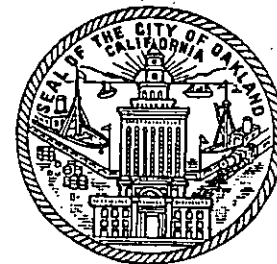


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OAKLAND

2009 JUN 25 PM 5:29

CITY OF OAKLAND

BILL ANALYSIS



Date: July 2nd, 2009

Bill Number: AB 155

Bill Author: Assembly Member Mendoza

DEPARTMENT INFORMATION

Contact: Elinor Buchen
Department: City Council
Telephone: 510 238-7240

RECOMMENDED POSITION: OPPOSE

Summary of the Bill

This bill would prohibit a local public entity from declaring bankruptcy unless granted approval by the California Debt and Investment Advisory Commission (CDIAC).

Under existing law, local public entities may file a petition and prosecute to completion bankruptcy proceedings permitted under Chapter 9 of federal law. Under this bill, local public entities would be required to submit a request to the CDIAC for the authority to petition the federal bankruptcy court for financial relief under Chapter 9 in federal law.

The CDIAC is an existing advisory commission under the purview of the State Treasurer's Office that provides information, education and technical assistance on debt issuance and public fund investments to local public agencies and other public finance professionals.

A local public entity seeking Chapter 9 protection would have to submit a thorough analysis to the CDIAC that a) demonstrates that it is unable to pay its debts and that it has exhausted all other options, and b) details a specific plan for restoring its financial plans. The local entity would also have to provide a list of creditors that might seek damages.

The CDIAC would then evaluate the information and within 30 business days (or 5 days if there is a request for an expedited evaluation), publish its evaluation. After the publication of the staff evaluation, the CDIAC would conduct a public hearing and vote to approve or deny the request. The CDIAC could also set conditions on the approval of a request, such as limiting changes to a contract, prohibiting the abrogation of a contract or otherwise limiting the amount of relief that a local public entity could seek.

Item: _____

Rules and Legislation Committee

Local entities can reapply if their request is denied. The bill also allows CDIAC to assess a fee on the requesting agency if their request is denied to cover some or all of the costs for the analysis and hearings.

Positive Factors for Oakland

There are no positive factors for Oakland.

Negative Factors for Oakland

If Oakland ever considered filing for bankruptcy, this bill would give a State board the power to deny the request or to set certain conditions on the types of relief that the City could seek through federal bankruptcy proceedings.

PLEASE RATE THE EFFECT OF THIS MEASURE ON THE CITY OF OAKLAND:

- Critical** (top priority for City lobbyist, city position required ASAP)
- Very Important** (priority for City lobbyist, city position necessary)
- Somewhat Important** (City position desirable if time and resources are available)
- Minimal or** **None** (do not review with City Council, position not required)

Known support:

California Professional Firefighters
CDF Firefighters Local 2881

Known Opposition:

California League of Cities
California State Association of Counties
California Special Districts Association

Respectfully Submitted,

Elinor Buchen
Legislative Analyst

Item: _____
Rules & Legislation Comte.
July 2, 2009

AMENDED IN ASSEMBLY JUNE 1, 2009
AMENDED IN ASSEMBLY MARCH 27, 2009
CALIFORNIA LEGISLATURE—2009–10 REGULAR SESSION

ASSEMBLY BILL

No. 155

Introduced by Assembly Member Mendoza
(Principal coauthor: Assembly Member Torrico)
(Coauthors: Assembly Members Brownley, Coto, De Leon, Fuentes,
Furutani, Krekorian, Lieu, Ma, Nava, John A. Perez, V. Manuel
Perez, Price, and Yamada)
(Coauthor: Senator Wiggins Coauthors: Senators DeSaulnier, Liu, and
Wiggins)

January 26, 2009

An act to amend Section 53760 of, and to add ~~Section 8860~~ *Sections 8860, 8861, 8862, 8863, and 8864* to, the Government Code, relating to local government.

LEGISLATIVE COUNSEL'S DIGEST

AB 155, as amended, Mendoza. Local government: bankruptcy proceedings.

Under existing law, any taxing agency or instrumentality of the state may file a petition and prosecute to completion bankruptcy proceedings permitted under the laws of the United States.

This bill would provide that a local public entity may only file under federal bankruptcy law with the approval of the California Debt and Investment Advisory Commission, as specified.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. The Legislature hereby finds and declares all of
2 the following:

3 (a) *The California Constitution and current statutory law*
4 *provide for a continuity and interdependence between state and*
5 *local government entities. Seeking financial relief through the*
6 *provisions of Chapter 9 (commencing with Section 901 of Title*
7 *11) of the United States Code imposes costs on a municipality,*
8 *potentially exceeding \$1 million. It can reduce service levels to*
9 *the taxpayers and residents of a municipality. In some*
10 *circumstances, it can have major short- and long-term fiscal*
11 *consequences to the municipality, the surrounding local public*
12 *entities, and the state. In 2009, bond counsel stated that “filing*
13 *for bankruptcy protection under Chapter 9 should be considered*
14 *a last resort, to be effected only after every effort has been made*
15 *to avoid it.”*

16 (b) *The Legislature has an interest in monitoring the conditions*
17 *under which local entities seek Chapter 9 protection. The relief*
18 *provided through the federal courts can affect state and municipal*
19 *government service levels, debt, and contracts. The Legislature*
20 *also has a strong interest in ensuring adequate disclosure of the*
21 *conditions under which a municipality may seek Chapter 9*
22 *protection.*

23 (c) *To the extent financial relief granted through Chapter 9 can*
24 *affect debt service payments, the state’s investors and bondholders*
25 *have a direct interest in the Bankruptcy Court’s decisions.*

26 (d) *The state has established a statewide system of public*
27 *employee collective bargaining for state and local government*
28 *employers and employees intended to protect the state’s interest*
29 *in promoting peaceful and harmonious labor relations and*
30 *preventing work stoppages. The validity and enforceability of*
31 *contracts arrived at through collective bargaining are essential*
32 *to maintaining labor peace and the uninterrupted delivery of vital*
33 *public services, and these agreements may be subject to review*
34 *and amendment or rescission in the event of a Chapter 9*
35 *bankruptcy proceeding.*

36 (e) *The state has established and administers statewide pension*
37 *systems that provide retirement and health benefits to state and*
38 *local agency employees, many of whose benefits rely on contracts*

1 *negotiated between local agencies and the California Public*
2 *Employees' Retirement System, and that may be subject to review*
3 *and amendment or rescission in the event of a Chapter 9*
4 *bankruptcy proceeding.*

5 (a)

6 (f) California is one of only 12 states that grants blanket
7 authority for its municipalities to petition for bankruptcy and offers
8 no opportunity for its municipalities to receive state-level,
9 prebankruptcy guidance, oversight, or assistance for those
10 jurisdictions that are truly insolvent and face no other alternative
11 to bankruptcy.

12 ~~(b) The costs of municipal financial default are borne by the~~
13 ~~state as a whole, including every California taxpayer.~~

14 (e)

15 (g) State intervention in local affairs should only occur in
16 exceptional circumstances and not without a compelling interest
17 of statewide concern.

18 (d)

19 (h) Given the connection between state allocations and local
20 budgets, the state has a role in mitigating possible local bankruptcy.

21 (e)

22 (i) It is the duty of all state and local elected officials to ensure
23 that governments provide essential services to the communities
24 they are elected to serve.

25 (f)

26 (j) California's taxpayers who rely on public safety, senior,
27 park, and library services, as well as those who own and operate
28 businesses in our communities deserve every effort that state and
29 local government can make to avoid the long-term devastation of
30 bankruptcy.

31 (g)

32 ~~(k) The California Debt and Investment Advisory Commission,~~
33 ~~as established by the Legislature in 1981, Commission is the~~
34 ~~appropriate body to provide the expert oversight and guidance~~
35 ~~sought by local public agencies who find themselves in a fiscal~~
36 ~~crisis, given its current statutory duties to collect municipal finance~~
37 ~~data, conduct research, administer educational seminars, and~~
38 ~~provide information and technical assistance on behalf of local~~
39 ~~public agencies and their finance professionals, and given the~~

1 commission's diverse membership that includes state and local
2 government financial experts.

3 SEC. 2. Section 8860 is added to the Government Code, to
4 read:

5 8860. (a) The commission shall, upon request of a local public
6 agency entity, advise and, if deemed appropriate by the
7 commission, grant approval to the ~~agency entity~~ to exercise its
8 rights pursuant to Section 53760, which may include conditions
9 prescribed by the commission.

10 (b) Upon request under subdivision (a), the local public ~~agency~~
11 entity shall submit all of the following to the commission:

12 ~~(1) A proposed plan for restructuring debt and other financial~~
13 ~~obligations to avoid a fiscal crisis:~~

14 *(1) A resolution or ordinance, adopted by that governing body*
15 *at a public hearing held pursuant to the Ralph M. Brown Act*
16 *(Chapter 9 (commencing with Section 54950) of Part 1 of Division*
17 *2 of Title 5), that does both of the following:*

18 *(A) Requests authority pursuant to Section 53760 to petition*
19 *the federal bankruptcy court for financial relief under the*
20 *provisions of Chapter 9 (commencing with Section 901 of Chapter*
21 *11) of the United States Code.*

22 *(B) Acknowledges that the state's fiscal and financial*
23 *responsibilities are not changed by the application or the*
24 *commission's decision pursuant to Section 8861.*

25 *(2) A thorough analysis of the entity's request to petition under*
26 *Chapter 9 (commencing with Section 901 of Title 11) of the United*
27 *States Code. In addition to any other information it may provide,*
28 *the entity shall do all of the following:*

29 *(A) Demonstrate that it is or will be unable to pay its undisputed*
30 *debts.*

31 *(B) Demonstrate that it has exhausted all options to avoid*
32 *seeking relief under Chapter 9.*

33 *(C) Detail a specific plan for restoring the soundness of the*
34 *entity's financial plans.*

35 ~~(2)~~

36 *(3) An itemization of creditors that may be impaired or may*
37 *seek damages as a result of the proposed ~~restructuring~~ plan.*

38 ~~(3) Any and all supporting documentation that the local public~~
39 ~~entity deems appropriate in support of the stated fiscal crisis or as~~

1 requested by the commission, that may be required to perform a
2 desk audit.

3 (c) *The local entity may request, and the commission chair may*
4 *approve, an expedited evaluation. The commission chair may*
5 *approve the expedited evaluation if the entity sufficiently*
6 *demonstrates a need for improved cashflow or protection from*
7 *creditors claims. If the request is approved, the expedited*
8 *evaluation shall be completed within 5 days.*

9 (e)

10 (d) Upon receipt of the information required by subdivision (b),
11 the commission shall do all that it deems necessary to evaluate the
12 fiscal condition of the local public agency, including, but not
13 limited to, reviewing the submission and recommending specific
14 action to be taken by the public agency to avert fiscal insolvency.

15 (d) ~~Any recommendations released, or approvals granted, by~~
16 ~~the commission shall be conducted in a noticed public hearing.~~
17 *evaluate the information presented and publish its evaluation*
18 *within 30 business days, or, in the case of an expedited request*
19 *pursuant to subdivision (c), within 5 days. In conducting its*
20 *evaluation, the commission staff shall specifically evaluate the*
21 *extent to which the local public entity has done the following:*

22 (1) *Demonstrated that it has exhausted other remedies.*

23 (2) *Demonstrated that it has taken sufficient steps to reduce the*
24 *negative consequences of its proposed bankruptcy relief.*

25 (3) *Has anticipated the transfer of service responsibility to other*
26 *governments or parties and to what extent the entity has*
27 *documented the consequences for the transfer of municipal and*
28 *other government services.*

29 (4) *Documented the likely effect a successful petition will have*
30 *on state and local finances, including the impact on credit access*
31 *and debt service.*

32 (5) *Has proposed a remedy that is appropriate and*
33 *proportionate to the entity's fiscal problems.*

34 (e) *The commission shall conduct a hearing and publish a*
35 *decision within 15 days of, but not less than 10 days after, the*
36 *publication of the staff evaluation conducted pursuant to*
37 *subdivision (d). The hearing shall be conducted according to the*
38 *provisions of Section 8861. The commission hearing on the*
39 *application shall be held in convenient proximity of the entity filing*
40 *the application.*

1 (f) A governing board of a local public entity may reapply if its
2 request was denied pursuant to Section 8861. In making the
3 reapplication, the local public entity shall adopt another resolution
4 and submit documentation to address the deficiencies identified
5 by the commission pursuant to Section 8861.

6 (e)

7 (g) As used in this ~~section~~, chapter, “local public entity” means
8 any city, county, city and county, district public authority, public
9 agency, or other entity that is a “municipality” within the meaning
10 of paragraph (40) of Section 101 of Title 11 of the United States
11 Code, or that qualifies as a debtor under any federal bankruptcy
12 law applicable to local public entities.

13 SEC. 3. Section 8861 is added to the Government Code, to
14 read:

15 8861. (a) The commission shall hold a public hearing to
16 consider a request made pursuant to Section 8860. The hearing
17 shall provide sufficient time for public testimony.

18 (b) The commission shall, in a recorded vote, approve or deny
19 the request.

20 (c) If the commission approves a request, it may order the entity,
21 as a condition of approving the request, to limit the nature and
22 extent of relief provided through Chapter 9 bankruptcy
23 proceedings, including all of the following:

24 (1) The commission may limit the changes to a contract.

25 (2) The commission may prohibit the abrogation of contracts.

26 (3) The commission may limit the amount of relief to ensure the
27 protection of debt service payments.

28 (d) If the commission disapproves a request, the commission
29 shall adopt specific findings that address the deficiencies of the
30 application.

31 (e) The hearing shall be subject to the provisions of the
32 Bagley-Keene Open Meeting Act (Article 9 (commencing with
33 Section 11120) of Chapter 1 of Part 1 of Division 3 of Title 2). At
34 the same time that the notice and agenda for the hearing is posted
35 to comply with the requirements of the Bagley-Keene Open Meeting
36 Act, then the commission shall do all of the following:

37 (1) Post the notice in a location in the entity that is freely
38 accessible to members of the public.

39 (2) Deliver the notice personally, by United States mail, or by
40 facsimile transmission, to each local newspaper of general

1 *circulation whose circulation area reasonably includes the local*
2 *public entity.*

3 (3) *Deliver the notice by United States mail, or by facsimile*
4 *transmission, to each radio or television station that has requested*
5 *notice in writing.*

6 (4) *Request publication of the notice in the daily file of each*
7 *house of the Legislature at least 24 hours prior to the date of the*
8 *meeting, if the Legislature is in session.*

9 SEC. 4. *Section 8862 is added to the Government Code, to*
10 *read:*

11 8862. (a) *After the commission receives a request pursuant to*
12 *Section 8860, the executive director shall record costs incurred*
13 *by the commission to make and publish the evaluation pursuant*
14 *to Section 8860 and conduct the hearing required under Section*
15 *8861. The director shall report those costs to the commission at*
16 *the next regularly scheduled commission hearing.*

17 (b) *Upon denial of the request, the executive director or*
18 *commission may assess the requesting entity a fee to cover some*
19 *or all the costs associated with making the findings and conducting*
20 *the hearing. Fee revenue shall be deposited in the California Debt*
21 *and Investment Advisory Commission Fund.*

22 (c) *The commission may propose regulations to govern the*
23 *request and review process required under Sections 8860 and*
24 *8861.*

25 SEC. 5. *Section 8863 is added to the Government Code, to*
26 *read:*

27 8863. *In enacting Sections 8860, 8861, 8862, and the changes*
28 *in Section 53760, the state assumes no new or additional fiscal*
29 *responsibilities for local entities that may apply to the commission*
30 *for review pursuant to this chapter.*

31 SEC. 6. *Section 8864 is added to the Government Code, to*
32 *read:*

33 8864. *This chapter shall only apply to a local public entity on*
34 *or after the effective date of this chapter.*

35 ~~SEC. 3.~~

36 SEC. 7. *Section 53760 of the Government Code is amended*
37 *to read:*

38 53760. (a) *Except as otherwise provided by statute, a local*
39 *public entity in this state may, with the approval of the California*
40 *Debt and Investment Advisory Commission, under the terms and*

1 conditions that the commission may impose pursuant to Section
2 ~~8860~~ 8861, file a petition and exercise powers pursuant to
3 applicable federal bankruptcy law.

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

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BILL ANALYSIS

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ASSEMBLY THIRD READING
 AB 155 (Mendoza)
 As Amended June 1, 2009
 Majority vote

LOCAL GOVERNMENT 4-3 APPROPRIATIONS 12-5

Ayes:	Caballero, Davis, Krekorian, Skinner	Ayes:	De Leon, Ammiano, Charles Calderon, Davis, Fuentes, Hall, John A. Perez, Price, Skinner, Solorio, Torlakson, Krekorian
Nays:	Knight, Arambula, Duvall	Nays:	Nielsen, Duvall, Harkey, Miller, Audra Strickland

SUMMARY : Prohibits a local public entity, as defined, from exercising its rights under applicable federal bankruptcy law unless granted approval by the California Debt and Investment Advisory Commission (CDIAC), under CDIAC's terms and conditions. Specifically, this bill :

- 1) Allows a local public entity, if CDIAC approves, under the terms and conditions that CDIAC may impose, to file a petition and exercise powers pursuant to applicable federal bankruptcy law (chapter 9).
- 2) Requires CDIAC, upon request of a local public entity, to advise, and if deemed appropriate by CDIAC, grant approval to the local public entity to exercise its right pursuant to chapter 9.
- 3) Requires the local public entity to submit to CDIAC all of the following:
 - a) A resolution or ordinance adopted by that governing body at a public hearing held pursuant to the Ralph M. Brown Act that does both of the following:
 - i) Requests authority through state law to petition the

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federal bankruptcy court for financial relief under the provisions of chapter 9 in federal law; and,

- ii) Acknowledges that the state's fiscal and financial responsibilities are not changed by the application or CDIAC's decision.
 - b) A thorough analysis of the entity's request to petition under the provisions of chapter 9 in federal law; in addition to any other information it may provide, the entity shall do all of the following:
 - i) Demonstrate that it is or will be unable to pay its undisputed debts;
 - ii) Demonstrate that it has exhausted all options to avoid seeking relief under chapter 9; and,
 - iii) Detail a specific plan for restoring the soundness of entity's financial plans.
 - c) An itemization of creditors that may be impaired or may seek damages as a result of the proposed plan.
- 4) Allows the local public entity to request an expedited evaluation within five days, to be approved by the CDIAC chair, if the entity sufficiently demonstrates a need for improved cashflow or protection from creditors' claims.
- 5) Requires CDIAC, upon receipt of the information listed in 3) above, to evaluate the information presented and publish its evaluation within 30 business days, or, in the case of an expedited request, within five days.
- 6) Requires CDIAC staff to specifically evaluate the extent to which the local public entity has done the following:
- a) Demonstrated that it has exhausted other remedies;
 - b) Demonstrated that it has taken sufficient steps to reduce the negative consequences of the proposed bankruptcy relief;
 - c) Has anticipated the transfer of service responsibility

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to other governments or parties and to what extent the entity has documented the consequences for the transfer of municipal and other government services;

- d) Documented the likely effect a successful petition will have on state and local finances, including the impact on credit access and debt service; and,
 - e) Has proposed a remedy that it is appropriate and proportionate to the entity's fiscal problems.
- 7) Requires CDIAC to conduct a hearing and publish a decision within 15 days of, but not less than 10 days after the publication of the staff evaluation; and requires that the hearing on the application shall be held in convenient proximity of the entity filing the application.
- 8) Allows the governing body of a local public entity to reapply if a previous request has already been denied by CDIAC, and requires the local public entity, if reapplying, to adopt another resolution and submit documentation to address the deficiencies identified by CDIAC.
- 9) Specifies that CDIAC shall, in a recorded vote, approve or deny the request of the local public entity.
- 10) Specifies that if CDIAC approves a request, it may 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 all of the following:
- a) CDIAC may limit changes to a contract;
 - b) CDIAC may prohibit the abrogation of contracts; and,
 - c) CDIAC may limit the amount of relief to ensure the protection of debt service payments.
- 11) Requires CDIAC to adopt specific findings that address the deficiencies of the application, if the application is denied.
- 12) Requires that the hearing held by CDIAC be subject to the provisions of the Bagley-Keene Open Meeting Act.

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- 13) Requires, after CDIAC receives an application from a local public entity, the executive director to record costs incurred by CDIAC to make and publish the evaluation and conduct the public hearing; and requires the director to report the costs

to CDIAC at the next regularly scheduled CDIAC hearing.

- 14) Allows the executive director or CDIAC, upon denial of the request, to assess a fee on the requesting entity to cover some or all of the costs associated with making the findings and conducting the hearing.
- 15) Requires that fee revenue be deposited in the CDIAC Fund.
- 16) Allows CDIAC to propose regulations pursuant to this bill.
- 17) Declares that in enacting this bill, the state assumes no new or additional fiscal responsibilities for local entities that may apply to CDIAC.
- 18) Specifies that the bill shall only apply to a local public entity on or after the effective date of the bill.
- 19) Defines "local public entity" to mean any city, county, city and county, district public authority, public agency, or other entity that is a "municipality" within the meaning of federal bankruptcy law applicable to local public entities.
- 20) Makes findings and declarations relating to municipal bankruptcies.

EXISTING LAW :

- 1) Allows a local public entity in California to file a petition and exercise powers pursuant to applicable federal bankruptcy law, without any statewide approval or pre-conditions.
- 2) Defines a "local public entity" as a 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, or that qualifies as a debtor under any other federal bankruptcy law applicable to local public entities.
- 3) Allows a legislative body authorized to conduct a proceeding

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pursuant to this chapter (Government Code 59125) to file a petition and exercise powers under applicable federal bankruptcy law as provided by Section 53760.

- 4) Defines the term "municipality" as a political subdivision or public agency or instrumentality of a state, in federal law (11 U.S.C. 101 (40)).

- 5) Allows the Superintendent of Public Instruction to assume control of a school district that becomes insolvent to ensure the district's return to fiscal solvency.

FISCAL EFFECT : According to the Assembly Appropriations Committee:

- 1) Given the complexity of the fiscal and legal evaluations required by the bill - and the tight time frames under which such evaluations would have to be made - costs to CDIAC (including staff time and contracts for legal, accounting, auditing, and financial consulting) could exceed several hundreds of thousands of dollars in a bankruptcy involving a large municipality. Measure provides CDIAC with authority to charge fees to cover some or all of their costs in the event they deny the municipality access to bankruptcy.
- 2) Possible state exposure to legal challenges and related fiscal pressures, potentially in the hundreds of millions of dollars.

COMMENTS :

MUNICIPAL BANKRUPTCY 101 UNDER FEDERAL LAW

- 1) The list of eligibility requirements for a "municipal debtor" in federal law under chapter 9 is contained in 11 U.S.C Section 109(c) and specifies the following:

First, an entity may be a debtor under chapter 9 only if such entity:

- a) Is a municipality;
- b) Is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by state law, or by a governmental officer or organization

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empowered by state law to authorize such entity to be a debtor;

- c) Is insolvent;
- d) Desires to effect a plan to adjust such debts; and,
- e) Has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in case under such chapter:

- i) Has negotiated in good faith with creditors and it has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that the municipality intends to impair under a plan of adjustment of claims;
- ii) Is unable to negotiate with creditors because such negotiation is impracticable; or,
- iii) Reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

A municipality must meet all of these conditions for the bankruptcy petition to be accepted by the court.

- 1) According to the U.S. Courts, "the purpose of chapter 9 is to provide a financially-distressed municipality protection from its creditors while it develops and negotiates a plan for adjusting its debts. Reorganization of the debts of a municipality is typically accomplished either by extending debt maturities, reducing the amount of principal or interest, or refinancing the debt by obtaining a new loan."

Chapter 9 provides a municipal debtor with two primary benefits: a) a breathing spell with the automatic stay; and, b) the power to readjust debts through a bankruptcy plan process. The process enables municipalities to continue to provide essential public services while allowing them to adjust their debts.

- 2) Federal law regarding municipal bankruptcy rose out of the financial crises of the 1930s.

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Chapter 9 federal law was created in 1934 and after several revisions, was made a permanent part of the Bankruptcy Act in 1946, and incorporated into the new Bankruptcy Code in 1978. In 1994, Congress amended the Bankruptcy Code to require that municipalities be "specifically authorized" under state law to file a petition under chapter 9 - this was an express invitation to the states to revisit the types of local agencies that could seek federal relief. SB 1323 (Ackerman), Chapter 94, Statutes of 2002, sponsored by the California Law Revision Commission (CLRC), accomplished this by bringing state law in line with the "specific authorization" as required under federal law.

CALIFORNIA'S RESPONSE TO CHAPTER 9

- 3) In response to the federal creation of chapter 9, the

California Legislature enacted bankruptcy authorization for municipalities in 1934. The general state statutes authorizing bankruptcy filings by local governments were codified in 1949 and those provisions were not amended until SB 1323 became law in 2002.

There were several attempts in the 1990s to streamline California law with federal law requiring specific authorization:

- a) SB 1274 (Killea, 1995-1996) and AB X2 2 (Caldera, 1995-1996) would have granted the broadest authority permissible under federal law by adopting the federal definition of "municipality;"
- b) AB X2 29 (Archie-Hudson, 1995-1996) would have provided authority for a municipality as defined by federal law to file "with specific statutory approval of the Legislature" and required the plan for adjustment of debts under Bankruptcy Code Section 941 to be "submitted to the appropriate policy committees of the Legislature prior to being submitted to the United States Bankruptcy Code;" and,
- c) SB 349 (Kopp, 1995-1996) would have modernized the obsolete references and adopted the "municipality" definition language in federal law. The bill would have established a Local Agency Bankruptcy Committee" to determine whether to permit a municipality to file a

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chapter 9 petition, and the committee would have contained the Treasurer, Controller and Director of Finance. The bill passed the Legislature, but was vetoed by then-Governor Wilson.

These bills were introduced mainly in response to the Orange County bankruptcy filing in 1994. According to a study done by the Public Policy Institute of California on the Orange County bankruptcy, "the financial difficulties leading to the bankruptcy were the direct result of an enormous gamble with public funds taken by a county treasurer who was seriously under-qualified to deal in the kinds of investments he chose."

At that time, Orange County and its investment pool - which suffered nearly \$1.7 billion in investment losses - filed for bankruptcy protection on December 6 in two separate cases. The bankruptcy judge ruled that only the county, and not the investment pool, could file for bankruptcy.

- 4) Currently, California state law authorizes federal bankruptcy filing by a "local public entity" - "a 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, or that qualifies as a debtor under any other federal bankruptcy law applicable to local public entities". As referenced, federal law defines "municipality" as a political subdivision or public agency or instrumentality of a state (11 U.S.C. 101 (40)). However, the California Law Revision Commission notes that the definitions in state and federal law create some ambiguity as to what exactly falls under the definition of "municipality" and can therefore seek financial relief through the chapter 9 bankruptcy process.

There is some debate about how broad the definition of "municipality" and "local public entity" is - it may be that the definition includes anything from library districts, parking districts, public cemetery districts, community service districts and the like. The Legislature may wish to discuss whether there is a legitimate statewide interest in preventing these small local government entities from filing for bankruptcy.

BANKRUPTCY PRACTICES IN OTHER STATES

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- 5) The 10th amendment to the United States Constitution says that "the powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people," otherwise known as the sovereign rights of the states. In the context of municipal bankruptcy filing, it is up to each state to decide whether to empower its municipalities to utilize federal bankruptcy laws.

Other states approach authorization for municipalities in various ways - some explicitly authorize municipalities and provide unlimited access, or explicitly authorize certain types of municipalities, some states are silent, one state expressly prohibits municipalities from filing, and yet others have their own state pre-conditions, processes or "gate-keeping" requirements.

Those states comparable to California in terms of population, like Texas and Florida, provide explicit authorization for municipalities in their state statutes. The state of New York allows a municipality or its emergency financial control board to file any petition within any United States district court or court of bankruptcy and explicitly notes in the statute that "nothing contained in this title shall be construed to

limit the authorization granted by this section [for municipalities to file a petition under federal bankruptcy law]."

For those states with preconditions or "gatekeeping" provisions, the following is a sample of the wide range of state statutes:

Iowa : Permits "a city, county, or other political subdivision" to become a chapter 9 debtor only if it is rendered insolvent as a result of debt (a defined term in the state statute) involuntarily incurred.

Michigan : Requires notice to be given to the local emergency financial assistance loan board and authorization from the emergency financial manager.

Montana : Applies to a "local entity." The local entity's legislative body must pass an ordinance or resolution declaring that it meets all eligibility requirements found in

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109 of the federal Bankruptcy Code.

New Jersey : Applies to "any county, municipality, school district or other political subdivision of this State." The political subdivision must get the approval of the municipal finance commission before filing the petition. Also, the governing body of the political subdivision must pass an ordinance authorizing the filing by a not less than two-thirds vote of all the members elected to the governing body. The municipal finance commission must approve the plan of adjustment before the political subdivision files it with the court and the commission must approve in writing each payment for attorneys, agents, committees, or other representatives of creditors.

North Carolina : Applies to "any taxing district, local improvement district, school district, county, city, town, or village." The local unit must get the approval of the Local Government Commission of North Carolina, which oversees local government debt and financial management.

PROPOSED LAW

6) This bill places conditions on how and when a municipality could seek chapter 9 relief under federal bankruptcy law. Current law authorizes municipalities to file a petition under the federal bankruptcy process without any prior state approval or pre-conditions to filing. This bill creates

"gatekeeper" provisions by granting a state entity - CDIAC - the authority to allow or disallow a municipality from exercising its rights to file a petition under federal chapter 9.

- 7) CDIAC, under the purview of the State Treasurer's office, currently collects data on municipal finance, conducts research, and provides information and technical assistance to local public agencies and their finance professionals. Since CDIAC has expertise in the financial health of local governments, it makes sense to put the review process in their hands. CDIAC's Board is comprised of the State Treasurer as Chair, and other members including the State Controller, the Governor, two members each from the Senate and Assembly, and two local government officials with expertise in debt issuance.

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- 8) The author bases the justification for this bill on a California Law Revision Commission report from 2001, in which CLRC studied California's municipal bankruptcy statute. CLRC recommended that the Legislature revise the state law to conform to the federal provisions and what resulted was SB 1323 by Senator Ackerman. However, the CLRC's report only suggested that California law be updated to provide explicit authority for municipalities, per the federal statute requiring states to have explicit authorization. The report did not recommend any other substantive policy changes or pre-conditions, or "gate-keeping" in order to access the federal bankruptcy process, and instead, the report noted that "there does not appear to be any general agreement on the best approach to reform, or even as to the need for additional protections or controls."

The California State Legislature has a long history, dating back to the Orange County bankruptcy filing in 1994, of debating access to federal municipal bankruptcy laws every few years (see Comments under 3) and 4) above, and ultimately in 2002, made the decision to seek the broadest author municipal bankruptcies that exists under federal law.

- 9) The author argues that a municipal bankruptcy filing will have repercussions in terms of credit rating and spillover effects that will raise borrowing costs for other California municipalities and the state. Arguably, a municipal bankruptcy, depending on the size of the entity, could potentially affect other local agencies and the state as a whole. The author argues that the state government should have the opportunity to consider whether bankruptcy is the

best approach to the problem, since municipal affairs are of interest to the state and should not be left to the sole discretion of the municipality.

- 10) CSAC, in their opposition letter, poses the question of what CDIAC would have advised in the instance earlier this year when the state withheld hundreds of millions of dollars in state payments to counties due to the state's cash flow crisis. CSAC notes that "the process outlined by this bill would place the local agency at risk of default, creditors at risk of not getting paid, and the state with the potential liability for damages as a result, with little to no benefit

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for citizens."

- 11) The issue of state liability is of great concern. As noted in Governor Wilson's veto of SB 349 (Kopp) in 1996, state interference in municipal bankruptcy "could raise questions of the liability of the state to creditors of the public agency if eligibility for bankruptcy is denied. State denial of access to chapter 9 may create the implication that the state has assumed responsibility for the debts of the distressed municipality."
- 12) The Association of California Water Agencies writes that "this bill is an unwarranted and unjustified intrusion on local control" and that the "determination to pursue protection under federal bankruptcy law should be left to the discretion of a local agency's board of directors." This bill undercuts local authority by giving the state the right to intervene in local decisions. Voters elect their local representatives and expect that their local elected officials know best about the municipality's financial condition, which will vary from jurisdiction to jurisdiction based on unique local needs. This bill effectively undoes the will of the voters by allowing the state to take the reigns on making a local decision.
- 13) The League of California Cities, in opposition, writes that "[local governments] will use all means available to avoid bankruptcy" and even then it is strictly a last resort. They cite the rare usage of the chapter 9 process under federal law - only three filings by cities and counties since the adoption of the state Bankruptcy Code in 1949 - Orange County in 1994 (See Comment #4), the City of Desert Hot Springs in 2001 because of a judgment against the city, and the City of Vallejo in May of 2008.

14) According to the California Professional Firefighters (CPF), a co-sponsor of the bill, "last year's bankruptcy filing by the City of Vallejo has only served to further devastate an already struggling community, including local businesses that were already feeling the adverse impact of a stagnant economy. Since the filing, Vallejo's litigation costs have escalated to over \$5 million thereby further encumbering an already dried up

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general fund budget."

Additionally, CPF notes that "bankruptcy may appear to provide a municipality quick relief from certain [types] of debt obligations, but the municipality will ultimately end up paying in the financial markets."

The Assembly Local Government Committee held a hearing in February 2009 jointly with Assembly Budget Subcommittee #4 on State Administration to hear directly from local cities and counties about the effect of the economic downturn on their budgets. Many local officials noted that sales tax revenue is down and the effect of the housing market is now being felt in decreasing property tax revenues. Along with the Pooled Money Investment Board's decision in December 2008 to stop funding local projects, the declining sales and property tax revenues are troubling for local governments. The committees also received information from cities and counties in California about the types of cuts they were making and had already made to stay solvent - everything from staff volunteering to be furloughed, involuntary furloughs and lay-offs, and cutting of services to seniors, parks and recreation, and other local programs, cuts to planning departments and public safety, among other solutions to scale back local budgets.

Unfortunately, the bankruptcy filing in Vallejo seems to be a situation created out of nightmare conditions, given the highly political and volatile nature of the ongoing bankruptcy proceedings. In a March 13, 2009, memorandum, Michael McManus, the

U.S. Bankruptcy Judge assigned to the Vallejo case, addressed whether chapter 9 of the Bankruptcy Code permits a municipality to reject collective bargaining agreements with its public employee unions. He found that "if a municipality is authorized by the state to file a chapter 9 petition, it is entitled to fully utilize 11 U.S.C. 365 (Section 365) to accept or reject its executory contracts" and that "unexpired collective bargaining agreements are executory contracts subject to rejection under Section 365."

15) In order to not put the financial affairs of a local government purely in the hands of the state, the Legislature may wish to consider adding a "local government override" provision into the bill, through which a local government can

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still file a petition under chapter 9 if they truly feel that no other viable options remain, even if the local government's application to petition is denied by CDIAC.

Analysis Prepared by : Debbie Michel / L. GOV. / (916)
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FN: 0001333

FILED
OFFICE OF THE CITY CLERK
OAKLAND

OAKLAND CITY COUNCIL

DRAFT

City Attorney

2009 JUN 25 PM 7:04
RESOLUTION No. _____ C.M.S.

Introduced by Councilmember Kernighan

Resolution In Opposition to Assembly Bill 155 (Mendoza) Which Would Require Local Agencies To Obtain Approval From The California Debt And Investment Advisory Commission (CDIAC) Prior To Filing For Bankruptcy

WHEREAS, under existing state law, local public entities can petition the federal government directly to file for bankruptcy protection under Chapter 9; and

WHEREAS, municipal bankruptcy is rarely used and when it is used, it is a last resort; and

WHEREAS, since the adoption of Chapter 9 of the Bankruptcy Code in 1949, only two cities have petitioned for its use; and

WHEREAS, local governments should be able to exercise control over their own finances and rely on their locally-elected officials to make critical financial decisions; and

WHEREAS: AB 155, would require local public entities to submit a request to the CDIAC for the authority to petition the federal bankruptcy court for financial relief under Chapter 9 in federal law; and

WHEREAS: AB 155 would allow the CDIAC to require changes to the relief that a city seeks, therefore be it

RESOLVED: that the City of Oakland declares its oppositions to AB 155 (Mendoza); and be it

FURTHER RESOLVED: that the City Council hereby directs the City Administrator and the City's legislative lobbyist to advocate for the above position in the California State Legislature.

IN COUNCIL, OAKLAND, CALIFORNIA, _____, 20____

PASSED BY THE FOLLOWING VOTE:

AYES - BROOKS, DE LA FUENTE , KAPLAN, KERNIGHAN, NADEL, QUAN, REID, and PRESIDENT BRUNNER

NOES -

ABSENT -

ABSTENTION -

ATTEST: _____

LaTonda Simmons
City Clerk and Clerk of the Council
of the City of Oakland, California