Atlantic City takeover legislation could have consequences for other New Jersey municipalities
By Maria Amante
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Legislation proposed for a state takeover of **Atlantic City** governance and finances could have consequences for other municipalities and their bondholders, said Ted Gavin, senior managing director and founding partner at Gavin Solmonese.

Gavin Solmonese is a turnaround firm specializing in corporate and municipal advisory services.

Two criteria are set forth by legislation floated by **New Jersey** Senate President Steve Sweeney (D) outlining municipal distress: a decrease of more than 50% of assessed property value or an increase of more than 50% in outstanding debt in a five-year period. Those criteria are subject to the discretion of the director of the Division of Local Government Services (LGS).

As a result, if the legislation is approved, the director could apply those criteria to other municipalities, subjecting them to the same powers outlined in the bill, Gavin said.

“What (bondholders will be) focused on is (those criteria), rather than bond performance,” Gavin said. “It leads to measuring risk by metrics set by the state … it’s a new transaction risk for the bond community and may not be comforting.”

Atlantic City Mayor Don Guardian (R) blasted the bill Monday, as reported, and said it could have a contagion effect to other New Jersey municipalities.

“Today it’s Atlantic City, tomorrow it could be Paterson or Newark,” Guardian said.

Expanding state power

Sweeney’s legislation gives the LGS director the power to take “any steps” to stabilize the finances, restructure debt or assist in financial rehabilitation of a distressed municipality. Those powers include amending or terminating collective bargaining agreements, appointing, transferring or removing employees, and disposing of municipal assets. The legislation updates Sweeney’s proposal introduced last month, providing more explicit information about the powers provided to LGS and limiting the amount of time to five years from 15.

In addition, Sweeney’s proposal amends the method in which a municipality can file for bankruptcy in New Jersey. Current law requires a three-fifths vote of city council and approval from the Local Finance Board, but the Sweeney proposal gives the LGS director power to authorize and file a petition and written approval from the legislative Joint Budget Oversight Committee.

That gives the state the lead role in restructuring negotiations with bondholders, said Craig Barbarosh, a partner at Katten Muchin Rosenman, LLP specializing in bankruptcy and restructuring, who represented creditors in Detroit and San Bernardino. The aggressive nature of the legislation suggests the state is looking to expedite the process, including bondholder negotiations.

“It’s a step in the right direction,” Barbarosh said. “A financially challenged city might not be able to solve issues on its own, and the state will facilitate a resolution. It’s broad, vesting in whomever they designate full authority to manage the city, to negotiate labor and reject other agreements and negotiate payments to creditors and deal with vendors and file if necessary.”

States can place any condition they want for a city to file for bankruptcy, said Juliet Moringiello, professor of law at Widener University Commonwealth Law School. It's also questionable that legislators would approve bankruptcy -- the word itself is toxic and marked with baggage.

"This stuff is incredibly politicized," Moringiello said. "When a city is teetering toward insolvency, it's absolutely politicized. It's made more politicized by kicking it to the legislature, but you don't want to make it too hard for a city to file. If what Atlantic City needs is to get rid of the debt overhang in a coordinated proceeding provided by bankruptcy code, why make it too hard?"

Resistance is futile

The city's financial position necessitates the legislation, said State Senator Jim Whelan in an interview with *Debtwire Municipals*.

Atlantic City is "in crisis" and "uncharted territory," Whelan said.

"There are no good alternatives here," Whelan said. "We're not blaming the city for the collapse of the casino industry, that's the problem … because of that problem, the city is out of money."

It's expected the city runs out of cash 1 April, but it could be even sooner with the city's largest taxpayer, the Borgata Casino Hotel, skipping first quarter taxes to offset money owed for tax appeals, as reported.

"For all of the moaning and whining from the city, what's their path forward to deal with the problem?" Whelan said. "We're giving them money, taking it from other resources, not the general fund, from the Casino Reinvestment Development Authority and Atlantic City Alliance, because we see how desperate (the situation is)…rather than going to bankruptcy, we'll take the money for marketing the town and make ends meet rather than missing payroll."

The legislation's most impactful provision gives control to an outside party to modify contracts and isn't dissimilar to Michigan's emergency management law, said Dennis Drebsky, senior counsel at Nixon Peabody. The efforts are dictated by dollars and sense: the gap between revenue and expenses must be bridged somehow, either with aid from the state or restructuring obligations, he said.

"This is a shot across the barrel to unionized workers, that it may be better to seek a consensual arrangement than an overseer or manager trying to impose something," Drebsky said. "(Labor costs) are the biggest expense of any municipality, and certainly the case in Atlantic City...there's no magic wand that will stop the economic reality."

The broad powers given to LGS allow them to have everything on the table for discussion, Drebsky said.

The bill is likely to change during the legislative process, said Marc Pfeiffer, assistant director of the Bloustein Local Government Research Center at Rutgers University and former deputy director of LGS. Some suggest that some of the provisions—like giving LGS the ability to break contracts—are unconstitutional or problematic, he said.

Moody's Investors Service rates Atlantic City Caa1/negative and Standard & Poor's rates the city at CCC-/negative.

A USD 5.17m tranche of 5% Series 2013 general obligation bonds last traded in odd lots at 73.587 to yield 9.973% on 18 February.