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MARC A. LEVINSON (STATE BAR NO. 57613)
malevinson@orrick.com
NORMAN C. HILE (STATE BAR NO. 57299)
nhile@orrick.com
PATRICK B. BOCASH (STATE BAR NO. 262763)
pbocash@orrick.com
ORRICK, HERRINGTON & SUTCLIFFE LLP
400 Capitol Mall, Suite 3000
Sacramento, California 95814-4497
Telephone: +1-916-447-9200
Facsimile: +1-916-329-4900

ROBERT M. LOEB (Admitted pro hac vice)
(District of Columbia Bar No. 997838)
rloeb@orrick.com
ORRICK, HERRINGTON & SUTCLIFFE LLP
Columbia Center
1152 15th Street
Washington, D.C. 20005
Telephone: +1-202-339-8475
Facsimile: +1-202-339-8500

Attorneys for Debtor
City of Stockton

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re:

CITY OF STOCKTON, CALIFORNIA,

Debtor.

Case No. 2012-32118

D.C. No. JD-2

Chapter 9

CITY OF STOCKTON'S OPPOSITION TO FRANKLIN'S MOTION TO ALTER AND AMEND FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING ALLOWED AMOUNT OF RETIREE HEALTH BENEFIT CLAIMS

Date: December 10, 2014
Time: 11:00 a.m.
Dept: C, Courtroom 35
Judge: Hon. Christopher M. Klein

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The Court ruled on October 30, 2014, that the Allowed Amount of the Retiree Health Benefit Claims is approximately $545,000,000.[1] On November 12, 2014, pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), Franklin filed a Motion to Alter and Amend Findings of Fact and Conclusions of Law Regarding Allowed Amount of Retiree Health Benefit Claims [Dkt. No. 1779] (the "Motion").[2] For the reasons set forth below, the Motion should be denied.

I. PRELIMINARY STATEMENT AND BACKGROUND

The Court correctly determined that the amount of the Retiree Health Benefit Claims is $545 million. The Retiree Health Benefit Claims were calculated by The Segal Company, a company with unquestioned expertise in this area.[3] The result was the $545 million in aggregate claims included in the Plan. Franklin scoffs at the amount of the allowed claims for health benefits as though the City simply conjured it from thin air.[4] To the contrary, it is the product of a careful analysis by the actuaries at The Segal Company of the amount the City would have to pay in health benefits, calculated as of the date of the filing of its bankruptcy petition. The City has never argued that the $545 million amount reflected the present value of the Retiree Health Benefit Claims and did not introduce any evidence of a discount rate.

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[1] Transcript of confirmation hearing, Oct. 30, 2014, at 47:22 and 54:5. Any capitalized term used but not defined herein shall have the meaning ascribed to it in the First Amended Plan for the Adjustment of Debts of City of Stockton, California, As Modified (August 8, 2014) (the "**Plan**"). Dkt. No. 1645. Unless otherwise noted, all references to a section are to a section of title 11 of the United States Code (the "**Bankruptcy Code**").

[2] Federal Rule of Civil Procedure 52(b), which is applicable to bankruptcy cases under Bankruptcy Rules 7052 and 9014, provides that "[o]n a party's motion . . . the court may amend its findings—or make additional findings—and may amend the judgment accordingly." Fed. R. Civ. P. 52(b). The primary purpose of a Rule 52(b) motion is "to correct findings of fact which are central to the ultimate decision; the Rule is not intended to serve as a vehicle for a rehearing." *Davis v. Mathews*, 450 F. Supp. 308, 318 (E.D. Cal. 1978). Further, a party "may not use a Rule 52(b) motion to introduce any new facts or legal theories that were available to them at trial, [nor] re-litigate facts and legal theories that have previously been rejected by the court." *ATS Prods. v. Ghiorso*, 2012 U.S. Dist. LEXIS 43117 at *3-4 (N.D. Cal. 2012) (citations omitted). At the October 30, 2014, hearing, the Court stated that Franklin could bring a Rule 52(b) motion on the issue of whether the Retiree Health Benefit Claims must be discounted to present value under the Bankruptcy Code, and Franklin subsequently filed the Motion.

[3] *See* Trial Ex. No. 2042 ("Retiree Health Benefit Cost Analysis Explanation," prepared by the City for distribution to Retiree Health Benefit Claimants by the Retirees Committee).

[4] Franklin appears to suggest that, even apart from the present value issue, the City's calculation of claims for retiree health benefits "vastly overstates" the actual amounts of the claims. Its argument is all rhetoric—citing nothing that would suggest that the numbers it underlines and calls "unbelievable" are anything but sound. In any event, Franklin's drive-by argument appears not to be an actual argument, but simply another way of suggesting that the City is involved in a sinister scheme to inflate retiree health benefit costs to deprive of Franklin of another penny on the dollar.

Franklin argues that the claim amount should be discounted to present value which would result in each Retiree having a smaller claim amount, but Franklin having a greater share of payments to Class 12 unsecured creditors. Its argument, if successful, would result in all manner of claims in all bankruptcy cases being discounted to present value, which is clearly not a prevailing practice and, more importantly, is not required by the Bankruptcy Code.

In this Opposition, the City explains why the express language of section 502(b) does not require discounting claims to present value, why the authorities on which Franklin relies are inapposite, and why the one Circuit Court case to carefully consider the question concluded that discounting to present value is not required.

II. ARGUMENT

Because Franklin has reargued the previously-cited cases interpreting Bankruptcy Code §502(b), the following discussion re-states the City's view of the law and explains why the Court correctly ruled on October 30th that the Retiree Health Benefit Claims should be allowed at $545 million and should not be discounted to present value.

A. Section 502(b) Requires The Court To Determine The *Amount* Of A Claim, Rather Than The *Value* Of A Claim.

The Bankruptcy Code uses specific language where it requires claims or other property to be discounted to net present value. The ten sections of the Bankruptcy Code that require a present value calculation ask courts to "determine the ***value***" as of a specific date. 11 U.S.C. §§ 1129(a)(7), (9), (15); 1129(b)(2); 1173(a)(2); 1225(a)(4), (5); 1325(a)(4), (5); 1328(b)(2). In sharp contrast, section 502(b) requires the court to determine the "***amount***" of a claim. That section 502(b) uses different language is no accident and should not be ignored. *In re Oakwood Homes Corp.*, 449 F.3d 588, 597 (3d Cir. 2006) ("'amount' does not mean the same thing as 'value' . . .where the Bankruptcy Code intends a court to discount something to present value, the Code clearly uses the term 'value, as of' a certain date."). The use by Congress of differing terminology in these two contexts makes clear that it knew how to specify under what circumstances discounting to present value was necessary, and that it intentionally chose not to include that requirement under section 502(b).

Moreover, this interpretation is consistent with the overarching principle that the Bankruptcy Code accelerates the maturity of future obligations to the petition date. *In re Oakwood Homes*, 449 F. 3d at 602 ("[t]he general rule of both the Bankruptcy Code and § 502(b) . . . is acceleration to the date of filing of the bankruptcy petition . . . not the *lack* of acceleration") (emphasis in original). *See also* H.R. Rep. No. 95-595, at 353-54 (1977) (section 502(b) stands for the principle that "bankruptcy operates as the acceleration of the principal amount of all claims against the debtor").

B. The Exceptions to Section 502(b) Do Not Include Discounting Claims To Present Value.

Section 502(b) contains a list of specific exceptions limiting the allowance of some claims (for instance, a cap on landlord claims and disallowance of unmatured interest). Conspicuously absent from these exceptions is any mention of a disallowance of a claim to the extent the claim amount exceeds its discounted present value. Interpreting the Bankruptcy Code to require the discounting of claims to present value, as Franklin asks the Court to do, would require reading an additional, non-existent exception into section 502(b) and would render the other exceptions superfluous. *In re Gretag Imaging, Inc.*, 485 B.R. 39, 46 (Bankr. D. Mass. 2013) ("Section 502(b) contains a series of exceptions . . . [i]f 502(b) required all claims to be present-valued, there would be no need for these exceptions."). *Cf. In re Oakwood Homes*, 449 F.3d at 593 (interpreting section 502(b) as generally requiring present value discounting of all claims would result in impermissible *double* discount of claims for which section 502(b)(2) disallows unmatured interest).

Section 502(b)'s limitations on landlord lease rejection claims, employment contract rejection damages, and unmatured interest represent the specific circumstances under which Congress deemed a departure from the normal rule of acceleration to be appropriate. As a result, for all other claims under section 502(b) (including the Retiree Health Benefit Claims), "[t]he default state . . . is acceleration." *In re Oakwood Homes*, 449 F.3d at 602. Had Congress wanted to include Retiree Health Benefit Claims among the types of claims limited under section 502(b), it would have done so explicitly.

C. The Authorities Upon Which Franklin Relies Are Not Persuasive.

Franklin ignores the text of the Bankruptcy Code, as well as the careful analysis of *In re Oakwood Homes* and *In re Gretag Imaging*, and states that "overwhelming authority" requires present value discount of the Retiree Health Benefit Claims. However, Franklin's key authorities (i) rely on non-bankruptcy law mandating discounting to present value, (ii) analyze irrelevant section 502 exceptions, and/or (iii) are no longer good law. By contrast, the more recent cases cited by the City carefully consider the language and intent of the Bankruptcy Code and find that section 502(b) does not require a present value discount.

1. The ERISA Cases

The three cases most heavily relied upon by Franklin are Employee Retirement Income Security Act (ERISA) cases, in which discounting to present value was mandated by ERISA, and not by any provision of the Bankruptcy Code. These cases do contain passing suggestions, without the benefit of statutory or doctrinal analysis, that the Bankruptcy Code provides for such discounting to present value. But this language is clearly *dicta*, because the question of discounting the Pension Benefit Guaranty Corporation's ("**PBGC**") claims (*vel non*) was not in dispute. The reason it was not in dispute is because explicit language in ERISA mandated the discount to present value. And because of that ERISA mandate, none of these courts had occasion to analyze (much less resolve) the application of the Bankruptcy Code provisions they cited. These cases therefore have no application to the Retiree Health Benefit Claims at issue here. Franklin's Motion misleadingly suggests that its cherry-picked quotations constitute the holdings of these cases rather than the *obiter dicta* that they are.

In *LTV Corp. v. Pension Benefit Guar. Corp. (In re Chateaugay Corp.)*, 115 B.R. 760 (Bankr. S.D.N.Y. 1990), the court held that bankruptcy law, rather than the ERISA, governed the ***discount rate*** for calculating allowed claims for terminated pension plans, but recognized that ERISA mandated the discount to present value. *Id.* at 767 ("Pursuant to these statutory provisions, when an underfunded plan terminates, the PBGC is charged with determining the amount of unfunded guaranteed benefits under the plan. Under § 2619.43(a) of the Code of Federal Regulations, the PBGC is also charged with *determining the present value of all future*

plan benefits when a plan is terminated, and applies a range of discount rates for the purpose of determining termination liability, dependent on when the plan will have to pay out benefits.") (emphasis added).

Similarly, *Pension Benefit Guar. Corp. v. CF&I Fabricators of Utah, Inc. (In re CF&I Fabricators)*, 150 F.3d 1293 (10th Cir. 1998), was not a case about *whether* the PBGC claims had to be reduced to present value – the parties agreed that it did, as ERISA requires – but *which* ERISA provision provided the appropriate valuation method to calculate net present value. *Id.* at 1300 ("We turn now to the problem of valuing the claim for liabilities that accrued for plan benefits when PBGC terminated the plan. Inasmuch as those liabilities are for beneficiaries' payments that extend into the future, the amount of the liability must be reduced to present value so the debt can be dealt with under the reorganization plan. While the parties agree to the necessity for such a valuation, they disagree over the methodology to be employed.").

Pension Benefit Guar. Corp. v. Belfance (In re CSC Indus.), 232 F.3d 505 (6th Cir. 2000), is more of the same: The opinion only speaks to the dispute about the discount rate to be used. *Id.* at 507 (6th Cir. 2000) ("If a DBPP [defined benefit pension plan] is terminated, the PBGC is required to pay benefits to beneficiaries of the DBPPs as they become due, even if the assets of the terminated plan are insufficient to cover such payments. The PBGC has a claim against the employer for any unfunded benefit liabilities it is forced to pay. An unfunded benefit liability is *defined as the difference between the present value of the predicted future liabilities* of the plan and the present value of the plan's assets. See 29 U.S.C. § 1301(a)(18).") (emphasis added).

Thus, though these cases contain uncareful language about the requirements of the Bankruptcy Code, it is clear that the acknowledged basis for requiring a discounting to present value in each case was the express language of ERISA. These cases are unhelpful and unpersuasive because they conflate the requirements of ERISA with those of the Bankruptcy Code and do not consider the actual language of the Bankruptcy Code.

2. <u>Franklin's Non-ERISA Cases</u>

Franklin pads its argument with citations to a number of other low-grade precedents. Several of these other authorities merely parrot the broad language of the ERISA cases in

different contexts, *Pereira v. Nelson (In re Trace Int'l Holdings, Inc.)*, 284 B.R. 32 (Bankr. S.D.N.Y. 2002), and/or contain no analysis whatsoever. *In re Thomson McKinnon Secs., Inc.*, 149 B.R. 61, 75 (Bankr. S.D.N.Y. 1992); *Kucin v. Devan*, 251 B.R. 269 (D. Md. 2000).

In *In re O.P.M. Leasing Servs., Inc.*, 79 B.R. 161, 161-67 (S.D.N.Y. 1987), for example, the District Court improbably found that the mere requirement in section 502(b) that a claim for rejection of an executory contract be *determined as of the petition date* should be interpreted to mandate a discount to present value of all lease rejection claims. This reasoning is clearly incorrect. Unless this Court were to believe that mere reference to calculating a claim as of the petition date requires that the claim be discounted to present value, *OPM Leasing* is of little instructive or persuasive value. Indeed, the Third Circuit in *In re Oakwood Homes* dismantled this reasoning: "Viewed against the remainder of the Bankruptcy Code, 'amount of such claim . . . as of the date of the filing of the petition' simply does not clearly and unambiguously require discounting a claim to present value. Rather, 'the *full face amount* of a debt instrument is the *proper amount of claim* in a bankruptcy case' where, as here, original issue discount is not at issue. 4-502 COLLIER ON BANKRUPTCY ¶ 502.03 (5th rev. ed. 2005)." *In re Oakwood Homes*, 449 F.3d at 596-597 (emphasis in original).

Further, at least one of Franklin's purported authorities, *In re Loewen Grp. Int'l, Inc.*, 274 B.R. 427 (Bankr. D. Del. 2002), is no longer good law. *In re Oakwood Homes*, 449 F.3d at 601 ("[w]e decline to follow the approach of *Loewen*")).

D. *Oakwood Homes* Is Persuasive Because It Carefully Considers The Language And Intent Of The Bankruptcy Code.

The decision that should guide this Court's reading of the statute is *In re Oakwood Homes*, which focuses on the language of the Bankruptcy Code. The Third Circuit considered this language carefully, and held as follows:

> We are not convinced that a plain reading of § 502(b) supports the Bankruptcy Court's conclusion. "The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341, 117 S.Ct. 843, 136 L.Ed.2d 808 (1997). Neither "amount" nor "value" is defined in the Bankruptcy Code. *See* 11

> U.S.C. § 101 (definitions). At argument, however, U.S. Bank conceded that "amount" does not mean the same thing as "value."
>
> Most significant is how the Bankruptcy Code itself uses "amount" and "value." U.S. Bank argues that "as of the date of the filing of the petition" axiomatically requires that a present value calculation be performed on the "amount" of a claim. However, as JP Morgan correctly notes, where the Bankruptcy Code intends a court to discount something to present value, the Code clearly uses the term "value, as of" a certain date. *See, e.g.*, 11 U.S.C. §§ 1129 ("value, as of the effective date of the plan"), 1173 (same), 1225 (same), 1325 (same), 1328 (same). Many sources support the use of the term "value" for this purpose; *none* support U.S. Bank's contention that "amount . . . as of" also implies a present value calculation. For example, *Collier on Bankruptcy*, in describing another section of the Bankruptcy Code, states that:
>
> > "In three places in section 1129(b)(2), and in at least two other places in section 1129, confirmation requires that a creditor or interest holder receive property 'of a value, as of the effective date of the plan' equal to some amount, usually the allowed amount of the participant's claim. *Congress was clear that the use of this term meant that courts were to calculate the 'present value' of the property*."
>
> 7-1129 COLLIER ON BANKRUPTCY ¶ 1129.06 (emphasis added); *id*. at n. 3 ("This contemplates a present value analysis that will discount value to be received in the future.") (quoting H.R.Rep. No. 95-595, at 414 (1977)). Thus, 11 U.S.C. § 502(b) does not contain the language used elsewhere in the Bankruptcy Code to require a present value calculation.

In re Oakwood Homes Corp., 449 F.3d at 597 (emphasis in original) (footnotes omitted).

The Third Circuit recognized the crucial distinction between the use of the term "value" as of a certain date, when Congress intended a discount to present value, and the term "amount" when no discount is contemplated. In footnote 8 of its decision, the Third Circuit noted that

> "Amount" is defined by one dictionary as "the total number or quantity; a principal sum and the interest on it." WEBSTER'S THIRD NEW INT'L DICTIONARY (unabr.1965). "Value," in contrast, is defined as "the monetary worth or price of something; the amount of goods, services, or money that something will command in an exchange." BLACK'S LAW DICTIONARY (8th ed.2004).

In re Oakwood Homes, 449 F.3d at 597.

Franklin attempts to distinguish this case based on its frequent references to the concept of a "double discount" if the principal amounts owing were to be reduced to present value. This is a

red herring. As Franklin points out in the Motion, *In re Oakwood Homes* was decided in the context in which the claimants' unmatured interest claims had already been disallowed. However, there is no reason why the statutory interpretation and analysis of the Third Circuit would, or should, be any different in a case where unmatured interest was not involved. To conclude otherwise would be to hold that the very meaning of the words "amount of such claim . . . as of the date of the filing" would take on a different meaning from case to case, depending on the applicability of other Bankruptcy Code provisions.

In sum, by use of the word "amount" and enumeration of the 502(b) exceptions, the Bankruptcy Code mandates the conclusion that the Retiree Health Benefit Claims need not be discounted to present value. Franklin makes light of this statutory analysis and instead urges the Court to follow the earlier cases, which, as explained above, are irrelevant and/or sparsely reasoned. The more recent and considered case law has departed from that earlier precedent in favor of well-reasoned statutory construction. *See generally In re Oakwood Homes*, 449 F.3d 588; *In re Gretag Imaging*, 485 B.R. 39.

III. PRESENT VALUE AMOUNT

Even if there were a legal basis for this Court to discount the Retiree Health Care Claims to present value, the $261.9 million amount urged by Franklin would not be the correct amount. Franklin's $261.9 million number is not a discount to present value of the $545 million amount—which Franklin does not challenge as a factual matter. Rather, it is an accounting number determined as of June 30, 2011 (a year before the City's petition date).[5] Moreover, the $261.9 million was determined in accordance with accounting principles for a purpose unrelated to a bankruptcy claim, and was determined using a discount rate that is not applicable to the market rates prevailing today[6] or even at the petition date.

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[5] Trial Ex. No. 2056 at 44 (displaying actuarial present value of total projected benefits for current retirees, beneficiaries, and dependents as of June 30, 2011, in the amount of $261, 863,360).

[6] Collier notes that discounts to present value are typically the value prevailing at the time of plan confirmation, not the petition date. "The relevant date for all determinations of present value required by the Code is the 'effective date' of the plan." 7-1129 COLLIER ON BANKRUPTCY ¶ 1129.05.

The record is devoid of what a proper discount to present value would yield. This is because the City, Franklin, and Retirees Committee entered into a pre-trial stipulation[7] that allowed Franklin to pursue its argument that the Retiree Health Benefit Claims should be discounted to present value without the need to file approximately 1,100 individual objections, but also stated that any objection to the allowance of the Retiree Health Benefit Claims had to be made on notice to the holders of such claims in accordance with the Bankruptcy Code and Federal Rules of Bankruptcy Procedure. Essentially, any challenge to the amount of the Retiree Health Benefit Claims, with the exception of Franklin's net present value argument, could only be made through a formal objection.

IV. CONCLUSION

For the foregoing reasons, this Court should deny the Motion.

Dated: November 26, 2014

MARC A. LEVINSON
ROBERT M. LOEB
NORMAN C. HILE
PATRICK B. BOCASH
Orrick, Herrington & Sutcliffe LLP

By: */s/ Marc A. Levinson*
MARC A. LEVINSON
Attorneys for Debtor
City of Stockton

[7] Stipulation For Order Confirming Lack Of Prejudice To Franklin High Yield Tax-Free Income Fund And Franklin California High Yield Municipal Fund And Lack Of Prejudice To Retirees By Not Objecting To The Allowance Of Retiree Health Benefit Claims Listed On The Amended Creditor List [Dkt. No. 1356].