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## From Wreckage Comes Reason: How Detroit's Chapter 9 Filing Helps Develop a Practicable and Principled "Good Faith" Standard

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FROM WRECKAGE COMES REASON:  
HOW DETROIT'S CHAPTER 9 FILING HELPS  
DEVELOP A PRACTICABLE AND PRINCIPLED  
"GOOD FAITH" STANDARD

SCOTT A. KRYSINIAK\*

ABSTRACT

*The city of Detroit is beginning to rise from the ashes following decades of fiscal ineptitude, social failure, and corruption. Bolstered by protections under Chapter 9 of the Bankruptcy Code, Detroit has eliminated billions of dollars in debt and established a feasible plan for municipal reorganization. Now, Detroit is even considered an American "comeback story." However, Detroit's revitalization began on a tenuous foundation. The city's creditors objected vigorously to the bankruptcy petition by claiming that Detroit had not filed its bankruptcy petition in good faith under § 921(c). Despite the relatively scarce and imprecise case law and jurisprudence surrounding § 921(c), Judge Stephen Rhodes ruled that Detroit met the good faith requirement in addition to all of the requirements for Chapter 9 eligibility. In doing so, however, Judge Rhodes forged a new path in Chapter 9 analysis and established a practicable and principled "good faith" test. Now, Judge Rhodes's approach to § 921(c) good faith can serve as a beacon of reason in an imprecise area of bankruptcy law.*

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\* J.D. Candidate 2016, William & Mary Law School. First and foremost, the author would like to thank his friends and family for their unyielding support. The author would also like to thank all the wonderful editors and staff of the *William & Mary Business Law Review*, who made this Note possible. Your diligence and patience is forever appreciated.

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## INTRODUCTION

Once a thriving metropolis and the backbone of the nation, the city of Detroit is now facing unprecedented social and financial hardship. Between 2012 and early 2013, leadership from the city of Detroit and the state of Michigan began planning a civil restructuring to combat the city's destitute condition.<sup>1</sup> Shortly after the appointment of Emergency Manager Kevyn Orr in the summer of 2013, the city of Detroit opted for Chapter 9 bankruptcy after loose negotiation proceedings failed to assuage the city's abundant creditors.<sup>2</sup> It was the largest municipal bankruptcy filing in United States history, surpassing the previous record by over 400 percent.<sup>3</sup> Finance experts calculated Detroit's debt at over \$18 billion.<sup>4</sup> Over 100,000 creditors claimed to have a stake in the massive debt.<sup>5</sup> Despite its apparent urgency, the bankruptcy filing was strongly contested by many of these creditors.<sup>6</sup> With over 100 parties actively opposing the bankruptcy, the objections included constitutional challenges and alleged impropriety and lack of good faith.<sup>7</sup>

The objections based on lack of good faith proved to be formidable contentions.<sup>8</sup> Most of the accusations alleging lack of good

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<sup>1</sup> Monica Davey & Mary Williams Walsh, *Billions in Debt, Detroit Tumbles Into Insolvency*, N.Y. TIMES (July 18, 2013), [http://www.nytimes.com/2013/07/19/us/detroit-files-for-bankruptcy.html?pagewanted=all&\\_r=2&](http://www.nytimes.com/2013/07/19/us/detroit-files-for-bankruptcy.html?pagewanted=all&_r=2&); Matt Helms & Nathan Bomey, *Detroit Bankruptcy Time Line*, DETROIT FREE PRESS (July 14, 2014), <http://archive.freep.com/article/20140713/NEWS01/307130100/detroit-bankruptcy-timeline-DIA> [<http://perma.cc/D3CU-ZCAF>].

<sup>2</sup> Davey & Walsh, *supra* note 1.

<sup>3</sup> See Aryn McCumber, *Beauty and the Beast: The Taxing Tale of the Detroit Institute of Arts and the Largest Municipal Bankruptcy in History*, 40 MI TAX L. 42, 65 (2014). The previous mark was set in 2011 by Jefferson County, Alabama, with a then-record \$4 billion in estimated debt. *Id.*

<sup>4</sup> Helms & Bomey, *supra* note 1.

<sup>5</sup> *Id.*

<sup>6</sup> McCumber, *supra* note 3, at 43.

<sup>7</sup> *In re City of Detroit*, 504 B.R. 97, 110 (Bankr. E.D. Mich. 2013). Bankruptcy Judge Steven Rhodes noted that 110 parties filed objections to Detroit's bankruptcy filing. *Id.*

<sup>8</sup> See generally *id.* at 181–86. Before reaching his decision on Detroit's good faith, Judge Rhodes took the initiative to consider each of the objectors' theories of bad faith and the factual support behind them. *Id.*

faith centered on whether the bankruptcy proceedings allowed Detroit's leadership to skirt the city's financial obligations and contravene worker benefits entrusted under the Michigan State Constitution.<sup>9</sup> In deciding on these objections, bankruptcy Judge Steven Rhodes adopted a rationale from several previous Chapter 9 cases.<sup>10</sup> However, Judge Rhodes's consideration of the applicable law to support his ruling was made much more difficult because the term "good faith" is not defined anywhere within Title 11's provisions.<sup>11</sup> Furthermore, the case law addressing § 921(c) is meager in its guidance for subsequent cases.<sup>12</sup> Despite the relatively scarce and imprecise case law and jurisprudence surrounding § 921(c), Judge Rhodes ruled that Detroit met the good faith requirement in addition to all of the requirements for Chapter 9 eligibility.<sup>13</sup>

This Note will explore Detroit's bankruptcy proceedings with an emphasis on Detroit's alleged bad faith in its initial Chapter 9 bankruptcy filing. Part I will first provide a background on Chapter 9 bankruptcy filings generally, beginning with the purposes and history of municipal bankruptcies. Then, Part I will discuss the good faith petitioning requirement under 11 U.S.C. § 921(c) and its relevant jurisprudence, or lack thereof. Part II will set the

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<sup>9</sup> Nick Carey, *Analysis: Constitutional, Good Faith Arguments Unlikely to Halt Detroit Bankruptcy*, REUTERS (Aug. 20, 2013, 2:26 AM), <http://www.reuters.com/article/2013/08/20/us-usa-detroit-court-analysis-idUSBRE97J05620130820> [<http://perma.cc/T7TE-F3L4>].

<sup>10</sup> See *In re City of Detroit*, 504 B.R. at 180. In addressing whether the city of Detroit filed its Chapter 9 bankruptcy petition in good faith pursuant to § 921(c), Judge Rhodes looked to numerous cases to construct the applicable law. These cases are discussed in Part II and Part III of this Note.

<sup>11</sup> See *Good Faith Standard Required for Confirmation of Chapter 9 Plans*, GOODWIN PROCTOR (2012), <http://www.goodwinprocter.com/~media/82A5B4B8568B4E239A228D5CB4980745.pdf> [<http://perma.cc/DUD3-52LN>] ("The term 'good faith' is not defined in the Bankruptcy Code, and there is limited case law exploring its meaning in the context of a Chapter 9 plan.").

<sup>12</sup> *Id.*

<sup>13</sup> Chad Halcom, *Judge Rhodes: Detroit Bankruptcy, Filed in Good Faith, Will Continue*, CRAIN'S DETROIT BUS. (Dec. 3, 2013, 9:46 AM), <http://www.crainsdetroit.com/article/20131203/NEWS/131209960/judge-rhodes-detroit-bankruptcy-filed-in-good-faith-will-continue> [<http://perma.cc/FR6J-YZLE>].

backdrop for Detroit's financial history leading up to the bankruptcy filing, and then address the § 921(c) objections in detail.

Finally, Part III of this Note will highlight the approach Judge Rhodes took in ruling that Detroit's bankruptcy filing was ultimately conducted in good faith. This Note will reason that Judge Rhodes's analysis on Chapter 9 good faith postulates a pragmatic and principled exploration of the Chapter 9 good faith requirement and lays a solid foundation for an 11 U.S.C. § 921(c) analysis. More specifically, this Note will argue that Judge Rhodes's four-part analysis on good faith Chapter 9 filings creates a new framework that fills a void in inconsistent and imprecise Chapter 9 bankruptcy law. Now, with the nation held as a captive audience, Detroit's bankruptcy case can be a beacon of reason in a nebulous area of bankruptcy law.

#### I. BACKGROUND: CHAPTER 9 BANKRUPTCIES

Chapter 9 of Title 11 of the United States Code provides the statutory mechanism for municipalities to file for bankruptcy.<sup>14</sup> Like other bankruptcy proceedings, the main goal of Chapter 9 bankruptcy is to protect the financially distressed entity from its creditors while allowing the entity to restructure its debt with the added oversight of the judiciary.<sup>15</sup> For individuals, bankruptcy law originated in part to protect citizens from creditors in order to avoid substantial debt becoming tantamount to indentured servitude.<sup>16</sup> Municipal bankruptcy, on the other hand, is designed to allow a municipal entity to continue its governmental functions while civic officials work to restructure the municipality's debt.<sup>17</sup> Although critics remain fervent as to the value of

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<sup>14</sup> 11 U.S.C. §§ 901–946 (2014). These sections make up Chapter 9 of the Bankruptcy Code.

<sup>15</sup> *Chapter 9: Municipality Bankruptcies*, USCOURTS.GOV (2014), <http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter9.aspx> [<http://perma.cc/KUB8-RXMY>]. Just as Chapter 9 provides the legal mechanism for municipal bankruptcy, Chapter 11 provides corporations with an avenue for the reorganization of debt.

<sup>16</sup> See Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 516–18 (1996).

<sup>17</sup> See *Chapter 9: Municipality Bankruptcies*, *supra* note 15.

Chapter 9 bankruptcy, and it is often considered a “last resort” for a struggling municipality,<sup>18</sup> Chapter 9 bankruptcy remains an important facet of the Bankruptcy Code.

As a legal institution, bankruptcy is a complex conglomeration of legal procedure, business law, and constitutional law.<sup>19</sup> Chapter 9 bankruptcy is no different.<sup>20</sup> In order to provide context for Chapter 9 bankruptcy issues, Section A of Part I of this Note will provide further history and background on Chapter 9 bankruptcy. Section B will then discuss Chapter 9 eligibility requirements under 11 U.S.C. § 109(c). Finally, Section C will examine Chapter 9’s good faith filing requirement under 11 U.S.C. § 921(c).

#### *A. The History of Chapter 9 Bankruptcy*

Despite the paucity of Chapter 9 bankruptcy filings in comparison to their individual and corporate bankruptcy counterparts,<sup>21</sup> Chapter 9 filings are still an emergent field in both the business and the legal world.<sup>22</sup> In fact, the ability of a municipality to file for bankruptcy only became possible during the 1930s.<sup>23</sup> The United States Congress first enacted a law allowing municipalities to file for bankruptcy in 1934.<sup>24</sup> Despite articulate

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<sup>18</sup> Henry C. Kevane, *Chapter 9 Municipal Bankruptcy: The New “New Thing”?*, AMERICAN BAR ASSOC.: BUS. LAW TODAY (May 2011), [http://www.americanbar.org/publications/blt/2011/05/01\\_kevane.html](http://www.americanbar.org/publications/blt/2011/05/01_kevane.html) [<http://perma.cc/TAU7-J6RN>].

<sup>19</sup> See generally David A. Skeel, Jr., *When Should Bankruptcy be an Option (For People, Places, or Things)?*, 55 WM. & MARY L. REV. 2217, 2217–25 (2014).

<sup>20</sup> *Id.*

<sup>21</sup> U.S. Census Bureau, *Statistical Abstract of the United States* (2012), <http://www.census.gov/library/publications/2011/compendia/statab/131ed/business-enterprise.html> [<http://perma.cc/7V76-UA4V>]. According to the American Bankruptcy Institute, of more than 55,000 municipal entities, fewer than 600 have filed for bankruptcy protection since 1937. In comparison, for the twelve month period ending June 30, 2007 alone, the Administrative Office for the U.S. Courts reported 450,332 Chapter 7 filings, 5,586 Chapter 11 filings, and 23,889 total business filings. *Id.*

<sup>22</sup> Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 352 (2010).

<sup>23</sup> *Chapter 9: Municipality Bankruptcies*, *supra* note 15.

<sup>24</sup> Bankruptcy Act of 1898, Pub. L. No. 251, 48 Stat. 798 (1934).

drafting, however, only two years later, the Supreme Court held that the law was unconstitutional in *Ashton v. Cameron County Water Improvement Dist. No. 1*.<sup>25</sup> As a federal law that heavily influenced the state's ability to oversee its internal affairs, the bankruptcy provision at issue in *Ashton* raised state sovereignty concerns under the Tenth Amendment.<sup>26</sup> This comes as no surprise, as concerns stemming from the Tenth Amendment are a persistent point of contention in Chapter 9 filings and continue to occur in bankruptcy filings today.<sup>27</sup>

In the wake of *Ashton*, Congress followed its unsuccessful endeavor with a revised municipal bankruptcy act in 1936.<sup>28</sup> The Supreme Court ultimately ruled that this iteration was constitutionally permissible two years later in *United States v. Bekins*.<sup>29</sup> The statutory structure of Chapter 9 bankruptcies would remain largely unchanged until the 1970s.<sup>30</sup>

As mentioned above, Chapter 9 bankruptcy shares similar goals with its individual and corporate bankruptcy counterparts.<sup>31</sup> However, a large difference between Chapter 9 bankruptcy cases and other types of bankruptcies is the relative involvement of the court.<sup>32</sup> In all bankruptcy cases, a specialized bankruptcy court is responsible for overseeing an entity's debt restructuring.<sup>33</sup> In corporate or individual bankruptcy cases, the court's oversight involves a painstaking review of a vast number of the entity's transactions.<sup>34</sup> A bankruptcy court may also play a substantial part in actually creating the restructuring plan for individuals and corporations.<sup>35</sup> However, the bankruptcy court has

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<sup>25</sup> 298 U.S. 513, 532 (1936).

<sup>26</sup> *Id.*

<sup>27</sup> Kevane, *supra* note 18.

<sup>28</sup> Bankruptcy Act of 1936, Pub. L. No. 302, 50 Stat. 653 (1937).

<sup>29</sup> *United States v. Bekins*, 304 U.S. 27 (1938).

<sup>30</sup> Kimhi, *supra* note 22, at 365.

<sup>31</sup> Kevane, *supra* note 18.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

a reduced role in Chapter 9 cases.<sup>36</sup> Generally, the bankruptcy courts have two main objectives in Chapter 9 cases.<sup>37</sup> First, the bankruptcy court will act as a gatekeeper in the beginning of a municipal bankruptcy case.<sup>38</sup> At this stage, the bankruptcy court will determine a municipality's Chapter 9 eligibility.<sup>39</sup> The second main objective of the bankruptcy court is to approve the municipality's finalized restructuring plan upon the completion of the bankruptcy proceedings.<sup>40</sup> Furthermore, municipalities themselves are left to create their own restructuring plan.<sup>41</sup>

Although the bankruptcy courts will have a reduced role in the overall restructuring scheme, municipalities deemed Chapter 9 eligible are entitled to certain special protections that are unique to Chapter 9 cases.<sup>42</sup> These protections are designed to further assist the municipality in continuing its civic operations for the benefit of the public; meanwhile, the municipality's officials can restructure the debt.<sup>43</sup> The protections afforded to municipalities generally limit the ability of creditors to "reach" the municipality.<sup>44</sup> For example, in individual or corporate bankruptcy, a creditor may be able to foreclose or repossess a debtor's assets in order to satisfy the debtor's debt. Such an analog is not available in the Chapter 9 context; a municipality's creditor may not foreclose a civic building in an effort to recuperate its debt because the building is put to use for the general public within

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<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* The reduced role of the judiciary in municipal bankruptcy cases is grounded in Tenth Amendment concerns. *Id.* For more reading on Tenth Amendment concerns in Chapter 9 cases, see Juliet M. Moringiello, *Goals and Governance in Municipal Bankruptcy*, 71 WASH. & LEE L. REV. 403, 458–59 (2014).

<sup>42</sup> Kevane, *supra* note 18.

<sup>43</sup> *Id.*

<sup>44</sup> *In re Mount Carbon Metro. Dist.*, 242 B.R. 18, 33 (Bankr. D. Colo. 1999) (“[U]nlike Chapter 11 [of the Bankruptcy Act], Chapter 9 cases cannot be involuntarily initiated by creditors; creditors may not propose a plan; a trustee cannot be appointed; and the inability to reorganize cannot result in liquidation of the municipality’s assets under Chapter 7.”).

the municipality.<sup>45</sup> Furthermore, a municipality's debtors cannot force the municipality to liquidate its assets involuntarily.<sup>46</sup>

Some of the other protections afforded to municipalities in Chapter 9 bankruptcies that are not reciprocated in other types of bankruptcies also directly reflect the level of involvement of the court. For example, a municipality is not subject to the reporting duty in which it must communicate transactional data directly to the bankruptcy court.<sup>47</sup> This freedom is not reciprocated in other types of bankruptcy.<sup>48</sup> Furthermore, a municipality is still afforded the right to borrow and spend without court authority.<sup>49</sup>

### *B. Chapter 9 Eligibility Standards Under § 109(c)*

Because of the added protections and freedoms afforded to municipalities in Chapter 9 bankruptcy proceedings, one of the main procedural differences between Chapter 9 bankruptcies and their corporate and individual bankruptcy counterparts is the threshold a municipality must meet in establishing its Chapter 9 eligibility.<sup>50</sup> Furthermore, creditors have the added ability to challenge such eligibility.<sup>51</sup> Section 921(c) of Chapter 9 is written as if it bestows upon the judiciary a discretionary power in dismissing a bankruptcy petition for failing to meet this threshold: "After any objection to the petition, the court, after notice and a hearing, may dismiss the petition ... if the petition does not meet the requirements of this title."<sup>52</sup> In practice, however, courts have been reluctant to interpret § 921(c) so broadly and conclude that failure to meet the Chapter 9 eligibility standards requires mandatory dismissal of the bankruptcy

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<sup>45</sup> Moringiello, *supra* note 41, at 458–59.

<sup>46</sup> David G. Heiman, Heather Lennox, Lori Sinanyan, Mark K. Sisitsky & Jayant W. Tambe, *An Overview of Chapter 9 of the Bankruptcy Code: Municipal Debt Adjustments*, JONES DAY (Aug. 15, 2010), <http://www.jonesday.com/an-overview-of-chapter-9-of-the-bankruptcy-code-municipal-debt-adjustments-08-15-2010/> [<http://perma.cc/57ZB-9W2R>].

<sup>47</sup> *See* 11 U.S.C. § 1107 (2012).

<sup>48</sup> *Id.*; *see also* 11 U.S.C. § 904 (2012).

<sup>49</sup> *See* 11 U.S.C. § 904 (2012).

<sup>50</sup> *See* Kimhi, *supra* note 22, at 356–57.

<sup>51</sup> *See id.* at 357.

<sup>52</sup> 11 U.S.C. § 921(c) (2012).

petition.<sup>53</sup> Therefore, the petitioning municipality must show by a preponderance of the evidence that it satisfies each of the five elements under 11 U.S.C. § 109(c) in order to meet the Chapter 9 eligibility threshold.<sup>54</sup>

The first element of eligibility under § 109(c) mandates that an entity filing for Chapter 9 bankruptcy must meet the definition of “municipality” under Title 11.<sup>55</sup> Title 11 reads the definition of “municipality” as a “political subdivision or public agency or instrumentality of a state.”<sup>56</sup> This requirement does not limit the eligibility strictly to cities or other local governments.<sup>57</sup> By including “public agency” or “instrumentality of the state,” the Bankruptcy Code allows entities such as school districts, sanitation resource providers, and even local health systems to file for Chapter 9 relief.<sup>58</sup>

The second element for Chapter 9 eligibility is set out in § 109(c)(2) and requires the state to authorize the municipality as a “debtor” under Title 11:

An entity may be a debtor under chapter 9 of this title if and only if such entity ... is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter ....<sup>59</sup>

State authorization is an important aspect of Chapter 9 cases because it circumvents many state sovereignty issues arising from the Tenth Amendment.<sup>60</sup>

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<sup>53</sup> See *Int’l Ass’n of Firefighters, Local 1186 v. City of Vallejo*, 408 B.R. 280, 289 (B.A.P. 9th Cir. 2009) (“[C]ourts have construed § 921(c) to require the mandatory dismissal of a petition filed by a debtor who fails to meet the eligibility requirements under § 109(c).”); *In re Sullivan Cty. Reg’l Refuse Disposal Dist.*, 165 B.R. 60, 83 (Bankr. D.N.H. 1994) (“The debtors in the present case have failed to establish the requisites for Chapter 9 relief ... under § 109(c) ... and therefore their petitions must be dismissed ....”).

<sup>54</sup> Heiman et al., *supra* note 46.

<sup>55</sup> 11 U.S.C. § 109(c) (2012).

<sup>56</sup> 11 U.S.C. § 101(40) (2012).

<sup>57</sup> CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 109 (3d ed. 2014).

<sup>58</sup> *Id.*

<sup>59</sup> 11 U.S.C. § 109(c)(2) (2012).

<sup>60</sup> Moringiello, *supra* note 41, at 458–59.

Third, the petitioning municipality must be “insolvent” under 11 U.S.C. § 109(c)(3).<sup>61</sup> Insolvency is a heightened requirement that is not reciprocated in non-Chapter 9 bankruptcy provisions.<sup>62</sup> “Insolvent” is defined within the Bankruptcy Code as a “financial condition” whereby a municipality is “generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute” or is “unable to pay its debts as they become due.”<sup>63</sup> Despite this definition, “insolvent” is still a somewhat indefinite term with potentially outcome-determinative powers.<sup>64</sup> However, some courts have gone to considerable lengths to address this haziness in the past.<sup>65</sup> Ultimately, objections based on the insolvency requirement are substantial weapons in a creditor’s arsenal because they surreptitiously allow creditors to weigh in on a Chapter 9 filing while stalling the bankruptcy proceedings<sup>66</sup> and ensuring that municipalities are not unduly resorting to Chapter 9 relief instead of opting for private restructuring.<sup>67</sup>

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<sup>61</sup> 11 U.S.C. § 109(c)(3) (2012).

<sup>62</sup> Sara Coelho, *Is the Debtor Bankrupt Enough? Application of the Chapter 9 Insolvency Test to the City of Vallejo*, WEIL, GOTSHAL & MANGES LLP (Apr. 13, 2011), <http://business-finance-restructuring.weil.com/chapter-9/is-the-debtor-bankrupt-enough-application-of-the-chapter-9-insolvency-test-to-the-city-of-vallejo/> [<http://perma.cc/J7ZL-BD8W>].

<sup>63</sup> 11 U.S.C. § 101(32)(C)(i)–(ii) (2012).

<sup>64</sup> See Coelho, *supra* note 62.

<sup>65</sup> See generally *In re City of Vallejo*, 408 B.R. 280 (B.A.P. 9th Cir. 2009). When the city of Vallejo, California filed for bankruptcy in 2009, the city’s creditors argued that the city was not “insolvent” for purposes of § 109(c)(3). *Id.* The bankruptcy court overseeing the case viewed “insolvency” as a financial condition whereby a municipality’s “cash flow” is so restricted that it cannot pay off debts due within the next year and still have the flexibility to use its remaining funds to continue requisite municipal operations and progress with other creditor negotiations. See *id.* at 290–94. The court ultimately upheld the city’s eligibility and a bankruptcy appellate panel from the Ninth Circuit affirmed. *Id.* at 290.

<sup>66</sup> See Coelho, *supra* note 62. Even when creditors fail to get a bankruptcy petition dismissed for want of eligibility, Coelho suggests that creditors receive a “tactical advantage” just from contesting a municipality’s eligibility because eligibility litigation can tie up the bankruptcy proceedings while creditors seek private negotiations with the municipality. *Id.*

<sup>67</sup> Meagan Costello, *Chapter 9 Eligibility: The Test for Insolvency (Part 2 of 3)*, GOODWIN PROCTOR (Jan. 29, 2013), <http://blog.munibk.com/chapter-9-eligibility-the-test-for-insolvency-part-2-of-3> [<http://perma.cc/Q3FQ-9C7W>].

The fourth element of Chapter 9 eligibility under § 109(c) requires the petitioning municipality to “desire[ ] to effect a plan to adjust such debts.”<sup>68</sup> This requirement is “highly subjective” and corresponds with the good faith filing requirement under § 921(c), which is addressed later in this Note.<sup>69</sup> Essentially, the petitioning municipality must illustrate that its bankruptcy filing is the result of an intention to restructure its debt rather than to evade creditors or buy time.<sup>70</sup>

The final element for Chapter 9 eligibility under § 109(c) addresses pre-petitioning negotiations between the municipality and its creditors.<sup>71</sup> Under § 109(c)(5), the municipality can satisfy the fifth requirement if it falls into any of four categories for pre-petitioning negotiations.<sup>72</sup> More specifically, the municipality must demonstrate that (1) it has reached an agreement with its creditors; (2) it has negotiated with its creditors in good faith; (3) negotiations would be impracticable; or (4) a creditor would be able to obtain a preference.<sup>73</sup> The categories under § 109(c)(5) ensure that Chapter 9 filings are not capricious but still provide Chapter 9 bankruptcy as an option for municipalities struggling to negotiate with creditors privately.<sup>74</sup>

The five requirements under § 109(c) are mandatory hurdles a municipality faces when filing for Chapter 9 bankruptcy. However, a municipality’s eligibility does not end with those five requirements. Even if a municipality can meet the eligibility requirements under 11 U.S.C. § 109(c), a creditor can still challenge the municipality’s Chapter 9 bankruptcy petition based on lack of good faith in its filing.<sup>75</sup>

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<sup>68</sup> 11 U.S.C. § 109(c)(4) (2012).

<sup>69</sup> COLLIER ON BANKRUPTCY P 900.02[2][d] (Alan N. Resnick & Henry J. Sommers eds., 16th ed. 2014).

<sup>70</sup> *Id.* (“A statement by the municipality of its intent to implement a plan of adjustment coupled with evidence of actions taken and/or being taken by the municipality in furtherance of such intent should be sufficient to meet the statutory requirement.”).

<sup>71</sup> 11 U.S.C. § 109(c)(5) (2012).

<sup>72</sup> *Id.* at (B)–(D).

<sup>73</sup> *Id.*

<sup>74</sup> COLLIER ON BANKRUPTCY, *supra* note 69.

<sup>75</sup> 11 U.S.C. § 921(c) (2012).

*C. The Good Faith Filing Requirement*

Although some of the requirements under § 109(c) touch upon Chapter 9's good faith filing requirement, the Bankruptcy Code still explicitly mandates the municipality to file its petition in good faith under § 921(c).<sup>76</sup> Part I, Section B of this Note cited § 921(c) due to its role in requiring the municipality to meet certain eligibility thresholds.<sup>77</sup> However, in addition to providing the statutory scaffolding for the court to dismiss Chapter 9 bankruptcy petitions based on ineligibility, the provision also imposes a duty on the municipality to conduct its filing in good faith.<sup>78</sup> In its entirety, § 921(c) reads: "After any objection to the petition, the court, after notice and a hearing, may dismiss the petition if the debtor did not file the petition in *good faith* or if the petition does not meet the requirements of this title."<sup>79</sup>

The good faith filing requirement is not unique to Chapter 9 cases.<sup>80</sup> However, the rationale behind § 921(c) also aligns itself with some of the other unique requirements for Chapter 9 bankruptcy. As mentioned before, some of these requirements entwine themselves with constitutional issues under the Tenth Amendment.<sup>81</sup> The most compelling reason for these requirements is the nature of the entity filing for bankruptcy. As mentioned in Part I, Section B, both the court's and the creditor's roles are minimized compared to individual and corporate bankruptcy cases.<sup>82</sup> At the heart of Chapter 9 bankruptcy is the protection of the municipality for the benefit of the civic community. However, § 921(c) of the Bankruptcy Code is a final threshold that a municipality must overcome.

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<sup>76</sup> *Id.*

<sup>77</sup> *See supra* Part I.B.

<sup>78</sup> *See* 11 U.S.C. § 921(c) (2012).

<sup>79</sup> *Id.* (emphasis added).

<sup>80</sup> The Bankruptcy Code expresses a good faith filing requirement in almost every type of bankruptcy. To be specific, 11 U.S.C. § 707(a) establishes the good faith filing requirement for Chapter 7 cases. 11 U.S.C. § 1112(b), as well as a wealth of case law, establishes the good faith filing requirement for Chapter 11 cases. The Chapter 13 good faith filing requirement is codified at 11 U.S.C. § 1307(c).

<sup>81</sup> *See supra* Part I.A; *see also* Moringiello, *supra* note 41, at 458–59.

<sup>82</sup> *See supra* Part I.B.

Section 921(c) of the Bankruptcy Code is the cornerstone of this Note. Because § 921(c) has the potential to completely thwart a municipality from successfully filing for Chapter 9 bankruptcy, it carries a wealth of statutory potency.<sup>83</sup> Surprisingly, “good faith”—the core term of the provision—is not defined anywhere within § 921(c), nor anywhere else within the Bankruptcy Code, despite this outcome-determinative power. Left with little statutory guidance, courts have considered the good faith requirement under § 921(c) in myriad ways. Despite these various good faith practices under § 921(c), there is still no definitive standard in the Chapter 9 bankruptcy context. Furthermore, as it stands, no single “good faith” adaptation or interpretation stands out as particularly instructive or illustrative in Chapter 9 cases.<sup>84</sup> The remainder of Part I, Section C will address alternative good faith practices and discuss the difficulties they present.

### 1. *The Chapter 11 Good Faith Test*

The most established endeavor to systematize a good faith test occurs in the Chapter 11 bankruptcy context.<sup>85</sup> Because the Bankruptcy Code fails to offer a “good faith” definition, judges have used Chapter 11 cases to develop a good faith analysis.<sup>86</sup>

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<sup>83</sup> See *supra* Part I.B. Spread throughout Chapter 9 jurisprudence, however, courts and scholars have noted that the discretionary language of § 921(c) does not call for the mandatory dismissal of a bankruptcy petition for municipalities who fail to file the petition in good faith. See *In re Cty. of Orange*, 183 B.R. 594 (Bankr. C.D. Cal. 1995). See also COLLIER ON BANKRUPTCY, *supra* note 69. However, almost no cases have specifically addressed this permissive nature. See *In re City of San Bernardino, Cal.*, 499 B.R. 776 (Bankr. C.D. Cal. 2013) (stating that almost no cases have addressed the permissive language of § 921(c) in terms of a dismissal requirement but rationale regarding the finality of a dismissal of a motion to dismiss the petition based on bad faith under § 921(c) sheds light on the judiciary’s discretion in dismissing the Chapter 9 bankruptcy petition). *Id.* at 791.

<sup>84</sup> See generally Paul D. Leake, *Making the Case for a “Good Faith” Chapter 11 Filing*, JONES DAY (Dec. 2004), <http://www.jonesday.com/newsknowledge/publicationdetail.aspx?publication=2083> [<http://perma.cc/LA7V-4PL7>] (“Unfortunately, case law guidance on the concept of ‘good faith’ is often abstruse, offering little concrete guidance, and sometimes contradictory.”).

<sup>85</sup> See *id.*

<sup>86</sup> See, e.g., *In re Sullivan Cty. Reg’l Refuse Disposal Dist.*, 165 B.R. 60, 80 (Bankr. D.N.H. 1994).

Some bankruptcy courts presiding over Chapter 9 cases have then looked to these Chapter 11 cases in the past in order to grasp a meaningful test for § 921(c)'s good faith requirement.<sup>87</sup> Although Chapter 11's test has been the basis for Chapter 9 good faith determinations in the past, no formal adoption has occurred.<sup>88</sup>

The test in Chapter 11 calls for a largely subjective good faith assessment that evaluates the petitioner's bankruptcy filing with an eye toward dismissing the bankruptcy petition "for cause."<sup>89</sup> In these Chapter 11 cases, the longstanding test presents a dichotomy: "[t]he test is whether a debtor is attempting to unreasonably deter and harass creditors *or* attempting to effect a speedy, efficient reorganization on a feasible basis."<sup>90</sup> This test allows the courts to look into an "amalgam" of factors,<sup>91</sup> but ultimately asks the courts to "get into the debtor's head" and subjectively determine the debtor's motives for filing for bankruptcy.<sup>92</sup> Because of this, alleged "bad faith" is often found when debtors attempt to use bankruptcy proceedings in an effort to abuse the judicial process for their benefit.<sup>93</sup> Like in Chapter 9 cases, if the court determines that the debtor has failed to file its bankruptcy petition in good faith, then the court should dismiss the case.<sup>94</sup>

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<sup>87</sup> See *id.* at 81 ("Determining whether a [chapter 11] petition has been filed in good faith requires an evaluation of a debtor's 'financial condition, motives, and the local financial realities.' These comments would appear to be equally applicable, at least in part, to a Chapter 9 petition.").

<sup>88</sup> See *id.*

<sup>89</sup> See *In re Arnold*, 806 F.2d 937, 939 (9th Cir. 1986); *In re Marsch*, 36 F.3d 825, 828 (9th Cir. 1994). See also 11 U.S.C. § 1112(b) (2012).

<sup>90</sup> *In re Marsch*, 36 F.3d at 828 (citing *In re Arnold*, 806 F.2d at 939).

<sup>91</sup> *In re Marsch*, 36 F.3d at 828.

<sup>92</sup> See Leake, *supra* note 84.

<sup>93</sup> See *id.*

Bad faith generally refers to a chapter 11 filing with the purpose of abusing the judicial process. For instance, a chapter 11 filing for the sole purpose of fending off litigation (e.g., foreclosure) if the debtor has no real prospect of reorganizing its business is often found to qualify as the kind of abuse that rises to the level of bad faith. Similarly, a filing by a solvent debtor merely to obtain a tactical litigation advantage has also been found to be abusive.

*Id.*

<sup>94</sup> See 11 U.S.C. § 1112(b) (2012).

Although this good faith test proves mostly sufficient and equitable in the Chapter 11 context,<sup>95</sup> subsuming the same Chapter 11 good faith test to Chapter 9 bankruptcies as an official practice poses three significant problems. These problems originate from the fact that the dichotomy derived from Chapter 11 case law presents an either/or scenario in which the entire bankruptcy case sits on a knife's edge.

The first problem arises regardless of the facts of the specific Chapter 9 case at hand or the standard the bankruptcy court uses to reach its determination. It arises because current bankruptcy courts are not given any statutory guidance on how to adjudicate the good faith filing requirement and must rely on inconsistent case law or forge their own path.<sup>96</sup> In such a context, judges are frequently asked to speculate on the intentions of the

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<sup>95</sup> See Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV. 919, 921, 946–47 (1991) (“[T]he bankruptcy courts’ adaptation of the good faith doctrine presents an excellent example of the law in evolution, a process we believe to be describable in meaningful terms from the positive law of the cases.”). Ponoroff and Knippenberg discuss how Chapter 11 bankruptcy cases use the good faith filing requirement to combat corporations abusing bankruptcy proceedings in order to solve particular business problems or exigencies that cannot be solved through more traditional business models. *Id.* at 921 (“[G]ood faith is transformed from a tired cliché, invoked in suspicious response to an array of novel filings, to a useful instrument pressed into service by the courts to bring order and standards to the business of assuring that bankruptcy policy and purposes evolve in a sensible, purposeful way.”). *But see* Robert J. Bein, *Subjectivity, Good Faith and the Expanded Chapter 13 Discharge*, 70 MO. L. REV. 656, 658 (2005) (“[T]he law views subjective determinations ... as inherently less stable.”). In this article, the author ultimately argues for a mix of both subjective and objective analysis in determining good faith; however, he also highlights difficulties of an inherently subjective analysis. *Id.* at 685 (“The law must be sufficiently objective as to be predictable so that individuals can order their affairs with some confidence in how they will be treated by the law. Without objectivity, the law devolves into disorder.” (footnote omitted)).

<sup>96</sup> In the context of Chapter 7 bankruptcies, the Eighth Circuit has echoed concerns that the lack of a statutory basis for good faith “will be ‘employed as a loose cannon which is to be pointed in the direction of a debtor whose values do not coincide precisely with those of the court.’” *In re Huckfeldt*, 39 F.3d 829, 832 (8th Cir. 1994) (citing *In re Latimer*, 82 B.R. 354, 364 (Bankr. E.D. Pa. 1988)).

bankruptcy petitioners.<sup>97</sup> Leaving such an unrestrained opportunity for unilateral judicial discretion has raised red flags in the past, and these concerns are found in many types of bankruptcy law.<sup>98</sup> In fact, Congress responded to a lack of uniformity in bankruptcy cases in the not too distant past when it created the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.<sup>99</sup> In order to curb potential prejudices and raise judicial accountability in the bankruptcy context, some scholars advocate for further legislative activism.<sup>100</sup> However, a fitting piece of legislation has yet to solve this problem, and the particular issue of lack of statutory guidance with regard to § 921(c) is likely to persist until the Bankruptcy Code is amended, or a single, unified test becomes a widely accepted standard for future cases.

The second problem is that the Chapter 11 test could result in too light a burden for municipalities to meet when petitioning for Chapter 9 bankruptcy. The thrust of the Chapter 11 good faith filing analysis is to make sure that the debtor's motives are not "antithetical to the basic purposes of bankruptcy."<sup>101</sup> Meanwhile, challenging a municipality's good faith is only one of a very limited number of opportunities that a creditor has to combat a municipal bankruptcy due to the municipality's protections under Chapter 9.<sup>102</sup> Therefore, if creditors are only left to challenge a Chapter 9 bankruptcy petition based on the argument that the municipality has filed its petition for reasons adverse to the basic purposes of bankruptcy, then creditor-objectors may repeatedly fail to have a municipality's Chapter 9 petition dismissed.<sup>103</sup> This failure is a likely result because municipalities

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<sup>97</sup> See Bein, *supra* note 95, at 658.

<sup>98</sup> *In re Huckfeldt*, 39 F.3d at 832. See also Bein, *supra* note 95, at 658.

<sup>99</sup> Kara J. Bruce, *Rehabilitating Bankruptcy Reform*, 13 NEV. L.J. 174, 189 (2012). "BAPCPA" was signed into law almost a decade ago with an impetus to streamline the administration of bankruptcy cases. The new statutory provisions created enhanced statutory standards for bankruptcy professionals to meet when attempting to restructure debt. *Id.*

<sup>100</sup> Bein, *supra* note 95, at 658.

<sup>101</sup> See Leake, *supra* note 84.

<sup>102</sup> *In re Mount Carbon Metro. Dist.*, 242 B.R. 18, 33 (Bankr. D. Colo. 1999).

<sup>103</sup> See *In re City of San Bernardino, Cal.*, 499 B.R. 776, 788 (Bankr. C.D. Cal. 2013). In this case, the court concluded that it was enough to show proper intent for Chapter 9 bankruptcy by taking an "affirmative step to file chapter 9

have an inherent power to argue that the Chapter 9 bankruptcy petition was filed so that the municipality can continue its civic functions while benefiting from Chapter 9 protection from its creditors.<sup>104</sup> If the Chapter 11 test of peeking into the minds of the petitioner is the test used in Chapter 9 cases, then civic officials will likely be able to preempt good faith challenges by showing their aspirations to keep a municipality running, despite both well-grounded and ardent pressures from its creditors, and actual bad faith in the municipality's subjective intentions.<sup>105</sup>

Finally—and in contrast to making the good faith petitioning requirement too easy—the third problem is that Chapter 11's good faith test could afford creditor-objectors an unbridled opportunity to thwart a municipal debtor's Chapter 9 bankruptcy attempt. This was a primary concern in Detroit's bankruptcy case.<sup>106</sup> In the alternative to the second problem above, this third problem could result whenever the court has the capability to determine whether the debtor is using the bankruptcy proceedings in any way inconsistent with an “efficient reorganization on a feasible basis.” Again, challenging a municipality's good faith filing is one of the few safeguards creditor-objectors are given in a Chapter 9 bankruptcy case.<sup>107</sup> However, as mentioned previously, § 921(c) has outcome-determinative power and this allows

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that it could restructure the debt and impair the creditors as necessary to achieve a balanced budget.” *Id.*

<sup>104</sup> See *id.*; see also *In re Sullivan Cty. Reg'l Refuse Disposal Dist.*, 165 B.R. 60, 82 (Bankr. D.N.H. 1994). In *In re Sullivan*, the court dismissed the bankruptcy petition because the municipality presented “no evidence of any meaningful discussion of [sic] what type of plan might be appropriate under Chapter 9.” *Id.* This suggests that even a menial effort in discussing a Chapter 9 would justify filing for Chapter 9 bankruptcy. *Id.*

<sup>105</sup> See generally *In re Ravenna Metro. Dist.*, 522 B.R. 656, 684 (Bankr. D. Colo. 2014). This case seems to suggest that the good faith requirement under § 921(c) is likely to be met if the petitioning municipality can articulate a threat to the health and well-being of the citizens. *Id.* Because providing services is within the purview of municipalities and they can control these services, almost any municipality facing budget issues could articulate a threat to the health and well-being of the citizens by stating that the services are in jeopardy.

<sup>106</sup> *In re City of Detroit*, 504 B.R. 97, 180 (Bankr. E.D. Mich. 2013).

<sup>107</sup> *In re Mount Carbon Metro. Dist.*, 242 B.R. at 33.

creditor-objectors the opportunity to have a Chapter 9 case dismissed.<sup>108</sup> Therefore, a creditor-objector need only show that the municipality has taken actions that are not directed towards an “efficient reorganization on a feasible basis” and the bankruptcy court could dismiss the Chapter 9 petition, even if the Chapter 9 filing was onset by the proper purposes and bankruptcy is the most adequate legal remedy for the municipality.

The Chapter 11 good faith test ultimately proves too imprecise and either too accommodating or harsh for the municipal bankruptcy context, depending on the specific circumstances of the case. Overall, a Chapter 11 analogy is an impracticable and misguided prospect for a unified Chapter 9 good faith analysis. Although a void exists in Chapter 9’s good faith jurisprudence, the void likely will not find an adequate substitute in its individual or corporate bankruptcy brethren under Chapter 11.

## *2. Other Alternative Tests for Chapter 9 Good Faith*

Without a formal “test” to draw from, courts have approached Chapter 9 cases in a multitude of ways. In some cases, bankruptcy courts merely take a cursory glance into the municipality’s good faith filing requirement.<sup>109</sup> However, bankruptcy courts have also taken a more holistic approach in previous Chapter 9 bankruptcy cases and considered many important aspects that frequently arise in good faith filing challenges.<sup>110</sup>

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<sup>108</sup> See *supra* Part I.B.

<sup>109</sup> See *In re Pleasant View Util. Dist.*, 24 B.R. 632, 639 (Bankr. M.D. Tenn. 1982); *In re Vills. at Castle Rock Metro. Dist. No. 4*, 145 B.R. 76, 81 (Bankr. D. Colo. 1990). In these cases, the courts do not even provide a basis for § 921(c) eligibility, yet they both still cite it as mandatory authority.

<sup>110</sup> See *In re City of San Bernardino, Cal.*, 499 B.R. 776, 790 (Bankr. E.D. Cal. 2012) (“As in many other considerations of good faith in the context of bankruptcy, the test is a totality of the circumstances where the Court is given the power to weigh the numerous factors in light of the circumstances as a whole in determining whether good faith is lacking.”); *In re Mount Carbon Metro. Dist.*, 242 B.R. at 40–41:

Borrowing from the good faith analysis of Chapter 11 and Chapter 13, it is easy to conclude that the Court should consider the totality of the circumstances. The factors which a

While some courts will impute the Chapter 11 good faith test into a Chapter 9 case, some of the jurisprudence surrounding Chapter 9's good faith requirement merely pays homage to Chapter 11's dichotomous test.<sup>111</sup> Perhaps the most permeating consideration is the bankruptcy court's willingness to inquire into the intent of the bankruptcy petitioner.<sup>112</sup> As seen in Chapter 11, this consideration is not a significant breakthrough in Chapter 9 good faith analysis but illustrates the importance of the bankruptcy petitioner's motives and goals in its filing. Overall, for reasons similar to the difficulty of applying this inquiry in Chapter 11 cases, determining the subjective motives of the petitioning municipality alone is a largely unpersuasive test that makes the proceedings very difficult for both the bench and opposing parties.

While many Chapter 9 cases facetiously dance around Chapter 11's good faith test, some cases go well beyond the simple either/or analysis that the Chapter 11 test mandates.<sup>113</sup> Today, many scholars and opinions cite Collier's bankruptcy resources as the most unified collection of Chapter 9 good faith analysis.<sup>114</sup> It reads:

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Court should examine in each chapter include: (1) whether a plan comports with the provisions and purpose of the Code and the chapter under which it is proposed, (2) whether a plan is feasible, (3) whether a plan is proposed with honesty and sincerity, and (4) whether a plan's terms or the process used to seek its confirmation was fundamentally fair.

<sup>111</sup> See *In re Pleasant View Util. Dist.*, 24 B.R. at 639; *In re Vills.* at Castle Rock Metro. Dist. No. 4, 145 B.R. at 81. In these cases, the courts do not even provide a basis for § 921(c) eligibility, yet they both still cite it as mandatory authority.

<sup>112</sup> See *In re City of San Bernardino, Cal.*, 499 B.R. 776, 789–91 (Bankr. C.D. Cal. 2013); *In re N.Y. City Off-Track Betting Corp.*, 427 B.R. 256, 280–81 (Bankr. S.D.N.Y. 2010); *In re Pierce Cty. Hous. Auth.*, 414 B.R. 702, 720–21 (Bankr. W.D. Wash. 2009); *In re Cty. of Orange*, 183 B.R. 594, 608 (Bankr. C.D. Cal. 1995). All these cases cite the inquiry into the subjective intent of the municipality when filing for Chapter 9.

<sup>113</sup> See *id.*

<sup>114</sup> See *In re City of San Bernardino, Cal.*, 499 B.R. at 785–86; *In re N.Y. City Off-Track Betting Corp.*, 427 B.R. at 274; *In re Pierce Cty. Hous. Auth.*, 414 B.R. at 714; *In re Cty. of Orange*, 183 B.R. at 608. These four cases cite Collier's when determining § 921(c)'s requirements.

The facts that may be relevant in a good faith inquiry include (i) the debtor's subjective beliefs; (ii) whether the debtor's financial problems fall within the situations contemplated by chapter 9; (iii) whether the debtor filed its chapter 9 petition for reasons consistent with the purposes of chapter 9; (iv) the extent of the debtor's prepetition negotiations, if practical; (v) the extent that alternatives to chapter 9 were considered; and (vi) the scope and nature of the debtor's financial problems.<sup>115</sup>

Much of the language in Collier's is subsumed from Chapter 11 analysis.<sup>116</sup> However, even with six factors for bankruptcy courts to consider, there is still no instructive impetus for dealing with § 921(c)'s concerns. Without more specificity, judges continue to wield unbridled power when dealing with bankruptcy cases.<sup>117</sup> Because of this, the basic concerns associated with the judge's discretionary power in other bankruptcy contexts are reciprocated in Collier's take on Chapter 9's § 921(c) good faith requirement.<sup>118</sup>

Overall, courts have not shied away from imputing a thorough analysis for Chapter 9 good faith. Some courts have gone to great lengths by analogizing Chapter 9 cases to Chapter 11 cases.<sup>119</sup> They have explored a multitude of analyses, such as looking into the intent of the bankruptcy petitioner to find good or bad faith,<sup>120</sup> as well as other fact-intensive considerations such as those found in Collier's Chapter 9 good faith scheme.<sup>121</sup> However, this holistic approach has not been methodized or widely adopted. Even though the Chapter 9 good faith analysis has found somewhat reasonable footing in these past cases, none of the previous analyses have proven to be a viable, definitive standard or test going forward. None have stood out to be the holistic approach worthy of widespread adoption. However, Detroit's bankruptcy case can fill the

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<sup>115</sup> COLLIER ON BANKRUPTCY, *supra* note 69.

<sup>116</sup> Both Collier's scheme (in particular, items (i)–(iii)) and the Chapter 11 good faith test are grounded upon viewing the subjective intent of the debtor.

<sup>117</sup> Bein, *supra* note 95.

<sup>118</sup> *See id.*

<sup>119</sup> *See infra* Part II.C.

<sup>120</sup> *Id.* *See also In re City of San Bernardino*, Cal., 499 B.R. 776, 789–91 (Bankr. C.D. Cal. 2013); *In re N.Y. City Off-Track Betting Corp.*, 427 B.R. 256, 280–81 (Bankr. S.D.N.Y. 2010); *In re Pierce Cty. Hous. Auth.*, 414 B.R. 702, 720–21 (Bankr. W.D. Wash. 2009); *In re Cty. of Orange*, 183 B.R. 594, 608 (Bankr. C.D. Cal. 1995).

<sup>121</sup> COLLIER ON BANKRUPTCY, *supra* note 69.

void left by Congress's silence in addressing § 921(c)'s good faith requirement. In order to understand both how Detroit's case can be the leading and preeminent guide for future cases, and how the court handled the complexities associated with Detroit's Chapter 9 bankruptcy filing, an overview of Detroit's financial history leading up to and including its bankruptcy is pertinent.

## II. AN OVERVIEW OF DETROIT'S BANKRUPTCY

To some extent, Detroit's financial distress was largely foreseeable.<sup>122</sup> Judge Rhodes opined that because Detroit faced such overwhelming fiscal exigency, even the objecting creditors knew that the Chapter 9 bankruptcy filing was ultimately a "foregone conclusion."<sup>123</sup> The origins of the city's anguish can be traced through the last seven decades of Detroit's history.<sup>124</sup> This history, however, demonstrates that no singular personality or event led to the ultimate financial downturn. Indeed, many factors gave rise to Detroit's downward spiral.<sup>125</sup>

Part II, Section A of this Note will discuss Detroit's financial history prior to the bankruptcy filing. Section B will explore the time period directly in line with Detroit's Chapter 9 filing. Finally, Section C will provide an overview of Detroit's Chapter 9 eligibility and the challenges raised by the city's creditors.

### *A. Detroit in the Twentieth and Early Twenty-First Century*

There was a long period in American history when the city of Detroit seemed infallible.<sup>126</sup> Riding alongside the successes of the booming auto industry, Detroit blossomed in the early years of the twentieth century.<sup>127</sup> In fact, the first seven decades of the

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<sup>122</sup> Nathan Bomey & John Gallagher, *A Free Press Investigation: How Detroit Went Broke*, DETROIT FREE PRESS (Sept. 15, 2013).

<sup>123</sup> *In re City of Detroit*, 504 B.R. 97, 176 (Bankr. E.D. Mich. 2013).

<sup>124</sup> Bomey & Gallagher, *supra* note 122.

<sup>125</sup> See Amy Padnani, *Anatomy of Detroit's Decline*, N.Y. TIMES (Dec. 8, 2013), [http://www.nytimes.com/interactive/2013/08/17/us/detroit-decline.html?\\_r=0](http://www.nytimes.com/interactive/2013/08/17/us/detroit-decline.html?_r=0) [<http://perma.cc/NQ8Z-SL9P>].

<sup>126</sup> Bomey & Gallagher, *supra* note 122.

<sup>127</sup> SCOTT MARTELLE, DETROIT: A BIOGRAPHY 95 (2012).

twentieth century earmarked the swift rise of Detroit as a rich, prosperous city.<sup>128</sup>

Detroit's climb to the upper strata of American society stems from its role as the birthplace and hotbed for much of the nation's industrialization.<sup>129</sup> The rise of automobile manufacturing at the turn of the twentieth century predicated this boom in industry.<sup>130</sup> In 1908, Ford Motor Company introduced the Model T.<sup>131</sup> Henry Ford then announced the five-dollar workday in 1914.<sup>132</sup> Subsequent to these two events, Ford produced and distributed over 15 million Model Ts<sup>133</sup> and Detroit's population exploded, eventually becoming the fourth largest city in the United States.<sup>134</sup> Suddenly, Detroit could offer a livable wage to just about anyone.

Bolstered by this industrial influx, Detroit even managed to endure the Great Depression. In the 1930s, former Detroit Mayor Frank Murphy stated: “[Detroit] is a great, rich city ... it has never repudiated an obligation nor defaulted upon a debt—and it never will.”<sup>135</sup> Mayor Murphy's words mostly rang true as the city survived the Great Depression without a total economic collapse, although it did come with great hardship.<sup>136</sup> Automobile sales plunged due to lack of consumerism.<sup>137</sup> Jobs were cut, taxes went unpaid, and the population fluctuated.<sup>138</sup> Due to its lack of revenue, the city itself faced such great hardship that it paid policemen, teachers, and other civic workers in promissory

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<sup>128</sup> Bomey & Gallagher, *supra* note 122.

<sup>129</sup> Joel Kurth, Mike Wilkinson & Louis Aguilar, *Special Report—Six decades in Detroit: How abandonment, racial tensions and financial missteps bankrupted the city*, DETROIT NEWS (Oct. 4, 2013), <http://www.detroitnews.com/article/20131004/METRO01/310040001> [<http://perma.cc/5S3J-49WS>].

<sup>130</sup> MARTELLE, *supra* note 127.

<sup>131</sup> HENRY FORD & SAMUEL CROWTHER, *MY LIFE AND WORK* (2008). *See also* Kurth, Wilkinson & Aguilar, *supra* note 129. In the article, long-time Detroit city residents describe their memories of looking back into Detroit's past and seeing a Utopia.

<sup>132</sup> FORD & CROWTHER, *supra* note 131.

<sup>133</sup> *Id.*

<sup>134</sup> Bomey & Gallagher, *supra* note 122.

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> *Id.*

<sup>138</sup> *Id.*

notes, then known as “scripts.”<sup>139</sup> The city struggled, but there was at least an intermediate end in sight when the nation would call upon Detroit for help.<sup>140</sup>

The city of Detroit found a new purpose with the onset of World War II.<sup>141</sup> Eventually, the city completely shut down commercial automobile manufacturing and began manufacturing tanks and airplanes for the Allied forces.<sup>142</sup> Jobs that had evaporated during the Great Depression became available again and the industrial boom of World War II brought newfound prosperity to the city of Detroit.<sup>143</sup> The economy stabilized and the city’s population settled.<sup>144</sup> Soon after the war, Detroit again became the hub for American auto manufacturing.<sup>145</sup> In fact, the U.S. Census of 1960 revealed that Detroit had the highest per-capita income of any American city at the time.<sup>146</sup>

While Detroit maintained its fiscal opulence throughout the majority of the twentieth century, the city also faced social ills and drug issues that threatened the city’s populace as well as its prosperity.<sup>147</sup> Although much of the nation endured egregious hardships brought on by race tensions, Detroit may have suffered the worst of it. Finally, in 1967, police invaded an unlicensed speakeasy operated by African Americans, and a ruinous riot erupted and left 43 dead, 1,189 injured, and 2,000 buildings destroyed.<sup>148</sup> The violence would continue and eventually cause many families and individuals to move out of the city.<sup>149</sup> The city also suffered from the prevalence of drugs.<sup>150</sup> According to the

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<sup>139</sup> DETROIT PUB. LIBRARY, WARTIME DETROIT: THE ARSENAL OF DEMOCRACY, [http://web.archive.org/web/20070901171535/http://www.detroit.lib.mi.us/GoldenJubileeExhibit/GJ%20WEB/II\\_Wartime\\_Detroit.htm](http://web.archive.org/web/20070901171535/http://www.detroit.lib.mi.us/GoldenJubileeExhibit/GJ%20WEB/II_Wartime_Detroit.htm) [<http://perma.cc/MUW2-5EPR>].

<sup>140</sup> *See id.*

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> MARTELLE, *supra* note 127.

<sup>144</sup> *See id.*

<sup>145</sup> *See id.*

<sup>146</sup> *Detroit is Dying Quickly*, FREAKONOMICS (Mar. 23, 2011), <http://freakonomics.com/2011/03/23/detroit-is-dying-quickly/> [<http://perma.cc/BK26-AKTD>].

<sup>147</sup> Kurth, Wilkinson & Aguilar, *supra* note 129.

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

Detroit News, the abuse of crack cocaine served as a catalyst for illness and violence.<sup>151</sup> Both hospital admittances and crime rates rose dramatically.<sup>152</sup> Detroit became known as the murder capital of America.<sup>153</sup>

In addition to a plague of social decay, Detroit's steady decline would continue as the city fell victim to stunning fiscal losses during the 1970s.<sup>154</sup> As war broke out in the Middle East in 1973, gas prices spiked.<sup>155</sup> The Detroit economy, which was buttressed by gas-guzzling automobiles, faced an uphill battle.<sup>156</sup> Meanwhile, foreign automakers were finding new footing in the automobile industry and threatened the American auto industry with complete obsolescence.<sup>157</sup> Notable journalist Peter Hitchens wrote that "the U.S. car industry lost the confidence even of patriotic Americans, and has never fully regained it."<sup>158</sup>

Because Detroit relied so heavily on this single industry, the auto industry would remain a common indicator of the difficulties ahead. During the 1980s and 1990s, the Michigan auto industry faced an immense downturn.<sup>159</sup> Trade agreements were put into place that ostensibly allowed American manufacturers to leave the country in favor of foreign countries.<sup>160</sup> Therefore, when these and many other economic and industrial trends left Detroit's

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<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> Peter Hitchens, *From Motown to Ghost Town: How the Once Mighty Detroit is Heading Down a Long, Slow Road to Ruin*, DAILY MAIL (July 9, 2011), <http://www.dailymail.co.uk/news/article-2012971/From-Motown-Ghost-town-How-mighty-Detroit-heading-long-slow-road-ruin.html> [<http://perma.cc/U659-CXJZ>].

<sup>155</sup> *Id.*

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> See Richard N. Block & Dale L. Belman, *Automotive and Other Manufacturing Industries in Michigan: Output, Employment, Earnings, and Collective Bargaining, 1980–2001*, in MICHIGAN AT THE MILLENNIUM 145 (Charles L. Ballard et al. eds., 2003) (providing an in-depth analysis of Michigan's economic stature during the last few decades of the twentieth century).

<sup>160</sup> See Barry Lynn, *How Detroit Went Bottom-Up*, THE AMERICAN PROSPECT (Sept. 19, 2009), <http://prospect.org/article/how-detroit-went-bottom> [<http://perma.cc/SN2T-WWZ5>].

auto industry in a precarious position, the city, too, found itself on hard times.

Finally, General Motors's Rick Wagoner, Ford's Alan Mulally, Chrysler's Robert Nardelli, and the president of the United Auto Workers Union, Ron Gettelfinger, petitioned for a bailout from Congress in 2008.<sup>161</sup> Sitting before the Senate Banking Committee, the corporate executives could not muster logical or precise answers when confronted with what would otherwise be considered fairly straightforward questions.<sup>162</sup> At one point, Senator Bob Corker of Tennessee retorted, "I just want the numbers!"<sup>163</sup> Unsurprisingly, the auto executives came back to the city of Detroit empty-handed. After continued efforts to assuage Congress's concerns, all but Ford would partake in a bailout funded by the U.S. Treasury.<sup>164</sup> The woes of the auto industry prefaced what was to come of the city.<sup>165</sup>

### *B. Detroit's Chapter 9 Bankruptcy Filing*

Despite the absence of one singular event or personality in Detroit's history that led to the city's financial collapse, there were still pivotal decisions and circumstances that hastened or altogether ensured the downward spiral.<sup>166</sup> While the reliance on the auto industry certainly did not help Detroit's chances of success at the turn of the twenty-first century, many of the more overwhelming difficulties the city faced stemmed from the city's poor leadership.<sup>167</sup>

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<sup>161</sup> CHARLIE LEDUFF, *DETROIT: AN AMERICAN AUTOPSY* 82 (2013).

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

<sup>164</sup> Kimberly Amadeo, *Auto Industry Bailout (GM, Ford, Chrysler): Why the Big 3 Needed a Bailout and What It Cost the U.S. Taxpayer*, US ECONOMY (Dec. 21, 2014), [http://useconomy.about.com/od/criticalssues/a/auto\\_bailout.htm](http://useconomy.about.com/od/criticalssues/a/auto_bailout.htm) [<http://perma.cc/3CZC-XY42>].

<sup>165</sup> Padnani, *supra* note 125.

<sup>166</sup> *Id.*

<sup>167</sup> See Bomey & Gallagher, *supra* note 122. One of the frequent challenges Detroit's leadership faced was trying to balance a budget and make cuts that favor long-term relief but adversely affect short-term gains. Few, if any, were willing to rise to meet these challenges. *Id.*

Detroit's civic leadership has a storied past.<sup>168</sup> While some of Detroit's mayors—such as Hazen Pingree and Frank Murphy—will go down in history as some of the best the nation has ever seen, many others will also go down as some of the most inept and corrupt.<sup>169</sup> Out of these inept and corrupt mayors, Kwame Kilpatrick, is widely regarded as the worst of them.<sup>170</sup> Because Detroit faced a plethora of issues that went back many decades, Kwame Kilpatrick should not be singled out as the lone reason for Detroit's affliction.<sup>171</sup> However, his legacy serves as a microcosm of the anguish and despair that befell Detroit.

During Kwame Kilpatrick's time in office, the city of Detroit was already feeling the oppressive approach of bankruptcy.<sup>172</sup> However, in an effort to evade total financial collapse, Kilpatrick made decisions that favored short-term acquiescence over long-term strategy.<sup>173</sup> In a crime-ridden city, Kilpatrick cut the police force by over 25 percent.<sup>174</sup> He also reduced the number of police precincts, which resulted in an exponential increase in police response time.<sup>175</sup> The combination of these decisions essentially made the city unlivable for many. Although the exodus away from Detroit had started decades earlier, the population continued to dwindle as Detroit lost even more of its tax revenue.<sup>176</sup> The faults of Kwame Kilpatrick were many, but the major issue was that he had favored short-term relief over long-term strategy—a

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<sup>168</sup> Dan Austin, *Meet the 5 Worst Mayors in Detroit History*, DETROIT FREE PRESS (July 23, 2014), <http://www.freep.com/article/20140723/OPINION/307230054/Meet-5-worst-mayors-Detroit-history> [<http://perma.cc/J4KE-84FA>].

<sup>169</sup> *Id.*

<sup>170</sup> *Id.* (“Kilpatrick is more culpable—and his conduct more pervasive—than any other public corruption defendant sentenced in recent memory,” federal prosecutors said. “The scale of his corruption was astonishing. The impact on the region was devastating.”).

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> *Id.* The author notes that Detroit's police force went from 4,200 officers to 3,000 officers. *Id.*

<sup>175</sup> *Id.*

<sup>176</sup> See *Editor's Note: The Harris Manifesto*, DETROIT METRO TIMES (Apr. 27, 2005), <http://www.metrotimes.com/detroit/the-harris-manifesto/Content?oid=2181304> [<http://perma.cc/R845-2MFX>].

strategy that exacerbated Detroit's financial condition.<sup>177</sup> The major consequence of this failed relief was that the city of Detroit faced unprecedented municipal debt with no way to pay it back.<sup>178</sup>

The breaking point for Detroit's indebtedness occurred in early 2013. From 1998 to 2012, politicians from Michigan's state government, seated in Lansing, cut Detroit's state-shared revenue by 48 percent and withheld \$172 million from the city.<sup>179</sup> Due to these revenue cuts and the losses suffered from the reduction of its tax base, Detroit leadership—including Kwame Kilpatrick—began to reallocate funds in order to meet short-term obligations.<sup>180</sup> However, these responses further exacerbated the city's destitute condition.<sup>181</sup> Most of Detroit's indebtedness arose from unfunded pension benefits to previous civic employees and health care liabilities for employees past and present.<sup>182</sup> Over half of the city's budget was consumed by these "legacy costs."<sup>183</sup> These debt holders had been shoved aside, despite other corner-cutting strategies by Detroit leadership.<sup>184</sup> The levee soon broke.

In the summer of 2013, Kevyn Orr, a prominent bankruptcy attorney at Jones Day, was appointed as the city of Detroit's emergency manager in a heavily contested situation that brought to light many state constitutional concerns.<sup>185</sup> The appointment also

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<sup>177</sup> *Id.*

<sup>178</sup> Bob Adelman, *Detroit's Bankruptcy Plan Reveals Fraud in Funding Pensions*, THE NEW AMERICAN (Feb. 10, 2014), <http://www.thenewamerican.com/usnews/crime/item/17591-detroit-s-bankruptcy-plan-reveals-fraud-in-funding-pensions> [<http://perma.cc/3NNP-JJPE>]. This article suggests that even when Kwame Kilpatrick did try to address the pension liabilities, he did so by "clever legal circumvention" that allowed the city to exceed its debt limit. *Id.*

<sup>179</sup> See Bomey & Gallagher, *supra* note 122.

<sup>180</sup> *Id.*

<sup>181</sup> *Id.*

<sup>182</sup> *Id.*

<sup>183</sup> See Charlie LeDuff, *The Americans with Charlie LeDuff: Detroit's Bankruptcy is Helping Police Do Their Jobs*, YOUTUBE (June 26, 2014), <https://www.youtube.com/watch?v=zOWG8Xq3dZA> [<http://perma.cc/3EBQ-KY38>].

<sup>184</sup> Austin, *supra* note 168.

<sup>185</sup> Monica Davey & Mary Williams Walsh, *Billions in Debt, Detroit Tumbles Into Insolvency*, N.Y. TIMES (July 18, 2013), [http://www.nytimes.com/2013/07/19/us/detroit-files-for-bankruptcy.html?pagewanted=all&\\_r=2&](http://www.nytimes.com/2013/07/19/us/detroit-files-for-bankruptcy.html?pagewanted=all&_r=2&) [<http://perma.cc/5XRA-4YGZ>].

called into question the legitimacy of state laws that were then recently passed with the intention of fueling a push for Detroit to file for bankruptcy. In the end, the Michigan leadership, spearheaded by the efforts of Governor Snyder and Emergency Manager Orr, opted for Chapter 9 bankruptcy in a final effort to save the city.

### *C. Detroit's Chapter 9 Eligibility*

In some ways, Detroit's financial history is analogous to the histories of many other bankrupt municipal entities. Detroit certainly was not the first municipality to face bankruptcy in response to insurmountable debt wrought by a multitude of adverse conditions.<sup>186</sup> For example, Detroit's predecessor in the record books for largest municipal bankruptcy, Jefferson County, Alabama, also had millions—if not billions—in debt accrued through similar debt issuances, such as municipal bonds and retirement and healthcare services rendered to past and current civic employees.<sup>187</sup> However, Detroit is a unique case, especially in its magnitude. With its debt calculated somewhere between \$18 and \$20 billion,<sup>188</sup> Emergency Manager Kevyn Orr and the financial manager's team had to move quickly in order to stop the bleeding. Subsequently, Orr immediately initiated prepetition bankruptcy proceedings.<sup>189</sup>

The Honorable Judge Stephen Rhodes, sitting on the bench for the bankruptcy court for the Eastern District of Michigan, was assigned Detroit's case at the trial level.<sup>190</sup> His first assignment was to rule on Detroit's Chapter 9 eligibility under 11 U.S.C. § 109(c).<sup>191</sup> This task was the beginning of what was to become an arduous process of weeding through state constitutional law

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<sup>186</sup> Mary Williams Walsh, *In Alabama, a County That Fell Off the Financial Cliff*, N.Y. TIMES (Feb. 12, 2012), <http://www.nytimes.com/2012/02/19/business/jefferson-county-ala-falls-off-the-bankruptcy-cliff.html?pagewanted=all> [http://perma.cc/K7HH-9TCR].

<sup>187</sup> *Id.*

<sup>188</sup> Helms & Bomey, *supra* note 1.

<sup>189</sup> *Id.*

<sup>190</sup> *Id.*

<sup>191</sup> *Id.*

and bankruptcy law while also managing the outward challenge of a vast number of creditors who actively contested Detroit's eligibility. Despite this added difficulty, Judge Rhodes ultimately ruled in favor of Detroit's Chapter 9 eligibility.<sup>192</sup> For the most part, Judge Rhodes gracefully considered the creditors' arguments for ineligibility but came down firm on why Detroit maintained its eligibility under § 109(c).<sup>193</sup>

The most pertinent conclusions reached in Judge Rhodes's § 109(c) analysis were (1) that Detroit's prepetition negotiations were conducted in good faith;<sup>194</sup> and (2) that Detroit "desire[d] to effect a plan to adjust such debts."<sup>195</sup> These determinations would play a continued role later in Judge Rhodes' opinion, in which he tackled Detroit's good faith filing requirement under § 921(c).<sup>196</sup>

In addition to challenges under § 109(c), Detroit's creditor-objectors took issue with the petition being filed in good faith under § 921(c).<sup>197</sup> Judge Rhodes noted that some of these objections may have been brought on by potentially valid findings stemming from important concerns.<sup>198</sup> However, had Judge Rhodes considered these objections without looking at the petition's broader context, Detroit's creditor-objectors could have thwarted the city's only reasonable means of recovery. Judge Rhodes could have only looked at the intent and actions of those filing the petition or adopted the basic Chapter 11 test. Furthermore, the court could have simply decided on the creditor-objectors' claim that Emergency Manager Orr and Governor Snyder acted with impropriety in the first place. In both of these circumstances, which were used in other Chapter 9 cases, Detroit's chances of recovery could have been lost. Instead, Judge Rhodes appropriately viewed Detroit's circumstances wholly to decide the § 921(c) and § 109(c) eligibility thresholds, in light of the possibility of valid concerns raised by the creditor-objectors.<sup>199</sup>

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<sup>192</sup> *Id.*

<sup>193</sup> *Id.*

<sup>194</sup> 11 U.S.C. § 109(c)(5) (2012); *In re City of Detroit*, 504 B.R. 97, 110 (Bankr. E.D. Mich. 2013).

<sup>195</sup> 11 U.S.C. § 109(c)(4) (2012); *In re City of Detroit*, 504 B.R. at 172.

<sup>196</sup> *In re City of Detroit*, 504 B.R. at 179–89.

<sup>197</sup> *Id.* at 112.

<sup>198</sup> *See id.* at 187.

<sup>199</sup> *See id.* at 187–89.

III. DETROIT'S BANKRUPTCY PETITION AND THE § 921(C)  
GOOD FAITH REQUIREMENT

In the last section of *In re Detroit*, Judge Rhodes addressed Detroit's good faith filing requirement under § 921(c).<sup>200</sup> By this point, Judge Rhodes had already ruled that Governor Snyder and Emergency Manager Orr did not violate Michigan state constitutional concerns.<sup>201</sup> Adding on to this, Judge Rhodes convincingly arrived at the conclusion that Detroit had sufficiently met § 921(c)'s good faith petitioning requirement.<sup>202</sup> However, Judge Rhodes used considerable tact not only to address the creditor-objectors' claims but also to address the good faith requirement in light of circumstances not traditionally prescribed by § 921(c) case law.<sup>203</sup> What he arrived at was a more complete and thorough analysis of the issues implicated under § 921(c).<sup>204</sup> By doing so, Judge Rhodes carved a path for a more practicable and principled good faith analysis. However, Judge Rhodes had to go to great lengths to put this analysis together.

The creditor-objectors (many of whom were represented by some of the best attorneys in the country) brought up every instance possible in order to show that Detroit had petitioned for Chapter 9 bankruptcy in bad faith.<sup>205</sup> Indeed, Judge Rhodes noted dozens of testimonials that alleged impropriety in all stages leading up to the bankruptcy.<sup>206</sup> For example, unions representing Detroit's police and firefighters argued "one of the City's express purposes ... is to attempt to use these Chapter 9 proceedings to illegally impair the constitutionally protected pension rights of employees and retirees."<sup>207</sup> However, this argument, as well as

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<sup>200</sup> *Id.* at 179–89.

<sup>201</sup> *See id.* at 154–67.

<sup>202</sup> *See id.* at 179–89.

<sup>203</sup> Melissa B. Jacoby, *The Detroit Bankruptcy, Pre-Eligibility*, 41 *FORDHAM URB. L.J.* 849, 853 (2014) ("The written decision finding Detroit eligible for Chapter 9 responded to a remarkable number of objections in detail.").

<sup>204</sup> *Id.* at 865 ("[W]hat happens in this bankruptcy could set a blueprint for future municipal cases.").

<sup>205</sup> *See In re City of Detroit*, 504 B.R. at 181–87.

<sup>206</sup> *See id.*

<sup>207</sup> *Id.*

many others, proved to lack merit because Judge Rhodes already ruled that Michigan state constitutionality concerns were unfounded. Ultimately, a large portion of the objections were dismissed upon a finding that they were either too vague or simply unsupported by particular evidence to move the result in the creditor-objectors' favor.<sup>208</sup>

While addressing the most potent of the creditor-objector concerns, Judge Rhodes laid out a four-part analysis to determine whether Detroit had met the requirements for good faith filing under § 921(c).<sup>209</sup> It is important to note, however, that nowhere in the opinion did Judge Rhodes state that the four-part analysis he provided for considering § 921(c) good faith issues was to be understood as the definitive test moving forward. Furthermore, Judge Rhodes cited other prominent § 921(c) cases while setting up his test for Detroit's good faith assessment.<sup>210</sup> Therefore, much of Judge Rhodes's test is akin to past Chapter 9 assessments,<sup>211</sup> but Judge Rhodes's test also explores deeper and more equitable facets associated with the consequences of a dismissal of a Chapter 9 petition under § 921(c). Judge Rhodes's test offers a compelling hybrid of many of the prominent § 921(c) cases while also considering the complexity of Detroit's bankruptcy case.

#### A. *Step One: Contemplation of Chapter 9 Relief*

The first step in Judge Rhodes's test was to ask whether "the City's financial problems are of a type contemplated for Chapter 9 relief."<sup>212</sup> At this stage, Judge Rhodes argued that Detroit's

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<sup>208</sup> *Id.* at 183 ("The Court finds, however, that in some particulars, the record does support the objectors' view of the reality that led to this bankruptcy filing. It is, however, not nearly supported in enough particulars for the Court to find that the filing was in bad faith.").

<sup>209</sup> *Id.*

<sup>210</sup> *Id.* at 187. The two primary cases Judge Rhodes used in establishing his good faith analysis were *Stockton* and *N.Y. City Off-Track Betting*. However, he also used individual cases to support each step of his good faith determination. *See id.* at 187–89.

<sup>211</sup> The first two—and arguably the first three—parts of the "Rhodes Test," have been explored in previous cases that address § 921(c). However, looking into the prejudice placed upon the city's residents was a largely unprecedented step in Chapter 9 case law.

<sup>212</sup> *In re City of Detroit*, 504 B.R. at 187.

financial situation was exacerbated by the city's shortcomings, but that the city's problems were very rightfully in line with the types contemplated for Chapter 9 relief.<sup>213</sup> In the opinion, Judge Rhodes wrote:

It is true that the City does not have a clear picture of its assets, income, cash flow, and liabilities, likely because its book-keeping and accounting systems are obsolete. But this only suggests the need for relief. It does not suggest bad faith. Moreover, as the City's financial analysts' subsequent months of work have sharpened the focus on the City's finances, the resulting picture has only become worse.<sup>214</sup>

Here, Judge Rhodes noted that many of the objections pushed for by the creditor-objectors were not grounded in indications of lack of good faith, but more properly expressed a multitude of areas where the city has experienced egregious problems and shortcomings.<sup>215</sup> Moreover, Judge Rhodes concluded that Chapter 9 is likely the only remedy that affords the city the protection it needs to solve these issues.<sup>216</sup> What is most important about Judge Rhodes's analysis here is that he focused on the municipality's objectively identifiable problems that called for Chapter 9 relief and not on the subjective arguments pushed forward by the opposing parties.

*B. Step Two: Consistency with the Remedial Purpose of Chapter 9*

In his second consideration of Detroit's good faith under § 921(c), Judge Rhodes looked to see if the "reasons for filing [for Chapter 9] are consistent with the remedial purpose of Chapter 9."<sup>217</sup> Judge Rhodes noted that the remedial purpose sought by Detroit was to receive a "breathing spell" in order to "establish a plan for adjustment."<sup>218</sup> This language mirrors the "highly subjective"<sup>219</sup> element of § 109(c)(4) in which a municipality must

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<sup>213</sup> *Id.*

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

<sup>216</sup> *Id.* at 189.

<sup>217</sup> *Id.* at 187.

<sup>218</sup> *Id.* (quoting *In re Cty. of Orange*, 183 B.R. 594, 607 (Bankr. C.D. Cal. 1995)).

<sup>219</sup> COLLIER ON BANKRUPTCY, *supra* note 69.

“desire[ ] to effect a plan to adjust such debts.”<sup>220</sup> Here, Judge Rhodes delved into any possible ulterior motives of the municipality’s leaders and looked for empirical evidence, rather than guessing at the subjective intentions of the municipality.<sup>221</sup>

Judge Rhodes ultimately found that Detroit’s bankruptcy petition was filed for the exact reason of achieving a “breathing spell” so that it could adjust its debt.<sup>222</sup> The creditor-objectors argued that the city’s endeavor to impair the payment of pension obligations was inconsistent with any remedial purpose for Chapter 9.<sup>223</sup> However, Judge Rhodes reduced this argument to semantics by illustrating that impairing pension payments with the help of Chapter 9 is, in the net result, equivalent to discharging debt owed to creditors. Ultimately, it is consistent with a lawful availment of federal bankruptcy law.<sup>224</sup>

### *C. Step Three: Detroit’s Efforts to Improve the State of its Finances*

In exploring a third factor in Detroit’s good faith petitioning requirement, Judge Rhodes made a difficult determination of whether the municipality had “made efforts to improve the state of its finances prior to filing, to no avail.”<sup>225</sup> Judge Rhodes quickly determined that Emergency Manager Kevyn Orr had gone to considerable lengths in order to improve the municipality’s finances.<sup>226</sup> Judge Rhodes noted that the efforts included “reducing the number of City employees, reducing labor costs through implementation of the City Employment Terms, increasing the City’s corporate tax rate, working to improve the City’s ability to collect taxes, increasing lighting rates, deferring capital expenditures, reducing vendor costs, and reducing subsidies to the Detroit Department of Transportation.”<sup>227</sup> These efforts proved

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<sup>220</sup> 11 U.S.C. § 109(c)(4) (2014).

<sup>221</sup> *In re City of Detroit*, 504 B.R. at 187–88.

<sup>222</sup> *Id.* at 187 (quoting *In re Cty. of Orange*, 183 B.R. 594, 607 (Bankr. C.D. Cal. 1995)).

<sup>223</sup> *Id.* at 188.

<sup>224</sup> *Id.* (citing *In re Chilhowee R–IV Sch. Dist.*, 145 B.R. 981, 983 (Bankr. W.D. Mo. 1992)).

<sup>225</sup> *Id.*

<sup>226</sup> *Id.*

<sup>227</sup> *Id.* at 188.

insufficient to stave off the inevitable bankruptcy petition, but they paved the way for healthy decisions to be made under Chapter 9 protections.<sup>228</sup> Furthermore, Judge Rhodes reduced any argument to an absurdity by stating that deny[ing] Detroit's "opportunity to reorganize in chapter 9 based on lack of good faith would be to ignore fiscal reality and the general purposes of the Bankruptcy Code."<sup>229</sup>

*D. Step Four: Residents of Detroit Potentially Prejudiced*

The biggest departure Judge Rhodes took in ruling on Detroit's § 921(c) good faith was in his final step, where he asked whether "[t]he residents of Detroit will be severely prejudiced if this case is dismissed."<sup>230</sup> Judge Rhodes noted that this consideration was of "paramount" importance.<sup>231</sup> However, this consideration was unique to Detroit's bankruptcy case. This uniqueness is likely due to a longstanding bankruptcy principle that the debtors and creditors are the only parties with whom bankruptcy law should concern itself.<sup>232</sup> However, Chapter 9 is once again distinct from other forms of bankruptcy in this regard. The true benefit of considering the prejudice to the city's residents is that if the dismissal of the Chapter 9 bankruptcy would result in prejudice to them, then it validates the necessity for Chapter 9 relief. Ultimately, the city of Detroit's residents have benefited more than anybody by Judge Rhodes's decision to allow the city bankruptcy protection.

*E. The Effects of Detroit's Eligibility on the City*

With over one hundred parties actively opposing Detroit's bankruptcy and challenging it from a multitude of angles, Detroit's Chapter 9 eligibility was tenuous.<sup>233</sup> As mentioned above, if Judge Rhodes had taken an approach similar to many other Chapter 9 cases, which turned on the good faith requirement under § 921(c),

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<sup>228</sup> *Id.*

<sup>229</sup> *Id.*

<sup>230</sup> *Id.*

<sup>231</sup> *Id.* at 189.

<sup>232</sup> Plank, *supra* note 16, at 516–18.

<sup>233</sup> Jacoby, *supra* note 203, at 853.

then Detroit could have lost its only valuable opportunity for recovery.<sup>234</sup> However, the importance of Detroit's Chapter 9 eligibility, in light of potent § 921(c) challenges, is unmistakable in how the city has used this eligibility to revive itself.

Although Detroit's bankruptcy exit plan was approved in November of 2014, the positive effects of Detroit's Chapter 9 eligibility were felt almost immediately upon Judge Rhodes's decision. With permission to go ahead, Kevyn Orr took bold and dramatic steps to help the ailing city. The city received much-needed flexibility because it could use the money saved from paying off immediate debt obligations on functions essential to the city's operation.<sup>235</sup> These operations would have been much more difficult without Chapter 9 protection. One of Kevyn Orr's strongest moves as Detroit's Emergency Manager was appointing a new Chief of Police.<sup>236</sup> He appointed James Craig and allotted extra revenue to add more officers and provide better equipment.<sup>237</sup> James Craig brought much-needed experience to the position, as he formerly served as the chief of police for the city of Cincinnati.<sup>238</sup> Due to these changes made under Orr and Craig's direction, crime has gone down.<sup>239</sup>

Detroit has also found new life with increased industry from sources both old and new.<sup>240</sup> Detroit's fabled auto industry has

<sup>234</sup> *Id.*

<sup>235</sup> See also Charlie LeDuff, *The Americans with Charlie LeDuff: Detroit's Bankruptcy is Helping Police Do Their Jobs*, YOUTUBE (June 26, 2014), <https://www.youtube.com/watch?v=zOWG8Xq3dZA> [<https://perma.cc/TAK3-3VLU>] ("Ironically, because Detroit is bankrupt, Detroit police are doing better. Less money being paid to the creditors means more money invested in the police.").

<sup>236</sup> Gena Damron & Matt Helms, *Detroit's New Police Chief James Craig: 'I've Come Home'*, DETROIT FREE PRESS (May 15, 2013), <http://archive.freep.com/article/20130515/NEWS01/305150098/Detroit-police-chief-Craig> [<http://perma.cc/PG64-V7B7>].

<sup>237</sup> *Id.* Some of the much-needed funds came from generous donations from Detroit's Big Three automakers. GM, Ford, and Chrysler offered Detroit \$22 million to help revitalize the city's civic functions. *Id.*

<sup>238</sup> *Id.*

<sup>239</sup> Barbara L. McQuade, *U.S. Attorney: Violent Crime is Falling in Detroit*, DETROIT NEWS (Oct. 10, 2014), <http://www.detroitnews.com/story/opinion/2014/10/10/mcquade-violent-crime-falls-detroit/16992633/> [<http://perma.cc/E8SA-HDFB>] ("Detroit is on pace to have its fewest homicides in the city since 1967.").

<sup>240</sup> See Tim Alberta, *Why Detroit's New Mayor Thinks His City Is Poised for an Economic Reinvention*, NAT'L JOURNAL (Feb. 25, 2014), <http://www.national>

found renewed success.<sup>241</sup> The real estate market in downtown Detroit has seen a significant spike.<sup>242</sup> Employment has risen.<sup>243</sup> Recognizing higher employment rates, the population has begun to return.<sup>244</sup> Even foreign investors have pinned their eyes on Detroit as an inevitable “comeback story.”<sup>245</sup> However, the recent revitalization would likely not have been possible if Detroit had not gone through bankruptcy.<sup>246</sup> The “comeback story” may not have begun without Judge Rhodes’s part in Detroit’s bankruptcy.

Indeed, Judge Rhodes went to considerable lengths to address Detroit’s good faith petitioning in accordance with § 921(c). Such an in-depth analysis is unparalleled in other Chapter 9 cases. Yet it is inescapable that Judge Rhodes’s test is, at most, a judicially rendered guideline for conducting Chapter 9’s good faith filing analysis. In its present incarnation, it is not, and

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journal.com/next-economy/america-360/why-detroit-s-new-mayor-thinks-his-city-is-poised-for-an-economic-reinvention-20140225 [http://perma .cc/6E3W-B7BZ] (interviewing Mayor Duggan on the economic comeback of Detroit); Dan Rafter, *Life After Bankruptcy? in Detroit, it’s Getting Better*, RE JOURNALS (Dec. 12, 2013), <http://www.rejournals.com/2013/12/12/life-after-bankruptcy-in-detroit-its-getting-better/> [http://perma.cc/8VUG-B59Z] (discussing the growing real estate market); Shahrukh Khan, *Detroit’s Bankruptcy: Motor City’s Path to Recovery*, HARVARD UNIV. INST. OF POLITICS, <http://www.iop.harvard.edu/detroit%E2%80%99s-bankruptcy-motor-city%E2%80%99s-path-recovery> [http://perma.cc/GA46-UXGE] (discussing the elimination of abandoned structures and the increase in investment).

<sup>241</sup> Dan Alexander, *Four Months After Bankruptcy, Michigan Leaders Reframe Detroit as America’s Comeback City*, FORBES (Nov. 8, 2013), <http://www.forbes.com/sites/danalexander/2013/11/08/four-months-after-bankruptcy-michigan-leaders-reframe-detroit-as-americas-comeback-city/>.

<sup>242</sup> Rafter, *supra* note 240.

<sup>243</sup> Alexander, *supra* note 241.

<sup>244</sup> *Id.*

<sup>245</sup> See *Foreign Billionaires Are on a Detroit Real Estate Buying Spree*, MODEL D (Apr. 13, 2015), <http://www.modeldmedia.com/inthenews/foreign-investment041315.aspx> [http://perma.cc/T9S7-E9BC].

<sup>246</sup> See generally Khan, *supra* note 240. This article discusses Detroit’s efforts to provide a sustainable economic foundation in the wake of the bankruptcy proceedings (“Toying with Detroit’s balance sheet issues will not be enough, however, to bring the city back. Detroit has been stabilizing itself slowly: by diversifying its economy and becoming home to new, powerful financial institutions.”). *Id.*

likely will not be, mandatory authority that other courts must follow. However, with a substantial gap in statutory authority and silence from Congress, there is perhaps no more practicable or principled approach than Judge Rhodes's test for determining Chapter 9 eligibility in light of creditor-objector good faith challenges. Therefore, until amendments to the Bankruptcy Code provide new statutory scaffolding for § 921(c)'s good faith requirements, Judge Rhodes's test can stand out as particularly instructive. It provides manageable points of assessment in the good faith analysis and ensures that the best interests of all parties in a municipal bankruptcy case are being considered. Municipalities and bankruptcy courts alike can look to Detroit's case to find a pragmatic and principled approach where a dearth of legislative instruction and statutory authority has left a substantial gap in bankruptcy law.

#### CONCLUSION: SPERAMUS MELIORA | RESURGET CINERIBUS

The city of Detroit's flag is emblazoned with two women gesturing towards two very different cityscapes. On the left, a sorrowful woman is facing a burning city silhouette, which represents the once-fallen Detroit after the great fire of 1805. Below this scene, the Latin words "*speramus meliora*" are inscribed, which translates to "we hope for better things." On the right, however, a woman with a more upright and confident posture is pointing towards a lush, reconstructed cityscape. This picture sits atop the Latin words "*resurget cineribus*," which means "it will rise from the ashes."

The imagery depicted in Detroit's flag is a fitting display of the city's past and current hardships. Indeed, the last seven decades of Detroit's history mark the second time the city has fallen. This time, the city suffered the slow burn of ineptitude, failure, and corruption.

However, throughout Detroit's Chapter 9 bankruptcy proceedings, the city has begun the long, slow rise out of the ashes. Although the hardship is far from over, the city of Detroit has taken significant steps since it was afforded bankruptcy protection under Chapter 9. The year 2014 marked the arduous and painful process of debt restructuring, but the city found relief and even success through its bankruptcy protection.

Judge Rhodes ultimately ruled that Detroit's eligibility could not be thwarted by its creditors. His ruling considered four main principles. Each of these principles helped paint the landscape of § 921(c)'s good faith requirement. However, before Judge Rhodes opined on the matter, these considerations had not been synthesized into one opinion and methodized within existing case law. His test can bring a practicable and principled good faith standard to municipal bankruptcy proceedings. Now, other municipalities and bankruptcy courts alike can look to *In re Detroit* as a signal of stability within an imprecise and precarious realm of bankruptcy jurisprudence and America can look to Detroit to find hope that it, too, can find reason in wreckage.

