

**UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA**

In re: : CHAPTER 9
: :
CITY OF HARRISBURG, : Bky. No. 11-06938 MDF
: :
Proposed Debtor. : :

REBUTTAL BRIEF IN SUPPORT OF OBJECTION OF TD BANK, NATIONAL ASSOCIATION, MANUFACTURERS AND TRADERS TRUST COMPANY AND ASSURED GUARANTY MUNICIPAL CORP. TO CHAPTER 9 PETITION

TD Bank, National Association ("TD"), Manufacturers and Traders Trust Company ("M&T") and Assured Guaranty Municipal Corp. ("Assured") submit this rebuttal brief in support of their Objection to the proposed debtor's bankruptcy petition (the "Petition"). The Objection identifies two reasons the Petition should be dismissed: (1) the Petitioner lacks the "specific authorization" from the state required under Section 109(c) of the Bankruptcy Code because of the passage of Act 26 which prohibits distressed cities of the third class, such as Harrisburg, from filing a Chapter 9 bankruptcy petition until July 2012; and (2) even if state authorization existed, the City failed to authorize the filing of the Petition through the passage of an ordinance as required by law.

In an attempt to avoid the prohibitions of Act 26, Petitioner has filed a scattershot answer and brief raising a litany of purported constitutional and legal defects in Act 26. As set forth below, none of these contentions have merit. The City had no vested right under state law to file a Chapter 9 petition. Act 26 is constitutional and is not an *ex post facto* law, "special legislation", or the product of legislation that violated the "one subject" requirement. Petitioner has also failed to establish that the City complied with applicable law in authorizing the filing of

the Petition by a resolution as opposed to an ordinance. Accordingly, for the reasons set forth below, the Petition should be dismissed.

I. Harrisburg Cannot File For Bankruptcy Because It Is Not Authorized To Do So

A. Act 26 Precludes Bankruptcy Filings By Distressed Cities Of The Third Class

As briefed more fully in the initial objections, in recognition of the rights reserved to states under the Tenth Amendment, section 109(c) of the Bankruptcy Code requires that a municipality must have specific state authorization to seek Chapter 9 relief. See In re County of Orange, 183 B.R. 594, 604 (Bankr. C.D. Cal. 1995) (the 1994 amendment to section 109(c) “requires that the state give the municipality express authority to file.”); United Bldg. & Constr. Trades Council of Camden Cnty. & Vicinity v. Mayor & Council of City of Camden, 465 U.S. 208, 215 (1984)(“[A] municipality is merely a subdivision of the State from which its authority is derived”); In re City of Vallejo, CA, 432 B.R. 262, 267-68 (Bankr. E.D. Cal. 2010) (states “act as gatekeepers to their municipalities’ access to Chapter 9”). The Commonwealth of Pennsylvania has expressed in clear terms in Act 26 that distressed cities of the third class, including Harrisburg, may not file for bankruptcy until at least July 2012. Therefore, the Petition must be dismissed.

Petitioner argues, inconsistently, that Harrisburg is the target of Act 26 and simultaneously not subject to it because the City was determined to be distressed before Act 26 was passed.¹ In an effort to evade the clear prohibition of Act 26, Petitioner advances a number of challenges to Act 26, none of which is legally sustainable.

¹ Petitioner has included in its brief arguments about why the Petition meets the requirements of section 109 beyond those in section 109(c)(2). Pursuant to the Court’s Orders of October 14 and October 19, those issues were expressly reserved and, therefore, are not addressed in this rebuttal brief.

B. The City has No Vested Right to File for Bankruptcy and Act 26 is not an Ex Post Facto Law

It has long been recognized as a fundamental principle of law that municipalities have no more power than is granted to them by the State and have no vested rights in any authority granted by the State.

Municipal corporations are mere instrumentalities of the State for the more convenient administration of local government. Their powers are such as the legislature may confer, and these may be enlarged, abridged, or entirely withdrawn at its pleasure. This is learing [sic], found in all adjudications on the subject of municipal bodies and repeated by text-writers. There is no contract between the State and the public that the charter of a city shall not at all times be subject to legislative control. All persons who deal with such bodies are conclusively presumed to act upon knowledge of the power of the legislature. **There is no such thing as a vested right held by any individual in the grant of legislative power to them.**

Merriwether v. Garrett, 102 U.S. 472, 511 (1880) (Field, J. concurring) (emphasis supplied). A full ten years earlier, the Pennsylvania Supreme Court had adopted the same principle of law:

The City of Philadelphia is beyond all question a municipal corporation, that is, a public corporation created by the government for political purposes, and having subordinate and local powers of legislation...an incorporation of persons, inhabitants of a particular place, or connected with a particular district, enabling them to conduct its local government...**It is merely an agency instituted by the sovereign for the purpose of carrying out in detail the objects of government – essentially a revocable agency—having no vested right to any of its powers or franchises...and therefore fully subject to the control of the legislature, who may enlarge or diminish its territorial extent or its functions, may change or modify its internal arrangement, or destroy its very existence, with the mere breath of arbitrary discretion.**

Philadelphia v. Fox, 64 Pa. 169, 1870 WL 8678 at *11 (Pa. 1870) (emphasis supplied). In 1901, the Pennsylvania Supreme Court reiterated this rule more succinctly:

Municipal corporations are agents of the state, invested with certain subordinate governmental functions for reasons of convenience and public policy. They are created, governed, and the extent of their powers determined, by the legislature, and subject to change, repeal, or total abolition at its will. **They have no vested rights in their offices, their charters, their corporate powers, or even their corporate existence. This is the universal rule of constitutional law, and in no state has it been more clearly expressed and uniformly applied than in Pennsylvania.**

Commonwealth ex rel. Elkin v. Moir, 49 A. 351, 352 (Pa. 1901)(emphasis supplied).

This long established principle remains in full force today. City of Chester v. Commonwealth, 434 A.2d 695, 700 (Pa. 1981); Philadelphia Facilities Mgmt. Corp. v. Biester, 431 A.2d 1123, 1133 (Pa. Commw. Ct. 1981) (“The powers of the state legislature over a municipality were considered to be, except for constitutional limitations, plenary or absolute.”); Se. Pennsylvania Transp. Auth. v. City of Phila., 20 A.3d 558, 566 (Pa. Commw. Ct. 2011) (“[Municipal corporations] are created, governed, and the extent of their powers determined by the Legislature and subject to change, repeal or total abolition at its will.”). As a consequence of this engrained “universal rule of constitutional law”, there can be no credible argument that the City had any vested interest in the right to file bankruptcy under Act 47 as it existed prior to the enactment of Act 26. Accordingly, because Act 26 prohibited the filing of the Petition, the City had no legal entitlement to file for bankruptcy at the time that it actually purported to do so.

Similarly, Act 26 is not an *ex post facto* law and, in any event, is not being applied retroactively. Article I, section 17 of the Pennsylvania Constitution states:

No *ex post facto* law, nor any law impairing the obligation of contracts, or making irrevocable any grant of special privileges or immunities, shall be passed.

Pa. Const., Art. I, §17. This constitutional prohibition on *ex post facto* laws relates only to “penal statutes which disadvantage the offender affected by them.” Commonwealth v. Estman, 915 A.2d 1191, 1195, n.5 (2007) (citing Collins v. Youngblood, 497 U.S. 37, 41 (1990)). Act 26 is not a penal statute and therefore the constitutional prohibition against *ex post facto laws* is inapplicable. Further, Act 26 is not being applied retroactively. Act 26 precludes any City of the Third Class, which is or becomes “distressed,” from filing for bankruptcy prior to July 2012. Act 26 by its terms does not apply retroactively to a city which had previously filed for bankruptcy. Instead, it applies prospectively to preclude the filing of any bankruptcy by a distressed city of the third class. Further, at the time Act 26 was enacted, Harrisburg had not

filed for bankruptcy. Thus, in actual application in this case Act 26 is operating prospectively, not retroactively.²

C. Act 26 is Not Special Legislation

In Pennsylvania, legislative acts of the General Assembly enjoy a strong presumption of constitutionality and the party challenging the legislation carries a heavy burden of persuasion. Harristown Dev. Corp. v. Commonwealth, 614 A.2d 1128, 1132 (Pa. 1992); Spahn v. Zoning Bd. of Adjustment, 977 A.2d 1132, 1147-48 (Pa. 2009). Viewed through this prism and the established case law of this Commonwealth, Act 26 does not violate the constitutional prohibition on “special legislation.”³

Act 26 applies to any city of the third class that is or becomes “distressed” and thus is not special legislation. Section 20 of Article III of the Pennsylvania Constitution states:

The Legislature shall have power to classify counties, cities, boroughs, school districts, and townships according to population, and all laws passed relating to each class, **and all laws passed relating to, and regulating procedure and proceedings in court with reference to, a class, shall be deemed general legislation within the meaning of this Constitution.**

Pa. Const., Art. III, §20 (emphasis added.) In defining “special legislation” the Pennsylvania Supreme Court has stated:

A special law is not uniform throughout the state or as applied to a class. A general law is. It is well known that the Legislature has classified cities and counties. A law dealing

² Petitioners argue that Act 26 is retroactive because it alters the City’s rights that were available at the time it filed for distressed status under Act 47. This argument presumes again that the City had a vested right in being able to file for bankruptcy once it sought distressed status under Act 47. The case law cited above establishes that no such vested right existed.

³ Article II section 32 of the Pennsylvania Constitution states:

The General Assembly shall pass no local or special law in any case which has been or can be provided by general law and specifically the General Assembly shall not pass any local or special law: 1. Regulating the affairs of counties, cities, townships, wards, boroughs or school districts . .

Pa. Const., Art III, §32.

with all cities or all counties of the same class is not a local or special law, but a general law, uniform in its application But a law dealing with but one county of a class consisting of ten, would be local or special. This is what is interdicted by Article 3, Sec. [32].

Heuchert v. State Harness Racing Comm'n, 170 A.2d 332, 336 (Pa. 1961)(citations omitted); accord Appeal of Torbik, 696 A.2d 1141, 1146 (Pa. 1997); Wings Field Pres. Assocs. v. Commonwealth, 776 A.2d 311, 315 (Pa. Commw. Ct. 2001). Act 26 applies to all cities of the third class and therefore, in accordance with the definition applied by the Supreme Court and required by the Pennsylvania Constitution, it is a general, not a special law.

City Council argues that Act 26 is a “special” law because “[i]t is a single bullet aimed at a single target: Harrisburg.” Petitioners’ Brief at 29. However, the fact that a statute may only apply to one or a small number of members of a class does not make it “special legislation” if other members of the class could come within the scope of the statute. Harristown, 614 A.2d at 1132 n.9 (“This court has held that a classification of one member is not unconstitutional so long as other members might come into that class.”); Tranter v. Allegheny Cnty. Auth., 173 A. 289, 294 (Pa. 1934) (“It is immaterial that the accident of population placed but one county in the second class for the time being There is no ground for plaintiff’s criticism that the statute is a local law, because only a limited number of those counties which would be entitled to do so may avail themselves of its application”); Perkins v. City of Phila., 27 A. 356, 359 (Pa. 1893)(“[I]f the act was intended to apply to but one particular city, county, or township and was not intended to and could never apply to any other, it was local, and therefore unconstitutional.”)

Harrisburg is not the only city of the third class that has been determined to be financially distressed and therefore subject to Act 26 as Petitioners suggest. The website for the Department of Community and Economic Development (“DCED”), which oversees financially distressed cities under Act 47, identifies at least ten cities of the third class that have been determined to be

financially distressed under Act 47.⁴ This means that there are at least nine other cities that are currently subject to the prohibition of Act 26. Further, any other of the fifty-three cities of the third class could be declared “financially distressed” under Act 47 if their financial condition sufficiently deteriorated. Since nine other cities are currently within the prohibition of Act 26, and it is possible that any other city of the third class could become subject to Act 26, the legislation is general, not “special”.

D. Act 26 Is Not Otherwise Unconstitutional

Even if Act 26 were determined to be “special” legislation, it would not end the analysis. Special legislation is not unconstitutional if the “special” classification bears a reasonable relationship to the legislative purpose. “In other words, a classification must rest upon some ground of difference which justifies the classification and have a fair and substantial relationship to the object of the legislation.” DeFazio v. Civil Serv. Comm’n, 756 A.2d 1103, 1106 (Pa. 2000); accord Harrisburg School District v. Hickock, 761 A.2d 1132, 1136 (Pa. 2000) (citing Freezer Storage v. Armstrong Cork Co., 382 A.2d 715, 718 (Pa. 1978)) (“If the distinctions are genuine, the courts cannot declare the classification void, though they may not consider it to be on a sound basis. The test is not wisdom, but good faith....”); Harristown, 614 A.2d at 1132 (The “inquiry is whether there is any rational basis pursuant to which the classification may have been made;” affirming constitutionality of a statute that affected only one entity).⁵

⁴ The DCED’s website page showing the cities declared financially distressed under Act 47 can be found at <http://www.newpa.com/get-local-gov-support/technical-assistance/request-assistance/act-47>.

⁵ This analysis is the same as is applied to claims of violations of the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution. Harristown, 614 A.2d at 1132 (“The analysis of both federal [equal protection] and state [special legislation] is essentially the same.”); Laudenberger v. Port Auth. of Allegheny Cnty., 436 A.2d 147, 155 n.13 (Pa. 1981)(“Appellees’ contentions concerning the Equal Protection Clause...and Art. III, §32 of the Pennsylvania Constitution may be reviewed simultaneously, for the meaning and purpose of the two are sufficiently similar to warrant like treatment.”). For the reasons discussed herein, Petitioner’s Equal Protection arguments fail.

Here, Act 26 is a reasonable and rational response to a topic uniquely in the public interest. The Pennsylvania Constitution reflects the Commonwealth's interest in protecting the ability of its local governments to borrow money at reasonable rates in the municipal bond market by ensuring that the debt obligations of its local government entities are honored. Article IX, section 10 of the Pennsylvania Constitution requires that municipal debt obligations be paid. That section states:

Any unit of local government, including municipalities and school districts, incurring any indebtedness, shall at or before the time of so doing adopt a covenant, which shall be binding upon it so long as any such indebtedness shall remain unpaid, to make payments out of its sinking fund or any other of its revenues or funds at such time and in such annual amounts specified in such covenant as shall be sufficient for the payment of the interest thereon and the principal thereof when due.

Pa. Const. Art. IX, § 10. (emphasis added).

The Legislature has given effect to this public policy in various provisions of the Local Government Unit Debt Act, 53 Pa. Cons. Stat. Ann. § 8001, *et seq.* ("Debt Act") by requiring municipalities to, among other things:

Duly and punctually pay or cause to be paid from its sinking fund or any other of its revenues or funds the principal of and interest on every bond or note or, to the extent of its obligation, the amount payable in respect of the guaranty, at the dates and places and in the manner stated in the bonds and in the coupons thereto appertaining or in the guaranty, according to the true intent and meaning thereof.

53 Pa. Cons. Stat. Ann. § 8104(a)(3). The Debt Act further requires that the municipality "shall pledge its full faith, credit and taxing power" to its debt obligations. Id., § 8104(b) (emphasis added).

Through these constitutional and statutory provisions, the Commonwealth has expressed a strong interest in the payment of municipal obligations. The prohibition on bankruptcy filings

is a further expression of this public policy and an appropriate exercise of the state's powers.

Act 79, which was recently enacted and authorizes the filing of bankruptcy after July 2012 only by a receiver appointed by the Governor, provides:

It is hereby declared to be a public policy of the Commonwealth to foster fiscal integrity of municipalities so that they provide for the health, safety and welfare of their citizens, pay due principal and interest on their debt obligations when due; meet financial obligations to their employees, vendors and suppliers; and provide for proper financial accounting procedures, budgeting and taxing practices. The failure of a municipality to do so is hereby determined to affect adversely the health, safety and welfare not only of the citizens of the municipality but also of other citizens in this Commonwealth.

2011 Pa. Legis. Serv. Act 2011-79 (S.B. 1151) at §§102(a) (Oct. 20, 2011).

The Commonwealth's interest in the payment of municipal debt obligations and its concern about the impact of a bankruptcy on the ability of municipalities and the Commonwealth to obtain funding for state and municipal projects provides a forceful and highly rational basis for the purported "special" classification of Act 26.⁶ See Twp. of Forks v. Forks Twp. Mun. Sewer Auth., 759 A.2d 47, 56 (Pa. Commw. Ct. 2000) (Failure to enforce payment provisions of bonds would "jeopardize the credit of all authorities created for the purpose of issuing bonds by destroying potential bond buyer's preference for bonds sold by Pennsylvania municipal authorities").⁷

⁶ Debt Watch Harrisburg also argues that the City's constitutional rights to equal protection were violated because Harrisburg is treated differently from cities in different classes. As discussed previously, the Pennsylvania Constitution grants the General Assembly the ability and right to provide for different classes of cities and to treat each class differently. Pa. Const. Art. III, § 20. Pennsylvania law consistently distinguishes between classes of cities, including, for example, by providing a code for cities of the first class, a code for cities of the second class, and a code for cities of the third class. Further, the legislature has provided for restrictions and prohibitions for each class of city with regard to the filing of Chapter 9 bankruptcies. See 53 P.S. § 12720.210 (prohibition and limitations on the ability of cities of the first class to file for bankruptcy); 53 P.S. § 28211 (prohibition and limitations on the ability of cities of the second class to file for bankruptcy).

⁷ Petitioner also suggests that the presence of the penalty provision in Act 26, which takes away state funding for any distressed city of the third class that files for bankruptcy, means that the prohibition in Act 26 for filing for bankruptcy is "directory rather than mandatory" and that a breach of the provisions does not mean the filing is void. Petitioners' Brief at 33. Courts that have considered the "specific authorization" requirement of section 109(c)(2) have concluded that the specific authorization standard is satisfied only

E. Act 26 Does Not Violate the “One Subject” Rule

Senate Bill 907, which contained Act 26, does not violate the “one subject” requirement of Article III, section 3 of the Pennsylvania Constitution. Article III, §3 provides that:

No bill shall be passed containing more than one subject, which shall be clearly expressed in its title, except a general appropriation bill or a bill codifying or compiling the law or a part thereof.

Pa. Const. Art. III, § 3.

The general rule is that “[p]lurality of subjects is not objectionable so long as they are reasonably germane to each other. A title need not be an index or synopsis of an act, yet it must not mislead. It is enough if it gives such notice of the contents of the act as to put the reader to further inquiry.” Lehigh Nav. Coal Co. v. Pa. Pub. Util. Comm'n, 1 A.2d 540, 546-47 (Pa. Super. Ct. 1938) (internal citations omitted). In addressing whether a title adequately gave notice, the Supreme Court has declared that a party seeking to have the bill declared unconstitutional must show that: 1) “the legislators and the public were actually deceived as to the act’s contents”; or 2) “no reasonable person would have been on notice of the act’s contents.” Pennsylvanians Against Gambling Expansion Fund Inc. v. Commonwealth, 877 A.2d 383, 405-06 (Pa. 2005). Petitioners have made no allegation that any member of City Council, the public or the General Assembly was misled by the title.⁸ Here the title of the Senate bill specifically

when the authorization is “exact, plain, and direct with well-defined limits so that nothing is left to inference or implication.” In re New York City Off-Track Betting Corp., 427 B.R. 256, 267 (Bankr. S.D.N.Y. 2010) (citing In re Timberon Water & Sanitation District, No. 9-07-12142 ML, 2008 WL 5170581, at *2 (Bankr. D.N.M. June 18, 2008)). See also In re Slocum Lake Drainage Dist. of Lake Cnty., 336 B.R. 387, 390 (Bankr. N.D. Ill. 2006) (same); In re Alleghany-Highlands Econ. Dev. Auth., 270 B.R. 647, 649 (Bankr. W.D. Va. 2001) (same); In re Cnty. of Orange, 183 B.R. 594, 604 (Bankr. C.D. Cal. 1995) (same). Thus, Petitioner’s attempt to infer permission by negative implication is improper under the Bankruptcy Code.

⁸ Petitioner’s brief cites to statements of two representatives. However, their statements do not indicate a lack of understanding of the bill, rather they understood, but did not like, some of the provisions contained therein. Petitioners Brief at 20-21.

refers to “providing for financially distressed municipalities.” This description is more than sufficient to give notice that a portion of the bill applies to financially distressed municipalities.

An act of assembly is presumptively valid and will only be declared void if it violates the Constitution “clearly, palpably and plainly.” Commonwealth v. McCafferty, 758 A.2d 1155, 1160 (Pa. 2000). The party challenging the legislation carries a heavy burden of persuasion. Harristown, 614 A.2d at 1132. Petitioner’s Brief fails to sustain this heavy burden and, indeed, with the exception of a general assertion that the statute is unconstitutional, the brief is devoid of analysis as to why the statute violates Article III, section 3 of the Pennsylvania Constitution.⁹

Here the topics of Act 26 are germane to each other because they all relate to amendments to the Fiscal Code and the allocation of funds under the Fiscal Code. Even Harrisburg Debt Watch agrees that the single subject relates to amendments to and allocation of funds under the Fiscal Code, although it incorrectly argues that the portion of Act 26 relating to distressed municipalities relates only to Act 47. Harrisburg Debt Watch Brief at 9. Because the provisions of Act 26 at issue contain a provision withholding funds otherwise provided under the Fiscal Code to a city that improperly files for bankruptcy, these provisions are appropriately included in a bill that addresses various provisions of the Fiscal Code.

II. Petitioner Proffers No Justification for Authorization to File the Petition by Resolution

Petitioner also fails to prove compliance with the requirements of section 261 of Act 47. In contrast to their ultra-fine focus on the requirements for legislation from the Commonwealth, Petitioners provide no explanation as to why a resolution was a legally appropriate means of authorizing bankruptcy under prevailing municipal law, other than making what appears to be an argument that the form of action does not really matter. As explained in the brief in support of

the Objection, a resolution of the type employed by City Council here is nothing more than “an expression of opinion of the Council [which] does not have the force and effect of law. . . .” Harrisburg Codified Ordinance, 1-301.3(10)(Ord. 80-1960). Accordingly, even if one were to disregard the express prohibition of Act 26, the City has not satisfied the specific authorization requirements of Section 109(c)(2) because it did not properly authorize the filing of the Petition in accordance with applicable state law.

CONCLUSION

For the reasons set forth above, TD, M&T and Assured respectfully request that the City’s bankruptcy case be dismissed because Petitioners lacked “specific authority” from the

Commonwealth to file, and even if such authorization existed, Petitioners failed to comply with the requirements of Act 47 in authorizing the bankruptcy petition..

Respectfully submitted,

Dated: November 18, 2011

/s/ Adam H. Isenberg
Paul M. Hummer
Adam H. Isenberg
Eric L. Brossman
James S. Gkonos
SAUL EWING LLP
Centre Square West
1500 Market Street, 38th Floor
Philadelphia, PA 19102
(215) 972-7777

Attorneys for Assured Guaranty Municipal Corp.

Vincent J. Marriott, III
Martin C. Bryce, Jr.
Vincent J. Marriott, III
Matthew A. White
Matthew G. Summers
BALLARD SPAHR, LLP
1735 Market Street, 51st Floor
Philadelphia, PA 19103-7599
(215) 665-8500

*Counsel for TD Bank, National Association,
as Indenture Trustee for the 2003 Indenture
and Retrofit Indenture and as Statutory
Trustee, and Manufacturers and Traders
Trust Corp as Indenture Trustee for the
2002 Indenture and as Statutory Trustee*