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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re: CITY OF STOCKTON, CALIFORNIA, Debtor.	Case No. 2012-32118 Chapter 9 D.C. No. OHS-15 **CITY'S SUPPLEMENTAL MEMORANDUM OF LAW IN SUPPORT OF CONFIRMATION OF FIRST AMENDED PLAN FOR THE ADJUSTMENT OF DEBTS OF CITY OF STOCKTON, CALIFORNIA (NOVEMBER 15, 2013)** **Confirmation Hearing** Date: May 12, 2014 Time: 9:30 a.m. Dept: Courtroom 35 Judge: Hon. Christopher M. Klein

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I. INTRODUCTION

An investment of $35 million is a significant one, even for two "high yield" investment funds with a combined $1 billion in assets. But when the Plan[1] is confirmed and Franklin is paid its 1% return on its capped lease rejection claim—even if Franklin exercises its right to take possession of two money-losing City golf courses and a park for the next 35 or more years—the two Franklin funds will suffer a loss of less than half of one percent of their assets. The City, on the other hand, is fighting for its very existence. As the Court is well aware, despite its dramatic cost-cutting measures, despite the reduction of City staffing, and despite the significant concessions made by its unions, the City was insolvent entering the 2012-13 fiscal year, and had no choice but to file this chapter 9 case. Shortly thereafter, it made the gut-wrenching decision to reduce its health benefit payments to over 1,100 retirees and dependents, and to eliminate all such payments the following fiscal year. Its labor unions bargained away the health benefits to which their members would have been entitled, saving the City hundreds of millions of dollars, if not more.

The City then faced a costly and time-consuming eligibility battle waged by three capital markets creditors, one of which was Franklin. After the eligibility ruling of a year ago tomorrow, the mediation process previously ordered by this Court and orchestrated by Judge Perris began in earnest. It was painful and arduous, but as reflected in the Plan, resulted in agreements with two of the capital markets creditors, Assured Guaranty and NPFG, as well as with virtually all other creditors. Meanwhile, Stockton residents, who have felt the pain of understaffing, crime and violence, and reduction or elimination of the funding of community-based organizations, inflicted more pain on themselves last November by approving a 3/4 cent sales tax, making the City's sales tax rate one of the highest in Northern California.

The City is filing this memorandum because no agreement could be reached with Franklin. The Plan discussed and defended herein represents the best efforts of the City, all but one of its key creditors, its nine labor unions, and the committee representing the City's 2,400

[1] Any capitalized term used but not defined herein shall have the meaning ascribed to it in the First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. No. 1204] (the "**Plan**").

retirees and dependents to adjust the City's debts fairly and within the construct of the Bankruptcy Code. Franklin's 66-page summary objection attacks virtually every aspect of the Plan, raising virtually every perceived technical, legal, and moral flaw in it. But the gist of the onslaught is that Franklin does not believe that it is treated fairly in the Plan. This memorandum responds to Franklin's various arguments, demonstrating in each case how the Plan satisfies the chapter 9 confirmation requirements. But at 50,000 feet, the response is simple: Just as the settlements with Ambac, Assured Guaranty, and NPFG recognize that collateral counts, the treatment of Franklin in the Plan does so as well. Were the leases securing the City's obligation to pay rent (the stream of which was then to be used to pay the bonds purchased by Franklin) leases of police or fire stations or of other structures necessary to the operation of the City, Franklin would have fared better in the negotiation process and/or in the Plan. Because the Franklin claims could not be resolved through negotiation and mediation, the City has provided the treatment to Franklin mandated by the Bankruptcy Code given that Franklin is the assignee of an unsecured lease rejection claim. Thus, the Plan affords Franklin all to which it is entitled, and despite its fervent opposition, and notwithstanding the costs that the discovery and briefing have imposed on the City, Franklin's objections should be overruled and the Plan confirmed.

II. PROCEDURAL BACKGROUND

The procedural background to the Confirmation Hearing is set forth in the City's Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. No. 1243] (the "Confirmation Memorandum"). Confirmation Memorandum at 3. After the City filed the Confirmation Memorandum, the following creditors filed objections: Franklin [Dkt. No. 1273], Michael A. Cobb [Dkt. No. 1261], and T. To Can Nguyen [Dkt. Nos. 1276, 1277]. Limited objections were filed by CalPERS [Dkt. No. 1255] and by Wells Fargo in its capacity as indenture trustee to various securities [Dkt. No. 1257].[2] On February 21, 2014, an employee of Rust Consulting/Omni Bankruptcy filed a declaration regarding the tabulation and certification of the

[2] On March 28, 2014, the City responded separately to the objections filed by Mr. Cobb and Ms. Nguyen [Dkt. Nos. 1298 and 1300, respectively]. At this stage, it is not responding to the placeholder limited objections filed by Wells Fargo and CalPERS.

ballots voting to accept or reject the Plan [Dkt. No. 1268]. Classes 1A, 1B, 3, 4, 5, 6, 7, 12, and 18 voted to accept the Plan. Class 14 rejected the Plan. No valid votes were received for Classes 9 or 19. Dkt. No. 1268 at ¶ 11.[3]

This Court conducted a status conference on March 19, 2014, which was continued to April 7, 2014 at 1:30 p.m. [Dkt. No. 1282]. The Confirmation Hearing as well as the trial in the adversary proceeding that Franklin and Wells Fargo filed against the City [Adv. No. 13-02315-C] (the "Adversary") are scheduled to commence on May 12, 2014 at 9:30 a.m. Dkt. No. 1242 ¶ 19.

III. FRANKLIN'S OBJECTIONS TO THE PLAN SHOULD BE OVERRULED

A. The Plan Properly Classifies the Lease Rejection Claim

Based on the facts and circumstances of the case, the City classified the Claims into 19 separate Classes. Franklin disparages this classification scheme as "bizarre and convoluted" and asserts that the number of Classes renders this scheme "facially suspect."[4] Summary Objection of Franklin High Yield Tax-Free Income Fund and Franklin California High Yield Municipal Fund to Confirmation of First Amended Plan of Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. 1273] (the "Summary Objection") at 32, line 17; 34, line 24.

The City developed the classification scheme set forth in the Plan by diligently analyzing the Claims scheduled and/or filed in the case. In compliance with section 1122, it then exercised its considerable discretion under the Bankruptcy Code to develop a scheme that classifies substantially similar Claims in the same Class.[5] In particular, the Plan properly classifies the Golf Course/Park Claims of the 2009 Golf Course/Park Bond Trustee/Franklin (referred to hereafter as the "Lease Rejection Claim").[6] The Lease Rejection Claim is a General Unsecured Claim in the

[3] Classes 2, 8, 10, 11, 13, 15, 16, 17 are not Impaired and thus did not vote.

[4] In *Steelcase Inc. v. Johnston (In re Johnston)*, 21 F.3d 323 (9th Cir. 1994), the most recent major Ninth Circuit classification case, the order confirming the debtor's plan was affirmed. That plan listed 26 classes. *Id.*, 21 F.3d at 325.

[5] Unless otherwise noted, all references to a "section" are to a section of title 11 of the United States Code (the "**Bankruptcy Code**").

[6] The Golf Course/Park Claims of the 2009 Golf Course/Park Bond Trustee/Franklin are defined in the Plan as follows:

> the Claims arising from the rejection by the City of the Golf Course/Park Lease Back (as limited under section 502(b)(6)) and the Claims, if any, arising from the rejection by the City of the Golf Course/Park Lease Out, which claims are asserted by the 2009 Golf Course/Park Bond Trustee at the direction of Franklin, or its authorized successor in interest, as the sole holder of the 2009 Golf Course/Park Bonds as a result of the assignment by the Financing Authority of all of its rights under the Golf Course/Park Lease Out and the Golf Course/Park Lease Back to the 2009 Golf Course/Park Bond Trustee. The Golf Course/Park

amount of $10,358,773.[7] As such, it is substantially similar to the other General Unsecured Claims in Class 12. Further, the Plan properly classifies the Claims of other creditors, specifically those of Ambac, Assured Guaranty, and NPFG, separately from the Class 12 Claims because these Claims either have a different legal character and/or because there are valid business or economic reasons for doing so. Franklin's complaints that the Plan "runs afoul" of section 1122, section 1123(a)(4), and section 1129(b)(1) are baseless. Summary Objection at 32, line 14.

1. The City Has Considerable Discretion in Classifying Claims

Franklin glosses over the fact of the City's discretion in classifying Claims in the Plan. As stated in the Confirmation Memorandum, debtors have "considerable discretion" to classify claims in a reorganization plan. *In re Wabash Valley Power Ass'n*, 72 F.3d 1305, 1321 (7th Cir. 1995); *In re City of Colorado Springs, Spring Creek Gen. Improvement Dist.*, 187 B.R. 683, 687 (Bankr. D. Colo. 1995) ("Generally, § 1122 allows plan proponents broad discretion to classify claims and interests according to the particular facts and circumstances of each case."); Collier ¶ 1122.03[3][a] ("Courts recognize that both the proponent of the plan and the court itself have wide latitude in determining whether similar claims may be classified separately."). Using its business judgment, the City has exercised this discretion to classify the Claims in compliance with the requirements of section 1122.

2. The Lease Rejection Claim Is Substantially Similar to the Retiree Health Benefit Claims

Whether claims are substantially similar is a question of fact, and the bankruptcy judge

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> Claims of the 2009 Golf Course/Park Bond Trustee/Franklin do not include any claims arising out of non-payment of the 2009 Golf Course/Park Bonds as all such claims are non-recourse claims against the Financing Authority secured only by the assignment by the Financing Authority of the Golf Lease Back Rental Payments and all of its rights under the Golf Course/Park Lease Out and the Golf Course/Park Lease Back, and are not obligations of the City.
>
> Plan at § I.A.94.

[7] Franklin states repeatedly that it has a $35 million Claim against the City. *See, e.g.*, Summary Objection at 1, line 9. On March 27, 2014, the City filed Defendant City of Stockton's Motion for Judgment to Be Entered in Favor of Plaintiffs [Adv. Dkt. No. 28]. In this motion, the City seeks an order dispensing with the major issues in the Adversary and directing entry of a judgment in favor of the plaintiffs and against the City in the form, content and manner described therein. If and when the Court grants the City's motion, Franklin will indeed have a claim for $35 million (albeit a disputed claim). However, if the Court does not grant the City's motion, the City intends to object to the proof of claim filed by the 2009 Golf Course/Park Bond Trustee [Claim 187-1] on the ground that this Claim is a General Unsecured Claim limited to the amount of $10,358,773 by section 502(b)(6).

"must evaluate the nature of each claim, i.e., the kind, species, or character of each category of claims." *Steelcase Inc. v. Johnston (In re Johnston)*, 21 F.3d 323, 327 (9th Cir. 1994). Here, the Lease Rejection Claim is "substantially similar" to the other Claims in this Class—namely, the Retiree Health Benefit Claims—because the Lease Rejection Claim is a General Unsecured Claim arising under sections 502(g) and 502(b)(6) as a result of the City's rejection of the Golf Course/Park Lease Out and the Golf Course/Park Lease Back.

Franklin argues that the Lease Rejection Claim is not substantially similar to the Retiree Health Benefit Claims because "the Bonds are payable at least in part from restricted funds"—specifically, from "restricted PFFs [public facilities fees]." Summary Objection at 40, lines 15-16. But the bond documents make it abundantly clear that, as discussed below: (i) the General Fund was the only legally obligated source of repayment of the Lease Payments;[8] (ii) no PFFs were pledged to Franklin, or for that matter even mentioned in the Golf Course/Park Lease Out, the Golf Course/Park Lease Back, and the 2009 Golf Course/Park Bonds Indenture; and (iii) the City merely had the option to reimburse its General Fund from certain PFFs for a portion of the Lease Payments. Moreover, the City does not even expect that any PFF revenues will be available for any debt service for the foreseeable future. Finally, Franklin's attempted distinction is no distinction at all, for the City has the option of using restricted revenues to fund a portion of the Retiree Health Benefit Claims also. For these reasons, discussed in more detail below, Franklin's claimed distinction is without substance.

a. <u>The General Fund Was the Primary Source of Repayment of the 2009 Golf Course/Park Bonds</u>

Franklin appears to base its argument largely on the following statement from Appendix A to the Official Statement for the 2009 Golf Course/Park Bonds issued on August 20, 2009:[9] "The City *expects* that the Public Facilities Impact Fees generated from the General City Office Space,

[8] "'*Lease Payments*' means the aggregate amount of all the payments required to be paid by the City pursuant to Section 4.3 of the Lease Agreement." 2009 Golf Course/Park Bonds Indenture at § 1.01[Dieker Decl. Ex. A].

[9] In bond parlance, an official statement is a document prepared by a bond issuer that is distributed to potential investors. It "describes the essential terms of the bonds, including whether and on what terms the bonds can be redeemed prior to maturity, the sources pledged to repay the bonds, the issuer's covenants for the benefit of investors, and much more. There are no strict requirements regarding the contents of an official statement." "What Is an Official Statement?" EMMA (Electronic Municipal Market Access), http://emma.msrb.org/Education Center/WhyReadOS.aspx.

Fire Stations, Street Tree and Street Signs and Police Stations will be sufficient to pay the debt service, when due on the 2009 Bonds." Official Statement at A-8 (emphasis added) [Declaration of Kenneth Dieker in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Dieker Decl.") Ex. B]. In addition to the fact that this statement is buried in an appendix, it is the type of statement that the Official Statement defines as "forward-looking":

> Such statements are generally identifiable by the words "expects," . . . and analogous expressions. The achievement of certain results or other expectations contained in such forward-looking statements are subject to a variety of risks and uncertainties that could cause actual results to differ materially from those that have been projected. *No assurance is given that actual results will meet the forecasts of the City in any way, regardless of the optimism communicated in the information, and such statements speak only as of the date of this Official Statement*.

Id. at ii (emphasis added). Thus, Franklin's reliance on the statement in Appendix A to support its argument that the 2009 Golf Course/Park Bonds must be paid at least in part from restricted funds—specifically, from restricted PFFs—is misplaced.

Further, Franklin's citations to this statement stand in contradiction to statements in the body of the Official Statement, which track the terms of the 2009 Golf Course/Park Bonds Indenture and the other bond documents and confirm that (i) the Lease Payments are not secured by a pledge on any revenues of the City; and (ii) the source of payment for the 2009 Golf Course/Park Bonds is the General Fund, not restricted funds. Although the 2009 Golf Course/Park Bonds are secured by the Lease Payments, "[t]he Lease Payments due under the Lease Agreement . . . *are not secured by any pledge of taxes or any other revenues of the City* but are payable from any funds lawfully available to the City." *Id*. at 16 (emphasis added). This language tracks language in the Golf Course/Park Lease Back: "Lease Payments shall be payable from any source of available funds of the City, subject to the provisions of Articles VI and X hereof [these provisions are not applicable to the present analysis]." Golf Course/Park Lease Back at § 4.3(d) [Dieker Decl. Ex. D]. Further, the 2009 Golf Course/Park Bonds Indenture specifies that those funds "lawfully available to the City" are funds available in the General Fund,

as stated in the fifth recital: "under . . . [the Golf Course/Park Lease Back] the City will agree to make lease payments to the Authority *from moneys in the General Fund* and the City will budget and appropriate sufficient amounts in each year to pay the full amount of principal of and interest on the Bonds." 2009 Golf Course/Park Bonds Indenture at 1 (emphasis added) [Dieker Decl. Ex. A].

b. No PFFs Were Pledged for Repayment of the 2009 Golf Course/Park Bonds

The only collateral the 2009 Golf Course/Park Bond Trustee obtained under the 2009 Golf Course/Park Bonds Indenture was an assignment of the Financing Authority's interests in the Golf Course/Park Lease Out and Golf Course/Park Lease Back. *Id.* § 5.01(b). No PFFs were pledged. The City could not have pledged PFFs because the City was not an obligor under the 2009 Golf Course/Park Bonds Indenture. The City had the option, but not the obligation, to reimburse the General Fund for a portion of Lease Payments from PFF revenues.

c. The City Expects That No Net PFFs Will Be Available for Debt Repayment Purposes

As discussed in more detail herein, Stephen Chase, the City's Director of Community Development, has testified in deposition and will testify at trial that the City expects that no PFF revenues will be available for any purpose other than providing the infrastructure improvements for which PFFs are collected from developers. Declaration of Stephen Chase in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Chase Decl.") ¶ 9. In general, PFFs are charges levied on new development to pay for development's fair share of infrastructure needs to mitigate the incremental impacts of the development. *Id.* ¶ 2. The ability of the City to divert PFF revenues to other purposes is tightly limited by California law. *Id.* ¶ 2-6. The Police and Fire PFF funds are currently in deficit and will need to be replenished from future PFFs. *Id.* ¶ 13. In addition, the rate of developers taking out new building permits has fallen sharply after the 2008 recession and still has not recovered, despite recent projections of such a recovery, *id.*, and the City's real property market remains weak. Declaration of Laurie

Montes in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Montes Decl.") ¶ 6.

The sum total is that the low level of PFF revenue now expected by the City has far more urgent and compelling uses than making the Lease Payments or paying the City's unsecured creditors, and no net PFF revenues will be available for debt service for the foreseeable future.

d. Just as the Golf Course/Park Lease Back Rentals Can Be Paid with Restricted PFF Revenues, the Retiree Health Benefit Claims Can Be Paid with Restricted Revenues

Because some portion of the 1,100 retirees holding Retiree Health Benefit Claims worked for operations of the City that generate restricted revenues, their Retiree Health Benefit Claims (just like their pension obligations) can be paid from restricted revenues, rather than the General Fund. Thus, the fact that the rental payments on the Golf Course/Park Lease Back owing by the City could, at the option of the City, and assuming such revenues exist, be funded with restricted PFF revenues does not distinguish the Franklin claims from the Retiree Health Benefit Claims in the first instance.

3. The Plan Treats the Lease Rejection Claim and the Retiree Health Benefit Claims the Same

Franklin's argument that the "retirees holding Retiree Health Benefit Claims in fact are receiving substantially superior treatment on their claims . . . " displays a fundamental misunderstanding of basic bankruptcy principles. Summary Objection at 41, lines 14-15. Franklin argues that this Court must conflate the Retiree Health Benefit Claims with the Claims such retirees hold for pension obligations. As conflated, Franklin argues that retirees are receiving more than 70% on their Claims, since the pension Claims will be paid in full. *Id.* at 41, lines 18-19.

Franklin knows that plans classify and treat "claims" and not "creditors." *Id.* at 38, lines 6-7 ("only the nature of the claim or interest is supposed to be relevant to classification, not the identity of the holder of the claim or interest," quoting Collier). But that knowledge does not stop Franklin from making elaborate arguments about how the Retiree Health Benefit Claims are

"inexorably joined" to the treatment of the retirees' pension Claims and why two sets of claims must be considered as one merely because they are held by the same person. In fact, a Retiree Health Benefit Claimant has two separate and distinct interests. One of these, pension benefits paid to him or her by the City through CalPERS, is shared with all 2,100 CalPERS retirees; the other, lifetime health benefits paid to him or her by the City pursuant to labor agreements executed by the City, is not. Declaration of Teresia Zadroga-Haase in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Zadroga-Haase Decl.") ¶ 2. Further, each argument that Franklin makes could be made equally with respect to a consenting secured creditor whose collateral has a value of less than the full amount of the secured creditor's claim.

In an example where the collateral value is, say, 80% of the debt owing to the creditor, and unsecured creditors were receiving 5 cents on the dollar, Franklin's conflation argument would be that the claim of the undersecured creditor would be receiving 80 cents on the dollar on account of the secured claim (which secured claim is "inexorably joined" to the unsecured deficiency claim) plus another 1 cent for the unsecured deficiency claim, for a total of 81 cents on the dollar, far better than other unsecured creditors in the unsecured class who only receive 5 cents on the dollar.

Further, the cases Franklin cites in support of its conflation argument are inapposite. For example, it relies on *ACC Bondholder Grp. v. Adelphia Commc'ns Corp. (In re Adelphia Commc'ns Corp.)*, 361 B.R. 337 (S.D.N.Y. 2007), for the proposition that the Plan's treatment of Retiree Health Benefit Claims and retiree pension Claims—as conflated—violates the equal treatment requirement of section 1123(a)(4). But the *Adelphia* court did not rule on section 1123(a)(4), and it is clear from the court's discussion that what motivated its dicta was the fact that certain creditors within a class were given additional consideration if they voted to accept the plan, compared to other class claimants who did not vote in favor of the plan. Here, the retirees in Class 12 will receive no additional consideration if they vote to accept the Plan. Nor does the Plan attempt to impair a retiree's pension if he or she votes against the Plan. Thus, the underlying

quid pro quo at issue in *Adelphia* is absent here.

Franklin's reliance on *New Century* is similarly misguided. *Schroeder v. New Century Liquidating Trust (In re New Century TRS Holdings, Inc.)*, 407 B.R. 576, 592 (D. Del. 2009). The Plan is wholly unlike the one in *New Century* because the latter provided a higher percentage recovery to certain claims in a given class than it did to other claims in the same class. Here, in contrast, the distribution percentage is the same for the Retiree Health Benefit Claims and Franklin's Class 12 Claim.

For the foregoing reasons, Franklin is receiving exactly the same treatment as the Retiree Health Benefit Claims, and the fact that retirees hold other Claims that receive different treatment is logically and legally irrelevant.

4. The City Has the Discretion to Classify the Claims of Ambac, Assured Guaranty, and NPFG Separately from the Lease Rejection Claim

Substantially similar unsecured claims may be placed in separate classes when their legal character is different or when there are business or economic justifications. *Steelcase*, 21 F.3d at 328; *In re Loop 76, LLC*, 465 B.R. 525, 536 (B.A.P. 9th Cir. 2012). The City has exercised such discretion, classifying the Claims of Ambac, Assured Guaranty, and NPFG separately from the Lease Rejection Claim because these Claims are of a different legal character and/or because there are business or economic reasons for doing so. Specifically, even though the lease transactions insured by Ambac, Assured Guaranty, and NPFG generally have a structure similar to the Golf Course/Park Lease Back Transaction—the lease out / lease back structure described in the Disclosure Statement—these transactions have distinctive characteristics and impacts on the General Fund that render them different from the one involving Franklin. Disclosure Statement at 33-34. Importantly, each involves leased properties that the City has determined to be essential or at least important to its provision of services to its residents. The Golf Course/Park Properties are not essential. Further, the Claims of Ambac, Assured Guaranty, and NPFG were not classified separately to gerrymander these Claims—that is, to create a Class of Impaired Claims that would vote to accept the Plan. Having reached agreement through the mediation process with these creditors and the Retirees' Committee, the City knew long ago that the Plan would satisfy

section 1129(a)(10).[10]

a. The Claims of Ambac, Assured Guaranty, and NPFG May Be Classified Separately Because There Are Business or Economic Justifications for Doing So

The leased properties relating to the Claims of Ambac are three fire stations (Fire Stations No. 1, 5, and 14), the City's Main Police Station, and the Maya Angelou Southeast Branch Library. The Main Police Station, which is the command center for the City's Police Department, and Fire Stations 5 and 14 (Fire Station 1 has been closed) provide a critical health and safety function for the City. Dieker Decl. ¶ 22 ("Ambac Settlement"). The Library features an extensive collection of materials for Spanish and Hmong speakers, two important communities in the City; in addition, it offers numerous programs for residents in this district, including programs for children, job seekers, and community members seeking information about health insurance and other matters, as well as computer work stations and Internet access. In the exercise of its business judgment, the City has determined that it cannot relinquish control of these properties because of their importance. Declaration of Kurt Wilson in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Wilson Decl.") ¶ 4.

The leased properties relating to the SEB Claims of the SEB Bond Trustee/NPFG are the Stewart/Eberhardt Building and an eight-story parking structure for the building. The Stewart/Eberhardt Building was designed to meet the standard for, and is certified as, an "essential services building." An essential services building is "any building, including buildings designed and constructed, for public agencies used, or designed to be used, or any building a portion of which is used or designed to be used, as a fire station, police station, emergency operations center, California Highway Patrol office, sheriff's office, or emergency communication dispatch center." Cal. Health & Safety Code § 16007. The California

[10] Indeed, Franklin cannot colorably argue gerrymandering because other Impaired Classes, including Class 12, voted to accept the Plan. *See, e.g., In re Red Mountain Machinery Co.*, 448 B.R. 1, 7 (Bankr. D. Ariz. 2012) ("Because it is clearly not the case that the sole purpose of Debtor's separate classification [of the deficiency claim] was to obtain acceptance of the Plan in order to satisfy § 1129(a)(10), the gerrymandering limitation on classification does not apply."); *In re City of Colorado Springs, Spring Creek Gen. Improvement Dist.*, 187 B.R. 683, 689-90 (D. Colo. 1995) (chapter 9 debtor could separately classify similarly situated bond claims because classification was not the result of improper gerrymandering).

Legislature intended for essential services buildings to "be capable of providing essential services to the public after a disaster." *Id.* at § 16001. The Stewart/Eberhardt Building currently houses several City departments, including Human Resources, Police Emergency Communications (911 Dispatch), Police Investigations, Public Works, and the Police Crime Lab. Wilson Decl. ¶ 5. It is an essential civic property because the City must be able to provide essential services to its residents in the event of a disaster. *Id.*

The leased property relating to the Arena Claims of the 2004 Arena Bond Trustee/NPFG is the Stockton Arena, which is part of the Stockton Events Center. The Arena, the anchor of the City's downtown waterfront redevelopment program, is located next to the Stockton Ballpark and is within walking distance of the Weber Point Event Center and the Bob Hope Theatre. *Id.* It is the home of the City's Thunder ice hockey team, and it is the site of a wide variety of events, including athletic, performing arts, and community-based events. *Id.* This property is important to the City because it creates jobs—not only for the Arena itself, but also for nearby hotels, restaurants, and shops. It attracts and retains residents and visitors alike to Downtown in order to build the City's tax base through the sales of tickets, concessions, and merchandise and to avoid a return to insolvency in the future. More intangibly, but nevertheless important to the leadership of the City, it instills a sense of civic identity and pride among the City's residents. In short, the Arena's loss and possible closure would have a negative impact on the City's downtown waterfront redevelopment program and would have catastrophic symbolic significance.

The leased properties relating to the Parking Structure Claims of the 2004 Parking Bond Trustee/NPFG are three parking structures in downtown Stockton: (i) the Edmond S. Coy Parking Structure, a six-story structure with about 575 parking spaces as well as ground commercial space for workers in and visitors to the Central Business District; (ii) the Stockton Events Center Parking Structure, a seven-story structure with about 600 parking spaces for sports fans, concert goers, and event attendees; and (iii) the Market Street Garage, a four-story structure with about 780 parking spaces, which provides monthly parking for employees of downtown businesses and hourly parking for patrons of downtown businesses. *Id.* These properties are important to the City because the City must ensure that parking in the downtown area is ample

and reasonably priced in order to encourage employees, residents, and visitors to continue to patronize the heart of the City. *Id.*

The leased property relating to the Office Building Claims of the 2007 Office Building Bond Trustee/NPFG is the 400 E. Main Office Building Property, a Class A, eight-story, steel-framed building of approximately 246,541 square feet, located in the heart of the City's business district. The City intended to make this building its new City Hall, replacing the outdated and crumbling City Hall built over 100 years ago. *Id.* ¶ 4. Although the 400 East Main Building Property did not become the new City Hall, the City did move certain of its operations there, including its information technology department, and it invested several millions of dollars in upgrades to provide the necessary cabling and chillers for its main computer servers and related equipment. *Id.* This property is important to the City because it cannot operate effectively without a state-of-the-art facility for its information technology department, and this space therefore fills an essential need for the City. *Id.* Without the property and the new lease, the City would face the difficult task of finding office space suitable for its operations, and would likely be unable to secure a lease in an equivalently modern building under such favorable terms. *Id.* Furthermore, the City would face an estimated $1.8 million expense of relocating its information technology operations to a different building. Disclosure Statement § IV.A.8.f(ii). These underlying business considerations further justify the City's separate classification of Assured Guaranty's claims.

The City's separate classification of Assured Guaranty's Pension Obligation Bonds Claim is also predicated on sound business and economic justifications. The City's settlement agreement with Assured Guaranty extends the City's payment schedule on the Pension Obligations Bonds from the original 2038 maturity date until 2052. Supplemental Plan Supplement in Connection with the First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. No. 1259], Collective Ex. 1.a. (Reimbursement Agreement, between Assured Guaranty and the City, at Scheds. 1-4). This restructured payment schedule, combined with the structure of the settlement itself, which only requires the City to make payments above a certain threshold if and when the City's revenues exceed projections,

provides the City with needed flexibility. Moreover, the settlement with Assured Guaranty has allowed the City to move forward with its reorganization, rather than wasting valuable time and resources in litigating the difficult legal issues raised by Assured Guaranty in respect of the Pension Obligation Bonds. *See In re Corcoran Hosp. Dist.*, 233 B.R. 449, 456 (Bankr. E.D. Cal. 1999) (business and economic concerns justified chapter 9 debtor's separate classification of a settling creditor where the settlement agreement freed the debtor from expending resources in continued litigation with the creditor).

The City issued the Pension Obligation Bonds to refund certain of its pension funding obligations. Assured Guaranty has contended in this case that the Pension Obligation Bonds represent the same underlying obligation as those original pension funding obligations, are obligations imposed by law, and thus share priority and status with the City's other pension obligations. *See, e.g.*, Preliminary Objection of Assured Guaranty Corp. and Assured Guaranty Municipal Corp. to Debtor's Chapter 9 Petition and Statement of Qualifications [Dkt No. 482] at 22; *Selby v. Oakdale Irrigation Dist. et al.*, 140 Cal. App. 171, 182 (1934) (courts would be justified in according refunding bonds the same preferred position as obligation being refunded).

First, Assured Guaranty asserts that, as recognized by various states, including the California Supreme Court and California state legislature, refunding bonds issued do not create a new indebtedness; instead, they merely evidence the same, existing liability which they refund. *City of Los Angeles v. Teed*, 112 Cal. 319, 327 (1896); Cal. Gov. Code § 16942 ("[T]he Legislature finds . . . that the [state pension obligation bonds] authorized to be issued under this chapter have the same character under the Constitution as the pension obligations funded or refunded."); *see also Reichenberger v. Salt River Project Agric. Improvement & Power Dist.*, 150 P.2d 758, 760 (Ariz. 1944) (a refunding bond is "merely a change in the [original bond's] form, with all rights, remedies, and privileges carried over to the holder of the new bonds that pertained to the [original bonds]."); *State v. City of New Smyrna Beach*, 148 Fla. 482, 484-85 (1941) ("The ordinance and resolution [authorizing the refunding bonds] did nothing more than continue the old obligation as then existing."); *Kocsis v. Chicago Park Dist.*, 362 Ill. 24, 35 (1935) ("The issuance of refunding . . . bonds does not create additional indebtedness, but merely

evidences existing debts."). Assured Guaranty argues that the City continues to have the same pension liability but, following issuance of the Pension Obligation Bonds, it is now evidenced by two instruments: the CalPERS contract and the Pension Obligation Bonds.

Second, the City sought and obtained a judgment from the California Superior Court that the Pension Obligation Bonds were one-and-the-same as the City's existing pension obligations and that the Pension Obligation Bonds fell within the debt ceiling exception provided for "obligations imposed by law."[11]

Based on these circumstances, Assured Guaranty contends that the City could not confirm any plan over its objection that afforded the Pension Obligation Bonds less than the full recovery promised to the City's remaining pension obligations. The City believes there are strong counterarguments to Assured Guaranty's position, but since there are no cases directly on point, it recognizes the risk that Assured Guaranty's view could be adopted by a court. Such a determination would strike a death blow to the Plan, and would pose a significant risk to the City's ability to propose a feasible plan of adjustment. The settlement with Assured Guaranty reflects in part the City's view of this risk.

By contrast, the leased properties relating to the Lease Rejection Claim—Swenson Golf Course, Van Buskirk Golf Course, and Oak Park—are desirable assets for City residents, but they do not have the same importance as others discussed above. Wilson Decl. ¶ 8. For example, there are several golf courses in the vicinity of Stockton as well as numerous parks. In addition, each of the leased properties, individually and in the aggregate, have operated at a loss before debt service for the last five years, and for the last eight years in the aggregate (Swenson Golf Course showed some positive cash flow in fiscal years 2005-06, 2006-07, and 20007-08, but not enough to even offset the operating losses at Van Buskirk Golf Course, not to mention the

[11] *See* Declaration of Norman C. Hile in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Hile Decl.") Ex. D (Memorandum of Points and Authorities in Support of Plaintiff's Application for Entry of Default in Validation Proceedings (C.C.P. § 860-870, Superior Court of the State of California, County of San Joaquin, Case No. CV030753, filed Dec. 20, 2006) at 13, lines 15-19 ("With the Issuance of the [Pension Obligation] Bonds, the City has not satisfied its obligations under the City Charter and the Retirement Law, it has simply changed the form of its obligations. The characteristics of the indebtedness remain the same and are transferred to the Bonds.")); *see also id.* Ex. E (Judgment, Superior Court of the State of California, County of San Joaquin, Case No. CV030753, filed Jan. 3, 2007, ¶¶ 7-8).

additional operating losses at Oak Park). Declaration of Val Toppenberg in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Toppenberg Decl.") ¶ 2. For this reason, the City has been subsidizing operations at all three of these properties for several years. *Id.* at ¶ 3. In order to confirm the Plan, the City is willing to lose its possessory interest in these less important, money-losing properties. In contrast, the City believes that it cannot continue to adequately serve its residents if it were to lose its interest in the other properties described in this section.

b. The Legal Character of Certain of These Claims Is Different from the Lease Rejection Claim

The legal character of certain of the Claims of Ambac, Assured Guaranty, and NPFG is different from that of the Lease Rejection Claim. For example, Ambac's Claim with respect to the Fire/Police/Library Lease Back Transaction is secured. Pursuant to the terms of the 2003 Fire/Police/Library Certificates Reimbursement Agreement, the Successor Agency is obligated to reimburse the City for lease payments the City makes under the Fire/Police/Library Lease Back from Housing Set-Aside Amounts (as defined in the 2003 Fire/Police/Library Certificates Reimbursement Agreement). Under the Reimbursement Agreement, the Successor Agency was obligated to apply a portion of the tax increment revenue consisting of 20% of all tax increment revenue allocated to it (the "Housing Set-Aside Revenue") to reimburse the City for lease payments evidenced and represented by the 2003 Fire/Police/Library Certificates. In addition, as a result of the enactment of Assembly Bill X1 26, as modified by Assembly Bill 1484, amending certain sections of the California Health and Safety Code, which together effected the dissolution of redevelopment agencies in the State of California (collectively, the "Dissolution Act"), certain other tax increment monies formerly allocated to the redevelopment projects in the City over and above the Housing Set-Aside Revenue are now obligated to be used—in addition to the Housing Set-Aside Revenue—to make such reimbursement payments. *See* Dieker Decl. ¶ 22 ("Ambac Settlement").

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The Arena Claims of the 2004 Arena Bond Trustee/NPFG also are secured. Specifically, under the Arena Pledge Agreement and the related assignment, the 2004 Arena Bond Trustee holds a pledge of certain incremental tax revenues expected to be collected from the West End Urban Renewal Project No. 1, a former development project area consisting of 642 acres surrounding and including the Arena, located in the heart of Downtown, just north of the City's Crosstown Freeway and east of Interstate 5, containing a mix of commercial, industrial, and residential uses. In addition, as a result of the enactment of the Dissolution Act, certain other tax increment monies formerly allocated to the other redevelopment projects in the City are now obligated to be used, in addition to the originally pledged revenues, to pay enforceable obligations such as the Arena Pledge Agreement. *See id.* ¶ 22 ("NPFG Arena Settlement").

Further, the recovery provided to Assured Guaranty in respect of the 2007 Office Building Bonds is a direct result of the prepetition unlawful detainer action by the 2007 Office Building Bond Trustee as directed by Assured Guaranty against the City in respect of the 400 E. Main Office Building Property itself. *See* Hile Decl. Exs. A-B. Assured Guaranty took the economic bet prepetition on the 400 E. Main Office Building Property and by doing so altered the legal nature of its Claim as compared to Franklin, which chose not to expose itself to any economic risk from holding and operating the money-losing Golf Course/Park Properties. *See* Dieker Decl. ¶ 22 ("Assured Guaranty Settlement").

5. Franklin Confuses Classification Analysis with Cramdown Analysis

Beginning on the first page of the Summary Objection, Franklin repeatedly but mistakenly insists that the Plan attempts to cram down the Lease Rejection Claim. Summary Objection at 1, 16, 19, 28, 42, 51, 52. By asserting that the Plan improperly classifies, disparately treats, and unfairly discriminates against the Lease Rejection Claim, Franklin confuses classification analysis with cramdown analysis. Section 1129(b) permits a debtor to cram down a class that is impaired and that has not accepted the plan. The cramdown analysis, however, does not apply to the Lease Rejection Claim because this Claim is classified in Class 12, and Class 12 voted to accept the Plan. Declaration of Catherine Nownes-Whitaker Regarding Tabulation and Certification of Ballots Voting to Accept or Reject the First Amended Plan for the Adjustment of

Debts of City of Stockton, California (November 15, 2013). Dkt. No. 1268 at ¶ 9. *See also City of Colorado Springs*, 187 B.R. at 690 (bondholder's unfair discrimination challenge did not apply because the bondholder was a member of a class that voted to accept chapter 9 debtor's plan). Therefore, contrary to the assertions of Franklin, analysis of disparate treatment and unfair discrimination is not relevant in this context.[12]

B. The Plan Is in the Best Interests of Creditors

A chapter 9 plan of adjustment is in the best interests of creditors if it provides a better alternative for creditors than what they already have—that is, if it is a better alternative than dismissal of the case. The City submits that the Plan is in the best interests of the City's creditors—including the holder of the Lease Rejection Claim, which, to be precise, is the 2009 Golf Course/Park Bond Trustee rather than Franklin—because it provides a better alternative than any recovery that could be expected were this case dismissed. Franklin welcomes dismissal, boasting that it is financially equipped to continue litigating against the City for the next 35 years to increase its recovery. Summary Objection at 27, line 14; 30, line 17. This bravado notwithstanding, it is unlikely that Franklin would fare any better by pursuing this path. Further, dismissal would unleash chaos on the City and the more than one thousand other

[12] Even if Franklin could argue unfair discrimination, that challenge would fail under applicable law. *See In re Ambac La Mesa L.P.*, 115 F.3d 650, 656 (9th Cir. 1997) (articulating four-part test). First, the City is justified in treating Franklin differently from creditors with which it has settled. *See In re Dow Corning Corp.*, 244 B.R. 705, 711 (Bankr. E.D. Mich. 1999) (finding rational basis for differing treatment of settling and non-settling creditors, as Plan proponents "ha[d] a perfectly legitimate reason" to attempt to resolve claims through settlement); *In re Coastal Equities Inc.*, 33 B.R. 898, 905 (Bankr. S.D. Cal. 1983) (forbidding a debtor from disfavoring holdouts would unfairly put holdouts in a "no-lose situation" and hinder negotiations). Second, the City's treatment of the Lease Rejection Claim is necessary because the City already has made deep cuts to its services. *In re City of Stockton, Cal.*, 493 B.R. 772, 780-81 (Bankr. E.D. Cal. 2013); Disclosure Statement § I. The City simply does not have the revenues to pay Franklin what it wants if the City is to maintain an adequate level of municipal services. *See In re Creekstone Apts. Assocs.*, 168 B.R. 639, 645 (Bankr. M.D. Tenn. 1994) (plan did not unfairly discriminate where payout to dissenting creditor was the maximum the debtor could pay while effectively reorganizing). Third, nothing in the City's actions during this case would suggest that it is proposing its Plan, including the treatment of Franklin, in anything but good faith. *See infra* § IV.C. Fourth, the degree of difference in Franklin's recovery is directly related to the City's rationale for Franklin's treatment: (i) the disparate legal character of the Lease Rejection Claim; and (ii) the City's need to both avail itself of the properties associated with the Claims of the settling creditors and to facilitate negotiations. The City's bankruptcy is immense and highly complex, with numerous creditors and hundreds of millions of dollars in liabilities. Although every creditor has its own unique stake in the City's finances and future, it is crucially important to bring the various interests together in vigorous negotiations. Thus, any disparity in recovery is justified by what this Court recognized early on in this case—the importance of negotiation and mutual resolution in municipal bankruptcies.

creditors whose Claims have been resolved through the mediation conducted by Judge Perris and who have voted to accept the Plan.[13]

1. Section 943(b)(7) Requires the Plan to Be in the "Best Interests of Creditors"—Not in the Best Interests of Franklin As an Individual Dissenting Creditor

Section 943(b)(7) provides that the court may confirm a plan if "the plan is in the best interests of creditors and is feasible." 11 U.S.C. § 943(b)(7). The plain language of this section does not reference individual dissenting creditors. Franklin therefore bases its argument that it deserves protection as an individual dissenting creditor on the fact that section 1129(a)(7)(A) protects individual dissenting creditors—which it does, through the reference to each holder of a claim or interest of each impaired class. 11 U.S.C. § 1129(a)(7)(A). Franklin overreaches when it asserts that the test set forth in section 1129(a)(7)(A) infuses section 943(b)(7).

While Congress made several subsections of section 1129(a) applicable to chapter 9 through section 901(a), it pointedly did not import section 1129(a)(7) because it understood the dissimilarity between chapter 11 and chapter 9 debtors. It is worth citing the legislative history at length because Franklin reads it selectively:

> In particular, if the requirements of section 1129(a)(8) are not complied with, then the proponent may request application of section 1129(b). The court will then be required to confirm the plan if it complies with the "fair and equitable" test and is in the best interests of creditors. The best interests of creditors test does not mean liquidation value as under chapter XI of the Bankruptcy Act. In making such a determination, it is expected that the court will be guided by standards set forth in *Kelley v. Everglades Drainage District, 319 U.S. 415 (1943)* and *Fano v. Newport Heights Irrigation Dist., 114 F. 2d 563 (9th Cir. 1940),* as under present law, the bankruptcy court should make such findings as detailed as possible to support a conclusion that this test has been met. However, it must be emphasized that unlike current law, the fair and equitable test under section 1129(b) will not apply if 1129(a)(8) has been satisfied in addition to the other confirmation standards specified in section 943 and incorporated by reference in section 901 of the House amendment. To the extent that *American United Mutual Life Insurance Co. v. City of Avon Park,* 311 U.S. 138 (1940) and other cases are to the contrary, such cases are overruled to that extent.

[13] While the result of denial of confirmation of the Plan and dismissal of the case would be catastrophic for the City, its employees, retirees, and residents, and would be not in the best interests of its creditors, confirmation of the Plan would have a minimal impact on the two funds that purchased the 2009 Golf Course/Park Bonds. When the Plan is confirmed and Franklin is paid its 1% return on its capped lease rejection claim—even if Franklin exercises its right to take possession of two money-losing City golf courses and a park for the next 35 or more years—the two Franklin funds will suffer a loss of less than half of one percent of their assets. *See* Hile Decl. Exs. G-I.

124 Cong. Rec. 32,403 (Sept. 28, 1978) (statement of Rep. Edwards). The statement by Representative Edwards confirms that the best interests test in chapter 9 does not mean the liquidation value test set forth in section 1129(a)(7). Instead, to determine whether a chapter 9 plan is in the best interests of creditors, he suggested that courts be guided by *Kelley* and *Fano* by making "findings as detailed as possible to support a conclusion that this test has been met." Neither case supports the principle that the best interests test provides protection to individual dissenting creditors.

Franklin tries to make this argument by, for example, including the following quotation from *Kelley*:

> minorities under the various reorganization sections of the Bankruptcy Act cannot be deprived of the benefits of the statute by reason of a waiver, acquiescence or approval by the other members of the class. The applicability of that rule to proceedings under Ch. IX is plain. [T]he fact that the vast majority of security holders may have approved a plan is not the test of whether that plan satisfies the statutory standard. The former is not a substitute for the latter. They are independent.

Summary Objection at 10 (emphasis in Franklin's citation but not in *Kelley*). What Franklin neglects to mention, however, is that the last three sentences of this passage are a quotation from *Avon Park*, in which the Supreme Court interpreted the "express provision against unfair discrimination," which was set forth in section 83(e) of the Bankruptcy Act. *Avon Park*, 311 U.S. at 147. This section provided in part that a plan will be confirmed if the judge finds that "it is fair, equitable, and for the best interests of the creditors and does not discriminate unfairly in favor of any creditor or class of creditors." Bankruptcy Act § 83(e). Not only is this *not* the language of section 943(b)(7), but Representative Edwards made a point of emphasizing "that unlike current law [which in 1976 was the Bankruptcy Act], the fair and equitable test under section 1129(b) will not apply if 1129(a)(8) has been satisfied in addition to the other confirmation standards specified in section 943 and incorporated by reference in section 901 of

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the House amendment." Further, he stated that to the extent that *Avon Park* and other cases are contrary to this principle, they are overruled.[14]

Congress could have made section 943(b)(7) creditor-specific if it had so intended. Thus, the Court may confirm the Plan if it "is in the best interest of creditors," as the plain language of the statute provides—not in the best interest of an individual creditor such as Franklin.

2. The City Is Not Required to Meet Too Strict a Standard to Establish That the Plan Provides a Better Alternative to Creditors

There are limited precedents on the best interests test in chapter 9. Most of the cases agree that a plan satisfies the standard if it "provides a better alternative for creditors than what they already have." *In re Pierce County Hous. Auth.*, 414 B.R. 702 (Bankr. W.D. Wash. 2009) (quoting *In re Mount Carbon Metro. Dist.*); *In re Mount Carbon Metro. Dist.*, 242 B.R. 18, 37-38 (Bankr. D. Colo. 1999). The same cases state that the test has been described as a floor requiring a reasonable effort at payment of creditors. *Id.*; *see also* Collier ¶ 943.03[7][a]. Further, it is often "easy" to establish that the plan provides a better alternative for creditors because the only alternative is dismissal of the case. *Mount Carbon*, 242 B.R. at 37; *see also* Collier ¶ 943.03[7][a] ("The municipal debtor is not required to meet too strict a standard, and the plan can go forward with the consent of all classes of creditors. The court must also temper its examination into the debtor's ability to pay with due regard for the debtor's exercise of its political and governmental powers.").

3. Dismissal of the Case Is Not a Better Alternative to the Plan for the Creditors, Generally, or for Franklin in Particular

What other alternatives to the Plan are available to creditors? This Court has held that there are three possible outcomes in chapter 9: the plan is confirmed with a discharge for the debtor, the case is dismissed with no discharge for the debtor, or "a dismissal in which a sufficient number of affected parties voluntarily agree to modify their rights," which operates as a de facto

[14] Collier does state: "However, since the test is designed to protect the dissenting minority of a class that has accepted the plan, one must not be so carried away with the potentially adverse consequences of the alternative to a chapter 9 plan that one reaches the conclusion that any plan is better than the alternative." Collier ¶ 943.03[7][a]. However, Collier provides no authority for this statement.

plan. *In re City of Stockton, Cal.*, 493 B.R. 772, 791-92 (Bankr. E.D. Cal. 2013). The only real alternative to confirmation in this case is the first form of dismissal without a discharge because all of the agreements that the City has negotiated with its creditors other than Ambac are contingent on confirmation of the Plan, and thus all parties in interest, with the possible exception of Ambac, would return to square one.[15]

This Court has stated that this form of dismissal "bodes trouble." *Id.* at 792. Indeed, it has concluded:

> If the City's case were to be dismissed without a sufficient number of agreements to restore its fiscal health, then even more financial trouble would be in store. One of the consequences of such a dismissal of this case would be revival of the retirees' claims that their health benefits are contracts to be enforced, leaving the City exposed to demands for restoration of those benefits and claims for damages. *11 U.S.C. § 349*, incorporated by *id. § 901(a)*. In other words, when the City implemented unilateral cost-cutting measures at the outset of this case, it committed itself to the goal of either confirming a chapter 9 plan or achieving agreements sufficient to constitute a de facto plan with respect to the victims of those measures. Any other outcome would be troublesome for the City.

Id.

Franklin nevertheless encourages this Court to dismiss the case because Franklin believes that it would recover substantially more upon dismissal: "The Plan here does not satisfy the 'best interests' of Franklin and dismissal of the case would be a welcome improvement of the treatment the City now deigns to provide on account of Franklin's claim. Any allegedly-dire consequences of dismissal . . . would be squarely of the City's own making." Summary Objection at 30, lines 6-10. Franklin bases this conclusion largely on the fact that the 2009 Golf Course/Park Bond Trustee would have the right to sue the City every six months and obtain a judgment for each missed Lease Payment on the 2009 Golf Course/Park Bonds, plus interest and attorneys' fees and expenses. Summary Objection at 25-26. Further, acknowledging that it is a deep-pocketed and sophisticated party, Franklin trumpets that it "undoubtedly is 'financially equipped' to do so and

[15] A copy of the Ambac Settlement Agreement is attached as Exhibit A to the Declaration of Robert Deis in Support of the City of Stockton's Motion under Bankruptcy Rule 9019 for Approval of Its Settlement with Ambac Assurance Corporation, filed on February 26, 2013 [Dkt. No. 725]. On April 24, 2013, the Court entered its order granting the Ambac Settlement Agreement Motion and approving the Ambac Settlement Agreement in its entirety [Dkt. No. 888]. Section 2.14 ("Effect of Dismissal of the Bankruptcy Case") of the Ambac Settlement Agreement provides Ambac the option on dismissal of the case without confirmation of a plan of adjustment to abrogate the agreement or to agree to honor it. Dkt. No. 725 Ex. A at 9-10.

promptly would pursue all available rights and remedies." *Id.* at 27, lines 14-15. Franklin apparently believes that pursuing and obtaining judgments against the City every six months for the next 35 years is an efficient strategy by which it can tap more of the City's revenues from future property taxes, sales taxes, and utility users' taxes as well as PFFs, hoping to jump ahead of the line of other creditors (including retirees seeking health benefit payments and CalPERS seeking the payment of the City's pension obligations to its thousands of current and former employees).

The sunny picture that Franklin paints of its prospects were the case dismissed becomes much gloomier once it is examined in more detail, with a focus on how events would unfold. With the possible exception of the Ambac Settlement Agreement, all of the settlement agreements that the City has struck with its creditors and unions would be unraveled, and Franklin would be just one out of more than one thousand creditors pursuing individual remedies in state court. As this Court has predicted, many of these creditors would be retirees fighting to collect their health benefits. For example, the filing of the bankruptcy case has enabled the City to avoid paying approximately $26.6 million in retiree health benefit coasts to date, an amount that has been forecast to increase each subsequent fiscal year. *See* Zadroga-Haase Decl. ¶ 3 and Ex. A. Other creditors, such as Ambac, Assured Guaranty, NPFG, and the indenture trustee, are potent adversaries that also are financially equipped to litigate aggressively. They would not sit on their rights and permit Franklin to vacuum up all or any of the City's cash. NPFG and Assured Guaranty, acting through the indenture trustee for the debt they insured, proved prior to the bankruptcy filing that they could move quickly and efficiently in state court for the appointment of a receiver and other prejudgment remedies. CalPERS, too, would be poised to strike should the City impair its payments to CalPERS in response to this financial catastrophe.

The City thus would be buried in an avalanche of lawsuits. Those filed by the capital markets creditors likely would proceed in the same manner. Using the Golf Course/Park Lease Back Transaction as an example, the City would be obligated to pay the 2009 Golf Course/Park Bond Trustee the approximately $6,019,795 of Lease Payments that are past due and to make future payments on each payment date. These amounts would accumulate over time. For

example, $1,755,200 would be due on September 1, 2014, $1,171,131.25 would be due on March 1, 2015, and so on through September 1, 2038. The 2009 Golf Course/Park Bond Trustee would bring suit against the City once during each six-month Lease Payment period to collect the amount due during that period. It would be obligated to bring suit over and over again for the next 35 years in a litigation almost as protracted as the multigenerational litigation in Dickens' *Bleak House* because it has no right under the Golf Course/Park Lease Back to accelerate the Lease Payments. It could also take possession (but not ownership) of the Golf Course/Park Properties pursuant to the assignment of the two leases.[16]

For each suit, the state court would award the 2009 Golf Course/Park Bond Trustee a money judgment. The payment of these money judgments would be governed by sections 970 to 971.2 of the California Government Code and the related case law. Franklin would obtain a writ of mandate to compel City officials to enforce the judgments. Cal. Gov't Code § 970.2; *Leuzinger v. County of Lake*, 253 F.R.D. 469, 474 (D. N.D. Cal. 2008). There would be insufficient funds to pay this judgment in light of the other judgments that would be piling up—in addition to the City's payroll and other current obligations. This process likely would have political as well as financial ramifications, as other creditors would be obtaining similar judgments at the same time. Assuming no total meltdown but merely inadequate funds to pay all creditors, the City undoubtedly would pay salaries and benefits to its employees, including making its CalPERS payments. Otherwise, the City would shut down. Franklin, with its interest in nonessential properties, would be last in line for any additional cash, as payment would be made to preserve the City's tenancy in the SEB Properties, the police stations, and so on. In short, as Justice Frankfurter wrote in *Faitoute Iron & Steel Co. et al. v. City of Asbury Park*, "[a] policy of every man for himself is destructive of the potential resources upon which rests the taxing power which in actual fact constitutes the security for unsecured obligations outstanding against a city." In particular, he described "the spectacle of taxing officials resigning from office

[16] The Golf Course/Park Lease Back provides that "there shall be no right under any circumstances to accelerate the Lease Payments or otherwise declare any Lease Payments not then in default to be immediately due and payable or to terminate this Lease Agreement or to cause the fee interest or the leasehold interest of the City in the Property to be sold, assigned or otherwise alienated." Golf Course/Park Lease Back at § 9.2 [Dieker Decl. Ex. D].

in order to frustrate tax levies through mandamus, and officials running on a platform of willingness to go to jail rather than to enforce a tax levy, and evasion of service by tax collectors, thus making impotent a court's mandate." 316 U.S. 502, 510-11 (1942) (internal citations omitted).

Generally, the City would be required to pay each judgment out of any funds that are "(a) Unappropriated for any other purpose unless the use of such funds is restricted by law or contract to other purposes; or (b) Appropriated for the current fiscal year for the payment of judgments and not previously encumbered." Cal. Gov't Code § 970.4; *see also Flora Crane Serv., Inc. v. Ross*, 61 Cal. 2d 199, 209 ("mandate does not lie to compel a public officer to authorize expenditures when the proper funds are lacking") (Cal. 1964); *Tevis v. San Francisco*, 43 Cal. 2d 190, 200 (Cal. 1954) ("the general rule [is] that a public officer may not be compelled to authorize the payment of compensation or issue a warrant when funds are lacking, and the decisions which hold that, in an action for mandate to compel the drawing of a warrant by a public official, allegation and proof of available money are essential elements of the petitioner's case").

While section 970.8 of the California Government Code may require the City to include in its budget a provision to provide funds in an amount sufficient to pay all judgments, the City could hardly do so if judgments were obtained by all of the creditors when the City was no longer protected by its bankruptcy filing. Such creditors would include CalPERS, holders of Retiree Health Benefit Claims, NPFG, Assured Guaranty, possibly Ambac, various tort claimants, and numerous other creditors.[17] The inevitable and unavoidable result would be financial chaos that would undoubtedly adversely affect all City operations, staff retention, crime prevention and other law enforcement actions, the desirability of Stockton to both potential and current home buyers and businesses, collections of taxes, collection of fee revenues, etc. *See* Declaration of Robert Leland in Support of City's Supplemental Memorandum of Law in Support of

[17] The state court also could order that the City pay the judgment in not more than 10 equal annual installments if the City Council "has adopted an ordinance or resolution finding that an unreasonable hardship will result unless the judgment is paid in installments" and the court "after hearing, has found that payment of the judgment in installments as ordered by the court is necessary to avoid an unreasonable hardship." Cal. Gov't Code § 970.6.

Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Leland Decl.") ¶ 20. Why Franklin believes it would be in any position other than the back of the line of creditors in such a situation is curious, especially given its non-essential and uneconomic collateral (assignment of the Golf Course/Park Leases).

4. The City Has Made a Reasonable Effort to Repay Creditors

One of the themes that runs through Franklin's Summary Objection is that the City is withholding millions of dollars of cash that could be used to pay the Lease Rejection Claim. This assumption is fundamentally flawed. Through the Plan, the City is committed to making a reasonable effort to repay its creditors, including the 2009 Golf Course/Park Bond Trustee, and it has already described those efforts. Confirmation Memorandum at 23-24. At the same time, the City is not operated for the benefit of Franklin or any creditor or group of creditors, and the primary purpose of the Plan must be to ensure the sustainability of the City while treating creditors fairly. *Mount Carbon*, 242 B.R. at 39 ("The primary purpose of debt restructure for a municipality is not future profit, but rather continued provision of public services."). Indeed, there comes a point—the so-called death spiral—at which raising taxes too aggressively has negative consequences not only for municipalities and their residents, but for creditors as well:

> This court needs to address the specific objection under the "best interest" test of Section 943(b)(7). The alternative to confirmation of a plan similar to the one before the Court is dismissal of the case. That would permit the parties to go back to state court and permit the state judge to order the debtor to levy sufficient taxes to pay all prepetition bonds plus accrued interest in full. There is evidence before this Court which this court finds convincing that such a procedure would create such a high level of taxes for the district and the homeowners of the district that it is likely the revenues would not be made available to the district by taxpayers and the bondholders would still not be paid. This Court sees no benefit in permitting this matter to go back through the state court system which has no power to permit compromise of the debt structure without consent of all parties.

In re Sanitary & Improvement Dist., 98 B.R. 970, 975-76 (Bankr. D. Neb. 1989) (denying confirmation but not dismissing case).

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a. The City Is Striving to Attain a Minimum Reserve Amount of 15%, and the Purpose of Doing So Is Not to Avoid Paying the Lease Rejection Claim

Franklin argues that the City modeled its financial projections conservatively in the Long-Range Financial Plan of the City of Stockton (the "LRFP"), and that these projections show that the City can pay the Lease Rejection Claim in full. It appears to base this argument in part upon the portion of the LRFP that projected that the ending available balance of the General Fund will be $58.34 million (15.4% of total expenditures) in fiscal year 2040-41—which is the end of the projection period. Disclosure Statement, Ex. B at 36, line 108. Because Franklin apparently believes (or wants to believe) that these funds are available to pay the Lease Rejection Claim, it is important to understand what this number means and why it is not appropriate to use these funds to pay creditors.

According to the Government Finance Officers Association (the "GFOA"),[18] the annual operating reserves that culminate in the "ending available balance" of the General Fund is the minimum reserve amount that the City Council has determined to strive to maintain in order to "to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates." Leland Decl. Ex. C at 1. The GFOA "recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund." *Id.* The GFOA further recommends:

> at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular fund operating revenues or regular general fund operating expenditures. The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances.

Id. at 2. This two-month recommended fund balance that acts as an operating reserve translates to 16.67% of total annual expenditures.

In establishing a policy for the level of appropriate unrestricted fund balance in its general

[18] The GFOA is a nonprofit organization whose mission is "to enhance and promote the professional management of governments for the public benefit by identifying and developing financial policies and best practices and promoting their use through education, training, facilitation of member networking, and leadership." *See* GFOA, "About Us: Mission Statement," at http://www.gfoa.org/index.php?option=com_content&task=view&id=76&Itemid=96.

fund, a city should take into account various factors, which may lead it to conclude that it may require a level "significantly in excess of this recommended minimum level." *Id.* These factors include, but are not limited to, the predictability of revenues and the volatility of expenditures and exposure to major one-time outlays such as natural disasters or state budget cuts. *Id.* In addition, credit rating agencies "are likely to favor increased levels of fund balance. Opposing pressures often come from unions, taxpayers and citizens' groups, which may view very high levels of fund balance as 'excessive." *Id.* at 1.

In 2006, the City Council adopted a resolution approving a policy that aspired to maintain in the General Fund a "catastrophic reserve" that is "equivalent to five percent of the General Fund annual appropriations and transfers out" and an "economic contingency/budget uncertainty reserve" that is also "equivalent to five percent of the General Fund annual appropriations and transfers out." Leland Decl. ¶ 12. However, as the City's financial health began to deteriorate, it became clear that this total reserve of 10% was inadequate. *Id.* In the LRFP any resources in excess of 15% of total expenditures are assumed available to be applied toward unmet operating needs. *Id.* Currently, it is projected that the City will not achieve a 15% reserve level until fiscal year 2032-33. If the City's finances were more favorable than currently projected, the City could achieve its operating reserves earlier. *Id.* In its fourth quarter financial review for fiscal year 2013-14 held on February 25, 2014, the City staff report cited the GFOA's recommended reserve policy of two months of operating revenues or expenditures and now recommends moving toward that level of reserve. *Id.* By inference this supersedes the City's 2006 policy of a 10% total reserve, which has not been cited in the City's Annual Budget since May 2010. *Id.*

Franklin's suggestion that a reserve fund of 10% or less is sufficient and that money from this fund is available to pay the Lease Rejection Claim indicates a deep misunderstanding of the purpose of reserves. *Id.* ¶ 13. Reserves are a one-time resource designed to help bridge a downturn in the economy that results in lower revenues than projected, or to help meet an unexpected one-time increase in expenditures. *Id.* Reserves are not available to pay an ongoing increase in obligations such as the Lease Rejection Claim. If the General Fund began paying the full $2.9 million in 2009 Golf Course/Park Bonds debt service starting in the fiscal year 2013-14,

the General Fund would be in deficit within six years. Although Franklin ought to be concerned about the City tumbling back into insolvency in the future, apparently that scenario is of little concern as long as Franklin gets its money.

b. The Contingency Reserve Included in the LRFP is to Provide a Buffer Against Economic Downturns During the 30-Year Term of the LRFP

Like the annual operating reserves discussed above, the role and function of the annual contingency ($2 million per year in the LRFP) is to protect the City against financial setbacks. *Id.* ¶ 14. Whereas the annual operating reserve represents a one-time funding of reserve monies to use in the case of unexpected expenditures or unanticipated shortfalls during a given year, the annual contingency is meant to be a long-term buffer against larger swings in the City's revenues or expenditures caused by changing economic conditions. *Id.* In years of an economic downturn or recession, the City could fall short of the projections in the LRFP by millions, or even tens of millions of dollars, over the term of the economic downturn or recession, and it may take a number of years for the shortfall to be recovered—if the shortfall can be recovered at all during times of economic expansion. *Id.* The annual contingency allows the City to make projections of future finances without making predictions of the timing or severity of future recessions or the adverse impact that such recessions will have on City finances. *Id.* It thus acts as a "smoothing factor" allowing for more straight line projections. *Id.*

While the City could eliminate the annual contingency from the LRFP, the LRFP would need to be changed to predict future economic expansions and contractions, predict the severity of the expansions and contractions, and predict the impact of the same upon the City's finances, all with precision and granularity. *Id.* ¶ 14. Since no one realistically could be expected to do so accurately, particularly over a 30-year time frame, the level of predictability of projections that go up during presumed expansion years and drop during presumed contraction years are inherently less predictable and uncertain, with a greater risk that the City's finances would suffer grievously without the buffer of the contingency reserve. Because of the loss of predictability and certainty in the LRFP, reserves of a different nature would be called for in any event.

Franklin's suggestion that the City forgo the annual contingency reserve and pay the same

over to Franklin is yet another request that this Court second-guess the business decisions of the City Council about the City's future finances.

c. The City's Projected Tax Revenues Are Realistic

Franklin argues that the City's projected revenues from property taxes, sales taxes, and utility users' taxes ("UUTs") are low, and implies that the City has failed to make a reasonable effort to increase tax revenues to repay Franklin and other creditors. As demonstrated below, the City's projected revenues from these taxes are realistic. The City has worked zealously to raise revenues from taxes to the extent possible within the constraints of California law, in particular Articles 13C and 13D of California Constitution, which were incorporated by Proposition 218, known as the Right to Vote on Taxes Act, which the voters of California passed in 1996. Wilson Decl. ¶ 10. As described in the Official Statement:

> Proposition 218 requires that all new local taxes be submitted to the electorate before they become effective. Taxes for general government purposes of the City require a majority vote and taxes for specific purposes only require a two-thirds vote. The voter approval requirements reduce the flexibility of the City Council to deal with fiscal problems by raising revenue and no assurance can be given that the City will be able to raise taxes in the future to meet increased expenditure requirements.

Official Statement at 70 [Dieker Decl. Ex. B]. Despite these limitations, in November 2013, the City placed on the ballot Measure A and Measure B, which the electorate passed, as discussed in more detail in the Confirmation Memorandum and below.

Property Taxes. The City's projections of property tax revenues are based on reports prepared by its consultant HdL. Robert Leland, the principal author of the LRFP, has explained why these projections are realistic. Leland Decl. ¶¶ 3-4. Property taxes are the General Fund's largest source of revenues. However, the City has no control over the amount of property taxes that it receives because these taxes are levied, collected, and distributed by the County of San Joaquin, and are strictly limited both as to tax rate and as to the calculation of the assessed value of property by the California Constitution—in particular, Article 13A, which was incorporated after the passage in 1978 of Proposition 13, also known as the Jarvis-Gann Initiative. As described in the Official Statement, Article 13A, among other things, affects the valuation of real property for the purpose of taxation and limits the amount of any *ad valorem* tax on real property

to 1% of the full cash value (although "additional taxes may be levied to pay debt service on indebtedness approved by the voters prior to July 1, 1978, and bonded indebtedness for the acquisition or improvement or real property on or after July 1, 1978 by two-thirds of the votes cast by the voters voting on the proposition"). Official Statement at 66 [Dieker Decl. Ex. B].

Sales Taxes. The City's projections of sales taxes also are based on reports prepared by HdL. And as Mr. Leland explains, these projections are realistic. Leland Decl. ¶¶ 3-4. Sales taxes are the General Fund's second largest source of revenues. As explained above, to increase the sales tax the City must obtain voter approval. Exercising its business judgment, the City calculated that a 0.75% increase in the sales tax was most likely to receive voter approval. Former City Manager Robert Deis explains in detail how the City proposed Measure A and Measure B, and how the City's assumptions were proven correct by the narrow passage rate of Measure A, which received only 51.86% of the votes. Declaration of Robert Deis in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Deis Decl.") ¶¶ 7-13; Wilson Decl. ¶¶ 10-12. Indeed, Measure A's narrow victory vindicated the City's business judgment that the voters likely would not tolerate a tax increase that higher than 0.75%, while Measure B's more resounding victory confirmed what the City had surmised: the people of the Stockton want the City to emerge from bankruptcy successfully, and also want the implementation of the Marshall Plan, which will increase the authorized budgeted positions for the Police Department to 485. Declaration of Eric Jones in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Jones Decl.") ¶ 6. That will translate into a safer City, which means a City that is more likely to retain and attract residents, see property values (and property tax collections) rise, and thus avoid future insolvency and bankruptcy.

Utility Users' Taxes. Mr. Leland explains why the City's projections of UUTs are realistic. Leland Decl. ¶ 5. UUTs are the General Fund's third largest source of revenues. Franklin correctly observes that the City cut the UUT between 2005 and 2007 by 2% but

mistakenly chastises the City for not having "attempted to raise the tax back to its baseline level." Summary Objection at 19, lines 6-7. It is easy for Franklin to observe the reduction of this tax and then conclude that it should be increased to its prior level. But that argument misses the mark. In 2004, the City was forced to reduce the UUT from 8% to 6% in order to prevent challengers from bringing a ballot measure to reduce the UUT to 2% or 0%. Wilson Decl. ¶ 13. Political pressure against increasing the UUT remains strong. Deis Decl. ¶ 5. The City placed Measure U on the November 2008, ballot, which the voters passed. *Id.* ¶ 2. The purpose of Measure U was to modernize the current UUT ordinance to treat taxpayers equally regardless of what technology they used for telecommunication and video services. Wilson Decl. ¶ 13. Specifically, it was intended to protect the tax from litigation alleging that local phone taxes should have been repealed when the federal government ceased taxing long-distance calls in 2006. *Id.* It was also intended to extend the tax to new technologies such as text messaging. In order to convince voters to support the extension of the UUT to new technologies, Measure U included a commitment to maintain the UUT at no higher than 6%. *Id.* ¶ 14.

d. <u>There Are Practically No PFFs Available to Pay the Lease Rejection Claim</u>

PFFs are charges levied on new development to pay the fair share of infrastructure required to mitigate the incremental impacts of the development. Chase Decl. ¶ 2. The California Mitigation Fee Act of 1987, also known as California Assembly Bill 1600, sets forth a comprehensive statutory scheme regulating the application of PFFs. *Id.*; Cal. Gov't Code § 66000 *et seq*. The imposition of a fee as a condition of approval of a development project by a local agency, such as the City, requires the agency to:

> (1) Identify the purpose of the fee.
> (2) Identify the use to which the fee is to be put. If the use is financing public facilities, the facilities shall be identified. That identification may, but need not, be made by reference to a capital improvement plan as specified in Section 65403 or 66002, may be made in applicable general or specific plan requirements, or may be made in other public documents that identify the public facilities for which the fee is charged.
> (3) Determine how there is a reasonable relationship between the fee's use and the type of development project on which the fee is imposed.
> (4) Determine how there is a reasonable relationship between the need for the public facility and the type of development project on which the fee is imposed.

Cal. Gov't Code § 66001(a).

PFFs are thus restricted to the purposes for which the charges are imposed. Chase Decl. ¶ 3. Those purposes are set forth in a fee study that the City was required to undertake to levy the charges. *Id*. The proceeds of the 2009 Golf Course/Park Bonds funded certain infrastructure improvements that would have otherwise been eligible for funding from certain PFF funds. Consequently, the PFF funds from which the improvements would have otherwise been eligible for funding may reimburse the General Fund for the portions of the Lease Payments on the principal of the 2009 Golf Course/Park Bonds that are allocable to those improvements. *Id.* ¶ 7. The City, however, is not *required* to use PFF funds to reimburse the General Fund payments. *Id.* ¶ 8. Further, PFF receipts may not be used to refund the interest in the 2009 Golf Course/Park Bonds because the fee study did not establish fees in an amount designed to cover interest carry on the cost of improvements. *Id.* ¶ 10. Therefore, the relevant PFF revenues, even if they existed, could not be used to pay the interest component of the City's lease obligations assigned to the payment of debt service on the bonds issued by the Financing Authority, including the 2009 Golf Course/Park Bonds.

Moreover, the City has entered into other obligations to use PFF revenues to pay for infrastructure built or to be built by developers. *Id.* ¶ 11. PFFs only are paid in when property is developed, so the City has no control over the timing or amount of receipt of PFF revenues in any given period. *Id.* ¶ 9. Because the improvements to be funded by PFFs are intended to mitigate the impacts of new development, the City cannot feasibly allocate all or even a substantial portion of future PFFs to refund the principal payments on the 2009 Golf Course/Park Bonds lest it fail to have funding to pay for the infrastructure required to serve the new development that will generate the fees. *Id.*

During the AB 506 process, the City proposed to use PFF revenues from four different funds to make debt service payments on account of the 2009 Golf Course/Park Bonds, with each of the following funds paying its respective share as follows:

Streets (Funds 910-915): 34.05%

Fire Stations (Fund 940): 17.36%

Police Stations (Fund 960) 12.37%

Parkland (Fund 970): 36.21%

Declaration of David N. Millican in Support of City of Stockton's Statement of Qualifications under Section 109(c) of the United States Bankruptcy Code (the "Ask"), Dkt. No. 454 at 785. At the same time, the City expressly noted that "under the existing documents these revenues are not pledged as security for the bonds." *Id.* The City also observed that because the number of housing permits had declined dramatically, to less than 150 per year, "the funds are insufficient to make the full debt service payments." *Id.* In addition, the City proposed to eliminate the General Fund subsidy of the debt payments. *Id.* As stated above, Franklin made one counterproposal to the City's offer, but it was so far from the relief the City needed, further negotiations broke off. As of the date hereof, the City is not permitted to reveal Franklin's counterproposal because of mediation confidentiality; but on March 24, 2014, the City filed a motion seeking such relief after Franklin declined to consent.[19] The motion will be heard on April 7, 2014.

The City crafted the Ask before it had fully developed information about the extent of other obligations to be funded by PFF revenues, and before a detailed growth projection was prepared by its outside consultant.[20] In hindsight, the City's offer would not have worked even if it had been accepted because, as shown below, the amount of projected PFF revenues is actually much smaller than originally thought, and the demands on the PFFs to pay other costs the City is or will be obligated to pay are greater.

Specifically, the City commissioned Economic & Planning Systems, Inc. ("EPS"), a consulting firm, to prepare a development impact review report as part of a comprehensive review of development impact fees. Chase Decl. ¶ 14. This report was presented to the City's Development Oversight Commission on June 6, 2013. *Id.* Based on the data available at the time, it was projected that the City would ramp up over several years to approximately 700

[19] City of Stockton's Motion for Order Admitting Evidence of the AB 506 Counteroffer of the Franklin Funds [Dkt. No. 1283].

[20] This approach was consistent with one of the City's key goals and assumptions in crafting the Ask. For example, see page 20 of 790: "The City seeks to eliminate the General Fund backstop and shift the burden by pledging other internal sources of repayment where applicable." Similarly, page 44, in discussing the essentiality of assets, references the intent to ". . . limit or eliminate any General Fund subsidy. The Ask elaborates on the goal with respect to each of the proposals on pages 45 and 46.

building permits per year. Chase Decl. Ex. A at 6, 61, 71. The report stated that this assumption was premised upon improvements in several economic metrics of the City's economy, including unemployment rate, improvement in the housing market, availability of developer financing and other factors. *Id.* at 57-58, 61-62, 82.

In general, these economic metrics have not improved as predicted even as recently as June 2013, the date of the EPS report. As discussed in the report, building permit activity is volatile and depends on many factors, including the strength of the housing market, the capacity of local developers who control developable property to obtain financing for and execute development plans, and the complex web of regulatory restrictions and approval processes related to new development. The actual number of building permits has fallen far short of the EPS projection: in the first nine months of the current fiscal year, the City has issued only 64 building permits for residential units, regardless of type. Chase Decl. ¶ 14. Therefore, the amount of PFF revenues that the City will receive this year will be considerably lower than what had been forecasted. Further, the Police and Fire PFF funds, which the City was proposing to use a source of debt repayment for the 2009 Golf Course/Park Bonds, are collectively $3.7 million in deficit, having had to receive loans to help pay their share of debt service costs prior to 2012. *Id.* ¶ 13.

As a result, the millions of dollars of PFFs that Franklin argues are available to pay the Lease Rejection Claim have not at this point materialized, are not likely to materialize in the near term, will be volatile and unpredictable, and will be subject to many competing, legitimate, and necessary uses.

e. Franklin's Argument about the City's Alleged Refusal to Confront Its Pension Problem Is Inaccurate and Irrelevant

Franklin argues that the City's decision not to impair its obligations to fund pensions for its employees (required by the City's nine union contracts and otherwise) is such a major financial undertaking that the City can hardly fail to pay Franklin the amount to which Franklin believes it is entitled. As Franklin asserts, "If the City is willing and able to assume that 'staggering', unpredictable liability without any adjustment in this case, the City cannot credibly claim that it has no future ability whatsoever to pay any portion of its substantially smaller debt to

Franklin." Summary Objection at 25, lines 3-5. While the funding of pension benefits for its employees is a large undertaking, and while it may be somewhat unpredictable in amount over the next 30 years, given the lack of any feasible alternatives that would allow the City to maintain its workforce and operations, the City has made the business decision to fund the promised pension benefits for its employees. Further, there appears to be no logical or financial nexus between the City's decision and the treatment of Franklin in the Plan, much less a legal argument that Franklin must receive far more under the Plan if the City funds it pension obligations.

Franklin conveniently ignores the great strides the City has made in reducing its payroll obligations, which will generate significant corresponding reductions in pension obligations, and the concessions that the City has negotiated that further directly reduce its pension obligations (such as negotiating for employees to fund a portion of the pension contributions, establishing a two-tier system with lower pension obligations, and implementing further changes required by the California Public Employees' Pension Reform Act ("PEPRA")). *See* Declaration of Ann Goodrich in Support of City's Supplemental Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) (the "Goodrich Decl.") ¶ 3; Leland Decl. ¶ 18e. Franklin rolls out past abuses and past practices of the City and its employees in the pension arena (some of which may be true, albeit irrelevant because the City has remedied them, *City of Stockton*, 493 B.R. at 780-81), and references the LRFP's projections showing that pension funding obligations will increase after having been reduced (Franklin ignores the fact that a large part of the increase is the result of the passage of Measure B, which endorses the Marshall Plan and the funding for the hiring of 120 additional police officers and 43 other nonsworn employees). Jones Decl. ¶ 8. The City is keenly aware of the increases in pension costs it will face due to several known factors, and it has carefully modeled those increases into the LRFP, which shows that the City is capable of absorbing these increases. Leland Decl. ¶¶ 18-19.

While Franklin bristles at the City honoring its promise to its employees and retirees, it offers no viable alternative that would be less costly to the City and not have an adverse impact upon the ability of the City to retain its vital employees, and thus to provide services to its

residents and businesses. Does Franklin suggest that the City unilaterally announce that it only intended to fund, say, 80% of the promised pension benefits? Does Franklin have any suggestion about how the City should deal with the consequences of that approach (i.e., the breach of the City's nine labor contracts, the default in its payment obligations to CalPERS, CalPERS's likely termination of the City's participation in the CalPERS pension system, etc.)? Does Franklin suggest that the City should simply terminate its participation in the CalPERS system? Does Franklin have answers for the dire consequences to the City of the loss of its employees? And what of the $1.62 billion CalPERS Claim that the City would face on account of unfunded pension obligations? Leland Decl. ¶ 17.

The answer to each of these questions is clearly no, as Franklin complains about the high cost of funding pension benefits and the inherent uncertainty in the cost of funding pension benefits over a 30-year period, but offers absolutely no solutions. The argument seems to be that if the City has money to fund pension benefits, it must have money to fund a greater payment to Franklin. Such an argument is not logical, not accurate in light of the LRFP, and not based in any cognizable legal theory. The City realizes that it faces some financial uncertainty related to pension costs (just as it does related to many other factors). It has carefully and thoroughly modeled and predicted these costs and planned to build up a two month of expenditures operating reserve over the next seventeen years (which, perplexingly, Franklin thinks is unnecessary and should instead be paid to Franklin) to provide some cushion against unexpected results. Franklin offers no concrete and plausible alternative to the City's analysis and exercise of its business judgment with respect to these issues. Instead, it simply demands that it receive more money.

C. The Plan Is Proposed in Good Faith

The Plan satisfies section 1129(a)(3), incorporated into chapter 9 by section 901(a), because the City has proposed the Plan in good faith and not by any means forbidden by law. Franklin, of course, argues the contrary. Summary Objection at 51, line 6. It bases this argument on a skewed version of settled law in a botched attempt to persuade this Court that determining whether the Plan complies with section 1129(a)(3) depends solely on how the Plan treats Franklin. In fact, as stated in the Confirmation Memorandum, courts determine what constitutes

good faith based on the totality of the circumstances, and under this well-settled standard, the Plan satisfies section 1129(a)(3). Confirmation Memorandum at 13, lines 14-15.

"A plan is proposed in good faith where it achieves a result consistent with the objectives and purposes of the Code." *Platinum Capital v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070, 1074 (9th Cir. 2002). Good faith "also requires a fundamental fairness in dealing with creditors." *Stolrow v. Stolrow's, Inc. (In re Stolrow's Inc.)*, 84 B.R. 167, 172 (B.A.P. 9th Cir. 1988). Further, the "requisite good faith determination is based on the totality of the circumstances." *Sylmar Plaza, L.P.*, 314 F.3d at 1074; *Stolrow*, 84 B.R. 167 at 172 ("Good faith in proposing a plan of reorganization is assessed by the bankruptcy judge and viewed under the totality of the circumstances."). The good faith determination under section 1129(a)(3) is thus similar to that under section 1325(a)(3). In a case addressing this chapter 13 requirement, the Bankruptcy Appellate Panel of the Ninth Circuit held that the:

> settled law of the circuit [is] that good faith is to be assessed through the matrix of whether the plan proponent "acted equitably" taking into account "all militating factors" in a manner that equates with the "totality" of circumstances. *Goeb v. Heid (in re Goeb)*, 675 F.2d 1386, 1390-91 (9th Cir. 1982); *Nelson v. Meyer (In re Nelson)*, 343 B.R. 671, 677 (9th Cir. B.A.P. 2006); *cf. Platinum Capital v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070, 1075 (9th Cir. 2002) (§ 1129(a)(3) decision citing *Goeb* as "our long settled interpretation of the good faith [confirmation] requirement"). That test dampens the risk of dysfunctionally divergent results that cannot be regulated by appellate review.

Fridley v. Forsythe (in re Fridley), 380 B.R. 538, 543 (B.A.P. 9th Cir. 2007) (Klein, J.); *Mattson v. Howe (In re Mattson)*, 468 B.R. 361, 371 (B.A.P. 9th Cir. 2012).

Here, the totality of the circumstances shows that the City has proposed the Plan in good faith. Above all, the City has proposed the Plan to achieve a result consistent with the objectives and purposes of chapter 9. The legislative purpose of this chapter "is to allow an insolvent municipality to restructure its debts in order to continue to provide public services. Chapter 9's purpose differs from that of Chapter 11. A Chapter 9 plan must be consistent with the governmental nature and obligations of the Chapter 9 debtor." *Mount Carbon*, 242 B.R. at 41.

In *Mount Carbon*, a case described selectively by Franklin, the debtor was a metropolitan taxing district whose plan of adjustment was not proposed in good faith in part because it

transferred control of its taxing and revenue-raising powers to a single landowner and abandoned the provision of public services. *Id.* Similarly, in *Ault v. Emblem Corp. (In re Wolf Creek Valley Metro. Dist. No. IV)*, 138 B.R. 610 (D. Colo. 1992), another case that Franklin describes selectively, one of the appellees (Emblem) desired the land of appellant (Ault), Ault refused to sell, and Emblem then informed the debtor that it would support the plan only if the plan were amended so that the appellant's land be exempted from beneficial tax relief. *Id.* at 613. On the day set for confirmation, the debtor filed two motions to modify the plan and to exempt Ault from treatment under the amended plan. It also failed to provide notice to Ault. Not surprisingly, the court found a lack of good faith, holding:

> Although there was a pressing necessity to reorganize the finances of the District, that purpose was being adequately accomplished by the first plan. In contrast, the amended plan was proposed by Emblem to induce Ault to give up his property or to make a windfall payment to Emblem. In these circumstances, it is clear that the provisions of Chapter 9 were being used as a device other than for the reorganization of the District's financial affairs.

Id. at 618-19.

In contrast to the plans at issue in both *Mount Carbon* and *Ault*, the Plan here restructures the City's debts with the specific goal of ensuring that the City can continue to provide police and fire services, maintain its infrastructure, treat its employees fairly, retain those employees and attract new hires, and create an environment in which its residents can prosper. In short, it was proposed consistent with the basic purpose of chapter 9. *See* Goodrich Decl. ¶¶ 5-10; Dieker Decl. ¶¶ 18-22; Montes Decl. ¶ 5.

The Plan also reflects the City's fundamental fairness in dealing with creditors. The fact that all but one of the City's major creditors negotiated agreements with the City to resolve their Claims and then accepted consensual settlements is powerful evidence of the City's good faith in its dealings with its creditors. Indeed, Franklin is the only challenger to the City's good faith. These negotiations were not trivial matters. They were protracted and often spirited, but ultimately productive because the parties worked together diligently to reach common ground under the guidance of Judge Elizabeth Perris.

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The City was also willing to negotiate with Franklin, but quickly reached deadlock.[21] With no party on the other side of the negotiating table, the City's only alternative was to treat the Lease Rejection Claim as it must be treated under sections 365 and 502, as a General Unsecured Claim—a decision that is not evidence of bad faith. As the Ninth Circuit has held,

> Moreover, that a creditor's contractual rights are adversely affected does not by itself warrant a bad faith finding. "In enacting the Bankruptcy Code, Congress made a determination that an eligible debtor should have the opportunity to avail itself of a number of Code provisions which adversely alter creditors' contractual and nonbankruptcy rights." *In re PPI Enter., Inc., 228 B.R. 339, 344-45 (Bankr. D. Del. 1998)* (citation omitted). "The fact that a debtor proposes a plan in which it avails itself of an applicable Code provision does not constitute evidence of bad faith." *Id. at 347* (citation omitted) (stating that it is not bad faith to take advantage of a particular provision of the Code for the purpose of capping the amount of a creditor's claim).

Sylmar Plaza, L.P., 314 F.3d at 1075.

Franklin cites several cases in support of its lack of good faith argument. They generally involve plans proposed by debtors who have engaged in shenanigans of a sort that bear no similarity to the City's conduct, and they are easily distinguishable. *Mount Carbon* and *Ault*, described above, are two examples. Another is *Avon Park*, described below in Section III.D., in which the creditors' acceptances of a plan were tainted by unfair dealing and breach of fiduciary obligations, among other transgressions. Yet another is *Wright v. City of Coral Gables, Fla.*, 137 F.2d 192 (5th Cir. 1943). There, the debtor offered a voluntary plan to its creditors, outside of bankruptcy, and more than 90% of them accepted it. But a few creditors held out, and the plan was abandoned. The city proceeded to make sometimes preferential settlements with other creditors. Several years later, the city filed a chapter 9 petition based on the premise that the voluntary plan had not been completed. It also took the position that it had the right to rely on the consents obtained from holders of the refunded bonds issued under the voluntary plan to compel

[21] Franklin implies that it has showered the City with "good-faith settlement offers" while the City has not reciprocated. Summary Objection at 5, line 20. The Summary Objection references, but does not describe, the counteroffer that Franklin made to the City's offer during the neutral evaluation process. As stated above, on March 24, 2014, the City filed a motion seeking an order authorizing the City to introduce Franklin's counteroffer and related evidence to permit the City to tell the other side of the story [Dkt. No. 1283]. After the City filed for bankruptcy, it resumed mediations with many of its creditors, including Franklin, under the auspices of Judge Perris. The City made another offer to Franklin, and Franklin made a counteroffer. The parties are not permitted to disclose any of the details due to the confidentiality of the mediation.

nonconsenting creditors to accept the chapter 9 plan. The court held that the city had not filed the chapter 9 petition in good faith because it had fully completed the voluntary plan; therefore, the chapter 9 plan was a new one, and for that reason the city could not rely on the consents that it obtained from the holders of the refunded bonds.

D. The Plan Satisfies Section 943(b)(3)

Franklin argues that the Plan does not satisfy section 943(b)(3) because the City has not disclosed the professional fees it has paid to date. On March 10, 2014, at Franklin's request, the City produced a chart showing its bankruptcy-related professional fees through January 31, 2014. In the spirit of full disclosure, but without conceding that the Court has the power under 943(b)(3) or otherwise to rule upon the reasonableness of such fees, the City will file an updated version of the chart as part of its confirmation hearing evidence. Section 943(b) provides that the court shall confirm a plan if "all amounts to be paid by the debtor or by any person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable." 11 U.S.C. § 943(b)(3). In the absence of relevant case law or legislative history, to determine the meaning of the phrase *to be paid* it is necessary to look to the plain language of the statute. *U.S. v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1985) ("Congress worked on the formulation of the [Bankruptcy] Code for nearly a decade. It was intended to modernize the bankruptcy laws, ... In such a substantial overhaul of the system, it is not appropriate or realistic to expect Congress to have explained with particularity each step it took. Rather, as long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute."). Further, "'[w]here the statute's language is plain, the sole function of the courts is to enforce it according to its terms, for courts must presume that a legislature says in a statute what it means and means in a statute what it says there.' *Int'l Ass'n of Machinists & Aerospace Workers v. BF Goodrich Aero-space Aerostructures Grp.*, 387 F.3d 1046, 1051 (9th Cir. 2004) (citations and internal quotation marks omitted)." *Meruelo Maddux Properties, Inc. v. Bank Of America, N.A.*, 667 F.3d 1072, 1076 (9th Cir. 2012).

Here, the plain language of section 943(b)(3) leads to the inescapable conclusion that the phrase *to be paid* means what it says: it is prospective language that means "fees that *will* be paid

in the future," not retrospective language that means "fees that *have been* paid during the course of the case."

Franklin argues that *Avon Park* stands for the proposition that "disclosure of professional fees has been a required component of municipal restructuring from the earliest days of chapter 9." Summary Objection at 58, lines 21-22. Its reliance on *Avon Park* is misplaced because not only was this issue decided under section 83(b) of the Bankruptcy Act, which differs from section 943(b)(3) of the Bankruptcy Code, but the facts are not analogous to the facts of the City's case. In *Avon Park*, the debtor proposed a plan of composition whereby its fiscal agent, a private corporation named R. E. Crummer & Co., would defray the expenses incident to the refunding and would be reimbursed and compensated for its services by an assessment of participating bondholders. The fiscal agent solicited acceptances of the plan, but failed to disclose that the fiscal agent was a creditor. Nor did it disclose its financial stake in the plan. It is thus not surprising that the Supreme Court held, as Franklin quotes, that "[t]he very minimum requirement for fair dealing was the elementary obligation of full disclosure of all of [Crummer's] interests" and that "allowance of compensation to Crummer without scrutiny of Crummer's speculation in the securities does not comport with the standards for surveillance of courts of bankruptcy before confirming plans of composition or reorganization or before making such allowance." Summary Objection at 58-59 (citing *Avon Park*).

Although there are more recent cases that reference section 943(b)(3), the City could find none that define the precise meaning of "to be paid." Nor does the legislative history appear to shed any further light on this issue. Instead, it focuses on the interpretation of the phrase *by any person*. H.R. Rep. No. 94-686, 94th Cong., 1st Sess. 33 (1975). *In re County of Orange*, 179 B.R. 195 (Bankr. C.D. Cal. 1995), which Franklin cites, involved the payment of interim compensation to committee professionals, rather than the meaning of "to be paid"—although the Court would not know this by the way that Franklin altered the quotation it cites (text in bold is text that Franklin deleted):

> *Section 943* provides that if a plan is to be confirmed, all allowed administrative expenses, including committee/subcommittee professional fees, must be satisfied on the effective date of the plan. **Chapter 9 contemplates, therefore, that committee professionals will**

> **be paid at the end of the case rather than during its pendency.** . . . [several paragraphs of text are then skipped] **This creates a situation where I might award interim compensation without requiring the County to pay before the effective date of the plan. *Section 943* provides that in order for a plan to be confirmed, all administrative expenses must be satisfied before the effective date.** This requirement does not violate § 904(2) because in order for the County to obtain the benefits of a Chapter 9 adjustment of debts, it must pay its administrative claims. The price for these benefits is the County's implied consent to this court's power to apply all the provisions of *§ 943*. If the County does not wish to pay this price, it can dismiss the case at any time.

Id. at 198.

Franklin also cites *In re Barnwell County Memorial Hospital*, 471 B.R. 849 (Bankr. D. S.C. 2012), a case decided by Judge David Duncan of the Bankruptcy Court for the District of South Carolina. In *Barnwell*, the debtor paid and disclosed professional fees during the pendency of the case, and the court held that the debtor satisfied section 943(b)(3). *Id*. at 868. The more relevant case, however, is *In re Connector 2000 Associates, Inc.*, 447 B.R. 752 (Bankr. D. S.C. 2011), which was also decided by Judge Duncan. Although he did not analyze the meaning of the phrase *to be paid* specifically, Judge Duncan did confirm a plan in which the debtor only disclosed fees "to be paid." The debtor (as well as the senior bonds trustee and the subordinate bonds trustee) had been paying amounts due to their service providers and professionals during the pendency of the case. In its plan confirmation brief, the debtor did not disclose amounts that had been paid to date. Hile Decl. Ex. F (*In re Connector 2000 Associates, Inc.*, U.S. Bankruptcy Court for the District of South Carolina, Case No. 10-04467-dd [Dkt. No. 132]). Instead, the debtor attached an exhibit to the brief setting forth the amounts to be paid between then and confirmation. Hile Decl. Ex. F. In its discussion of section 943(b)(3) in the brief, the debtor stated in part: "Because the foregoing amounts have been kept current, the only open amounts expected to be paid as of confirmation will be amounts due because of administrative lag time (which amounts are to be determined) and amounts to be paid incident to the issuance of the Amended and Restated Bonds and the related actions incident to effectuating the Plan (set forth on Exhibit D)." *Id*. at 15. The court held that the debtor satisfied section 943(b)(3):

> Section 943(b)(3) requires that all amounts to be paid by the Debtor or other persons for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable. Debtor has been paying its administrative expenses in the case on a current basis and any open amounts are expected to be paid within 10 days of the Effective Date of the Plan. Debtor, the Senior Bonds Trustee and the Subordinate Bonds Trustee have

> been currently paying amounts due to their service providers and professionals during the pendency of the case. Because the foregoing amounts have been kept current, the only open amounts expected to be paid as of confirmation will be amounts due because of administrative lag time (which amounts are to be determined) and amounts to be paid incident to the issuance of the Amended and Restated Bonds and the related actions incident to effectuating the Plan. The additional amounts to be paid or reimbursed incident to the Plan in connection with confirmation and the transactions contemplated by the Plan, including exchange of the Bonds for the Amended and Restated Bonds, are reasonable and necessary to effectuate the Plan and have been fully disclosed in Exhibit D to the Plan Confirmation Brief and on the record at the Confirmation Hearing. Section 943(b)(3) is satisfied here.

Connector 2000 Associates, 447 B.R. at 764-65.

Based on the plain language of section 943(b)(3) and the cases cited above, the phrase *to be paid* applies prospectively, not retrospectively.

E. The Plan Complies with Other Applicable Sections of the Bankruptcy Code

1. The Plan Does Not Inflate the Retiree Health Benefit Claims

There is no requirement that the Retiree Health Benefit Claims be discounted to net present value. Section 502(b) uses different language than the Bankruptcy Code provisions that require discounting claims to net present value. Section 502(b) requires that the court "determine the *amount*" of a claim "as of the date of the filing of the petition." 11 U.S.C. § 502(b) (emphasis added). By contrast, in the other portions of the Bankruptcy Code that require discount to present value, the statute requires a determination of the *value* as of a specific date. 11 U.S.C. §§ 1129(a)(7), (9), (15); 1129(b)(2); 1173(a)(2); 1225(a)(4), (5); 1325(a)(4), (5); 1328(b)(2). This difference in language indicates that section 502(b) does not require present value discount of all claims. *In re Oakwood Homes Corp.*, 449 F.3d 588, 597 (3d Cir. 2006) ("'amount' does not mean the same thing as 'value.' . . . where the Bankruptcy Code intends a court to discount something to present value, the Code clearly uses the term 'value, as of' a certain date").

In addition, 502(b) contains a list of exceptions specifically limiting the allowance of some claims (such as the cap on landlord claims), but conspicuously does not require a net present value calculation. Interpreting section 502(b) to require discounting to present value would be an additional exception that does not exist in the Bankruptcy Code. *In re Gretag Imaging*, 485 B.R. 39, 46 (Bankr. D. Mass. 2013) ("[s]ection 502(b) contains a series of

exceptions… [i]f § 502(b) required all claims to be present-valued, there would be no need for these exceptions"). *Cf. Oakwood*, 449 F.3d at 593 (interpreting section 502(b) as generally requiring present value discount of all claims would result in impermissible double discount of claims for which 502(b)(2) disallows unmatured interest). Reducing the Retiree Health Benefit Claims to net present value would result in a discount unless the Claim, as reduced to net present value, were paid in full. As Franklin is painfully aware, Class 12 Claims are being paid less than one cent on the dollar under the Plan. The impact of that minimal payment on the retirees is severe. Zadroga-Haase Decl. ¶ 4.

Several of the cases cited in the Summary Objection are irrelevant. For example, some examine rejected employment contracts, which are specifically limited by section 502(b)(7). *See, e.g., Thompson v. Credit Union Fin. Group*, 453 B.R. 823 (W.D. Mich. 2011); *Pereira v. Nelson (In re Trace Int'l Holdings, Inc.)*, 284 B.R. 32 (Bankr. S.D.N.Y. 2002). The Retiree Health Benefit Claims arise under collective bargaining agreements rather than employment contracts, Goodrich Decl. ¶¶ 7-8. Nor has the City rejected any of the collective bargaining agreements. Another of Franklin's alleged authorities examines a claim arising from the rejection of equipment leases, which are addressed in section 502(g). *In re O.P.M. Leasing Servs., Inc.*, 79 B.R. 161, 161-67 (S.D.N.Y. 1987). However, 502(g) is inapplicable to the Retiree Health Benefit Claims because such Claims do not arise on account of rejection of an unexpired contract or lease.

Other cases Franklin cites either erroneously conclude that section 502(b) requires discounting *all* claims to present value or fail to conduct any legal analysis on that point; other courts have declined to follow these cases. *See, e.g., Oakwood*, 449 F.3d at 599, n. 13 (citing and declining to follow *Trace Int'l Holdings, O.P.M. Leasing Servs.*, and *Pension Benefit Guar. Corp. v. CF&I Fabricators (In re CF&I Fabricators)*, 150 F.3d 1293 (10th Cir. 1998)); *Gretag Imaging*, 485 B.R. at 46 (following *Oakwood*). *Oakwood* also overrules another case on which Franklin relies. *Oakwood*, 449 F.3d at 601 (overruling *In re Loewen Group Int'l, Inc.*, 274 B.R. 427 (Bankr. D. Del. 2002) and rejecting the conclusion that all non interest-bearing claims must be discounted to present value).

The City acknowledges that *Oakwood* does not hold that section 502(b) *never* requires discounting to net present value. Rather, that case confronted the issue of whether discounting is appropriate for interest-bearing claims for which interest is already disallowed pursuant to section 502(b)(2). *Oakwood*, 449 F.3d at 598. However, the logic underlying prohibition of present value for interest-bearing claims applies equally to non-interest-bearing claims. *Gretag Imaging*, 485 B.R. at 46 (the analysis in *Oakwood* is "equally compelling" in the context of a non interest-bearing claim and holding that section 502(b) does not require discounting to present value of non interest-bearing, breach of contract claims).

Further, cases Franklin cites rely on an incorrect interpretation of an irrelevant provision of the Bankruptcy Code. They view section 502(b) as requiring present value discount for all claims in order to uphold the alleged principle in section 1123(a)(4) that similarly situated creditors be treated equally. *In re CSC Indus.*, 232 F.3d 505, 509 (6th Cir. 2000); *CF&I Fabricators*, 150 F.3d at 1300. However, section 1123(a)(4) "has nothing to do with allowance of claims." *Dugan v. Pension Ben Guar. Corp. (In re Rhodes, Inc.)*, 382 B.R. 550, 556 (Bankr. N.D. Ga. 2008). Instead, the chief purpose of section 1123(a)(4) is "to protect the integrity of the voting process in a Chapter 11 case." *Id.*; 11 U.S.C. § 1123(a)(4). In fact, when read in conjunction with the provisions of the Bankruptcy Code that do require a present value discount, interpreting section 502(b) also to require this calculation would result in the unequal treatment of similarly situated claims. For example, in cramdown, claims would be discounted to present value twice—once under 502(b) and again under section 1129(b)(2). 11 U.S.C. §§ 502(b), 1129(b)(2). This calculation would achieve the double-discounting prohibited in *Oakwood*. *Oakwood*, 449 F.3d at 593.

Interpreting section 502(b) as not requiring discounting to present value also is consistent with the overarching principle that the Bankruptcy Code accelerates the maturity of future obligations to the petition date. *Oakwood*, 449 F.3d at 602 ("[t]he general rule of both the Bankruptcy Code and § 502(b) is acceleration to the date of filing of the bankruptcy petition . . . not the *lack* of acceleration") (emphasis in original). *See also* H.R. Rep. No. 95-595, at 353-54 (1977) (section 502(b) stands for the principle that "bankruptcy operates as the acceleration of the

principal amount of all claims against the debtor").

The 502(b) limitations upon landlord lease rejection claims upon lease termination, employment contract rejection damages, and unaccrued interest indicate those instances in which Congress detoured from the claims "acceleration" rule and limited the amount of those claims. *Oakwood*, 449 F.3d at 602 (referencing sections 502(b)(6)-(7)). Consequently, for the Retiree Health Benefit Claims and all other Claims under 502(b), "the default state . . . is acceleration," and no present value discount is justified. *Id.*

2. The Plan Properly Caps the Lease Rejection Claim and Properly Accounts for the Lease Rejection Claim for Administrative Rent

Franklin's argument on this point turns totally on its expectation that it will prevail in the Adversary Proceeding in recharacterizing the Golf Course/Park Leases as a disguised secured financing transaction and that it would be improper to apply a landlord cap to a secured claim. Of course, Franklin is correct, but the current status is that Franklin has not so prevailed and the relevant transaction properly involves applying the landlord cap of Bankruptcy Code section 502(b)(6). Despite peppering its brief with numerous statements that it has a $35 million claim against the City, Franklin does not appear to dispute the applicability and effect of section 502(b)(6) on the Lease Rejection Claim.

Franklin also claims that its putative administrative rent claim is not included in the Plan; however, that is incorrect because administrative claims are neither classified nor treated. They must be paid.

3. The City Has Provided Adequate Information about Its Creditor Settlements

Franklin complains that the Disclosure Statement did not provide adequate information about the City's settlements with certain major creditors. Pursuant to the order approving the Disclosure Statement [Dkt. No. 1220], the City timely filed hundreds of pages of the settlement documents it has negotiated with its major creditors, most of which were in close-to-final form as filed. Specifically, on January 27, 2014, the City filed its Plan Supplement [Dkt. No. 1236], which included close-to-final drafts of the Assured Guaranty Settlement Documents, the Arena

Settlement Documents, and the NPFG Parking Settlement Documents. On February 10, 2014, the City filed the Supplemental Plan Supplement in Connection with the First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. No. 1259], which included updated drafts of these documents as well as close-to-final drafts of the settlement agreements with DBW and the Price Judgment Creditors. Further, on February 13, 2014, the City filed a redlined comparison of the Plan Supplement and the Supplemental Plan Supplement [Dkt. No. 1263] to enable the parties in interest to review any changes more easily. An agreement with the Thunder is close to being finalized. Montes Decl. ¶ 8. In addition, the City remains hopeful that it can reach an agreement with the Ports. Documents reflecting those deals will also be filed with the Court. Moreover, in 2013, the City filed its settlement agreement with Ambac, which the Court has approved [Dkt. No. 888].

The City will file final drafts of all settlement documents, as approved by the City Council, before the Confirmation Hearing. Its goal is to do so as soon as practicable after the April 15, 2014, City Council meeting at which the agreements will be considered. It does not believe that any modifications to documents that have been filed in the Plan Supplement or Supplemental Plan Supplement will be material. Nor does it believe that that any documents that have not yet been filed will affect the treatment of the Lease Rejection Claim or that Franklin has been prejudiced in any way.

IV. THE PLAN SHOULD BE CONFIRMED EVEN THOUGH IT WAS NOT ACCEPTED BY CLASS 14 BECAUSE IT SATISFIES SECTION 1129(b)

Class 14 voted to reject the Plan. Nevertheless, the Plan nevertheless should be confirmed over that negative vote. Class 14 is comprised of General Liability Claims—that is, tort or contract Claims filed against the City pursuant to the Government Claims Act, California Government Code section 810 *et seq*. Each such Claim potentially consists of two portions. The self-insurance retention portion, or SIR Claim Portion, the first $1 million of the Claim, is an obligation of the City that will be paid from the City's Risk Management Internal Service Fund (which is a separate fund that includes funds from both the General Fund and restricted funds) and will receive the same percentage payout of Allowed Claims as will the holders of Class 12

Claims. The Insured Portion is any amount that is reduced to judgment or later settled in an amount of above $1 million, which will be paid by one or more of the excess risk-sharing pools of which the City is a member, and is not Impaired. Thus, the legal character of the Class 14 Claims is not substantially similar to that of the Class 12 Claims—none of which is entitled to payment from an excess risk-sharing pool. As a result of this potential blended recovery on the amount of these Claims (approximately 1% for the first $1 million and presumably 100% for all amounts over $1 million, up to the City's maximum policy limits), the legal character of the Class 14 Claims is significantly different from the legal character of the Class 12 Claims.

Section 1129(b) authorizes the court to confirm a plan even if not all impaired classes have accepted the plan (a "cramdown"), provided that the plan has been accepted by at least one impaired class and that "the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." (emphasis added) 11 U.S.C. § 1129(b)(1).

With respect to the fair and equitable requirement, chapter 9 incorporates the absolute priority rule of section 1129(b), which is easily met by the Plan in that no Class of Claims junior in priority to the Class 14 Claims will receive any payment under the Plan. Further, courts have applied additional requirements in chapter 9 cases to satisfy the fair and equitable requirement, including whether the Plan pays the creditors "all that they 'can reasonably expect in the circumstances'". *Lorber v. Vista Irrigation Dist.*, 127 F.2d 628, 639 (9th Cir. 1942); Collier ¶ 943.03 [1][f][i][B]. Among other things, this determination is not contingent on whether the plan dedicates all collected taxes to the payment of creditors. *Lorber v. Vista Irrigation Dist.*, 143 F.2d 282 (9th Cir. 1944); Collier ¶ 943.03 [1][f][i][B]. Nor it is required that taxes be increased. *In re Corcoran Hosp. Dist.*, 233 B.R. 449, 459 (Bankr. E.D. Cal. 1999); Collier ¶ 943.03 [1][f][i][B].

The City believes that it satisfies the "reasonable expectations" test given that it has drastically reduced expenditures and increased taxes, and that unsecured creditors (and the tort claimants in Class 14 for the SIR Portion of their Claims) would likely receive nothing in a mad scramble to the courts to collect on their Claims by writ of mandate (in competition with Franklin

on the Lease Rejection Claim, Ambac, Assured Guaranty, NPFG, the Retiree Health Benefit Claimants on the Retiree Health Benefit Claims, and perhaps CalPERS) if the Plan were not confirmed and the case dismissed. In fact, the Supreme Court has called the right to enforce claims against a city through mandamus, "the empty right to litigate." *Asbury Park*, 316 U.S. at 510.

The unfair discrimination requirement "goes hand-in-hand with the fair and equitable rule, and where a plan discriminates unfairly, it will most likely not meet the requirements of fair and equitable." Collier ¶ 943.03[1][f][ii] (referencing the House Report to the 1976 Act). The Plan does not discriminate unfairly against the holders of Class 14 Claims because each Claim potentially consists of two portions: the SIR Claim Portion and the Insured Portion. The SIR Claim Portion will receive exactly the same percentage payout of Allowed Claims as will the holders of Class 12 Claims, while the Insured Portion is not Impaired and thus will be paid in full by a third party.

V. CONCLUSION

For the reasons set forth above, Franklin's objection to the Plan should be overruled. Therefore, the Plan meets all of the requirements set forth in section 943(b) and should be confirmed.

Dated: March 31, 2014

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