

24

1 WINSTON & STRAWN LLP  
Lawrence A. Larose (admitted *pro hac vice*)  
2 llarose@winston.com  
Samuel S. Kohn (admitted *pro hac vice*)  
3 skohn@winston.com  
200 Park Avenue  
4 New York, NY 10166-4193  
Telephone: (212) 294-6700  
5 Facsimile: (212) 294-4700

6 WINSTON & STRAWN LLP  
Matthew M. Walsh (SBN: 175004)  
7 mwalsh@winston.com  
333 S. Grand Avenue, 38th Floor  
8 Los Angeles, CA 90071-1543  
Telephone: (213) 615-1700  
9 Facsimile: (213) 615-1750

10 WINSTON & STRAWN LLP  
Sarah L. Trum (admitted *pro hac vice*)  
11 strum@winston.com  
1111 Louisiana, 25th Floor  
12 Houston, TX 77702-5254  
Telephone: (713) 651-2600  
13 Facsimile: (713) 651-2700

14 Attorneys for Creditor  
MOVANT NATIONAL PUBLIC FINANCE  
15 GUARANTEE CORPORATION

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

19 In re: ) Case No. 12-32118  
20 CITY OF STOCKTON, CALIFORNIA, ) D.C. No. OHS-1  
21 Debtor. ) Chapter 9  
22 ) **NATIONAL PUBLIC FINANCE**  
23 ) **GUARANTEE CORPORATION'S**  
24 ) **SUPPLEMENTAL OBJECTION TO**  
25 ) **THE CITY OF STOCKTON'S**  
26 ) **QUALIFICATIONS UNDER**  
27 ) **SECTIONS 109(C) AND 921(C)**  
28 )  
Date: February 26, 2013  
(Status Conference)  
Time: 1:30 P.M.  
Dept: C, Courtroom 35  
Judge: Hon. Christopher M. Klein

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

**TABLE OF CONTENTS**

	<b>Page</b>
I. Introduction.....	1
II. The City Cannot Meet Its Burden Under Section 109(c) to Show It Negotiated in Good Faith with Its Creditors .....	3
A. The City Concedes That It Did Not Negotiate at All with Its Single Largest Unsecured Creditor .....	4
B. The City’s Decision To Refuse to Negotiate with CalPERS Was Tainted by Conflicts of Interest and Made Without Due Care and Thus Not Made in Good Faith .....	6
(1) The Decision Not To Impair CalPERS Was Tainted by Self-Interest.....	7
(2) The City Failed to Make Reasonable Inquiry Into Its Decision Not to Impair CalPERS.....	9
(3) An Actual Examination of the Facts Establishes That the City Will Remain a Competitive Employer Even if CalPERS is Impaired, Further Demonstrating the City’s Flawed Decision-Making Process .....	11
III. The City’s Petition Also Should Be Dismissed Under Section 921(c) Because It Was Not Filed in Good Faith .....	13
IV. CalPERS Can Indeed be Impaired by the City in its Chapter 9 Case.....	16

**TABLE OF AUTHORITIES**

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

**Page(s)**

**CASES**

*Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*,  
298 U.S. 513 (1936).....17

*Ass’n of Retired Emp. of the City of Stockton (In re City of Stockton)*,  
478 B.R. 8 (Bankr. E.D. Cal. 2012) [*Stockton II*].....17, 18

*Brandt v. Hicks, Muse & Co. (In re Healthco Int’l, Inc.)*,  
208 B.R. 288 (Bankr. D. Mass. 1997) .....10

*Cent. Virginia Cmty. Coll. v. Katz*,  
546 U.S. 356 (2006).....16

*In re Am. Capital Equip., LLC*,  
688 F.3d 145 (3d Cir. 2012).....9

*In re City of Stockton*,  
475 B.R. 720 (Bankr. E.D. Cal. 2012) [*Stockton I*] .....3, 14

*In re City of Vallejo*,  
403 B.R. 72 (Bankr. E.D. Cal. 2009) [*Vallejo I*], *aff’d*, 432 B.R. 262 (E.D. Cal. 2010)  
[*Vallejo II*].....17, 18

*In re Cnty. of Orange*,  
191 B.R. 1005 (Bankr. C.D. Cal. 1996).....17

*In re Coram Healthcare Corp.*,  
271 B.R. 228 (Bankr. D. Del. 2001) .....7

*In re Cottonwood Water and Sanitation Dist., Douglas Cnty., Colo.*,  
138 B.R. 973 (Bankr. D. Colo. 1992) .....4

*In re Ellicott Sch. Bldg. Auth.*,  
150 B.R. 261 (Bankr. D. Colo. 1992) .....3, 4, 6

*In re Fiesta Homes of Ga., Inc.*,  
125 B.R. 321 (Bankr. S.D. Ga. 1990).....9

*In re Sullivan Cnty. Reg’l Refuse Disposal Dist.*,  
165 B.R. 60 (Bankr. D.N.H. 1994) .....4, 5, 13

*In re Unichem Corp.*,  
72 B.R. 95 (Bankr. N.D. Ill. 1987), *aff’d*, 80 B.R. 448 (N.D. Ill. 1987).....9

*In re Valley Health Sys.*,  
383 B.R. 156 (Bankr. C.D. Cal. 2008).....3

1 *Int’l Ass’n of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo)*,  
 2 408 B.R. 280 (9th Cir. BAP 2009).....3, 13

3 *Mills Acquisition Co. v. MacMillan, Inc.*,  
 4 559 A.2d 1261 (Del. 1989) .....8

5 *Mission Indep. Sch. Dist. v. Texas*,  
 6 116 F.2d 175 (5th Cir. 1940) .....18

7 *N.Y. v. Irving Trust Co.*,  
 8 288 U.S. 329 (1933).....16, 18

9 *Perez v. Campbell*,  
 10 402 U.S. 637 (1971).....16

11 *Tenn. Student Assistance Corp. v. Hood*,  
 12 541 U.S. 440 (2004).....18

13 *United States v. Bekins*,  
 14 304 U.S. 27 (1938).....17, 18

15 *Van Huffel v. Harkelrode*,  
 16 284 U.S. 225 (1931).....18

17 **STATUTES**

18 11 U.S.C. § 109(c) ..... passim

19 11 U.S.C. § 362.....4

20 11 U.S.C. § 903.....18

21 11 U.S.C. § 921(c) .....2, 13, 14, 15

22 11 U.S.C. § 1129(b)(1) .....18

23 Cal. Gov’t Code § 53760.3(Q).....1

24 Cal. Gov’t Code § 53760 *et seq.*.....2

25

26

27

28

1 National Public Finance Guarantee Corporation (“National”), a creditor and party in interest,<sup>1</sup>  
2 hereby submits the following supplemental objection (the “Supplemental Objection”), pursuant to  
3 sections 109(c)(5) and 921(c) of the Bankruptcy Code, to the City of Stockton, California’s (the  
4 “Debtor,” or the “City”) eligibility for relief under chapter 9 of the Bankruptcy Code. In support of  
5 this Supplemental Objection, National states as follows:

6 **I. Introduction**

7 1. On August 8, 2012, National submitted its Objection to the City of Stockton’s  
8 Qualifications Under Section 109(c) [Dkt. No. 477] (the “Objection”). The facts and legal  
9 arguments set forth in the Objection are incorporated by reference herein. Pursuant to the Court’s  
10 Scheduling Order [Dkt. No. 558], Stipulation and Order Modifying Eligibility Scheduling Order  
11 [Dkt. No. 579], and Stipulation and Order Modifying Eligibility Scheduling Order [Dkt. No. 623],  
12 National conducted discovery and took depositions of the City and of the California Public  
13 Employees Retirement System (“CalPERS”).<sup>2</sup> This discovery establishes three independent reasons  
14 that the City is ineligible for chapter 9.

15 2. First, it is undisputed that the City failed (and in fact refused) to seek any concessions  
16 from or negotiate at all with its single largest unsecured creditor, CalPERS, while demanding deeply  
17 disproportionate concessions from its bondholder creditors. As a matter of law, a debtor fails to  
18 negotiate in good faith under section 109(c) when it shields its largest creditor while insisting the  
19 remaining similarly-situated creditors compensate by carrying a disproportionate burden of  
20 impairment.

21 3. Second, discovery revealed that the City’s business managers who made the decision  
22 not to impair CalPERS all have CalPERS pensions themselves – as did three of the seven City  
23 Council members who affirmed this decision. The City thus relied upon the self-interested decision

---

24  
25 <sup>1</sup> See National’s Joinder of Creditor National Public Finance Guarantee Corporation to Indenture  
26 Trustee’s Limited Objection to the Debtor’s Emergency Motion for Leave to Introduce Evidence  
27 Relating to Neutral Evaluation Process under Government Code Section 53760.3(Q) [Dkt. No. 78]  
(the “Joinder”) establishing that National is a secured creditor and party in interest of the City of  
28 Stockton, California. Capitalized terms not otherwise defined herein shall have the meaning  
ascribed to such terms in the Objection.

<sup>2</sup> Excerpts of the deposition testimony referenced herein are attached to the Declaration of Matthew  
M. Walsh in Support of National’s Supplemental Objection (the “Walsh Decl.”).

1 of employees seeking to protect their own pensions rather than conduct a neutral analysis fair to all  
2 of the City's creditors. This tainted the City's decision and is itself evidence of the City's lack of  
3 good faith under section 109(c). In addition, the City's tainted decision not to seek any impairment  
4 of CalPERS rested on no factual or analytical bases other than a "feeling" that cutting pensions  
5 would perhaps cause "a mass exodus" of employees or generate recruiting issues. Rather than a  
6 reasoned business decision based on reasonable inquiry and due care, this was at best an uneducated  
7 guess that, rather conveniently, protected the guessers' personal financial interests. As shown by the  
8 accompanying expert report of Professor David Neumark, the assumption that modifying pensions  
9 would cause retention or recruiting issues is demonstrably incorrect and unsupportable. Taken  
10 together, the conflicts of interest and lack of due care in the City's decision-making process  
11 independently doom any finding that negotiations with creditors were conducted in good faith as  
12 required by section 109(c).

13 4. Third, discovery also demonstrated that the City cannot meet its burden under section  
14 921(c) to show it filed its chapter 9 petition in good faith. As detailed below, the overwhelming  
15 evidence establishes that the City never intended – before, during, or after the AB 506 process<sup>3</sup> – to  
16 seek impairment of its largest unsecured creditor, CalPERS. Indeed, in a conversation less than two  
17 months ago (and nearly four months after the City's chapter 9 filing), counsel for the City openly  
18 told CalPERS that the City would not seek any impairment, period. The City's lack of good faith is  
19 further established by the City's December 2012 Memorandum of Understanding with one of its  
20 police unions, in which the City purports to agree to continue to provide unsustainable CalPERS  
21 benefits to its employees under its chapter 9 plan. In short, the evidence demonstrates that the City  
22 entered bankruptcy intending to spread losses disproportionately among a subset of creditors so that  
23 it could protect its largest creditor, CalPERS, and the related pensions of the very City employees  
24 making this improper decision. The City continues to pursue this goal today. The primary purpose  
25 of the City's chapter 9 filing is thus not to equitably adjust the City's debts but to maintain bloated  
26 CalPERS pensions doled out to its managers and employees during richer times that the City itself

---

27  
28 <sup>3</sup> On March 27, 2012, the City commenced a "neutral evaluation process" pursuant to AB 506,  
which is codified at California Government Code Section 53760 *et seq.*

1 can no longer afford and force the City's remaining creditors (including National) to foot the bill.  
2 That fails to meet the good faith filing standard of section 921(c).

3 5. Finally, the City cannot rely on the "impracticability" exception under section  
4 109(c)(5)(C) by arguing that the CalPERS liability cannot be impaired, which would purportedly  
5 eliminate any obligation of the City to negotiate with CalPERS. The United States Constitution,  
6 Supreme Court precedent, as well as precedent in this very District are perfectly clear: In a chapter 9  
7 case, CalPERS must be treated like every other creditor, and the City's liability to CalPERS can  
8 indeed be impaired. Thus, the City has the same negotiating leverage against CalPERS that it has  
9 with all of its other creditors and the impracticability exception provides no defense to the City's  
10 failure to seek to impair CalPERS.

11 6. For each of these reasons, the City has failed to carry its burden to show eligibility,  
12 and this case should be dismissed.

13 **II. The City Cannot Meet Its Burden Under Section 109(c) to Show It Negotiated in Good**  
14 **Faith with Its Creditors**

15 7. This Court recently acknowledged that "[t]he burden of proof, at least as to the five  
16 § 109(c) elements, is on the municipality as the proponent of voluntary relief." *In re City of*  
17 *Stockton*, 475 B.R. 720, 725 (Bankr. E.D. Cal. 2012) [*Stockton I*]; *see also Int'l Ass'n of*  
18 *Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo)*, 408 B.R. 280, 289 (9th Cir. BAP  
19 2009); *In re Valley Health Sys.*, 383 B.R. 156, 161 (Bankr. C.D. Cal. 2008). Here, discovery  
20 established that the City did not negotiate in good faith with its creditors as required by section  
21 109(c)(5)(B) of the Bankruptcy Code because the City did not negotiate at all with CalPERS before,  
22 during, or after the AB 506 process.

23 8. In order to prove that its negotiations were in good faith, a debtor must actually  
24 engage in meaningful negotiations with its creditors. *See In re Ellicott Sch. Bldg. Auth.*, 150 B.R.  
25 261, 266 (Bankr. D. Colo. 1992) ("take it or leave it" proposal in which "the substantive terms of a  
26 proposal were not open to discussion" does not constitute good faith negotiations); *see also Vallejo*,  
27 408 B.R. at 297 (finding that the bankruptcy court erred in deciding that the City of Vallejo satisfied  
28

1 section 109(c)(5)(B) because it “never negotiated with Unions or any of its creditors over the  
2 possible terms of a plan of adjustment”).

3 9. Indeed, the bankruptcy court in *Ellicott School Building Authority* found that to  
4 satisfy section 109(c)(5)(B), the debtor must actually be open to negotiating the substantive terms of  
5 a proposed plan, stating:

6 However, the Authority admits that the bondholders were advised that  
7 the “economic provisions” of that proposed plan were not negotiable.  
8 It is difficult to imagine that any true negotiations could take place in  
9 an environment where the substantive terms of a proposal were not  
10 open to discussion.

11 *Ellicott*, 150 B.R. at 266; *see also In re Sullivan Cnty. Reg’l Refuse Disposal Dist.*, 165 B.R. 60, 78  
12 (Bankr. D.N.H. 1994) (“A commercial party can hardly ‘negotiate in good faith’ regarding unpaid  
13 obligations if it chooses to ignore clear, unambiguous contractual rights of the other party and, more  
14 importantly, refuses to acknowledge or throw into the negotiating equations a large and significant  
15 asset that it holds.”); *In re Cottonwood Water and Sanitation Dist., Douglas Cnty., Colo.*, 138 B.R.  
16 973, 979 (Bankr. D. Colo. 1992) (“The ‘creditor protection’ provided by section 109(c)(5), as  
17 interpreted by this Court, insures that the creditors have an opportunity to negotiate concerning a  
18 plan on a level playing field with the debtor before their rights are further impaired by the provisions  
19 of section 362 of the Code.”). Against this backdrop, the City’s unstinting efforts to shelter  
20 CalPERS at the expense of its bondholders fails to satisfy section 109(c)(5)(B).

21 **A. The City Concedes That It Did Not Negotiate at All with Its Single Largest**  
22 **Unsecured Creditor**

23 10. The City lists CalPERS as its single largest unsecured creditor. *See* List of Creditors  
24 Holding 20 Largest Unsecured Claims [Dkt. No. 4]. The City estimates its CalPERS liability at  
25 \$245 million over the next ten years. *See* Decl. of David N. Millican in Support of City of  
26 Stockton’s Statement of Qualifications Under Section 109(c) of the United States Bankruptcy Code  
27 Ex. A at 65 [Dkt. No. 454] (Attaching the City’s Proposals for Modifications to Obligations Under  
28 AB 506 Process (the “Ask”) to the AB 506 participants). This massive liability is a material  
contributing factor to the City’s projected deficits (even under its Pendency Plan) over the next  
decade of nearly \$100 million. *Ask* at 70. At the same time, CalPERS’ most recent reports project



1 that the pension plans it administers for the City are underfunded by an astonishing \$322 million.  
2 *See* Walsh Decl., Ex. J (CalPERS Annual Valuation Report as of June 30, 2011 (Miscellaneous Plan  
3 of the City of Stockton)), at 6; Walsh Decl., Ex. K (CalPERS Annual Valuation Report as of June  
4 30, 2011 (Safety Plan of the City of Stockton)), at 6. As stated in the City’s Eligibility Pleadings,  
5 such liability is “[a] major contributing factor to the City’s cash and budget crisis.” Ex. P to Decl. of  
6 Laurie Montes in Support of City of Stockton’s Statement of Qualifications Under Section 109(c) of  
7 the United States Bankruptcy Code [Dkt. No. 25], at 41.

8 11. Incredibly, the City admits it did not negotiate at all with CalPERS. The City’s 790-  
9 page Ask did not contain a single dollar of reductions in obligations to CalPERS. In fact, Ann  
10 Goodrich, the City’s labor relations consultant who participated in drafting the Ask, admits that she  
11 never “consider[ed] any pension reductions” in developing the Ask. Goodrich Dep. 116:5-15.  
12 Moreover, in the few meetings CalPERS participated in during the AB 506 process, there were no  
13 conversations between the City and CalPERS regarding reduction or modification of the City’s  
14 pension obligations. *See* Goodrich Dep. 131:12-132:4 (testifying that she is unaware of any  
15 discussions between the City and CalPERS during the AB 506 process concerning reduction of the  
16 City’s pension obligations); Deis Dep. 213:7-13 (same); Montes Dep. 179:5-180:13 (same); Millican  
17 Dep. 218:23-219:5 (same); *see also* Mixon Dep. 134:16-21 (CalPERS’ 30(b)(6) witness testifying  
18 that “during the AB 506 mediation process, the City did not make a request to modify its  
19 relationship, including its obligations, to CalPERS”), Mixon Dep. 126:11-23 (same), Mixon Dep.  
20 135:7-135:23 (CalPERS’ 30(b)(6) witness testifying that, during the AB 506 process, CalPERS did  
21 not offer to reduce the City’s obligations to CalPERS). Notably, the City refused to negotiate with  
22 CalPERS even after its bondholder creditors demanded such negotiations in the AB 506 process.

23 12. The City’s complete refusal to negotiate an impairment to its single largest liability  
24 flies in the face of *Sullivan County*. There, the Court found that a debtor failed to negotiate in good  
25 faith under section 109(c)(5)(B) when it “refuse[d] to acknowledge or throw into the negotiating  
26 equations a large and significant asset that it holds.” *Sullivan Cnty.*, 165 B.R. at 78. Of course,  
27 when a debtor refuses to include a major asset in plan negotiations, that forces the creditors to fight  
28 over a reduced pool and thus accept artificially low recoveries. Here, the City concedes it excluded

1 its single largest unsecured liability both in the Ask and from the AB 506 process. If the City has its  
2 way, the remaining creditors will be forced to fight over a radically reduced pool because future  
3 payments to CalPERS will continue unabated at 100%, decreasing what is left for the remaining  
4 creditors. *Sullivan County* is directly on point.

5 13. At the same time, the City's presentation of a "take it or leave it" proposal that would  
6 leave CalPERS unimpaired also runs afoul of *Ellicott School Building Authority*, which rejected such  
7 actions and specified that a debtor must actually engage in meaningful negotiations with all of its  
8 creditors. *Ellicott*, 150 B.R. at 266. Flatly refusing to seek concessions from CalPERS falls far short  
9 of this standard.

10 14. If it wishes to invoke the protections of chapter 9, the City cannot cherry-pick which  
11 liabilities (or assets) it wishes to shield and refuse to engage in negotiations otherwise. The City's  
12 admission that it did not intend to, and indeed did not, negotiate with CalPERS is itself enough to  
13 show that the City fails to meet the section 109(c)(5)(B) requirement of negotiating with creditors in  
14 good faith. This requires dismissal of this chapter 9 case.

15 **B. The City's Decision To Refuse to Negotiate with CalPERS Was Tainted by**  
16 **Conflicts of Interest and Made Without Due Care and Thus Not Made in Good**  
17 **Faith**

18 15. Looking deeper at the City's decision not to impair CalPERS reveals an independent  
19 reason why the City cannot meet its burden under section 109(c)(5)(B). To negotiate in good faith  
20 under section 109(c)(5)(B), a debtor must make rational choices that are equally fair – or equally  
21 unfair – to all its creditors. Here, however, the City's decision not to seek concessions from  
22 CalPERS was fatally flawed in several respects: (i) it was made by employees who themselves hold  
23 CalPERS pensions and are thus conflicted; (ii) it was made without a modicum of analysis, study, or  
24 due diligence; and (iii) it was based on a single premise – that there would be a "mass exodus" of  
25 City employees (mainly sworn officers) and difficulty recruiting replacements should CalPERS be  
26 impaired – that is demonstrably false. The myriad flaws in the City's decision not to seek  
27 concessions from or negotiate with CalPERS further preclude any finding that the City negotiated in  
28 good faith under section 109(c)(5)(B).

1                   **(1) The Decision Not To Impair CalPERS Was Tainted by Self-Interest**

2           16. Prior to the AB 506 process, the City formed the Strategic Direction Team (“SDT”) –  
3 a group consisting of the City’s attorneys and outside counsel, the City’s key managers and  
4 department heads, and representatives of the City’s outside consultants – to develop the foundation  
5 for the City’s Ask. See Millican Dep. 150:16-151:5, 222:10-224:15; Montes Dep. 185:3-16, 187:9-

6 17. Bob Deis, the City Manager, was the ultimate decision-maker on the SDT. Deis Dep. 222:4-10.

7           17. During this process, the SDT made a recommendation to the City Council not to  
8 impair the City’s CalPERS obligations. Deis Dep. 223:23-224:17 (“My recommendation [to the  
9 City Council] was not to impair the [CalPERS] contract.”); see also Goodrich Dep. 261:9-22 (“The  
10 Strategic Direction Team made a determination - made recommendations to the City Council as to  
11 what changes the City would make as far as both its labor, retiree and other obligations, and it did  
12 not include a restructuring of the PERS benefits.”). The City Council then accepted the SDT’s  
13 recommendation in full and approved the Ask, which, as discussed above, did not impair the City’s  
14 CalPERS liability. Montes Dep. 208:5-18 (the City Council made the decision not to seek a  
15 reduction in its CalPERS liability based on a recommendation from the SDT).

16           18. Aside from the City’s outside counsel and outside consultants, however, **all** of the  
17 members of the SDT had pensions covered by the City’s CalPERS contracts, including Bob Deis,  
18 the SDT’s ultimate decision-maker. Deis Dep. 225:24-226:5. The individuals directly responsible  
19 for the City’s decision not to seek a reduction of its CalPERS liability thus had a personal financial  
20 interest in that decision - if CalPERS were to be impaired, their own pensions could be reduced. Not  
21 surprisingly, they voted to leave CalPERS untouched.

22           19. Moreover, three of the members of the City Council had pensions covered by the  
23 City’s CalPERS contracts when they voted not to impair CalPERS. Montes Dep. 204:3-9, 205:21-  
24 206:16 (Mayor Ann Johnston, Councilmember Dale Fritchen, and Councilmember Albert Holman  
25 were enrolled in Stockton’s CalPERS pension plan at the time the decision was made not to seek a  
26 reduction in the City’s CalPERS pension liability).

27           20. This is a classic example of a decision tainted by self-interest that precludes the City  
28 from establishing it exercised good faith under section 109(c)(5)(B). *In re Coram Healthcare Corp.*

1 is instructive. 271 B.R. 228 (Bankr. D. Del. 2001). In *Coram*, the debtors' chief restructuring  
2 officer ("CRO") received almost \$1 million a year under a separate employment agreement with one  
3 of the debtors' largest creditors. The court understandably was concerned about the effect of this on  
4 the ability of the debtor to propose a good faith plan of reorganization. *Id.* at 232. Although the  
5 debtors eventually disclosed the conflict, *id.* at 238-39, the court held that the "conflict of interest is  
6 a violation of . . . [the CRO's] duty to the Debtors and the estate and is so persuasive as to taint the  
7 'Debtors' restructuring of its debt, the Debtors' negotiations towards a plan, even the Debtors'  
8 restructuring of its operations." *Id.* at 240. As a result, the court refused to confirm the plan on  
9 statutory "good faith" grounds. *Id.*

10 21. Boiled down, *Coram* stands for the common-sense principal that a debtor's business  
11 decisions cannot be made by conflicted managers. Any such conflicted decisions will be deemed  
12 tainted and not made in good faith. While it is true that *Coram* is not a chapter 9 case, the rule of  
13 *Coram* and its reliance on a statutory good faith requirement to reject a debtor's decision should  
14 apply equally here. A debtor – be it in chapter 7, 9, or 11 – cannot ask a court to find it acted in  
15 good faith when pivotal decisions were made by managers with a personal financial interest in the  
16 outcome, particularly when the ultimate decision is eerily consistent with the financial interests of  
17 those decision-makers. This is especially true here, where the City's decision not to impair  
18 CalPERS was the fulcrum of the Ask and the AB 506 process.

19 22. Moreover, when governing boards turn a blind eye toward the conflicts of the  
20 advisors they rely upon, the resulting decision is also deemed tainted and not made in good faith.  
21 *See Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261 (Del. 1989) (enjoining a board decision  
22 because the board relied on the advice of an advisor with a personal financial stake in the outcome of  
23 the decision). Here, the City Council failed adequately to oversee the development of the Ask by  
24 blindly accepting the SDT's recommendation not to impair CalPERS despite what were obvious  
25 conflicts of interest. Indeed, Vice Mayor Katherine Miller, a member of the City Council who did  
26 not have a CalPERS pension, admits she generally believed the information she received from the  
27 SDT was accurate and was unaware of any potential bias or conflict. Miller Dep. 79:17-81:1. At the  
28 same time, Miller admits the decisions she made based on the recommendations of the SDT would

1 be impacted had she known they were biased or involved personal financial interests. *Id.* 81:25-  
2 84:12 (“I would hope and I would insist on receiving full and accurate and complete information on  
3 which to base a decision.”). Accordingly, the City Council’s decision to accept without question the  
4 recommendation of the SDT was effectively tainted and, therefore, not made in good faith.

5 23. For each of these reasons, the City cannot be found to have acted in good faith under  
6 section 109(c)(5)(B). *See also In re Am. Capital Equip., LLC*, 688 F.3d 145, 156 (3d Cir. 2012)  
7 (holding that debtor’s plan resulted in a conflict of interest and thus failed to meet the good faith  
8 requirement for confirmation because the plan indirectly incentivized the debtor to sabotage the  
9 defense of certain asbestos claims); *In re Fiesta Homes of Ga., Inc.*, 125 B.R. 321, 325 (Bankr. S.D.  
10 Ga. 1990) (recognizing that the plan proponent’s conflicts of interest made diligent pursuit of certain  
11 preference actions unlikely and made an appearance of impropriety inevitable); *In re Unichem*  
12 *Corp.*, 72 B.R. 95, 100 (Bankr. N.D. Ill. 1987) (concluding that the plan was designed to reward its  
13 proponent, an individual whose “inequitable conduct was the cause of [the debtor’s] financial  
14 distress” which was inherently “in conflict with the objectives and purposes of the Bankruptcy  
15 Code.”), *aff’d*, 80 B.R. 448 (N.D. Ill. 1987).

16 **(2) The City Failed to Make Reasonable Inquiry Into Its Decision Not to**  
17 **Impair CalPERS**

18 24. Tellingly, the City also failed to conduct any detailed study or analysis of its decision  
19 not to impair CalPERS when that decision was made. The City made no serious effort in this regard  
20 at all until months after the AB 506 process, when it retroactively attempted to justify its decision in  
21 the face of the initial objections to this chapter 9 case.

22 25. The City admits that before and during the AB 506 process, it had no evidence to  
23 support its decision not to reduce or modify its CalPERS obligations. *See Haase Dep.* 88:15-19  
24 (unable to recall any study or analysis conducted by the City or any outside consultant, aside from  
25 materials prepared after the AB 506 process, concerning the City’s decision not to impair CalPERS);  
26 *Montes Dep.* 115:4-10 (unable to recall any study or analysis concerning the potential impact of not  
27 offering a CalPERS plan). Neither did the City ever calculate the potential savings it could realize  
28 from restructuring its CalPERS obligations. *See Goodrich Dep.* 194:15-18 (the City did not

1 calculate the “potential savings from a restructuring of the pension benefit obligation”). Nor did the  
2 City consider alternatives to CalPERS, such as forming an independent benefit plan or joining an  
3 existing defined benefit plan. *See* Deis Dep. 206:15-21; *see also* Haase Dep. 89:8-13 (unaware of  
4 any “effort to study alternative benefit structures” to replace CalPERS). Rather, the City based its  
5 decision not to impair CalPERS purely on the anecdotal concern that “the City needs to maintain a  
6 pension benefit that makes [it] a competitive employer, otherwise [the City] won’t be able to attract  
7 or retain employees,” and that impairing its contract with CalPERS in any way would somehow  
8 make it uncompetitive. Montes Dep. 192:6-17; *see also* Deis Dep. 229:14-233:9 (testifying that the  
9 City’s decision not to seek to impair CalPERS in the AB 506 process was primarily based on the fear  
10 of “losing employees” and “filling vacancies”). This “gut” feeling led the City to decide not to  
11 impair its single largest creditor to the detriment of all the remaining creditors.

12         26. Proving that the decision not to impair CalPERS was uninformed, it was only **after**  
13 the filing of its chapter 9 petition that the City began investigating possible ways to reduce its  
14 CalPERS liability. First, the City inquired whether CalPERS would reduce the 5% COLA benefit  
15 afforded to pensioners that was artificially inflating the City’s obligations to CalPERS. *See, e.g.*,  
16 Walsh Decl., Ex. L (June 7, 2012 letter from Laurie Montes to CalPERS regarding “Revision to the  
17 City of Stockton’s 5% COLA Allowance for Miscellaneous Employees”). Second, in December  
18 2012 the City inquired whether CalPERS could reamortize the City’s liability over a longer period,  
19 thus potentially reducing the annual payments that would be owed to CalPERS. *See* Haase Dep.  
20 122:9-20. While both measures fall short of actually impairing CalPERS in any way, the City’s  
21 belated inquiries as to potential ways to reduce its CalPERS liability establish that the City had  
22 previously – including with respect to the AB 506 process – simply failed to give the matter any  
23 thought. A snap decision was made by City managers not to impair CalPERS (which had the  
24 collateral benefit of protecting their own pensions), and that snap judgment carried through as the  
25 sole basis for the City’s improper refusal to seek concessions from CalPERS in the AB 506 process.  
26 *See Brandt v. Hicks, Muse & Co. (In re Healthco Int’l, Inc.)*, 208 B.R. 288, 305 (Bankr. D. Mass.  
27 1997) (rejecting corporate decision because directors’ analysis was inadequate).

28

1           27.     The City’s neglect is highlighted by its subsequent actions. After filing its chapter 9  
2 petition and learning that creditors would object, the City scrambled to construct an after-the-fact,  
3 belated justification for its failure to pursue CalPERS. In particular, in July and August 2012, the  
4 City met with Management Partners to develop a “business case” to support its decision not to  
5 impair CalPERS. *See* Haase Dep. 82:20-83:14; Goodrich Dep. 267:15-268:2. Teresia Haase  
6 testified that “[t]his was the first meeting [she] recall[s] where the purpose . . . was to discuss the  
7 information we may want to gather to help us understand what the market was with respect to PERS  
8 or a PERS reciprocal defined retirement benefit system.” Haase Dep. 84:4-12. The objective of  
9 these meetings was “to make the business case for remaining current and in good standing with  
10 CalPERS” for purposes of providing “evidence in [the City’s] eligibility case.” Walsh Decl., Ex. M  
11 (Management Partners’ Follow-Up Notes from August 8, 2012 Meeting with Ann Goodrich and  
12 Teresia Haase and SDT Meeting); *see also* Goodrich Dep. 280:12-20 (testifying that the purpose of  
13 seeking this information was because “we anecdotally knew most of this information[,] . . . [b]ut we  
14 wanted to be able to specifically state that we had checked with all these jurisdictions and that - that  
15 it wasn’t just based on anecdotal understanding of what common practices are.”).

16           28.     Evidence shows that the City’s decision not to negotiate with or impair CalPERS, at  
17 the expense of the City’s remaining creditors, was, at the time it was made, plainly based on little  
18 more than anecdote and innuendo and lacked any sound factual basis. This further bars the City  
19 from establishing it negotiated with its creditors in good faith under section 109(c)(5)(B) given that  
20 the key decision that drove the negotiations was, at best, off-the-cuff and totally uninformed when it  
21 was made.

22                   **(3)     An Actual Examination of the Facts Establishes That the City Will**  
23                   **Remain a Competitive Employer Even if CalPERS is Impaired, Further**  
24                   **Demonstrating the City’s Flawed Decision-Making Process**

25           29.     An analysis conducted by a renowned labor economics expert, Professor David  
26 Neumark of the University of California—Irvine, further demonstrates that the City’s decision not to  
27  
28



1 impair CalPERS was completely unsubstantiated.<sup>4</sup> In particular, the Neumark Report found that the  
2 City's justification for its decision - namely, that a reduction in pensions for existing and/or future  
3 retirees would lead to a "mass exodus" of experienced police officers and related retention and  
4 recruiting issues - does not stand up to scrutiny for three reasons: (1) the City's "evidence" is  
5 anecdotal; (2) data provided by the City contradicts the City's conclusion; and (3) the City's  
6 assumptions are flawed.

7 30. First, Professor Neumark found that the "evidence" supporting the City's claim that it  
8 could face a "mass exodus" is purely anecdotal. *See* Neumark Report at 6-7. Indeed, Police Chief  
9 Eric Jones testified that the basis for this claim is an "informal list" of employees who have told his  
10 command staff "that they are applying or in an application process or seriously considering leaving."  
11 Jones Dep. 132:11-133:17; *see also* Neumark Report at 6-7.

12 31. Second, after reviewing all of the information provided by the City pertaining to  
13 retention and recruitment, Professor Neumark found that the City's claim is contradicted by its own  
14 data pertaining to retention and recruitment. For instance, the City's data indicates that 27 police  
15 officers have left the City for other law enforcement jobs since January 1, 2012. *Id.* at 7. Although  
16 these departures occurred during a time when the City made cuts in pay and non-pension benefits,  
17 there is no causal link between these compensation reductions and the employee departures. *Id.*  
18 Rather, Professor Neumark indicates that several other factors could have played a role in these  
19 moves, such as upward career moves, jobs becoming available in more desirable cities, and  
20 discontent with the former police chief. *Id.* at 6-9.

21 32. Finally, Professor Neumark found that the City's assumptions are flawed. For  
22 example, although the City assumes that pension cuts would leave it with a less-experienced  
23 workforce, the lateral moves documented by the City have actually led to a more experienced police  
24 force. *Id.* at 19-21. Further, the City has hired over 60 police officers in 2012 (during a large part of  
25

---

26 <sup>4</sup> The Expert Report of David Neumark, dated Dec. 14, 2012 (the "Neumark Report"), is appended  
27 to the Declaration of David Neumark in Support of National Public Finance Guarantee  
28 Corporation's and Assured Guaranty Corp. and Assured Guaranty Municipal Corp's Supplemental  
Objections to the City of Stockton's Qualification Under Section 109(c) and 921(c).



1 which the City was in chapter 9), seriously undermining the notion that compensation cuts or feared  
2 pension cuts deter police officers from Stockton. *Id.* at 20. There are many additional bases set  
3 forth in Professor Neumark's report, such as the report's analysis of all of the many factors that  
4 influence an employee's decision to change jobs. *Id.* at 9-16. Myriad factors are far more important  
5 from a social science perspective than the desire for a slightly larger pension at some distant point in  
6 the future.

7 33. Professor Neumark's report demonstrates that the City's decision not to impair  
8 CalPERS relied on flawed and unsubstantiated evidence and, indeed, was contrary to the City's own  
9 data. The fact is that the City will remain a competitive employer even if CalPERS is moderately  
10 impaired. This is particularly true if the Stockton pension plans are terminated and the assets placed  
11 in the terminated agency pool – which is currently over-funded by some \$180 million – and replaced  
12 by new affordable defined benefit plans. *See* Objection at 8; Lamoureux Dep. 107:19-108:4. The  
13 fact that the City's concerns regarding recruiting and retention are so grossly misplaced is yet  
14 another indication of its lack of good faith in deciding not to impair CalPERS.

15 34. In sum, the City cannot establish that its decision not to negotiate with or impair  
16 CalPERS (or even to negotiate with CalPERS) was made in good faith under section 109(c)(5)(B)  
17 because that decision was the product of a tainted process rife with conflicts of interest and was not  
18 adequately informed.

19 **III. The City's Petition Also Should Be Dismissed Under Section 921(c) Because It Was Not**  
20 **Filed in Good Faith**

21 35. Section 921(c) of the Bankruptcy Code provides: "After any objection to the petition,  
22 the court, after notice and a hearing, may dismiss the petition if the debtor did not file the petition in  
23 good faith or if the petition does not meet the requirements of this title." 11 U.S.C. § 921(c).

24 36. "Good faith is not defined in the Bankruptcy Code nor is there any meaningful  
25 discussion of the Congressional intent behind the good faith requirement found in the legislative  
26 history of this section." *Sullivan Cnty.*, 165 B.R. at 80. However, while the requirement to file the  
27 petition in good faith under section 921(c) is distinct from the requirement to negotiate in good faith  
28 under section 109(c)(5)(B), "these statutory provisions do involve considerable overlapping from an

1 evidentiary standpoint.” *Id.* at 80 n.56. In *Sullivan County*, the court found that the debtors did not  
2 file their petition in good faith under section 921(c) for many of the same reasons that it found that  
3 the debtors did not meet section 109(c)(5)(B) and concluded that “[t]he debtors in the present case  
4 have failed to establish the requisites for Chapter 9 relief, both under § 109(c) and § 921(c), and  
5 therefore their petitions must be dismissed under the former and should be dismissed under the  
6 latter.” *Id.* at 83.

7 37. This Court further noted that “[f]ive essential elements for eligibility to be a chapter 9  
8 debtor are set forth at 11 U.S.C. § 109(c), to which is appended a good faith filing requirement by 11  
9 U.S.C. § 921(c).” *Stockton I*, 475 B.R. at 725 (citing 2 COLLIER ON BANKRUPTCY ¶ 109.04  
10 (Alan N. Resnick & Henry J. Sommer eds. 16th ed. 2011)). Here, under section 921(c), the City’s  
11 petition should be dismissed in light of the extensive evidence that the petition was not filed in good  
12 faith and the City’s failure to establish it has satisfied the eligibility requirements.

13 38. As detailed above, the City never intended, and still does not intend, to seek to impair  
14 its largest unsecured creditor, CalPERS. The City Manager, Bob Deis, testified that he could not  
15 recall any efforts by the City to seek to reduce, modify or restructure its obligations with CalPERS.  
16 *See* Deis Dep. 213:7-13; *see also* Goodrich Dep. 123:17-25, 125:10-15 (noting City’s failure to  
17 engage union personnel regarding the reduction or modification of the City’s pension obligations);  
18 Levinson Decl. Ex. B (noting CalPERS’ extremely limited role in the AB 506 mediation process).  
19 Further, as recently as October 2012, counsel to the City told CalPERS that the City has no intention  
20 to seek to impair CalPERS. *Mixon* Dep. 65:7-18. And the City Manager told as much to the  
21 representatives of the City’s labor unions. *See* Deis Dep. 233:14-237:3.

22 39. Indeed, in recent days the City Council passed a motion authorizing the City to enter  
23 into that certain Memorandum of Understanding (“MOU”), effective July 1, 2012, through June 30,  
24 2014, regarding salary, CalPERS pension benefits and other terms and conditions of employment for  
25 the members of the Stockton Police Officers’ Association (SPOA). *See* Walsh Decl., Ex. N.  
26 Specifically, the City agrees in the MOU to treatment under a chapter 9 plan of claims by the SPOA  
27 and affirmation of terms of the MOU, which include leaving existing SPOA employees with the  
28 same level of benefits as they have received to date. Thus, the City has clearly demonstrated that it

1 will carry out its prepetition objective to maintain CalPERS pensions at current unsustainable levels  
2 to the detriment of all other creditors.

3 40. Moreover, as of the date the City filed its chapter 9 petition, the record is clear that  
4 the City did not have a legitimate justification for the failure to impair, or even negotiate with,  
5 CalPERS. It was only after the petition date and after the conclusion of the AB 506 mediation  
6 process in which the City failed to seek a reduction or modification of its obligation to CalPERS that  
7 the City tried to cook up an after the fact “business justification” for its failure to impair CalPERS.  
8 This blatant attempt to cover its tracks in connection with filing its chapter 9 petition strongly  
9 suggests the petition was not filed in good faith. In July 2012, after the submission of the Ask and  
10 the conclusion of the AB 506 process, the City had its first telephonic meeting to discuss developing  
11 its business case for not impairing CalPERS. Goodrich Dep. 267:15-268:2. In August 2012, the  
12 City first met with Management Partners to develop the business case for its decision not to impair  
13 CalPERS. Haase Dep. 82:20-83:4, 84:4-12. After meeting with Ann Goodrich, Teresia Haase, and  
14 the SDT, Andy Belknap of Management Partners understood that Management Partners’ “objective  
15 is to make the business case for remaining current and in good standing with CalPERS. To be used  
16 as evidence in eligibility case.” *See* Walsh Decl., Ex. M (Management Partners’ Follow-Up Notes  
17 from August 8, 2012 Meeting with Ann Goodrich and Teresia Haase and SDT Meeting), at 1.  
18 Belknap’s notes went on to list six items needed “in order to craft our argument.” *Id.* This belated  
19 attempt to concoct an after-the-fact justification for the City’s failure to negotiate with its largest  
20 unsecured creditor evinces the City’s pre-determination to file a petition for the sole purpose of  
21 cramming down other creditors while protecting CalPERS. That these decisions were made by  
22 managers with a personal financial interest in maintaining the City’s CalPERS relationship only  
23 further proves the City’s lack of good faith.

24 41. All of this is evidence of the City’s primary goal in its bankruptcy filing, which is to  
25 maintain the bloated CalPERS pensions doled out to City employees (including members of the  
26 SDT) in richer times and have its remaining creditors, including National, foot the bill. The City can  
27 no longer afford these pensions, and instead of seeking a reduction or modification in its CalPERS  
28

1 liability, the City adopted a strategy designed to force its other unsecured creditors to do what the  
2 City refuses to ask CalPERS to do. This is clear evidence of a lack of good faith in filing its petition.

3 42. The City's failure from the outset to seek concessions from CalPERS at the expense  
4 of its remaining creditors, and continued actions to continue on this path, proves that the City's  
5 primary goal in this bankruptcy is not to equitably adjust its debts to exit bankruptcy a stronger  
6 municipality, but to use bankruptcy as a weapon to adjust only certain debts while sheltering favored  
7 creditors. The City's desire for a "Burger King-style" Bankruptcy – the City wants to have  
8 everything its own way – does not meet the good faith requirement of section 921(c).

9 **IV. CalPERS Can Indeed be Impaired by the City in its Chapter 9 Case**

10 43. CalPERS has asserted that the obligations to it cannot as a matter of law be impaired  
11 in a chapter 9 bankruptcy, providing the City with a purported "defense" to the City's failure to  
12 negotiate with CalPERS: Because CalPERS cannot be impaired, the argument goes, the City's  
13 failure to seek concessions from CalPERS was harmless, and thus negotiations were "impracticable"  
14 under section 109(c)(5)(C). This assertion is fundamentally flawed. CalPERS is merely an  
15 unsecured creditor of the City, similarly situated to all other of the City's unsecured creditors and is  
16 subject to all of the provisions of the Bankruptcy Code, based on the United States Constitution  
17 longstanding Supreme Court precedent and established case law in this District. Thus, the City has  
18 the same negotiating leverage against CalPERS that it has against all of its other creditors, and  
19 impracticability is no defense to the City's failure to seek concessions from CalPERS.

20 44. It would be futile for the City to argue that CalPERS cannot be impaired because of  
21 state law. Such an argument completely ignores governing authority – including the Supremacy  
22 Clause and the Bankruptcy Clause of the United States Constitution, decisions of the United States  
23 Supreme Court and applicable chapter 9 precedent – establishing that federal law, in this case the  
24 Bankruptcy Code, preempts and supersedes inconsistent state law.

25 45. The Supremacy Clause provides that the "Constitution, and the Laws of the United  
26 States . . . shall be the supreme Law of the Land." U.S. Const. art. VI, § 2. Where the Constitution  
27 grants the federal government the power to act, the Supremacy Clause establishes that federal law  
28 prevails over competing state provisions. *See Perez v. Campbell*, 402 U.S. 637, 652 (1971) ("any

1 state legislation which frustrates the full effectiveness of federal law is rendered invalid by the  
2 Supremacy Clause”). Such federal law includes the Bankruptcy Code:

3           The Federal government possesses supreme power in respect of  
4 bankruptcies. . . . If a state desires to participate in the assets of a  
5 bankrupt, she must submit to appropriate requirements by the controlling  
6 power; otherwise, orderly and expeditious proceedings would be  
frustrated.

7 *N.Y. v. Irving Trust Co.*, 288 U.S. 329, 333 (1933) (citations omitted); *see also Cent. Virginia Cmty.*  
8 *Coll. v. Katz*, 546 U.S. 356, 373 (2006) (“the history of the Bankruptcy Clause . . . shows that the  
9 Framers’ primary goal was to prevent competing sovereigns’ interference with the debtor’s  
10 discharge”).

11           46. The “Bankruptcy Clause” of the United States Constitution provides that “Congress  
12 shall have Power [t]o . . . establish . . . uniform Laws on the subject of Bankruptcies throughout the  
13 United States.” U.S. Const., art. I, § 8, cl. 4. Thus, the federal bankruptcy law preempts contrary  
14 state law, leaving the state law inapplicable and unenforceable. *See In re City of Vallejo*, 403 B.R.  
15 72, 78-79 (Bankr. E.D. Cal. 2009) [*Vallejo I*] (finding that a chapter 9 debtor may reject collective  
16 bargaining agreements under section 365 of the Bankruptcy Code notwithstanding conflicting state  
17 law), *aff’d*, 432 B.R. 262 (E.D. Cal. 2010) [*Vallejo II*]. The California Constitution also must yield  
18 to the extent it conflicts with the Bankruptcy Code. *See Vallejo I*, 403 B.R. at 77.

19           47. Neither the City nor CalPERS can assert that CalPERS cannot be impaired in this  
20 chapter 9 case because such impairment would violate state law (including the PERL). Such an  
21 argument would ignore controlling Supreme Court authority upholding the primacy of the  
22 Bankruptcy Code in relation to state law. In *Ashton v. Cameron County Water Improvement District*  
23 *No. 1*, the Supreme Court held that the “especial purpose of all bankruptcy legislation is to interfere  
24 with the relations between the parties concerned – to change, modify, or impair the obligation of  
25 their contracts.” 298 U.S. 513, 530 (1936). Further, in *United States v. Bekins*, the Supreme Court  
26 explained that bankruptcy law provides a remedy - the right to impair contracts - that the states  
27 cannot provide on their own due to the prohibitions of the Contracts Clause, Article I, Sec. 10, of the  
28 United States Constitution. 304 U.S. 27, 53-54 (1938).

1           48.     Such an argument would also ignore chapter 9 precedent, including precedent in this  
2 Court, upholding the preemption of state law in bankruptcy. Despite what the City or CalPERS may  
3 assert to the contrary, “the California legislature cannot rewrite bankruptcy priorities.” *See In re*  
4 *Cnty. of Orange*, 191 B.R. 1005, 1017 (Bankr. C.D. Cal. 1996). Previously in this case, this Court  
5 examined the Supremacy Clause and the Bankruptcy Clause as well as the preemption issues raised  
6 in chapter 9 cases and found that state laws are ineffective and preempted in a chapter 9 case. *See*  
7 *Ass’n of Retired Emp. of the City of Stockton (In re City of Stockton)*, 478 B.R. 8, 16-17 (Bankr. E.D.  
8 Cal. 2012) [*Stockton II*] (retiree benefits could be impaired under the Bankruptcy Code, and  
9 conflicting California statutes and the California Constitution are ineffective and preempted in a  
10 chapter 9 case); *Vallejo I*, 403 B.R. at 75 (California labor law and the California Constitution are  
11 preempted by the Bankruptcy Code).

12           49.     Granting special treatment to CalPERS in chapter 9 is unsupported by any law or  
13 facts and, if granted, would permit the single largest unsecured creditor in this case to obtain  
14 preferential treatment to the detriment of all of the City’s other creditors. As this Court stated, “the  
15 lessons of recent chapter 9 cases teach that successful plans of adjustment are most likely to be  
16 achieved by the parties in interest all coming to the table and participating in bona fide negotiations.”  
17 *Stockton II*, 478 B.R. at 25. Since both the City and CalPERS simply refuse to negotiate this case  
18 must be dismissed.<sup>5</sup>

---

19  
20 <sup>5</sup> The Tenth Amendment of the United States Constitution and section 903 of the Bankruptcy Code  
21 do not save the City from failing to negotiate with CalPERS. *See Bekins*, 304 U.S. at 51-52  
22 (Supreme Court held that, with state consent, the municipal bankruptcy law provided a remedy that  
23 the states could not provide on their own due to the prohibitions of the Contracts Clause). Indeed,  
previously in this case, the Court ruled that “[a] state cannot rely on the § 903 reservation of state  
power to condition or to qualify, i.e. to ‘cherry pick,’ the application of the Bankruptcy Code  
provisions that apply in chapter 9 cases after such a case has been filed.” *Stockton II*, 478 B.R. at 16.

24 CalPERS also cannot claim that it is an “arm of the state” that is exempt from application of the  
25 Bankruptcy Code. Whether or not CalPERS is an arm of the state, in this matter it is simply an  
26 unsecured creditor of the City. As such, it must comply with the provisions of the Bankruptcy Code  
27 as all other creditors, even including the State itself, must. *See Mission Indep. Sch. Dist. v. Texas*,  
116 F.2d 175 (5th Cir. 1940). Further, CalPERS cannot argue that it is a “sovereign” that is exempt  
28 from application of the Bankruptcy Code. Even if it is considered a “sovereign,” in numerous cases,  
the Supreme Court has reiterated that states acting as creditors are subject to federal bankruptcy  
laws. *See, e.g., Van Huffel v. Harkelrode*, 284 U.S. 225 (1931) (debtor may sell property free and  
clear of a state tax lien); *Irving Trust Co.*, 288 U.S. 329 (late-filed state tax claim barred); *Tenn.*  
*Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004) (state bound by bankruptcy court’s discharge  
order notwithstanding alleged sovereign immunity).

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

50. Thus, in its chapter 9 case, the City is subject to all provisions of chapter 9, including those provisions allowing for the impairment of its liability to CalPERS. And CalPERS cannot hide behind state law that it asserts protects its claims. Yet the City never attempted to even negotiate a reduction in its crushing liability to CalPERS, electing instead to protect the unsustainable CalPERS pensions that it awarded but that the City itself cannot now afford while forcing its other creditors (including National) to foot the bill. The City's steadfast intent to impair its bondholder creditors in order to protect its CalPERS pensions tainted this chapter 9 case before it was even filed. On this record, the City has not proven that its negotiations prior to filing the petition and during the AB 506 process were in good faith and meet the statutory requirements of section 109(c)(5)(B) or, alternatively, that such negotiations were impracticable under section 109(c)(5)(C).

---

In addition, CalPERS may be impaired in a plan of adjustment. It is black letter law that the Bankruptcy Code permits the impairment of claims in a plan of adjustment even over the objection of impaired creditors. *See* 11 U.S.C. § 1129(b)(1). National reserves the right to further address these issues if raised by the City or CalPERS.

1           WHEREFORE, National respectfully requests that this Court issue an order (1) dismissing  
2 the City's chapter 9 petition and (2) granting such other and further relief as is just and proper under  
3 the circumstances.

4 Dated: December 14, 2012

WINSTON & STRAWN LLP

5  
6 By: /s/ Lawrence A. Larose  
7 Lawrence A. Larose (admitted *pro*  
8 *hac vice*)

and

9 /s/ Matthew M. Walsh  
10 Matthew M. Walsh

11 Attorneys for Movant  
12 National Public Finance  
13 Guarantee Corporation  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28