope to those actions necessary and proper to achieve the timely confirmation of the County's plan. This limitation furthers the underlying interests of the state in avoiding the credit disruption that would result from a default under the County's obligations to its private creditors (<u>e.g.</u>, vendors, employees and bondholders).

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[4] **<u>See Attachments</u>**: Statutes of 1995, Chapter 747: Orange County--Bankruptcy Adjustment Plan--Trustee Appointed by Governor.

☞ State Debt Limitation Provisions ☜

A significant concern in the Orange County case stemmed from the possible application of California's debt limitation provisions to the claims of noteholders and other general unsecured creditors. California law imposes strict limitations on the incurring and satisfaction of municipal debt.[5] The debt limits ordinarily serve the salutary purpose of matching government expenditures to anticipated income. They may have an unintended consequence, however, when applied to a municipality in Chapter 9. In that situation, the bankruptcy case may extend beyond the expiration of the fiscal year in which the claims first arose and thereby potentially limit the remedies for their repayment. This, in turn, may provide a basis for the disallowance of the claims under bankruptcy principles. Even if the municipality desires to pay the debt, other creditors (or taxpayers generally) may claim that such distributions would render the plan of adjustment unconfirmable as a matter of law.

Generally speaking, the debt limitation provisions restrict the ability of certain enumerated political subdivisions of the state (1) to incur, without a popular vote, indebtedness that exceeds anticipated fiscal year revenues or (2) to satisfy, without a popular vote, indebtedness incurred in one fiscal year out of future fiscal year revenues. The provisions operate as a form of legal admonishment, encouraging municipalities to live within their means or seek voter approval before subjecting the taxpayers to additional debt.

Court decisions construing the debt limitation provisions have supplied a rather harsh remedy for violations by limiting the funds to which creditors may look for repayment. A debt subject to the limitation typically may be satisfied only out of the income and revenues of the year during which the debt was incurred. For this reason, a debt presented for payment at a time when funds are exhausted may be temporarily uncollectible.

The crucial issue confronting a creditor in a Chapter 9 case is whether this temporary nonpayment of a claim under the state debt limitation provisions should affect the allowance of the claim under federal law. See 11 U.S.C. § 502. A Chapter 9 case, moreover, may have several effects on the obligations of the municipality that were not anticipated by the framers of the debt limitation provisions.

For instance, the municipal debtor will likely suspend routine payments on account of prepetition obligations as they come due during the fiscal year. As a result, the fiscal year may expire during a Chapter 9 case prior to confirmation of a plan of adjustment. If so, can the debtor lawfully satisfy such claims in the following fiscal year(s)? Or must every municipal debtor in California that is subject to the debt limitation provisions confirm its plan by the end of its fiscal year?

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[5] **See Attachments**: Reprint of Article 16, § 18 of Cal. Const. and § 25256 of Cal. Gov't Code.

Under §§ 943(b)(4) and (6) of the Bankruptcy Code, confirmation of a plan will be denied if the debtor is "prohibited by law from taking any action necessary to carry out the plan" or has not obtained any "regulatory or electoral approval necessary under applicable nonbankruptcy law." Do these provisions permit (or even require) the use of the debt limitation provisions to avoid the satisfaction of otherwise valid claims?

Another anomaly is the effect of the debt limitation provisions on the debtor's ability to reject burdensome contracts and unexpired leases and to avoid preferential or fraudulent transfers. Claims arising from such rejection or avoidance are deemed under the Bankruptcy Code to arise prepetition, and thus will fall within the first fiscal year of the bankruptcy case, even if the rejection or avoidance actually occurs in later fiscal years. Does this mean that a debtor may enjoy the benefit of these federal powers and then repudiate the resulting claim under state law on the basis that the claim is deemed to have arisen in a fiscal year for which no revenues remain?

Perhaps most importantly, a Chapter 9 debtor has the exclusive right (a) to determine whether and when a bankruptcy case will be filed, (b) to manage its own affairs and property during the pendency of the case, and (c) to file a plan of adjustment during a virtually perpetual exclusive period. The debtor thus controls the timing of its entry into and exit from bankruptcy. This degree of control may enable the debtor to manipulate the recoveries received by various claimants by, for example, satisfying certain obligations attributable to a fiscal year in which expenses outstrip revenues, and then commencing a Chapter 9 case near the end of that fiscal year.

In light of these many uncertainties and anomalies, can the debt limitation provisions be overcome in Chapter 9? In the Orange County case, the official creditors' committee negotiated with the County to obtain a voluntary, one-year extension ("rollover") of the maturity dates of $975 million in short-term note debt. The rollover was accompanied by a detailed compromise agreement under which the County waived all debt limitation defenses to the allowance and satisfaction of the note debt. The rollover and compromise agreements were vigorously contested by the County's public agency creditors and pool investors but were ultimately approved by the bankruptcy court on June 27, 1995. The agreements are currently the subject of several pending appeals. If the County's plan of adjustment is confirmed, however, the appeals will be dismissed.

Another possible solution is to amend Chapter 9 to expressly override the debt limitation provisions. Under the Supremacy Clause of the U.S. Constitution, to the extent that a state law conflicts with federal law (including the Bankruptcy Code), or impedes execution of the objectives of Congress in enacting such laws, the state law is preempted. The Bankruptcy Code contains numerous provisions governing the allowance, treatment, satisfaction, and discharge of claims against municipal debtors. The debt limitation provisions appear to be fundamentally inconsistent with many of these provisions and, perhaps more importantly, with the priority and ratable distribution scheme that pervades bankruptcy law.

Although an excellent argument can be made that existing provisions of the Code already supersede any inconsistencies or anomalies under the debt limitation provisions, an explicit amendment to Chapter 9 might codify this result. An ad hoc committee of municipal creditors has proposed an amendment to Chapter 9 that would permit the bankruptcy court to issue any order necessary to provide for the repayment of bonds, "notwithstanding any provision of State law that otherwise imposes limits upon the debtor's ability to repay such bonds."[6]

Yet another solution is to legislate an exception to the debt limitation provisions for claims against Chapter 9 debtors. There are numerous exemptions from the operation of the debt limitation provisions. If exempt, municipal obligations that exceed the income and revenues provided for a particular fiscal year may nonetheless be satisfied out of future fiscal-year revenues without electoral approval. The exemptions fall into three broad and somewhat overlapping categories: (i) obligations incurred by an entity other than the municipality itself (exemptions based on the identity of the payor), (ii) obligations payable from special funds (exemptions based on the source of payment), and (iii) obligations that do not constitute "indebtedness" as that term is used in the California constitution (exemptions based on the theory that no payments will be made on account of the obligations to which the debt limits are directed).

Among the exceptions are "obligations imposed by law." California courts have consistently held that the debt limits apply only to voluntarily incurred indebtedness, not obligations imposed upon local agencies by statute or arising from the tortious conduct of the agency (compared to its ordinary contractual relations). In these instances, the agency may satisfy the claim notwithstanding the lack of current fiscal year revenues. The California Legislature recently took the unusual step of retroactively declaring certain obligations to have been "imposed by law." After a California appellate court determined that the state had improperly assessed certain sales taxes against federal contractors, the Legislature amended certain borrowing statutes to permit affected local agencies to satisfy their refund obligations over time without regard to the debt limitation provisions. This was accomplished by statutorily categorizing the refund obligations as obligations imposed by law. Cal. Gov't Code § 53550(b).[7] A similar statute could be proposed declaring that the claims allowed against a Chapter 9 debtor are imposed by law (for example, by operation of the Bankruptcy Code), and thus are entitled to be satisfied from any income and revenues of the public agency, regardless of the lapse of the fiscal year during the pending case.

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[6] **See Attachments**: Excerpt from Executive Summary of the Report of the Ad Hoc Committee on Municipal Bankruptcy Law Reform: proposed §§ 903, 905 of Bankruptcy Code.

[7] **See Attachments**: Reprint of §§ 53550, et seq. of Cal. Gov't Code.

☞ Liens on Tax Revenues ☜

Local governmental agencies exercise their power to borrow through a variety of statutory schemes. Generally, if payable within a year of issuance, such borrowings do not run afoul of the debt limitation provisions. In many instances, statutory provisions expressly authorize the local agency to pledge existing and anticipated tax revenues as security for repayment of the borrowing, usually a public bond. In a pair of decisions in the Orange County case, the nature of these pledges was carefully scrutinized. In re County of Orange, 179 B.R. 185 (Bankr. C.D. Cal. 1995) (pledge of tax revenues was a security interest not a statutory lien); In re County of Orange, 189 B.R. 499 (C.D. Cal. 1995) (reversing bankruptcy court: pledge of tax revenues was a statutory lien).

The decisions were followed closely by municipal bondholders throughout the state. In the first decision, the bankruptcy court concluded that a pledge of anticipated tax revenues pursuant to the Government Code constituted a form of consensual security interest. As a consequence, the pledge was subject to section 552(a) of the Bankruptcy Code, which significantly curtails the scope of a prepetition security interest. As the bondholders discovered, debt which initially appeared to be fully secured was suddenly converted to unsecured debt. To add insult to injury, the County proceeded to expend the tax revenues that were formerly subject to the pledge for governmental operations. In the second decision, the district court reversed the bankruptcy court and concluded that the pledge qualified as a statutory lien and therefore survived the commencement of the case. According to the district court, state law imposed the pledge of taxes without further action by the County. Although this decision was appealed to the Ninth Circuit, the parties subsequently reached a settlement pursuant to which the appeal was withdrawn, leaving the district court decision as controlling law, to the relief of bond counsel throughout the state.

Notwithstanding the current state of the law, the original bankruptcy court decision exposed certain risks in the public bond market and led the County, and others, to propose remedial legislation that would allay the concerns of the purchasers of the County's recovery bonds. This legislation specifies that the lien created under state law is mandatory and does not require any further action of the issuer to be binding and effective.[8]

Other concerned parties have focused on expanding the "special revenue" exemption under Chapter 9 to insure the continued vitality of tax pledges as security for bond transactions. Unlike general obligation bonds, secured by the full faith, credit, and taxing power of the issuer, a revenue bond is secured solely by income generated by the project or facility financed with the proceeds of the bond. Ordinarily, a revenue bond might be deemed a riskier investment than a general obligation bond because the holder of the revenue bond faces the risk of project failure and lacks recourse to any collateral other than the specific

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[8] **See Attachments**: Statutes of 1995, Chapter 748: Orange County--Finances.

revenue stream pledged by the issuer (as a public facility, bondholders generally lack the ability to foreclose on the physical asset itself). Changes to the Bankruptcy Code in November 1988, however, rendered the rights of a revenue bondholder in Chapter 9 comparatively more favorable than the rights of a general obligation bondholder.

If the revenue bond qualifies as a "special revenue" obligation under section 902(2) of the Bankruptcy Code, then (a) its lien will survive the commencement of the case notwithstanding section 552(a), (b) its indebtedness will continue to be serviced notwithstanding the automatic stay under section 362, and (c) any prepetition payments will be immune from preference recovery (this provision applies to all bonds and notes). Of course, the risk of project failure will still affect the bondholder's ultimate recovery. For this reason, expansion of the special revenue exemption would enhance the rights of those bondholders presently secured only by the general tax receipts of the municipality. The ad hoc committee has proposed increasing the scope of the special revenue exemption to include all tax revenues or receipts that secure any municipal bond, even the traditional general obligation bonds.[9] This expansion would dramatically alter the relative rights and remedies of debtors and creditors under Chapter 9 and it is very uncertain whether these proposed amendments will be adopted by Congress.

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[9] **See Attachments**: Excerpt from Executive Summary of the Report of the Ad Hoc Committee on Municipal Bankruptcy Law Reform: proposed § 902 of Bankruptcy Code.