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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

1 UNITED STATES BANKRUPTCY COURT
2 EASTERN DISTRICT OF CALIFORNIA
3 SACRAMENTO DIVISION

4 In re)
5) Case No. 08-26813-A-9
6 CITY OF VALLEJO, CALIFORNIA)
7)
8 Debtor.)
9)

9 FINDINGS OF FACT AND CONCLUSIONS OF LAW

10 Pursuant to Fed. R. Civ. P. 52(a), made applicable to
11 bankruptcy proceedings by Fed. R. Bankr. P. 7052 and 9014, the
12 court makes its findings of fact and conclusions of law
13 concerning the objections to the City of Vallejo's May 23, 2008
14 Statement of Qualifications pursuant to 11 U.S.C. § 109(c). The
15 objections were interposed by the Vallejo Police Officers
16 Association ("VPOA"), the International Association of
17 Firefighters ("IAFF"), and the International Brotherhood of
18 Electrical Workers ("IBEW"), collectively, the "Unions."

19 The Statement of Qualifications and the objections to it
20 were supported by declarations. Because those declarations
21 revealed material disputed factual issues, the court scheduled an
22 evidentiary hearing on the contested matter as required by Fed.
23 R. Bankr. R. 9014(d). That hearing commenced on July 23, 2008,
24 and concluded on August 22, 2008. At the hearing, the parties
25 addressed whether the City meets the chapter 9 eligibility
26 criteria. See 11 U.S.C. § 109(c).

27 At the hearing, Marc A. Levinson, Norman C. Hile, and
28 Michael Weed appeared for the City of Vallejo (the "City"). Dean

1 M. Gloster, Kelly A. Woodruff, and Monica M. Swanson appeared for
2 the Unions. Robert Kaplan and Nicolas DeLancie appeared for
3 Union Bank. Michael Buckley appeared for Wells Fargo Bank.
4 Other appearances were noted on the record.

5
6 FINDINGS OF FACT

7 1. In the two fiscal years ending prior to the filing of
8 the petition, July 1, 2005 through June 30, 2006, and July 1,
9 2006 through June 30, 2007, the City operated at deficits of \$3.2
10 million and \$4.2 million, respectively. City's Trial Exhibits
11 ("CTE") 1, ¶ 6 & Exh. C, p. 1.

12 The City estimates that in the fiscal year ending June 30,
13 2008, approximately one month after the bankruptcy petition was
14 filed, it continued to operate at a deficit. That deficit is
15 projected to be \$4.2 million. Id.

16 2. At this point it is unclear whether the City's General
17 Fund began the current fiscal year with merely no reserve or a
18 deficit. CTE 1, ¶¶ 15-16, 5, ¶ 7 & Exh. B, pp. 2, 9. This is
19 uncertain because the City does not yet know its final revenue
20 figures and it is still accruing receipts; it has not finished
21 paying its bills from fiscal year 2007-08; and reimbursements due
22 the General Fund by other funds have not been calculated.

23 Reporter's Transcript of Proceedings ("RT"), 8/5/08, p. 211:11-
24 214:6.

25 3. Despite this uncertainty, because fiscal year 2007-08
26 labor costs were higher than budgeted, and because revenues were
27 less than expected, the City's General Fund likely ended the year
28 with a negative balance. Id. pp. 211:20-214:16.

1 4. To maintain financial stability, the Government Finance
2 Officers Association recommends that a city establish and
3 maintain funding reserves of at least 5% of annual revenues. CTE
4 1, ¶ 51 & n. 8, 5, ¶ 26; RT 8/19/08, pp. 116:21-117:11.

5 5. The City derives most of its General Fund revenues from
6 payments received from the State of California and Solano County.
7 These payments include property and sales taxes, and other fees
8 and assessments, for which the City periodically receives lump-
9 sum payments. CTE 1, ¶ 16 & Exh. L, p. 2.

10 a. The City's General Fund receives the bulk of
11 property tax revenues December and April each fiscal
12 year. CTE 1, ¶ 16 & Exhs. C, p. 1, L, p. 2. Each of
13 these payments is approximately \$9 million. CTE 1,
14 ¶ 16 & Exh. L, p. 2. It also receives a small
15 installment of property taxes in June, approximately
16 \$400,000. Id.

17 b. The City receives sales tax revenues on a
18 monthly basis. RT 7/23/08, pp. 84:21-85:1.

19 c. Other revenues are received into the General
20 Fund on a monthly, quarterly, or semi-annual basis, but
21 no substantial revenues are received on a daily basis.
22 CTE 1, ¶ 16.

23 6. Recent adverse economic conditions have negatively
24 impacted the City's primary revenue sources: property taxes,
25 sales taxes, assessments, and fees. CTE 5, Exh. 0, pp. 1-6; CTE
26 1, ¶¶ 24, 26 & Exhs. B, p. 5, 0, pp. 1-3; CTE 1, ¶¶ 26, 27. For
27 instance, the prior fiscal year, the closing of the Vallejo Wal-
28 Mart store significantly reduced the City's sales tax revenue.

1 CTE 1, ¶ 27.

2 7. Also, the General Fund will no longer receive revenue
3 sharing funds from Six Flags/Marine World as a result of the
4 owner's exercise in 2007 of its option to buy the amusement park
5 from the City. CTE 1, ¶ 27 & n. 4.

6 8. Further complicating the City's 2008-09 revenue
7 projections is the possibility that the State of California will
8 decrease funding and reimbursements to cities. RT 8/7/08,
9 pp. 57:16-60:13; RT 8/22/08, pp. 41:25-42:20, 44:19-45:25. Based
10 on a Legislative Analyst's Office's report, the City initially
11 projected a \$1 million decrease from 2007-08 levels of state
12 funds available to the City. CTE 1, ¶ 31 & Exhs. M, p. 15, C, p.
13 1; RT 8/7/08, pp. 57:16-60:13. This could increase to as much as
14 \$3 million. CTE 39, pp. 1-3; RT 8/22/08, pp. 45:15-23.

15 9. Prior to filing its petition, the City projected that
16 General Fund revenues in fiscal year 2008-09 would be
17 approximately \$77.9 million, \$5.3 million less than it expects to
18 collect in 2007-08. CTE 1, ¶ 23 & Exh. C, p. 1, Column A; CTE 1,
19 ¶ 25 & Exh. C, p. 1.

20 10. While revenue has decreased, costs have increased. CTE
21 1, ¶ 6 & Exh. C, p. 1. On May 16, 2008, the City projected
22 expenditures for fiscal year 2008-09 to be approximately \$95
23 million, resulting in a projected General Fund budget deficit
24 approaching \$17 million. CTE 1, ¶ 23 & Exh. C, p. 1, Column A.

25 11. Faced with this deficit, the City prepared an
26 alternative 2008-09 financial projection based on the assumption
27 that it would be compelled to severely reduce funding for
28 services and programs not controlled by contract. It also

1 investigated new revenue sources and projected an additional \$1.4
2 million in revenue. CTE 1, ¶ 54 & Exh. C, p. 1, Column B; RT
3 7/23/08, pp. 93:8-24, 95:7-96:21, 99:5-100:17. However, even
4 under this alternative projection, the City's General Fund
5 deficit remains in excess of \$10 million for fiscal year 2008-09.
6 CTE 1, ¶¶ 54, 58 & Exh. C, p. 1, Column B; RT 7/23/08, pp. 93:8-
7 24, 95:7-96:21.

8 12. Considering the City's falling revenues, its prior
9 years of operating deficits, and the program cuts and deferrals
10 those deficits have necessitated, continuing to shoulder the
11 contractual obligations under the existing Collective Bargaining
12 Agreements (each a "CBA" and together, the "CBAs") with the
13 Unions makes projecting a realistic balanced 2008-09 General Fund
14 budget exceedingly difficult and unlikely. CTE 1, ¶ 58, Exh. C,
15 p. 1; RT 7/23/08, pp. 92:10-18, 96:4-97:5; RT 8/19/08, pp. 80:20-
16 82:5, 84:6-15, RT 8/22/08, pp. 5:18-7:10. The CBAs dictate the
17 employment terms of represented employees, including base pay,
18 overtime, health and medical benefits, minimum staffing levels,
19 pension and retiree health benefits and other compensation
20 components, such as vacation accrual. CTE 1, ¶ 35 & Exh. B, pp.
21 3-4; CTE 2, ¶ 4.

22 13. The City's 2008-09 budget and cash flow projections,
23 based on current service levels and CBA obligations, show that
24 the General Fund would end each month of the fiscal year with a
25 negative cash balance ranging from \$6.1 million to \$22.7 million.
26 CTE 1, ¶¶ 17, 23 & Exhs. C, p. 1, L, pp. 1, 3; RT 7/23/08, pp.
27 101:4-103:14; RT 8/7/08, pp. 5:10-8:25.

28 14. Under the more austere alternative budget projection,

1 the General Fund would experience a \$10 million deficit and,
2 without reserves to begin the year, would operate at a negative
3 cash balance in each month of fiscal year 2008-09. CTE 1, ¶¶ 54-
4 58 & Exh. L, p. 4; CTE 5, Exh. D, pp. 1-5; RT 7/23/08, pp.
5 102:15-25; RT 7/24/08, pp. 31:10-32:6; RT 8/5/08, pp. 36:4-37:17.

6 15. Without relief in this court, the City would not have
7 sufficient funds in any month in fiscal year 2008-09 to pay all
8 the General Fund obligations. CTE 1, ¶ 17 & Exh. L, pp. 1, 3;
9 CTE 5, Exh. D, pp. 1-5; CTE 1, ¶¶ 16-17 & Exh. L, p. 4.

10 16. The City was obligated to make payroll on July 11,
11 2008, for the pay period ending on July 4, 2008. CTE 1, ¶ 17 &
12 Exh. L, p. 4; RT 8/7/08, pp. 5:8-8:4; CTE 1, ¶¶ 17, 39 & Exh. L,
13 p. 4; CTE 5, ¶ 7; RT 8/19/08, pp. 84:17-85:3. Prior to filing
14 the bankruptcy petition, the City projected this payroll payment
15 would be approximately \$2.6 million. CTE 1, ¶ 17 & Exh. L, p. 4;
16 RT 8/7/08, pp. 5:8-8:4. The actual amount was \$2.4 million. CTE
17 5, ¶ 7 & Exh. D, p.1; RT 8/7/08, p. 7:4-8; RT 8/19/08, p. 126:8-
18 13.

19 17. As of July 11, 2008, the General Fund had not received
20 sufficient revenues and did not have enough money on hand to
21 cover the July 11th payroll. CTE 5, ¶ 7 & Exh. D pp. 1-5. The
22 General Fund was approximately \$1.6 million short of making this
23 payroll. CTE 5, Exh. D, pp. 1-5; RT 8/7/08, pp. 5:8-8:4.

24 18. Without a balanced General Fund 2008-09 budget, the
25 City could not borrow money to pay the July 11, 2008 payroll.
26 CTE 5, ¶ 7; RT 8/5/08, pp. 22:4-24:13; RT 8/7/08, p. 8:5-25.

27 19. However, because it filed a chapter 9 petition, the
28 City was able to adopt a balanced 2008-09 budget. CTE 5, ¶ 7; RT

1 8/7/08, p. 8:5-25. It did so based on its ability to adjust
2 General Fund obligations under chapter 9 of the Bankruptcy Code.
3 These adjustments are reflected in the City's Pendency Plan. CTE
4 5, ¶¶ 5, 7.

5 20. In light of its now balanced budget for 2008-09, the
6 City was permitted by the California Constitution and Government
7 Accounting Standards Board ("GASB") regulations to borrow money
8 in the short term from other City funds to cover its cash
9 shortfall. CTE 5, ¶ 7 & Exh. E, pp. 1-4; RT 8/7/08, p. 8:9-25.

10 21. Over several years, the City has attempted to address
11 the deficits in the General Fund and to implement measures to
12 balance the General Fund and avoid bankruptcy. CTE 1, ¶¶ 7-15,
13 41-49; RT 8/19/08, pp. 97:16-98:2.

14 22. The City has reduced expenditures to the point that
15 municipal services have been decreased and are under-funded. CTE
16 1, ¶¶ 41, 42, 45, 48; RT 7/23/08, pp. 110:6-15, 111:14-20; RT
17 8/19/08, pp. 109:25-110:15.

18 23. From the 2003-04 fiscal year to the date the bankruptcy
19 petition was filed, the City reduced the General Fund employee
20 rolls by 87 full-time positions. CTE 1, ¶ 41 & Exh. N, p. 1; CTE
21 1, ¶¶ 41-45; RT 8/19/08, pp. 109:25-110:3. The City also has cut
22 funding for community services, such as its senior center,
23 library, parks, convention and visitors bureau, symphony and
24 other community programs and services. CTE 1, ¶ 48; RT 8/19/08,
25 p. 110:11-15.

26 24. The City has cut funding for street maintenance and
27 vehicle replacement. CTE 1, ¶ 46. The General Fund finances 70%
28 of the maintenance and replacement costs of the City's 400-plus

1 vehicles and pieces of equipment. CTE 1, ¶ 47. As of June 30,
2 2007, the fleet was 82% depreciated. Id. The City repeatedly
3 has extended the "lives" of the majority of its vehicles and
4 equipment. Id. Approximately 70% of the vehicles supported by
5 the General Fund are 3 to 5 years beyond their expected life,
6 which has resulted in increased maintenance costs. CTE 1, ¶¶ 4,
7 47; RT 7/23/08, p. 110:6-15.

8 25. From December 2006 through June 2007, as the City
9 adopted its 2007-08 fiscal year budget, it identified
10 approximately \$10 million in cuts to City programs and service
11 expenditures that did not require the mutual agreement of other
12 parties in order to be implemented. CTE 1, ¶ 8; CTE 11, pp. 1-
13 57.

14 26. On November 13, 2007, the General Fund budget update
15 for the 2007-08 fiscal year showed a deterioration in the
16 financial position of the General Fund despite the City's cuts in
17 expenditures. CTE 1, ¶ 9. The City Council then focused on
18 developing strategies to establish a General Fund financial
19 structure that could ensure the short-term and long-term fiscal
20 solvency. CTE 1, ¶ 9 & Exhs. E, pp. 1-13, F, pp. 1-10, G, pp. 1-
21 55; CTE 11, pp. 1-57.

22 27. On December 18, 2007, staff presented to the City
23 Council an analysis of the status of the General Fund and
24 detailed financial projections for the General Fund through the
25 end of the 2009-10 fiscal year. CTE 1, ¶ 10 & Exh. H, pp. 1-2,
26 10. The analysis showed that, due to greater than anticipated
27 declines in revenues and increases in expenditures, the General
28 Fund would be depleted before the end of the fiscal year of the

1 2007-08 fiscal year. CTE 1, ¶ 10 & Exh. H, pp. 5-6.

2 28. Staff also recommended that the City discuss with VPOA,
3 IAFF, IBEW, and CAMP modifications to the CBAs, which are
4 effective through June 30, 2010, to obtain economic concessions
5 in order to reduce the City's labor costs as one component of the
6 City's financial recovery plan. CTE 1, ¶ 10 & Exh. H, pp. 1, 2,
7 4-5.

8 29. On February 13, 2008, staff and the City Council
9 conducted a public study session to explore in detail the City's
10 financial position and strategies for recovery. CTE 1, ¶ 12 &
11 Exh. I, pp. 1-3. At the study session, staff provided financial
12 projections that expanded the General Fund budget analysis
13 through the end of fiscal year 2011-12. CTE 1, ¶ 12 & Exh. I,
14 pp. 1, 11. The study session indicated that, absent immediate
15 action to reduce costs and increase revenues, it was likely that
16 the reserves in the General Fund would be exhausted before the
17 end of the 2007-08 fiscal year. CTE 1, ¶ 12 & Exh. I, p. 2.

18 30. In February 2008, the City retained a consultant to
19 identify potential sources of new and additional revenue. CTE 6,
20 ¶ 8. The consultant prepared a draft report which preliminarily
21 described a number of potential avenues by which the City might
22 generate additional revenues. Id.; Unions' Trial Exhibit ("UTE")
23 DD, pp. 1-23.

24 31. In February 2008, several police officers and
25 firefighters unexpectedly retired, obligating the City to pay
26 unbudgeted retiree pay-outs of approximately \$3.4 million. These
27 pay-outs exacerbated the imbalance in the General Fund for fiscal
28 year 2007-08. CTE 1, ¶ 12 & n. 1.

1 32. In March 2008, the City adopted a Fiscal Emergency Plan
2 and revised the 2007-08 General Fund budget. CTE 5, ¶ 10; CTE
3 14, pp. 2, 9-11, 19-23; RT 7/23/08, pp. 85:20-86:4, 86:9-12,
4 87:6-12, 88:19-89:3. As part of this plan, the City identified
5 and transferred a total of \$2.4 million to the General Fund from
6 the Vehicle Replacement Fund, Arts and Convention Fund, Repair
7 and Demolition Fund, and Transportation Fund. CTE 5, ¶ 10; CTE
8 14, pp. 9-11, 19-23; RT 8/19/08, pp 85:19-87:7.

9 33. Additional funding reductions threaten, in the judgment
10 of the City, its ability to provide minimal levels of service to
11 its residents and provide for their basic health and safety. CTE
12 1, ¶ 49; RT 7/23/08, pp. 110:6-15; 111:14-20.

13 34. As of May 2008, the City had over 100 special purpose
14 and enterprise funds, apart from the General Fund, that had cash
15 and investments totaling approximately \$136 million. CTE 1,
16 Exhs. A, pp. 1-3, K, pp. 1-3. The Unions contend that some of
17 this \$136 million in cash and investments could be transferred
18 to, or borrowed by, the General Fund. UTE U, ¶¶ 23-27, Exh. B,
19 pp. 13-15; RT 8/21/08, p. 232:4-21. However, nearly all of this
20 cash and the investments are restricted by law or grant to
21 specific uses and are not available to cover the operating
22 expenses of the General Fund. CTE 1, Exh. A, pp. 1-3; CTE 5, ¶
23 8; RT 7/24/08, pp. 136:3-138:12, 138:13-141:7; RT 8/5/08, pp.
24 23:17-25:13; RT 8/7/08, pp. 13:10-14:18.

25 35. The General Fund is the City's unrestricted fund. RT
26 8/5/08, p. 206:20-24. When special purpose or enterprise funds
27 are unable to break even, the General Fund is the fund of last
28 resort that must make up for the deficiency. Id., pp. 205:15-

1 207:18.

2 36. As of June 30, 2008, the City's special purpose or
3 enterprise funds had no significant and legally available money
4 that could be used to cover operating expenses in the General
5 Fund. CTE 5, ¶ 10.

6 37. The Unions nonetheless contend that the City could
7 transfer \$1.7 million from the City's Public Finance Authority to
8 the General Fund. RT 8/19/03, pp. 181:24-182:8; RT 8/22/08, pp.
9 18:8-19:3.

10 38. However, the Public Finance Authority funds pertain to
11 the sale of Six Flags/Marine World. RT 8/22/08, pp. 21:21-22:11.
12 These funds were already budgeted and spent by the General Fund
13 in fiscal year 2007-08. RT 8/22/08, pp. 22:5-11; CTE 1, Exh. A,
14 p. 3; CTE 1, Exh. B, p. 30.

15 39. The Unions further contend that the Convention and Arts
16 Fund could transfer \$4.1 million in advances or loans receivable
17 from the Empress Theatre to the General Fund, providing the
18 General Fund with an additional \$400,000 of cash, and \$4.1
19 million in reserves. RT 8/19/03, pp. 182:25-183:7.

20 40. The unrestricted cash balance in the Convention & Arts
21 Fund has already been appropriated for transfer to the General
22 Fund in fiscal year 2007-08 as part of the Fiscal Emergency Plan.
23 CTE 1, Exh. A, p. 3; CTE 1, Exh. J, pp. 7, 27; RT 8/19/08, pp.
24 85:19-86:23. The remaining \$4.1 million advance or loan
25 receivable, whether recorded in the Redevelopment Agency or
26 Convention & Arts Fund or moved to the General Fund, still
27 represents a non-current asset and does not create any new
28 available fund balance. UTE J, p. 17. The Merged Redevelopment

1 Project Area that has received this advance from the General Fund
2 does not have the additional \$400,000 in surplus fiscal year
3 2008-09 cash flow to commence this repayment to the City. CTE 5,
4 ¶ 12; UTE K, p. F-8.

5 41. The Unions contend that the Hiddenbrooke Overpass and
6 Bridge Construction Funds could loan the General Fund \$4.1
7 million against the \$4.1 million Empress Theatre loan receivable.
8 RT 8/19/03, pp. 185:1-186:12.

9 42. Both the Hiddenbrooke Overpass and Bridge Construction
10 Funds are Development Impact Funds restricted in use by the state
11 Constitution. CTE 1, Exh. A, p. 1. Diversion of cash from
12 either of these two capital funds would impair progress on the
13 capital program for which the funds were collected. UTE K, p. 8.
14 The Bridge Construction Fund is fully leveraged for the Vallejo
15 Station project, as the local contribution to a project that is
16 providing over \$50 million in Federal and State grant investment
17 in the City's waterfront development project. UTE K, p. I-1; RT
18 8/22/08, pp. 58:14-59:21. Further, the \$500,000 advance to the
19 Redevelopment Agency for the Empress Project by the Hiddenbrooke
20 Overpass Fund in fiscal year 2006-07 was not made from existing
21 cash reserves in the fund. UTE J, p. 100; RT 8/22/08, pp. 58:14-
22 59:21. The \$500,000 advance was from new developer receipts into
23 the fund from an amendment to the development agreement that
24 changed the permitted use of this receipt to funding for the
25 Empress Theater project. Id.

26 43. The Unions contend that the City could transfer more
27 money to the General Fund from the Redevelopment Agency. RT
28 8/19/03, pp. 185:12-190:11.

1 44. The Redevelopment Agency is a separate legal entity
2 established under authority of the State of California's Health
3 and Safety Code. RT 8/22/08, pp. 22:19-24:11. It adopts its own
4 budget, issues its own debt, maintains separate bank and
5 investment accounts, receives separate tax allocations/
6 distributions from the City Council, and publishes separately
7 audited financial statements. Id.

8 45. The City Council sits as the governing board of the
9 Redevelopment Agency, but with separate meeting agenda and
10 minutes. RT 8/22/08, pp. 23:16-22. The City Council has
11 fiduciary duties to the agency as its board. RT 8/22/08, pp.
12 23:18-22, 26:25-27:6. Transactions between the City and the
13 agency must be at arm's length transactions and properly
14 documented. Id.

15 46. Redevelopment activities are authorized by the state
16 law in geographic areas referred to as "Project Areas." RT
17 8/22/08, p. 24:1-11. Vallejo currently has two redevelopment
18 project areas: Flosden and the "Merged" project areas. RT
19 8/22/08, pp. 24:12-25:4. The Flosden project area comprises the
20 Six Flags/Marine World and the county fairgrounds area. RT
21 8/22/08, p. 25:5-14. The Merged Project Area comprises the
22 waterfront and downtown area. RT 8/22/08, p. 25:15-20.

23 47. Flosden's remaining outstanding advances from the
24 General Fund were retired in cash in 2001. UTE JJ, p. 2,
25 Flosden Column; RT 8/22/08, p. 28:1-5.

26 48. The City Council retired a portion of the Redevelopment
27 Agency's advances to the General Fund fourteen years ago. CTE
28 46, pp. 1-12; UTE HH, pp. 1-2; UTE II, pp. 1-6. In 1994, the

1 City Council deliberated and determined that interest rate being
2 charged on advances to agency, 10%, was too high because that
3 rate was greater than the City's costs of funds. It determined
4 that the appropriate rate of interest was 4%. This adjustment
5 was made retroactively. CTE 46, pp. 1-12; UTE HH, pp. 1-2; UTE
6 II, pp. 1-6. The Unions suggest that the 10% interest rate be
7 reinstated. RT 8/22/08, p. 28:6-25.

8 49. In 1994, the City Council also authorized the
9 retirement of debt in exchange for the transfer of infrastructure
10 assets, including transfer of title to City Hall and the adjacent
11 library, and project improvements such as roads and sidewalks.
12 CTE 46, pp. 1-12; UTE HH, pp. 1-2; UTE II, pp. 1-6; RT 8/22/08,
13 pp. 29:5-14, 32:14-33:6. Despite these transfers to the City,
14 the Unions believe the City Council, fourteen years after the
15 fact, should reinstate the retired debt of the Redevelopment
16 Agency.

17 50. Consistent with its fiduciary obligations, the City
18 cannot justify the reinstatement of these advances. RT 8/22/08,
19 pp. 28:6-25, 32:17-33:6. Further, even if reinstated, there is
20 no persuasive evidence that the Redevelopment Agency could repay
21 the advances.

22 51. The Merged Project Area has no cash available to pay
23 the General Fund. RT 8/22/08, pp. 35:24-38:21. It receives
24 approximately \$2.2 million in tax revenues per year. UTE K, p.
25 F-8; RT 8/22/08, p. 36:13-16. From this revenue, it has
26 approximately \$1.4 million in fixed costs for debt service,
27 county and trustee fees, and tax pass-through obligations that
28 are budgeted in its debt service funds. RT 8/22/08, p. 36:16-20.

1 In addition, the Merged Project Area pays \$331,323 in overhead to
2 the City (i.e., payment for full cost recovery to the General
3 Fund for City services), and has budgeted an annual \$400,000 loan
4 repayment to the City, leaving less than \$100,000 per year in
5 discretionary spending for all other development agreement
6 obligations. RT 8/22/08, p. 37:1-12. The \$400,000 is the
7 maximum amount that can be repaid to the General Fund annually
8 without jeopardizing the viability of the project area and its
9 own debt service obligations. RT 8/22/08, p. 38:5-21.

10 52. With respect to the Flosden project area, the City
11 Council shifted the entire housing set-aside requirement for the
12 Redevelopment Agency onto Flosden. RT 8/22/08, pp. 38:24-39:21.
13 The Redevelopment Agency pays \$299,732 to the General Fund for
14 overhead. RT 8/22/08, p. 39:22-25. After taking these two costs
15 into account, only \$700,000 remains in the fund for the annual
16 redevelopment mission of the Flosden project area. Id. The fund
17 also is obligated to build a \$7 million parking garage pursuant
18 to the Six Flags development agreement. RT 8/22/08, pp. 40:9-
19 41:2. This obligation will be triggered when the county develops
20 the fairgrounds along I-80 and eliminates a significant portion
21 of the existing Six Flags/Marine World parking facilities. RT
22 8/22/08, pp. 40:9-41:2. There have been recent discussions
23 between Solano County and the City Manager on this development.
24 RT 8/22/08, pp. 50:23-51:6. The 2008-09 year budget
25 appropriated \$1 million of this \$7 million obligation. RT
26 8/22/08, pp. 40:1-14, 50:23-51:6.

27 53. The Unions contend that Hiddenbrooke Overpass and
28 Bridge Construction Funds could loan the General Fund monies

1 against \$3 million in surplus properties. RT 8/19/08, p. 186:5-
2 11.

3 54. Both the Hiddenbrooke Overpass and Bridge Construction
4 Funds are Development Impact Funds restricted in use by the state
5 Constitution. CTE 1, Exh. A, p. 1. The City would not meet its
6 fiduciary responsibility to these restricted funds if it
7 exchanged interest-earning cash for a non-productive surplus land
8 asset of uncertain value in a declining real estate market. RT
9 8/5/08, pp. 67:3-9, 71:19-72:3, 97:20-98:4.

10 55. Also, the Unions' estimate of real estate value is
11 based on a draft report that has since been updated. UTE Q, p.
12 25; CTE 6, ¶ 8; RT 7/25/08, p. 70:8-15. Further, the City's
13 surplus land is not an asset reportable in the City's
14 governmental fund financial statements. These statements do not
15 include either capital assets or long-term debt based upon the
16 required GASB "modified accrual" accounting basis. Instead, the
17 focus is on "current financial resources." UTE J, p. 37. Thus,
18 there is no "asset" to transfer from the General Fund to either
19 of these restricted funds. In addition to violating GASB and
20 sound fiscal policy, the California Constitution prohibits the
21 City from incurring in any year a debt which it cannot pay from
22 revenues attributable to the same year.

23 56. The Unions contend that the City could transfer money
24 from the Transportation Fund to the General Fund. RT 8/21/08,
25 pp. 198:8-199:7.

26 57. The Transportation Fund has significant financial
27 challenges of its own, in large part due to increasing fuel costs
28 and decreasing ridership. CTE 1, Exh. A, p. 2; CTE 5, ¶ 14; RT

1 7/24/08, pp. 120:20-121:17; RT 8/5/08, pp. 107:12-24, 150:7-25,
2 152:23-155:13, 205:14-16. The General Fund is the fund of last
3 resort and is the fund that covers deficiencies in the City's
4 enterprise funds. RT 8/5/08, p. 206:20-24. Because the
5 Transportation Fund relies on federal and state reimbursement
6 grants, it can be reimbursed only for its actual expenditures,
7 and therefore does not earn a profit or surplus funds that can be
8 made available for repayment of prior subsidies from the General
9 Fund. RT 8/5/08, p. 150:19-25.

10 58. The Unions contend that the General Fund could reduce
11 its subsidy to the Marina Fund by \$200,000 a year.

12 59. The General Fund subsidizes the Marina Fund because the
13 Marina Fund cannot pay its debt service and the General Fund is
14 obligated as the ultimate guarantor of Marina debt through bond
15 documents. CTE 1, ¶ 51; RT 7/23/08, p. 115:3-12; RT 8/7/08, p.
16 38:6-15. All available Marina Fund revenues, including the 2008-
17 09 CPI rate increase, have already been included in the 2008-09
18 budget. UTE K, p. E-1. The net assets of the Marina in the last
19 audited financial statements, dated June 30, 2007, show that
20 Marina Fund liabilities exceed its assets by \$209,297, creating a
21 deficit equity position. UTE J, p. 26; RT 8/5/08, pp. 30:6-31:6.

22 60. The City also has worked with outside parties to
23 identify and consider ways to improve operations, including
24 privatization, but has not identified any viable options to
25 improve cash flow to permit the Marina Fund to fully cover its
26 operation and debt obligations. RT 8/5/08, pp. 18:6-25:13,
27 205:23-207:19; RT 8/7/08, pp. 39:16-40:10.

28 61. The Housing Authority's monies are restricted by the

1 U.S. Department of Housing and Urban Development to use for
2 housing operations. RT 7/24/08, pp. 136:16-19, 138:3-12, 18-25.

3 62. Constitutional protections under Proposition 218, as
4 well as bond covenants restrict, and protect revenues of the
5 Water Fund. RT 8/7/08, pp. 13:20-14:5.

6 63. The City's other special purpose & enterprise funds are
7 similarly restricted. CTE 1, Exh. A, pp. 1-3.

8 64. The City's Risk Management/Self Insurance Fund ("Risk
9 Management Fund") is available to support General Fund cash
10 needs. However, as of June 2007 claim liabilities on the fund
11 exceeded assets by \$2.3 million. CTE 5, ¶ 11; RT 7/24/08, pp.
12 120:4-121:17; RT 8/5/08, pp. 151:5-155:13. Despite this
13 insolvency, the City in its Pendency Plan transferred \$1 million
14 from the Risk Management Fund to the General Fund for fiscal year
15 2008-09. Id.; RT 8/19/08, pp. 120:2-121:1. Further draws upon
16 the Risk Management Fund creates the risk that the City could
17 lose the state's self-insurance certification. It would then be
18 required to purchase outside insurance coverage. CTE 5, ¶ 11.

19 65. The Risk Management Fund's cash position also is
20 negatively impacted by the approximate \$2 million in excess
21 insurance premiums that are due at the start of the fiscal year.
22 Id.; RT 7/24/08, pp. 119:24-121:17.

23 66. The City's labor cost is the largest annual General
24 Fund expenditure. CTE 1, ¶ 34 & Exh. C, p. 1. For the 2007-08
25 fiscal year, the City's General Fund labor cost likely totaled
26 \$74.2 million. CTE 1, ¶ 36 & Exh. C, p. 1. For fiscal year
27 2008-09, based on contractual obligations to raise salaries under
28 the CBAs, the total labor cost is projected to be \$79.4 million.

1 Id.; CTE 5, Exh. B, p. 1, Column A. Of this amount, \$56.8
2 million represents the labor cost for police and firefighter
3 services. CTE 1, ¶ 37 & Exh. C, p. 1, Column A; CTE 2, ¶ 22; CTE
4 5, Exh. B, p. 1, Column A.

5 67. Given the prior year reductions in funding for city
6 services, and given that the labor costs are a majority of the
7 City's General Fund expenditures, it is clear from the evidence,
8 that achieving solvency will require, among other things, serious
9 consideration of economic concessions from the City's labor
10 groups. CTE 1, ¶ 13; RT 7/25/08, pp. 34:5-12, 39:6-22, 92:22-
11 93:2; RT 8/5/08, p. 89:15-21; RT 8/19/08, pp. 80:5-81:23, 96:12-
12 98:7, RT 8/22/08, pp. 5:18-7:8.

13 68. The majority of City employees are represented by one
14 of the four labor groups, each of which is a party to a CBA. CTE
15 1, ¶ 34. Police officers are represented by the VPOA;
16 firefighters are represented by the IAFF; various administrative,
17 engineering, information technology and public works employees
18 are represented by the IBEW; and management employees are
19 represented by Confidential, Administrative, Managerial and
20 Professional Employees Association of Vallejo ("CAMP"). CTE 1,
21 ¶ 34 & Exh. B, p. 3.

22 69. The CBAs are effective through June 30, 2010, and,
23 absent modification, the City is obligated to pay the
24 compensation and maintain the staffing required by the CBAs. CTE
25 1, ¶ 35 & Exh. B, p. 3; CTE 2, ¶ 4.

26 70. In December 2007, the City discussed with the labor
27 groups issues related to the future solvency of the City's
28 General Fund. CTE 2, ¶ 22; RT 8/19/08, pp. 71:21-72:13. The

1 City focused these discussions with the VPOA and the IAFF whose
2 members would receive approximately \$56.8 million of the \$79.4
3 million budgeted for labor costs in 2008-09. CTE 1, ¶ 37 &
4 Exh. C, p. 1, Column A; CTE 2, ¶ 22; CTE 5, Exh. B, p. 1, Column
5 A. Hence, absent sufficient economic concessions from VPOA and
6 IAFF, establishing and maintaining General Fund solvency would be
7 unlikely regardless of any economic concessions IBEW or CAMP
8 might make. Id. However, discussions included IBEW and CAMP,
9 whose members would receive approximately \$13.7 million and \$9.0
10 million, respectively, in 2008-09 under existing contracts. CTE
11 2, ¶ 22 & n. 6.

12 71. The first formal meeting between the City and the
13 Unions occurred on December 10, 2007. CTE 11, pp. 1-58; RT
14 8/19/08, p. 77:16-22. At this meeting, the City provided
15 information to the Unions regarding its dire financial situation.
16 RT 8/19/08, pp. 73:20-74:19.

17 72. The City and the Unions met several times from December
18 2007 through February 2008 but they came to no agreement. RT
19 8/19/08, pp. 81:20-82:14. With the General Fund on the verge of
20 running out of money, on February 28, 2008, City staff
21 recommended to the City Council that the City file a petition
22 under chapter 9 of the Bankruptcy Code. CTE 1, ¶ 14 & Exh. J, p.
23 1; RT 8/19/08, pp. 83:13-84:16.

24 73. Before the City Council considered this recommendation,
25 however, the City, VPOA, and IAFF tentatively agreed on certain
26 interim modifications to the CBAs. These interim changes were
27 approved by the City Council on March 3, 2008 (the "Interim
28 Agreement"). CTE 1, ¶ 14; CTE 13, pp. 1-11; UTE B, pp. 1-5; UTE

1 C, pp. 1-7; UTE D, pp. 1-3; RT 8/19/08, pp. 83:2-84:16.

2 74. Before entering into the Interim Agreement, the Unions
3 required the City settle their grievances and all arbitration and
4 litigation pending between the City and the Unions. CTE 13, pp.
5 8-10; CTE 14, pp. 2-3, 7-8; UTE D, pp. 1-2; RT 8/19/08, pp. 85:9-
6 89:2, 90:22-93:22. The City agreed to this requirement. CTE 13,
7 pp. 8-10; CTE 14, pp. 2-3, 7-8; UTE D, pp. 1-3; RT 8/19/08, pp.
8 88:19-91:23.

9 75. The Interim Agreement was effective through June 30,
10 2008, the end of the 2007-08 fiscal year; it was not effective
11 from and after July 1, 2008. CTE 1, ¶ 14; CTE 2, ¶¶ 7, 8, 23;
12 CTE 13, pp. 2-3; UTE B, pp. 2-3; UTE C, pp. 2-3; RT 8/19/08, pp.
13 84:17-85:3.

14 76. In the Interim Agreement, VPOA and IAFF members waived
15 1.7% and, effective March 1, 2008 through June 30, 2008, roll-
16 back 6.5% of their 2007-08 salary increase due under the CBAs.
17 CTE 2, ¶¶ 7, 23; RT 7/23/08, pp. 89:14-90:5. IAFF agreed that
18 the City could reduce firefighter staffing to levels sufficient
19 for 6 fire stations (22 firefighters), as opposed to the 8
20 stations (28 firefighters) required under the CBAs, through June
21 30, 2008. Id. Also, as part of the Interim Agreement, VPOA
22 deferred its minimum staffing requirement of 145 authorized sworn
23 police positions to May 2010. Id.; CTE 1, ¶ 8; UTE D, p. 1; UTE
24 N, p. 1.

25 77. Department heads, distinct from employees represented
26 by CAMP, took a 3% salary reduction concurrently with (though not
27 as a term of) the Interim Agreements. CTE 1, Exh. C, p. 1; CTE
28 2, ¶ 20; RT 7/24/08, pp. 56:2-57:2, 59:5-12; RT 8/19/08, pp.

1 84:25-85:2.

2 78. As specified in the Interim Agreement, the City, VPOA,
3 and IAFF agreed to engage in mediation for 45 days. RT 8/19/08,
4 p. 94:3-7. The negotiated purpose of the mediation was "[t]o
5 discuss expenditure reductions, revenue enhancements and CBA
6 modifications in an attempt to develop a General Fund budget plan
7 that ensured funding for a range of city services (e.g.,
8 including, but not limited to, fire services, police services,
9 street repair) and provided for a positive General Fund reserve
10 at the end of each fiscal year through June 30, 2012." CTE 2, ¶
11 24; CTE 6, ¶ 5; RT 7/25/08, p. 81:13-23; RT 8/19/08, pp. 94:3-
12 96:9.

13 79. Consistent with their agreed mediation objectives, from
14 March 3, 2008 through May 14, 2008, the parties, joined on
15 occasion by IBEW, met 11 times in mediation and discussed
16 potential revenue enhancements the City could pursue, expenditure
17 reductions the City might be able to implement, and modifications
18 to the CBAs. The City's lead negotiator was Craig Whitton,
19 Assistant City Manager/Community Development. CTE 2, ¶ 21-24;
20 CTE 6, ¶ 4; CTE 10, p. 1; RT 8/7/08, p. 19:9-25; RT 8/19/08, pp.
21 98:24-99:11, 101:15-110:19, 112:12-121:1, 121:18-128:4, 132:18-
22 134:22, 135:13-138:12. Additionally, during this period of time,
23 the parties had less formal discussions not involving the
24 mediator. CTE 2, ¶ 24; RT 8/19/08, pp. 98:24-99:11.

25 80. With respect to potential revenue enhancements, at the
26 Unions' request, the City provided their representatives with the
27 draft revenue enhancement report that had been prepared by the
28 City's consultant. UTE U, Exh. C, pp. 1-23; UTE DD, pp. 1-23; RT

1 7/25/08, pp. 64:9-65:21; RT 8/7/08, pp. 60:14-61:24. The Unions
2 requested that the City delay presentation of that report to the
3 City Counsel until such time as the City and the Unions were able
4 to simultaneously present their anticipated agreed modification
5 to the CBAs. UTE P p. 1; RT 7/25/08, p. 65:10-19; RT 8/7/08, p.
6 61:5-20.

7 81. The parties exchanged several proposals during the
8 course of mediation. RT 8/19/08, pp. 101:15-24, 112:15-23,
9 121:2-122:9, 134:19-22.

10 a. The City made a written proposal on March 17,
11 2008. UTE LL, pp. 1-14; RT 8/19/08, p. 101:15-24.
12 With respect to salary levels, the City proposed a
13 roll-back in salaries to June 30, 2006 levels. UTE LL,
14 p. 4; RT 8/19/08, p. 103:18-23. This rollback would
15 result in lower salaries than those that had been
16 established under the Interim Agreement. RT 8/19/08,
17 pp. 103:18-104:2.

18 b. The City's March 17th proposal also offered a
19 two-year extension of the CBAs (through June 30, 2012)
20 and contained a salary re-opener for these two years
21 pursuant to which salary increases would be possible.
22 UTE LL, pp. at 1; RT 8/19/08, p. 104:5-23. The City
23 also proposed that it work with the labor groups and
24 the community to generate support for voter-approved
25 revenue increases, such as a voter-approved tax
26 measure. UTE LL, at pp. 2-3; RT 8/19/08, pp. 105:3-
27 106:24.

28 c. The City's March 17, 2008, proposal also

1 addressed General Fund expenditure reductions in the
2 form of additional cuts to City services and positions,
3 as well as negotiations with bond holders and banks to
4 reduce the City's debt costs. UTE LL, p. 3; RT
5 8/19/08, p. 109:2-24.

6 d. The City made a second proposal to the Unions
7 on April 17, 2008. CTE 15, pp. 1-16; RT 8/19/08, p.
8 112:15-23. With respect to salary levels, the City
9 proposed a 5% roll back in salaries from the March 1,
10 2008 levels (i.e., the Interim Agreement levels). The
11 proposed 5% roll back was more favorable to the Unions
12 than the rollback to June 30, 2006 salary levels
13 proposed in the City's March 17th offer. CTE 15, p. 1;
14 CTE 15, p. 1; RT 8/19/08, p. 115:21-116:11; RT 8/19/08,
15 p. 115:16-20; RT 8/19/08, p. 115:21-116:11.

16 e. In its April 17th proposal, the City again
17 offered a 2-year contract extension with salary re-
18 openers for those years. CTE 15, p. 1; RT 8/19/08, p.
19 116:12-14. The City added a new term providing for
20 restoration of salaries in connection with the
21 establishment of a 5% General Fund reserve. CTE 15, p.
22 1; RT 8/19/08, pp. 116:15-117:3.

23 f. The City also added new commitments to
24 increase revenues, including: (i) repayment of the
25 Redevelopment Agency's debt to the General Fund in the
26 Merged Project Area via the Flodden payment of the
27 required 20% housing set aside; (ii) annually filing SB
28 90 claims and; (iii) a one-time transfer of \$1,000,000

1 cash from the Risk Management Fund to the General Fund.
2 CTE 15, pp. 2-4; RT 8/19/08, pp. 117:16-121:1. The
3 City has subsequently implemented each of these revenue
4 proposals. RT 8/19/08, pp. 117:16-121:1.

5 g. In its April 17th proposal, the City also offered
6 to make additional expenditure reductions. CTE 15, pp.
7 4-5.

8 h. On April 21, 2008, the Unions made a written
9 proposal to the City. RT 8/19/08, pp. 121:2-123:4.
10 Among other terms, the Unions proposed a two-year
11 contract extension through June 30, 2012. RT 8/19/08,
12 pp. 122:23-123:16.

13 i. The City responded to the Unions' proposal on
14 May 4, 2008. CTE 17, pp. 1-7; RT 8/19/08, pp. 121:18-
15 122:9. In its May 4th proposal, the City again moved
16 its position with respect to salary levels, offering to
17 maintain salaries at the levels established in the
18 Interim Agreements, levels that were higher than the 5%
19 rollback previously offered by the City. CTE 17, pp.
20 1, 4; RT 8/19/08, pp. 125:9-126:7. The City's proposal
21 again included a two-year contract extension with
22 salary re-openers tied to the City's economic condition
23 and the salaries paid by comparison cities to be agreed
24 upon by the parties. CTE 17, pp. 1, 2, 4, 5; RT
25 8/19/08, pp. 126:14-127:2.

26 j. The Unions did not accept the City's May 4,
27 2008, offer. RT 8/19/08, p. 132:15-17.

28 82. On May 6, 2008, the City Council, by a unanimous vote,

1 authorized the City to file a petition under chapter 9 of the
2 Bankruptcy Code. CTE 2, ¶ 24; Statement of Qualifications Under
3 Section 109(c), Exh. 1; RT 8/19/08, pp. 132:18-133:6.

4 83. The City and the Unions continued the mediation after
5 the City Council authorized the bankruptcy filing, meeting again
6 with the mediator on May 9th and May 14th. CTE 2, ¶ 24 & n. 7;
7 RT 8/19/08, pp. 133:7-134:22.

8 84. On May 14, 2008, the City made another proposal to the
9 Unions. CTE 18, pp. 1-8; RT 8/19/08, p. 134:19-22. This
10 proposal again provided for salaries at the Interim Agreement
11 levels, a two-year contract extension, and salary re-openers.
12 CTE 18, pp. 1-8; RT 8/19/08, pp. 134:19-22, 135:13-136:13. The
13 City also proposed to make certain revenue enhancements and
14 expenditure reductions. CTE 18, p. 8.

15 85. The Unions did not accept the City's May 14, 2008
16 offer. RT 8/19/08, p. 136:14-16. Nonetheless, discussions
17 between the City and the Unions continued after the mediation
18 formally ended, from May 14, 2008 through May 16, 2008. RT
19 8/19/08, pp. 136:17-138:2.

20 86. During this period of time, the City proposed
21 additional terms, and the Unions made their final offer. UTE W,
22 pp. 1-5; RT 8/19/08, pp. 136:17-138:2. The City did not accept
23 the Unions' final offer because it did not provide General Fund
24 solvency beyond one year. CTE 24, pp. 1-6; CTE 25, pp. 1-5; RT
25 8/19/08, pp. 138:13-141:6. In other words, the Unions' final
26 offer did not meet the agreed-to mediation objective that the
27 parties "develop a General Fund budget plan that ensured funding
28 for a range of city services (e.g., including, but not limited

1 to, fire services, police services, street repair) and provided
2 for a positive General Fund reserve at the end of each fiscal
3 year through June 30, 2012." CTE 2, ¶ 24; RT 8/5/08, pp. 188:17-
4 195:8, 203:6-204:1; RT 8/7/08, pp. 9:6-11:17; RT 8/19/08, pp.
5 97:2-15, 138:13-141:6.

6 87. Under the terms of the Unions' final offer, the City
7 would be obligated: (1) beginning no later than July 1, 2009, and
8 as early as March 1, 2009, to pay a 6.5% salary increase over
9 Interim Agreement levels to police and firefighters;
10 (2) beginning July 1, 2010, to pay another salary increase to
11 police and firefighters, and a salary increase to employees
12 represented by IBEW, of at least 3% and up to 5%; (3) in the
13 subsequent three fiscal years (2011-12, 2012-13, and 2013-14), to
14 pay an additional salary increase to police, firefighters and
15 IBEW members of at least 3% and up to 5% in each year; and (4) to
16 return to full daily staffing of 28 firefighters on July 1, 2010
17 and minimum staffing of 145 sworn police positions in May 2010.
18 CTE 6, ¶ 15; UTE W, pp. 1-5; RT 8/19/08, pp 138:13-141:6.

19 88. The Unions' final offer also required that the CBAs be
20 extended four additional years, through the end of fiscal year
21 2013-14. UTE W, pp. 1-5. And, while the Unions' final offer
22 would have allowed the City to arbitrate annual salary increases
23 that would accrue during this extension if the City believed it
24 could not afford those increases, the City did not consider the
25 right to arbitrate contractually-obligated salary increases to be
26 fiscally prudent given that the City's cost projections
27 demonstrated that the Unions' proposals would not generate
28 solvency for the General Fund except possibly in fiscal year

1 2008-09. CTE 6, ¶ 15 n. 2; CTE 24, pp. 1-6; CTE 25, pp. 1-5; RT
2 7/25/08, pp. 87:19-88:6; RT 8/5/08, pp. 38:18-24, 188:17-195:8,
3 195:15-201:24; RT 8/7/08, pp. 9:6-11:17; RT 8/19/08, pp. 132:8-
4 14, 139:12-140:10.

5 89. Throughout the mediation, the City generated cost
6 projections to calculate the economic results of the Unions'
7 proposals. CTE 24, pp. 1-6; CTE 25, pp. 1-5; RT 7/25/08, pp.
8 87:19-88:6; RT 8/5/08, pp. 38:18-24, 188:17-195:8, 195:15-201:24;
9 RT 8/7/08, pp. 9:6-11:17. For fiscal year 2009-10, the City's
10 cost projection of the Unions' final offer showed a substantial
11 General Fund budget deficit. CTE 24, pp. 1-6; RT 8/5/08, pp.
12 192:25-194:16, 198:2-201:2. The projections demonstrated that,
13 once the 6.5% salary increase was restored in fiscal year 2009-
14 10, General Fund revenues could no longer cover expenses. RT
15 8/5/08, pp. 194:5-16. Likewise, in fiscal years 2010-11 and
16 2011-12, the Unions' proposal would result in substantial and
17 increasing General Fund budget deficits. CTE 25, pp. 1-5; RT
18 8/5/08, pp. 199:17-200:10.

19 90. Further, the City's cost projection did not factor in a
20 3% to 5% increase in the out years, the restoration of two fire
21 stations beginning fiscal year 2010-11 through 2013-14, or the
22 increase of police officer staffing beginning fiscal year 2010-11
23 through 2013-14, all of which would be required by the Unions'
24 final offer. RT 8/7/08, pp. 9:10-11:17, 18:5-10. These facts
25 would have increased the deficits calculated in CTE 24 and CTE
26 25. Id.

27 91. The City concedes that prior to the filing of its
28 petition that it did not discuss with the Unions a specific

1 chapter 9 "plan of adjustment." However, the City and the Unions
2 did discuss the City's potential chapter 9 filing and the ways in
3 which that filing would affect the City's and the Unions'
4 positions during: (a) the negotiations; (b) the mediation
5 proceedings from March 3 until May 14; and (c) after the
6 mediation concluded. CTE 2, ¶¶ 21-25; CTE 4, ¶¶ 5-8; CTE 10, p.
7 1; RT 8/19/08, pp. 72:23-73:19, 83:13-84:16, 132:18-134:22,
8 135:13-138:12. Those discussions addressed what claims the
9 Unions would have in a chapter 9 case, how those claims could be
10 enhanced by extending the Union contracts before a petition was
11 filed, and how the City's acceptance of the Unions' offers might
12 compel a later chapter 9 filing by the City. RT 8/19/08, pp.
13 130:5-23, 138:3-141:6, 143:12-144:16. Also, their discussions,
14 both in and out of the agreed mediation process, addressed not
15 only the Unions' rights under the CBAs and the modification of
16 those rights, but how the City might increase its revenues. In
17 other words, the parties discussed both debt adjustment and
18 revenue enhancement in the context of an out-of-court-debt
19 restructure. They attempted to negotiate a plan of arrangement
20 that would eliminate the need for a petition.

21 92. The City has approximately \$54 million in outstanding
22 bonds that are obligations of the General Fund. CTE 1, ¶¶ 50-53.
23 Much of this debt is secured by letters of credit, one of which
24 will expire in December 2008. CTE 1, ¶ 53.

25 93. In its General Fund budget projections for fiscal year
26 2008-09, the City based its debt service expenditure projection
27 on an assumed 9% debt service cost. CTE 1, ¶ 51. The City
28 established the 9% projection based on discussions with the

1 City's financial consultants and the terms of the bond documents.
2 CTE 5, ¶ 28.

3 94. The General Fund subsidizes the Marina Fund debt
4 service obligation because the Marina Fund cannot pay its debt
5 service and the General Fund is obligated as the guarantor of the
6 Marina Fund debt. CTE 1, ¶ 51; RT 7/23/08, p. 115:3-12; RT
7 7/24/08, pp. 22:8-24:11; RT 8/5/08, pp. 21:15-22:3; RT 8/7/08,
8 pp. 38:24-39:7.

9 95. After the City implemented its Pendency Plan on July 1,
10 2008, the City's letter of credit provider invoked a mandatory
11 tender of approximately \$47 million in outstanding variable rate
12 bonds backed by the General Fund. CTE 5, ¶ 28. The City is
13 obligated to pay the Reference Rate (i.e., prime rate) plus 1%
14 after 90 days on the tendered bonds and potentially could be
15 required to pay the Reference Rate plus 3% should a default be
16 declared. CTE 1, ¶ 51; CTE 5, ¶ 28; UTE G, p. 5; RT 7/23/08, pp.
17 124:22-126:1, 129:21-25.

18 96. The City Council has appropriated funds to retire
19 approximately \$7 million of bonds by repaying cash derived from
20 bond issuances that had not been used or dedicated to a project.
21 CTE 5, ¶ 28 & n. 8; RT 7/24/08, pp. 25:3-26:18.

22 97. In March and April 2008, the City discussed its
23 potential bankruptcy filing and potential debt obligation
24 adjustments with Union Bank, the credit enhancer of several of
25 the letters of credit supporting the City's bond obligations.
26 CTE, ¶¶ 5-8; RT 7/24/08, pp. 81:9-17, 83:3-14, 84:10-13. The
27 City requested that the bank extend the letter of credit that is
28 scheduled to come due December 1, 2008 and requested that the

1 bank commit to a lower interest rate on the City's outstanding
2 debt obligations. RT 7/24/08, pp. 85:19-87:2.

3 98. Union Bank's CDTM Credit and Risk Management Division
4 Senior Vice President and Manager, Cecilia Valente, testified
5 that the bank could not determine or implement specific
6 adjustments to the City's debt obligations without a viable,
7 long-term plan from the City establishing General Fund solvency.
8 CTE, ¶¶ 5-8. Ms. Valente testified that Union Bank concluded
9 that it should defer detailed discussions with the City regarding
10 adjustments to the City's General Fund bond obligations until the
11 City and the labor groups finalized a viable solution for the
12 City's long-term labor costs. CTE, ¶¶ 5-8; RT 7/24/08, pp.
13 93:11-94:5, 95:12-97:3.

14 99. Prior to filing its petition, the City could not
15 identify all its creditors for purposes of pre-petition
16 negotiation, including, in particular, an unknown number of
17 retirees who collectively hold the largest claim against the City
18 (approximating \$215 million), as well as unknown bondholders and
19 potential tort claimants who may or may not have yet asserted a
20 claim against the City. See City's List of Creditor's Holding 20
21 Largest Unsecured Claims, filed May 23, 2008; Statement of
22 Position by California Public Employees Retirement System
23 Regarding Motion for Order Appointing Unions as Retiree Benefit
24 Representative for Retirees from their Work Units, filed July 23,
25 2008.

26 100. The sole witness called by the Unions to support their
27 objections was Roger Mialocq. Mr. Mialocq was retained by the
28 Unions in the spring of 2008 to analyze the City's 2008-09 budget

1 and its underlying assumptions and projections. While Mr.
2 Mialocq's profession entails assisting municipalities with public
3 agency budgeting, he is not a certified public accountant, an
4 accountant, or a financial auditor.

5 101. Neither Mr. Mialocq's report nor his testimony
6 persuades the court that the City is solvent or will be solvent
7 in 2008-09, has acted in bad faith, or has significantly
8 misstated its 2008-09 likely revenues or expenditures. The basic
9 thrust of both his report and his testimony is that the City
10 could realize approximately \$3.1 million in new revenues and it
11 has overstated its labor expenses by approximately \$5 million.
12 The court is unpersuaded.

13 102. Mr. Mialocq damaged his credibility with the court when
14 he admitted that, after initially declining to assist the Unions,
15 he took the assignment because he felt that the City's bankruptcy
16 petition would harm his other clients. RT 8/21/08, pp. 143:11-
17 144:2.

18 103. On the other hand, the court found the testimony of
19 Susan Mayer, the City's Assistant Finance Director, and Craig
20 Whitton, the City's Assistant City Manager/Community Development,
21 to be much more helpful and credible. While the court is mindful
22 that each is a City employee and therefore could be expected to
23 testify in the City's interests, even counsel for the Unions
24 conceded at the hearing that the City was lucky to have Ms. Mayer
25 and Mr. Whitton helping it deal with its serious financial
26 problems. The court agrees.

27 a. Mr. Whitton has more than eighteen years of
28 experience at the City and has a thorough knowledge of

1 the City's financial operations. It is primarily
2 because of his efforts during the negotiations with the
3 Unions that the court concludes, as indicated below,
4 that the City attempted in earnest to come to fair
5 terms with the Unions in order to avoid a bankruptcy
6 petition.

7 b. Ms. Mayer, unlike Mr. Mialocq, is a certified
8 public accountant. She has twenty-two years of
9 professional experience, with eighteen years in
10 municipal financial accounting. CTE 1, ¶ 2; RT
11 7/23/08, p. 81:15-20. During a lengthy cross-
12 examination, she displayed a thorough knowledge of
13 municipal accounting in general and the City's finances
14 in particular. As Ms. Mayer indicated, budgeting is
15 not a science. Nonetheless, the court found her
16 analysis and opinions regarding the City's likely
17 insolvency in 2008-09 very persuasive, complete, and
18 based on sound analysis and assumptions.

19 104. To the extent Mr. Mialocq may be of the opinion that
20 the City is or could be solvent, the persuasiveness of his
21 opinion was undercut by an admission by the Unions' attorney.
22 During argument counsel indicated that the Unions' final offer to
23 the City required a four-year extension of the CBAs in order to
24 ensure that their members had a larger rejection claim if the
25 City accepted their proposal but thereafter filed a bankruptcy
26 petition. RT 8/19/08, pp. 129:18-130:23, 143:12-144:16. To the
27 court, this was an acknowledgment that efforts to avoid
28 bankruptcy by further cost-cutting and attempting to enhance

1 revenues (along the lines suggested by Mr. Mialocq) were unlikely
2 to be successful.

3 105. The basic problem with Mr. Mialocq's report and
4 testimony was that he did not conclude that the City was not
5 insolvent or that the General Fund would be able to pay its debts
6 as they came due during 2008-09. UTE U, ¶¶ 1-40 & Exh. B, pp. 1-
7 15 & Attachments; RT 8/21/08, pp. 138:10-139:14, 140:19-21,
8 141:10-14, 158:5-8, 159:23-25, 160:9-19. In fact, Mialocq
9 concluded that in fiscal year 2008-09 the General Fund would
10 experience a deficit of \$3,355,031, and he admitted the City's
11 financial condition was dire. UTE U, Exh. B, p. 16, Schedule 1;
12 RT 8/21/08, pp. 232:1-234:5.

13 106. Mr. Mialocq's suggestions for enhancing City revenues
14 by approximately \$3.1 million were taken from a draft report
15 commissioned by the City. Cf. UTE U, Exh. B, Attachment 2 with
16 Exh. C; see also CTE 6, ¶ 8; UTE U, ¶¶ 11, 12, 15-27, p. 18
17 (Appendix 1), Exhs. B, pp. 3-5, 5-11, Attachment 2, & C; RT
18 8/21/08, pp. 176:25-177:18, 179:1-4, 179:20-180:6, 180:14-181:6,
19 185:5-11, 187:8-10.

20 a. Mr. Mialocq asserted that the City might
21 obtain \$1.3 million in new revenue by instituting a 911
22 service fee. UTE U, Exh. B, Attachment 2. The
23 legality of a non-voter approved 911 service fee,
24 however, has been called into question. RT 8/5/08, pp.
25 102:10-103:13; see Bay Area Cellular Telephone Co. v.
26 City of Union City, 2008 Cal. App. LEXIS 634 (April 29,
27 2008); CTE 1, ¶ 32. Mr. Mialocq conceded that a 911
28 service fee likely would require voter approval, and

1 therefore could not be feasibly included as revenue in
2 fiscal year 2008-09. UTE U, ¶ 12; RT 8/21/08, p.
3 183:5-9, 20-22. Further, in the current economic and
4 political environment, the City reasonably believes
5 that voter approval of any additional taxes and
6 assessments is unlikely. CTE 1, ¶ 28; CTE 5, ¶ 23; RT
7 8/7/08, pp. 30:17-31:7; RT 8/19/08, pp. 105:20-107:9.
8 And, seeking voter approval could be expensive. A vote
9 to increase or create new general taxes must occur in
10 an election in which City Council membership is on the
11 ballot, or be approved by unanimous City Council vote
12 for placement on an off-Council year ballot. CTE 5, ¶
13 23. An off-Council year ballot tax measure costs
14 approximately \$500,000 to \$700,000 because the City is
15 charged by the County. Id.

16 b. Mr. Mialocq also asserted that the City could
17 raise \$900,000 in new revenue by charging for Emergency
18 Medical Services. UTE U, Exh. B, Attachment 2. The
19 implementation and administration costs of an Emergency
20 Medical Services fee program, in addition to the
21 uncertainties involved in collecting the charges after
22 services have been provided (to people who often lack
23 the resources to pay), lessen the potential revenue-
24 generating capacity of this program. CTE 5, ¶ 19; RT
25 8/5/08, pp. 210:17-212:19; RT 8/7/08, pp. 47:19-48:20.

26 c. Mr. Mialocq recommended the City attempt to
27 collect an additional \$350,000 from a Landscape
28 Maintenance Assessment District expansion. UTE U, Exh.

1 B, Attachment 2. In order to implement an assessment
2 district, the favorable vote of all property owners
3 assessed is required, thus a city-wide landscape
4 assessment district would require the affirmative vote
5 of the owners of city property. Id. If the vote were
6 unfavorable, the City would bear the costs of
7 conducting the election. Id. However, no monies could
8 be recovered in fiscal year 2008-09 even if a vote were
9 successful because the City cannot implement an
10 assessment district mid-year. CTE 5, ¶ 18.
11 Furthermore, assessment districts only can generate the
12 amount of money required to pay for the services
13 provided by the district. CTE 5, ¶ 18. Even if a
14 city-wide landscape district were implemented, the City
15 could replace only services costing \$99,000 that are
16 currently paid out of the General Fund. Id.; RT
17 8/5/08, pp. 118:7-120:1.

18 d. Mr. Mialocq also recommended that the City
19 sell surplus properties. He believed that \$351,563
20 could be raised in fiscal year 2008-09. However, the
21 City has a program in place to sell surplus property
22 and in October 2007, the City identified four such
23 properties for sale. UTE Z, pp. 1-7. However, the
24 City's ability to sell these or any of its surplus
25 properties before June 30, 2009 is speculative. RT
26 8/5/08, pp. 67:3-9, 71:19-72:3, 97:20-98:4.

27 e. Mr. Mialocq also suggested the City budget
28 \$164,000 in fiscal year 2008-09 for revenues derived

1 from reimbursement to the City from the State of
2 California in connection with SB 90 claims. UTE U,
3 Schedule 1. However, the City received less than
4 \$7,500 per year in reimbursements for the last two
5 years in which the City submitted eligible SB 90
6 claims. CTE 5, ¶ 24 & Exh. H-1, pp. 1-7; UTE FF, pp.
7 1-5. In fiscal year 2008-09, given the state's
8 financial situation, receipt of SB 90 reimbursements is
9 particularly speculative, and Mr. Mialocq acknowledged
10 that payment by the state on SB 90 claims is
11 "sporadic." Id.; UTE U, Exh. B, p. 5. Nevertheless,
12 the City has retained a consultant familiar with the
13 City's finances and records to prepare and file current
14 and delinquent SB 90 claims. CTE 5, ¶ 24; RT 8/5/08,
15 pp. 135:23-137:18.

16 f. Mr. Mialocq suggested that the City increase
17 its fees. UTE U, ¶ 20, Exh. B, p. 4; RT 8/21/08, pp.
18 188:9-189:6. The City, however, previously updated
19 significant development-related fees on July 1, 2007 to
20 provide for full cost recovery. CTE 5, ¶ 16; RT
21 8/5/08, pp. 106:4-107:5; RT 8/19/08, p. 189:2-6. An
22 automatic annual Consumer Price Index ("CPI")
23 adjustment increase was applied to the remaining fees.
24 RT 8/5/08, pp. 84:6-7, 106:20-23.

25 g. Mr. Mialocq recommended that the City
26 increase fares for its ferry service. UTE U, Exh. B,
27 p. 4; RT 8/21/08, pp. X. The City recently increased
28 fares on its ferry service. RT 8/5/08, p. 107:6-24.

1 Following the fare increase, ridership declined 21%.
2 Id. Even had revenues increased, revenues generated
3 from the ferry are restricted to the Transportation
4 Fund and are not available for use in the General Fund.
5 RT 8/5/08, p. 107:19-24.

6 h. In short, the City has taken steps to
7 increase its revenues where and when possible, and Mr.
8 Mialocq appears to have seriously miscalculated the
9 feasibility and timing of obtaining new revenues. And,
10 to the extent potential new revenues are derived from
11 sales or transfers, such revenue is a one-time
12 occurrence that cannot be prudently budgeted to meet
13 recurring expenses. RT 8/21/08, pp. 194:5-10.

14 107. Mr. Mialocq also analyzed the City's projected General
15 Fund expenditures for fiscal year 2008-09. UTE U, Exh. B, pp. 1-
16 15 & Attachments.

17 a. Mr. Mialocq erroneously discounted the City's
18 projected labor costs based on vacancies identified
19 from the February 29, 2008 payroll, thereby mistakenly
20 assuming that \$5.1 million of the City's projected
21 General Fund labor costs could be eliminated. CTE 5, ¶
22 30, Exhs. K, p. 5 & L, pp. 1, 12; RT 8/21/08, pp.
23 204:2-6, 205:5-19. Due to minimum staffing
24 requirements in the IAFF CBA, and the overtime the City
25 must pay to meet those staffing requirements when
26 firefighter positions are vacant, the City could not
27 realize the labor cost savings Mr. Mialocq attributed
28 to the vacant firefighter positions without breaching

1 the CBA. CTE 5, ¶ 30, Exhs. K, p. 5 & L, pp. 1, 12; RT
2 8/21/08, pp. 207:1-209:24

3 b. Mr. Mialocq also failed to take into account
4 that if the City's fiscal year 2008-09 labor expenses
5 were reduced based on vacant positions, the General
6 Fund would lose revenue for services no longer provided
7 to other fund projects. CTE 5, ¶ 30, Exhs. K, p. 6 &
8 L, pp. 1, 12; RT 8/21/08, pp. 218:16-220:18. Mr.
9 Mialocq reduced the City's projected labor expenses
10 based on vacant positions within the group of
11 reimbursable job classifications, but he did not
12 correspondingly decrease projected General Fund
13 revenues that would not be received because the
14 positions were vacant. Id. The General Fund provides
15 services to other funds and City programs and is, in
16 return, reimbursed by those funds. CTE 5, ¶ 16; RT
17 8/5/08, p. 81:2-19. The City has retained a consultant
18 in each of the past two fiscal years to update its cost
19 allocation plan to ensure full cost recovery to the
20 General Fund from all City funds receiving General Fund
21 services. CTE 5, ¶ 16. The City updated its cost
22 allocation plan during the 2007-08 fiscal year, and the
23 City will update the plan again for fiscal year 2008-
24 09. RT 8/5/08, p. 81:2-19.

25 c. Mr. Mialocq used a 4.8% interest rate to
26 calculate the City's projected debt service obligation
27 for fiscal year 2008-09. UTE U, ¶ 32 (weighted average
28 of 4.0% and 6.0%); CTE 5, ¶ 29, Exhs. B, pp. 7-8 & K,

1 p. 3; RT 8/21/08, pp. 228:5-7. However, a member of
2 his staff acknowledged that a 4.8% interest rate was
3 too low. CTE 45, p. 1; RT 8/21/08, 229:24-231:1. And,
4 Mr. Mialocq also acknowledged in a memorandum to Alan
5 Davis (counsel to the Unions), dated April 18, 2008,
6 that his debt service calculation was incorrect. Cf.
7 CTE 5, Exh. K, p. 3 (General Fund debt "\$1,390,419"),
8 with UTE U, Exh. B, Schedule 1 (General Fund debt
9 "\$1,018,057").

10 d. Mr. Mialocq recommended reduced vehicle
11 replacement and maintenance expenditures. UTE U, ¶ 31,
12 Exh. B, p. 6, Schedule 1. The City, however, has
13 reduced vehicle expenditures in fiscal year 2008-09,
14 both in the Pendency Plan and its adopted budget for
15 the 2008-09 fiscal year. CTE 5, ¶ 31 & Exh. B.

16 e. Mr. Mialocq suggested that the City prepay
17 its CalPERS contribution to save money. UTE U, ¶ 33,
18 Exh. B, p. 8. The liquid funds held by the City in the
19 State Local Agency Investment Fund ("LAIF"), however,
20 are not sufficient to cover the CalPERS prepayment
21 proposed by Mr. Mialocq as well as the other General
22 Fund cash flow requirements the City will encounter
23 during the fiscal year. CTE 5, ¶ 33.

24 f. Mr. Mialocq suggested that the City
25 overstated its projection of expenditures on
26 compensated absences in fiscal year 2008-09 by
27 approximately \$336,000. UTE U, ¶ 34, Exh. B, pp. 10-
28 11. The evidence shows, however, that in fiscal year

1 2007-08, due to the extraordinary number of police and
2 firefighters that departed, the City incurred
3 compensated absence payout obligations totaling \$5.3
4 million. CTE 5, ¶ 34. Under the Interim Agreements,
5 the City and the Unions and those departing individuals
6 agreed that the City could defer payment of \$1.7
7 million of that total until December 2008. Id.
8 Anticipating further departures, as opposed to an
9 average year based on prior "normal" years as
10 calculated by Mr. Mialocq, the City projected an
11 additional \$1.75 million in employee payout expenses,
12 for a total projected of \$3.45 million. Id. Mr.
13 Mialocq did not account for any anticipated departures
14 above normal attrition in his compensated absences
15 calculation. Id.; RT 8/21/08, pp. 222:23-226:4.

16 108. With no General Fund reserves to start fiscal year
17 2008-09, even if one were to accept all of Mr. Mialocq's opinions
18 and recommendations, his conclusion that the General Fund budget
19 will operate at a \$3.3 million deficit confirms that, absent its
20 chapter 9 filing, the General Fund would not have sufficient
21 funds and cash flow to pay its bills as they become due in fiscal
22 year 2008-09. RT 8/21/08, pp. 159:19-25, 232:2-234:5.

23 109. On May 6, 2008, the City Council, by a unanimous vote,
24 authorized the City to file a petition for bankruptcy under
25 chapter 9 of the Bankruptcy Code. CTE 2, ¶ 24; RT 8/7/08, p.
26 71:15-19; 8/19/08, pp. 132:18-133:6. The City filed its petition
27 on May 23, 2008. See Chapter 9 Voluntary Petition, Form B-1, pp.
28 1-3.

1 110. The City filed its petition in order to implement a
2 plan of adjustment that provides for the long-term fiscal
3 solvency of the City. CTE 2, ¶ 26; Statement of Qualifications
4 Under 109(c), p. 2.

5 111. The City certified its desire to effect a plan of
6 adjustment in its Statement of Qualifications Under Section
7 109(c).

8 112. On June 26, 2008, the City adopted a balanced budget
9 for fiscal year 2008-09. RT 8/5/08, p. 74:6-14. The City
10 adopted this budget based upon its Pendency Plan. CTE 5, ¶ 5,
11 Exh. B, pp. 1-29; UTE K; RT 7/24/08, pp. 112:16-113:2).

12 113. The City's Pendency Plan addresses all City employees'
13 compensation and benefits, not just the members of the Unions;
14 continues employee compensation (rather than cutting
15 compensation) at the levels employees were being paid on the
16 petition date; caps at 6% the debt service the City will pay to
17 Union Bank and any other holder of the City's municipal debt
18 obligations; identifies \$1.4 million in new (\$1 million) and on-
19 going (\$400,000) additional General Fund revenues; cuts all
20 General Fund expenditures for the City's library, parks,
21 convention and visitor's bureau, senior center, symphony,
22 community arts, and naval and historical museum; further reduces
23 employment rolls to a total of 379 positions; and cuts spending
24 on infrastructure and physical plant items such as street repair
25 and vehicle replacement. CTE 5, ¶ 5 & Exh. B, pp. 1-8; RT
26 7/24/08, p. 63:13-25.

27 114. The City is unable to transfer the \$1.4 million in
28 additional revenues to the General Fund as of July 1, 2008. The

1 Risk Management Fund (from which the \$1 million transfer will
2 come) is the City's primary source of working capital loans for
3 grant reimbursements. RT 7/24/08, pp. 120:1-121:17. The City's
4 estimate as of June 2008 is that borrowing from the risk
5 management fund to cover grant reimbursements could exceed \$6
6 million. Id. Also, within the first few weeks of the fiscal
7 year, the Risk Management Fund is required to pay almost \$2
8 million in self-insurance premiums to its excess insurance pools.
9 Id. Similarly, the Redevelopment Agency will be unable to
10 transfer \$200,000 of \$400,000 to the General Fund until December
11 2008 when it receives property tax payments. The remaining
12 \$200,000 would be transferred in April 2009, after receipt of the
13 second installment of property taxes. RT 7/24/08, p. 117:1-15.

14 115. The City implemented the Pendency Plan as a bridge
15 between the City's filing of its petition and the development and
16 implementation of a plan of adjustment. CTE 2, ¶ 26; CTE 5, ¶ 5,
17 Exh. B, pp. 1-29; RT 8/7/08, p. 8:9-25.

18 19 CONCLUSIONS OF LAW

20 1. To be eligible for relief under chapter 9, a petitioner
21 must meet certain statutory criteria that "are to be construed
22 broadly to provide access to relief in furtherance of the Code's
23 underlying policies." In re Valley Health Systems, 383 B.R. 156,
24 163 (C.D. Cal. 2008). "The general policy of chapter 9 is to
25 give a debtor a breathing spell from debt collection efforts so
26 that it can work out a repayment plan with creditors." In re
27 County of Orange, 183 B.R. 594, 608 (C.D. Cal. 1995).

28 2. Section 109(c) of the Bankruptcy Code provides that an

1 entity is eligible to be a debtor under chapter 9 if such entity:

- 2 (1) is a municipality;
- 3 (2) is specifically authorized, in its capacity as a
4 municipality or by name, to be a debtor under such
5 chapter by State law, or by a governmental officer or
6 organization empowered by State law to authorize such
7 entity to be a debtor under such chapter;
- 8 (3) is insolvent;
- 9 (4) desires to effect a plan to adjust such debts; and
- 10 (5) (A) has obtained the agreement of creditors
11 holding at least a majority in amount of the
12 claims of each class that such entity intends
13 to impair under a plan in a case under such
14 chapter;
(B) has negotiated in good faith with
15 creditors and has failed to obtain the
16 agreement of creditors holding at least a
17 majority in amount of the claims of each
18 class that such entity intends to impair
19 under a plan in a case under such chapter;
(C) is unable to negotiate with creditors
20 because such negotiation is impracticable; or
(D) reasonably believes that a creditor may
21 attempt to obtain a transfer that is
22 avoidable under section 547 of this title.

23 11 U.S.C. § 109(c).

24 3. The City has the burden of establishing its eligibility
25 under chapter 9 by a preponderance of the evidence. See Orange
26 County, 183 B.R. at 599.

27 4. The City is a political subdivision of the state of
28 California and is a municipality within the meaning of section
109(c)(1).

5. The City satisfies the eligibility requirement set out
in section 109(c)(1).

6. The City is authorized by California law to bring a
petition under chapter 9. California Government Code section
53760 provides that "[e]xcept as otherwise provided by statute, a
local public entity in this state may file a petition and
exercise powers pursuant to applicable federal bankruptcy law."

1 Cal. Gov't Code § 53760(a). A local public entity includes a
2 city. Cal. Gov't Code § 53760(b).

3 7. The City satisfies the eligibility requirement set out
4 in section 109(c)(2).

5 8. A municipality is insolvent under the Bankruptcy Code
6 when its financial condition is such that it is (i) generally not
7 paying its debts as they become due unless such debts are the
8 subject of a bona fide dispute; or (ii) unable to pay its debts
9 as they become due. 11 U.S.C. § 101(32)(C).

10 9. Insolvency is determined based on the debtor's
11 financial condition on the date the petition is filed. In re
12 City of Bridgeport, 129 B.R. 332, 337 (Bankr. D. Conn. 1991).

13 10. Insolvency is determined using a cash flow analysis.
14 Bridgeport, 129 B.R. at 337. It is not enough to show that the
15 City has a budget gap, that is, for the coming fiscal year its
16 total revenues will be outstripped by expenditures. Id.
17 Instead, the City must demonstrate that, taking into account cash
18 on hand and cash to be received, it will be unable to pay debts
19 as they become due. Id. The analysis is prospective. The City
20 is not required to wait until it runs out of money and defaults
21 on its debts before it is deemed to be insolvent. Id.

22 11. Because the City was unable to adopt a balanced budget
23 for fiscal year 2008-09, it could not demonstrate the ability to
24 pay back any loan with revenues generated in fiscal year 2008-09.
25 Therefore, it cannot lawfully borrow from the private market or
26 other city funds. See Cal. Const., art. XVI, § 18; Rider v. City
27 of San Diego, 18 Cal. 4th 1035 (1998); Starr v. San Francisco, 72
28 Cal. App. 3d 164, 174-75 (1997).

1 12. The City was insolvent as of the date the petition was
2 filed.

3 a. The City's General Fund will begin fiscal year
4 2008-09 with no reserves, and possibly with a negative
5 balance;

6 b. absent this case, the General Fund would operate
7 at a multi-million dollar deficit in fiscal year 2008-
8 09, with projections by the City ranging from a \$10
9 million to \$17 million deficit;

10 c. with no reserves and a multi-million dollar
11 deficit, the General Fund would not have sufficient
12 available funds and cash flow to pay its debts as they
13 become due; and

14 d. the General Fund cash flow experienced in the
15 first two weeks of the 2008-09 fiscal year demonstrated
16 that, absent this case, the General Fund would not have
17 been able to pay its debts as they became due and, in
18 particular, the City would not have been able to pay
19 the General Fund payroll that became due on July 11,
20 2008.

21 13. The court rejects the Unions' argument that the City is
22 not an eligible debtor under chapter 9 based on the existence of
23 the Unions' offer to modify the CBAs. Insolvency is determined
24 based on the City's obligations as of the petition date as those
25 obligations actually exist, not as they could exist under
26 hypothetical circumstances. See Bridgeport, 129 B.R. at 337; In
27 re Sullivan County Regional Refuse Disposal District, 165 B.R.
28 60, 76 (Bankr. D.N.H. 1994). Further, the court was not

1 persuaded that if the offer had been accepted by the City, that
2 it would not operate with a General Fund deficit. The evidence
3 offered by the Unions suggested that the deficit would be
4 approximately \$3.34 million.

5 14. Accordingly, the City satisfies the eligibility
6 requirement set out in section 109(c)(3).

7 15. The evidence establishes the City desires to effect a
8 plan to adjust its debts within the meaning of section 109(c)(4).
9 The evidence, as well as the City's pre-petition efforts to
10 develop and implement a plan to avoid the need for bankruptcy
11 relief, corroborates the City's certification filed on the
12 petition date.

13 16. The City is not required to have proposed a plan of
14 adjustment in this case in order for the court to determine that
15 the City desires to effect a plan of adjustment. See 11 U.S.C.
16 § 109(c)(4) (requiring for eligibility a "desire" to effect a
17 plan of adjustment, not a proposed plan).

18 17. Accordingly, the City satisfies the eligibility
19 requirement set out in section 109(c)(4).

20 18. To the extent possible, the City negotiated with its
21 creditors prior to filing its petition.

22 19. As required by section 109(c)(5)(B), the City
23 negotiated in good faith with the Unions prior to filing its
24 petition but failed to obtain their agreement to a plan adjusting
25 the City's debts. See Valley Health Systems, 383 B.R. at 162.
26 In particular, the City established that:

- 27 a. the City engaged in extensive negotiations with
28 the Unions in an attempt to develop a comprehensive

1 plan that would provide solvency for the City in fiscal
2 year 2008-09 and several years thereafter;

3 b. the City's negotiations with the Unions addressed
4 potential revenue increases and expenditure reductions,
5 in addition to potential modifications to the CBAs;

6 c. the City's negotiations with the Unions were in
7 good faith as evidenced by the many attempts at a
8 negotiated settlement both with and without the aid of
9 a mediator, its cooperation with the Unions'
10 negotiating team and experts, its settlement of
11 litigation/arbitrations with the Unions, the scope of
12 the negotiations addressing both the terms of the CBAs
13 and revenue enhancements, and the City's willingness to
14 discuss different possible resolutions (cf. Ellicott
15 Schapter Bldg. Auth., 150 B.R. 261, 266 (Bankr. D.
16 Colo. 1992) (public agency did not negotiate in good
17 faith when it told creditors that its plan was
18 nonnegotiable); and

19 d. the City did not reach agreement on such a plan or
20 plans with the Unions.

21 20. The City also attempted to negotiate an adjustment to
22 the City's municipal debt obligations with Union Bank, the holder
23 of the majority in amount of the City's municipal debt
24 obligations, as part of a comprehensive plan providing for long
25 term General Fund solvency but was unable to reach any agreement.

26 21. Section 109(c)(5)(B) does not require that the City
27 engage in pre-petition negotiations concerning a specific plan of
28 adjustment. See 11 U.S.C. § 109(c)(5)(B) (requiring that the

1 City have "negotiated in good faith with creditors" but not
2 requiring negotiations to involve a specific "plan of
3 adjustment"); Sullivan, 165 B.R. at 78; Collier on Bankruptcy, ¶
4 900.02[2][e][ii] at 900-21 (15th ed. Rev. 1996). Cf. former 11
5 U.S.C. § 404 (1976).

6 22. Accordingly, the City satisfies the eligibility
7 requirement set out in section 109(c)(5)(B).

8 23. As an adequate, independent basis for satisfying
9 section 109(c)(5), the City's pre-petition negotiation with
10 creditors was impracticable within the meaning of section
11 109(c)(5)(C). In particular:

12 a. the City could not negotiate firm or meaningful
13 adjustments to its municipal debt obligations with
14 Union Bank unless the City first reached a viable,
15 long-term financial plan founded on adjustments to the
16 City's General Fund labor costs;

17 b. prior to filing its petition, the City could not
18 identify all its creditors for purposes of pre-petition
19 negotiations, including, in particular, an unknown
20 number of retirees who collectively hold the largest
21 claim against the City (approximating \$215 million), as
22 well as unknown bondholders and potential tort
23 claimants who may or may not have yet asserted a claim
24 against the City;

25 c. even if such unknown creditors could have been
26 identified prior to filing its petition, the City could
27 not succeed in pre-petition negotiations if it involved
28 the numerous individual creditors in the complex and

1 extensive negotiations the City undertook with the
2 Unions regarding the CBAs (see In re Villages at Castle
3 Rock Metropolitan Valley Health, 145 B.R. 76, 85
4 (Bankr. D. Colo. 1990);

5 d. the City had to act to preserve its assets and
6 continue operations to provide uninterrupted services
7 to the community, and a delay in filing in order to
8 negotiate with all creditors, known or unknown, would
9 put those assets and functions at risk (see Valley
10 Health, 383 B.R. at 163);

11 e. because the City's labor costs comprise the most
12 significant element of its annual budget, pre-petition
13 negotiation with the City's creditors other than the
14 Unions was futile unless and until the City and the
15 Unions reached a firm, viable plan modifying the City's
16 obligations under the CBAs (see Valley Health, 383 B.R.
17 at 165). Without an agreement with the Unions,
18 agreements with other creditors either were not
19 possible or, if possible, would not resolve the City's
20 insolvency; and

21 f. because no agreement was reached with the Unions
22 on a resolution that would avoid a bankruptcy filing,
23 it was doubtful in the extreme that they would reach
24 consensus on a plan of arrangement.

25 24. Section 109(c)(5)(C) does not require that the City
26 satisfy a numerosity requirement before it can be determined that
27 pre-petition negotiation with its creditors was impracticable.
28 See Valley Health, 383 B.R. at 163. Impracticality is determined

1 based on the facts of each case. Here, other than the Unions,
2 negotiating with creditors was impractical because some were
3 unknown, comprised an insignificant portion of the City's debt,
4 or were unwilling to negotiate absent an agreement with the
5 Unions.

6 25. Accordingly, the City satisfies the eligibility
7 requirement set out in section 109(c)(5)(C).

8 26. The court rejects the argument that the City has acted
9 in bad faith, either in connection with its negotiations with the
10 Unions or in connection with the filing of the petition because
11 it rejected the Unions' proposal for the modification of the
12 CBAs. This would be contrary to the mandate of the Tenth
13 Amendment and sections 903 and 904 of the Bankruptcy Code. See,
14 e.g., 11 U.S.C. § 904 (bankruptcy court may not "interfere with
15 . . . any of the political or governmental powers of the
16 debtor[.]"); In re City of Wellston, 42 B.R. 282, 285 (Bankr.
17 E.D. Mo. 1984). Concluding that the City was not eligible to
18 file a chapter 9 petition based on its rejection of the Unions'
19 contract proposal would, in effect, accomplish through denying
20 access to the bankruptcy court what the court would be prohibited
21 from ordering within a chapter 9 bankruptcy case. Further, the
22 Unions' proposal did not assure the City's solvency.

23 27. Because the City satisfies each of the eligibility
24 requirements of section 109(c), the court concludes that the City
25 is eligible to be a debtor under section 109(c).

26 28. The court also concludes that the City filed its
27 petition in good faith within the meaning of section 109(c).

28 29. Therefore, this case shall not be dismissed under

1 section 921(c), and an order for relief shall be entered.

2

3 To the extent that any portion of a Finding of Fact contains
4 or constitutes a Conclusion of Law, such portion shall be deemed
5 to be a Conclusion of Law, and to the extent that any portion of
6 a Conclusion of Law contains or constitutes a Finding of Fact,
7 such portion shall be deemed a Finding of Fact.

8 A separate order for relief shall be entered.

9 Dated: *5 Sept. 2008*

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By the Court

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Michael S. McManus, Chief Judge
United States Bankruptcy Court

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