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**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
SACRAMENTO DIVISION**

In re:) **Case No. 12-32118**
)
CITY OF STOCKTON, CALIFORNIA,) **D.C. No. OHS-5**
)
Debtor.) **Chapter 9**

**SUPPLEMENTAL BRIEF OF CAPITAL
MARKETS CREDITORS REGARDING
THE CITY OF STOCKTON'S MOTION
FOR ORDER RULING THAT APPROVAL
OF SETTLEMENT AGREEMENT IS NOT
REQUIRED UNDER RULE 9019 OF THE
FEDERAL RULES OF BANKRUPTCY
PROCEDURE**

Date: January 30, 2013
Time: 10:00 a.m.
Dept.: C, Courtroom 35
Judge: Hon. Christopher M. Klein

1 Assured Guaranty Corp., Assured Guaranty Municipal Corp., National Public Finance
2 Guarantee Corporation, Franklin High Yield Tax-Free Income Fund, Franklin California High Yield
3 Municipal Fund, and Wells Fargo Bank, National Association, in its role as indenture trustee
4 (collectively the “Capital Markets Creditors”), hereby submit this supplemental brief in support of
5 their previously-filed Limited Objection [Dkt. No. 605] to the City of Stockton, California’s (the
6 “City”) Motion For Order (1) Ruling That Approval of Settlement Agreement Is Not Required
7 Under Rule 9019 of the Federal Rules of Bankruptcy Procedure; Or Alternatively (2) Approving
8 Settlement Agreement Pursuant to Rule 9019 [Dkt. No. 585] (the “9019 Motion”).

9 **I. INTRODUCTION**

10 1. At the preliminary hearing on the 9019 Motion, the Court requested additional
11 briefing on the question of whether Rule 9019 of the Federal Rules of Bankruptcy Procedure (the
12 “Bankruptcy Rules”) applies in Chapter 9 cases, specifically with respect to a debtor’s settlement of
13 disputed prepetition claims.

14 2. As demonstrated below, the answer to that question is “yes.” Rule 9019, by its terms,
15 applies to all cases under Title 11, including Chapter 9 cases. This was no legislative oversight or
16 accident. Rule 9019 plays a pivotal role in the “adjustment of the debtor-creditor relationship,”
17 which the Court previously has found to be at “[t]he core of a chapter 9 case.” *Assoc. of Retired*
18 *Emps. v. City of Stockton (In re City of Stockton)*, 478 B.R. 8, 25 (Bankr. E.D. Cal. 2012).
19 Specifically, Rule 9019 preserves the sanctity of the claims allowance process – itself at the heart of
20 the “debtor-creditor relationship” – by requiring notice and an opportunity to be heard with respect
21 to, as well as judicial oversight over, proposed compromises or settlements of disputed prepetition
22 claims that are to be treated in a plan of adjustment.

23 3. The purpose of Rule 9019 is to “prevent the making of concealed agreements which
24 are unknown to the creditors and unevaluated by the court.” *Motorola, Inc. v. Official Comm. of*
25 *Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452, 461 (2d Cir. 2007) (quoting *In re*
26 *Masters, Inc.*, 141 B.R. 13, 16 (Bankr. E.D.N.Y. 1992)). This is important in every bankruptcy case
27 – including Chapter 9 cases – because the settlement of disputed debts creates the possibility of
28 preferential or unequal treatment of similarly-situated creditors. It is of paramount concern in a

1 reorganization case – including Chapter 9 cases – because compromises outside of the plan process
2 may seek to provide treatment of a prepetition claim that otherwise would not be permissible under
3 the specific confirmation standards set forth in sections 943 and 1129 of the Bankruptcy Code.
4 Simply put, if a municipal debtor could settle and provide for treatment of a disputed prepetition
5 claim without notice and the approval of the court, nothing would prevent the debtor from “buying
6 off” favored creditors during the pendency of a case at the expense of others less fortunate (or less
7 politically connected), accomplishing via secret settlements that which it could not accomplish
8 through a properly-noticed plan of adjustment.

9 4. The City’s actions in this very case demonstrate that this concern is real and not
10 hypothetical. Just last week, the City announced that it had reached a Memorandum of
11 Understanding (“MOU”) with the Stockton Police Officers’ Association (SPOA), a true and correct
12 copy of which is attached as Exhibit A hereto. In addition to providing new terms and conditions for
13 the employment of the SPOA’s members and a continuation of unsustainable pension benefits, that
14 MOU contains far-reaching provisions that purport to “settle” and resolve SPOA’s disputed,
15 multimillion dollar claim against the City, mandate the treatment of that claim in the City’s plan of
16 adjustment, and require the SPOA to support the City and the City’s plan by delivering the votes of
17 its members – all without notice, court approval, or even the filing of a plan or disclosure statement,
18 much less balloting and a confirmation hearing. If Chapter 9 means anything, it means that a debtor
19 cannot side-step the plan process so easily and effortlessly. *See City of Stockton*, 478 B.R. at 25
20 (issues of allowance and treatment of claims “are central to the debtor-creditor relationship to be
21 dealt with, along with every other unhappy creditor, in the collective chapter 9 proceeding”)
22 (emphasis added).

23 5. The City’s argument that the application of Rule 9019 in Chapter 9 cases “would
24 conflict with [a] municipality’s freedom to control its properties and revenues, and to make
25 governance decisions,”¹ does not withstand scrutiny. The Court’s oversight of proposed settlements
26 of prepetition claims no more interferes with the City’s property or revenues than does the Court’s
27 determination of whether a proposed plan of adjustment – with its various provisions for allowance,

28 ¹ See City’s Reply in Support of 9019 Motion [Dkt. No. 613] at 3.

1 treatment, and payment of claims – may be confirmed. The claim resolution process is part and
2 parcel of the plan confirmation process, and each is a necessary, critical component of the
3 “adjustment of the debtor-creditor relationship” that is at “the core of a chapter 9 case.” That is why
4 Congress specifically incorporated section 502, among other important provisions, into Chapter 9.

5 6. As a consequence, the City’s assertion that the Court is powerless to consider the
6 reasonableness or propriety of any settlement that it wishes to make of its prepetition liabilities is
7 wrong as a matter of statutory construction and common sense, and the 9019 Motion should be
8 denied to the extent that the City seeks a declaration of immunity from the standard rules of
9 bankruptcy practice and procedure respecting proposed compromises.

10 **II. ARGUMENT**

11 **A. The Bankruptcy Rules Generally Apply In All Title 11 Cases.**

12 7. Bankruptcy Rule 1001 provides that the “Bankruptcy Rules and Forms govern
13 procedure in cases under title 11 of the United States Code.” Fed. R. Bankr. P. 1001. Although
14 certain Bankruptcy Rules are specifically limited to a particular chapter or chapters, many others are
15 not and, per Rule 1001, instead are intended to apply generally to all bankruptcy cases.

16 8. Bankruptcy Rule 9019, in particular, contains no express or implied limitation on its
17 applicability. Rather, Rule 9019 simply and plainly provides that, “[o]n motion by the trustee and
18 after notice and a hearing, the court may approve a compromise or settlement.” Fed. R. Bankr.
19 P. 9019(a).² Thus, under the plain language of Rule 1001, Rule 9019 applies in all “cases under
20 title 11,” including Chapter 9 cases. *Cf. Educ. Credit Mgmt. Corp. v. Coleman (In re Coleman)*, 560
21 F.3d 1000, 1004 n.7 (9th Cir. 2009) (“Bankruptcy Rules [4007(a) and (b)] apply equally to debtors
22 filing under Chapter 7 and debtors filing under Chapter 13.”).

23 9. Perhaps for this reason, courts regularly apply Rule 9019 in Chapter 9 cases, and no
24 court has ever suggested, much less held, that Rule 9019 is inapplicable in the context of a municipal
25 bankruptcy. *See, e.g.,* Limited Objection at 5-6 (citing 9019 motions filed in *In re City of Vallejo*
26

27 ² Pursuant to section 902(5) of the Bankruptcy Code, Rule 9019’s reference to “the trustee” is a
28 reference to the debtor in a Chapter 9 case. 11 U.S.C. § 902(5) (“‘trustee’, when used in a
section that is made applicable in a case under this chapter by section 103(e) or 901 of this title,
means debtor . . .”).

1 and *In re Corcoran Hospital District*); *In re Jefferson County*, 11-05736(TBB9) [Dkt. No. 1450]
2 (Bankr. N.D. Ala. Nov. 27, 2012) (9019 Motion).

3 **B. Bankruptcy Rule 9019 Applies In Chapter 9 Cases.**

4 10. Additionally, even if the plain language of the Bankruptcy Rules permitted any doubt
5 on the question (it does not), the nature, purpose and structure of the municipal debt adjustment
6 provisions of the Bankruptcy Code make it clear that Rule 9019 applies in Chapter 9 cases.

7
8 **1. Rule 9019 Is A Critical Component Of
The Chapter 9 Claims Allowance Process.**

9 11. Chapter 9 contains a very clear and specific claims allowance process. To start,
10 section 922 provides for an “automatic stay of enforcement of claims against the debtor,” thereby
11 channeling all claims into the collective bankruptcy process. 11 U.S.C. § 922. Chapter 9 then
12 incorporates sections 501 and 502 of the Bankruptcy Code, which empower a creditor to file a proof
13 of claim in the bankruptcy case and provide that a filed proof of claim is “deemed allowed” unless a
14 party in interest objects to the claim. *See* 11 U.S.C. §§ 901, 501, and 502(a). Section 924, in turn,
15 requires a municipal debtor to file a list of creditors and section 925 provides that claims so listed are
16 “deemed filed” unless listed as “contingent, unliquidated or disputed.” 11 U.S.C. §§ 924, 925.
17 Bankruptcy Rule 3003 provides that, if a claim is either not listed or is listed as disputed, contingent
18 or unliquidated, the creditor must file a proof of claim and, if it fails to do so, “shall not be treated as
19 a creditor with respect to such claim for the purposes of voting and distribution.” Fed. R. Bankr.
20 P. 3003(a) and (c)(2). Rule 3007, in turn, enables parties in interest to object to the allowance of a
21 claim via an objection that is “in writing and filed” in the bankruptcy case. Fed. R. Bankr.
22 P. 3007(a). Finally, section 944 provides for a discharge of allowed claims and other debts upon the
23 effectiveness of a plan confirmed in accordance with the requirements of sections 943 and 1129 of
24 the Code (including provisions requiring notice and court approval of the proposed plan and
25 disclosure statement). *See* 11 U.S.C. §§ 944(b) and (c).

26 12. This claims allowance process confers rights and protections on both the debtor and
27 creditors. Among other things, creditors are afforded the right to object to claims and assured that
28 unknown claims (*i.e.*, claims not listed or filed) and disputed claims will either be (a) discharged or

1 (b) formally adjudicated in an open claims allowance process in which creditors are given notice and
2 an opportunity to be heard. As the Court has observed, all of this furthers “the bankruptcy policy of
3 favoring a collective proceeding to work out a comprehensive solution to municipal insolvency.”

4 *City of Stockton*, 478 B.R. at 26.

5 13. Rule 9019 plays a critical role in that claims allowance process, as it permits the
6 Court to approve compromises and settlements that allow the judicial system and the administration
7 of a bankruptcy case to function more efficiently. *See Iridium*, 478 F.3d at 455 (noting that
8 settlements “help clear a path for the efficient administration of the bankruptcy estate”).³
9 Specifically, Rule 9019 preserves the sanctity of the claims allowance process by requiring notice
10 and an opportunity to be heard on, as well as judicial oversight over, any compromises or settlements
11 involving the allowance of disputed claims. Absent the requirement of notice and court approval,
12 the entire claims allowance process summarized above would be an empty shell, as a municipal
13 debtor could pay any and all disputed claims – whether or not listed, subject to a timely-filed proof
14 of claim, or otherwise – without even notifying creditors and before even proposing, much less
15 confirming, a plan of adjustment. Clearly this is not the import or purpose of the statute.

16 14. At the preliminary hearing on the 9019 Motion, the City’s counsel argued that
17 section 502 cannot provide any statutory authority for Rule 9019 at this time because no bar date has
18 been set. (November 20, 2012 Transcript at 48.) That argument proves too much. If the City were
19 right, it freely could settle disputed claims without notice or court approval until a bar date is set and
20 proofs of disputed claims are filed, at which time section 502 suddenly would spring to life. The
21 City cites nothing to support such a tortured and illogical reading of the statute.⁴

22
23 ³ Contrary to the City’s assertions, Rule 9019 is not limited, by its language or otherwise, to
24 implementing section 363 or any other particular section of the Bankruptcy Code. Rather,
25 Rule 9019 has a myriad of statutory bases, including section 502 (regarding allowance of claims)
26 and sections 943 and 1129 (regarding the payment on and treatment of claims). *See, e.g., In re*
Columbia Gas Sys., Case No. 91-803, 1995 Bankr. LEXIS 936 (Bankr. D. Del. June 16, 1995)
(approving Rule 9019 settlement premised on section 502).

27 ⁴ Moreover, the claim that is the subject of the 9019 Motion was listed as disputed by the City in
28 its List of Creditors. As noted above, section 944 of the Bankruptcy Code provides for disputed,
unliquidated and contingent claims to be discharged upon confirmation even in the absence of a
filed proof of claim. Creditors reasonably can expect disputed claims (like the claim at issue
here) will not share in recoveries from the City absent allowance by the Court on notice to all.

1 2. **Rule 9019 Does Not Conflict With Section 904.**

2 15. Rule 9019's requirement that the proposed settlement, and allowance, of disputed
3 prepetition claims be accompanied by notice, an opportunity to be heard, and judicial oversight also
4 does not conflict with section 904 of the Bankruptcy Code or run afoul of the strictures of the Tenth
5 Amendment.

6 16. Section 904 provides in relevant part that, absent the consent of a municipal debtor,
7 the court may not "interfere with . . . any of the property or revenues of the debtor." 11
8 U.S.C. § 904(2). Section 904 "assure[s] that the bankruptcy power not be used in municipal
9 insolvencies in a manner that oversteps delicate state-federal boundaries," *City of Stockton*, 478 B.R.
10 at 20, by prohibiting judicial oversight of or interference with the day-to-day operations of the
11 municipal debtor. *See* 6 COLLIER ON BANKRUPTCY ¶ 904.01[2] (Alan N. Resnick & Henry J.
12 Sommer, 16th ed. 2011). Legislative history indicates that section 904 is intended to "make[] clear
13 that the court may not interfere with the choices a municipality makes as to what services and
14 benefits it will provide to its inhabitants." *City of Stockton*, 478 B.R. at 19-20 (quoting H.R. Rep.
15 No. 95-595, at 398) (emphasis added).

16 17. In short, as a consequence of section 904, a bankruptcy court cannot dictate a
17 municipality's provision of services and benefits through control of its purse strings. The court's
18 authority, rather, is directed to matters involving adjustment of the debtor-creditor relationship – the
19 matters at "[t]he core of a chapter 9 case." *Id.* at 25. Unlike a decision not to pay retiree health
20 benefits during a bankruptcy case – properly the province of the municipal debtor – the resolution,
21 allowance and adjustment of a disputed prepetition claim (whether by litigation and judgment or
22 settlement) is not a governmental function – it is a bankruptcy function.⁵ As explained above, the
23 claims resolution process in fact is a core purpose of municipal bankruptcy, as the "especial purpose
24 of all bankruptcy legislation is to interfere with the relations between the parties concerned – to
25 change, modify or impair the obligation of their contracts." *Ashton v. Cameron County Water*

26
27 ⁵ Notably, the claim at issue in the 9019 Motion has nothing to do with the City's ongoing
28 provision of services or benefits. It is a claim that "allege[s] damages against the City for
 claimed violations of certain of [the claimant's] constitutional rights stemming from the
 defendants' alleged use of excessive force." 9019 Motion at 2.

1 *Improvement Dist.*, 298 U.S. 513, 530 (1936); *e.g.*, *City of Stockton*, 478 B.R. at 16 (“The goal of the
2 Bankruptcy Code is adjusting the debtor-creditor relationship.”).

3 18. The text of section 904 reinforces this point. Section 904 begins with the phrase
4 “[n]otwithstanding any power of the court” – it is a statutory limitation on the authority of the
5 court. It is not a limitation on the provisions of the Bankruptcy Code that Congress made applicable
6 in Chapter 9 cases. Had Congress intended section 904 to operate in that manner, the lead-in to the
7 statute would begin with “[n]otwithstanding any other provision of this title,” a formulation
8 specifically employed by Congress in many other sections of the Code. *See, e.g.*, 11 U.S.C.
9 §§ 521(j)(1); 524(l); 541(f); 753; 767; 782(a)(1); 1114(e)(1); 1326(d).

10 19. Where Congress chose to incorporate a provision of the Code into Chapter 9 –
11 including a provision (like section 502) that limits a debtor’s actions through the requirement of
12 judicial oversight and approval – Congress acted pursuant to its Constitutionally-delegated authority
13 under the Bankruptcy Clause. *See City of Stockton*, 478 B.R. at 20 (noting that section 904 prevents
14 the court from using other sources of inherent or equitable power to restrict the actions of a
15 municipality, not from applying and enforcing statutory provisions incorporated and made applicable
16 to Chapter 9). The enforcement of those applicable statutory provisions (including section 502) does
17 not offend the Tenth Amendment or state sovereignty. As the Court has already held, the
18 “municipality’s voluntary act of filing a chapter 9 case [means that] the municipality consents,
19 within the meaning of § 904, to interference by a federal court as to the Bankruptcy Code provisions
20 that apply in chapter 9 cases [and that] sovereign immunity is voluntarily abrogated to the extent
21 provided in § 106.” *Id.* at 22.

22 20. The resolution, treatment, and payment of contingent, disputed, unliquidated and/or
23 unscheduled prepetition claims are matters governed by sections of the Bankruptcy Code explicitly
24 incorporated into Chapter 9. By filing its Chapter 9 petition, the City consented to the Court’s
25 enforcement of those sections and voluntarily relinquished the unfettered ability to compromise and
26 pay claims without notice or approval of the Court. The City’s consent is further and specifically
27 evidenced by its voluntary act of seeking to compromise a disputed prepetition claim before
28

1 establishment of a bar date and outside of the plan process, rather than relying on the automatic stay
2 and resolving the claim through a noticed plan of adjustment.⁶

3 **3. The Structure Of Chapter 9 Demonstrates That Section 904**
4 **Does Not Override Applicable Provisions Of The Bankruptcy Code.**

5 21. Not all provisions of the Code apply in Chapter 9 cases. Section 103(f) provides that,
6 “[e]xcept as provided in section 901 of this title, only chapters 1 and 9 of this title apply in a case
7 under . . . chapter 9,” 11 U.S.C. § 103(f), and Congress made the specific determination not to apply
8 various statutory provisions that it believed might “encroach[] on state sovereignty.” *City of*
9 *Stockton*, 478 B.R. at 20 (citing failure to incorporate sections 363 and 1104 as examples).

10 22. Congress, however, did incorporate into Chapter 9 a myriad of statutory sections that
11 protect creditors and limit a municipal debtor’s use of its property and revenues during a Chapter 9
12 case, including: (a) section 365 (requiring notice and court approval prior to assumption or rejection
13 of an executory contract); (b) section 501 (permitting creditors to file proofs of claim, thereby
14 superseding claims listed by the debtor); (c) section 502 (permitting parties in interest to object to
15 claims, empowering the court to determine allowance of claims, authorizing the court to estimate
16 contingent or unliquidated claims, and requiring the court to disallow claims held by recipients of
17 voidable preferences); (d) section 503 (requiring notice and a hearing prior to allowance of
18 administrative expenses and prohibiting allowance and payment of “other transfers or obligations
19 that are outside the ordinary course of business and not justified by the facts and circumstances of
20 the case”); (e) section 510 (authorizing the court to equitably subordinate claims after notice and a
21 hearing); (f) section 549(a) (authorizing avoidance of unauthorized postpetition transfers); and
22 (g) section 1109 (permitting creditors to be heard on any “issue” in the bankruptcy case). To read
23 section 904’s reach as broadly as the City proposes here would be to render each of these provisions
24 meaningless.

25 23. Section 926 of the Bankruptcy Code is particularly instructive. In that provision,
26 Congress specifically authorized bankruptcy courts to appoint a trustee to pursue voidable transfers

27 ⁶ Section 904 is expressly qualified by the phrase “unless the debtor consents . . .” 11
28 U.S.C. § 904. By electing to settle a prepetition disputed claim prior to the bar date and outside
of a plan process, the City has consented to review of the compromise by the Court upon proper
notice to all interested parties.

1 if a municipal debtor refuses to do so, including commencement of an action to avoid unauthorized
2 postpetition transfers pursuant to section 549(a) of the Code. *See* 11 U.S.C. § 926(a). The
3 legislative history of section 926(a) makes it crystal clear that Congress in fact intended for the
4 bankruptcy courts to have full authority to enforce the incorporated provisions of the Code, even in
5 the face of resistance by the municipal debtor:

6 [The ability to appoint a trustee pursuant to section 926] is necessary
7 because a municipality might, by reason of political pressure or desire
8 for future good relations with a particular creditor or class of creditors,
9 make payments to such creditors in the days preceding the petition to
10 the detriment of all other creditors. No change in the elected officials
of such a city would automatically occur upon filing of the petition,
and it might be very awkward for those same officials to turn around
and demand the return of payments following the filing of the petition.
Hence, the need for a trustee for such purpose.

11 S. Rep. No. 95-989, at 68 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5795. The concern
12 expressed by Congress is no less implicated by postpetition transactions than by prepetition
13 transactions and, if “authorized” means nothing more than “authorized” by a municipal debtor,
14 transfers “authorized” by a municipality would not be subject to avoidance and a trustee would never
15 be appropriate or available – the opposite of what the statute provides. Section 926 thus makes clear
16 that section 904 does not empower a municipality to make postpetition transfers or compromises that
17 otherwise violate applicable provisions of the Code. *See In re N.Y. City Off-Track Betting Corp.*,
18 No. 09-17121(MG), 2011 Bankr. LEXIS 319, at *17 (Bankr. S.D.N.Y. Jan. 25, 2011) (The
19 “contention that section 904 prohibits a court from appointing a trustee without the consent of the
20 debtor renders section 926 mere surplusage.”).

21 24. Properly read, section 904 is an “anti-injunction statute.” *City of Stockton*, 478 B.R.
22 at 13. It is not, and is not intended to be, an overarching limitation on the enforcement of the core
23 provisions of the Bankruptcy Code that Congress expressly incorporated into Chapter 9. As a
24 consequence, nothing in section 904 should be read to limit the applicability of section 502 of the
25 Code – and the accompanying Rule 9019 – in Chapter 9 cases.

26 **C. The City’s Interpretation Of Section 904 Would Eviscerate The Plan Process.**

27 25. In furtherance of the core purpose of the municipal bankruptcy law, Congress
28 incorporated into Chapter 9 a specific, detailed set of parameters and requirements for the

1 confirmation of a plan of adjustment, including: (a) section 1123(a)(4) (requiring the same treatment
2 for all claims in the same class); (b) section 1125 (requiring “adequate information” regarding the
3 plan); (c) section 1129(a)(2) (requiring compliance with all applicable provisions of title 11);
4 (d) section 1129(a)(3) (requiring the debtor to propose the plan in good faith); (e) section 1129(b)(1)
5 (requiring that the plan not discriminate unfairly and be fair and equitable); (f) section 1142(b)
6 (authorizing the court to require the debtor to “perform any other act, including the satisfaction of
7 any lien, that is necessary for the consummation of the plan”); (g) section 943(b)(3) (requiring that
8 “all amounts to be paid by the debtor . . . for services or expenses in the case or incident to the plan
9 have been fully disclosed and are reasonable”); and (h) section 943(b)(7) (requiring that the plan be
10 in the best interests of creditors and be feasible).

11 26. Under the City’s interpretation of section 904, the Court is powerless to prevent the
12 City from resolving and making payments on disputed prepetition claims. If the City were correct,
13 municipal debtors would be free to make an end-run around each and every one of the confirmation
14 requirements noted above. The City, for example, could pay claims of favored creditors in full,
15 while proposing pennies-on-the-dollar recoveries to other creditors through a plan, thereby nullifying
16 the statutory requirement of equal treatment of similarly-situated claims and protection against unfair
17 discrimination. The City could deplete its coffers through selective pre-plan compromises, thereby
18 rendering the “best interests of creditors” test meaningless. The City even could lock up votes
19 before proposing a plan, much less receiving approval of a disclosure statement, making a mockery
20 of the Code’s rules respecting disclosure and solicitation.

21 27. As noted above, these are not mere hypothetical concerns. Through the MOU that it
22 recently signed with the Stockton Police Officers’ Association (SPOA) – for which the City
23 apparently has no intention to seek the approval of the Court, *see* Transcript of Hearing at 47:17-21,
24 48:1-2 (Nov. 20, 2012) [Dkt. No. 624] (“The City is on the cusp of settling the police union. The
25 police union has asserted a \$13 million claim on behalf of its members against the City on account of
26 the fiscal emergencies that the City declared. And as part of that settlement, we are settling those
27 claims. . . . I just don’t think you have the power in Chapter 9 to [adjudicate the merits of the
28

1 settlement], Judge.”) – the City already has taken a number of steps that contravene the statutory
2 process for allowance of claims and confirmation of a plan.

3 28. The MOU not only purports to allow the SPOA’s disputed claim, MOU § 23.2(a), it
4 also specifies exactly how that claim “shall be satisfied under the Plan by the City,” *id.* § 23.2(b).
5 Moreover, the MOU requires the City to pay a fee to certain SPOA members (in the form of paid
6 leave) for agreeing to the allowed amount of the SPOA claim, which essentially sets a minimum,
7 irrevocable floor on the treatment of the SPOA claim, regardless of whether it is ultimately allowed
8 by the Court. *Id.* §§ 23.2(b), (c) (providing for payment of the SPOA claim even “in the event that
9 the Plan is not confirmed and does not become effective” and the claim “shall not be allowed as
10 specified herein”). Finally, despite the fact that no plan has been filed, no disclosure statement
11 approved, and no ballots cast, the MOU requires the SPOA to support the City’s plan when filed and
12 to use best efforts to cause SPOA members “to vote to approve the Plan . . . and not to object to, or
13 otherwise commence any proceeding against, or take any other action opposing any of the terms of
14 the MOU, the Plan or any disclosure statement filed in connection with the Plan.” *Id.* § 23.4 (“At the
15 City’s request, such support may also include the execution by SPOA of an agreement to
16 recommend that its members vote in favor of the Plan.”).

17 29. The City’s cavalier disregard for the fundamental requirements of the Code illustrates
18 the dangerous ramifications of the declaratory relief sought in the 9019 Motion. Indeed, absent
19 Rule 9019, it is difficult to see how the Court otherwise could preserve its ability to assess, on a full
20 and complete record, the City’s good faith in proposing any plan of adjustment and compliance with
21 the confirmation requirements of sections 943 and 1129, including the fundamental requirements
22 that the plan be in the best interests of creditors and not discriminate unfairly. *See, e.g., Platinum*
23 *Capital, Inc. v. Sylmar Plaza, L.P. (In re Sylmar Plaza, L.P.)*, 314 F.3d 1070, 1074 (9th Cir. 2002)
24 (“The requisite good faith determination is based on the totality of the circumstances.”).

25 30. It also is impossible to draw a principled distinction between the City’s opposition to
26 the retirees’ previously-filed motion for relief from stay – to which the City objected on the ground
27 that the retirees’ claims properly were treated and resolved through the collective debt adjustment
28 mechanism of the bankruptcy process – with the City’s position in the 9019 Motion that it is free to

1 settle and pay disputed prepetition claims of its choosing and at its whim. In that prior context –
2 when the City desired to prevent payment to a disfavored group of creditors – the City argued that
3 relief from the stay was inappropriate because it would result in “determining the treatment of
4 prepetition debts outside the structure of a plan of adjustment and without the protections and
5 procedures provided to the City and other creditors by Bankruptcy Code § 943 and the various
6 provisions of Subchapter II of chapter 11 incorporated into chapter 9 by § 901.” City’s Response To
7 Plaintiffs’ Supplemental Brief [Dkt. No. 61], No. 12-02302, at 6-7 (emphasis added); *see id.* at 2
8 (“granting relief from the stay would effectively leave the City without the protections of chapter 9
9 [and] give Plaintiffs an unfair advantage over all the City’s other prepetition creditors”). Yet now,
10 when it wants to pay claims held by more favored creditors, the City urges that those very same
11 “protections and procedures provided to . . . other creditors” somehow do not apply.

12 31. Chapter 9 simply does not create the lopsided regime apparently envisioned by the
13 City, in which the City purportedly is free to pick and choose which debts to run through the
14 bankruptcy claims adjustment process and which to exempt from that process. If the claims of the
15 retirees are subject to the bankruptcy process (as the Court has now held), so too are the claims of
16 other prepetition creditors, regardless of whether the City desires to pay them outside of a plan.⁷ As
17 a result, and for all of these reasons, the City simply is incorrect in its assertion that Rule 9019 does
18 not apply in this case, and the 9019 Motion should be denied to the extent that the City seeks a
19 declaration to that effect.

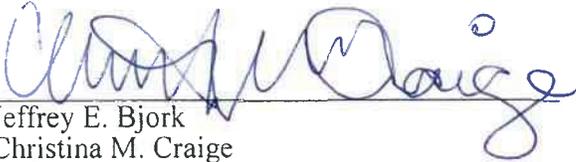
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26 ⁷ For the same reason, the claims of the *Price* plaintiffs, who filed a pending motion for relief from
27 stay to enforce their prepetition claims [Dkt. No. 626], also are subject to the bankruptcy debt
28 adjustment process. *See, e.g., In re County of Orange*, 179 B.R. 185, 191 (Bankr. C.D. Cal.
1995) (“The two main benefits of a Chapter 9 filing are (1) the breathing spell provided by the
automatic stay, and (2) the ability to adjust debts of claimants through the plan process. If the
automatic stay is to be lifted routinely to allow claimants to assert their claims in state court, a
municipality will not have the time, opportunity or ability to confirm a plan.”) (emphasis added).

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WHEREFORE, the Capital Markets Creditors respectfully request that this Court issue an Order (i) ruling that Bankruptcy Rule 9019 applies in Chapter 9 cases; and (ii) granting such other and further relief as is just and proper under the circumstances.

Dated: December 19, 2012

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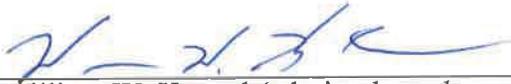
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