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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 **CITY OF STOCKTON'S MOTION FOR ORDER (1) RULING THAT APPROVAL OF SETTLEMENT AGREEMENT IS NOT REQUIRED UNDER RULE 9019 OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE; OR ALTERNATIVELY (2) APPROVING SETTLEMENT AGREEMENT PURSUANT TO RULE 9019** Date: November 20, 2012 Time: 9:30 a.m. Dept: C, Courtroom 35 Judge: Hon. Christopher Klein

The City of Stockton, California, on behalf of itself and the Stockton Police Department ("SPD"), Officer Christopher Slate, Officer Kyle Pierce, Officer Mitchell Tiner and Officer Carlos Vina, Jr. (collectively, the "City"[1]), respectfully moves this Court for an order ruling that the City is not required to seek the Court's approval of a settlement agreement (the "Settlement Agreement") by and between the City and Christopher Hallon (together with the City, the "Parties"), a copy of which is attached as Exhibit B to the Declaration of Marci Arredondo submitted in conjunction with this motion, under Rule 9019 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"). The basis for the request is that Rule 9019 does not create a substantive requirement to seek such approval and because such a requirement would impermissibly conflict with the City's substantive rights as a chapter 9 debtor under 11 U.S.C. § 904. In the alternative, should the Court determine that bankruptcy court approval is required, the City requests an order approving the Settlement Agreement pursuant to Rule 9019.[2]

The Settlement Agreement encompasses a settlement and resolution of the allowance, determination and payment of certain claims (the "Claims") arising from *Hallon v. City of Stockton et al.*, Case No. 2:11-CV-00462-GEB-GGH (E.D. Cal. 2011) (the "District Court Case") and avoids the substantial costs associated with further litigation of the Claims. *See* Declaration of Marci Arredondo ("Arredondo Decl."), ¶¶ 7, 8. The Claims brought by Hallon in the District Court Case allege damages against the City for claimed violations of certain of his constitutional rights stemming from the defendants' alleged use of excessive force. Arredondo Decl., ¶¶ 3-4. In entering into the settlement with Hallon, the City factored into its calculations the likelihood that unsecured creditors like Hallon will be substantially impaired by any plan of adjustment confirmed in this case. Arredondo Decl., ¶ 9. Even with this consideration, the City believes that

[1] Bringing this motion on behalf of the City and its individual employees is appropriate because, as a matter of state law and City policy, the City generally is required to defend a civil action brought against its employees. *See* Cal. Gov't Code § 995. The City also is required to pay any claim or judgment against its employees in favor of third-party plaintiffs. *See* Cal. Gov't Code § 825. Thus, any dollar nominally recovered against an employee (such as the officers here) ultimately comes out of the City's pocket, as do all defense costs incurred defending the officers.

[2] Even if the Court construes this as a request for a declaratory judgment, this does not require the commencement of a separate adversary proceeding. Under Rule 7001, a proceeding to obtain a declaratory judgment requires an adversary proceeding only if it relates to a prescribed category of actions. Fed. R. Bankr. P. 7001(10). This motion falls within none of these categories, and thus no adversary proceeding is required (particularly where there is no defendant against whom the City could file a complaint). *See generally* 10-7001 COLLIER ON BANKRUPTCY ¶ 7001.08 (16th ed. 2012) (notes omitted).

the terms of the Settlement Agreement—and specifically the amount of 100-cent dollars for which the City has agreed to settle the case—are fair, reasonable and in the best interests of all the Parties. *Id.*

As noted above and as explained below, the City submits that a chapter 9 debtor is not required to seek the Court's approval of a compromise or settlement under Rule 9019. Nevertheless, out of an abundance of caution, the City seeks the alternative relief of a Court order approving the Settlement Agreement.

I. THE CITY IS NOT REQUIRED TO SEEK THE COURT'S APPROVAL OF THE SETTLEMENT AGREEMENT BECAUSE RULE 9019 DOES NOT CREATE A SUBSTANTIVE REQUIREMENT TO SEEK SUCH APPROVAL AND ITS APPLICATION WOULD CONFLICT WITH 11 U.S.C. § 904.

Rule 9019 provides in relevant part that "[o]n motion by the trustee . . . the court may approve a compromise or settlement." Fed. R. Bank. P. 9019. The City submits, however, that Rule 9019 does not (and cannot) obligate the City to seek the Court's approval of the Settlement Agreement. The reasons for this are twofold: First, Rule 9019 does not, on its own, create a substantive requirement that debtors seek court approval of settlements and compromises. Second, even if Rule 9019 did impose such a requirement, it would improperly conflict with the City's freedom to control its property and revenues under section 904 of the Bankruptcy Code, in violation of 28 U.S.C. § 2075.

A. Rule 9019 Is A Procedural Rule That Does Not Create A Substantive Requirement That Debtors Seek The Court's Approval Of A Compromise Or Settlement

Rule 9019 is a rule of procedure, and thus "cannot create a substantive requirement for court approval that does not exist in the Code itself." *In re Telesphere Communications, Inc.*, 179 B.R. 544, 551-52 (Bankr. N.D. Ill. 1994); *see also In re Dow Corning Corp.*, 198 B.R. 214, 246 (Bankr. E.D. Mich. 1996) (Rule 9019 is "merely a rule, [it] can do no more than establish a procedural mechanism for exercising statutory power."). Multiple courts in non-chapter 9 cases have recognized this, and have held that the substantive requirement to seek court approval of compromises and settlements is instead found in 11 U.S.C. § 363, which permits the "use" or "sale" of property of the estate only after "notice and a hearing." *See Northview Motors, Inc.*

v. Chrysler Motors Corp., 186 F.3d 346, 351 n. 4 (3d Cir. 1999) ("[A]s a matter of law, Bankruptcy Rule 9019(a), a rule of procedure, cannot, by itself, create a substantive requirement of judicial approval of [a] settlement . . . Section 363 of the Code is the substantive provision requiring court approval."); *In re Sparks*, 190 B.R. 842, 844 (Bankr. N.D. Ill. 1996) (holding that Rule 9019 itself did not provide a basis for a Court's refusal to enforce a settlement it did not approve, but that such basis could be found in section 363). For example, in the leading Ninth Circuit case on the interplay between Rule 9019(a) and § 363(b), the Bankruptcy Appellate Panel for the Ninth Circuit held that "the disposition by way of 'compromise' of a claim that is an asset of the estate is the equivalent of a sale of the intangible property represented by the claim, which transaction simultaneously implicates the 'sale' provisions under section 363 as implemented by Rule 6004 and the 'compromise' procedure of Rule 9019(a)*." In re Mickey Thompson Entm't Group, Inc. (Goodwin v. Mickey Thompson Entm't Group, Inc.)*, 292 B.R. 415, 421 (B.A.P. 9th Cir. 2003) (*citing Myers v. Martin (In re Martin)*, 91 F.3d 389, 394-95 (3d Cir. 1996)).

Section 363, however, is not applicable in chapter 9 cases. 11 U.S.C. § 901. Thus, as Rule 9019 implicates no substantive requirement for seeking court approval of a settlement, and as the Bankruptcy Code section that provides that requirement is inapplicable to a chapter 9 debtor, the Bankruptcy Code does not require the City to seek the Court's approval of the Settlement Agreement.

B. Requiring A Chapter 9 Debtor To Seek The Court's Approval Of A Compromise Or Settlement Is Impermissible Under 11 U.S.C. § 904 and 28 U.S.C. § 2075.

Even if Rule 9019 could supply a substantive requirement for court approval of compromises and settlements, such a requirement could not be applied to a chapter 9 debtor because it would conflict with a municipality's freedom to control its property and revenues under 11 U.S.C. § 904. Section 904 of the Bankruptcy Code, titled "Limitation on jurisdiction and powers of court," states that a bankruptcy court, absent the debtor's consent or a plan provision to the contrary, "may not, by any stay, order, or decree . . . interfere with - (1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property." As this Court

recently held, "§ 904 performs the role of the clean-up hitter in baseball. Its preambular language . . . is so comprehensive that it can only mean that a federal court can use no tool in its toolkit—no inherent authority power, no implied equitable power, no Bankruptcy Code § 105 power, no writ, no stay, no order—to interfere with a municipality regarding political or governmental powers, property or revenues, or use or enjoyment of income-producing property." *In re City of Stockton, California*, 478 B.R. 8, 20 (Bankr. E.D. Cal. 2012).

Requiring the City to seek the Court's approval of the Settlement Agreement is impermissible because § 904 prohibits a court from interfering with a debtor's property and revenues without the debtor's consent. 11 U.S.C. § 904(2). This Court has held that "[t]he contents of the City treasury are 'property and revenues' within the meaning of § 904(2)." 478 B.R. at 21. The expenses of continuing to litigate the District Court Case will require payments of additional attorneys' fees and other costs, as will the expenses of settling the case – although the latter expenses will be lower. These payments will come from the City of Stockton's treasury, which this Court has held constitute its property and revenues. Thus, requiring the City to seek the Court's approval of the Settlement Agreement—with the implication that the Court could deny such approval—would interfere with the City's freedom to control its property and revenues.

Where there is a conflict between the Bankruptcy Code and the Bankruptcy Rules, that conflict "must be settled in favor of the code." *In re Pac. Atl. Trading Co.*, 33 F.3d 1064, 1066 (9th Cir. 1994). This is because 28 U.S.C. § 2075, which confers power on the Supreme Court to prescribe the Bankruptcy Rules, expressly states that "[s]uch rules shall not abridge, enlarge, or modify any substantive right." Thus, a bankruptcy rule "cannot create an exception to the Bankruptcy Code." *In re Jastrem*, 253 F.3d 438, 441 (9th Cir. 2001); *see also In re Cisneros*, 994 F.2d 1462, 1465 (9th Cir. 1993) (where Bankruptcy Code and Bankruptcy Rules conflict, the statute must take precedence).

Therefore, Rule 9019 cannot abridge the City's substantive rights under section 904. Nor can Rule 9019 create a substantive right or requirement where none exists. *See* Section I.A., *supra*. The City is not required to seek the Court's approval of the Settlement Agreement.

II. ALTERNATIVELY, THE COURT SHOULD APPROVE THE SETTLEMENT AGREEMENT PURSUANT TO RULE 9019

Should the Court deem Rule 9019 applicable, in the alternative, it should approve the Settlement Agreement between the City and Hallon.

A. The District Court Case

As alleged in his complaint, on the evening of January 15, 2010, Hallon was walking down a street in an area of downtown Stockton known for drug trafficking. *See* Arredondo Decl., ¶ 3, Ex. A. He was detained by Officers Slate, Pierce, Tiner and Vina, Jr. *Id.* The officers used force during the detention. *Id.* Hallon argues that the force used was excessive; the City argues that it was not. *Id.*

On February 18, 2011, Hallon initiated the District Court Case by filing a complaint in the United States District Court for the Eastern District of California. Arredondo Decl., ¶ 2, Ex. A. He brought the case under 42 U.S.C. § 1983 and other statutory and common law causes of action to recover damages against the City for claimed violations of certain constitutional rights resulting from the alleged use of excessive force during his detention. *Id.*, ¶ 4. On April 16, 2012, the City filed a motion for summary judgment, and on May 1, 2012, Hallon filed an opposition, arguing that the motion must fail because it involved disputed facts. *Id.*, ¶ 5. On June 28, 2012 (the "Petition Date"), the City filed its chapter 9 petition. *Id.* On July 6, 2012, the district court judge ordered that the City's motion for summary judgment be deemed withdrawn in light of the imposition of the automatic stay. *Id.* On July 16, 2012, Hallon filed a notice of settlement. *Id.*

B. The Terms Of The Settlement Agreement

1. Payment By The City To Hallon

Subject to Court approval, should the Court determine that approval is required, the City agrees to pay Hallon $55,000 (the "Settlement Amount"). *See* Arredondo Decl., ¶ 7, Ex. B. The Parties arrived at this amount after a lengthy series of negotiations. *Id.*, ¶ 8. It reflects their evaluation of the strengths of their respective cases, of Hallon's potential recovery and of the benefit they gain from reducing future litigation costs in the District Court Case. *Id.* As noted

above, in entering into the settlement with Hallon, the City was well aware of, and factored into its calculations, the likelihood that unsecured creditors like Hallon will be substantially impaired by any plan of adjustment confirmed in this case. *Id.*, ¶ 9. Subject to obtaining Court approval, within fourteen days of the approval of the Settlement Agreement by the Stockton City Council, the Settlement Amount will be paid to Hallon and his attorney of record, Richard G. Hyppa. *Id.*, ¶ 7.

2. Release

Hallon will release and discharge the City of and from any and all liability, claims, demands, damages, punitive damages, causes of action, disputes, suits, actions, claims for relief, and causes of action arising out of or relating to the allegations of the Complaint or arising out of related to the facts and circumstances underlying such allegations. *Id.*, ¶ 7, Ex. B.

C. The Proposed Compromise Should Be Approved

1. The Legal Standard Pursuant To Rule 9019

The Supreme Court set forth the standard for approval of a compromise in *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, *reh'g denied*, 391 U.S. 909 (1968). In *TMT Trailer*, the Supreme Court held that compromises reached during the course of insolvency proceedings must be "fair and reasonable." 390 U.S. at 424. Significantly, the Court stated that "[b]asic to this process in every instance, of course, is the need to compare the terms of the compromise with the likely rewards of litigation." *Id.*

The Ninth Circuit Court of Appeals has held that the determination of whether a proposed settlement agreement meets the requisite standards of fairness, equity and reasonableness, is a function of several factors: (a) the probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (d) the paramount interest of creditors and a proper deference to their reasonable views. *See Martin v. Kane (In re A&C Properties)*, 784 F.2d 1377, 1381 (9th Cir.), *cert. denied sub nom.*, *Martin v. Robinson*, 479 U.S. 854 (1986); *accord Woodson v. Fireman's Fund Insur. Co. (In re Woodson)*, 839 F.2d 610, 620 (9th Cir. 1988); *In re MGS Marketing*, 111 B.R. 264, 267 (B.A.P. 9th Cir. 1990). Each of these

enumerated factors weighs in favor of approving the Settlement Agreement.

In ruling on a proposed compromise, a court should not substitute its own judgment for that of the trustee or debtor in possession. *See In re Carla Leather, Inc.*, 44 B.R. 457, 466 (Bankr. S.D.N.Y. 1984), *aff'd*, 50 B.R. 765 (S.D.N.Y. 1985). Nor is a court required to determine whether the settlement was the best that the debtor could have obtained. *See In re W.T. Grant*, 699 F.2d 599, 608 (2d Cir. 1982), *cert. denied*, 464 U.S. 822 (1983). Rather, the court should "canvass the issues and see whether the settlement 'fall[s] below the lowest point in the range of reasonableness.'" *Id.* at 608; *In re Bell & Beckwith*, 87 B.R. 472, 474 (N.D. Ohio 1987).

2. The Settlement Agreement Meets The Standard For Approval Under Bankruptcy Rule 9019

The Settlement Agreement should be approved under the applicable decisional standards. As applied here, the *A&C Properties* factors support this Court's approval of the Settlement Agreement as in the best interest of the City and its creditors. The Settlement Agreement should be approved for the following reasons:

Probability of Success. The factual and legal arguments regarding the allowability of Hallon's Claims are disputed. Hallon maintains that the officers used excessive force when they detained him, which excessive force resulted in significant bodily injury; by contrast, the City maintains that the stop of Hallon and the force used were justified. *See* Arredondo Decl., ¶ 3. Ultimately, a jury would be charged with deciding the validity of the Claims; thus, the outcome is plagued with uncertainty. What is certain is that substantial time and resources would be consumed in pursuing the litigation to trial, even if such litigation does not occur until after the lifting of the automatic stay. Under the circumstances, the proposed compromise is fair and reasonable, as it approximates the City's and Hallon's good-faith estimation of the risks associated with their respective claims and defenses.

Complexity of Litigation; Related Expense. The disputes between the Parties—one plaintiff and six defendants—about the facts of the case, as well as tendentious discovery disputes involving such issues as expert witness disclosure have elevated the litigation's complexity. Continuing the litigation to resolve the case's factual and legal disputes would

require not only the usual costs and delay attendant to litigation, but may entail expenses beyond any benefit that could be achieved. For these reasons, all of the Parties decided that a consensual resolution would avoid the expense, delay and inconvenience of litigation. They pursued this goal diligently and were ultimately able to arrive at the Settlement Agreement, which is not only a reasonable but an essential alternative to further litigation.

Interest of Creditors. The Settlement Agreement is in the interest of creditors because it will end the litigation at a price attractive to the City in light of the future litigation costs and potential exposure to liability, leaving more funds available for creditors. Having analyzed and weighed the above factors, the City believes that the Settlement Agreement—achieved after good faith, arm's length negotiations—is fair and reasonable, and in the best interest of creditors.

III. CONCLUSION

For the reasons set forth above, the City respectfully requests (1) entry of an order ruling that it is not required to seek the Court's approval of the Settlement Agreement; or alternatively, should the Court determine that court approval is required, (2) entry of an order approving the Settlement Agreement, authorizing the City to make immediate payment of the Settlement Amount to Hallon pursuant to the terms of such agreement and granting such other and further relief as the Court deems appropriate under the circumstances.

Dated: October 23, 2012

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