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21 and Assured Guaranty Municipal Corp.

22 UNITED STATES BANKRUPTCY COURT
23 EASTERN DISTRICT OF CALIFORNIA
24 SACRAMENTO DIVISION

25 In re:) Case No. 12-32118
26)
27 CITY OF STOCKTON, CALIFORNIA,) DC No. OHS-1
28)
Debtor,) Chapter 9
)
)
)
) Date: August 23, 2012 (Status Conference)
) Time: 10:00 a.m.
) Courtroom: 35
) Judge: Hon. Christopher M. Klein
)
)

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EXHIBIT A

News

CREDITOR TEARS INTO STOCKTON

ASSURED GUARANTY INSISTS CITY DID NOT EXHAUST ALL OPTIONS BEFORE BANKRUPTCY

By Scott Smith
June 30, 2012
Record Staff Writer

STOCKTON - A jilted Wall Street creditor shamed Stockton on Friday, promising to fight the city in bankruptcy court because leaders lacked the political courage needed to fix its finances without shorting investors.

New York-based Assured Guaranty insures \$161 million worth of debt the city has stopped paying down, including bonds issued to buy an eight-story downtown building that represents unrealized plans to relocate City Hall.

Assured Guaranty in a prepared statement scolded the City Council for not averting bankruptcy by trying first to sell off property, end unessential services, raise taxes and force further concessions from employees and retirees.

City Manager Bob Deis called Assured's statement arrogant.

The city will ask a bankruptcy judge to make records from the three-month mediation public so the world can see how Assured conducted itself behind closed doors, Deis said.

Most galling, Deis said, was Assured's suggestion that Stockton should take more from its employees, like the city's understaffed Police Department. Crime in Stockton is rampant, he said.

"They literally want anarchy in the streets," Deis said. "They don't care. They just want to get paid."

Assured insures \$60 billion in bonds throughout California and has \$13 billion set aside to pay claims in case of defaults, such as Stockton's.

The City Council chose to ignore its obligations, Assured Guaranty argued, rather than get to the root of its problems and restructure its finances.

"Many other cities across the country are experiencing similar financial challenges, but they ... have responsibly chosen to make the difficult decisions rather than choosing bankruptcy," Assured said.

Stockton's bankruptcy caps three years of chronic debt. City leaders blamed the crisis on poor management at City Hall dating back to the 1990s. The Great Recession that started in 2008 then brought Stockton to its knees. It's cut \$90 million in the past three years.

A budget adopted this week to see Stockton through bankruptcy overcomes a \$26 million deficit mostly by stopping the bond payments insured by Assured and terminating a city-funded health care program for the city's retirees, who also have lashed back at the city.

Like the retirees, Assured was among creditors who met with Stockton officials for three months in confidential mediation that ended Monday. On Tuesday, the City Council voted to send Stockton into bankruptcy.

Assured Guaranty also backed three parking garages Wells Fargo Bank repossessed for missed payments.

Mayor Ann Johnston said Friday she was not surprised by Assured's reaction to the bankruptcy filing.

"Assured has always said, 'Everybody but us. We're the ones who need to be paid,' " Johnston said. "I'm sure they're not going to give up easily."

The city's bankruptcy formally began Thursday, when attorneys hit the send button, electronically filing the first

three-page form. Stockton is the nation's largest city to file bankruptcy. The court filing fee for its Chapter 9 cost \$1,046.

The city's initial filings begin to reveal the city's financial portfolio, listing its obligations large and small. Officials said they will seek relief on only some very specific obligations.

Stockton has assets of more than \$1 billion, and its liabilities are between \$500 million and \$1 billion, says the initial three-page filing signed by Deis and attorney Marc Levinson of Orrick, Herrington & Sutcliffe LLP.

Topping a list of Stockton's top 20 creditors is the California Public Employees' Retirement System, which manages pensions for the city's employees. CalPERS is listed as having a \$147 million interest in Stockton.

Wells Fargo Bank represents those who have the most at stake.

Julie Campbell, a Wells Fargo spokeswoman, said in an email that the bank acts as a trustee for bondholders - individuals, mutual funds, pension funds and retirement accounts. Assured insures many of these bonds.

Wells Fargo controls seven financial commitments with Stockton worth a total of \$258 million. The bank "expects to take an active role in the bankruptcy proceedings," Campbell said.

Also listed among Stockton's top creditors are The Spanos Family Trust at a debt of \$2.5 million for an unspecified trade debt.

With Thursday's filing - and more Friday - Stockton's finances enter the public domain.

Hundreds of pages now available through the federal bankruptcy filing list all the city's employees, retirees and vendors. Each will be notified that they can file a claim in the city's bankruptcy case. They range from Stockton's Brannon Tire Corp. to Xerox Corp. in Santa Ana.

Stockton next awaits the assignment of a federal judge to oversee its case and a date for its first court hearing, which could come within weeks.

Contact reporter Scott Smith at (209) 546-8296 or ssmith@recordnet.com. Visit his blog at recordnet.com/smithblog.

EXHIBIT B

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Posted: 9:51 p.m. Friday, July 20, 2012

Stockton, CA mayor responds to Mayor Brown's remarks

By Gene Wexler

JACKSONVILLE, FLA. — Mayor Ann Johnston of Stockton, California responds to Mayor Alvin Brown.

Last week, Mayor Alvin Brown gave his budget address to the city. At one point, he made it clear that reforming the city's costly pension system is one of his primary goals.

"We're obligated to spend more than a hundred and fifty million dollars on pensions," Brown said.

"That's an increase of more than forty-six million dollars...To balance the budget, we must eliminate nearly five hundred positions through attrition and layoffs."

"That's why I'm saying clearly and definitely, pension reform must be our city goal...Jacksonville will not follow the path of Stockton, California, Harrisburg, Pennsylvania, and Jefferson County," Brown said to an applauding room.

Stockton, California recently declared chapter 9 bankruptcy after years of battling with debt.

In an exclusive interview with WOKV, Stockton Mayor Ann Johnston said she thinks Stockton is being looked at by cities across the country "in terms of lessons to be learned."

Three major problems she named for her city's public employees:

- Generous employee salaries
- Retiree pension benefits
- Generous retiree health benefits

"Just like Jacksonville, the percentage of our budget that is going towards pensions continues to escalate," Johnston said.

The housing collapse was the nail in the coffin in the last ten years because they no longer had the property and sales taxes coming in to support it.

But Johnston said pensions and health benefits for retired public employees were a growing problem over the last 20 years.

"A lot of very 'Cadillac' benefits," she said.

She said Mayor Brown can learn from Stockton's situation.

"I appreciate your Mayor's concern about the situation and saying that 'you don't want to be a Stockton.'

We don't want anybody to be in the situation that we're in either," Johnston said.

She offered some advice for Jacksonville's Mayor.

"Don't overspend," she said. "Make sure you're not in deficit spending. Make sure that you can cover all the costs not just for next

year, but for the succeeding years because Florida, I know, has had some of the same challenges that California has had with the housing collapse.”

Stockton, California is in the top ten cities with foreclosures and has an unemployment rate of 18%.

As far as the bankruptcy goes, “We were up against a wall,” Mayor Johnston said.

“We did not have a choice.”

She hopes Mayor Brown is successful in his efforts to reform Jacksonville’s costly pension system.

“I’m not sure how your Mayor is gonna do it. When he does it, will you let me know so we can take lessons from how we make changes in something as entrenched and as huge as a state pension system?”



EXHIBIT C

Bloomberg

Police Chief's \$204,000 Pension Shows How Cities Crashed

By Alison Vekshin, James Nash and Rodney Yap - Jul 31, 2012

Stockton, [California](#), Police Chief Tom Morris was supposed to bring stability to [law enforcement](#) when he was appointed to the job four years ago.

He lasted eight months and left the now-bankrupt city at age 52 with an annual pension that pays more than \$204,000 -- the third of four chiefs who stayed in the position for less than three years and retired with an average of 92 percent of their final salaries.

Stockton, which filed for [bankruptcy protection](#) on June 28, is among California cities from the Mexican border to the [San Francisco Bay](#) confronting rising pension costs as they contend with growing unemployment and declining property- and sales-tax revenue. The pensions are the consequence of decisions made when stock markets were soaring, technology money flooded the state, and retirement funds were running surpluses.

"We didn't have very many people looking out for the taxpayers when these deals were negotiated," [San Jose](#) Mayor Chuck Reed, 63, said in a telephone interview. San Jose, the state's third-largest city, approved a ballot measure in June to contain annual retirement costs that soared to \$245 million from \$73 million in the past decade.

Bloomberg News compiled data from the [California Public Employees' Retirement System](#) for more than a dozen cities facing the financial strains of rising pension costs and declining revenue. The data show how local governments struggle to support six-figure lifetime benefits for some retirees even as they cut police and fire services for city residents.

Intractable Costs

Many cities are hobbled by retiree obligations that consume 10 percent or more of revenue. And unlike other expenses, which can be cut or deferred, pension costs are intractable, said Eric Friedland, head of municipal-credit research for Schroder Investment Management North America.

"As their tax revenues go down, they're stuck with these fixed costs," Friedland said. "I see this as a major driver of fiscal stress."

City councils across the state, spurred by then-Governor [Gray Davis's](#) move to enhance pensions for

California Highway Patrol officers in 1999, sweetened retirement benefits for police, firefighters and other workers in the decade that followed. Public-safety employees could retire after working for 30 years, collect 90 percent of their top salaries and take jobs elsewhere while still in their 50s.

Younger Retirement

San Bernardino, a city of 209,000 about 60 miles (100 kilometers) east of [Los Angeles](#), is typical of the phenomenon. Its city council voted July 18 to approve an emergency bankruptcy filing, about six years after the panel unanimously lowered the [retirement age](#) for public-safety workers to 50 from 55.

The council acted in August 2006 even though Aon Plc, the city's risk-management consultant, had warned it that such a change would add millions of dollars to San Bernardino's long-term pension costs. In the fiscal year that ended in June, pensions consumed 13 percent of the city's general fund, up from 9 percent in fiscal 2007.

"I knew it was going to be costly in the long run," San Bernardino City Councilwoman Wendy McCammack said of the lower retirement age. "However, this city is one of the toughest to police. In order to attract and retain the kind of officers that it takes to police a city like this, that was a benefit that we had to negotiate."

Cities and counties began boosting pensions for police and firefighters after Davis signed the bill enhancing the benefit for state troopers. The Legislature enacted the measure in a year when Calpers, the largest U.S. pension fund, had 138 percent of the assets needed to cover projected liabilities.

None Understood

"It got out of control," said Jay Goldstone, who was [Pasadena's](#) finance director from 1996 to 2006 and now is chief operating officer of [San Diego](#). "No one understood the potential impacts of what these increased benefits were and how they were being paid."

State Controller John Chiang said steps toward bankruptcy taken by Stockton, San Bernardino and Mammoth Lakes within weeks of each other shows the need for greater scrutiny of city finances and pensions.

"You want to have a sound, fair compensation package for your public servants," Chiang said. "You don't want them in a vulnerable position where they easily could be lost, but then you also have to make sure that you have a fair system that can make adjustments if a city's finances are tanking."

Pension Liabilities

Pension liabilities in the cities of Fairfield, Inglewood, Pomona, San Bernardino, Stockton and Vallejo rose 6 percent to \$4.3 billion for the year ending June 30, 2010, from \$4.1 billion in 2009, according to the most recent data available from Calpers. In the northern California municipality of Fairfield, near

the famed Napa Valley winegrowing region, 18 percent of the general-fund budget goes toward pension costs, up from 14 percent in fiscal 2008, said David White, the deputy city manager.

Fairfield, Inglewood, Pomona and other municipalities including Compton are on a list of cities “on the precipice” compiled by Matt Fabian, a managing director for Concord, Massachusetts-based Municipal Market Advisors, who cited news reports in identifying them in a July 23 research note.

Fairfield’s White said the city isn’t approaching bankruptcy because it doesn’t have a lot of debt in its general fund. He said he expected pension costs to ease because benefits for new employees are less generous than before.

Six Figures

Across the state, former city managers and public-safety employees are collecting six-digit annual pensions for life at taxpayers’ expense as cities slash staff and basic services such as police and fire protection and library hours to keep up with the payments.

In San Bernardino, two former police chiefs are among those who receive six-figure pensions, according to Calpers. Keith Kilmer, who retired last year, gets a pension of \$216,581, Calpers said. He now serves as interim chief of the Seal Beach, California, Police Department. Michael Billdt, his predecessor, who receives \$205,014 annually, took a medical retirement in 2009 after two no-confidence votes by officers.

Billdt, who had no college degree, was accused of trying to induce an officer to withdraw a union grievance in exchange for the department dropping an internal-affairs investigation into his conduct. Billdt didn’t return a telephone call seeking comment, and Kilmer declined to comment.

Possible Bankruptcy

In Compton, where the treasurer raised the possibility of bankruptcy at a July 17 meeting, former city managers Barbara Kilroy and Charles Evans were fired by their city councils, records show. Kilroy, who worked in government for more than 34 years, is collecting an annual pension of \$172,917, while Evans receives \$136,712 after almost 22 years in the public sector, according to Calpers data.

Kilroy, 65, in a telephone interview, said she never received a definitive explanation for her firing. Her pension is fair, she said, adding that there is a property assessment in Compton that provides a dedicated revenue stream for pensions. Evans didn’t return a phone call seeking comment.

On July 24, the new city manager of Compton, Harold Duffey, denied the municipality was considering a bankruptcy filing.

Amy Norris, a Calpers spokeswoman, said the average pension of someone in the Calpers system who retired in fiscal 2011 is \$3,065 a month, or \$36,780 annually.

“For most of our retirees, it’s a very modest retirement,” Norris said in a telephone interview. “People are giving their entire careers to public service.”

National Average

Among California’s municipal police and fire workers, the average retirement age is 54 after 25 years of service with a monthly pension of \$7,059 a month, or \$84,708 a year, Norris said. The average retirement benefit for all public employees nationally is \$22,600, according to the Denver-based National Conference of State Legislatures.

Municipalities are moving to counter earlier largesse by reducing pension benefits for new hires, according to a February survey by the League of California Cities. Most that allowed police and firefighters to retire at 50, and collect as much as 90 percent of active-duty income as pensions, have bumped the age back to 55, the survey showed.

Stockton, a city of about 292,000 residents about 80 miles east of San Francisco, illustrates the array of benefits that can be combined to maximize employee compensation in retirement, Kathy Miller, the city’s vice mayor, said in a telephone interview.

“In Stockton, we took every bad practice and put it into place,” Miller said. “We have some safety retirees that are actually earning more in retirement than they earned when they were working because they were able to manipulate the system enough in that last year that they could crank that last year’s income and then get 3 percent times their 25 to 30 years.”

Revolving Door

The revolving door of police-chief departures began after Edward Chavez retired in October 2003 with 30 years of service to become the city’s mayor. Mark Herder succeeded Chavez as chief, staying just over two years before retiring in March 2006. He collects a pension of \$166,890, according to Calpers.

Wayne Hose was in the process of retiring as an assistant chief in Stockton, then retracted the paperwork to apply for the chief’s position when Herder retired, Miller said. Hose stayed in the position for two years before retiring in March 2008 to collect a pension of \$202,398, the second-highest in the city, according to Calpers.

“The pensions are so fat that it doesn’t pay them almost to stay on the job,” Miller said. “It’s crazy. The system is just completely out of control.”

Highest Pension

Morris, now 55, took the post in 2008 after Hose left. Morris collects the highest pension in Stockton. Four months after retiring, he took a job as an investigator at the San Joaquin County District Attorney’s Office, collecting an annual salary of \$76,066 in addition to his six-figure Stockton pension.

He since has left the district attorney's office.

Next came Blair Uring, who retired in September 2011 and stayed on the job until February of this year as interim chief. He collects an annual pension of \$193,417, the third-highest in the city, and is one of four finalists for the police chief's job in Omaha, Nebraska, according to Aida Amoura, a spokeswoman for the Omaha mayor's office. He also applied for the police chief's jobs in Spokane, Washington, and Flagstaff, Arizona, spokesmen for those cities said.

Herder, reached by telephone, declined to comment. Morris, Hose and Uring didn't respond to requests for comment made through the Stockton police department.

Good Faith

Stockton Councilmember Elbert Holman said public-safety employees negotiated in good faith for the benefits they received, and blamed city leaders who agreed to the pensions without making provisions for them.

"It's the people that were sitting in office who authorized those benefits but did not put the money away to pay for it," Holman said in a telephone interview.

Stockton's latest police chief, Eric Jones, is 40 years old and isn't eligible to retire for another 10 years.

"I would have never expected that I would get the job this early in my career," Jones, who became chief in March, said in a June interview in his office at the Stockton Police Department.

"What the department and the community and the city leaders wanted was some longevity and stability in this office," he said. "To build a solid plan and see the solid plan come to fruition, it takes somebody to be here for a little while."

To contact the reporters on this story: Alison Vekshin in San Francisco at avekshin@bloomberg.net; James Nash in Los Angeles at jnash24@bloomberg.net; Rodney Yap in Los Angeles at ryap@bloomberg.net.

To contact the editor responsible for this story: Jeffrey Taylor in San Francisco at jtaylor48@bloomberg.net

EXHIBIT D



JOHN CHIANG
California State Controller

April 2, 2012

Mr. Bob Deis
City Manager
City of Stockton
425 N. El Dorado Street
Stockton, CA 95202

Dear Mr. Deis:

This is to notify you that I have directed my Division of Audits to conduct an investigation of the financial practices and reporting of the City of Stockton (City) and the Stockton Community Redevelopment Agency (RDA) and its Successor Agency. The investigation will be conducted under Government Code (GC) sections 12464(a), 12468, 12410 and Health and Safety (H&S) Code section 34167.5. The basis for this investigation is as follows:

Annual Reporting Requirements: Neither the City nor the RDA has complied with state laws regarding the timely submittal of annual financial transaction reports as follows:

City of Stockton's Financial Transaction Report

- The City has not submitted the City of Stockton Financial Transaction Report for Fiscal Year 2010-11. The due date was on or before October 18, 2011.

Stockton Community Redevelopment Agency's Financial Transaction Report

- The RDA did not submit the RDA Financial Transaction Report for Fiscal Year 2010-11. The due date was on or before December 31, 2011.

City of Stockton's Annual Street Report

- The City has not submitted the Annual Street Report for Fiscal Year 2010-11. The due date was on or before October 1, 2011. Our office withheld the City's Highway Users Tax Account (HUTA) allocation of \$653,021 for February and we will continue to withhold all future monthly HUTA allocations until the report is submitted to and reviewed by my office.

Bob Deis
April 2, 2012
Page 2

While the City and the RDA timely submitted the above three reports for Fiscal Year 2009-10, several discrepancies raise questions regarding their reliability. Specifically, the City reported a net deficit between income and expenditures of approximately \$37 million and the RDA reported a net positive equity position of \$90 million. Yet, the Independent Audit Report for the City and RDA for the same year disclosed deficit equity balances in the following funds:

- The RDA Capital Projects Fund has a deficit fund balance of \$6.2 million as of June 30, 2010.
- The General Liability Insurance Fund has deficit net assets of \$3.5 million.
- The Worker's Compensation Insurance Fund has deficit net assets of \$32.5 million.
- The Employee Health Insurance Fund has deficit net assets of \$6.0 million.
- The Retiree Health Insurance Fund has deficit net assets of \$75.9 million.
- The Other Benefits and Insurance Fund have deficit net assets of \$3.5 million.

Moreover, the Independent Audit findings for Fiscal Year 2008-09 did not disclose any fund deficits. The emergence of such deficits in such a short time raises concerns about the reliability and accuracy of the information in the Fiscal Year 2009-10 reports. In addition, it also raises questions about the data that you will be using to compile the Fiscal Year 2010-11 reports, particularly given the Stockton City Council's recent action to enter a mediation process allowed under Assembly Bill 506 to address severe financial issues that threaten the City with bankruptcy. You have stated that Stockton's current financial issues are due, in part, to fiscal mismanagement in recent years. My investigations of other cities and RDAs have linked mismanagement to significant reporting errors by those local agencies.

Based on the above information, I have concluded that there is reason to believe that the City's ability to provide reliable and accurate financial information relating to the required financial reports is questionable. Therefore, under GC Section 12464(a), I have directed my Division of Audits to conduct an investigation to validate the FY 2009-10 financial transactions reports (City, Street, and RDA) and review the data that will be used to compile the FY 2010-11 reports. Under GC section 12464(b), the costs of this investigation, including preparing a report of the results and transmitting copies to the City Council of Stockton, will be borne by the City and the RDA.

State and Federal Funded Programs

In addition, I have directed my Division of Audits to review any programs with State general or special funding, and/or any federal funding passed through a State agency to the city or the RDA. These additional activities will be conducted under GC section 12468, which authorizes the State Controller to ". . . regularly audit the apportionment and allocation by counties of property tax revenue . . ." and under GC section 12410, which authorizes the Controller to ". . . superintend the fiscal concerns of the state. The Controller shall audit all claims against the state, and may audit the disbursement of any state money, for correctness, legality, and for sufficient provisions of law for payment." These statutorily required review costs will be borne by the State Controller's Office.

Bob Deis
April 2, 2012
Page 3

Redevelopment Agency Transfer of Assets

Under H&S section 34167.5, my office is required to perform a review of all RDA assets transferred to any local public agency between January 1, 2011 and January 31, 2012 and where appropriate require that the assets be returned to the Successor Agency for use in the timely dissolution of the former RDA and its operations. The costs of this review will be borne by the Successor Agency under H&S section 34183 (d).

The Division of Audits will contact you about scheduling an entrance conference date and providing information regarding the specifics of the investigation, including a list of materials that will need to be available. We expect the entrance will be held in late April with the actual work to begin in May.

I am aware that the City is in sensitive negotiations under the provisions of Assembly Bill 506. As you know, interested organizations and individuals – including current and former elected officials representing the Stockton community - have requested that I audit the City's finances to ascertain reliable information that might inform decision-making during the AB 506 process. Because my auditors are completing their work on other audits and will not be available until early May, it is unlikely that my office will complete its audit of Stockton before the 60 to 90 day process afforded by AB 506 runs its course.

Many of these same audit requests have also urged my office to perform a review of the City's internal controls, cash management, accounting procedures, procurement/contracting policies, and overall fiscal management practices to identify the origins of Stockton's current fiscal distress. Review of these factors and any root cause analysis will be included in the investigation my auditors will perform and the final report will include detailed recommendations for how to remedy any identified management shortcomings. My belief is that this information will assist Stockton in implementing any reforms and recovery plan that the City will need to embrace to regain its fiscal footing.

If you have any questions about the investigation and the audits, please contact Jeffrey V. Brownfield, Chief, Division of Audits, at (916) 324-1696.

Sincerely,

Original signed by

JOHN CHIANG
California State Controller

Bob Deis
April 2, 2012
Page 4

cc: Ann Johnston
Mayor of the City of Stockton
Chairperson of the Successor Agency to the RDA
Elbert H. Holman Jr., Council Member
Stockton City Council
Katherine M, Miller, Council Member
Stockton City Council
Leslie Baranco Martin, Council Member
Stockton City Council
Diana Lowery, Council Member
Stockton City Council
Susan T. Eggman, Council Member
Stockton City Council
Dale Fritchen, Council Member
Stockton City Council

EXHIBIT E



1 of 1 DOCUMENT

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October 16, 1995, Monday

SECTION: NORTHEAST; Pg. 14

LENGTH: 716 words

HEADLINE: Trends in the Region: Two Struggling New England Cities Turn It Around

BYLINE: By Patrick M. Fitzgibbons

BODY:

All of New England got hammered during the economic slowdown at the turn of the decade, but two cities - Chelsea, Mass., and Bridgeport, Conn. - were especially hard hit.

Massive layoffs, plant shutdowns, and even tales of widespread corruption in Chelsea were all part of the news of the day. But now, almost five years after their brushes with bankruptcy, the two cities have more than a glimmer of hope.

Soon Bridgeport will be out from under the thumb of its Financial Control Board, which voted earlier this month to dissolve. The board said city leaders could manage their finances.

That may not seem like a lot, but for Bridgeport it's a major accomplishment.

In 1991 the city, which has a population of only 150,000, faced an \$18 million deficit. The mayor at the time, Mary C. Moran, filed for Chapter 9 municipal bankruptcy protection - only to be turned down.

A state judge said the city had too many assets to receive protection. The city planned an appeal, but in the meantime Moran lost her reelection bid.

Mayor Joseph P. Ganim, taking office in 1992, dismissed the whole idea of bankruptcy. Since then, the city has been on a slow-but-steady climb.

Connecticut established the Bridgeport Financial Control Board in 1989 after the city needed state support to sell about \$60 million in deficit recovery bonds. In August, the city met the final condition of the review board, reentrance into the bond market.

Now, as Ganim seeks a third term, the city has set its sights on landing a casino. State lawmakers are meeting in a special session this fall to decide whether or not to allow a \$1 billion casino in the city.

"We are not a community saying to the state that casinos are the answer to all of our problems," Ganim said. "Rather, we view this as a tool to get us other things. The casino offers us the prospect of 10,000 new jobs and a \$1 billion investment in our city over three years."

In Chelsea, Mass., the best sign of the recovery may be an empty office - the Office of State Receiver.

In 1991, the city could not pay its bills and faced several unresolved municipal contracts. Massachusetts, like Connecticut, had placed city finances under a review board, but even that did not work.

So Gov. William F. Weld put the city in receivership under James F. Carlin, a millionaire businessman with a reputation for speaking his mind.

The Bond Buyer, October 16, 1995

Carlin cut \$10 million from the city's \$40 million budget in 1991, settled disputes with the city's unions, and helped rewrite the city charter to create a new system of government. The work was carried on by his successor, Harry Spence.

The office of mayor was recently replaced by a more powerful city manager. Guy Santagate, the city's former assessor, was chosen for the post by Spence and the Board of Aldermen in August.

Now Spence has retired from the scene and Santagate is the city's leader. "There are two things we need to consider, the financial problems and the changes in the city's charter," Santagate said in a recent interview. "The changes in the charter are going well. We are all feeling our way along and making sure we don't step on people's turf." After a year, he said, the city will be able to better assess the new charter.

On the financial side, he said, the city may have to cut about \$1.7 million from the projected \$58 million budget for next year.

But revenues could become healthier if the Massachusetts Port Authority goes ahead with expanding Logan Airport, Santagate said, since some of the affected businesses could move to neighboring Chelsea.

Chelsea, whose last bonds were retired during the 1970s, has returned to the debt market. At a meeting tonight, Santagate said he will ask the City Council to issue \$1.2 million in bonds for necessary water and sewer work.

In the past year, the city has sold two bond issues, both backed with several guarantees. The larger of the two was a \$109 million issue to help rebuild the city's crumbling school system.

While the bonds were city-backed credits, the state reimburses communities for 90% of school rebuilding. Chelsea had been the only city in the entire state that had not sold bonds for new schools since the state school building program was created in 1947. In fact, the city's newest school was built in 1909.

LOAD-DATE: October 14, 1995

EXHIBIT F

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Rising costs push California cities to fiscal brink

Throughout the state, local governments are slashing services to avoid bankruptcy. For some, it's too late.

July 12, 2012 | By Phil Willon, Catherine Saillant and Abby Sewell, Los Angeles Times

Facing the same financial stressors that pushed San Bernardino toward bankruptcy, cities across California are slashing day-to-day services and taking other drastic actions to skirt a similar fiscal collapse.

For some, it may not be enough.

San Bernardino on Tuesday became the third California city to seek bankruptcy protection in the last month and, while no one expects the state to be consumed by municipal insolvencies, other cities teeter on the abyss.

PHOTOS: California cities in bankruptcy

"There are likely to be more in the future, but it's hard to know, since a lot of struggling cities may manage to work things out," said Michael Coleman, a fiscal policy advisor for the California League of Cities. "Some cities may not go into a bankruptcy, but they may dissolve. They may cease to exist."

Once rare, turning to bankruptcy has become a painful but enticing option for cities whose labor costs and municipal debt far outpace anemic tax revenues. The Bay Area city of Vallejo began the current trend in May 2008, filing for Chapter 9 bankruptcy protection because, city leaders said, salaries and benefits for its public safety workers were eating up too much of the general fund.

Last month, Stockton became the largest city in the state to seek bankruptcy protection after it was unable to come to agreement with its employee unions and creditors on a plan to close a \$26-million gap in its general fund. On July 2, the tiny resort town of Mammoth Lakes filed bankruptcy papers in part because it was saddled with a \$43-million court judgment it couldn't pay.

San Bernardino couldn't close a \$45.8-million budget shortfall and would be unable make its payroll this summer. Days before Tuesday's City Council vote, the city of 211,000 people had just \$150,000 in the bank. The city barely scraped together enough money to cover its June payroll.

The city had largely patched over its growing fiscal ills, exacerbated by the struggling economy, by tapping out its reserves over the last several years, according to a fiscal report submitted to the council before Tuesday's vote.

DOCUMENT: San Bernardino bankruptcy report

That 4-2 decision to file for bankruptcy protection was the easy part, San Bernardino Mayor Patrick Morris said Wednesday. Now the city has to pull together a plan to emerge from its fiscal crisis. It has already cut its workforce by 20% over the last four years.

Morris, a former judge elected on an anti-gang platform, says the city may have to dissolve its Fire Department or portions of the Police Department, an unavoidable reality when public safety accounts for nearly 75% of the general fund budget. The city would then contract with county and state agencies for those services.

"I think all possibilities should be on the table," Morris said. "That includes privatizing services; that includes regionalizing services."

Steve Tracy, a fire engineer and spokesman for the city firefighters union, said San Bernardino's labor groups already gave up \$10 million in concessions. He blamed the financial crisis on the mayor and former city manager spending money on such pet projects as a new downtown movie theater.

"Before you start putting blame on the labor groups, get your own fiscal house in order," Tracy said.

Vallejo was in a similar bind when it filed for bankruptcy four years ago. Now Mayor Osby Davis wonders if the painful road to recovery was worth the cost.

The Bay Area city of 112,000 was forced to shut down two of its fire stations and today fixes just 10% of its crumbling roads. Its workforce, including police and firefighters, is about half its pre-bankruptcy size and those people left are "insanely" overworked.

Meanwhile, Vallejo spent \$10 million on legal fees. It ended up with employee contracts that Osby thinks the city could have struck more cheaply if it had stayed out of bankruptcy court and turned to the bargaining table.

His advice to other cities on the financial brink? Don't do it.

"It takes an enormous toll on everyone," Davis said. "And you have the stigma of being a bankrupt city. How do you come out of being labeled a bankrupt city to one that is a desirable place to live?"

The San Bernardino City Council meets Monday to hash out the painful road ahead, including how to scrape together enough money to sustain city services before officially filing for bankruptcy protection. That could take a month or longer.

The city is expected to declare a fiscal emergency, which would trigger an "emergency exit" clause in the new state law that governs municipal bankruptcies. Otherwise the city would be forced to mediate with labor unions and creditors, an expensive, months-long process that Stockton slogged through without arriving at any agreement.

Karol Denniston, an attorney who helped draft the state bankruptcy law, said the emergency exit was designed for cases such as that of Orange County, which in 1994 became the largest county in the United States to go bankrupt, largely because of an unanticipated downturn in its risky investments.

Meanwhile, San Bernardino is likely to be scrutinized over how it managed to come to the brink of disaster, seemingly so quickly. City Atty. James Penman said budget figures submitted to the council had been fabricated for 16 years. Interim City Manager Andrea Miller was less harsh, saying the city's budget was erroneously said to be balanced for the last two years.

"The real horrible question here is: How do you end up with 30 days of liquidity?" Denniston said. "You have city leaders saying fiscal information was not accurate or reliable. This could create multiple layers of litigation that hurts creditors, employees and taxpayers for a very long time to come."

Rising public pension costs are one of the catalysts pushing cities into fiscal peril. In San Bernardino, the city's obligation to its employee retirement system rose from \$1 million in the 2006-07 fiscal year to nearly double that in the current budget year. In three years, those costs are expected to swallow up 15% of the budget.

Pension spending grew an average of 11.4% a year in the state's biggest cities and counties between 1999 and 2010, roughly twice as fast as spending on public safety, social services, recreation, health and sanitation, according to a February report by the Stanford Institute for Economic Policy Research.

Joe Nation, a Stanford economics professor and co-author of the February report, thinks that for at least some cities, insolvency is inevitable unless they can wrest much bigger concessions on salaries and pensions from public employees.

"I think this is the tip of the iceberg in terms of the problem," Nation said. "Stockton was spending \$12 [million] or \$13 million on pensions 10 years ago. By 2010, it was \$30 million ... and will double again over the next five years, unless something is changed."

Meanwhile, as news of the bankruptcy wafted though San Bernardino on Wednesday, residents feared for the city's uncertain future.

"People are losing their homes because they have no jobs. It's been really tough, so it doesn't surprise us," said Rose Garcia, 46.

But Garcia, a stay-at-home mother, said she and her husband, a dispatcher for Vulcan Materials, are anxious about potential cuts to public safety.

"It's an uncertain feeling we have right now," she said. "We're actually talking about moving."

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EXHIBIT G

News

ROLLING THE DICE

BANKRUPT STOCKTON MAY HAVE TO SEEK A LOAN TO REPAIR ITS RICKETY SEWAGE TREATMENT SYSTEM

By Scott Smith
July 17, 2012
Record Staff Writer

STOCKTON - The city's aging sewer plant, a stinky corner of town drawing comparisons to Dante's Inferno, may be the problem that forces Stockton officials, bankruptcy baggage and all, back to Wall Street begging for a loan.

Parts of the treatment facility were built 70 years ago. The machinery is still hard at work - barely. Rust has frozen in place steel gates designed to protect Stockton residents from flooding.

The City Council learned last week that \$156 million is needed to modernize the plant.

Stockton's plunge into Chapter 9 bankruptcy protection will likely complicate the city's ability for several years to borrow money for such projects.

The city is trying to restructure its debt in part by making bondholders take a loss. Stockton is the first large city to try this, and the tactic has already bruised its reputation in the nation's finance centers.

"This is the kind of thing that makes Wall Street shudder," said San Francisco-based municipal bankruptcy attorney Michael Sweet of the Fox Rothschild LLP law firm.

"If the city succeeds in impairing the bonds through this Chapter 9 bankruptcy, it could have extraordinary reverberations on the municipal bond market."

A storm brewing

Without the millions needed to upgrade its wastewater treatment equipment, officials fear the next major rainstorm to hit Stockton could spell catastrophe.

Jeff Willett, assistant director of Stockton's Municipal Utilities, in a recent tour of the Navy Drive plant, said some key equipment dates back to 1946, the year it was built.

"Not many people drive around in 1940s cars," he said.

The plant is in need of repair to avoid millions of dollars in regulatory fines for failing to properly clean its wastewater before sending into the Delta.

The aging equipment that cleans Stockton's sewage before it enters the Delta stands in stark contrast to the new \$220 million Delta Water Supply Project, which extracts Delta water and delivers it to thousands of residential taps.

The wastewater plant - in the event of heavy winter rains - presents a nightmare, worst-case scenario of raw sewage backing up into city streets.

Emblematic of the problem, Willett points to massive steel gates designed to block such an overload. They have rusted into place.

"We tried to move them," Willett said. "They don't budge."

Educating investors

The Stockton council, in its first meeting after filing bankruptcy, considered issuing bonds and other sources to pay for badly needed upgrades to the sewer plant.

This will take some creativity. The council instructed City Manager Bob Deis to apply for a low-interest state loan. But bonds from Wall Street will inevitably be in the funding mix.

The city has two or more years during the design stage of wastewater upgrades before it will need the money. Deis told the council that two years is like a lifetime for Stockton.

The city's bond consultant, Ken Dieker of Modesto-based Del Rio Advisors, reported to the council that Stockton will be able to issue bonds despite its bankruptcy. But, he said, it may take some time to educate potential buyers.

Revenue bonds that Stockton could issue for its sewer plant are backed by the rates users pay in their regular bills, not by the city's ailing general fund subject to bankruptcy proceedings.

Revenue bonds are protected under the California Constitution and can be used only for their designated purpose, he said.

"Sophisticated buyers understand this," Dieker said. "I do believe there will be a market for these bonds. It may take a little time to shake out as things develop."

Dieker may be overly optimistic. Fitch Ratings, a major Wall Street credit-rating agency, downgraded \$252 million worth of Stockton water bonds in June to below investment grade, or "junk bond," status.

Chicago attorney James Spiotto at the Chapman and Cutler law firm said that Stockton's bankruptcy is unique because city leaders will try to force bond holders to take a loss on their principal investment.

Vallejo in its bankruptcy forged deals with its labor groups and convinced lenders to adjust the interest rates, Spiotto said, adding that Vallejo is a smaller community.

"The stigma of defaulting means you're not going to have access or you're going to borrow at a higher price," he said.

No doubt

Mel Lytle, Stockton's new director of Municipal Utilities, said that upon taking the job he toured the city's wastewater treatment plant.

Within five minutes, he was dedicated to the cause of making the necessary improvements.

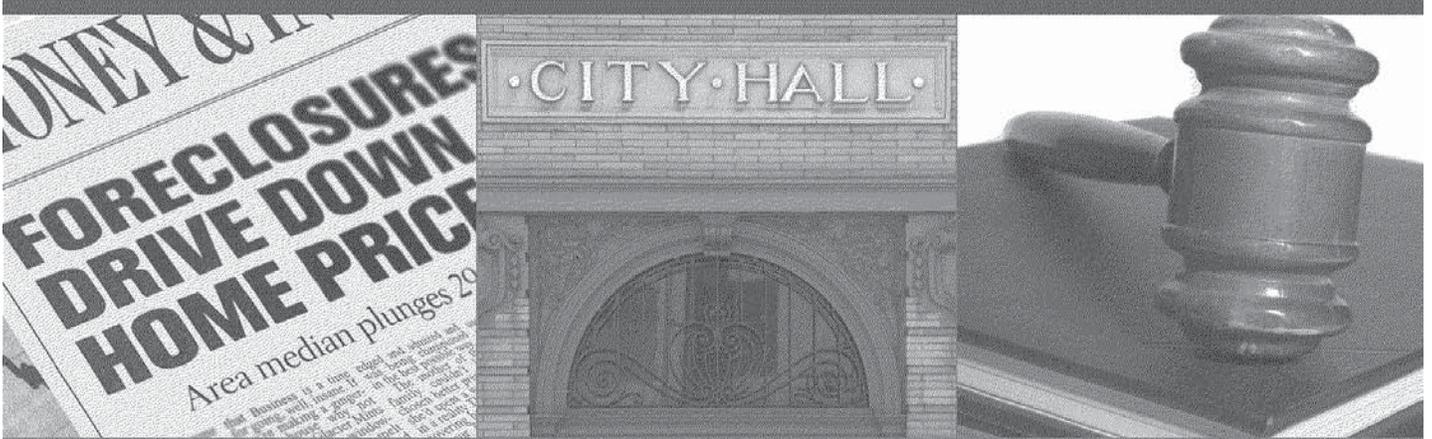
He described with shock the state of the immobile gates that are needed to prevent a deluge from overwhelming the plant in a heavy storm.

"They're corroded. They're gone. There's no way to control the flow into the wastewater plant," he said, next describing the plant's general condition. "It was sort of the lowest step of Dante's Inferno that you can imagine."

Contact reporter Scott Smith at (209) 546-8296 or ssmith@recordnet.com. Visit his blog at recordnet.com/smithblog.

EXHIBIT H

Municipal Bankruptcy:



Avoiding and Using Chapter 9
in Times of Fiscal Stress

DISCLAIMER: Nothing in this booklet should be construed or relied upon as legal or financial advice. Instead, this booklet is intended to serve as an introduction to the general subject of municipal bankruptcy under chapter 9 of the Bankruptcy Code and related matters, from which better informed requests for advice, legal and financial, can be formulated.

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Municipal Bankruptcy:

Avoiding and Using Chapter 9
in Times of Fiscal Stress

JOHN KNOX and MARC LEVINSON



Municipal Bankruptcy: Avoiding and Using Chapter 9 in Times of Fiscal Stress

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Introduction

Municipalities¹ have been increasingly squeezed between the cost of providing basic services (which in general has been increasing at a rate significantly higher than inflation) and flat or declining revenues (due to the economic slowdown and in particular the difficulties in the housing market affecting property tax revenues and spending patterns). In the face of these pressures, the possibility that some may want or need to seek protection under chapter² 9 of the United States Bankruptcy Code has become more real. In May 2008, the City of Vallejo, California filed a chapter 9 petition, and several other California municipalities have been reported in the media to be considering a filing. Jefferson County, Alabama, also has been reported to be on the edge of filing for several months due to financial problems with its sewer system, among other things. Whether this is the start of a larger trend remains to be seen, but it is clear that the stresses that can produce the drastic step of filing for bankruptcy protection currently are affecting many municipalities.

We intend this pamphlet to provide an overview of chapter 9 for those who manage and govern municipalities. We offer some thoughts on how to avoid filing as well as how to successfully navigate a bankruptcy case and emerge in stronger financial health. This pamphlet does not provide an exhaustive technical exposition of the law. Due to its size and format, this pamphlet only briefly summarizes, and in some cases omits entirely, areas that in particular cases might be very significant, but which we feel would not be of interest to the majority of our audience.

¹ Throughout, we use the term “municipality” to refer to a local government entity that may file a chapter 9 case. The term covers a wide variety of local governments that may or may not be considered “municipalities” under state law.

² The observant reader will note that “chapter” is not capitalized when referring to the chapters of the Bankruptcy Code. This is the standard convention.

Accordingly, this pamphlet does not purport to provide legal advice or serve as a template for a practitioner seeking to advise a client considering a chapter 9 filing or to prosecute the case once there. Rather, what we hope to achieve in this effort is to provide a basic framework to consider the chapter 9 alternative and enough background to enable decision makers and managers to ask informed questions of their advisors and appropriately consider the alternatives. Bankruptcy is a complex area of the law, and the adage “don’t try this at home” should be heeded. Any municipality seriously considering a chapter 9 filing should obtain expert legal counsel as well as financial advisory help.

CHAPTER ONE

Avoiding Chapter 9

If the reader takes away only one thing from this pamphlet, it should be that filing for bankruptcy protection under chapter 9 should be considered a last resort, to be effected only after every effort has been made to avoid it. As we discuss below, there are several significant downsides to such a filing, and in the end, the problems that brought the municipality to the point of filing will have to be solved anyway, so it is far better to resolve them, if possible, outside of bankruptcy.

Assessing the Problem(s)

The initial step in trying to avoid bankruptcy is to clearly and dispassionately assess the underlying problem(s) that are pushing the municipality in that direction. The degree of self awareness and transparency among municipalities can vary widely, and for some, one of the main problems may be just getting a good handle on the real drivers of financial stability and solvency. Not being financial managers, we will leave it to those more qualified to get into the technical details, but suffice it to say that if a municipality cannot identify in clear terms the specific factors that are driving revenues down and/or expenses up, it has some serious homework to do before venturing into bankruptcy court.

Municipalities that have been forced to the brink of, or into, bankruptcy, generally experience one or both of two types of fiscal problems. The first is a large and extraordinary one-time financial hit that cannot be absorbed by the budget or covered out of reserves. This could be a sudden and catastrophic investment loss (such as that experienced by Orange County, California, leading to its chapter 9 filing in 1994) or a large judgment rendered against the municipality (such as that experienced by Desert Hot Springs, California, leading to its chapter 9 filing in

“... filing for bankruptcy protection under chapter 9 should be considered a last resort, to be effected only after every effort has been made to avoid it.”

2001). In each case, these significant one-time liabilities forced the municipality into seeking bankruptcy protection.

The second kind of problem is a structural operating deficit that continues long enough to burn through reserves and is not resolved by revenue increases or spending cuts quickly enough for the municipality to avoid running out of cash as it attempts to meet necessary and fixed expenses such as debt service and payroll. A municipality with this type of problem could be pushed over the edge by a relatively small one-time expense or drop in revenues, as it may have little or no cushion available to absorb even a modest setback. For example, the City of Vallejo,

which had spent down its reserves in order to meet its obligations over a period of several years, became insolvent as a result of California’s economic slowdown and the concomitant drop in real estate and sales tax revenues, combined with significant employee salary and benefit cost increases dictated by collective bargaining agreements.

In general, fiscal stress related to one-time problems can be resolved by financing the cure costs over a long enough period so that those costs can be absorbed in the budget over time. And while bankruptcy protection may be necessary to buy time to get such a financing done and delay disruptive collections efforts or the forced liquidation of collateral, all efforts should be made to convince creditors to be patient and not to cause the municipality to incur the significant costs associated with a bankruptcy filing.

Fiscal stress related to ongoing structural deficits and lack of reserves is much more difficult to tackle because a financing will have little impact on solving the underlying structural problem: in fact this tactic will likely make things worse by “kicking the can down the road” and increasing the overall costs to the municipality. In these circumstances, painful cuts in service levels, employee compensation and other expenses may be required, as well as increased revenues through higher taxes or fees. Bankruptcy protection may be needed to avoid

immediate sanctions for breaching contracts, including labor agreements, missing debt service payments or failing to provide required levels of service.

Cash Position and Special Funds

Most municipalities (particularly general purpose entities such as cities and counties) maintain scores of separate funds within their treasuries, each having a particular function and source of revenues, and each burdened by legal or grantor restrictions as to the use of the funds. For example, in California, revenues from municipal utilities such as water and sewer systems may be used only to pay the costs of operating and maintaining those systems or for capital improvements (including debt service) to those systems. Many states require that special funds be held in trust and not diverted for unrelated uses. Similarly, moneys received in grants and state subventions may be restricted for particular uses by the terms of the grants, or by statutes or regulations. Careful analysis must be made of the various funds held by the municipality to determine what diversions can legally be made and, more importantly, how limitations on the uses of funds will affect the true available cash position of the municipality. While it is not uncommon for all of these funds to be commingled for investment purposes into a pooled cash account, a significant positive balance in pooled cash can mask a serious problem in the municipality's underlying financial condition.

Typically, the only fund completely unrestricted as to its use is the municipality's general fund. It is common and accepted practice for municipalities to use their pooled cash accounts as a source of cash flow within a fiscal year to carry funds that have *intra-year* cash inflows that do not match their cash outflows; *provided*, that the budget and reserves are sufficient³ to ensure that at the end of the fiscal year, restricted funds are not in a position of having funded items not permitted within their restrictions. For example, the general fund may receive large infusions from property tax revenues twice a year, but have a monthly cash outflow that is relatively even. Generally, it is not improper for the cash outflow deficits to be covered from pooled cash during the year so long as the general fund makes up the difference from cash inflows by the end of the fiscal year.

³ The Government Finance Officers Association (GFOA) recommends that agencies maintain general fund unrestricted reserves of at least five to fifteen percent of the annual general fund budget.

The trouble arises when the budgeted revenues for a general fund will not meet budgeted expenditures, and there are insufficient reserves to cover the shortfall. Often these imbalances are not apparent until the fiscal year is well under way and it becomes clear that projections of revenue and expense will not be met. In such a case, use of restricted funds in pooled cash could be a violation of the restrictions imposed on the special funds and therefore illegal. It is important to note that while municipal financial officers generally have immunity from personal liability for official acts, that immunity does not necessarily extend to *knowing* violations of the law. Thus, a municipal finance officer should be very careful not to permit advances from restricted funds *intra-year* if he or she knows that the amounts cannot be restored from budgeted revenues or reserves by the end of the fiscal year.

It is very important for a municipality that appears to be headed for insolvency to monitor its cash position, particularly in the funds that are

“... the municipality could be faced with the choice of either breaking the law by using restricted funds for an impermissible purpose or by failing to pay contracted for wages after work has been performed.”

projected to go negative by the end of the fiscal year, so that it can determine when it will run out of funds to keep operations going. A municipal official who requires or even permits employees to come to work if the official knows that the municipality will not be able to pay them may be violating state labor laws or committing common law fraud. In some states, this may even constitute a criminal offense. For example, if an employee is paid from a municipality's general fund (and cannot be allocated to some other special restricted fund because the employee's duties do not support the special fund's activities), and the general fund budget position is such that, taking into account any available reserves, it will be unable to achieve at least a zero year-end balance without using legally restricted funds in pooled cash, the municipality could be faced with the choice of either breaking the law by using restricted funds for an impermissible purpose or by failing to pay

contracted for wages after work has been performed. If either of these occurs with foreknowledge by the municipality's managers or governing body, normal governmental immunity for official acts may not protect such officials from personal liability. This issue becomes important with respect to the timing of a bankruptcy filing, as will be seen below.

Acknowledgement by Stakeholders

Once the municipality's management has identified and quantified the underlying fiscal problems, it must recognize that a key ingredient to solving them is to clearly and transparently communicate the nature and scope of the challenges to all potentially impacted stakeholders so that they are able to understand and acknowledge the problems. Managers and political leaders should insist on clear and open disclosure of the financial data and related facts, and they should make sure that stakeholders both receive all relevant information and have an opportunity to ask questions and offer solutions. All reasonable suggestions to solve the problems should be investigated and taken seriously.

The ins and outs of labor negotiations are far beyond the scope of this pamphlet, but if payroll costs or benefits are a key component of the municipality's fiscal stress, it will be necessary to engage labor law advisors and to assist resolving these problems. Outside a bankruptcy case, in most states labor laws applicable to public employee contracts place numerous restrictions on revising labor agreements, even if the agreements are pushing the municipality toward bankruptcy. However, if all parties realize that failure to modify extant agreements would likely land the municipality in bankruptcy court, all parties should be willing to work very hard to achieve consensual modification of burdensome agreements. Although bankruptcy may provide more flexibility in dealing with labor agreements, bankruptcy is not necessarily a "silver bullet" with respect to such matters, so every effort should be made to reach an agreement that provides a workable arrangement for the municipality prior to the decision to file.

Similarly, creditors such as banks, bondholders and credit enhancers may be willing to restructure long term debt in order to avoid forcing a municipality into bankruptcy. Attempts should be made to approach these stakeholders with clear and transparent information in order to reach some accommodation.

Often an intermediate step in such a restructuring is a forbearance agreement under which the creditors agree not to declare a default and/or take remedial action against the municipality for a specified period of time while the parties attempt to reach a negotiated settlement.

Finally, the officers and governing body of the ailing municipality must make the hard decisions about ongoing projects and programs that may have to be postponed, scaled back or cancelled in order to free up cash. These are often painful political choices, but the looming possibility of a bankruptcy filing can serve as a catalyst to reach consensus on these difficult issues.

CHAPTER TWO

Advantages and Disadvantages of a Chapter 9 Filing

There are many misconceptions about the utility of a bankruptcy filing in addressing extreme financial problems for municipalities. While bankruptcy clearly provides certain benefits for municipalities that cannot otherwise solve their fiscal problems, it is no panacea and comes with some significant downsides.

Advantages

Protection. One of the most important and immediate advantages of a bankruptcy filing is the protection against actions that might be taken by creditors or others against the municipality, its officers, elected officials, employees and even its inhabitants. Filing a bankruptcy petition invokes an automatic stay—basically a federal court injunction—against any action that could otherwise be taken against the municipality (which becomes the debtor upon the filing of the bankruptcy case) or its officers or employees. Unlike a bankruptcy involving a private entity, in chapter 9, the automatic stay extends to elected officials and to all inhabitants of the jurisdiction of the debtor municipality. This means that even if the municipality or other protected persons take or omit to take actions related to claims against the municipality that would otherwise subject them to sanctions or liability in state or federal court, or to actions by regulatory bodies, those actions may not proceed without the claimants first obtaining the permission of the bankruptcy court. The

“... the automatic stay extends to elected officials and to all inhabitants of the jurisdiction of the debtor municipality.”

stay lasts during the pendency of the chapter 9 case, but the bankruptcy judge retains the right to modify or terminate the stay for cause shown.

Breathing Space. Bankruptcy gives the debtor breathing space in which to function while it tries to work out its creditor and cash flow problems. Raising new revenues, renegotiating contracts and restructuring debt obligations takes time. If a municipality is forced to breach contracts or face other legal claims caused by fiscal stress outside of bankruptcy, it may have to spend time fighting off creditors trying to seize assets or collateral, or be forced into regulatory or other state fora to answer for such actions and redress grievances before it is able to fashion a workable solution for the benefit of all creditors and residents. The bankruptcy case allows all of these disputes to be addressed in one forum, and the automatic stay provides the municipality the opportunity to focus on a comprehensive solution rather than simultaneously fighting multiple brushfires.

Access to an Expert Arbiter. An often underestimated advantage of a bankruptcy filing is found behind the bench of the bankruptcy courts. Bankruptcy judges are experts in financial restructuring, negotiations and arbitrating complex debtor/creditor and intercreditor disputes. While chapter 9 filings may be rare, bankruptcy judges see similar issues in the private sector day in and day out, and generally are very well equipped by dint of knowledge and temperament to help the parties arrive at workable compromises. Furthermore, because of the unique system of assigning bankruptcy judges to chapter 9 cases, it is very likely that a chapter 9 case will be assigned to one of the most qualified and experienced judges within the applicable federal circuit. The value of a highly qualified and experienced judge in helping the stakeholders get to a solution should not be underestimated.

Ability to Adjust Obligations. Most people see the ability to adjust debts and other obligations as the prime benefit of a bankruptcy filing. If a plan of adjustment can be confirmed in a chapter 9 case, it may provide that unpaid claims of creditors be either reduced (paid in “tiny bankruptcy dollars”) and/or extended and restructured. There are limitations on how these adjustments can be made, and it may be possible for creditors to block a debtor from making

the adjustments they would like (or feel that it needs) to make. Nevertheless, in situations where it is not possible to fully repay all creditors absent some sort of debt relief, the plan of adjustment can provide a fresh start and the ability to achieve long-term financial stability for the municipality by deferring and/or reducing past obligations.

Disadvantages

Credit Markets Reaction. Municipalities that seek bankruptcy relief (and even those that seriously consider filing) should expect the immediate suspension and/or downgrade of their credit ratings. Particularly if bondholders are not fully repaid, this credit stigma may last for many years. However, it is certainly possible, as was seen with Orange County, that the municipality may emerge from bankruptcy and have its credit standing restored to robust levels within only a few years.

Municipalities contemplating bankruptcy should expect intense scrutiny from their capital markets creditors and rating agencies. One of the best things a municipality can do to position itself to get its credit ratings restored is to be able to provide timely and transparent information about its financial condition to the capital markets and rating agencies. Establishing a track record of providing trustworthy information, even if it is not favorable information, is an absolute necessity if a municipality expects to emerge from bankruptcy and get back on its feet in the credit markets. This effort takes time and resources from the municipality's finance staff at a time when the staff will be under tremendous stress. Municipalities must take this burden into account when they contemplate a filing.

“Establishing a track record of providing trustworthy information, even if it is not favorable information, is an absolute necessity if a municipality expects to emerge from bankruptcy and get back on its feet in the credit markets.”

Cost and Distraction. Filing and pursuing a chapter 9 case is very expensive. Legal and financial consulting fees can easily range into seven figures (or even more for very large and complex entities). Every dollar spent on these costs is a dollar that cannot go toward solving the underlying financial problem. It is therefore in the interest of all stakeholders to realize that unless they can come to a negotiated settlement that avoids bankruptcy, these costs ultimately will consume funds that otherwise could be more productively used.

Another component of cost is the opportunity cost that will be expended by taking valuable senior staff time away from solving core problems and directing it to managing and responding to the demands of the case itself. Most municipalities that take the drastic step of filing a bankruptcy petition already will have cut staff to the bone in order to try to avoid insolvency. The distraction of dealing with a bankruptcy case - preparing for and attending hearings and depositions, responding to endless requests for information and documents from creditors, rating agencies, collective bargaining units, elected officials and the public - can be a major distraction from the core work the staff must do to keep the organization functioning. A municipality contemplating a bankruptcy filing should have a clear plan regarding how to address these issues going in, lest the demands of the case simply overwhelm the ability of the organization to function.

Stigma on the Community. Bankruptcy likely will be viewed by citizens, workers, and creditors as a stigma, and that perception can affect the self-esteem of the citizens and have an adverse impact on the overall business climate in the community. New businesses may be reluctant to locate in the community, real estate sales may be affected, and general economic conditions may be depressed. This stigma could linger for a period of time after the municipality emerges from the bankruptcy in the legal sense. Of course, the bankruptcy filing is not the cause of the municipality's problems, but rather the result of not being able to solve them any other way. It is the underlying financial health of the municipality, including its ability to deliver services and promote a strong community, that really matters.

CHAPTER THREE

Preparing for Chapter 9

The Importance of Negotiations

It is crucial that, once the magnitude of a financial crisis is established, thorough negotiations be undertaken with creditors and stakeholders to avoid insolvency. In fact, such negotiations, undertaken in good faith, are a legal prerequisite to filing a chapter 9 case. Even if the municipality already has determined that it likely will be forced to file for bankruptcy protection, it should continue to try to negotiate with key creditors to avoid that result, and should carefully document what steps are taken to reach agreement. It is not necessary that a municipality accept a short term fix that only briefly defers an inevitable meltdown. But if such a fix is offered, the municipality must analyze it carefully and make sure it can prove that in fact it will not solve the municipality's problems sufficiently to avoid both short-term and long-term insolvency. For example, it makes no sense to renegotiate a long-term debt obligation by deferring interest or other payments for a year if, on the first anniversary of the deferral, the municipality will be unable to satisfy the revised obligation absent something akin to divine intervention. Similarly, a municipality should not accept one-time concessions from labor that would avoid insolvency in the short term but extend unsustainable labor agreements by one or more years such that insolvency is inevitable and the deficit facing the municipality will be even deeper as a result of the extension.

Authorization to File

A municipality may not validly file a chapter 9 petition unless the governing body of the municipality specifically authorizes the filing. Local law determines what form this authorization must take, but the typical approach would be by resolution adopted by the governing board in an open meeting. In many states, while

discussions with counsel leading up to and after a filing usually are conducted in closed or executive sessions under the litigation exception to most open meeting laws, the actual vote on whether or not to file typically must take place in an open meeting, or at least be reported out immediately after the vote in an open meeting.

Authorization could take the form of an immediate direction to file, or a delegation to the executive officer of the municipality to file in the event that certain conditions are not satisfied (such as approval by creditors or bargaining units of offers made by the municipality pursuant to authorizations from the governing body).

Taking a vote to file a bankruptcy petition is obviously a momentous step; the municipality should expect significant public and media attention, and should be prepared to respond fully and accurately to inquiries, providing relevant details and information regarding the process. While media strategy is beyond the scope of this pamphlet, municipalities should carefully consider how they will provide timely responses to media inquiries, and should have a clear plan in place including identification of one or more spokespersons. Also, legal counsel should be consulted about public statements and press releases so as not to inadvertently waive important privileges concerning confidential negotiations and strategy.

Federal Securities Law Considerations

If the municipality has any outstanding publicly-traded securities, counsel should be consulted regarding its obligations under the federal securities laws with respect to the bankruptcy filing and other material events. Securities issued after July of 1995 are generally covered by Securities Exchange Commission (“SEC”) Rule 15c2-12, which requires both annual and material event disclosure to be made by the issuing municipality. Filing for bankruptcy protection is a material event that triggers disclosure. It is possible (even likely) that leading up to the bankruptcy filing, deteriorating finances and public discussion of the potential for insolvency will trigger rating agency actions, which may constitute material events as well.

Any statement to the market by an issuer, such as a material event notice, must satisfy Rule 10b-5 promulgated by the SEC. Rule 10b-5 requires that information provided to the public intended to be a statement to the securities market may

not misstate a material fact nor omit to state a material fact necessary, in light of the circumstances, to make the statements made not misleading. The omission portion of the rule is most difficult with which to comply. In general, saying that a credit rating has been downgraded or that a bankruptcy petition has been filed by itself will not be enough. Experienced counsel should be consulted to assist in crafting a public statement that provides the relevant facts and materials in order to satisfy the broader standard of Rule

10b-5. Establishing a pattern of complete and accurate information dissemination to the market will be important in helping a municipality reestablish a good credit rating after it emerges from bankruptcy. Bad news is made worse by late discovery, much more so if it appears that suppression or obfuscation was involved.

“Bad news is made worse by late discovery, much more so if it appears that suppression or obfuscation was involved.”

Timing

As noted earlier, it is important to monitor the municipality’s cash position in the period leading up to a potential bankruptcy filing so as not to knowingly violate the law—for example by permitting employees to work when the municipality lacks the ability to pay them, disregarding legal restrictions on special funds, or entering into essential contracts knowing that there will be a lack of sufficient funds to meet the contract terms. Having an idea of when this crossover point may occur is crucial in determining when a petition must be filed in order to protect the municipality and its officers. While there will be tremendous pressure from many quarters to delay the ultimate step of filing a chapter 9 petition until the last possible moment, it is prudent to leave at least some room between the time management would be compelled to shut the doors of the municipality and the date of filing the petition. The precise amount of time will depend on the circumstances of that particular municipality, but in general, 60 to 90 days would be a prudent period. The reason for this is to allow the court time to conduct an orderly process of considering the petition and any objections to it before drastic actions that potentially affect public health and safety (such as forced furloughs of essential service personnel) must be taken.

Dealing With Vendors and Trade Creditors

Most local government agencies have significant commercial relationships with vendors and trade creditors of various types, such as specialized service providers and suppliers. A municipality preparing to file a chapter 9 petition should expect that these providers will stop extending credit to the municipality in the form of delayed billing arrangements once news of the filing becomes public. It is likely that they will require COD or prepayment terms for future transactions and the municipality should be prepared to implement these arrangements for critical services and supplies. Moreover, payments made within 90 days of the filing of the bankruptcy case on account of prior unpaid invoices may be recoverable as preferences, so in order to protect favored vendors that have not put it on COD terms, the municipality should pay them during the normal payment cycle rather than to fall behind and then make catch-up payments. Unlike in chapter 11, though, payments on account of a note or bond are not avoidable as preferences.

CHAPTER FOUR

Seeking Bankruptcy Protection

Pre-Filing Requirements

In order to be eligible for relief under chapter 9, an entity must meet certain threshold requirements:

1. The entity must be a municipality within the meaning of the Bankruptcy Code. The definition of municipality in the Bankruptcy Code is quite broad, and includes cities, counties and other instrumentalities of the state. It does not include states themselves. Section 109(c) defines municipality to mean *“a political subdivision or public municipality or instrumentality of a state.”*
2. Applicable state law also must authorize municipalities to seek chapter 9 protection. In some states, such as California, there is a very broad statute that grants blanket filing authority to all California municipalities. However, many states limit which entities can file and under what circumstances, or require special approval of state authorities to permit a filing. For example, in Connecticut, the governor must approve all chapter 9 filings. Twenty-six states prohibit chapter 9 filings. A municipality in those states in need of bankruptcy relief must seek enactment of a specific statute particular to it authorizing the filing. It goes without saying that floundering municipality faces an uphill battle in such states.

3. The municipality must be insolvent as defined in the Bankruptcy Code, which means that the municipality either must not be paying its undisputed debts as they come due at the time of filing, or be unable to pay such debts when they become due in the near future. The latter test is a prospective, but must be based on a projection of the current or immediately ensuing fiscal year. A projection that the municipality will not be able to meet its obligations in subsequent years is not sufficient to establish insolvency.
4. The municipality must “desire to effect a plan to adjust its debts.” It is important to note that the plan of adjustment does not have to be in existence as a precondition to filing, but there must be evidence that the municipality wants to effect a plan through the vehicle of the bankruptcy case.
5. The municipality must demonstrate that it has attempted to avoid the filing or that the filing was necessary by proving one of the following:
 - a. 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, or
 - b. It has negotiated in good faith and is unable to reach such an agreement, or
 - c. Negotiations are impracticable (for example, because there are a multitude of claimants and no practical way to negotiate with all of them individually or to identify a representative with authority to negotiate), or
 - d. A creditor is attempting to gain a preference (basically a payment that would unfairly disadvantage other creditors because it disproportionately favors the creditor that seeks to receive the payment).

Assignment of the Bankruptcy Judge

In all other types of bankruptcy cases (such as chapter 11 cases), the bankruptcy judge is assigned by lot to each case as it is filed. Due to the importance and rarity of municipal bankruptcies, and due to the powers reserved to the states under the Tenth Amendment to the United States Constitution, the Bankruptcy Code provides that the Chief Judge of the Circuit in which the case is filed has the task of assigning a judge to each chapter 9 case. While it is probably likely that a judge

from the District in which the case is filed will be assigned, the Chief Judge could assign any bankruptcy judge in the Circuit to hear the case. This is an important feature because it means it is very likely that a chapter 9 case will be assigned to a highly competent and very experienced judge, which is good for all parties. Moreover, the Chief Judge will consider whether a judge who resides in or near the debtor municipality ought to play a role in the case filed by that municipality.

Bankruptcy judges, unlike judges of the U.S. Supreme Court, the various Circuit Courts of Appeal and the numerous U.S. District Courts, serve pursuant to Article I of the United States Constitution, for terms of 14 years. Any party to a chapter 9 case has the right to petition the federal District Court to remove the case to the District Court so that it can be heard by a District Court judge, who serves under Article III of the United States Constitution and is appointed for a lifetime term. It is up to the District Court to decide whether or not to take the case away from the bankruptcy court or to leave it there. In either case, all rulings by the bankruptcy court are appealable to the Article III court system.

CHAPTER FIVE

The Tenth Amendment and Limitations on the Role of the Court

Tenth Amendment Limitations

The Tenth Amendment to the United States Constitution reserves certain powers to the states regarding the management of their internal affairs. In chapter 11 cases (which municipalities are ineligible to file), the bankruptcy judge wields significant power to control what the debtor may and may not do during the course of the case. For example, without court approval, any proposed action by the debtor outside the ordinary course of business must be approved by the court after creditors and other parties in interest have been provided with the time and the opportunity to object. Nor may the debtor borrow funds outside of the ordinary course of business, grant collateral for a new loan or settle a significant claim against it absent court approval. However, in light of the Tenth Amendment and provisions of the Bankruptcy Code that implement it, the court plays a significantly more limited role in a chapter 9 case, and state law restrictions on the activities of municipalities and their uses of funds must continue to be observed.

Thus, for example, the court cannot take over the operation of the municipality, remove governing board members, direct the actions of the governing board or appoint a receiver or trustee to run the affairs of the municipality. Similarly, the court cannot permit the municipality to override state laws such as those requiring voter approval for new taxes, or limiting the use of restricted funds for particular purposes. Obviously, the court lacks the power to require the sale or lease of a park or a sewage facility in order to satisfy the municipality's obligations to creditors.

One important effect of the Tenth Amendment on municipal bankruptcies, distinguishing them from nongovernmental entity bankruptcies, is that there can be no forced liquidation of a municipality under the Bankruptcy Code. If a private firm files for bankruptcy under chapter 11 seeking to reorganize and thus continue

*“... the court cannot
‘take over’ the
operation of the
municipality...”*

to operate, but it fails to achieve that objective, the case likely will be converted to a liquidation case under chapter 7 of the Bankruptcy Code. In chapter 7, a trustee is appointed, and is charged with liquidating all assets for the benefit of creditors, who go away with whatever share they can receive. Assets are sold or foreclosed upon, the

entity no longer operates, and it ceases to conduct business. For obvious practical reasons, and due to the Tenth Amendment’s limitations on the powers of the federal courts, there is no chapter 7 analogue for municipalities other than those that may be provided by applicable state law outside of the bankruptcy court system. Thus, if the chapter 9 case fails to produce a plan of adjustment allowing the municipality to exit bankruptcy, the case is dismissed and the municipality continues to exist with all of its problems and claims as it did before bankruptcy, with whatever remedies are available to the municipality and its creditors under state law.⁴

Role of the Bankruptcy Judge

The primary responsibilities of the bankruptcy judge are to approve or disapprove the bankruptcy petition by determining eligibility, to oversee the assumption or rejection of executory contracts and unexpired leases, to decide avoidable transfer actions (i.e., preferences and fraudulent transfers) and to confirm or decline to confirm a plan of adjustment. The municipality may consent to the judge’s exercise of jurisdiction in many of the more traditional areas of bankruptcy court oversight in bankruptcy in order to obtain the protection of court orders and eliminate the need for multiple fora to decide issues. Indeed, these latter features reflect some of the benefits of filing for bankruptcy in the first place.

Despite this limited role, the judge in a chapter 9 case does exert considerable influence over the parties and can be a very helpful neutral arbiter of difficult disputes. While, as described below, the only real “hammer” the judge ultimately has is to dismiss the case and throw the municipality out of court, the judge nevertheless is likely to be very helpful in bringing the parties to the point where a plan can be approved.

⁴ The rules governing the ability of municipalities to disincorporate or otherwise be dissolved vary greatly by jurisdiction and type of entity and are beyond the scope of this pamphlet.

CHAPTER SIX

The Chapter 9 Case

The following sections discuss specific aspects of filing and prosecuting the chapter 9 case important to municipalities.

Initiating the Chapter 9 Case

In addition to filing the chapter 9 petition itself, the municipality must file a number of pleadings in order to initiate the bankruptcy case. These include the following:

Creditors List—This is a list of all persons who may assert a claim against the municipality. The Bankruptcy Code defines the term “claim” very broadly, and the municipality should include each and every person that may assert a claim, even if the municipality believes that a given claim is specious.

List of Creditors Holding the 20 Largest Unsecured Claims—This list contains more detail than the general list of creditors, including the requirement that contact persons and phone numbers be listed. The list is used by the United States Trustee to solicit creditors to join an official committee or committees.⁵

Pleadings Establishing Eligibility—The Bankruptcy Code contains a number of eligibility requirements, and the municipality must prove that it satisfies each one. It does so by submitting a pleading and declarations. If the municipality

⁵ The Office of the United States Trustee is an arm of the United States Department of Justice, and the various regional offices assist the court system in administering bankruptcy cases. The U.S. Trustee’s role in a chapter 9 case is much more limited than it is in cases under chapters 7 or 11.

anticipates that one or more creditors or parties in interest will object to the claim of eligibility, the pleadings and declarations will need to be more extensive than in a case where eligibility is unquestioned.

Notice by Publication—The municipality must publish a notice once a week for three weeks in a local newspaper and in a national publication read by bondholders. The notice must provide details about the filing of the chapter 9 case and provide the date by which objections to eligibility must be filed. The form of notice and the eligibility objection date must be approved by the bankruptcy judge in advance of publication.

Official Committees

Following the entry of the order for relief—in other words, after the court determines that the municipality is eligible to be a chapter 9 debtor—the United States Trustee for the relevant district may appoint a committee or committees to represent the interests of creditors holding similar classes of claims. In the Vallejo case, for example, there is one committee, and it represents the interests of retirees. Unlike in the case of a chapter 11 debtor, a municipality is not obligated to fund the costs of counsel to such a committee, but prudence may dictate that the municipality should pay reasonable costs because an informed and organized creditor body will expedite the resolution of the case.

Effect on Litigation

The automatic stay that becomes effective the moment the chapter 9 petition is filed serves to enjoin litigation against the debtor, its officers and its inhabitants. The stay also prevents all other forms of creditor enforcement remedies such as seeking a judgment lien or foreclosing on an asset (other than special revenues, as described below). The stay continues throughout the chapter 9 case, although a claimant may seek permission to terminate or modify the stay by filing pleadings that attempt to convince the bankruptcy judge that cause exists for the litigation to proceed in court or for an enforcement action to resume.

Assumption and Rejection of Contracts and Leases

The Bankruptcy Code provides a chapter 9 debtor with the ability to assume its favorable contracts and real and personal property leases and to reject its burdensome ones. Neither is automatic, though. To assume a contract or lease, absent consent by the nondebtor party, the municipality must cure all monetary defaults and provide adequate assurance that it will be able to perform under the agreement in the future. So-called *ipso facto* clauses in contracts or leases (which provide that the contract or lease terminates on account of a bankruptcy filing by one of the parties) are not enforceable in a chapter 9 case or any other bankruptcy case. In the event a lease or contract is rejected, the nondebtor party will have a general unsecured claim against

the municipality for the damages it has suffered on account of the rejection of the agreement. The damage claim will have to be addressed in the plan of adjustment along with the other general unsecured claims against the municipality.

Collective bargaining agreements are subject to assumption and rejection as well. However, due to the importance and the widespread impact rejection of a collective bargaining agreement could have, the U.S. Supreme Court has placed extra burdens on debtors seeking to reject such agreements. These include mandating that the bankruptcy court balance the hardships employees would suffer as a result of rejection of the agreements against the benefits to the municipality for rejecting those agreements. The court also must conclude that the municipality employed reasonable efforts to resolve contract issues short of rejection, and that a prompt resolution would not be forthcoming. A special Bankruptcy Code provision makes it even more difficult to reject a collective bargaining agreement in a chapter 11 case, but Congress has chosen not to extend the sweep of that provision to chapter 9 cases.

“...due to the importance and the widespread impact rejection of a collective bargaining agreement could invariably have, the U.S. Supreme Court has placed extra burdens on debtors seeking to reject such agreements.”

Special Revenues

Many agencies have separate governmental enterprises that are owned and operated by the municipality but are not separate legal entities. For example a city may own and operate a system that provides potable water to its inhabitants and businesses. Typically, such systems are treated as separate accounting units and are paid for from revenues received from the users of the system in the form of fees and charges for service. Often, new users that desire to connect to the system and receive service must pay a capital charge or assessment to contribute their share of the capital cost of the system. These systems often are financed through debt obligations secured by a pledge of a lien on the system revenues, and the capital, operations and maintenance costs of the system are similarly supported only by the system revenues. In most cases, this is the sole source of security and payment for the obligations of the system, but in some cases, the municipality also is obligated to pay such amounts from the general fund if revenues are insufficient.

The Bankruptcy Code treats the revenues of such a system that are pledged to the payment of debt obligations as “special revenues” and provides that those special revenues may not be diverted to pay the debts of the municipality that are unrelated to the system or enterprise that generated them. As noted above, in many jurisdictions, this also is the result under state law, which restricts the use of such revenues to the enterprise itself. Notwithstanding the automatic stay, which prohibits certain post-bankruptcy actions by creditors, the automatic stay in chapter 9 permits the holder of a lien on special revenues to apply such revenues to the obligation secured by the lien. Obligations payable from special revenues are treated as secured obligations for bankruptcy purposes, and as such the plan of adjustment may not impair those obligations at least to the extent they can be paid from the special revenues (but, for example, if the special revenues are insufficient, the municipality’s obligation to pay from general revenues, if any, could be impaired by the plan).

Another class of special revenues obligations is special assessment or special tax financing, which is commonly used to construct infrastructure to serve new development or to improve infrastructure of special benefit to the assessed property. In these situations, the special assessments or taxes levied and pledged to support the bonds issued to provide such financing are treated as special

revenues and cannot be invaded to pay other obligations of the municipality in bankruptcy. This is also generally consistent with most state laws restricting the use of these types of revenues solely to the purposes for which the assessment or tax was levied.

Financing Leases

In many states, municipal agencies use lease financing for capital projects and equipment. Although styled as leases (usually to avoid limitations on debt under state statutory or constitutional provisions), these instruments typically bear tax-exempt interest to the investors who fund the projects or equipment (which requires that they be treated as debt for federal tax purposes), and are also treated as debt for accounting purposes. Although the matter is not entirely free from doubt and will depend on the facts and circumstances of each case, these instruments should in general be treated as debt obligations under the Bankruptcy Code and not as true leases. The significance of such characterization might be that the municipality would not be required to assume or reject the lease within a relatively short period of time after the court's acceptance of the chapter 9 petition, and that the creditor (lessor) might be unable to evict the municipality from the "leased" property (or to require return of the "leased" equipment) in the event of a payment default.

CHAPTER SEVEN

Emerging From Bankruptcy

Dismissal of the Case

The bankruptcy court may dismiss the chapter 9 case for cause, including unreasonable delay by the debtor or denial of confirmation of a plan of adjustment. Conversely, the case may be voluntarily dismissed by the municipality, as the bankruptcy judge cannot force it to remain in bankruptcy against its will due to Tenth Amendment considerations. Thus, if the municipality and its key creditors (such as indenture trustees, major vendors and unions) reach agreements during the case and such agreements are binding on the parties under applicable nonbankruptcy law, the municipality can and should dismiss the case not only because confirming a plan of adjustment is no longer necessary, and also because there is no need to incur the significant cost and delay of drafting, confirming and consummating a plan of adjustment.

The Plan of Adjustment

A Good Plan Is the Product of Negotiation Among All Constituencies.

A plan of adjustment, like a chapter 11 plan of reorganization, is little more than a contract among various parties that provides for the treatment of the various claims against the municipality. One of the benefits of chapters 9 and 11, other than preserving assets by way of the automatic stay during the negotiation period, is that the bankruptcy court has the power to approve a plan over the objection of dissenting creditors so long as the requisite majorities of creditors holding similar claims have approved the plan and so long as the plan does not discriminate among holders of similar claims. As described above, the municipality is not eligible for chapter 9 unless it has, among other things, negotiated with its creditors prior to filing the case in an attempt to

“One of the benefits of chapters 9 and 11, other than preserving assets by way of the automatic stay during the negotiation period, is that the bankruptcy court has the power to approve a plan over the objection of dissenting creditors...”

avoid the need for a filing. Once the case is filed, the negotiations should resume as soon as possible with the goal of either reaching agreement and dismissing the case or reaching agreement with the requisite majorities and confirming a plan of adjustment. Unfortunately, if a creditor (or creditors) mount an eligibility challenge, there is less room for negotiation during the several month period that will be devoted to determining whether the debtor is eligible for chapter 9 relief.

The Role of Committees in the Plan Process.

Committees serve and speak for all similarly situated creditors, and the members of and professionals employed by a committee have a fiduciary duty to the class they represent. An energetic and informed committee, particularly one that is both proactive and constructive during the process of negotiating a plan of adjustment, will be beneficial for all parties to the bankruptcy case.

The Role of the Court in Approval of the Plan of Adjustment.

The bankruptcy court must confirm the plan of adjustment if it finds that the various chapter 9 confirmation requirements have been satisfied. These include, among others,

that at least one class of impaired creditors has voted to accept the plan; that post-bankruptcy claims will be paid in full on the plan’s effective date (unless an impacted creditor agrees to different treatment); that any necessary approval by regulators or voters (in the case of most tax increases) has been obtained; and that creditors will receive as much under the plan as they would were the case dismissed. Broadly stated, the court should find that the debtor municipality has used all reasonable efforts to pay its creditors

as much and as quickly as possible, recognizing that application of state law (such as tax limitation initiatives or other restrictions) may dramatically limit the ability of municipality to raise revenues. The court also must find that the plan is feasible, which means that the municipality will not need further reorganization or another chapter 9 case in the near future.

Failure to Approve a Plan of Adjustment. If the plan of adjustment is not confirmed either by consent or by a court order binding non-consenting creditors (often referred to in bankruptcy parlance as a “cramdown”), the bankruptcy judge has the discretion to send the parties back to the drawing board to craft a better plan, or to simply can dismiss the chapter 9 case. Due to the Tenth Amendment and the applicable Bankruptcy Code provisions, the judge has no ability to craft a plan of adjustment and compel the municipality to accept it. Dismissal of the case, of course, is a nightmare scenario because the municipality, which the judge earlier concluded (during the eligibility phase of the case) was unable to pay its debts, is now out of court, without the protection of the automatic stay, and is still unable to pay its debts. Such a result benefits neither the municipality nor its residents nor its creditors, and should provide a compelling incentive for the parties to the chapter 9 case to reach agreement on a plan of adjustment.

CHAPTER EIGHT

Yes, There Is Life After Bankruptcy

Capital Markets Issues

As should be expected, the capital markets will punish a municipality for having become insolvent. The degree and length of that punishment will depend in large part on several factors:

- The degree to which capital market debt holders and guarantors are made whole
- The strength and viability of the negotiated settlement or plan of adjustment
- The degree of cooperation and “buy in” among stakeholders
- Whether voters and/or elected officials have contributed to the settlement or plan by approving new taxes, fees or other revenue sources
- Whether the municipality can demonstrate that it has stable and effective management in place
- How well the municipality communicates with the market and the timeliness and transparency of the financial information presented
- How well the settlement or plan of adjustment is implemented and monitored

While it is unavoidable that access to the capital markets after a bankruptcy will be more expensive and limited than it normally would be, it is not certain that the fact of a bankruptcy will be a permanent or even a very long term problem. Focus on the factors listed above will help municipalities mitigate the adverse effects of a bankruptcy and emerge stronger and in a better financial position than before they filed the case.

Avoiding a “chapter 18”

When a private company successfully navigates through a chapter 11 case with a confirmed plan of reorganization, but either cannot perform its obligations under the plan or the plan is flawed because it failed to adequately resolve all of the

company's financial problems, the company may be forced back into bankruptcy court to seek yet another reorganization. This is euphemistically referred to as seeking "chapter 22" relief; several commercial airlines have taken this route. If this were to happen to a municipality after a chapter 9 case, we assume that the second round would be deemed a "chapter 18" case. However, given the cost, disruption and pain of going through a bankruptcy case, chapter 18 is to be avoided at all costs. Also, and particularly if the need for new bankruptcy relief occurs soon after the completion of the original case, the bankruptcy court may be very skeptical of the municipality's eligibility to file again (remember, that one of the criteria is that the municipality "desires to effect a plan of adjustment").

Avoidance of a "chapter 18" scenario will be best achieved by driving the hard bargains required to achieve a settlement or plan of adjustment that not only works, but that can weather contingencies and uncertainties. The successful arrangement must:

- Provide for adequate rainy day reserves
- Leave the municipality with flexibility to adjust costs and service levels to account for future unforeseen downturns
- Limit exposure to undue risks in the debt markets (by for example, relying on too much variable rate debt without appropriate hedges or cushions against rising rates)
- Avoid reliance on uncertain future revenue streams, particularly if they require voter approval or are otherwise outside the control of the municipality
- Be supported by a consensus of at least a majority of the affected stakeholders, and backed by a meaningful commitment to implement the plan

Finally, the municipality's management and governing board must have the discipline to stick to any settlement or plan and make it work. Remember that the bankruptcy court has limited oversight powers due to the Tenth Amendment. It may be tempting in light of the heartfelt and legitimate desires of the citizens and the politicians who represent them to spend more or tax less than the plan contemplates. Perhaps a review of the costs of going through the first bankruptcy—in money, time, energy and reputation—would be warranted if such temptations arise.

CHAPTER NINE

Conclusion

For the overwhelming majority of municipalities, even severe economic downturns such as the one currently being experienced will not result in the filing of a petition under chapter 9 of the Bankruptcy Code. Municipalities feeling financial stress should work as hard as possible, accepting as much pain as they and their constituents, creditors and employees can endure, to avoid that path. However, for some municipalities, the challenges will be too great, the avenues of solution too limited, and the window of opportunity for corrective action too small, to avoid using chapter 9 as a tool to help right the ship. For those entrusted to manage and govern municipalities, we hope this pamphlet provides some initial guidance and promotes a disciplined and thoughtful approach to avoiding or using chapter 9 in times of fiscal stress.

About the Authors

John H. Knox, a partner in the San Francisco office of Orrick, Herrington & Sutcliffe LLP, is a member of the firm's Public Finance Department. Mr. Knox has been involved in several municipal workout situations, representing the City of Vallejo, California, in its chapter 9 bankruptcy case, the City of Richmond, California, in a successful financial restructuring that allowed it to emerge from a near-bankruptcy situation to become a solid "A" rated credit, and the City of Half Moon Bay, California, in connection with a very large judgment that threatened to bankrupt it. His bond practice focuses on local governmental infrastructure financing, primarily for cities and counties, including general fund financings, pension bonds, special assessment and other land-secured financings, redevelopment tax increment financings, enterprise revenue bonds, municipal lease transactions and general obligation bonds. He also has been involved in creating various statewide financing programs, including financings for governmental receivables, infrastructure and development impact fees. He also assists nonprofit institutions, including colleges, universities, and private K-12 schools with tax-exempt financings.

Marc A. Levinson, a partner in the Sacramento office of Orrick, Herrington & Sutcliffe LLP, is a member of the firm's Restructuring Group. Mr. Levinson is nationally recognized for his capabilities in complex reorganizations and restructurings, out-of-court workouts and other insolvency matters. Mr. Levinson is the lead insolvency lawyer on the Orrick team that filed a chapter 9 case for the City of Vallejo—the largest California city to seek bankruptcy relief. The case has generated cutting edge legal issues, as well as litigation over a number of hotly-contested factual issues, including those relating to the City's insolvency and its eligibility to be a chapter 9 debtor. Mr. Levinson is a conferee of the National Bankruptcy Conference and a member of the Board of Directors of the American College of Bankruptcy, and he is a frequent speaker on bankruptcy topics.

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EXHIBIT I

Nearly Bankrupt Stockton Has \$7 Million In Uncollected Parking Tickets

June 6, 2012 11:51 PM

Reporting [Laura Cole](#)

STOCKTON (CBS13) – We hate getting parking tickets but if you don't pay the meter you have to pay the fine.

Now, as high as it sounds, the city of Stockton has \$7 million worth of unpaid tickets they just never collected.

The issue was exposed at Tuesday night's city council meeting and the \$7 million figure seems to be shocking more than just the public.

The jaw-dropping number even caught the mayor off guard. And, with the city facing a \$26 million deficit, that \$7 million is just the beginning of their unpaid debts. There's still another \$13 million in other assets the city never collected.

"We could certainly use that \$7 million dollars," said Stockton Vice Mayor Kathy Miller.

Miller says the fines were issued, but no department ever followed up to see if they were paid.

"The more important issue for this council is figuring out where was the breakdown in the process," said Miller. "Why was a fine levied by parking or the police department and then there was no follow-up on it?"

But collecting the money now is not that easy. The \$7 million in fines dates back years.

"My guess is that a collection agency will be involved," said Miller. "But a collection agency will take a percentage of whatever they collect."

So Stockton won't see much of that \$7 million.

This multi-million dollar mistake is just the latest blunder in a city on the brink of bankruptcy, where people are becoming all too accustomed to hearing.

So now city leaders say they're figuring out the next step and how to make sure parking tickets get paid in the future.

EXHIBIT J

Michael Fitzgerald

STOCKTON SHOULD CONSIDER SELLING SOME OF ITS REAL ESTATE BONANZA

By Michael Fitzgerald
May 16, 2010
Record Columnist

Question: If the city of Stockton is so broke, what with its \$23 million budget agony, why doesn't it sell something? That's what regular folks do.

The city owns almost 600 pieces of property. I know because I did a Public Records Act request on them. And some of this property will surprise you.

Oh, sure, most are predictable: City Hall, parks, firehouses. But some things on the city's Monopoly board make you wonder why on earth they own them.

Such as cattle grazing land. The city owns "over 100" acres of cow country around New Hogan Reservoir in Calaveras County. Why this foray into Marlboro Country?

As best I can determine, when the city replaced old Hogan Dam with New Hogan Dam in 1964, it had to buy land to accommodate the expanded reservoir.

Some parcels included more land than necessary for the basin. The city rented the grassland above water to ranchers.

It's not clear why the city keeps these wide open spaces. Perhaps it finds them difficult to sell unimproved.

It seems equally possible the city is playing "Bonanza" up there because hardly anybody in City Hall even knows the city owns it, and neither do potential buyers.

"I just have not been given direction to go ahead and sell the property," said Joe Mulligan, the city's supervising real property agent. "That would come from the powers that be above me."

Within city limits, the city owns numerous vacant residential lots. Two on Amber Lane near Hammer Lane are typical.

A single-family home used to stand on each. The city bought and demolished both homes, preparing to widen Hammer. Then funds ran dry. The project halted.

"They just told me they were going to widen the street, but they never did," said Susie Alacantara, who lives next to one vacant lot. "I don't like it, but what can I do?"

The city might sell off a few vacant residential lots, Mulligan said.

The city owns at least one house, a two-story family home at 314 N. Pilgrim St. Why?

The city funneled federal housing rehab money to the owner. But she died. Disinterested heirs let the home go into foreclosure. The city wound up with it.

Why not sell it? Like the pack rats on the TV show "Hoarders," who cannot bear to part with their stuff, the city has an excuse for keeping this, too.

"Internally, we might be able to use it," Mulligan said. "All I've been told is that some folks are looking into it, and they'll get back to me."

At 139 S. Center St., in front of the Greyhound bus station, the city owns a prime piece of commercial real estate on one of Stockton's busiest streets.

Alas, there's no money to redevelop it. It sits idle.

Another curiosity is the Philomathean Club. Learned ladies founded this club in 1893 to bring culture to the rough characters of pioneer Stockton.

The city bought the building in 2000 to preserve it. Plans to develop adjacent Philomathean land and actually generate some profit fell through, of course.

But the other part of the deal remains: Club members enjoy the legal right to meet in the Philomathean Club as long as membership remains above a minimum.

Any buyer inherits a gaggle of cultured ladies with the right to meet there in perpetuity. The city will never sell that building.

Scores of city properties are odds and ends: abandoned street-ends, park strips, half-blocks abutting highways, and medians such as the grassy center of Oxford Circle.

Other properties are utilitarian: detention basins, landfills, pump houses.

How about Firehouse 5? The Eighth Street building has languished vacant for years. OK, not entirely vacant. The old Victory Park totem pole is stored there.

Why not sell the building? Throw in the totem pole as a bonus.

Another oddity: Stockton has a spare City Hall.

Remember, in 2007 the city bought the 8-story Washington Mutual building, griping that old City Hall is cramped and leaky. They paid \$35 million.

But they never moved into it. Given the budget crunch, they want to spare moving costs.

Then why not sell the WaMu building? Because it was financed with bonds, said city spokesperson Connie Cochran, and the property value has come down.

"If we were able to sell that building today, and weren't able to get the full bond amount for it, we would still have debt," she explained. "It's not like a home mortgage."

Besides, the WaMu building is 40 percent full of tenants. They're paying the bond cost.

"Selling properties would provide a one-time infusion of cash and not relieve the structural budget issues that the City currently faces," Cochran said. Besides, "Today is not a good market to sell anything.

Sure, fixing "structural" money holes is better. And yes, the market is crummy. Still, sometimes you just need some extra dough to get through a bad year.

I mean, come on. Out of 600 properties, there must be something they can sell.

Not for any serious money, maintained Mulligan.

"What you end up with, it's not much," he shrugged. "Which is 99.9 percent of what you see on my list."

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EXHIBIT K

TO RESOLUTION 1

Exhibit 1

2012-13 Proposed Budget with Pendency Plan and Other Adjustments
General Fund - 010 by Program

	FY 2012-2013	FY 2012-2013 Pendency Plan Adjustments					FY 2012-2013
	Baseline	Service Reductions	Revenue Solutions	Debt Reductions	Other Funding Sources	Salary & Benefit Reductions	Proposed Budget
Revenues							
General Tax Revenues	\$ 135,279,867				\$ 300,000		\$135,579,867
Program Revenues	11,331,189		175,000				11,506,189
Interfund Reimbursements	7,532,129						7,532,129
Transfers In	772,220		64,308				836,528
	<u>154,915,405</u>	<u>-</u>	<u>239,308</u>	<u>-</u>	<u>300,000</u>	<u>-</u>	<u>155,454,713</u>
Expenditures							
<u>Programs</u>							
Police	93,023,477	70,445		(3,734,413)	(185,000)	(7,316,005)	81,878,504
Fire	40,529,586			(1,789,268)	(135,000)	(2,593,145)	36,012,173
Public Works	7,369,140	(295,000)		(61,860)	(125,000)	(414,330)	6,472,950
Economic Development	725,760			(8,191)		(39,564)	678,005
Peacekeeper Program	249,615			(11,535)		(67,831)	170,249
Arts Commission	37,687			(825)		(4,035)	32,827
	<u>141,935,265</u>	<u>(224,555)</u>	<u>-</u>	<u>(5,606,092)</u>	<u>(425,000)</u>	<u>(10,434,910)</u>	<u>125,244,708</u>
<u>Program Support for Other Funds</u>							
Library	4,125,000				(23,000)	(45,000)	4,057,000
Recreation	2,800,000	(110,000)					2,690,000
Entertainment Venues	2,152,000			(370,000)	(44,650)		1,737,350
RDA Successor Agency	1,319,248				(250,000)		1,069,248
Downtown Marina	732,000			(684,701)			47,299
Capital Improvement	1,575,000	(1,000,000)					575,000
Administration Building	2,588,442			(2,588,442)			-
Golf Courses	322,000						322,000
Grant Match	500,000				(50,000)		450,000
Development Services	1,000,000						1,000,000
	<u>17,113,690</u>	<u>(1,110,000)</u>	<u>-</u>	<u>(3,643,143)</u>	<u>(367,650)</u>	<u>(45,000)</u>	<u>11,947,897</u>
<u>Administration</u>							
City Council	495,641			(7,816)		(28,711)	459,112
City Manager	1,087,031			(17,625)		(74,265)	995,141
City Attorney	1,004,351			(19,945)		(63,967)	920,439
City Clerk	789,120			(14,832)		(69,224)	705,064
City Auditor	508,827			(7,826)		(29,268)	471,733
Administrative Services	3,822,076			(61,250)		(297,940)	3,462,886
Human Resources	2,185,971			(28,906)	(150,000)	(122,250)	1,884,815
Tax Collection & Election	2,745,250						2,745,250
Other Administration	(842,177)			(510,785)		(47,172)	(1,400,134)
Labor Litigation	2,312,500	3,500,000		(312,500)			5,500,000
AB506 Funds	-				(500,000)		(500,000)
	<u>14,108,590</u>	<u>3,500,000</u>	<u>-</u>	<u>(981,487)</u>	<u>(650,000)</u>	<u>(732,797)</u>	<u>15,244,306</u>
Debt Service	2,737,133			(1,750,573)			978,560
Contingency	2,000,000						2,000,000
Baseline Subtotal	<u>177,894,678</u>	<u>2,165,445</u>	<u>-</u>	<u>(11,989,295)</u>	<u>(1,442,650)</u>	<u>(11,212,707)</u>	<u>155,415,471</u>
Fiscal Stabilization Measures	2,929,016	(2,929,016)					-
Subtotal	<u>180,823,694</u>	<u>(763,571)</u>	<u>-</u>	<u>(11,989,295)</u>	<u>(1,442,650)</u>	<u>(11,212,707)</u>	<u>155,415,471</u>
Total	<u>\$ (25,908,289)</u>	<u>\$ 763,571</u>	<u>\$ 239,308</u>	<u>\$ 11,989,295</u>	<u>\$ 1,742,650</u>	<u>\$ 11,212,707</u>	<u>\$ 39,242</u>

EXHIBIT L

THE SACRAMENTO BEE [sacbee.com](http://www.sacbee.com)

Dan Walters: California just as insolvent as bankrupt cities

Published Friday, Jul. 13, 2012

So far this summer, three California cities have moved toward bankruptcy and several others are distressed enough that the b-word has left the lips of their elected and appointed officials – including those in the two largest, Los Angeles and San Diego.

With the exception of tiny Mammoth Lakes, which sought bankruptcy protection after losing a lawsuit, the conditions of California's financially distressed cities are remarkably similar.

Elected leaders and appointed managers succumbed to hubris and political pressure, particularly from their employee unions. They committed their cities to spending on employee salaries and fringe benefits, especially pensions and health care, and civic improvements that could not be sustained when the housing bubble burst and revenue declined.

As their gaps between income and outgo widened, officials covered them with questionable transfers, bookkeeping gimmicks, loans and lies – hoping against hope that the downturn would be brief and revenue would once again surge and bail them out.

"For the last 16 years, the budget prepared for the council showed the city was in the black. The mayor and the council were not given accurate information," San Bernardino City Attorney James Penman told his council members the other night before they voted to join Mammoth Lakes and Stockton in bankruptcy court.

San Bernardino thus becomes the second-largest city in American history to pursue bankruptcy – second only to Stockton.

Officials in Stockton, San Bernardino and other upside-down California cities should bear the onus of their irresponsible decision-making. Their first responsibility was to protect the financial integrity of their cities but they allowed other considerations, mostly political, to get the best of them.

That said, what's happened at the municipal level is no worse than what's happened to state government for similar reasons.

For years, governors and legislators have squandered brief revenue windfalls on permanent spending and tax cuts, passed budgets based on whimsy, ignored liabilities (especially pensions and retiree health care), and covered resulting deficits with ever-more-elaborate accounting tricks and borrowing.

Democrat Jerry Brown ran for governor on a promise to straighten out the state's tangled finances – just as Republican predecessor Arnold Schwarzenegger had pledged.

But Brown has signed two budgets based on fingers-crossed revenue assumptions and gimmicks. The first one failed totally and the second hinges on voter approval of new taxes that have no better than a 50-50 chance of being passed.

There's no provision in federal bankruptcy law for states, nor should there be.

But make no mistake – at this moment, California is every bit as insolvent as the cities that are trooping to bankruptcy court.

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