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presented at  
**CALPELRA**  
moving forward, together

# Bankruptcy: Chapter 9

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## Agenda

- Introduction and Background
- The Nuts and Bolts of Chapter 9
- City Manager's Perspective
- Union Leadership Perspective

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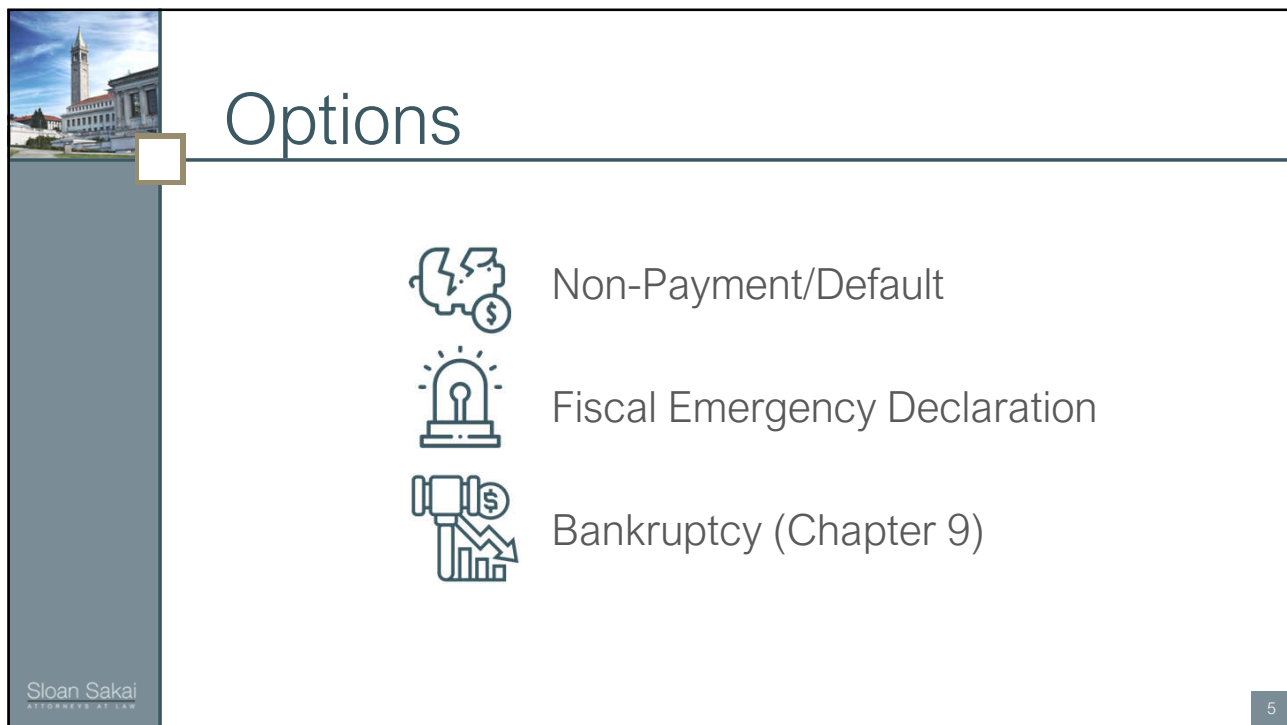
## Background

Local governments have liquidity issues:




- ↓ Drop in sales tax revenue
- ↓ Drop in TOT
- ↓ Drop in program revenue
- ✊ Unbudgeted costs due to federal mandates and protests

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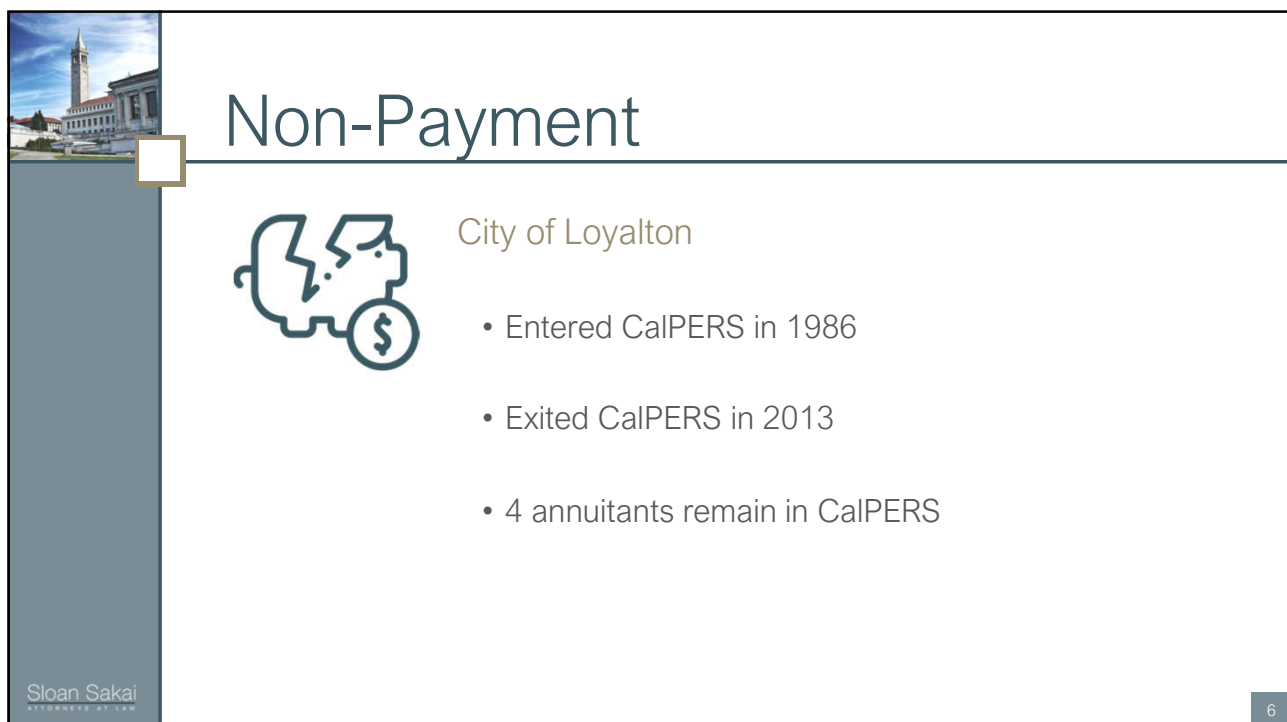
Options

-  Non-Payment/Default
-  Fiscal Emergency Declaration
-  Bankruptcy (Chapter 9)


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Non-Payment

-  City of Loyalton
  - Entered CalPERS in 1986
  - Exited CalPERS in 2013
  - 4 annuitants remain in CalPERS


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## Emergency Declaration




*"It is the settled law of this court that the interdiction of statutes impairing the obligation of contracts does not prevent the State from exercising such powers as are vested in it for the promotion of the [benefit of the general public] or are necessary for the general good of the public, though contracts previously entered into between individuals may thereby be affected."*

*Home Bldg. & Loan Assn. v. Blaisdell, 290 U.S. 398 (1934)*  
*See Sonoma County Org. of Public Employees v. County of Sonoma, 23 Cal. 3d 296, 305 (1979).*


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## Fiscal Emergency





San Jose

- Fiscal and service level emergency
- Report presented to Council November 22, 2011
- Change in pension costs

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## Fiscal Emergency



Stockton

- May 26, 2010 – initial declaration of fiscal emergency
- Additional resolutions preceding FY 2010-11 budget adoption (June 2010)
- Additional resolutions approaching 2011-12 budget

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## Fiscal Emergency

Los Angeles

- September 2, 2020 – declaration of fiscal emergency
  - Up to 18 furlough days per year
- Council declines to direct City to seek deferral of police raises

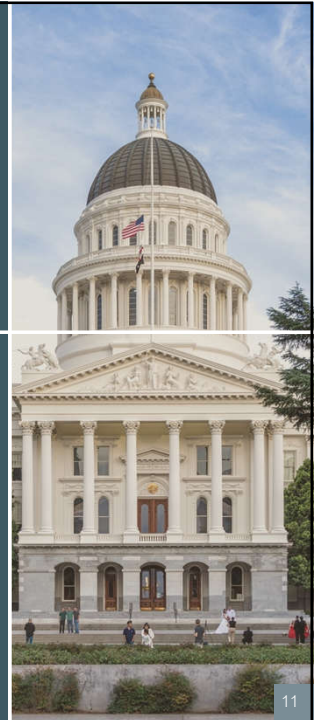
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# The Nuts and Bolts of Chapter 9

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## Alternatives when the music stops and there aren't enough chairs to go around




- Cut to the bone
- Declare a fiscal emergency
- Default, including default interest and impact on future borrowings
- Workout
- Chapter 9


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## What Chapter 9 can and cannot do




- Adjust debt
- It does not generate new revenue, but it may set the table for a tax raise


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## Tenth Amendment




- Reserves powers to the States
- Implemented in Chapter 9 by Bankruptcy Code §§ 903 and 904
- States are the gatekeepers for Chapter 9 filings
- Chapter 9 does not trump State law related to the exercise of political or governmental powers
  - § 904 - Chapter 9 does not interfere with property or revenues of the municipality, but permits the municipality to consent to court intervention
- See generally, *In re City of Stockton, California*, 478 B.R.8 (Bankr. E.D. Cal. 2020)


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## Filing the Chapter 9 case




- The Chief Judge of the Circuit assigns the bankruptcy judge
- Automatic stay applies to the municipality and to its officers and inhabitants
  - Does not apply to application of current and future pledged special revenues to debt secured by the revenues
- There may be official committees


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## Eligibility to be a debtor



Petition does not constitute an order for relief. Court first must hear and determine objections to eligibility. Debtor must:


- ✓ Be a "Municipality"
- ✓ Be specifically authorized by state law to be a Chapter 9 debtor
  - Half the states have no authorization
  - Particular issues in California, New York, Alabama, Pennsylvania, among others
- ✓ Be "insolvent"
  - Either generally not paying its debts as they become due; or
  - Unable to pay its debts as they become due in the next fiscal year
- ✓ Desire to effect a plan to adjust its debts
- ✓ Prove at least one of the following:
  - Agreement of creditors holding a majority in amount of impaired claims in each class

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## Eligibility to be a debtor (Part II)




- ✓ Municipality has negotiated in good faith and has failed to obtain agreement
- ✓ Municipality is unable to negotiate with creditors because negotiation impracticable
- ✓ Municipality reasonably believes a creditor may attempt to obtain a preference
- ✓ In addition, the municipality must act in good faith


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## Rejection of Labor Agreements




- A Chapter 9 debtor may assume or reject executory contracts and unexpired leases
- Rules for assumption – defaults cured; adequate assurance of future performance
- Test for rejection – business judgment rule
- Special rule for rejection of labor agreements in Chapter 9. Court must find:
  - The agreement burdens the debtor;
  - After careful scrutiny, the equities balance in favor of rejection; and
  - The prospects of reaching a deal in the near future are not good
- After rejection, California law (MMB) governs next steps


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## Rejection of Pension Agreements




- Vallejo did not seek to reject its pension-related agreements with CalPERS
- In the Stockton case, CalPERS played an active role from the outset, aggressively asserting that its agreements were not subject to rejection
  - Capital markets creditors argued that such agreements not only were subject to rejection, but that the court should order they be rejected
  - The City chose not to reject the agreements, arguing that the result would be the loss of key employees, particularly experienced police officers
  - The court ruled that it had the power to reject the agreements, but that the City was not compelled to do so, and that the City's decision did not bar confirmation of the plan of adjustment
    - The court found that CalPERS, despite its insistence, was a conduit with no economic skin in the game rather than a creditor
    - Commenting on the proactive role CalPERS took throughout the case, the court said "The bully may have an iron fist, but it also turns out to have a glass jaw." In re City of Stockton, California, 526 B.R. 35, 39 (Bankr. E.D. Cal 2015); aff'd, 542 B.R. 261 (9<sup>th</sup> Cir. B.A.P. 2015)


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## Plan of adjustment



- Must classify claims, provide equal treatment for claims in each class
- May modify claims or leave classes of claims unimpaired
- May assume or reject executory contracts and unexpired leases
- Must provide adequate means for implementation, including asset sales
- May contain any other provisions not inconsistent with Chapter 9
- Plan must be proposed in good faith
- Plan must provide for the payment of administrative expenses
- Plan is in best interests of creditors
- Class acceptances or cram down
- Actions needed to carry out the plan are not prohibited by applicable non-bankruptcy law; any electoral or regulatory approval required under non-bankruptcy law must be a condition to the plan

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# When Things Get Really, Really Bad

## A City Manager's Perspective

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### There are 3 basic approaches during recessions and other fiscal calamities:



Cut, cut and cut some more



Declaring a fiscal emergency—untested recently in courts




Filing for bankruptcy court protection—the law is rather clear


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## The 3 forms of insolvency are signs for where you are headed:



Service



Budget



Cash insolvency

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The other two may be the standard for declaring a fiscal emergency

The standard when filing for bankruptcy protection

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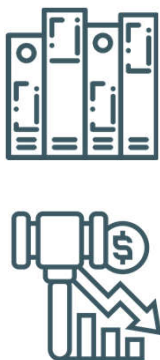
## Chapter 9 under the Bankruptcy Code

- Allows you to impair contracts under certain conditions
- Yes, that includes pensions and retiree health—but be careful, will you be a viable employer if you do?

## Fiscal Emergency

- May allow you to selectively impair contracts


Is it needed to address the crisis?  
Would only be effective while crisis exists




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## Timing Issues to Consider




### Bankruptcy Protection

- Need to try mediation under state law—it's crazy
  - Stockton case—labor tried but Wall Street did not
  - Your/their actions influences what courts think
  - Can stop paying bills almost immediately, but be careful if it's secured debt
- Court grants a stay, i.e. stopping lawsuits, etc.
- Eventually there is a court fight whether you were/are eligible for bankruptcy protection—Stockton's case cleared the air some
- Eventually you have to try and negotiate deals with creditors
- You may try the "cram down" approach as last resort
- Eventually, you have to submit a bankruptcy exit plan
- What will your agency look like after exiting?


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## Timing Issues to Consider (cont.)




### Fiscal Emergency

- MMB doesn't get turned off
- Can go into effect immediately—but labor and others can access the courts
- What about arbitration provisions in MOUs?
- Depending upon the situation, there will be an eventual trial on its merits
  - If you lose, what happens?
- Got to periodically revisit the rationale for the emergency—is it still there?
- Eventually it gets turned off, now what?


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## Other Issues to Consider




- ✓ Your employees (and labor) need to hear and understand what is going on--could impact (pre-BK) mediation and court fights
- ✓ Your community needs to hear what to expect
- ✓ Employees can leave when you need them the most and replacing them will be hard—their exit has costs e.g. vacation and sick leave cash outs, etc.
- ✓ If bankruptcy, you will get bombarded by the media and others
- ✓ Things can get nasty, for you and your family
- ✓ Need a “situation room” or “emergency operations center” that meets weekly
- ✓ Plan for the politics at the local and statewide level

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## Union Leadership Perspective

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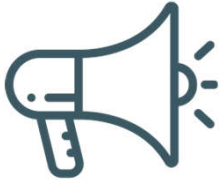
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## Frequent Communication




- Early engagement
- Routine, frequent, and clear status reports
- Create a safe environment for open dialogue
- Messaging must be consistent


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## Transparency




- Optics matter
- Fairness matters
- Consistent & universally applied strategies
- Pain must be equitably shared by all stakeholders


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## Understanding the Role of Labor



- Recognized creditor
  - Active versus retired members
  - Mediation
- Minimize impacts
  - Mitigate concessions
  - Concessions aren't one size fits all
  - Picking your poison
- Manage expectations

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## Collaboration



- Identify stakeholders with shared interests
  - Employer
    - Interests aren't as divergent as perceived
  - Other recognized employee organizations
    - Every REO for itself is shortsighted
  - Community
    - Tell your story, share your commitment

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## Planning for Recovery




- Restoration
- Exiting bankruptcy
- Fight for fiscally sustainable compensation philosophy for all


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## Adjusting to the New Normal

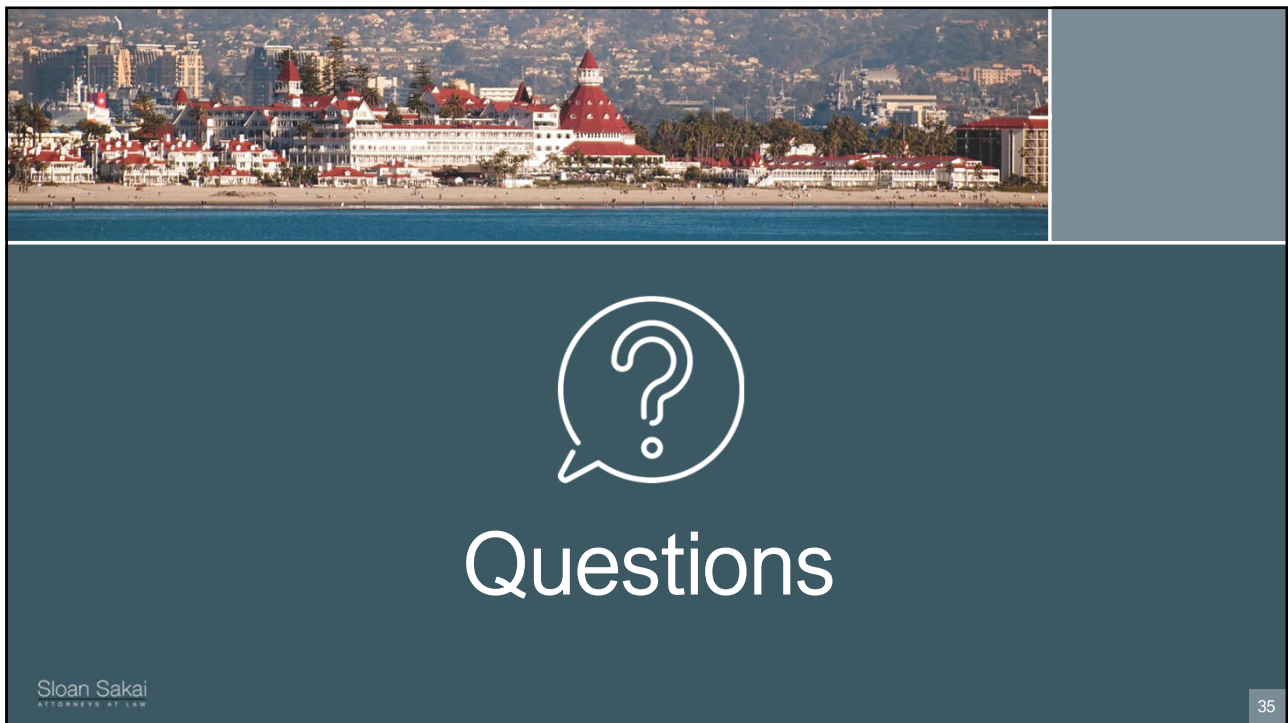


- Maintaining and expanding relationships
- Ensure recognition
- Tend to employee health
- Resetting mission, goals, and objectives
- Expand engagement

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