14-1550

In the United States Bankruptcy Appellate Panel for the Ninth Circuit

IN RE CITY OF STOCKTON, CALIFORNIA,

Debtor.

FRANKLIN HIGH YIELD TAX-FREE INCOME FUND AND FRANKLIN CALIFORNIA HIGH YIELD MUNICIPAL FUND,

Appellants,

v.

CITY OF STOCKTON, CALIFORNIA,

Appellee.

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA,
CASE NO. 12-32118, HON. CHRISTOPHER M. KLEIN

DEBTOR AND APPELLEE CITY OF STOCKTON, CALIFORNIA'S REPLY IN SUPPORT OF MOTION TO DISMISS THE APPEAL AS EQUITABLY MOOT

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I. Introduction

The City's confirmed plan of adjustment ("Plan") has been fully consummated, and the myriad payments, transfers, and other actions taken by the City to implement the Plan cannot be undone. In its objection, Franklin argues that it does not seek to undo the Plan, asking only for more money. But the complex financial projections on which the Plan and its constituent compromises are premised leave no room for additional payments. Any such payments, which cannot be taken out of other creditor recoveries, would necessarily be borne by the City's workforce and residents in the form of reduced services, infrastructure investment, and essential reserves. The City's return to full service solvency and the establishment of a fiscal safety net are as fundamental to the Plan as are its compromises with creditors, and cannot be ignored.

Franklin's objection raises a number of red herring issues, such as a purported waiver, the contention that equitable mootness does not apply in chapter 9, and the inaccurate claim that the City consented to the Bankruptcy Court modifying the Plan. None should distract this Court from the essential facts that Franklin has failed to diligently pursue a stay, the Plan has been fully implemented, and Franklin cannot be simply given "more money" without eroding the underpinnings of the Plan. This Court should exercise its equitable discretion and dismiss the appeal as equitably moot.

II. The City's Equitable Mootness Argument Was Properly Brought As A Separate Motion.

Franklin's contention that the City waived its equitable mootness argument by failing to incorporate it into the City's Answering Brief is meritless. *See* Obj.[1] at 6-7. The City's mootness argument was properly brought as a separate motion. *See* Fed. R. Bank. P. 8013(a)(1) ("A request for an order or other relief is made by filing a motion."); Ninth Circuit Rule 27-11 (listing motions for dismissal among motions to be brought separate from appellate briefing); *see also In re Thorpe Insulation Co.*, 677 F.3d 869, 879 n. 3 (9th Cir. 2012) (equitable mootness motion was "not asserted within [appellee's] appellate brief, but was the subject of a separate motion ...").

The cases cited by Franklin simply hold that arguments relevant to the merits of an appeal are waived if not raised in a party's appellate briefing. The Motion does not pertain to Franklin's substantive challenges to the confirmation order; it is a plenary matter raised in this Court for this Court to decide in the first instance. Seeking dismissal due to equitable mootness is therefore wholly proper, does not somehow indicate gamesmanship, and cannot be said to prejudice Franklin, which has had sufficient time to prepare a response. The issue has been fully and properly presented on motion and should be decided on the merits of the Motion.

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[1] Throughout this Reply, we use "BAP Dkt. No." to cite filings in this Court; "Motion" to cite to the City's equitable mootness motion, BAP Dkt., No. 34-1; and "Obj." to cite to Franklin's objection to the Motion, BAP Dkt. No. 38.

III. Equitable Mootness Applies In Chapter 9.

Franklin misguidedly asserts that the equitable mootness doctrine should not be applied to chapter 9 cases, Obj. at 19, and asks the Court to follow *Bennett v. Jefferson County*[2], a flawed ruling out of the Northern District of Alabama, while ignoring existing Ninth Circuit precedent that has recognized and applied the doctrine of equitable mootness in a chapter 9 case. *See In re City of Vallejo*, 551 F. App'x 339 (9th Cir. 2013) (mem.). As recently recognized by the thoughtful opinion issued in *In re City of Detroit* granting that city's equitable mootness motion:

> [T]he [equitable mootness] doctrine is not concerned with the specific chapter under which the debtor's case was brought. Rather, what matters is whether hearing the bankruptcy appeal could unravel the debtor's plan and disturb the reliance interests created by it. Because the underlying equitable considerations of promoting finality and good faith reliance on a judgment applies with equal force to a Chapter 9 bankruptcy appeal, the Court sees no reason why the doctrine should not be applied [in chapter 9].

No. 15-cv-10036, 2015 WL 5697779, at *4 (E.D. Mich. Sept. 29, 2015) (copy attached to the Motion). Indeed, "the interests of finality and reliance ... surely apply with *greater* force" to a chapter 9 plan. *Id.* at *5 (emphasis added). The court went on to hold that the interests of the city, its creditors, and its residents "cannot be marginalized

[2] *Bennett v. Jefferson Cty., Ala.*, 518 B.R. 613 (N.D. Ala. 2014), *appeal docketed*, No. 15-11690 (11th Cir.). The Eleventh Circuit granted the motion for an interlocutory appeal, but has not yet ruled on the merits.

and dismissed in the broad brush manner adopted by the *Jefferson County* court," whose rationale the *Detroit* court found "particularly problematic." *Id.*

Franklin essentially ignores the *Detroit* opinion—including it merely as a "contra" citation without any discussion—and does not acknowledge the Ninth Circuit's own precedent applying the equitable mootness doctrine in the *Vallejo* chapter 9 case. Put simply, both policy considerations and Ninth Circuit law support application of equitable mootness to chapter 9 cases.

IV. The Bankruptcy Court Cannot Simply Award Franklin More Money.

Franklin repeatedly asserts that all it wants is to be paid "more money." Obj. at 2, 5, 11, 14, 17. While a larger payout is a universal creditor goal, Franklin over-simplifies the impact of its request. Franklin seeks the reversal of confirmation of the Plan, and while it asserts that every other aspect of the Plan can simply be held in stasis while it is awarded a greater recovery, this does not comport with the Bankruptcy Code. Either the confirmation order is affirmed, or it is not.

A court cannot simply order a municipal debtor to pay a given creditor more while keeping all other facets of a plan in place. Unlike in chapter 11, where a creditor may propose a plan after termination of exclusivity should a confirmation order be reversed, in chapter 9, only the debtor can propose or modify a plan, 11 U.S.C. §§ 941, 942. Moreover, a bankruptcy court "shall confirm" such plan if it satisfies the requirements of the Bankruptcy Code. Franklin attempts to skirt this basic principle by

presenting its ultimatum as the City's "choice." Obj. at 15. But the alternative its putative "choice" offers is for the City "to start over with a new plan," Obj. at 15, which only serves to drive home the City's point. The Plan has been not only confirmed, but fully consummated, and, as discussed in the Motion, the underlying settlements cannot be undone. The City, its creditors, and its residents relied on the consummated Plan and cannot go back to square one (even if the City could, contrary to the Long-Range Financial Plan ("LRFP"), cut its reserves and services to pay Franklin). This is the epitome of "fatally scrambl[ing] the plan." *In re Tribune Media Co.*, 799 F.3d 272, 280 (3d Cir. 2015).

Franklin selectively quotes the language of the Plan to support its claim that the City has "consented" to line-item modifications through the Plan's retention of jurisdiction and severability provisions (Articles XII and XIV(B), respectively). Like any chapter 9 or chapter 11 plan, the Plan preserves the jurisdiction of the Bankruptcy Court to enter such orders as are necessary to implement it. But the excerpts in the Objection omit a critical portion of Article XIV(B) (omitted portion emphasized):

> If any term or provision of this Plan is held by the Bankruptcy Court or any other court having jurisdiction, including on appeal, if applicable, to be invalid, void, or unenforceable, the Bankruptcy Court, *in each such case at the election of and with the consent of the City*, shall have the power to alter and interpret such term or provision to make it valid or enforceable to the maximum extent practicable, consistent with the original purpose of the term or provision held to be invalid, void, or unenforceable, and such term or provision shall then be applicable as altered or interpreted.

In other words, consistent with the Tenth Amendment and Bankruptcy Code § 904, the Bankruptcy Court may approve a modified plan, but only with the City's consent. Article XIV(B) does not serve as advance consent to give the Bankruptcy Court carte blanche to impose new plan provisions or payment obligations.

V. Reversal Of Confirmation Will Disrupt The Foundations Of The Plan.

If Franklin is granted its requested remedy, reversal of confirmation and "more money," *see* Obj. at 17, it would "completely knock[] the props out from under the plan." *See In re Thorpe*, 677 F.3d at 881. The most significant "prop" being undercut in this case is the LRFP, which contains the thorough and detailed financial projections on which the Plan, and the compromises it memorializes, are premised. ER 790-827.

The LRFP, which was presented and discussed at length at the confirmation trial,[3] provided the financial underpinnings of the Plan and illustrated that, notwithstanding Franklin's repeated contentions, the City is not and will not be awash in loose cash available to be paid to Franklin or any other creditor. To the contrary, the LRFP shows that the City has conscientiously laid out a frugal, but feasible, path to both fiscal stability and improved service solvency that makes a reasonable effort to pay its creditors and leaves little to no room for additional cuts or expenses. For instance,

[3] The Bankruptcy Court ultimately credited the LRFP and the testimony of its principal author, Robert Leland, over the testimony of Franklin's expert. Franklin's bald assertion that it "established" that the City could pay Franklin more without undermining the Plan, for which it cites only its own briefs and evidence, is therefore baseless. *See* Obj. at 3, 11.

under the LRFP, the City will build its safety net slowly, and will not reach its recommended reserve levels until FY 2032-33, *18 years* after confirmation. ER 791-92; SER 412-13, 415, 572. Then, and only then, will the City have any "spare" money to begin catching up on two decades of deferred maintenance, infrastructure investment, and restoration of previously slashed services such as libraries, administrative support, and recreation. ER791-92; SER 426, 569, 572, 579-80. The LRFP also showed that the City will need every penny of its reserves to make it through a bulge in its expenses approximately 10 years into its forecast while maintaining a bare minimum reserve. Put simply, the City has already cut as much as it prudently could. ER 791-92; *see* ER 357 (Bankruptcy Court's oral findings) ("[T]his court is persuaded that no better plan is likely under the circumstances."); ER 442 (confirmation opinion) (same).

While Franklin continues to imply that it can be paid more without any external effect, the obvious reality is that any additional payments to Franklin must come from somewhere—either out of the pockets of the City's other creditors, which Franklin insists is not its intent (*see, e.g.*, Obj. at 1, 11, 13, 14), or out of the pockets of the City's employees and citizens as a result of reduced funds available for infrastructure, services, and necessary reserves.

Franklin is quick to cite the Bankruptcy Court's comments that it is "conceivable that some additional funds could be made available to Franklin," if confirmation were reversed. While it is theoretically possible for the City to shift the cost of paying

Franklin more money to the City's employees and citizens by, for instance, cutting police officer positions (such as those funded by the City's tax measure), extending the time required to build its necessary reserves (thus increasing the risk of a chapter 18), or imposing hiring and compensation freezes (which risks the loss of critical personnel), it cannot do so without knocking out the key bases of the LRFP and, with it, the Plan.

VI. Franklin Failed To Diligently Pursue A Stay.

Franklin rationalizes its failure to diligently pursue a stay by arguing that it did not need to seek a stay from this Court (or the Ninth Circuit) because it was satisfied with the Bankruptcy Court's non-binding comments on the possibility of future relief. Obj. at 17. However, the Ninth Circuit has made clear that "it is *obligatory* upon appellant ... to pursue with diligence *all available remedies to obtain a stay*." *In re Roberts Farms, Inc.*, 652 F.2d 793, 797 (9th Cir. 1981) (emphasis added). No court has held that an appellant-creditor can shirk the requirement of pursuing a stay based on the conjecture, however optimistic, of the trial court.

While Franklin cites a handful of cases in which courts, exercising their equitable discretion, have forgiven an appellant's failure to seek a stay in not finding an appeal moot, Obj. at 17-18, the Ninth Circuit's most recent pronouncement on the doctrine of equitable mootness reaffirms that an appellant's decision not to fully pursue a stay still "weigh[s] heavily in favor of holding the appeal equitably moot." *In re Transwest Resort Properties, Inc.*, No. 12-17176, 2015 WL 5332447, at *4 (9th Cir. Sept. 15,

2015). *Transwest* expressly contrasted two prior cases: *In re Mortgages Ltd.*, 771 F.3d 1211, 1214 (9th Cir. 2014) (*Mortgages I*), which held an appeal equitably moot where appellant failed to seek a stay, with *In re Mortgages Ltd.*, 771 F.3d 623, 629 (9th Cir. 2014) (*Mortgages II*), which held an appeal not equitably moot where the appellant sought a stay from both the bankruptcy court and, subsequently, the district court. Franklin's citation to only select Ninth Circuit precedent notwithstanding, the failure of an appellant to fully and diligently pursue a stay continues to weigh strongly in favor of a finding of equitable mootness. *See Mortgages I*, 771 F.3d at 1215 (reiterating the rule of *Roberts Farms* that an appellant must "pursue with diligence all available remedies to obtain a stay of execution"); *id.* at 1216 ("[T]he appellant has a high obligation to seek a stay pending appeal, even if the chances of success seem dim.").

Franklin has not mustered any equitable explanation for its failure to seek a stay through all available avenues. Moreover, its initial stay motion before the Bankruptcy Court made no credible effort to establish the need for a stay. Not only did Franklin's motion misstate the law, but the only potential harm Franklin identified was the chance the City would bring an equitable mootness motion. *See* Motion at 10. Franklin made no attempt to claim any other likelihood of injury (in fact, it argued that its only claimed harm, the risk of equitable mootness, was itself unlikely). *Id.* Then, when its perfunctory motion was denied, Franklin chose to sit on its rights rather than continue to pursue a stay. The reason for this is obvious: Franklin did not actually *want* a stay

because of the massive bond that would have accompanied it.[4] Franklin argues that, pursuant to *Mortgages II*, it would not have needed to post an expensive bond in any case, Obj. at 17 n. 4, but simultaneously ignores the holding in *Mortgages I*, that the mere possibility a burdensome bond might be ordered is not an adequate reason for failing to diligently pursue a stay. 771 F.3d at 1216.

Appellants are expected to diligently pursue a stay through all available avenues. Rather than uphold this obligation, Franklin filed a pro forma motion meant only to "check the equitable mootness box" and then sat back while the Plan was consummated (including allowing the indenture trustee to accept the City's approximately $4.3 million wire transfer made in payment of Franklin's claims). Neither Franklin's desire to avoid posting a bond, nor its reliance on the Bankruptcy Court's comments, provides an equitable excuse for Franklin to sidestep this basic requirement. Franklin's failure to diligently pursue a stay, whether alone or combined with the impact on the Plan and the rights of third parties not before this Court, renders Franklin's appeal moot.

VII. Conclusion

For these reasons, the appeal should be dismissed as equitably moot.

Dated: October 16, 2015 Respectfully submitted,

[4] Franklin attempts to deflect this point by arguing that the City never requested a bond. Obj. at 17 n.4. Obviously, had Franklin been granted a stay, the next issue before the Bankruptcy Court would have been the size of the required bond.

/s/ Marc A. Levinson

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CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing reply with the Clerk of the Court for the Bankruptcy Appellate Panel for the Ninth Circuit by using the appellate CM/ECF system on October 16, 2015, which will automatically serve all parties of record who are registered CM/ECF users. I further certify that parties of record to this appeal who are not CM/ECF users have consented in writing to electronic service, and that I have served these parties via email.

October 16, 2015

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