

Clients & Friends Memo

“ToMAYto, ToMAHto”: District Court Holds That Differences in State Law Determine Whether Unpaid Annual Pension Contributions Establish “Insolvency” for Chapter 9 Eligibility Purposes

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On March 21, 2025, the U.S. District Court for the Northern District of California affirmed a bankruptcy court's dismissal of the San Benito Healthcare District's chapter 9 bankruptcy petition on the grounds that the district's unpaid annual pension contributions did not suffice to establish that the district was “insolvent”—one of the prerequisites for chapter 9 eligibility. This outcome contrasts with a recent decision in Chester, Pennsylvania's chapter 9 proceeding, where Chester's unpaid annual pension contributions helped to establish that Chester was “insolvent” and therefore eligible for chapter 9. The differing outcomes in the two cases can be explained by differences in the applicable state laws. Whereas Chester's pension system was created under a state statute that made annual pension contributions mandatory and legally enforceable, a similar, enforceable right to annual contributions was not found to exist for the San Benito Healthcare District's pension fund. The *San Benito* decision therefore highlights the central role that state laws governing municipal pension contributions can play in assessing whether a municipality is “insolvent” for purposes of chapter 9 eligibility. *In re San Benito Health Care District*, Case No. 24-cv-02266-JD, 2025 WL 885510 (N.D. Cal. Mar. 21, 2025).

Chapter 9 Eligibility

Chapter 9 of the Bankruptcy Code provides bankruptcy relief for municipal debtors. Among other things, chapter 9 gives municipalities the breathing spell of an automatic stay, as well as the ability to discharge certain debts. But to benefit from these protections, municipal debtors must satisfy certain statutory eligibility requirements.

One such statutory requirement is that a municipal debtor be “insolvent.” 11 U.S.C. § 109(c)(3). The Bankruptcy Code provides that a municipality is “insolvent” when it is either (i) “generally not paying its debts as they become due” or (ii) “unable to pay its debts as they become due.” *Id.* § 101(32)(C). The Bankruptcy Code defines a “debt” as a “liability on a claim,” *id.* § 101(12), and defines a “claim” as a “right to payment,” even if that right is contingent, unmatured, or unliquidated. *Id.* § 101(5)(A).

Background

San Benito Health Care District (“San Benito” or the “District”) operated a hospital in San Benito County, California. The District filed for chapter 9 protection in 2023. Certain unions representing employees of the District objected to the District’s chapter 9 petition by arguing that the District was not “insolvent” for purposes of the Bankruptcy Code. The District responded by arguing that it was “insolvent” because it had not paid its annual actuarially-determined pension contributions for a number of years.

The bankruptcy court agreed with the unions and held that the District’s unpaid annual pension contributions did not qualify as “debts” that were “due.” Specifically, the bankruptcy court held that under California law “an actuary’s recommendation for funding does not represent a legal obligation.” As such, the bankruptcy court held that the District failed to demonstrate its insolvency, because its pension contributions were not a presently enforceable debt that “it was not paying or could not pay.” The bankruptcy court dismissed San Benito’s chapter 9 petition, finding that it was not eligible for chapter 9 relief.

The District appealed the bankruptcy court’s decision.

The District Court’s Decision

On appeal, the District challenged the bankruptcy court’s finding that its annual pension contribution should be excluded from the insolvency analysis. The District claimed that its “proffered actuarially determined numbers did suffice to show a presently enforceable, and so statutorily relevant, debt.”

In support of its position, the District relied on cases regarding the California Public Employees Retirement System, or “CalPERS.” Those cases held that the state laws governing CalPERS gave participating employees “a *contractual right* to an actuarially sound retirement system” (emphasis added). However, the district court found that there was no evidence “that the [District’s] pension fund was created pursuant to” those same laws or that participants in the District’s pension fund were given a contractual right similar to that of CalPERS participants.

The District also cited the chapter 9 cases of Chester, Pennsylvania and Detroit, Michigan as precedents where the requirement to make pension contributions had contributed to a finding of “insolvency” for chapter 9 eligibility purposes. The district court distinguished these cases as well, concluding that *City of Chester* and *City of Detroit* involved “state law requiring actuarially determined contributions,” similar to the CalPERS regime and unlike the District’s pension fund. As a result, the District’s pension contributions were not presently enforceable obligations under California law.

Based on its conclusion that the District had failed to establish insolvency, the district court affirmed the bankruptcy court's dismissal of the District's chapter 9 case.

Key Takeaways and Conclusions

- Many municipalities in the United States have significantly underfunded pension liabilities, and some of those municipalities may look to chapter 9 as a means to restructure those liabilities. To qualify for chapter 9 relief, however, a municipality must be “insolvent” as defined in the Bankruptcy Code—meaning that the municipality is not paying, or is unable to pay, its debts as they become due.
- The *San Benito* decision raises questions about whether failure to make contributions to a pension fund, standing alone, can satisfy the “insolvency” requirement, because actuarially-determined annual pension contributions might not qualify as “debts” in all cases. As the *San Benito* ruling demonstrates, whether a municipality’s obligation to make a contribution to a pension fund qualifies as a “debt” will usually hinge on state law.
- If state law provides that a municipality’s obligation to contribute to a pension fund is presently due and legally enforceable, then a court may find that such a liability is “debt” for purposes of determining whether the municipality is “insolvent.” For example, in Chester, Pennsylvania’s case, specific Pennsylvania statutes required Chester to make actuarially-determined annual contributions to its pension system and provided an express mandamus remedy in the event Chester failed to make those contributions. *See, e.g.*, 53 Pa. Cons. Stat. §§ 895.302(d), 895.303(d), 895.306(e). Those statutes helped support the conclusion that Chester’s pension contributions constituted enforceable “debts” that rendered Chester “insolvent.”
 - No similar state statute mandating legally-enforceable pension contributions applied in San Benito’s case, with the result that San Benito failed to establish its “insolvency.”
- The *San Benito* case also helps to clear up an ambiguity arising from the *Chester* decision. Specifically, the *Chester* court referenced in its insolvency analysis not only Chester’s statutorily-mandated annual pension contributions, but also the pension fund’s full “unfunded actuarial accrued liability,” or “UAAL,” which consists of the present value of *all* future projected benefits that the pension fund currently lacks sufficient assets to pay. However, the *Chester* court’s reference to UAAL was probably not essential to its “insolvency” finding, since Chester’s unpaid annual contributions were sufficient to establish “insolvency.”
 - By contrast, the *San Benito* bankruptcy court clearly held that UAAL is not a “debt” for purposes of the chapter 9 “insolvency” analysis, but instead is merely “a projection made by actuaries based upon assumptions regarding future events.” No party contested that holding in the *San Benito* appeal, where the parties focused instead on the issue of whether annual *contributions* constituted debt. *San Benito* therefore helps to establish that UAAL probably does not suffice to prove “insolvency” for chapter 9 eligibility purposes, notwithstanding a passing suggestion to the contrary in the *Chester* decision.

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