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I. Introduction

In July of 2011, the city of Central Falls, Rhode Island, was on a path towards municipal bankruptcy.[1] It carried a structural budget deficit of approximately $6 million per year and had no cash on hand to pay the $80 million in pension and health insurance benefits it owed to its retired police officers and

1. *See* Jess Bidgood, *Plan to End Bankruptcy in Rhode Island City Gains Approval*, N.Y. TIMES (Sept. 6, 2012), http://www.nytimes.com/2012/09/07/us/central-falls-ri-to-emerge-from-bankruptcy.html (last visited Apr. 2, 2015) (describing Central Fall's dire financial straits) (on file with the Washington and Lee Law Review).

firefighters.[2] Its principal creditors included pensioners, municipal employees, and general obligation (GO) bondholders.[3]

In Providence, state legislators were concerned about the economic consequences that might follow if the city made the politically popular choice: filing for bankruptcy, then cutting bondholder repayments (as opposed to current and former employee benefits).[4] In an attempt to "lure investors to bonds that will be sold by other Rhode Island municipalities," the General Assembly passed a law guaranteeing that Central Fall's bondholders would be repaid in full in the event of a municipal bankruptcy—a contingency that occurred when the city filed its petition two weeks later.[5]

Ultimately, the plan worked.[6] After a year in bankruptcy, a federal judge approved Central Falls' reorganization plan, which repaid GO bondholders in full while slashing some pensions by up to fifty-five percent.[7] With a clear priority structure established by state law, Central Falls avoided protracted litigation between GO bondholders and other creditors and exited bankruptcy in "record time" and with "record efficiency."[8] Shortly thereafter,

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2. *See id.* (noting that the city "found itself with a structural budget deficit of about $6 million, and with no way to pay the roughly $80 million it owed in pension and health insurance benefits to more than 200 police officers and firefighters").

3. *See id.* (listing these groups as creditors during the pendency of the bankruptcy case).

4. Michael Corkery, *Bondholders Win in Rhode Island*, WALL ST. J. (Aug. 4, 2011, 12:58 PM), http://www.wsj.com/articles/SB10001424053111903885604576486610528775994 (last visited Apr. 2, 2015) (describing the law, the property interest it created in favor of all GO bondholders, and its implications in the Central Falls bankruptcy) (on file with the Washington and Lee Law Review).

5. *See id.* (describing the city's plan to repay bondholders "the entire $635,000 it owes them" while reducing claims made by other creditor groups, like pensioners, by up to 34%). Without the law, state legislators argued, "future bond deals in Rhode Island likely would need to carry higher interest rates in order to entice potential buyers scared by the Central Falls bankruptcy filing." *Id.* For a more complete description of the law, its mechanics, and its effects, see *infra* notes 150–154.

6. *See infra* notes 7–9 and accompanying text (describing the relative success of the law in protecting GO bondholder interests and ensuring a quick municipal recovery by sustaining access to credit markets).

7. *See* Bidgood, *supra* note 1 (indicating that the effect of the Rhode Island law was to create a property right recognizable in bankruptcy and that this property right was why the municipality could repay its bondholders in full).

8. *Id.*

Moody's upgraded its outlook on Central Falls' GO bonds from junk bond status to "positive."[9]

A few short weeks after Central Falls petitioned for bankruptcy relief, Jefferson County, Alabama, filed for its own four billion-dollar bankruptcy.[10] In this case, the county defaulted on a series of "sewer revenue bonds"—bonds that were issued to fund a new county sewer system and that were payable from the user fees generated by that system.[11] During the two years that the county remained in bankruptcy,[12] the presiding judge required the county to continue to pay principal and interest on its sewer revenue bonds, even though they lacked the same kind of state statute-based priority enjoyed by the GO bondholders in Central Falls.[13]

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9. *See Moody's Upgrades Formerly Bankrupt Central Falls, R.I.*, REUTERS (Jul. 18, 2013, 5:21 PM), http://www.reuters.com/article/2013/07/18/usa-rhodeisland-centralfalls-rating-idUSL1N0FO27920130718 (last visited Apr. 2, 2015) (explaining that Moody's upgraded the credit rating for Central Falls' general obligation debt based on its "belief that Central Falls will maintain its structural balance" by continuing to make its reduced pension contributions) (on file with the Washington and Lee Law Review).

10. Mary William Walsh, *Alabama Governor Fails to Prevent County's Record $4 Billion Bankruptcy Filing*, N.Y. TIMES (Nov. 9, 2011), http://www.nytimes.com/2011/11/10/us/alabama-governor-fails-to-prevent-jefferson-countys-record-4-billion-bankruptcy-filing.html (last visited Apr. 2, 2015) (explaining that Jefferson County entered bankruptcy in November of 2011 with $4 billion in overall debt) (on file with the Washington and Lee Law Review).

11. *See* Mary Williams Walsh, *Bankruptcy Filing Raises Doubts About a Bond Repayment Pledge*, N.Y. TIMES (Dec. 23, 2011), http://www.nytimes.com/2011/12/24/business/in-alabama-a-test-of-the-full-faith-and-credit-pledge-to-repay-bonds.html (last visited Apr. 2, 2015) (explaining how revenue bond financing works and noting that "[m]ost of Jefferson County's $4.1 billion of debt is, in fact, the revenue type" of bond debt as opposed to GO debt) (on file with the Washington and Lee Law Review); Walsh, *supra* note 10 ("Jefferson County's debt grew out of poorly conceived efforts to finance a court-ordered rebuilding of its decrepit sewer system.").

12. Kent Faulk, *Judge Says Jefferson County Can Exit Historic $4.23 Billion Bankruptcy*, AL.COM (Nov. 21, 2013, 4:13 PM) (last updated Nov. 21, 2013, 11:04 PM), http://blog.al.com/spotnews/2013/11/judge_says_jefferson_county_ca.html (last visited Apr. 2, 2015) (noting a filing date of November 9, 2011 and a plan confirmation date of November 21, 2013) (on file with the Washington and Lee Law Review).

13. *See infra* notes 189–191 (describing the rulings, which allowed the county's revenue bondholders to be paid throughout the pendency of the bankruptcy).

In Detroit's recent eighteen billion-dollar bankruptcy, bondholders were not so lucky.[14] Over the strident objections of the bond insurers who covered the city's default, the city maintained that bankruptcy rendered its GO bonds worthless and that bondholders should receive fifteen cents on the dollar for their claims.[15] While Detroit eventually agreed to pay bondholders seventy-four cents on the dollar after mediation,[16] the question remains: what makes Detroit's bondholders so different from those in Central Falls or Jefferson County?

Recent scholarship on Chapter 9[17] of the Bankruptcy Code[18] has focused on everything from the efficacy of municipal bankruptcy[19] to its intersection with pensioner

14. *See* Michael Aneiro, *Detroit Takes Aim at Bondholders*, BARRONS (Jul. 20, 2013), http://online.barrons.com/article/SB50001424052748704093404578607853463077028.html (last visited Apr. 2, 2015) (describing the city's negative outlook on repayment of its bondholders and noting that "[n]ever in the field of municipal finance was so much owed to so many by a city with so little") (on file with the Washington and Lee Law Review).

15. *See* Christine Sgarlata Chung, *Zombieland / the Detroit Bankruptcy: Why Debts Associated with Pensions, Benefits, and Municipal Securities Never Die . . . and How They Are Killing Cities Like Detroit*, 41 FORDHAM URB. L.J. 771, 837–40 (2014) (explaining how the city classified its GO debt as "unsecured," how this gave Detroit the ability to pay bondholders only a fraction of their claims against the city, and how the major monoline insurers who were responsible for footing the bill filed motions in court to challenge this classification); Chad Halcom, *Detroit Agrees to Pay Bondholders 74% on $388M Claim in Bankruptcy*, CRAIN'S DETROIT BUS. (Apr. 9, 2014, 12:14 PM) (last updated Apr. 10, 2014, 5:57 AM), http://www.crainsdetroit.com/article/20140409/NEWS/140409839/detroit-agrees-to-pay-bondholders-74-on-388m-claim-in-bankruptcy (last visited Apr. 2, 2015) (noting that "the city [originally] proposed to issue new bond notes to the class of unlimited tax general obligation bondholders worth about 15 percent of their present claims") (on file with the Washington and Lee Law Review).

16. Halcom, *supra* note 15.

17. 11 U.S.C. §§ 901–946 (2012).

18. 11 U.S.C. §§ 101–1532 (2012).

19. *See generally* Clayton P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. CHI. L. REV. 281 (2012) (exploring the possible incentives and disincentives for municipalities to abuse the protections available under Chapter 9); Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351 (2010) (arguing that Chapter 9 is poorly designed to address the fiscal difficulties of the municipalities that seek its protections and suggesting that states should bear the burden of municipal rehabilitation); Juliet M. Moringiello, *Goals and Governance in Municipal Bankruptcy*, 71 WASH. & LEE L.

rights[20] and collective bargaining agreements.[21] However, few (if any) writers have addressed the more intricate question of whether, how, and why *certain bondholders* have claims superior to *other bondholders* for scarce municipal assets.[22] This Note seeks to fill that void.

REV. 403 (2014) (maintaining that Chapter 9 is most effective when deployed as part of an overall rehabilitation scheme that exists at both the federal and state levels); Richard C. Schragger, *Democracy and Debt*, 121 YALE L.J. 860 (2012) (arguing that institutionalized bankruptcy proceedings like Chapter 9 do nothing to address the underlying factors that caused the bankrupt municipality's fiscal distress in the first place).

20. *See generally* Jack M. Beermann, *The Public Pension Crisis*, 70 WASH. & LEE L. REV. 3, 67–84 (2013) (exploring the impact that municipal bankruptcy can have on pension obligations); Richard M. Hynes & Steven D. Walt, *Pensions and Property Rights in Municipal Bankruptcy*, 33 REV. BANKING & FIN. L. 609, 649–59 (2014) (proposing a property rights-based structure on which to ground priority for pensioners over other municipal stakeholders); Hannah Heck, Comment, *Solving Insolvent Public Pensions: The Limitations of the Current Bankruptcy Option*, 28 EMORY BANKR. DEV. J. 89 (2011) (providing a complete overview of the impact that bankruptcy law has on pension obligation and summarizing proposals for reform).

21. *See generally* Ryan Preston Dahl, *Collective Bargaining Agreements and Chapter 9 Bankruptcy*, 81 AM. BANKR. L.J. 295 (2007) (examining the impact of municipal bankruptcy on collective bargaining agreements); Richard W. Trotter, *Running on Empty: Municipal Insolvency and Rejection of Collective Bargaining Agreements in Chapter 9 Bankruptcy*, 36 S. ILL. U. L.J. 45 (2011) (same).

22. *See generally* Clayton P. Gillette, *Bondholders and Financially Stressed Municipalities*, 39 FORDHAM URB. L.J. 639 (2012) (discussing the allocation of monitoring responsibilities for municipal finances between citizens and bondholders and concluding that bondholders should bear the lion's share of the burden in the case of a municipal default); Richard C. Schragger, *Citizens Versus Bondholders*, 39 FORDHAM URB. L.J. 787 (2012) (performing several historical case studies on the allocation of rights and monitoring responsibilities between bondholders and municipal residents). Most of the articles that mention bondholder rights and remedies at all do so in the broader, evaluative sense without focusing on the statutory language that gives life to those rights and remedies. *See* Gillette, *supra*; Schragger, *supra*. Kevin A. Kordana is one of the few scholars to address how and why Chapter 9 treats different kinds of bondholders differently. *See* Kevin Kordana, *Tax Increases in Municipal Bankruptcies*, 83 VA. L. REV. 1035, 1046–55 (1997) (summarizing how holders of GO bonds, revenue bonds, certificates of participation, and revenue anticipation notes would proceed with their claims against a bankrupt municipality but ultimately focusing on whether the Code permits compulsory tax increases). Most other sources of information about the mechanics of bondholder rights in bankruptcy are more technical and practitioner-oriented. *See, e.g.*, Paul Groenwegen, *"Revenues" as Collateral: the Limits of the Revenue Pledge as a Security Device*, 39 UCC L.J. 545, 547–66 (2007) (exploring the impact of several

Part II offers a basic primer on the kinds of bonds traded in the municipal finance industry and analyzes how bankruptcy alters the rights and remedies available to bondholders.[23] It concludes that the answers to two questions dictate the treatment of municipal bonds in bankruptcy. The first question—whether the bonds are "secured" under state statute or the terms of the bond itself—relates to a state-by-state and case-by-case determination of the property rights afforded to a particular set of bondholders.[24] The second question—whether the bonds are payable from "special revenues" as defined in § 902(2)[25] of the Bankruptcy Code—is the focus of Part III.[26]

Part III explains how and why the current definition of "special revenues" is too narrow to suit the needs of municipalities and their financiers.[27] It goes on to discuss the consequences of this narrow definition, including potential disparities between actual risk of non-payment for certain types of bonds and the risk premiums charged by the market.[28] Part III concludes with a discussion of *In re Heffernan Memorial Hospital*

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bankruptcy code provisions on the kinds of "pledges" made under different municipal financing structures); Michael L. Hall & George D. Gaskin III, *Municipal Bonds in Chapter 9: A Primer*, AM. BANKR. INST. J., July/Aug. 2011, at 38, 38–39 (describing the potential treatment of GO bonds and revenue bonds in bankruptcy). Groenwegen is the only author to mention § 902(2)—the focus of this Note—in any detail. *Compare* Groenwegen, *supra*, at 547–66 (discussing how the presence of "special revenues" dictates the outcome of most secured bond transactions), *with* Hall, *supra*, at 79–80 (quoting the entirety of § 902(2) without any substantive analysis), Hynes, *supra* note 20, at 650 nn.220 & 221 (referencing § 902(2) without any extensive discussion), *and* Kordana, *supra*, at 1049 n.73, 1053 n.87 (citing § 902(2) in two footnotes without any substantive discussion).

23. *See infra* Part II.A (analyzing the current municipal bond market); *infra* Part II.B (analyzing the effect of municipal bankruptcy on various types of bonds currently traded on the market).

24. *Infra* notes 97, 181 and accompanying text.

25. 11 U.S.C. § 902(2) (2012).

26. *See infra* Part III.A (exploring the five-part definition for "special revenues" under § 902(2)).

27. *See infra* Part III (providing several examples of bonds not covered by § 902(2) and examining a bankruptcy court decision that illustrates the shortcomings of § 902(2)).

28. *Compare infra* Table 1 (outlining municipal debt expectations pre-bankruptcy), *with infra* Table 2 (outlining how municipal debt is treated in bankruptcy), *and infra* Table 3 (outlining which kinds of debt qualify for what kind of treatment under Table 2).

District,[29] a bankruptcy court decision that illustrates the shortcomings of the current definition of "special revenues" and calls for a broader test.[30]

Part IV offers a new definition for special revenues that accounts for the concerns illustrated in Part III.[31] It goes on to suggest two means—one legislative and one driven by the market itself—to implement the protections provided by this new definition.[32] Either method should allow public finance professionals to alert the market in advance about the consequences for any given group of bondholders when a municipality declares bankruptcy.[33] If properly applied, this test will re-introduce a degree of clarity into a market muddled by Detroit's Chapter 9 administration.[34]

II. Laying Out the Problem: the Muddled Treatment of Bonds in Bankruptcy

The public finance industry loosely groups municipal bonds[35] into three categories: (1) general obligation bonds (like those involved in Central Falls and Detroit),[36] (2) revenue bonds (like those involved in Jefferson County),[37] and (3) short-term debt securities.[38] The differences in how

29. 202 B.R. 147 (Bankr. S.D. Cal. 1996).

30. *Infra* Part III.B.

31. *Infra* Part IV.A.

32. *Infra* Part IV.B–C.

33. *Infra* Part V.

34. *See, e.g.*, Kevin Kordana & Chris Herzeca, *What's the Status of General Obligation Bonds in Municipal Bankruptcy?*, PUBLIC SECTOR INC. (Jan. 2014), http://www.publicsectorinc.org/debates/whats-the-status-of-general-obligation-bonds-in-municipal-bankruptcy/ (last visited Apr. 2, 2015) (recounting a debate between two municipal finance experts about the degree to which the Detroit bankruptcy has muddled market expectations about the value of GO bonds) (on file with the Washington and Lee Law Review).

35. Unless otherwise specified, I use the words "bonds," "notes," "securities," and "devices" interchangeably to refer generally to all forms of municipal debt obligations, including warrants, certificates of participation, and other unique devices.

36. *Supra* notes 3–9, 14–16.

37. *Supra* notes 10–13.

38. *See, e.g.*, ROBERT S. AMDURSKY & CLAYTON P. GILLETTE, MUNICIPAL DEBT

municipalities[39] structure these three types of obligations are what create expectations regarding the risk of non-payment outside of bankruptcy.[40] As the risk of non-payment increases, the market demands a higher "risk premium" in the form of steeper interest rates.[41] However, as Detroit revealed (and as this Part explains), the same factors that would cause bonds to have a lower risk of non-payment outside of a municipal bankruptcy filing create a significantly *higher* risk of non-payment after a municipal bankruptcy filing.[42]

A. The Mechanics of the Bond Market Pre-Bankruptcy

1. General Obligation Bonds

Outside of bankruptcy, GO bonds are the "gold standard" of the municipal finance industry.[43] By issuing a GO bond, a municipality promises its bondholders that it will do anything

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LAW: THEORY AND PRACTICE 25–33 (1992) (listing three types of debt under the heading "Classification and Characteristics of Municipal Securities," including general obligation bonds).

39. Unless otherwise specified, I use the phrases "city," "local entity," and "municipality" interchangeably throughout this Note to refer to "any political subdivision, including a county, city, town, village or special district, and any public agency or instrumentality of a state, including a public authority, public benefit corporation or body corporate and politic" capable of filing for bankruptcy under Chapter 9. Robert S. Amdursky, *The 1988 Municipal Bankruptcy Amendments: History, Purposes, and Effects*, 22 URB. LAW. 1, 1 n.2 (1990).

40. *See infra* notes 61–65, 69–73 and accompanying text (describing market expectations for municipal debt securities outside of bankruptcy).

41. *See, e.g.*, Mark N. Berman, *What Municipal Bond Investors Can Learn From Detroit*, LAW360 (Nov. 25, 2014, 4:50 PM), http://www.law360.com/articles/599587/what-municipal-bond-investors-can-learn-from-detroit (last visited Apr. 2, 2015) (noting that "higher interest rates flow from the perception that [certain bonds] are at greater risk because their status as secured claims is in doubt" and that this increases borrowing costs for municipalities) (on file with the Washington and Lee Law Review).

42. *See infra* Tables 2, 3 (demonstrating that the pre-bankruptcy expectations about the security of various types of municipal debt do not match the effects of bankruptcy on each of those devices).

43. Patrick Darby et al., *Corporate Bankruptcy Panel: Municipal Restructuring*, 29 EMORY BANKR. DEV. J. 333, 357 (2013) (statement of Patrick Darby).

within its power to repay the bonds, including raising taxes or redirecting other available revenues.[44] These promises are backed by state law, which frequently mandates repayment of GO bonds before any other bonds are paid.[45] This combination of a contractual promise of repayment and state-law backing gives bondholders the right to sue in state court to enforce the municipality's pledge of its "full faith and credit" in the event of a municipal default.[46] Revenue bonds and short-term debt

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44. *See* AMDURSKY & GILLETTE, *supra* note 38, § 1.3.1, at 26 (stating that the full faith and credit pledge behind general obligation bonds means that the issuer will "use any and all available revenue-producing powers," including taxation, fee generation, or assignment of payments received, to meet debt service obligations and cover any shortfalls that may arise); W. Bartley Hildreth, *What Are General Obligation Bonds? Reactions to "Diversity and Default Risks of Municipal Bonds,"* MUN. FIN. J., Summer 2013 at 89, 91–98 (compiling dozens of definitions of GO bonds, each of which features a similar irrevocable promise to repay bondholders using all available municipal resources).

45. *See, e.g.*, Hollstein v. First Nat'l Bank of Aurora, 437 N.W.2d 512, 516 (Neb. 1989) (answering a certified question by stating that, under applicable state law, GO "bonds [must] be fully paid according to their terms prior to utilizing revenues" to repay other types of municipal debt).

46. *See* AMDURSKY & GILLETTE, *supra* note 38, §§ 5.4.1–.2, at 241–46 (discussing the "mandamus" action, a suit brought by bondholders in state court to enforce their rights under a GO bond agreement); Hildreth, *supra* note 44, at 91–98 (compiling dozens of definitions of GO bonds, almost all of which feature this state law "full faith and credit" enforceability component). Commentators and courts differ on the degree to which a "full faith and credit" pledge can compel a municipality to act. *Compare* Flushing Nat'l Bank v. Mun. Assistance Corp., 358 N.E.2d 848, 852 (N.Y. 1976) (finding that two state laws—one mandating that all local debt must carry "full faith and credit" pledge and the other allowing localities to exceed debt limits to pay debt service if required—"express a constitutional imperative: debt obligations must be paid, even if tax limits be exceeded"), *with* State v. City of Lakeland, 16 So. 2d 924, 925 (Fla. 1943) (finding that a "full faith and credit" pledge "does no more . . . than express an *undertaking* by the city to be irrevocably obligated" (emphasis added)), Clayton P. Gillette, *Bankruptcy and Its By-Products: A Comment on Skeel*, 50 HOUS. L. REV. 1129, 1133–34 (2013) (noting, by implication, that most states "simply mak[e] a promise to repay or pledg[e] their faith and credit" without further guarantee rather than implementing structural mechanisms to ensure repayment of general obligation debt), Gillette, *supra* note 19, at 288 (arguing that a general obligation pledge "means little more than an obligation to exercise good faith in making payments"), *and* Kordana, *supra* note 34 ("[A] 'full faith and credit' pledge is, as a matter of contract law . . . , merely equivalent to an 'and I really mean it' pledge, lacking the discrete and tangible connection to a particular property interest necessary to constitute a secured claim in bankruptcy.").

securities do not typically come with this kind of "full faith and credit" pledge; only GO bonds carry these powerful contractual rights.[47] Thus, in the municipal finance world, GO bonds are considered one of the "safest" forms of municipal debt.[48]

GO bonds come in three varieties: unlimited tax GO bonds (UTGOs), limited tax GO bonds (LTGOs), and general fund securities.[49] UTGOs and LTGOs are virtually identical,[50] except for one critical difference: as the "limited" in the name suggests, LTGOs typically contain a truncated form of a "full faith and credit" pledge.[51] In the indenture,[52] a municipality will limit LTGO bondholder recourse by capping tax increases, imposing

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47. *See* 1 DAVID GELFAND, STATE AND LOCAL GOVERNMENT DEBT FINANCING § 10:17 (James A. Coniglio ed., 2d ed. 2013) ("The full-faith-and-credit guarantee distinguishes general obligation bonds (as well as certain notes backed by full faith and credit) from revenue bonds (and revenue anticipation notes), which are backed only by a particular fund or revenue source.").

48. *See* Christine Sgarlata Chung, *Municipal Securities: The Crisis of State and Local Government Indebtedness, Systemic Costs of Low Default Rates, and Opportunities for Reform*, 34 CARDOZO L. REV. 1455, 1461 (2013) ("[U]nless a municipal securities issuer (or its revenue-generating infrastructure) ceases to exist, bondholders (particularly general obligation bondholders) are likely to get paid."); Christine A. Scheel, Comment, *Amended SEC Rule 15c2-12: An Attempt to Improve Disclosure Practices in the Municipal Securities Market*, 45 DEPAUL L. REV. 1117, 1122 n.29 (1996) ("[M]unicipal general obligation bonds [are] conventionally perceived as a very safe investment because investors could look to all of the municipality's revenue sources for repayment.").

49. *See* KROLL BOND RATINGS, NOT ALL G.O. BONDS ARE CREATED EQUAL 4 (2013), http://www.treasurer.ca.gov/cdiac/seminars/2014/20140205/kroll.pdf (listing and comparing all three forms in one chart); Robert Doty, *Diversity and Default Risks of Municipal Bonds*, MUN. FIN. J., Summer 2013, at 57–65 (describing all three of these types of securities and comparing them).

50. *See* KROLL, *supra* note 49, at 4–5 (comparing UTGOs and LTGOs and concluding that LTGOs are a close variant of UTGOs); Doty, *supra* note 49, at 57–61 (defining UTGOs and LTGOs together and only adding a minor footnote to suggest any variation).

51. *See* KROLL, *supra* note 49, at 5 ("[T]his pledge limits the ability of the issuer to levy property taxes. These property tax limits can be in the form of an absolute cap on the millage rate or a limit on the total dollar amount of taxes that can be levied in any one fiscal year.").

52. Unless otherwise specified, I use the terms "security agreement" and "indenture" to refer to any indenture, authorizing resolution, or other document prepared by the issuer that contains the terms and conditions of a particular issuance. *See generally infra* notes 112–114 and accompanying text (defining and describing typical terms in an indenture).

maximum dollar values on taxes collected, or limiting payment to a particular tax source (like a portion of a general sales tax).[53]

Like UTGOs, and unlike LTGOs, general fund securities are typically payable from any available general funds.[54] However, general fund securities are *not* secured by the "full faith and credit" of the municipality or by liens against future revenue streams.[55] Instead, the mechanism used to structure the general fund security dictates how likely it is that it will be repaid. For "collateralized" general fund securities (called "certificates of participation" (COPs) in California), municipalities sell fractional interests in a lease agreement to the public.[56] In other words, holders of Californian COPs own the right to collect a certain percentage of the lease payments made by the municipality to a trustee under the lease agreement.[57] For "uncollateralized"

53. *See, e.g.*, METRO. WATER RECLAMATION DIST. OF GREATER CHI., OFFICIAL STATEMENT 5 (2006), http://emma.msrb.org/MS248796-MS224104-MD436403.pdf (making LTGOs payable only from ad valorem revenues collected from all property in the district up to a certain amount dictated by state statute); CITY OF BESSEMER, LIMITED OBLIGATION LIBRARY WARRANTS 6–7 (2012), http://emma.msrb.org/EP712352-EP552465-EP953577.pdf (limiting repayment sources to two property taxes specifically levied to finance library reconstruction and refusing to pledge any additional revenues for repayment); *Glossary of Municipal Securities Terms*, MUN. SEC. RULEMAKING BOARD, http://msrb.org/glossary/definition/limited-tax-general-obligation-bond.aspx (last visited Apr. 2, 2015) (defining a limited tax general obligation bond as a "general obligation bond payable from ad valorem taxes that are limited by law in rate or amount") (on file with the Washington and Lee Law Review).

54. *See* Doty, *supra* note 49, at 61–62 ("General fund securities are . . . payable from whatever monies happen to be in an issuer's general fund.").

55. *See id.* at 61 ("[G]eneral fund securities do not have the protections of statutory liens or of pledges enforceable under state law to increase taxes.").

56. GELFAND, *supra* note 47, § 12:8 (explaining that COPs provide their holders with "a security interest in property being leased to the public agency borrowing the funds in case the agency should terminate its lease or default in it rental payments").

57. CAL. DEBT ADVISORY COMM'N, GUIDELINES FOR LEASES AND CERTIFICATES OF PARTICIPATION 4 (1993), http://www.treasurer.ca.gov/cdiac/reports/Guidelines93-8.pdf ("Technically, a COP is a security that evidences an undivided fractional interest in an underlying lease or installment sale agreement. In other words, a COP entitles its owner to a proportionate share of lease . . . payments made by a government agency pursuant to a lease . . . agreement."). Because collateralized debtholders are secured by their fractional ownership interest in the leased asset or facility itself, they do have some limited security in that they can typically foreclose on the facility. *See* Doty, *supra* note 49, at 62 n.15 (explaining that lease financings and certificates

general fund securities, municipalities sell investors the general right to future payments made by the municipality.[58] In either case, payment depends upon the municipality's decision to make the promised annual or semi-annual payment.[59] Nothing guarantees that the municipality will continue to make these appropriations, making general fund securities a "risky" investment.[60]

The contractual rights provided by UTGOs and LTGOs are not *property* rights.[61] A municipality cannot typically grant creditors an interest in public property by mortgaging its roads or its schools.[62] Where state law does not directly prevent it, most courts have held mortgaging municipal property is against public policy.[63] However, outside bankruptcy, the contractual rights

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of participation are "collateralized" because the "leased property serves as collateral" and creditors can reclaim and re-lease the property itself in the event of a municipal default).

58. *See, e.g.*, *In re* City of Detroit, No. 13-53846, 2014 WL 7409724, at *33–34 (Bankr. E.D. Mich. Dec. 31, 2014) (explaining COPs issued by Detroit, in which the city entered into service agreements with shell corporations to fund the city's pension obligations in exchange for future contract payments; a shell trustee then issued COPs that granted holders the rights to a proportional share of those future contract payments).

59. *See, e.g.*, KROLL, *supra* note 49, at 5 (noting that certain general obligation warrants at issue in the Jefferson County bankruptcy were "essentially a general fund pledge" because the County was "under no obligation to raise property taxes or other taxes and fees" in order to make debt service payments).

60. *See* Doty, *supra* note 49, at 63 ("For those who emphasize the risks of municipal fiscal stress, then, the securities to watch are general fund securities, especially uncollateralized general fund securities, not general obligation bonds.").

61. *See* GELFAND, *supra* note 47, § 3:16 (noting that GO bonds do not create a property interest, like a lien, in favor of GO bondholders "without a specific statutory or constitutional provision").

62. *See* S. REP. 100-506, at 25 (1988) ("[M]ost municipalities cannot mortgage their real property . . . ."); *Legislation to Amend Chapter 9 of the Bankruptcy Code: Hearing Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary*, 100 Cong. 70 (1988) [hereinafter *House Hearing*] ("[M]unicipal law prohibits the encumbrance of municipal property with mortgages.").

63. *See* S. REP. NO. 100-506, at 13 (noting that most municipalities cannot create real property mortgages "either for legal reasons or because of compelling considerations of public policy"). *But see* Peter Molk, Comment, *Broadening the Use of Municipal Mortgages*, 27 YALE J. ON REG. 397, 406 (2010) (stating, without citation or support, that "revenue bonds secured by newly acquired

granted to GO bondholders (like the ability to compel a municipality to raise taxes to repay bonds) are as effective as the property rights afforded by a mortgage (like foreclosure).[64] Absent some special state law to the contrary, GO bondholders can use a writ of mandamus to force a struggling municipality to repay its GO debt before it pays municipal employees or pensioners.[65]

2. Revenue Bonds

Municipalities can grant creditors an interest in one limited form of municipal property: money.[66] They do this by granting bondholders a lien on an incoming stream of municipal revenue.[67] Thus, to "secure" repayment of bonds issued to construct a sewer, a municipality could grant bondholders a lien on all incoming sewer fees from the new local sewer system; or, to secure bonds

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property are not particularly uncommon.").

64. *See, e.g.*, R.I. GEN. LAWS § 45-12-1 (2014) (creating all of the typical GO bondholder protections, including a full faith and credit pledge, a state mandate to set aside enough money to pay all principal and interest payments, and a requirement that an issuing municipality increase its taxes "without limitation of rate or amount" to guarantee repayment); Flushing Nat. Bank v. Mun. Assistance Corp., 358 N.E.2d 848, 851–52 (N.Y. 1976) (distinguishing obligations secured by the "faith and credit" of the municipality from mere "revenue obligation[s]" and "moral obligation[s]" and implying that the former are more powerful than the latter); AMDURSKY & GILLETTE, *supra* note 38, § 5.4.1 (calling the writ of mandamus—a common tool available exclusively to general bondholders that allows them to mandate tax increases—the "most effective remedy" for bondholders); *id.* § 5.4.3, at 246–50 (noting that the remedy of execution or foreclosure "will not be awarded to enforce a judgment against a municipal corporation absent a statute to the contrary" and that courts are unwilling to "dissolve or dismantle municipal corporations in order to satisfy creditors"); Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 431 (1993), 429–33 (noting that execution, a property rights-based remedy is, in practice, "unavailable to the municipal creditor").

65. *See* AMDURSKY & GILLETTE, *supra* note 38, § 5.4.1 (describing the remedy and its application).

66. *See infra* note 67 and accompanying text (describing how municipalities can grant property rights in their revenue streams).

67. *See* 4 JOHN MARTINEZ, LOCAL GOVERNMENT LAW § 25:25 & n.21 (noting that pledges of a tax revenue stream "as security for municipal obligations is ordinarily viewed as creating a closed, enforceable lien on the fund required to be created by the agreement between issuer and bondholders" and compiling dozens of cases in support of the proposition).

issued to construct a new convention center, a municipality could grant bondholders a lien on all tax revenues from a special lodging tax.[68]

Revenue bonds typically contain this lien-based security device.[69] In a typical revenue bond transaction, the proceeds from revenue bonds are used to fund the construction or development of a facility, system, or set of improvements (like the sewer system or the convention center mentioned above).[70] The facility, system, or set of improvements will then generate a revenue stream, which is used to repay the principal and interest on the issuance.[71] Because the encumbered revenue stream represents the only potential source of repayment for revenue bondholders,[72] a municipality cannot divert it for other purposes.[73]

"Conduit financing" is an increasingly popular variant on the traditional revenue bond transaction.[74] Under this structure,

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68. *See* S. REP. NO. 100-506, at 13 (listing these as examples of typical revenue streams used to repay revenue bonds).

69. *See, e.g.*, H.R. REP. NO. 100-1011, at 4 (1988) ("[R]evenue bonds . . . are usually backed by and repaid only from the revenues generated from the physical asset built with the money raised by the bond offering. A lien in favor of the bondholders exists on this revenue stream, but not on the physical asset itself.").

70. *See* AMDURSKY & GILLETTE, *supra* note 38, § 1.3.2, at 29 (explaining that revenue bond proceeds are used to finance the construction or operation of "such revenue-producing capital projects as toll bridges, electrical generating plants, and water works systems").

71. *See id.* (suggesting that such revenues from such systems, once constructed, serve as the security and repayment source for the bonds).

72. *See* S. REP. NO. 100-506, at 9 ("[I]f water revenues are insufficient to pay operating expenses and the debt service on water revenue bonds, other funds of the city should not be reachable to pay the bonds."); AMDURSKY & GILLETTE, *supra* note 38, § 1.3.2, at 30 ("[P]rojects constructed with revenue-bond proceeds place no additional burden on the taxing power of the issuer and do not place the issuer's constituents at financial risk in the event of a project's failure . . . .").

73. *See* S. REP. NO. 100-506, at 8 (describing how municipalities will separate revenue-generating projects into multiple enterprises and that "the funds derived from one source are often legally unavailable for other enterprises or for general governmental purposes").

74. *See* Gina M. Torielli, *Opining on the 501(c)(3) Tax-Free Bond Transaction: Avoiding Common Borrower's Counsel Misconceptions*, 31 WM. MITCHELL L. REV. 147, 153 n.26 (2004) ("These transactions are called 'conduit' financings because the governmental issuer of the bonds serves as the conduit between the bondholder and the ultimate obligor on the debt."). Bonds issued in conduit projects involving a public entity and a private entity are sometimes

municipalities (typically special-purpose entities like building authorities)[75] issue bonds to finance the construction of facilities that are, in turn, leased to third parties, including other municipal entities.[76] The issuer then grants bondholders some form of interest in the lease payment revenue stream that the issuer receives from the third party.[77] In a variant of this structure, the conduit issuer will loan the proceeds of the bond issuance to a third-party borrower, which will construct the facility using those proceeds.[78] The conduit issuer would secure

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referred to as "industrial revenue bonds" or "private activity bonds." *See, e.g.*, AMDURSKY & GILLETTE, *supra* note 38, § 1.3.2, at 30–31 (using such labels).

75. *See* Steven L. Schwarcz, *The Use and Abuse of Special-Purpose Entities in Public Finance*, 97 MINN. L. REV. 369, 370–77 (2012) (explaining what special purpose entities are, what they do, and how states use them to avoid state law requirements placed on cities and counties); *supra* note 39 (defining the phrase "municipality" to include reference to special purpose districts). Though I use the phrase "municipality" here for consistency, conduit deals are typically undertaken by special purpose districts designed specifically to issue bonds that cities and counties cannot issue because of debt restrictions or other state law limitations.

76. *See, e.g.*, Torielli, *supra* note 74, at 156 & n.44 (noting that municipal issuers will frequently create or use existing local entities, like economic development, public housing authorities, education facility financing authorities, or health care facility financing authorities to conduct the transaction); Sean Carey, Note, *Post-*Davis *Conduit Bonds: At the Intersection of the Dormant Commerce Clause and Municipal Debt*, 78 FORDHAM L. REV. 121, 153–56 (2009) (describing conduit financing and summarizing the arguments on both sides of the controversy over whether conduit bond transactions involving private parties should receive preferential tax treatment).

77. *See, e.g.*, ELMORE CNTY. PUB. BLDG. AUTH., BUILDING REVENUE WARRANTS (DHR Building) 4 (2014) (noting that bondholders are "secured" by the lease payments made by the lessee—Elmore County, in this case—that will begin after the building authority completes construction of an office building). In the direct loan context, bondholders have a lien on the stream of loan payments made by the municipality. *See* Torielli, *supra* note 74, at 155–57 (describing this structure).

78. *See* Torielli, *supra* note 74, at 155–56 (describing a typical conduit transaction involving a 501(c)(3) and a public entity). Critically, even a transaction structured as a lease could be treated as a loan with a grant of a security interest in bankruptcy. *See, e.g.*, United Airlines, Inc. v. HSBC Bank USA, N.A., 416 F.3d 609, 612–18 (7th Cir. 2005) (analyzing whether a lease arrangement arising out of a conduit bond transaction was a "true" lease or a grant of a security interest and concluding that the transaction was a grant of a security interest).

these bonds by pledging the debt service payments made by the third-party borrower.[79]

Lacking a "full faith and credit" pledge, the only thing that revenue bondholders can rely upon to guarantee repayment is the lien on the revenue stream itself.[80] Outside of bankruptcy, such bonds are considered riskier than GO bonds because the sewer system could fail or the convention center guests could stop staying in local hotels, leaving bondholders with no revenue to repay their investment.[81] GO bondholders, on the other hand, could simply demand property tax increases if the municipality ran short of revenue.[82]

3. Short-Term Debt Securities

Municipalities use short-term debt, usually styled as "notes" that mature within a year, to "regulate cash flow or to initiate capital projects" while waiting to secure more permanent financing.[83] Short-term notes combine certain aspects of GO bonds and revenue bonds.[84] Municipalities will secure some "tax

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79. *See* Torielli, *supra* note 74, at 155–57 (noting that this is the typical structure for such transactions).

80. *See* AMDURSKY & GILLETTE, *supra* note 38, § 1.3.2, at 29 (defining revenue bonds generally as self-liquidating obligations "payable solely from the proceeds generated through operations of the facility financed with the bond proceeds"); MARTINEZ, *supra* note 67, § 25:25 (suggesting this as the potential remedy for revenue bondholders and outlining various lien enforcement mechanisms); *supra* note 47 and accompanying text (noting that revenue bonds lack a full faith and credit guarantee).

81. *See* Tracy Nichols Eddy, *The Referendum Requirement: A Constitutional Limitation on Local Government Debt in Florida*, 38 U. MIAMI L. REV. 677, 700 (1984) ("Because revenue bonds are less secure than general obligation bonds backed by the issuer's taxing power, higher interest rates are necessary to compensate investors for the added risks." (citations omitted)).

82. *See supra* notes 44–48, 64–65 and accompanying text (describing GO bonds, the tax increases they promise, and the enforcement mechanisms they create).

83. AMDURSKY & GILLETTE, *supra* note 38, § 1.3.3, at 33; *see* GELFAND, *supra* note 47, §§ 3.29–3.31 (describing tax anticipation notes (TANs) and revenue anticipation notes (RANs) as devices that "can smooth out and maintain cash flow" and bond anticipation notes (BANs) as debt "issued to provide short-term financing for a project during its design and construction phases").

84. *Compare* NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT

anticipation notes" and "revenue anticipation notes" with a revenue bond-like structure: a "pledge to trap the anticipated revenues upon their receipt into a specified fund to be applied to pay the notes."[85] Like revenue bonds, such notes can create a lien on the bond, revenue, or tax streams pledged for repayment.[86] In other cases, short-term notes are—like GO bonds—payable from any source within the municipality's general fund.[87] Some short-term notes are supported by the "full faith and credit" guarantee, while others are not.[88]

4. Securing Bonds with Statutory Liens

Thus far, this Part has introduced two mechanisms by which municipalities provide peace of mind to bondholders: contractual pledges of "full faith and credit" (in the case of UTGOs, LTGOs, and some short-term securities)[89] and contractual provision of property rights (in the form of a lien on a revenue stream).[90] There is, however, a third mechanism through which *states*, not municipalities, can provide security for all types of municipal

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TWENTY YEARS (FINAL REPORT) § 4.3.6 (Oct. 20, 1997) (recommending that Chapter 9 be altered to treat TANs and RANs as "special revenue" obligations because they "are similar to special revenues and should receive the same treatment"), *with In re* Cnty. of Orange, 179 B.R. 185, 192 n.17 (Bankr. C.D. Cal. 1995) (noting that there was "no disagreement" that the TANs in that case were general obligations because they were pledged from first available municipal general revenues).

85. GELFAND, *supra* note 47, § 3.29 (noting that many RANs contain "trapping" covenants).

86. *See Cnty. of Orange*, 179 B.R. at 193–94 (finding that Orange County created a contractual lien on certain tax revenue anticipation notes at issue in its bankruptcy); AMDURSKY & GILLETTE, *supra* note 38, § 1.3.3, at 33 (maintaining that these bonds "are often secured by a particular revenue stream and take their name from that source" and listing taxes, revenues, and bonds as potential repayment sources).

87. *See* William M. Loafman & Milton S. Wakschlag, *Tax-Exempt Financing*, 48 TAX LAW. 1347, 1354 (1995) (noting that a municipality paid bond anticipation notes out of its general fund).

88. *See* GELFAND, *supra* note 47, § 10:17 ("The full-faith-and-credit guarantee distinguishes general obligation bonds (as well as certain notes backed by full faith and credit) from revenue bonds (and revenue anticipation notes), which are backed only by a particular fund or revenue source.").

89. *Supra* notes 42–64, 88 and accompanying text.

90. *Supra* notes 66–82 and accompanying text.

debt.[91] This mechanism is called a "statutory lien," and is a close cousin to the "contractual liens" provided by revenue bonds.[92]

Like contractual liens, statutory liens provide the holders of certain bonds with property rights to the income stream promised by the indenture.[93] However, statutory liens differ from contractual liens in two major ways. First, statutory liens arise by force of *state law*; they exist outside the terms of the indenture because they are created automatically by operation of state statute.[94] Second, a state legislature can impress *any* kind of municipal debt with a statutory lien.[95] While contractual liens rarely exist outside the revenue bond context, a state could choose to place a statutory lien on all UTGOs, LTGOs, or even short-term securities issued by its municipalities.[96] Ultimately, the creation of a lien is a property law issue, and the exact

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91. *See* JAMES E. SPIOTTO ET AL., MUNICIPALITIES IN DISTRESS? HOW STATES AND INVESTORS DEAL WITH LOCAL GOVERNMENT FINANCIAL EMERGENCIES 57–58 (2012) (indicating that statutory liens can provide GO bondholders with additional protection in a municipal bankruptcy and that they can only be created by force of state statute).

92. *See id.* (defining statutory lien).

93. *See id.* at 58–59 (noting that statutory liens, like contractual liens created by revenue bonds, provide property rights that are protected under bankruptcy law).

94. *See id.* at 58 (noting that a statutory lien "comes into existence by virtue of the [state] statute and arises by force of the statute on specific circumstances or conditions and [does] not requir[e] further action by the municipality" (citing *In re* Cnty. of Orange, 189 B.R. 499 (C.D. Cal. 1995))). *Compare In re* Cnty. of Orange, 179 B.R. 185, 192 (Bankr. C.D. Cal. 1995) (finding that no statutory lien arose where a municipality consented to (and actually authorized) the granting of a lien), *with In re* Cnty. of Orange, 189 B.R. 499, 502–03 (C.D. Cal. 1995) (reversing the bankruptcy court and finding that the statute gave rise to a lien even if the municipality *also* created a contractual lien because the "distinguishing feature of a statutory lien is that it arises 'solely' by force of a statute," and the statute clearly granted a lien).

95. *See* SPIOTTO ET AL, *supra* note 91, at 58 & n.111 (claiming that "thirty-two states recognize some form of statutory lien in relation to their bond obligations" and providing a reference to a chart listing the state statutes that authorize these provisions).

96. *See, e.g.*, Doty, *supra* note 49, at 58 ("[O]nly five states provide statutory liens broadly in support of local general obligation bonds (California, Colorado, Florida, Louisiana, and Rhode Island). . . . A number of states permit statutory liens for certain types of debt, and others do so conditionally." (citation omitted)).

language that creates a lien will vary significantly from state to state.[97]

While this additional layer of protection may seem unnecessary, especially given the powerful contractual rights already afforded to holders of GO bonds, the property rights provided by a statutory lien could make the difference between full repayment and partial repayment in bankruptcy.[98] For example, the statutory lien that Rhode Island impressed on all outstanding GO bonds in 2011 guaranteed that Central Falls' GO bondholders—who would otherwise have received pennies on the dollar—were entitled to top priority in bankruptcy.[99] Part II.B, after the Table below, explains why.

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97. *See* Butner v. United States, 440 U.S. 48, 55 (1979) ("Property interests are created and defined by state law."); SPIOTTO ET AL, *supra* note 91, at B1–2 (charting the presence or absence of statutory liens in all 50 states); Caitlin Devitt, *Detroit Judge Hears Challenge To ULTGO Treatment*, BOND BUYER (Feb. 19, 2014, 5:39 PM), http://www.bondbuyer.com/issues/123_34/detroit-judge-hears-challenge-to-ultgo-treatment-1060015-1.html (last visited Apr. 2, 2015) (discussing how several municipal bond rating agencies are currently surveying laws in all fifty states to determine which states grant contractual liens and on which revenues they grant them) (on file with the Washington and Lee Law Review).

98. *See* Corkery, *supra* note 4 (describing how the statutory lien impressed on GO bonds by Rhode Island ensured that GO bondholders received full repayment in Central Falls' bankruptcy).

99. *See* R.I. GEN. LAWS § 45-12-1 (2014) (mandating that a municipality's promise of full faith and credit "shall constitute a first lien on . . . ad valorem taxes and general fund revenues" pledged for repayment of the bonds); Corkery, *supra* note 4 (recounting the details of the Central Falls bankruptcy proceedings).

5. Summarizing Pre-Bankruptcy Expectations

Table 1: Rights and Remedies Available to Bondholders Pre-Bankruptcy[100]

Bond Type	**Payment Stream**	**Means of Guaranteeing Repayment**
Unlimited Tax General Obligation	An unlimited amount of a certain type of tax revenue, typically ad valorem taxes (plus any other revenues necessary if property tax revenues are insufficient).	*Contractual rights*: mandating municipal tax increases or payments from other revenue sources. *Property rights*: typically none, unless the state has imposed a statutory lien.
Limited Tax General Obligation	A certain type of tax revenue, typically ad valorem taxes, limited by rate or amount (plus, in some cases, other revenues up to a certain point).	*Contractual Rights*: mandating tax increases up to a certain extent or (potentially) payment from other limited sources. *Property Rights*: typically none, unless the state has imposed a statutory lien.
Collateralized General Fund	Periodic lease payments or other allocations made directly from the municipality's general fund by its elected officials.	*Contractual rights*: no right to increase taxes; other limited rights may be available. *Property rights*: undivided fractional interest in underlying lease
Uncollateralized General Fund	Periodic allocations made directly from the municipality's general fund by its elected officials.	*Contractual rights*: no right to increase taxes; other limited rights may be available. *Property rights*: typically none, unless the state has imposed a statutory lien.
Project-Based Revenue	Receivables, like sewer fees or tolls, generated by the financed project or tax revenue correlated with the success of the project.	*Contractual rights*: mandating rate or fee increases to pay for the financed system.[101] *Property rights*: lien on the underlying revenue stream.

100. Any information not directly derived from the text of Part II.A is referenced with a footnote.

101. *See* AMDURSKY & GILLETTE, *supra* note 38, § 5.4.2, at 246–50 (describing this remedy).

Conduit-Based Revenue[102]	Payments from the third-party beneficiaries of the bonds.	*Contractual rights*: acceleration under default; other remedies vary from contract to contract. *Property rights*: lien on the underlying revenue stream
Aid/Transfer Revenue[103]	Transfer payments from another governmental entity or a third party that did not benefit from the bond issuance.	*Contractual rights*: typically none, but specific terms of issuance may vary this rule. *Property rights*: lien on the underlying revenue stream
Bond Anticipation Notes	Proceeds from an anticipated bond issue.[104]	*Contractual rights*: varies from issuance to issuance. *Property rights*: sometimes granted in form of a lien.
Revenue Anticipation Notes	Proceeds from the anticipated receipt of non-tax payments, like rents, charges, or intergovernmental aid.[105]	*Contractual rights*: varies from issuance to issuance. *Property rights*: sometimes granted in form of a lien.
Tax Anticipation Notes	Proceeds from future receipts of specified state or local tax revenue.[106]	*Contractual rights:* varies from issuance to issuance. *Property rights*: sometimes granted in form of a lien.

B. Reversing Expectations: The Mechanics of the Bond Market Post-Bankruptcy

Part II.A discussed the two primary mechanisms by which municipalities can guarantee repayment of debt: contractual rights (typically associated with GO bonds) and property rights (in the form of statutory and contractual liens). Outside bankruptcy, or "prepetition," contractual rights afford the same—

102. *See supra* notes 74–77 and accompanying text (explaining conduit revenue bonds). This category includes pollution control, private activity, 501(c)(3) conduit issuance, or any other situation in which a third-party beneficiary receives the proceeds of the issuance.

103. I use this as short-hand for revenue bonds that are neither project-based nor conduit transactions. In these transactions, the third party—typically a state, federal, or local entity—is *not* the beneficiary of the bond proceeds, but provides the revenue stream used to repay bondholders.

104. GELFAND, *supra* note 47, § 10:22 ("BANs are backed by the anticipated revenues from approved bond issues.").

105. *Id.* ("RANs are issued in anticipation of state or local government revenues other than real estate taxes, e.g., sales taxes, rents, charges, and intergovernmental aid.").

106. *Id.* ("TANs are issued in anticipation of the receipt of certain state or local taxes, usually real estate taxes, from the current or recent fiscal year(s).").

and perhaps greater—protections that property rights do.[107] After the filing of a bankruptcy petition, or "postpetition," the Bankruptcy Code reverses these market expectations for the reasons explored below.

1. Impairing Contractual Rights

The principal goal of the Bankruptcy Code is the "adjustment of the debtor-creditor relationship."[108] To that end, the Bankruptcy Clause of the United States Constitution[109] "necessarily authorizes Congress to make laws that would impair contracts."[110] Though bankruptcy law "endeavors to provide a system of orderly, predictable rules for treatment of parties whose contracts are impaired, that does not change the starring role of contract impairment in bankruptcy."[111]

This notion of contract impairment is critical in municipal bankruptcy because every bond transaction is predicated on a set of contractual documents, collectively referred to as an "indenture."[112] The indenture creates a series of contractual rights; it delineates how bondholders will be repaid, how much they will be repaid, and how they can compel payment if the municipality defaults on its obligations.[113] It also establishes a single fund or a series of funds into which the municipality

107. *See supra* notes 43–82 and accompanying text (describing the contractual and property rights that secure general obligation and revenue bonds and noting the market preference for the former over the latter).

108. *In re* City of Stockton, 478 B.R. 8, 25 (Bankr. E.D. Cal. 2012).

109. U.S. CONST. art. I, § 8, cl. 4.

110. *City of Stockton*, 478 B.R. at 15 (noting that "[i]t long has been understood that bankruptcy law entails impairment of contracts" and citing Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 191 (1819)).

111. *Id.*

112. *See infra* notes 113–114 and accompanying text (discussing the elements of a typical bond indenture and how they drive the structure of the transaction).

113. *See, e.g.*, Charles L. Jarik et al., *Municipal Financial Distress: A Case Study of a Partnership Between the Village of Maywood and the Illinois Development Finance Authority*, 25 URB. LAW. 995, 1007–09 (1993) (describing an indenture that specified how a local authority would trap tax revenues from a nearby village, apply those revenues towards various funds set up by the indenture, and pay bondholders given amounts of debt service at given times).

transfers revenues that will ultimately be used to repay bondholders.[114]

The filing of a Chapter 9 petition does not automatically eliminate or annul an indenture; the payment fund structures, the principal and interest payment amounts, and the default remedies specified in the indenture technically survive.[115]

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114. *See* Bank of N.Y. Mellon v. Jefferson Cnty. (*In re* Jefferson Cnty.), 482 B.R. 404, 415–19 (Bankr. N.D. Ala. 2012) (describing a "waterfall" fund structure where collected sewer revenues went to pay the operating expenses of the sewer, then flowed into a debt service fund to repay bondholders, then flowed into a reserve fund to cover capital expenditures and depreciation). Where bonds are payable from a specific tax levy, the mechanism can be quite simple. *See, e.g.*, GELFAND, *supra* note 47, § 3.29 (noting that many tax anticipation notes, a form of short-term debt, contain simple "trapping" covenants that pledge to trap the revenue securing the notes in a given fund dedicated to bondholder repayment as soon as the municipality acquires the funds). The indenture typically instructs the municipality to collect the tax each month and deposit it into a special account, usually called a "debt service fund," to which only one individual—a fiduciary of the bondholders called an "indenture trustee"—has access. *See* Jarik et al., *supra* note 113, at 1002, 1007–08 (describing such an indenture and noting that the bond trustee receives all payments of principal and interest and manages them on behalf of the bondholders). In the case of project funding with revenue bonds, the indenture will often establish a more elaborate payment structure because the same stream of revenue used to repay bondholders must also pay for the operating expenses of the project or system. *See Bank of N.Y. Mellon*, 482 B.R. at 415–19 (describing how the indenture mandated payment of operating expenses before any revenue flowed through to bondholders under its "waterfall" payment system).

115. *See* Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 451–57 (1973) (noting that a debtor can only reject executory contracts and establishing a test to determine whether a given contract is executory); Richard M. Cieri, Barbara J. Oyer & Dorothy J. Birnbryer, *"The Long and Winding Road": The Standards to Confirm A Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (Part I)*, 3 J. BANKR. L. & PRAC. 3, 23 n.103 (1993) (applying Countryman's test and suggesting that an indenture may not be an executory contract because the bondholders have fully performed by paying for their bonds while the municipality performed only partially because it has not yet repaid the bondholders). The authors of the latter article are careful to note that the issue of "[w]hether debt indentures may be rejected under Section 365 of the Bankruptcy Code continues to be unresolved." Cieri, Oyer & Birnbryer, *supra*. Absent rejection, nothing about the filing of a bankruptcy petition automatically *terminates* contractual obligations; it merely renders them unenforceable. *See infra* notes 118–134 and accompanying text (describing the effects of the automatic stay and the presumption that the filing of a bankruptcy petition does not destroy the payment structure established by the indenture).

However, bankruptcy law can impair and even invalidate any of the contractual rights contained in the indenture.[116]

While dozens of Bankruptcy Code provisions could potentially impair a bondholder's contractual rights, two sections are particularly relevant.[117] The first is the "automatic stay" contained in § 362.[118] The second is the plan confirmation and "cramdown" process, which is discussed in Part II.B.2.

Immediately after a municipality files a Chapter 9 petition, § 362 prevents bondholders from taking any action to "obtain possession" or "exercise control over" the municipality's property or "recover claims" against the municipality.[119] Technically, the automatic stay bans everything from compelling a tax increase with a writ of mandamus[120] to "self-help," which involves the bond trustee taking money *already in her possession* and using it to repay bondholders.[121]

This stay represents a broad barrier to creditor action against a municipality.[122] For example, if Central Falls had stopped paying its GO bondholders a month after it filed for

116. *See infra notes* 118–134 and accompanying text (describing how the automatic stay contained in Section 362(a) effectively renders the indenture unenforceable).

117. *See infra* notes 118–134 and accompanying text (explaining how these provisions impact contractual rights and why they are so significant to bondholders).

118. 11 U.S.C. § 362(a) (2012); *see infra* notes 119–134 and accompanying text (describing the automatic stay).

119. *See* 11 U.S.C. § 362(a) (creating an automatic stay that prevents almost all action against the debtor to enforce any contractual rights that could be used to compel repayment); 11 U.S.C. § 901 (incorporating § 362 into Chapter 9 by reference); 3 COLLIER ON BANKRUPTCY ¶ 362.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011) [hereinafter COLLIER] (noting that the automatic stay prevents both secured and unsecured claimants from taking any action to "enforce or collect prepetition claims").

120. *See* 11 U.S.C. § 362(a)(1) (barring creditors from "commenc[ing]" any "judicial" proceeding, like a writ action).

121. *See* 6 COLLIER, *supra* note 119, ¶ 922.05[2] (discussing this remedy and noting that, absent § 922(d), it would be unavailable to secured bondholders in municipal bankruptcy).

122. *See, e.g.*, S. REP. 100-506, at 11 (1988) ("The automatic stay of Bankruptcy Code Section 362 is extremely broad, preventing any post-petition collection activities against the debtor . . . . This provision is overly broad in Chapter 9, requiring the delay and expense arising from a request for relief from the automatic stay to accomplish what many state statut[]es mandate . . . .").

Chapter 9, § 362(a) would have prevented bondholders from walking into state court and enforcing their "full faith and credit" pledge.[123] Indeed, it would have even prevented GO bondholders from being paid out of funds sitting in an account reserved for their exclusive use.[124]

2. Impairing Property Rights

Nothing in the Constitution prevents Congress from using bankruptcy law to alter contractual rights.[125] However, the uneasy relationship between the Bankruptcy Clause and the Takings Clause[126] has led Congress to inscribe a respect for claims based on property rights into the Bankruptcy Code.[127] The Code generally requires that any creditor with property rights (which are referred to as "liens" throughout much of the Code)[128] must either be allowed to retain the lien after a bankruptcy discharge or receive "just compensation" if the bankruptcy process impairs or destroys the lien.[129] Thus, lienholders have

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123. *See supra* note 120 and accompanying text (explaining why writs of mandamus and other actions to secure are ineffective against the automatic stay).

124. *See supra* note 121 and accompanying text (describing how and why a bond trustee cannot take monies paid into a specially designated fund and distribute them to the bondholders).

125. *See, e.g.*, *In re* City of Stockton, 478 B.R. 8, 15 (Bankr. E.D. Cal. 2012) ("Significantly, the [Constitution] bans a *state* from making a law impairing the obligation of contract; it does not ban *Congress* from making a law impairing the obligation of contract. This asymmetry is no accident.").

126. U.S. CONST. amend. V, cl. 4 ("[N]or shall private property be taken for public use, without just compensation.").

127. *See* James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 977–97 (1983) (describing the proposition that "any impairment of the liquidation value of a secured creditor's collateral attributable to the exercise of powers conferred on the reorganization court by bankruptcy legislation is, in the absence of just compensation, a violation of the takings clause of the fifth amendment").

128. The Code defines a "lien" as any "charge against or interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101(37) (2012).

129. *See* 11 U.S.C. § 506(a) (2012) (providing that any allowed claim "secured by a lien on property in which the estate has an interest" is a "secured

"secured" claims because the Code guarantees that they will receive at least the value of their property interest in the plan of adjustment that concludes a Chapter 9 proceeding.[130]

Claimants without liens—like most GO bondholders and short-term note holders—have no property rights to protect in bankruptcy, rendering them "unsecured" claimants.[131] No portion of the Bankruptcy Code requires municipalities to pay unsecured claimants the full value of their claims.[132] Indeed, Chapter 9 grants municipalities the exclusive right to propose a plan of adjustment that pays unsecured bondholders only a fraction of what they are owed under the terms of the indenture.[133] Though all creditors have the opportunity to approve or reject the

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claim"); 11 U.S.C. § 901 (incorporating §§ 506 and 1129(b)(2)(A) into Chapter 9); *id.* § 1129(b)(2)(A) (mandating that any plan of adjustment permit secured claimholders to retain their liens and receive deferred cash payments equal to the value of their lien or receive the "indubitable equivalent" of their claims). Note that "the estate" is "the debtor" in Chapter 9. *See id.* § 902 (defining "property of the estate" as "property of the debtor" in the Chapter 9 context).

130. *See* MARGARET HOWARD, BANKRUPTCY: CASES AND MATERIALS 176 (5th ed. 2012) ("Holders of secured claims have a legally recognized property interest in collateral of the debtor . . . ."); *id.* at 284 (noting that "[o]ne of bankruptcy's fundamental policy decisions is that property rights created under nonbankruptcy law will be respected in bankruptcy[,]" but that "the *value* of a secured creditor's rights is respected rather than the *in rem* rights themselves"); sources cited *supra* note 129 (listing the Bankruptcy Code mechanisms designed to ensure that secured claimants receive the value of their property interest, even if paid out over time). A "plan of adjustment" is the Chapter 9 phrase for a "plan of reorganization." *See* 11 U.S.C. § 941 (requiring debtors to file a plan of adjustment as opposed to a plan of reorganization).

131. *See* HOWARD, *supra* note 130, at 176 (noting that unsecured creditors "have no property interests to support the debtor's obligation").

132. *See, e.g.*, David S. Kupetz, *Municipal Debt Adjustment Under the Bankruptcy Code*, 27 URB. LAW. 531, 595 (1995) (maintaining that unsecured municipal creditors should only receive what the court believes they "could reasonably expect under the circumstances" and implying that this amount can be less than the face value of their claims).

133. *See* 11 U.S.C. § 941 (providing the municipality with the exclusive right to propose and file a plan of adjustment); *id.* § 1129(b) (establishing the absolute priority rule, which permits a municipality to "cram down" a plan of adjustment on unwilling unsecured creditors). A thorough discussion of the cramdown provision, the absolute priority rule, and the overall standards for confirming a plan of adjustment over the objections of certain creditors is well beyond the scope of this Note. For a more complete discussion of these issues, see David S. Kupetz, *Standards for Confirming a Chapter 9 Plan of Debt Adjustment: Incorporating and Diverging from Chapter 11 Plan Standards*, 32 CAL. BANKR. J. 289 (2012), which contains a treatise-like analysis of plan confirmation.

proposed plan of adjustments, a bankruptcy court still can confirm a plan over the objections of a group of unsecured bondholders.[134] In effect, this allows the bankruptcy court to force unsecured bondholders to accept pennies on the dollar in satisfaction of their claims.[135]

In sum, the first key to bondholder treatment in municipal bankruptcy is the presence or absence of property rights to municipal revenue.[136] However, to complicate matters further, the Bankruptcy Code does not respect all property rights equally.[137] While the general bankruptcy policy of respecting property rights in bankruptcy holds true in most contexts, there are certain exceptions.[138] One of these exceptions is for contracts that place a lien on a debtor's future income.[139]

This future-income exception is grounded in the "fresh start" policy first articulated in *Local Loan Co. v. Hunt*.[140] In *Local*

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134. *See, e.g.*, Zack A. Clement & R. Andrew Black, *How City Finances Can Be Restructured: Learning from Both Bankruptcy and Contract Impairment Cases*, 88 AM. BANKR. L.J. 41, 52 (2014) ("Creditors have the opportunity to vote to approve or reject a proposed chapter 9 plan. If one or more of the classes of creditors vote to reject the plan, the plan can still be confirmed if it satisfies the cram down provisions of chapter 11 that are made applicable in chapter 9 cases." (citations omitted)).

135. *See, e.g.*, *In re* Corcoran Hosp. Dist., 233 B.R. 449, 451, 457–59 (Bankr. E.D. Cal. 1999) (employing the cramdown provision in § 1129(b)(2)(B) on a class of unsecured creditors who rejected the plan of adjustment because they only received 50% of their allowed claims over a fifteen year period).

136. *Compare supra* notes 128–130 and accompanying text (describing the entitlement to full repayment enjoyed by bondholders with a lien on a municipal revenue stream), *with supra* notes 131–135 (describing the drawbacks of the unsecured status afforded to bondholders without property rights to municipal revenues).

137. *See infra* notes 138–153 and accompanying text (demonstrating several instances in which certain property rights are either impaired temporarily or permanently).

138. *See, e.g.*, Rogers, *supra* note 127, at 992–93 (noting that §§ 361–364 of the Code permit the bankruptcy judge to terminate a secured creditor's lien against an asset, provided that the secured creditor receives a lien against different property of equal value in exchange).

139. *See infra* notes 140–154 and accompanying text (describing § 552).

140. 292 U.S. 234 (1934). In *Local Loan*, a debtor assigned his future wages to a bank as security for a loan. *See id.* at 238 ("[R]espondent borrowed from petitioner the sum of $300, and as security for its payment executed an assignment of a portion of his wages thereafter to be earned."). After the debtor received his discharge, the bank brought suit to enforce the assignment, arguing that the assignment was a lien and that such property rights survive the filing

Loan, the Court explained that "[o]ne of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'"[141] Subsequent courts have found that the centrality of this policy to the objectives of the Bankruptcy Code justify any potential Fifth Amendment concerns.[142]

Section 552(a)[143] codifies the "fresh start" goal articulated in *Local Loan*.[144] Its primary application is in business bankruptcy. Under Article 9 of the Uniform Commercial Code (UCC),[145] lenders can secure their loans by placing a lien on all "existing and after-acquired" inventory and equipment of the debtor.[146]

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of a bankruptcy. *See id.* at 238–39 (outlining the procedural history of the case and the arguments made by both parties). The Court ultimately held that future earnings are not "property" under bankruptcy law until they are *actually earned*. *See id.* at 243 ("The earning power of an individual is the power to create property; but it is not translated into property within the meaning of the Bankruptcy Act until it has brought earnings into existence."). Any lien not "arising from, or connected with, preexisting property" should not receive its full value in bankruptcy. *Id.* (maintaining that bankruptcy will only respect liens "existent when the bankruptcy became effective or . . . arising from, or connected with, preexisting property," not promises predicated on "the fruit of the subsequent labor of the bankrupt").

141. *See id.* at 245 (citation omitted).

142. *See In re* Hamilton, 18 B.R. 868, 870 (Bankr. D. Colo. 1982) (justifying the termination of a lien on property acquired after the petition by noting that the creditor's rights to that property were not vested at the time the bankruptcy was filed, meaning that they were still contractual in nature and could be abridged without concern for the Fifth Amendment).

143. 11 U.S.C. § 552(a) (2012).

144. *See In re* Nielsen, 48 B.R. 274, 276 (D.N.D. 1984) ("The purpose of [section 552(a)] is to facilitate a debtor's "fresh start" by enabling him or her to use after-acquired property free and clear of prebankruptcy liens."); *In re* Patio & Porch Sys., Inc., 194 B.R. 569, 573 (Bankr. D. Md. 1996) ("The purpose of [Section 552(a)] is to further the 'fresh start' goals of the Bankruptcy Code by not allowing prepetition liens to encumber property acquired by the debtor postpetition."); *In re* Texas Tri-Collar, Inc., 29 B.R. 724, 727 (Bankr. W.D. La. 1983) ("An order allowing a prepetition security interest to extend to property acquired by the debtor after commencement of the case would be in contravention of section 552(a) and its goal of bolstering the debtor's fresh start.").

145. U.C.C. §§ 9-101 to -709 (2014).

146. *See* U.C.C. § 9-204(a) ("Except as otherwise provided in subsection (b), a security agreement may create or provide for a security interest in after-acquired collateral."); LINDA J. RUSCH & STEPHEN L. SEPUNICK, PROBLEMS AND MATERIALS ON SECURED TRANSACTIONS 75 (3d ed. 2010) (providing an example of

Such a provision gives the lender a perfected security interest in everything the debtor currently has in its warehouse *and* any inventory it receives in the future.[147] These "after-acquired property" clauses are typically not the only source of security for business loans; rather, they are part of an overall package whereby the bank perfects security interests in as much of the debtor's real and personal property as possible.[148] In corporate bankruptcy, § 552(a) terminates these "floating liens," but allows creditors to retain their security interest in any proceeds relating to the sale of inventory or equipment that was in the debtor's possession before the petition date.[149]

Like *Local Loan*, § 552(a) only covers liens "resulting from any security agreement,"[150] meaning that it only terminates *contractual* liens and leaves *statutory* liens intact.[151] This is why GO bondholders in Rhode Island could breathe easy after the General Assembly created their statutory lien; they knew that they would be secured creditors because § 552(a) would have no effect on their lien.[152] For contractual liens, however, § 552(a)

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a transaction involving an after-acquired property clause).

147. *See* RUSCH & SEPUNICK, *supra* note 146, at 75 (explaining that this is how after-acquired property clauses work in commercial transactions).

148. *See id.* at 75–76 (advising attorneys to draft the language creating the security interest as broadly as possible to include both existing and after-acquired property).

149. *See* 11 U.S.C. § 552 (2012) (noting that property acquired "after the commencement of the case is not subject to any lien" that arose prepetition but allowing creditors to retain security interests in "proceeds, products, offspring, or profits" of the collateral); DAVID G. EPSTEIN ET AL., BANKRUPTCY 412–13 (1993) (confirming this application of § 552 and providing examples).

150. 11 U.S.C. § 552(a); *see id.* § 901 (making § 552(a) applicable in Chapter 9); *see also id.* § 101(50) ("The term 'security agreement' means agreement that creates or provides for a security interest."); *id.* § 101(51) ("The term 'security interest' means lien created by an agreement.").

151. *See* 11 U.S.C. § 552(a) (terminating all liens on property acquired after the petition date); SPIOTTO ET AL., *supra* note 91, at 58, 61–62 (noting that a "statutory lien cannot be canceled on the filing of a bankruptcy petition or by the bankruptcy court," but that liens terminated by § 552(a) "would not continue postpetition"); DAVID G. EPSTEIN ET AL., BANKRUPTCY 412 (1993) ("[S]ection 552(a) applies only to consensual liens, not judicial or statutory liens." (citation omitted)).

152. *See* SPIOTTO ET AL., *supra* note 91, at 60–61 (giving examples of statutory liens in favor of bondholders and discussing why they provide such powerful protection).

would, absent congressional intervention, terminate the bondholders' lien on a future municipal revenue stream—the exact (and only) source of security granted to revenue bondholders.[153] Revenue bondholders in this position would have a secured claim for any principal and interest payments due (but not yet paid) prepetition; they would then have an unsecured claim for the remaining amount due.[154]

The rationale for applying this provision in the municipal context is far weaker than it is in the corporate context.[155] Municipalities cannot grant the same kinds of security interests in real or personal property that businesses can.[156] In the municipal context, a lien on an existing revenue stream does not supplement other security interests; it is *the* security interest.[157] Removing that otherwise valid and enforceable lien would deny bondholders the "benefit of their bargain."[158] Worse, it could make underwriters reticent about buying bonds backed by contractual liens because of their concerns over the lack of security provided by bankruptcy law.[159] This would effectively cut off municipal

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153. *See* S. REP. NO. 100-506, at 6 (1988) (stating that, by virtue of § 552, any prepetition "pledge is terminated" upon the filing of a municipal bankruptcy and that this problem particularly affects revenue bondholders). Though § 552(b) creates an exception to the rule in § 552(a) for "proceeds" of prepetition property, at least one bankruptcy court has held that future tax revenues are not "proceeds" of any prepetition municipal property. *See In re* Cnty. of Orange, 179 B.R. 185, 194 (Bankr. C.D. Cal. 1995).

154. *See* SPIOTTO ET AL., *supra* note 91, at 61 ("After giving value to the prepetition lien on property or proceeds, there is an unsecured claim to the extent there is recourse to the municipality or the debtor.").

155. *See infra* notes 156–160 and accompanying text (explaining this assertion).

156. *See supra* note 62–63 and accompanying text (noting the legal and policy reasons why states cannot mortgage their municipal property).

157. *See supra* notes 66–82 and accompanying text (describing revenue bonds and explaining how the revenue stream lien is the primary source of security for that type of debt).

158. S. REP. NO. 100-506, at 12.

159. *See* H.R. REP. NO. 100-1011, at 5 (1988) ("Lenders may be reluctant to advance funds for projects, particularly in municipalities that are having some financial difficulties, when the possibility exists that the lien securing repayment could be avoided if the municipality files bankruptcy. Proponents argue that bond rating agencies may downgrade the creditworthiness of . . . bonds . . . ."); S. REP. NO. 100-506, at 4 (noting that this exact concern was what prevented lenders from providing cash-strapped Cleveland with much-needed liquidity during its financial crisis in the 1970s).

access to credit markets.[160] Fortunately for revenue bondholders, Congress recognized the failure of § 552(a) in the municipal context, and tried to solve the problem by taking the steps described in the next Section.

3. Lien Survival and the 1988 Amendments

Two instances of municipal distress brought the § 552(a) problem to a head.[161] In 1979, creditors cited the concerns caused by § 552(a) when they refused to extend further credit to Cleveland, which was under serious financial stress at the time.[162] In 1983, the San Jose Unified School District (SJUSD) filed for bankruptcy because it was unable to resolve protracted labor dispute with its teachers.[163] Though § 552(a) "terminate[d] the lien of pre-petition revenue bondholders, . . . San Jose continued post-petition to make payments to these bondholders in the same manner as if no bankruptcy has been filed."[164] San Jose "ignored the federal law" for two reasons: first, it felt legally bound by the California Constitution to continue making its bond payments; and, second, a total default would "cause[] irreversible harm to the school district's ability to issue debt for any other public purpose."[165]

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160. *See* H.R. REP. NO. 100-1011, at 4 (noting that the amendments eliminate lender reticence about "advanc[ing] funds for projects . . . when the possibility exists that the lien securing repayment could be avoided if the municipality files bankruptcy"); S. REP. NO. 100-506, at 6, 13 (suggesting that it is important to guarantee "the debtor's continued access to credit markets" by ensuring that ratings agencies do not "downgrade the creditworthiness of certain special revenue bonds" based upon negative perceptions of creditor rights in municipal bankruptcy).

161. *Infra* notes 162–165.

162. *See* S. REP. NO. 100-506, at 4 (providing a general overview of Cleveland's financial situation and suggesting that "lenders who contemplated providing financing during the financial troubles of the city were discouraged given the concern that their security interests might terminate upon a Chapter 9 filing by the city").

163. *See* H.R. REP. NO. 101-1011, at 3 (1988) (describing the "bitter labor negotiations" that resulted in San Jose's bankruptcy filing, in which the "vast majority of creditors were individual teachers").

164. *Id.*

165. *Id.* (internal quotation marks omitted).

In 1988, Congress addressed the problems raised by Cleveland and San Jose with the passage of the Municipal Bankruptcy Amendments of 1988 (the 1988 Amendments).[166] Among other things, they addressed three major concerns with the 1978 incorporation of corporate bankruptcy principles into Chapter 9: (a) contractual lien termination and the § 552(a) problem,[167] (b) the continuation of bondholder payments despite the automatic stay in § 362(a),[168] and (c) the potential conversion of revenue-backed non-recourse obligations into general obligations.[169]

a. Contractual Lien Survival and the § 552(a) Problem

Given the precarious position of bondholders in the Cleveland and San Jose defaults, Congress made resolving the § 552(a) contractual lien termination problem the focus of the 1988 Amendments.[170] Congress added § 928(a)[171] to Chapter 9 as a direct response to the § 552(a) problem.[172] Congress designed § 928(a) to ensure that creditors backed by contractual liens retained "unimpaired rights to the project revenue pledged to them."[173] Acknowledging the practical realities of municipal finance, the Senate Report maintained that § 928(a) "amounts to a recognition of a hypothetical mortgage from which revenues are derived where a real mortgage cannot be created either for legal reasons or because of compelling considerations of public policy."[174]

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166. Pub. L. No. 100-597, 102 Stat. 3028 (codified as amended at 11 U.S.C. §§ 902–946).

167. *Infra* Part II.B.3(a).

168. *Infra* Part II.B.3(b).

169. *Infra* Part II.B.3(c).

170. *See* H.R. REP. NO. 100-1011, at 4 (1988) (indicating that the "main problem" leading to the enactment of the amendments was the § 552(a) issue).

171. 11 U.S.C. § 928(a) (2012).

172. H.R. REP. NO. 100-1011, at 7–8 (noting that § 928(a) is "key to the bill" because it reverses the effects of § 552(a)); S. REP. NO. 100-506, at 12–13 (1988) (maintaining that § 928(a) is intended to directly reverse the effects of § 552(a)).

173. S. REP. NO. 100-506, at 12.

174. *Id.* at 13.

Section 928 states that: "[n]otwithstanding section 552(a) of this title . . . , special revenues acquired by the debtor after the commencement of the case shall remain subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case."[175] The ultimate application of § 928(a) is clear from the legislative history: if a bondholder has a contractual lien on a special revenue stream, then § 928(a) prevents § 552(a) from terminating the lien, and the bondholder has a fully secured claim.[176] However, if a bondholder has a contractual lien on a revenue stream that does *not* qualify as "special revenues," then § 928(a) does not apply, and § 552(a) terminates the lien.[177] If a bondholder has a statutory lien, of course, § 928(a) is irrelevant because § 552(a) will not terminate his lien in the first place.[178]

Two key phrases in § 928(a) dictate whether it applies: (1) whether a "security agreement" created the lien—in other words, whether the lien is contractual;[179] and (2) whether that

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175. 11 U.S.C. § 928(a) (2012) (emphasis added).

176. *See* H.R. REP. NO. 101-1011, at 7–8 ("[Section 928(a)] states that a lien on special revenues acquired by the debtor after the commencement of the case cannot be avoided under Bankruptcy Code section 552(a); the lien is still valid post-petition."); S. REP. NO. 100-506, at 12 ("New Section 92[8] . . . protects the lien on revenues.").

177. *See* SPIOTTO ET AL., *supra* note 91, at 61 (concluding that bondholders have a secured claim for any amounts due prepetition, but that they have an unsecured claim for any remaining amount).

178. *See supra* notes 150–152 and accompanying text (explaining why § 552(a) does not terminate statutory liens). *Collier on Bankruptcy*, a leading bankruptcy treatise, includes a curious sentence in its description of § 928(a): "[A] statutory lien or judicial lien on after acquired assets will be terminated as to property acquired after the petition date," noting that § 928(a) does not save such liens. 6 COLLIER, *supra* note 119, ¶ 928.02. Collier is correct that § 928(a) does not save such liens, but this is because it was never intended to do so; it was only intended to reverse the effects of § 552(a), which only terminates *contractual* liens. *See supra* notes 171–177 and accompanying text (explaining why this is the case). Collier appears to be incorrect in its assertion that statutory liens are terminated as to property acquired after the petition date. *See supra* notes 150–152 and accompanying text (citing several sources in unanimous support of the proposition that a bankruptcy petition does not terminate a statutory lien on property acquired postpetition).

179. 11 U.S.C. § 928(a) (2012); *see also id.* § 101(50) ("The term 'security agreement' means agreement that creates or provides for a security interest."); *id.* § 101((51) ("The term 'security interest' means [a] lien created by an agreement."). Such "agreements" are contractual in nature.

contractual lien is on a "special revenue" stream.[180] The first question is a matter of contractual interpretation.[181] The second is dictated by the definition of "special revenues," which appears in § 902(2) and is discussed at length in Parts III and IV.

b. Continued Bondholder Payments and the Automatic Stay Problem

In drafting the 1988 Amendments, Congress expressed frustration with the idea that revenue bondholders could have their payments delayed indefinitely by a bankrupt municipality.[182] Newly drafted § 928(a) mandated that all bondholders with contractual liens backed by "special revenues" would retain those liens (and the corresponding payments to which they were entitled by those liens) in bankruptcy.[183] Knowing that it would likely have to pay bondholders the full amount due under the terms of the indenture, a *willing* municipality could agree to continue to pay principal and interest to § 928(a)-secured bondholders throughout the pendency of the bankruptcy.[184] However, under the automatic stay in § 362, bondholders could not sue to compel a municipality that was *unwilling* to make principal and interest payments during the pendency of the bankruptcy.[185]

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180. 11 U.S.C. § 928(a).

181. *See, e.g.*, *In re* Cnty. of Orange, 179 B.R. 185, 192–95 (Bankr. C.D. Cal. 1995) (providing an excellent and thorough example of how to perform the kind of contractual interpretation on a bond indenture that determines whether both parties intended to create a lien, including citations to relevant authority and statutes).

182. *See* S. REP. NO. 100-506, at 21 (1988) (suggesting that, where a "pledge of revenues" survives under Section 928, "it would be needlessly disruptive to financial markets for the effectuation of the pledge to be frustrated by an automatic stay").

183. *See id.* at 21, 22–23 (explaining the application of § 928).

184. *See* H.R. REP. NO. 100-1011, at 3–4 (1988) (discussing the situation in San Jose's municipal bankruptcy, where the debtor allowed its bondholders to retain their liens and continued to pay them throughout the bankruptcy in order to retain access to the credit markets); S. REP. NO. 100-506, at 6 (same).

185. *See* S. REP. NO. 100-506, at 11 (explaining that § 362 is too broad in the municipal financing context and that it prevents creditors from claiming what is rightfully theirs under the terms of the indenture and state statutes mandating payment).

According to the Senate Report, this application of the automatic stay "is overly broad in Chapter 9, requiring the delay and expense arising from a request for relief from the automatic stay to accomplish what many state statutues [sic] mandate: the application of pledged revenues . . . to the payment of secured bonds."[186] Noting that "[r]easonable assurance of timely payment is essential to the orderly marketing of municipal bonds and notes and continued municipal financing," Congress enacted § 922(d) to fix the automatic stay problem.[187] This provision states that any petition filed under Chapter 9 "does not operate as a stay of *application* of *pledged special revenues* in a manner consistent with section 92[8] . . . to payment of indebtedness secured by such revenues."[188]

The ponderous wording of this provision has led to some litigation over its exact meaning.[189] However, recent case law from the Jefferson County bankruptcy suggests that because the 1988 Amendments "were designed to retain in a bankruptcy case how special revenue financing had been structured outside a

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186. *Id.* at 11.

187. *Id.* at 21.

188. 11 U.S.C. § 922(d) (2012) (emphasis added). The actual text of the statute cross-references § 927, but this is a drafting error most likely resulting from the differently numbered provisions in the Senate draft of the bill. *See generally* S. REP. NO. 100-506 (referring to § 928 as § 927); Amdursky, *supra* note 39, at 12–13 (1990) (noting the error and correcting it to a cross reference to § 928).

189. *See* 6 COLLIER, *supra* note 119, ¶ 922.05[2] (noting that the Code does not define "pledged" or "application"). Because the Code lacks definitions for "application" and "pledged," Collier opines that Congress only intended to exempt creditors from engaging in "the self-help remedy of 'application' of special revenues in the possession of the secured creditor," and that the provision does not require bankrupt municipalities to continue payments during the pendency of a bankruptcy. *Id.* In the Jefferson County litigation, the court disagreed, adopting a broader interpretation. *See In re* Jefferson Cnty., 474 B.R. 228, 267 n.15 (Bankr. N.D. Ala. 2012), *aff'd*, No. BR 11-05736-TBB, 2012 WL 3775758 (N.D. Ala. Aug. 28, 2012) (noting disagreement with Collier over a key portion of the legislative history and suggesting that a "careful reading" of that portion of the legislative history rebuts Collier's position). Jefferson County appealed the ruling to the Eleventh Circuit, but the case was settled and dismissed before the appellate court could resolve the controversy. *See generally* Brief of Appellee/Cross-Appellant Jefferson Cnty., Assured Guar. Mun. Corp. v. Jefferson Cnty. (*In re* Jefferson Cnty.), No. 12-13654-BB, 2012 WL 4901391 (11th Cir. Oct. 9, 2012), *appeal dismissed* (Dec. 26, 2013) (doing so without issuing a written opinion on the appeal and with prejudice).

bankruptcy case,"[190] Section 922(d) requires municipalities to keep making post-petition payments in the exact manner specified by the indenture.[191]

Like § 928(a), § 922(d) is only activated by the presence of "special revenues."[192] Unlike § 928(a), however, § 922(d) may apply to bonds secured by contractual liens *or* statutory liens.[193] A two-part analysis demonstrates why. First, § 922(d) creates a stay exception for any application of pledged special revenues to "indebtedness *secured by such revenues*."[194] Here, "such revenues" refers back to "pledged special revenues." Second, because "pledged" has a broad meaning in municipal finance, "pledged special revenues" could refer to *any* special revenues promised in the indenture—including special revenues promised without a corresponding contractual lien, as in the case of a GO bond.[195] If a state then secured these bonds with a statutory lien (as Rhode Island did), § 922(d) would apply because (1) the bonds are backed by "pledged" special revenues and (2) the bonds are "secured" by a statutory lien.[196] Thus, whether intentionally or by

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190. Bank of N.Y. Mellon v. Jefferson Cnty. (*In re* Jefferson Cnty.), 482 B.R. 404, 433 (Bankr. N.D. Ala. 2012).

191. *See In re Jefferson Cnty.*, 474 B.R. at 271 (holding that the "automatic stays . . . do not apply to the Indenture and warrant required payments of the Net Revenues" in the hands of the county as of the petition and all future payments specified in the indenture, even those set to occur "during the postpetition period").

192. *See* 11 U.S.C. § 928(a) (applying its lien survival provision only to "special revenues acquired by the debtor after the commencement of the case"); *In re Jefferson Cnty.*, 474 B.R. at 271 (applying the stay exception only for "pledged special revenues").

193. *See infra notes* 194–197 and accompanying text (arguing that there is no textual limitation on the application of Section 922(d) to all secured bonds).

194. 11 U.S.C. § 922(d) (2012) (emphasis added).

195. *See, e.g.*, Consolidated Response and Reply Brief of Appellants at 47–55, Assured Guar. Mun. Corp. v. Jefferson Cnty., No. 12-13654-B, 2012 WL 5817088 (11th Cir. Nov. 13, 2012) (compiling dozens of case citations and scholarly texts in support of the proposition that "pledged" has a broad meaning in municipal finance and that this was the meaning Congress intended when drafting the word into § 922(d)); *Glossary of Municipal Securities Terms: Pledged Revenues*, MUN. SEC. RULEMAKING BOARD, http://msrb.org/glossary/definition/limited-tax-general-obligation-bond.aspx (last visited Apr. 2, 2015) (defining "pledged" as "[t]he funds obligated for the payment of debt service and the making of other deposits required by the bond contract") (on file with the Washington and Lee Law Review).

196. *See supra* notes 194–195 and accompanying text (providing the two-

congressional omission, § 922(d) may apply to bonds backed by contractual liens *and* statutory liens on any special revenue stream.[197]

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part explanation referenced here).

197. *See* 11 U.S.C. § 928 (referring only to "lien[s] resulting from any *security agreement* entered into by the debtor before the commencement of the case" (emphasis added)). As demonstrated by § 928(a), Congress refers to a "security agreement" when it wants a provision to apply only to contractual liens. *See id.* Had Congress wanted to limit § 922(d) to contractual liens, they would have substituted the phrase "evidenced by the security agreement" for "secured by such revenues." *Cf.* Ransom v. FIA Card Servs., N.A., 131 S. Ct. 716, 724 (2011) (arguing that Congress chooses the words it places in the Bankruptcy Code carefully and uses them to achieve certain results); Leocal v. Ashcroft, 543 U.S. 1, 12 (2004) ("[W]e must give effect to every word of a statute wherever possible."). This broad reading is supported by the Senate Report, which evidences a strong intent to continue payment of pledged revenues where state law otherwise requires it. S. REP. NO. 100-506, at 11, 21 (1988).

The counterargument runs as follows: § 922(d) expressly states that the application of any revenue must be "*consistent with* Section 92[8]," a section that deals explicitly with contractual liens and *not* statutory liens. However, this cross reference only means that in the case of a lien *created by security agreement* where § 928 would otherwise apply, payment of pledged revenues can still be subordinated under § 928(b). *See* 11 U.S.C. § 928(b) (mandating that any lien on special revenues "derived from a project or system shall be subject to the necessary operating expenses of such project or system"). The most likely reason for the inclusion of this cross reference was Congress's concern that, in a certain subset of revenue bond transactions, creditors might abuse the protections afforded by the 1988 Amendments. *See* S. REP. NO. 100-506, at 11 (1988) (discussing the misapplication of gross revenue pledges). Some revenue bond indentures create a "gross revenue" pledge rather than a "net revenue" pledge, meaning that bondholders get paid before operating expenses get paid. *See* Bank of N.Y. Mellon v. Jefferson Cnty. (*In re* Jefferson Cnty.), 482 B.R. 404, 433–35 (Bankr. N.D. Ala. 2012) (describing these as the primary effects of a gross revenue pledge versus a net revenue pledge). Congress worried that, where a sewer system could not generate enough revenue to cover both operating costs and debt service, gross revenue-backed bondholders would apply all funds towards debt service, leaving none for the "necessary operating expenses" of the system. *See id.* (suggesting that these were Congress's primary concerns with allowing continued repayment). The legislative history suggests that, by including the cross reference, the bankruptcy court would be able to "enjoin application of proceeds . . . where a secured creditor was about to apply proceeds of a gross revenue pledge in a matter inconsistent with policies" of the newly proposed sections of the Code, including § 928(b). S. REP. NO. 100-506, at 11.

c. Limiting Bondholder Recourse to Other Municipal Assets

In most revenue-bond transactions and short-term debt sales, and even in certain LTGO deals, the indenture does not provide the bondholder with recourse against other municipal assets outside the revenue stream pledged for debt service payments.[198] However, certain provisions in the Bankruptcy Code, like §§ 552(a) and 1111(b), permit partially secured bondholders to turn non-recourse claims like these into recourse claims against *all municipal assets*, including other revenue streams not pledged to bondholders in the indenture.[199] These provisions effectively convert limited obligation (or "non-recourse") bonds into general obligation (or "recourse") bonds.[200] This contravenes municipal intent to segregate revenues within the enterprises that generated them.[201] In addition, it might violate state law (making plan confirmation impossible) where state statutes forbid limited recourse bondholders from satisfying their claims out of general municipal funds.[202]

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198. *See* H.R. REP. No. 100-1011, at 4 ("In the event of a default, [special revenue] bondholders cannot look to any other assets of the municipality for repayment. Only the income stream generated by the asset or the income specifically pledged as security by the municipality can be used."); *supra* Table 1 (reciting the funding sources for these bonds and describing their limited recourse nature).

199. *See* S. REP. NO. 100-506, at 8–9 (1988) (noting that a "partially secured bondholder (i.e., one whose lien on revenues is insufficient to pay his bonds), if he does not have recourse against the debtor for the remainder of his claim under nonbankruptcy law, will be treated as if he did have recourse" and explaining why).

200. *See* H.R. REP. NO. 100-1011, at 4 (1988) ("Special revenue bonds of a bankrupt municipality would essentially be turned into general obligation bonds—but without the authorization by popular vote usually required before a municipality can issue a general obligation bond."); S. REP. NO. 100-506, at 8 ("[I]f a pledge of future revenues is defeated . . . by [§] 552, . . . the revenue bonds may be transformed into, in effect, a recourse claim changing the revenue bonds into a general obligation of the debtor.").

201. *See* S. REP. NO. 100-506, at 8–9 (discussing how municipalities segregate revenue within the enterprise that generated it, like keeping water system receipts unavailable for general municipal uses, and that taking revenue from these enterprises contravenes the intent behind segregating the revenues in the first place).

202. *See* 11 U.S.C. § 943(b)(4) (2012) ("The court shall confirm the plan [of adjustment] if . . . the debtor is not prohibited by law from taking any action necessary to carry out the plan . . . ."); H.R. REP. NO. 100-1011, at 4 ("The effect of section 552, which could result in general treasury funds being used to repay

To ensure that special revenue-backed bondholders had no recourse against the general assets of the municipality, the drafters added § 927 to "ensure that non-recourse revenue bonds cannot be converted . . . into recourse, or general obligation[,] debt."[203] Section 927 provides that the "holder of a *claim* payable *solely* from special revenues of the debtor under applicable nonbankruptcy law shall not be treated as having recourse against the debtor."[204] Like § 928(a) and § 922(d), Congress keyed the applicability of § 927 on the presence of "special revenues."[205] However, Congress made § 927 broader than either of these two sections.[206] Section 928(a) only applies in cases where bondholders have a contractual lien on special revenues.[207] Section 922(d) only applies to municipal debt "secured by" special revenues—in other words, it only applies when bondholders have some form of secured claim (contractual or otherwise) on a municipality's special revenues.[208] Section 927 applies to any claim—secured or unsecured—payable solely from special revenues.[209]

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revenue bondholders, would be to defeat this purpose. In some states, it might even run afoul of state constitutions and statutes if general treasury funds are used to repay specific revenue bond obligations."); S. REP. NO. 100-506, at 9 ("[T]he transformation of revenue bond (nonrecourse) financing into general obligation bond (recourse) financing permits municipalities to violate state statutory and constitutional provisions which in many cases prohibit such recourse debt (general obligation bonds) above a certain percentage of assessed value or other limits without voter approval.").

203. H.R. REP. NO. 101-1011, at 7 (1988).

204. 11 U.S.C. § 927 (emphasis added). Though no case has ever interpreted this provision, one key portion seems to be the use of the word "solely." Technically, under the language of the statute, § 927 would not apply to *any* portion of a claim payable from both special revenues and another revenue source. These bonds, payable from two sources at once, are typically called "double-barreled" bonds and appear to be insulated from the application of § 927. *See, e.g.*, Amdursky, *supra* note 39, at 8, 15 (noting that "[d]ouble-barrelled [sic] bonds are backed not only by special revenues but also by the general credit of the municipality, including its power to levy property and other taxes" and that § 927 "should not be construed to affect the claim of holders of double-barrelled [sic] bonds").

205. *See* S. REP. NO. 100-506 ("The definition of special revenues is needed for the purposes of revised Sections 922, 925 and 92[8].").

206. *Infra* notes 207–209 and accompanying text.

207. *Supra* notes 175–180 and accompanying text.

208. *Supra* notes 192–197 and accompanying text.

209. *See* 11 U.S.C. § 927 (2012) (failing, in the text of the statute, to

4. Summarizing the Treatment of Bonds in Bankruptcy

As the preceding discussion demonstrates, the treatment of municipal bonds in bankruptcy is opaque at best. For ease of reference, Table 2 summarizes the information provided above in chart form. It demonstrates that favorable treatment for bonds in municipal bankruptcy hinges on (1) whether those bonds are backed by some form of statutory or contractual lien, and (2) whether those bonds are payable from a special revenue stream. The first question is a matter of contractual interpretation and state law,[210] and it is outside the scope of this Note. Part III explores the second question.

constrain the term "claim" in any way); *id.* § 101(5) (defining "claim" as any "right to payment," irrespective of whether such right is "secured" or "unsecured"); 2 COLLIER, *supra* note 119, at ¶ 101.05[1] ("By fashioning a single definition of "claim" in the Code, Congress intended to adopt the broadest available definition of that term.").

210. *See supra* notes 97, 181 and accompanying text (describing the kind of state law statutory exploration and contractual interpretation necessary to determine the presence of a statutory or a contractual lien).

Table 2: A Summary of the Effects of Bankruptcy on Municipal Bonds

Bond Type	Statutory Lien	Contractual Lien	No Lien
Payable from Special Revenues	**Secured Status:** Full claim secured by § 506(a) and not bifurcated by § 552(a). **Payment During Bankruptcy:** Yes—claim payable from "indebtedness secured by" special revenues under § 922(d). **Recourse:** No—claim payable from special revenues; thus, § 927 prevents recourse to other municipal assets.	**Secured Status:** Full claim secured by § 928(a) (subject to § 928(b) subordination). **Payment During Bankruptcy:** Yes—claim payable from "indebtedness secured by" special revenues under § 922(d). **Recourse:** No—claim payable from special revenues; thus, § 927 prevents recourse to other municipal assets.	**Secured Status:** None—claim is unsecured under § 506(a). **Payment During Bankruptcy:** None—no secured claim; thus, § 922(d) does not apply. **Recourse:** No—claim payable from special revenues; thus, § 927 prevents recourse to other municipal assets.
Not Payable from Special Revenues	**Secured Status:** Full claim secured by § 506(a) and not bifurcated by § 552(a). **Payment During Bankruptcy:** None—claim not payable from "indebtedness secured by" special revenues under § 922(d). **Recourse:** Yes—lacking a claim payable from special revenues, § 927 does not apply, and the bondholder's fully secured claim is payable from any municipal asset pools.	**Secured Status:** Bifurcated by § 552(a) into secured claim for amounts due prepetition and unsecured claim for amounts due postpetition. **Payment During Bankruptcy:** None—no secured claim postpetition; thus, § 922(d) does not apply. **Recourse:** Yes—lacking a claim payable from special revenues, § 927 does not apply, and both halves of the bifurcated claim are payable from any municipal asset pools.	**Secured Status:** None—claim is unsecured under § 506(a). **Payment During Bankruptcy:** None—no secured claim; thus, § 922(d) does not apply. **Recourse:** Yes—bondholder is unsecured and is entitled to pro-rata distribution of municipal assets.

III. Getting Through the Doorway: Qualifying as "Special Revenue"

Part II explained that most of the critical new protections afforded to bondholders under the 1988 Amendments are only triggered by the presence of "special revenues."[211] However, as Part III will show, the current definition of "special revenues" in § 902(2) does not adequately match the kinds of bonds Congress intended to protect with the protections afford by §§ 928(a), 922(d), and 927.[212] Ultimately, § 902(2) fails to cover the proper kinds of municipal financing devices; as a result, it must be broadened.[213]

A. The Breadth of the Doorway: The Five Categories of Special Revenue

Section 902(2) creates five categories of "special revenues."[214] Two of these categories cover non-tax receivables,[215] while three cover tax revenue streams.[216]

1. Non-Tax Receivables

The first category of special revenues covers many, if not most, of the non-tax receivables used as security for "traditional" project-financing revenue bonds.[217] Under

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211. *Supra* notes 180, 192, 205.

212. *Infra* Table 3.

213. *Infra* Part III.A.

214. *See* 11 U.S.C. § 902(2) (2012) (breaking "special revenues" down into five categories).

215. *Infra* Part III.A.1. This Note uses "non-tax receivables" as shorthand for any kind of municipal revenue not derived from taxation by the municipality itself.

216. *Infra* Part III.A.2.

217. *See* H.R. REP. NO. 100-1011, at 4 (1988) (noting that the definition of "special revenues" is intended to protect "revenue bonds," which "are usually backed by and repaid only from the revenues generated from the physical asset built with the money raised by the bond offering"); S. REP. NO. 100-506 (1988) (noting that the definition of special revenues is intended to capture revenue bonds, which "are issued to finance projects or programs, and the revenues from such a project or program are pledged to repay the bond").

§ 902(2)(A),[218] all "receipts derived from the ownership, operation, or disposition of projects or systems" that are "primarily used" to "provide transportation, utility, or other services" are "special revenues."[219] When broken down into its constituent parts, § 902(2)(A) sets two criteria on which non-tax receivables qualify as "special revenues": (1) municipal "ownership, operation, or disposition" of the "project or system" generating the revenues, and (2) that the system be used to provide a public service.[220] Some typical projects or systems that meet these two criteria include "water, sewage, waste, or electric systems"[221] and "toll highway or bridge or other projects or systems which impose user fees."[222]

Congress only included one other, narrow type of non-tax receivables in § 902(2).[223] Section 902(2)(D)[224] defines "other revenues or receipts derived from particular functions of the debtor, whether or not the debtor has other functions" as special revenues.[225] Though § 902(2)(D) sounds broad, the House and Senate Reports suggest that the phrase "particular functions" includes minor revenue-raising capabilities—like "regulatory fees and stamp taxes imposed for the recording of deeds"—that should qualify as special revenues.[226]

However, these two criteria effectively exclude a number of very common receivables used as security for revenue bonds. For instance, state aid used to secure a bond issuance would not qualify as "special revenues" because such transfer payments would be non-tax receivables not related to "municipal ownership, operation, or disposition" of a project.[227] Indeed, the wording of

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218. 11 U.S.C. § 902(2)(A).

219. *Id.*

220. *See id.* (setting these as the two criteria for qualification under § 902(2)(A)).

221. H.R. REP. NO. 100-1011, at 6.

222. *House Hearing*, *supra* note 62, at 42 (Report of the National Bankruptcy Conference on Proposed Municipal Bankruptcy Amendments).

223. *See infra* notes 224–226 and accompanying text (describing the remainder of the special revenues definition that includes non-tax receivables).

224. 11 U.S.C. § 902(2)(D) (2012).

225. *Id.*

226. H.R. REP. NO. 100-1011, at 6; S. REP. NO. 100-506, at 21.

227. *See, e.g.*, CITY OF SAN DIEGO TOBACCO SETTLEMENT REVENUE FUNDING CORP., TOBACCO SETTLEMENT ASSET-BACKED BONDS S-7, 20–21, 25 (2006),

both these provisions would suggest that *any* payments made through a conduit financing transaction may not qualify as "special revenues."

In a conduit financing transaction,[228] one of two parties could file for bankruptcy: the conduit *issuer* or the conduit *borrower*. If the conduit *issuer* files for Chapter 9 protection, the third party lease or the debt service payments used to secure the bond issue would derive from municipal "ownership" of a project, satisfying the first criterion of § 902(2)(A).[229] However, there is no guarantee that the conduit-financed facility provides a public service (like transportation or utilities);[230] where the facility is an office building or an industrial plant, the second criterion of § 902(2)(A) would not apply, meaning that the bonds would not be backed by "special revenues."[231] As a result, if the third party refused to make its lease or loan payments directly to the bondholders, § 928(a) would not preserve a lien granted to the revenue bondholders, and § 927 would not preserve the issuing entity's contractual protection against bondholder recourse to other issuer assets.[232]

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http://emma.msrb.org/MS248286-MS223594-MD435378.pdf (explaining that, in this complex transaction involving a purchase of tobacco settlement assets from the City of San Diego, the bankruptcy of either the city or the issuing entity could render bondholders unsecured, reducing or eliminating payments altogether); COFFEEVILLE SCH. DIST., STATE AID CAPITAL IMPROVEMENT BONDS 2 (1998), http://emma.msrb.org/MS140107-MS115415-MD223724.pdf (granting bondholders an irrevocable pledge of state aid revenue which were not derived from the "municipal ownership, operation, or disposition" of the schools themselves, but were instead derived from the state).

228. For a brief reminder of how these transactions work, see *supra* notes 74–79 and accompanying text.

229. In the direct loan context, the municipality would arguably derive the loan payments from its "disposition" of the property, which would qualify it under the first criterion in § 902(2)(A). This assumes that the financing documents reflect the fact that the issuing entity holds title in fee simple to the improvements. If, however, the documents reflect that the municipality does not hold title to the financed improvements, then this question could be hotly contested.

230. *See, e.g.*, ELMORE CNTY. PUB. BLDG. AUTH., *supra* note 77, at 4–5 (describing the project, in which the building authority will construct an office building and lease it to the county, which may sublease it to the state).

231. *See supra* notes 219–222 and accompanying text (describing how the two criteria in § 902(2)(A) work together to exclude these kinds of bonds).

232. *See* ELMORE CNTY. PUB. BLDG. AUTH., *supra* note 77, at 25 (noting that the "filing of a bankruptcy petition by the . . . Building Authority could have the

In the second scenario, a conduit *borrower*—which, under a typical transaction, would have entered into a lease arrangement with the conduit issuer to acquire the property purchased or

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result of terminating or releasing the claim or charge of the holders of the Warrants on such payments, in which even such holders would in effect . . . be general unsecured creditors"); *supra* note 211 (noting that these provisions are cued to the presence of "special revenues"). The terms of such bonds typically allow no recourse to the issuing entity's assets if the public or private entity using the facility defaults on the underlying loan or lease agreement. *See* GELFAND, *supra* note 47, § 3.26 (maintaining that, without specific authorization as a "double-barreled revenue bond," such debts are not payable from any general funds of the issuer). Thus, the direct application of §§ 902(2), 928(a) and 552(a) in this case would defeat both the intention of Congress (in creating § 927) and the intent of the parties (in not providing recourse to the issuer's finances).

To avoid this problem, some academics have theorized that bondholders would not have cognizable "claims" against the municipal issuer because these pass-through payments are neither assets nor debts of the municipal issuer. *See House Hearing*, *supra* note 62, at 31, 89 (explaining that revenue bondholders supported by payments generated by industrial third parties do not have claims against the issuing municipality because such "transactions do not create either assets or debts of the municipal issuer for bankruptcy purposes" (citing S. REP. NO. 95-989 (1978))); 9C AM. JUR. 2D *Bankruptcy* § 2540 ("[T]he term 'claim' does not include a right to payment under an industrial development bond issued by a municipality . . . for a third party. Amounts owed by private companies to the holders of industrial development revenue bonds are not to be included among the assets of the municipality . . . .").

This explanation has two problems. First, the authorities support this narrow view of "claim" by referencing a Senate Report, which, in turn, cites a definition of "claim" in § 902(2) that *explicitly excluded* claims arising out of conduit bonds issued on behalf private industrial actors. *See* S. REP. NO. 95-989, at 109–10 (1978) (noting that "all claims" against the municipality should be included except for those predicated on "tax exempt industrial development bonds"). This definitional provision no longer exists in § 902(2); instead, the definition of "claim" is coextensive with the broad definition in § 101. *See* 11 U.S.C. § 902(2) (failing to mention the word "claim" anywhere in the statute); *id.* § 901(b) (incorporating the definitions in § 101 by implication). Under the more general version of "claim" in the current Code, a claim is literally *any right to payment*. *See id.* § 101(5) (defining claim as any "right to payment," even where such right is unmatured, disputed, unliquidated, or unsecured). Conduit bondholders technically have such rights under the terms of the indenture. The second problem is the narrow breadth of the exception the sources cited above discuss. While both sources mention industrial development bonds, neither provides any guidance as to what would happen if a 501(c)(3) or another municipality was the conduit borrower. *See House Hearing*, *supra* note 62, at 31, 89 (predicating its conclusions on examples using industrial revenue bonds); 9C AM. JUR. 2D *Bankruptcy* § 2540 (referring exclusively to industrial revenue bonds in its explanation of the rule).

improved with the bond proceeds—could file for bankruptcy.[233] If the conduit borrower is a municipal entity, it would almost certainly stop making lease payments to the conduit issuer after filing a Chapter 9 petition.[234] Because those lease payments constitute the revenue stream used to secure the bonds issued by the conduit issuer, bondholders would have a claim against the conduit borrower–debtor for the remaining amount due to the conduit issuer under the lease agreement.[235]

Whether this claim would be secured or unsecured, however, depends upon what funds the municipality used to make its rent payments.[236] If the municipality allocated a specific revenue stream—such as revenue from a sublease[237]—for all future lease payments, that revenue stream might qualify as "special revenues" under § 902(2).[238] However, if the municipality merely

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233. *See supra* notes 74–79 and accompanying text (describing typical conduit financing transactions).

234. *See* Amdursky, *supra* note 39, at 16–17 (noting this as the primary concern behind the enactment of 11 U.S.C. § 929 (2012)).

235. *See* 11 U.S.C. § 929 (2012) ("A lease to a municipality shall not be treated as an executory contract or unexpired lease for the purposes of section 365 or 502(b)(6) of this title solely by reason of its being subject to termination in the event the debtor fails to appropriate rent."). Under § 929, a bankruptcy court would likely conclude that the conduit transaction created a "financing lease" as opposed to a "true lease," meaning that the municipality could not reject the lease after filing for bankruptcy. *See* 6 COLLIER, *supra* note 119, at ¶ 929.01 ("Section 929 makes clear that the presence in a lease of language that permits the debtor to terminate the lease if the debtor fails to appropriate rent does not change the fundamental characteristic of the lease as a financing lease, notwithstanding section 365(m)."); Amdursky, *supra* note 39, at 16–17 (explaining that this was how § 929 was designed to work). The conduit borrower–debtor would then have to treat the remaining amount due under the lease agreement as a debt obligation, giving rise to a claim in bankruptcy. *See* H.R. REP. NO. 100-1011, at 8 (1988) (explaining this application); S. REP. NO. 100-506, at 10–11 (1988) (explaining §§ 365(d) and 502(b)(6) and how those provisions would otherwise negatively impact bondholder claims in the absence of § 929).

236. *See infra* notes 237–240 and accompanying text (explaining why this is the case).

237. *See, e.g.*, ELMORE CNTY. PUB. BLDG. AUTH., *supra* note 77, at 4 (explaining that the county, which was the lessee under the terms of the conduit transaction, would make its lease payments out of revenues it received from subleasing the property to the state).

238. *See, e.g.*, 11 U.S.C. § 902(2)(D) (providing that "special revenues" includes "receipts derived from particular functions of the debtor," which could include the ability to sublease property). Lacking any dispositive case law on

pledged the lease payments from any available resources in its general fund, the lease payment stream would not be composed of "special revenues,"[239] meaning that bondholders would lose any contractual lien they were granted under the terms of the indenture.[240]

2. Tax Revenue Streams

In defining "special revenues," Congress avoided the inclusion of broad-based taxes that already exist as part of the "general tax levy," like property or sales taxes.[241] Instead, Congress included three very specific kinds of taxes in the definition of special revenues.[242]

First, § 902(2)(B)[243] includes "special excise taxes imposed on particular activities or transactions" in the definition of special revenues.[244] Congress intended for § 902(2)(B) to capture items like "excise tax[es] on hotel and motel rooms or the sale of alcoholic beverages," provided that those items were "specifically identified and pledged in the bond financing documents and . . . not 'generally' available to all creditors under state

§ 902(2)(D), this interpretation is hypothetical at best. However, if the debtor pledged its lease payments from a particular stream of tax revenue, that could also qualify under § 902(2)(B), (C), or (E). *See infra* Part III.A.2 (discussing which kinds of taxes could qualify as "special revenue").

239. *See infra* notes 293–300 and accompanying text (explaining why funds that are available for "general municipal purposes" cannot qualify as special revenues under § 902(2)).

240. *See supra* Part II.B.3(a) (explaining why a lien on a bond not backed by special revenues is not preserved by § 928(a)).

241. *See* H.R. REP. NO. 100-1011, at 6 (1988) (distinguishing special property taxes collected through a tax increment financing transaction, which would qualify as special revenues, from general property taxes, which, as part of the "pre-existing tax base of the community," were not special revenues); S. REP. NO. 100-506, at 13, 21 (1988) (noting that "local sales, income or property taxes" are only special revenues in "some instances" and inferring that a more general tax, like a blanket sales tax, would not qualify as special revenues).

242. *See infra* notes 243–266 and accompanying text (describing these forms of tax collections as special revenues).

243. 11 U.S.C. § 902(2)(B) (2012).

244. *Id.*

law."[245] The Senate Report explicitly excluded a "general state sales tax" from this category.[246]

Second, Congress designed § 902(2)(C)[247] to cover a special type of revenue bond transaction.[248] Called "tax increment financing," this deal structure involves borrowing to fund a project designed to benefit a given area—for example, issuing bonds to fund landscaping, parking, and lighting in a downtown entertainment district.[249] If the project goes well, property values in the area will increase, which will lead to a corresponding increase in property or sales tax receipts for that same area. The issuer will then pay those incremental increases in tax revenues, identified in the indenture as security for the loan, directly to the bondholders.[250] The key distinction here is that tax-increment financed projects are "not part of the pre-existing tax base of the community"; the project itself creates a new revenue stream—the additional property tax revenue—which is used to provide security to bondholders.[251] Section 902(2)(C) protects this revenue stream by including "incremental tax receipts" from an area bettered by tax-increment financing within the definition of special revenues.[252]

Up to this point, none of the other definitions in § 902(2) have included general taxes—like property, sales, and income taxes—as special revenues.[253] Thus, GO bondholders and others with

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245. S. REP. NO. 100-506, at 21.

246. *Id.*

247. 11 U.S.C. § 902(2)(C).

248. *See* H.R. REP. NO. 100-1011, at 6 (1988) (noting that § 902(2)(C) is intended to include revenues derived from "tax-increment financing" alone); S. REP. NO. 100-506, at 21 (same).

249. *See* 6 COLLIER, *supra* note 119, ¶ 902.03 (describing tax increment financing and noting that it is the sole concern of § 902(2)(C)).

250. *Id.*

251. H.R. REP. NO. 100-1011, at 6; S. REP. NO. 100-506, at 21 (1988). Because any incremental revenue increases are paid directly to creditors, they are never available for general municipal use and, as a result, they are not generally available to other creditors. *See* S. REP. NO. 100-506, at 21 (describing tax increment financing and noting this proposition).

252. 11 U.S.C. § 902(2)(C) (2012).

253. *See* 133 Cong. Rec. 31,824 (1988) ("Property, sales, and income taxes would generally not be considered special revenues."); *supra* notes 243–252 and accompanying text (noting that neither of the two provisions permitting taxes to qualify as special revenues allow general taxes to qualify, and the general taxes

liens on general tax collections who want to qualify for special revenue treatment have no other option but § 902(2)(E).[254] This Code section covers "taxes *specifically levied* to finance one or more *projects or systems*, excluding receipts from general property, sales, or income taxes (other than tax-increment financing) levied to finance the general purposes of the debtor."[255] Just as each of the previous categories of "special revenue" was predicated on an existing type of bond,[256] § 902(2)(E) perfectly encapsulates two very specific kinds of property taxes, called "special assessments" and "special taxes," that are issued as part of neighborhood improvement projects.[257]

However, the Senate Report recognizes a broader definition: tax receipts from assessments levied specifically to provide debt service payments in a municipal finance transaction.[258] For instance, voters in a California municipality might approve an extra one percent property tax levy to pay debt service on UTGO bonds issued to fund the construction of a new hospital.[259] In light of the Senate Report, the property tax revenue raised would

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involved in tax increment financing create an entirely different kind of revenue stream than typical general taxes like sales and property taxes).

254. 11 U.S.C. § 902(2)(E); *see infra* notes 255–266 (describing how UTGO and LTGO bondholders could qualify under this section).

255. 11 U.S.C. § 902(2)(E).

256. *See supra* notes 217–252 and accompanying text (describing each of these categories). Section 902(2)(A) covers project finance and traditional revenue bonds, § 902(2)(B) covers excise tax revenue bonds and other tax-based project financing, § 902(2)(C) covers tax increment financing, and § 902(2)(D) covers fee-backed revenue bonds.

257. See GELFAND, *supra* note 47, § 3:20 (explaining that municipalities use special tax bonds to finance a "particular type of project" and that they are typically secured by a pledge of the revenues derived from the special tax, even if that tax is a sales, property, or income tax); *id* § 3:22 (describing special assessment bonds as cousins of special tax bonds that are typically assessed against those who benefitted from the improvement rather than against the district as a whole).

258. *See* S. REP. NO. 100-506, at 21 (1988) ("Likewise, any special tax or portion of a general tax specifically levied to pay for a municipal financing shall be treated as special revenues.").

259. *See* SIERRA KINGS HEALTHCARE DIST., GENERAL OBLIGATION BONDS, ELECTION OF 2006 3, 12 (2007) (describing a similar situation in California, in which voters approved a tax increase in order to fund a general obligation bond issuance in the amount of $20,000,000).

qualify as "special revenues" under § 902(2)(E).[260] More importantly, in light of the statutory lien placed on such UTGO hospital issuances in California, these UTGO bondholders would have a lien on special revenues payable throughout the bankruptcy under § 922(d).[261] Yet, because the UTGO bond would qualify as "special revenues," § 927 would apply, limiting the "unlimited tax" backing for the bondholder's claim to a limited portion of existing property tax revenues.[262]

Critically, under the plain language of § 902(2)(E), the tax must be a *new tax* levied in conjunction with the bond issuance.[263] It cannot be a mere rededication of existing tax revenues towards debt service because such revenues would have originally been "levied to finance the general purposes of the debtor."[264] The Senate Report notes that the entire amount collected by the new tax does not need to be dedicated exclusively to debt service.[265] However, the portion of the tax that *is* dedicated to debt service cannot be made available for any other general municipal function.[266]

Detroit's bankruptcy is illustrative of how the same kinds of property taxes could lead to entirely different results under § 902(2)(E).[267] Detroit secured its UTGO bonds with a pledge of

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260. *See In re* Sierra Kings Healthcare Dist., No. 09-19728-B-9, 2010 WL 10018073, at *2 (Bankr. E.D. Cal. Sept. 13, 2010) (ordering the parties to draft documents reflecting the fact that the revenues described in *supra* note 259 were "special revenues" under § 902(2)(E)).

261. *See id.* (noting the existence of this statutory lien on the revenues derived from the tax increase); *supra* Part II.B.3(b) (discussing § 922(d) and concluding that any bond secured by a statutory lien is payable during the pendency of a bankruptcy).

262. *See supra* Part II.B.3(c) (explaining how and why § 927 would apply).

263. *See* 133 Cong. Rec. 31,824 (1987) ("[W]here a *special* property tax is levied and collected *for the specific purpose* of paying principal and interest coming due on bonds issued *in conjunction with the levy of the property tax*, the revenues may constitute special revenues." (emphasis added)).

264. *See* 11 U.S.C. § 902(2)(E) (2012) (containing this limitation).

265. *See* S. REP. NO. 100-506, at 21 (1988) ("Likewise, any special tax or *portion of a general tax* specifically levied to pay for a municipal financing shall be treated as special revenues." (emphasis added)).

266. *See* 11 U.S.C. § 902(2)(E) (noting that the taxes cannot be levied to "finance the general purposes of the debtor"); 6 COLLIER, *supra* note 119, ¶ 902.03[5] ("If, however, the taxes are identified and restricted in use to a specific project or system, they may qualify as special revenues.").

267. *See infra* notes 268–276 and accompanying text (explaining why this is

new property tax revenue derived from a special election.[268] Creditors alleged that the city council's authorizing resolutions and the voter approvals for the property tax increase limited the use of the new revenues to the construction of certain capital improvements—in other words, the new property taxes were not available for the "general purposes" of the debtor.[269] Thus, the UTGO bonds could have qualified as special revenue bonds because (1) the tax was specifically levied to finance a capital project and (2) the tax revenues were *only* available to finance payment on the bonds issued in conjunction with the project.[270]

Detroit secured LTGO bonds with a pledge of *existing* municipal tax revenue.[271] However, the revenues underlying the LTGOs would not qualify as special revenues because the ad valorem tax in question was not *levied* to finance the capital project, but merely *rededicated* to finance the particular project.[272] Thus, § 902(2) would not qualify the revenue stream backing the LTGOs as "special revenues,"[273] meaning that § 927

the case).

268. *See* Complaint of Ambac Assurance Corporation for Declaratory Judgment and Order, Ambac Assurance Corp. v. City of Detroit (*In re* City of Detroit), No. 13-53846, 2013 WL 6162940, at *2 (Bankr. E.D. Mich. Nov. 8, 2013) [hereinafter Ambac Complaint] (claiming that the UTGOs were "unique" among the city's obligations because they were "approv[ed] by a majority of the voters in a city-wide election establishing a pledge of ad valorem taxes, as security, to repay these obligations exclusively").

269. *See id.* at *2–5 (explaining that the property tax revenues raised by the new tax were intended exclusively to repay bondholders and that "the City has no equitable or beneficial interest in . . . the proceeds of the ad valorem taxes levied and pledged specifically to secure repayment of the Unlimited Tax Bonds").

270. *See* Chung, *supra* note 14, at 840 (discussing how UTGO bondholders could have a plausible argument because "[t]here is some authority for the proposition that . . . voter-authorized general-obligation debt for capital projects backed by a specific tax levy that do not feed the general fund would be considered special-revenue debt").

271. *See* Ambac Complaint, *supra* note 268, at *3 ("The City pledged as security for the repayment of the Limited Tax Bonds the first *ad valorem* taxes collected within the constitutional tax rate limit.").

272. *See id.* at *5 (admitting that the ad valorem taxes backing the LTGOs were merely "pledged," while the ad valorem taxes backing the UTGOs were "*levied* and pledged" (emphasis added)).

273. *See supra* notes 263–266 (explaining why taxes must be "specifically levied," not merely rededicated, in order to qualify as special revenues).

would not apply.[274] Rephrased, Detroit's UTGO bondholders, who have recourse to all municipal assets outside of bankruptcy, would have their claims in bankruptcy constrained to the extra property tax revenues generated by the new ad valorem tax levy.[275] Detroit's LTGO bondholders, who only have recourse to a limited amount of property tax revenue outside of bankruptcy, would have claims in bankruptcy against *any available municipal assets*.[276]

3. Summarizing the Types of Municipal Financing that § 902(2) Captures

As in previous sections of this Note, the extent of coverage provided by § 902(2) lends itself to tabular summarization. This Section presents such a chart below. In the left-hand column, it lists the major categories of bonds discussed in this Part and in Part II.A. In the right hand column, it summarizes the preceding discussion on whether the underlying revenue stream in a given type of bond deal qualifies as "special revenues" under § 902(2).

274. *See* 11 U.S.C. § 927 (2012) (requiring the presence of a claim against "special revenues" in order to apply).

275. *See supra* Part II.B.3(c) (explaining how § 927 applies to claims against "special revenues" and how it works to protect other municipal assets outside the pledged revenue stream).

276. *See id.* (explaining why non-special revenue bondholders can make claims against any available municipal assets).

Table 3: Post-Bankruptcy Consequences for Municipal Debt

Bond Type	**Qualification as "Special Revenue"**
UTGO	Possible; depends on whether the tax backing issuance was "specifically levied" to finance a project under § 902(2)(E).
LTGO	Doubtful; most cases would involve rededication of existing tax revenue and would not qualify under § 902(2)(E).
Collateralized General Fund	Possible; if holders have security interest in lease *payments* (as opposed to the leased asset itself), and the municipality promises those payments from a defined source that independently qualifies for § 902(2), then the lease revenue stream is special revenue.
Uncollateralized General Fund	Highly doubtful; most of these pledges are made from general municipal funds derived from general taxation, which could not qualify under any provision of § 902(2).
Project-Based Revenue	Probable; most public system-derived revenues qualify under § 902(2)(A), and tax-derived revenues associated with projects could qualify under § 902(2)(B), (C) or (E), depending on the tax.
Conduit-Based Revenue (Issuer Bankruptcy)	Possible; if the project financed with the conduit borrowing is "primarily used" to provide "transportation, utility, or other services," the payments from the conduit borrower will qualify; § 902(2)(A).
Conduit-Based Revenue (Borrower Bankruptcy)	Possible; if municipality promises to make lease or loan payments to the conduit issuer from a defined source that independently qualifies for § 902(2), then the revenue stream used to secure the conduit issuance is special revenues.
Aid/Transfer Revenue	Highly doubtful; transfers of non-tax receivables (like state aid) cannot qualify under § 902(2)(A) or (D). Unless the transfers are of taxes that would otherwise qualify as special revenues under § 902(2)(B) or (E), they will not qualify as special revenues.
Bond Anticipation Notes	Possible; the proceeds of a bond distribution for a project that would generate special revenues under § 902(2)(A) would qualify as special revenues.[277] The proceeds of other bond distributions would not.[278]
Revenue Anticipation Notes	Possible; RANs are typically secured by the future receipt of "rents, fees, charges, and other revenues other than real estate taxes."[279] These might qualify under § 902(2)(D) as "particular functions" of the debtor or under § 902(2)(B) or (C), depending upon the type of special tax revenue anticipated.
Tax Anticipation Notes	Doubtful; TANs are typically secured by the future collection of property taxes or some other general local tax that would not qualify as special revenues under § 902(2)(B), (C), or (E).[280]

277. *See* 11 U.S.C. § 902(2)(A) (2012) ("'[S]pecial revenues' means . . . the proceeds of borrowings to finance the projects or systems [contemplated by § 902(2)(A)] . . . .").

278. Aside from the reference to "proceeds of borrowings" in (A), no portion of § 902(2) references the proceeds of bond issuances, implying that the proceeds of a borrowing predicated on special excise taxes or incremental tax receipts would not qualify as special revenue, even if the bonds being sold *are* supported by special revenue.

279. JOEL A. MINTZ ET AL., FUNDAMENTALS OF MUNICIPAL FINANCE 9 (2010).

280. *See id.* ("TANs are used in anticipation of the receipt of *ad valorem* property taxes or other local taxes.").

B. Opening the Doorway to § 902(2)(E): In re Heffernan

The elasticity of § 902(2)(E) makes it an ideal target for GO bondholders and for others looking to qualify for special revenue treatment.[281] However, some claimants have relied on the legislative intent to stretch § 902(2)(E) beyond its statutory language.[282] In one such case, the court chose policy over statute, reaching the right result for the wrong reasons.[283] The case—*In re Heffernan*—ultimately stands as an exemplar for why Congress must rethink the definition of special revenues.[284]

1. The Opinion

In *In re Heffernan*, a hospital district in Calexico, California (the District) filed for bankruptcy under Chapter 9 after suffering a "multitude of operational and financial problems."[285] As part of its plan of adjustment, the District partnered with the City of Calexico (Calexico) to create a special authority (the Authority) to gain access to capital markets.[286] The Authority, an independent entity free from the District's bankruptcy, issued revenue bonds to the general public, took the proceeds, and used them to "purchase" the remaining outstanding creditor claims against the

281. *See, e.g.*, *In re* Sierra Kings Health Care Dist., No. 09-19728-B-9, 2010 WL 10018073 (Bankr. E.D. Cal. Sept. 13, 2010) (containing a description of a GO bond issuance that was payable from special revenues under Section 902(2)(E)); 6 COLLIER, *supra* note 119, ¶ 902.03[6][d] (maintaining that "the boundaries of special revenue financing are being tested" by those claiming to qualify under § 902(2)(E)).

282. *See infra* subpart III.B (discussing *In re Heffernan*, a case in which the presiding judge stretched the boundaries of special revenues farther than the statutory language permits).

283. *See infra* Part IV (discussing why the result in *In re Heffernan* is actually optimal).

284. *See id.* (exploring the policy objectives behind the 1988 Amendments and why an alternative definitional framework would effectuate these objectives).

285. *See In re* Heffernan Mem'l Hosp. Dist., 202 B.R. 147, 148 (Bankr. S.D. Cal. 1996).

286. *See id.* ("Pursuant to the Plan, the District and the City formed the Authority for the purpose of implementing the transactions contemplated under the Plan . . . .").

District.[287] To secure the bonds, the District assigned the Authority its rights to a sales tax revenue stream.[288] The District did not directly impose the tax itself; rather, Calexico imposed and collected the tax, then transferred all revenues collected to the District to cover its general expenses.[289] The underlying tax that generated the revenue stream was, in effect, a general sales tax levied against all sales of tangible personal property within Calexico city limits.[290] Calexico residents had to approve the additional sales tax with a two-thirds majority vote before it could be levied.[291] All proceeds were "exclusively" dedicated to the District by law.[292]

The court held that these sales tax revenues, though not *levied specifically* to finance a new *capital project*, were nevertheless special revenues under § 902(2)(E).[293] Rather than focusing on whether the taxes were "specifically levied" to "finance a project," the court offered a different test to determine whether the tax revenues were "special revenues."[294] This test,

287. *See id.* ("The Authority will generate sufficient proceeds from the Bonds (approximately $9 million) to pay creditors in accordance with the Plan. As a result, the District will be indebted to the Authority on account of its "buying" all claims against the District.").

288. *See id.* ("Accordingly, the District pledged and assigned the Sales Tax Revenue stream to the Authority to secure and provide payment to the bondholders." (footnote omitted)).

289. *See id.* at 148 n.1 (describing the electoral process by which Calexico voters approved a 0.5% sales tax increase and dedicated the revenue stream for the District's use).

290. *See id.* (noting that the law was a general transactions and use tax); *Analysis of the Transactions And Use Tax Law*, CA. STATE BD. OF EQUALIZATION, http://www.boe.ca.gov/lawguides/business/current/btlg/vol1/tutl/transactions-and-use-tax-law-analysis.html (last visited Apr. 2, 2015) (describing a transactions and use tax as a tax on "tangible personal property sold at retail in the district, or purchased outside the district for use in the district") (on file with the Washington and Lee Law Review).

291. *In re Heffernan*, 202 B.R. at 148 n.1.

292. *Id.*

293. *See id.* at 149 (concluding that the assigned revenue was "special revenue" because the incremental sales tax in question was "available only for the purpose of providing security and payment to the bondholders," and because those bondholders had no "recourse to the general revenues" of the district or the city).

294. *See id.* (quoting Collier for a test that ignores the portion of the statute requiring that the taxes not be levied to "finance the general purposes of the debtor").

borrowed from *Collier on Bankruptcy* (a leading treatise),[295] is predicated on whether the taxes were "restricted in use to a specific project or system."[296]

To explain what "restricted in use to a specific project or system" means, the court relied on three factors.[297] First, the agreement made the sales tax stream available to provide "security and payment to the bondholders."[298] Second, the stream was not available for "general municipal purposes"—in other words, the District could no longer use the sales tax revenue stream to cover its general expenses.[299] Third, the bonds funded by the stream were nonrecourse in nature, meaning that bondholders could not rely on anything beyond the sales tax revenue stream for repayment.[300]

2. The Collier Explanation

Collier acknowledges that the reasoning in *Heffernan* is questionable.[301] Merely being "[un]available for general municipal purposes" is not sufficient to qualify a tax revenue stream as special revenues.[302] Instead, the stream must fit within one of the five categories enumerated by the statute.[303] According to Collier, this error was harmless because the sales tax revenue stream still qualifies as "incremental sales taxes intended to benefit the

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295. *See, e.g.*, Lamie v. U.S. Tr., 540 U.S. 526, 540 (2004) (referencing Collier as a "leading treatise on bankruptcy law").

296. *In re Heffernan*, 202 B.R. at 149.

297. *See infra* notes 298–300 and accompanying text (listing these three reasons and explaining the relevance of each).

298. *In re Heffernan*, 202 B.R. at 149.

299. *Id.*

300. *See id.* ("[T]he Bonds do not constitute a debt or liability of the City or the District, but are payable solely from and secured by an absolute and irrevocable assignment and pledge of the Sales Tax Revenues to the Authority.").

301. *See* 6 COLLIER, *supra* note 119, ¶ 902.03[6][d] n.23 (noting that "it is not enough for taxes to not be available for general municipal purposes" to qualify for Section 902(2)(E) and that "the taxes at issue in [the case] were not related to any specific project or system").

302. *Id.*

303. *See id.* ("The taxes must fall within one of the categories specified in section 902(2).").

district," which would constitute special revenues under § 902(2)(C).[304] However, this characterization misconstrues the definition of tax-increment financing.[305]

Tax-increment financing is a very specific, statutorily authorized financing device wholly separate from the mere assignment of an incrementally increased sales tax.[306] Tax-increment financing only works if new taxpayers, enticed by the improvement financed with the bonds (like a new entertainment district), spend money within the tax increment district.[307] In this case, the hospital had been in operation since before 1975;[308] the legislative intent behind the original act authorizing the tax increase appears to have been to provide the hospital district with additional operating capital to offset losses incurred in providing indigent care.[309] Indeed, the incidence of the tax fell *exclusively* on the "pre-existing tax base of the community,"[310] which is why its implementing legislation required mandatory voter approval.[311] Thus, the tax revenue in this case cannot be deemed "incremental tax receipts from the

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304. *See id.* ("The Sales Tax Revenue at issue in *In re Heffernan Memorial Hospital District* qualified as special revenues pursuant to section 902(2)(C) as they were incremental sales taxes intended to benefit the District.").

305. *See infra* notes 306–312 and accompanying text (describing why Collier is incorrect in its assessment).

306. *Compare* CAL. GOV'T CODE §§ 53595.5–15 (West 2013) (containing laws on tax increment revenue pledges and definitions), *with* CAL. REV. & TAX. CODE § 7286.20 (West 2013) (authorizing Calexico's transactions and use tax in an entirely different chapter of the California code).

307. *See supra* notes 249–252 and accompanying text (describing tax increment financing as understood in the legislative history).

308. *See In re* Heffernan Mem'l Hosp. Dist., 202 B.R. 147, 148 (Bankr. S.D. Cal. 1996) (noting that the hospital itself had been in operation since the District acquired its operating license in 1975).

309. *See* Tony Perry, *Calexico Stands By Hospital Despite Health Violations*, L.A. TIMES (Mar. 8, 1993), http://articles.latimes.com/1993-03-08/news/mn-1584_1_calexico-hospital (last visited Apr. 2, 2015) (describing the deplorable conditions at the hospital, noting its lack of funding because of its overprovision of indigent care, and suggesting that voters approved the "local sales tax to keep the hospital afloat") (on file with the Washington and Lee Law Review).

310. S. REP. NO. 100-506, at 21 (1988) (noting that the tax must fall on those outside the preexisting tax base to constitute tax increment financing).

311. *See* CAL. REV. & TAX. CODE § 7286.20 (describing the type of tax at issue as a "transactions and use tax at a rate of 0.5 percent," indicating permission to levy a general tax not pegged to capture specific improvements in the local economy caused by the hospital).

benefited area" without substantially broadening the definition of special revenues in § 902(2)(C).[312] If the court was correct that these tax receipts are special revenues, they must fit the definition given in § 902(2)(E).[313]

3. Assessing Heffernan*: Do Tax Transfer Payments Fit Within § 902(2)(E)?*

Section 902(2)(E) includes three key phrases: the taxes must (1) be "specifically levied" to (2) "finance one or more projects or systems," and (3) those tax revenues *cannot* include any "general property, sales, or income taxes . . . levied to finance the general purposes of the debtor."[314] There are two readings of the facts in this case that could plausibly fit two of the three elements of the three-part definition in subsection (E).[315] Both readings ultimately omit a critical element of the definition, however, and fail as a result.[316]

The first reading would maintain that the "project" was the *Authority's bond issuance*, and that, because the revenues were pledged and assigned entirely to that purpose, they were not general sales taxes available for the "general purposes" of the hospital district.[317] At first, the legislative history, which allows general taxes (like sales taxes) "specifically levied to pay for a municipal financing" to qualify as special revenues, appears to justify this stance.[318] Wholly absent from this interpretation, though, is the fact that the tax must be "*specifically* levied" to finance the proposed project or system.[319] Because municipal

312. *See supra* notes 306–311 and accompanying text (explaining why the tax in *In re Heffernan* cannot be justified under Section 902(2)(C)).

313. *See infra* Part III.B.3 (resolving this question in the negative under a strict statutory interpretation but justifying this answer based on a public policy rationale).

314. 11 U.S.C. § 902(2)(E) (2012).

315. *See infra* notes 317–325 and accompanying text (explaining these two interpretations).

316. *See id.* (making this argument).

317. *See supra* notes 285–292 and accompanying text (describing the factual setup of *In re Heffernan* from which to draw this reading).

318. S. REP. NO. 100-506, at 23 (1988).

319. *Id.* (emphasis added).

residents levied these taxes to close the hospital's operating deficit (caused by providing indigent care services), *not* to allow the authority to issue bonds five years later, this reading does not comply with the first clause of § 902(2)(E)—that the general tax must be "specifically levied" to finance the project in question.[320]

The second reading of the facts in *Heffernan* would maintain that the taxes were "specifically levied" to finance a system of indigent care at the Heffernan Memorial Hospital.[321] This interpretation hinges upon whether the general sales tax at issue was "levied to finance the general purposes" of the hospital district.[322] Had the tax proceeds been constrained to a specific *use* statutorily or by city ordinance, they might meet this final element of the "special revenues" definition. However, neither the authorizing legislation[323] nor press accounts of the voter approval process[324] indicate that the proceeds were constrained in such a fashion. Indeed, most press accounts indicate that the revenues were, in fact, *explicitly* designed to furnish the debtor hospital district with funds for "operating expenses or general purposes," both of which were singled out in the Senate Report as an examples of non-special revenues.[325] Thus, neither re-reading of *In re Heffernan* fits the tight definition in § 902(2)(E). However, as Part IV suggests, any failure to fit within the statutory definition says more about the inadequacy of the statutory

320. *See supra* note 309 and accompanying text (revealing that municipal residents simply wanted to keep their hospital in operation).

321. *See supra* notes 285–292 and accompanying text (describing the factual setup of *In re Heffernan* from which to draw this reading).

322. 11 U.S.C. § 902(2)(E) (2012).

323. *See* 1991 Cal. Legis. Serv. Ch. 973 (West) (failing to delineate any restrictions on the use of the proceeds in any of the authorizing resolutions or legislative history).

324. *See* Perry, *supra* note 309 (suggesting that the sales tax levy would go towards the general rehabilitation of the hospital and towards offsetting the deficits created by indigent care).

325. S. REP. NO. 100-506, at 21 (1988); *see, e.g.*, Aaron Claverie, *Calexico Hospital Board to Get Detailed Numbers of New Bond Issuance*, IMPERIAL VALLEY PRESS (July 2, 2001), http://articles.ivpressonline.com/2001-07-02/bond-issuance_24201684 (last visited Apr. 2, 2015) ("Th[e] half-cent sales tax was approved by Calexico voters in 1992 to offset the hospital's losses from providing indigent care at Calexico Hospital.") (on file with the Washington and Lee Law Review).

definition than it does about the inequity of the result reached by the court.

IV. Broadening the Doorway: Redefining Special Revenues

In drafting the 1988 Amendments, Congress had a choice between protecting certain kinds of *bonds* or certain kinds of *transactions*.[326] Congress chose the latter.[327] For example, Congress could have written § 928 to protect "revenue bonds" from the application of § 552(a); instead, Congress wrote it to protect contractual liens on certain revenue streams.[328] In the same way, Congress could have written § 927 to prevent claims by "revenue bondholders" against other municipal assets; instead, Congress wrote § 927 to limit special revenue-based claims, whether secured or unsecured, to those special revenue streams.[329]

In taking this transactional approach, Congress had to draft a definition for "special revenues" in § 902(2) that was broad enough to cover all revenues "derived from a project or from a specific tax levy where such revenues are meant to serve as security to the bondholders."[330] To achieve its goal, Congress would have had to include, in the definition of special revenues, *every* current or future revenue stream derived from a project or a tax levy that could possibly be used as security for revenue bondholders. Because of the diversity and complexity of the revenue streams municipalities rely upon to "serve as security to [revenue] bondholders,"[331] crafting a definition that includes

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326. *See generally* Amdursky, *supra* note 39 (describing the history behind the 1988 Amendments).

327. *See id.* at 7–8 (noting that the 1988 Amendments were designed to protect project financing, not any particular kind of revenue or general obligation bonds per se).

328. *See* 11 U.S.C. § 928(a) (2012) (cueing its application to special revenues, not any particular type of bond).

329. *See* 11 U.S.C. § 927 (phrasing its protection in this manner).

330. H.R. REP. NO. 100-1011, at 6 (1988) (describing the general intent behind the definition for "special revenues").

331. *Id.*

every possibility was difficult—if not impossible—from the start.[332]

Despite this, Congress was ultimately correct in its decision to protect transactions as opposed to types of bonds.[333] Had Congress chosen to cue the 1988 Amendments to the presence of "revenue bonds," there would still be the definitional issue of what, precisely, qualifies as a "revenue bond," the names and characteristics of which vary widely from state to state.[334] Given the relative paucity of Chapter 9 case law,[335] different courts could reach different conclusions on a subject critical to the success of the 1988 Amendments, leaving the municipal bond market more unsettled than it had been before.[336]

The problem with the 1988 Amendments is the narrow scope that § 902(2) imposes on the bondholder protections available under § 928(a) and § 922(d), and the municipal protections available under § 927.[337] As in *In re Heffernan*, a special-purpose district might have nothing more for operating capital than a transferred general sales and property tax stream that it also relies upon for "general municipal purposes."[338] Under § 902(2),

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332. *See, e.g.*, Amdursky, *supra* note 39, at 7–8 (noting, in a piece written shortly after the passage of the 1988 Amendments, that the drafters already missed a potential revenue stream in the definition for "special revenues").

333. *See infra* notes 334–336 and accompanying text (making this argument).

334. *See, e.g.*, AMDURSKY & GILLETTE, *supra* note 38, § 1.3.2 (describing dozens of types of revenue bonds, most of which do not bear the strict label of "revenue bond" but follow the form of a revenue bond transaction).

335. *See, e.g.*, Moringiello, *supra* note 19, at 405–06 (noting that "very few municipalities have filed for bankruptcy" and that even the fact that 700 have been filed since 1938 is misleading because most of those filings were by "special-purpose districts").

336. *Cf.* H.R. REP. NO. 100-1011, at 2–3 (1988) (reciting the history of the financial crises in Cleveland and San Jose, which were severely exacerbated by the uncertainty surrounding the treatment of municipal debt obligations in bankruptcy); S. REP. NO. 100-506, at 4 (1988) (same).

337. *Compare supra* Table 1 (establishing pre-bankruptcy expectations for the treatment of municipal obligations), *with supra* Table 3 (establishing which of those obligations are backed by special revenue), *and* Table 2 (outlining how those obligations are treated given their special revenue status, which leads to different outcomes than those described in Table 1). *But see* 6 COLLIER, *supra* note 119, at ¶ 902.03[6][c] ("The 1988 Amendments were not intended to protect far ranging security devices to secure loans that would be shaky if secured by a lien only on project- or system-derived revenues.").

338. *See supra* notes 285–292 and accompanying text (describing an

the revenue in that stream is not, and cannot ever become, "special revenues."[339] Thus, § 928(a) would not, by definition, apply to any bonds issued by the district;[340] absent state intervention (in the form of a statutory lien), the district could not issue bonds that would be secured in bankruptcy.[341] In sum, the narrow scope of § 902(2) not only excludes a number of common types of revenue streams used to support revenue bonds—it prevents certain types of municipal entities from *ever* offering bankruptcy-proof contractual liens.

This Part proposes a new definition for "special revenues" that would allow municipalities to control their own destinies in the municipal bond market.[342] It begins by establishing, as a matter of public policy, the proper breadth of § 902(2).[343] Next, it suggests a legislative amendment that would accomplish this goal.[344] Finally, it discusses the potential for broadening § 902(2) without legislative amendment and evaluates the proper course moving forward.[345]

A. Redesigning § 902(2)

Because the revenue sources that could serve as security for municipal bonds are legion,[346] the new definition of special

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identical scenario to the posed hypothetical).

339. *See supra* Part III.B.3 (explaining why, in the parallel factual scenario to the posed hypothetical, the revenue stream involved could not, by definition qualify as special revenues).

340. *See* 11 U.S.C. § 928(a) (2012) (preserving liens on special revenue streams alone).

341. *See supra* Part II.B.2 (explaining the application of § 552(a), which would, absent any intervening force, cut off any lien on the district's revenue stream). Unless the municipality granted a security interest in something besides its future revenues (like some form of real property), § 552(a) would apply. However, most municipalities lack the ability to mortgage real property, meaning that bond financing (using future revenues) is their only recourse. *See supra* notes 62–63 and accompanying text (explaining why most municipalities cannot grant creditors security interests in real property).

342. *Infra* Part IV.A–B.

343. *Infra* Part IV.A.

344. *Infra* Part IV.B.

345. *Infra* Part IV.C.

346. *See supra* Table 1 (compiling a large list of potential bond funding

revenues should be more flexible and all-inclusive than its predecessor. Unlike the current statute, it should not be so narrow as to exclude contractually secured bonds payable exclusively from a limited revenue stream from the reach of §§ 928(a) and 922(d).[347] However, it should not be so broad that it unintentionally subjects GO bonds or other devices secured by general municipal revenues to the claim limitation provision in § 927.[348]

As a matter of public policy, a broader definition of special revenues should benefit both cash-strapped municipalities and their creditors.[349] Markets prize certainty because it allows for accurate valuation of potential bond deals.[350] If a municipality was able to conclusively state that (1) its bonds are backed by special revenues, and (2) there is either a statutory or a contractual lien on those revenues, potential purchasers could predict the bankruptcy outcome for their bonds.[351] This would

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sources).

347. *See supra* notes 337–341 and accompanying text (describing the dire consequences of what could happen when a municipality cannot offer bonds backed by special revenues); Table 3 (listing several bond types that are payable from non-special revenue sources under the current definition).

348. *See supra* notes 267–276 and accompanying text (explaining how this exact scenario could happen under the current definition of "special revenues" in § 902(2)).

349. *See infra* notes 350–356 and accompanying text (explaining why this is the case).

350. *See generally* James M. Kurtenbach & Jayaraman Vijayakumar, *Information Asymmetry and Municipal Revenue Bonds*, 11 J. PUB. BUDGETING, ACCT. & FIN. MGMT. 177 (1999) (arguing that investors compensate for informational asymmetry in the revenue bond market by pricing bonds according to known facts about the issuance or the issuer, like the presence of sinking funds to repay bondholders); Jacqueline L. Reck & Earl R. Wilson, *Information Transparency and Pricing in the Municipal Bond Secondary Market*, 25 J. ACCT. & PUB. POL'Y 1 (2006) (relying on secondary market bond pricing data to conclude that the bond markets impound information about municipal issuers and use that information to adjust pricing); Kelly Nolan et al., *Detroit Bankruptcy Reverberates in Michigan and in Municipal Bond Markets*, WALL ST. J. (Jul. 19, 2013, 7:06 PM), http://www.wsj.com/articles/SB10001424127887324263404578616273666128496 (last visited Apr. 2, 2015) (explaining that many GO bondholders who lacked information about the secured status of their bonds in bankruptcy were selling off at a loss out of fear that what happened to the GO bonds in Detroit could happen to them) (on file with the Washington and Lee Law Review).

351. *See supra* Table 2 (providing a reference guide cued to these two factors

provide troubled municipalities desperate for a capital infusion with a means by which to sell bonds that might not otherwise be marketable.[352] In bankruptcy, these purchasers would then receive the "benefit of the bargain" on which they predicated the transaction—a key goal of the 1988 Amendments.[353]

A broader definition could create more secured debt, which would leave unsecured creditors like municipal employees and pensioners with less money under a plan of adjustment.[354] However, a municipality could choose *not* to secure bonds pledged from a special revenue source with a contractual lien; in this case, § 927 would apply, limiting these unsecured bondholders to recourse against the special revenue stream pledged to them and keeping more money available for other unsecured creditors.[355] If the municipality *did* secure its special revenue bonds with a contractual lien, *all* municipal residents would ultimately benefit from the lower interest rates that creditors would be willing to offer.[356]

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that should conclusively indicate how every type of bond backed by a future revenue stream should be treated in bankruptcy).

352. *Cf.* S. REP. NO. 100-506, at 8, 27 (1988) (noting that the greater degree of market certainty provided by the 1988 Amendments could help "troubled municipalities which desperately need additional financing" to get the financing they need).

353. *See id.* at 12 (noting that one of the key goals of the 1988 Amendments was to ensure "that revenue bondholders receive the benefit of their bargain with the municipal issuer, namely, they will have unimpaired rights to the project revenue pledged to them"); *In re* Heffernan Mem'l Hosp. Dist., 202 B.R. 147, 148 (Bankr. S.D. Cal. 1996) (establishing this as one of the primary concerns of Congress in drafting the 1988 Amendments).

354. *See* Bidgood, *supra* note 1 (explaining how a plan of adjustment involving bondholders with secured claims had to make "deep cuts" in pension payments and payments to current municipal employees).

355. *See supra* Table 2 (explaining what happens when a special revenue-backed bond is not secured by either a contractual lien or a statutory lien).

356. *See supra* notes 350–353 and accompanying text (arguing that the presence of additional information allows for more accurate bond pricing). This would also obviate the need to purchase bond insurance, which would save municipalities even more money. *See generally* Oliver Renick & Maria Bonello, *Bond Insurance Then & Now: The Revival of an Industry*, BOND BUYER (Apr. 30, 2014, 6:16 PM), http://www.bondbuyer.com/issues/123_83/bond-insurance-then-and-now-revival-of-industry-1062071-1.html (last visited Apr. 2, 2015) (providing a general history of bond insurance and explaining that it is only necessary to the extent that it allows municipalities to get better interest rates because of the protection it affords purchasers) (on file with Washington and

However, creating an overly inclusive definition could create additional problems for cash-strapped municipalities once they file for bankruptcy. The beauty of the "fresh start" policy codified in § 552(a) is that it allows the "honest but unfortunate" municipal debtor the ability to equitably distribute its limited resources between competing creditors—many of whom are also its constituents.[357] The broader the definition of "special revenues" in § 902(2), the greater the likelihood that creditor liens would be preserved by § 928(a).[358] *Collier on Bankruptcy* emphasizes this point in its discussion of § 902(2), noting that:

> [S]ection 902(2) should not be construed as authorizing the special treatment afforded by section 928 to liens on special revenues unrelated to the project, system, or works for which the bonds were issued. For example, a lien on receipts from an existing hotel/motel tax to secure bonds issued to build a new city college facility, or a lien on sewer tax revenues to secure bonds for an electric generating station, should not qualify for the special treatment afforded revenue bonds by the 1988 Amendments. Indeed, one of the objections to the 1979-80 version of the special revenue bond amendments was that they would have enabled creditors to tie up a significant portion of the future revenues of a municipality and exercise a stranglehold on its finances. Such a scheme should not be permitted through the back-door by a construction of section

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Lee Law Review).

357. *See* Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (articulating one of bankruptcy's central goals as providing the "honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt"); Chung, *supra* note 14, at 778 (describing the battle between pensioners, residents, and lenders that played out in Detroit's municipal bankruptcy); Michael W. McConnell & Randal C. Picker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 470–71 (1993) (discussing the ramifications of the fresh start policy in municipal finance, one of which is to prevent an undue burden on a municipality's taxpayers).

358. Because § 902(2) would apply in this hypothetical, creditors would know that they would retain their lien on an existing revenue stream under § 928(a)—but only if such a lien existed in the first place. This would become the centerpiece of the argument. *Cf. In re* Cnty. of Orange, 179 B.R. 185, 192–95 (Bankr. C.D. Cal. 1995) (containing an example of a detailed discussion in which the court found that the parties had created a contractual lien).

> 902(2) or section 928 that unlinks the special revenue lien from the project from which the revenues flow.[359]

In this passage, Collier seems to propose that, in writing § 902(2), Congress intended to erect a firewall between bonds secured by project-derived revenues and bonds secured by other, unrelated revenues.[360] Assuming *arguendo* that this passage accurately depicts congressional intent, it is not clear that a new definition for "special revenues" must incorporate this firewall in order to preserve the Bankruptcy Code's "fresh start" policy.[361] A municipality's elected officials could justifiably decide to issue construction bonds for a new city college and to secure them with existing hotel tax revenues for any number of reasons. They may be able to obtain a better interest rate by using a stable funding source (the existing tax revenue) rather than a volatile one (the future revenue generated by the new college). There may be a high market demand for bonds backed by the hotel tax and the municipality may want to take advantage of it. Or there may even be a strange local law against using city college receivables as security for a bond issuance. In any event, these examples demonstrate that municipalities make financing decisions based on a wide array of endogenous local factors that cannot be predicted or summarized *in toto* by Congress.

Ultimately, the breadth of § 902(2) relates directly to the degree to which the "fresh start" policy should apply to municipalities in bankruptcy. Is a municipality that pledges a specific, limited revenue stream to secure a multi-million dollar financing an "honest but unfortunate" debtor deserving of § 552(a)'s protection? In most cases, the answer is no. In corporate bankruptcy, § 552(a) provides relief to businesses that

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359. 6 COLLIER, *supra* note 119, ¶ 902.03[6][c].

360. *See id.* (implying that the "special revenue lien" should always be linked to the "project from which the revenues flow").

361. Ultimately, Collier makes its point in this passage with the aid of a straw man. If a project itself generates its own revenues, then it makes economic and practical sense to secure bonds sold to fund that project with the revenues it generates. The trickier question that Collier avoids is what should happen to a *non*-revenue generating project, like the indigent care ward run by Heffernan Memorial. *See* Perry, *supra* note 309 (describing the indigent care service that the hospital provided and the need to finance the hospital with outside revenues because provision of indigent care involved huge capital outlays without much return on investment).

would not otherwise be able to acquire or sell its inventory or equipment free and clear of a creditor's lien.[362] It facilitates the debtor's "fresh start" by allowing the debtor to pocket the profits from sales of inventory acquired postpetition.[363] Without the ability to pocket those profits, the debtor would have no capital to run its business, and reorganization would be impossible.[364]

The situation in Chapter 9 is entirely different. Unlike the inventory pledged in the corporate bankruptcy hypothetical, a municipality does not depend on the revenue pledged under the terms of an indenture for its very survival.[365] On the contrary, under the terms of a typical indenture, a municipality loses access to the revenue stream used to secure a bond issue from the moment of issuance until it makes the final principal payment.[366] The pledged revenue stream should play no part in the municipality's reorganization because, under the terms of the typical indenture, it never belonged to the municipality in the

362. *See* Craig H. Averch, *The Heartbreak Hotel for Secured Lenders: When Postpetition Revenue from A Hotel Is Not Subject to A Prepetition Security Interest*, 107 BANKING L.J. 484, 487 n.14 (1990) ("[T]he underlying policy of § 552 is to aid a debtor's reorganization efforts by treating, as unencumbered, property acquired postpetition that would, but for § 552, be encumbered . . . .").

363. *See* RUSCH & SEPINUCK, *supra* note 146, at 129 (providing an example that reaches this conclusion).

364. *See* Averch, *supra* note 362, at 487 n.14 (noting the link between the debtor's "fresh start" and its ability to treat inventory that would otherwise be encumbered as unencumbered assets).

365. *Compare supra* notes 362–364 and accompanying text (noting the critical role that the encumbered inventory and other assets freed by § 552 play in corporate reorganization), *with infra* notes 366–367 and accompanying text (describing how the funds pledged in a municipal bond transaction are not at all critical to the municipality's reorganization).

366. *See, e.g.*, S. REP. NO. 100-506, at 8–9 (1988) (discussing a typical revenue bond issuance, which is secured by revenue generated from the funded enterprise that is unavailable for general municipal purposes from the time of issuance until the bonds are settled); Ambac Complaint, *supra* note 268, at *5 (arguing that Detroit had no "equitable or beneficial interest" in the property tax revenues used to fund its UTGO and LTGO issuances); CITY OF SAN DIEGO TOBACCO SETTLEMENT REVENUE FUNDING CORP., *supra* note 227, at S-1 to -15 (outlining a transactional structure in which the Settlement Revenue Funding Corporation had no right to the tobacco settlement payments pledged to its bondholders); ELMORE CNTY. PUB. BLDG. AUTH., *supra* note 77, at 4–6 (outlining a transactional structure in which the issuer has no right to the lease payment revenue stream used to support the bonds).

first place.[367] Even if the pledged stream does not directly relate to the project itself, the very fact that the municipality was willing to irrevocably dedicate a revenue source to creditors (cutting off its own access to that revenue source in the process) demonstrates that the source is not necessary to an effective reorganization. Thus, in crafting a broader § 902(2), Collier's proposed limiting principle—that "special revenues" should only include revenue directly related to the financed project—should be rejected.

There is one limited context in which § 552(a) performs the same role in Chapter 9 that it does in Chapters 7 or 11. When § 552(a) terminates a contractual lien on all revenues in a municipal general fund, on all tax revenue, or on all collected receipts, it has the same effect of freeing a municipality to use its generally available funds in pursuit of its "fresh start."[368] Thus, the definition of special revenues should not include "generally available municipal funds," "all available tax revenue," or "all available receipts." This limiting principle more effectively accomplishes the goal set out by Collier—preventing creditors from placing a "stranglehold" on a municipality's available finances.[369]

B. Legislative Revision to Chapter 9

The most obvious way to alter the definition of "special revenues" is to amend § 902(2). Given the concerns discussed in Part IV.A, a new definition for special revenues must toe the line between overinclusion and underinclusion. It should include any source of revenue intended by the municipality to be used

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367. *See* sources cited *supra* note 366.

368. This was the reason that Congress was so insistent in the legislative history that "special revenues" should not be broad enough to include revenues collected for the "general purposes" of the debtor. *See* H.R REP. NO. 100-1011, at 4 (1988) ("Special revenue bonds are issued so that if the asset financed fails, repayment will not come out of general treasury funds—meaning the taxpayer will not have to foot the bill."); S. REP. NO. 100-506, at 9 (1988) (making substantially the same point).

369. *See* 6 COLLIER, *supra* note 119, ¶ 902.03[6][c] (claiming this as the primary objection to a previous version of the 1988 Amendments).

exclusively for the benefit of its bondholders,[370] but it should not include sources of revenue that a municipality would depend upon for a successful reorganization.[371] Thus, the new definition should read:

> § 902(2): "special revenues" means any specific source of revenue that (a) is irrevocably pledged and assigned under an indenture, bond resolution, or similar contractual arrangement to an indenture trustee, bondholders, or other direct beneficiaries and (b) is clearly identified in the indenture as "special revenues under § 902(2) of the Bankruptcy Code;" provided, however, that special revenues shall under no circumstances consist of generally available municipal funds, including all available tax revenue or all available receipts.

This new statutory definition benefits each of the three groups—bondholders, municipalities, and taxpayers—that Congress referenced in the legislative history to the 1988 Amendments.[372] For bondholders, the new definition guarantees that almost any revenue stream pledged for their exclusive use and secured with a contractual lien will remain secured under § 928(a).[373] This guarantee allows bondholders to retain "unimpaired rights to the . . . revenue pledged to them."[374]

The inclusion of new § 902(2)(b) ultimately cedes control of the scope of "special revenues" to municipalities. Under proposed § 902(2)(b), a revenue stream could not qualify as "special revenues" unless the municipality assents in advance. In other words, the municipality itself—not Congress or the courts—would

370. *See supra* notes 365–367 and accompanying text (explaining why this exclusive use limitation comports with the rejection of the fresh start policy in this instance).

371. *See supra* notes 368–369 and accompanying text (describing this concern).

372. *See In re* Heffernan Mem'l Hosp. Dist., 202 B.R. 147, 148 (Bankr. S.D. Cal. 1996) (listing these as the three primary groups that Congress considered in drafting the 1988 Amendments).

373. *See* 11 U.S.C. § 928(a) (2012) (applying only where bonds are backed by a contractual lien on special revenues).

374. S. REP. NO. 100-506, at 12 (1988); *see* 100 CONG. REC. S16,230 (daily ed. Nov. 12, 1987) (statement of Sen. Dennis DeConcini) (noting that bondholders have a "legitimate expectation to rely on and receive specific collateral").

have the authority to dictate whether its bonds receive "special revenue" treatment.[375]

This new qualifier benefits bondholders as well because it provides them with greater certainty when entering the transaction.[376] This certainty allows for more effective risk assessment and, as a result, better pricing.[377] In theory, this greater certainty should redound to the municipality's benefit, as well, by providing them with lower interest rates on transactions involving special revenues.[378] Additionally, it gives financially distressed special purpose entities without other funding sources the ability to issue bonds that they know will be secured in bankruptcy.[379]

Municipal residents stand to benefit from the new definition because it works with § 927 to prevent revenue bondholders with claims based "exclusively" on special revenues from seeking other available municipal sources for repayment.[380] The broader the definition in § 902(2), the greater the protection to taxpayers afforded by § 927. For example, under the new § 902(2), creditors with claims predicated on a pledge of state sales tax revenue (which is not covered by the current definition) could not make a claim in bankruptcy against local property tax collections.[381] Thus, the new scope of § 902(2) actually affords *stronger* protection to municipal taxpayers than ever before.

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375. *See supra* Table 2 (providing a summary of the benefits of qualification as special revenues).

376. Because bondholders will know whether their bonds qualify for the protections afforded to debt backed by special revenues, they need only answer the question of whether their bonds are backed by statutory or contractual liens in order to get a full picture of how bankruptcy will affect them. *See supra* Table 2 (outlining this process).

377. *See* sources cited *supra* note 366.

378. *See id.*

379. Municipalities would only issue these bonds if they were willing to pay the steep interest rates that would almost certainly accompany them. However, they might make an attractive alternative to a cash-strapped municipality that has already hit its general obligation debt limit but needs additional working capital to stay out of bankruptcy.

380. 11 U.S.C. § 927 (2012).

381. *See supra* note 227 and accompanying text (explaining why state aid transfer payments do not qualify as special revenues); Table 3 (listing these as "possible" special revenues).

Finally, it properly aligns the policy objectives of the Bankruptcy Code with the protections afforded to bondholders by § 928(a) and to municipalities by § 552(a). Where a revenue stream is "irrevocably pledged" to bondholders, municipalities lose access to it.[382] Thus, the inclusion of the "irrevocably pledged" qualifier means that special revenues would not otherwise be available to assist a municipality in getting a "fresh start" during reorganization. Next, the inclusion of the clause beginning with "provided" at the end of the definition guarantees that "special revenues" does not include any revenue that a municipality would depend upon for its fresh start.[383] If a municipality granted a contractual lien on "all available revenues," § 928(a) would not apply because those revenues would not qualify as "special revenues" under the new § 902(2), and § 552(a) would terminate the lien.

C. Judicial and Market Revision of Chapter 9

The slow pace at which Congress typically acts becomes even more glacial when it comes to Chapter 9 revisions.[384] In the event that Congress chooses not to fix the § 902(2) problem in a timely manner, two cases—*In re Heffernan* and *In re Sierra Kings Healthcare District*[385]—provide a possible market-based solution.

In *Heffernan*, the court introduced a new test for "special revenues" that asks whether the revenues were "restricted in use to a specific project or system."[386] The three factors relied upon by the court in making this determination were: (1) whether the tax

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382. *See supra* notes 362–367 and accompanying text (providing support for this assertion).

383. *Cf. supra* notes 368–369 and accompanying text (discussing the one limited situation in which § 552(a) does work to preserve the municipal debtor's ability to obtain a fresh start).

384. *See* 6 COLLIER, *supra* note 119, ¶ 900.LH (noting that there have only been two or (arguably) three significant updates to Chapter 9 since it was made permanent in the mid-1940s, and that for most of its life, it has remained "unchanged and virtually unused").

385. No. 09.19728-B-9, 2010 WL 10018073 (Bankr. E.D. Cal. Sept. 13, 2010).

386. *In re* Heffernan Mem'l Hosp. Dist., 202 B.R. 147, 149 (Bankr. S.D. Cal. 1996).

revenue was not available for "general municipal purposes;"[387] (2) whether the tax revenue existed exclusively "for the purpose of providing security and payment to the bondholders;"[388] and (3) whether the bondholders did not have recourse to any other general revenues besides those specified in the indenture.[389]

Many—if not most—of the bonds backed by tax revenues but not currently covered by § 902(2) should fit within this broader "restricted in use to a specific project or system" test. Using this case as precedent, bond counsel could insert the following phrase into each new indenture they draft:

> The parties acknowledge that any funds described in this Indenture as a Source of Payment for the Bonds (a) are impressed with a [statutory lien] [contractual lien] and (b) are "special revenues" under the definition provided by § 902(2) of the Bankruptcy Code and existing case law interpreting this provision. The Borrower [or other municipal entity] irrevocably waives the right to assert and covenants not to assert any contention in the future that funds described as a Source of Payment are not "special revenues" under 11 U.S.C. § 902(2).

At first blush, such a provision seems unenforceable in bankruptcy. It is, after all, "emphatically the province and duty of the judicial department to say what the law is,"[390] and an agreement dictating the legal application of a statutory definition seems suspect. Such an agreement, however, appears to be fully enforceable—and, indeed, encouraged—under *In re Sierra Kings*.[391]

In *Sierra Kings*, a healthcare district defaulted on its debt and declared bankruptcy on October 8, 2009.[392] A portion of this debt included principal and interest payments owed on GO bonds

387. *Id.*

388. *Id.*

389. *See id.* ("[T]he Bonds do not constitute a debt or liability of the City or the District, but are payable solely from and secured by an absolute and irrevocable assignment and pledge of the Sales Tax Revenues to the Authority.").

390. Marbury v. Madison, 5 U.S. 137, 177 (1803).

391. *See infra* notes 392–398 and accompanying text (describing the facts in *In re Sierra Kings*).

392. *In re* Sierra Kings Health Care Dist., No. 09.19728-B-9, 2010 WL 10018073, at *3 (Bankr. E.D. Cal. Sept. 13, 2010).

issued in 2002 and 2007 to upgrade and expand several existing facilities owned by the district.[393] Both issuances were garden-variety GO bonds secured by general ad valorem taxes without limitation as to rate or amount.[394]

Objectively, the voter-approved ad valorem tax revenue pledged as security for the bonds may fit into the narrow definition in § 902(2)(E) because it came from a new tax specifically levied to finance a project.[395] However, the presiding judge never explicitly made that determination himself. Instead, he signed an order requiring the debtor to:

> enter into agreements with the appropriate parties to reaffirm and protect the interests and rights of the holders of the 2002 Bonds and the holders of the 2007 Bonds, each such agreement to provide for, among other things: . . . (c) the recognition of such ad valorem taxes[396] as "special revenues" as defined in 11 U.S.C. section 902(2)(e) of the Bankruptcy Code . . . . [In addition, the order required the debtor to] waive[] and withdraw[] any contention by it and covenant[] not

393. *See* SIERRA KINGS HEALTHCARE DIST., *supra* note 259, at 12 ("A portion of the proceeds of the Bonds will be used by the District to (i) complete more stringent earthquake and handicap accessibility standards . . . , (ii) construct an approximate 8,000 square-foot Birthing Center expansion, and (iii) complete an approximate 16,000 square-foot expansion, renovation and equipping program . . . .").

394. *See id.* at 8–9 ("The Bonds are general obligations of the District and the District has the power and is obligated to cause to be levied and collected by the County annual ad valorem taxes for payment when due of the principal of and interest on the bonds upon all property within the District subject to taxation by the District without limitation as to rate or amount.").

395. *See In re Sierra Kings*, 2010 WL 10018073, at *4 (describing the collection mechanism by which the district levied the property taxes and paid them over to bondholders). Under the terms of the Bond Resolution, the district caused the county in which it was located to levy the property taxes used to repay the bondholders. *Id.* The county paid all property taxes collected into a special interest and sinking funds made available exclusively for bondholder repayment and *not* for the general use of the district. *Id.* If any money remained in the fund after the district repaid the bonds, it was to be refunded to the county taxpayers. *Id.* Thus, the tax revenue would certainly have qualified as "special revenues" under the *Heffernan* test because (1) it was not available for the "general purposes" of the district, (2) it existed solely to provide "security and payment" to the bondholders, and (3) bondholders had no recourse to other funds under the indenture.

396. "Such" ad valorem taxes are "ad valorem taxes levied or collected for the payment of principal of or interest on the 2002 Bonds or 2007 Bonds." *See In re Sierra Kings*, 2010 WL 10018073, at *6.

> to assert any contention in the future . . . that the ad valorem taxes levied to pay the Bonds are not "special revenues" under 11 U.S.C. § 902(2)(E).[397]

By issuing this order, the judge approved an independent agreement between the parties that (1) stipulated to the fact that the tax receipts were special revenues and (2) waived any right to challenge that determination in the future.[398]

Together, *In re Heffernan* and *In re Sierra Kings* offer a narrow sliver of hope for non-legislative reform. When liberally construed, *Heffernan* stands for the broader proposition that the exact wording in § 902(2) should not dictate which revenue streams are "special" and which are not.[399] In reliance on this broader principle in *Heffernan*, municipalities issuing bonds that fall into one of the gray areas highlighted in Table 3 could insert clauses similar to the one proposed above into the indenture. If the municipality files for bankruptcy protection, there are two possible scenarios: either (1) the bankruptcy court declares the waiver ineffective and holds that § 902(2) does not apply; or (2) the waiver is effective and § 902(2) applies.

In the worst-case Scenario (1), the result is the same as the status quo; even without inserting the proposed clause, a bankruptcy judge could find that § 902(2) does not apply to, say, LTGOs. In the best case Scenario (2), insertion of the proposed clause creates a far better result than the status quo. Following the model established by *In re Sierra Kings*, a judge could decide to preserve the intent of the parties and permit both sides to enjoy the benefits (for bondholders)—and drawbacks (for the municipality)—of the bargain they negotiated. In short, inserting the proposed clause has a substantial upside and, at worst, has no downside whatsoever.

Nevertheless, there are doubts as to whether this approach would work in practice. First, it glosses over the fact that, aside from *In re Heffernan*, no precedent exists to declare anything that

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397. *Id.*

398. *See id.* (permitting both features).

399. *See In re* Heffernan Mem'l Hosp. Dist., 202 B.R. 147, 149 (Bankr. S.D. Cal. 1996) (ignoring the strict statutory language in favor of an alternative test proposed by Collier); *supra* Part III.B.3 (explaining why the *Heffernan* decision went beyond the scope of what § 902(2)(E) technically permits).

does not fit within § 902(2) to be "special revenues."[400] Much of the gray area discussed in Table 3 does not fit neatly within *any* of the five existing definitional sections, and extending *Heffernan* to cover a revenue source that resembles § 902(2)(A) or § 902(2)(D) may be a bridge too far. Next, it assumes that all municipalities and their bond counsel are aware of the *existence* of § 902(2), let alone the problems it could pose. Without knowledge of the problems § 902(2) could pose, neither municipalities nor their lawyers would think to protect themselves in the first place.

Finally, it ignores the rate at which municipalities file Chapter 9 cases. Because of the low number of Chapter 9 filings, only three judicial opinions have relied on § 902(2) in any capacity.[401] There is little likelihood that a bankruptcy court would ever have the opportunity to test a clause like the one suggested above. Without judicial precedent on which to rely, parties are unlikely to give such a clause much weight and will price the deal as though it did not exist.

While these issues are vexing, the simple answer to the problems they present is this: why not? There is no downside to inserting the proposed language into an indenture when such a provision is freely negotiated and both sides understand the consequences. At best, the clause preserves the benefits that the parties bargained for in the first instance—the same bargain which served as a basis for pricing the deal. At worst, the clause gets thrown out in bankruptcy, and the parties are left to argue over whether *In re Heffernan* applies.

Recognition of this problem by the National Association of Bond Lawyers, the Municipal Securities Rulemaking Board, or a

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400. *See* Zev Shechtman, *Compendium of Judicial Decisions Under Chapter 9 of the Bankruptcy Code As of August 15, 2012*, 32 CAL. BANKR. J. 339, 369 (2012) (mentioning only one other case in its discussion of precedent involving "special revenues" and noting that that case did not interpret the definition of special revenues but rather addressed the scope of §§ 922(d) and 928(b)).

401. *See* Bank of N.Y. Mellon v. Jefferson Cnty. (*In re* Jefferson Cnty.), 482 B.R. 404, 428 (Bankr. N.D. Ala. 2012) (holding that sewer fee revenues, sewer taxes, and the interest they generated in a holding account all collectively qualified as "special revenues" under § 902(2)(A)); *In re* Sierra Kings Health Care Dist., No. 09.19728-B-9, 2010 WL 10018073, at *2 (Bankr. E.D. Cal. Sept. 13, 2010) (citing and relying on § 902(2)(E)); *In re Heffernan*, 202 B.R. at 148–49 (same).

similar trade or regulatory association would go a long way towards effectuating this potential solution. With increased awareness would come additional insertions of the language described above into the form documents used by most bond counsel. As more and more bond counsel adopted this clause and inserted it into their form documents, the likelihood of a judicial test case would increase exponentially. In addition, the potential futility of solving the problem in such a piecemeal fashion might become evident to Congress, which would spur the passage of an amendment to fix § 902(2) once and for all.

V. Conclusion

As of the writing of this Note, it is unclear whether the aftershocks of the Great Recession will claim another round of municipal victims.[402] However, as Chapter 9 filings become more and more common, there are some signs that the stigma traditionally associated with municipal bankruptcy may be fading.[403] When the next financial crisis comes, municipalities across the country will consider whether they are willing to bear the reputational damage in exchange for the protections afforded by Chapter 9. Those municipalities considering bankruptcy should know, with a reasonable degree of certainty, what fate awaits their outstanding bonds. This Note posits that an overly narrow definition of "special revenues" obfuscates the otherwise

402. *See* R. Theodore Clark, Jr., *Public Sector Collective Bargaining at the Crossroads*, 44 URB. LAW. 185, 221 & n.161 (2012) (noting that there has been a "virtual onslaught of articles and speeches" predicting a coming wave of municipal bankruptcy filings and compiling several articles in support of the proposition); Timothy R. Casey & Daniel Northrop, *Chapter 9: An Rx for Health Care Districts and Public Hospital Authorities?*, DRINKER BIDDLE (Oct. 14, 2013) http://www.drinkerbiddle.com/resources/publications/2013/Chapter-9-An-Rx-for-Health-Care-Districts-and-Public-Hospital-Authorities (last visited Apr. 2, 2015) (mentioning the uptick in healthcare district Chapter 9 filings, which could be particularly relevant given the fact that *In re Heffernan* and *In re Sierra Kings* were both healthcare cases) (on file with the Washington and Lee Law Review).

403. *See, e.g.*, Liz Farmer, *The 'B' Word: Is Municipal Bankruptcy's Stigma Fading?*, GOVERNING (Mar. 2013), http://www.governing.com/topics/finance/gov-bword-stigma-municipal-bankruptcy-going-away.html (last visited Apr. 2, 2015) ("There's a growing sense among some leaders that municipal bankruptcy—unthinkable just a few years ago—may be a valuable tool.") (on file with the Washington and Lee Law Review).

clear effects of §§ 928(a), 922(d), and 927 in a way that could materially impact a municipality's choice about whether to file for bankruptcy in the first place.[404] It proposes two solutions, but ultimately concludes that the best way to resolve the problems created by § 902(2) is to raise awareness of its effects.[405] That way, our elected officials can make better and more informed choices about the debt burden they place on future generations.

404. *Supra* Part III.
405. *Supra* Part IV.