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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re CITY OF STOCKTON, CALIFORNIA., Debtor.	Case No. 2012-32118 D.C. No. OHS-5 Chapter 9 **CALPERS' REPLY IN SUPPORT OF ITS SUPPLEMENTAL BRIEFING ON CONFIRMATION OF THE CITY'S PLAN OF ADJUSTMENT AND THE ENFORCEABILITY OF THE PERL** Date: October 1, 2014 Time: 10:00 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

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CalPERS files this Reply in support of its Supplemental Brief in Support of the City of Stockton's (the "City" or "Stockton") First Amended Plan of Adjustment [Dkt. No. 1662] (the "CalPERS Supplemental Br.") and its Memorandum Regarding Constitutional, Statutory, and Preemption Arguments Supporting the Enforceability of the Public Employees' Retirement Law in Chapter 9 (the "CalPERS Con. Law Br.") [Dkt. No. 1663].

I. INTRODUCTION

Franklin's primary complaint is that the City has the ability to pay more to Franklin. This complaint has nothing to do with pensions.[1] However, Franklin seeks to hold the City hostage by arguing that, unless Franklin is paid more, the City must terminate its relationship with CalPERS. The City has consistently and more than adequately made its case that the CalPERS relationship is important to the future welfare of the City and its citizens. The City needs to be able to attract and retain qualified employees and its participation in CalPERS promotes retention and hiring. Franklin is not being discriminated against by the City's decision to retain its relationship with a State agency counterparty that is important to the City's mission of delivery of services to its citizens.

Franklin's argument is based on the premise that the City has a less expensive viable alternative to CalPERS that will provide sufficient benefits to attract and retain employees. There is no evidence in the record that such an alternative exists. Without evidence of a lower cost viable alternative, there is no point in evaluating the effect of termination of the City's pension plans. Franklin repeatedly argues that by continuing its relationship with CalPERS the City is somehow assuming a massive prepetition pension obligation. While the costs of providing pensions are significant, there is no prepetition claim that is being assumed and, as a result, Franklin has no basis to argue that CalPERS has an unsecured prepetition claim that is being paid in full.[2]

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[1] In fact, Franklin vigorously argues that the City has more than enough resources to make its future pension contributions and to pay Franklin in full.

[2] Interestingly, Franklin points out that the estimated termination liability presented to the Court is too high because the calculation is two years old. Franklin notes that, since the filing of this case, CalPERS has had two years of stellar returns (undermining Franklin's attack of "irresponsible stewardship of CalPERS"), far in excess of its actuarial rate of 7.5%, thus significantly increasing plan assets. Franklin further notes that long-term interest rates have increased during this time period, decreasing the present value of plan liabilities. As a result, Franklin reasons that the termination

Notwithstanding Franklin's strident *ad hominem* attacks on CalPERS that have nothing to do with Franklin's treatment under the Plan, Franklin's legal arguments are fundamentally flawed. Franklin ignores the reality that the best interests of the City and its creditors cannot be served through termination of the CalPERS plan. Franklin ignores the reality that the City cannot confirm a plan premised upon termination of its relationship with CalPERS unless it pays CalPERS on a priority basis in that hypothetical plan. Perhaps most importantly, Franklin continues to ignore the City's business judgment in retaining the CalPERS relationship and continues to seek to substitute its judgment for that of the governing body of the City.

II. REPLY

A. It is Not Necessary for the Court to Rule on Whether Hypothetical Termination Liability May be Impaired.

This Court can confirm (or deny) the City's Plan without addressing pensions or, if it chooses, by assuming, without deciding, the myriad of issues that pension impairment (or non-impairment) raises. This approach is consistent with this Court's past practice. *In re City of Stockton*, 478 B.R. 8, 14 (Bankr. E.D. Cal. 2012) ("For purposes of the present analysis (but without deciding the question), the retiree health benefits are regarded as bargained-for and vested contractual rights.") (hereafter "*Stockton II*"). Most obviously, it is unnecessary to reach the issues regarding the enforceability of section 20487 of the PERL, because as Franklin points out, the City could terminate its relationship under State law. Contrary to Franklin's suggestion, CalPERS does not argue that the City cannot terminate its relationship with CalPERS, but only argues that the City must terminate in compliance with State law. Accordingly, any analysis of whether section 20487 is preempted by section 365 of

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liability must actually be lower. While Franklin conflates termination liability ($1.6 billion) with unfunded accrued actuarial liability (approximately $211 million as of June 30, 2012 (Direct Testimony Declaration of David Lamoureux [Dkt. Nos. 1439-1444] (the "Lamoureux Decl."), Ex. 6 at 52; Ex. 7 at 139)), it raises an important point: the Actuarial Valuations presented to the Court are over two years old and there is no evidence before this Court regarding any ***current*** unfunded liability. Accordingly, there is no evidence before this Court that any payments the City will make to CalPERS postconfirmation are on account of a prepetition claim. Franklin may complain that the costs of providing pensions is too high, but it cannot complain that CalPERS has a prepetition claim that is being treated differently than Franklin.

the Bankruptcy Code is unnecessary because a bankrupt debtor does not need rejection powers under section 365 to terminate its CalPERS plan.

B. Franklin Lacks Standing to Challenge the Plan's Non-Impairment of the City's Pension Obligations.

Franklin lacks standing to insist that the Court consider pension issues in ruling on confirmation of the City's Plan. Franklin claims CalPERS' standing argument is "beyond ridiculous." Franklin's Post-Trial Brief [Dkt. No. 1689] (hereafter "Franklin Br.") at 6. Far from it. The fact that Franklin has standing to challenge the City's Plan does not confer it with standing to challenge two California laws that have never been invoked by the City as a justification for Franklin's treatment under the Plan. As the party claiming standing, Franklin must prove, with respect to each challenge that it raises, (1) injury in fact; (2) traceability, *i.e.*, a causal connection between the injury and the challenged laws; and (3) redressability. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560-61 (1992).[3]

While Franklin might argue that it is injured by its treatment under the Plan,[4] that injury has nothing to do with California pension laws or the City's exercise of its business judgment to not seek to impair pensions. A party "who challenges a statute must demonstrate a realistic danger of sustaining ***a direct injury as a result of the statute's operation or enforcement***." *Babbit v. United Farm Workers National Union*, 442 U.S. 289, 298 (1979) (emphasis added); *see also Thomas v. Anchorage Equal Rights Comm'n*, 220 F.3d 1134, 1141 (9th Cir. 2000) (en banc). Even assuming the

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[3] In bankruptcy cases, all parties must meet three standing requirements: (1) "party in interest" standing; (2) "Article III constitutional" standing; and (3) "federal court prudential standing requirements." *In re Thorpe Insulation Co.*, 677 F.3d 869, 884 (9th Cir. 2012). Thus, Franklin's suggestion that it satisfies its standing requirement merely by being a party in interest to the bankruptcy case is incorrect.

[4] Franklin suggests that CalPERS has "no interest at all in these proceedings" because it believes CalPERS does not bear any financial risk. Franklin Br. at 13. While this is not true as a factual matter, the fact that Franklin is making this argument is curious. In its Summary Objection, Franklin made clear that one of its purposes in opposing the City's Plan was to protect the "rights of its investors (many of whom are retirees who rely on Franklin's funds for safe and steady income)." Franklin Summary Obj. [Dkt. No. 1273] at 57. If this is true, then Franklin's claim that CalPERS has no interest in this case should apply equally to Franklin because any financial risk of impairment apparently falls not on Franklin, but its investors.

pension impairment question is a "necessary predicate" to Franklin's objection, that objection cannot create Article III standing absent an actual injury occurring "as a result" of the laws in question.

Franklin has pulled the standing rug out from under itself on pension issues by arguing that the City's Plan is too conservative and "[e]ven as forecast – ***including assumption and payment of all prepetition pension liabilities*** – the City builds ample cash with which it could pay Franklin." Franklin Br. at 36 (emphasis in original). This statement is fatal to its claim that it is injured by the City's decision not to impair pensions. Without such an injury, no Article III standing exists.

Even assuming injury, Franklin cannot satisfy Article III's other mandatory prongs: causational traceability and redressability. *Townley v. Miller*, 722 F.3d 1128, 1135 (9th Cir. 2013). With respect to causation, Franklin must demonstrate that it has been injured by the challenged law itself, not by the actions of a third party (the City) or by the Plan generally. *Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 41-42 (1976). It cannot so demonstrate because the City has not relied on either statute as a justification for its treatment of Franklin. In *Thorpe Insulation*, the court found standing to challenge a plan of reorganization because the "injury is traceable to the plan." 677 F.3d at 887. *Thorpe Insulation* does not stand for the proposition that standing to challenge a plan creates standing to challenge any laws under the sun that might make a party's treatment under a challenged plan better. Such a rule would swallow whole Article III's standing requirements in the context of plan challenges.

Franklin also cannot demonstrate that, even if this Court were to conclude that pensions could be impaired, the City would actually propose a plan impairing pensions that ***also*** provides Franklin with a full recovery. In other words, Franklin cannot establish an injury that is redressable by a decision of this Court. The City could propose an alternate plan seeking to impair CalPERS or not impair CalPERS, while not changing its treatment of Franklin sufficient enough to satisfy Franklin's demands. Under that scenario, Franklin would still object to its treatment under that alternative hypothetical plan. Franklin's alleged injury is also not redressable because this Court does not have the authority, given 11 U.S.C. § 904, to propose a plan for the City. Thus, even if this Court determined that pensions could be impaired, it is too speculative to assume that the City would ultimately propose a plan impairing pensions that also pays Franklin in full. "Simply put, [Franklin] can only speculate as to how [the City] will exercise [its] discretion in determining" who will be impaired and by how much, which is insufficient to satisfy Article III's redressability requirement. *Clapper v. Amnesty Int'l USA*, 133 S. Ct. 1138, 1148 (2011) (applying the language to the parties in this case).

Instead of meeting the tests for Article III standing, Franklin's challenge to California pension law is much like the claim that the Supreme Court rejected in *Lujan.* Franklin, like the respondents in *Lujan*, seems to think that being affected by any part of the debtor's "ecosystem" is enough to challenge any component of it. That theory did not suffice in *Lujan* nor does it here. Franklin's injury and its traceability are, as was the claim in *Lujan*, conjectural and speculative. In fact, the claim of injury here is contradicted by Franklin itself. And the redress of any injury is not within the Court's hands.

Franklin suggests that even if it lacks standing, this ***Court*** has standing. Franklin Br. at 6. Franklin is wrong. Article III standing applies to parties, not courts. Whether it is proper for this Court to opine on these issues is distinct from whether Franklin has Article III standing. Thus, Franklin's proclamation that this Court issued a "prior holding . . . on the question of justiciability"—albeit during a statement made during trial—holds no water. *Id.* To be sure, both standing and avoidance concepts often fall under the general rubric of "justiciability," but they are very distinct concepts. Standing is rooted in a court's subject-matter jurisdiction and goes directly to the Court's authority to address certain questions, while advisory opinion/constitutional avoidance is rooted in prudential concerns regarding the proper exercise of a court's subject matter jurisdiction. Consequently, even if this Court believes discussing these issues is not prohibited under the latter, it still has an independent obligation to determine whether Franklin has standing to challenge the constitutionality and/or application of these laws. *City of Los Angeles v. Kern*, 581 F.3d 841, 845 (9th Cir. 2009). A desire to opine on an important issue does not, however, create Article III standing. *Hollingsworth v. Perry*, 133 S. Ct. 2652, 2661 (2013) ("In light of this 'overriding and time-honored concern about keeping the Judiciary's power within its sphere, we must put aside the natural urge to proceed directly to the merits of [an] important dispute to "settle" it for the sake of convenience and efficiency.'") (quoting *Raines v. Byrd*, 521 U.S. 811, 820 (1997)) (alteration in original).[5]

C. The PERL Does Not Intend or Countenance Termination and Reduction of Benefits.

1. Franklin Is Wrong in Stating That There Is No State Policy Prohibiting Impairment of Pensions.

To assert that there is no State policy prohibiting impairment of pensions, is to completely disregard the long-standing expression of the protected status of pensions by the California constitution, State statutes and the California courts. Cal. Const., art. XVI, § 17 subd. (b), which governs the CalPERS Board of Administration (the "Board"), mandates that the CalPERS Board ensure the rights of CalPERS members and retirees to their full earned benefits. *City of Oakland v. Pub. Emps. Ret. Sys.*, 95 Cal. App. 4th 29, 39-40 (2002). In 1992, California voters approved Proposition 162, which amended article XVI, section 17 of the California Constitution, to read in part as follows:

> Notwithstanding any other provisions of law or this Constitution to the contrary, the retirement board of a public pension or retirement system shall have ***plenary authority and fiduciary responsibility*** for investment of 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.

Bd. of Ret. of the Santa Barbara Cnty. Emps. Ret. Sys. v. Santa Barbara Cnty. Grand Jury, 58 Cal. App. 4th 1185, 1192 (1997) (emphasis added). Proposition 162 also amended the California Constitution to provide that the CalPERS Board has "the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets" of the system. Cal. Const., art. XVI, § 17, subd. (e). The intent behind the measure was to ***protect*** public pension funds by vesting the authority to direct actuarial determinations solely with the governing board. *See* Lamoureux

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[5] Franklin suggests that *United Student Air Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010) overruled all of the Supreme Court's advisory opinion/constitutional avoidance cases, or created some broad exception to Article III in the context of plan confirmation contests. Franklin Br. at 8. Obviously, the Court said no such thing in *Espinosa* and Franklin's suggestion must be dismissed out of hand. *Espinosa* has nothing to do with standing and only requires this Court to determine whether or not a proposed plan meets the requirements of the Bankruptcy Code.

Decl., Exhibit 3 at 35 (Ballot Pamp., Analysis by the Legislative Analyst, Proposition 162, Gen. Election (Nov. 3, 1992)). Similarly, Cal. Gov. Code §§ 20120, *et seq*. reiterates CalPERS' plenary authority and fiduciary responsibility bestowed upon it by the California constitution.

California law clearly establishes that public employee retirement benefits are a form of deferred compensation and part of the employment contract. Rights to this deferred compensation are earned when the employee provides service to the public employer. *See Betts v. Bd. of Admin.*, 21 Cal.3d 859, 863 (1978). The California Supreme Court established that a promise of a pension made by a public employer to its employees is a promise that must be kept. For example, in *Bellus v. City of Eureka*, 69 Cal.2d 336, 351 (1968), the California Supreme Court explained that when retirement laws "can reasonably be construed to guarantee full payment to those entitled to its benefits regardless of the amount in the fund established by the pension plan, then we are, of course, required to construe the provision liberally in favor of the [pensioner] so as to carry out their beneficent policy." *Id*. at 351 (quotations omitted). The Court went on: "It obviously would be unjust to make the payment of pensions dependent upon the solvency of a particular fund, thereby depriving employees of the benefits of the system, unless we are compelled to do so by a clear, positive command in the [applicable retirement law]." *Id*. at 352.

Moreover, the courts have recognized the protected status of pensions by emphasizing the fiduciary relationship between the system's members (*i.e.*, employees) and the trustee of the funds. *Hittle v. Santa Barbara Cnty. Emps. Ret. Ass'n*., 39 Cal. 3d 374, 391-93 (1985). The trustee must exercise this fiduciary trust "in good faith and must deal fairly" with the participants and beneficiaries. *Id.* at 392. In addition, the California Constitution cannot be interpreted to require CalPERS to administer the system to the advantage of the employer and at the expense of the beneficiaries to whom it owes a fiduciary duty. *City of Sacramento v. PERS*, 229 Cal. App. 3d 1470, 1493 (1991). The underlying principle of a pension system is "affording retirees with a reasonable degree of economic security." *United Firefighters of LA v. City of LA*, 210 Cal. App. 3d. 1095, 1113 (1989).

California law also protects pension benefits by safeguarding the funding of pension plans. California law guarantees adequate funding for full payment to participants and beneficiaries. *Bd. of Admin of PERS. v. Wilson*, 52 Cal. App. 4th 1109, 1131–32 (1997); *see also Valdes v. Cory*, 139 Cal. App. 3d 773, 785-86 (1983). The right to an actuarially sound system is "necessarily implied" from a public employer's commitment to provide a pension benefit, because otherwise the converse would impair the pension right. *Wilson*, 52 Cal. App. 4th at 1133.

2. <u>While the PERL Authorizes Termination, it Anticipates that the Termination Payment Will Be Fully Paid and Confirms that the State Intended that Pension Obligations Have Priority.</u>

Franklin's characterization of the termination process under the PERL oversimplifies, misconstrues and ignores the context and consequences of the process. Its mischaracterization does not change the reality of what the PERL provides and how it operates. Section 20577 of the PERL provides that if the terminating agency has not already contributed the amount necessary to fund the accrued member benefits, then the amount necessary to make full payment is subject to interest and "the agency ***shall*** contribute [this amount] to this system under terms fixed by the board." Cal Gov. Code § 20577 (emphasis added). The PERL anticipates that all the available resources of a terminating employer will be made available to satisfy the termination liability.

To suggest that the termination process can be used as a means for an employer to reduce its pension obligations flies in the face of CalPERS' foundation and the State policy protecting pension benefits. Section 17(a) of the California Constitution provides that "[t]he retirement board shall also 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." Cal. Const., art. XVI, § 17(a). To this end, the PERL requires that CalPERS take all reasonable steps to collect the required amounts, including pursuing all available legal remedies. *See, e.g.*, Cal. Gov. Code §§ 20574, 20575, 20577.5.

The lien statute confirms the legislature's intent to fully exhaust all resources of a terminating employer before CalPERS could reduce benefits. It provides the following:

> A terminated agency shall be liable to the system for any deficit in funding for earned benefits, as determined pursuant to Section 20577, interest at the actuarial rate from

> the date of termination to the date the agency pays the system, and for reasonable and necessary costs of collection, including attorney's fees. The board shall have a lien on the assets of a terminated contracting agency, ***subject only to a prior lien for wages***, in an amount equal to the actuarially determined deficit in funding for earned benefits of the employee members of the agency, interest, and collection costs. The assets shall also be available to pay actual costs, including attorneys' fees, necessarily expended for collection of the lien.

Cal. Gov. Code. § 20574 (emphasis added). Legislative history confirms that this section immediately provides CalPERS with the rights of a senior secured creditor as a matter of law in and out of bankruptcy. The legislature expressly intended to "grant PERS a lien against the assets of public agencies who have terminated their membership in the system, usually as a result of agency dissolution and bankruptcy who have unfunded liabilities owed to PERS for vested employee benefits and have no ability to pay such liabilities." *See* Legislative History of California Government Code § 20574, located in CalPERS' Compendium of Trial Exhibits, Transcripts, and Legislative History Relied Upon In Supplemental Briefing Related to Plan Confirmation, p. 230 [Dkt. No. 1675]. The intended priority status of CalPERS' claim for any termination liability cannot be refuted.

3. Benefit Reductions Are a Last Resort That Would Only Be Exercised After All Resources of the Terminating Employer Have Been Applied to the Termination Liability.

Only after all efforts to recoup the termination payment have failed will benefits be reduced in line with section 20577 of the PERL. Thus, any suggestion that the PERL authorizes the reduction of benefits in the event a termination payment is not made as a matter of course is not supported by the structure and language of the PERL.

D. Franklin's Statutory and Constitutional Arguments Are Misleading and Unhelpful.

In its Brief, Franklin mischaracterizes CalPERS' position and does little to assist this Court in determining the myriad of statutory and constitutional questions raised by the pension impairment issue. Stripped of its rhetoric, Franklin's arguments amount to little more than reliance on inapt platitudes and ignorance of the law.

1. Franklin's "Law of the Case" Argument Is Baseless.

Franklin asserts this Court already has determined the full scope and extent of section 903 and preemption in general, going so far as to claim that the acknowledged dictum in *Stockton II* is now "law of the case" and chiding CalPERS for showing "a lack of respect" for this Court. Franklin Br. at 22. Franklin has a short memory. During the Rule 9019 hearing, the following colloquy occurred between this Court and Franklin's counsel:

> Mr. Johnston: I have some remarks on section 903. I don't know if you want to hear them or not.
>
> The Court: Not particularly. I'm not going to decide this issue on section 903. I already conceded that my discussion of 903 in the retired employees case [*Stockton II*] was, I think, ***unquestionably dictum***, that I included to provide my view of the landscape. And that if I was presented with a square 903 decision, that I would not be bound by it. I'm not even bound by the retired employees decision I entered.
>
> Remember, a decision by a trial judge does not bind other trial judges anywhere. It doesn't even bind the state trial judge in another matter. ***So I'm free to change my mind and be better educated.***

Hr'g. Tr. 80-81, Jan. 30, 2013 (emphasis added) (attached hereto as Exhibit A); *see also id.* at 44 (same), 63 (same) & 82 (same). Despite this, Franklin tries to convince this Court that it has already made up its mind. If true, there would have been no reason for this Court to invite CalPERS to address these important issues of statutory interpretation and constitutional law.

2. Section 20487 Is Part of the State's Consent.

Rather than address CalPERS' arguments on how the California Supreme Court would interpret the relationship between sections 20487 and 53760, Franklin sidesteps the issue, focusing on the fact that section 53760 does not mention 20487. While true, that fact is irrelevant under California rules of statutory interpretation that this Court must apply.

Section 20487's broad "notwithstanding" clause amounts to a declaration of "legislative intent to override all contrary law . . . which might otherwise govern." *Klajic v. Castaic Lake Water Agency*, 16 Cal. Rptr. 3d 746, 751 (2004). This, coupled with the fact that the California Legislature is presumed to be aware of its own laws when enacting new laws and the near iron-clad presumption against implied repeals explains why, as a matter of California law, Franklin's argument is specious. *See* CalPERS Con. Law Br. at 27-28. The fact that section 53760 does not mention section 20487 leads to the exact opposite result advanced by Franklin: that section 20487 was not repealed by section 53760 and should be construed as part of the State's consent.

CalPERS' reading of the legislative intent is supported by section 20487's legislative history and the rule of construction that the PERL is to be construed in a manner favoring affected beneficiaries. *Khan v. Los Angeles City Employees' Ret. Sys.*, 187 Cal. App. 4th 98, 107 (2010). CalPERS' interpretation need not be the best interpretation; rather, it only needs to be "fairly debatable," given the possible constitutional questions that a contrary reading might present. *Cent. Delta Water Agency v. State Water Res. Control Bd.*, 21 Cal. Rptr. 2d 453, 460 (1993).

Franklin misstates legislative history from the prior authorization statute, which is no longer in effect and therefore has nothing to do with this case. Franklin Br. at 19 (arguing that the prior chapter 9 enabling statute intended limited state oversight once the case was filed). The type of "state oversight" the legislative history of this former statute refers to references the California Legislature's creation of a "Local Agency Bankruptcy Committee," which was authorized to approve or reject any attempt by a California municipality to enter into chapter 9. *See* Legislative History of SB 349; *see also* Bill Analysis of AB 155.[6] That legislation was vetoed by Governor Wilson and never became effective. *See* Franklin Compendium of Material Cited in Franklin's Post-Trial Brief ("Franklin's Compendium") at 413. Moreover, the concept of allowing for the "broadest possible access" to chapter 9 was a statement relating to the court's conclusion in *In re Cnty. of Orange*, 183 B.R. 594, 609 (Bankr. C.D. Cal. 1995), where the court determined that the Orange County Investment Pool was neither a "municipality" nor "specifically authorized to file chapter 9" under § 53760's predecessor. *See* Franklin's Compendium at 380. Thus, it speaks to ***who*** is authorized to file for chapter 9, not whether certain restrictions were placed on such authorization. Left with nothing else to say, Franklin grasps at the fact that the term "pension fund" is used in the current authorization statute. Franklin Br. at 20. While true, not every California municipality, as that term is defined in the Code, is in CalPERS (*e.g.*, '37 Act counties, Los Angeles, etc.); thus, the suggestion that this can only refer to CalPERS is a step too far. In any event, there are meaningful ways for CalPERS to participate in the pre-filing process that do not include outright rejection or impairment of CalPERS'

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[6] Copies of the Legislative History of SB 349 and the Bill Analysis of AB 155 are attached hereto as Exhibit B and Exhibit C, respectively.

interests. *See, e.g.*, Cal. Gov. Code § 20812 (hardship extension). The legislative history Franklin points to (most of which is from a law that never became effective) cannot bear the weight it places on it and ignores the real issue before this Court—how the California Supreme Court would interpret the interplay between sections 20487 and 53760.

3. Enforcing State Law Governing the Relationship Between the State and its Municipalities Is Not "Cherry Picking."

CalPERS previously explained why section 903 must have independent meaning and force and why it protects laws like section 20487 from invalidation under the Supremacy Clause. CalPERS Con. Law Br. at 4-15 & 30-32. Franklin ignores all of this, redundantly resorting to its "cherry picking" mantra as if that phrase alone defines section 903. To cavalierly dismiss section 903 as "cherry picking" is both a distraction and wrong as a matter of constitutional law.

Franklin cites this Court's *Stockton II* decision for the proposition that section 903 "is limited by the Supremacy Clause." Franklin Br. at 21 (quoting *Stockton II*). With respect, enforcing section 903 as Congress intended raises no issues under the Supremacy Clause because section 903 is part of the Bankruptcy Code, which is part of the "supreme Law of the Land." U.S. Const. art. VI, cl. 2. How can a State be accused of "cherry picking" or "revis[ing] chapter 9" in violation of the Supremacy Clause when all it is doing is asking a court to enforce the plain terms of a Federal statute? To ask this question is to answer it. By invoking section 903, a State does not challenge the primacy of federal bankruptcy law over State law; rather, it merely asks that the law Congress wrote be enforced as Congress intended.

In none of the "cherry picking" cases cited by Franklin was the State itself the party seeking to enforce a State law that governed the relationship between the State and its municipalities. *See, e.g.*, *Stockton II* (retirees); *In re City of Vallejo*, 403 B.R. 72 (Bankr. E.D. Cal. 2009) (unions); *In re Cnty. of Orange*, 191 B.R. 1005, 1018 & 1021 (Bankr. C.D. Cal. 1996) (Merrill Lynch); *In re City of Columbia Falls, Mont. Special Impr. Dist. No. 25*, 143 B.R. 750, 759 (Bankr. D. Mont. 1992) (bondholders).[7] Accordingly, any statements relating to the substantive force and meaning of section 903—which specifically addresses State control over its subdivisions—were likely unnecessary *obiter dicta* because it is questionable whether a private party has standing to raise section 903's protections. *York Cnty. Nat. Gas Auth. v. Carolina Pipeline Co.*, 266 F. Supp. 244, 248 (D.S.C. 1967) (holding private party could not "invoke" section 903's precursor).[8] The fact that the State, not a private party, is here invoking section 903 is a critical fact setting this case apart because "[m]unicipal bankruptcies implicate a state's sovereignty and Tenth Amendment rights to a greater degree than other bankruptcy contexts because of the special relationship between a state and its municipalities." *In re City of San Bernardino*, 2014 WL 2511096, at *12 (C.D. Cal. June 4, 2014); *see also In re Jefferson Cnty.*, 474 B.R. 228, 276 (Bankr. N.D. Ala. 2012) (section 903 protects "those powers exercised by the state . . . that are within its sovereign powers which must be differentiated for bankruptcy purposes from a court's exercise of powers enforcing private rights.") ("*Jefferson County I*").

Franklin ignores that the relationship it, and other private creditors, has with the City differs *toto caelo* from the relationship that the City has with the State, of which CalPERS is undisputedly a part.[9] For example, in the Ninth Circuit the relationship between a State and one of its political subdivisions is so sacrosanct that municipalities "may not challenge the validity of a state statute in a federal court on federal constitutional grounds," including Supremacy Clause grounds. *Palomar*

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[7] *Mission Independent School District v. Texas*, 116 F.2d 175 (1940), was decided before the current section 903 was adopted and did not discuss section 903's precursor. Thus, Franklin's claim that CalPERS' position on that score is "a head scratcher," while cute, is of no assistance to this Court in determining what section 903 means and why it applies in this case.

[8] At the time all of those cases were issued (except for *Stockton II*), private parties lacked Tenth Amendment standing. *Bond v. United States*, 131 S. Ct. 2355, 2363 (2011) (directly holding, for the first time, individuals have standing to raise Tenth Amendment claims).

[9] Franklin baldly states that there is "no fundamental State interest" at stake here because "the State itself has not chosen to participate." Franklin Br. at 10. Franklin could not be more wrong. First, CalPERS ***is*** an arm of the State and ***is here*** representing the State's interest. The State can only act through its officers and agencies. Second, if Franklin actually believed this, one would have expected it to follow the procedures set forth in 28 U.S.C. § 2403, Fed. R. Civ. P. 5.1 and Fed. R. Bankr. P. 9005.1 requiring notice to the State Attorney General when the constitutionality of a State statute is at issue.

Pomerado Health Sys. v. Belshe, 180 F.3d 1104, 1107-08 (9th Cir. 1999) (quotations & citations omitted); *see also Burbank-Glendale-Pasadena Airport Auth. v. City of Burbank*, 136 F.3d 1360, 1363-64 (9th Cir. 1998) (rejecting Supremacy Clause exception to "per se rule" that political subdivisions lacks standing to sue the State in federal court) & *id.* at 1365 (Kozinski, J., concurring) (citing *Printz v. United States*, 521 U.S. 898 (1997)). Section 903 acknowledges the unique relationship between a municipal debtor and its parent State.

Federal courts must be wary when approaching this constitutional line. *In re Cnty. of Orange*, 179 B.R. 177, 183 (Bankr. C.D. Cal. 1995) ("The history of chapter 9 reflects concern on the part of Congress not to overstep the boundary between legislation necessary for municipalities to reorganize and the rights of states to control the functions of their municipalities. This boundary has not always been easy to define. Section 903 is a specific directive to bankruptcy courts to proceed cautiously when approaching this line."). This is one of the critical failings of *Mission Independent*. Despite Congress's express intent to the contrary, in that case the court failed to address the school district's relationship with its creator, unnecessarily making a broad pronouncement on the Supremacy Clause that no longer comports with modern-day Supreme Court jurisprudence on preemption. *Mission Independent* is a relic of a bygone era that has no bearing on the meaning or effect of section 903.

Further, claims of "cherry picking" make little sense given the interplay between sections 903 and 904. While section 904 "operates as an anti-injunction statute" barring this Court from "interfering" with a municipal debtor's "political or governmental powers," *Stockton II*, 478 B.R. at 13, section 903 is an anti-preemption statute limiting what a municipal debtor can consent to. *In re Jefferson Cnty.*, 484 B.R. 427, 463 (Bankr. N.D. Ala. 2012) (section 903 limits section 904) ("*Jefferson County II*"); *In re New York Off-Track Betting Corp.*, 434 B.R. 131, 141 (Bankr. S.D.N.Y. 2010) (same). It simply cannot be that section 904 means what it says but section 903 does not. Congress intended that these two provisions work in tandem to ensure that State sovereignty is respected throughout the entire chapter 9 proceeding, not just at its inception. *Jefferson Cnty. I*, 474 B.R. at 276.

Even if enforcing section 20487 through section 903 could be seen as "cherry picking" the real question is: why isn't this appropriate?

The answer cannot be the Supremacy Clause, because section 903 is part of the Code. The answer cannot be the Bankruptcy Clause's uniformity requirement because that constitutional provision is a restriction on Congress, not on the States. The courts readily accept variances in outcomes based on different State laws. *Stellwagen v. Clum*, 245 U.S. 605, 613 (1918) ("Such recognition in the application of state law does not affect the constitutionality of the Bankruptcy Act, although in these particulars the operation of the Act is not alike in all the states.").

The answer cannot be that chapter 9's overriding purpose is to ensure that every municipality be able to structure it debts ***in any manner*** it sees fit. In this regard, the *Columbia Falls'* dicta (repeated by *Orange County*) that enforcing section 903 as written undercuts the efficacy of chapter 9 is gross overstatement. Franklin Br. at 27 (quoting *Columbia Falls*, *supra*). As part of chapter 9, section 903 reflects Congressional intent, which was to allow a municipality to adjust its debts ***while also*** respecting State law. Neither of these purposes is superior to the other, nor are they at all inconsistent. Indeed, this case presents a perfect example because Stockton has been able to propose a Plan to readjust its debts without offending State law. The answer also cannot be that States cannot place preconditions on eligibility, because they can. According to Congress, States have the authority to pull the plug on a chapter 9 proceeding at any time. CalPERS Con. Law Br. at 7.

The answer cannot be that bankruptcy law always displaces State law, because it does not. The contrary is true. Bankruptcy law in general has a healthy respect for State law. *Butner v. United States*, 440 U.S. 48, 56 (1979). Congress's respect for State law is on "steroids"—as this Court has put it in another context—in chapter 9. The entire structure of chapter 9 is designed to respect State law and the relationship that exists between a State and one of its subdivisions. *Cf. Stockton II*, 478 B.R. at 20. ***Section 903 is not the odd-man out***. Rather, it is the centerpiece of Congress's acknowledgement and respect for State law because it says in no uncertain terms that nothing in chapter 9 interferes with the State's ability to control is political subdivisions, including expenditures, and such control is protected by the Tenth Amendment.

It makes no difference whether the State's control is exercised before or after a case is filed. Nothing in the plain text of section 903 suggests a contrary result, and section 903's legislative history supports such a reading. It says: "***Any State law that governs municipalities or regulates the way in which they may conduct their affairs controls in all cases.***" H.R. REP. NO. 94-686, at 19 (1975), *reprinted in* 1976 U.S.C.C.A.N. 539, 557; *see also City of Pontiac Retired Employees Assn. v. Schimmel*, 751 F.3d 427, 433 (6th Cir. 2014) (en banc) (McKeague, J., concurring) ("The principal purpose of § 903 is to make clear that Chapter 9 of the Bankruptcy Code does ***not*** limit or impair State power.") (emphasis in original); *San Bernardino*, 2014 WL 2511096, at *12 (noting section 903 is a "special rule[ ]" designed to "protect the sovereignty of the state ***in*** Chapter 9 municipal bankruptcies.") (emphasis added); *In re City of Harrisburg*, 465 B.R. 744, 755 (Bankr. M.D. Pa. 2011) ("***Even after an order for relief is granted***, states maintain significant control over their political subdivisions. This position is set forth bluntly in § 903 . . . .") (emphasis added). Franklin ignores all of this, instead claiming that enforcing section 903 somehow interferes with the distributional priorities that Congress established in the Code.

Franklin's real complaint is that correctly applying section 903 might provide the State with an advantage over other creditors in a chapter 9 case. Even assuming that is true, that is a choice Congress was empowered to make under its Bankruptcy Clause power. While Franklin may not like that choice, Congress made it. Likewise, bankruptcy courts may feel that their authority is lessened by the limitations imposed by section 903, in comparison to the broad authority they enjoy under other chapters of the Code. And so it is. But it is the will of Congress and must be given effect.

The only retort Franklin has is a misreading of the Supreme Court's decision in *United States v. Bekins*, 304 U.S. 27 (1938). Franklin Br. at 23. Franklin claims the "entire premise" of why *Bekins* upheld the facial validity of the new bankruptcy law was because California consented to the filing at issue. Franklin Br. at 23. Franklin misreads *Bekins*. To be sure, the Court mentioned this fact, but only after making the following clear:

> Our attention has been called to the difference between section 80(k) of chapter 9 and section 83(i) of chapter 10 of the Bankruptcy Act, in the omission from the latter of the provision requiring the approval of the petition by a governmental agency of the State whenever such approval is necessary by virtue of local law. ***We attach no***

> ***importance to this omission. It is immaterial, if the consent of the State is not required to make the federal plan effective, it is equally immaterial if the consent of the State has been given, as we think it has in this case.***

Id. at 49 (internal citations omitted; emphasis added). Thus, consent is not the "entire premise" of *Bekins*. If that were true, the Court would not have struck down chapter 9 in *Ashton v. Cameron County Water Improvement Dist. No. 1*, because that statute, unlike the new chapter 10, had an authorization provision. 298 U.S. 513, 527 (1936). Rather, the *Bekins* Court facially upheld chapter 10 not because the State had consented to the filing at issue, but rather because the new law was "carefully drawn so as not to impinge upon the sovereignty of the State. The State retains control of its fiscal affairs. The bankruptcy power is exercised in relation to a matter normally within its province and only in a case where the action of the taxing agency in carrying out a plan of composition approved by the bankruptcy court is authorized by state law." *Bekins*, 304 U.S. at 51.

Bekins stands for nothing more than, as a matter of constitutional law, that the basic idea of municipal bankruptcy legislation is not inconsistent with Our Federalism. This Court said as much in *Stockton II*, 478 B.R. at 17-18 (noting *Bekins* "repudiated *Ashton's* structural objection" which was that "municipal bankruptcy was an impossible contradiction to federalism"). *Bekins* says nothing about any particular ***application*** of such a law. *See, e.g.*, Giles J. Patterson, *Municipal Debt Adjustment Under the Bankruptcy Act*, 90 U. PA. L. REV. 520, 531 (1942) ("It must be kept in mind that though the present statute was held constitutional, that decision was based upon the fact that it did not conflict with state and local sovereignty. Merely because the Act is constitutional, a Federal court may not invade the field of the state's power."). Likewise, *Bekins* says nothing about what section 903 means and how it should be applied.

Even so, intervening Supreme Court authority undercuts Franklin's misreading of *Bekins*. States cannot "consent" away their sovereignty, of which control over their political subdivisions is unquestionably part. This is the central holding of *New York v. United States*, 505 U.S. 144 (1992), which was reaffirmed and bolstered by *Bond v. United States*, 131 S. Ct. 2355 (2011). CalPERS Con. Law Br. at 14-16. Moreover, nothing in California's authorization statute (or any statute for that matter) provides any clear and unequivocal waiver of the State's sovereign interests. *See* CalPERS Con. Law Br. at 40. The view that a State cedes all of its authority over its political subdivisions by merely authorizing them to file for chapter 9 is far too simplistic and wrong as a matter of constitutional law and statutory construction.

If there was any doubt that CalPERS's interpretation of section 903 best effectuates Congress's intent, canons of statutory interpretation lay those doubts to rest. ***First***, CalPERS' interpretation does not render section 903 superfluous because it provides section 903 meaning independent of 11 U.S.C. § 109(c)(2). *See TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001). ***Second***, it reads chapter 9's text, history and structure as whole. *See Corley v. United States*, 556 U.S. 303, 314 n.5 (2009). ***Third***, CalPERS' reading avoids a possible constitutional issue that would arise (*i.e.*, Tenth Amendment and Supremacy Clause) under a contrary reading. *See Zadvydas v. Davis*, 533 U.S. 678, 689 (2001). Not only is it "fairly possible," *id.*, that Congress intended to allow States to retain control over their subdivisions while in bankruptcy, section 903 expressly says this. ***Finally***, it acknowledges the "plain statement rule," which requires that courts read a statute in a manner that respects, not rejects, State sovereignty. This rule's application is most important where a federal law seeks to "interpos[e] federal authority between a State and its municipal subdivisions." *Nixon v. Missouri Muni. League*, 541 U.S. 125, 140 (2004). Simply stated, every canon of construction favors CalPERS' interpretation of section 903.

At the end of the day, Franklin does not seriously dispute that section 20487 "controls" California municipalities in the exercise of their "political or governmental powers," which is all that is required for section 903 to apply. Instead, it claims that section 903—one of the constitutional underpinnings of chapter 9—means nothing and ceases to have effect once a State authorizes one of its municipalities to file for chapter 9. That view of section 903 is not supported by section 903's plain text, its legislative history, the structure of chapter 9 and numerous canons of statutory interpretation and should be rejected as both unsound and unwise.

4. Independent of Section 903, Section 20487 Is Not Preempted.

The Court need not consider the application of various preemption doctrines, because of the explicit anti-preemption effect of section 903. Nevertheless, even setting aside section 903, Franklin's preemption analysis is wrong.

Franklin claims that this Court, in *Stockton II*, "thoroughly covered the modern law of preemption." Franklin Br. at 24. This overstates this Court's discussion of the issue in *Stockton II*. *Stockton II*, 478 B.R. at 16. Nothing in *Stockton II* discusses either of the two "cornerstones" of every preemption analysis: Congressional intent and the presumption against preemption. *Wyeth v. Levine*, 555 U.S. 555, 565 (2009). Nor does *Stockton II* discuss the Supreme Court's *Nixon* decision, which demonstrates precisely why section 20487 is not preempted.

Franklin does not dispute that the only form of preemption that could be applied here is so-called "obstacle" preemption, which is a form of implied preemption. In other words, preemption can only occur via inference of Congressional intent. Intent is key because "it is Congress rather than the courts that preempts state law." *Chamber of Commerce of the U.S. v. Whiting*, 131 S. Ct. 1968, 1985 (2011) (quotation omitted). "[T]the best evidence of Congress's pre-emptive intent" is the relevant statutory language and scheme. *CSX Transp. Inc. v. Easterwood*, 507 U.S. 658, 664 (1993). The proper inference to draw from section 903, the structure of chapter 9 as a whole, as well as chapter 9's legislative history is that Congress did not intend to preempt State laws like section 20487. Rather, "[t]he entire structure of chapter 9 has been influenced by this pervasive concern to preserve the niceties of the state-federal relationship." *Stockton II*, 478 B.R. at 20. By allowing a chapter 9 debtor to reject its relationship with CalPERS in violation of State law, particularly when there are a series of State laws relating to termination, means that the "bankruptcy power" is being "exercised . . . at the expense of, the sovereign state." *Id.* at 20. The Supreme Court in *Bekins* forbids such an expansion of the bankruptcy power.

Franklin, relying on statements made by this Court, argues that State laws such as section 20487 come to the Court with a presumption of unconstitutionality. Franklin Br. at 17 (arguing CalPERS must provide "an explanation" as to why section 20487 is not preempted). Franklin has it backwards. State laws like section 20487 come into this Court with a heavy presumption against preemption and this presumption is at its zenith when Federal law "interpos[es] federal authority between a State and its municipal subdivisions." *Nixon*, 504 U.S. at 140. Under *Nixon*, courts must apply a "working assumption that federal legislation threatening to trench on the States' arrangements for conducting their own governments should be treated with great skepticism, and ***read in a way that preserves a State's chosen disposition of its own power***." *Id* (emphasis added). This is so because preemption in such contexts does not "work like a normal preemptive statute if applied to a governmental unit." *Id.* at 138. As such, Congress's preemptive intent must be "***unequivocally***" clear that it intended "to treat governmental" actors "on par with private firms." *Id.* at 141 (emphasis added). Through section 365, Congress did not evince any such unequivocal intent to override State laws relating to pensions.

The entire history of municipal bankruptcy laws is one that is in constant tension with the special relationship that exits between a State and its municipal subdivisions. Congress has recognized this from the beginning. It was only by making it clear that the fiscal affairs of the State, which include the provision of public pensions, were not impaired during a chapter 9 proceeding that the Supreme Court upheld the precursor to chapter 9 constitutional in *Bekins*. *Bekins* forecloses any preemption argument because it expressly recognized that nothing in chapter 9 interfered with the States' "fiscal affairs" and that any plan of composition must be "authorized by state law." 304 U.S. at 51. If section 20487 is preempted and municipal debtors are allowed to ignore State laws regarding rejection and termination, then it can hardly be said that California is still in control of its "fiscal affairs" as such affairs relate to public pensions.

Not even Franklin disputes that chapter 9 represents a delicate balance between the need for municipal reorganization and the Tenth Amendment rights of the States to be free from federal interference and to control their political subdivisions. A proper preemption analysis, guided by *Nixon*, shows why Franklin's preemption arguments are at odds with Supreme Court precedent and must be rejected.

5. <u>Franklin Mischaracterizes CalPERS' Tenth Amendment Claim.</u>

CalPERS does not, as Franklin suggests, claim that chapter 9 is unconstitutional on its face. Franklin Br. at 31 n.79. While that question is an interesting one, CalPERS argues only that ***if*** this Court concludes that obligations owed to a State-run pension system can be impaired in chapter 9, ***then*** such an application of chapter 9 would violate the Tenth Amendment because (1) it would unconstitutionally inject the Federal bankruptcy power between the State and one of its creatures, and (2) be contrary to the fundamental holding of *Bekins*. CalPERS Con. Law Br. at 11-16.

Only by mischaracterizing CalPERS' claims can Franklin assert that the decision in *In re City of Detroit*, 504 B.R. 97 (Bankr. E.D. Mich. 2013), has any relevance to this case. There, the court made two Tenth Amendment holdings. ***First***, it concluded that chapter 9 was not unconstitutional on its face largely based on an improper view of "consent." *See id.* at 136-49. CalPERS has already explained how the *Detroit* court misconstrued *New York v. United States*, 505 U.S. 144 (1992) and completely ignored *Bond I*, which make that court's treatment of the issue inconsistent with Supreme Court precedent. CalPERS Con. Law Br. at 14-15. ***Second***, building on this misconstruction, the *Detroit* court concluded that chapter 9 would not be applied in an unconstitutional manner if pensions were to be impaired. *In re City of Detroit*, 504 B.R. at 149-50. The opinion was advisory, or at best *dictum*, on the issue of pension impairment, because it dealt with the claim by objectors to Detroit's eligibility that the Michigan statute (P.A. 436) authorizing a chapter 9 petition was violative of the Michigan Constitution's pension-rights provision, merely because the authorization statute was silent about protecting pensions. The objectors were jumping the gun. The neutral authorization statute did not violate anything by silence. The filing of the petition did not impair pensions. The issue of pension impairment would have been before the *Detroit* court only if and when a plan proposing pension impairment was proposed for confirmation.

E. The PERL Encourages Employers to Provide Defined Contribution Plans As Well As Defined Benefit Plans.

Franklin misreads section 20485 of the PERL.[10] The statute does not "encourage[] employers to pursue alternatives to CalPERS pensions." Franklin Br. at 29. Nothing in the statute evidences an intent by the California Legislature that contracting agencies terminate their relationships with CalPERS and instead pursue defined contribution plans. To read such a meaning into the statute

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[10] Cal. Gov. Code § 20485 provides as follows: "It is the intent of the Legislature that the contracting agencies in conjunction with recognized local employee organizations, develop alternative retirement plans that provide benefits under a defined contribution program."

ignores its plain language given the statute's use of the term "contracting agency." Under the PERL, a "contracting agency" is a public agency that participates in CalPERS. *See* Cal. Gov. Code § 20022. If a public agency terminates its relationship with CalPERS, it would no longer be a contracting agency and thus section 20485 would not apply to it. Therefore, at the very least, section 20485 must contemplate that a contracting agency maintain its relationship with CalPERS while also developing defined contribution plans to supplement already-existing CalPERS defined benefit plans. In addition, section 20485 cannot be read to sanction the City's unilateral termination of its relationship with CalPERS because section 20485 asks that contracting agencies develop defined contribution plans "in conjunction with recognized local employee organizations." Cal. Gov. Code § 20485. Unilaterally terminating an employer's relationship with CalPERS would not satisfy the Legislature's intent that contracting agencies work with recognized local employee organizations in developing defined contribution plans.

F. The Testimony of Charles Moore Regarding the Effect of Pension Impairment in Detroit Is Irrelevant.

The City has overwhelmingly established that its decision to maintain its relationship with CalPERS was made in good faith and for legitimate business reasons. The evidence before this Court, including testimony from City Managers, the Police Chief, and the City's pension expert, demonstrates that the termination of the City's relationship with CalPERS would negatively affect the City's ability to hire and retain well-qualified employees and specifically safety employees. Franklin's attempt to discredit the evidentiary record before the Court should be rejected. The only evidence Franklin lodges in support of its argument is the anecdotal testimony of its financial expert, Charles Moore, regarding the City of Detroit. Mr. Moore's testimony regarding Detroit should be given little weight.

Mr. Moore's testimony that he has not seen an exodus of public employees in Detroit as a result of Detroit's adjustment of pension benefits compares apples to oranges. It could not be more obvious that Detroit and Stockton are different. In its plan of adjustment, the City of Detroit proposes to ***adjust*** its pension benefits; it is not proposing, as Franklin urges in this case, to completely eliminate its defined benefits plan. Second, the ***adjustment*** of pension benefits proposed by the City of Detroit does not even approximate the effect that ***termination*** of the entire CalPERS plan would have on the City and its employees. With respect to holders of General Retirement System pension claims, Detroit proposes in its plan of adjustment to cut pensions by some 4.5% in addition to the elimination of cost-of-living increases. Holders of a Police and Fire Retirement System pension claims are affected even less severely, as they are only subject to reductions in their annual cost-of-living increases. *See* Seventh Amended Plan for the Adjustment of Debts of the City of Detroit [Dkt. No. 7502], *In re City of Detroit*, Case No. 13-53846, United States Bankruptcy Court for the Eastern District of Michigan, at p. 16, 21. Third, given the portability of a CalPERS plan and the large number of contracting agencies across the State, the incentive for well-qualified police officers to leave Stockton (the 13th largest city in the State) is much greater than in Detroit (the largest city in Michigan), which utilizes a city-run pension plan. Lastly, Mr. Moore's testimony that the adjustment of benefits has had no effect on employees is contradicted by news reports issued days after he testified. *See e.g.*, Simon Shaykhet, *Detroit Police Officers Consider Retiring Over Bankruptcy Cuts*, May 20, 2014, http://www.wxyz.com/news/detroit-police-officers-consider-retiring-over-bankruptcy-cuts- (last visited on Sept. 18, 2014).[11] Because the plan proposed by the City of Detroit is entirely different than the hypothetical termination urged by Franklin in this case, Mr. Moore's comments regarding Detroit should be given little weight.

G. The Plan's Ratification of Its Relationship with CalPERS Does Not Constitute Unfair Discrimination.

1. <u>Unfair Discrimination Is a Concept that Applies to Classes of Creditors, Not Individual Creditors.</u>

Contorting the facts, Franklin argues that the Plan unfairly discriminates against Franklin by "paying prepetition pensions in full." Franklin Br. at 39. Unfair discrimination is a concept that applies to the treatment of classes of creditors in the City's Plan. The text of section 1129(b)(1) of the Bankruptcy Code prohibits unfair discrimination "with respect to each ***class*** of claims or interests that

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[11] A copy of the news article is attached hereto as <u>Exhibit D</u>.

is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). The class of creditors in which Franklin has been classified, Class 12, has voted in favor of the Plan. Thus, the plain language of section 1129(b)(1) does not permit Franklin to argue, on behalf of Class 12, that the Plan unfairly discriminates.

Courts considering the issue have reached the same conclusion, including the Third Circuit Court of Appeals when it rejected an unfair discrimination argument in the context of a chapter 9 proceeding. *In re Jersey City Med. Ctr.*, 817 F.2d 1055, 1062 (3d Cir. 1987) (stating that because the class to which a creditor in chapter 9 case belonged had voted to accept the debtor's plan, section 1129(b)(1) afforded the creditor "no protection"); *see also In re Journal Register Co.*, 407 B.R. 520, 532 (Bankr. S.D.N.Y. 2009) (stating that the rule "is concerned with plan treatment between classes—not within classes").

2. "Unfair Discrimination" Is Not a Valid Objection to Plan Confirmation Where, As Here, Franklin and CalPERS Are Not Substantially Similar.

Franklin's argument that the City's treatment of CalPERS constitutes unfair discrimination in violation of section 1129(b)(1) also fails because for unfair discrimination to exist, the Plan must propose disparate treatment of similarly situated creditors. As one court stated, "it is not a valid objection, nor 'unfair discrimination' to complain that other classes are being treated differently, *unless* their claims are substantially similar to each other." *In re Linda Vista Cinemas, LLC*, 442 B.R. 724, 753 (Bankr. D. Ariz. 2010) (emphasis in original). Franklin's unfair discrimination argument assumes, erroneously, that CalPERS (a) has asserted a prepetition claim that is subject to treatment under the City's Plan, and (b) that such claim is substantially similar to its own claim.

CalPERS has not filed a claim in the bankruptcy case that is subject to treatment by the City under the Plan. Section IV.P.2 of the Plan provides that "[t]he City will continue to honor its obligations under the CalPERS Pension Plan." The Plan does not, however, propose to treat any prepetition claim held by CalPERS because the City is current on its obligations to CalPERS. Thus, because Franklin's unfair discrimination argument is not premised on the disparate treatment of filed claims under the Plan, it must fail.

Even if Franklin can overcome the fact that its argument is not premised on the City's payment of a claim filed by CalPERS, its unfair discrimination argument must be rejected because the City's relationship with CalPERS is fundamentally different than the claim held by Franklin. The legal character of CalPERS' relationship with the City—that of an arm of the State dealing with a municipal creature of the State—is fundamentally different than Franklin's relationship with the City. Franklin does not have a continuing, executory relationship with the City. Franklin merely loaned money to the City, assuming the financial risk of nonpayment, and is a garden variety unsecured creditor with respect to its deficiency claim. CalPERS, unlike Franklin, maintains an ongoing relationship with the City that continues to advantage and benefit the City and its employees.

The assumption of an executory relationship by the City justifies disparate treatment under the City's Plan. *See In re Bouy Hall & Howard & Assoc.*, 141 B.R. 784 (Bankr. S.D. Ga. 1992) (rejecting creditor's unfair discrimination argument where the unfair treatment complained of concerned the debtor's assumption of a franchise agreement). The *Bouy* court, in rejecting a secured creditor's argument that it was unfair discrimination for the debtor to pay its franchisor on its unsecured claim over a shorter term than the payment term applying to secured creditor claims, reasoned that the debtor's payment to the franchisor was part of its cure and assumption of its franchise agreement. According to the court, "[t]his is not a case in which one unsecured creditor is paid more favorably than another unsecured creditor similarly situated." *Id*. at 793. Rather, "because of Section 365, Choice Motels is entitled to separate classification and different treatment, including prompt cure of any pre-petition default." *Id*. Moreover, disparate treatment of trade creditors may be justified where such creditors have an ongoing relationship with the debtor, even absent the formal assumption of an executory contract. *See In re Leblanc*, 622 F.2d 872, 879 (5th Cir. 1980) (separate classification of trade creditors not discriminatory).

Termination of CalPERS' relationship with the City would result in a massive termination liability and leave the City to bear the additional cost of a replacement pension plan, notwithstanding the mass exodus of qualified safety employees. The evidence presented at trial demonstrates that the City's participation in CalPERS allows it to attract well-qualified employees and retain existing employees. Because the City's assumption of its relationship with CalPERS is fundamentally different than its payment of a prepetition claim held by an entity with no continuing relationship with the City, Franklin cannot argue that the City's treatment of CalPERS under the Plan amounts to unfair discrimination.

H. Only Termination Would Cause CalPERS To Be a Creditor With a Termination Claim in the Estimated Amount of $1.6 Billion.

Franklin argues that CalPERS' hypothetical claim for termination liability is an existing, unliquidated claim which CalPERS has incorrectly calculated. But no claim for termination liability exists because the City has not terminated its relationship with CalPERS. Under the PERL, CalPERS has a "right to payment" of the termination liability only upon termination. The City has not terminated its relationship with CalPERS—nor has it ever indicated that it will in the future. In fact, the evidence before the Court is that terminations, especially for municipalities of the size of Stockton, are an exceedingly rare occurrence. *See* Lamoureux Decl., at ¶¶ 11, 12. Given that termination of the CalPERS relationship is not contemplated by the parties, it cannot be said that a contingent right to payment exists any more than a landlord has a claim for all future rents prior to the rejection of its lease. *See In re SNTL Corp.*, 571 F.3d 826 (9th Cir. 2009) ("a claim arises when a claimant can fairly or reasonably contemplate the claim's existence even if a cause of action has not yet accrued under nonbankruptcy law"). For these reasons, no claim (unliquidated or otherwise) for termination liability exists.

In re United Merchants & Manufacturers, Inc. is supportive of CalPERS' position. There, the bankruptcy court held that a private benefit plan held no claim against the reorganized debtor for "withdrawal liability," the ERISA equivalent to termination liability, where no payment delinquency existed and the debtor-employer's participation in the plan had not terminated. 166 B.R. 234, 237, 241 (Bankr. D. Del. 1994). The Third Circuit adopted the "thorough and appealing" reasoning of *United Merchants* in *CPT Holdings, Inc. v. Industrial & Allied Employees Union Pension Plan*, 162 F.3d 405, 409 (6th Cir. 1998). There, the court held that "withdrawal liability" was not discharged by the debtor's plan because withdrawal from the debtor's private pension plan did not occur preconfirmation. The court reasoned that "[a] multiemployer pension plan has no enforceable right to payment for withdrawal liability until an employer actually withdraws from a plan, leaving the plan underfunded." *Id*. The same can be said with respect to termination liability under the PERL. Because the City has not terminated its relationship with CalPERS, CalPERS has no enforceable right to payment of the termination liability.

Franklin also argues that the City's hypothetical termination liability is "inflated." Franklin Br. at 59-62.[12] In the event that the City were to propose a different plan that contemplated the termination of the City's relationship with CalPERS, the termination liability owed by the City to CalPERS would be based on the facts and assumptions existing as of the effective date of plan termination. Franklin's arguments regarding the amount of any hypothetical termination liability should be rejected because they lack evidentiary foundation. The testimony of Mr. Lamoureux supporting CalPERS' calculation of the estimated termination liability is the only probative evidence of the City's potential termination liability. During pre-trial discovery and at trial, Franklin had the ability to challenge the hypothetical termination liability but did not. Franklin failed to hire a pension expert to refute CalPERS' calculation and failed to cross-examine Mr. Lamoureux on this point. Franklin failed to introduce any evidence at all to calculate the estimated termination liability. Franklin's attempt to reopen the evidence in this case should be rejected.

Franklin's argument regarding calculation of the hypothetical termination liability also ignores that the amount of any hypothetical termination liability is governed by State law. The PERL provides that termination liability is determined by the CalPERS Board. Cal. Gov. Code § 20577. Thus, according to State law, the CalPERS Board is given plenary authority to calculate the liability owed by any terminating agency. The calculation is not subject to review or dispute by the terminating agency. Franklin's suggestion that CalPERS' methodology is flawed ignores the

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[12] Franklin misstates the unfunded liabilities of the City under the CalPERS plans. Franklin inaccurately states the amount of the ***unfunded liability*** as $1.6 billion and references the calculation of ***termination liability*** in the valuation statements (Franklin Br. at 4 n.6). As of June 30, 2012, the unfunded liability is in the range of $211 million, not $1.6 billion. Lamoureux Decl., Ex. 6 at 52; Ex. 7 at 139.

Supreme Court's pronouncement that "[c]reditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code." *Raleigh v. Illinois Dept. of Rev.*, 530 U.S. 15, 20 (2000) (bankruptcy court should apply burden of proof set forth in state statute in considering whether debtor was liable for tax penalty); *see also Gen. Elec. Capital Corp. v. Future Media Prods. Inc.*, 536 F.3d 969 (2008) (oversecured creditor entitled to interest at default rate, pursuant to contract with debtor).

The amount of any termination liability is therefore calculated pursuant to State law. That Franklin believes the CalPERS' calculation is overly conservative is of no moment. The hypothetical termination liability is only subject to revision by "any qualifying or contrary provisions of the Bankruptcy Code." *Raleigh*, 530 U.S. at 20. Franklin has failed to point to any such provision of the Bankruptcy Code. In *In re U.S. Airways Group, Inc.*, 303 B.R.784 (Bankr. E.D. Va. 2003), the debtor terminated its private pension plan postpetition, giving rise to a claim held by the Pension Benefit Guaranty Corporation (the "PBGC").[13] The PBGC asserted an over $2 billion claim for unfunded liabilities under the pension plan, which the debtors and postconfirmation creditors committee argued was "approximately three times greater than the amount the PBGC actually needs to pay the pilots their promised benefits." *Id*. at 786. The debtors, through their actuary, argued that the plan liabilities would be significantly lower using more reasonable assumptions. The court concluded, relying on *Raleigh*, that the amount of the claim should be determined by the PBGC according to a regulation it promulgated governing the calculation of liabilities of a terminated pension plan. The court reasoned that it was not simply valuing a contingent future loss; rather, the PBGC has the statutory authority to a "*present* right to recover an amount determined in accordance with the valuation regulation." *Id*. 793 (emphasis in original).

Franklin's arguments regarding the termination liability are analogous to those made by the debtor and creditors committee in *U.S. Airways*. Because State law provides for the calculation of

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[13] The PBGC assumes the liabilities of private ERISA-governed pension plans that are terminated as a result of a "distress termination."

termination liability, and because no contrary provision of the Bankruptcy Code exists, CalPERS' calculation of the hypothetical termination liability controls. Moreover, the Court should defer to the calculations of the CalPERS Board because it is the administrative body charged with implementing and enforcing the PERL provisions that give rise to the termination liability. *See Bernard v. City of Oakland*, 202 Cal. App. 4th 1553 (2012) (CalPERS' construction of statutory language of the Public Employees' Medical Hospital Care Act (PEMHCA) while not binding, was "entitled to deference.").

Even if the Court were to adopt Franklin's view that the hypothetical termination liability may be less, the difference cannot be material. Whether the hypothetical termination liability is $1.3 billion or $1.6 billion, it is a claim that overwhelms Franklin's $32 million deficiency claim, and it is a claim that negatively, and dramatically, affects the City's restructuring options.

I. In Order To Satisfy the Best Interests Test, a Hypothetical Plan Implementing Termination Would Have To Require that Termination Liability Be Paid Before Paying Franklin.

Franklin asserts that the City's Plan does not satisfy the "best interests" test because it does not impair pensions. Franklin Br. at 35. But under Franklin's own standard, any plan terminating the CalPERS relationship and impairing pensions would never satisfy the "best interests" test unless it paid CalPERS before Franklin was paid anything on its unsecured deficiency claim. The "best interest" requirement of 11 U.S.C. § 943(b)(7) "is generally regarded as requiring that a proposed plan provide a better alternative for creditors than what they already have." *In re Mount Carbon Metro. Dist.*, 242 B.R. 18, 34 (Bankr. D. Colo. 1999). In a chapter 9 case, because "creditors cannot propose a plan; cannot convert to Chapter 7; cannot have a trustee appointed; and cannot force a sale of municipal assets under state law, their only alternative to a debtor's plan is dismissal." *Id*. Thus, the "best interests" test requires that the Court compare a proposed plan's treatment of a creditor's claim against what that creditor would receive outside of bankruptcy. Franklin agrees. Franklin Summary Obj. [Dkt. No. 1273] at 13.

Based on Franklin's own legal standard for determining whether a plan of adjustment satisfies the "best interests" test, a plan incorporating Franklin's proposed treatments of CalPERS (impairing pensions by terminating the CalPERS relationship) would not result in a better treatment of Franklin or other creditors. The "best interests" requirement would apply to the treatment of CalPERS under such a plan. Consequently, any plan that involved terminating the City's statutory relationship with CalPERS while at the same time providing Franklin with a recovery on its claim would need to be compared against the treatment CalPERS would receive if the City terminated its relationship with CalPERS outside of bankruptcy. Outside of bankruptcy, CalPERS would indisputably have a lien on the City's assets for the amount of the termination liability (approximately $1.6 billion). The City would have to pay this amount before it could pay Franklin a dime. Paying the CalPERS termination liability, however, would undoubtedly exhaust the City's resources and leave nothing to pay Franklin or other creditors for a very long time. Thus, Franklin's proposed alternative to the City's Plan—termination of the CalPERS relationship—would not benefit the City or its other creditors.

J. Franklin's Claims Regarding "Pension Spiking" Are Nothing More Than Irrelevant *Ad Hominem* Attacks on CalPERS.

Franklin's claims regarding "pension spiking" are nothing more than irrelevant *ad hominem* attacks on CalPERS' Board. Franklin put on no evidence of this issue at trial. In fact, when pressed, Franklin conceded that it had nothing to offer this Court on how such spiking could be addressed in this case, and simply suggested that either the "City could impair its pension liabilities," or more money should be paid to Franklin. *See* Hr'g Tr. 189-90, 198-99, June 4, 2014 (attached hereto as Exhibit E). Franklin's eleventh-hour requests for judicial notice should be seen for what they are—an irrelevant attack on CalPERS that has absolutely nothing to do with Franklin's treatment under the Plan. Its requests for judicial notice should be rejected.

In any event, if such spiking exists, it is the result of negotiated labor contracts that are outside of CalPERS' control. Notably, however, City witnesses testified at the eligibility hearing that they had curbed the abuses of the past on this score. *See, e.g.*, Hr'g. Tr. 348-49, March 26, 2013 & Hr'g. Tr. 398-400, March 27, 2013 (attached hereto as Exhibit F and Exhibit G, respectively). Franklin agrees. *See, e.g.*, Franklin's Summary Obj. [Dkt. No. 1273] at 24 (acknowledging City "curbed those abuses."). Further, while Mr. Lamoureux testified such spiking may exist, it also true that CalPERS is better equipped to deal with such spiking than other pension administrators. Hr'g. Tr. 187-88, May

14, 2014 (attached hereto as Exhibit H). The recent Report issued by the State Controller supports this testimony. *See* Franklin's Supplemental Request for Judicial Notice [Dkt. No. 1697], p. 7-40. Notably, the Report notes that of the eleven audited plans, ***not a single instance of pension spiking was found***; rather, the primary concern of the State Controller was that CalPERS could do a better job as an administrative and staffing matter in proactively recognizing pension spiking. *Id.* at 12-17 (Executive Summary of Review Report). Further, the Report noted specific concerns regarding the "Employer Paid Member Contribution" ("EPMC"), which is no longer available to "new members" under PEPRA's recent enactments. *Id.* at 16. At the end of the day, it is not clear what Franklin seeks to gain by attempting to lay all of the perceived evils of pension spiking at the feet of CalPERS. The reality is, however, the unrefuted testimony of City officials demonstrates that the City has already taken steps to address this issue and no amount of misdirection by Franklin can change that fact.[14]

III. CONCLUSION

Notwithstanding Franklin's continuation of the scorched earth litigation tactics that drew the attention of the Court in the eligibility phase of this case, the evidence presented to this Court establishes that the City, its citizens, its employees and its creditors benefit from the City's relationship with CalPERS. The City has more than established the reasonableness of its decision to retain the benefits of that relationship.

For many reasons, Franklin is nothing like CalPERS, and accordingly, Franklin's argument that it is being discriminated against due to the City's ratification of its CalPERS relationship has no basis in fact or law. Franklin has no right to dictate the terms of the City's plan of adjustment and should not be allowed to coerce the City to make a business decision which is not in the City's interests nor in the interests of the creditors and parties in interest to this case.

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[14] Franklin's attack on CalPERS highlights why its claim that CalPERS "injected itself into this case" ignores reality. Franklin Br. at 9. From day one, Franklin and its allies have made CalPERS central to their argument—whether during the neutral evaluation process, the eligibility phase or the plan confirmation trial. *See, e.g.*, *In re City of Stockton*, 493 B.R. 772 (Bankr. E.D. Cal. 2013). CalPERS had no choice but to defend itself given the salvos Franklin and its allies were firing at CalPERS. For Franklin (or anyone) to say that CalPERS "injected itself" into this case, and that it is "hypocritical" for it to take the position that it is not necessary to determine the question of pension impairment, is revisionist history.

While the City has a right to terminate its relationship with CalPERS under State law, termination has catastrophic consequences for the City because it creates a massive termination liability without any viable alternative for the provision of employment benefits. A plan of adjustment premised on termination would be less advantageous to creditors as it would have to deal with the substantial termination claim and recognize CalPERS' nonbankruptcy rights to priority payment of the termination liability. It is for these reasons that discussion of a plan that terminates the CalPERS relationship and the constitutional and statutory issues raised in such a plan are remote and hypothetical. CalPERS respectfully requests that the Court confirm the City's Plan and refrain from expressing opinions regarding CalPERS' rights in a hypothetical termination circumstance or impairment of a hypothetical termination claim.

Respectfully submitted,

Michael J. Gearin
Michael B. Lubic
Michael K. Ryan
K&L GATES LLP

Dated: September 18, 2014

By: */s/ Michael J. Gearin*
Michael J. Gearin
Attorneys for California Public Employees' Retirement System

EXHIBIT A

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

---oOo---

In re:	)Case No. 12-32118-C-9
	)
CITY OF STOCKTON, CALIFORNIA,	)Chapter 9
	)
Debtor.	)DCN: OHS-5, OHS-6
	)

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BEFORE THE HONORABLE CHRISTOPHER M. KLEIN, JUDGE OF THE UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF CALIFORNIA, AND ON JANUARY 30, 2013.

REPORTER'S TRANSCRIPT OF PROCEEDINGS

CONTINUED MOTION FOR ORDER (1) RULING THAT APPROVAL OF SETTLEMENT AGREEMENT IS NOT REQUIRED UNDER RULE 9019 OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE; OR ALTERNATIVELY (2) APPROVE SETTLEMENT AGREEMENT WITH CHRISTOPHER HALLON and MOTION TO ASSUME LEASE OR EXECUTORY CONTRACT

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APPEARANCES:

(See pg. 2)

Reported by: VICKI L. BRITT, RPR, CSR No. 13170 the merits of the Hallon settlement.

Your Honor, I am going to -- we did have a discussion on how to deal with the effect of section 903 of the Bankruptcy Code, which really is the section of the code that deals with the state's retained powers over its municipality while it is in chapter 9. And those issues aren't before you here today. We did want them before you because there's been prior discussion of section 903 in the *ARECOS* decision.

THE COURT: You didn't like that discussion I take it?

MR. GEARIN: We'd like an opportunity to fully address those matters before you, and imagine we will get to those at plan confirmation. But we do think that 903 has --

THE COURT: Well, I'll help you out a little bit, they were dicta. I confess, they were dicta, in which I was attempting to explain it so the decision would be understandable. Discussion of 903 is not a narrow holding.

MR. GEARIN: I understand and thank you for that. Your Honor, we do think 903 has an important role in chapter 9. And we think that as Mr. Levinson points out, state law continues to govern and to control the municipality during the course of the chapter 9.

So, for example, the public disclosure laws and the need to have settlements come before in open meetings, specifically held -- maybe it was dicta -- but you wrote the words -- that section 904 poses no bar or impediment to the application of the --

THE COURT: I was making a holding regarding 904. CalPERS' worry was about what I said about 903. I agree what I said about section 903 was dicta. I didn't say that what I said about 904 was not a holding. As a matter of fact, I think it's probably the square holding.

MR. JOHNSTON: Well, I believe that holding is dispositive of the City's argument. If I read it correctly, you held that section 904 poses no bar or impediment to the application of the incorporated provisions of the Bankruptcy Code in chapter 9. And that by voluntarily commencing this case, the City and state have consented to the operation of those provisions.

THE COURT: Well, that may be a little -- the point of that pencil needs to be sharpened a little bit. If that's what you think I actually said in context, then Mr. Levinson is saying, judge, you've got to sharpen the point of that pencil.

MR. JOHNSTON: And I would love for you to educate me. And maybe this isn't the time or place for it, but that at least is the logical import of the conclusions reached in the retiree decision.

And I think that leads directly to the conclusion

MR. JOHNSTON: But assume it's true. Assume that at the time they say that, that is the best they can do, in part because they took a material part of their assets and paid it to other creditors before confirmation, that is not an adjustment of debt regime that's provided for in chapter 9. That's not the way I would submit that the statute works.

THE COURT: Well, you're arguing against confirmation. And if I agreed with you, then I'd say, I'm sorry, Mr. Levinson. Your plan of adjustment is not confirmed. Go back and take another swing at the pitch.

MR. JOHNSTON: And if we get to that point, we will. The gravamen of the argument today is that the creditors who aren't the favored 95 percent in this hypothetical shouldn't be put in the position of that being their only remedy. This is the chapter 4 adjustment of debts of a municipality. It's a two-way street, not a one-way street. The creditors have protections afforded to them by the statute and they're entitled to be heard on that. That's where we come out, Your Honor.

THE COURT: Okay. Anything else?

MR. JOHNSTON: I have some remarks on section 903. I don't know if you want to hear them or not.

THE COURT: Not particularly. I'm not going to decide this on section 903. I already conceded that my discussion of 903 in the retired employees case was, I think, unquestionably dictum, that I included to provide my view of the landscape. And that if I was presented with a square 903 decision, that I would not be bound by it. I'm not even bound by the retired employees decision I entered.

Remember, a decision by a trial judge does not bind other trial judges anywhere. It doesn't even bind the state trial judge in another matter. So I'm free to change my mind and be better educated.

MR. JOHNSTON: And I would just say for the record, we categorically disagree with the way that CalPERS interprets section 903. In the context of a motion like this --

THE COURT: Well, I understand that you and CalPERS are not friends. On another front, I'll be hearing all about your disagreements.

MR. JOHNSON: And in the context of this motion, 903 is not remotely called into question. There's no issue of state control. The State of California has not directed the City to settle with Mr. Hallon; has not directed the City to pay Mr. Hallon any amount. It's just not implicated. So I think I'm safe to leave it at that for now and note our disagreement on the bigger picture issues.

THE COURT: Well, the City hasn't argued that 903 controls the analysis. CalPERS has said, please don't talk more about 903 until you need to, judge, and you've said don't talk about 903 until you need to. And I've already said what I said about 903 is just talking.

MR. JOHNSTON: Unless you have anything further for me?

THE COURT: I have nothing further. Do any of your colleagues want to bat cleanup?

MR. BJORK: Yes, Your Honor. I guess we're into the afternoon by now. Jeff Bjork from Sidley Austin on behalf of Assured Guaranty.

Just one additional point to make. 3003 authorizes you to fix a bar date.

THE COURT: That's a rule.

MR. BJORK: That's a rule. And I believe it's incorporated by virtue of chapter 9 in terms of 924, 925 and the like. The debtor has taken in compliance with the provisions applicable in chapter 9 the step to file a list of creditors and identify those creditors or those claims that it disputes.

If you set a bar date, and disputed creditors by operation of the code and the rules would be forced to file claims, 502 says any party in interest can object to those claims. So we've been in hypothetical land, but let's just take this hypothetical one step further.

If that's where we were, a bar date established,

EXHIBIT B

Senate Bill No. 349

Passed the Senate August 31, 1996

____
Secretary of the Senate

Passed the Assembly August 28, 1996

____
Chief Clerk of the Assembly

This bill was received by the Governor this ___ day

of ________, 1996, at ___ o'clock __M.

____
Private Secretary of the Governor

CHAPTER ____

An act to repeal Sections 43739 and 53761 of, and to repeal and add Section 53760 of, the Government Code, relating to local agencies.

LEGISLATIVE COUNSEL'S DIGEST

SB 349, Kopp. Local agencies: bankruptcy.

Under existing law, any taxing agency or instrumentality of the state may file a petition and prosecute to completion bankruptcy proceedings permitted under the laws of the United States.

This bill would provide that a municipality may only file under federal bankruptcy law with the approval of the Local Agency Bankruptcy Committee that would consist of the Controller, the Treasurer, and the Director of Finance. The committee would be required to respond to a request for approval within 5 days or the request would be considered as approved.

The bill would authorize a county that has requested approval to file under federal bankruptcy law to require local agencies with funds invested in the county treasury to provide a 5-day notice of withdrawal before the county is required to comply with a request for withdrawal of funds by a local agency.

The bill would specify that it only applies to a municipality that files under federal bankruptcy law on or after the date that the bill becomes effective.

Existing law requires state agencies to provide notice of a meeting at least 10 days in advance of the meeting.

This bill would authorize the committee to provide notice of its meetings at least 24 hours in advance and would specify the manner in which notice shall be provided.

The people of the State of California do enact as follows:

SECTION 1. Section 43739 of the Government Code is repealed.

SEC. 2. Section 53760 of the Government Code is repealed.

SEC. 3. Section 53760 is added to the Government Code, to read:

53760. (a) Any municipality in this state, as that term is defined in paragraph (40) of Section 101 of Title 11 of the United States Code, may, with the written approval of the Local Agency Bankruptcy Committee, under the terms and conditions that the committee may impose, file for adjustment of debts pursuant to Chapter 9 (commencing with Section 901) of Title 11 of the United States Code.

(b) As used in this section, "committee" means the Local Agency Bankruptcy Committee consisting of the Treasurer, the Controller, and the Director of Finance.

(c) The committee shall provide its written response of consent or denial of consent to file for adjustment of debts under federal bankruptcy law not later than five calendar days from receipt of the request of a municipality.

(d) If the committee does not respond to the request within five days after receipt of the request, the request shall be considered approved.

(e) A county that has requested approval to file under subdivision (a) may require local agencies with funds invested in the county treasury to provide a five-day notice of withdrawal before the county is required to comply with a request for withdrawal of funds by a local agency.

(f) Notwithstanding subdivision (a) of Section 11125, the committee may provide notice of its meeting at least 24 hours in advance of the meeting. The notice shall be posted in a location in the municipality that is freely accessible to members of the public. The notice shall be delivered personally, by the United States mail, or by facsimile transmission to each local newspaper of general circulation whose circulation area reasonably includes the municipality and shall similarly be delivered to each radio or television station that has requested notice in writing. The notice shall be received by the newspaper, radio, or television station at least 24 hours prior to the date of the meeting specified in the notice. In addition, if the Legislature is in session, the committee shall request that the meeting notice be published in the daily file of each house at least 24 hours prior to the date of the meeting.

(g) If the committee approves a filing under this section, that approval does not obligate the state, in any manner, regarding financing a plan for adjustment of the municipality's debts or any act relating to that financing.

(h) This section shall only apply to a municipality that files as a debtor, as specified in subdivision (a), on or after the effective date of this section.

SEC. 4. Section 53761 of the Government Code is repealed.

Approved ______________________________, 1996

____

Governor

EXHIBIT C

BILL ANALYSIS

SENATE LOCAL GOVERNMENT COMMITTEE
Senator Patricia Wiggins, Chair

BILL NO: AB 155 HEARING: 7/8/09
AUTHOR: Mendoza FISCAL: Yes
VERSION: 7/1/09 CONSULTANT:
Weinberger

LOCAL GOVERNMENT BANKRUPTCY

Background and Existing Law

Federal bankruptcy law for public agencies (Chapter 9) gives government debtors time to come up with repayment plans, providing them a breathing spell from creditors' collection efforts. Unlike private bankruptcy law (Chapter 11), however, municipal bankruptcy law must respect the states' sovereign powers. Consequently, the states can control their local agencies' access to federal bankruptcy protection.

Like 11 other states, California grants its local public agencies the broadest possible access to federal bankruptcy available. The state statutes broadly authorizing bankruptcy filings by local governments were first enacted in 1939 (SB 338, Phillips, 1939) and codified in 1949 (SB 768, Cunningham, 1949). In 2001, after studying the state statutes authorizing bankruptcy filings by local public entities, the California Law Revision Commission recommended revisions to conform the statutes to changes in federal bankruptcy law and to reaffirm the intent of the statute to provide the broadest possible access to municipal debt relief under federal law. Legislators approved the Commission's recommendations the following year (SB 1323, Ackerman, 2002).

Because one municipality's bankruptcy may have a negative effect on other local governments' borrowing power, some states limit or prohibit their local governments to access federal protections. Local governments in 22 states do not have access to municipal bankruptcy, while 16 other states impose some conditions on municipal bankruptcy filings. The conditions imposed by other states range from a requirement that a local entity's legislative body must pass an ordinance or resolution before filing for bankruptcy to a requirement that a state commission grant approval before a local government may file for bankruptcy

AB 155 -- 7/1/09 -- Page 2

After the 1994 Orange County bankruptcy, the Legislature tried to establish state oversight for municipal bankruptcy filings. The bill passed, but Governor Pete Wilson vetoed it (SB 349, Kopp, 1996). The Law Revision Commission's 2001 study also considered proposals to require prefiling approval by the Governor or a governmental committee, but did not recommend any substantive reforms.

The California Debt and Investment Advisory Commission (CDIAC) provides information, education, and technical assistance on debt issuance and public fund investments to local public agencies. The Commission has nine members, including the State Treasurer, the Governor or the Director of Finance, the State Controller, two local government finance officials, two Assembly Members, and two Senators. The State Treasurer serves as the Chairperson and appoints the two local government officials. The Assembly Speaker appoints the Assembly's representatives and the Senate Rules Committee appoints the Senate's representatives.

In response to concerns about the City of Vallejo's recent decision to file bankruptcy and the potential for additional municipal bankruptcy filings, labor unions and others want to require state oversight of local governments' bankruptcy petitions.

Proposed Law

Assembly Bill 155 authorizes a local public entity, with the approval of the California Debt and Investment Advisory Commission (CDIAC), and under CDIAC's terms and conditions, to file a petition and exercise powers pursuant to applicable federal bankruptcy law.

I. Submitting a request . AB 155 requires a local public entity, upon making a request to CDIAC for approval to exercise its rights under federal bankruptcy law, to submit

all of the following to the Commission:
A resolution or ordinance, adopted by the governing body at a public hearing held pursuant to the Ralph M. Brown Act that does both of the following:
o Requests authority pursuant to statute to petition the federal bankruptcy court for financial relief.

o Acknowledges that the state's fiscal and financial responsibilities are not changed by the application or the Commission's decision.
A thorough analysis of the entity's request to petition under federal bankruptcy law. The entity must:
o Demonstrate that it is or will be unable to pay its undisputed debts.
o Demonstrate that it has exhausted all options to avoid seeking relief under Chapter 9.
o Detail a specific plan for restoring the soundness of the entity's financial plans.
An itemization of creditors that may be impaired or may seek damages as a result of the proposed plan.
Evidence of irreparable harm that may result during the 30-day evaluation period and the 15 days allotted for a hearing authorized by the bill.

AB 155 allows a county that requests approval from CDIAC to require local agencies with funds invested in the county treasury to provide a five-day notice of withdrawal before the county must comply with a request for withdrawal of funds.

II. Initial review . Within five days of receiving the information that must accompany a local public entity's request, CDIAC must evaluate the information and notify the entity of one of the following results:
Approval of the request, or
The Commission will proceed with a further evaluation based on a finding that the local public entity did not provide sufficient evidence of irreparable harm.
If CDIAC does not respond within five days, the request is deemed approved.

III. Evaluation . AB 155 requires the Commission to publish its evaluation within 30 business days of receiving the information that must accompany a local public entity's request. After notifying the local public entity of its intent to further evaluate a request, the Commission's staff must specifically evaluate the extent to which the local public entity has done the following:
Demonstrated that it has exhausted other remedies,
Demonstrated that it has taken sufficient steps to reduce the negative consequences of its proposed

bankruptcy relief,
Anticipated the transfer of service responsibility to other governments or parties and to what extent the entity has documented the consequences for the transfer of municipal and other government services,
Documented the likely effect a successful petition will have on state and local finances, including the impact on credit access and debt service, and
Proposed a remedy that is appropriate and proportionate to the entity's fiscal problems.

IV. Hearing . AB 155 requires CDIAC to hold a public hearing to consider a local public entity's request for approval to file a petition and exercise powers pursuant to federal bankruptcy law. The hearing must:
Occur at least 10 days, but not more than 15 days, after the publication of CDIAC's staff evaluation of the request,
Comply with the provisions of the Bagely-Keene Open Meeting Act and additional public notice provisions,
Provide sufficient time for public testimony, and
Be held in convenient proximity of the local public entity.

V. Approval or denial . AB 155 requires CDIAC, in a recorded vote on the date of the public hearing, to approve or deny the local entity's request.

AB 155 authorizes the Commission, if it approves a request,

to order the entity, as a condition of approving the request, to limit the nature and extent of relief provided through Chapter 9 bankruptcy proceedings, including:
Limiting changes to a contract,
Prohibiting the abrogation of contracts, and
Limiting the amount of relief to ensure the protection of debt service payments.

If CDIAC disapproves a request, AB 155 requires the Commission to adopt specific findings that address the deficiencies of the application. If CDIAC denies its request, a governing board of a local public entity may reapply for approval by adopting another resolution and submitting documentation to address the deficiencies identified by the Commission.

VI. Additional provisions . The bill requires CDIAC's

executive director, after the Commission receives a local public entity's request for review and approval of a bankruptcy filing, to record the costs incurred by CDIAC in conducting an evaluation of and holding a hearing on the request. The director must report those costs to the Commission at its next regularly scheduled hearing. Upon denial of the request, the director or Commission may assess the requesting entity a fee to cover some or all of CDIAC's costs. Fee revenue must be deposited in a specified fund.

AB 155 allows CDIAC to propose regulations to govern the request and review process enacted by the bill.

AB 155 states that, in enacting the bill, the state assumes no new or additional fiscal responsibilities for local entities that may apply to CDIAC for review.

The bill requires the State Treasurer to temporarily replace a local government finance officer serving on CDIAC who is employed by an entity requesting CDIAC's approval to petition for bankruptcy with another local government representative who meets the qualifications for membership on the Commission.

The bill contains extensive legislative findings and declarations regarding the interdependence of state and local finances and the state's interest in various impacts of municipal bankruptcy.

Comments

1. Compelling state interest . Municipal bankruptcy's broad and significant impact on residents within the bankrupt entity's jurisdiction, on other local government entities, and on the state necessitates state oversight of local public entities' bankruptcy filings. Because local and state finances in California are inextricably linked, the state has a direct interest in the fiscal health of its local governments. A municipal bankruptcy can have statewide repercussions, including higher borrowing costs for other local entities and the state. The state also has a compelling interest in ensuring the validity and enforceability of contracts negotiated through the collective bargaining process, which provides the foundation for positive and stable labor relations. The

review process authorized by AB 155 could help local officials find alternative strategies to address short-term fiscal challenges in ways that avoid the broad and lasting spillover effects of municipal bankruptcy. AB 155 follows a model used successfully in other states to protect the interests of a broad coalition of stakeholders who are impacted by municipal bankruptcies.

2. Local control . By authorizing CDIAC to either deny, or impose conditions on, a local public entity's bankruptcy filing, AB 155 critically undermines local officials' discretion in responding to fiscal crises. Local elected officials are directly accountable to residents within communities affected by a municipal bankruptcy. As a result, a decision to enter bankruptcy is a last resort that those officials do not take lightly. High legal costs, damaged credit ratings, and a lasting stigma that can deter investment and growth in a community all weigh heavily against a decision to authorize a bankruptcy

filing. The principal benefit of federal bankruptcy is the automatic stay of financial obligations which allows a local entity some breathing space to formulate a debt readjustment plan that is consistent with the fiscal interests and priorities of the local community. Allowing CDIAC to deny, or limit, a local entity's bankruptcy restructuring could place the burden of fiscal recovery solely on cuts to public services, which might not reflect local residents' priorities. The Committee may wish to consider whether AB 155 constitutes an unjustifiable intrusion into local affairs.

3. What's changed ? Local officials have used municipal bankruptcy protection sparingly during the 70 years that it has been available to local public entities in California. Only three general purpose governments have filed for municipal bankruptcy protection: Orange County (1994), the City of Desert Hot Springs (2001), and the City of Vallejo (2008). During the past decade, 18 local public entities have filed for bankruptcy; more than half were small health care districts. This recent average of fewer than two municipal bankruptcy filings per year from among the thousands of local public entities in California may reflect the substantial, inherent disadvantages of resorting to bankruptcy. Proponents of AB 155 argue that this history of bankruptcy filings and the inherent disincentives are not reliable indicators of future

behavior. The immense fiscal challenges now confronting many local governments and the precedent set by Vallejo's bankruptcy may open the door to more widespread, and less responsible, use of bankruptcy protection in the near future. The Committee may wish to consider whether these potential changes to the frequency and purpose of municipal bankruptcy filings justify the changes that AB 155 makes to the state's long-standing municipal bankruptcy statute.

4. What happens next ? It is unclear what might happen after CDIAC denies a local public entity's request to file for bankruptcy, or imposes conditions on a bankruptcy filing that make restructuring impossible. As mentioned in Governor Wilson's veto of the 1996 Kopp bill, some opponents of state oversight of municipal bankruptcy argue that a denial of eligibility for bankruptcy "could raise questions of liability of the state to creditors of the public agency." However, there is no evidence that this theoretical concern has, in fact, become a problem in states that block access to municipal bankruptcy. Regardless of whether the state may incur legal liability, it may face heightened political pressure to provide fiscal assistance to a local entity that can't seek bankruptcy protection. Legislators may feel obligated to intervene to ensure that an insolvent local entity doesn't stop providing vital public services. The Committee may wish to consider whether the state oversight authorized by AB 155 to protect limited state interests could result in expanded state obligations to struggling local entities.

Assembly Actions

Assembly Local Government Committee: 4-3
Assembly Appropriations Committee: 12-5
Assembly Floor: 47-25

Support and Opposition (7/2/09)

Support : California Professional Firefighters, CDF Firefighters Local 2881, California Labor Federation, California State Treasurer Bill Lockyer, AARP, American Federation of State, County and Municipal Employees, AFL-CIO, Association for Los Angeles Deputy Sheriffs, California Alliance for Retired Americans, California

Association of Highway Patrolmen, California Conference Board of the Amalgamated Transit Union, AFL-CIO, California Nurses Association, California Reinvestment Coalition, California School Employees Association, California State Employees Association, California State Firefighters' Association, Inc., California Teamsters Public Affairs Council, Consumer Federation of California, Engineers and Scientists of California, Glendale City Employees Association, International Longshore & Warehouse Union, Kern County Fire Fighters Union, Inc., Los Angeles County Probation Officers Union, Livermore-Pleasanton Firefighters Local 1974, Los Angeles County Fire Fighters Local 1014, Los Angeles Police Protective League, National Nurses Organizing Committee, North Bay Labor Council, AFL-CIO, Orange County Employees Association, Orange County Professional Firefighters Association, Organization of SMUD Employees, Peace Officers Research Association of California, Production Strategies, Inc., Professional and Technical Engineers Local 21, Professional Engineers in California Government, Riverside Sheriffs' Association, San Bernardino Public Employees Association, San Diego Municipal Employee's Association, San Francisco Labor Council, San Luis Obispo County Employees Association, Santa Rosa City Employees Association, Service Employees International Union, State Building and Construction Trades Council of California, UNITE HERE, United Food and Commercial Workers Union, Western States Council.

Opposition : Counties of Butte, Imperial, Nevada, Madera, Orange, Riverside, San Luis Obispo, Yolo, Cities of Antioch, Adelanto, Apple Valley, Atascadero, Arvin, Bellflower, Belmont, Benicia, Berkeley, Beverly Hills, Blythe, Brea, Burbank, Burlingame, California City, Calistoga, Carmel-by-the-Sea, Carson, Carlsbad, Chowchilla, Clayton, Cloverdale, Clovis, Coalinga, Commerce, Concord, Cotati, Covina, Cypress, Danville, Diamond Bar, Dixon, El Segundo, Encinitas, Exeter, Fairfield, Fontana, Fountain Valley, Fowler, Fremont, Fullerton, Glendora, Greenfield, Guadalupe, Hanford, Healdsburg, Hermosa Beach, Highland, Hollister, Hughson, Huntington Park, Huntington Beach, Irvine , Kingsburg, La Palma, La Puente, La Verne, Laguna Hills, Lake Forest, Lafayette, Lathrop, Lawndale, Lemoore, Lindsay, Livermore, Long Beach, Madera, Mammoth Lakes, Manhattan Beach, Manteca, Merced, Mendota, Mill Valley, Modesto , Moreno Valley, Murrieta, Napa, Newport Beach, Norco, Norwalk, Oakdale, Oakland, Ontario, Oroville,

Palmdale, Palo Alto, Paradise, Patterson, Pinole, Placentia, Pleasanton, Pomona, Rancho Cordova, Rancho Cucamonga, Reedley, Ridgecrest, Rialto, Rio Vista, Rohnert Park, Rolling Hills Estates, Rosemead, Salinas, San Francisco, Sanger, San Luis Obispo, San Marcos, San Pablo, Santa Cruz, Santa Maria, Santa Rosa, Seaside, Sebastopol, Shafter , Signal Hill, Stockton, Tehachapi, Torrance, Tracy, Tulare , Tustin, Vacaville, Villa Park, Visalia, Walnut Creek, Wasco, West Hollywood, Westminster, Windsor, Woodlake, Yorba Linda, Yountville, and Yucaipa, Association of California Health Care Districts, Association of California Water Agencies, California Contract Cities Association, California Society of Municipal Finance Officers, California State Association of Counties, California Special Districts Association, Howard Jarvis Taxpayers Association, League of California Cities, League of California Cities Inland Empire Division, League of California Cities Orange County Division, Marin County Council of Mayors and Councilmembers, South Bay Cities Council of Governments.

EXHIBIT D

Detroit Police officers consider retiring over bankruptcy cuts

BY: Simon Shaykhet (mailto:simon.shaykhet@wxyz.com)
POSTED: 11:20 PM, May 20, 2014
UPDATED: 11:37 PM, May 20, 2014

(WXYZ) - The future of public safety in Detroit is up in the air as Detroit Police officers ponder retiring much sooner than expected.

Hundreds of officers eligible to retire could be swayed by the outcome of Detroit's bankruptcy. Last Friday, both Detroit Police Officers Association and Detroit Fire Fighters Association filed formal objections to Detroit's plan of adjustment with bankruptcy court.

Now, we know a lot more about why.

On the front lines, Detroit Police are spending their days and nights battling crime against incredible odds.
But just as crime stats are improving, the head of the department's largest union representing cops says they won't accept what's been offered to them from the city during bankruptcy.

Even worse, since the city has already reached deals with retiree unions, more officers could be leaving by July 1 rather than choosing to wait and see what happens in collective bargaining and terms imposed by a bankruptcy judge in a cram down.

"We have a lot of seasoned police officers eligible to retire looking at cuts in their pension upwards of $400 a month so their hands are tied," says DPOA President Mark Diaz.

Diaz says pay cuts and pension and benefit reductions offered are too severe.

Also, a drop program that's enticed officers eligible to retire to work longer by providing additional benefits is also part of collective bargaining.

Former Chief of Police Ralph Godbee knows this issue better than anyone. He's negotiated with unions before.

"These officer have been working 2 to 3 years under a 10 percent pay cut in a very busy city where they are under compensated," said Godbee. "I think it's reasonable to take that normal 140, 150 officers per year attrition, maybe extend that to 200, 250. I don't think it's unreasonable at all to think there would be a spike in retirement."

"You can't replace experience and the experience our officers in Detroit have," said Diaz.

The bankruptcy trial is scheduled for July. If the unions and emergency manager can't come to terms, then a judge will impose terms.

EXHIBIT E

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

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HON. CHRISTOPHER M. KLEIN
COURTROOM THIRTY-FIVE
DEPARTMENT C

In re: CITY OF STOCKTON, CALIFORNIA, Debtor.	Bankruptcy No. 12-32118-C-9
WELLS FARGO BANK NA, Plaintiff, v. CITY OF STOCKTON, CALIFORNIA, Defendant.	Adversary No. 13-2315 **SECOND AMENDED TRANSCRIPT**

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REPORTER'S TRANSCRIPT OF PROCEEDINGS (EXPEDITED)

held on

Wednesday, June 4, 2014

9:30 a.m.

Reported by: ERIC L. THRONE, CSR No. 7855, RPR, RMR, CRR cities in a moment.

The City's pension liabilities are almost completely disproportionate to the size of its workforce. You heard this morning, according to CalPERS, Stockton's safety plan contributions, currently 34.6 percent of payroll, and they are projected to rise to an astounding 57 percent of payroll in Fiscal Year 2019-20. You can see that from Table 7 in Mr. Moore's report.

And it's no secret why the City's pension contributions are so high. The City has admitted that its past practices enabled employees to turn pension spiking into a, quote, unquote, art form, and thus get much larger pensions for the rest of their lives. That's right there in Exhibit 410.

In this case, by assuming pension liabilities in full and not restructuring them, the City will continue to pay for its past mistakes for the next three decades or more.

THE COURT: So what do you contend should be done with the pension liabilities?

MR. JOHNSTON: One of two things, Your Honor. First, the City could impair its pension liabilities. And we can talk about how that's legal under the Bankruptcy Code and the supremacy clause of the constitution, it can treat pension creditors on a fair, equitable, and nondiscriminatory basis with other creditors, or it can roll the dice, it can swallow hard and say it's going to assume its pension liabilities and at the same time give Franklin a fair share of the probable estimated future revenues.

That's the choice that the City faces. The City can't say "We're going to assume our pension liabilities, our largest liability in full, and we have nothing left over for anybody. I don't believe that that's how the best interest tests works.

You heard some testimony this morning --

THE COURT: So it's your contention that pensions can and should be impaired?

MR. JOHNSTON: Yes. And I'll turn to that right now, why not, briefly. We heard the argument from Mr. Gearin a little bit and we read it in the CalPERS brief that there's really no opportunity for the City here, because pensions can't be impaired, period, end of story.

I submit that that's just wrong, Your Honor. We did file a separate brief on this very subject, which I think goes into it in some detail. And, frankly, Your Honor's opinion on retiree health benefits comes pretty close to deciding the issue as is, but I will hit some highlights for you.

To start, as you held in the retiree decision and as many cases before you have held, state law that runs contrary to the Bankruptcy Code is preempted, even in Chapter 9 cases.

doing in this case, but it also has to come up with the money to pay Franklin more than a penny on the dollar.

And I think the evidence shows that in fact the City easily could do that, if it wanted to. Our fundamental point is the City can't say "We're going to unimpair pensions, we're going to pay for the pension spiking because it would be inequitable to all the people who didn't spike their pensions and they are not getting a large pension," and then turn to Franklin and say "Sorry, we have nothing left for you." That is our beef with respect to the pension liabilities.

THE COURT: But what I'm still not getting is whether you have a solution for remedying past pension spiking that does not amount to getting so angry at a pension spiker that you are going to take a non-pension spiker out and shoot them.

MR. JOHNSTON: I think that we heard Mr. Lamoureux testify that if there's an impairment of pension, the impairment applies ratably.

THE COURT: That means across the board.

MR. JOHNSTON: Yeah. So I don't know that there is a solution that says you can pick and choose among people with vested benefits and say you're not touched and you're touched. I don't believe that that can be done, at least according to Mr. Lamoureux's testimony.

THE COURT: Well, I'm just testing your theory.

MR. JOHNSTON: Uh-huh.

THE COURT: So Franklin's theory is you could not identify pensioners by name and treat them separately based on whether they were spikers or not?

MR. JOHNSTON: I know of no way to do that, correct. If pensions are impaired, I understand that the impairment has to be across the board.

Moving back to best interest. We went through the three categories of evidence, the ability to pay under the Long-Range Financial Plan, the ability to pay from PFFs, and the ability to impair pensions.

We submit the City's plan is not in the best interest of creditors, certainly not in the best interest of Franklin. As a consequence, we submit the City hasn't cleared the first and most basic hurdle toward confirmation.

Let's turn to the second one, which is classification, unfair discrimination. We assert that the plan unfairly discriminates against Franklin by providing other creditors with recoveries that are 50 to 100 times greater than Franklin's recovery.

This one is more straightforward from a legal sense, in the sense that there really isn't a unique Chapter 9 overlay like in the best interest test. But it is a bit nuanced due to the way that the City classified plans under

EXHIBIT F

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

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In re:	)Case No. 12-32118-C-9
	)
CITY OF STOCKTON, CALIFORNIA,	)Chapter 9
	)
Debtor.	)
	)

---oOo---

BEFORE THE HONORABLE CHRISTOPHER M. KLEIN, JUDGE OF THE UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF CALIFORNIA, AND ON MARCH 26, 2013.

REPORTER'S TRANSCRIPT OF DAILY PROCEEDINGS

TRIAL (VOLUME II - P.M.)
(Pg. 330-377)

---oOo---

APPEARANCES:

(See pg. 2)

Reported by: APRIL GASKINS, CSR No. 13618

DIAMOND COURT REPORTERS
1107 2nd St., Suite 210
Sacramento, CA 95814
916-498-9288

Q That's okay.
A Got it. Thank you.
Q So Mr. Geolot asked you some questions regarding this salary survey, and I wanted to ask you for context. Can you explain what was the purpose of the salary survey?
A The purpose of the salary surveys performed by Doug Johnson was to assess where the City was in terms of the labor market with respect to all forms of compensation.
Q And why were three sets of salary survey comparator agencies as listed on page 80 used?
A This set of comparators is what we used for our nonpublic safety.
Q And, I'm sorry. When you say "this," can you reference it?
A Oh, I'm sorry. The chart as shown on this page are the comparator agencies used for the nonpublic safety positions in the City, and the first grouping under "Local" are agencies that we would look at in terms of classifications or positions that we felt we could easily recruit for within the local labor market. And then depending upon the labor market and the difficulty when creating the types of certifications that are required, et cetera, we may have to go out to a

regional or even a statewide look at the labor market because that's the market we're competing in for that level of employee.
Q And what's your understanding of why agencies such as Chula Vista and Bakersfield were used?
A Because they're similar in either geographic location or in terms of the size of the agency, the mix of services the agency may provide, so they would have similar classifications. Oftentimes certain cities may not have particular utility workers, for example, and so it wouldn't do you any good to compare to that type of an agency.
Q Thank you. I'd like to now direct your attention to an Exhibit 62, and at the top of the page there's a designation of page 51 of 115.
(Whereupon, Exhibit No. 62 was identified for the record.)
BY MR. RIDDELL:
Q Do you recall Mr. Geolot asked you questions regarding this document?
A Yes.
Q And what is this document again?
A It's the Action Plan for Fiscal Sustainability that the City Council adopted in 2010.
Q And do you recall Mr. Geolot asking you

questions regarding the issues --
A Yes.
Q -- represented in the document?
A Yes, I do.
Q Could you please explain to the Court what steps the City has taken since the time that this Action Plan was written on June 22nd, 2010 with respect to the issues that are presented in it?
MR. GEOLOT: Objection, Your Honor; beyond the scope. I mean, I asked about one or two. There are eight or nine matters here. I didn't ask anything about any of those.
THE COURT: Stay in the scope.
MR. RIDDELL: Your Honor --
Which issues were -- did you key in on, Mr. Geolot?
MR. GEOLOT: So one I asked a question about, two, and three.
MR. RIDDELL: Well, let's handle those in turn and just focus for the time being on issues one, two, and three.
BY MR. RIDDELL:
Q Can you please explain to the Court what steps the City's taken with respect to each of those issues since the time that this Action Plan was drafted on

June 22nd, 2010?
A Yes. With respect to Issue No. 1: Since 2010, the City has significantly reduced the forms of additional compensation by reducing or eliminating altogether various Add Pays. In 2011 alone, that was over $25 million in compensation that was cut based on just reducing Add Pays and various other forms of compensation.
With respect to Issue No. 2, transparency and side letters: The letter has included -- first of all, we needed to identify what all those side letters were, and once we did that, we either obsoleted those side letters through the bargaining process, and all of our current MOUs contain language now that discuss that all agreements between the parties are now included within those MOUs. So there are no longer any side letters that exist outside of those labor contracts, unless there's been a reason for that and that side letter has been taken to City Council and approved in a public meeting.
With respect to Issue No. 3: The labor agreements have all -- there are no longer any automatic compensation or wage adjustments that are contained in any of the existing MOUs, so that's all been deleted.
Q And did the City address any issues besides

EXHIBIT G

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

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In re:	) Case No. 12-32118-C-9
	)
CITY OF STOCKTON, CALIFORNIA,	) Chapter 9
	)
Debtor.	)
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BEFORE THE HONORABLE CHRISTOPHER M. KLEIN, JUDGE OF THE UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF CALIFORNIA, AND ON MARCH 27, 2013.

REPORTER'S TRANSCRIPT OF DAILY PROCEEDINGS

TRIAL (VOLUME III - A.M/P.M.)
(Pg. 378-542)

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APPEARANCES:

(See pg. 2)

Reported by: APRIL GASKINS, CSR No. 13618

DIAMOND COURT REPORTERS
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916-498-9288

people all the time, but especially when you are running a campaign. It's important for people to know where you stand on the issues and where you're likely to stand if you are either elected or reelected.

Q What was the outcome of the election?

A I was reelected.

Q Mr. Neal pointed you to a number of benefits and salary issues that were described by you as being the "Lamborghini Plan" and other things. Let me ask, has the City in advance of its Chapter 9 filing, was it able to correct some of the things that you had pointed to in the video?

A Yes, many of the things were corrected. The Council beginning in 2010 declared a fiscal emergency, and we imposed reductions on closed labor contracts which was very difficult, very painful, and it was an unusual step, but the Council felt very strongly that before we did anything else we needed to regain the trust of the people in Stockton and show that we were willing to make tough decisions and clean up our fiscal house, put it in order.

Q What is the status right now of the Add Pays?

A Most of the Add Pays which were deemed by our staff to be outside of the industry norm have been eliminated. There's many categories that have --

they're wiped out now. They don't exist anymore. It's resulted in an overall compensation reduction to our employees that's fairly significant, and in some cases to some families very significant. And this was on top of reducing medical benefits, requiring our employees to make their full contribution to their pension fund. There was a whole host of changes that were made that resulted in not only significant savings to our operating expenses, but very real reductions in family budgets to our employees and to our retirees.

Q Let me ask you, then, particularly with respect to the retiree medical program, where does that stand today?

A The City is no longer contributing -- well, let me say, until July 1 the City is contributing the stipend. After July 1 the City will no longer contribute anything to our retirees' medical benefit. And in the case of some of our retirees, they retired before the 90s when the enhanced pensions were in place. This is a very significant reduction in their retirement income that they've depended on, and it was extremely painful to do that. The night we made the decision to do that in open session, we had a gentleman with a brain tumor who stood up and required assistance to walk and said we were condemning him to inferior medical care and

most likely death. We had a family who has a daughter that was born with a congenital heart defect who essentially stood up and told us that we were condemning their daughter to a shortened life span. And they weren't lying. I mean, these were real people that were in real pain, and they were people that we know; for some of us, they're people that are friends, or were friends. And the Council still made the decision to reduce that benefit for both retirees and our employees because that was the benefit our existing employees also received. And we still made the decision to make those reductions, and it made a huge immediate impact in our yearly budget; but in terms of the future, it was also a huge, huge reduction in our longterm liabilities.

Q Now, did you vote as a council member for the City to begin the process under what we've been referring to as AB506?

A Yes, I did.

Q And did you also vote that the City should --

MR. WALSH: Objection, Your Honor; scope. It's outside the scope of the direct, Your Honor.

THE COURT: Overruled. It's within the scope.

BY MR. HILE:

Q Ms. Miller, Mr. Neal showed you a portion on page 4 of the transcript of your You Tube video that

talks about the possibility of raising revenue. Do you have that still? Is that page still in front of you?

A No.

Q All right. Maybe we can put it up there.

A Uh-huh, yes.

Q Do you have it now?

A Yes, I do. Thank you.

Q And you say, "And that's if it passed."

Why did you say that?

A Well, because in the State of California there's a fairly high bar to pass tax measures. In addition, while Ms. Anderson is quoted here as saying that her anecdotal evidence indicated that everyone would support a tax increase, the Council was well aware that Ms. Anderson is married to a former Stockton police officer. So the individuals that Ms. Anderson was most likely talking to were also police officers or public employees. The Council was also receiving a lot of anecdotal input from the community from a wide range of members of the business community, the nonprofit sector, and the anecdotal evidence and input that we were receiving was that it was not a slam dunk that people were just going to go pass a tax measure. And, in fact, most people were telling us that they wouldn't vote for a tax measure if it was just going to go to pay for

EXHIBIT H

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

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HON. CHRISTOPHER M. KLEIN
COURTROOM THIRTY-FIVE
DEPARTMENT C

In re: CITY OF STOCKTON, CALIFORNIA, Debtor.	Bankruptcy No. 12-32118-C-9
WELLS FARGO BANK NA, Plaintiff, v. CITY OF STOCKTON, CALIFORNIA, Defendant.	Adversary No. 13-2315

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REPORTER'S DAILY TRANSCRIPT OF PROCEEDINGS

held on

Wednesday, May 14, 2014

9:30 a.m.

Reported by: ERIC L. THRONE, CSR No. 7855, RPR, RMR, CRR
DEBBIE MAYER, CSR No. 9654, RPR, CRR, CRP, CLR

DIAMOND COURT REPORTERS
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Q. We heard -- we haven't heard about it at all during this trial, but during eligibility there was a concept of pension-spiking. Can you describe what that is if? Are you familiar with the term?

A. Yes, I'm familiar with the term pension-spiking. Pension-spiking is usually referred to when someone is able to inflate their salaries in their last year of employment to apply toward retirement purposes. And from an actuary -- from perspective where our goal is to try to fund the plan, usually what happens is if it's something you did not plan in the funding of the system, pension-spiking creates this unfunded -- or creates this unfunded obligation when it occurs.

At CalPERS, sometimes it's a -- it was in the newspapers a lot the last few years, especially as pension reform was going through. And I would say that pension-spiking at CalPERS, it's probably not as much of an issue as it is in other places. We have regulations in place at CalPERS that state what is reportable compensation.

What you hear the most with respect to pension-spiking as an issue maybe applies to some of the other retirement systems where they allow, for example, either overtime or unused vacations to be counted as reportable compensation. None of these apply at CalPERS.

The other thing, too, at CalPERS is we also have what we call a compensation review unit where, when someone retires at retirement, they will, if you want to flag individuals for which the final compensation, let's say, has increased by more than 10 percent in the last year, they would look at that individual to find out, is this allegedly a pay increase, or was that an attempt for pension-spiking?

In many cases we put a stamp of approval on it, and it goes through. In other cases, we deny it and calculate the retirement benefit on a lower salary than originally reported to CalPERS. So we do have a mechanism in place.

I cannot say here, tell you, that pension-spiking does not exist etch at CalPERS. But we do have, just because of the types of compensation that are allowable at CalPERS to be reported, we believe that at CalPERS we have -- it is less likely that this will be an issue.

Q. Now, with respect to reciprocity, does CalPERS have reciprocity with any private pension funds or pension administrators?

A. No.

Q. So it's only other governmental?

A. Only governmental agencies in California.

Q. Do me a quick favor and go to Exhibit 8, which is the contract. And I believe the first page of it, which is page 240 of Exhibit 4015 --

A. Yes.