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Ten Considerations for Financially Distressed
Local Governments and Public Authorities

Municipalities today face significant challenges reconciling increased public demands for services with declining revenue and tax base, escalating labor and pension costs, and limited access to capital. No communities are immune; and, as state and local governments strain to meet budget realities, every elected official and senior administrator should be vigilant in searching for opportunities to assure their constituencies that public service delivery is a priority, and will not be put at risk because available operating revenues are insufficient to satisfy the cost of those services.

These strains affect not only cities, counties, and towns but similarly put other government instrumentalities, such as special districts and authorities at risk. While commentators generally refer to these current local government fiscal challenges as "municipal" financial distress, the principles of financial restructuring addressed below generally apply to all such units of local government -- whether they be actual political subdivisions or special purpose districts and the like.

Recent trends have only heightened the prospect that municipalities will face increasing fiscal problems this decade. Critical sources of revenue that provided meaningful solutions for financing the cost of local government were historically able to keep pace with rising costs and allowed municipalities to fulfill their mandates with balanced budgets; however, the unprecedented erosion in real property values, and the high unemployment rates following in the wake of the 2008 recession are now part of the landscape and are not, according to most economists, likely to materially improve for at least several years to come. The impact of a shrinking tax base and revenue sources on a municipality's (including special purpose district's) ability to make ends meet is only now starting to be felt in most communities, as the public sector is struggling to balance their budgets, while providing core services. To add to the distress, it is more likely than not that many federal programs which previously aided local governments or special districts will be sharply constrained if not eliminated altogether as Congress works to bring our federal budget more into balance. Moreover, throughout the United States, state governments and legislatures are already actively reducing funding to their municipalities and other local authorities and districts, or are giving clear warnings that they intend to do so soon.

While the sources of revenue to finance local governments are seriously eroding, the high costs of government service delivery -- for years a municipal governance

concern -- remain largely unabated. These unchecked municipal operating expenses typically include high labor costs for both unionized and non-unionized employees, financially burdensome or inefficient existing service contracts and, not infrequently, significant retiree benefit obligations which often are underfunded.

With mounting financial pressures, some municipalities are already confronting the possibility that they will face insolvency in the near term. Yet other municipalities are concerned that their operating costs could someday soon outpace their revenue sources. With this backdrop, municipalities need to explore how best to manage their financial challenges in the current market. Our goal with this paper is to address ten principles for municipalities and special districts to consider when confronting financial challenges. Of course, no one suggestion alone can provide a solution, and some suggestions may be more applicable to a given local government than others; however, we feel these principles will increase awareness for innovative solutions that impact current and future challenges facing the public sector.

Ten Principles That Municipal Governments Should Consider When Addressing Their Financial Challenges

1. Be Proactive And Focus On A Comprehensive Long-Term Solution
2. Multiple Causes Of Financial Distress Likely Require Multiple Solutions
3. A Well-Formulated Plan Should Address All Meaningful Sources And Uses Of Municipal Revenues
4. Municipalities Facing Financial Challenges Should Not Be Concerned About Adverse Credit Ratings Arising Because They Have Indicated Their Intention To Address Their Fiscal Issues



5. Filing Bankruptcy Should Be A Last Resort; But A Municipality's Preparedness To Seek Bankruptcy Protection If A Feasible Consensual Plan Cannot Be Achieved Is The Best Way To Motivate Creditors To Agree To Needed Concessions
6. Should A Chapter 9 Filing Become Necessary, More Likely Than Not The Municipality Will Materially Benefit From The Process
7. The Bankruptcy Laws Provide A Financially Challenged Local Government With Significant Protections While Its Plan Is Awaiting Approval
8. A Municipality Should Engage Independent Professionals
9. Proper Selection And Direction Of The Retained Professionals Will Be Critical To The Restructuring's Success
10. Municipal Officials Have The Capacity To Effectively Manage and Control Their Restructuring Costs And Achieve Meaningful Economies By Doing So

1. Be Proactive And Focus On A Comprehensive Long-Term Solution: There is no benefit in waiting until a municipality is confronted with a fiscal crisis to start addressing how best to increase its revenues or control its operating costs. Public officials should not be criticized for grappling with challenging issues early so there is ample time to consider a range of solutions. While this seems obvious, in many cases, public officials often are inclined to wait, hoping that conditions will correct themselves. While past experience may have justified the patient, wait-and-see approach, current economic conditions in the United States presage a

much more challenging environment, where early action plans will, in the final analyses, be applauded more than scoffed at by the electorate or those served by special districts or authorities. The bottom line is that if a municipality needs financial support from its creditors and principal constituencies, the best way to illustrate that concessions could not have been avoided is to have affirmatively implemented solutions within its control as soon as is possible, rather than seeking a bailout because it waited too long to act.

When addressing how best to solve a local government's liquidity concerns, temporary fixes should be avoided. Usually, the lack of adequate operating funds is merely a sign that a municipality has more serious and pervasive financial challenges. Resolving a short-term liquidity problem with a stop-gap solution, generally, will be ill-advised. Even if the voters and other constituencies were not to lose confidence in their government officials in the wake of repeated fire drills to address short-term funding shortfalls, such spasmodic fixes will deplete the energies that will be required for a community to address long-term solutions that will allow it to prosper without future episodic financial upheavals. Moreover, it is often the case that stop-gap cures deplete the range of options available to a municipality for achieving a comprehensive and enduring resolution of its financial challenges. Hence, when fiscal problems reach the level where operating shortfalls will likely soon occur, municipalities should take that as the opportunity to fix the systemic causes of their financial distress utilizing a comprehensive set of solutions that can lead to their long-term and sustainable health.

2. Multiple Causes Of Financial Distress Likely

Require Multiple Solutions: While it may occasionally be the case that a local government's fiscal challenges can be attributed to one or a couple of isolated causes, more typically for most municipalities the sources of their financial distress are numerous. Thus, developing a long-term financial plan that reviews all expenses and debt obligations is essential and should involve concessions from the municipality's creditors as early as possible. Since no constituency wants to give up any of its contractual rights, its willingness to make financial accommodations, short of litigation or bankruptcy risks, is likely to occur only if it perceives that all the other constituencies are fairly "sharing in the pain" required to forge a viable long-term solution to the local government's fiscal difficulties. As municipal distress broadens and become a recurring phenomenon (as most economists and analysts are now predicting), major stakeholders will come to expect that they will need to be part of a feasible and enduring plan. So despite their early protestations, which should certainly be anticipated, government officials should persist in their goal to forge a plan that requires all constituencies to fairly contribute to a feasible and balanced solution.

3. A Well-Formulated Plan Should Address All Meaningful Sources And Uses Of Municipal Revenues:

Before creditors are likely to agree to reduce their contractual claims in any meaningful respect, a municipality will need to satisfy its creditors that it has looked closely and rigorously at optimizing every significant source of revenue, as well as how best to cut the costs of delivering services it is obligated to provide. To be credible, a municipality should not be forced by the demands of its creditors to look for increased revenue sources or belt-tighten its overall payroll costs. Rather, if a municipality reasonably expects to earn creditor support for a comprehensive restructuring plan that includes meaningful debt relief, it should begin a dialogue with its major creditors only after first commencing to implement both a range of efforts to increase revenues while also concurrently implementing specific payroll and other cost-cutting measures.

In addition, municipalities will need to look for creative opportunities to raise capital or reduce their operating costs by exploring a range of public to private financial options that are becoming more readily available. Long-term solutions may also be aided by capital raising transactions, including asset monetization strategies and public-private partnerships.

Most municipalities contract for certain services and products with third-party vendors, and often these are substantial contracts. As part of any restructuring effort, local governments will need to make a serious effort to review those contracts for possible inefficiencies or cost savings, reviewing each relationship for value benefits at the lowest possible cost. When the cost of such services or products is in excess of the current market, the municipality should also look to cheaper sources or new technologies. Even where the municipality is bound to a long-term contractual obligation, it should consider seeking concessions from its long term service providers, threatening, if necessary, to terminate those contracts if there is a refusal to agree to modified terms. Most service providers and significant vendors will be inclined to restructure their relationships with municipalities rather than confront the possible loss of a significant contract and uncertainties that are entailed in proving an entitlement to damages arising from the contract's termination.

In addition, governments need to further review their procurement and operational strategies, with the ultimate goal of achieving savings, without compromising public service. Saving cuts might result from adopting streamlined processes, developing consistent performance metrics, implementing cost transparency and accountability, eliminating redundancies, standardizing procedures and updating outdated technology. Even though start-up costs related to these efforts can be expensive, implementing them can achieve long-term savings and improved service.

Finally, while it will undoubtedly be troubling, many local governments will need to realistically explore and implement the consolidation of certain governmental services currently rendered separately by multiple jurisdictions or authorities. The goal, of course, would be to achieve economies by consolidating the same services into one umbrella district or authority thereby spreading a single cost for oversight and administration among a much larger population. Consolidation of services is apt to stir considerable public reaction, and some who have benefitted from the historic proliferation of small special districts will be antagonistic to such efforts, preferring to stay with a highly localized delivery of key local governmental functions. For this reason, managing fair and fiscally necessary consolidation of services will require patience and astute political leadership; but, in truth and in the long run, that is what our citizenry will want their trusted public officials to provide.

Understand, too, that growing pressures from state governments, will likely require consolidation to be part of the municipal landscape this decade; so local governments that intend to seek state financial support are best advised to take active steps to explore realistic consolidation opportunities as part of their comprehensive financial restructuring considerations. Indeed, some states have already enacted legislation that provide financial benefits to local governments which voluntarily implement consolidation measures; and these legislative actions only presage the likelihood that in years to come there will be more rigorous efforts by the states to compel municipalities to implement service consolidation at the risk of losing some state funding or perhaps suffering even more imposing solutions should they fail to comply.

4. Municipalities Facing Financial Challenges Should Not Be Concerned About Adverse Credit Ratings Arising Because They Have Indicated Their Intention To Address Their Fiscal Issues:

Considerable attention has recently been focused on whether a municipality's articulated concern about its financial difficulties may alone adversely impact its credit ratings as well as those of the state or other nearby local governments. Several observations are warranted.

The simple truth is that the best fix for a municipality worried about future access to the debt markets is not to continue languishing without a solution, but to take the steps needed to bring its income and expenses into balance. Even if debt relief is needed to do so, the optimal way to assure future access to the credit markets is to do that which is necessary to put the community on a solid financial footing. Stated differently, credit markets prefer to lend to a municipality that acknowledges its financial problems, and undertakes the needed restructuring to achieve long-term financial stability. That this is so is best confirmed by the lack of any evidence to suggest that municipalities which comprehensively fix their fiscal problems, even where debt relief from creditors is required, will be adversely impacted when they seek access to the credit markets. In fact, there are many cases where the opposite is true, and municipalities prospered and regained favorable credit ratings following a successful financial restructuring.

It is certainly obvious that when a municipality is experiencing serious financial challenges, the bond market will react accordingly. Thus, in the case of publicly issued and traded bonds, downgraded credit



ratings below investment grade can be expected for municipalities facing financial distress, with such issues often trading below par. That said, the focus for financially challenged municipalities should not be on how their prior debt issues are trading, but rather, first, on its ability to raise funds from the bond market going forward, and, second, on the cost of such borrowings. Absent corrective steps to fix their fiscal distress, municipalities necessarily face the serious threat that they will be unable to obtain debt financing at rates typically established for investment grade general obligation issues. Worse still, many municipalities will confront the risk that they will be unable to obtain any new debt financing, whether that be through the bond market or from any other lending source.

The bottom line is that unless a financially troubled local government can find solutions that provide for a long-term and stable capacity to finance the performance of its public functions in the future from the revenues it can collect, its ability to borrow funds through the issuance of general obligation bonds will be sharply curtailed. Accordingly, a municipality's need to seek concessions from its principal creditors to avoid a Chapter 9 filing, or to urge those concessions in Chapter 9 if creditors do not voluntarily agree to them, is apt to already be reflected in the municipality's lower bond ratings. In sum, deteriorating ratings do not result from asking creditors for debt relief; they exist because of the inherent financial distress that the local government is experiencing.

Nor should a municipality be threatened by fears that if it seeks debt relief from bondholders and other creditors, doing so will hurt credit ratings for other local communities in its state or the state's own credit rating. Each government stands on its own and, based on its unique financial condition, should be underwritten as such. If nearby communities have different demographics, lower debt and better cash flows, those governments need not fear that the credit agencies will rate them adversely merely because another city in the region had specific financial challenges that caused its need to restructure and seek debt relief.

5. Filing Bankruptcy Should Be A Last Resort; But A Municipality's Preparedness To Seek Bankruptcy Protection If A Feasible Consensual Plan Cannot Be Achieved Is The Best Way To Motivate Creditors To Agree To Needed Concessions:

Before discussing how a municipality might consider using either the threat of filing bankruptcy or the actual filing (were that to become necessary) to achieve a sound long-term financial plan, several preliminary comments are warranted about a local government's right to avail itself of bankruptcy protections. The Bankruptcy Code permits municipalities to seek protection under a special section of the Code applicable only to local governments -- Chapter 9. But Chapter 9 permits municipal bankruptcies only if state law so authorizes. About half of the states allow a local government to seek bankruptcy protection if, despite its best efforts, it cannot obtain consensual agreements from its key creditors to a feasible long-term plan. Even in the states that do not have specific legislation authorizing their municipalities to file Chapter 9, a local government can obtain the authorization to file Chapter 9 from a government officer or organization empowered by state law to grant such authority.

Significantly, filing under Chapter 9 is not only permitted for actual political subdivisions such as cities, towns, and counties but, also, for special districts or authorities or instrumentalities created by the state or under state law. Thus, while the Bankruptcy Code refers to the right of "municipalities" to seek Chapter 9 protection, the Code broadly authorizes the right of most special units of state government to file Chapter 9 if their state has conferred on them the authority to do so.

Aside from state authorization, the Bankruptcy Code conditions the filing of Chapter 9 on a municipality's demonstration that before resorting to Chapter 9 it made a good faith effort to resolve its financial difficulties

without judicial intervention. In those states that impose a similar condition before granting a municipality the authority to file Chapter 9, this showing will essentially be redundant and easily satisfied. But where no state law preconditions must first be satisfied, a municipality will need to prove to the bankruptcy court that prior to seeking Chapter 9 protection, it engaged in significant out-of-court efforts with its principal creditor constituencies to achieve a workable global resolution of its financial difficulties.

Finally, a municipality seeking Chapter 9 protection must upon filing be able demonstrate that it already had been suffering meaningful cash shortfalls, or that it will almost certainly experience serious cash flow difficulties in funding its operating and essential maintenance costs. More precisely, the Code requires that a local government seeking Chapter 9 protection prove that it is "insolvent", meaning either that it cannot presently pay its operating and maintenance expenses, as well as debt service on borrowings as those obligations are currently coming due, or that in the near future it is reasonably anticipated that it will be unable to do so.

For further information regarding Chapter 9's filing requirements, please refer to McKenna Long & Aldridge's "Understanding the Chapter 9 Option: A Strategic Guide for Municipalities and Special Purpose Districts" (the "Chapter 9 Guide"). The Chapter 9 Guide provides a comprehensive and candid discussion of the issues that local government officials will need to understand to fully assess the benefits and risks of a Chapter 9 filing including, an in-depth discussion of the criteria that a court will utilize in deciding whether to approve a plan that seeks to alter and reduce the rights of creditors. This, after all, is the key inquiry, because the only meaningful reason that a municipality would be motivated to file Chapter 9 is because it was not able to obtain needed concessions through an out-of-court consensual resolution process.

Having explained the criteria that a municipality must satisfy were it to seek protection under Chapter 9, it cannot be stated more strenuously that it is clearly preferable to negotiate a long-term set of solutions to a municipality's fiscal problems without resorting to the judicial process. The out-of-court process is preferable for several reasons. First, Chapter 9's provisions have been limitedly tested; some key issues, important to local governments and creditors alike, have not been sufficiently resolved to a point where outcomes in a disputed environment can be entirely predictable.

These uncertainties, of course, make creditors anxious when Chapter 9 is mentioned as an option in a workout setting. As such, a municipality's willingness, if necessary, to file Chapter 9 can be very effective in stimulating agreements by creditors that avoid their exposure to the uncertain results of the bankruptcy resolution process. That said, those same uncertainties apply equally to the local government. So while a municipality will want to put Chapter 9 on the table to stimulate movement toward a consensual resolution, it ought not perceive Chapter 9 as a favorable approach in every instance. Moreover, for the reasons discussed below, though the costs of a Chapter 9 process are not likely to be significantly greater than the costs incurred if a consensual plan can be accomplished without resort to the judicial process, they will be somewhat higher. But, more significantly, the timetable to accomplish the restructuring goal is apt to be meaningfully longer if a municipality must avail itself of a Chapter 9 to force a feasible plan for its financial future than were it able to achieve that plan through a consensual process.

While Chapter 9 is not the preferred path to resolve municipal financial distress, if a local government expects to accomplish the needed restructuring with its principal creditor constituencies, it has to be prepared to have some tough discussions and those with whom the municipal government is negotiating must be put at risk that if an agreement is not reached, there exists the real prospect that less favorable treatment of their claims and rights might well occur. The only realistic situation that creates that specter is the power of a bankruptcy court to impose (or, to use the bankruptcy parlance, "cram down") less favorable treatment of the claims of creditors,

over their objection, as part of a court-approved plan of adjustment. Anecdotal evidence seems to suggest that creditors will only seriously engage in making meaningful concessions where Chapter 9 is put on the table during the negotiation process as a credible alternative.

Since virtually everything that a local government would need to undertake to be positioned to seek bankruptcy protection will likely be required of it as it attempts to negotiate an acceptable resolution of its financial difficulties out-of-court, preparedness for Chapter 9 will not occasion a fundamentally new set of undertakings. To realistically warn creditors about the Chapter 9 alternative, and to put pressure on them to explore terms of an acceptable restructuring without resort to bankruptcy, a municipality will need to incorporate into the comprehensive restructuring efforts that it is already undertaking a set of critical talking points regarding the Chapter 9 process and how it would intend to utilize the provisions of Chapter 9 to obtain debt relief involuntarily if necessary. Absent such pressure, it is unrealistic to expect that any key creditor constituency will make its best proposal early in negotiations, clinging to the hope that lesser concessions might prove to be sufficient. Similarly, most creditors will be inclined to withhold their best offer until other constituencies are likewise agreeing to accept reduced treatment of their claims in a comparable fashion. Given these predispositions, if movement toward an acceptable consensual plan by the principal players appears to be languishing, as frequently will be the case, the threat of a Chapter 9 filing, realistically conveyed, will be the best expedient to jump-start achieving the consensual resolution goal.



6. Should A Chapter 9 Filing Become Necessary, More Likely Than Not the Municipality Will Materially Benefit From The Process:

As noted earlier, the uncertainties and the extended timetable for achieving a confirmed plan of adjustment under Chapter 9 make it less desirable for a local government to choose that course over a consensual agreement achieved through out-of-court negotiations. As such, it would not make sense to resort to Chapter 9 only to gain marginally superior results from those than could be achieved through the negotiation of an out-of-court set of agreements. But there are times when, despite the municipality's best efforts and contrary to conditions that would warrant creditors to agree to a settlement, the required consents from creditors to a consensual restructuring cannot be obtained. Consider, for example, a situation where a majority of bondholders are agreeable to a plan, but a meaningful minority of them oppose it. Unless the bond documents were to provide otherwise, nothing short of the powers vested in a bankruptcy court under Chapter 9 will permit the vote of the majority of bondholders to bind dissenters to a proposed plan that the majority is willing to support. Myriad other examples would, if described, confirm the proposition that there will be times when Chapter 9 provides the only realistic hope for achieving a resolution that will solve a municipality's financial troubles. If resorting to Chapter 9 ultimately becomes the inevitable course of action, municipalities should be optimistic that, provided their Chapter 9 process is handled effectively, there is a real prospect that their plan will be approved even over the opposition of one or more dissenting classes of creditors.

It is beyond the scope of this briefing to explain the inner workings of the plan approval process and how, despite creditor opposition, a municipality's restructuring plan can be confirmed. The Chapter 9 Guide discusses these matters in considerable depth. For now, it is enough to observe that to achieve the desired result in a contested setting will require careful and comprehensive planning. Municipalities must understand that attaining approval of a plan over meaningful creditor opposition will not be easy to accomplish. Leaving the details to be discussed in another setting, it should generally be assumed that where a municipality seeks approval of its plan over creditor objections, the local government will need to have already taken steps on its own to maximize revenues and to reduce its operating and maintenance costs. Additionally, it will have needed to have done all within its power to increase revenues or generate capital through asset sales and public-private partnerships. The municipality should also have explored whether, and to what extent, it could realistically solve its financial shortfalls through tax increases, understanding, of course, that any such increases would only be justified where imposing them would not be at cross purposes to the fundamental goal of the restructuring --- assuring the public that the municipality's revenues will be sufficient to pay for required government services, while not significantly and negatively impacting economic development. Since building a financially viable community depends on the stimulation of meaningful economic development, the requirement of additional taxes may run entirely counter to the local government's prudent long term plans. In that setting, substantial financial proof of the adverse effect of new or higher taxes on the municipality's growth plans and fiscal integrity may well be required to satisfy a court that "taxing its way out", as creditors are apt to urge as the solution to avoid debt relief, is neither realistic or practical for the financially challenged municipality.

In addition, a Chapter 9 municipality will be required to use all means of political persuasion at its disposal to build broad constituency support; it will need to coalesce the endorsement of its plan among meaningful and influential partners in the private sector; and it will need to rely upon rigorous and sophisticated expertise from financial and legal professionals and arduous efforts by its staff and local team of professionals. But if it is prepared to take all these steps, a municipality stands a very realistic chance that the bankruptcy court will require creditors to make debt concessions which they oppose but which are needed to make a plan workable both now and into the future.



7. The Bankruptcy Laws Provide A Financially Challenged Local Government With Significant Protections While Its Plan Is Awaiting Approval:

Aside from the prospect that the Chapter 9 process can result in approval of its comprehensive restructuring plan, numerous provisions of the Bankruptcy Code make Chapter 9 at least as attractive to a municipality, and in some ways more so, than Chapter 11 is to business debtors. In the Chapter 9 Guide, there is a detailed discussion of all the key benefits that are afforded a municipality while in Chapter 9 and pursuing approval of its restructuring plan. Highlighted below, without significant elaboration or specificity, are many of the essential features of Chapter 9 that are intended to afford local governments ample time, free of some of the concerns that make Chapter 11 debtors anxious, to fashion a financially feasible long-term plan that a court may approve.

Like Chapter 11, municipalities are protected from most adverse creditor actions from the moment they file, and the rights of creditors are severely limited while the case is pending. Also, similar to Chapter 11, Chapter 9 allows a municipality to reject burdensome contracts and leases, affording it a negotiating position to bargain for more favorable terms against the threat that it will exercise its rights to reject. This rejection right applies to collective bargaining agreements as well but, importantly, what a municipality must show to be allowed to reject a collective bargaining agreement is less imposing than the requirements that a Chapter 11 business debtor must satisfy to obtain that same relief.

Unlike Chapter 11, the court in a Chapter 9 case has no right to inject itself in the municipality's management, whether that consists of elected officials or senior level employees. In a business Chapter 11 case, the court under certain circumstances can appoint an independent trustee to take charge of operations, removing current management from any meaningful role; but in Chapter 9, the court is expressly precluded from exercising any similar remedy. A complementary "hands off" concept applies to the daily operations of the municipality. While a Chapter 11 business must seek approval of virtually all but routine actions it is considering, a municipality is entitled to engage in or implement a vast array of actions without the need to obtain creditor consents or court approval. The retention and payment of professionals in a Chapter 9 context also can be made without the court's oversight

or approval. This non-intervention approach stands in sharp contrast with the rules applicable in Chapter 11 where the retention and compensation of professionals is subject to detailed supervision by the court and the right of creditors to object. Since disgruntled creditors often attempt to challenge the retention or fees of Chapter 11 professionals in order to gain leverage in negotiating in a variety of a business debtor's decisions and proposals which the creditor opposes, the fact that a municipality's professionals cannot be subjected to similar pressures in a Chapter 9 case better assures that the government's goals will be vigorously advocated without reprisal against the professionals who are responsible for best accomplishing those goals.

8. A Municipality Should Engage Independent Professionals:

Whenever government officials first commence an effort to comprehensively restructure a local government's financial obligations, they are apt to be subjected to considerable criticism from some of the public and by significant creditor constituencies. This is likely even where, as often will be the case, those currently in decision-making roles had nothing to do with creating the numerous causes that collectively have contributed to the community's financial challenges. The public worries about higher taxes, layoffs, reduced retirement benefits and the like, while creditors are anxious that they will be expected to agree to material debt relief to bring the municipality back to financial health. In that setting, the best means available to government officials to insulate themselves from anticipated public and creditor criticism is their retention of independent professionals to both advise them about the range of solutions and to opine about why the plans that the municipality is urging are prudent, balanced, and optimal.

The independence of financial and legal advisors is key to their effectiveness. If such professionals were to be tied to local politics or constituencies, the analyses or recommendations they make are likely to be subjected to charges of bias or favoritism. Moreover, when difficult decisions, perhaps even unpopular ones, such as job cuts or the potential need to examine existing retiree benefits, are required to achieve a workable long-term solution, public officials can justifiably deflect accusations by relying on the views of their specially-retained independent professionals -- experts who are not affiliated with local interest groups or subject to be inappropriately influenced or pressured.



Moreover, because such professionals will justify the municipality's difficult decisions based on their expert advice, they can better facilitate achieving agreement with creditors who will be inclined to resist any solutions that do not rest on independent expert input. Since a municipality should assume that its principal creditor constituencies will retain their own financial and legal advisors to support their resistance to the concessions that the municipality is seeking, to be most effective and to expedite the resolution process, a municipality will need to be armed with its own highly capable set of advisors.

9. Proper Selection And Direction Of The Retained Professionals Will Be Critical To The Restructuring's Success: What scope of services should the municipality expect its independent professionals to provide? Virtually every local government already has a team of financial and legal professionals in place; and most local governments, as they should, have a high level of confidence in the skills and loyalty of their people, whether they are employees of the government or retained by them. The use of independent professionals, as suggested here, is not intended to replace those currently engaged. Indeed, in a setting where a municipality is facing financial distress, there is an even greater need to engage additional help, not reduce the municipality's commitment to the existing staffing in those areas. Even though city hall professionals are extremely qualified to do their jobs, no single set of skills is sufficient when addressing the myriad complex issues likely to arise in working through a municipality's readjustment plan; thus, offering them support from

professionals who are uniquely trained and qualified to look at distress situations, from financial and legal considerations, could be extremely beneficial. In this sense, a municipality's retention of financial and legal advisors is no different than when a struggling business must retain an expert group of restructuring professionals to assist it in developing and negotiating a restructuring plan with the company's creditors. The role of such restructuring professionals is discrete, and, though significant while being performed, is relatively short-lived.

Consider, too that at times during the restructuring process certain types of professionals may take center stage, while at other times the critical roles will be shouldered by a different set of professionals. No single set of skills will be sufficient when addressing the array of challenging issues likely to arise in working through a municipality's readjustment plan. Additionally, professionals with distinct skills will at times need to work on an integrated and coordinated basis toward the implementation of a plan. Accordingly, it should be expected that both legal and financial advisors will often need to work collaboratively with the municipality's staff and officials to achieve optimal results.

Depending on the circumstances, the financial advice required by a municipality dealing with fiscal distress may consist of investment banking services, forecasting and modeling, or valuations; in yet other situations, skilled turnaround management services may be required. No one group of financially trained advisors will be right for every situation.

Specialized legal services in a municipal distress setting are likewise apt to range broadly in scope. A municipality should, of course, assess whether any law firm that it is considering has sophisticated knowledge of the unique legal principles relevant to financial restructurings. But, as importantly, those responsible for selecting a law firm need to assess the candidate firm's capacities in government affairs -- a critical element involving not only the firm's sensitivity to shape the restructuring process to the local landscape and the variety and uniqueness of each of the municipality's creditor constituencies, but to guide a variety of compliance, regulatory and contractual matters involving the municipality's interrelationship with other local jurisdictions, state governments, the federal government and various agencies and instrumentalities of those governments.

Additionally, when selecting a law firm, the municipality should ascertain whether a candidate firm has attorneys who are skilled negotiating and enforcing government contracts with third-party vendors, has a sophisticated labor and employment law practice capable of guiding labor negotiations and advising it about a broad array of related state and federal employment laws, offers a team of retirement law experts capable of addressing the complex issues that will arise if there is a need to make adjustments to existing plans and has a team of attorneys whose practice is concentrated on infrastructure financing and the negotiation and documentation of public-private partnerships.

10. Municipal Officials Have The Capacity To Effectively Manage and Control Their Restructuring Costs And Achieve Meaningful Economies By Doing So:

Undoubtedly, when local governments consider the additional cost of legal and financial services that may be required, resistance is the natural first reaction. After all, the municipality is already under financial strains, so how can it justify incurring new and incremental costs? Here, too, that concern is similar to what financially challenged businesses face when they find it necessary to retain a team of financial and legal professionals to help them achieve their restructuring. Despite being true, it may not be sufficiently assuaging to view the incremental costs as relatively modest when weighed against the long-term financial benefits and savings that a restructuring is intended to accomplish.

So, a municipality should not focus as much on the fact that it will incur incremental costs, but rather on whether it is likely to receive the most efficient and cost-effective performance from the professionals it either contemplates retaining or has already retained.

Thus, decision makers should consider whether a legal or financial firm candidate is prepared to offer a blended rate, understanding that the rates of senior professionals heading up the engagement are apt to be considerably higher than those with less experience. Significantly, a municipality should also assess whether any candidate firm intends to materially rely on local professionals and staff support, since many assignments can prudently be performed by some combination of the municipality's existing staff, including in-house professionals, as well as by already-engaged local professionals. Finally, municipalities should explore whether an alternative fee arrangement, based other than exclusively on hourly rates for the time devoted to the engagement, is an approach that a professional firm is willing to consider.

Key Contacts

For more information about the Municipal Reform & Innovation Practice or a copy of our guide, “*Understanding the Chapter 9 Option: A Strategic Guide for Municipalities and Special Purpose Districts*,” please contact:

Mark S. Kaufman
Partner

T: 404.527.4120
T: 212.905.8300
mkaufman@mckennalong.com

Keith W. Mason
Partner

T: 404.527.4930
T: 212.905.8300
kmason@mckennalong.com

Jonathan A. Ballan
Partner

T: 212.905.8304
jballan@mckennalong.com

About the Municipal Reform & Innovation Team | McKenna Long & Aldridge LLP’s Municipal Reform & Innovation Team consists of a multidisciplinary group of experienced lawyers, managing directors and strategic advisors that are renowned practice leaders in the areas of public finance, restructuring, insolvency, (including municipal bankruptcy under Chapter 9 of the Federal Bankruptcy Code), government contracting, procurements, corporate finance, employee benefits, labor contract negotiations, public–private partnerships, asset sales and other monetization processes, environmental issues, public policy and government affairs (at all levels, including federal, state, and local), and governance. Team members include the following former public officials: mayors, governors, state attorney general, board members and directors of municipal special purpose entities, chiefs of staff and legal advisors to mayors and governors, Chief Counsel to the Federal Highway Administration, and members of the U.S. Congress and state legislatures.

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