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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re: CITY OF STOCKTON, CALIFORNIA, Debtor.	Case No. 12-32118 (CMK) Chapter 9 Adv. Proceeding No. 13-02315-C **PRETRIAL REPLY BRIEF OF FRANKLIN HIGH YIELD TAX-FREE INCOME FUND AND FRANKLIN CALIFORNIA HIGH YIELD MUNICIPAL FUND**
WELLS FARGO BANK, NATIONAL ASSOCIATION, FRANKLIN HIGH YIELD TAX-FREE INCOME FUND, AND FRANKLIN CALIFORNIA HIGH YIELD MUNICIPAL FUND, Plaintiffs. v. CITY OF STOCKTON, CALIFORNIA, Defendant.	Date: May 12, 2014 Time: 9:30 a.m. Dept: C, Courtroom 35 Judge: Hon. Christopher M. Klein

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The City has now conceded that Franklin was right all along – neither the Nominal Lease nor the Leaseback Agreement is an unexpired lease within the meaning of the Bankruptcy Code. Rather, the City admits that the Agreements "are in economic substance a secured financing transaction."[1]

That belated concession simplifies this action. The issues that remain before the Court concern the allowability, nature, extent, and value of Franklin's secured claim, which are the subject of Counts 2, 3, and 4 of the Complaint.[2] As summarized below, Franklin has shown and will prove at trial that it has an allowed claim for the full amount due and owing on the Bonds. That claim is secured by the right to use, operate, and re-let the Property until the Bonds are paid in full. Under the Plan, the City proposes to discharge its obligations under the Agreements (and hence the Bonds) through a payment of less than 1%. Because value is not otherwise sufficient to repay the Bonds, Franklin's collateral is a perpetual possessory interest in the Property. Frederick Chin, Franklin's expert with decades of experience appraising, valuing, owning and operating golf courses and other assets similar to the Property, has opined that the collateral is worth approximately $15 million.

The City, on the other hand, apparently asserts that Franklin's claim should be disallowed due to the City's alleged violation of California's constitutional debt limitation. The City also asserts that, if the claim is allowed, the duration of Franklin's possessory security interest extends only until 2048. Relying only on the biased opinion of a City employee with no formal appraisal or valuation experience (who admitted that, in formulating his opinion, he did not actually "prepare any calculations") and on a last-minute rebuttal report by a putative "expert" with essentially no experience in valuing or operating golf courses or similar asserts, the City asserts that such collateral has no value. The City conspicuously has offered no expert opinion of value of the collateral, only a rebuttal of the opinion of Franklin's expert.

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[1] *See Partial Judgment In Favor Of Plaintiffs* [adv. pro. doc. no. 56] (the "Partial Judgment"). This is a reply to the City's Pretrial Brief ("City Br."). Capitalized terms not defined in this Brief have the meanings given to them in Franklin's Pretrial Brief ("Franklin Br.").

[2] The claim technically is held by Wells Fargo as indenture trustee for Franklin's benefit. *See* Franklin Br. at 9. Because Franklin owns all of the Bonds and has the right to direct Wells Fargo to exercise of its rights and remedies, this Brief continues the convention of referring to the claim as "Franklin's claim."

This Reply Brief demonstrates that each of the City's attempts to limit or eliminate Franklin's secured claim is without merit.

I. FRANKLIN'S CLAIM IS AN ALLOWED CLAIM

Citing Article XVI, Section 18 of the California Constitution, the City's initial line of attack is that, if the Agreements are "recharacterized as a secured financing transaction subject to acceleration of the 'debt,' the recharacterized transaction would be unenforceable due to the absence of two-thirds voter approval."[3]

Anticipating this potential argument, Franklin demonstrated in its Opening Brief that, even as "recharacterized" in accordance with their true economic substance rather than their form, the Agreements did not violate the constitutional debt limitation when executed and are fully enforceable.[4] In particular, municipal financing transactions (and a host of other agreements) satisfy the debt limitation so long as, at the time the transaction is consummated, the municipality's future obligations from year-to-year are contingent.

The City agrees that this is the governing inquiry, correctly observing that "[t]he California Supreme Court has stated that 'we have long held that the debt limitation in section 18 does not apply when a local government enters into a contingent obligation.'"[5] The City also agrees that the inquiry is the same whether the obligation takes the form of a lease or something else, noting that "courts have indeed permitted contingent obligations that are not leases" in the face of debt limit challenges.[6] Franklin's Opening Brief summarizes many of those cases.[7]

The City's concession is dispositive. In holding that the Agreements are not "leases" within the meaning of the Bankruptcy Code, the Court has not changed the substance or nature of the City's obligations. To the contrary, the Court has enforced substance over form. Because those obligations were enforceable when incurred and at the time the City filed for bankruptcy (as the City concedes

[3] City Br. at 9; *see id.* at 10 (seemingly disputing the allowability of Franklin's claim).

[4] Franklin Br. at 18-22.

[5] City Br. at 6 (quoting *Rider v. City of San Diego*, 18 Cal. 4th 1035, 1047 (Cal. 1998)).

[6] City Br. at 6.

[7] Franklin Br. at 19-21.

they were), they remain enforceable now that the Court has disregarded their form and enforced their substance.

The City cannot escape liability by claiming that enforcement of the Agreements as a secured financing transaction results in "acceleration of the 'debt.'"[8] An agreement need only satisfy the debt limitation at the time it is executed. Once a contingency comes to pass, it matters not that the municipality's resulting obligations would then exceed the constitutional threshold at that time. *See, e.g.*, *American Co. v. City of Lakeport*, 220 Cal. 548, 558 (1934) ("The validity of the obligation must be determined as of the time it was incurred. Otherwise, the whole doctrine of contingent liability is repudiated, since upon the happening of the contingency an obligation validly assumed becomes illegal."). Moreover, the City's obligations under the Agreements have been accelerated, if at all, only through the automatic acceleration of all of its debts as a consequence of its bankruptcy petition. Obviously, the City's decision to seek adjustment of its debts in this case did not transform those debts into illegal and unenforceable obligations.

As a consequence, Franklin's claim is fully enforceable in the amounts set forth in the proof of claim attached as Exhibit E to the Complaint.

II. FRANKLIN'S COLLATERAL INCLUDES THE RIGHT TO USE, OPERATE, AND RE-LET THE PROPERTY UNTIL THE BONDS ARE PAID IN FULL

The City agrees that Franklin's claim is secured by a valid, perfected, and unavoidable security interest in collateral that includes the right "to take possession of the [Property] and operate the businesses that are conducted from [the Property] for the possessory term set forth in the [Agreements]."[9] The City also has abandoned its prior argument that Franklin's only right upon possession of the Property would be to lease it back to the City.[10] In fact, the City's analysis of collateral value specifically considers what a "rational third party would be willing to pay" for

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[8] City Br. at 9.

[9] City Br. at 10. The Bonds also are secured by a lien on the various accounts maintained by Wells Fargo and the pledge of the Authority's revenues as set forth in Article V of the Indenture.

[10] Franklin refuted that argument in Section III.B.2 of its Opening Brief.

possession of the Property – a clear concession of Franklin's rights to sell its interest in the Property to the highest bidder or bidders.[11]

The City, however, insists that the collateral only includes the right to possess and re-let the Property through 2048. The City is wrong. The possessory interest collateral emanates from the Nominal Lease. In the Nominal Lease, the City granted the Authority the right to possess the Property until all amounts due in respect of the Bonds "shall be fully paid or provision made for such payment,"[12] a fact that the City's municipal finance advisor and designated witness confirmed at deposition.[13] There is no limit or end date on that possessory interest other than payment in full of the Bonds. Accordingly, because the City proposes to discharge its obligations under the Agreements (and hence the Bonds) through a payment of less than 1% and (as described below) the value of the Property is not otherwise sufficient to repay the Bonds, Franklin's collateral includes the right to possess and re-let the Property indefinitely.

The City resists this by pointing to the Leaseback Agreement, which has a term that concludes in 2048.[14] The Leaseback Agreement is irrelevant to the issue. Under the Leaseback Agreement, the Authority transferred the right of possession back to the City. The Agreement says nothing about the Authority's rights (and hence Franklin's rights by assignment) in the event of a default that terminates the City's rights of possession. The Authority's rights are derived solely from the Nominal Lease, the document by which the City granted the possessory interest in the first place.

The City also claims that section 510 of the City Charter "provides that no lease of City property may exceed 55 years."[15] This too is irrelevant to the issue, which relates to the duration of Franklin's possessory interest collateral through an agreement (the Nominal Lease) that the City has conceded and the Court has found not to be a lease. Indeed, the indefinite nature of Franklin's possessory interest is further evidence that the parties never intended to create a "lease" at all. *See*

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[11] City Br. at 13.

[12] Nominal Lease § 3.

[13] Dieker Tr. 61:9-11.

[14] City Br. at 11.

[15] City Br. at 11 (emphasis added).

Palmer v. Conn. Ry. & Lighting Co., 311 U.S. 544, 567 (1941) ("A lease renewable forever or a lease in perpetuity . . . is the equivalent of a fee interest.").

III. FRANKLIN'S COLLATERAL IS WORTH APPROXIMATELY $15 MILLION

In its Opening Brief, Franklin summarized the opinion of its expert, Frederick Chin, that the collateral is worth nearly $15 million assuming that the possessory interest is perpetual, and worth nearly $5 million if the possessory interest terminates in 2048 or 2053 (the date through which the City has restructured other debt obligations).[16] The City, through its "Economic Development Advisor" Val Toppenberg and its putative rebuttal "expert" Raymond Smith, attempts to poke holes in Mr. Chin's opinion and ultimately leaps to the conclusion that the collateral – the right to possess and assign the Property for any period of time – "has no value."[17] Notably, the City has provided no expert opinion of the value of the collateral. It merely has offered the uninformed lay opinion of its employee Mr. Toppenberg (who has no valuation experience) and the "rebuttal opinion" of Mr. Smith (who has no experience valuing golf courses or properties similar to the collateral) to rebut portions of Mr. Chin's opinion.

The City's basic thesis is that "it is difficult to imagine that any rational third party would be willing to pay *anything* to take over the operation of" the Property because the City historically has lost money operating the Property, the Property requires various capital improvements, and the Property is subject to various zoning and other restrictions.[18] Thus, Mr. Toppenberg and Mr. Smith criticize Mr. Chin's perpetual interest valuation for the "unsubstantiated assumption" that the City "would want to maximize taxes and other revenues by converting the subject park and recreation properties to residential, commercial or industrial use" or otherwise would "support[] value maximizing changes in use."[19] Next, the City and Mr. Smith assert that the only way to value the

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[16] Franklin Br. at 23-26.

[17] City Br. at 13.

[18] City Br. at 13 (emphasis in original).

[19] *Submission By The City Of Stockton Of Rebuttal Expert Report Of Raymond Smith* [doc. no. 1343; adv. pro. doc. no. 43], Ex. A ("Smith Report") at 5; *Declaration Of Val Toppenberg In Support Of City's Supplemental Memorandum Of Law In Support Of Confirmation Of First Amended Plan* [doc. no. 1318] ("Toppenberg Decl.") ¶ 15.

Property is through "classic discounted cash flow analysis" and, because it has lost money operating the Property, "the discounted cash flow approach to value yields a zero value."[20] In other words, the City and its expert would have the Court believe that no investor would make an investment in an asset that has lost money in the past.

That, of course, is not how the world works. Investors commonly pay real money to acquire distressed, money-losing properties in the belief that they can rehabilitate and operate the assets more efficiently and economically than the seller, whether through the properties' current use or a more optimum function. Given this reality, as shown below, the City's critiques of Mr. Chin's valuation do not withstand scrutiny.

A. Mr. Chin's Perpetual Interest Valuation Is Sound.

For the perpetual interest, Mr. Chin valued the Property as vacant land on the basis that the Property eventually would be put to its highest and best use, which would be something other than the current uses of the Property. Mr. Chin explained:

> A possessory interest perpetually is similar to fee ownership in a property. As such, the holder does not face the same challenges and constraints related to financing, redeveloping and changing the use of the Properties when specific ownership periods exist. The highest and best use of the Properties is different as if possession is perpetual than if time constrained. With perpetual possession, it is reasonably probable, physically possible and economically feasible that the improvements on the Properties would be demolished, and the land converted into residential, commercial or mixed-uses some time during the possessory period perpetually.
>
> The value for the Properties with a possessory interest perpetually is land value. The existing improvements are considered to be interim uses until such time as a change of use can be achieved, and as market conditions dictate. I have used the sales of vacant land to estimate the Properties' value presuming a possessory interest perpetually.[21]

As noted, Mr. Smith criticizes as "unsubstantiated" the premise that the City "would want to maximize taxes and other revenues by converting the subject park and recreation properties to residential, commercial or industrial use."[22] In so doing, Mr. Smith ignores reality. If the City were

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[20] City Br. at 14, 16 n.20.

[21] Chin Report at 48.

[22] Smith Report at 5. Mr. Toppenberg similarly avers that Mr. Chin's opinion "displays a lack of appreciation for the political process of obtaining land use approvals." Toppenberg Decl. ¶ 15.

deprived of possession and control of the Property perpetually, there is every reason to believe that the City would seek to maximize the taxes and revenues associated with the Property, just like it does with other privately-developed properties, particularly given the City's tenuous financial situation. Notably, at deposition Mr. Smith could not defend his criticism of Mr. Chin other than to proclaim that Mr. Chin had made "a superficial assumption about the City's motivations to make money,"[23] as if such a motivation would be unusual.

Mr. Smith would have the Court instead assume that the City would withhold zoning changes to limit the use of the Property – over which it would not otherwise possess or have control – to its own economic detriment simply to punish Franklin. While the City's conduct in this case would indicate that indeed is a realistic possibility over the near term, it is fair to assume that, eventually, economic rationality would prevail and the City would facilitate the development of the Property. Mr. Chin appropriately made that assumption. *See, e.g.*, *Metropolitan Water Dist. of S. Cal. v. Campus Crusade for Christ, Inc.*, 41 Cal. 4th 954, 967 (2007) ("Where due to zoning restrictions the condemned property is not presently available for use to which it is otherwise geographically and economically adaptable, the condemnee is entitled to show a reasonable probability of a zoning change in the near future and thus to establish such use as the highest and best use of the property.") (citing *City of Los Angeles v. Decker*, 18 Cal. 3d 860, 867 (1977)).

Notably, Mr. Smith takes no specific issue with Mr. Chin's actual land valuation other than to note, without elaboration, that "Mr. Chin's presentation and analysis of sales data in this part of his report was insufficient to allow a reader to have confidence in his value conclusions."[24] To the contrary, as set forth in the Chin Report, Mr. Chin described in detail his analysis of comparable sales data (and will be prepared to testify to that analysis at trial). Mr. Chin's valuation in this regard thus stands completely unrebutted.

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[23] Rough Transcript of Deposition of Raymond Smith ("Smith Tr.") 129:19-20.

[24] Smith Report at 5. Mr. Smith also criticizes Mr. Chin for "provid[ing] value conclusions assuming term extensions beyond September 1, 2048." *Id.* at 3. At deposition, however, Mr. Smith admitted that this "was based on legal interpretation of a law firm" and that "I'm not a lawyer, so I don't have any information on that." Smith Tr. 98:15-16 and 99:9-10.

The City and the director of its Community Development Department, Stephen Chase, also imply that no development could be conducted on the site of the Van Buskirk golf course because it "sits in a floodplain of the San Joaquin River."[25] The fact is that nearly all of the City sits in that same floodplain. The City obviously is able to continue development within its borders, as Mr. Chase effectively concedes by noting that development within the floodplain can be accomplished by "meet[ing] FEMA standards as well as emerging State mandated provisions under SB5 that require 200-year flood zone protections."[26]

Finally, the City, Mr. Chase, and Mr. Smith point to "deed restrictions" relating to the Van Buskirk site that purportedly limit use to "public recreation or public park purposes."[27] Those restrictions, however, do not apply to a possessor of the Property by way of foreclosure – exactly the interest that the Court is valuing in this proceeding. By their terms, they apply only to the "Grantee" (the City). Moreover, the deed restrictions may not be enforceable in any event. For example, the City apparently has flouted the prohibition of sale of "intoxicating liquor" on the property for years, without any consequence,[28] and the City does not know whether there even exists any person who could enforce the restrictions (as the original grantors passed away more than thirty years ago without children).[29]

B. Mr. Chin's Limited-Duration Interest Valuation Is Sound.

For his valuation of the possessory interest assuming a termination date of 2048 (or 2053), Mr. Chin did not "turn[] a blind eye to the discounted cash flow approach," as the City claims.[30] To the contrary, Mr. Chin specifically explained that the use of the discounted cash flow methodology is inappropriate for valuation of a property that has experienced a net operating loss.[31] Instead, Mr.

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[25] City Br. at 11, 13; *Declaration Of Stephen Chase In Support Of City's Supplemental Memorandum Of Law In Support Of Confirmation Of First Amended Plan* [doc. no. 1321] ("Chase Decl.") ¶ 23.

[26] Chase Decl. ¶ 23.

[27] Chase Decl. ¶ 24; *see* City Br. at 11, 13; Smith Report at 5.

[28] Ex. 2075 (CTY253005).

[29] Ex. 2026 (CTY107685); Ex. 2027 (CTY233028).

[30] City Br. at 16.

[31] Chin Report at 38.

Chin applied the gross income multiplier income capitalization methodology, or "GIM," which involves the application of a multiplier to the gross revenue produced by the property at issue. As Mr. Chin explained, the use of the GIM methodology is the common, accepted way to value assets that historically have lost money, including golf courses:

> To estimate the value of a possessory interest in Swenson and Van Buskirk, I have considered both the KemperSports and Golf Consultant's revenue projections and have applied the gross income multiplier ("GIM") income capitalization method. While other income capitalization methods are available (discounted cash flows and direct capitalization), Swenson and Van Buskirk have experienced net operating losses in the recent past which prohibit the use of these other methods. Capital and operational improvements are also needed at both Swenson and Van Buskirk to maximize value.
>
> The GIM method is appropriate to use in the case of Swenson and Van Buskirk as it takes into account, in one single ratio, all the factors that market participants consider in pricing properties. It's also one method commonly employed to convert gross income to value for properties which have experienced persistent declines in revenues and weak or negative margins. According to the Society of Golf Appraisers ("SGA") 2014 Financing & Investing Survey, a number of buyers and sellers give credence as to the relevancy of the GIM approach. The survey information indicate GIM's generally in the .9 to 1.3x range for clubs with nominal or negative net margins. The SGA survey indicated that the average GIM for all clubs was 1.4x gross income.
>
> The survey information is also corroborated with listings for sale of golf courses around the country. I have gathered 31 golf course listings of public, semi-private and private golf courses. Current listing prices reflect GIMs that commonly range from .77 to 1.77. Many of the listed courses also are under-performing, whereby net operating incomes are negative, and whereby revenue enhancements and other operating improvements would likely be implemented after closing.[32]

At deposition, Mr. Smith retreated from his insistence on exclusive application of the discounted cash flow methodology, and stated only that the GIM methodology should be employed "carefully."[33] He did not explain how Mr. Chin was not "careful" in his application of the GIM.

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[32] Chin Report at 38-39 (emphasis added).

[33] Smith Tr. 108:6. Indeed, an appraiser consulted by Mr. Smith (after he issued his report) provided Mr. Smith with data showing the application of the GIM methodology resulting in positive values for money losing golf courses. Smith Tr. 86:2-87:23; Ex. 2991 (CTY258431). This is the same appraiser that allegedly told Mr. Toppenberg that he likely "would" (but did not) opine that "the leases have no value." *See* Section III.D, below.

The City and Mr. Smith also criticize the gross revenue figures to which Mr. Chin applied the GIM, asserting that "Mr. Chin projected significantly higher revenue for both golf courses than historically substantiated, under the assumption that capital expenditures would be required to maximize value."[34] This mischaracterizes Mr. Chin's opinion. Mr. Chin's revenue projections are based upon his "analysis of competitor rates, the past performance of the courses, and the enhancements in revenues that could be made."[35] They are not premised in any way on capital improvements.

Rather, the "revenue enhancements" referenced by Mr. Chin relate to the ability of a new, profit-minded operator to maximize revenues in a way that the City has been unable to do. As Mr. Chin will testify, there is little doubt that the City's stewardship of the Property has not produced maximized value. The outside general manager of the Swenson and Van Buskirk golf courses that comprise part of the collateral confirmed just this point:

> We needed to bring in professionals. . . . Cities don't know how to run a business. That's not their job. They don't know who to market to. Before (July 2011), the courses were run on a piece of paper and a $200 cash register.[36]

In Mr. Chin's expert opinion, informed by his thirty-five years of experience in evaluating, appraising, owning, and operating golf courses, an experienced operator working for a profit-maximizing entity could improve the revenues at the Property. Mr. Smith, who has no experience owning or operating golf courses and who has appraised only a single golf course twenty years ago,[37] is in no position to question Mr. Chin in this regard.

Neither is Mr. Smith in any position to question the selection of relevant golf course sales comparisons in Mr. Chin's alternative "sales comparison" approach to valuation. Mr. Chin applied

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[34] Smith Report at 4; *see* City Br. at 17 ("The assumption of increased prices is clearly based, at least in part, upon an assumption of the needed capital improvements actually being funded and completed in addition to unsupported wishful thinking.").

[35] Chin Report at 39.

[36] Ex. 2958 (*Golf Courses Take Swing At Change*, CENTRAL VALLEY BUSINESS JOURNAL, http://cvbj.biz/golf-courses-take-swing-at-change/) (emphasis added).

[37] Smith Tr. 55:4-23.

his expertise to the selection of "comps" and application of the relevant metrics (price per hole and price per acre).[38] Mr. Smith has no such expertise to apply.[39]

Mr. Smith also criticizes Mr. Chin's valuation of the Van Buskirk community center on the grounds that Mr. Chin "did not give consideration to external obsolescence." Apparently, Mr. Smith believes that it is inappropriate to use the cost approach to valuation of the facility because "the community center is not revenue generating."[40] As Mr. Chin explained, it is precisely because "the current use of the property is typically for public/community purposes and not for its income-producing ability" that the cost approach is appropriate under the circumstances.[41] Specifically, the City's current non-revenue generating use of the facility made the income approach inappropriate. The cost approach, on the hand, provided a reliable indication of the value that could be realized if the property were in the hands of a profit-seeking possessor of the collateral.

Finally, Mr. Smith takes issue with the discount applied by Mr. Chin to the values derived for the Property to account for the finite duration of the possessory interest, asserting that "Mr. Chin's methodology and conclusions relative to discounting a fee simple value in order to conclude possessory interest value were unsupported."[42] That, however, is the entirety of Mr. Smith's critique. It is not an "expert" opinion. It is an unhelpful declaration uninformed by any of the "knowledge, skill, expertise, training, or education" required of an expert by Rule 702 of the Federal Rules of Evidence.

C. Mr. Smith's Rebuttal Opinion Is Invalid.

Mr. Smith's entire report, in fact, is unhelpful and an invalid critique of Mr. Chin. To start, Mr. Smith's report is the product of "a limited assignment and should not be construed as an

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[38] *See* Chin Report at 40-41.

[39] Mr. Smith criticizes Mr. Chin's valuation of Oak Park stating without elaboration that, "as with his golf course valuation, Mr. Chin's possessory interest discount methodology and conclusion were unsupported." Smith Report at 5. This is not "expert" analysis. It is meaningless, unsupported, and unhelpful text.

[40] Smith Report at 5.

[41] Chin Report at 10.

[42] Smith Report at 4, 5.

appraisal of the subject property."[43] Rather, the report summarizes a "desk review" that "did not include a field inspection of the subject property or other properties referred to in the appraisal."[44]

Moreover, the report is not the product of any reasoned, deliberate analysis. Mr. Smith got his assignment from counsel for the City on April 1 and issued his report three days later on April 4. He purportedly spent twenty-three hours working on his report. In contrast, Mr. Smith spent more time (27.75 hours) after issuing his report attempting to backfill support for the opinions set forth in the report.[45] Also, as noted above, Mr. Smith has essentially no experience or expertise valuing golf course, community centers, parks or other property of a nature similar to the Property.[46]

Mr. Smith's lack of expertise pervades his report and taints his conclusions. For example, Mr. Smith asserts that it was not appropriate for Mr. Chin to value separately the different components of the Property (Swenson golf course, Van Buskirk golf course, Van Buskirk community center, and Oak Park) and, relatedly, that it was not appropriate for Mr. Chin to value the ice arena at Oak Park without ascribing a value to other portions of the park property.[47] Although he retreated from this untenable position at deposition, Mr. Smith apparently believed that subleasing or other transfer of an interest in the Property is an all-or-nothing proposition, such that each of the discrete parcels of property – located miles from each other and the subject of independent and unrelated operations – must be acquired by a single party and thus valued together rather than individually.[48]

Mr. Smith's belated retreat from that unequivocal but uninformed assertion is wise, as his all-or-nothing approach to valuation of the Property is methodologically unsound and legally unsupported. To start, far from determining the value that the holder of the collateral could generate, Mr. Smith's approach would drastically reduce, if not eliminate, the pool of potential acquirers of the

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[43] Smith Report at 6.

[44] Smith Report at 6 (emphasis in original).

[45] Smith Tr. 39:5-20.

[46] Smith Tr. 54:13-56:2 and 68:15-19.

[47] Smith Report at 3, 4, 5-6.

[48] While Mr. Smith's report suggests that segregating the Property for valuation purposes is methodologically improper, he stated at deposition that segregation is merely inconsistent with the Nominal Lease (which he admitted he has no expertise to interpret). Smith Tr. 98:15-18.

collateral. To wit, it is less likely that any one party would want to acquire interests in all of the golf courses, the community center and the park facilities, which are the subject of different businesses and operations and could benefit from operators with different areas of expertise. A more likely scenario – and the one that would maximize value – is that parties with particular expertise in managing golf courses would want to acquire interests in one or both of the golf courses, while other entities would be interested in the community center and the park.

California law recognizes the economic importance of a lessee's right to freely sublet and subdivide all or part of its interest in real property, absent the existence of express provisions restricting that right in the lease. *See* Cal. Civ. Code § 1995.210(b) (where lease is silent regarding tenant's ability to sublet without landlord's consent, tenant may freely assign its interest under the lease without landlord's consent or approval); *Carma Dev. (Cal) v. Marathon Developers Cal.*, 2 Cal. 4th 342, 355 (1992) ("Unless a lease specifically provides otherwise, a tenant's rights are generally considered freely alienable.") (citing *Kassan v. Stout*, 9 Cal. 3d 39, 43 (1973)). Moreover, any ambiguity as to whether a tenant may transfer his interest in a lease is construed in favor of transferability. *See* Cal. Civ. Code § 1995.200.

Mr. Smith testified that he had only "scanned" the lease documents and did not know whether or not the Nominal Lease permits subletting of the Property.[49] Had he reviewed the Nominal Lease more carefully, he would have discovered that it restricts the right of assignability or subletting only to the extent that the City is not in default under the Leaseback Agreement.[50] Thus, now that the City has defaulted, the Authority (and, by extension, Franklin) is free to assign its rights under the Nominal Lease or to sublet the Property as it sees fit in accordance with California law. Moreover, the Nominal Lease contains no restrictions with respect to the subletting or assignment of any particular part of the leasehold interest. Therefore the Authority has broad power to sublease or assign its interest so as to maximize its value, including by subleasing or assigning particular sites or

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[49] Smith Tr. 125:9-14.

[50] Nominal Lease § 7 ("[u]nless the City shall be in default under the [Leaseback] Agreement, the Authority may not assign its rights under this Site and Facility Lease or sublet the Site or the Facility . . . without the written consent of the City.").

facilities. *Crowell v. Riverside*, 26 Cal. App. 2d 566, 579 (1938) ("[I]t is as much a subletting to sublease part of a property as the whole.").

Mr. Smith's hasty and uninformed critique serves as no "rebuttal" to Mr. Chin's thorough and circumspect opinion of the value of Franklin's collateral, which now stands unimpeached.

D. Mr. Toppenberg Is Not Competent To Render An Opinion.

Mr. Toppenberg, the City's "Economic Development Advisor," blithely opines that "the prospect of ever operating the three properties at a profit are extremely remote and as a result, a lease of Oak Park, Swenson Golf Course, and Van Buskirk Golf Course would have virtually no value to a third party."[51] Mr. Toppenberg is not qualified to render that or any other opinion relevant to resolution of this case.

To start, Mr. Toppenberg has no formal training in real estate appraisals or valuation.[52] Indeed, it is apparent that Mr. Toppenberg is not even competent to understand Mr. Chin's opinions. For example, Mr. Toppenberg appears to believe that Mr. Chin's report advanced an opinion regarding the value of the Property to the City.[53] Mr. Chin, of course, did no such thing, as value to the City is irrelevant in the context of determining the value of the Franklin's collateral and the amount of its secured claim. Mr. Toppenberg also criticizes Mr. Chin for relying exclusively on the cost approach, to the exclusion of all other valuation methodologies.[54] As explained above, Mr. Chin did no such thing, and actually employed the cost approach in just one component of his valuation (for the Van Buskirk community center) while using the income and sales approaches in the other components of his appraisal. Mr. Toppenberg's failure to grasp Mr. Chin's basic methodology illustrates his utter lack of qualification to provide helpful opinion testimony as to any issue in this case.

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[51] Toppenberg Decl. ¶ 15.

[52] Transcript of first Deposition of Val Toppenberg ("Toppenberg I") 32:18-20.

[53] Toppenberg Decl. ¶ 15 ("The appraisal submitted by Franklin displays a clear lack of understanding of how cities value their assets.").

[54] Toppenberg Decl. ¶ 15 ("Because there are no comparable sales and no income to assess, the appraiser reverts to the cost approach.").

Moreover, at deposition, Mr. Toppenberg admitted that he did not "prepare any actual calculations" in formulating his opinion.[55] Instead, Mr. Toppenberg relied on alleged hearsay statements from two appraisers that the City allegedly retained at some point during the bankruptcy case but conspicuously did not designate as experts to provide any opinion in connection with this litigation. Mr. Toppenberg states that "no appraisal was ever completed," but then adopts without question and without qualification the alleged statement of the appraisers – purportedly relayed "during their conversations with me and other representatives of the City" – that, had the appraisers actually completed their work, they "would likely [produce] a formal appraisal report showing that the leases have no value."[56] Although the appraisers therefore would have provided the City with exactly the "zero value" opinion it desired, Mr. Toppenberg states that the City then determined "that there was no point to continuing with a full appraisal."[57] Yet now Mr. Toppenberg uncritically adopts the appraisers' alleged hearsay statements – which are not the product of any written report (much less one that complies with the Federal Rules of Civil Procedure) – as his own opinion.

This backdoor attempt to introduce alleged oral opinions of alleged non-retained experts who have not written reports, been deposed, or otherwise made a part of this case is patently inappropriate. Mr. Toppenberg's testimony therefore is useless and unhelpful to the City, as will be explained in Franklin's forthcoming motion to exclude Mr. Toppenberg's lay opinion.

IV. CONCLUSION

For all of the foregoing reasons, and based on the evidence that will be presented at trial, Franklin requests that the Court enter judgment declaring that (a) the Agreements give rise to an allowed claim for the City's liability thereunder (including all amounts payable in respect of the Bonds), not subject to objection, dispute, disallowance, offset, recoupment, subordination or recharacterization, that is secured by a valid, perfected, enforceable and unavoidable security interest in and lien on the right to possess, use and lease the Property until such time as the Bonds are repaid

[55] Toppenberg I 13:10-16, 13:23-14:4, 32:18-20; Transcript of second Deposition of Val Toppenberg ("Toppenberg II") 169:8-16, 182:25-183:7.

[56] Toppenberg Decl. ¶ 4.

[57] Toppenberg Decl. ¶ 4.

in full; and (b) for purposes of the City's proposed Plan, such allowed claim shall be an allowed secured claim against the City, not subject to objection, dispute, disallowance, offset, recoupment, subordination or recharacterization, in the amount of $14,860,000, with the balance an allowed unsecured claim; and otherwise granting such further relief as the Court deems appropriate.

Dated: April 21, 2014 JONES DAY

By: */s/ James O. Johnston*
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