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16 UNITED STATES BANKRUPTCY COURT  
 17 EASTERN DISTRICT OF CALIFORNIA  
 18 SACRAMENTO DIVISION

19 In re  
 20 CITY OF STOCKTON, CALIFORNIA,  
 21 Debtor.

22 Case No. 2012-32118

23 D.C. No. OHS-15

24 Chapter 9

25 **CALPERS' RESPONSE TO FRANKLIN'S  
 26 OBJECTION TO CONFIRMATION OF  
 27 THE CITY OF STOCKTON'S FIRST  
 28 AMENDED PLAN OF ADJUSTMENT**

Date: May 12, 2014

Time: 9:30 a.m.

Place: Robert T. Matsui U.S. Courthouse,  
 501 I Street  
 Department C, Fl. 6, Courtroom 35  
 Sacramento, CA 95814

Judge: Hon. Christopher M. Klein

**TABLE OF CONTENTS**

**Page**

1

2

3 I. BACKGROUND ..... 1

4     A.     What Is CalPERS? ..... 1

5     B.     The California Government Code Requires the Preservation of the

6             Integrity of the State’s Public Employees’ Retirement System. .... 4

7             1.     A Sound Public Pension System Benefits the State and its Citizens. .... 4

8             2.     An Actuarially Sound Pension System is Essential for the Payment

9                 of Pension Benefits. .... 4

10     C.     Stockton’s Relationship with CalPERS. .... 5

11     D.     Explanation of the Nature of Certain Calculated Liabilities. .... 6

12     E.     The Termination Process and the Consequences of Termination. .... 9

13             1.     Termination and the Termination Process. .... 9

14             2.     Termination Lien. .... 11

15             3.     Termination Is Not a Viable Option for Stockton. .... 11

16             4.     Potential Jeopardy to Tax Exempt Status. .... 12

17 II. ARGUMENT ..... 14

18     A.     Franklin’s “Best Interests” Objection Misapprehends the Ability to

19             Reduce the City’s Obligations to CalPERS and the Consequences of

20             Terminating the City’s CalPERS Pension Plan. .... 14

21     B.     Franklin’s “Good Faith” Objection to the City’s Decision to Continue its

22             Relationship with CalPERS Is Legally and Factually Unsound. .... 14

23             1.     The City Has the Authority under 11 U.S.C. § 1123(b)(6) to

24                 Continue its Relationship with CalPERS. .... 14

25             2.     Good Faith under 11 U.S.C. § 1129(a)(3) Does Not Require the

26                 City to Pursue Franklin’s Suggestion that the City Attempt to

27                 “Adjust” its Obligations to CalPERS. .... 15

28             3.     The City’s Decision to Continue its Relationship with CalPERS

               Satisfies the Good Faith Standard of 11 U.S.C. § 1129(a)(3). .... 20

               a.     The City Reasonably Concluded that it Would Be at a Severe

                       Competitive Disadvantage in Retaining and Attracting Employees

                       Without a CalPERS Pension Plan. .... 20

               b.     Terminating the CalPERS Pension Plan Would Likely Cause a

                       Substantial Number of Employees to Leave the City’s Employ to

                       Preserve their Pension Benefits. .... 21

III. CONCLUSION ..... 21

**TABLE OF AUTHORITIES**

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

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**Federal Cases**

*Acequia, Inc. v. Clinton (In re Acequia, Inc.)*,  
787 F.2d 1352 (9th Cir. 1986).....19

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175 B.R. 646 (Bankr. E.D. Mich. 1994) .....20

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89 F.3d 942 (2d Cir. 1996).....18

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943 F. Supp. 2d 1062 (E.D. Cal. 2013).....2

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297 U.S. 288 (1936).....16

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No. C09-03628, 2009 WL 3809816 (N.D. Cal. Nov. 10, 2009).....2

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131 S.Ct. 2020 (2011) .....16

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2006 WL 7074335 (Bankr. D. Ore. March 14, 2006), *aff’d*, 360 B.R. 702 (D. Ore. 2007) .....18

*In re City of Detroit, Mich.*,  
504 B.R. 97 (Bankr. E.D. Mich. 2013) .....15, 16

*In re City of Stockton*,  
493 B.R. 772 (Bankr. E.D. Calif. 2013).....18

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543 U.S. 371 (2005).....16

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225 B.R. 719 (Bankr. N.D. Cal. 1998).....17

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298 B.R. 670 (Bankr. C.D. Cal. 2003).....17

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133 B.R. 221 (Bankr. N.D. Calif. 1991) .....20

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508 U.S. 439 (1993).....15

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28

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555 U.S. 353 (2009) .....16

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4 52 Cal. App. 4th 1109 (1997) .....4, 5, 6

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*Grand Jury*,

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95 Cal. App. 4th 29 (2002) .....2, 3, 5

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64 Cal. App. 3d 764 (1976).....5

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18 25 Cal.3d 600 (1979) .....2

19 **Federal Statutes**

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25 11 U.S.C. § 1123(b)(6).....14, 15

26 11 U.S.C. § 1129(a) .....17

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28

1 28 U.S.C. § 158(d)(2)(A) .....16

2 I.R.C. § 503 .....12, 13

3 I.R.C. § 503(a)(1)(B).....12

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5 I.R.C. § 503(b)(4).....13

6 I.R.C. § 503(b)(5).....13

7 Federal Insurance Contributions Act ("FICA") .....13

8 Federal Unemployment Tax Act ("FUTA") .....13

9 **State Statutes**

10 Cal. Gov. Code § 20001 .....2

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12 Cal. Gov. Code § 20021 .....3

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17 Cal. Gov. Code §§ 20460 to 20593.....5

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19 Cal. Gov. Code § 20506.....5

20 Cal. Gov. Code § 20532.....5

21 Cal Gov. Code § 20570.....6, 9

22 Cal. Gov. Code § 20571 .....9

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24 Cal. Gov. Code § 20574.....10, 11

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26 Cal. Gov. Code § 20577 .....9, 11

27

28

1 Cal. Gov. Code § 20577.5.....10, 11, 12

2 Cal. Gov. Code § 20578.....11

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5 Cal. Gov. Code § 20831.....5

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7 State Employees’ Retirement Act.....6

8 **Constitutional Provisions**

9 Tenth Amendment.....16, 17

10 Eleventh Amendment.....2

11 Cal. Const., Article XVI, § 17.....3

12 Cal. Const., Article XVI, § 17 subdiv. (b) .....3

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15 Federal Constitution.....16

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<http://www.calpers.ca.gov/eip-docs/about/pubs/vested-rights-members.pdf> .....1

1 The California Public Employees' Retirement System ("CalPERS" or the "System") files this  
 2 Response to Franklin's Objection to Confirmation of the City's First Amended Plan of Adjustment  
 3 [Dkt. 1273] ("Franklin Objection").<sup>1</sup>

4 Franklin argues, among other things, that Franklin would be better off if the City would  
 5 somehow "confront" its obligations to CalPERS, and that the City did not act in good faith when it  
 6 decided to continue its relationship with CalPERS. Franklin's arguments and assertions about  
 7 CalPERS reflect a fundamental misunderstanding about the relationship between CalPERS and the  
 8 City and the significant benefits the City derives from that relationship.

## 9 **I. BACKGROUND**

### 10 **A. What Is CalPERS?**<sup>2</sup>

11 The California Legislature established CalPERS in 1932, in the midst of the Great  
 12 Depression, to provide retirement benefits to California State employees. Beginning in 1939, public  
 13 "agencies" (including municipalities like Stockton) were allowed to elect to participate in CalPERS.  
 14 *See Vested Rights of CalPERS Members* (July 2011) at 2 ("CalPERS Profile"),  
 15 <http://www.calpers.ca.gov/eip-docs/about/pubs/vested-rights-members.pdf>. CalPERS administers the  
 16 State's pension plan and healthcare services for almost 1.7 million California public employees,  
 17 retirees, and their families. *See CalPERS Office of Public Affairs, Facts at a Glance* (March 2014),  
 18 <https://www.calpers.ca.gov/eip-docs/about/facts/facts-at-a-glance.pdf>. A "state employee generally  
 19 becomes a member of the Public Employees' Retirement System . . . 'upon his or her entry into  
 20 employment.'" *Cal. Ass'n of Prof'l Scientists v. Schwarzenegger*, 137 Cal. App. 4th 371, 376 (2006)  
 21 (quoting Cal. Gov. Code §§ 20058, 20281). Local government employers may participate in the  
 22 CalPERS system to provide pension and retirement benefits to their employees. Cal. Gov. Code  
 23 § 20460.

---

24  
 25 <sup>1</sup>"Franklin" refers collectively to Franklin High Yield Tax-Free Income Fund and Franklin California  
 26 High Yield Municipal Fund.

27 <sup>2</sup> The Court has inquired on multiple occasions as to the nature of the relationship between CalPERS  
 28 and the City. CalPERS provides a summary of information regarding that relationship here and will  
 offer testimony on these facts at the confirmation trial.



1 CalPERS is an arm of the State of California, the operations of which are governed not by  
2 corporate organizational documents, but by the California Constitution and the California  
3 Government Code. CalPERS is an integral part of the State, and an agency through which the State  
4 acts. *See* Cal. Gov. Code § 20002 (stating CalPERS “is a unit of the Government Operations  
5 Agency”); *see also* *Arya v. CalPERS*, 943 F. Supp. 2d 1062, 1072 (E.D. Cal. 2013) (“[A] number of  
6 California district courts have concluded that CalPERS is in fact an arm of the state” and therefore  
7 “benefits from sovereign immunity under the Eleventh Amendment”) (citing *Barroga v. Bd. of*  
8 *Admin. CalPERS*, No. 2:12-cv-01179, 2012 WL 5337326, at \*5 (E.D. Cal. Oct. 26, 2012); *CalPERS*  
9 *v. Moody’s Corp.*, No. C09-03628, 2009 WL 3809816, at \*6 (N.D. Cal. Nov. 10, 2009)).<sup>3</sup>

10 The Public Employees’ Retirement Law, California Government Code § 20000, *et seq.*  
11 (“PERL”), establishes the retirement system for certain State and local government employees. *City*  
12 *of Oakland v. Pub. Emps. Ret. Sys.*, 95 Cal. App. 4th 29, 33 (2002). The PERL “effect[s] economy  
13 and efficiency in the public service” by creating a pension plan to pay retirement compensation and  
14 death benefits. Cal. Gov. Code § 20001; *see also* *Wheeler v. Bd. of Admin. of PERS*, 25 Cal.3d 600,  
15 605 (1979) (“Pension programs for public employees serve two objectives: to induce persons to enter  
16 into and continue in public service, and to provide subsistence for disabled or retired employees and  
17 their dependents.” (internal quotation marks omitted)).

18 For public employees serving municipalities in California, the legislature created a three-party  
19 structure for CalPERS to provide retirement benefits. First, each municipality elects a “contract”  
20 with CalPERS that triggers the applicability of statutes and other laws and regulations governing the  
21 provision of pension benefits through CalPERS. Second, each public servant has an employment  
22 contract with the municipality that includes pension benefits. Finally, CalPERS has a constitutionally  
23 defined responsibility to provide pension benefits to its members and retirees and to protect these  
24 benefits.

25  
26 <sup>3</sup> The California Attorney General recently affirmed its view that CalPERS is an “arm of the state.”  
27 *See* Decl. of Michael B. Lubic [Dkt. 712] (“Lubic Decl.”), Ex. 2 (relevant portions of State of  
28 California’s Complaint against Standard & Poor’s, filed Feb. 5, 2013) ¶ 37 (“PERS and STRS are  
arms of the State of California, operating under the California Constitution and the California  
Government Code.”).

1 The CalPERS Board is governed by the California Constitution and statutes, such as Cal.  
2 Const., art. XVI, § 17 subdiv. (b), which mandates that the CalPERS Board<sup>4</sup> ensure the rights of  
3 CalPERS members and retirees to their full earned benefits. *City of Oakland*, 95 Cal. App. 4th at 39-  
4 40. In 1992, California voters approved Proposition 162, which gave the CalPERS Board exclusive  
5 authority over the administration and investment of pension funds.<sup>5</sup> In enacting Proposition 162, the  
6 electorate amended article XVI, section 17 of the California Constitution, to read in part as follows:

7 Notwithstanding any other provisions of law or this Constitution to the  
8 contrary, the retirement board of a public pension or retirement system shall  
9 have **plenary authority and fiduciary responsibility** for investment of  
10 moneys and administration of the system, subject to . . . the following: [¶] . . .  
The retirement board shall . . . have sole and exclusive responsibility to  
administer the system in a manner that will assure prompt delivery of benefits  
and related services to the participants and their beneficiaries.

11 *Bd. of Ret. of the Santa Barbara County Emps. Ret. Sys. v. Santa Barbara County Grand Jury*, 58  
12 Cal. App. 4th 1185, 1192 (1997) (omissions in original) (internal quotation marks omitted).

13 Proposition 162 amended the California Constitution to provide that the CalPERS Board has “the  
14 sole and exclusive power to provide for actuarial services in order to assure the competency of the  
15 assets” of the system. Cal. Const., art. XVI, § 17, subdiv. (e). The intent behind the measure was to  
16 protect public pension funds by vesting the authority to direct actuarial determinations solely with the  
17 CalPERS Board. *See* Lubic Decl., Ex. 4 at 36 (relevant portions of official ballot pamphlet (Nov. 3,  
18 1992)). By granting the CalPERS Board sole authority to administer the system, Proposition 162  
19 prevented the legislative and executive branches from “raiding” pension funds to balance the State  
20 budget. *Id.* at 38.

21  
22  
23  
24  
25  
26 <sup>4</sup> CalPERS Board refers to the Board of Administration of the Public Employer’s Retirement  
System. Cal. Gov. Code § 20021.

27 <sup>5</sup> The ballot pamphlet accompanying Proposition 162 explained that pension system boards should  
28 give “highest priority” to providing benefits to members and their beneficiaries. *City of Oakland*, 95  
Cal. App. 4th at 54 (internal quotation marks omitted).

1           **B.     The California Government Code Requires the Preservation of the Integrity of**  
2           **the State’s Public Employees’ Retirement System.**

3                   1.     *A Sound Public Pension System Benefits the State and its Citizens.*

4           In the late 1920s, the State of California created the Commission on Pensions of State  
5           Employees to investigate the establishment and structure of a statewide public retirement system. *See*  
6           Chapter 431 of the Statutes of 1927. The Commission engaged in a comprehensive process which  
7           included open meetings, study of other public retirement systems, analysis of existing State employee  
8           data and questionnaires to develop a proposed framework. Lubic Decl., Ex. 5 at 5-7 (relevant  
9           portions of Report of the Commission on Pension of State Employees (December 31, 1928)). The  
10          Commission Report described the State’s public retirement system as a means to secure the  
11          improvement of its working personnel. The Commission Report emphasized that, with the increasing  
12          complexity of governmental and regulatory functions, a sound retirement system helps recruit top-  
13          level talent for its workforce. *Id.* at 9. For the retirement system to be an effective tool, the  
14          Commission stressed the need for the system to have a “sound financial basis.” *Id.* This principle  
15          remains true. California and its citizens benefit when the State and its local municipalities are able to  
16          offer an overall competitive compensation and benefits package. But this holds true only if the  
17          retirement system is able to fund the promised benefits.

18          The safety, discipline, and rigor imposed on the public pension system by the PERL and  
19          CalPERS are a vital assurance that pensions will be honored. For the overwhelming majority of  
20          California’s participating cities and other agencies, the CalPERS System has proven to be a sound  
21          and fiscally manageable way of assuring employees that benefits will be paid when and as promised,  
22          thus providing long-term financial security for public employees.

23                   2.     *An Actuarially Sound Pension System is Essential for the Payment of Pension*  
24                   *Benefits.*

25          The funding of California pension plans must be safeguarded. California law guarantees  
26          adequate funding for full payment to participants and beneficiaries. *Bd. of Admin of PERS. v. Wilson*,  
27          52 Cal. App. 4th 1109, 1131–32 (1997); *see also Valdes v. Cory*, 139 Cal. App. 3d 773, 785-86  
28          (1983). The right to an actuarially sound system is “necessarily implied” from a public employer’s

1 commitment to provide a pension benefit, because otherwise the converse would impair the pension  
2 right. *Wilson*, 52 Cal. App. 4th at 1133.

### 3 C. Stockton's Relationship with CalPERS.

4 Under the PERL, a municipality elects to participate in the CalPERS system by entering into a  
5 contract with CalPERS in compliance with Chapter 5 of the PERL, Cal. Gov. Code §§ 20460 to  
6 20593. Cal. Gov. Code § 20460. The PERL specifies in detail the provisions of the contract, the  
7 procedure by which a public agency may elect to participate, and many other terms. However, this  
8 "contract" is not of the same character as a commercial contract; rather, it is an election to participate  
9 in a statutory system of deferred compensation. *See Jasper v. Davis*, 164 Cal. App. 2d 671, 675  
10 (1958). Once a city makes this statutory election, it is bound and controlled by the statutory  
11 provisions governing the system and the decisions of the CalPERS Board. Cal. Gov. Code § 20506  
12 ("Any contract heretofore entered into shall subject the contracting agency and its employees to all  
13 provisions of this part and all amendments thereto . . ."); *see also City of Oakland v. PERS*, 95 Cal.  
14 App. 4th 29, 55 (2002) ("[B]y entering into a contract with the PERS system, and extending that  
15 contract to include safety members, the City bound itself to follow the applicable statutory definitions  
16 governing firefighters, and bound itself to abide by the lawful decisions of the PERS Board, including  
17 decisions to correct mistakes in classification of members."<sup>6</sup> The governing statutes require the  
18 municipality to timely pay all required employer contributions. Cal. Gov. Code §§ 20532, 20831.  
19 The PERL also prohibits the contracting agency from rejecting any contract pursuant to Section 365  
20 of the Code. *Id.* § 20487.<sup>7</sup> The statutory pension provisions are a fundamental part of the

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21  
22 <sup>6</sup> *See also City of Los Altos v. Bd. of Admin., PERS*, 80 Cal. App. 3d 1049, 1052 (1978) ("The state  
23 statute dealing with PERS and the board of administration's interpretation and enforcement of those  
24 statutes preempt any municipal provisions."); *Marsille v. City of Santa Ana*, 64 Cal. App. 3d 764, 771  
25 (1976) ("The Legislature has enacted statutes dealing with retirement of public employees. State  
26 statutes dealing with PERS matters preempt municipal provisions . . .") (citation omitted) (citing  
27 former version of § 20506).

28 <sup>7</sup> The legislative history of Cal. Gov. Code § 20487 makes clear that the California legislature  
intended the restrictions on assumption and assignment of the CalPERS rights and obligations to be  
modifications of the basis upon which the State has consented to allow municipalities to file for  
bankruptcy protection. *See* pertinent pages of Legislative History of Cal. Gov. Code § 20487  
attached as "Exhibit A" (Documents from deliberations by the California Senate and Assembly  
discuss the summary of the legislation as, "Would prohibit the debtor's trustee of a PERS contracting  
agency that has filed for Chapter 9 bankruptcy from making an election to end -- by rejection,

1 employment relationship, and should be read to require adequate funds to meet reasonable  
 2 expectations of the employees. *Valdes*, 139 Cal. App. 3d at 786. Participating cities cannot alter  
 3 their funding obligation to CalPERS. *Wilson*, 52 Cal. App. 4th at 1122.<sup>8</sup>

4 For this reason, the City's obligations to CalPERS are not limited to those found in the  
 5 language of the document labeled a "contract"; rather, the City's obligations are defined primarily by  
 6 applicable State law and regulations.

7 In September 1944, the City of Stockton, through its City Council, elected to participate in the  
 8 California State Retirement System, subject to the provisions of the State Employees' Retirement  
 9 Act. *See, e.g.*, Exs. 232, 233 & 234 (Stockton/CalPERS Original Contract & Certain Amendments).<sup>9</sup>  
 10 The City's retirement plan has two subplans with different benefit formulas—safety employees and  
 11 miscellaneous employees. *See* CalPERS Actuarial Office, *Safety Plan of the City of Stockton Annual*  
 12 *Valuation Report as of June 30, 2012*, (October 2013), [http://www.calpers.ca.gov/eip-](http://www.calpers.ca.gov/eip-docs/about/pubs/public-agency-reports/cities-towns/2012/stockton-city-safety-2012.pdf)  
 13 [docs/about/pubs/public-agency-reports/cities-towns/2012/stockton-city-safety-2012.pdf](http://www.calpers.ca.gov/eip-docs/about/pubs/public-agency-reports/cities-towns/2012/stockton-city-safety-2012.pdf) ("Safety  
 14 Valuation Report"); CalPERS Actuarial Office, *Miscellaneous Plan of the City of Stockton Annual*  
 15 *Valuation Report as of June 30, 2012*, at 28 (October 2013), [http://www.calpers.ca.gov/eip-](http://www.calpers.ca.gov/eip-docs/about/pubs/public-agency-reports/cities-towns/2012/stockton-city-miscellaneous-2012.pdf)  
 16 [docs/about/pubs/public-agency-reports/cities-towns/2012/stockton-city-miscellaneous-2012.pdf](http://www.calpers.ca.gov/eip-docs/about/pubs/public-agency-reports/cities-towns/2012/stockton-city-miscellaneous-2012.pdf)  
 17 ("Miscellaneous Valuation Report"). Most City employees who are not safety employees are part of  
 18 the miscellaneous subplan.

19 **D. Explanation of the Nature of Certain Calculated Liabilities.**

20 The City's financial obligations to CalPERS are calculated pursuant to the PERL. CalPERS  
 21 determines the City's contribution obligations on an actuarial basis, taking into account expected

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22  
 23 assignment, or assumption -- its contract with PERS," and analysis of the legislation is that it would  
 24 "add language to the PERS law specifically prohibiting the debtor's trustee of a PERS local  
 25 contracting agency that has filed for Chapter 9 Bankruptcy from making an election to end -- by  
 26 rejection, assignment, or assumption, its contract with PERS.").

27 <sup>8</sup> As discussed more fully below, a participating agency may elect to terminate its participation in the  
 28 retirement system prospectively, but such termination does not affect contribution obligations for  
 benefits accrued prior to termination. *See* Cal Gov. Code § 20570.

<sup>9</sup> CalPERS will submit as exhibits and offer into evidence the Original Contract and all currently  
 applicable amendments.

1 investment returns, inflation, employee life expectancy, projected retirement date, and projected  
 2 compensation. All actuarial calculations are necessarily based on a number of assumptions about the  
 3 future. Demographic assumptions include the percentage of employees that will terminate, die,  
 4 become disabled, and retire in each future year. Economic assumptions include future salary  
 5 increases for each active employee and future investment returns. *See* Decl. of David Lamoureux  
 6 [Dkt. 713] (“Lamoureux Decl.”), ¶ 5. The basic premise of a defined benefit pension plan is that the  
 7 payments are determined based on actuarial assumptions and calculations, and the risk is pooled  
 8 among the participants in the plan. For a homogeneous population, predictions for larger groups are  
 9 more accurate than for smaller groups. Accordingly, as a pool is made larger and larger, the volatility  
 10 of the cost per member decreases because the risk is pooled among a larger group. *Id.* at ¶ 6.

11 The “**Employee Contribution**,” which is also known as a “Member Contribution,” is an  
 12 amount set by a California statute and is the percentage of compensation an individual employee  
 13 must contribute through each paycheck to participate in the CalPERS system. Cal. Gov. Code §§  
 14 20671-20776; Lamoureux Dep. 39:16-25 & 40:1.<sup>10</sup> The “**Employer Contribution Rate**” is an amount  
 15 that is set by the CalPERS actuarial staff on an annual basis. Cal. Gov. Code §§ 20790-20842. The  
 16 PERL mandates that CalPERS annually calculate each Employer’s Contribution Rate based on a  
 17 percentage of payroll. Lamoureux Decl., ¶ 8.

18 The most recent Annual Valuation Reports prepared by CalPERS’ actuaries for the City of  
 19 Stockton were issued in October 2013, and provide valuations as of June 30, 2012. These reports:

- 20 (1) Set forth the actuarial assets (including actuarial and market valuations) and accrued  
 21 liabilities (including the unfunded actuarial liability) of each plan as of June 30, 2012;
- 22 (2) Determine the required Employer Contribution Rate for each plan for the fiscal year  
 23 July 1, 2014 – June 30, 2015;
- 24 (3) Provide actuarial information as of June 30, 2012, to the CalPERS Board of  
 25 Administration and other interested parties; and
- 26 (4) Provide pension information as of June 30, 2012, to be used in financial reports  
 27 subject to Governmental Accounting Standards Board Statement 27 for a single  
 28 employer defined benefit pension plan.

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<sup>10</sup> Cited portions of the deposition of David Lamoureux are attached as Exhibit 6 to the Lubic Decl.



1 See Miscellaneous Valuation Report & Safety Valuation Report; *see also* Lamoureux Decl., ¶ 9.<sup>11</sup>

2 For any given year, Employer Contribution Rates are calculated by adding together two  
 3 different elements. The first element is the “Normal Cost,” which means “the cost of providing one  
 4 year of benefits to the current employees.” Lamoureux Dep. 44:3-5. In other words, it is the plan’s  
 5 annual premium for service earned in the upcoming year in the absence of any unfunded or  
 6 overfunded liability to be amortized. It is expressed as a percentage of payroll. Lamoureux Decl.,  
 7 ¶ 11. The second element is the payment toward any “Unfunded Liability,” which (on an actuarial  
 8 value basis) is obtained by comparing the actuarial value of the assets of the plan to the actuarial  
 9 accrued liability of the plan. *Id.* Unfunded Liability is expressed as a lump sum dollar amount. *Id.*  
 10 Because each employee member is guaranteed a certain level of benefits, the Employer Contribution  
 11 Rate can vary from year to year based on the various actuarial factors discussed above. Lamoureux  
 12 Dep. 40:2-7 & 41:12-16. Notably, Employer Contribution Rates, because they are determined as a  
 13 percentage of payroll, also depend upon the amount of the City’s payroll such that if an employer  
 14 reduces its total payroll, its rates will increase even though the total amount contributed may decline.

15 The Unfunded Liability calculations described in the Annual Valuation Reports are not  
 16 amounts currently owed by any employer. The Unfunded Liability is merely one component of the  
 17 actuarial calculation used to determine the Employer Contribution Rate for the upcoming fiscal year.  
 18 Lamoureux Decl., ¶ 12.<sup>12</sup> The total annual contribution is borne by both the employer and the  
 19 employees, and the future benefits for current employees will be assured only if all contributions of  
 20 both employer and employees are made timely and in full. *Id.* at ¶¶ 13-14.

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 22  
 23 <sup>11</sup> The Lamoureux Decl. discusses the valuation reports as of June 30, 2011, however, the procedure  
 24 and types of information provided in the previous valuation reports discussed in his declaration and  
 25 the most recent valuation reports are similar. The June 30, 2012 Valuation Reports are available at  
<http://www.calpers.ca.gov/eip-docs/about/pubs/public-agency-reports/cities-towns/2012/stockton-city-safety-2012.pdf> and  
<http://www.calpers.ca.gov/eip-docs/about/pubs/public-agency-reports/cities-towns/2012/stockton-city-miscellaneous-2012.pdf>.

26 <sup>12</sup> According to the most recent Annual Valuation Reports, the City must pay CalPERS  
 27 approximately \$29.8 million (\$19.3 million for safety and \$10.5 million for miscellaneous) during the  
 28 2013-2014 fiscal year in order to remain current on its payments to CalPERS. *See* Miscellaneous  
 Valuation Report & Safety Valuation Report (“Required Employer Contribution” line item).

1 Finally, in the event of termination (discussed below), a terminated agency is required to  
 2 make a payment to CalPERS in an amount determined by the CalPERS Board (based on actuarial  
 3 calculations) to be sufficient to ensure payment of all vested pension rights of the terminated  
 4 agency's employees accrued through the termination date. This is referred to as the "Termination  
 5 Payment." *Id.*, ¶ 15. The PERL indicates that the Termination Payment is due immediately and is  
 6 subject to interest, as discussed more fully below. Cal. Gov. Code § 20577; Lamoureux Dep. 191:17-  
 7 23.

8 **E. The Termination Process and the Consequences of Termination.**

9 *1. Termination and the Termination Process.*

10 As set forth in the PERL, some circumstances allow for the termination of the relationship, or  
 11 a portion thereof, between a contracting agency<sup>13</sup> and CalPERS. For instance, contracts which have  
 12 been in effect for at least five years can be terminated through approval of an ordinance or resolution  
 13 of the contracting agency's governing body, or through an ordinance adopted by the electorate, with  
 14 one year's notice to CalPERS. Cal. Gov. Code §§ 20570 & 20571. Also, if a contracting agency  
 15 fails to pay its required periodic contributions within 30 days after demand by the CalPERS Board, or  
 16 fails to file any information required in the administration of the system, or if the CalPERS Board  
 17 determines the contracting agency no longer exists, the CalPERS Board may terminate the contract  
 18 by resolution. *Id.* § 20572. A public agency may not enter into a new contract with CalPERS within  
 19 three years of termination. *Id.* § 20460.

20 In the event of termination, the PERL requires the terminated agency to make a payment to  
 21 CalPERS in an amount determined by the CalPERS Board (based on actuarial calculations) to be  
 22 sufficient to ensure payment of all pension benefits of the terminated agency's employees accrued  
 23 through the termination date. *Id.* § 20577. The Termination Payment is due immediately and subject  
 24 to interest. *Id.* ("The amount of difference shall be subject to interest at the actuarial rate from the  
 25 date of contract termination to the date the agency pays this system."). The Termination Payment  
 26

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27 <sup>13</sup> "Contracting agency" means, among other entities, any public agency that has elected to have all  
 28 or any part of its employees become members of this system and that has contracted with the board  
 for that purpose. *See* Cal. Gov. Code § 20022.



1 goes into the “Terminated Agency Pool.” *Id.* § 20577.5. Once the Termination Payment is made,  
2 CalPERS has no further recourse to a terminating employer.

3         When determining the Termination Payment, CalPERS is subject to actuarial risks including  
4 longevity risk, investment risk, inflation, and wage-growth risk associated with the future payment of  
5 the terminated agency’s benefits. Lubic Decl., Ex. 13 (Dec. 2012 Agenda Item). Unlike in an  
6 ongoing plan, these risks cannot be addressed by adjusting contribution rates in future years. Because  
7 there is no mechanism for receiving additional payments should the actuarial assumptions not be met,  
8 the investments in the Terminated Agency Pool, and the assumptions to determine the Termination  
9 Payment, must be more conservative. Lamoureux Dep. 113:3-24. To address the longevity risk, the  
10 Termination Payment calculation includes an increase to the liabilities to address mortality  
11 fluctuations. *See* Cal. Gov. Code § 20576. To address investment risk, inflation, and wage-growth  
12 risk, the CalPERS Board has adopted a policy to determine the discount rate, inflation assumption,  
13 and wage growth assumption for termination calculations. *See* Lubic Decl., Ex. 11 (CalPERS  
14 Circular Letter No. 200-058-11 (August 19, 2011)); Lubic Decl., Ex. 12 (August 2011 Agenda Item).  
15 In addition, the CalPERS Board recently adopted a conservative asset allocation for the Terminated  
16 Agency Pool, providing that assets will be invested in treasury bonds. *See id.*, Ex. 13 (Dec. 2012  
17 Agenda Item); Lamoureux Dep. 90:16-92:5, 110:6-25, 111:1-25 & 113:3-24.

18         A primary driver in determining the amount of the Termination Payment is the setting of the  
19 discount rate, which is “a reflection of the asset policy or how the assets are invested.” *Id.* at 190:15-  
20 17. Given the conservative nature of the investments in the Terminated Agency Pool, the discount  
21 rate related to a Termination Payment is low when compared with the actuarial rate for the portfolio  
22 for ongoing participating agencies. *Id.* at 190:15-25 & 191 1-15. The cumulative effect of these  
23 policies is that a terminated agency’s actuarial liability upon termination is larger than the actuarial  
24 liability on an ongoing basis.<sup>14</sup>

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26  
27 <sup>14</sup> Furthermore, a terminating agency owes CalPERS the costs of collection, including attorneys’ fees.  
28 Cal. Gov. Code § 20574.

1 Stockton's Annual Valuation Reports each provide a line item for "unfunded termination  
2 liability," which is an estimate of how much Stockton would owe to CalPERS if its contracts had  
3 been terminated as of *June 30, 2012*. The Miscellaneous Plan lists this liability at \$575,931,065 and  
4 the Safety Plan lists this liability at \$1,042,390,452, for a total of more than \$1.6 billion. *See*  
5 Miscellaneous Valuation Report at 28 & Safety Valuation Report at 28. If a terminated agency fails  
6 to pay the Termination Payment, benefits to employees must be reduced pro rata based on the amount  
7 of the Termination Payment that is not funded.<sup>15</sup> Cal. Gov. Code § 20577. CalPERS may reduce the  
8 benefits payable under the terminated contract only once. *Id.* After the terminated agency's assets  
9 and liabilities have been merged into the Terminated Agency Pool account, the PERL permits no  
10 further benefit adjustments. *Id.* § 20578.

11 2. *Termination Lien.*

12 When a plan is terminated, the PERL imposes a lien in favor of CalPERS "on the assets of a  
13 terminated contracting agency, subject only to a prior lien for wages." Cal. Gov. Code § 20574.  
14 Legislative history confirms that this section immediately provides CalPERS with the rights of a  
15 senior secured creditor as a matter of law. The legislature expressly intended to "grant PERS a lien  
16 against the assets of public agencies who have terminated their membership in the system, usually as  
17 a result of agency dissolution and bankruptcy who have unfunded liabilities owed to PERS for vested  
18 employee benefits and have no ability to pay such liabilities." *See* Lubic Decl., Ex. 7 at 35 (relevant  
19 portions of Legislative History of California Government Code § 20574).

20 3. *Termination Is Not a Viable Option for Stockton.*

21 If Stockton chose to terminate its relationship with CalPERS, the City would be faced with an  
22 immediately due and owing massive termination liability secured by a senior lien on all its assets.

23 Moreover, in a termination, CalPERS would continue benefits without reduction only if the  
24 Board were to find that benefit continuation will not impact the actuarial soundness of the Terminated  
25

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26 <sup>15</sup> CalPERS may choose to make no reduction or a lesser reduction if the CalPERS Board has made  
27 reasonable efforts to the collect the payment and the CalPERS Board determines that failure to make  
28 a reduction will not impact the actuarial soundness of the Terminated Agency Pool account. Cal.  
Gov. Code § 20577.5.

1 Agency Pool. Cal. Gov. Code § 20577.5. As a result, if Stockton could not fund its shortfall  
2 following a hypothetical termination, CalPERS would be required to reduce benefits before merging  
3 Stockton's assets into the Terminated Agency Pool.

4 Further, if the City chooses to terminate its relationship with CalPERS, the City could not  
5 enter into a new relationship with CalPERS for at least three years from the date of termination. *Id.*  
6 § 20460. Although the City's existing employees that had benefits accrued as of the termination date  
7 in CalPERS would retain their benefits (albeit likely reduced dramatically), they would earn no  
8 additional benefits, and new employees would have no retirement system in which to participate.  
9 Such a situation would impact Stockton's ability to retain and hire new employees and further impair  
10 its ability to provide essential services to its residents.

11 4. *Potential Jeopardy to Tax Exempt Status.*

12 In addition to these State law constraints, any unilateral reduction of pension benefits may  
13 ultimately impact the federal tax treatment of CalPERS' members' benefits. A tax-qualified pension  
14 plan must comply with its terms to maintain tax-qualified status. If a tax-qualified plan's operation  
15 does not comply with its terms, the plan has an operational failure that could jeopardize the plan's  
16 tax-qualified status. *See* Lubic Decl., Ex. 9 (Internal Revenue Procedure 2008-50, Section 5.01(2)(b),  
17 2008-35 I.R.B. 464). In the case of CalPERS, the PERL and the relevant parts of the California Code  
18 of Regulations serve as the official plan document for federal tax purposes. Thus, CalPERS and its  
19 Board cannot take any action under the plan that is not authorized by the PERL without jeopardizing  
20 the tax-qualified status of the plan.

21 A tax-qualified plan may not violate prohibited transaction rules. Governmental plans that are  
22 tax-qualified are subject to the prohibited transaction rules of Section 503 of the Internal Revenue  
23 Code of 1986, as amended (the "IRC") and, if violated, the plan may lose its tax-qualified status.  
24 I.R.C. § 503(a)(1)(B). This section of the IRC generally requires arm's-length dealings between the  
25 creator of the trust and the trustee. *See* Lubic Decl., Ex. 10 (General Counsel Memorandum 38972  
26 (Mar. 25, 1983) (citing S. Rep. No. 2375, 81st Cong., 2d Sess. 36-37, 1950-2 C.B. 483, 509-511)).  
27 The prohibited transactions include: (1) the lending of any part of the trust income or corpus without  
28 the receipt of adequate security and a reasonable rate of interest to the creator or contributor, (2) the

1 substantial purchase of securities or other property for more than adequate consideration from the  
2 creator or contributor, and (3) the sale of a substantial part of its securities or property for less than  
3 adequate consideration to the creator or contributor. I.R.C. § 503(b)(1), (4) and (5).

4 Any restructuring of CalPERS' members' benefits could potentially violate the prohibited  
5 transaction rules of IRC Section 503 if the restructuring applies to contributions already owed. The  
6 IRS has issued guidance regarding a City's delay in making immediate cash contributions for which  
7 it was currently liable and held that "a loan may be implied and . . . transactions must be viewed  
8 according to their real nature rather than mere form." *See* Lubic Decl., Ex. 10 (General Counsel  
9 Memorandum 38972 (Mar. 25, 1983) (citing *Fuqua Nat'l, Inc. v. United States*, 334 F. Supp. 1116  
10 (S.D. Ga. 1971)). Loss of tax-qualified status would mean that *all* members and retirees under the  
11 CalPERS system, not just Stockton members, would have immediate tax liability.<sup>16</sup> The IRS treats a  
12 plan as disqualified for all plan years after an error has occurred until the error is corrected. Under  
13 this approach, a disqualification error that occurred prior to the open tax years (*i.e.*, occurred in years  
14 for which the statute of limitations has run) can cause the plan to be treated as disqualified in the open  
15 years if the IRS identifies the error. If a plan is disqualified for some or all open tax years, the  
16 employer, the plan participants, and the plan trust may suffer significant negative consequences.

17 In essence, any restructuring of CalPERS' members' benefits has the potential to cause great  
18 financial harm to the both the City and its employees and retirees, as well as the State of California  
19 itself, because it may jeopardize the tax-exempt status of CalPERS.

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20  
21 <sup>16</sup> First, to the extent taxes were owed, the sponsoring employer may risk liability for failure to  
22 withhold and remit income, FICA, and FUTA taxes on vested contributions and earnings owned by  
23 the employees. Second, if a plan loses its qualified status, the plan trust might be required to pay  
24 taxes and penalties on the investment earnings earned during the disqualified years. Finally, to the  
25 extent that employees are vested or became vested in contributions made in (or with respect to) the  
26 disqualified years, they may owe income and FICA taxes on such contributions and associated  
27 investment earnings. In addition, plan participants may also owe penalties for failure to pay taxes on  
28 their income in a timely manner. Former employees who received distributions from the plan during  
the disqualified period must pay taxes on the entire amount of the distribution, even if they rolled the  
distribution over to another plan or IRA.

## II. ARGUMENT

### A. **Franklin’s “Best Interests” Objection Misapprehends the Ability to Reduce the City’s Obligations to CalPERS and the Consequences of Terminating the City’s CalPERS Pension Plan.**

In the course of its argument that the City’s plan is not in the best interests of creditors, Franklin contends that the City should “confront” its “pension problem,” and claims that Franklin could recover “substantially more” outside bankruptcy. Franklin Objection at 23-30. On both points, Franklin’s objection is uninformed.

Franklin does not explain how the City might “confront” its “pension problem” and “pension obligations.” In particular, Franklin does not provide any alternative for the City’s provision of pension benefits to its employees. Neither CalPERS nor the City has authority to reduce pension benefits, other than as a consequence of termination. Terminating the City’s CalPERS Pension Plan would trigger an immediate obligation of the City to CalPERS of more than \$1.6 billion. This obligation would be secured by a senior lien on all of the City’s property, including the funds that Franklin speculates might be available to pay Franklin. Franklin Objection at 20 & 26. Any argument about “best interests” predicated on an illegal modification or hypothetical termination of the CalPERS Pension Plan must take those realities into account. Neither Franklin, nor other creditors nor the City itself would be better off under those circumstances and, accordingly, Franklin’s best interests arguments fail.

### B. **Franklin’s “Good Faith” Objection to the City’s Decision to Continue its Relationship with CalPERS Is Legally and Factually Unsound.**

As part of its “good faith” argument, Franklin asserts that what Franklin characterizes as the City’s “wholesale assumption of its single largest liability - unfunded pensions” is evidence that the Plan lacks the good faith necessary for confirmation. Franklin Objection at 54. This proposition is legally and factually unsound.

#### 1. *The City Has the Authority under 11 U.S.C. § 1123(b)(6) to Continue its Relationship with CalPERS.*

Franklin fails to cite the applicable standard for assessing compliance with the “good faith” requirement of 11 U.S.C. § 1129(a)(3). “A plan is proposed in good faith where it achieves a result

1 consistent with the objectives and purposes of the Code.” *Platinum Capital, Inc. v. Sylmar Plaza,*  
2 *L.P. (In re Sylmar Plaza, L.P.),* 314 F.3d 1070, 1074 (9th Cir. 2002).

3 Section 1123(b)(6) of the Code (which applies in chapter 9, *see* 11 U.S.C. § 901(a)), provides  
4 that a plan may “include any other appropriate provision not inconsistent with the applicable  
5 provisions of this title.” Section 1123(b)(6) defines the “outer boundary” of the broad “flexibility”  
6 afforded to a plan proponent. *In re Associated Vintage Grp., Inc.,* 283 B.R. 549, 560 (9th Cir. BAP  
7 2002).

8 The Plan provision ratifying the CalPERS relationship is appropriate under section  
9 1123(b)(6). Nothing about the City’s decision is “inconsistent with the applicable provisions” of  
10 Title 11. The City’s decision to continue its relationship with CalPERS is consistent with applicable  
11 state law and does not violate any nonbankruptcy federal law or policy.

12 2. *Good Faith under 11 U.S.C. § 1129(a)(3) Does Not Require the City to Pursue*  
13 *Franklin’s Suggestion that the City Attempt to “Adjust” its Obligations to*  
*CalPERS.*

14 Franklin contends that the City might have attempted to “adjust” the City’s obligations to  
15 CalPERS, citing a decision applying Michigan law. Franklin Objection at 55 (citing *In re City of*  
16 *Detroit, Mich.,* 504 B.R. 97 (Bankr. E.D. Mich. 2013)). Franklin is wrong, but the Court need and  
17 should not decide that question.

18 The City has stated its intention to leave its obligations to CalPERS intact and therefore the  
19 question of whether or not the City’s obligations to CalPERS could or could not be impaired under  
20 chapter 9 is not before this Court. It would be improper for this Court to opine on any issue that is  
21 not actually before it because Federal Courts lack the power under Article III to issue advisory  
22 opinions. *See, e.g., U.S. Nat’l Bank of Or. v. Indep. Ins. Agents of Am., Inc.,* 508 U.S. 439, 446  
23 (1993) (“[A] federal court lacks the power to render advisory opinions.”) (internal quotation marks  
24 and alteration omitted); *see also Human Life of Wash., Inc. v. Brumsickle,* 624 F.3d 990, 1000 (9th  
25 Cir. 2010) (“Because the court’s role is neither to issue advisory opinions nor to declare rights in  
26 hypothetical cases, the case or controversy standard also requires that a claim be ripe for review.”)  
27 (internal quotation marks omitted).

1 Likewise, the question of whether the City’s obligations to CalPERS, an undeniable arm of  
2 the State of California, can or cannot be impaired in a chapter 9 case involve complex and thorny  
3 statutory and constitutional questions involving the application of 11 U.S.C. § 903 and the Tenth  
4 Amendment. It has long since been settled that Federal Courts are duty-bound to refrain from  
5 deciding constitutional questions if they are unnecessary to the issues before the Court or if the case  
6 can be decided on non-constitutional grounds. *See, e.g., Camreta v. Greene*, 131 S.Ct. 2020, 2031  
7 (2011) (“[A] ‘longstanding principle of judicial restraint requires that courts avoid reaching  
8 constitutional questions in advance of the necessity of deciding them.’”) (quoting *Lyng v. N.W.*  
9 *Indian Cemetery Protective Ass’n.*, 485 U.S. 439, 445 (1988)); *see also Ashwander v. TVA*, 297 U.S.  
10 288, 346-47 (1936) (Brandeis, J., concurring); *cf. Clark v. Martinez*, 543 U.S. 371, 380-81 (2005)  
11 (explaining doctrine of constitutional avoidance in interpreting statutes and noting that construction  
12 that avoids constitutional issues should prevail over one that raise constitutional issues). Thus, this  
13 Court should exercise judicial restraint and avoid deciding these questions because it raises issues of  
14 the highest constitutional magnitude, which go to the very structure of Our Federalism (*i.e.*, the  
15 relationship between the Federal Government and the Sovereign States).

16 Franklin’s reliance on *In re City of Detroit, Mich.*, 504 B.R. 97 (Bankr. E.D. Mich. 2013), is  
17 sorely misplaced for several reasons. First, that decision addressed whether a municipal, as opposed  
18 to a State-run, pension system could be impaired in a chapter 9 case. Given that municipalities do not  
19 have the same sovereign rights as States under the Federal Constitution, *Ysursa v. Pocatello Educ.*  
20 *Ass’n*, 555 U.S. 353, 362 (2009) (“Political subdivisions of States—counties, cities, or whatever—  
21 never were and never have been considered as sovereign entities.”) (internal quotation marks  
22 omitted), the issues before the court in Detroit are wholly different than the issues that would be (but  
23 are not presently) before this Court if the City attempted to impair its obligations to CalPERS.  
24 Second, the Detroit decision applied Michigan state law to the municipal pension system. Michigan  
25 law regarding municipal pension systems is different that California law. Third, the Detroit decision  
26 is not binding on this Court, and frankly, given that the United States Court of Appeals for the Sixth  
27 Circuit has taken the extraordinary step of granting review of that case under 28 U.S.C. 158(d)(2)(A),  
28



1 any reliance on that case is, at best, questionable. Nevertheless, even if the Detroit decision was  
2 applicable (which it is not), it is simply wrong in its analysis of the Tenth Amendment.

3 The issue under section 1129(a)(3) is not whether an objecting party can dream up some  
4 alternative plan that it may think is better, but whether the plan on the table is consistent with the  
5 Code and is not the product of collusion, conflict of interest, or some other act of bad faith.

6 Section 1129(a)(3) does not compel a debtor to “consider every feasible alternative form of  
7 plan, so long as the proposed plan meets the requirements of § 1129(a).” *In re Marshall*, 298 B.R.  
8 670, 676 (Bankr. C.D. Cal. 2003). There is “no authority . . . for the proposition that, in order to  
9 propose a plan in good faith, a Chapter 11 debtor must explore and consider all possible alternative  
10 forms of plans, or all feasible alternative forms, or even any alternative forms so long as the one that  
11 is proposed meets the requirements of 11 U.S.C. § 1129(a).” *In re General Teamsters*,  
12 *Warehousemen & Helpers Union, Local 890*, 225 B.R. 719, 729 (Bankr. N.D. Cal. 1998) (holding,  
13 *inter alia*, that a debtor union’s decision not to seek a dues increase from its members in order to be  
14 able to increase payment to creditors was not evidence of bad faith), *aff’d sub nom. Sec. Farms v.*  
15 *General Teamsters, Warehousemen & Helpers Union Local 890 (In re General Teamsters*,  
16 *Warehousemen and Helpers Union Local 890)*, 265 F.3d 869, 877 (9th Cir. 2001).

17 Franklin cites only one case to support its position that “good faith” under section 1129(a)(3)  
18 can be challenged if an objecting creditor complains that the debtor did not exhaust options that the  
19 objecting party recommends pursuing. Franklin’s case, *Wolph v. U.S. Department of Education (In*  
20 *re Wolph)*, 479 B.R. 725 (Bankr. N.D. Ohio 2012), has nothing to do with section 1129(a)(3). *Wolph*  
21 involved an individual debtor with student loans who filed a chapter 7 petition. The debtor sought a  
22 discharge of the loans, and argued that the statutory exception of such loans from discharge, 11  
23 U.S.C. § 523(a)(8), did not apply because she satisfied the “undue hardship” exception to the  
24 exception. *Id.* at 728-29. The court looked to the test for undue hardship, originating in the decision  
25 *Brunner v. New York State Higher Education Services Corp.*, 831 F.2d 395 (2nd Cir.1987). That  
26 *Brunner* test, in turn, considered as one element whether the debtor had made “good faith efforts to  
27 repay the loans.” *Id.* at 396. Balancing a number of considerations, the court in *Wolph* treated as a  
28 “negative” consideration the fact the debtor had agreed to make a partial payment on student loans



1 that her parents had guaranteed, while proposing to pay nothing on the other student loans. *Wolph*,  
2 479 B.R. at 732. It is beyond remote for Franklin to rely, as a key point in its argument on the  
3 statutory meaning of “good faith” proposal of a plan, on one court’s use of a family-based  
4 preferential treatment of creditors as one of many considerations in applying a common-law “good  
5 faith” test for an exception to an exception from discharge.<sup>17</sup> Moreover, even if *Wolph* had some  
6 bearing on this matter, Franklin has not attempted to show that the City had any analogous “personal  
7 motive” for allegedly favoring CalPERS.<sup>18</sup>

8 Franklin also says that the City lacked good faith because of the City’s supposed “disregard”  
9 of out-of-court third-party comments about the City of Vallejo.<sup>19</sup> Of course, the assertions about

---

10 <sup>17</sup> As the Court earlier noted in this case, “As these various versions of good faith in chapter 9 arise in  
11 different contexts, they may have different meanings.” *In re City of Stockton*, 493 B.R. 772, 784  
12 (Bankr. E.D. Calif. 2013).

13 <sup>18</sup> To the extent that Franklin is using its “good faith” arguments about CalPERS to complain about  
14 classification or “unfair discrimination” as it relates to CalPERS, case law supports a decision by the  
15 City to distinguish the treatment of simple creditors like Franklin from that of creditors crucial to a  
16 successful reorganization.

17 Preserving employee relations and goodwill is a valid reason for separate classification. In *Aetna*  
18 *Cas. & Sur. Co. v. Clerk (In re Chateaugay Corp.)*, 89 F.3d 942, 949 (2d Cir. 1996) (holding that  
19 debtor had a “legitimate reason” for separate classification of employees’ workers compensation  
20 claims from other unsecured claims, based on anticipated negative worker reaction to nonpayment).

21 More broadly, courts have concluded that legitimate grounds for separate classification exist  
22 where the debtor has reasonable grounds to conclude that one group creditors has a different on-going  
23 interest and importance to the debtor’s continued viability than does a different group of creditors.  
24 The court in *In re EPB, Inc.*, 172 B.R. 241 (Bankr. N.D. Ohio 1994) concluded that the debtor had a  
25 legitimate basis for separate classification of a tort claimant “providing no continuing benefit to the  
26 Debtor’s estate” from trade creditors who “provide a potential continuing benefit to the Debtor’s  
27 estate which will sustain the Debtor’s business if confirmation is achieved.” *In re EPB*, 172 B.R. at  
28 244.

21 Courts within the Ninth Circuit have likewise held that debtors had legitimate justifications for  
22 separate classification in order to maintain their ability to operate. *In re Carolina Tobacco Co.*, 2006  
23 WL 7074335 (Bankr. D. Ore. March 14, 2006), *aff’d*, 360 B.R. 702, 714 (D. Ore. 2007), held that the  
24 debtor had a legitimate reason for separately classifying its obligations to make statutory escrow  
25 payments in order to be able to operate postpetition. *In re Indian National Finals Rodeo Inc.*, 453  
26 B.R. 387, 400 (Bankr. D. Mont. 2011), held that the debtor had legitimate business justification in  
27 separately classifying claims by creditors from whom the debtor “anticipated future aid or  
28 contributions of money and/or services.”

26 <sup>19</sup> CalPERS notes that there are also articles saying that Vallejo is not in financial trouble. *See, e.g.*,  
27 “Vallejo Bankrupt Again? ‘We Are Not Going There,’” *Calpensions*, March 17, 2014 (quoting  
28 Vallejo Mayor Davis following a council vote closing a gap in the current budget, “It’s going to be a  
tough struggle, but I’m sure we will get there,” and City Manager Deborah Lauchner, “We are not on  
the brink of bankruptcy. We are not going there.”).

1 Vallejo's situation are inadmissible hearsay,<sup>20</sup> and Franklin has no evidence that the City in any case  
2 "disregarded" what may or may not be happening there. More fundamentally, to the extent that  
3 Franklin is relying on Vallejo to question the feasibility of Stockton's Plan, Franklin's argument is  
4 flawed. Section 1129(a)(3) may include some consideration of feasibility in establishing good faith,  
5 but that analysis only requires that feasibility be established. *See Beal Bank USA v. Windmill*  
6 *Durango Office, LLC (In re Windmill Durango Office, LLC)*, 481 B.R. 51, 67, 68 (9th Cir. BAP  
7 2012) (noting in a chapter 11 case that the standard of feasibility is a "reasonable probability of  
8 success" (quoting *Acequia, Inc. v. Clinton (In re Acequia, Inc.)*, 787 F.2d 1352, 1363 (9th Cir.  
9 1986)), and "a relatively low threshold of proof" will suffice (citing *Wells Fargo Bank v. Loop 76,*  
10 *LLC (In re Loop 76, LLC)*, 465 B.R. 525, 544 (9th Cir. BAP 2012))). Even if Franklin could point to  
11 an actual example of a failed chapter 9 plan, that example would have no more relevance than would  
12 an analogous effort in a chapter 11 case to show that some other chapter 11 reorganizations have  
13 failed. Franklin's speculation regarding the Vallejo circumstances is also misleading. It is a matter  
14 of public record that in the past ten years, there have been only four municipal bankruptcy cases filed  
15 in the State of California including Vallejo. One of those cases (City of Mammoth Lakes) was  
16 voluntarily dismissed within a matter of months. These numbers belie Franklin's rhetoric about the  
17 overwhelming burden of pension liabilities on municipalities and the risk of serial filings of chapter 9  
18 cases in California.

19 The issue before the court is the feasibility of Stockton's plan, not anyone else's plan, and  
20 speculation based on newspaper reports and reports by ratings agencies is patently inadmissible and  
21 misleading.

22 This Court does not have an obligation to only confirm the most feasible plan, nor does it  
23 have an obligation only to confirm a plan that *it believes* is in the best interests of the City in the long  
24 term. In fact, to impose its view of the most desirable plan for the City would conflict with § 904 of  
25 the Bankruptcy Code because it would interfere with the governmental powers of the City. This

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26  
27 <sup>20</sup> For example, "[n]ewspaper articles are rank hearsay." *Nooner v. Norris*, 594 F.3d 592, 603 (8th  
28 Cir. 2010) (internal quotation marks omitted). Likewise, any article authored by the ratings agency  
Moody's Inc., among other disqualifying factors, is equally "rank hearsay."

1 Court's only duty is to assess whether the actual Plan proposed by the City is feasible. If it is not,  
2 then this Court can reject the Plan and allow the City to propose a second plan, but the Court should  
3 not reject the City's Plan because Franklin believes a better plan can be proposed.

4 3. *The City's Decision to Continue its Relationship with CalPERS Satisfies the*  
5 *Good Faith Standard of 11 U.S.C. § 1129(a)(3).*

6 As noted above, "[a] plan is proposed in good faith where it achieves a result consistent with  
7 the objectives and purposes of the Code." *In re Sylmar Plaza, L.P.*, 314 F.3d at 1074. The purpose  
8 of chapter 9 is to "foster[] the continuance of municipalities rather than their dissolution" so that they  
9 can continue to provide "essential services to residents." *In re Addison Cmty. Hosp. Auth.*, 175 B.R.  
10 646, 648 (Bankr. E.D. Mich. 1994). Chapter 9 attempts "to meet the special needs of a municipal  
11 debtor," *In re Richmond Unified School Dist.*, 133 B.R. 221, 225 (Bankr. N.D. Calif. 1991). "A  
12 Chapter 9 plan must be consistent with the governmental nature and obligations of the Chapter 9  
13 debtor." *In re Mount Carbon Metro. Dist.*, 242 B.R. 18, 41 (Bankr. D. Colo. 1999).

14 Evidence at the confirmation hearing will establish that the City reasonably and genuinely  
15 concluded that continuing the City's relationship with CalPERS was crucial to the City's efforts to  
16 retain and attract employees performing the governmental services that are the City's reason for  
17 existing. The City's decision is consistent with the objectives and purposes of the Bankruptcy Code  
18 and cannot be challenged on the basis of good faith.

19 **a. The City Reasonably Concluded that it Would Be at a Severe**  
20 **Competitive Disadvantage in Retaining and Attracting Employees**  
21 **Without a CalPERS Pension Plan.**

22 At the confirmation hearing, CalPERS and the City will show that a CalPERS pension plan is  
23 the overwhelming choice for municipalities in California, and that to attract new employees and to  
24 retain existing employees, the City is advantaged by its participation in CalPERS. If the City were to  
25 purport to terminate its relationship with CalPERS, it would trigger a massive termination obligation  
26 and the City would be ineligible to begin a new CalPERS plan for three years. Cal. Gov. Code  
27 § 20460. Even if non-CalPERS plans were an available substitute, a concept for which Franklin has  
28 produced no evidence, the City would be left bearing the costs of that replacement plan while also  
facing the termination obligation.

1 The City has reasonably concluded that without a CalPERS plan, the City would be severely  
2 disadvantaged in hiring new employees and retaining its existing ones. This risk is especially grave  
3 in the case of public safety personnel, who can likely find employment elsewhere with a California  
4 city that does offer a CalPERS plan. Particularly for a city, like Stockton, facing elevated rates of  
5 violent crime, the loss of experienced public safety personnel could initiate a downward spiral  
6 threatening the City’s viability (including, of course, its ability to generate revenues to pay creditors).  
7 In a chapter 9 case, when assessing feasibility, this concern must be part of the calculus.

8 **b. Terminating the CalPERS Pension Plan Would Likely Cause a**  
9 **Substantial Number of Employees to Leave the City’s Employ to**  
10 **Preserve their Pension Benefits.**

11 One particularly acute problem for the City if it were to terminate its CalPERS Pension Plan  
12 is that current employees who wanted to preserve their existing pension benefit accrual levels would  
13 have a strong incentive to stop working for the City and seek employment from another city or public  
14 agency with CalPERS benefits, or CalPERS reciprocal benefits, as soon as possible. Even the  
15 announcement of an intent to terminate would likely begin a rush for the exits, especially by  
16 employees who intend to accrue benefits for significant additional years and who have the most to  
17 lose if their benefits are slashed following termination.

18 **III. CONCLUSION**

19 For the foregoing reasons, Franklin’s objections to the Plan based on the City’s decision to  
20 continue its relationship with CalPERS should be overruled.

21 Respectfully submitted,

22 Michael J. Gearin  
23 Michael B. Lubic  
24 Michael K. Ryan  
25 Manoj D. Ramia  
26 K&L GATES LLP

27 Dated: March 31, 2014

28 By: /s/ Michael J. Gearin  
Michael J. Gearin

Attorneys for California Public Employees’  
Retirement System

# EXHIBIT A



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### *Legislative History of*

## CALIFORNIA GOVERNMENT CODE § 20487 (Formerly § 20486)

*As Added By*  
Statutes of 1996, Chapter 502, § 1  
Senate Bill 1945 – Craven

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### *Authentication of the Records and Table of Contents*

Legislative History Research Report Regarding:  
CALIFORNIA GOVERNMENT CODE § 20487 (Formerly § 20486)  
*As Added By Statutes of 1996, Chapter 502, § 1, SB 1945 – Craven*

I, Lisa Hampton, declare that this report includes:

- *Historical documents relating to the above legislation.* These documents were obtained by the staff of Legislative Research & Intent LLC and are true and correct copies of the originals obtained from the designated official, public sources in California unless another source is indicated, with the following exceptions: In some cases, pages may have been reduced in size to fit an 8 ½” x 11” sized paper. Or, for readability purposes, pages may have been enlarged or cleansed of black marks or spots. Lastly, paging and relevant identification have been inserted.

Since 1983 LRI has specialized in the historical research surrounding the adoption, amendment and/or repeal of California statutes, regulations and constitutional provisions pursuant to California Code of Civil Procedure § 1859 which states in pertinent part: "In the construction of a statute the intention of the Legislature ... is to be pursued, if possible ...." Our research and expert witness services have assisted the courts in understanding and applying the underlying purpose of enactments in countless cases, such as *Redlands Community Hospital v. New England Mutual Life Insurance Co*, 23 Cal. App.4th 899 at 906 (1994). LRI also provides similar research for other states and at the federal level. (Formerly Legislative Research Institute and Legislative Research, Incorporated.)

- *A table of contents itemizing the documents.* This table of contents cites the sources of the documents.

I declare under penalty of perjury under the laws of the United States and the State of California that the foregoing is true and correct and that I could and would so testify in a court of law if called to be a witness.

Executed August 13, 2012, in Sacramento, California.

Lisa Hampton, Research Director





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# Documents Generated During Senate Deliberations

Legislative Research & Intent LLC hereby certifies that the accompanying record/s is/are true and correct copies of the original/s obtained from one or more official, public sources in California unless another source is indicated, with the following exceptions : In some cases, pages may have been reduced in size to fit an 8 ½" x 11" sized paper. Or, for readability purposes, pages may have been enlarged or cleansed of black marks or spots. Lastly, for ease of reference, paging and relevant identification have been inserted.

SENATE PUBLIC EMPLOYMENT & RETIREMENT COMMITTEE  
Teresa Hughes, Chairwoman  
SB 1945 (Craven), as introduced

BILL NO: SB 1945  
Hearing date: 4/8/96  
FISCAL: yes

**PERS: BANKRUPTCY OF LOCAL CONTACTING AGENCIES**

**HISTORY:**

Sponsor: PERS Board of Administration

Prior legislation: none

**SUMMARY:**

Would prohibit the debtor's trustee of a PERS contracting agency that has filed for Chapter 9 Bankruptcy from making an election to end -- by rejection, assignment, or assumption -- its contract with PERS.

**BACKGROUND:**

1) The committee is advised that the recent Orange County fiscal crisis has raised the possibility that a PERS' contracting agency could file a Chapter 9 Bankruptcy, and that the agency's trustee in bankruptcy might seek to reject its contract with PERS, thereby transferring the liability for its retirees' retirement allowances to PERS.

2) Existing PERS law contains the following sections relating to its relationship with local governmental agencies that enter into a contract with the system to provide retirement benefits to their employees:

- a) Section 20450 authorizes any public agency to contract for all or part of its employees to become members of PERS,
- b) Section 20450.1 permits the PERS Board to refuse to contract for any benefit provision not specifically authorized which would adversely affect the administration of the system,
- c) Section 20499.5 provides that a contracting agency forced to reduce employee compensation because of a fiscal emergency cannot reduce retirement benefits below the level before the reduction,
- d) Section 20531 permits PERS to assess costs for late contributions and section 20531.5 permits PERS to charge interest on unpaid contributions,
- e) Section 20562 permits PERS to cancel a contracting agency's contract when that agency has failed to pay after 30 days from written demand by the PERS Board; it may also terminate the contract by resolution effective 60 days after mailing to an agency it decides no longer exists,
- f) Section 20563 states that where the agency's accumulated contributions do not satisfy the actuarial equivalent set forth in section 20563, the agency must contribute the difference on terms fixed by the PERS Board; furthermore, the amount of the difference is subject to interest. And, if the agency fails to pay, the Board may declare a proportional reduction in benefits. However, section 20567 assures that the right to a retirement allowance of an annuitant is not affected by termination of the contract unless the contracting agency fails to make its required contributions, and

g) Section 20757.2 declares that despite any other provision of the law, no employer may refuse to make its contributions to CalPERS.

3) Existing federal law, under Chapter 9 of the United States Bankruptcy Code, provides for reorganization of a municipality under strict parameters that include: insolvency; desire to adjust debts; agreement by creditors holding a majority of the outstanding amounts to be adjusted under the plan; and good faith negotiation with those creditors resulting in inability to succeed because of impracticability or the possibility of an unavoidable transfer under section 547 of the Bankruptcy Code.

U. S. Bankruptcy Code section 101(40) defines "municipality" to include any political subdivision or agency of the state. Section 901 provides many of the general provisions of the Bankruptcy Code including sections 362 (automatic stay), 365 (executory contracts and unexpired leases), 1129 (confirmation of plan), and 1142 (implementation of plan). But section 903 says that the power of a state to control the exercise of a municipality's governmental powers including expenditure for such an exercise is not limited.

And section 904 provides that without consent of the debtor or provision in the plan, the court may not interfere with the exercise of its governmental powers or use of its property and revenues. 28 U.S.C. § 959(b) says that the trustee shall manage the property like an owner or possessor would.

**California Government Code sections 53760 and 53761 effectively consent to the provisions of the Bankruptcy Code for its governmental subdivisions and taxing agencies.**

4) The committee is advised by PERS bankruptcy counsel that federal Bankruptcy Code also contains the following:

a) Section 922 provides additional authority to that set forth in section 362, to stay all entities that seek to enforce any claim against a debtor,

b) Section 941 requires the debtor agency to file a plan. Section 943(b) ordains that the court shall affirm the plan if: it complies with the Bankruptcy Code; contains no action prohibited by law; contains any regulatory or electoral approval necessary; and is both feasible and in the best interests of creditors,

c) Section 944 says the confirmed plan binds both the debtor and creditors even if they have not accepted the plan.

Under section 365 as applied to Chapter 9, any assumption, assignment, or rejection of a contract requires court approval. Contracts must be assumed or rejected as a whole, not in part. If assumed, all defaults and deficiencies must be cured. Clauses in a contract canceling it because of insolvency are invalid. Non-assignable contracts are also not subject to assumption or assignment.

**While the purpose of the federal bankruptcy law is to permit the impairment of contracts to effect a reorganization of debt, Chapter 9 only provides relief in states which have consented to its application. Only 18 states, including California, have done so. Of those 18, a number have established conditions on the right to seek bankruptcy relief. An example is requiring approval by a state agency before a municipality can apply for Chapter 9 relief. New Jersey, Louisiana, Kentucky, Ohio, and Pennsylvania require such preapproval. Other states -- North Dakota, Montana, and Kentucky -- and Louisiana set forth specific procedures which must be followed.**

**ANALYSIS:**

This bill would add language to the PERS law specifically prohibiting the debtor's trustee of a PERS local contracting agency that has filed for Chapter 9 Bankruptcy from making an election to end -- by rejection, assignment, or assumption -- its contract with PERS.

**COMMENTS:**

1) The committee is advised that, under existing PERS law, if a PERS local contracting public agency were to file for reorganization under Chapter 9, PERS' ability to terminate a contract could be abrogated by the automatic stay.

In that event, CalPERS might not be able to assess for deficient contributions but may still be liable to annuitants whose allowances are not fully funded.

2) **SUPPORT:**

California State Firefighters' Association  
California Professional Firefighters  
Service Employees International Union, California State Council

3) **OPPOSITION:**

none to date

David Felderstein  
April 4, 1996

SB 1945

**SENATE BILL 1945**

**PUBLIC EMPLOYMENT & RETIREMENT COMMITTEE**

**April 8, 1996**

**MADAM CHAIRMAN AND MEMBERS:**

**SENATE BILL 1945 IS PROMPTED BY THE RECENT ORANGE COUNTY BANKRUPTCY.**

**THE BILL WOULD PROHIBIT PUBLIC AGENCIES CONTRACTING WITH CAL-PERS FROM TERMINATING, EITHER BY REJECTION, ASSIGNMENT, OR ASSUMPTION ITS OBLIGATIONS WITH THE RETIREMENT BOARD THROUGH CHAPTER 9 BANKRUPTCY FILINGS.**

**WITHOUT THIS CHANGE IN LAW, CAL-PERS MAYBE LIABLE TO CONTINUE PROVIDING BENEFITS TO EMPLOYEES OF PUBLIC AGENCIES EVEN IF DEPRIVED OF CONTRIBUTIONS BECAUSE OF A CHAPTER 9 DISCHARGE.**

**THE BILL VERY SIMPLY SPECIFIES THAT A PUBLIC AGENCY SUBJECT TO BANKRUPTCY MAY NOT ALTER ITS CONTRACT WITH**

**CAL-PERS WITHOUT THE PRIOR CONSENT OF THE RETIREMENT  
BOARD.**

**I KNOW OF NO OPPOSITION TO THE BILL AND WOULD ASK  
FOR YOUR "AYE" VOTE.**

AMENDMENT DATE: Original  
 POSITION: Neutral  
 SPONSOR: Public Employees' Retirement System

BILL NUMBER: SB 1945  
 AUTHOR: W. Craven

**BILL SUMMARY**

SB 1945 prohibits a local agency that has contracted with the Public Employees' Retirement System (CalPERS) for retirement program services from voiding its contract with CalPERS by filing for federal Chapter 9 Bankruptcy.

**FISCAL SUMMARY**

No fiscal impact.

**COMMENTS**

CalPERS sponsored this bill to prevent a public agency in financial distress, such as Orange County, from shifting the liability for funding its employees' retirement benefit payments to CalPERS.

Code/Department Agency or Revenue Type	(Fiscal Impact by Fiscal Year)							Fund Code
	SO	LA		CO		PROP	FC	
	RV	98	FC	1995-1996	FC	1996-1997		
1900/PERS	SO	No	----- No/Minor Fiscal Impact -----					0830

Fund Code: 0830 Title: Public Employees Retirement Fund

Analyst/Principal (0931) W. Young	Date	Program Budget Manager Robert J. Straight	Date
<i>W. Young</i>	4-17-96	<i>RF Straight</i>	4-18-96
Department Deputy Director			Date

Governor's Office: \_\_\_\_\_ By: \_\_\_\_\_ Date: \_\_\_\_\_  
 Position Noted \_\_\_\_\_  
 Position Approved \_\_\_\_\_  
 Position Disapproved \_\_\_\_\_

**BILL ANALYSIS**

Form DF-43 (Rev 03/95 Buff)

**SENATE RULES COMMITTEE**

SB 1945

Office of Senate Floor Analyses  
1020 N Street, Suite 524  
(916) 445-6614 Fax: (916) 327-4478

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THIRD READING

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Bill No: SB 1945  
Author: Craven (R)  
Amended: As introduced  
Vote: 21

---

SENATE PUBLIC EMP. & RET. COMMITTEE: 3-0, 4/8/96  
AYES: Haynes, Rogers, Hughes  
NOT VOTING: Costa, Solis

SENATE APPROPRIATIONS COMMITTEE: Senate Rule 28.8

---

**SUBJECT:** Public employees: retirement

**SOURCE:** Public Employees Retirement System Board of Administration

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**DIGEST:** This bill prohibits contracting agencies and public agencies that become subject to federal bankruptcy proceedings from rejecting retirement coverage contracts or assuming or assigning those contracts without the prior consent of the Public Employees Retirement System (PERS) Board.

**ANALYSIS:** The Senate Public Employment and Retirement Committee analysis indicates that the recent Orange County fiscal crisis has raised the possibility that a PERS' contracting agency could file a Chapter 9 Bankruptcy, and that the agency's trustee in bankruptcy might seek to reject its contract with PERS, thereby transferring the liability for its retirees' retirement allowances to PERS.



Existing PERS law contains the following sections relating to its relationship with local governmental agencies that enter into a contract with the system to provide retirement benefits to their employees:

1. Section 20450 authorizes any public agency to contract for all or part of its employees to become members of PERS,
2. Section 20450.1 permits the PERS Board to refuse to contract for any benefit provision not specifically authorized which would adversely affect the administration of the system,
3. Section 20499.5 provides that a contracting agency forced to reduce employee compensation because of a fiscal emergency cannot reduce retirement benefits below the level before the reduction,
4. Section 20531 permits PERS to assess costs for late contributions and section 20531.5 permits PERS to charge interest on unpaid contributions,
5. Section 20562 permits PERS to cancel a contracting agency's contract when that agency has failed to pay after 30 days from written demand by the PERS Board; it may also terminate the contract by resolution effective 60 days after mailing to an agency it decides no longer exists,
6. Section 20563 states that where the agency's accumulated contributions do not satisfy the actuarial equivalent set forth in section 20563, the agency must contribute the difference on terms fixed by the PERS Board; furthermore, the amount of the difference is subject to interest. And, if the agency fails to pay, the Board may declare a proportional reduction in benefits. However, section 20567 assures that the right to a retirement allowance of an annuitant is not affected by termination of the contract unless the contracting agency fails to make its required contributions, and
7. Section 20757.2 declares that despite any other provision of the law, no employer may refuse to make its contributions to CalPERS.

Existing federal law, under Chapter 9 of the United States Bankruptcy Code, provides for reorganization of a municipality under strict parameters that include: insolvency; desire to adjust debts; agreement by creditors

holding a majority of the outstanding amounts to be adjusted under the plan; and good faith negotiation with those creditors resulting in inability to succeed because of impracticability or the possibility of an unavoidable transfer under section 547 of the Bankruptcy Code.

U. S. Bankruptcy Code section 101(40) defines "municipality" to include any political subdivision or agency of the state. Section 901 provides many of the general provisions of the Bankruptcy Code including sections 362 (automatic stay), 365 (executory contracts and unexpired leases), 1129 (confirmation of plan), and 1142 (implementation of plan). But section 903 says that the power of a state to control the exercise of a municipality's governmental powers including expenditure for such an exercise is not limited.

And section 904 provides that without consent of the debtor or provision in the plan, the court may not interfere with the exercise of its governmental powers or use of its property and revenues. 28 U.S.C. § 959(b) says that the trustee shall manage the property like an owner or possessor would.

California Government Code sections 53760 and 53761 effectively consent to the provisions of the Bankruptcy Code for its governmental subdivisions and taxing agencies.

The Public Employment and Retirement Committee has been advised by PERS bankruptcy counsel that federal Bankruptcy Code also contains the following:

1. Section 922 provides additional authority to that set forth in section 362, to stay all entities that seek to enforce any claim against a debtor,
2. Section 941 requires the debtor agency to file a plan. Section 943(b) ordains that the court shall affirm the plan if: it complies with the Bankruptcy Code; contains no action prohibited by law; contains any regulatory or electoral approval necessary; and is both feasible and in the best interests of creditors,
3. Section 944 says the confirmed plan binds both the debtor and creditors even if they have not accepted the plan.

Under Section 365 as applied to Chapter 9, any assumption, assignment, or rejection of a contract requires court approval. Contracts must be assumed or rejected as a whole, not in part. If assumed, all defaults and deficiencies must be cured. Clauses in a contract canceling it because of insolvency are invalid. Non-assignable contracts are also not subject to assumption or assignment.

While the purpose of the federal bankruptcy law is to permit the impairment of contracts to effect a reorganization of debt, Chapter 9 only provides relief in states which have consented to its application. Only 18 states, including California, have done so. Of those 18, a number have established conditions on the right to seek bankruptcy relief. An example is requiring approval by a state agency before a municipality can apply for Chapter 9 relief. New Jersey, Louisiana, Kentucky, Ohio, and Pennsylvania require such preapproval. Other states -- North Dakota, Montana, and Kentucky -- and Louisiana set forth specific procedures which must be followed.

This bill would add language to the PERS law specifically prohibiting the debtor's trustee of a PERS local contracting agency that has filed for Chapter 9 Bankruptcy from making an election to end -- by rejection, assignment, or assumption -- its contract with PERS.

Comments:

The Senate Public Employment and Retirement Committee states that, under existing PERS law, if a PERS local contracting public agency were to file for reorganization under Chapter 9, PERS' ability to terminate a contract could be abrogated by the automatic stay.

In that event, CalPERS might not be able to assess for deficient contributions but may still be liable to annuitants whose allowances are not fully funded.

**FISCAL EFFECT:** Appropriation: No Fiscal Com.: Yes Local: No

**SUPPORT:** (Verified 5/1/96)

Public Employees Retirement System Board of Administration (source)  
California State Firefighters' Association  
California Professional Firefighters

Service Employees International Union, California State Council  
California School Employees Association

DLW:lm 5/1/96 Senate Floor Analyses

SUPPORT/OPPOSITION: SEE ABOVE

\*\*\*\* **END** \*\*\*\*

**SENATE BILL 1945**

**SENATE FLOOR THIRD READING**

**MR. PRESIDENT & MEMBERS:**

**SENATE BILL 1945 IS PROMPTED BY THE RECENT ORANGE COUNTY BANKRUPTCY.**

**THE BILL WOULD PROHIBIT PUBLIC AGENCIES CONTRACTING WITH CAL-PERS FROM TERMINATING, EITHER BY REJECTION, ASSIGNMENT, OR ASSUMPTION ITS OBLIGATIONS WITH THE RETIREMENT BOARD THROUGH CHAPTER 9 BANKRUPTCY FILINGS.**

**WITHOUT THIS CHANGE IN LAW, CAL-PERS MAY BE LIABLE TO CONTINUE PROVIDING BENEFITS TO EMPLOYEES OF PUBLIC AGENCIES EVEN IF DEPRIVED OF CONTRIBUTIONS BECAUSE OF A CHAPTER 9 DISCHARGE.**

**THE BILL VERY SIMPLY SPECIFIES THAT A PUBLIC AGENCY SUBJECT TO BANKRUPTCY MAY NOT ALTER ITS CONTRACT WITH CAL-PERS WITHOUT THE PRIOR CONSENT OF THE RETIREMENT BOARD.**

**I KNOW OF NO OPPOSITION TO THE BILL AND WOULD ASK FOR YOUR "AYE" VOTE.**



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ASSEMBLY COMMITTEE ON PUBLIC EMPLOYEES, RETIREMENT AND SOCIAL SECURITY  
Howard Kaloogian, Chairman  
322-4320 / FAX 324-9991

BACKGROUND INFORMATION REQUEST

Measure: SB 1945 Date Sent: June 6, 1996  
Author: Senator Craven Return by: June 12, 1996  
Author's Staff Contact: to Room 2163  
Name: Scott Johnson Phone: 445-3731

1. What organization or governmental agency requested introduction?

Sponsor: CAI PERS  
Contact: Sue Meyers Phone: 326-3678

2. Identify all previous or similar legislation by bill number and include the disposition of those measures, all previous votes in any committee in either house and relevant dates.

None

3. Please attach an author's statement of purpose for this legislation including the specific problem or deficiency in the law which the bill seeks to remedy--and how. Also state all resulting fiscal costs or impact to the state or to any entity or individual.

4. Please attach any studies, reports, statistics or facts which support the need for this measure. Include interim studies and previous committee and floor analyses to similar legislation.

5. Please attach copies of all letters of support and opposition received. Also list all known support and opposition and state precise reasons for positions. Include all known positions of any governmental agency.

6. Do you plan to amend this bill prior to hearing? Yes  No

If yes, please attach a draft copy of the proposed amendments or provide ASAP. Amendments in Legislative Counsel form must be received by committee (Rm. 2163) by noon Tuesday the week prior to the hearing date of this bill.

7. List the names and telephone numbers of the witnesses you plan to have testify. Witnesses must be noticed with committee prior to hearing.

Sue Meyers or Rep. from CAI PERS

Please Note: No bill will be set until a completed BIR is received.

Date of Hearing: July 3, 1996

ASSEMBLY COMMITTEE ON PUBLIC EMPLOYEES RETIREMENT & SOCIAL SECURITY  
Howard Kaloogian, Chairman

SB 1945 (Craven) - As Amended: June 26, 1996

SENATE VOTE: 36-0

SUBJECT: Public employees: retirement.

VOTE REQUIREMENT: Majority

SUMMARY: Prohibits a CalPERS contracting agency debtor's trustee from making an election to end, by rejection, assignment, or assumption, its contract with CalPERS. Allows public employees to participate in deferred compensation. Specifically, this bill:

- 1) Prohibits a contracting agency or public agency seeking bankruptcy protection from rejecting any contract or agreement between the agency and the Board or, without prior consent of the Board, from assuming or assigning any contract or agreement between the agency and the Board.
- 2) Permits all public employees to participate in deferred compensation programs.

FISCAL EFFECT: Unknown

BACKGROUND: Since the Orange County bankruptcy, concern regarding the possibility of a CalPERS' contracting agency filing a Chapter 9 Bankruptcy has arisen. In particular, the concern is that such an agency's trustee in bankruptcy will choose to reject its contract with CalPERS thereby transferring the liability for its retirees' retirement allowances to CalPERS.

ARGUMENTS IN SUPPORT: The state should protect its retirement system and its beneficiaries as a priority to prevent use of the Bankruptcy Code by a political subdivision or agency to avoid its obligations to its employees and annuitants.

ARGUMENTS IN OPPOSITION: A bankruptcy judge might refuse to recognize the power of the state to control bankruptcy proceedings or to set conditions for using bankruptcy protection.

REGISTERED SUPPORT / OPPOSITION:

Support

CalPERS

Opposition/None on file.

Analysis prepared by: Michael J. D'Arelli / aper&ss / (916)322-4320



ASSEMBLY PUBLIC EMPLOYEES, RETIREMENT  
AND SOCIAL SECURITY COMMITTEE  
REPUBLICAN ANALYSIS

SB 1945 (Craven) -- PUBLIC EMPLOYEES: RETIREMENT  
Version: 6/26/96 Chair: Kaloogian  
Analyzed: 7/1/96 Vote: Majority  
Recommendation: Support Tax/Fee: No

SUMMARY: Prohibits contracting agencies and public agencies that become subject to federal bankruptcy proceedings from rejecting retirement coverage contracts or assuming or assigning those contracts without the prior consent of the Public Employees Retirement System (CalPERS) Board. States CalPERS' deferred compensation program is available to all public employees, not just CalPERS members.

FISCAL EFFECT: No fiscal impact according to Dept. of Finance.

POTENTIAL EFFECTS: Would prevent public agencies declaring bankruptcy from shifting the liability for funding employee retirement benefit payments to CalPERS.

SUPPORT: CalPERS (sponsor); CA State Firefighters' Assoc.; CA Professional Firefighters; Service Employees International Union; CA School Employees Assoc.

OPPOSITION: None on file.

GOVERNOR'S POSITION: Unknown.

COMMENTS:

- o **Existing PERS law** declares that no governmental agency may reduce or refuse to make its contribution to CalPERS.
- o **Background:** The idea for this bill arose out of the recent Orange County fiscal crisis. There were concerns that the county's trustee in bankruptcy might try to reject its contract with CalPERS, which would stick CalPERS with the liability for the county employees' retirement allowances.
- o **Purpose of bill:** This bill would prevent a financially troubled agency from ending its CalPERS contract through bankruptcy without consent and leaving CalPERS liable for the agency's obligations. Federal bankruptcy law authorizes this protection with requisite state legislation.
- o **Deferred compensation:** Language allowing CalPERS to offer its deferred compensation plan to all public employees rather than just CalPERS members is a technical cleanup. CalPERS already offers its deferred compensation plan to all public employees.

Senate Republican Floor Vote -- 5/9/96 -- CONSENT CALENDAR

(36-0) Ayes: All Republicans except  
Abs.: Craven, Russell

Assembly Republican Committee vote

PER&SS -- 7/3/96  
(>) Ayes: >  
Noes: >  
Abs.: >  
N.V.: >

Consultant: Todd Eberle

**SENATE BILL 1945**

**ASSEMBLY P E & R COMMITTEE**

**MR. CHAIRMAN & MEMBERS:**

**SENATE BILL 1945 IS PROMPTED BY THE RECENT ORANGE COUNTY BANKRUPTCY.**

**THE BILL WOULD PROHIBIT PUBLIC AGENCIES CONTRACTING WITH CAL-PERS FROM TERMINATING, EITHER BY REJECTION, ASSIGNMENT, OR ASSUMPTION ITS OBLIGATIONS WITH THE RETIREMENT BOARD THROUGH CHAPTER 9 BANKRUPTCY FILINGS.**

**WITHOUT THIS CHANGE IN LAW, CAL-PERS MAY BE LIABLE TO CONTINUE PROVIDING BENEFITS TO EMPLOYEES OF PUBLIC AGENCIES EVEN IF DEPRIVED OF CONTRIBUTIONS BECAUSE OF A CHAPTER 9 DISCHARGE.**

**THE BILL VERY SIMPLY SPECIFIES THAT A PUBLIC AGENCY SUBJECT TO BANKRUPTCY MAY NOT ALTER ITS CONTRACT WITH CAL-PERS WITHOUT THE PRIOR CONSENT OF THE RETIREMENT BOARD.**

**I KNOW OF NO OPPOSITION TO THE BILL AND WOULD ASK  
FOR YOUR "AYE" VOTE.  
(AUTHOR'S AMENDMENT)**