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11 **UNITED STATES BANKRUPTCY COURT**
12 **EASTERN DISTRICT OF CALIFORNIA**
13 **SACRAMENTO DIVISION**

14 In re
15 CITY OF STOCKTON, CALIFORNIA,
16 Debtor.

17 Case No. 12-32118-C-9
18 Chapter 9
19 Docket Control No. DM-1
20 Date: August 20, 2013
21 Time: 9:30 a.m.
22 Place: 501 I Street, Courtroom 35
23 Sacramento, CA 95814
24 Judge: The Honorable Christopher M. Klein

25 **MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF MOTION**
26 **FOR RELIEF FROM THE AUTOMATIC STAY BY PRESTON PIPELINES, INC.**

27 Preston Pipelines, Inc. (“PPI”) respectfully submits this Memorandum of Points and
28 Authorities in support of its Motion for Relief from the Automatic Stay (“Motion”) filed
concurrently herewith, and represents as follows:

29 **I. INTRODUCTION**

30 PPI moves for relief from the automatic stay under 11 U.S.C. §§ 362(d)(1) and 922(a) to
31 (i) file suit against debtor City of Stockton, California (the “City”) in San Joaquin County
32 Superior Court for breach of contract and other claims related to PPI’s construction of the Delta

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1 Water Supply Project Intake and Pump Station Facility (“Pump Station”), and (ii) once PPI’s
2 claims against the City (and other non-debtor parties) are fully liquidated, to recover on its claims
3 from funds in the City’s Delta Water Supply Project Account (“Water Project Account”), a
4 restricted use fund containing the proceeds of bonds issued to finance PPI’s construction of the
5 Pump Station, among other components of the City’s Delta Water Supply Project (“Water
6 Project”).
7

8 Simply put, PPI is not a run of the mill general unsecured creditor seeking to liquidate a
9 tort or employment claim against the City. Rather, PPI is a secured creditor whose claim must be
10 paid from pledged funds in a dedicated account that cannot be used to fund the City’s operating
11 expenses. Moreover, PPI is informed and believes that the City may access this same fund to pay
12 its legal fees and costs related to the Water Project. Accordingly, liquidation and recovery of
13 PPI’s claim will have no bearing on the City’s efforts to file and confirm a plan of adjustment.
14 Thus, for all the reasons discussed below, cause exists to grant PPI immediate relief from stay to
15 liquidate its claim against the City in state court, and then seek recovery from the restricted use
16 fund specifically created to pay its claim.
17

18 **II. FACTUAL BACKGROUND**

19 **A. City Council Approves the Water Project, to Be Funded Through Issuance of** 20 **Water Revenue Bonds.**

21 On November 8, 2005, Stockton City Council (“Council”) approved the Water Project, an
22 undertaking which included construction of a new intake and pump station facility to divert water
23 from the San Joaquin River through miles of underground pipeline to a new water treatment plant
24 providing 33 million gallons per day of treated, potable water. See Page K-3 to the City’s 2012-
25 2013 Proposed Annual Budget, attached as **Exhibit 1** to the Request for Judicial Notice (“RJN”)
26 in support of the Motion, filed herewith. To that end, the Council directed City staff to proceed
27 with the design, financing, and permitting for the Water Project. See Agenda Item 8.01 (Delta
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1 Water Supply Project Intake and Pump Station Facility Construction (Project No. M09110)) to
2 the September 9, 2009 Board of Directors Meeting Agenda of the Northeastern San Joaquin
3 County Groundwater Banking Authority (“Agenda Item 8.01”), RJN, **Exhibit 2**.

4 Pursuant to Council Resolution No. 09-0258, the City financed the Water Project by
5 issuing a series of Water Revenue Bonds with an aggregate principal amount not to exceed
6 \$260,000,000. RJN, **Exhibit 3**. Of particular note, the City issued 2009 Series A & B Revenue
7 Bonds, in the amount of \$173,125,000, which were used to fund the design and construction of
8 the first phase of the Water Project, as well as 2010 Revenue Bonds, Variable Rate, in the amount
9 of \$55,000,000, to provide financing for completion of the Water Project. See page M-3 to the
10 City’s 2012-2013 Proposed Budget, RJN, **Exhibit 1**.

11
12 The latter group of bonds, formally styled the \$55,000,000 Stockton Public Financing
13 Authority Variable Rate Demand Water Revenue Bonds, Series 2010A (Delta Water Supply
14 Project) (the “2010 Bonds”), were issued specifically to fund the Pump Station and certain other
15 designated components of the Water Project:
16

17 *Proceeds from the issuance of the Series 2010A Bonds will be used to construct*
18 *the Intake and Pump Station Facility*; acquire and install approximately 12 miles
19 of underground pipelines along Eight Mile Road; and constructing and equipping
20 a 30 mgd water treatment plant. Construction of these components of the Water
Project commenced in September 2009 and is expected to be completed in late
spring 2012.

21 (emphasis added). See Official Statement to 2010 Bonds at p. 8, RJN, **Exhibit 4**.

22 **B. City Solicits Bids, Awards Contract for Construction of Pump Station to PPI.**

23 In the spring of 2009, the City solicited prime contractors for construction of the Pump
24 Station, fielding responses from some 20 contractors. See Agenda Item 8.01, RJN, **Exhibit 2**. A
25 selection committee comprised of City staff and project consultants, among others, vetted the
26 responses submitted and narrowed the pool of contractors to PPI and a few other selected
27 contractors, who in turn submitted sealed bids for the Pump Station project. Id. In Council
28

1 Resolution No. 09-0293, passed August 25, 2009, the City accepted PPI’s bid, in the amount of
2 \$16,156,000, and awarded PPI the contract for construction of the Pump Station. See, RJN,
3 **Exhibit 5**.

4 **C. City Directs Payment to PPI from Bond Proceeds.**

5 Council Resolution No. 09-0293, by its terms, directs payment to PPI from the Water
6 Project Account:

7
8 The City Manager is hereby authorized to transfer and appropriate the necessary
9 bond funds as approved by Resolutions 09-0258 and PFA 09-01 by the Stockton
10 City Council and Stockton Public Financing Authority on July 28, 2009 to/from
11 the Delta Water Supply Project Account (399-9922-670) and to make all necessary
12 entries required to complete the intent of this action.

13 RJN, **Exhibit 5**.

14 Agenda Item 8.01, approved and signed off by City Manager J. Gordon Palmer, Jr.,
15 likewise provides that PPI’s contract will be funded with bond proceeds from the Water Project
16 Account:

17 On July 28, 2009 by Resolutions 09-0258 and PFA 09-01, the Stockton City
18 Council and Stockton Public Financing Authority approved the issuance and sale
19 of water revenue bonds in an amount not to exceed \$260 million to fund the Delta
20 Water Supply Project (399-9922-670). *The Preston Pipelines contract in the
21 amount of \$16,156,000 will be funded with these proceeds.*

22 RJN, **Exhibit 2** (emphasis added).

23 **D. City and PPI Enter into Contract for Construction of Pump Station; City
24 Breaches Contract, Causing PPI over \$4.6 Million in Damages.**

25 On August 25, 2009, in accordance with Resolution No. 09-0293, the City and PPI entered
26 into a Construction Contract (“Contract”) for construction of the Pump Station. See Exhibit A to
27 the Declaration of Ron Bianchini (“Bianchini Declaration”), filed herewith. The Contract
28 provides for payment in the amount of \$16,156,000, before adjustments for change orders.

Among other terms, the Contract required the City to issue change orders when PPI
performed extra work, encountered conditions that differed from those shown in the contract

1 documents or that reasonably could have been anticipated, or when PPI incurred costs which
2 otherwise were the responsibility of the City. To that end, during PPI's performance the amount
3 of the Contract was adjusted by written change orders totaling approximately \$423,916.59.

4 In addition to the work and costs specified in the change orders, PPI performed extra
5 work, and incurred related costs, for which it is entitled to change orders under the Contract. This
6 extra work was necessitated by deficiencies in the City's plans, designs, information, and
7 specifications for the Pump Station, as well as by differing site conditions and changes in the
8 project schedule for the Pump Station. Accounting for the extra work and costs for which the
9 City should have issued change orders but did not, PPI is entitled to an estimated \$1,178,008.80,
10 inclusive of amounts owed to PPI for its own work, as well as for labor, equipment, materials, and
11 services furnished through PPI by subcontractors and suppliers, together with an additional
12 \$1,255,392 for delay, inefficiencies, escalation, and similar deficiencies.

13 In addition to the above damages, the City also failed to make progress payments under
14 the Contract that are undisputed, totaling not less than \$320,000, and failed to allow retention
15 totaling not less than \$1,657,000 to be released from escrow. Thus, in total, PPI has suffered
16 damages in the amount of approximately \$4,679,454, as detailed in PPI's draft Complaint for
17 Breach of Contract, Declaratory Relief, Interference with Contract, Indemnity and Contribution
18 ("Draft Complaint"), attached as **Exhibit B** to the Bianchini Declaration.¹

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22 **E. The Water Project Account Contains Restricted Funds that Cannot Be Used
to Fund the City's Operating Expenses.**

23 The Water Project Account contains restricted use funds that must be used to fund the
24 Water Project, including all outstanding obligations, debts, and liabilities related to construction
25 of the Pump Station. Accordingly, the damages PPI has sustained in connection with the Contract

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27 ¹ Carollo Engineers, Inc. a Delaware corporation acting as construction manager on behalf of the City, is also a
28 named defendant in the Draft Complaint.

1 and construction of the Pump Station, as prayed for in the Draft Complaint, must be paid from the
2 Water Project Account.

3 Moreover, since it is a restricted use fund, the Water Project Account cannot be used to
4 fund the City's general operating expenses. As the City confirmed in its News Release dated
5 June 26, 2012, "The majority of the City's budget is not impacted by the City's fiscal crisis. *The*
6 *total budget of \$521 million includes \$366 million in restricted funds, which cannot be used to*
7 *resolve the General Fund crisis.*" (emphasis added) RJN, **Exhibit 6**.

9 **III. DISCUSSION**

10 PPI moves for relief from stay for "cause" under 11 U.S.C. §§ 362(d)(1) and 922(a) to (i)
11 file suit against the City in San Joaquin County Superior Court for breach of contract and other
12 claims related to PPI's construction of the Pump Station, and (ii) once PPI's claims against the
13 City (and other non-debtor parties) are fully liquidated, to recover on its claims from the Water
14 Project Account.² Section 362(d)(1) provides that on request of a party in interest and after notice
15 and a hearing, a court shall grant relief from stay for "cause." "Cause" for relief from stay under
16 section 362(d)(1) is determined on a case by case basis. In re Kronemyer, 405 B.R. 915, 921 (9th
17 Cir. BAP 2009).

18
19 Section 922(a), in turn, provides that a petition filed under chapter 9 "operates as a stay, in
20 addition to the stay provided by section 362 ... applicable to all entities, of – (1) the
21 commencement or continuation, including the issuance or employment of process, of a judicial,
22 administrative, or other action or proceeding against an officer or inhabitant of the debtor that
23 seeks to enforce a claim against the debtor...." Moreover, "[t]he procedure and standards for
24

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26 _____
27 ² PPI notes that the application of pledged "special revenues," as defined in section 902(2), is not stayed by sections
28 362(d) and 922(a). See 11 U.S.C. § 922(d). PPI reserves all rights to argue that funds in the Water Project Account
constitute pledged special revenues, application of which is exempted from the automatic stays of sections 362(d) and
922(a).

1 obtaining relief from the § 922(a) automatic stay are nominally identical to those for obtaining
2 relief from the § 362 automatic stay.” In re City of Stockton, 484 B.R. 372, 376 (Bankr. E.D. Cal.
3 2012).³

4 As this Court has explained, in determining whether “cause” exists to terminate the
5 automatic stay to allow litigation against a municipality to proceed, “an important criterion is the
6 effect of potential stay relief on the municipality’s effort to reorganize through a plan of
7 adjustment.” Stockton, 484 B.R. at 377. Moreover, under section 362(g)(2), it is the debtor
8 municipality’s burden to demonstrate lack of cause. Id.

9 Here, granting PPI relief from stay will not impact the City’s finances or otherwise disrupt
10 its efforts to formulate and confirm a plan of adjustment. As explained, PPI seeks to recover from
11 the Water Project Account, which contains restricted use funds earmarked by the City to pay
12 PPI’s fees and expenses related to the Contract and construction of the Pump Station. These
13 funds cannot be used to fund either the City’s operating expenses or its plan of adjustment, and
14 will have no impact on the distribution to other creditors in this case.

15 In addition, PPI is informed and believes that the City may access funds in the Water
16 Project Account to the extent necessary to pay litigation costs related to the Water Project. As
17 such, the state court action PPI intends to file will not burden the City’s finances. Moreover,
18 there is no danger that granting PPI relief from stay will somehow “open the floodgates” to other
19 claimants, since PPI is a uniquely situated secured creditor whose litigation will in no way impede
20 the City’s efforts to confirm a plan.

21 The City and its residents have benefited immensely from PPI’s work in constructing the
22 Pump Station, which is instrumental in providing the City an additional 33 million gallons per day
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27 ³ PPI seeks relief from stay under section 922(a) in the event it becomes necessary to name an officer or inhabitant of
28 the Debtor as a party to its intended litigation, or if a non-party to the litigation otherwise asserts that it is protected by
the stay of section 922(a).

1 of potable water. There is no good reason to delay PPI in seeking redress for all amounts owed to
2 it, and then accessing the pledged funds specifically set aside to compensate it for its work. For
3 all the reasons described above, cause exists to grant PPI relief from stay.

4 **IV. CONCLUSION**

5 For all the foregoing and proper reasons, the Court should grant the Motion and terminate
6 the automatic stays of sections 362 and 922(a) to permit PPI to (i) file suit against the City in San
7 Joaquin County Superior Court for breach of contract and other claims related to PPI's
8 construction of the Pump Station, and (ii) recover on its claims from the Water Project Account.
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10 Dated: July 18, 2013

DUANE MORRIS LLP

11 By: /s/ Ron M. Oliner (152373)
12 **RON M. OLINER**
13 Attorneys for Preston Pipelines, Inc.
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