

EXHIBIT B



COMMONWEALTH OF PENNSYLVANIA
DEPARTMENT OF COMMUNITY & ECONOMIC DEVELOPMENT

February 8, 2022

M. Michael Doweary
Receiver for the City of Chester
419 Avenue of the States, Suite 401
Chester, PA 19013

Dear Receiver Doweary:

I am in receipt of your counsel's letter dated January 14, 2022 requesting authorization to file a municipal debt adjustment action on behalf of the City of Chester, Delaware County, Pennsylvania under the United States Bankruptcy Code (11 U.S.C. § 101 et seq.) (hereinafter the "Bankruptcy Code") and to act on the municipality's behalf in the proceeding pursuant to 53 P.S. § 11701.706(a)(9) (the "Request").

The Receiver, Chapter 9, and the Required Analysis

Under Act 47 of 1987, as amended, the Receiver possesses the sole power to file a municipal debt adjustment action under Chapter 9 of the Bankruptcy Code. 53 P.S. § 11701.706(a)(9). However, the Receiver may only exercise this power upon the written authorization of the Secretary (the "Secretary") of the Pennsylvania Department of Community and Economic Development ("DCED"). *Id.* Once the Secretary provides written authorization, the Receiver "shall consult with the [Act 47 municipal financial recovery] advisory committee" prior to filing the municipal debt adjustment action. *Id.* § 11701.711(e). These are the only express limitations upon the Receiver's power to file for bankruptcy on behalf of the distressed municipality.

Although Section 706(a)(9) of Act 47 provides no other specific guidance or procedures that the Secretary must follow once he receives a request from the Receiver to file an action under Chapter 9, another section of Act 47 does provide guidance when reviewing a municipality's request to file a bankruptcy action which may prove useful or persuasive when reviewing a Receiver's request. Section 261(a) of Act 47 allows a municipality to apply to the Secretary for written authorization to file a Chapter 9 bankruptcy action if it is faced with one of the following conditions:

- a. imminent jeopardy of an action by a creditor, claimant or supplier of goods or services which is likely to substantially interrupt or restrict the continued ability of the municipality to provide health or safety services to its citizens.
- b. one or more creditors of the municipality have rejected the proposed or adopted [Recovery] plan, and efforts to negotiate resolution of their claims have been unsuccessful for a ten-day period.

- c. a condition substantially affecting the municipality's financial distress is potentially solvable only by utilizing a remedy exclusively available to the municipality through Chapter 9.

Id. § 11701.261(a)(1)-(3). Applying Section 261(a)(3) of Act 47 to the instant matter, a two-part analysis is required: first, whether the Request has identified a condition substantially affecting the City's financial condition; and second, whether this condition is potentially solvable only by utilizing a remedy exclusively available to the City through the Bankruptcy Code.

The Request Has Identified a Condition Substantially Affecting the City's Financial Condition

Here, the Request identified the City's obligations to its retirees, specifically the condition of its pension plans and the additional obligation to provide post-retirement medical coverage, as the most important factors affecting the City's financial distress. As of this writing, the City owes \$32,400,000 in outstanding minimum municipal obligation ("MMO") payments and interest payments that were not paid to its police pension plan in previous years as required by Act 205 of 1984, as amended, 53 P.S. § 895.101 *et seq.* Request, p. 4. On an accounting basis, Act 205 considers the outstanding \$32,400,000 to be a "receivable" which the actuary, in turn, is required to assume is already in the police pension fund for the purposes of pension valuation. *Id.* In reality, the police pension fund only holds \$2,567,027 in assets, of which approximately \$1,149,000 is set aside for officers participating in the City's Deferred Retirement Option Plan. *Id.* The remaining \$1,149,000 is the equivalent of only four months of pension payments. *Id.* Furthermore, the City owes \$2,064,489 to the Officers and Employees ("O&E") Pension Plan and \$2,134,303 to the firefighter pension plan. *Id.* In total, the City owes \$36,598,798 to its pension funds which is compounded by an additional \$67,173,192 in unfunded pension liabilities. *Id.*

The City has been unable to meet its annual MMOs since 2013. Request, p. 4. As noted in the Receiver's Amended Recovery Plan submitted to the Commonwealth Court on April 7, 2021, although the City budgeted \$10.8 million for 2021 towards its MMO, the City is still unable to repay the full amount it owes to each of its pension plans. Amended Recovery Plan, p. 26.¹ As an example, the \$10.8 million payment nearly covered the outstanding 2016 MMO for the police pension and the 2019 MMOs for the other two plans. *Id.* Nonetheless, outstanding liabilities for 2017, 2018, 2019, and 2020 and interest penalties will continue to accrue on the total balance. On top of its unsustainable pension plan burden, the City's obligation to provide post-retirement medical benefit obligations alone exceeds another \$232 million. Request, p. 4.

Additional information concerning the health of the City's General Fund clearly demonstrates that the City is perilously close to being unable to meeting its day-to-day obligations. The joint status report filed with the Commonwealth Court of Pennsylvania by the City and the Receiver on January 14, 2022, highlighted the following:

- a. the City risked finishing 2021 with a negative cash balance, but for the availability and use of American Rescue Plan Act of 2021 funds;
- b. the City's expenditures in 2022 are budgeted to exceed revenues by \$0.2 million;

¹ The Commonwealth Court approved the Amended Recovery Plan on June 7, 2021.

- c. the City required a \$5 million emergency tax revenue anticipation note and loan from DCED in order to avoid running out of money before its real estate tax receipts came in; and
- d. the City recently discovered it owed approximately \$750,000 in taxes to the Internal Revenue Service stemming from W-2 and W-3 form discrepancies from filings between 2016 and 2018.

Joint Status Report, pp. 3-4, Ex. A “2022 Budget by the Numbers.” Thus, the City lacks any flexibility in its General Fund to be able to successfully address its unresolved retiree obligations.

Given that the current MMOs, outstanding amount owed to its pension funds, unfunded pension plan liabilities, and post-retirement medical benefit obligations cumulatively total in the hundreds of millions of dollars which far exceeds the City’s ability to pay, I find that the Request has identified a condition substantially affecting the City of Chester’s financial condition under 53 P.S. § 11701.261(a)(3).

The Aforementioned Condition is Potentially Solvable Only By Utilizing a Remedy Exclusively Available to the City Through the Bankruptcy Code

Addressing the second prong of Section 261(a)(3), I turn to whether the City’s outstanding retiree obligations are potentially solvable only by utilizing a remedy exclusively available to the municipality through the Bankruptcy Code. Initially, in order for a municipality to file municipal debt readjustment action, a municipality must meet four requirements:

- a. the municipality must be specifically authorized to be a debtor by state law or by a governmental officer or organization empowered by state law to authorize the municipality to be a debtor;
- b. the municipality must be insolvent²;
- c. the municipality must desire to effect a plan to adjust its debts; and
- d. the municipality must either:
 - a. obtain the agreement of creditors holding at least a majority in amount of the claims of each class that the debtor intends to impair under a plan in a case under chapter 9;
 - b. negotiate in good faith with creditors and fail to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that the debtor intends to impair under a plan;
 - c. be unable to negotiate with creditors because such negotiation is impracticable; or
 - d. reasonably believe that a creditor may attempt to obtain a preference.

² The Bankruptcy Code defines “insolvent” as follows:

- (C) with reference to a municipality, financial condition such that the municipality is—
- (i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or
 - (ii) unable to pay its debts as they become due.

11 U.S.C. § 101(32)(c)(i)-(ii).

11 U.S.C. § 109(c)(2)-(5). I find that a municipal debt readjustment action under the Bankruptcy Code filed by the Receiver would likely meet these requirements because: 1) once the Receiver receives written authorization from the Secretary, Section 706(a)(9) of Act 47 authorizes the City to be a debtor; 2) the City is insolvent as it is unable to pay its pension and medical retiree debts as they become due, as discussed above; 3) the Receiver desires to effect a plan to adjust the City's debts; and 4) the Receiver, in his Request, has committed to negotiating with the City's creditors prior to the filing of any action.

Once a municipality successfully files a bankruptcy petition, Section 365 of the Bankruptcy Code provides a municipal debtor with the power to reject an executory contract subject to the bankruptcy court's approval. 11 U.S.C. § 365. One such contract could be a municipality's commitments to provide pension benefits to its employees. Bankruptcy courts presiding over high-profile municipal bankruptcies (such as those filed by the City of Detroit, Michigan and the City of Stockton, California) have agreed that a municipality's pension obligations may be adjusted as part of a plan by using Section 365's rejection power. In the City of Detroit bankruptcy case, the court concisely stated that:

The state constitutional provisions prohibiting the impairment of contracts and pensions impose no constraint on the bankruptcy process.³ The Bankruptcy Clause of the United States Constitution, and the bankruptcy code enacted pursuant thereto, explicitly empower the bankruptcy court to impair contracts and to impair contractual rights relating to accrued vested pension benefits. Impairing contracts is what the bankruptcy process does.

In re City of Detroit, 504 B.R. 191, 244 (Bankr. E.D. Mich. 2013); *see also In re City of Stockton*, 526 B.R. 35, 59⁴ (Bankr. E.D. Cal. 2015) (reasoning that pension obligations could be rejected or modified subject to the Supreme Court's standard for collective bargaining agreements set in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984)).

The Secretary's Determination

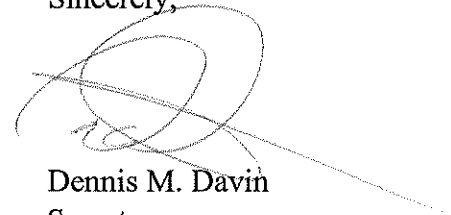
Based on the above review of the Bankruptcy Code, I find that the condition of the City's pension and post-retirement medical obligations are "potentially solvable only by utilizing a remedy exclusively available to the municipality through the Federal Municipal Debt Readjustment Act." 53 P.S. § 11701.261(a)(3). Therefore, I hereby grant the Receiver's request to file a municipal debt adjust action under the Bankruptcy Code and to act on behalf of the City of Chester in the proceeding and provide the following authorization (*italics added for clarity*):

³ The Pennsylvania Constitution contains a similar provision prohibiting the impairment of contracts. Pa. Const. Art. I, § 17.

⁴ The bankruptcy court eventually found that it was not faced with the rejection of a pension obligation, but with a contract merely involving the pension fund servicer, thus, it did not actually apply the *Bildisco* standard to a proposed pension obligation rejection. *In re City of Stockton*, 526 B.R. 35, 60 (Bankr. E.D. Cal. 2015).

Please be advised that pursuant to 53 P.S. Section 11701.706(a)(9) of the Pennsylvania Municipalities Financial Recovery Act ("Act 47"), the written unconditional authorization and consent of the Secretary of Community and Economic Development of the Commonwealth of Pennsylvania (the "Secretary") is hereby granted. All appropriate authority and powers are unconditionally conferred upon the Receiver for the City of Chester to institute, file, and pursue on behalf of the City of Chester the filing of a municipal debt adjustment action under the United States Bankruptcy Code, 11 U.S.C. Section 101 et. seq. (the "Bankruptcy Code") to the fullest extent permitted under the Code and applicable law. As part of this written consent, the Secretary unconditionally and without limitation authorizes and consents to the Receiver for the City of Chester to act on the City of Chester's behalf and to take all other necessary and appropriate action during that proceeding and under the Bankruptcy Code in order to enable the City to adjust all debts and all financial obligations, including but not limited to pension and post-employment health and other benefits. The Receiver is authorized to take all action necessary to allow the Receiver, on behalf of the City, to take and receive the full benefits of such a filing and of the municipal debt adjustment action, without conditions or limitation.

Sincerely,

A handwritten signature in black ink, appearing to read 'Dennis M. Davin', is written over a horizontal line. The signature is stylized and somewhat cursive.

Dennis M. Davin
Secretary

cc: John McLaughlin, Esquire, Counsel for the Receiver for the City of Chester
Neil Weaver, DCED Executive Deputy Secretary