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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
SACRAMENTO DIVISION

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

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BEFORE THE HONORABLE CHRISTOPHER M. KLEIN, JUDGE
OF THE UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF
CALIFORNIA, AND ON APRIL 1, 2013.

REPORTER'S TRANSCRIPT OF PROCEEDINGS
(FINDINGS OF FACT AND CONCLUSIONS OF LAW)

TRIAL - VOLUME IV (A.M.)
(Pg. 544-596)

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APPEARANCES:

(See pg. 2)

Reported by: VICKI L. BRITT, RPR, CSR No. 13170

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1 MONDAY, APRIL 1, 2013 AT THE HOUR OF 10:00 A.M.

2 BEFORE THE HONORABLE CHRISTOPHER M. KLEIN

3 ---oOo---

4 THE COURT: This is the time set for me to make
5 findings of fact and conclusions of law orally on the record
6 pursuant to Federal Rule of Civil Procedure 52, as
7 incorporated by Federal Rules of Bankruptcy Procedure 7052
8 and 9014, which I will proceed to do after I get entries of
9 appearance by anybody who wishes to appear. I am not, as I
10 indicated at the close of our last session, entertaining
11 argument from anybody. So in the courtroom.

12 MR. HILE: Good morning, Your Honor. Normal Hile
13 of Orrick, Herrington & Sutcliffe on behalf of the City of
14 Stockton. With me today is Marc Levinson, John Killeen and
15 Jonathan Riddell. And, also, I introduce to the Court again
16 the Stockton City Manager, Bob Deis, and the Stockton City
17 Attorney, John Luebberke.

18 THE COURT: And also in the courtroom.

19 MR. WALSH: Good morning, Your Honor. Matthew
20 Walsh with Winston & Strawn on behalf of National Public
21 Finance Guarantee Corporation.

22 THE COURT: Is there anybody else in the
23 courtroom?

24 MR. GEARIN: Good morning, Your Honor. Michael
25 Gearin of K&L Gates on behalf of CalPERS. With me in the

1 courtroom is Peter Mixon, the general counsel of CalPERS.
2 And I believe a couple of my partners are on the phone
3 listening in.

4 THE COURT: All right, I have a note that there
5 are telephone appearances by Mr. De Lancie. Is
6 Mr. De Lancie out there? Apparently not. Mr. Gardener.

7 MR. GARDENER: Yes, good morning, Your Honor.
8 Michael Gardener on behalf of Wells Fargo, the Indenture
9 Trustee.

10 THE COURT: Wells Fargo in its capacity as
11 Indenture Trustee.

12 Mr. Johnston.

13 MR. JOHNSTON: Good morning, Your Honor. Jim
14 Johnston from Jones Day on behalf of the Franklin entities.

15 THE COURT: The Franklin entities. Mr. Larose.

16 MR. LAROSE: Good morning, Your Honor. Lawrence
17 Larose, Winston & Strawn, for National Public Finance
18 Guarantee.

19 THE COURT: And Mr. Morse.

20 MR. MORSE: Good morning, Your Honor. Joshua
21 Morse from Jones Day on behalf of Franklin High Yield
22 Tax-Free Income Fund and Franklin California High Yield
23 Municipal Fund.

24 THE COURT: And Mr. Neal.

25 MR. NEAL: Good morning, Your Honor. Guy Neal of

1 Sidley Austin for Assured Guaranty entities.

2 THE COURT: And Mr. Ryan.

3 MR. RYAN: Yes, good morning, Your Honor. Michael
4 Ryan of K&L Gates on behalf of CalPERS.

5 THE COURT: Okay, is there anybody else appearing
6 by telephone? There is nobody.

7 Let me then proceed. As I indicated at the start
8 of trial last week, what is going on here as a matter of
9 bankruptcy procedure is that the City has filed its petition
10 under chapter 9 of the Bankruptcy Code last June, the end of
11 June, and the Bankruptcy Code provides that under the
12 chapter 9, even though the case is voluntary, the order for
13 relief is not automatic, as it is in all other bankruptcy
14 cases that are voluntary. Instead, the municipality must
15 litigate its way to an order for relief over any objections.
16 And objections have been made by Assured Guaranty, National
17 Public Finance, the Franklin entities, and Wells Fargo as
18 Indenture Trustee for, I guess, all the opponents. It seems
19 to be ubiquitous as the Indenture Trustee.

20 And as a result, we had a substantial period of
21 both court-ordered mediation, which I ordered at the outset
22 of the case on the theory that in reorganization matters,
23 the best solutions are usually achieved through negotiation.
24 And during that time was also a time for the confidence
25 building in terms of getting the appropriate information so

1 that the various creditors and stakeholders could develop a
2 sense of how much to trust the information the City was
3 providing. It's inherent in this business that,
4 particularly when lawyers hear what the other side is
5 saying, they instinctively do not trust it. And it really
6 is a situation that requires a period of time with the
7 actual numbers and the people in order to get a sense of how
8 accurate things are being stated. So that is what has been
9 going on.

10 We finally got to the question of the order for
11 relief. If I order relief, as I indicated, it's much like
12 in a competitive event, a qualifying round of success on
13 behalf of the City at this point merely would advance the
14 case moving toward a plan of adjustment, which is the
15 equivalent of what in Chapter 11 practice is known as the
16 plan of reorganization. And, of course, the history of
17 those and the experience of those is that those are
18 ordinarily the result of significant negotiation over time.
19 The order for relief merely opens the door to the formal
20 presentation of the plan, and then a plan would have to be
21 approved through the confirmation process. And the
22 confirmation process is itself a substantial litigation
23 process in which parties can complain that they are not
24 being dealt with fairly, and that the plan, for example, did
25 discriminate unreasonably against them. So if I were to

1 grant an order for relief, that is merely the opening round
2 in a much more complicated analysis.

3 The matrix of analysis is laid out in the
4 Bankruptcy Code; specifically, section 109 of the Bankruptcy
5 Code says that an entity may be a debtor under chapter 9 if
6 and only if such entity, first, is a municipality. And that
7 is a defined term at section 101 of the Code to mean
8 political subdivision or public agency or instrumentality of
9 the state.

10 The second requirement is that the entity be
11 specifically authorized in its capacity as a municipality or
12 by name to be a debtor under such chapter by state law, or
13 by a governmental officer or organization empowered by state
14 law, to authorize such entity to be a debtor under such
15 chapter. And, of course, there's provisions in the
16 California Government Code that channels the filing of
17 chapter 9 cases. And the State of California has
18 established that as a gateway, and the State of California
19 is the gatekeeper in filing. And we'll be talking more
20 about that later as I deal with the conclusions of law.

21 The third requirement is that the entity be
22 insolvent. And insolvent is specifically defined at section
23 101 of the Bankruptcy Code with the language -- with
24 reference to a municipality, insolvent means financial
25 condition such that the municipality is "generally not

1 paying its debts as they become due unless such debts are
2 the subject of a bona fide dispute; or unable to pay its
3 debts as they become due." And the City has relied on the
4 second prong of that inability to pay debts as they become
5 due.

6 The fourth requirement is that the municipality
7 must desire to effect a plan to adjust its debts.

8 And then the fifth requirement has four
9 independent alternatives, any one of which is sufficient to
10 warrant the filing. One is -- the first alternative is that
11 the municipality also has the agreement of creditors holding
12 at least a majority in amount of the claims of each class
13 that such entity intends to impair under a plan in a case
14 under such chapter. The second alternative is that the
15 municipality has negotiated in good faith with creditors and
16 has failed to obtain the agreement of creditors holding at
17 least a majority in amount of the claims of each class that
18 such entity intends to impair under a plan in a case under
19 chapter 9.

20 The next alternative is that the municipality is
21 unable to negotiate with creditors because such negotiation
22 is impracticable.

23 And the final alternative is that the municipality
24 reasonably believes that a creditor may attempt to obtain a
25 transfer that is avoidable under section 547 of Title 11.

1 That's the so-called "avoidable preference."

2 In addition to those requirements, section 921 of
3 the Bankruptcy Code provides that after any objection to the
4 petition -- that's what we're dealing with here today --
5 "the court, after notice and a hearing, may dismiss the
6 petition if the debtor did not file the petition in good
7 faith or if the petition does not meet the requirements of
8 this title." Specifically, the requirements of Title 11 are
9 the requirements I just went through.

10 And section 921(d) further provides that if the
11 petition is not dismissed under subsection (c), then the
12 Court shall order relief under chapter 9.

13 So that is the statutory framework that I'm
14 applying as I look at the facts. And I've spent the last
15 several days going through literally thousands of pages. I
16 was here until after midnight, as a matter of fact, last
17 night. And I am persuaded of the following facts by a
18 preponderance of the evidence, and they go as follows:

19 When Bob Deis arrived to become the City Manager
20 for the City of Stockton on July 1, 2010 -- and that's the
21 first day of the City's fiscal year; that was the first day
22 of its 2010 to 2011 fiscal year -- he came into a
23 municipality in financial distress. In a progression
24 beginning at least in 2008, the City Council had declared
25 fiscal emergencies and imposed unilateral actions in order

1 to stop the hemorrhage of funds that were not being
2 supported by revenues, and it imposed a number of unilateral
3 actions.

4 On June 22, 2010, the City Council had adopted an
5 action plan for fiscal sustainability that Mr. Deis was to
6 implement. There were basically ten points in that plan.
7 Literally, the cross-examination of Mr. Deis focused at some
8 length on those particular situations.

9 And the situations -- if I can summarize them --
10 are that some of the problems were due to what we're now
11 calling the "great recession," the recession that has now
12 lasted longer than any recession at least during my
13 lifetime.

14 And Stockton was ground zero for subprime
15 mortgages. Unemployment was 22 percent. The median income
16 for a family of four was somewhere around \$63,000. Property
17 values -- and it's both commercial property values and
18 residential property values -- had declined by about
19 5 percent. Specifically, median sales price of residences
20 declined from \$422,000 in 2006 to \$140,000 in 2012; so
21 looking at a long and a steep slide. And that is included
22 in the testimony of Vanessa Burke, who is the Chief
23 Financial Officer, who I found both Mr. Deis and Ms. Burke
24 to be credible witnesses.

25 Stockton had one of the highest foreclosure rates

1 in the nation. And that's something of which I am painfully
2 aware because of the ordeal of having had to preside over
3 the tragedy of bankruptcy cases of literally thousands of
4 individual Stockton citizens, who had essentially done
5 nothing wrong, other than be seduced by easy credit in
6 purchasing a home, before being slammed by unexpected loss
7 of income when laid off or furloughed.

8 Property tax revenues, sales tax revenues and
9 other public revenues, characteristics of a functioning
10 local economy, local governmental economy, had plummeted.
11 For example, the sales tax revenue declined from
12 \$47 million in fiscal year 2006, to \$32.7 million in fiscal
13 year 2010.

14 And recovery was far over the horizon. The
15 expectation was 2015 or '16, and I'm not sure that that
16 horizon has gotten much closer. We do just now begin to see
17 glimmerings of some hope in housing markets, at least in
18 Sacramento. I do not know, and the record does not
19 indicate, what the situation is in Stockton.

20 Some of the problems -- in addition to there being
21 problems with the great recession, some of the problems were
22 due to earlier excessive optimism on the part of City
23 management. The municipality had committed itself to
24 payment of long-term bonds to finance redevelopment projects
25 and other projects that were authorized on what can only be

1 described as an overly saying of, "If you build it, they
2 will come" mentality, and they did not come. So revenues
3 were not sufficient to pay the bills for the projects.

4 That, of course, becomes important because, in
5 some of the bond issues, there was sufficient concern from
6 the lending side of the equation that the City was required
7 to backup payments by promising to pay out of the City's
8 general fund. And the focus in insolvency ultimately is on
9 the City's general fund.

10 And some of the problems were also the
11 incrustation of a multi-decade, largely invisible or
12 nontransparent pattern of above-market compensation for
13 public employees. Among other things, the City offered
14 generous health care benefits, to which employees did not
15 contribute. Retirees had their entire health bills paid for
16 by the City. The City permitted, to an unusual degree,
17 so-called "Add Pays" for various jobs that allowed nominal
18 salaries to be increased to totals greater than those
19 prevailing for other municipalities. Mr. Deis testified to
20 those at length. Some so-called "Add Pays" are perfectly
21 legitimate and standard features of compensation generally
22 for public employees, and some were regarded as really not
23 what one would find elsewhere, and, therefore, overly
24 generous.

25 Not only that, collective bargaining agreements

1 were being agreed to on a multi-year basis, which reduces
2 flexibility, and they included predetermined, automatic
3 annual cost of living pay increases.

4 And some of the problems were also rooted in
5 generous retirement practices. The pensions, of course, are
6 themselves a form of implicit compensation. Pensions were
7 allowed to be based on the final year of compensation, and
8 only the final year of compensation, and that compensation
9 could include essentially an unlimited accrued vacation and
10 sick leave. So it was possible to engage in the phenomenon
11 that's become known as "pension spiking," in which a pension
12 can wind up being substantially greater than the annual
13 salary that the retiree ever had. And there's been a number
14 of those situations that have come into public view,
15 generally, not entirely from Stockton, as part of a debate
16 that seems to be going on in the larger community.

17 In any event, pension spiking was an issue in
18 Stockton because Stockton's obligations to CalPERS were
19 based on the amount of pensions that were having to be paid
20 out. So projected pension expenses in particular were
21 soaring.

22 And prior management of the City also deserves
23 some of the blame. The City Council is in such disarray
24 that it's taken literally years to unscramble. Ms. Burke
25 has described her efforts at length. And various elements

1 of compensation and cost of living increases that had been
2 contractually agreed upon left little latitude for exercise
3 of managerial supervision. So that was the situation when
4 Mr. Deis came on the scene and got his marching orders from
5 the City Council.

6 If one looks at each fiscal year during Mr. Deis's
7 tenure, in other words, July 1, 2010, to today, fiscal
8 emergencies were declared in each year, which it had the
9 effect of enabling the limitation of payments under certain
10 otherwise applicable City policies, some of which were in
11 collective bargaining agreements and some were just in
12 straightforward personnel policies. And it also authorized
13 the reduction of staff.

14 In the City's fiscal year that began July 1, 2010,
15 unrepresented employees suffered. They suffered furloughs
16 of 96 hours. Those were continued from a prior year. It
17 had actually been imposed the year previously. They were
18 required to begin paying a portion of their medical premiums
19 and health plan deductibles and copays were increased. And
20 when one looks at the collective bargaining agreements --
21 and there are a number of collective bargaining agreements,
22 and the City has agreements -- there were similar
23 concessions obtained.

24 When one moves on to the fiscal year beginning
25 July 1, 2011, the same pattern appears. If one looks at the

1 unrepresented employees, 96-hour furloughs continued;
2 medical benefits were eliminated for new hires, just flat
3 out eliminated; sick leave accruals were reduced, together
4 with other limits on sick leave cashouts at retirement;
5 vacation leave accruals were reduced, together with other
6 limits on vacation sellback and accrual maximums; extra
7 salary payments above workers' compensation were eliminated;
8 the Add Pay feature for longevity was eliminated for certain
9 employees; educational incentive pay was eliminated;
10 employees were required to contribute 7 percent toward their
11 retirement plan, when previously the City had made all the
12 contributions; the maximum City contribution to the health
13 plan was decreased. And when one turns and looks at the
14 collective bargaining agreements, there are parallel
15 concessions from the collective bargaining agreements.

16 And of particular significance for the City's
17 pension expense, age limits were raised. People had to work
18 longer, achieve a greater age before being permitted to draw
19 a pension. And the pension calculations themselves were
20 changed to be based on income not during the final year of
21 service, but the final three years of service. That final
22 three-year provision, coupled with the limits on the various
23 additives and so-called sellbacks and so on regarding
24 vacation, accrued vacation and sick leave and other items,
25 had significant effect in reducing the opportunity for

1 pension spiking. It does not eliminate it, but it makes it
2 more difficult to get a dramatically higher pension.

3 And I note that Council Member Kathy Miller
4 testified, in my view credibly, about the extent of the
5 measures that were taken over that entire period of time.
6 She referred to some of her friends, or former friends, and
7 in a manner that confirmed her description of just how
8 painful the toll had been on the entire City workforce and
9 on the City's ability to provide basic public services as
10 the City Council sought to regain control of the budget and
11 build some trust with the people. Because the revelations
12 that were coming out were of a nature that were -- that did
13 not inspire confidence in the City's citizenry.

14 If one looks at the basic employment numbers from
15 July 1, 2008, through December 31, 2011 -- that's the
16 midyear of the 2011-2012 fiscal year -- you will see the
17 number of City employees decreased by 25 percent, from 1,886
18 employees to 1,420 employees. That included a 20 percent
19 reduction for police, 30 percent reduction for fire,
20 38 percent reduction for public works, 46 percent reduction
21 in the library, and 56 percent reduction in recreation
22 personnel.

23 At about the same time, in the middle of the
24 2012-2013 fiscal year -- actually, the next fiscal year --
25 it became apparent that despite this year struggle to adjust

1 the City's finances and this significant reduction of the
2 workforce and of the compensation terms of the workforce, it
3 became apparent that the general fund would reach
4 June 30, 2012 with a deficit of \$8,652,768, unless drastic
5 action was taken. That was the projection of Ms. Burke, as
6 the Chief Financial Officer, and concurred by Ms. Montes,
7 Deputy City Manager, and Mr. Deis.

8 And, of course, that is a problem because
9 California requires that municipal budgets be in balance and
10 forbids deficit finance. One can borrow for a particular
11 fiscal year only if one can repay the borrowing within the
12 same fiscal year. And that means that, in fact, there can
13 be small borrowings in anticipation of, say, property tax
14 revenues, which come in twice a year. California property
15 tax bills are usually sent out twice a year, and so there
16 are spikes or peaks in the flow of revenues into a
17 municipality.

18 But in the end, the municipality has to be in the
19 black at the end of a fiscal year, period. And it cannot
20 enter a new fiscal year if it does not have a budget that is
21 projected to put it in the black by the end of that fiscal
22 year.

23 So Mr. Deis and his team, supported by the
24 independent analysis of the consulting firm, Management
25 Partners, concluded that it was time to ask the City Council

1 to initiate the neutral evaluation process under California
2 Government Code 53760 and 53760.3; that is, California's
3 gateway in filing a municipal debt adjustment case under
4 chapter 9 of the Bankruptcy Code.

5 In a 54-page memorandum dated February 28, 2012,
6 about which there was extensive cross-examination, and there
7 was a memo from Mr. Deis to the City Council, he reported
8 the projected \$8,652,768 deficit on projected expenditures
9 of \$166,655,282, and projected a deficit for the fiscal year
10 ending -- well, a projected deficit for the next fiscal
11 year, the one beginning July 1, 2012, last July, ranging
12 from anywhere from \$20,207,540, to \$38,182,873.

13 Mr. Deis reviewed at length the alternatives for
14 closing the then current gap and for dealing with the
15 projected future gaps. He noted that despite the
16 significant reductions that have already been incurred, that
17 have been incurred over the past several years, the greatest
18 opportunity to cut costs was in service reductions because
19 that's where the general fund expenses are. 71 percent of
20 general fund expenses are devoted to labor. If one views
21 general fund expenses by function, the number rises to
22 77 percent, just related to public safety. Public safety,
23 police and fire consume 77 percent of the budget. He
24 projected that a further 15 percent cut might save about
25 \$20 million, but noted that staffing had already been

1 slashed during the three previous years to close budget gaps
2 of \$37 million, \$23 million and \$28 million respectively.

3 And public safety was a particular concern. A
4 15 percent reduction in the police budget would eliminate
5 all 30 community service officers and 64 of approximately
6 323 sworn officers. The same reduction -- that is, the same
7 15 percent reduction in the fire budget -- would eliminate
8 41 sworn fire positions, three fire engines and one fire
9 truck. And I'm not quite sure what the difference is
10 between a fire engine and a fire truck. Apparently, there
11 is a significant distinction from the way it's listed at
12 various points in the evidence.

13 The Police Chief, Eric Jones, pointed out that
14 even without a 15 percent reduction in police, the Stockton
15 crime situation was a very difficult environment. The
16 Stockton Police Department had -- without the 15 percent cut
17 had about 1.10 officers per 1,000 residents, which is a
18 standard or mode of analysis that U.S. Department of Justice
19 applies. And when you look at the comparable national
20 standard per 1,000 residents for cities of comparable size,
21 it is not 1.1; it is 2.7 police.

22 The police during peak activity respond only to
23 crimes in progress. If you don't have a crime in progress,
24 don't call and expect to get somebody to respond
25 immediately. Elimination of school resources officers

1 contributed to a rise in juvenile crime and gang membership.
2 Gang-related homicides had increased by 575 percent; going
3 from 4 homicides to 27 homicides.

4 Elimination of the narcotics enforcement team has
5 led to more drug trafficking, and at the same time reduced
6 the revenues from asset forfeitures. At least a certain
7 portion of asset forfeitures wind up being able to be used
8 by the municipalities of the enforcement agencies.

9 The police department had to pare down its
10 security camera monitoring from full-time to part-time, and
11 that impaired the ability to spot crimes or to follow
12 pursuits.

13 And although in 2010, violent crime rates dropped
14 5.5 percent nationally, Stockton's, they rose. And they
15 rose to put Stockton No. 10 nationally, with 13.81 violent
16 crimes per 1,000 residents. Homicides are at an all time
17 record. Aggravated assaults with a firearm rose from 99 in
18 2009, to 196 in 2011, and increased another 30 percent in
19 2012.

20 Mr. Deis concluded that in his words, quote, these
21 kinds of cuts simply pose too much of a safety risk to our
22 citizens, unquote.

23 Mr. Deis's conclusion was consistent with the
24 conclusions of the independent consultant, Management
25 Partners, that as of February 12, the City was in a state of

1 insolvency. It identified three different concepts of
2 insolvency. First, it concluded the City was in a state of
3 what it called "service delivery insolvency." That means a
4 municipality's ability to pay for all the costs of providing
5 services at the level and quality that are required for the
6 health, safety and welfare of the community.

7 Management Partners also concluded that the City
8 of Stockton was in a state of what it termed "budget
9 insolvency"; that is, the ability of an agency to create a
10 balanced budget that provides sufficient revenues to pay for
11 its expenses that occur within the budgeted period.

12 It also opined that the City was on the verge of
13 cash insolvency; that is, an insolvency in which the
14 organization's ability to generate and maintain cash
15 balances to pay all of its expenditures as they come due is
16 in peril. And, of course, in the filing of a chapter 9
17 case, at least the standard understanding is that the
18 statutory definition of insolvency means cash insolvency;
19 although I'm not persuaded that that view is precisely
20 correct.

21 On February 28, 2012, the City Council accepted
22 Mr. Deis's recommendation and authorized the initiation of
23 the neutral evaluation process that the State of California
24 has prescribed as a prerequisite for permission to file a
25 chapter 9 case under the Bankruptcy Code.

1 The City Council also authorized the diversion of
2 various funds to meet the budget shortfall. It went in and
3 swept every account that was available. As Ms. Burke
4 testified, "they stole the arts fund," and lots of other
5 funds.

6 And one thing they did intentionally was there
7 were three specific bond issues that the general fund had
8 backed up, and the payments were going to have to be made
9 from the general fund before June 30, 2012.

10 So Mr. Deis represented that the City suspend
11 payments from the general fund, not payments from other
12 sources, but payments from the general fund on what's known
13 as the 2004 lease revenue bond parking, the 2009 lease
14 revenue bonds public facilities fees, and the 2007 variable
15 rate bonds for City Hall. The total payments that were
16 expected to be due before June 30, 2012 from the general
17 fund were \$2,048,658. The total anticipated funds, payments
18 from the general fund on those and other bonds backed by the
19 general fund for the fiscal year beginning July 1, 2012, was
20 projected to total \$11,787,182.

21 The City Council, as I noted, authorized the
22 diversion of funds and the suspension of payments. The
23 \$2,048,658 was not paid. The City ended the fiscal year
24 June 30, 2012 with less than \$2,048,658 in the bank. In
25 other words, the City would not have been paying its debts

1 as they came due during the fiscal year ending
2 June 30, 2012, but for the fact that it suspended payments
3 on those three bonds.

4 As a result of the suspension of payments, the
5 bond trustee, Wells Fargo, acting at the behest of National
6 Public Finance Guarantee Corporation and Assured Guaranty,
7 exercised their rights under the bond indentures and
8 obtained orders from the Superior Court appointing receivers
9 to take over and operate some of the properties and collect
10 revenues. So there was a receiver to take over and operate
11 three parking garages. That's a National Public Finance
12 Guarantee Corporation receiver.

13 And there's also a receiver for the new office
14 building at 400 East Main Street in Stockton that was
15 intended to serve as the new City Hall. There, the receiver
16 was obtained by Wells Fargo at the direction of Assured
17 Guaranty. And as we sit here today, those receivers remain
18 in place. And there have been several occasions during this
19 case in which I've been asked to authorize specific
20 transfers of funds from the receivers on the further payment
21 of bond obligations which have been consensual on the part
22 of the City on the basis that it does reduce the total debt.

23 Returning to the Chapter 9 process, the notice of
24 the initiation of the neutral evaluation process was given
25 promptly after the City Council's action on February 28,

1 2012. National Public Finance Guarantee Corporation
2 responded with notice of its intent to participate as an
3 interested party under California Government Code section
4 53760. That's the one that everybody keeps calling
5 "AB 506." That was the California Assembly bill that was
6 the vehicle through which it was enacted.

7 And that was a letter from Matthew Cohn, Director
8 of National Public Finance Guarantee Corporation, dated
9 March 15, 2012. And although California Government Code
10 section 53760.3(s) provides that, quote, the local public
11 entity shall pay 50 percent of the costs of neutral
12 evaluation, including, but not limited to, the fees of the
13 evaluator, and the creditors shall pay the balance, unless
14 otherwise agreed to by the parties, unquote. Mr. Cohn
15 stated, quote, National expressly disclaims any obligation
16 or liability for the payment of any costs or expenses under
17 section 53760.3(s) of the Act, or otherwise in connection
18 with the 506 notice, the Act, or pursuant to the 506
19 process, or otherwise, unquote. That's City Exhibit 1385 at
20 page 175.

21 Neither National Public Finance Guarantee
22 Corporation, nor Assured Guaranty, nor Franklin Advisers,
23 nor Wells Fargo, paid any of the costs or expenses allocated
24 to them by Government Code section 53760.3(s). The City did
25 not agree to pay their share.

1 The neutral evaluator selected was a gentleman
2 named Ralph Mabey, a former bankruptcy judge and eminent
3 bankruptcy professional, widely known, widely respected.
4 The neutral evaluation process under California Government
5 Code continued for 90 days. The statute specifies 60 days,
6 but permits an extension of 30 days if there is a majority
7 of the parties in interest and the City or the municipality
8 agree, and that agreement was obtained. So the neutral
9 evaluation process ran its full 90-day course.

10 The neutral evaluator met with different groups.
11 He decided who he was going to see and when. The
12 declaration of Mr. Levinson explains a process of shuttled
13 diplomacy, in which he was not always present for various
14 meetings, and Mr. Mabey did what he could where he saw
15 opportunities for reaching a consensus.

16 The City began the neutral evaluation process by
17 presenting a proposed plan of adjustment in the form of what
18 it called the "Ask," in which it described in 790 pages how
19 it proposed to deal with all the parties. The City intended
20 the "Ask" to be the opening of a negotiation. And this is a
21 very typical thing in reorganization practice or in workout
22 practice before the filing of a reorganization. The
23 proposal was made, and there are counterproposals and there
24 are negotiations if the parties are willing to negotiate
25 with each other.

1 And that's exactly what the "Ask" was, was just an
2 opening position that formed the basis for conversation with
3 the parties, with a view toward give and take, to the extent
4 of the goal of getting the City in a spot where it would be
5 able to pay its bills as they come due year in/year out
6 could be achieved.

7 And I would note that there was substantial
8 success in the neutral evaluation process in dealing with
9 collective bargaining agreements. On the first status
10 conference in the chapter 9 case, counsel for the City stood
11 up in this courtroom and announced that agreement had been
12 reached to modify all unexpired collective bargaining
13 agreements, and progress had also been made with respect to
14 other agreements. There was, however, no agreement with the
15 bonds.

16 When I come back to this "Ask" in the opening of
17 the negotiation, let me give a couple of examples of
18 proposed treatments of bonds. There's been a -- during
19 argument, there was a sound bite of they're only proposing
20 to pay 17 percent. And, of course, when a lawyer argues a
21 case, one picks the number that helps that person's client
22 the most. So we're always hearing a worst-case scenario.
23 Lawyers who hear those points made in argument know to be
24 cautious about evaluating things.

25 Let's look at several of the proposed bond

1 treatments. As to the three parking garages that were
2 covered by the 2004 lease revenue bond parking that have
3 been presently in the hands of the receiver appointed at the
4 behest of National Public Finance Guarantee Corporation, the
5 City did not propose to reestablish possessory interest, its
6 possessory interest. In other words, it was saying let the
7 receiver keep it and collect the revenues. And the City did
8 not propose to pay debt service going forward. In other
9 words, it was saying, all right, operate the garages. Keep
10 the revenues. Pay off the bonds.

11 As to the so-called "2006 lease revenue bonds"
12 regarding what's known as the "Stewart/Eberhart -- that's
13 S-T-E-W-A-R-T/E-B-E-R-H-A-R-T -- Building" and an adjacent
14 parking garage, for which the insurer is also a National
15 Public Finance Guarantee Corporation, the City proposed debt
16 service relief for five years, followed by five years of
17 interest-only payments and substitution of a pledge of
18 parking district revenues and public facilities fees in
19 place of the present situation where the general fund is the
20 backstop. That's a pretty typical example of how secured
21 debt is dealt with in basic reorganization practice.

22 If I turn to the proposal in the "Ask" as to the
23 2007 variable rate demand lease revenue bonds that were
24 insured by Assured Guaranty relating to the intended City
25 Hall at 400 East Main Street, the City proposed debt service

1 relief for five years, followed by five years of
2 interest-only payments, and then 30 years of full
3 amortization; in other words, payment in full. The City
4 would pledge net revenues of the building up to the amount
5 of the original scheduled debt service, to be backstopped by
6 the general fund up to the amount of restructured debt
7 service. So the general fund would not be entirely out of
8 the situation.

9 So those are three examples of proposed treatments
10 of the various bonds. They're all laid out in the "Ask,"
11 which you'll find it two places in the record: There's the
12 Objector's Exhibit 50 -- that's 5-0 -- and there's the
13 City's Exhibit 1376.

14 Now, during the neutral evaluation process,
15 National Public Finance Guarantee Corporation and Assured
16 Guaranty each took the position that there was nothing to
17 talk about unless and until the City proposed to add a plan
18 provision that would impair its obligation to CalPERS
19 regarding pensions. Translated, if you don't prepare us to
20 impair CalPERS, we're not going to talk to you.

21 When the City indicated that it did not intend to
22 impair CalPERS -- and that was after the second neutral
23 evaluation meeting attended by bondholders -- they absented
24 themselves from all further discussions, and I conclude that
25 Judge Mabey regarded them as having voted with their feet

1 and there was no point in talking to them further.

2 Now, the Objector, Franklin Advisers, actually did
3 make a counterproposal that the City concedes was made in
4 good faith. But the City indicated that it was not going to
5 proceed further talking with Franklin Advisers about it
6 because the counterproposal was just too far removed from
7 the relief that the City needed on that particular bond
8 issue in order for it to be a viable situation. And, thus,
9 the City, in effect, viewed the position of the bondholders
10 as a situation in which they were being asked to bid against
11 themselves; they, the City, was being asked to bid against
12 itself. It already had a bid out there, and there was
13 nothing but a stone wall from the other side.

14 The neutral evaluation process that was conducted
15 by Judge Mabey did, however, achieve substantial agreements
16 regarding, as I indicated, all unexpired collective
17 bargaining agreements and substantial progress in
18 discussions with other stakeholders.

19 Following the conclusion of the neutral evaluation
20 process, this chapter 9 case was filed June 28, 2012, and it
21 was assigned to me by the Chief Judge of the Court of
22 Appeals, which is the chapter 9 judge assignment procedure.
23 National Public Finance Guarantee Corporation, Assured
24 Guaranty, Franklin Advisers and Wells Fargo, as Indenture
25 Trustee, objected to entry of an order for relief, and the

1 litigation that we've had over the past week ensued.

2 As I indicated in the narratable, between the date
3 of the filing, it has been consumed by court-ordered
4 mediation. That's mediation ordered by me with the
5 Honorable Elizabeth Perris, a city bankruptcy judge in the
6 District of Oregon, whom the Chief Judge of the Court of
7 Appeals authorized to come into this district to try to work
8 with the parties to achieve a mediated solution. And that's
9 because, as I have said on multiple occasions in this case,
10 in writing and in this room, a successful plan of adjustment
11 will require very significant agreement among the parties
12 and, therefore, is an ideal subject for continuing
13 mediation.

14 All right, that gets me to conclusions of law.
15 And I propose to proceed through that statute that I read at
16 the outset because those are the essential elements. And
17 the way we lawyers think about these kind of things has us
18 marching through essential elements in a not very
19 imaginative way. So I will come back and apply my
20 conclusions of law to the facts.

21 Section 109(c) of the Bankruptcy Code has as its
22 first requirement that the entity, the debtor, be a
23 municipality. And a municipality is, as I indicated, a
24 political subdivision or a public agency or instrumentality
25 of the state. And the one thing that seems to be not

1 controversial in this case is that the City of Stockton is a
2 municipality within the meaning of that term; that is, a
3 chartered City in the State of California that qualifies as
4 a political subdivision of the state.

5 The second requirement is more complicated here.
6 The City of Stockton must be specifically authorized in its
7 capacity as a municipality, or by name, to be a debtor under
8 chapter 9, or by a governmental officer or organization
9 empowered by state law to authorize such entity to be a
10 debtor under state law.

11 Now, that raises a number of possibilities in
12 various states around the country in their gatekeeping
13 function, and this is what gives the states the power to
14 control whether chapter 9 cases are filed, have a number of
15 alternatives. For example, in the State of Rhode Island,
16 which recently went through the case of Central Falls, Rhode
17 Island, the state-mandated procedure was that there was a
18 receiver in charge of the city that came in, had the
19 authority to throw out the city council, the mayor, run the
20 city, and have all the deals that could be made. And that
21 receiver had authority to file a chapter 9 case if the
22 receiver concluded that chapter 9 was necessary for him to
23 accomplish his mission, and that's what happened. So that's
24 an example of somebody empowered by state law to authorize
25 an entity to file.

1 Likewise, we know from the *New York Off-Track*
2 *Betting* case that the governor of the State of New York, as
3 a matter of state constitutional law, had inherent authority
4 to authorize the filing of that entity. That's another
5 example. A state legislature could, even in a state that
6 otherwise forbids chapter 9, enact a special law saying the
7 City of X may file a chapter 9 case. And that has happened
8 in different states.

9 California goes with the first option, that it's
10 specifically authorized in its capacity as a municipality.
11 The State of California -- the California Government Code
12 authorizes what it calls a "local public entity" -- that's
13 the language of the California statute -- to file a petition
14 if either the local public entity has participated in a
15 neutral evaluation process under California Government Code
16 section 53760.3, or if the local public entity declares a
17 fiscal emergency and adopts a resolution by majority vote of
18 the governing board pursuant to California Government Code
19 section 53760.5.

20 I understand that the recent filing by the City of
21 San Bernardino was done on the latter, the fiscal emergency
22 alternative. Here, Stockton elected to follow the neutral
23 evaluation process. And the purpose of the neutral
24 evaluation process is to get as close as possible to a
25 so-called "prepackaged" or "preagreed" plan of adjustment if

1 the bankruptcy power is to be used. And I would emphasize,
2 as I explained in the decision in the *Association of Retired*
3 *Employees of the City of Stockton v. City of Stockton*, the
4 adversary proceeding that I decided August 6, 2012, and
5 reported at 478 Bankruptcy Reporter at page 8, what chapter
6 9 brings to the table that is not in state law is the
7 exclusive power of the Congress under the Constitution to
8 make uniform laws concerning bankruptcy. And uniform laws
9 concerning bankruptcy mean impairment of contracts. The
10 contracts clause of the United States Constitution says that
11 no state may make a law impairing the obligation of
12 contracts. And that limitation does not apply to Congress.
13 And, for the reasons I explained in that decision, the
14 asymmetry is absolutely intentional on the part of the
15 founders, the framers of the Constitution, because
16 bankruptcy is nothing but the impairment of contracts. I've
17 been doing this job for more than 25 years. I've had more
18 than 138,000 bankruptcy cases. I've been party to
19 impairment of millions of contracts and it's all
20 constitutional.

21 And I explained in that decision also that a
22 parallel contracts clause in the state constitution must
23 give way to the Bankruptcy Code, to the power of the
24 Congress under the Supremacy Clause of the Constitution;
25 perfectly straightforward, garden variety constitutional law

1 proposition.

2 So when one is trying, by whatever means, to
3 ratchet down the expenses of a municipality, the ability to
4 impair contracts can wind up looming large because sometimes
5 that's the only way to get to the point where you need to
6 go. And that's the point where a chapter 9 case comes in,
7 because that -- you can basically under the valuation
8 concepts of the bankruptcy process dispense with contractual
9 obligations under the terms that are specified. And the
10 Bankruptcy Code itself has an elaborate set of protections
11 for parties that are the victims of that impairment. So
12 that's why the state is of a mind to permit municipalities
13 to file chapter 9 cases. It's the recognition that
14 sometimes there's just no other way to deal with it.

15 The neutral evaluation statute was followed. The
16 neutral evaluator has to be impartial, objective and
17 independent and free from prejudice, and an individual who
18 has various qualifications, one of which is -- one
19 alternative of which is at least ten years of high level
20 business or legal practice involving bankruptcy or service
21 as a United States Bankruptcy Judge. The selected neutral,
22 Ralph Mabey, met all aspects of that; at least that more
23 than ten years of high level business and legal practice
24 involving bankruptcy, and he has served as a United States
25 Bankruptcy Judge.

1 The evaluation process requires notification to
2 the interested parties. It points out the neutral evaluator
3 shall not impose a settlement on the parties, but rather use
4 best efforts to assist parties to reach a satisfactory
5 resolution of their dispute. And he can request
6 documentation and provide counsel and guidance to all the
7 parties, and can even assist in negotiating a prepetition,
8 preagreed plan of adjustment.

9 Section 53760.3 provides that, quote, the local
10 public entity and all interested parties participating in
11 the neutral evaluation process shall negotiate in good
12 faith, quote. At one point in the trial I asked counsel for
13 National Public Finance Guarantee if the Capital Markets
14 Creditors had an obligation to negotiate in good faith, and
15 the response back to me was, "No, only the City has the
16 obligation to negotiate in good faith."

17 California Government Code section 53760.3 is
18 specifically to the contrary. The bondholders, that is, the
19 Capital Creditors, I am persuaded did not negotiate in good
20 faith within the meaning of section 53760.3. And,
21 therefore, they do not have the ability to complain about
22 eligibility under section 109(c)(2), that second prong.

23 And there's an adequate, independent reason for
24 reaching exactly the same conclusion. And that is, as I
25 indicated earlier, this is -- as a matter of California law,

1 I am concluding that a creditor who does not pay the
2 appropriate share of the costs of the neutral evaluation or
3 allocated to the creditor by California Government Code
4 section 53760.3(s) is in no position to complain about
5 whether the California procedure has been complied with
6 because they have, in effect, created their own
7 self-inflicted harm.

8 So I conclude that, like section 109(c), where I
9 concluded that the City of Stockton is a municipality, I
10 conclude that the City of Stockton, after evaluating
11 California Government Code section 53760, is specifically
12 authorized to be a debtor in this case, specifically
13 authorized by California law. Therefore, the second
14 essential element of an order for relief has been
15 established.

16 The third essential element is that the City must
17 be solvent. As I indicated here, the relevant argument that
18 is presented is that the term "insolvent" is defined in the
19 Bankruptcy Code at section 101(32)(C)(ii) to be financial
20 conditions such that the municipality is unable to pay its
21 debts as they become due.

22 The focus is on the date of filing, June 28, 2012.
23 Now, we know that if the City had not suspended payment of
24 the \$2,048,000 some-odd dollars on the three relevant bond
25 issues that wound up with receivers being appointed, the

1 City would have been in the red on June 30, 2012. In other
2 words, it would not have had any funds in the bank and would
3 have had outstanding bills not being paid.

4 Now, there's also credible evidence that I'm
5 persuaded of that looking into the month of July, the first
6 month or so of the chapter 9 case, that the City also would
7 not have accumulated revenues sufficient to meet basic
8 payroll expenses that were projected. And I further
9 conclude that slashing 15 percent of the City's personnel
10 budget -- remember, I said 71 percent of the budget is
11 personnel; 77 percent of the budget is police and fire.
12 Those are two different concepts because police and fire
13 includes equipment and other things in addition to
14 personnel.

15 But this is a situation where the City was, as
16 Management Partners indicated, service insolvent, and the
17 crime statistics are fully consistent with that view. So
18 this is not a case in which the City, quote, budgeted itself
19 into insolvency, unquote, as the Objectors have argued. And
20 I'm mindful that there are some reported chapter 9
21 provisions in which bankruptcy judges have dismissed cases
22 after concluding that the local public entity had
23 artificially created a technical insolvency, but this is not
24 such a case. The City of Stockton was, by any measure,
25 insolvent on June 28, 2012; specifically cash insolvent,

1 unable to pay debts as they became due.

2 Immediately upon the beginning of the fiscal year,
3 the City imposed what has been termed its "pendency plan,"
4 in which it, among other things, took the health benefits of
5 the retired employees and changed the terms such that the
6 retired employees were no longer having their bills paid
7 directly by the City in full. And the decision I described
8 a few minutes ago was the decision resolving the class
9 action that they brought in this case seeking to have me
10 stop the City from doing that.

11 And I concluded that I simply did not have the
12 authority to do that. And the City pointed out that these
13 types of measures were the only way that the City could, in
14 the fiscal year beginning July 1, 2012, have a budget that
15 complied with the basic requirement of California law, that
16 it would come out of the fiscal year in the black, or at
17 least not in the red; it had to get at least a zero. And I
18 am persuaded that that was, in fact, the situation.

19 And, accordingly, I reject the view of the
20 Objectors that the City had artificially manipulated the
21 situation to create an insolvency. The insolvency is
22 unambiguous, in my view, and I so conclude. Therefore,
23 section 109(c)(3) is also satisfied.

24 Section 109(c)(4) requires that the municipality
25 desire to effect a plan to adjust its debts. There has been

1 debate in the case law about what this particular provision
2 means. In the *City of Vallejo* case, the Bankruptcy
3 Appellate Panel took the position that it meant more than a
4 simple term sheet and something that looked more like a plan
5 of adjustment. It's known as the plan of adjustment in a
6 chapter 9 case and a plan of reorganization in a chapter 11
7 case, but they are essentially the same things.

8 Regardless of whether the Bankruptcy Appellate
9 Panel was correct in its conclusion in the *Vallejo* case, by
10 any measure, the 790-page "Ask," prepared by the City and
11 presented by the City, is a plan to adjust debts. That
12 satisfies the requirement of section 109(c)(4); that is, not
13 essential that the plan be confirmable. That's an objection
14 that has been made, and I reject that proposition. It is
15 not essential that the plan be itself confirmable.

16 There is a line drawing exercise in which I cannot
17 be precise about how much is good enough. But the mere
18 proposal of a plan that could not be confirmed is not itself
19 a nonstarter. And, as a matter of fact, it's very common in
20 chapter 11 cases for plans to be proposed that could not be
21 confirmed absent the actual acceptance by a particular class
22 of creditors because some essential element for confirmation
23 of a plan is not satisfied. And those plans are allowed to
24 go forward with the disclosure and the understanding that
25 if, for example, the Internal Revenue Service does not

1 accept this plan because it proposes to pay taxes over a
2 period longer than the law allows, as long as it's disclosed
3 that there's that actual acceptance requirement, the plan
4 goes forward. And then at the time of confirmation, it's
5 not confirmed if there has not been the actual acceptance.
6 So those kind of situations occur with a fair degree of
7 regularity in reorganization practice, and I see no reason
8 why a chapter 9 plan should be any different. Therefore, I
9 conclude that section 109(c)(4) has also been satisfied.

10 That gets me to section 109(c)(5), where there are
11 four alternatives that are laid out in the statute. The
12 final alternative, the fourth one, is not a consideration in
13 this case; that is, the municipality reasonably believes
14 that a creditor may attempt to obtain a transfer that is
15 avoidable under section 547 as a preferential transfer.
16 There's been no suggestion that that was an issue in the
17 case.

18 One alternative is that the municipality is unable
19 to negotiate with creditors because such negotiation is
20 impracticable, that is, not practical. There, it is argued
21 that there are approximately 2,400 retirees out there, and
22 they all must be dealt with individually. That is not
23 practicable to do so. But, of course, if relief were to be
24 ordered, a committee could be appointed to represent the
25 retired employees and they could be heard with a unified

1 voice. That's one of the points that's been made, and that
2 is a meritorious point.

3 The first possibility that the City has obtained
4 the agreement of creditors holding at least a majority in
5 the amount of the claims of such class that such entity
6 intends to impair under a plan in a case under chapter 9 has
7 not been satisfied because the bondholders have not agreed.

8 So the focus then narrows to the final
9 possibility, which is section 109(c)(5)(B), and that is the
10 municipality is required to have negotiated in good faith
11 with creditors and has failed to obtain the agreement of
12 creditors holding at least a majority in amount of the
13 claims of each class that such entity intends to impair
14 under a plan in a case under such chapter. That's the
15 requirement of the Bankruptcy Code.

16 And this has been the major focus with the Capital
17 Markets Creditors and the major focus of their challenge and
18 their objection to an order for relief. They contend that
19 the City has not negotiated in good faith with them. They
20 contend that the City gave them a take-it-or-leave-it
21 proposition and that that is not negotiation.

22 Again, a line drawing exercise is required that is
23 quite subjective. I have come back to the statement of
24 Counsel for National Public Finance when I asked about the
25 nature of the good faith negotiation requirement. And this

1 was the point at which I asked the question, and the
2 response was, "Well, the City has the duty to negotiate in
3 good faith, but we do not have the reciprocal duty to
4 negotiate back." I'm sorry. I'm not persuaded.
5 Negotiation is, by definition, a two-way street. You cannot
6 negotiate with a stone wall. You cannot do it. It cannot
7 be done. It is a contradiction in terms.

8 In evaluating the overall scenario, I am persuaded
9 that the City did negotiate in good faith. That is
10 evidenced by the substantial agreements reached on the
11 collective bargaining agreements. And it is not undermined
12 by the fact that the Franklin Advisers made a
13 counterproposal, to which the City elected not to go
14 forward.

15 The City is in a situation where it has no choice
16 but to negotiate in good faith because it desperately needs
17 to adjust debts in a way that necessarily will force the
18 impairment of the contracts, and it can only do that with
19 the assistance of the Bankruptcy Code. So it makes no sense
20 to think that the City is playing some kind of a game to
21 target the Capital Markets Creditors.

22 Now, in litigation, it's always interesting, as
23 lawyers go by dealing with their case, a lot counts on how
24 you frame the case. The frame of the case from Capital
25 Markets Creditors begins, in effect, on February 28, 2012.

1 And it says, well, Mr. Deis said everybody else has had
2 pain, and now it's the turn of the Capital Market Creditors,
3 and this case is specifically targeted at them.

4 Well, Mr. Deis said what he said in a
5 February 28th memo. But the frame that I'm persuaded counts
6 is not the frame that starts February 28, 2012; it's the
7 frame that starts before July 1, 2010.

8 If you look at the overall situation over the last
9 several years, that gives a content and context to the
10 statement that is made in the February 28th memo by
11 Mr. Deis. And it's apparent that there had been ongoing
12 negotiation and ongoing imposition of pain on virtually all
13 City employees over a period of years, and it just kept
14 getting worse and more painful as time went by.

15 And, meanwhile, I have no doubt some of them were
16 in my court because they were losing their houses, and their
17 income was down, and they couldn't sell their houses. So
18 I'm not persuaded -- well, I'm just not persuaded that this
19 case is targeted at the Capital Market Creditors.

20 Now, the next point that the Capital Market
21 Creditors make is that there's no proposal to impair the
22 City's obligations with CalPERS on pension benefits. Now,
23 at this point, the evidentiary record regarding the precise
24 nature of the relationship with CalPERS, the details of the
25 structure of CalPERS and the financing, is nonexistent from

1 the standpoint of anything I could look at.

2 If I accept the Capital Market Creditors at a
3 view -- at face value, CalPERS is just a garden variety
4 creditor who bears the financial risk of loss, kind of as a
5 guarantor or something. I know that CalPERS has
6 vociferously at every stage of this proceeding contested
7 those kind of assertions. And it is no secret that the
8 Capital Markets creditors have CalPERS in the crosshairs for
9 a dispute over that.

10 THE COURT: Let me take a brief recess.

11 (Whereupon, a brief recess was taken.)

12 THE COURT: Before we took the break, I was
13 addressing section 109(c)(5)(B), the good faith negotiation
14 with creditors requirement and noting that the Objectors
15 were pointing to the proposition that, in their view, there
16 was an empty part of the proposed plan of adjustment,
17 to-wit: complete omission of CalPERS. And it was suggested
18 that the City, in electing not to impair CalPERS, that its
19 employees were engaging in an unlawful conflict of interest
20 because they were CalPERS' members. I'm not persuaded of
21 that under California law.

22 And more to the point, Mr. Millican, whom I
23 believed was acting at the time as a City employee and Chief
24 Financial Officer restructuring, and he testified that he
25 will wind up with no CalPERS pension on account of his

1 employment by the City. And he was a key manager in the
2 development of that plan. But, in any event, CalPERS is not
3 proposed to be impaired in the plan.

4 Now, the negotiation requirements, if one is
5 looking at the narrow language of the negotiation
6 requirement, it says, "as negotiated in good faith with
7 creditors and failed to obtain agreement of creditors
8 holding at least a majority in amount of the claims of each
9 class that such entity intends to impair under a plan."

10 There is not a requirement in that to negotiate with
11 CalPERS. The City does not intend to impair CalPERS;
12 therefore, there was no obligation for the City to negotiate
13 with CalPERS.

14 Now, the question is whether the omission of
15 CalPERS justifies another group of creditors would be
16 impaired from voting with their feet and choosing to act as
17 the stone wall. And my answer to that question is, no, it
18 does not justify a creditor in taking the position that it
19 need not negotiate in good faith on the basis that somebody
20 else is not being taken care of or being treated similarly
21 in the plan.

22 This does not mean that there's not potentially a
23 serious issue involving CalPERS. But at this point, I do
24 not know what that is. I do not know whether spiked
25 pensions can be reeled back in. There are very complex and

1 difficult questions of law that I could see out there on the
2 horizon, but no plan of adjustment can be confirmed
3 unless -- no plan of adjustment can be confirmed over the
4 rejection by a particular class unless that plan does not
5 discriminate unfairly and is fair and equitable with respect
6 to each class of claims that is impaired under or has not
7 accepted a plan. That's section 1129(b)(1) of the
8 Bankruptcy Code, which, by virtue of section 901, applies in
9 chapter 9 cases.

10 So the protection for the Capital Market Creditors
11 is in the plan confirmation process. If a plan is proposed
12 that does not deal with CalPERS and if the Capital Market
13 Creditors reject their treatment under the proposed plan,
14 then I will have to focus on the question of unfair
15 discrimination.

16 And the gravamen of the argument that the Capital
17 Markets Creditors make is one of unfair discrimination. But
18 that is not an eligibility question to be a problem at this
19 stage of the case. To the contrary, it is a plan
20 confirmation problem. And the City is going to have a
21 difficult time confirming a plan over an objection and claim
22 of unfair discrimination without being able to explain that
23 problem away. And that problem is probably going to require
24 me to get down into the nitty-gritty of the CalPERS
25 situation. And I, at this point, have no clue how that's

1 going to come out, but that is the protection.

2 Now, this is fully consistent with the point that
3 I made in the published decision in the *City of Stockton*
4 case decided February 5, 2013. It's reported at
5 486 Bankruptcy Reporter 194, where I was presented with the
6 argument from the Capital Market Creditors that under
7 Federal Rule of Bankruptcy Procedure 9019, the City has to
8 bring all compromises it makes with anybody before the Court
9 for approval, and by implication, the Capital Markets
10 Creditors get to object. And I concluded that that was not
11 the case and, instead, the protection for the Capital Market
12 Creditors was that in the face of an argument that, well,
13 with a series of compromises, one could have a creeping plan
14 of adjustment, my response was that in the end, there has to
15 be a plan of adjustment.

16 And that's where the arguments can be made that
17 inappropriate compromises have been made. So if the City
18 makes inappropriate compromises, the day of reckoning will
19 be the day of plan confirmation. And that's precisely my
20 analysis with respect to the CalPERS situation and the
21 omission of dealing with CalPERS in the City's "Ask;" that
22 is the plan that put on the table as part of eligibility.

23 So that leads me to conclude that the requirements
24 of section 109(c) have satisfied the facts by preponderance
25 of the evidence; actually, by more than a preponderance of

1 the evidence. The evidentiary requirement is preponderance
2 of the evidence. The City has negotiated in good faith to
3 the extent it's possible to negotiate and negotiated with
4 everybody that was willing to talk to them.

5 And it was the choice of the Capital Market
6 Creditors to take a position as a stone wall, is not
7 sufficient to defeat the City's negotiation in good faith
8 requirement. As I indicated at the outset, the proposition
9 that the City is required to negotiate in good faith and the
10 Creditor is not required to negotiate in good faith makes no
11 sense to me because it's a reciprocal obligation.

12 And I -- also with respect to the retired
13 employees I am persuaded that independently under section
14 109(c)(5)(C), that it is unable to negotiate with the
15 retired employees because such a negotiation is
16 impracticable so long as it's merely 2,400 individuals out
17 there.

18 Now, that does not end the analysis, however,
19 because as I indicated at outset, section 921(c) says that I
20 may dismiss the petition if the Debtor did not file the
21 petition in good faith or if the petition does not meet the
22 requirements of Title 11. Well, I have just concluded that
23 the petition does meet the requirements of Title 11. But I
24 come back to the independent question of good faith, whether
25 the City filed the petition in good faith.

1 And it's interesting; good faith shows up at a
2 number of occasions, four that come readily to mind here.
3 California Government Code Section 53760.30 requires that
4 all interested parties participating in the neutral
5 negotiation process shall negotiate in good faith. There's
6 one section.

7 Section 109(c)(5)(B) requires negotiation in good
8 faith. Section 921(c) requires the petition to be filed in
9 good faith. And then there's the requirement that's
10 implicit in Federal Rule of Bankruptcy Procedure 9011 that
11 lawyers be proceeding in good faith.

12 And it appears to me that good faith does not
13 always mean the same thing in the various contexts. I don't
14 know that I have to sort those out orally on the record
15 right now. But accepting the proposition of filing the
16 petition in good faith is a different concept than
17 negotiating with creditors in good faith.

18 If I look at the overall history of the City of
19 Stockton situation in the frame, as I indicated, that really
20 starts back before July 1, 2010, and perhaps even two years
21 before that, look at where the City was and where it got to
22 by June 28, 2012, when this case was filed, and where it
23 likely will need to go, and what position it would be in if
24 the case were to be dismissed, and it is apparent to me that
25 the City will not be able to perform its obligations to its

1 citizens relating to such fundamental matters as public
2 safety, as well as other basic governmental services,
3 without the ability to have the muscle of the contract
4 impairing power of federal bankruptcy law.

5 Therefore, I am persuaded that the petition was
6 filed in good faith. And I'm not sure whether the Objectors
7 have the burden to prove that the petition was not filed in
8 good faith or whether the City has the burden to prove that
9 it was filed in good faith; but under either analysis, I
10 reach the same conclusion, and that is that the case will
11 not be dismissed under section 921(c).

12 Which that brings me to the final step of the
13 analysis. Section 921(d) provides that if the petition is
14 not dismissed under subsection (c) of this section, the
15 Court shall order relief under this chapter, notwithstanding
16 section 301(b). And, accordingly, I will enter an order
17 ordering relief under chapter 9. And I will reserve
18 jurisdiction to issue a more formal opinion that articulates
19 the points of the law that I've covered orally on the
20 record.

21 And that concludes my findings of facts and
22 conclusions of law. But it does not conclude what we are
23 doing. I have two agenda items. First, does any party want
24 me to make any particular findings right now? And if
25 somebody ask me to do that, that's, of course, without

1 prejudice to their ability under Federal Rule of Civil
2 Procedure 52 to ask that I revisit the findings. I hear
3 none.

4 The second thing is, there's an item on the
5 calendar for tomorrow relating to a compromise. Is there
6 any opposition to that compromise that you anticipate,
7 Mr. Levinson?

8 MR. LEVINSON: There's no opposition, Your Honor.
9 The Capital Markets Creditors filed a statement of position,
10 which was really just a reservation of rights, but there was
11 no opposition to it filed.

12 THE COURT: Is that correct, Mr. Walsh?

13 MR. WALSH: That's correct, Your Honor.

14 THE COURT: Mr. Neal, is that correct?

15 MR. NEAL: Yes, it is, Your Honor.

16 THE COURT: Is there any objection to me acting on
17 that today, without the need for a hearing tomorrow?

18 MR. LEVINSON: Your Honor, Mr. Levinson again.
19 The only concern is that we proposed fairly specific
20 findings of fact that are important to the City and to the
21 Indenture Trustee with respect to the Indenture Trustee's
22 duties to the bondholders. And if there is any question
23 about that, we'd like to address it.

24 THE COURT: Well, the reason I'm raising this is
25 that I'm not going to be able to be here tomorrow. So I

1 would have to continue it. And a judge sitting in for me,
2 giving him the assignment -- the requirement that the Chief
3 Judge of the Court of Appeals assigned the case, means that
4 I would have to continue the matter. So give me a date you
5 want to continue it to. You don't have to do it on the
6 record right now.

7 MR. LEVINSON: I'll have to consult with the
8 Indenture Trustee, but I'll get back to your chambers as
9 soon as I can.

10 THE COURT: Just contact my courtroom deputy and
11 give a continued date because I will be unable to hear it to
12 tomorrow.

13 MR. LEVINSON: Thank you, Your Honor.

14 THE COURT: I believe that concludes the
15 proceedings. We are adjourned.

16 (Whereupon, the proceedings concluded at
17 12:03 p.m.)

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1 REPORTER'S CERTIFICATE

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3 STATE OF CALIFORNIA)
) ss.
4 COUNTY OF SACRAMENTO)

5 I, VICKI L. BRITT, do hereby certify that I was
6 the official Court Reporter, and that I reported verbatim in
7 shorthand writing the foregoing proceedings; that I
8 thereafter caused my shorthand writing to be reduced to
9 typewriting, and that pages 544 through 596, inclusive,
10 constitute a complete, true and correct record of said
11 proceedings:

12 COURT: United States Bankruptcy Court
13 Eastern District of California

14 JUDGE: THE HONORABLE CHRISTOPHER M. KLEIN

15 CAUSE: In re: City of Stockton, California
16 Case No. 12-32118-C-9

17 DATE: Monday, April 1, 2013

18 IN WITNESS WHEREOF, I have subscribed this
19 certificate at Sacramento, California, on the 1st day of
20 April, 2013.

21 *s/Vicki L. Britt*

22 _____
23 VICKI L. BRITT, RPR, CSR NO. 13170