

AMENDED IN SENATE SEPTEMBER 8, 2011

AMENDED IN SENATE SEPTEMBER 2, 2011

AMENDED IN SENATE AUGUST 31, 2011

AMENDED IN SENATE AUGUST 15, 2011

AMENDED IN SENATE JULY 12, 2011

AMENDED IN SENATE JUNE 29, 2011

AMENDED IN ASSEMBLY MAY 31, 2011

AMENDED IN ASSEMBLY MARCH 31, 2011

CALIFORNIA LEGISLATURE—2011–12 REGULAR SESSION

---

---

**ASSEMBLY BILL**

**No. 506**

**Introduced by Assembly Member Wieckowski**

February 15, 2011

---

---

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

LEGISLATIVE COUNSEL'S DIGEST

AB 506, as amended, 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.

Vote: majority. Appropriation: no. Fiscal committee: no.  
 State-mandated local program: no.

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

1 SECTION 1. The Legislature hereby finds and declares all of  
 2 the following:  
 3 (a) Filing for Chapter 9 can reduce service levels to the taxpayers  
 4 and residents of a municipality. In some circumstances, it can have  
 5 major short- and long-term fiscal consequences for the  
 6 municipality, the surrounding municipalities, and the state. Filing  
 7 for bankruptcy protection under Chapter 9 should be considered  
 8 a last resort, to be instituted only after other reasonable efforts  
 9 have been made to avoid a bankruptcy filing or otherwise  
 10 appropriately plan for it. It is in the interest of the state, local  
 11 governments, and the public that local governmental entities have  
 12 sufficiently sound financial capacity to provide required services  
 13 to the public and meet their contractual and other obligations during  
 14 any restructuring or financial reorganization process. Furthermore,  
 15 it is in the best interest of the public, the state, and local  
 16 governmental entities that employees, trade creditors, bondholders,  
 17 and other interest holders be included in an appropriate  
 18 restructuring process and have an adequate understanding of the  
 19 financial capacity of local governmental entities and their  
 20 obligations, as a clear understanding of both is necessary for any  
 21 restructuring or reorganization process.  
 22 (b) To the extent financial relief granted through Chapter 9 can  
 23 affect debt service payments, the bondholders have a direct interest  
 24 in the Chapter 9 process, particularly prior to filing. Therefore, it  
 25 is important for those parties to be able to participate in a pre-filing  
 26 confidential neutral evaluation process that could assist parties in  
 27 reaching a settlement and avoiding a bankruptcy filing or otherwise  
 28 lead to a prenegotiated consensual plan of readjustment as clearly

1 contemplated by Section 109(c) of Title 11 of the United States  
2 Code.

3 (c) To the extent financial relief granted through Chapter 9 could  
4 affect public employee compensation, employees have a direct  
5 interest in the Chapter 9 process, particularly prior to filing.  
6 Therefore, it is important for those parties to be able to participate  
7 in a prefiling confidential neutral evaluation process that could  
8 assist parties in reaching a settlement or otherwise lead to a  
9 prenegotiated, consensual plan of adjustment and avoid a Chapter  
10 9 filing.

11 (d) Given the connection between state allocations and local  
12 budgets, the state has a role in assisting municipalities to address  
13 potential insolvency with the goal of averting municipality  
14 bankruptcy filings where possible and providing a process designed  
15 to make the debt restructuring process in or outside of a Chapter  
16 9 bankruptcy as cost effective and efficient as possible for all  
17 participants.

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

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

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

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

3 53760. A local public entity in this state may file a petition and  
4 exercise powers pursuant to applicable federal bankruptcy law if  
5 either of the following apply:

6 (a) The local public entity has participated in a neutral evaluation  
7 process pursuant to ~~subdivision (a) of~~ Section 53760.3.

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

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

13 53760.1. As used in this article the following terms have the  
14 following meanings:

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

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

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

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

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

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

39 (e) “Interested party” means a trustee, a committee of creditors,  
40 an affected creditor, an indenture trustee, a pension fund, a

1 bondholder, a union that, under its collective bargaining  
2 agreements, has standing to initiate contract or debt restructuring  
3 negotiations with the municipality, or a representative selected by  
4 an association of retired employees of the public entity who receive  
5 income from the public entity convening the neutral evaluation.  
6 A local public entity may invite holders of contingent claims to  
7 participate as interested parties in the neutral evaluation if the local  
8 public entity determines that the contingency is likely to occur and  
9 the claim may represent five million dollars (\$5,000,000) or  
10 comprise more than 5 percent of the local public entity's debt or  
11 obligations, whichever is less.

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

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

23 (h) "*Neutral evaluation*" is a form of *alternative dispute*  
24 *resolution that may be known as mandatory mediation. A "neutral*  
25 *evaluator" may also be known as a mediator.*

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

28 53760.3. (a) A local public entity may initiate the neutral  
29 evaluation process if the local public entity is or likely will become  
30 unable to meet its financial obligations as and when those  
31 obligations are due or become due and owing. The local public  
32 entity shall initiate the neutral evaluation by providing notice by  
33 certified mail of a request for neutral evaluation to all interested  
34 parties as defined in Section 53760.1.

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

38 (c) ~~Interested~~(1) *The local public entity and the interested*  
39 *parties agreeing to participate in the neutral evaluation shall,*  
40 *through a mutually agreed upon process, select the neutral*

1 evaluator to oversee the neutral evaluation process and ~~shall~~  
 2 facilitate all discussions in an effort to resolve their disputes.

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

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

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

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

- 23 (A) Municipal organization.
- 24 (B) Municipal debt restructuring.
- 25 (C) Municipal finance dispute resolution.
- 26 (D) Chapter 9 bankruptcy.
- 27 (E) Public finance.
- 28 (F) Taxation.
- 29 (G) California constitutional law.
- 30 (H) California labor law.
- 31 (I) Federal labor law.

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

37 (f) The neutral evaluator shall avoid a conflict of interest or the  
 38 appearance of a conflict of interest during the neutral evaluation  
 39 process. The neutral evaluator shall make a reasonable inquiry to  
 40 determine whether there are any facts that a reasonable individual

1 would consider likely to create a potential or actual conflict of  
2 interest. Notwithstanding subdivision (n), if the neutral evaluator  
3 is informed of the existence of any facts that a reasonable  
4 individual would consider likely to create a potential or actual  
5 conflict of interest, the neutral evaluator shall disclose these facts  
6 in writing to the local public entity and all interested parties  
7 involved in the neutral evaluation. If any party to the neutral  
8 evaluation objects to the neutral evaluator, that party shall notify  
9 all other parties to the neutral evaluation, including the neutral  
10 evaluator, within 15 days of receipt of the notice from the neutral  
11 evaluator, the neutral evaluator shall withdraw and a new neutral  
12 evaluator shall be selected pursuant to subdivisions (a) and (b) of  
13 Section 53761.3.

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

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

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

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

38 (k) The neutral evaluator may request from the parties  
39 documentation and other information that the neutral evaluator  
40 believes may be helpful in assisting the parties to address the

1 obligations between them. This documentation may include the  
2 status of funds of the local public entity that clearly distinguishes  
3 between general funds and special funds, and the proposed plan  
4 of readjustment prepared by the local public entity.

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

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

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

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

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

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

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

38 (2) The information is deemed necessary by a judge presiding  
39 over a bankruptcy proceeding pursuant to Chapter 9 of Title 11 of  
40 the United States Code to determine eligibility of a municipality

1 to proceed with a bankruptcy proceeding pursuant to Section 109(c)  
2 of Title 11 of the United States Code.

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

11 ~~(s)The~~

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

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

18 (1) The parties execute an settlement agreement.

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

21 (3) The neutral evaluation process has exceeded 60 days  
22 following the date the neutral evaluator was selected, the parties  
23 have not reached an agreement, and ~~the parties do not agree on~~  
24 ~~extension of~~ *neither the local public entity or a majority of the*  
25 *interested parties elect to extend the neutral evaluation process*  
26 *past the initial 60 day time period.*

27 ~~(4) The neutral evaluator confirms that a neutral evaluation was~~  
28 ~~initiated by the local public entity but that no interested parties~~  
29 ~~participated.~~

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

33 (5) The fiscal condition of the local public entity deteriorates  
34 to the point that a fiscal emergency is declared pursuant to Section  
35 53076.5 and necessitates the need to file a petition and exercise  
36 powers pursuant to applicable federal bankruptcy law.

37 (u) If the 60 day time period for neutral evaluation has expired,  
38 including any extension ~~agreed to by the local public entity of the~~  
39 ~~neutral evaluation past the initial 60 day time period pursuant to~~  
40 ~~subdivision (r), and the neutral evaluation is complete with~~

1 differences resolved, the neutral evaluation shall be concluded. If  
2 the neutral evaluation process does not resolve all pending disputes  
3 with creditors the local public entity may file a petition and exercise  
4 powers pursuant to applicable federal bankruptcy law if, in the  
5 opinion of the governing board of the local public entity, a  
6 bankruptcy filing is necessary.

7 ~~SEC. 4.~~

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

10 53760.5. Notwithstanding Section 53760.3, a local public entity  
11 may file a petition and exercise powers pursuant to applicable  
12 federal bankruptcy law, if the local public entity declares a fiscal  
13 emergency and adopts a resolution by a majority vote of the  
14 governing board at a noticed public hearing that includes findings  
15 that the financial state of the local public entity jeopardizes the  
16 health, safety, or well-being of the residents of the local public  
17 entity's jurisdiction or service area absent the protections of  
18 Chapter 9. The resolution shall make findings that the public entity  
19 is or will be unable to pay its obligations within the next 60 days.  
20 Prior to a declaration of fiscal emergency and adoption of a  
21 resolution, the local public entity shall place an item on the agenda  
22 of a noticed public hearing on the fiscal condition of the entity to  
23 take public comment. *The board of supervisors of a county that*  
24 *intends to take action pursuant to this section and places a notice*  
25 *on an agenda regarding a proposed resolution to declare a fiscal*  
26 *emergency may require local agencies with funds invested in the*  
27 *county treasury to provide a five-day notice of withdrawal before*  
28 *the county is required to comply with a request for withdrawal of*  
29 *funds by that local agency.*

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

32 53760.7. *This article shall not impose any liability or*  
33 *responsibility, in law or equity, upon the state, any department,*  
34 *agency, or other entity of the state, or any officer or employee of*  
35 *the state, for any action taken by any local public entity pursuant*  
36 *to this article, for any violation of the provisions of this article by*  
37 *any local public entity, or for any failure to comply with the*  
38 *provisions of this article by any local public entity. No cause of*  
39 *action against the state, or any department, agency, entity of the*  
40 *state, or any officer or employee of the state acting in their official*

1 *capacity may be maintained for any activity authorized by this*  
2 *article, or for the act of a local public entity filing under Chapter*  
3 *9 of Title 11 of the United States Code, including any proceeding*  
4 *following a local public entity's filing.*

5 ~~SEC. 5.~~

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

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

O