

Local Governments Facing Tough Times, Bankruptcy

August 23, 2012 By [Daniel Freedman](#)

What do Stockton, San Bernardino and Mammoth Lakes, California have in common?

If you were thinking about warm weather, plenty of sunshine and the California lifestyle, you might be right, but that's not the answer we're looking for.

Warm weather and sunshine aside, these three California cities have a black cloud hanging over their financial futures because all three filed bankruptcy in July 2012.

Mammoth Lakes led the way, followed by Stockton, then San Bernardino, all three using Chapter 9 of the Bankruptcy Code which covers the reorganization of municipalities.

The reasons for their filings may be somewhat different – Mammoth Lakes faced a \$43 million breach of contract judgment brought by a developer, Stockton over-expanded during boom times and faced the music when the economy soured, and San Bernardino found its reserves tapped out in a difficult economy when declining tax revenue met increased pension, labor and other costs – but all three were due to financial pressure and the inability to meet their obligations.

Other cities in California, including Victorville and Compton, face similar problems and could file bankruptcy as well, according to a Reuters [article](#).

What happens when a city files for bankruptcy? Should the residents flee and others be concerned that their city is next?

Not according to another [article](#) published by Forbes. Chapter 9 allows a municipality the opportunity to reorganize its finances while it stops paying creditors. In other words, Chapter 9 isn't a death knell for the city. Rather, it's a tool that could lead to a sustainable financial future.

Of course, a city going through Chapter 9 may face cutbacks in services, though often these have already occurred as the city struggles to survive and reduce expenses prior to filing. And home prices may already have declined significantly as well. In fact, real estate declines are often a primary catalyst leading a municipality into troubled waters.

By the time a city files for reorganization much of the damage has already been done. That doesn't mean residents should stay put, but Chapter 9 does raise hope that a city can get its financial house in order and things will improve. Of course, bankruptcy "may leave a stigma that lasts for years, making it more difficult [for a city] to access credit and/or obtain favorable rates" as noted in this [report](#) from a website focused on long term financial planning. The cost and distraction of filing bankruptcy, combined with the stigma that attaches to the community are reasons why municipalities avoid bankruptcy if at all possible.

But some situations are so bad that an opportunity to reorganize under the Bankruptcy Code seems the best or only alternative, especially since doing so provides protection from creditors and breathing room in the face of severe

financial problems. An added bonus: bankruptcy judges have special expertise and serve as valuable arbiters in overseeing the effort, helping to work things out among various stakeholders in a difficult situation.

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