

## Assembly Bill No. 506

### CHAPTER 675

An act to amend Section 53760 of, and to add Sections 53760.1, 53760.3, 53760.5, and 53760.7 to, the Government Code, relating to local government.

[Approved by Governor October 9, 2011. Filed with  
Secretary of State October 9, 2011.]

#### LEGISLATIVE COUNSEL'S DIGEST

AB 506, Wieckowski. Local government: bankruptcy: neutral evaluation.

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

This bill would prohibit a local public entity from filing under federal bankruptcy law unless the local public entity has participated in a specified neutral evaluation process with interested parties, as defined, or the local public entity has declared a fiscal emergency and has adopted a resolution by a majority vote of the governing board at a noticed public hearing that includes findings that the financial state of the local public entity jeopardizes the health, safety, or well-being of the residents of the local public entity's jurisdiction or service area absent bankruptcy protections.

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

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

(a) Filing for Chapter 9 can reduce service levels to the taxpayers and residents of a municipality. In some circumstances, it can have major short- and long-term fiscal consequences for the municipality, the surrounding municipalities, and the state. Filing for bankruptcy protection under Chapter 9 should be considered a last resort, to be instituted only after other reasonable efforts have been made to avoid a bankruptcy filing or otherwise appropriately plan for it. It is in the interest of the state, local governments, and the public that local governmental entities have sufficiently sound financial capacity to provide required services to the public and meet their contractual and other obligations during any restructuring or financial reorganization process. Furthermore, it is in the best interest of the public, the state, and local governmental entities that employees, trade creditors, bondholders, and other interestholders be included in an appropriate restructuring process and have an adequate understanding of the financial capacity of local governmental entities and their obligations, as a clear

understanding of both is necessary for any restructuring or reorganization process.

(b) To the extent financial relief granted through Chapter 9 can affect debt service payments, the bondholders have a direct interest in the Chapter 9 process, particularly prior to filing. Therefore, it is important for those parties to be able to participate in a pre-filing confidential neutral evaluation process that could assist parties in reaching a settlement and avoiding a bankruptcy filing or otherwise lead to a prenegotiated consensual plan of readjustment as clearly contemplated by Section 109(c) of Title 11 of the United States Code.

(c) To the extent financial relief granted through Chapter 9 could affect public employee compensation, employees have a direct interest in the Chapter 9 process, particularly prior to filing. Therefore, it is important for those parties to be able to participate in a pre-filing confidential neutral evaluation process that could assist parties in reaching a settlement or otherwise lead to a prenegotiated, consensual plan of adjustment and avoid a Chapter 9 filing.

(d) Given the connection between state allocations and local budgets, the state has a role in assisting municipalities to address potential insolvency with the goal of averting municipality bankruptcy filings where possible and providing a process designed to make the debt restructuring process in or outside of a Chapter 9 bankruptcy as cost effective and efficient as possible for all participants.

(e) California's taxpayers who rely on public safety, senior, recreational, municipal health, library, and other public services, as well as those who own and operate businesses in our communities, deserve every reasonable and appropriate effort that state and local government can make to avoid adverse consequences of Chapter 9 bankruptcy filings, particularly where a neutral evaluation may lead to the avoidance of Chapter 9 filing by an out-of-court resolution of outstanding obligations and disputes.

(f) Resolving municipal and state business and financial issues in a timely, fair, and cost-effective manner is an integral part of a successful government and is in the public interest. It has long been recognized that alternative dispute resolution proceedings, like a neutral evaluation, offer an economical, discreet, and expeditious way to resolve potentially devastating situations.

(g) Through the neutral evaluation process, the neutral evaluator, a specially trained, neutral third party, can assist the municipality and its creditors and stakeholders to fully explore alternatives, while allowing the interested parties to exchange information in a confidential environment with the assistance and supervision of a neutral evaluator to determine whether the municipality's contractual and financial obligations can be renegotiated on a consensual basis.

SEC. 2. Section 53760 of the Government Code is amended to read:

53760. A local public entity in this state may file a petition and exercise powers pursuant to applicable federal bankruptcy law if either of the following apply:

(a) The local public entity has participated in a neutral evaluation process pursuant to Section 53760.3.

(b) The local public entity declares a fiscal emergency and adopts a resolution by a majority vote of the governing board pursuant to Section 53760.5.

SEC. 3. Section 53760.1 is added to the Government Code, to read:

53760.1. As used in this article the following terms have the following meanings:

(a) “Chapter 9” means Chapter 9 (commencing with Section 901) of Title 11 of the United States Code.

(b) “Creditor” means either of the following:

(1) An entity that has a noncontingent claim against a municipality that arose at the time of or before the commencement of the neutral evaluation process and whose claim represents at least five million dollars (\$5,000,000) or comprises more than 5 percent of the local public entity’s debt or obligations, whichever is less.

(2) An entity that would have a noncontingent claim against the municipality upon the rejection of an executory contract or unexpired lease in a Chapter 9 case and whose claim would represent at least five million dollars (\$5,000,000) or comprises more than 5 percent of the local public entity’s debt or obligations, whichever is less.

(c) “Debtor” means a local public entity that may file for bankruptcy under Chapter 9.

(d) “Good faith” means participation by a party in the neutral evaluation process with the intent to negotiate toward a resolution of the issues that are the subject of the neutral evaluation process, including the timely provision of complete and accurate information to provide the relevant parties through the neutral evaluation process with sufficient information, in a confidential manner, to negotiate the readjustment of the municipality’s debt.

(e) “Interested party” means a trustee, a committee of creditors, an affected creditor, an indenture trustee, a pension fund, a bondholder, a union that, under its collective bargaining agreements, has standing to initiate contract or debt restructuring negotiations with the municipality, or a representative selected by an association of retired employees of the public entity who receive income from the public entity convening the neutral evaluation. A local public entity may invite holders of contingent claims to participate as interested parties in the neutral evaluation if the local public entity determines that the contingency is likely to occur and the claim may represent five million dollars (\$5,000,000) or comprise more than 5 percent of the local public entity’s debt or obligations, whichever is less.

(f) “Local public entity” means any county, city, district, public authority, public agency, or other entity, without limitation, that is a municipality as defined in Section 101(40) of Title 11 of the United States Code (bankruptcy), or that qualifies as a debtor under any other federal bankruptcy law applicable to local public entities. For purposes of this article, “local public entity” does not include a school district.

(g) “Local public entity representative” means the person or persons designated by the local public agency with authority to make recommendations and to attend the neutral evaluation on behalf of the governing body of the municipality.

(h) “Neutral evaluation” is a form of alternative dispute resolution that may be known as mandatory mediation. A “neutral evaluator” may also be known as a mediator.

SEC. 4. Section 53760.3 is added to the Government Code, to read:

53760.3. (a) A local public entity may initiate the neutral evaluation process if the local public entity is or likely will become unable to meet its financial obligations as and when those obligations are due or become due and owing. The local public entity shall initiate the neutral evaluation by providing notice by certified mail of a request for neutral evaluation to all interested parties as defined in Section 53760.1.

(b) Interested parties shall respond within 10 business days of receipt of notice of the local public entity’s request for neutral evaluation.

(c) (1) The local public entity and the interested parties agreeing to participate in the neutral evaluation shall, through a mutually agreed upon process, select the neutral evaluator to oversee the neutral evaluation process and facilitate all discussions in an effort to resolve their disputes.

(2) If the local public entity and interested parties fail to agree on a neutral evaluator within seven days after the interested parties have responded to the notification sent by the public entity, the public entity shall select five qualified neutral evaluators and provide their names, references, and backgrounds to the participating interested parties. Within three business days, a majority of participating interested parties may strike up to four names from the list. If a majority of participating interested parties strikes four names, the remaining candidate shall be the neutral evaluator. If the majority of participating parties strikes fewer than four names, the local public entity may choose which of the remaining candidates shall be the neutral evaluator.

(d) A neutral evaluator shall have experience and training in conflict resolution and alternative dispute resolution and shall meet at least one of the following qualifications:

(1) At least 10 years of high-level business or legal practice involving bankruptcy or service as a United States Bankruptcy Judge.

(2) Professional experience or training in municipal finance and one or more of the following issue areas:

- (A) Municipal organization.
- (B) Municipal debt restructuring.
- (C) Municipal finance dispute resolution.
- (D) Chapter 9 bankruptcy.
- (E) Public finance.
- (F) Taxation.
- (G) California constitutional law.
- (H) California labor law.
- (I) Federal labor law.

(e) The neutral evaluator shall be impartial, objective, independent, and free from prejudice. The neutral evaluator shall not act with partiality or prejudice based on any participant's personal characteristics, background, values or beliefs, or performance during the neutral evaluation process.

(f) The neutral evaluator shall avoid a conflict of interest or the appearance of a conflict of interest during the neutral evaluation process. The neutral evaluator shall make a reasonable inquiry to determine whether there are any facts that a reasonable individual would consider likely to create a potential or actual conflict of interest. Notwithstanding subdivision (n), if the neutral evaluator is informed of the existence of any facts that a reasonable individual would consider likely to create a potential or actual conflict of interest, the neutral evaluator shall disclose these facts in writing to the local public entity and all interested parties involved in the neutral evaluation. If any party to the neutral evaluation objects to the neutral evaluator, that party shall notify all other parties to the neutral evaluation, including the neutral evaluator, within 15 days of receipt of the notice from the neutral evaluator, the neutral evaluator shall withdraw and a new neutral evaluator shall be selected pursuant to subdivisions (a) and (b) of Section 53761.3.

(g) Prior to the neutral evaluation process, the neutral evaluator shall not establish another relationship with any of the parties in a manner that would raise questions about the integrity of the neutral evaluation, except that the neutral evaluator may conduct further neutral evaluations regarding other potential local public entities that may involve some of the same or similar constituents to a prior mediation.

(h) The neutral evaluator shall conduct the neutral evaluation process in a manner that promotes voluntary, uncoerced decisionmaking in which each party makes free and informed choices regarding the process and outcome.

(i) The neutral evaluator shall not impose a settlement on the parties. The neutral evaluator shall use his or her best efforts to assist the parties to reach a satisfactory resolution of their disputes. Subject to the discretion of the neutral evaluator, the neutral evaluator may make oral or written recommendations for settlement or plan of readjustment to a party privately or to all parties jointly.

(j) The neutral evaluator shall inform the local public entity and all parties of the provisions of Chapter 9 relative to other chapters of the bankruptcy codes. This instruction shall highlight the limited authority of United States bankruptcy judges in Chapter 9 such as the lack of flexibility available to judges to reduce or cram down debt repayments and similar efforts not available to reorganize the operations of the city that may be available to a corporate entity.

(k) The neutral evaluator may request from the parties documentation and other information that the neutral evaluator believes may be helpful in assisting the parties to address the obligations between them. This documentation may include the status of funds of the local public entity that clearly distinguishes between general funds and special funds, and the proposed plan of readjustment prepared by the local public entity.

(l) The neutral evaluator shall provide counsel and guidance to all parties, shall not be a legal representative of any party, and shall not have a fiduciary duty to any party.

(m) In the event of a settlement with all interested parties, the neutral evaluator may assist the parties in negotiating a prepetitioned, preagreed plan of readjustment in connection with a potential Chapter 9 filing.

(n) If at any time during the neutral evaluation process the local public entity and a majority of the representatives of the interested parties participating in the neutral evaluation wish to remove the neutral evaluator, the local public entity or any interested party may make a request to the other interested parties to remove the neutral evaluator. If the local public entity and the majority of the interested parties agree that the neutral evaluator should be removed, the parties shall select a new neutral evaluator.

(o) The local public entity and all interested parties participating in the neutral evaluation process shall negotiate in good faith.

(p) The local public entity and interested parties shall provide a representative of each party to attend all neutral evaluation sessions. Each representative shall have the authority to settle and resolve disputes or shall be in a position to present any proposed settlement or plan of readjustment to the parties participating in the neutral evaluation.

(q) The parties shall maintain the confidentiality of the neutral evaluation process and shall not disclose statements made, information disclosed, or documents prepared or produced, during the neutral evaluation process, at the conclusion of the neutral evaluation process or during any bankruptcy proceeding unless either of the following occur:

(1) All persons that conduct or otherwise participate in the neutral evaluation expressly agree in writing, or orally in accordance with Section 1118 of the Evidence Code, to disclosure of the communication, document, or writing.

(2) The information is deemed necessary by a judge presiding over a bankruptcy proceeding pursuant to Chapter 9 of Title 11 of the United States Code to determine eligibility of a municipality to proceed with a bankruptcy proceeding pursuant to Section 109(c) of Title 11 of the United States Code.

(r) The neutral evaluation established by this process shall not last for more than 60 days following the date the evaluator is selected, unless the local public entity or a majority of participating interested parties elect to extend the process for up to 30 additional days. The neutral evaluation process shall not last for more than 90 days following the date the evaluator is selected unless the local public entity and a majority of the interested parties agree to an extension.

(s) The local public entity shall pay 50 percent of the costs of neutral evaluation, including but not limited to the fees of the evaluator, and the creditors shall pay the balance, unless otherwise agreed to by the parties.

(t) The neutral evaluation process shall end if any of the following occur:

(1) The parties execute a settlement agreement.

(2) The parties reach an agreement or proposed plan of readjustment that requires the approval of a bankruptcy judge.

(3) The neutral evaluation process has exceeded 60 days following the date the neutral evaluator was selected, the parties have not reached an agreement, and neither the local public entity or a majority of the interested parties elect to extend the neutral evaluation process past the initial 60-day time period.

(4) The local public entity initiated the neutral evaluation process pursuant to subdivision (a) and received no responses from interested parties within the time specified in subdivision (b).

(5) The fiscal condition of the local public entity deteriorates to the point that a fiscal emergency is declared pursuant to Section 53076.5 and necessitates the need to file a petition and exercise powers pursuant to applicable federal bankruptcy law.

(u) If the 60-day time period for neutral evaluation has expired, including any extension of the neutral evaluation past the initial 60-day time period pursuant to subdivision (r), and the neutral evaluation is complete with differences resolved, the neutral evaluation shall be concluded. If the neutral evaluation process does not resolve all pending disputes with creditors the local public entity may file a petition and exercise powers pursuant to applicable federal bankruptcy law if, in the opinion of the governing board of the local public entity, a bankruptcy filing is necessary.

SEC. 5. Section 53760.5 is added to the Government Code, to read:

53760.5. Notwithstanding Section 53760.3, a local public entity may file a petition and exercise powers pursuant to applicable federal bankruptcy law, if the local public entity declares a fiscal emergency and adopts a resolution by a majority vote of the governing board at a noticed public hearing that includes findings that the financial state of the local public entity jeopardizes the health, safety, or well-being of the residents of the local public entity's jurisdiction or service area absent the protections of Chapter 9. The resolution shall make findings that the public entity is or will be unable to pay its obligations within the next 60 days. Prior to a declaration of fiscal emergency and adoption of a resolution, the local public entity shall place an item on the agenda of a noticed public hearing on the fiscal condition of the entity to take public comment. The board of supervisors of a county that intends to take action pursuant to this section and places a notice on an agenda regarding a proposed resolution to declare a fiscal emergency may require local agencies with funds invested in the county treasury to provide a five-day notice of withdrawal before the county is required to comply with a request for withdrawal of funds by that local agency.

SEC. 6. Section 53760.7 is added to the Government Code, to read:

53760.7. This article shall not impose any liability or responsibility, in law or equity, upon the state, any department, agency, or other entity of the state, or any officer or employee of the state, for any action taken by any local public entity pursuant to this article, for any violation of the provisions of this article by any local public entity, or for any failure to comply with the provisions of this article by any local public entity. No cause of action against the state, or any department, agency, entity of the state, or any officer

or employee of the state acting in their official capacity may be maintained for any activity authorized by this article, or for the act of a local public entity filing under Chapter 9 of Title 11 of the United States Code, including any proceeding following a local public entity's filing.

SEC. 7. The Legislature finds and declares that Section 4 of this act which adds Section 53760.3 to the Government Code, impose a limitation on the public's right of access to the meetings of public bodies or the writings of public officials and agencies within the meaning of Section 3 of Article I of the California Constitution. Pursuant to that constitutional provision, the Legislature makes the following findings to demonstrate the interest protected by this limitation and the need for protecting that interest:

To facilitate the process to avoid municipal bankruptcy, it is necessary to provide for secure documents.