



Vallejo County: The Saga Continues

“In a First, Bankruptcy Judge Rules California City Can Void Union Contracts”

Before commenting on the headline above, allow me to first provide you with a refresher on Vallejo County California. As you may recall, in May 2008 the City of Vallejo filed for bankruptcy protection amidst ballooning labor costs and declining revenue. Specifically, by seeking Chapter 9 protection, the City attempted to rescind their union labor contracts.

On March 17, according to the National Law Journal, a bankruptcy judge (Michael McManus) found that under a Chapter 9 Bankruptcy filing the City does have the authority to rescind its onerous contracts with the labor unions. Previously, union lawyers had argued that labor laws govern collective bargaining agreements, even during bankruptcy. In this instance, the judge opined that the bondholders are a higher priority as he saw fit to reject the collective bargaining agreements rather than disturb the existing contract with bondholders. This in and of itself shouldn't cause an escalation in the number of bankruptcies that are filed. State and local governments won't all of a sudden be granted a free pass to reduce expenses and shed union contracts by filing for Chapter 9. They are required to show an inability, not simply an unwillingness to pay their bills.

We have often stated that bondholders are at the “top of the food chain” in terms of the financial obligations of a political subdivision. For example, in RSW's October 2008 commentary entitled “As anticipated, Jefferson County Alabama inches closer to a bankruptcy filing”, we said “Typically, when an entity needs help in alleviating the pressure on their budgets, a variety of actions can be taken such as renegotiating union contracts, lessening pension fund payments, or picking up trash just once a week.” In other words, while we are not dismissive of the ruling, we had already assumed this outcome. Of course, this doesn't eliminate the possibility that a rogue judge six months from now rules differently, but what we are saying is that legal precedence has already been in favor of the bondholder.

Bottom line: this ruling is favorable for bondholders but negative for municipal employees and pension beneficiaries. However, there can still be a lot of headlines printed and attorney fees collected before this final adjudication.

Sincerely,

Robert S. Waas
Managing Member

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