ADOPT A RESOLUTION APPROPRIATING FUNDS FROM BANKRUPTCY FUND BALANCE

RECOMMENDATION

It is recommended that by resolution, the City Council appropriate $1.8 million from the bankruptcy fund balance to the fiscal year 13-14 bankruptcy budget.

Summary

For the 2013-14 fiscal year, the City created a separate chapter 9 bankruptcy fund in the adopted budget as an extension of the General Fund to track specific bankruptcy costs. The 2013-14 budget appropriated $5.2 million for professional services expenditures in support of the chapter 9 process. There was also held in reserve additional fund balance in the newly created chapter 9 fund as contingency for increased costs or future payment of claims. The estimated $5.2 million for expenditures in 2013-14 was based on expectations for the bankruptcy process as understood at the time of budget adoption, including a successful Plan of Adjustment in the fall of 2013 with a trial date sometime in the spring of 2014.

However, the trial confirming the Plan of Adjustment has required far more resources than anticipated as the timeline has been extended and a final creditor has taken a position of opposition. This position has required significant resources to prepare for and conduct the trial. As was the case with the eligibility trial, it was understood that there were several factors that could impact the bankruptcy process, requiring additional resources. It is now projected that professional services expenditures in support of the chapter 9 process will total approximately $7 million. It is necessary to appropriate an additional $1.8 million from available fund balance in the bankruptcy fund to continue to support the chapter 9 process through conclusion of the trial. The additional resources that are necessary at this time will have a significant return on investment as have all previous resources allocated throughout the bankruptcy process.

DISCUSSION

Background

On June 28, 2012, the City of Stockton filed a petition for chapter 9 bankruptcy protection with the United States Bankruptcy Court, Eastern District of California, Sacramento. For the 2012-13 and 2013-14 fiscal years, the City budgeted for outside professional services and legal expertise to provide the necessary support for the chapter 9 bankruptcy process. The City did not have the staffing necessary to manage the chapter 9 process nor the level of expertise required to address unique aspects of the process. In essence, the City established through professional services the equivalent of an emergency operations center to staff the bankruptcy process while City staff provided strategic direction to this process and continued to carry out the daily operations of the City.
For the past two years, the resources and expertise provided by our professional services partners have been invaluable to the chapter 9 process. The workload has been enormous.

During the 2012-13 fiscal year the City initially budgeted $4.9 million to support the bankruptcy process. This budgeted amount was an estimate based on costs experienced during the AB 506 pre-bankruptcy mediations as well as projections of costs experienced by other municipalities experiencing chapter 9. However, staff was very clear at the time of budget appropriation that it was an estimate that could be impacted by many different factors. There were no truly comparable examples of municipal bankruptcy and many unknowns in the process. As the process bore out, the City's capital markets creditors took a litigation heavy approach in the eligibility trial for protection under chapter 9. As a result, it required far more resources than anticipated. In the end, the City expended $7.02 million in support of the chapter 9 process in fiscal year 2012-13. The additional expenses were funded through 1) carry over savings from resources budgeted for the AB 506 pre-bankruptcy process and 2) savings of $1.6 million in the Non-Departmental legal and labor relations professional services budget. The savings in the Non-Departmental legal and labor relations professional services budget were realized because labor negotiations were conducted in conjunction with the chapter 9 process and as a result the regular expenditures for the labor negotiation process were not incurred. Given the nexus between the two processes, the savings were allocated toward the additional bankruptcy costs. While the chapter 9 support in fiscal year 2012-13 required additional funding, the outcomes justified the expenses. The City was highly successful with the eligibility funding, which led to subsequent negotiations with creditors that were very productive. These productive negotiations led to the completion of the Plan of Adjustment in fiscal year 2013-14.

For the 2013-14 fiscal year, the City created a separate chapter 9 bankruptcy fund in the adopted budget which was funded primarily with ending available General Fund balance that the City Council committed toward bankruptcy costs. To date $5.6 million from the fiscal year ending June 30, 2012 and $13.6 million from the fiscal year ending June 30, 2013 have been committed from ending available General Fund balance to support bankruptcy legal fees, project management and potential settlements. The 2013-14 adopted budget appropriated $5.2 million for professional services expenditures in support of the chapter 9 process. There was also held in reserve additional fund balance in the newly created chapter 9 fund as contingency for increased costs or future payment of claims. The estimated $5.2 million for expenditures in 2013-14 was based on expectations for the bankruptcy process as understood at the time of budget adoption. This amount anticipated a successful Plan of Adjustment in the fall of 2013 with a trial date sometime in the spring of 2014. As was the case in fiscal year 2013-14, it was understood that there were other factors that could impact the bankruptcy process, requiring additional resources.

**Present Situation**

During fiscal year 2013-14, the City initially dedicated significant professional services resources in order to work towards deals for all creditors in the Plan of Adjustment. The number of successful deals reached is notable. The City delivered a Plan of Adjustment in the fall of 2013 with negotiated agreements with 15 of 19 creditors. The City continued to work toward deals with all creditors in anticipation of an early Spring trial date. However, as the trial date approached, the City continued to face significant opposition with one creditor. As a result the trial date was postponed beyond the originally anticipated time frame, with the trial scheduled for May. In advance of the trial, the City did reach negotiated agreements with all but the final creditor. However this final creditor has continued
to oppose the Plan of Adjustment, resulting in a much more extensive trial than anticipated.

Because the trial confirming the Plan of Adjustment has become more oppositional than anticipated, it has required a tremendous amount of resources. As was the case in the bankruptcy eligibility trial, the work leading up to court has required extensive preparation including responding to discovery requests, preparing depositions and other legal documents, and planning the trial proceedings themselves. This additional work has resulted in the expenditure of more resources than anticipated. Invoices that have been received for work completed as of April 1, 2014 claim the majority of the remaining budgeted appropriation for fiscal year 2013-14. While staff were aware that expenditures were likely to surpass the budgeted appropriation, the steep increase in costs was only experienced in the last two months, with a particularly large increase for the month of March during which time trial preparations were taking place in earnest.

In addition to the significant increase in costs noted in invoices received in recent months, it is anticipated that costs for April and May will likewise be high given continued trial preparation and the trial itself. Furthermore, with the extension of the trial into June, resources will be even more strained. The majority of the major cost increases in support of the chapter 9 process are related to legal fees for bankruptcy counsel as well as greater than anticipated costs for legal counsel for retirees.

As a result of increased costs for the trial, it is necessary to appropriate additional budget from the bankruptcy fund balance. Recently revised projections for the costs required to support the bankruptcy process estimate expenditures at approximately $7 million. This is approximately $1.8 million above the budgeted allocation of $5.2 million. There is sufficient fund balance in the bankruptcy fund to appropriate this additional funding. In fact, the proposed 2014-15 budget recently presented to the Council reflects the projected expenditures of $7 million in support of the bankruptcy process and projects a $10.8 million fund balance at the end of this fiscal year after this additional $1.8 million appropriation. It remains important to point out again, that even this revised projection is our best estimate at this time. There are other factors that may continue to impact the bankruptcy process, requiring additional resources.

For the reasons outlined above, as the City proceeds towards the final steps of chapter 9, the continued support of outside professional services and legal support is needed to bring this process to completion. The additional resources that are necessary at this time will have a significant return on investment as have all previous resources allocated throughout the bankruptcy process.

FINANCIAL SUMMARY

The 2013-14 budget appropriation in support of chapter 9 professional services was approximately $5.2 million for professional services. The proposed appropriation of additional funds would increase the 2013-14 appropriation by $1.8 million to $7 million. Sufficient funds are available for this appropriation in the bankruptcy fund balance in fund 012-0139-510 and the proposed action is consistent with the bankruptcy fund presentation in the FY 2014-15 Proposed Budget.

In addition, it is worth noting that all chapter 9 expenses to date have been allocated on a proportionate basis to funds outside the General Fund based on the benefits anticipated through savings that are expected to be achieved in those funds through the chapter 9 process. As a result, portions of this additional funding may be allocated to other funds as appropriate.