

1 The City of Stockton, California (the “City” or “Stockton”), National Public Finance
2 Guarantee Corporation (“National”), Assured Guaranty Corp. and Assured Guaranty Municipal
3 Corp. (collectively, “Assured”), Franklin High Yield Tax-Free Income Fund and Franklin California
4 High Yield Municipal Fund (collectively, “Franklin”), and Wells Fargo Bank, National Association,
5 in its role as indenture trustee (the “Indenture Trustee,” and together with the City, National,
6 Assured, and Franklin, the “Parties”), hereby request that the Court modify its Order on Motion for
7 Leave to Introduce Evidence Relating to Neutral Evaluation Process Under California Government
8 Code § 53760.3(q) [Dkt. No. 429] (the “Protective Order”) to allow the Parties to use any AB 506-
9 Related Communications (defined below) in their upcoming filings regarding eligibility.

10 In support of this Motion, the Parties state as follows:

11 **I. BACKGROUND**

12 **A. The AB 506 Process**

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14 1. On March 27, 2012, the City commenced a “neutral evaluation process” pursuant to
15 California Government Code § 53760.3, which has been referred to in this case as the “AB 506
16 Process.”

17 2. The City invited approximately 30 interested parties to participate in the AB 506
18 Process. *See* Declaration of Marc A. Levinson in Support of City of Stockton’s Statement of
19 Qualifications Under Section 109(c) of the United States Bankruptcy Code [Dkt. No. 452], Ex. A
20 (Attaching City of Stockton’s Mar. 21, 2012 Press Release). Nearly all of the potential interested
21 parties elected to participate in the AB 506 Process, including all of the City’s employee unions, the
22 indenture trustees of its public debt issuances, bond insurers, the sole holder of a series of bonds,
23 judgment creditors, and an organization representing City retirees.

24 3. The City was unable to resolve its financial and other issues through the AB 506
25 Process despite the creditors having extended the initial 60-day statutory period by an additional 30
26 days. As a result, the AB 506 Process concluded on June 25, 2012.

27 4. On June 28, 2012 (the “Petition Date”), the City commenced this case by filing a
28 voluntary petition for relief under chapter 9. In support, the City filed the Statement of

1 Qualifications Under Section 109(c) [Dkt. No. 5] (the “Eligibility Statement”) and the Memorandum
2 of Fact and Law in Support of Qualifications Under Section 109(c) of the United States Bankruptcy
3 Code [Dkt. No. 19] (the “Eligibility Memorandum”) and associated declarations and exhibits
4 (together with the Eligibility Statement and the Eligibility Memorandum, the “Eligibility
5 Pleadings”).

6 **B. The Protective Order**

7 5. On June 29, 2012, the City filed its Motion for Leave to Introduce Evidence Relating
8 to Neutral Evaluation Process Under California Government Code § 53760.3(q) [Dkt. No. 16] (the
9 “AB 506 Motion”). The AB 506 Motion sought permission to disclose publicly information relating
10 to the AB 506 Process as to: (1) the number and length of meetings between the City and its
11 creditors; (2) the identity of the participants at such meetings; (3) the types of issues discussed; (4)
12 the financial and other information shared; (5) the offers exchanged and the discussions between the
13 parties; and (6) the status of negotiations between the City and each interested party as of the
14 Petition Date. AB 506 Motion at 3-5.

15 6. On July 13, 2012, the Court issued an opinion denying the AB 506 Motion [Dkt. No.
16 426] (the “Opinion”). In particular, the Court found that while statements made, information
17 disclosed, or documents prepared or produced during the AB 506 Process (collectively, the
18 “AB 506-Related Communications”) are not necessarily privileged, it was nonetheless appropriate
19 for the Court to issue a protective order precluding the disclosure of such information. Opinion at
20 21-23.¹

21 7. The Protective Order provides that “no party, person, or entity may disclose without
22 the prior permission of this court, any statements made, information disclosed, or documents
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25 ¹ The Court also denied as unnecessary that portion of the AB 506 Motion regarding evidence
26 relating to the number and length of meetings between the City and its creditors, the identity of the
27 participants at such meetings, the types of issues discussed, and the status of negotiations between
28 the City and each interested party as of the June 28 petition date. The Court found that the
confidentiality of those matters ceased, as a matter of California law, once the AB 506 Process
ended. *Id.* at 16-17, 22-23.

1 produced during the neutral evaluation process that was conducted before the filing of this case
2 pursuant to California Government Code § 53760.3.” Protective Order at 1.

3 8. In issuing the Protective Order, the Court noted that it was “taking an incremental
4 approach” because “[a]s the case develops, it may become appropriate to relax the protective order
5 in various respects so that the rights of all parties can be fully examined.” Opinion at 21-22. The
6 Court specifically noted that “if objections to the petition are made that place various elements of
7 eligibility in actual dispute, then further relaxations of the protective order will be appropriate.” *Id.*
8 at 22.

9 **C. Objections to the City’s Eligibility**

10 9. On or before August 9, 2012, three creditors, joined by the Indenture Trustee, filed
11 objections to the City’s eligibility for relief under chapter 9 of the Bankruptcy Code (collectively the
12 “Objections”).² Among other things, the Objections assert that (a) the City did not meet its
13 obligation under 11 U.S.C. § 109(c)(5) to negotiate in good faith with its creditors because it failed
14 to negotiate with California Public Employees’ Retirement System (“CalPERS”), the holder of the
15 largest unsecured claim against the City, (b) the City did not meet its obligation under 11 U.S.C.
16 § 109(c)(2) because it failed to negotiate in good faith with its creditors within the meaning of
17 California Government Code § 53760.3(o), and (c) that the City did not meet its obligation under 11
18 U.S.C. § 921(c) to file the chapter 9 petition in good faith.

19 10. Pursuant to the Scheduling Order entered on August 31, 2012 [Dkt. No. 558],
20 following discovery, the parties filing the Objections may file supplemental objections to augment
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22 ² See, e.g., National’s Objection to the City of Stockton’s Qualifications Under Section 109(c) [Dkt.
23 No. 477] (“National’s Objection”); Joinder of Indenture Trustee to National’s Objection to the City
24 of Stockton’s Qualifications Under Section 109(c) [Dkt. No. 486]; Preliminary Objection of Assured
25 to Debtor’s Chapter 9 Petition and Statement of Qualifications [Dkt. No. 482] (“Assured’s
26 Objection”); Joinder of Indenture Trustee to Preliminary Objection of Assured to Debtor’s Chapter 9
27 Petition and Statement of Qualifications [Dkt. No. 487]; Franklin’s Objection to (A) the City of
28 Stockton’s Statement of Qualifications and Eligibility to be a Chapter 9 Debtor Pursuant to Sections
109(c) and 921(c) of the Bankruptcy Code and (B) Entry of an Order for Relief Pursuant to Section
921(d) of the Bankruptcy Code [Dkt. No. 484] (“Franklin’s Objection”); Joinder of Indenture
Trustee to Franklin’s Objection to (A) the City of Stockton’s Statement of Qualifications and
Eligibility to be a Chapter 9 Debtor Pursuant to Sections 109(c) and 921(c) of the Bankruptcy Code
and (B) Entry of an Order for Relief Pursuant to Section 921(d) of the Bankruptcy Code [Dkt. No.
485].

1 their Objections, including briefing, declarations, and expert reports, on or before November 9,
 2 2012. The City may file a reply to the Objections and to any such supplemental materials on or
 3 before December 21, 2012. A status conference is scheduled for January 8, 2013 to determine the
 4 schedule for conducting an evidentiary hearing regarding the City's eligibility.³

5 **D. The Modified Protective Order**

6 11. After discussions, the Parties and CalPERS agreed that discovery may include AB
 7 506-Related Communications. On September 24, 2012, the City submitted to the Court a stipulated
 8 form of proposed order to that effect, namely, the Stipulated Order Modifying Order on Motion for
 9 Leave to Introduce Evidence Relating to Neutral Evaluation Process Under California Government
 10 Code § 53760.3(q) (the "Modified Protective Order"). As of the date hereof, the Court has neither
 11 approved nor disapproved of the Modified Protective Order. The proposed order would amend the
 12 Protective Order "to permit any party, person or entity to disclose any AB 506-Related
 13 Communications to any Party pursuant to a discovery request or during a deposition in connection
 14 with this case" Modified Protective Order at 3. The Modified Protective Order also provides
 15 that the Protective Order "shall continue to protect any AB 506-Related Communications disclosed
 16 during the course of discovery from disclosure to the extent not explicitly permitted by this Order."

17 *Id.*

18 **E. Meet and Confer Efforts**

19 12. The Parties believe that the use of AB 506-Related Communications is critical to
 20 support their respective supplemental filings regarding the upcoming determination of the City's
 21 eligibility to be a debtor in this bankruptcy case. Given the scope of the issues that will be
 22 adjudicated in connection with the eligibility question, the Parties recognize that various aspects of
 23 the City's prepetition conduct, including in the AB 506 Process, are highly relevant to the eligibility
 24 determination.⁴ CalPERS, however, disagrees and has to date declined, despite numerous requests,
 25 _____

26 ³ The Parties expect that evidentiary hearing to be scheduled for the end of January or, at the latest,
 the beginning of February.

27 ⁴ Of course, the Parties recognize that the AB 506-Related Communications may include sensitive
 28 information and have therefore agreed that all such communications would only be used in this
 bankruptcy case pursuant to the terms and conditions of the Stipulation and Protective Order

1 to agree to permit the Parties to use AB 506-Related Communications in their court filings regarding
2 eligibility, even if such disclosure is made only under seal pursuant to the Stipulation and Protective
3 Order. This Motion is necessary because the Parties need to use AB 506-Related Communications
4 in their supplemental filings but have been unable to obtain CalPERS' agreement to do so.

5 **II. DISCUSSION**

6 13. To be eligible for relief under chapter 9, the City must meet certain criteria. Section
7 109(c)(5) of the Bankruptcy Code provides that an entity is eligible to be a debtor under chapter 9 if
8 it:

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10 (5)(B) has negotiated in good faith with creditors and has failed to obtain
11 the agreement of creditors holding at least a majority in amount of
12 the claims of each class that such entity intends to impair under a
13 plan in a case under such chapter; or

14 (C) is unable to negotiate with creditors because such negotiation is
15 impracticable.

16 11 U.S.C. § 109(c). Further, section 109(c)(2) of the Bankruptcy Code requires that a municipality
17 first be authorized by the state to file for chapter 9 relief, and California has required as a condition
18 to such authorization that the municipality negotiate in good faith with its creditors in the AB 506
19 process. The City bears the burden of satisfying each criterion; if it cannot do so, the Court must
20 dismiss the City's petition. *Int'l Ass'n of Firefighters, Local 1186 v. City of Vallejo (In re City of*
21 *Vallejo)*, 408 B.R. 280, 289 (B.A.P. 9th Cir. 2009).

22 14. In addition, section 921(c) of the Bankruptcy Code requires that a debtor under
23 chapter 9 "file the petition in good faith." 11 U.S.C. § 921(c).

24 15. In the Eligibility Pleadings, the City asserts that it has met these requirements. *See*
25 Eligibility Memorandum at 18-19, 38-43. For instance, the City states:

26 "[T]hrough the AB 506 process the City recently engaged most of its
27 major creditors in a way that revolved around their treatment under a
28 potential plan. . . . As the City will demonstrate after the Court allows in

approved by the Court on September 28, 2012 [Dkt. No. 564] (the "Stipulation and Protective Order").

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the relevant evidence, the City spent enormous time and resources developing its ask to each interested party/future plan class. . . . The *Vallejo* court anticipated exactly this sort of ‘proposed plan’ ‘in concept,’ and the City has satisfied subsection (c)(5)(B).

* * * *

As an alternative basis for satisfying § 109(c)(5)’s requirements, the City was unable to negotiate with its creditors because such negotiation was impracticable.

* * * *

Despite good faith efforts by the City and the interested parties, when the AB 506 process concluded on June 25, 2012, the City had not ‘resolved all pending disputes with creditors.’

* * * *

Only when [the AB 506 Process] failed did the City have no other choice. It filed its petition not as a litigation tactic, but because it ran out of time.

Id.

16. The Objections, on the other hand, assert, among other things, that the City has not demonstrated that it has met the eligibility requirements under section 109(c) or section 921(c). For example, National’s Objection states that:

The City has failed to carry its burden of showing that it meets the eligibility requirements under section 109(c) as it did not negotiate in good faith with its creditors as required by section 109(c)(5)(B) of the Bankruptcy Code because (i) the City did not intend to and in fact did not negotiate with its single largest unsecured creditor, CalPERS, either before, during or after the AB 506 process, which negotiations were not impracticable; and (ii) the Ask is not a feasible plan or in the best interests of creditors.

* * * *

Here, similar to *Sullivan County*, the City has failed to meet the good faith requirements under section 921(c) and section 109(c)(5)(B). As previously discussed, the City has not presented evidence that it negotiated with its creditors equitably and thus, in good faith. The Ask clearly demonstrates the City’s favorable treatment of CalPERS, its single largest unsecured creditor, to the detriment of other similarly-situated creditors, including National. Further, by the City’s own admission, the Ask is not a

1 plan that is feasible and in the best interests of creditors and that can be
2 confirmed in chapter 9.

3 National's Objection at 10-18; *see also* Assured's Objection at 15-20; Frankin's Objection at 2-3.

4 17. Assured additionally states in its Objection that:

5 Independent of whether the City negotiated in good faith within the
6 meaning of the Bankruptcy Code, Stockton did not negotiate in "good
7 faith" within the meaning of AB 506. The City contends it was
8 "specifically authorized" to be a municipal debtor under California law
9 because it "participated in a neutral evaluation process pursuant to Section
10 53760.3." Cal. Gov't Code § 53760(a). Section 53760.3(o) requires the
11 City to negotiate "in good faith," Assured believes that the City (i)
12 lacked the "intent to negotiate toward a resolution" of a consensual
13 adjustment of its debt with both Assured and CalPERS and (ii) did not
14 "provide complete and accurate information to provide the relevant parties
15 through the neutral evaluation process with sufficient information . . . to
16 negotiate the readjustment of the municipality's debt."

17 Assured's Objection at 18-19.

18 18. The Objections place three elements of good faith "in actual dispute," and therefore
19 the Parties submit that "further relaxation[] of the protective order" in respect of AB 506-Related
20 Communications is now "appropriate." Opinion at 22. The only purpose of expending the resources
21 to conduct discovery is to permit the Parties to develop and present it to the Court to support a
22 Party's position on a contested issue. In this case, the communications between the participants in
23 the AB 506 Process and the City's decisions with respect to CalPERS are highly relevant to the good
24 faith and impracticability issues under Section 109(c). Having undertaken the effort in discovery to
25 develop the evidentiary facts, the Parties should be allowed the incremental step of submitting the
26 discovered evidence to inform this Court's decision on eligibility. The Parties respectfully submit
27 that any concern over further disclosure of the AB 506-Related Communications will be sufficiently
28 addressed by the Stipulation and Protective Order.

19. Finally, the relief requested in this Motion is consistent with the Opinion. There, the
Court noted that, "if objections to the petition are made that place various elements of eligibility in

1 actual dispute, then further relaxations of the protective order will be appropriate.” Opinion at 22.
2 The further modification of the Protective Order sought by the Parties in this Motion is consistent
3 with the “incremental approach” contemplated by the Court.

4 WHEREFORE, the Parties respectfully request that this Court issue an order further
5 modifying the Protective Order to allow the Parties to use the AB 506-Related Communications
6 disclosed during the course of discovery to support their further briefing and in connection with the
7 evidentiary hearing on the City’s eligibility for chapter 9 relief, provided that any such disclosure in
8 Court filings or otherwise be made pursuant to the terms of the Stipulation and Protective Order.

9 Dated: October 2, 2012

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Dated: October 2, 2012

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