

state oversight of local governments' bankruptcy petitions.

Proposed Law

Assembly Bill 155 authorizes a local public entity, with the approval of the California Debt and Investment Advisory

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Commission (CDIAC), and under CDIAC's terms and conditions, to file a petition and exercise powers under federal bankruptcy law.

I. Submitting a request . When a local public entity asks CDIAC for approval to exercise its rights under federal bankruptcy law, AB 155 requires local officials to submit:

A resolution or ordinance, adopted by the governing body at a public hearing held pursuant to the Ralph M. Brown Act that does both of the following:

- o Requests authority to petition the federal bankruptcy court for financial relief.
- o Acknowledges that the state's fiscal and financial responsibilities are not changed by the application or CDIAC's decision.

A thorough analysis of the entity's request to petition under federal bankruptcy law. The entity must:

- o Demonstrate that it is or will be unable to pay its undisputed debts.
- o Demonstrate that it has exhausted all options to avoid seeking relief under Chapter 9.
- o Detail a specific plan for restoring the soundness of the entity's financial plans.
 - An itemization of creditors that may be impaired or may seek damages as a result of the proposed plan.
 - Evidence of irreparable harm that may result during the 30-day evaluation period and the 15 days allotted for a hearing.

AB 155 allows a county that requests approval from CDIAC to require local agencies with funds invested in the county treasury to provide a five-day notice of withdrawal before the county must comply with a request for withdrawal of funds.

II. Initial review . Within five days of receiving the information that must accompany a local public entity's request, CDIAC must evaluate the information and notify the entity of one of the following results:

- Approval of the request, or
- That CDIAC will proceed with a further evaluation based on a finding that the local public entity did not provide sufficient evidence of irreparable harm.

If CDIAC does not respond within five days, the request is deemed approved.

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III. Evaluation . AB 155 requires CDIAC to publish its evaluation within 30 business days of receiving the information that must accompany a local public entity's request. After notifying the local public entity of its intent to further evaluate a request, CDIAC's staff must specifically evaluate the extent to which the local public entity has done the following:

- Demonstrated that it has exhausted other remedies,
- Demonstrated that it has taken sufficient steps to reduce the negative consequences of its proposed bankruptcy relief,
- Anticipated the transfer of service responsibility to other governments or parties and to what extent the entity has documented the consequences for the transfer of municipal and other government services,
- Documented the likely effect that a successful petition will have on state and local finances, including the impact on credit access and debt service,
- Proposed a remedy that is appropriate and proportionate to the entity's fiscal problems.

IV. Hearing . AB 155 requires CDIAC to hold a public hearing to consider a local public entity's request for approval to file a petition and exercise powers pursuant to federal bankruptcy law. The hearing must:

- Occur at least 10 days, but not more than 15 days, after the publication of CDIAC's staff evaluation of

the request,
 Comply with the provisions of the Bagley-Keene Open Meeting Act and additional public notice provisions,
 Provide sufficient time for public testimony, and
 Be held in convenient proximity of the local public entity.

V. Approval or denial . AB 155 requires CDIAC, in a recorded vote on the date of the public hearing, to approve or deny the local entity's request.

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:

Limiting changes to a contract,
 Prohibiting the abrogation of contracts, and

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Limiting the amount of relief to ensure the protection of debt service payments.

If CDIAC disapproves a request, it must adopt specific findings that address the deficiencies of the application. If CDIAC denies a request, the local public entity may reapply by adopting another resolution and submitting documentation to address the deficiencies.

VI. Additional provisions . The bill requires CDIAC's executive director, after the Commission receives a local public entity's request for review and approval of a bankruptcy filing, to record the costs incurred by CDIAC in conducting an evaluation of and holding a hearing on the request. The director must report those costs to the Commission at its next regularly scheduled hearing. Upon denial of the request, the director or Commission may assess the requesting entity a fee to cover some or all of CDIAC's costs. Fee revenue must be deposited in a specified fund.

AB 155 allows CDIAC to propose regulations to govern the request and review process enacted by the bill.

AB 155 states that, in enacting the bill, the state assumes no new or additional fiscal responsibilities for local entities that may apply to CDIAC for review.

The bill requires the State Treasurer to temporarily replace a local government finance officer serving on CDIAC who is employed by an entity requesting CDIAC's approval to petition for bankruptcy with another local government representative who meets the qualifications for membership on the Commission.

The bill contains extensive legislative findings and declarations regarding the interdependence of state and local finances and the state's interest in various impacts of municipal bankruptcy.

Comments

1. Compelling state interest . Municipal bankruptcy's broad and significant impact on the bankrupt entity's residents, on other local government entities, and on the

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state necessitates state oversight of local public entities' bankruptcy filings. Because local and state finances are inextricably linked, the state has a direct interest in the fiscal health of its local governments. A municipal bankruptcy can have statewide repercussions, including higher borrowing costs for other local entities and the state. The state also has a compelling interest in ensuring the validity and enforceability of contracts negotiated through the collective bargaining process, which forms the foundation for positive and stable labor relations. The review process authorized by AB 155 could help local officials find alternative strategies to address short-term fiscal challenges in ways that avoid the broad and lasting spillover effects of municipal bankruptcy. AB 155 follows a model used successfully in other states to protect the interests of a broad coalition of stakeholders who are affected by municipal bankruptcies.

2. Local control . By authorizing CDIAC to either deny, or

impose conditions on, a local public entity's bankruptcy filing, AB 155 critically undermines local officials' discretion in responding to fiscal crises. Local elected officials are directly accountable to residents within communities affected by a municipal bankruptcy. As a result, a decision to enter bankruptcy is a last resort that those officials do not take lightly. High legal costs, damaged credit ratings, and a lasting stigma that can deter investment and growth in a community all weigh heavily against a decision to petition for bankruptcy protection. The principal benefit of federal bankruptcy is the automatic stay of financial obligations which allows a local entity some breathing space to formulate a debt readjustment plan that is consistent with the fiscal interests and priorities of the local community. Allowing CDIAC to deny or limit a local entity's restructuring could place the burden of fiscal recovery solely on cuts to public services, which may not reflect local residents' priorities. The Committee may wish to consider whether AB 155 is an unjustified state intrusion into local affairs.

3. What's changed ? Local officials have used municipal bankruptcy protection sparingly during the 70 years that it has been available to local public entities in California. Only three general purpose governments have filed for municipal bankruptcy protection: Orange County (1994), the City of Desert Hot Springs (2001), and the City of Vallejo

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(2008). Since 1999, 19 local public entities have filed for bankruptcy; more than half were small health care districts. This recent average of fewer than two municipal bankruptcy filings per year from among the thousands of local public entities in California may reflect the substantial, inherent disadvantages of resorting to bankruptcy. Proponents of AB 155 argue that this history of bankruptcy filings and the inherent disincentives are not reliable indicators of future behavior. The immense fiscal challenges now confronting many local governments and the precedent set by Vallejo's bankruptcy may open the door to more widespread, and less responsible, use of bankruptcy protection in the near future. However, despite the recession and additional state-imposed burdens on local finances, the Sierra Kings Health Care District is the only California local government that has filed for bankruptcy protection in the nearly two years since Vallejo entered bankruptcy. The Committee may wish to consider whether potential changes to the frequency and purpose of municipal bankruptcy filings justify the changes that AB 155 makes to the state's long-standing municipal bankruptcy statute.

4. What happens next ? It is unclear what might happen after CDIAC denies a local public entity's request to file for bankruptcy, or imposes conditions on a bankruptcy filing that make restructuring impossible. As mentioned in Governor Wilson's veto of the 1996 Kopp bill, some opponents of state oversight of municipal bankruptcy argue that a denial of eligibility for bankruptcy "could raise questions of liability of the state to creditors of the public agency." However, there is no evidence that this theoretical concern has become a problem in the other states that block access to municipal bankruptcy. Regardless of whether the state may incur legal liability, it may face heightened political pressure to provide fiscal assistance to a local entity that can't seek bankruptcy protection. Legislators may feel obligated to intervene to ensure that an insolvent county, city, or district doesn't stop providing vital public services. The Committee may wish to consider whether the state oversight authorized by AB 155 to protect limited state interests could result in expanded state obligations to struggling local entities.

5. Regulation or prohibition ? Six states broadly require some form of state approval before local governments can petition for Chapter 9 bankruptcy protection: Connecticut,

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Kentucky, Louisiana, New Jersey, North Carolina, and Ohio. Of the 76 local governments that have filed for Chapter 9 bankruptcy protection since 1999, only two received approval from one of these states: the South Brunswick Water & Sewer Authority (North Carolina, 2004) and the Lower Cameron Hospital Service District (Louisiana, 1999). Based on this recent pattern in other states, the Committee may wish to consider whether requiring state approval of Chapter 9 petitions filed by California local governments

would almost completely restrict access to municipal bankruptcy protection in California.

6. Take two . The Senate Local Government Committee considered AB 155 at its July 8, 2009 hearing. After taking testimony from 24 witnesses, the Committee held the bill at the request of the author. Although AB 155 has not been amended, the Committee will again hear testimony on the bill because two new members joined the Committee this year.

Assembly Actions

Assembly Local Government Committee: 4 - 3
 Assembly Appropriations Committee: 12- 5
 Assembly Floor: 47- 25

Support and Opposition (4/15/10)

Support : 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

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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.

Opposition : Counties of Butte, Imperial, Nevada, Madera, Orange, Riverside, San Bernardino, 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, Camarillo, Carmel-by-the-Sea, Carson, Carlsbad, Chowchilla, Clayton, Cloverdale, Clovis, Coalinga, Commerce, Concord, Costa Mesa, Cotati, Covina, Cypress, Daly City, 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, Irwindale, Kingsburg, La Palma, La Puente, La Verne, Laguna Hills, Lake Forest, Lafayette, Lakewood, 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, Novato, Oakdale, Oakland, Ontario, Oroville, Palmdale, Palo Alto, Paradise, Pasadena, Patterson, Pinole, Placentia, Pleasanton, Pomona, Rancho Cordova, Rancho Cucamonga, Reedley, Ridgecrest, Rialto, Rio Vista, Rohnert Park, Rolling Hills Estates, Rosemead, Salinas, Sanger, San Luis Obispo, San Marcos, San Pablo, Santa Cruz, Santa Maria, Santa Rosa, Seaside,

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Sebastopol, Shafter , Signal Hill, Stockton, Tehachapi, Tiburon, Torrance, Tracy, Tulare , Tustin, Vacaville, Vallejo, Villa Park, Visalia, Vista, Walnut Creek, Wasco, West Covina, West Hollywood, Westminster, Windsor, Woodlake, Woodland, Yorba Linda, Yountville, and Yucaipa, Ambrose Recreation and Park District, Bell Canyon Community Services District, El Dorado Hills Community Services District, Goleta Sanitary District, Lincoln rural County Fire Protection District, Mountain House Community Services District, Squaw Valley Public Service District, Stallion Springs Community Services District, Vista Irrigation District, Association of California Health Care Districts, Association of California Water Agencies, California Chamber of Commerce, California Contract Cities Association, California Public Securities 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 Empire Division, League of California Cities Orange County Division, Marin County Council of Mayors and Councilmembers, South Bay Cities Council of Governments.