

Assembly Bill 155 (Mendoza) – Local Government Bankruptcy Proceedings

SDCTA POSITION:

OPPOSE (8-12-2009)

Rationale:

Other than the City of Vallejo, there are only two local governments in California that have filed municipal bankruptcy: Orange County in 1994 and the City of Desert Hot Springs in 2001. There are several steps that should be taken to ensure that a local government remains solvent to avoid the financial and social stigmas associated with bankruptcy. However, regardless of the steps taken, there remains “the possibility that competing interests become so inflexible that officials will be forced to take extreme measures to break the stalemate.” In Vallejo’s case, these “competing interests” were personnel unions that were “inflexible” to reductions in personnel costs, specifically pension obligations.¹

The Senate Local Government Committee’s Analysis points to the impetus and support behind AB 155: “In response to concerns about the City of Vallejo's recent decision to file bankruptcy and the potential for additional municipal bankruptcy filings, *labor unions and others* want to require state oversight of local governments' bankruptcy petitions.”² When contracts cannot be renegotiated, and costs are so burdensome that it threatens the municipality’s solvency, the opportunity should remain for local governments to determine the next step—including the dissolution of labor contracts. Assembly Bill 155 sets up a bureaucratic framework that reduces the authority of local governments to decide something they have had authority to decide for decades.³

Background

On May 6, 2008, the City Council of Vallejo, CA voted to seek bankruptcy protection and adjustment of its debts under Chapter 9 of the United States Bankruptcy Code. On March 13, 2009, U.S. bankruptcy judge Michael McManus ruled that cities have the authority to void existing union contracts to reorganize and reemerge from bankruptcy. The City’s desire to void these contracts and start anew with employee labor contracts has resulted in the creation of Assembly Bill 155 (AB 155) (Mendoza). If passed, AB 155 will make it difficult for local governments to file for bankruptcy in California and will restrict their ability to alter labor contracts if allowed to declare bankruptcy.

Beginning in fiscal year 2005-06, Vallejo’s General Fund expenditures had exceeded revenues by nearly \$4 million. In May of 2008, it was anticipated that the City’s reserves would be depleted by June 30th 2008 resulting in an operating deficit for FY 2008-2009 exceeding \$16 million.⁴

¹ Michael Sweet and Peter Bianchini, “Cities Generally Have Alternatives to Bankruptcy,” *The Sacramento Bee*. July 28, 2009. Available from <http://www.sacbee.com/1190/story/2051800.html>.

² Senate Local Government Committee Analysis. “Assembly Bill 155.” Version July 1, 2009.

³ California’s broad bankruptcy authority was first enacted in 1939 and codified in 1949.

⁴ “Bankruptcy Questions and Answers,” *City of Vallejo Website*. June 19, 2009.
<http://www.ci.vallejo.ca.us/GovSite/default.asp?serviceID1=718&Frame=L1>

In March of 2008, there were some attempts to cut services and lay off workers to address the budget crisis. Unfortunately, that did not solve the crisis.

“With a staggering \$9 million deficit and no reserves, Vallejo began slashing funding to nearly every department and reducing the number of city employees. The city started by cutting funding to senior centers, the arts, museums, libraries and public works. It laid off 16 city workers and eliminated 12 slots for police officers. The city’s police and firefighters agreed to take a 6.5 percent pay cut and the city closed two fire stations to cut costs. The city canceled a 1.5 percent pay raise that union members had been owed since July and deferred half the \$3.5 million buyout packages owed to the 21 police officers and firefighters who had retired since news of Vallejo’s financial problems broke.”⁵

Governing Magazine stated that “the largest share of the blame in Vallejo has centered on public-safety salaries and benefits, which make up about 75 percent of the city’s general fund budget.”⁶

AB 155

Under Title 11, Chapter 9, Section 109 of the U.S. Bankruptcy Code, municipalities can file for bankruptcy if they are specifically authorized by the state. Through this, they have three additional requirements: the municipality must be insolvent, as defined in Title 11, Chapter 1, Section 101(32)⁷, the municipality must have a desire to adjust its debts, and they must negotiate (or try to) with “creditors”. The negotiation with creditors includes the following:

- 1) 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;
- 2) 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;
- 3) Be unable to negotiate with creditors because such negotiation is impracticable; or
- 4) Reasonably believe that a creditor may attempt to obtain a preference

California is one of 11 states that grants its local public agencies the broadest possible access to federal bankruptcy available.⁸ A local government, like the City of Vallejo, can decide

⁵ Baird, Charles W. “Emeryville: Take A Lesson from Vallejo,” *The San Francisco Business Times*. Oct. 10, 2008. <http://www.bizjournals.com/eastbay/stories/2008/10/13/editorial2.html>.

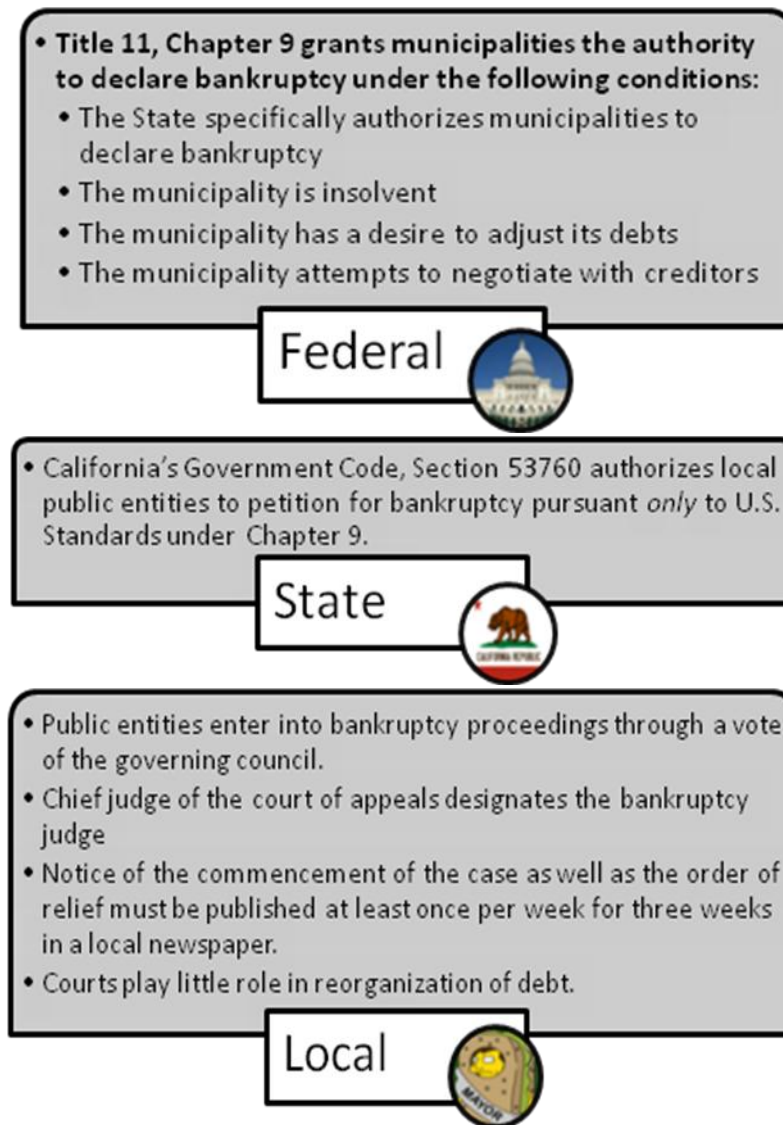
⁶ Sostek, Anya. “Vallejo’s Fiscal Freefall,” *Governing*. Nov. 1, 2008. <http://www.governing.com/article/vallejoes-fiscal-freefall>.

⁷ Insolvency is defined as “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)

⁸ There are 22 states that do not permit municipal bankruptcy and 16 states that impose conditions before filing for bankruptcy. California Government Code, Section 53760 states that: (a) Except as otherwise provided by statute, a local public entity in this state may file a petition and exercise powers pursuant to applicable federal

with a vote of the City Council to enter into bankruptcy proceedings, which can start immediately upon the city's filing of bankruptcy in court. See Figure 1.

Figure 1: Current Process for California Public Entity Bankruptcy



bankruptcy law. (b) As used in this section, "local public entity" means any county, city, district, public authority, public agency, or other entity, without limitation, that is a "municipality," as defined in paragraph (40) of Section 101 of Title 11 of the United States **Code** (bankruptcy), or that qualifies as a debtor under any other federal bankruptcy law applicable to local public entities.

AB 155 would completely change the bankruptcy filing process for California's local governments and municipalities. It would require the local governing body to first file a petition with the California Debt and Investment Advisory Commission (CDIAC) and would impose multiple new requirements to qualify for filing.

The CDIAC was "created to serve as the State's clearinghouse for public debt issuance information and to assist state and local agencies with the monitoring, issuance, and management of public debt. Its mission was later expanded to cover public investments."⁹ The Commission consists of Governor Schwarzenegger, State Treasurer Bill Lockyer (Chair), State Controller John Chiang, two State Senators, two Assemblymembers, and two local government officials, which are currently Jay Goldstone, the City of San Diego's Chief Operating Officer, and Jose Cisneros, San Francisco's Treasurer and Tax Collector.

One of the new requirements, which would be created by AB 155, would require the local entity petitioning for bankruptcy to present a thorough analysis of its request to petition for bankruptcy, wherein the entity must do the following:

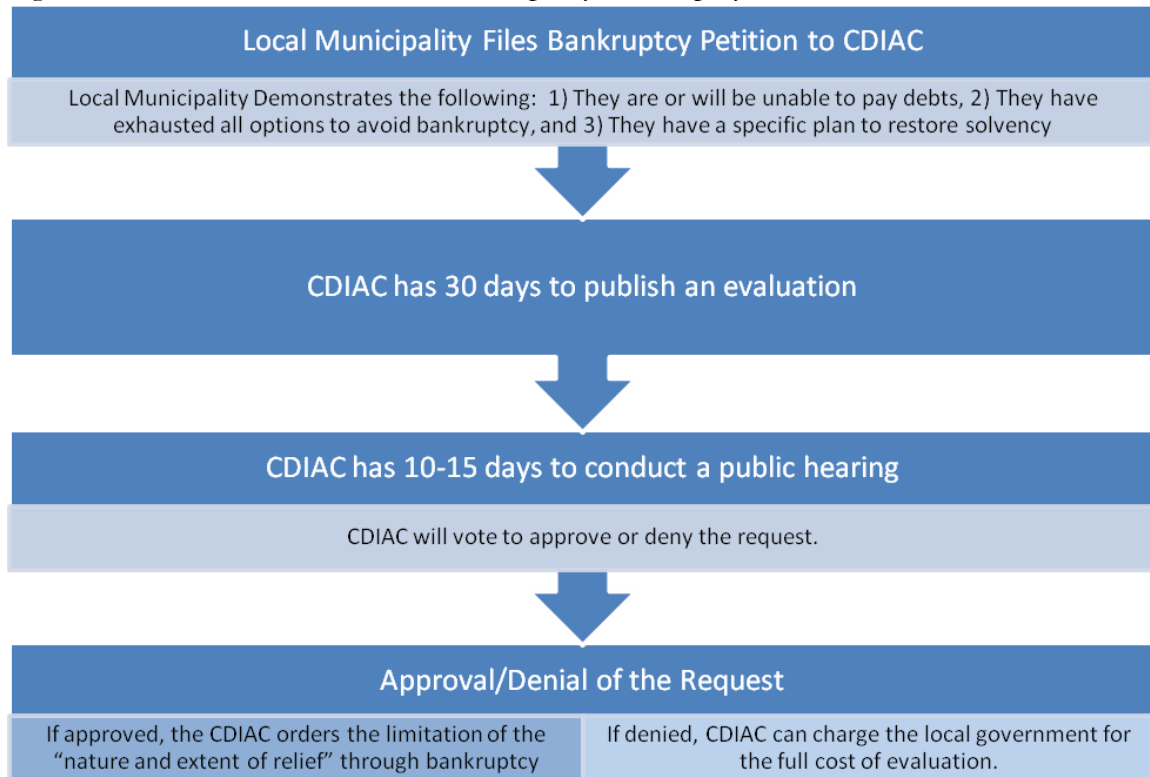
- Demonstrate that it is or will be unable to pay its undisputed debts
- Demonstrate that it has exhausted all options to avoid seeking relief under Chapter 9
- Detail a specific plan for restoring the soundness of the entity's financial plans

CDIAC staff will then have 30 days to publish an evaluation of the request. Between 10 and 15 days after the evaluation is published, the CDIAC will hold a public hearing where they will vote to approve or deny the local government's request.

If a request is denied, the CDIAC has the authority to charge the local entity for the full cost of evaluating their request. If a request is authorized and the local entity allowed to enter into bankruptcy proceedings, AB 155 authorizes the Commission to order the entity, as a condition of approving the request, to limit the nature and extent of relief provided through Chapter 9 bankruptcy proceedings, including **limiting changes to a contract, prohibiting the abrogation of contracts, and limiting the amount of relief to ensure the protection of debt service payments.** See Figure 2.

⁹ "About CDIAC," California State Treasurer Bill Lockyer's Website. July 16, 2009.
<http://www.treasurer.ca.gov/cdiac/>

Figure 2: AB 155 Method of Local Municipality Bankruptcy



Current Status:

AB 155 passed the State Assembly 47-25 on June 3, 2009.

AB 155 was discussed by the Senate Local Government Committee on July 8, 2009 where testimony was heard from the author, Assemblyman Mendoza, and labor leaders from across the state, as well as arguments against the bill by Vallejo’s mayor and bankruptcy attorney.

The bill will be voted on by the Senate Local Government Committee at a future date still to be determined.

Policy Implications

- The CDIAC would have overarching authority in determining whether or not labor contracts can be changed, re-negotiated, or voided even if a local government is allowed to declare bankruptcy.
- AB 155 limits the authority of local governments. The legislation also has an overwhelming number of unions in support and no local governments in favor.
- Could ensure that bankruptcy filings are *truly* a last resort.
- Could ensure that labor contracts are unable to be voided under any circumstance.
- Strengthens the stake labor unions have in the process.

List of Proponents: California Professional Firefighters, CDF Firefighters Local 2881, California Labor Federation, California State Treasurer Bill Lockyer, AARP, American Federation of State, County and Municipal Employees, AFL-CIO, Association for Los Angeles Deputy Sheriffs, California Alliance for Retired Americans, California Association of Highway Patrolmen, California Conference Board of the Amalgamated Transit Union, AFL-CIO, California Nurses Association, California Reinvestment Coalition, California School Employees Association, California State Employees Association, California State Firefighters' Association, Inc., California Teamsters Public Affairs Council, Consumer Federation of California, Engineers and Scientists of California, Glendale City Employees Association, International Longshore & Warehouse Union, Kern County Fire Fighters Union, Inc., Los Angeles County Probation Officers Union, Livermore-Pleasanton Firefighters Local 1974, Los Angeles County Fire Fighters Local 1014, Los Angeles Police Protective League, National Nurses Organizing Committee, North Bay Labor Council, AFL-CIO, Orange County Employees Association, Orange County Professional Firefighters Association, Organization of SMUD Employees, Peace Officers Research Association of California, Production Strategies, Inc., Professional and Technical Engineers Local 21, Professional Engineers in California Government, Riverside Sheriffs' Association, San Bernardino Public Employees Association, San Diego Municipal Employee's Association, San Francisco Labor Council, San Luis Obispo County Employees Association, Santa Rosa City Employees Association, Service Employees International Union, State Building and Construction Trades Council of California, UNITE HERE, United Food and Commercial Workers Union, Western States Council.

List of Opponents: *Counties of* Butte, Imperial, Nevada, Madera, Orange, Riverside, San Luis Obispo, Yolo, *Cities of* Antioch, Adelanto, Apple Valley, Atascadero, Arvin, Bellflower, Belmont, Benicia, Berkeley, Beverly Hills, Blythe, Brea, Burbank, Burlingame, California City, Calistoga, Carmel-by-the-Sea, Carson, Carlsbad, Chowchilla, Clayton, Cloverdale, Clovis, Coalinga, Commerce, Concord, Cotati, Covina, Cypress, Danville, Diamond Bar, Dixon, El Segundo, Encinitas, Exeter, Fairfield, Fontana, Fountain Valley, Fowler, Fremont, Fullerton, Glendora, Greenfield, Guadalupe, Hanford, Healdsburg, Hermosa Beach, Highland, Hollister, Hughson, Huntington Park, Huntington Beach, Irvine, Kingsburg, La Palma, La Puente, La Verne, Laguna Hills, Lake Forest, Lafayette, Lathrop, Lawndale, Lemoore, Lindsay, Livermore, Long Beach, Madera, Mammoth Lakes, Manhattan Beach, Manteca, Merced, Mendota, Mill Valley, Modesto, Moreno Valley, Murrieta, Napa, Newport Beach, Norco, Norwalk, Oakdale, Oakland, Ontario, Oroville, Palmdale, Palo Alto, Paradise, Patterson, Pinole, Placentia, Pleasanton, Pomona, Rancho Cordova, Rancho Cucamonga, Reedley, Ridgecrest, Rialto, Rio Vista, Rohnert Park, Rolling Hills Estates, Rosemead, Salinas, San Francisco, Sanger, San Luis Obispo, San Marcos, San Pablo, Santa Cruz, Santa Maria, Santa Rosa, Seaside, Sebastopol, Shafter, Signal Hill, Stockton, Tehachapi, Torrance, Tracy, Tulare, Tustin, Vacaville, Villa Park, Visalia, Walnut Creek, Wasco, West Hollywood, Westminster, Windsor, Woodlake, Yorba Linda, Yountville, and Yucaipa, Association of California Health Care Districts, Association of California Water Agencies, California Contract Cities Association, California Society of Municipal Finance Officers, California State Association of Counties, California Special Districts Association, Howard Jarvis Taxpayers Association, League of California Cities, League of California Cities Inland



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Empire Division, League of California Cities Orange County Division, Marin County Council of Mayors and Councilmembers, South Bay Cities Council of Governments.