

Mammoth Lakes' possible filing tests AB 506

By Michael Sweet

Banking analyst and pundit Meredith Whitney may have garnered some credibility for predicting the financial crisis in 2007. Thankfully, her 2010 warning that a flood of municipalities would soon be defaulting on their debts never materialized and likely was unwarranted.



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Still, considerable anxiety about the condition of local finances exists because revenues continue to stagnate, weighed down by the on-going malaise in real estate markets, especially in housing.

Moreover, there has been a recent trickle of Chapter 9 filings — the section in the U.S. Bankruptcy Code that applies to local government filings.

It is not yet evident how much these individual cases represent isolated, localized actions or how important they are as harbingers of an ominous national trend. Regardless, the media has directed a lot of attention on every instance of serious prospects for a bankruptcy proceeding. This has caught the public's attention, especially now that the tony ski resort town Mammoth Lakes indicated it's considering bankruptcy and the California legislature passed a new law, AB 506, to help public agencies sidestep bankruptcy.

Suddenly, people are asking once again, could our city file bankruptcy and is AB 506 the right tool to avoid it?

Chapter 9 has been part of the Bankruptcy Code since the Great Depression and it allows public agencies to restructure their debt. Yet in close to 70 years since it was enacted, there have been fewer than 700 local governments across the country that have sought protection under Chapter 9. To put this in perspective, there are more than 6,000 business and personal bankruptcy filings on any given day in the United States. In 2010, there were more than 255,000 bankruptcy filings in California alone.

While the economy seems to be showing signs of a recovery, the public sector, which generally lags the private sector both entering a recession and in a recovery, still has significant structural problems that have not been resolved. In fact, in many instances these problems are only now beginning to manifest themselves and are likely to challenge local governments for years to come.

Chapter 9 is a potential solution to the complex and weighty problems created by unsustainable pension and retiree benefit programs in the 21st century. Yet local governments continue to shy away from Chapter 9 due in large part to the stigma that such action carries and the wariness of public employees that such proceedings will unfairly burden them. Indeed, Vallejo's infamous and costly bankruptcy filing in 2008 certainly will not encourage communities to casually choose the bankruptcy route, even in cases where it might



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The resort community of Mammoth Lakes, Calif., sits atop a restless volcano.

be best for all involved.

Vallejo used the bankruptcy process to modify its collective bargaining agreements, but at an extraordinary cost (estimated at over \$13 million on the debtor's side alone). Indeed, the Vallejo case inflicted widespread pain on all parties. This case suggests that going the bankruptcy route will only occur in the most dire circumstances.

Bankruptcy undoubtedly inflicts costs on many parties, and it is not a way to chasten public employees — although the latter still express worry that such tactics are on the minds of public managers who wave the red flag of bankruptcy.

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However, the ice around Chapter 9 may be thawing with Mammoth Lakes following closely behind the City of Stockton in announcing it is on the brink of a bankruptcy filing. Outside of California, there have been large filings in Jefferson County, Alabama (the largest Chapter 9 filing in U.S. history) and Harrisburg Pennsylvania (dismissed due to lack of eligibility).

In the wake of the Vallejo bankruptcy, state lawmakers passed AB 506 last year as a way to assist local governments to achieve an outside-of-bankruptcy resolution of issues — thereby avoiding the costs (both direct and indirect) of a Chapter 9 filing by providing a mechanism for local governments to meet with their creditors and a mediator to try to hammer out a consensual restructuring of debts.

The law sought to balance the concerns of public employees that the bankruptcy threat would be used to bully them into unfair concessions and the need for public managers to have options to help them avoid completely devastating local services.

Although AB 506 represents a constructive

advance, it does have gaps which are dramatized in the differences between the Stockton and Mammoth Lakes cases.

The fiscal collapse of Mammoth Lakes results not from some general decay in local revenue or gold-plated benefits for city employees. Rather, the city's woes stem from a single, sudden monetary judgment resulting from a development plan gone awry. The \$43 million judgment is more than twice the ski hamlet's 2010-2011 general fund expenditure of about \$18 million.

Stockton's problem is much more typical of the challenges facing local governments, including expensive expansions of infrastructure during the go-go real estate days and unsustainable promises of pensions and healthcare benefits to municipal employees.

The decision by Mammoth Lakes' judgment-creditor to reject a facilitated negotiation is not surprising, and it reveals a weakness in the AB 506 scheme, which did not include incentives or levers to oblige individual creditors to bargain in good faith. As a result, Mammoth Lakes will have to decimate its services and encumber property owners for some time and possibly also enter bankruptcy proceedings.

In situations like Stockton (or Vallejo) on the other hand, the most significant creditor group constitutes current and former municipal employees. They have an interest in partnering with the city to see it survive and flourish. Everyone has incentives to work together to achieve a solution that will allow the government to get back on stable footing as quickly as possible.

It remains to be seen if labor and management can achieve a workable compromise through a facilitated negotiation under AB 506. However, both sides have much to gain by working with the new process as neither likely relishes the alternative that occurred in Vallejo. As for Mammoth Lakes, this is an instance where Chapter 9 is very much needed, if not inevitable and where AB 506 doesn't seem to provide an alternate route to restructuring the debt.