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**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
SACRAMENTO DIVISION**

In re:
CITY OF STOCKTON, CALIFORNIA,
Debtor.

**Case No. 12-32118
D.C. No. OHS-5
Chapter 9**

**LIMITED OBJECTION OF
CAPITAL MARKETS CREDITORS
TO THE CITY OF STOCKTON'S
MOTION FOR ORDER (1) RULING
THAT APPROVAL OF
SETTLEMENT AGREEMENT IS
NOT REQUIRED UNDER RULE
9019 OF THE FEDERAL RULES OF
BANKRUPTCY PROCEDURE; OR
ALTERNATIVELY (2) APPROVING
SETTLEMENT AGREEMENT
PURSUANT TO RULE 9019**

Date: November 20, 2012
Time: 9:30 a.m.
Dept.: C, Courtroom 35
Judge: Hon. Christopher M. Klein

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1 National Public Finance Guarantee Corporation, Assured Guaranty Corp., Assured Guaranty
2 Municipal Corp., Franklin High Yield Tax-Free Income Fund, Franklin California High Yield
3 Municipal Fund and Wells Fargo Bank, National Association, in its role as indenture trustee
4 (collectively the “Capital Markets Creditors”), each a creditor and party in interest,¹ hereby submit
5 this limited objection to the City of Stockton, California’s (the “Debtor” or the “City”) Motion For
6 Order (1) Ruling That Approval of Settlement Agreement Is Not Required Under Rule 9019 of the
7 Federal Rules of Bankruptcy Procedure; Or Alternatively (2) Approving Settlement Agreement
8 Pursuant to Rule 9019 [Dkt. No. 585] (the “9019 Motion”).

9 The Capital Markets Creditors are owed hundreds of millions of dollars by the City. Yet the
10 City seeks blanket authority to enter into settlements with prepetition creditors of its choosing,
11 outside the chapter 9 process, and without notice to its other creditors. Although section 502 of the
12 Bankruptcy Code applies in chapter 9, the City requests that this Court give no effect to the rights
13 provided to creditors under section 502. Because the City has filed no schedules and has set no bar
14 date, the only way creditors can protect their rights to ensure that settlements are fair and equitable
15 and to evaluate the amount of the City’s limited assets leaving its coffers is through the 9019
16 process. And as shown below, the law is clear that Rule 9019 of the Federal Rules of Bankruptcy
17 Procedure (the “Bankruptcy Rules”) applies in chapter 9 cases in this context. In support of this
18 limited objection, the Capital Markets Creditors further state as follows:

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23 ¹ See Joinder of Creditor National Public Finance Guarantee Corporation to Indenture Trustee’s
24 Limited Objection to the Debtor’s Emergency Motion for Leave to Introduce Evidence Relating to
25 Neutral Evaluation Process under Government Code Section 53760.3(Q) [Dkt. No. 78], Joinder of
26 Franklin Advisers, Inc. to Limited Objection of Wells Fargo Bank, National Association as
27 Indenture Trustee to Emergency Motion for Leave to Introduce Evidence Relating to Neutral
28 Evaluation Process under Government Code Section 53760.3(q) [Dkt. No. 79], Joinder of Assured
Guaranty Corp. and Assured Guaranty Municipal Corp. to Limited Objection of Wells Fargo Bank,
National Association as Indenture Trustee to Emergency Motion for Leave to Introduce Evidence
Relating to Neutral Evaluation Process under Government Code Section 53760.3(q) [Dkt. No. 80],
and Limited Objection of Wells Fargo Bank, National Association as Indenture Trustee to
Emergency Motion for Leave to Introduce Evidence Relating to Neutral Evaluation Process under
Government Code Section 53760.3(q) [Dkt. No. 76], establishing that each of the Capital Markets
Creditors is a creditor and party in interest of the City of Stockton, California.

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I. ARGUMENT

A. A Chapter 9 Debtor Is Required to Seek Court Approval of a Compromise or Settlement Under Bankruptcy Rule 9019

1. Bankruptcy Rule 9019 Requires Approval of the Settlement of a Claim Against the City

1. The City argues in the 9019 Motion that Bankruptcy Rule 9019 does not create a substantive requirement for debtors to seek court approval of settlements and compromises. 9019 Motion at 3. The City points to section 363 of the Bankruptcy Code and argues that the only substantive requirement to seek court approval of compromises and settlements is found in section 363 of the Bankruptcy Code, which is not applicable in chapter 9 cases. *Id.* at 3-4.

2. However, this argument ignores the important distinction between the settlement of a claim asserted **against** the City/debtor (as here), and a settlement of a claim held **by** the City/debtor against a third party. The authority cited by the City for the proposition that section 363 is the statutory underpinning for Bankruptcy Rule 9019 involves the latter situation, where a debtor was settling affirmative claims that it held. For example, *In re Mickey Thompson Entertainment Group, Inc. (Goodwin v. Mickey Thompson Entertainment Group, Inc.)*, 292 B.R. 415 (B.A.P. 9th Cir. 2003), which the City asserts is the “leading Ninth Circuit case on the interplay between Rule 9019(a) and §363(b),” 9019 Motion at 4, involves “the disposition by way of ‘compromise’ of **a claim that is an asset of the estate . . .**” 292 B.R. at 421. (emphasis added). In that case, the Bankruptcy Appellate Panel found that

the settlement is in reality a purchase by the Settling Parties of a chose in action of the estate and for which another entity has offered a higher price in circumstances that invite a competitive auction that could yield a considerably higher price. Settling Parties were free to bid against the third party overbidder.

Id. Similarly, the only other cases cited to by the City for this proposition also involve the settlement of claims held by the debtor against a third party. *See Northview Motors, Inc. v. Chrysler Motors Corp.*, 186 F.3d 346, 347 (3d Cir. 1999) (involving the settlement of a debtor-car dealership’s claims

1 against Chrysler Motors Corp.); *In re Sparks*, 190 B.R. 842, 844 (Bankr. N.D. Ill. 1996) (relating to
2 a settlement agreement which “involved settlement of estate assets”).

3 3. In contrast, here, the Settlement Agreement² does not involve the settlement of claims
4 held **by** the debtor, but rather, claims **against** the debtor. The claim allowance and settlement
5 process is a core function of the bankruptcy court in a chapter 9 case. Indeed, this Court has held
6 that “[t]he core of a chapter 9 case is adjustment of the debtor-creditor relationship.” *In re City of*
7 *Stockton*, 478 B.R. 8, 25 (Bankr. E.D. Cal. 2012). Notably, section 502 of the Bankruptcy Code –
8 the statutory provision governing “allowance of claims or interests” – **is** incorporated into chapter 9.
9 *See* 11 U.S.C. § 901(a). Section 502(b) specifically provides that “the court, after notice and a
10 hearing, **shall** determine the amount” of any disputed claim, 11 U.S.C. § 502(b) (emphasis added),
11 and thereby provides the statutory underpinning for Rule 9019 as it applies to compromises of
12 claims **against** the debtor. *See, e.g., In re The Heritage Organization, L.L.C.*, 375 B.R. 230, 285
13 (Bankr. N.D. Tex. 2007) (noting linkage between section 502 and Rule 9019).

14 4. Thus, just as this Court found that the issues raised by retirees seeking an injunction
15 prohibiting the City from implementing a reduction in their claims for retiree health benefits were
16 “central to the debtor-creditor relationship,” which are “to be dealt with . . . in the collective chapter
17 9 proceeding,” so are the issues raised by the settlement and compromise of claims against the City
18 under the Settlement Agreement. *City of Stockton*, 478 B.R. at 25. Given that the City is proposing
19 to settle claims against it in the District Court Case, which is “central to the debtor-creditor
20 relationship” in a chapter 9 case, court approval under Bankruptcy Rule 9019 is required. Further,
21 there is nothing in Bankruptcy Rule 9019 that says that it is not applicable in chapter 9 or that
22 chapter 9 debtors are not subject to the rule.

23 **2. Requiring the City to Seek Court Approval of the Settlement Agreement**
24 **Does Not Violate Section 904**

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28 ² Capitalized terms not otherwise defined herein shall have the meaning ascribed to them in the 9019 Motion.

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1 5. The City incorrectly asserts that requiring it to seek approval of a compromise or
2 settlement under Bankruptcy Rule 9019 violates section 904 of the Bankruptcy Code. 9019 Motion
3 at 4. Section 904 provides that

4 Notwithstanding any power of the court, unless the debtor consents or the
5 plan so provides, the court may not, by any stay, order, or decree, in the
6 case or otherwise, interfere with—

- 7 (1) any of the political or governmental powers of the debtor;
8 (2) any of the property or revenues of the debtor; or
9 (3) the debtor’s use or enjoyment of any income-producing property.

10 11 U.S.C. § 904.

11 6. The City argues that this Court’s approval of the Settlement Agreement will require it
12 to expend funds “continuing to litigate the District Court Case” and thus “interfere with the City’s
13 freedom to control its property and revenues.” 9019 Motion at 5. However, this argument ignores
14 the very facts of the case that the City is proposing to settle. The District Court Case is stayed and
15 the City will not be incurring legal fees in connection with continuing to litigate the case. *See*
16 Declaration of Marci Arredondo in Support of City of Stockton’s Motion for Order (1) Ruling That
17 Approval of Settlement Agreement Is Not Required Under Rule 9019 of the Federal Rules of
18 Bankruptcy Procedure; or Alternatively, (2) Approving Settlement Agreement Pursuant to Rule 9019
19 [Dkt. No. 587] at ¶ 5.

20 7. Thus, requiring Court approval of the Settlement Agreement in no way forces the
21 City to incur additional legal fees or otherwise “interfere with the City’s freedom to control its
22 property and revenues.” The only legal fees the City will incur in connection with Court approval of
23 the Settlement Agreement are those necessary to the bankruptcy process that the City invoked
24 voluntarily. Therefore, despite the City’s assertions, seeking this Court’s approval of the Settlement
25 Agreement does not violate or even implicate section 904.

26 **B. Chapter 9 Precedent in This District Establishes That Bankruptcy Rule 9019**
27 **Does Require Court Approval of Settlements and Compromises**

28 8. The City’s argument that court approval of settlements and compromises under
Bankruptcy Rule 9019 is not required is in direct contrast to the position that the City of Vallejo took

1 in its chapter 9 case in this Court. In Vallejo's chapter 9 case, the City of Vallejo, which had the
2 same counsel as the City of Stockton, sought bankruptcy court approval of settlement agreements
3 under Bankruptcy Rule 9019 on at least four separate occasions. *See* Joint Motion by Plaintiff
4 National Public Finance Guarantee Corporation and Defendant City of Vallejo for Order Approving
5 Compromise Pursuant to Federal Rule of Bankruptcy Procedure 9019 (WS-3), *In re City of Vallejo*
6 (*Nat'l Pub. Fin. Guar. Corp. v. City of Vallejo*), Case No. 08-26813, Adv. No. 10-02672 (Bankr.
7 E.D. Cal. June 17, 2011) [Dkt. No. 67], a true and correct copy of which is attached to Capital
8 Market Creditors' Exhibit Index filed herewith as Exhibit A (seeking approval of settlement
9 agreement under Bankruptcy Rule 9019 resolving claims of National against the City of Vallejo);
10 Joint Motion of City of Vallejo and International Association of Firefighters, Local 1186, for Order
11 Approving Compromise Pursuant to Federal Rule of Bankruptcy Procedure 9019 (OHS-27), *In re*
12 *City of Vallejo*, Case No. 08-26813 (Bankr. E.D. Cal. Nov. 23, 2011) [Dkt. No. 1148], a true and
13 correct copy of which is attached to Capital Market Creditors' Exhibit Index filed herewith as
14 Exhibit B (seeking approval of settlement agreement and stipulation under Bankruptcy Rule 9019
15 settling claims arising from the City of Vallejo's breach, rejection, or refusal to honor the collective
16 bargaining agreement with the International Association of Firefighters, Local 1186); Joint Motion
17 of City of Vallejo and International Brotherhood of Electrical Workers, Local 2376, for Order
18 Approving Compromise Pursuant to Federal Rule of Bankruptcy Procedure 9019 (OHS-28), *In re*
19 *City of Vallejo*, Case No. 08-26813 (Bankr. E.D. Cal. Nov. 23, 2011) [Dkt. No. 1151], a true and
20 correct copy of which is attached to Capital Market Creditors' Exhibit Index filed herewith as
21 Exhibit C (seeking approval of settlement agreement and stipulation under Bankruptcy Rule 9019
22 settling claims arising from the City of Vallejo's breach, rejection, or refusal to honor the collective
23 bargaining agreement with the International Brotherhood of Electrical Workers, Local 2376); Joint
24 Motion of City of Vallejo and Wynathen Ketchem, Ana Menjivar, and the Mastagni Law Firm for
25 Order Approving Compromise Pursuant to Federal Rule of Bankruptcy Procedure 9019 (OHS-31),
26 *In re City of Vallejo*, Case No. 08-26813 (Bankr. E.D. Cal. Dec. 13, 2011) [Dkt. No. 1166], a true
27 and correct copy of which is attached to Capital Market Creditors' Exhibit Index filed herewith as
28 Exhibit D (seeking approval of settlement agreement and stipulation under Bankruptcy Rule 9019

1 resolving claims against the City of Vallejo under the federal Fair Labor Standards Act, 29 U.S.C. §§
2 201 *et seq.*³ This relief was consistent with existing chapter 9 precedent in this District. *See In re*
3 *Corcoran Hospital District*, 233 B.R. 449, 455-56 (Bankr. E.D. Cal. 1999) (noting that the court had
4 approved a settlement that “reduced a claim from over \$2.7 million to a net allowed general
5 unsecured claim of \$725,000 with no administrative claim or rights of setoff” and that “[t]he
6 Committee was given notice of the motion to approve the settlement and did not oppose it”).

7 9. The settlement agreements that were the subject of the 9019 motions that the City of
8 Vallejo deemed necessary and required by Bankruptcy Rule 9019 are no different from the
9 settlement agreement at issue here. Each involves the settlement of claims **against** the City, which,
10 as discussed above, is a core function of the bankruptcy court in a chapter 9 case. The City is now
11 asking this Court to set a dangerous precedent whereby the City can settle the claims of its creditors
12 without disclosing the terms of such settlements and without giving this Court and other creditors an
13 opportunity to fully evaluate the settlement. Such a precedent is contrary to what other
14 municipalities and bankruptcy courts in this district determined was required by Bankruptcy Rule
15 9019 in a chapter 9 case.

16 WHEREFORE, the Capital Markets Creditors respectfully request that this Court issue an
17 Order (i) ruling that approval of the Settlement Agreement is required under Bankruptcy Rule 9019
18 and (2) granting such other and further relief as is just and proper under the circumstances.

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21 ³ The court approved each of the foregoing Bankruptcy Rule 9019 motions, applying “the four factor
22 test of *Fireman’s Fund v. Woodson* (*In re Woodson*), 839 F.2d 610, 620 (9th Cir. 1988), and *Martin*
23 *v. Kane* (*In re A&C Props.*), 784 F.2d 1877 (9th Cir. 1986).” *See* Order Granting Joint Motion by
24 Plaintiff National Public Finance Guarantee Corporation and Defendant City of Vallejo for Order
25 Approving Compromise Pursuant to Federal Rule of Bankruptcy Procedure 9019 (WS-3), *In re City*
26 *of Vallejo* (*Nat’l Pub. Fin. Guar. Corp. v. City of Vallejo*), Case No. 08-26813, Adv. No. 10-02672
27 (Bankr. E.D. Cal. Aug. 9, 2011) [Dkt. No. 73]; Order Granting Joint Motion of City of Vallejo and
28 International Association of Firefighters, Local 1186, for Order Approving Compromise Pursuant to
Federal Rule of Bankruptcy Procedure 9019 (OHS-27), *In re City of Vallejo*, Case No. 08-26813
(Bankr. E.D. Cal. Dec. 29, 2011) [Dkt. No. 1191]; Order Granting Joint Motion of City of Vallejo
and International Brotherhood of Electrical Workers, Local 2376, for Order Approving Compromise
Pursuant to Federal Rule of Bankruptcy Procedure 9019 (OHS-28), *In re City of Vallejo*, Case No.
08-26813 (Bankr. E.D. Cal. Dec. 29, 2011) [Dkt. No. 1192]; Order Granting Joint Motion of City of
Vallejo and Wynathen Ketchem, Ana Menjivar, and the Mastagni Law Firm for Order Approving
Compromise Pursuant to Federal Rule of Bankruptcy Procedure 9019 (OHS-31), *In re City of*
Vallejo, Case No. 08-26813 (Bankr. E.D. Cal. Dec. 29, 2011) [Dkt. No. 1190].

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Dated: November 6, 2012

WINSTON & STRAWN LLP

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