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8 UNITED STATES BANKRUPTCY COURT  
9 EASTERN DISTRICT OF CALIFORNIA  
10 SACRAMENTO DIVISION

11 In re:  
12 CITY OF STOCKTON, CALIFORNIA,  
13 Debtor.

CASE NO.: 12-32118-C-9

DCN: OHS-15

14 **OFFICIAL COMMITTEE OF**  
15 **RETIREE’S MEMORANDUM IN**  
16 **SUPPORT OF CONFIRMATION OF**  
17 **THE CITY OF STOCKTON’S**  
18 **AMENDED PLAN OF ADJUSTMENT**

19 Date: October 1, 2014  
Time: 10:00 a.m.  
Judge: Hon. Christopher M. Klein  
Courtroom: 35, Department C

20 The Official Committee of Retirees (the “Committee”) submits that the City of Stockton’s  
21 Amended Plan of Adjustment, as Modified (August 8, 2014) (the “Plan”) should be confirmed, as  
22 presented, without impairment of pensions, for several compelling reasons, including: (i) the  
23 Plan already imposes significant hardship on City’s retirees (the “Retirees”) from the loss of their  
24 health benefits that are the subject of the Retiree Health Benefit Claims<sup>1</sup> valued at approximately  
25 \$545,000,000 (the “Retiree Health Benefits”), (ii) impairment of pensions would impose a further  
26 undue and unreasonable hardship on the Retirees, who do not receive social security benefits for

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28 <sup>1</sup> Capitalized terms not defined herein shall have the meaning as defined by the Plan.

1 their service to the City, and would drive many of them into poverty after a lifetime of working  
2 for the City, (iii) the City has purposefully and in good faith determined that impairment of  
3 pensions would have significant adverse consequences on the City's ability to retain and attract  
4 qualified employees, particularly safety employees, and would impair the quality of the City's  
5 services to its residents, including Retirees, and (iv) denial of confirmation would put the City's  
6 negotiated compromises developed through judicially supervised mediation at risk, thereby  
7 jeopardizing the City's ability to successfully and promptly emerge from bankruptcy.

8 With the single exception of Franklin Fund's "hold out" objection, the Plan is the result of  
9 extensive mediation and compromise by the City and its creditors, including Retirees. The  
10 Committee participated in extensive mediation negotiations with the City that resulted in the  
11 Retiree Settlement provided in the Plan. (Plan, Definition 156.) Impairment of pensions would  
12 violate this compromise, vitiate the Retirees' votes overwhelmingly supporting the Plan (Decl. of  
13 Catherine Nownes-Whitaker Regarding Tabulation and Certification of Ballots, Dkt. No. 1268),  
14 unnecessarily send the City back to "square one", without any assurance of better treatment for  
15 creditors, and send the message that one hold-out creditor can torpedo the extensive mediation  
16 efforts of all other creditor groups.

## 17 ANALYSIS

### 18 I. Retirement Health Benefits.

19 As the Court will recall, this case began by the City unilaterally and greatly reducing and  
20 then terminating the Retiree Health Benefits that had been earned over many years of service by  
21 Retirees to the City. The Association of Retired Employees of the City of Stockton  
22 ("ARECOS"), and others, filed an adversary complaint and an application for a temporary  
23 restraining order to stop the City from unilaterally reducing and then terminating those hard-  
24 earned health benefits. (Adv. Proc. Case No. 12-02302). In support of its application for a  
25 temporary restraining order, ARECOS filed numerous declarations from individual Retirees  
26 detailing the financial and personal hardship that would result from the City's termination of the  
27 Retirement Health Benefits, as well as the economic benefits that the Retirees had already given  
28 up through the collective bargaining process in exchange for the City's promise to provide the

1 Retirees with lifetime Retiree Health Benefits. (See e.g. Declaration of D. Milnes, Adv. Proc.  
2 Case No. 12-02302, Dkt No. 9 ¶¶ 23-31 for negotiated concessions and loss of vested benefits  
3 imposed by City's termination). For example, the Declaration of Delia Fernandez, Adv. Proc.  
4 Case No. 12-02302, Dkt No. 22 ¶¶ 2-8 explains the economic and personal hardships she would  
5 suffer (and now has suffered) from the loss of Retiree Health Benefits that she earned over 39  
6 years of service to the City. Ms. Fernandez's annual income is stated as \$24,780. Payment of the  
7 City's health premium, even with the City's temporary limited subsidy that it provided as it was  
8 terminating the Retiree Health Benefits postpetition, would require payment of 21% of Ms.  
9 Fernandez's annual income. The City has since eliminated all Retiree Health Benefits, so Ms.  
10 Fernandez and all Retirees have had to seek alternative coverage and pay the full premiums. Ms.  
11 Fernandez further describes her ongoing need for medical treatment following blood infections,  
12 renal failure, congestive heart failure, and other medical conditions. Similarly, the Declaration of  
13 Pat Hernandez, Adv. Proc. Case No. 12-02302, Dkt No. 27 ¶¶ 2-8 explains the economic and  
14 personal hardships from the loss of Retiree Health Benefits that she earned over approximately 24  
15 years of service to the City. Ms. Hernandez's annual income is stated as \$29,263. Payment of the  
16 City's health premium, even with the City's temporary limited subsidy that it provided as it was  
17 terminating the Retiree Health Benefits postpetition, required payment of 52% of Ms.  
18 Hernandez's annual income. Ms. Hernandez further describes her and her husband's ongoing  
19 need for medical treatment including dialysis, heart conditions, and other medical conditions.  
20 These are just two examples of the hardships imposed on Retirees that have permanently lost their  
21 Retiree Health Benefits under the Plan.

22 The Court dismissed the ARECOS adversary proceeding, instructing the City's Retirees  
23 that their real remedy was to participate in the bona fide negotiations for the formulation of a plan  
24 of adjustment, *In re City of Stockton*, 478 B.R. 8, 25 (Bankr. E.D. Cal. 2012). The Court further  
25 stated that the Retirees' claims would be dealt with in the "collective proceeding to work out a  
26 comprehensive solution to municipal insolvency." *Id.* at 26. The Retirees have done just that.  
27 The Committee participated in extensive mediation negotiations with the City conducted by  
28 Judge Perris that resulted in the Retiree Settlement memorialized in the Plan. (Direct Testimony

1 Declaration “DTD” of A. Goodrich, Ex 3055 ¶ 10; Deposition Testimony of D. Milnes, Ex 2632  
2 pp. 72:7-74:8). The Retiree Settlement provides that the Committee will support confirmation of  
3 the Plan consistent with the settlement, including (i) the treatment provided for the Retiree Health  
4 Benefit Claims in Class 12 of the Plan, (\$5.1 million to be distributed pro-rata among  
5 approximately 1,100 Retiree Health Benefit Claims, whose claims total approximately  
6 \$545,000,000, resulting in a percentage distribution of approximately 0.935% of each Retiree  
7 Health Benefit Claim)<sup>2</sup> and (ii) leave unimpaired Retirees’ pension benefits as CalPERS Pension  
8 Plan Participants; see Class 15 of the Plan. (Trial Exhibit 2044).

9 The above-described \$5.1 million payment in exchange for the elimination of Retiree  
10 Health Benefits under the Plan is a major concession by Retirees. As explained by the testimony  
11 of Anne Goodrich, Retirees will receive one-time distributions ranging from \$460 to \$14,000  
12 (DTD A. Goodrich, Ex 3055, ¶ 10) for the loss of their lifetime Retiree Health Benefits. This one-  
13 time distribution, at its highest, is not enough to cover even one year of premiums for replacement  
14 health insurance and for many it will only cover a few months without providing any coverage for  
15 dependents that were covered by the City’s plan. (DTD T. Zadroga-Haase, Ex 3071 ¶ 4; DTD A.  
16 Goodrich, Ex 3055, ¶ 10; [www.coveredca.com\shopandcompare](http://www.coveredca.com/shopandcompare)).

17 The termination of Retiree Health Benefits under the Plan will also provide significant  
18 benefit to the City, its ability to provide payments to creditors, and its ability to provide services  
19 to its residents. As explained by Ms. Zadroga-Hasse, the City has already avoided payment of at  
20 least \$26.2 million from terminated health insurance since the City filed its Chapter 9 petition.  
21 (DTD T. Zadroga-Haase, Ex 3071 ¶ 3). And as noted, the cumulative value of the Retiree Health  
22 Benefits over the remaining lifetime of the Retirees that have earned those benefits is  
23 approximately \$545,000,000. Thus, the Retirees have not only suffered a substantial loss from  
24 the City’s bankruptcy, but their loss under the Plan will significantly help the City meet its  
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27 <sup>2</sup> See Class 12 Treatment at Section IV(M)(2) of the Plan, Unsecured Claim Payout Percentage at  
28 Definition 185 of the Plan, and the City’s Amended List of Creditors and Claims Pursuant to 11  
U.S.C. §§ 924 and 925 (Retiree Health Benefit Claims) (Dkt. 1150).

1 obligations and provide services in the future to make the Plan successful and to avoid the need  
2 for a future restricting of its debt.

3 Having participated in good faith in the judicially supervised mediation process and  
4 having already given up \$545 million in Retiree Health Benefits claims, the Retirees have  
5 contributed more than their fair share to the City's Plan and recovery.

## 6 **II. Impairment of Pensions Would Have a Devastating Impact on Retirees.**

7 The record shows that impairment of pensions would impose an undue burden on Retirees  
8 driving many of them into poverty. (DTD R. Deis, Ex 3046 ¶ 31.) Mr. Deis, the former City  
9 Manager, explains that the average Retiree who did not have City paid medical insurance as part  
10 of the Retiree's retirement package receives an average pension of \$24,000 per year. (DTD R.  
11 Deis, Ex 3046 ¶ 32.) He further explains that the Retirees that were receiving Retiree Health  
12 Benefits as part of their retirement package have an average pension of \$51,000. (*Id.*)

13 The City's pension expert, Kim Nicholl testified that the City's unfunded liability for its  
14 CalPERS pension obligations could reduce pension benefits by as much as 60%, if the City fails  
15 to make its payments to CalPERS. (Second Amended Trial Transcript for June 4, 2014, K.  
16 Nicholl, pp. 17:14-17,52:14-54:5; DTD D. Lamoureu, Ex 4015 ¶ 38, 41, and 43; DTD R. Leland,  
17 Ex 3057 ¶ 17). Thus, if the City were to cease performing its obligations to fund the CalPERS  
18 Pension Plan, and the plan was placed in the terminated agency pool, the pensions of both  
19 employees and Retirees could be reduced by the amount of the underfunding. A 60% reduction  
20 in an average Retiree pension of \$24,029 per year would leave an annual pension of only \$9,612.  
21 And a 60% reduction in an average Retiree pension of \$51,000 would leave an annual pension of  
22 only \$24,000.

23 Reducing pensions for Retirees who have dedicated their working years to serving the  
24 City of Stockton would be fundamentally unfair. These pension amounts are modest by any  
25 standard and such a significant reduction would put many Retirees below the poverty line.  
26 Moreover, many of these Retirees do not have alternative sources of income. The Pension  
27 Benefit Guaranty Corporation does not backstop public pensions. (See Amended Trial Transcript  
28 for May 14, 2014, D. Lamoureux, pp. 162:25-163:3) and the City did not participate in Social

1 Security, so City Retirees are not eligible to receive Social Security benefits based upon their  
2 years of City employment. (DTD A. Goodrich, Ex 3055, ¶ 15; Second Amended Trial Transcript  
3 for June 4, 2014, K. Nicholl, p. 19:9-22.) Thus, the Retirees do not have a social safety net to  
4 protect them from pension cuts that private employees have when private employers have  
5 impaired pensions in a chapter 11 case.<sup>3</sup> And because of because of their age, medical condition,  
6 or other factors, it would be unreasonable to expect Retirees to be able to earn supplemental  
7 income. Unlike the City's financial creditors, the Retirees did not underwrite a loan to the City,  
8 having performed the commensurate due diligence, or charge what the underwriters thought was  
9 a fair interest rate to account for inherent risk. Instead, the Retirees served the public with the  
10 reasonable expectation that they would receive the vested benefits they earned. The Retirees have  
11 already sacrificed enough for the adjustment of the City's debts with the loss of Retiree Health  
12 Benefits under the Plan and they should not be compelled to give more.

### 13 **III. Impairment of Pensions Would Not Benefit Creditors.**

14 Termination of the City's pension plan with CalPERS would not benefit creditors. On the  
15 contrary, the evidence shows that the City and its creditors would be worse off. Terminating the  
16 CalPERS Pension Plan would not eliminate the cost of providing pension benefits. The City has  
17 established that it needs an adequate and competitive pension system to attract and retain  
18 employees. (See e.g. DTD R. Deis, Ex 3046 ¶ 29, DTD K. Wilson, Ex 3068 ¶ 15). And while it  
19 may be a theoretical possibility to establish an alternative pension plan, it is not a realistic or  
20 viable alternative, and could not be relied upon to save the City any money as explained in the  
21 testimony from Ms. Kim Nicholl, Mr. Deis and Mr. Wilson. (Second Amended Trial Transcript  
22 for June 4, 2014, Kim Nicholl extensive testimony throughout transcript, DTD R. Deis, Ex. 3046  
23 ¶ 29; DTD K. Wilson, Ex 3068 ¶ 15). The testimony of David Lamoureux further supported this  
24 conclusion. (DTD D. Lamoureux, Ex 4015 ¶ 13; Amended Trial Transcript for May 14, 2014, D.

25 <sup>3</sup> The Committee acknowledges that some Retirees may be receiving some social security benefits  
26 on account of employment they may have had with other employers that did participate in the  
27 social security program but those benefits are discounted on account of the Retiree's receipt of a  
28 public pension and those payments were earned separate and apart from their service to the City  
so they are a collateral source that should not be relevant to the importance of their pensions from  
the City.

1 Lamoureux pp. 188:17-22, 195:5-17.) Terminating the CalPERS Pension Plan would also create  
2 a financial and practical incentive for valued City employees to seek employment at other  
3 CalPERS agencies due to the Public Employees' Pension Reform Act of 2013 ("PEPRA")  
4 regulations and the loss of confidence that employees would have in the City to fulfil its  
5 commitments. (See Second Amended Trial Transcript for June 4, 2014, K. Nicholl, pp. 29:20-  
6 37:1 and Ex. 3085).

7 Termination of the CalPERS Pension Plan would result in CalPERS having a potentially  
8 secured claim of an estimated \$1.6 billion based upon the testimony of Mr. Lamoureux. (DTD D.  
9 Lamoureux, Ex 4015 ¶¶ 41,43.) It's inconceivable that adding a \$1.6 billion claim, even if  
10 unsecured, would improve distributions to any unsecured creditors. Furthermore, as noted above,  
11 impairment of pensions would eliminate the Retirees votes and support for the Plan, it would  
12 require the City to renegotiate its collective bargaining agreements with its unions, and would put  
13 the City's compromises with other creditors at risk.

14 Taken together, the evidence demonstrates that impairment of pensions would cause the  
15 loss of valued City employees, the loss of Plan support from multiple creditor groups that have  
16 been carefully balanced through mediation, it would create a \$1.6 billion claim that would swamp  
17 all other claims, it would delay the City's emergence from bankruptcy, and all without any  
18 assurance that it would save the City any money or result in a larger payout to Franklin Fund or  
19 any other creditor. In short, it would cause harm to every interested party, including Franklin  
20 Fund itself, without any actual expected benefits.

21 **IV. The Claims of CalPERS and the CalPERS Pension Plan Participants are**  
22 **Appropriately Separately Classified in Class 15.**

23 Even assuming arguendo that pension rights can be modified, such modification should  
24 not be required as the Plan has been accepted by Class 12. The "fair and equitable" and "unfair  
25 discrimination" standards in Section 1129(b)(1) apply to classes that have not accepted a plan.  
26 Thus, since Franklin is in Class 12 and the class has accepted the Plan, Franklin's objection  
27 should be viewed as nothing more than a challenge to the Plan's separately classifying the  
28 pension related claims by CalPERS and Retirees. The City's separate classifications are  
appropriate in this case, and any such objection should be denied. As explained by the Ninth

1 Circuit in *In re Johnston*, 21 F.3d 323 (9<sup>th</sup> Cir. 1994), separate classification of claims is  
2 appropriate where there are reasonable nondiscriminatory reasons for the separate classification  
3 and where the legal character of the claims are not substantially similar. Here, the Retiree Health  
4 Benefit Claims and their claims related to the pensions involve separate claims with separate and  
5 distinct interests. (See DTD T. Zadroga-Haase, Ex 3071 ¶ 2). For example, a substantial amount  
6 of the City's pension obligations to its Retirees on account of their pension rights have already  
7 been funded. Moreover, unlike the City's pay-as-you-go and self-funded Retiree Health Benefits,  
8 the City's pension obligations involve substantial rights and obligations with a third party,  
9 CalPERS. These pension obligations are governed by and subject to a comprehensive statutory  
10 scheme (the California Public Employee Retirement Law, Government Code §§ 20000, et seq.,  
11 the "PERL"). While the Court is correct that the Retirees and employees will bear the brunt of  
12 the economic burden with respect to impairment of pensions, and that Retirees and employees  
13 would suffer from termination of the City's pension plan as outlined above, CalPERS is more  
14 than a conduit. The Retirees are beneficiaries of the CalPERS system which operates as a trust  
15 for the benefit of Retirees to fulfill the City's promises to Retirees to provide their pensions  
16 through CalPERS. Accordingly, in addition to the Retirees' rights to enforce the City's promises  
17 to the Retirees under memorandums of understanding and other agreements, CalPERS has rights  
18 and interests under the CalPERS Pension Plan and the PERL that it would seek to enforce on its  
19 own behalf and as Trustee of the pension plan. These differences, and others, are more than  
20 sufficient to support the City's separate classification of its pension obligations to CalPERS and  
21 Retirees.

## 22 **V. Pensions as Property Rights.**

23 The Committee agrees with the City that the question of whether pensions can be  
24 impaired need not and should not be decided in this case. The City's Plan does not propose to  
25 impair pensions. As explained above and in the City's extensive evidence submitted in support of  
26 the Plan, the City has proposed its Plan without impairment of pensions irrespective of whether or  
27 not pensions can be impaired because the City has determined in its judgment that leaving  
28 pensions unimpaired is necessary to the City's successful emergence from bankruptcy and no

1 feasible, less-costly alternative exists. Thus, the Plan should be confirmed as presented without  
2 unnecessary determinations about under what circumstances pensions could be impaired if the  
3 City were to propose a different plan.

4 The Committee further submits that because the City has not proposed to impair pensions,  
5 the Committee has not addressed the legal restrictions, prohibitions, and limitations on  
6 impairment of pensions. If the City were to propose a plan providing for impairment of pensions,  
7 the Committee reserves the right to assert all objections to such treatment, including objections  
8 based upon pensions being a property right that cannot be taken from Retirees without just  
9 compensation. For example, under California law, permanent public employees have an interest  
10 in the continuation of their employment that is a private property right that is protected by the due  
11 process clauses of the state and federal constitutions. (See *Skelly v. State Personnel Bd.*, 15  
12 Cal.3d 194, 206–208 (1975) U.S. Const., 5<sup>th</sup> Amend and 14<sup>th</sup> Amend.; Cal. Const., art. I, § 7,  
13 subd. (a).) The right to compensation is part and parcel of the right to employment. This is  
14 evident from the requirements noted in *Skelly* that compensation be paid for violation of an  
15 employee's right to due process. *Id.* at 204. The Committee submits that, since a City  
16 employee's right to employment is protected by constitutional due process such that it may not be  
17 terminated, the benefits of such employment earned by the employee should also be protected as  
18 a property right. The Retirees, having already fully performed and earned their pensions, cannot  
19 have their property interests in their employment taken from them under any standard of due  
20 process and, therefore, they cannot have their pensions taken from them either. Instead, the  
21 Retirees pensions should receive at least as much protection as the lien rights asserted by other  
22 creditors, since there is no basis for elevating a secured creditor's property interest in its lien  
23 rights above the Retirees' property interests in their pensions. As noted above, the City has not  
24 proposed to impair pensions in its Plan, so the Committee reserves the right to address these  
25 issues in more depth and detail and assert the Retirees' interests in their pensions as a property  
26 right in the unlikely event the City actually seeks to impair pensions.

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**VI. Conclusion**

The Committee supports confirmation of the Plan arrived at through judicially supervised mediation as in the best interest of the City and its creditors. Even if pensions can be impaired, the evidence overwhelmingly demonstrates that doing so in this case would cause unnecessary, undue, and irreparable harm to the Retirees, to the City, to employees, to creditors, to the City’s ability to emerge from bankruptcy, and to the City’s residents. The Court should approve the City’s sound and good faith business judgment in preserving pensions unimpaired, and confirm the City’s Plan as the best plan for all creditors under the circumstances of this chapter 9 case.

Dated: August 11, 2014

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