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UNITED STATES BANKRUPTCY COURT EASTERN
DISTRICT OF CALIFORNIA

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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

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

OPINION REGARDING CHAPTER 9 ORDER FOR RELIEF

Before: Christopher M. Klein
United States Bankruptcy Judge

Marc A. Levinson, Norman Hile, Jonathan Riddell, John W. Killeen,
Orrick, Herrington & Sutcliffe LLP, Sacramento, California, for
Debtor.

Nicholas De Lancie, Jeffer Mangels Butler & Mitchell LLP, San
Francisco, California, for Union Bank, N.A.

Michael S. Gardener, Boston, Massachusetts, for Wells Fargo Bank,
National Association.

James O. Johnston, Joshua D. Morse, Jones Day, Los Angeles,
California, for Franklin High Yield Tax Free Income Fund and
Franklin California High Yield Municipal Fund.

Lawrence A. Larose, Winston & Strawn LLP, New York City, New
York, for National Public Finance Guarantee Corporation.

Guy S. Neal, Sidney Austin, LLP, Washington, DC, for Assured
Guaranty Corporation and Assured Guaranty Municipal Corporation.

Michael Ryan, K&L Gates, Seattle, Washington, for California
Public Employees' Retirement System.

Michael J. Gearin, K&L Gates LLP, Los Angeles, California, for
California Public Employees' Retirement System.

Matthew M. Walsh, Winston & Strawn LLP, Los Angeles, California,
for National Public Finance Guarantee Corporation.

1 KLEIN, Bankruptcy Judge:

2 Chapter 9 is unique among voluntary Bankruptcy Code cases in
3 that a municipality must litigate its way to the order for relief
4 before restructuring its debt. Capital markets creditors of the
5 City of Stockton have required the City to prove its eligibility
6 for chapter 9 relief under 11 U.S.C. §§ 109(c) and 921(c). Such
7 a proceeding is like a qualifying round in a competition; success
8 leads only to the main event – the process of achieving a viable
9 plan of adjustment. Without a confirmed plan, a municipality
10 lacks constitutional authority to compel impairment of contracts.

11 This opinion addresses chapter 9 eligibility issues that
12 arose during the three-day trial on the question whether to order
13 relief and the post-trial motion to alter or amend the findings
14 regarding the strategy adopted by certain creditors. The focus
15 is on pre-filing obligations of the municipality in dealing with
16 creditors and stakeholders. Concluding that the City carried its
17 burden to establish the elements required for an order for relief
18 and concluding that the objectors inappropriately used an issue
19 relating to plan confirmation, but that is irrelevant to
20 eligibility, as a pretext to decline to negotiate in good faith
21 and to force a trial that should not have been necessary, relief
22 will be ordered.¹

23 _____

24 ¹This is the fifth formal opinion issued in the Stockton
25 case. The first dealt with California's chapter 9 gateway
26 statute. In re City of Stockton, Cal., 475 B.R. 720 (Bankr. E.D.
27 Cal. 2012) ("Stockton I"). The second addressed the City's
28 unilateral reduction of health care benefits for retirees. Ass'n
of Retired Employees v. City of Stockton (In re City of Stockton,
Cal.), 478 B.R. 8 (Bankr. E.D. Cal. 2012) ("Stockton II"). The
third involved the additional automatic stay imposed by 11 U.S.C.
§ 922(a). In re City of Stockton, Cal., 484 B.R. 372 (Bankr.

1 STATUTORY REQUIREMENTS

2 As chapter 9 eligibility is governed by Bankruptcy Code
3 §§ 101(32)(C), 101(40), 109(c), and 921(c) and (d), it is
4 appropriate to situate those statutes front and center:

5 § 101(32). The term "insolvent" means -

6 (C) with reference to a municipality, financial
condition such that the municipality is -

7 (i) generally not paying its debts as they become
8 due unless such debts are the subject of a bona fide
dispute; or

9 (ii) unable to pay its debts as they become due.

10 11 U.S.C. § 101(32).

11 ***

12 § 101(40). The term "municipality" means political
subdivision or public agency or instrumentality of a State.

13 11 U.S.C. § 101(40).

14 ***

15 § 109(c). An entity may be a debtor under chapter 9 of
16 this title if and only if such entity -

17 (1) is a municipality;

18 (2) is specifically authorized, in its capacity as a
municipality or by name, to be a debtor under such chapter
19 by State law, or by a governmental officer or organization
empowered by State law to authorize such entity to be a
debtor under such chapter;

20 (3) is insolvent;

21 (4) desires to effect a plan to adjust such debts; and

22 (5) (A) has obtained the agreement of creditors holding
at least a majority in amount of the claims of each class
23 that such entity intends to impair under a plan in a case
under such chapter;

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

25 (C) is unable to negotiate with creditors because
such negotiation is impracticable; or

26
27 E.D. Cal. 2012) ("Stockton III"). The fourth determined that a
municipality may, but is not required to, obtain court approval
28 of compromises made during the case. In re City of Stockton,
Cal., 486 B.R. 194 (Bankr. E.D. Cal. 2012) ("Stockton IV").

1 (D) reasonably believes that a creditor may attempt
2 to obtain a transfer that is avoidable under section 547
[preferences] of this title.

3 11 U.S.C. § 109(c).

4 ***

5 **§ 921**

6 (c) After any objection to the petition, the court,
after notice and a hearing, may dismiss the petition if the
7 debtor did not file the petition in good faith or if the
petition does not meet the requirements of this title.

8 (d) If the petition is not dismissed under subsection
(c) of this section, the court shall order relief under this
9 chapter notwithstanding section 301(b).

10 11 U.S.C. § 921(c)-(d).

11 ***

12 Relevant parts of California's gateway statute, Government
13 Code §§ 53760, 53760.1, and 53760.3, also deserve a billing:²

14 **§ 53760.** A local public entity in this state may file a
petition and exercise powers pursuant to applicable federal
15 bankruptcy law if either of the following apply:

16 (a) The local public entity has participated in a
neutral evaluation process pursuant to Section 53760.3.

17 (b) The local public entity declares a fiscal emergency
and adopts a resolution by a majority vote of the governing
board pursuant to Section 53760.5.

18 CAL. GOV'T CODE § 53760.

19 ***

20 **§ 53760.1(d).** "Good faith" means participation by a party
in the neutral evaluation process with the intent to
21 negotiate toward a resolution of the issues that are the
subject of the neutral evaluation process, including the
22 timely provision of complete and accurate information to
provide the relevant parties through the neutral evaluation
23 process with sufficient information, in a confidential
manner, to negotiate the readjustment of the municipality's
24 debt.

25 CAL. GOV'T CODE § 53760.1(d).

26 _____
27 ²A California patois employs the term "AB 506" to refer to
the California gateway statute. AB 506 was the bill that, when
28 passed by the legislature and signed by the Governor, enacted the
current version of Government Code § 53760.

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2 ***

3 § 53760.3(o). The local public entity and all interested
4 parties participating in the neutral evaluation process
5 shall negotiate in good faith.

6 CAL. GOV'T CODE § 53760.3(o).

7 ***

8 § 53760.3(s). The local public entity shall pay 50 percent
9 of the costs of neutral evaluation, including, but not
10 limited to, the fees of the evaluator, and the creditors
11 shall pay the balance, unless otherwise agreed to by the
12 parties.

13 CAL. GOV'T CODE § 53760.3(s).

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FACTS

When Bob Deis became City Manager for the City of Stockton on July 1, 2010, the first day of its fiscal year, he encountered a municipality in financial distress. In a progression beginning in 2008, the City Council had declared fiscal emergencies and imposed certain unilateral actions in an effort to staunch the hemorrhage. On June 22, 2010, the Council adopted an "Action Plan For Fiscal Sustainability" that it hired Deis to implement.

Some of the problems were due to the state of the economy in the Great Recession. Stockton was ground zero for the subprime mortgage crisis. Unemployment was 22 percent; median income for a family of four was about \$63,000. Property values, both commercial and residential, had declined by 50 percent.³

Stockton had one of the highest foreclosure rates in the nation, a fact of which this court is painfully aware from the ordeal of

³Median home sales prices were \$422,000 in 2006 and \$140,000 in 2012. Declaration of Chief Financial Officer Vanessa Burke, City Exhibit 1062, at page 91. Burke was a credible witness.

1 presiding over the tragedy of bankruptcies of literally thousands
2 of individual Stockton citizens who had done nothing wrong other
3 than be seduced by easy credit when purchasing a home in a
4 housing bubble before being slammed by unexpected loss of income
5 when laid off or furloughed. Property tax, sales tax, and other
6 public revenues characteristic of a functioning municipal economy
7 had plummeted. For example, sales tax revenue declined from
8 \$47.0 million in fiscal year 2006 to \$32.7 million in fiscal year
9 2010.⁴ Recovery was far over the horizon.

10 Some problems were due to excessive optimism. In better
11 times, Stockton committed its general fund to back long-term
12 bonds to finance development projects based on an overly-sanguine
13 "if-you-build-it-they-will-come" mentality. They did not come.
14 Hence, project revenues were insufficient to pay project bills.

15 Some problems were due to encrustation of a creeping multi-
16 decade, opaque pattern of above-market compensation of employees.
17 Among other things, the City paid for generous health care
18 benefits to which employees did not contribute, including
19 lifetime health care regardless of length of service. It
20 permitted, to an unusual degree, so-called "add-pays" for tasks
21 that allowed nominal salaries to be increased to totals greater
22 than those prevailing for other municipalities. And there were
23 pre-determined automatic annual cost-of-living pay increases not
24 tied to the state of the economy or local finances.

25 The submerged compensation problems included surprisingly
26 generous retirement practices. Pensions were allowed to be based

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28 ⁴Declaration of Deputy City Manager Laurie Montes, City
Exhibit 1054, at page 22. Montes was a credible witness.

1 on the final year of compensation, which compensation could
2 include essentially-unlimited accrued vacation and sick leave.
3 This led to a phenomenon of so-called "pension-spiking" in which
4 a pension could be substantially greater than the retiree's
5 actual final salary. Nor were individual employees required to
6 contribute to their pensions. In consequence, projected pension
7 expenses were soaring.

8 City management before the Great Recession deserves some of
9 the blame. City accounts were in such disarray that it has taken
10 literally years to unscramble them. Various work rules were
11 contractually agreed upon, often without approval in public view
12 by the City Council, that left little latitude for exercise of
13 managerial supervision. And one wonders about what prior City
14 Councils had been doing.

15 In each fiscal year during Deis' tenure, fiscal emergencies
16 have continued to be declared, which have enabled some limitation
17 of the adverse effects of some collective bargaining agreements.

18 In the fiscal year beginning July 1, 2010, unrepresented
19 employees suffered: furloughs of 96 hours; new medical premiums;
20 and increased health plan deductibles and co-pays. Similar
21 concessions were obtained from collective bargaining units.⁵

22 In the fiscal year beginning July 1, 2011, the economy
23 measures were ratcheted up. For unrepresented employees: 96-hour
24 furloughs continued; medical benefits were eliminated for new
25 hires; sick leave accruals were reduced, and limits imposed on
26 sick leave cash-outs at retirement; vacation leave accruals were

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28 ⁵The belt-tightening for all fiscal years beginning July 1,
2008, is documented at Objector's Exhibit 50, pages 70-79.

1 reduced, and limits imposed on vacation sell-back and accrual
2 maximums; extra salary above Workers' Compensation ceased;
3 longevity "add-pay" was eliminated for certain employees;
4 educational incentive pay was eliminated; employees were required
5 to contribute 7 percent toward their retirement plan; the maximum
6 City contribution to the health plan was decreased. Similar
7 concessions were obtained from collective bargaining units.

8 Of particular significance to the City's pension expense,
9 age limits were raised, which had the effect of requiring longer
10 service before being able to collect a pension, and the pension
11 calculation was revised to be based on income during the final
12 three years of service, instead of one year of service. The
13 final-three-year provision, coupled with the limits on additives,
14 dampened opportunities for "pension spiking."

15 Councilmember Kathy Miller testified credibly about the
16 extent of the corrective measures that have been taken since she
17 joined the City Council in January 2009 and about the painful
18 toll inflicted on the City workforce at the cost of impairing
19 basic public services as the Council sought to regain control of
20 the budget and the trust of the people.

21 In sum, the City workforce decreased by 25 percent from
22 1,886 on July 1, 2008, to 1,420 on December 31, 2011. This
23 included a 20 percent reduction for police, 30 percent for fire,
24 38 percent for public works, 46 percent for library, and 56
25 percent for recreation.

26 In the middle of the 2012-2013 fiscal year, it was apparent
27 that, despite the four-year struggle to tame the City's finances,
28 its general fund would reach June 30, 2012, with a projected

1 deficit of \$8,652,768 unless drastic action was taken.

2 Accordingly, Deis and his management team, supported by the
3 independent analysis of the consulting firm Management Partners,
4 concluded that it was time to ask the City Council to initiate
5 the neutral evaluation process under California Government Code
6 §§ 53760(a) and 53760.3 that is one of two alternatives
7 preliminary to filing a municipal debt adjustment case under
8 chapter 9 of the Bankruptcy Code.

9 A 54-page memorandum dated February 28, 2012,⁶ from Deis to
10 the City Council projected a \$8,652,768 deficit on expenditures
11 of \$166,655,282 as of the fiscal year end on June 30 and
12 projected a deficit for the fiscal year commencing July 1, 2012,
13 ranging from \$20,207,540 to \$38,182,873.

14 Deis reviewed the present and future options for closing the
15 gaps. He noted that more service reductions were an easy target
16 as 71 percent of general fund expenses are devoted to labor, or
17 viewed by function, 77 percent relates to public safety - police
18 and fire. But, although a further 15 percent cut would save
19 about \$20 million, staffing had already been slashed during the
20 three previous years to close gaps of \$37 million, \$23 million,
21 and \$28 million, respectively. The consequences were worrisome.

22 Public safety was a particular concern. In 2010, Stockton's
23 violent crime rate bucked a nationwide drop and rose to rank it
24 10th nationally, with 13.81 violent crimes per 1,000 residents.
25 Homicides were at an all-time record. Aggravated Assaults with a
26 Firearm rose from 99 in 2009 to 196 in 2011, and another 30

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28

⁶City Exhibit 1057; Objector's Exhibit 68.

1 percent in 2012.

2 A 15 percent reduction in the police budget would eliminate
3 all 30 community service officers and 64 of about 323 sworn
4 officers. The same reduction in the fire budget would eliminate
5 41 sworn fire positions, 3 fire engines, and 1 fire truck.

6 The Police Chief pointed out that, even without a 15 percent
7 cut, the Police Department had about 1.10 officers per 1,000
8 residents, compared to a national standard of 2.7 per 1,000
9 residents.⁷ The police, during peak activity, respond only to
10 crimes-in-progress. Ending the School Resource Officer program
11 was followed by a rise in juvenile crime, gang membership, and a
12 575 percent jump in gang-related homicides, from 4 to 27.
13 Abolishing the Narcotics Enforcement Team led to more drug
14 traffic and fewer asset forfeiture proceeds. Reducing security
15 camera monitoring from full-time to part-time impaired the
16 ability to spot crimes or follow pursuits.

17 Deis concluded that these "kind of cuts simply pose too much
18 of a safety risk to our citizens."⁸

19 This was consistent with the conclusion of the City's
20 consultant, Management Partners, that, as of February 2012, the
21 City was, first, in a state of "service delivery insolvency,"
22 which is a municipality's inability to pay for all the costs of
23 providing services at the level and quality required for the
24

25 ⁷If all authorized 343 sworn officer positions were filled,
26 the ratio would be about 1.16 per 1,000 residents. Declaration
27 of Police Chief Eric Jones, Objector's Exhibit 38, City Exhibit
28 1061, at page 3. The parties stipulated to introduction of this
declaration into evidence without the need for cross-examination.

⁸City Exhibit 1057; Objector's Exhibit 68, at page 27.

1 health, safety, and welfare of the community, and, second, was in
2 a state of "budget insolvency," which is the inability to create
3 a balanced budget that provides sufficient revenues to pay
4 expenses occurring within the budgeted period. Management
5 Partners also opined that the City was on the verge of "cash
6 insolvency," which is inability to generate and maintain cash
7 balances to pay expenditures as they come due.⁹

8 The City Council accepted the Deis recommendation on
9 February 28, 2012, and authorized initiation of the neutral
10 evaluation process that California prescribes under Government
11 Code §§ 53760 and 53760.3 as a prerequisite to permission to file
12 a chapter 9 case under the Bankruptcy Code.

13 The City Council also authorized diversion of various
14 earmarked funds to meet the projected \$8,652,768 budget
15 shortfall. Hence, the City suspended payments from the general
16 fund on the 2004 Lease Revenue Bond (Parking), the 2009 Lease
17 Revenue Bonds (Public Facilities Fees), and the 2007 Variable
18 Rate Bonds (City Hall), for which the expected general fund
19 payments due before June 30, 2012, totaled \$2,048,658. In the
20 next fiscal year beginning July 1, 2012, general fund payments to
21 service those, and other, bonds were projected at \$11,787,182.

22 As a result of measures authorized by the City Council on
23 February 28, 2012, including not paying \$2,048,658 on the bonds,
24 the general fund finished the fiscal year with about \$1.3 million
25 on hand.¹⁰ Without the intentional bond default, it would have
26

27 ⁹City Exhibit 1056, at pages 2 and 48-49.

28 ¹⁰City Exhibit 1062, at pages 5 & 27-28.

1 ended the fiscal year with a deficit exceeding \$700,000.

2 The bond default led Wells Fargo, as bond trustee acting at
3 the behest of National Public Finance Guarantee Corporation and
4 Assured Guaranty Municipal Corp., to have receivers appointed to
5 take over and operate three parking garages (National Public
6 Finance) and the building at 400 E. Main Street intended to serve
7 as the new city hall (Assured Guaranty). Those receivers remain
8 in place and are collecting project revenues.

9 National Public Finance responded to the notice of the
10 initiation of the neutral evaluation process with notice of
11 intent to participate as an "interested party" under California
12 Government Code § 53760 by letter dated March 15, 2012, from
13 Matthew Cohn, Director.

14 But, although § 53760.3(s) requires creditors to pay half of
15 the costs of neutral evaluation unless otherwise agreed, Cohn
16 stated: "National expressly disclaims any obligation or
17 liability for the payment of any costs or expenses under Section
18 53760.3(s) of the Act or otherwise in connection with the 506
19 Notice, the Act or pursuant to the 506 Process or otherwise."¹¹

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

24 Former Bankruptcy Judge Ralph Mabey was selected as the
25 neutral evaluator.

26 The neutral evaluation process continued for 90 days, having
27

28 ¹¹City Exhibit 1385, at page 175.

1 been extended for the additional 30 days permitted by Government
2 Code § 53760.3(t)(3).

3 The City began by presenting a proposed plan of adjustment
4 in the form of what was termed an "Ask" in which it described how
5 it proposed to deal with the affected parties. The City intended
6 the "Ask" as the opening proposal in a negotiation. Several
7 examples of the proposed treatment of bonds follow.

8 As to the three parking garages covered by the 2004 Lease
9 Revenue Bond (Parking) and in the hands of a receiver appointed
10 at the behest of National Public Finance Guarantee Corporation,
11 the City did not intend to reestablish a possessory interest or
12 to pay any debt service going forward.¹² The receiver would
13 collect parking revenues until the bonds are paid in full.

14 As to 2006 Lease Revenue Bonds on the so-called Stewart-
15 Eberhart Building and adjacent parking facility, for which the
16 insurer is National Public Finance, the City proposed debt
17 service relief of five years, followed by five years of interest-
18 only payments, and substituting a pledge of parking district
19 revenues and public facilities fees in place of the backstop of
20 the general fund.¹³ The bonds would eventually be paid in full.

21 As to the issue of 2007 Variable Rate Demand Lease Revenue
22 Bonds, insured by Assured Guaranty, for the intended city hall at
23 400 E. Main Street, the City proposed debt service relief for
24 five years, followed by five years of interest-only payments, and
25 thirty years of full amortization. The City would pledge all net
26

27 ¹²City Exhibit 1376; Objectors' Exhibit 50, at pages 756-58.

28 ¹³City Exhibit 1376; Objectors' Exhibit 50, at pages 762-67.

1 revenues of the building unto the amount of the originally
2 scheduled debt service, to be backstopped by the general fund up
3 to the amount of restructured debt service.¹⁴ The bonds
4 eventually would be paid in full.

5 National Public Finance and Assured Guaranty each took the
6 position that there was nothing to talk about unless and until
7 the City also proposed to impair its pension obligation to the
8 California Public Employees' Retirement System ("CalPERS"). When
9 the City declined to do so after the second neutral evaluation
10 meeting with the bondholders, they absented themselves from all
11 further discussions. They did not thereafter indicate a desire
12 to meet again with Judge Mabey.

13 Objector Franklin Advisors did make a counterproposal
14 regarding a different bond issue, which the City concedes was
15 made in good faith but which was too far removed from the relief
16 the City needed on that bond issue to open a path for
17 exploration. Neither Franklin Advisors, nor Wells Fargo as
18 indenture trustee, pursued further discussions with Judge Mabey.

19 The neutral evaluation process conducted by Judge Mabey
20 achieved agreements to adjust all unexpired collective bargaining
21 agreements and achieved substantial progress in discussions with
22 other stakeholders. The court is persuaded that Judge Mabey
23 would have worked further with the capital market creditors if
24 they had expressed interest. None was expressed.

25 This case was filed on June 28, 2012, and assigned to the
26 undersigned judge by the chief judge of the court of appeals.

27
28

¹⁴City Exhibit 1376; Objectors' Exhibit 50, at pages 774-79.

1 National Public Finance, Assured Guaranty, Franklin
2 Advisors, and Wells Fargo objected to an order for relief.

3 This litigation ensued. The interval since filing has been
4 consumed, first, by court-ordered mediation with the Hon.
5 Elizabeth Perris, U.S. Bankruptcy Judge, District of Oregon, it
6 being this court's experience that successful reorganizations
7 entail substantial agreement among most of the parties. Second,
8 during that mediation process, time has been consumed developing
9 and exchanging information essential to understanding the City's
10 finances and to the negotiation of a plan of adjustment.

11
12 JURISDICTION

13 Federal subject-matter jurisdiction is founded upon 28
14 U.S.C. § 1334. This is a core proceeding that a bankruptcy judge
15 may hear and determine. 28 U.S.C. § 158(d)(1). The chief judge
16 of the court of appeals has designated this bankruptcy judge to
17 conduct the case. 11 U.S.C. § 921(b).

18
19 DISCUSSION

20 Since the question of whether to order relief is governed by
21 six essential elements prescribed by statute, the analysis will
22 use those elements as an outline.

23
24 I

25 The first essential element is that the debtor must be a
26 "municipality" as defined in the Bankruptcy Code. 11 U.S.C.
27 § 109(c)(1). A "municipality" is a political subdivision or
28 public agency or instrumentality of a state. 11 U.S.C.

1 § 101(40). The objectors concede that Stockton is a municipality
2 for these purposes.

3
4 II

5 The second essential element for chapter 9 eligibility is
6 that the municipality must be specifically authorized in its
7 capacity as a municipality or by name, to be a chapter 9 debtor
8 by state law, or by a governmental officer or organization
9 empowered by state law to make such authorization. 11 U.S.C.
10 § 109(c)(2). This element is contested.

11 As explained in an earlier decision, the initial gateway
12 into chapter 9 is under the control of the state. Stockton I,
13 475 B.R. at 727-28. Hence, California law governs the question
14 whether the City is authorized to be a chapter 9 debtor.

15
16 A

17 California has enacted a standing authorization for its
18 municipalities to be chapter 9 debtors if they comply with the
19 California Government Code § 53760 by either pursuing a neutral
20 evaluation process or declaring a fiscal emergency. CAL. Gov'T
21 CODE § 53760.

22 As the City pursued California's neutral evaluation route,
23 our focus is on the terms that govern that process.

24
25 B

26 The course of the neutral evaluation conducted by former
27 Bankruptcy Judge Mabey is detailed in the evidence. The City
28 presented a tentative plan in the form of a 790-page "Ask" for

1 the purposes of discussions. The evaluation lasted the maximum
2 ninety days permitted by statute, having been extended by the
3 City and a majority of the participating parties. There were
4 more than forty sessions with various interested parties, in the
5 course of which the evaluator engaged in shuttle diplomacy.

6 The neutral evaluation produced agreements with some of the
7 participating parties, including all unions with unexpired
8 collective bargaining agreements. No agreement was reached with
9 the 2,400 retired employees, there being no common representative
10 with whom to negotiate.

11 Nor was there agreement with the capital market creditors.
12 They attended only two meetings with the neutral evaluator and,
13 having taken the position that there was nothing to talk about,
14 departed. That the evaluator, who established a record
15 demonstrating conscientious diligence in his mediation task,
16 elected not to attempt to work further with the capital markets
17 creditors warrants the inference that he saw little possibility
18 of bridging their gap with the City.

19
20 C

21 The objectors contend that, as a matter of state law, the
22 City did not satisfy its good faith negotiation obligation during
23 the California neutral evaluation process. Their rationale is
24 twofold. First, they contend that any proposal that would impair
25 the rights of capital markets creditors without simultaneously
26 impairing CalPERS is not made in good faith. Second, they
27 contend that the City's proposal was made on a take-it-or-leave-
28 it basis without the intention of actually negotiating.

1
2 The objectors' initial challenge to the City's good faith is
3 the first of at least four encounters with the term "good faith"
4 in this case. At the prefiling gateway, California requires good
5 faith negotiations in its neutral evaluation process. CAL. GOV'T
6 CODE § 53760.3(o).

7 The next three appearances of "good faith" are Bankruptcy
8 Code provisions. One of four alternatives for establishing the
9 fifth element of § 109(c) eligibility to be a chapter 9 debtor is
10 good faith negotiation with parties who would be impaired under a
11 proposed plan. 11 U.S.C. § 109(c)(5)(B). Next, even if a
12 municipality is eligible under § 109(c), the court may dismiss a
13 case that is not filed in good faith. 11 U.S.C. § 921(c).
14 Finally, a plan of adjustment must be proposed in good faith. 11
15 U.S.C. § 1129(a)(3), incorporated by id., § 901(a).

16 As these various versions of good faith in chapter 9 arise
17 in different contexts, they may have different meanings. Cf.
18 United States v. Memphis Cotton Oil Co., 288 U.S. 62, 67-68
19 (1933) ("'cause of action' may mean one thing for one purpose and
20 something different for another.") (Cardozo, J.). Those varying
21 contexts will be addressed in due course.

22
23
24 This first of the good faith objections, relating to the
25 California gateway neutral evaluation process, is rejected as a
26 matter of California law.
27
28

1 a

2 Black-letter California law requires the City and all
3 parties participating in the neutral evaluation process to
4 negotiate in good faith:

5 The local public entity and all interested parties
6 participating in the neutral evaluation process shall
negotiate in good faith.

7 CAL. GOV'T CODE § 53760.3(o).

8 It follows that good faith negotiation in the California
9 neutral evaluation process is a two-way street.

10 California defines "good faith" for purposes of its chapter
11 9 gateway neutral evaluation process:

12 (d) "Good faith" means participation by a party in the
13 neutral evaluation process with the intent to negotiate
14 toward a resolution of the issues that are the subject of
15 the neutral evaluation process, including the timely
16 provision of complete and accurate information to provide
the relevant parties through the neutral evaluation process
with sufficient information, in a confidential manner, to
negotiate the readjustment of the municipality's debt.

17 CAL. GOV'T CODE § 53760.1(d).

18 With this duty and this definition in mind, it is beyond
19 cavil that the City negotiated with its various unions toward a
20 resolution of the issues that were the subject of the neutral
21 evaluation process. The fact that pre-filing agreements were
22 reached to modify all unexpired collective bargaining agreements,
23 and that substantial progress was made regarding expired
24 agreements that were resolved soon after the chapter 9 case was
25 filed, persuasively testifies to the City's good faith
26 negotiations for purposes of § 53760(o).

27 Nor were these union contracts trivial matters. Labor
28 comprised about 71 percent of the City's prefiling budget. The

1 City's 790-page "Ask" included painful cuts to organized labor.
2 The City reports achieving the majority of the concessions it
3 sought from the unions in its "Ask." And, it is this court's
4 experience that organized labor ordinarily resists efforts to
5 reduce compensation and benefits.

6 Although the objectors complain bitterly that the City was
7 not proposing directly to impair the rights of CalPERS, they do
8 not address the obvious: material reductions in compensation to
9 employees correlatively will tend to reduce the City's future
10 pension obligations. In other words, renegotiated collective
11 bargaining agreements providing for reduced compensation
12 indirectly reduce the City's CalPERS obligations.

13 The question becomes whether good faith renegotiation of
14 collective bargaining agreements where labor expenses exceed two-
15 thirds of a municipality's budget constitutes sufficient good
16 faith to satisfy Government Code § 53760.3(o). This entails a
17 line-drawing exercise. While the question may not be free from
18 doubt, this court concludes that, as a matter of California law,
19 serious and productive negotiations with a category of claimants
20 who represent more than two-thirds of a municipality's annual
21 budget independently suffices to satisfy the good faith
22 negotiation requirement of § 53760.3(o).

23
24 b

25 The objectors took the position that the City was required
26 by the California statute to negotiate with them in good faith
27 but that, insofar as they were concerned, the obligation was not
28 reciprocal. That is, the objectors contended that they had no

1 correlative good faith negotiation obligation. Not so.

2 As already noted, the California statute imposes the good
3 faith negotiation requirement on all interested parties,
4 including the objectors. CAL. GOV'T CODE § 53760.3(o).

5 As a factual matter, this court is persuaded by a
6 preponderance of evidence that neither National Public Finance
7 nor Assured Guaranty negotiated in good faith during the
8 California neutral evaluation process. Rather, they took the
9 position that there was nothing to talk about unless the City
10 also proposed to impair a different creditor, which the City
11 declined to do.

12 The objectors, having adopted the posture of a stone wall by
13 refusing seriously to negotiate, will not now be heard to
14 complain about the negotiating behavior of their counterparty.

15 While this court understands that a principled impasse may
16 underlie the objectors' stone wall, the existence of impasse does
17 not necessarily undermine the City's compliance with the good
18 faith negotiation requirement of the California neutral
19 evaluation process.

20 The City's dire financial circumstances must have been
21 apparent to the objectors by the time of the trial on the
22 question of the order for relief. Even they conceded on the
23 record that long-term structural budget imbalances exist that
24 require radical surgery; this position also impeaches their
25 contention, to be addressed later, that the City is not
26 insolvent. Their complaint that the City should be more
27 aggressively attacking its pensioners by way of CalPERS is a
28 matter that relates to the structure of a confirmable plan, but

1 that is not relevant to the order for relief.

2 Although the CalPERS issue will become an important question
3 if the objectors raise it in a challenge to confirmation of a
4 plan of adjustment, their dissatisfaction with the City's
5 proposed manner of dealing with another creditor is not relevant
6 to the order for relief. Rather, its use at this stage is a mere
7 pretext that is not a responsible litigation position.

8

9

3

10 There is an adequate, independent reason for rejecting the
11 objectors' challenge to the City's compliance with the California
12 neutral evaluation gateway: the objectors declined to pay their
13 share of costs of the California neutral evaluation process.

14 California requires that the local public entity pay half of
15 the costs of neutral evaluation, including, but not limited to,
16 the fees of the evaluator, and that the creditors must pay the
17 balance, unless otherwise agreed to by the parties. CAL. GOV'T
18 CODE § 53760.3(s).¹⁵ The City did not agree otherwise.

19 None of the objectors paid any part of the costs of neutral
20 evaluation as required by § 53760.3(s). National Public Finance
21 was refreshingly candid when it wrote that it would participate
22

23

¹⁵The precise allocation of costs is:

24

25 (s) The local public entity shall pay 50 percent of the
26 costs of neutral evaluation, including, but not limited to,
the fees of the evaluator, and the creditors shall pay the
balance, unless otherwise agreed to by the parties.

27

CAL. GOV'T CODE § 53760.3(s).

28

1 in the neutral evaluation but that: "National expressly
2 disclaims any obligation or liability for the payment of any
3 costs or expenses under Section 53760.3(s) of the Act." Although
4 the other objectors were not so candid, they all concede that
5 none of them paid any portion of their § 53760.3(s) obligation.
6 This evidences a pattern of conscious parallelism.

7 Nor is it an excuse that boilerplate provisions in the bond
8 indenture contracts purport to saddle the City with the
9 objectors' legal expenses incurred in this chapter 9 battle. The
10 specificity of the language of California's Government Code
11 § 53760.3(s) indicates a public policy decision by the California
12 legislature to trump contractual fee-shifting provisions in order
13 to promote incentives to negotiate.

14 The mentality of the macho manager that authorizes
15 uneconomic litigation activity on the premise that the opponent
16 will pay the bills, which is the dysfunctional contractual
17 corollary of the so-called "American Rule" regarding fees that
18 escalates legal expense, has been rejected as a matter of
19 California law in the difficult arena of municipal insolvency.

20 In other words, the decisionmakers for the capital markets
21 creditors need to check their testosterone at the door, stop
22 assuming that they are spending their opponent's money when they
23 direct their counsel to pursue wasteful legal tasks, and make
24 their litigation business decisions on the premise that they will
25 be responsible for every dollar of legal effort that they order.
26 This merely reflects that basic management principle that
27 authority should not be separated from responsibility.

28 Here, the objectors are not only pursuing a wasteful

1 strategy, they put themselves in the position of freeloaders who,
2 as a matter of California law, will not be heard to complain
3 about the City's performance of its obligations during the
4 California neutral evaluation process. They should not expect
5 that they can add their legal fees to the debt owed by the City.

6 Arguably, the City being the prevailing party in the order-
7 for-relief dispute, the objectors could be obliged to pay the
8 City's expenses of litigating the order for relief. CAL. CIV. CODE
9 § 1717. That question, however, can be left to another day.

10
11 D

12 In short, the court is persuaded that the City has proved by
13 a preponderance of evidence that it honored the requirements of
14 the California neutral evaluation process and, in consequence, is
15 authorized by California law to be a chapter 9 debtor. 11 U.S.C.
16 § 109(c)(2).

17 Independently, as the objectors did not comply with their
18 obligations under California law to negotiate in good faith and
19 to pay their allotted share of the neutral evaluation process,
20 they waived the right to complain about the City's performance
21 during the California pre-filing negotiation process.

22
23 III

24 The third essential element for eligibility to be a chapter
25 9 debtor is that the municipality must be insolvent. 11 U.S.C.
26 § 109(c)(3).

27 A municipality is "insolvent" for purposes of § 109(c)(3) if
28 it either is generally not paying its debts that are not the

1 subject of a bona fide dispute or is unable to pay its debts as
2 they become due. 11 U.S.C. § 101(32)(c).¹⁶

3 The City relies on the second prong of the municipal
4 insolvency definition. It contends that, per § 101(32)(C)(ii),
5 as of the filing of its chapter 9 case on June 28, 2012, it was
6 "unable to pay" its debts as they became due. The objectors
7 contend that the City either was not insolvent or manipulated
8 itself into a technical insolvency that should be disregarded.

9 This trier of fact is persuaded that, by all relevant
10 measures, the City is insolvent.

11
12 A

13 Three types of insolvency inform the § 109(c)(3) analysis:
14 cash insolvency; budget insolvency; and service delivery
15 insolvency.

16 The theme underlying the two alternative definitions of
17 municipal insolvency in § 101(32)(C) is that a municipality must
18 be in bona fide financial distress that is not likely to be
19 resolved without use of the federal exclusive bankruptcy power to
20 impair contracts. The insolvency must be real and not
21 transitory. This follows from the language of § 101(32)(C) and
22

23 ¹⁶The precise definition of a municipal "insolvent" is:

24 (C) with reference to a municipality, financial condition
25 such that the municipality is -

- 26 (i) generally not paying its debts as they become due
27 unless such debts are the subject of a bona fide
28 dispute; or
(ii) unable to pay its debts as they become due.

11 U.S.C. § 101(32).

1 from other uses of insolvency in the Bankruptcy Code.

2
3 1

4 Insight into the meaning of the special definition of
5 "insolvent" for municipalities gains texture by comparison with
6 other forms of the term "insolvent" in the Bankruptcy Code.

7 The primary use of "insolvent" in other chapters of the
8 Bankruptcy Code refers to what is commonly described as "balance-
9 sheet insolvency," which is a financial condition such that
10 liabilities exceed assets. See, e.g., 11 U.S.C. § 548(a)(1)(B).

11 In addition, for those involuntary bankruptcy cases that are
12 premised on financial condition,¹⁷ the requirement for an order
13 for relief is that the debtor is "generally not paying such
14 debtor's debts as such debts become due unless such debts are the
15 subject of a bona fide dispute as to liability or amount." 11
16 U.S.C. § 303(h)(1). While § 303 does not actually use the term
17 "insolvent," the language of § 303(h)(1) focused on debts as they
18 become due is the same as the debts-as-they-become-due language
19 in the definition of municipal insolvency. § 101(32)(C).

20
21 2

22 The language "unable to pay as they become due" in the
23 municipal insolvency definition implicates the notions of time
24 and projections about the future.

25 Statutory construction rules likewise point to a temporal
26

27 ¹⁷Control of the debtor's property in some circumstances may
28 warrant an involuntary order for relief, independent of the
debtor's financial condition. 11 U.S.C. § 303(h)(2).

1 aspect as the § 101(32)(C)(ii) phrase "as they become due" must
2 mean something different than its § 101(32)(C)(i) partner
3 "generally not paying its debts." In re City of Bridgeport, 129
4 B.R. 332, 334-37 (Bankr. D. Conn. 1991).

5 The consequence of the § 101(32)(C)(ii) temporal definition
6 of insolvency is that a municipality need not be actually out of
7 cash before it is cash insolvent.

8 But how far one looks into the future to discern insolvency
9 has not been settled. Although the Bridgeport court purported to
10 announce a rule that limited the analysis to the current and the
11 next succeeding fiscal years, the putative rule in that decision
12 reflects the unpersuasive state of the evidence before the court
13 in that case, which it viewed as too speculative to be reliable.
14 Bridgeport, 129 B.R. at 337-38. The Bridgeport rule does not
15 purport to be a rule for all cases.

16 In this instance, as the City would run out of cash within a
17 matter of weeks after the case was filed, it is only necessary to
18 posit for future situations that § 101(32)(C)(ii) potentially
19 permits the actual point of running out of cash to be after the
20 next succeeding fiscal year.

21

22

B

23 The evidence establishes that as of February 28, 2012, the
24 City was not able to pay its debts as they became due and
25 remained cash insolvent through the date of filing the chapter 9
26 case on June 28, 2012.

27

28

1
2 As of February 28, 2012, little guesswork was needed to
3 project insufficient cash to complete the current fiscal year.
4 Although cash insolvency probably existed before February 28, it
5 was by then beyond cavil that the City was insolvent for purposes
6 of § 101(32)(C).

7 The main reason that there was about \$1.3 million on hand
8 when the case was filed on June 28, 2012, was that the City had,
9 by virtue of its February 28 decision, intentionally defaulted on
10 \$2,048,658 in bond payments due to the objectors before June 30,
11 2012. It suspended general fund payments on the 2004 Lease
12 Revenue Bond (Parking), the 2009 Lease Revenue Bonds (Public
13 Facilities Fees), and the 2007 Variable Rate Bonds (City Hall).

14 For the fiscal year scheduled to begin July 1, 2012, the
15 City was unable to project a balanced budget in compliance with
16 California law. Rather, it projected a deficit for the fiscal
17 year commencing July 1, 2012, ranging from \$20,207,540 to
18 \$38,182,873. Nor would the funds on hand, together with those
19 anticipated to be received during July, be sufficient for
20 payments required to be made during July. Succeeding months
21 looked similarly bleak. General fund payments scheduled to
22 service were projected to total \$11,787,182.

23 By filing the chapter 9 case, the City was able to impose
24 its so-called "pendency plan" according to which, among other
25 things, it unilaterally slashed health care benefits for
26 employees and its 2,400 retirees and suspended general fund
27 payments on bonds. The pendency plan reductions, the ultimate
28 effectiveness of which depends upon confirmation of a plan of

1 adjustment that discharges the breached obligations, Stockton II,
2 478 B.R. at 24-25, enabled the City to adopt a balanced budget.

3 The February 28 projections that led the City to initiate
4 the California neutral evaluation process also sufficed to
5 establish the requisite cash insolvency to file a chapter 9 case.

6 But, even if the projections of February 28 did not suffice
7 to support a conclusion of cash insolvency per § 101(32)(C), the
8 inability to formulate a balanced budget for the fiscal year
9 beginning July 1 without impairing contractual obligations
10 independently supports the finding of insolvency.

11 In other words, when a municipality lacks the funds to pay
12 its contractual obligations within the current or the next
13 succeeding fiscal year, it is unable to pay its debts as they
14 become due within the meaning of § 101(32)(C).

15
16 2

17 The objectors contend that the City's insolvency was
18 engineered and not genuine. This is where concepts of service
19 delivery insolvency and budget insolvency become relevant.

20 While cash insolvency – the opposite of paying debts as they
21 become due – is the controlling chapter 9 criterion under
22 § 101(32)(C), longer-term budget imbalances (budget insolvency)
23 and the degree of inability to fund essential government services
24 (service delivery insolvency) also inform the trier of fact's
25 assessment of the relative degree and likely duration of cash
26 insolvency.

1 a

2 Service delivery insolvency focuses on the municipality's
3 ability to pay for all the costs of providing services at the
4 level and quality that are required for the health, safety, and
5 welfare of the community.

6 The evidence demonstrates that the police department has
7 been decimated. The crime rate has soared. Homicides are at
8 record levels. The City has among the ten highest rates in the
9 nation of aggravated assaults with a firearm. Police often
10 respond only to crimes-in-progress.

11 That is a paradigm example of service delivery insolvency
12 that confirms that the cash insolvency is no chimera.

13
14 b

15 Budget insolvency focuses on the ability of a municipality
16 to create a balanced budget that provides sufficient revenues to
17 pay for its expenses that occur within the budgeted period.
18 Relevant budgeted periods include future fiscal years. The
19 projections in the February 28 memorandum, which are not
20 contested by the objectors, demonstrate imbalances that would
21 persist for decades without some radical surgery.

22 Nor do there appear to be untapped resources that would make
23 a material difference. Few fixed assets are available to be sold
24 or otherwise monetized. Sales tax revenues from an improving
25 regional economy will not suffice because, first, the City's
26 insolvency is more profound and, second, it is too speculative to
27 assume that such revenues will rise at the same or greater rate
28 as the regional economy in light of the City's service delivery

1 insolvency.

2 Nor will normal property tax revenues improve enough to make
3 a material difference. California property taxes are asymmetric:
4 elastic on the downside because it is comparatively easy to
5 obtain reductions in assessments; but inelastic on the upside
6 because increases in assessments and ad valorem rates are
7 restricted by the barriers erected by the famous Proposition 13.

8 It follows that the extra revenues needed to fund a plan of
9 arrangement probably will have to come from tax increases. The
10 difficulty is that local tax increases in California generally
11 require a vote of the people.

12 The objectors' assertion that relief should be rejected
13 because the City did not go to the people for a tax increase
14 before filing a chapter 9 case is not persuasive. Evidence that
15 a majority of local tax measures on the November 2012 ballot in
16 California were passed is not probative of, and does not warrant,
17 a conclusion that Stockton voters would have approved a tax
18 increase. The objectors did not point to a single local measure
19 that was enacted amidst fiscal chaos.

20 To the contrary, Deis testified credibly that a key lesson
21 learned from his long-term career in California local public
22 administration is that successful local tax measures for general-
23 purpose revenues occur in an atmosphere in which the predicate
24 message is that the fiscal house is already in order. Putting
25 the fiscal house in order so that voters might be willing to
26 entertain tax increases is the whole point of chapter 9.

27 To that end, the chapter 9 plan confirmation standards
28 incorporate the potential need for voter approval. A plan cannot

1 be confirmed unless "electoral approval necessary under
2 applicable nonbankruptcy law in order to carry out any provision
3 of the plan has been obtained, or such provision is expressly
4 conditioned on such approval." 11 U.S.C. § 943(b)(6).

5 Through that process, a budget can be returned to solvency
6 with a combination of debt adjustment and revenue enhancement, as
7 appropriate to the particular situation.

8

9

3

10 The sum of the evidence establishes that the City was
11 insolvent by all available measures when it filed its chapter 9
12 case. It was cash insolvent, unable to pay its debts as they
13 came due as required by § 101(32)(C) and § 109(c)(3). That it
14 was service delivery insolvent confirms that the cash insolvency
15 was not a mere technical insolvency. That it was budget
16 insolvent for the long term confirms that the insolvency would
17 persist without realignment of revenues and expenses. Hence, the
18 City satisfied the insolvency requirement of § 109(c)(3).

19

20

IV

21 The fourth essential element for chapter 9 eligibility of an
22 insolvent municipality that is authorized under state law to be a
23 chapter 9 debtor is that it "desires to effect a plan to adjust
24 such debts." 11 U.S.C. § 109(c)(4).

25 The cases equate "desire" with "intent" and make clear that
26 this element is highly subjective. E.g., In re City of Vallejo,
27 408 B.R. 280, 295 (9th Cir. BAP 2009).

28

1 A

2 At the first level, the question is whether the chapter 9
3 case was filed for some ulterior motive, such as to buy time or
4 evade creditors, rather than to restructure the City's finances.
5 Vallejo, 408 B.R. at 295; 2 COLLIER ON BANKRUPTCY ¶ 109.04[3][d], at
6 p. 109-32 (Henry J. Sommer & Alan N. Resnick eds. 16th ed. 2011)
7 (hereafter "COLLIER").

8 Evidence probative of intent includes attempts to resolve
9 claims, submitting a draft plan, and other circumstantial
10 evidence. Vallejo, 408 B.R. at 295.

11 In this instance, the City has engaged in extensive efforts
12 to resolve claims. One of the byproducts of the California
13 neutral evaluation process is evidence regarding efforts to
14 resolve claims.

15 The City's Ask that was used as a basis for discussion
16 during the prefiling discussion also functions as a draft plan
17 for purposes of § 109(c)(4).

18 And there is powerful circumstantial evidence of the City's
19 desire to effect a plan. Evidence of intent to effect a plan
20 includes the circumstance of the inability to fashion a balanced
21 budget for the impending fiscal year without unilaterally
22 imposing a pendency plan impairing contracts. The City's
23 unilateral reductions at to the outset of the case created an
24 imperative on the City either to have those contract impairments
25 excused by way of a bankruptcy discharge or to achieve agreement
26 with the affected parties.

27 The City's unilateral cut of retiree health benefits that
28 this court declined to prevent in the Stockton II decision echoes

1 the action of the general who burns bridges behind his own troops
2 to leave them with no choice but to attack. Slashing retiree
3 health benefits at the outset of the chapter 9 case left the City
4 with little choice but to effect a plan unless the retirees were
5 to agree to the impairment of their claimed contract rights.
6 Without such agreement or a confirmed plan validating the
7 unilateral action, the impaired rights could spring back into
8 existence in a manner that could be unfortunate for the City.
9

10 B

11 The § 109(c)(4) statutory phrase "desires to effect a plan
12 to adjust such debts" does not necessarily require that a
13 confirmed or confirmable chapter 9 plan be actually intended.
14 The phrase also subsumes a de facto plan in which a sufficient
15 number of affected parties voluntarily revise their contracts
16 with the municipality in the face of the alternative of the
17 potential compulsion of a confirmed plan of adjustment.

18 At first blush, chapter 9 has only two exits: confirmed plan
19 with attendant discharge or dismissal with no discharge. But
20 there really are three possible chapter 9 outcomes because
21 dismissal subdivides into two alternatives. First, a dismissal
22 in which a sufficient number of affected parties voluntarily
23 agree to modify their rights that the municipality does not
24 actually need a confirmed plan operates as a de facto plan.

25 Indeed, a de facto plan attendant to dismissal was the
26 recent resolution in this judicial district of the chapter 9 case
27 of the Town of Mammoth Lakes. That case was dismissed without
28 discharge concurrent with agreement among the key parties in

1 interest to a series of contracts that resolved the town's
2 financial difficulties, the muscle of chapter 9 having been what
3 forced everyone to take seriously the need to bargain. Order
4 Dismissing Case, In re Town of Mammoth Lakes, No. 12-32463,
5 Bankr. E.D. Cal., Nov. 16, 2012.

6 While the first form of dismissal without a discharge -
7 dismissal attendant to de facto plan that resolves the financial
8 problem - is a chapter 9 success, the second form of dismissal
9 without discharge bodes trouble.

10 If the City's case were to be dismissed without a sufficient
11 number of agreements to restore its fiscal health, then even more
12 financial trouble would be in store. One of the consequences of
13 such a dismissal of this case would be revival of the retirees'
14 claims that their health benefits are contracts to be enforced,
15 leaving the City exposed to demands for restoration of those
16 benefits and claims for damages. 11 U.S.C. § 349, incorporated
17 by id. § 901(a). In other words, when the City implemented
18 unilateral cost-cutting measures at the outset of this case, it
19 committed itself to the goal of either confirming a chapter 9
20 plan or achieving agreements sufficient to constitute a de facto
21 plan with respect to the victims of those measures. Any other
22 outcome would be troublesome for the City.

23 Thus, the court is persuaded by a preponderance of the
24 evidence that the City "desires to effect a plan to adjust such
25 debts" within the meaning of § 109(c)(4) and, in view of its
26 unilateral contract impairments imposed by way of its pendency
27 plan, has little choice but to effect a plan.

28

1
2 The fifth essential element for chapter 9 eligibility has
3 four alternatives, three of which are focused on negotiations
4 with creditors. 11 U.S.C. § 109(c)(5).

5 The first and fourth alternatives do not apply in this case.
6 The City has not obtained the agreement of a majority in amount
7 of each class of claims that it intends to impair under a plan.
8 11 U.S.C. § 109(c)(5)(A). Nor is there any suggestion that there
9 was a creditor who was attempting to obtain a preference that
10 would be avoidable under the bankruptcy avoidable preference
11 statute. 11 U.S.C. § 109(c)(5)(D). The second and third
12 alternatives do apply.

13 The City contends that it has negotiated in good faith with
14 creditors and has failed to obtain agreement of creditors holding
15 at least a majority in amount of each class of claims that it
16 intends to impair under a plan. 11 U.S.C. § 109(c)(5)(B).

17 And, it contends that negotiation is impracticable with
18 others, including its 2,400 retirees. 11 U.S.C. § 109(c)(5)(C).

A

19
20
21 The § 109(c)(5)(B) negotiations with each class that the
22 City would impair under a plan puts the focus on organized labor
23 and on the capital markets creditors.

24 As to labor, the court concludes for purposes of eligibility
25 that the City negotiated in good faith with its unions. During
26 the pre-filing neutral evaluation process, extensive discussions
27 with the various unions have been documented and were followed by
28 agreements to modify all unexpired collective bargaining

1 agreements before the case was filed. In addition, substantial
2 progress was made towards agreement with the police regarding
3 replacement of their expired collective bargaining agreement.
4 Recalling that personnel costs comprise more than two-thirds of
5 the City's expenses, this is persuasive evidence of negotiation
6 in good faith with a substantial body of creditors.

7 The objecting capital markets creditors contend that the
8 City did not similarly negotiate in good faith with them.
9 Although they brand the City's proposal as a take-it-or-leave-it
10 ultimatum that was not made in good faith, the exchange of salvos
11 in the good faith barrage and counter-barrage leave the capital
12 markets creditors in the weaker position.

13 The evidence is that the objecting capital markets
14 creditors, led by Assured Guaranty and National Public Finance,
15 chose to take a we-have-nothing-to-talk-about position once the
16 City indicated that it was not proposing to impair its
17 obligations to CalPERS. In other words, the objecting creditors
18 created a dynamic in which they categorically would not talk
19 about modifying their rights unless and until the City attacked
20 CalPERS. At trial, they expressly asserted that § 109(c)(5)(B)
21 good faith is a one-way obligation applicable to the City but not
22 to the objectors themselves.

23 The objectors' salvos are off-target. Just as it takes two
24 dancers to tango, good faith negotiations contemplate
25 reciprocity. It is not possible to negotiate with a stone wall.
26 It follows that, as a matter of law, a municipality's
27 § 109(c)(5)(B) good faith negotiation obligation is satisfied
28 with respect to any class of putatively impaired creditors that

1 declines to respond in good faith to a good faith proposal by the
2 municipality.

3 Although the objectors' complain that the City did not make
4 a good faith proposal, that salvo also misses the target. This
5 court is persuaded, as a matter of fact, that the City's Ask with
6 respect to the capital markets creditors was made in good faith.
7 The court is also persuaded, as a matter of fact, that the City
8 did not adopt a take-it-or-leave-it posture. Rather, the
9 proposals it set forth in the Ask were within the range of
10 reasonable starting positions in a negotiation of plan treatment.

11 A fair reading of the City's proposals indicates that
12 restoring the foundation of the City's financial structure, and
13 especially reinvigorating its general fund, will necessitate
14 substantial debt relief for up to a decade. One facet of its
15 proposal is a five-year holiday on paying interest and a ten-year
16 holiday on paying principal. Another facet is eliminating the
17 guaranty of general fund assets to back up revenue shortfalls in
18 bonds related to specific projects. The City was willing to pay
19 for both types of accommodation - typically in the form of
20 extended time for payment, increased interest, or other
21 adjustments yielding an appropriate value to the impaired party.
22 In short, the City was making a conventional proposal about which
23 there was much that could have been the basis for bargaining if
24 only the capital markets creditors had been willing to talk.

25 It follows that the City performed its good faith obligation
26 in the negotiations with labor and with the objecting creditors.
27 The fact that the objectors chose not to reciprocate does not
28 count against the eligibility of the City under § 109(c)(5)(B).

1 B

2 Impracticability of negotiations per § 109(c)(5)(C) is also
3 pertinent to the City's eligibility in two respects.

4 First, it is impracticable to negotiate with 2,400 retirees
5 for whom there is no natural representative capable of bargaining
6 on their behalf. A retiree committee to speak on behalf of the
7 retirees can be appointed by the United States trustee, but only
8 after entry of the order for relief. 11 U.S.C. § 1102,
9 incorporated by § 901(a).

10 Second, § 109(c)(5)(C) impracticability provides an
11 adequate, independent reason for concluding that the City has
12 satisfied the fifth essential element for eligibility to be a
13 chapter 9 debtor with respect to the objecting capital markets
14 creditors - it is impracticable to negotiate with a stone wall.

15
16 VI

17 The sixth preliminary to entry of an order for chapter 9
18 relief is a wild card that comes in through the back door. Even
19 if a municipality satisfies the eligibility requirements of
20 § 109(c), the court "may" dismiss the petition "if the debtor did
21 not file the petition in good faith." 11 U.S.C. § 921(c).

22 This is another of four encounters with the concept of "good
23 faith" in chapter 9. As already explained, there is a reciprocal
24 duty to participate in good faith in California's gateway neutral
25 evaluation process. CAL. GOV'T CODE § 53760.3(o). Chapter 9
26 eligibility contemplates good faith negotiation with impaired
27 classes that are willing to negotiate. 11 U.S.C. § 109(c)(5)(B).
28 Nor can a plan of adjustment be confirmed unless proposed in good

1 faith and not by any means forbidden by law. 11 U.S.C.
2 § 1129(a)(3), incorporated by § 901(a).

3
4 A

5 Section 921(c) "good faith" serves a policy objective of
6 assuring that the chapter 9 process is being used in a manner
7 consistent with the reorganization purposes of the Bankruptcy
8 Code. It is assessed on a case-by-case basis in light of all the
9 facts, which must be balanced against the broad remedial purpose
10 of chapter 9. 2 COLLIER at ¶ 921.04[2]. Indeed, if all of the
11 eligibility criteria set forth in § 109(c) as described above are
12 satisfied, it follows that there should be a strong presumption
13 in favor of chapter 9 relief.

14 Relevant considerations in the comprehensive analysis for
15 § 921 good faith include whether the City's financial problems
16 are of a nature contemplated by chapter 9, whether the reasons
17 for filing are consistent with chapter 9, the extent of the
18 City's prepetition efforts to address the issues, the extent that
19 alternatives to chapter 9 were considered, and whether the City's
20 residents would be prejudiced by denying chapter 9 relief. 2
21 COLLIER ¶ 921.04[2].

22
23 B

24 Since neither the statute nor the cases are explicit about
25 the burden of proof regarding § 921(c) good faith, it is
26 appropriate to address the question through the matrix of trial
27 procedure and the law of evidence.

28 Although it is straightforward that the § 109(c) eligibility

1 elements are matters as to which the City has the affirmative
2 burden to establish in all respects by preponderance of evidence,
3 the structure of the language of § 921(c) – “if the debtor did
4 not file the petition in good faith” – presents a significant
5 difference that implicates the distinction between the burden of
6 going forward and the burden of persuasion.

7 The use in § 921(c) of the conditional “if the debtor did
8 not,” when contrasted against the background of the direct
9 language of § 109(c), means that the City’s proof of the § 109(c)
10 elements also operates to create a rebuttable presumption that it
11 filed the case in good faith for purposes of § 921(c).

12 This presumption of § 921(c) good faith is directed against
13 the objectors, who thereby have the burden of producing evidence
14 to rebut the presumption. Fed. R. Evid. 301.¹⁸

15 If the objectors produce evidence to rebut the § 921(c) good
16 faith presumption, then the City must proceed to carry its
17 ultimate burden of persuasion. Fed. R. Evid. 301.

18 The quantum of evidence that must be produced to rebut the
19 § 921(c) good faith presumption is appropriately evaluated in
20 light of, first, the policy favoring the remedial purpose of
21 chapter 9 for those entities that meet the eligibility
22

23 ¹⁸Federal Rule of Evidence 301 provides:

24
25 In a civil case, unless a federal statute or these rules
26 provide otherwise, the party against whom a presumption is
27 directed has the burden of producing evidence to rebut the
28 presumption. But this rule does not shift the burden of
persuasion, which remains on the party who had it
originally.

Fed. R. Evid. 301.

1 requirements of § 109(c) and, second, the risk that City
2 residents will be prejudiced if relief nevertheless is denied.

3 In view of the multi-year effort to ratchet down expenses
4 during which the City reduced employees and reduced employee
5 compensation, its cash insolvency, its service insolvency, its
6 good faith negotiations or efforts to negotiate with creditors,
7 and its inability to achieve significant further reductions
8 without being able to compel the impairment of contracts, the
9 § 921(c) good faith presumption in this instance is strong.

10 The objectors' burden of going forward to produce evidence
11 to call into question § 921(c) good faith has not, in the
12 judgment of this trier of fact, been satisfied. The objectors
13 have not, by a wide margin, adduced evidence sufficient to rebut
14 the presumption that the case was filed in good faith.

15 The presumption that the case was filed in good faith not
16 having been rebutted, it follows that the City satisfied its
17 burden to persuade this trier of fact that it filed the case in
18 good faith for purposes of § 921(c).

19

20 VII

21 Assured Guaranty made a timely motion for amended findings
22 under Federal Rule of Civil Procedure 52(b) questioning the
23 findings regarding its lack of good faith. Fed. R. Civ. P.
24 52(b), incorporated by Fed. R. Bankr. P. 7052 & 9014. The effect
25 of this timely motion is to defer the deadline for appeal from
26 the order for relief until after this court disposes of the
27 motion. Fed. R. Bankr. P. 8002(b).

28 It is contended that the evidence does not support a finding

1 that Assured Guaranty did not negotiate in good faith, first, by
2 voting with its feet and acting as a stone wall in dealings with
3 the City and, second, by not paying its share of the California
4 neutral evaluation fees. The City has countered that the
5 findings are based on evidence in the record and reasonable
6 inferences drawn therefrom.

7 The gist of the motion is that the court is unfairly holding
8 Assured Guaranty accountable for the actions of National Public
9 Finance of entering the neutral evaluation process with a
10 renunciation of its obligation under California Government Code
11 § 53760.3(s) to pay a portion of the neutral evaluation fees and
12 for announcing to the neutral evaluator that there was nothing to
13 discuss so long as the City was declining to propose impairment
14 of its obligations to CalPERS.

15 After careful reflection, this trial court is persuaded that
16 its original findings are correct.

17
18 A

19 The premise of the Assured Guaranty motion is that the court
20 disregarded the direct evidence embodied in the declaration of
21 Assured counsel that was designed to explain and excuse the
22 negotiating conduct of Assured.

23
24 1

25 This requires clarity about the role of the trial court
26 when, as here, it acts as finder of fact without a jury.

27 The basic role of the fact finder is to determine
28 credibility of witnesses, resolve evidentiary conflicts, and draw

1 reasonable inferences from proven facts. Fed. R. Civ. P. 52(a),
2 incorporated by Fed. R. Bankr. P. 7052 & 9014; cf., e.g., United
3 States v. Hubbard, 96 F.3d 1223, 1226 (9th Cir. 1996).

4 Findings will not be set aside by an appellate court unless
5 clearly erroneous, with deference given to the trial court's
6 opportunity to judge witness credibility. Fed. R. Civ. P.
7 52(a)(6), incorporated by Fed. R. Bankr. P. 7052 & 9014.¹⁹

8 As part of that process, the trier of fact is entitled to
9 ascribe differing weights to admitted evidence. The trier of
10 fact is also entitled to disbelieve admitted evidence. Professor
11 McCormack explains in a passage invoked by Assured Guaranty that
12 direct evidence "is evidence which, if believed, resolves a
13 matter in issue." MCCORMACK ON EVIDENCE § 185 (emphasis supplied);
14 Reply of Assured Guaranty Corp. & Assured Guaranty Municipal
15 Corp. to City of Stockton's Opposition to Motion Pursuant to Rule
16 52(b), at 4.

17 The authority of the trier of fact to believe or disbelieve
18 and to ascribe weight to evidence looms large in this motion.

19
20 2

21 The focus is on the Bjork declaration that was admitted into
22

23 _____
24 ¹⁹The rule provides:

25 (a)(6). Setting Aside the Findings. Findings of fact,
26 whether based on oral or other evidence, must not be set
27 aside unless clearly erroneous, and the reviewing court must
give due regard to the trial court's opportunity to judge
the witnesses' credibility.

28 Fed. R. Civ. P. 52(a)(6), incorporated by Fed. R. Bankr. P. 7052
& 9014.

1 evidence. It is contended that this constitutes un rebutted
2 evidence of Assured Guaranty's good faith conduct.

3 First, as a basic matter of trial evidence, this written
4 declaration that was admitted into evidence by stipulation of the
5 parties is merely testimony that this court, in its capacity as
6 trier of fact, is entitled to believe or to disbelieve regardless
7 of whether there is cross-examination or other forms of rebuttal.

8 This trier of fact does not give much weight to the Bjork
9 declaration for two distinct reasons. First, there is the
10 structural problem that Mr. Bjork is a lawyer who represents one
11 of the objectors. Indeed, he is an excellent lawyer who can be
12 counted on to be careful to say nothing that might undermine his
13 client. Such testimony, especially written testimony presented
14 by agreement without cross-examination, is not likely to be fully
15 candid and complete.²⁰ In the judgment of this trier of fact, it
16 came with too much spin to be taken at face value.

17 The second reason for not giving much weight to the Bjork
18 declaration is that it is inconsistent with the obstinate stance
19 the objectors, including Assured Guaranty, have taken in this
20 case. The objectors' continued resistance to an order for relief
21 and insistence on a trial in the face of overwhelming financial
22 evidence of insolvency that was developed before trial defies
23

24 ²⁰Nor can the Bjork declaration be regarded as uncontested.
25 The assertion that the City's counsel provided a responsive
26 declaration that acknowledged that the Bjork declaration was
27 "largely accurate" does not lead to a different conclusion. Mr.
28 Levinson, like Mr. Bjork, is an excellent lawyer who can be
counted on to be careful to say nothing that might undermine his
client. The word "largely" leaves room for a great deal of
disagreement about what was and was not accurate and complete in
the Bjork declaration.

1 common sense. As trial approached, they must have recognized
2 that the evidence would compel the conclusion that the City is in
3 desperate financial straits that likely could only be solved by
4 impairing contracts through the chapter 9 process that follows
5 after entry of an order for relief.

6 Nor is the obstinance about an order for relief consistent
7 with their posture regarding CalPERS. It has long been evident
8 that the objectors are itching for a fight over pensions, to
9 answer interesting questions whether the City has an executory
10 contract with CalPERS and whether liabilities to CalPERS might be
11 dischargeable debts. And CalPERS itself has been bellowing and
12 pawing the sidelines during the eligibility phase waiting for the
13 main event that will come only after relief is ordered.

14 In this context, the assertion by the City's counsel that
15 the objectors' obstinacy actually is "all about leverage"
16 resonates. The objectors are trying to get their way by forcing
17 the City to incur massive legal expenses that should not be
18 necessary. An appropriate method for achieving their goal of
19 spreading the pain to CalPERS would be to challenge CalPERS head-
20 on in battle over an actual plan filed after relief is ordered,
21 in which battle the City could watch from the sidelines.

22 This trier of fact is persuaded that the carefully-drawn
23 declaration of a lawyer, and by a lawyer, and for a client
24 reflects a party in interest going through the motions without
25 sincerely intending to achieve a legitimate litigation goal.

28 The picture that emerged at trial at which Assured Guaranty

1 and National Public Finance shared the lead in contesting the
2 order for relief was a picture of a group of similarly situated
3 creditors that had been marching in lockstep throughout the case.
4 Although there is nothing improper about related litigants
5 presenting a united front, each participant assumes the risk of
6 being tainted by one of its associates.

7 National Public Finance may have been the one who was so
8 bold as to put in writing its defiance of the cost-sharing
9 obligation imposed by California Government Code § 53760.3(s).
10 But Assured Guaranty made no effort to disagree and concedes that
11 it paid nothing. The parallelism is eloquent.

12 Assured Guaranty protests that the City did not ask it to
13 pay any portion of the Government Code § 53760.3(s) obligation.
14 But the obligation is not an obligation to reimburse the City;
15 rather, it is a direct obligation imposed on parties in interest
16 that the California legislature intended to be self-executing.
17 Assured Guaranty was obliged to be proactive about the bill.

18 Assured Guaranty protests that pre-existing agreements in
19 its contracts with the City obliged the City to pay the Assured
20 Guaranty portion of the neutral evaluation obligation and that
21 this satisfies the "unless otherwise agreed by the parties"
22 clause of Government Code § 53760.3(s). As explained above, this
23 court is not persuaded that a cost-shifting clause in the
24 underlying contract satisfies the "otherwise agreed" clause.
25 Rather, Government Code § 53760.3(s), at a minimum,²¹ indicates a
26

27 ²¹As noted above, there is also a theory that the objectors
28 might be required to pay the City's costs of litigating the order
for relief because the City was the prevailing party.

1 public policy decision by the California legislature to trump
2 contractual fee-shifting provisions.

3 The objectors' trial presentation was a coordinated effort
4 that resembled close order drill. It is apparent that the
5 objectors had been marching together throughout the case.
6 National Public Finance may have been calling cadence, but
7 Assured Guaranty was keeping in step.

8 In short, the motion to amend the findings pursuant to
9 Federal Rule of Civil Procedure 52(b) will be denied. The court
10 was required at trial to weigh competing evidence, to make
11 credibility determinations, and to draw reasonable inferences.
12 After reflecting on the findings in light of the points raised by
13 Assured Guaranty, it remains confident that all of the questioned
14 findings are correct.

15
16 CONCLUSION

17 The City having prevailed on its contention that chapter 9
18 relief is appropriate, a chapter 9 order for relief will be
19 entered.

20 The motion by Assured Guaranty to alter or amend the court's
21 oral findings of fact and conclusions of law pursuant to Federal
22 Rule of Civil Procedure 52(b) will be denied.

23 Appropriate orders will issue.

24
25 Dated: June 12, 2013

26 
United States Bankruptcy Judge