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

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

Case No. 2012-32118

D.C. No. OHS-15

Chapter 9

16 **CALPERS' RESPONSE TO FRANKLIN'S**
 17 **REPLY REGARDING CONFIRMATION**
 18 **OF THE CITY OF STOCKTON'S FIRST**
 19 **AMENDED PLAN OF ADJUSTMENT**

Date: May 12, 2014

Time: 9:30 a.m.

Place: Robert T. Matsui U.S. Courthouse,
 501 I Street
 Department C, Fl. 6, Courtroom 35
 Sacramento, CA 95814

Judge: Hon. Christopher M. Klein

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1 The California Public Employees' Retirement System ("CalPERS" or the "System") files this
 2 response to Franklin's Reply to the CalPERS Brief Regarding Pension Liabilities [Dkt. 1397]
 3 ("Franklin Reply").¹

4 The Franklin "Reply" is not really a reply. Franklin purports to reply to CalPERS' Response
 5 to Franklin's Objections to Confirmation of the City's Plan [Dkt. 1308] (the "CalPERS Response").
 6 But rather than address the issues raised in the CalPERS response, the Franklin Reply attempts to
 7 open argument on numerous complex constitutional and statutory interpretation issues that are not
 8 relevant to the Plan of Adjustment proposed by Stockton. The Franklin Reply encourages the Court
 9 to ignore well-settled principles of constitutional avoidance and well-settled prohibitions on the
 10 issuance of advisory opinions. Franklin's arguments -- superficially presented -- about a hypothetical
 11 plan that Franklin says the City could have proposed, are not properly before the Court. The only
 12 issue ripe for decision in considering confirmation of the City's Plan is whether the Plan that has been
 13 proposed by the City should be confirmed.

14 **I. ARGUMENT**

15 **A. Franklin's Arguments Do Not Address Any Issue Before the Court.**

16 The CalPERS Response addressed two objections raised by Franklin in its Summary
 17 Objection to Confirmation of the City's First Amended Plan of Adjustment [Dkt. 1273] (the
 18 "Summary Objection"). Franklin's arguments do not relate to either of those issues.

19 First, Franklin objected that the City's Plan did not satisfy the "best interests" test because,
 20 among other things, "Franklin Could Recover Substantially More Outside Of Bankruptcy," after
 21 some unspecified "confron[tation]" of the City's pension liabilities. *See* Summary Objection [Dkt.
 22 1273], at 23, 25-30. The CalPERS Response demonstrated that, under California law, benefits
 23 provided under the CalPERS Pension Plan could be reduced only by terminating the Pension Plan,

24
 25 ¹"Franklin" refers collectively to Franklin High Yield Tax-Free Income Fund and Franklin California
 26 High Yield Municipal Fund. There is some question as to whether Franklin's "Reply" is properly
 27 presented under the scheduling order issued by the Court [Dkt. 1224], as modified by Dkt. 1242.
 28 Franklin takes the position that its "Reply" constitutes a further objection to confirmation of the
 City's plan under paragraph 53(b) of the scheduling order, as modified by paragraph 7 of Dkt. 1242,
 and if so construed, CalPERS is entitled to respond to that objection pursuant to paragraph 54(c) of
 the scheduling order, as modified by paragraph 7 of Dkt. 1242.

1 and termination would trigger an obligation of more than \$1.6 billion secured by a senior lien on all
 2 of the City's property. *See* CalPERS Response at 14. There can be no dispute that "outside of
 3 bankruptcy," the statutory lien under the PERL would apply and the termination liability would be
 4 secured. Any argument premised on what Franklin could recover "outside of bankruptcy" following
 5 a termination of the CalPERS Pension Plan must recognize both the impact of the termination
 6 liability and the costs of an effective, alternative benefits package. The Franklin Reply does not
 7 address these points, but rather argues about how a termination may be treated in a hypothetical
 8 bankruptcy.

9 The City has determined that it should continue to offer CalPERS pension benefits to its
 10 employees and considers these benefits critical to attracting and retaining employees, especially its
 11 beleaguered police force. Franklin's arguments about what might happen should the City take
 12 another direction would ensnare the Court in unnecessary speculation premised upon termination of
 13 the CalPERS relationship. For example, Franklin invites the Court to speculate about whether the
 14 termination will harm other creditors and whether the City could possibly find some less expensive
 15 benefits package that will allow it to compete with the myriad of other municipalities that continue to
 16 offer CalPERS benefits.² The Court should resist Franklin's invitation because fanciful speculation
 17 is not the province of the Court. The Court is instead engaged in the adjudication of the serious
 18 issues regarding confirmation of the City's present and real Plan.

19 Franklin's speculation about the treatment of a hypothetical termination claim in a
 20 hypothetical bankruptcy case demonstrates the imprudence of its approach. After mischaracterizing
 21 the termination obligation as a "penalty,"³ Franklin rushes into irrelevant and speculative assertions

22
 23 ² Notably, as the City points out, Franklin has not offered any viable alternative to CalPERS that
 24 would be less costly and would not have an adverse impact upon the City. *See* City's Supplemental
 Memorandum of Law in Support of Confirmation of First Amended Plan for the Adjustment of Debts
 of City of Stockton, California [Dkt. 1309] at 38.

25 ³ As explained at pages 9-10 of the CalPERS Response, the Termination Payment is the actual
 26 amount needed to fund the plans in the event of termination. The Termination Payment is not a
 27 "penalty" and there is no penalty component in the calculation. Specifically, in the event of
 28 termination, the PERL requires the terminated agency, such as a city, to make a payment to CalPERS
 in an amount determined by the CalPERS Board (based on actuarial calculations) to be sufficient to
 ensure payment of all pension benefits of the terminated agency's employees accrued through the
 termination date. Cal. Gov. Code § 20577; Direct Testimony Declaration of David Lameroux in

1 about whether the full amount of the termination payment would be an allowed claim in bankruptcy
 2 and whether the lien would be recognized in bankruptcy. Franklin Reply at 9. However, the claims
 3 allowance or disallowance in bankruptcy of the termination payment and the viability in bankruptcy
 4 of the statutory lien are not issues before the Court given the City has made it abundantly clear it has
 5 no intention of impairing CalPERS. The Court should reject Franklin's attempt to lure the Court into
 6 issuing an advisory opinion addressing these purely hypothetical considerations.⁴

7 The second Franklin objection addressed in the CalPERS Response was Franklin's "good
 8 faith" argument under 11 U.S.C. § 1129(a)(3). CalPERS argued -- and the Franklin Reply does not
 9 dispute -- that the good faith of a proposed plan is assessed by considering that plan, and not by
 10 weighing the claimed alternative benefits of an imprecise, hypothetical plan that a dissenting party
 11 seeks to impose upon the debtor, other parties in interest and the Court. CalPERS Response at 15-20.
 12 Instead, Franklin seizes on a three-word introductory clause in the CalPERS Response ("Franklin is
 13 wrong, but the Court need and should not decide that question.") to justify eight pages of superficial
 14 argument about difficult constitutional and statutory issues that would be implicated in a hypothetical
 15 case if the City concluded it did not want to continue offering CalPERS pension benefits. Because
 16 the City does not seek to modify or terminate the CalPERS Pension Plan, the legality of any such
 17 attempt is not an issue that the Court should address.

18 **B. The Court Should Not Rule on the Issues Raised in the Franklin Reply.**

19 Pursuant to 11 U.S.C. § 943(b)(7), the City must demonstrate that its Plan is feasible, taking
 20 into account the projected costs of providing services, including pension costs. Franklin and others
 21 supporting its agenda may have ideological objectives for seeking an opinion from the Court
 22 regarding whether pension obligations can be impaired in chapter 9, but vindication of their views
 23 regarding municipal pension "reform" is not a justification for allowing Franklin to impede the

24
 25 Support of CalPERS' Response to Franklin's Objection to Confirmation of the City of Stockton's
 First Amended Plan of Adjustment, ¶ 38-44.

26 ⁴ Of course, how Franklin and other creditors would fare outside bankruptcy is relevant to the best
 27 interests test, and the size and characterization of a CalPERS termination claim is relevant to that
 28 analysis. But that analysis is completely different than a determination of how CalPERS' claims
 might fare under a hypothetical termination in bankruptcy.

1 reorganization efforts of the City of Stockton. The City’s proof of the feasibility of its Plan stands on
2 its merits and cannot be obfuscated by politically motivated hyperbole and speculation.

3 “Our role is neither to issue advisory opinions nor to declare rights in hypothetical cases, but
4 to adjudicate live cases or controversies consistent with the powers granted the judiciary in Article III
5 of the Constitution.” *Thomas v. Anchorage Equal Rights Comm’n*, 220 F.3d 1134, 1138 (9th Cir.
6 2000) (en banc). The ripeness doctrine “is designed to ‘prevent the courts, through avoidance of
7 premature adjudication, from entangling themselves in abstract disagreements.’” *Id.* (quoting *Abbot*
8 *Laboratories v. Gardner*, 387 U.S. 136, 148 (1967), *abrogated on statutory grounds*, *Califano v.*
9 *Sanders*, 430 U.S. 99, 105 (1977)). Relying on “a prophecy as to future conditions” to “invoke[] the
10 judicial power not to decide an existing controversy, but to establish a rule for controlling predicted
11 future conduct” contravenes an “elementary principle” of federal judicial power. *United States v.*
12 *Hamburg-Amerikanische Packet-Fahrt-Actien Gesellschaft*, 239 U.S. 466, 475 (1916). “The court is
13 not empowered to decide ... abstract propositions, or to declare, for the government of future cases,
14 principles or rules of law which cannot affect the result as to the thing in issue in the case before it.”
15 *California v. San Pablo & Tulare R.R. Co.*, 149 U.S. 308, 314 (1893).

16 This imperative to avoid deciding unnecessary issues is heightened here. As CalPERS noted
17 in the CalPERS Response, because CalPERS is an arm of the State of California, the question of
18 whether the City’s obligations to CalPERS can or cannot be impaired in a chapter 9 case involves
19 complex and exacting statutory and constitutional questions involving the application of 11 U.S.C.
20 § 903 and the Tenth Amendment. Federal Courts are duty-bound to refrain from deciding
21 constitutional questions if they are unnecessary to the issues before the Court or if the case can be
22 decided on non-constitutional grounds. *See, e.g., Camreta v. Greene*, 131 S. Ct. 2020, 2031 (2011)
23 (“[A] ‘longstanding principle of judicial restraint requires that courts avoid reaching constitutional
24 questions in advance of the necessity of deciding them.’”) (quoting *Lyng v. N.W. Indian Cemetery*
25 *Protective Ass’n.*, 485 U.S. 439, 445 (1988)); *see also Ashwander v. TVA*, 297 U.S. 288, 346-47
26 (1936) (Brandeis, J., concurring); *cf. Clark v. Martinez*, 543 U.S. 371, 380-81 (2005) (explaining
27 doctrine of constitutional avoidance in interpreting statutes and noting that construction that avoids
28 constitutional issues should prevail over one that raise constitutional issues). Thus, the Court should

1 exercise judicial restraint and avoid deciding these questions because they raise issues of the highest
 2 constitutional magnitude which go to the very structure of Our Federalism (*i.e.*, the relationship
 3 between the Federal Government and the Sovereign States).

4 Franklin's breezy treatment of these serious issues is flawed on a number of grounds.
 5 CalPERS does not here attempt to enumerate all of the flaws in the Franklin Reply, but notes the
 6 following examples:

- 7 • The constitutional issue in *Ashton v. Cameron Co. Water Improvement District No. 1*, 298
 8 U.S. 513 (1936), was not that the municipality filed "over the objection of the state" (Franklin
 9 Brief at 3). *Ashton* involved the bankruptcy of a Texas water improvement district. Texas
 10 had expressly allowed its subdivisions to file under the then-new municipal bankruptcy act,
 11 *id.* at 527, and fundamental concerns about the Constitutional role of the States motivated the
 Supreme Court's ruling that the municipal bankruptcy act was unconstitutional. *Id.* at 531
 ("Neither consent nor submission by the states can enlarge the powers of Congress The
 sovereignty of the state essential to its proper functioning under the Federal Constitution
 cannot be surrendered; it cannot be taken away by any form of legislation.").
- 12 • State "consent" only to the filing of a municipal case was not the key to *United States v.*
 13 *Bekins*, 304 U.S. 27 (1938) (Franklin Reply at 3-4). In approving the recently amended
 14 municipal bankruptcy legislation, the Supreme Court noted, among other things, that "The
 15 State retains control of its fiscal affairs. The bankruptcy power is exercised ... only in a case
 16 where the action of the taxing agency in carrying out a plan of composition approved by the
 17 bankruptcy court is authorized by state law." *Id.* at 51 (emphasis added). (The analogous
 provision of Chapter 9 - not mentioned by Franklin - precludes confirmation if action
 necessary to carry out the plan is "forbidden by law." *See* 11 U.S.C. § 943(4)). In fact,
Bekins only addressed the facial validity of the law in question, leaving for another day any
 number of as-applied challenges that could be raised. *Bekins* at 45 ("They present the
 question of the constitutional validity of the Act[.]").
- 18 • Maintaining State power over municipal debtors does not contravene the Constitution's
 19 requirement for "uniform" bankruptcy law (Franklin Reply at 4). To the contrary, the
 20 uniformity clause "is an affirmative limit or restriction on Congress's power, not a limitation
 on the states." *In re Applebaum*, 422 B.R. 684, 692 (9th Cir. BAP 2009).
- 21 • The mere "gatekeeper" interpretation of section 903 in *In re Vallejo* (Franklin Reply at 4-6)
 22 ignores Congressional intent and makes superfluous either section 903 or section 109(c)(2).
 23 *See, e.g.*, H.R. Rep. No. 94-686, at 19, *reprinted in* 1976 U.S.C.C.A.N. 539, 557 ("Any State
 24 law that governs municipalities or regulates the way in which they may conduct their affairs
 controls in all cases. Likewise, any State agency that has been given control over any of the
 affairs of a municipality will continue to control the municipality in the same way, in spite of
 a Chapter IX petition.")(regarding predecessor to section 903).
- 25 • Franklin loosely refers to preemption (Franklin Reply at 2, 5), but ignores the well-recognized
 26 differences among express, field and conflict preemption. *Arizona v. United States*, 132 S. Ct.
 27 2492, 2500-01 (2012). No "express" language of chapter 9 preempts the PERL, indeed,
 28 section 903 says the exact opposite; likewise, there is no bankruptcy "field" preemption.
Midlantic Nat'l Bank v. New Jersey, 474 U.S. 494, 505 (1986); *In re Miles*, 430 F.3d 1083,
 1092 (9th Cir. 2005). The remaining possibility, conflict preemption, occurs only when
 "compliance with both federal and state regulations is a physical impossibility" or "in those
 instances where the challenged law stands as an obstacle to the accomplishment and execution

of the full objectives and purposes of Congress.” *Arizona*, 132 S. Ct. at 2501. Determining congressional purpose in a preemption analysis requires a careful “look to the statute’s language, structure, subject matter, context, and history” *Pacific Gas & Electric Co. v. California*, 350 F.3d 932, 943 (9th Cir. 2003) (quoting *Almendarez–Torres v. United States*, 523 U.S. 224, 228 (1998)). Thus, a broad invocation of the generic concept of “preemption” does nothing to further the analysis.

For the Court to make an informed decision on the issues touched upon in the Franklin Reply, it would have to undertake a far more searching and nuanced analysis than that suggested by Franklin. Accordingly, if the Court does conclude, after the presentation of evidence at the confirmation hearing, that resolving the issues before it requires consideration of the Constitutional or fundamental statutory issues governing California’s ability to define the relationship between it and one of its creatures (the City), CalPERS respectfully requests that the Court direct the relevant parties to provide post-trial briefing, where those weighty issues can be given the full attention that they warrant. At this point, however, the Court should not be drawn into this hypothetical dispute given the gravity of the constitutional and statutory issues it presents.

II. CONCLUSION

For the foregoing reasons, the Court should avoid addressing the issues presented in the Franklin Reply. Franklin’s objections to the Plan based on the City’s decision to continue its relationship with CalPERS should be overruled.

Respectfully submitted,

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