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7 Attorneys for California Public Employees'  
 8 Retirement System

9 UNITED STATES BANKRUPTCY COURT  
 10 EASTERN DISTRICT OF CALIFORNIA  
 11 SACRAMENTO DIVISION

12 In re  
 13 CITY OF STOCKTON, CALIFORNIA,  
 14 Debtor.

Case No. 2012-32118

DC No. OHS-5

Chapter 9

15 **EXHIBITS 1-3 IN SUPPORT OF**  
 16 **CALPERS' BRIEF REGARDING**  
 17 **APPLICABILITY OF RULE 9019 IN**  
 18 **CHAPTER 9 CASES**

Date: January 30, 2013

Time: 10:00 a.m.

19 Place: Robert T. Matsui U.S. Courthouse,  
 20 501 I Street  
 Department C, Fl. 6, Courtroom 35  
 Sacramento, CA 95814

1 The California Public Employees' Retirement System ("CalPERS") files the following  
2 exhibits in support of CalPERS' Brief Regarding Applicability of Rule 9019 in Chapter 9 Cases:

3 Exhibit 1- "Relevant Portions of H.R. Rep. No. 94-686, at 19 (1975), *reprinted in* 1976  
4 U.S.C.C.A.N. 539, 557" at page 3.

5 Exhibit 2- "Relevant Portions of Consolidated Brief of the Appellants filed in *Assured*  
6 *Guaranty Municipal Corp., et al. v. Jefferson County, Alabama*, 11th Cir., No. 12-13654-B (August  
7 27, 2012)" at page 5.

8 Exhibit 3- "Relevant Portions of Consolidated Response and Reply Brief of Appellants filed  
9 in *Assured Guaranty Municipal Corp., et al. v. Jefferson County, Alabama*, 11th Cir., No. 12-13654-  
10 B (November 13, 2012)" at page 35.

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12  
13 Respectfully submitted,

14 Michael J. Gearin  
15 Michael B. Lubic  
16 Brett D. Bissett  
17 K&L GATES LLP

18 Dated: January 16, 2013

19 By: /s/ Michael B. Lubic

20 Michael B. Lubic  
21 Attorneys for California Public Employees'  
22 Retirement System  
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# **EXHIBIT 1**

## BANKRUPTCY ACT

P.L. 94-260

interpret it as they have done in the past consistent with the purposes of Chapter IX and the powers of the court.

## SECTION 83

The purpose of section 83, copied from present section 83(i), is the same as that of section 82(c). It is to prevent the statute or the court from interfering with the power constitutionally reserved to the State by the Tenth Amendment. This section makes it clear that the chapter may not be construed to limit or impair the power of the State to control, by legislation or otherwise, any municipality, political subdivision or public agency or instrumentality in the exercise of its governmental functions. Any State law that governs municipalities or regulates the way in which they may conduct their affairs controls in all cases. Likewise, any State agency that has been given control over any of the affairs of a municipality will continue to control the municipality in the same way, in spite of a Chapter IX petition.

The proviso in current section 83(i), retained here, prohibiting state composition procedures was enacted in response to, and overruled the holding of the Supreme Court in, *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942)<sup>4</sup>. In that case, the court upheld a New Jersey statute that permitted a binding composition of a municipality's debts upon the acceptance of a plan by 85% of the municipality's creditors. The composition dealt only with unsecured obligations, and the state statute prohibited reduction in the principal amount of the outstanding obligations. The Court refused to go beyond the facts of the case, holding only that the Contracts Clause of the Constitution did not prohibit that particular composition.

The proviso is retained for the same reason it was enacted by Congress:

State adjustment acts have been held to be valid, but a bankruptcy law under which the bondholders of a municipality are required to surrender or cancel their obligations should be uniform throughout the [United] States, as the bonds of almost every municipality are widely held. Only under a Federal law should a creditor be forced to accept such an adjustment without his consent. H.R. REP. No. 2246, 79th Cong., 2d Sess. 4 (1946).

## SECTION 84

Section 84 is derived in part from current section 81. It sets the eligibility requirements for relief under Chapter IX. The entity that files must be a political subdivision or public agency or public instrumen-

4. 62 S.Ct. 1129, 86 L.Ed. 1629.

[page 20]

tality of a State. This is not meant to be limiting language, but rather is meant to be a description of general categories that cover all of the various entities now listed in section 81 of current law. The bill also omits any limiting reference to the manner by which the indebtedness of the entity is payable. The intention of these two changes is to broaden the applicability of Chapter IX as much as possible. The entity must not be prohibited from filing by state law. The reference to a prohibition by state law recognizes a limitation frequently expressed in the

# **EXHIBIT 2**

No. 12-13654-B

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In the  
**United States Court of Appeals  
for the Eleventh Circuit**

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ASSURED GUARANTY MUNICIPAL CORP., ET AL.,

*Appellants/Cross-Appellees,*

v.

JEFFERSON COUNTY, ALABAMA,

*Appellee/Cross-Appellant.*

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On Direct Appeal from the United States Bankruptcy Court for the Northern  
District of Alabama, Southern Division  
Case No. 11-05736-TBB-9

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**CONSOLIDATED BRIEF OF APPELLANTS THE BANK OF NEW YORK  
MELLON, AS INDENTURE TRUSTEE; JOHN S. YOUNG, JR., LLC, AS  
RECEIVER; THE BANK OF NOVA SCOTIA; SOCIÉTÉ GÉNÉRALE,  
NEW YORK BRANCH; THE BANK OF NEW YORK MELLON; STATE  
STREET BANK AND TRUST COMPANY; JPMORGAN CHASE BANK,  
N.A.; FINANCIAL GUARANTY INSURANCE COMPANY; ASSURED  
GUARANTY MUNICIPAL CORP.; AND SYNCORA GUARANTEE INC.**

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NAMES AND ADDRESSES OF COUNSEL FOR APPELLANTS PROVIDED BELOW

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**STATEMENT OF THE ISSUES**

1. Whether respect for the sovereignty of the State of Alabama (“Alabama”) demanded by the Tenth Amendment and preserved in a chapter 9 proceeding by §§ 903 and 904 of the Bankruptcy Code<sup>5</sup> precluded the Bankruptcy Court from interfering with Alabama’s exercise of control over the County’s sewer system (the “System”) by taking jurisdiction over the System from the Circuit Court of Jefferson County, Alabama (the “State Court”) and the Receiver.

2. Whether § 903, which bars bankruptcy court interference with a state’s control over the political and governmental affairs of its municipalities, required the Bankruptcy Court to abstain from exercising jurisdiction over the System given the State Court’s control over the System.

3. Whether the Bankruptcy Court erred in returning possession of the System to the County upon the filing of the County’s chapter 9 petition, when the State Court’s September 22, 2010, Order (the “Receiver Order”) divested the County of all property interests in the System other than bare title and granted the Receiver sole and exclusive possession, custody, and control over the System, and chapter 9 of the Bankruptcy Code does not provide the Bankruptcy Court with statutory turnover power.

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<sup>5</sup> Except as otherwise specified, all references to “§ \_\_\_” herein are to the applicable section of 11 U.S.C. § 101, *et. seq.* of Title 11 of the United States Code (the “Bankruptcy Code”).

4. Even if the automatic stay of § 362 is deemed to apply to the Receiver's control over the System, whether the Bankruptcy Court erred by failing to conclude that the stay does not apply to the Receiver's continued control and operation of the System under the police powers exception codified at § 362(b)(4).

5. Even if the automatic stay of § 362 is deemed to apply to the Receiver's control over the System, whether the stay terminated as provided in § 362(e) due to lack of entry, within thirty days of the filing of the Stay Motions, of an order making a final determination on the Stay Motions or continuing the stay pending the conclusion of the final hearing and finding that the County would likely prevail on the Stay Motions.

6. Even if the automatic stay of § 362 is deemed to apply to the Receiver's control over the System, whether the Bankruptcy Court erred by failing to require the County to demonstrate that cause did not exist to lift or modify the stay, or, alternatively, whether the Bankruptcy Court's finding that the County had presented sufficient evidence that cause did not exist, regardless of the County's demonstrated pre-petition mismanagement of the System, was clearly erroneous.

7. Even if the automatic stay of § 362 is deemed to apply to the Receiver's control over the System, whether the Bankruptcy Court erred by

continuing the stay without requiring the County to provide adequate protection to the Appellants.

### **STATEMENT OF THE CASE**

#### ***A. The Course of Proceedings and Dispositions in the Court Below***

This appeal presents questions of first impression concerning whether a municipality's chapter 9 bankruptcy filing automatically divests a state court that has appointed a receiver over the municipal debtor's sewer system of jurisdiction over the sewer system. The Bankruptcy Court held that the filing of the County's chapter 9 petition vested exclusive jurisdiction over the System in the Bankruptcy Court and that operation of the automatic stay of §§ 362(a) and 922(a) precluded further control over the System by the State Court's Receiver. In this appeal, Appellants request that this Court reverse the decision of the Bankruptcy Court and authorize the Receiver, under the jurisdiction and direction of the State Court, to regain exclusive possession and control over the System.

On August 3, 2009, the Trustee brought suit in the State Court to enforce the terms of the Indenture (as defined below), specifically its strict right to the appointment of a receiver over the System due to the occurrence and continuance of Events of Default (as defined in the Indenture). (Receiver Order, V.III:257:Ex.M.2 at 1-2). On September 22, 2010, the State Court entered the Receiver Order, taking possession and control of the System from the County and

appointing the Receiver to manage the System. From September 22, 2010, to January 6, 2012, the date the Bankruptcy Court entered its Order, the Receiver had exclusive control over the System, including the power to set rates and charges for System services. (V.III:257:Ex.M.2 at 13, 17; Hr'g Tr., V.VII:362 at 176:22-177:8). The System improved under the Receiver's control. The Bankruptcy Court determined:

[T]he Receiver has done a far better job overseeing the running of the County's sewer system than the former commissioners. . . . Mr. Young's capabilities and experience are better than those of the current county commissioners and the County employees when it comes to management and operation of a utility such as the County's sewer system.

(V.II:554 at 55).

Despite the Receiver's successful tenure, on November 9, 2011 (the "Petition Date"), the County filed its chapter 9 petition and sent a demand letter to the Receiver threatening the Receiver with contempt, asserting that the Receiver's continued control over the System violated the automatic stay of §§ 362 and 922, and demanding that the Receiver relinquish control of the System. (Demand Letter, V.V:258:Ex.M.44).

In response to the County's letter, the Trustee and Receiver filed the Stay Motions (in which the other Appellants joined), asking the Bankruptcy Court to find the stay inapplicable or otherwise to lift the stay to allow the Receiver to continue its control of the System in accordance with the Receiver Order. (V.II:40;

V.II:55; Financial Guaranty Joinder Mot. & Resp., V.II:144; Assured Guaranty Statement of Legal Issues, V.II:146; Syncora Resp., V.III:147; Liquidity Banks Joinder Mot., V.III:184; JPMorgan Chase Joinder Mot., V.III:187). The Bankruptcy Court denied the Stay Motions in part, holding that the System is under the exclusive jurisdiction of the Bankruptcy Court and the Trustee and Receiver are subject to the automatic stay of §§ 362(a) and 922(a), but agreeing that the Trustee's right to payment of Net Revenues (as defined below) of the System is not stayed. (V.VIII:508; V.VIII:509; V.II:554; V.IX:559). On February 29, 2012, the Bankruptcy Court *sua sponte* certified the Order for direct appeal to this Court pursuant to 28 U.S.C. § 158(d)(2)(A) and Bankruptcy Rule 8001(f). (Petition by the Bank of New York Mellon, as Indenture Trustee to Appeal at 1, Case No. 12-90012 (11th Cir. Mar. 28, 2012)). Appellants appealed, and the County cross-appealed. (V.IX:564; V.IX:730).

**B. *Statement of Facts***

**1. The Consent Decree and Issuance of the Warrants**

In 1993, the Environmental Protection Agency (the "EPA") and residents of the County sued the County, alleging that it was operating the System in violation of the federal Clean Water Act. (Consent Decree, V.V:258:Ex.M.26 at 5, 6). On December 9, 1996, the County, Alabama, the citizen plaintiffs, and the EPA entered into a Consent Decree issued by the United States District Court for the

Northern District of Alabama (the “District Court”) that required, among other remedial actions, the County to bring the System into compliance with the Clean Water Act by 2007. (*Id.* at 46-50; V.VII:362 at 158:17-21). The County is still not in compliance with the requirements of the Consent Decree. (V.VII:362 at 153:2-15).

The County issued the Warrants to fund, among other things, the improvements to the System mandated by the Consent Decree. (Receiver’s Rpt., V.IV:257:Ex.M.4 at 18-21). The Warrants were issued under that certain Trust Indenture, dated February 1, 1997, between the County and the Trustee, along with eleven supplemental indentures (collectively, the “Indenture”), which requires the County to establish and maintain sewer rates and charges at a level sufficient to service all of its obligations under the Indenture, including the payment of principal and interest on the Warrants. (Indenture, V.IV:257:Ex.M.10 at 70). This requirement is critical because the Warrants are payable solely from the Net Revenues<sup>6</sup> of the System. (*Id.* at 14-15). Upon an Event of Default (as defined in the Indenture), the Trustee is entitled “as a matter of strict right, . . . to the appointment of a receiver to administer and operate the System, with the power to

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<sup>6</sup> Pledged Revenues, as defined by the Indenture, will be referred to herein as “Net Revenues,” consistent with the Bankruptcy Court’s Memorandum Opinion dated January 19, 2012. (V.IX:554 at 31-32).

fix and charge rates and collect revenues sufficient to provide for payment of [the Warrants] . . . .” (*Id.* at 80).

**2. Numerous Events of Default Under the Indenture Have Occurred and Are Continuing**

Since February 2008, the County has been in continuous default under the Indenture, including the failure to: (a) pay all principal and interest on the Warrants when due, and (b) comply with the covenant to raise System rates and charges to a level necessary to comply with the Indenture. (V.III:257:Ex.M.2 at 3, 4; V.IV:257:Ex.M.10 at 78, 79). Further, since at least 2003, the County’s consultants have routinely informed the County it would be unable to honor its Indenture covenants without raising rates. (Proctor Mem. Op., V.II:76 at 15-16). The County chose to disregard these warnings. (*Id.* at 15-16). Indeed, in December 2008 the County suspended a 1997 resolution providing for automatic annual rate increases, and it has not implemented any rate increases since January 1, 2008, despite the Indenture’s express requirements and the recommendations of its own rate consultants. (Inadequate System Funding Chart, V.IV:257:Ex.M.4.A-11 at 2; Rate Suspension Resolution, V.V:258:Ex.M.25).

**3. The District Court Determined that the County Engaged in Fraudulent Conduct and Squandered System Revenues**

In September 2008, the Trustee and certain other Appellants filed suit in the District Court against the County and the Commissioners seeking the appointment

of a receiver for the System. (V.II:76 at 1-2). After holding two evidentiary hearings and appointing two Special Masters<sup>7</sup> to investigate the plaintiffs' allegations, Judge David Proctor entered a Memorandum Opinion on June 12, 2009, noting that the County had entered into twelve agreements promising that a receiver would be the appropriate remedy in the event of default and finding that the Trustee had proven every requirement for the appointment of a receiver. (*Id.* at 11-27).

Judge Proctor found the record "replete with evidence of fraudulent conduct and suppression by the County and its various representatives." (*Id.* at 16).<sup>8</sup> Judge Proctor also found that the County suppressed the existence of and ignored a report by the County's own consultant, which plainly warned of serious consequences if the County did not immediately act to raise additional System revenues by at least 89% between 2002 and 2008. (V.II:76 at 15-16; *see also* V.IV:257:Ex.M.4.A-11 at 2; 2003 Krebs Report, V.IV:258:Ex.M.20 at 9).

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<sup>7</sup> John Young was the County's nominee for Special Master. (V.II:76 at 18 n.14; V.VII:362 at 147:1-23). Young was the Chief Operating Officer of American Water, the nation's largest investor-owned utility, and has an extensive background in utility management and operations. (V.VII:362 at 133:4-18).

<sup>8</sup> The evidence of fraud by the County is overwhelming and supports the request for stay relief as described below. Numerous County officials who worked on the System have been indicted or found guilty for crimes related to the System. (V.II:76 at 14-15).

Judge Proctor concluded that the County had consistently (a) failed to investigate whether sewer rates were sufficient to cover the County's System-related debt obligations, and (b) wasted available System resources by (i) ignoring its consultants' advice to raise rates for the System to remain sustainable, (ii) improperly accounting for System-related operating expenses and diverting substantial Net Revenues, and (iii) failing to collect all of the System's revenues. (V.II:76 at 16-22).

Judge Proctor determined that the non-recourse nature of the Warrants meant that any judgment for the plaintiffs would be paid from the Net Revenues, that the Trustee had no adequate remedy at law other than the appointment of a receiver, and that the County would not be harmed by the appointment of a receiver. (*Id.* at 22-24). However, on June 12, 2009, despite finding that the Trustee was entitled to the appointment of a receiver, Judge Proctor determined that the Johnson Act, 28 U.S.C. § 1342, deprived federal courts sitting in diversity jurisdiction of the authority to appoint a receiver with rate-making authority over the County. (*Id.* at 27-40). Judge Proctor thus concluded that an Alabama state court was the appropriate forum for adjudicating the Trustee's request for the appointment of a rate-making receiver. (*Id.* at 41).

#### 4. The State Court Appointed a Receiver for the System

Following Judge Proctor's ruling, the Trustee brought suit in the State Court on August 3, 2009. On the day of trial, the County requested that the State Court forego the trial and rule based on the evidence already before it. The State Court agreed. (V.III:257:Ex.M.2 at 5, 6). After reviewing the factual record and applicable law, the State Court found that:

- The County's persistent defaults under the Indenture had caused the Warrantholders to suffer "irreparable harm by the loss of the System Revenues and Net Revenues . . . that the System could generate, but is not currently generating." (*Id.* at 6).
- The County was unwilling to raise sewer rates and generate additional revenues to resolve its financial issues. (*Id.* at 3, 4).
- "[T]he County . . . has failed to operate the Sewer System in an economical, efficient and proper manner," and having no other adequate remedy at law, the Trustee was entitled to the appointment of a receiver. (*Id.* at 6).
- "Unless a receiver is appointed, the [County's] failure to operate the System to generate revenues sufficient to provide for the payment of the Parity Securities . . . will reduce the overall value of the Trustee's collateral and result in further irreparable harm to the Trustee and the Parity Security Holders." (*Id.*).
- A receiver could "stabilize the System finances and . . . implement significant operational improvements and efficiencies that [could] generate greater System Revenues and Net Revenues . . . than [the County had] previously produced." (*Id.*).
- The Trustee was entitled to a money judgment against the County in the amount of \$515,942,500.11. (*Id.* at 22).

On September 22, 2010, the State Court entered the Receiver Order, divesting the County of its control over the System and vesting the Receiver with the power to operate the System and set rates, an outcome which the State Court concluded would benefit both the public and the Warrantholders. (*Id.* at 6, 8-9, 16). The County chose not to appeal the Receiver Order. (V.VII:362 at 69:23-70:1).

#### 5. The Receiver's Exclusive Rights and Powers

The State Court granted the Receiver, as its agent, “sole and exclusive right and authority to take complete and exclusive possession, control and custody of the System in order to operate and administer the System and to perform all acts necessary or desirable to administer and operate the System,” including “the sole and exclusive right and authority to fix and charge rates and charges for services furnished by the System” and “to collect revenues sufficient to provide for the payment of” the Warrants and other obligations. (V.III:257:Ex.M.2 at 8, 9). In doing so, the State Court expressly *divested* the County of any authority to control the System. (*Id.* at 16).

While the Receiver controlled the System, he formulated a comprehensive business plan, adopted a five-year personnel plan to dramatically reduce payroll costs, drafted a capital improvement plan, reduced operations and maintenance costs, reduced legal fees, worked to improve billing and collection practices, and commissioned all of the research necessary to improve the System's rate structure

and implement rate increases. (V.IV:257:Ex.M.4 at 30-45). The Receiver determined that an immediate interim rate increase sufficient to increase revenues by 25% was necessary and appropriate, but he was unable to implement any rate increase prior to the Petition Date. (*Id.* at 55).

#### 6. The Chapter 9 Case and Trial of the Stay Motions

On November 21 and 22, 2011, the Bankruptcy Court held a final hearing on the Stay Motions, where it heard testimony from Young, County Commission President David Carrington, Commissioner Sandra Little Brown, County Attorney Jeff Sewell, and the County's Director of the System, David Denard. During the hearing, the County did not dispute that the Receiver had identified inefficiencies and substantially improved the System.

Carrington testified that he agreed with Young's actions as Receiver; Young was committed to improving the System and operating it in an efficient manner; and Young was diligent, competent, hard-working, and responsive. (V.VII:362 at 66, 72:23-75:19, 97:6-9). The County never lodged an objection with the State Court to a single managerial decision made during the Receiver's tenure. (*Id.* at 190:11-16, 320:6-17). Despite their glowing review of the Receiver's management, both Carrington and Brown testified that they opposed the 25% rate increase the Receiver recommended. (*Id.* at 102:13-18, 373:5-7, 375:23-25). Carrington testified that the County intended to rely upon Denard or County

Manager Tony Petelos to serve as utility manager if the County regained control of the System. (*Id.* at 108:9-17). Young testified without contradiction, however, that no County employee possessed the skill set necessary to implement current industry standards for managed utilities. (*Id.* at 232:14-234:6, 234:22-235:19). Specifically, Young testified that Denard was not qualified to operate the System and did not effectively manage the System when it was under his control prior to September 2010. (*Id.* at 232:14-234:6, 234:22-235:19, 161:18-21). Young also testified that implementation of a multi-year comprehensive business plan would be difficult to achieve without a qualified operator. (*Id.* at 215:6-13, 238:17-239:15, 196:12-197:9). The Bankruptcy Court stated that it was “under no illusion that the County’s commissioners or its employees ha[d] the expertise of the [Receiver].” (V.II:554 at 57).

In late 2011 and early 2012, the Bankruptcy Court entered a series of orders regarding the Stay Motions. (V.VII:302; V.VII:408; V.VIII:460; V.VIII:508; V.VIII:509; V.II:554; V.IX:559). In denying the Stay Motions in part, the Bankruptcy Court held that the Trustee and Receiver are subject to the automatic stay of §§ 362 and 922 and that there was no cause to modify the stay to allow the Receiver to continue to administer and control the System. (V.II:554 at 57). The Bankruptcy Court held, however, that the Trustee’s right to receive and apply Net Revenues as set forth in the Indenture and § 922(d) were not stayed. (*Id.*)

**C. Statement of the Standards of Review**

The Court reviews the Bankruptcy Court's conclusions of law *de novo*. *Orix Credit Alliance, Inc. v. Delta Res., Inc. (In re Delta Res., Inc.)*, 54 F.3d 722, 727 (11th Cir. 1995). Under Bankruptcy Rule 8013, the Bankruptcy Court's findings of fact are reviewed under a "clearly erroneous" standard. *Id.*; *Nordberg v. Arab Banking Corp. (In re Chase & Sanborn Corp.)*, 904 F.2d 588, 593 (11th Cir. 1990).

**SUMMARY OF THE ARGUMENT**

This Court should reverse the Bankruptcy Court's denial of the Stay Motions and return control of the System to the Receiver. Principles of state sovereignty embodied in the Tenth Amendment, application of §§ 903 and 904, and the Receiver Order, which stripped the County of the right to operate the System, preclude the Bankruptcy Court's jurisdiction over the System and the application of the stay of §§ 362 and 922 to the Receiver. Further, even if the automatic stay were to apply, Appellants are entitled to relief from the stay under any or all of §§ 362(b)(4), (d)(1), and (e).

**ARGUMENT AND CITATIONS TO AUTHORITY****I. THE BANKRUPTCY COURT'S ORDER FINDING THE STAY APPLIED TO THE RECEIVER VIOLATED PRINCIPLES OF STATE SOVEREIGNTY**

The Bankruptcy Court's Order trespasses on the specific reservation of the State's power to control its municipalities. Congress's power to establish bankruptcy laws is not unlimited, and in chapter 9 of the Bankruptcy Code, Congress codified explicit limits on a bankruptcy court's power to interfere with the interests and rights of both the municipal debtor and, independently, the state of which the municipal debtor is an instrumentality. *See* 11 U.S.C. §§ 903, 904. The Bankruptcy Court's decision that the County's bankruptcy filing automatically vested it with jurisdiction over the System should be reversed because it is prohibited by the Tenth Amendment to the United States Constitution and §§ 903 and 904.<sup>9</sup>

Congress's power to establish "uniform Laws on the subject of Bankruptcies" is broad, but not unlimited. U.S. Const. art. I, § 8, cl. 4. Two years after Congress added chapter 9 to the Bankruptcy Act of July 1, 1898, which

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<sup>9</sup> The 1988 amendments to chapter 9 of the Bankruptcy Code were intended "to ensure that revenue bondholders receive the benefit of their bargain with the municipal issuer and that they will have unimpaired rights to the project revenues pledged to them." S. Rep. No. 100-506, at 12 (1988). Holding that a municipality's mere filing of a bankruptcy petition automatically nullifies revenue bondholders' bargained-for and judicially-granted receivership remedy contradicts congressional intent and undermines Appellants' rights under state law.

allowed, for the first time, a “municipality or other political subdivision of any State” to adjust its debts, the Supreme Court declared chapter 9 unconstitutional because it offended state sovereignty and deprived states of powers explicitly reserved to them by the Tenth Amendment. *Ashton v. Cameron Co. Water Improvement Dist., No. 1*, 298 U.S. 513, 524-25, 527-28, 532 (1936) (quoting section 80 of the Act); *see also* U.S. Const. amend. X. Since each state is a sovereign and a municipality of such a state is a “political subdivision of the state, created for the local exercise of her sovereign powers,” the Supreme Court reasoned that a municipality’s “fiscal affairs are those of the state, not subject to control or interference by the national government, unless the right to do so is definitely accorded by the Federal Constitution.” *Ashton*, 298 U.S. at 527-28. *Ashton* decisively held that “the federal government, acting under the bankruptcy clause” cannot “impose its will and impair state powers” or “pass laws inconsistent with the idea of sovereignty.” *Id.* at 531. Regard for state sovereignty imposes limits on a bankruptcy court’s power in municipal bankruptcies that are not present in the proceedings of private party debtors. *See In re Richmond Unified Sch. Dist.*, 133 B.R. 221, 224 (Bankr. N.D. Cal. 1991) (“Any federal debt relief legislation affecting municipalities must be sufficiently narrow in scope to avoid intrusion by the federal courts on the sovereign power of the states.”); *In re N.Y.C. Off-Track Betting Corp.*, 434 B.R. 131, 142 (Bankr. S.D.N.Y. 2010) (“Respect for the

sovereignty of state entities . . . substantially constrains the Court's powers when dealing with a chapter 9 debtor.”).

Out of deference to states' authority over their municipalities, Congress imposed constraints in chapter 9 proceedings that are absent from bankruptcy proceedings under other chapters, because “the law must be sensitive to the issue of the sovereignty of the states.” H.R. Rep. No. 95-595, at 215 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6221. These constraints limit the power of bankruptcy courts to interfere with the interests and rights of both the municipal debtor and, independently, the state of which the municipal debtor is an instrumentality. Section 904 protects the municipal debtor. Captioned “Limitation on jurisdiction and powers of court,” § 904 provides:

Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with - (1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property.

11 U.S.C. § 904. Correspondingly, § 903 protects the state's power to control its municipal debtor. Captioned “Reservation of State power to control municipalities,” it provides that “[t]his chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality . . . .”

11 U.S.C. § 903.

These limits on bankruptcy courts' power in a chapter 9 proceeding are significant. The Supreme Court relied on the statutory precursor to these provisions, which "avoid[ed] any restriction on the power of the States . . . in the exercise of their sovereign rights and duties [and] interference with the fiscal or governmental affairs of a political subdivision," in upholding the second municipal bankruptcy act. *United States v. Bekins*, 304 U.S. 27, 51 (1938). Legislative history shows that Congress enacted the current chapter 9 with the preservation of state sovereignty and compliance with the dictates of *Ashton* and *Bekins* in mind.<sup>10</sup> Bankruptcy courts have recognized that §§ 903 and 904 "reserve the power to control municipalities to the state and limit the jurisdiction and powers of the court." *In the Matter of Sanitary & Improvement Dist., No. 7*, 98 B.R. 970, 972 (Bankr. D. Neb. 1989).

Despite the plain constitutional and statutory limits on its power in a chapter 9 proceeding and the State Court's prior exercise of exclusive control over the System through the Receiver, the Bankruptcy Court improperly relied on *Taylor v. Sternberg*, 293 U.S. 470 (1935), to conclude that the County's chapter 9 filing automatically vested the Bankruptcy Court with paramount jurisdiction over the

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<sup>10</sup> "The purpose of this limitation derives from [*Ashton*] which held the first municipal bankruptcy act unconstitutional on the basis of infringement of state sovereignty. This limitation was included in the second act, and was relied upon in [*Bekins*], which upheld the second municipal adjustments statute." H.R. Rep. No. 95-595, at 263 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6221.

County's property, including the System. Specifically, it concluded that 28 U.S.C. § 1334, as elucidated by *Taylor*, generally affords a bankruptcy court jurisdiction over a debtor's property.

*Taylor*, however, is not a municipal bankruptcy case, and the *Taylor* Court, accordingly, addressed none of the limitations imposed by state sovereignty and §§ 903 and 904, which are material whenever a municipality files for bankruptcy. As demonstrated below, the Bankruptcy Court erred in concluding that it had jurisdiction over all aspects of the System because it ignored (a) the fundamental underpinnings of the Tenth Amendment and §§ 903 and 904, (b) the preclusive effect of the State Court's Receiver Order on the County's property rights in the System, and (c) the impact of the inapplicability of §§ 542 and 543 in chapter 9 proceedings.

**A. *Sections 903 and 904 Prohibit the Bankruptcy Court from Curtailing the State Court's Authority Over the System***

The Bankruptcy Court's conclusion that the County's chapter 9 filing automatically vested it with jurisdiction over the System contravenes the limits against federal encroachment that chapter 9 affords to both the municipal debtor and the state of which it is a subdivision.

Section 904 forbids the Bankruptcy Court in a chapter 9 case from interfering with any of a debtor's property absent such debtor's consent. As a result of the Receiver Order, the County did not have a property interest in the

control of the System as of the Petition Date. Therefore, it could not consent to the Bankruptcy Court's interference with the System, and indeed, the County has not consented to any interference by the Bankruptcy Court with any property. (*See, e.g.,* V.IX:605; Jefferson County Mot. for Clarification, V.VII:552 at 7). The Bankruptcy Court erred in concluding that the County's bankruptcy filing automatically vested it with jurisdiction over the System.

Even if the County had consented, § 903 independently limits the Bankruptcy Court's jurisdiction: "the ability of a chapter 9 debtor to consent under § 904 is limited by § 903 of the Bankruptcy Code and federalism concerns. Specifically, a chapter 9 debtor cannot consent to a court order that would violate a state law or administrative order." *N.Y.C. Off-Track Betting*, 434 B.R. at 141. Section 903 unambiguously prohibits the County's chapter 9 filing from "limit[ing] or impair[ing] the power of a State to control, by legislation or otherwise, [the County] in the exercise of the political or governmental powers of [the County.]" 11 U.S.C. § 903.<sup>11</sup>

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<sup>11</sup> The fact that Alabama authorized its municipalities to file chapter 9 petitions has no impact on the authority reserved to the states to control their municipalities under the Tenth Amendment and § 903.

The Bankruptcy Court itself acknowledged that the Receiver Order constitutes an exercise of “control” over the County.<sup>12</sup> Nevertheless, it concluded that the State Court was not “exercising the requisite sovereignty” needed to implicate § 903 because the State Court and the Receiver did “not hold the property in a sovereign capacity and [we]re not exercising public rights with respect to the property.” (V.II:554 at 46). The Bankruptcy Court erred in this conclusion.

First, by its plain language, § 903 bars the Bankruptcy Court from interfering with *any* exercise of control by Alabama over the County’s political or governmental affairs, not, as the Bankruptcy Court viewed it, solely instances of control rendered *in a sovereign capacity*. By limiting the applicability of § 903 to instances of “sovereign control,” rather than “control” as the statute states, the Bankruptcy Court imposed an additional qualification absent from the statute itself.

This, the Bankruptcy Court is not allowed to do:

[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute. . . . *The plain meaning of legislation should be conclusive, except in the rare cases in which the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.*

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<sup>12</sup> “Other than enforcing the rights and remedies provided for in the Indenture,” the State Court “has not otherwise acted to control or regulate the County.” (V.IX:554 at 28).

*Jove Eng'g, Inc. v. IRS (In re Jove Eng'g, Inc.)*, 92 F.3d 1539, 1550 (11th Cir. 1996) (emphasis and ellipsis in original) (quoting *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 240-42 (1989)). Because § 903 is not ambiguous and its application as written does not generate results at odds with the intention of its drafters, there is no opportunity for inquiry behind the plain language. Section 903 bars the County's bankruptcy filing from interfering with any instance of "control" by Alabama over the County's political or governmental affairs, including Alabama's control of the System through the Receiver Order.

Second, the State Court's exercise of control over the System through the Receiver Order *is* an exercise of sovereign control. Under the 1901 Alabama Constitution, judicial power is one of the three distinct departments embodying "the powers of the government of the State of Alabama. . . ." Ala. Const. art. III, § 42. "The judicial power of the state is vested exclusively in a unified judicial system. . ." that includes circuit courts. Ala. Code § 12-1-2 (1975). *See also Johnson v. Bd. of Control of Emps. Ret. Sys.*, 740 So. 2d 999, 1008 (Ala. 1999) (inferring that Alabama's judiciary is a portion of the state's sovereign power). The Alabama Supreme Court has recognized this constitutional exercise of the power of the State by the circuit court for over a century: "[C]ourts do not owe their existence to the legislative power, and the legislature can not dispense with them . . . . [T]hey proceed directly from the sovereign will. . . . They are each, in

their way, constitutional elements of the State sovereignty itself . . . .” *Perkins v. Corbin*, 45 Ala. 103, 118 (Ala. 1871). In other words, the acts of an Alabama circuit court are the acts of the state of Alabama itself. Further, “[a] receiver is a representative or arm of the court. A receiver acts on behalf of the court and is under its supervision, direction and control.”<sup>13</sup> *Burnett v. Nat’l Stonehenge Corp.*, 694 So. 2d 1276, 1281 (Ala. 1997) (internal citations and emphasis omitted). Accordingly, the Receiver Order constitutes an exercise of the judicial, and therefore sovereign, power of Alabama to control the County.

The Receiver Order constitutes state control over the County’s political or governmental affairs because it barred the County from exercising the powers granted to the County Commission by the Constitution of Alabama and gave them to the Receiver. Amendment 73 to the Alabama Constitution gives “[t]he governing body of Jefferson county” “full power and authority to manage, operate, control and administer” the System, including the power to “make [] rules and regulations fixing rates and charges, providing for the payment, collection and

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<sup>13</sup> The Receiver acts as an arm of the State Court. *Stuart v. Boulware*, 133 U.S. 78, 81 (1890) (noting “the receiver is an officer of the court, and subject ot [sic] its directions and orders. . . .”); *Am. Benefit Life Ins. v. Ussery*, 373 So. 2d 824, 828 (Ala. 1979) (“A receiver is a representative or arm of the court.”) (citations omitted). The Receiver Order itself provides that the Receiver acts as an arm of the State Court. (V.III:257:Ex.M.2 at 19) (“the Receiver shall owe duties only to the System and to this Court and shall not owe any duty, directly or indirectly, to the Plaintiff, the Defendants or any other party”).

enforcement thereof, and the protection of its property.” Ala. Const. amend. 73; *see also* 1949 Ala. Acts, No. 619 § 6(a) (providing that the County Commission shall set sewer rates). Before the County filed its chapter 9 petition, the State Court removed these powers from the County Commission and vested them exclusively in the Receiver:

The [Trustee, the County, and the County Commissioners] shall have no authority to administer or operate the business and affairs of the System, which authority by this Order is vested solely and exclusively in the Receiver.

(V.III:257:Ex.M.2 at 16). The Receiver Order gave the Receiver the “sole and exclusive right and authority” to:

- “take. . . possession, control and custody of the System” (*id.* at 8);
- fix rates and charge for System services (*id.* at 9); and
- “receive, collect, take possession of, and preserve all accounts, incomes, profits, and other revenues generated from and by the System,” (*id.*).

Because the County’s governing body, the County Commission, exercised these powers before entry of the Receiver Order, the Receiver Order plainly evidences that the State Court through the Receiver was exercising “control” by Alabama over the County’s “political or governmental powers” relating to the System under § 903. Therefore, § 903 bars the County’s chapter 9 proceeding from negating Alabama’s exercise of its sovereign authority to control the System through the Receiver Order. Consequently, the Bankruptcy Court’s purported exercise of

paramount jurisdiction over the System interferes with Alabama's own effort to control the System and is prohibited by § 903 and the Tenth Amendment.

Based on four cases, the Bankruptcy Court concluded that § 903's constraints apply only when control is exercised in a "sovereign capacity." (V.II:554 at 46). Yet none of these cases holds that a court appointing a receiver to control property is not exercising a judicial function or that such a receiver is not the agent of the appointing court. The cases hold merely that a receiver is not cloaked with sovereign immunity and is subject to the same claims and defenses to which the original owner would have been subject had he continued in possession of the property.<sup>14</sup> In fact, one of the cases clarifies that a receiver appointed at the

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<sup>14</sup> See *Nakash v. Zur (In re Nakash)*, 190 B.R. 763, 769 (Bankr. S.D.N.Y. 1996) (holding that efforts of an Israeli official serving as receiver for an insolvent bank to enforce a judgment of the bank against the bankruptcy debtor, a former director of the bank, were not protected by the Act of State Doctrine, which "[p]rohibits the examination of acts of an independent government by the courts of another sovereign nation," and violated the automatic stay) (internal citations and quotations omitted); *The Southern Cross*, 120 F.2d 466, 468 (2d Cir. 1941) (holding that a receiver appointed over private ships at the insistence of the United States, was "[a]n agent of the court, not of the Maritime Commission or the United States," and, like one appointed in a suit between private parties, was subject to state unemployment insurance taxes); *Rohrig v. Whitney*, 12 N.W.2d 866, 868 (Iowa 1944) (holding that the statute of limitations continued to run on a demand note while it was held by a state official serving as receiver of a bank because a "receiver is subject to the same rules that apply to any other individual unless there is some statutory exception. . .," which was not present); *Kluckhuhn v. Ivy Hill Ass'n, Inc.*, 461 A.2d 16, 18 (Md. Ct. Spec. App. 1983) (holding that the receiver's appointment does not toll the running of the limitations period required to establish adverse possession of property within the receiver's charge).

insistence of a private party deserves the same treatment as one appointed at the instance of a government entity. *See The Southern Cross*, 120 F.2d at 468. The fact that a private party asked the State Court to appoint the Receiver does not make the State Court's exercise of control through the Receiver any less an exercise of state sovereignty.

The Receiver Order constitutes Alabama's control over the County's political or governmental affairs under § 903. Thus, § 903 prevented the Bankruptcy Court from obtaining jurisdiction to impair the State Court's control of the System.

In the alternative, this Court should reverse the Bankruptcy Court's decision because the Bankruptcy Court should have abstained from exercising jurisdiction over the System. Mandatory abstention is required because § 903 limits the power of the Bankruptcy Court to enter an order that would violate the Receiver Order. Abstention is also warranted in order to avoid a conflict between the state and federal governments regarding the State Court's decision to put the Receiver in control of the System. Accordingly, the Bankruptcy Court's decision should be reversed.

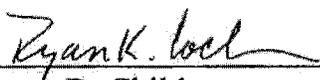
**B. *The Bankruptcy Court Cannot Disturb the Property Rights Adjudicated by the State Court***

The Bankruptcy Court recognized that the Receiver Order dispossessed the County of control of the System "for potentially decades, if not its useful life."

**CONCLUSION**

Appellants respectfully request that the Bankruptcy Court be reversed on the grounds set forth herein, and that this Court order that the System be returned to the exclusive possession and control of the Receiver.

Respectfully submitted on this the 27th day of August, 2012.

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# **EXHIBIT 3**

No. 12-13654-B

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In the  
**United States Court of Appeals  
for the Eleventh Circuit**

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ASSURED GUARANTY MUNICIPAL CORP., ET AL.,

*Appellants/Cross-Appellees,*

v.

JEFFERSON COUNTY, ALABAMA,

*Appellee/Cross-Appellant.*

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On Direct Appeal from the United States Bankruptcy Court for the Northern  
District of Alabama, Southern Division  
Case No. 11-05736-TBB-9

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**CONSOLIDATED RESPONSE AND REPLY BRIEF OF APPELLANTS  
THE BANK OF NEW YORK MELLON, AS INDENTURE TRUSTEE;  
JOHN S. YOUNG, JR., LLC, AS RECEIVER; THE BANK OF NOVA  
SCOTIA; SOCIÉTÉ GÉNÉRALE, NEW YORK BRANCH; THE BANK OF  
NEW YORK MELLON; STATE STREET BANK AND TRUST COMPANY;  
JPMORGAN CHASE BANK, N.A.; FINANCIAL GUARANTY  
INSURANCE COMPANY; ASSURED GUARANTY MUNICIPAL CORP.;  
AND SYNCORA GUARANTEE INC.**

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NAMES AND ADDRESSES OF COUNSEL FOR APPELLANTS PROVIDED BELOW

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**STATEMENT OF ISSUES<sup>1</sup>**

The County's cross-appeal presents two additional issues:

1. Whether the Bankruptcy Court correctly ruled that pledged special revenues under § 922(d) include all revenues dedicated to repayment of the Warrants, whether collected before or after the Petition Date.

2. Whether the Bankruptcy Court correctly ruled that under § 922(d), the automatic stay of §§ 362(a) and 922(a) is inapplicable to pledged special revenues and, therefore, the County must continue to pay all pledged special revenues received during the pendency of its bankruptcy case on the Warrants.

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<sup>1</sup> Capitalized terms not otherwise defined shall have the meaning given them in the Consolidated Brief of Appellants ("Appellants Brief").

### **SUMMARY OF ARGUMENT**

The County's assertion that Appellants seek "to overturn two fundamental pillars of bankruptcy law," (1) "exclusive jurisdiction over all of a debtor's property" and (2) the "protection of the automatic stay to give a debtor breathing room," misses the mark. First, in a chapter 9 case, § 904 provides that the bankruptcy court has no power over "[a]ny of the property or revenues of the debtor" without debtor consent. No consent has been given here. Therefore, jurisdiction over a municipal debtor's property does not automatically transfer to the bankruptcy court. Second, § 922(d) makes clear that a municipal debtor has no "breathing room" when it comes to complying with its special revenue obligations, like the Warrants at issue here. Thus, § 922(d) requires the County to continue to pay over all Net Revenues received after the Petition Date.

The pivotal issue in this case is really state sovereignty over its municipal debtor. Over one year before the Petition Date, the State Court, at the request of the Trustee, appointed the Receiver to exercise the County Commission's powers over the System. Appellants contend that the County's bankruptcy petition did not automatically divest State Court control over the System in the face of § 903, which declares that nothing in chapter 9 can limit or impair the power of a state to control a municipality in the exercise of its political or governmental powers.

Appellants demonstrated and the County has not challenged that the State Court's authority over the System, to the County's exclusion, is an exercise of Alabama's control over the County's political and governmental affairs within the meaning of § 903. Rather, the County argues that private parties lack standing to invoke §§ 903 and 904's limitations and that § 903 provides no substantive limit on bankruptcy court authority. This Court should reject the County's interpretation, which is at odds with binding Supreme Court precedent and a fundamental canon of statutory construction that requires courts to give effect to all of chapter 9's provisions.

By entry of a final and appealable order, the State Court divested the County of all property interests in the System, including the rights of use and control, leaving the County with only "bare" title. Alabama law provides such an order is final for claim and issue preclusion purposes, and the Full Faith and Credit Act requires federal courts to give it the same effect. Moreover, turnover power is inapplicable in chapter 9 cases, preventing the County's bankruptcy filing from altering interests in the System.

Even if the Bankruptcy Court could affect State Court action through the automatic stay of §§ 362 and 922, Appellants have demonstrated that § 362(b)(4) exempts the Receiver from the automatic stay and that the stay expired by operation of § 362(e). Appellants also demonstrated sufficient cause to require the

Bankruptcy Court to either grant relief from the stay or require the County to provide adequate protection.

Therefore, this Court should reverse the Bankruptcy Court's Order denying stay relief and determining that jurisdiction over the System resides in the Bankruptcy Court, and order the System returned to the exclusive possession and control of the Receiver.

Finally, the County's cross-appeal regarding § 922(d) is meritless. The Bankruptcy Court correctly held that pursuant to § 922(d), "pledged special revenues" include all System revenues dedicated by the County to repaying the Warrants, and the automatic stay of §§ 362(a) and 922(a) are inapplicable to pledged special revenues. The Bankruptcy Court's decision is supported by the Indenture, Alabama law, the use of the term "pledge" in municipal finance, and the legislative history of the 1988 amendments to chapter 9 (the "1988 Amendments"). Further, the Bankruptcy Court's consultation of each was consistent with canons of statutory interpretation. Therefore, this Court should affirm the Bankruptcy Court's conclusion that the County is obliged to pay to the Trustee all Net Revenues received post-petition.

**ARGUMENT AND CITATIONS TO AUTHORITY<sup>2</sup>****I. THE BANKRUPTCY COURT INFRINGED ON STATE SOVEREIGNTY.****A. THE BANKRUPTCY COURT'S ORDER VIOLATED THE TENTH AMENDMENT AND §§ 903 AND 904.**

The County offers no challenge to Appellants' showing that the State Court's exercise of control over the System through the Receiver Order is an exercise of Alabama's sovereign power to control the political and governmental powers of the County expressly protected by § 903. No doubt recognizing the strength of this point, the County attempts to shift the argument to one of standing in order to distract this Court's view of *the central issue*: that, by virtue of the federalism concerns expressed in §§ 903 and 904, the Bankruptcy Court could not wrest control of the System from the Receiver. The County's arguments fail.

1. Appellants have prudential standing to challenge the Bankruptcy Court's decision.

Bankruptcy courts have recognized that §§ 903 and 904 “reserve the power to control municipalities to the state and limit the jurisdiction and powers of the court.” *In the Matter of Sanitary & Improvement Dist., No. 7*, 98 B.R. 970, 972

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<sup>2</sup> For the expanded record excerpt (“ERE”) citations, “A-” indicates a reference to Appellants Brief ERE, and “A(Supp)-” refers to that submitted with this response and reply brief. ERE citations are then followed by “V.,” indicating the specific volume number, followed by the corresponding docket entry number, followed by the pin cite, if any. For example, a citation to “A-V.I:50 at 10” refers to Appellants’ Volume I of Appellants Brief’s ERE, document 50 at page 10.

(Bankr. D. Neb. 1989). The County wrongly contends that, as private parties, Appellants lack prudential standing to challenge the Bankruptcy Court's ruling based on the jurisdictional constraints of §§ 903 and 904 and the principles of state sovereignty codified therein. The County cannot cite any court decision and relies solely on *Collier on Bankruptcy* to support its assertion. (County Br.<sup>3</sup> at 19) (citing 6 *Collier on Bankruptcy* ¶ 903.02[3] (16th ed. rev. 2012)). The single case cited by *Collier*, however, never addressed who has standing to raise an objection under § 903. It merely rejected the argument that § 903 required the bankruptcy court to lift the stay to allow creditors to adjudicate their disputes in state court. *Alliance Capital Mgmt., L.P. v. Cnty. of Orange (In re Cnty. of Orange)*, 179 B.R. 185, 191 (Bankr. C.D. Cal. 1995).

Appellants have standing to demand compliance with the constitutional constraints codified in §§ 903 and 904. First, Congress provided that every “party in interest, including the debtor, . . . a creditor, . . . or any indenture trustee, may raise and may appear and be heard on *any* issue in a case under this chapter.” 11 U.S.C. § 1109(b) (emphasis added).<sup>4</sup> Each of Appellants meets this test and has suffered an injury in fact resulting from the Bankruptcy Court's Order. The

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<sup>3</sup> The Brief of Appellee/Cross-Appellant Jefferson County, Alabama is referred to herein as “County Brief.”

<sup>4</sup> Section 1109 is applicable in chapter 9. 11 U.S.C. § 901(a).

Trustee,<sup>5</sup> Warrantholders, and credit insurers<sup>6</sup> have unquestionably been aggrieved by the Bankruptcy Court's Order, because it wrested control of the System from the Receiver, depriving them of their bargained-for and judicially-granted remedy for the County's failure to pay Warrants when due, competently manage the System and generate an appropriate level of revenue to pay the Warrants. The Receiver was also aggrieved by the Order, because it stripped him of possession of and control over the System.<sup>7</sup>

Second, the Supreme Court has previously heard and decided the merits of challenges by private parties to the validity of municipal bankruptcy legislation on the grounds that it unconstitutionally infringed upon state sovereignty. *United States v. Bekins*, 304 U.S. 27, 46 (1938) (deciding merits of private parties' contention that the Municipal Corporation Bankruptcy Act "violated the Fifth and Tenth Amendments of the Federal Constitution"); *Ashton v. Cameron Cnty. Water*

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<sup>5</sup> The Trustee is charged with protecting the rights of the Warrantholders. (Indenture, A-V.IV:257:Ex.M.10 at 79-80).

<sup>6</sup> Other than the Trustee and Receiver, Appellants are either Warrantholders or credit insurers of the County who may be obligated to pay the Trustee amounts that become due to Warrantholders that cannot be paid by the County.

<sup>7</sup> The Receiver also has prudential standing to assert a Tenth Amendment challenge because it is a representative of the State Court and an arm of the State of Alabama. *Am. Benefit Life Ins. v. Ussery*, 373 So. 2d 824, 828 (Ala. 1979) ("A receiver is a representative or arm of the court."); *Johnson v. Bd. of Control of the Emps.' Ret. Sys.*, 740 So. 2d 999, 1008 (Ala. 1999) (inferring that Alabama's judiciary is a portion of the state's sovereign power).

*Improvement Dist., No. 1*, 298 U.S. 513, 524-25, 532 (1936) (holding that a state political subdivision's bankruptcy case was properly dismissed on claims of private party creditors that the first municipal bankruptcy legislation unconstitutionally infringed upon state sovereignty).

Third, this Court has held that private litigants “may make constitutional objections based on any [federal] provisions so long as they show the requisite injury in fact and its causal relation to the action in question.” *Atlanta Gas Light Co. v. U.S. Dep't of Energy*, 666 F.2d 1359, 1368 n.16 (11th Cir. 1982) (“reach[ing] the merits of the Tenth Amendment issue” asserted by a private party). Similarly, just last year, the Supreme Court explicitly held that a private party has standing to challenge the validity of a federal government action on the grounds that it “intrud[ed] upon the sovereignty and authority of the States.” *Bond v. United States*, 131 S. Ct. 2355, 2360 (2011).

Challenging her indictment under a federal statute, Bond contended that in enacting the legislation, Congress exceeded its powers and infringed upon powers reserved to states. *Id.* The Court of Appeals held Bond lacked standing to raise the Tenth Amendment without state participation in the proceeding. *Id.* The Supreme Court reversed, concluding that Bond had both Article III and prudential

standing to raise a Tenth Amendment issue. *Id.* at 2364-67. Amicus curiae<sup>8</sup> contended that the prudential rule that a party “generally must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interests of third parties,” precluded federal courts from adjudicating Bond’s claims because “argu[ing] that the [federal government] has interfered with state sovereignty in violation of the Tenth Amendment is to assert the legal rights and interests of States and States alone.” *Id.* at 2363. The Supreme Court disagreed, holding that an “individual, in a proper case, can assert injury from government action taken in excess of the authority that federalism defines.” *Id.* at 2363-64. The Court recognized that “the federal structure serves to grant and delimit the prerogatives and responsibilities of the States and the [federal government] vis-a-vis one another” and also “secures the freedom of the individual” and “the individual liberty secured by federalism is not simply derivative of the rights of the States.” *Id.* at 2364. Ultimately, the Court held that “where the litigant is a party to an otherwise justiciable case or controversy, she is not forbidden to object that her injury results from disregard of the federal structure of our Government.” *Id.* at 2366-67. Thus, it is settled law that private parties, such as Appellants, may

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<sup>8</sup> After Bond sought certiorari, the government advised the Court that it changed its position and agreed Bond had standing to challenge the legislation’s constitutionality on Tenth Amendment grounds. *Id.* at 2361. The Court granted certiorari and appointed an amicus curiae to defend the judgment of the Court of Appeals.

challenge federal government action, like the Bankruptcy Court's Order, that unconstitutionally infringes upon state sovereignty.

Because each of Appellants has been aggrieved by and suffered an injury in fact resulting from the Bankruptcy Court's Order, each unquestionably possesses Article III standing to challenge the Order. Therefore, under *Bond* and *Atlanta Gas*, Appellants have prudential standing to challenge the Order as violative of the state sovereignty principles codified in §§ 903 and 904.

2. Alabama's authorization of its counties' eligibility to file chapter 9 does not immunize the Bankruptcy Court's Order from state sovereignty concerns.

The County asserts that Appellants' argument fails on the merits simply because "Alabama expressly authorized the County to file bankruptcy" and, accordingly, consented to all Bankruptcy Court acts. (County Br. at 20). Because § 109(c)(2) provides that state consent is a prerequisite to any municipal bankruptcy case, the County's argument would render § 903's limitations inapplicable to bankruptcy court action. However, state authorization of a municipal bankruptcy cannot render valid bankruptcy court action that would otherwise violate the Tenth Amendment and § 903.

First, under binding Supreme Court precedent, state consent does not ratify federal government action that exceeds its authority relative to the States. *New York v. United States*, 505 U.S. 144, 182 (1992). In *New York*, the state defendants

argued that state officials' consent to the enactment of certain provisions of a federal act precluded the act from being "an unconstitutional infringement of state sovereignty." *Id.* at 153, 181. The Supreme Court disagreed, reasoning that "the Constitution divides authority between federal and state governments for the protection of individuals," because "[s]tate sovereignty is not just an end in itself: 'Rather, federalism secures to citizens the liberties that derive from the diffusion of sovereign power.'" *Id.* at 181 (quoting *Coleman v. Thompson*, 501 U.S. 722, 759 (1991) (Blackmun, J., dissenting)). *New York* establishes that this Court must reject the County's argument that Alabama's consent to bankruptcy court authority over its municipalities ratifies all actions that may infringe upon state sovereignty.

Second, the Supreme Court has recognized that state consent does not render municipal bankruptcy legislation immune from state sovereignty challenges. In *Ashton*, the Court held that the first municipal bankruptcy legislation unconstitutionally infringed upon state sovereignty, even though the water improvement district was a political subdivision of the State of Texas and "the Texas Legislature [had] declared that [its] . . . political subdivisions . . . might proceed under" that municipal bankruptcy legislation. 298 U.S. at 527.

Similarly, although the Court upheld the second municipal bankruptcy legislation in *Bekins*, it did not hold that state consent to *filing* waived the protections of states' rights required by the United States Constitution and the

Bankruptcy Code. 304 U.S. at 49. Rather, the *Bekins* Court noted that Congress had been “especially solicitous” in enacting legislation to prevent bankruptcy court action from interfering with state control over municipalities. *Id.* at 49-50. *Bekins* held that the legislation was constitutional because of the state consent requirement *plus* statutory limitations on bankruptcy court action that protected state sovereignty. *Id.* at 51-53.

3. Section 903 bars interference with the Receiver Order.

After first arguing that only the State of Alabama has standing to avail itself of the protections of § 903, the County then suggests that even Alabama could not proceed under § 903 because it provides no “independent substantive limit on the application of other provisions of chapter 9.” (County Br. at 22). In other words, according to the County, the only sovereign control Alabama can exercise regarding a municipal debtor is deciding whether the municipality is authorized to file a chapter 9 case. The County suggests that any reading of § 903 that offers a substantive limit on the application of any other provision of chapter 9 would constitute state revision of chapter 9. (County Br. at 22, 23). This argument essentially neuters § 903’s limitations on bankruptcy court power.

Under the County’s desired construction, i.e., that § 903 provides no “independent substantive limit” in chapter 9 proceedings, (County Br. at 22), § 903 is reduced to “mere surplusage,” an outcome that runs afoul of binding legal

precedent. “[O]ne of the most basic interpretive canons” is that “[a] statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant.” *Corley v. United States*, 556 U.S. 303, 314 (2009) (quoting *Hibbs v. Winn*, 542 U.S. 88, 101 (2004)); *see also TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (holding that statutes should be construed so that no words, clauses, or sentences are made superfluous or insignificant); *Myers v. TooJay’s Mgmt. Corp.*, 640 F.3d 1278, 1285 (11th Cir. 2011) (refusing to interpret “discriminate with respect to employment” to include the denial of employment, because doing so would render the words “deny employment” in § 525(a) of the Bankruptcy Code “meaningless, pointless, superfluous,” which “is an interpretative no-no”).<sup>9</sup>

In order to protect a state’s right to control its municipalities, § 903 must be applied to post-petition acts, including bankruptcy court orders. Interpreting a state’s consent under § 109(c)(2), as the County urges, as ratifying all actions taken

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<sup>9</sup> The County’s reliance on *In re City of Vallejo*, 403 B.R. 72 (Bankr. E.D. Cal. 2009); *Association of Retired Employees v. City of Stockton (In re City of Stockton)*, 478 B.R. 8 (Bankr. E.D. Cal. 2012); and *County of Orange v. Merrill Lynch & Co. (In re County of Orange)*, 191 B.R. 1005 (Bankr. C.D. Cal. 1996), for the proposition that § 903 does not limit the substantive provisions of Chapter 9, (County Br. at 22-23), is misplaced. These cases hold only that States cannot interpret § 903 to give them immunity from the other provisions of chapter 9 once a debtor is authorized to file and none address the effect of a municipal bankruptcy petition on a state’s taking of actual control over the municipal debtor’s property before a petition was filed.

by a bankruptcy court in a chapter 9 case effectively removes a municipality from the state's control in violation of congressional intent to protect state sovereignty. This Court cannot accept the County's position without rendering § 903 a nullity, and doing so would be particularly troubling because the Supreme Court relied on the inclusion of § 903's precursor to uphold the second municipal bankruptcy legislation. *Bekins*, 304 U.S. at 51.

Appellants rely on the plain language of § 903, which prevents a chapter 9 filing from unconstitutionally interfering with State control over the municipality's political or governmental affairs. *See* 11 U.S.C. § 903. In this case, Appellants have shown, and the County does not contest, that the State Court exercised Alabama's power to take certain political and governmental powers over the System from the County and transfer them to the Receiver. The plain language of § 903 prevented the County's chapter 9 filing from interfering with that act of Alabama's control.

4. The Bankruptcy Court ignored § 904.

Section 904 precludes the automatic transfer of municipal debtor property under 28 U.S.C. § 1334(e). Section 904 requires County consent before the Bankruptcy Court can interfere with its property and the County has never consented. Instead, in virtually every pleading it files with the Bankruptcy Court, the County reserves its § 904 rights. (*See, e.g.*, Mot. to Establish Notice, Service,

& Case Mgmt. Procedures, A(Supp)-V.II:11 at 18) (expressly reserving “all rights under § 904 of the Bankruptcy Code); (County Mot. for Clarification, A-V.VIII:552 at 7) (filing the motion without prejudice to the County’s § 904 rights and expressly asserting “nothing herein is intended as or shall be deemed to constitute the County’s consent pursuant to § 904” to Bankruptcy Court interference with its powers or property). As a result of the operation of § 904 and the County’s reservation of rights under § 904, the Bankruptcy Court did not automatically obtain jurisdiction over the County’s property upon the commencement of its chapter 9 case. Accordingly, the Bankruptcy Court’s ruling that it obtained jurisdiction over the System automatically upon the filing of the chapter 9 petition should be reversed.

5. The Bankruptcy Court should have abstained from exercising jurisdiction over the System.

The County misapprehends Appellants’ argument that the Bankruptcy Court should have abstained from interfering with the Receiver. As discussed, § 903 prevents the Bankruptcy Court from impairing the State Court’s control over the County and the System. In order to comply with the dictates of § 903 and avoid a conflict between state and federal governments, the Bankruptcy Court should have refrained from entering an order that impaired the State Court’s control over the System through the Receiver.

Respectfully submitted on this the 13th day of November, 2012.

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