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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re:

CITY OF STOCKTON, CALIFORNIA,

Debtor.

Case No. 12-32118 (CMK)

D.C. No. OHS-18

Chapter 9

RESPONSE OF FRANKLIN HIGH YIELD TAX-FREE INCOME FUND AND FRANKLIN CALIFORNIA HIGH YIELD MUNICIPAL FUND TO THE CITY OF STOCKTON'S MOTION FOR ORDER ADMITTING EVIDENCE OF THE AB 506 COUNTEROFFER OF THE FRANKLIN FUNDS

Date: April 7, 2013
Time: 1:30 p.m.
Dept: C, Courtroom 35
Judge: Hon. Christopher M. Klein

Franklin High Yield Tax-Free Income Fund and Franklin California High Yield Municipal Fund (collectively, "Franklin") hereby respond to the *City Of Stockton's Motion For Order Admitting Evidence Of The AB 506 Counteroffer Of The Franklin Funds* [Docket No. 1283] (the "Motion").[1]

By the Motion, the City requests that the Court lift its prior protective order to enable the City to introduce into evidence the counteroffer made by Franklin in the pre-bankruptcy neutral evaluation process, "along with deposition and other testimony relating to it." Motion at 5. This request is both substantively inappropriate and procedurally improper.

Substance. The City claims that it needs relief from the protective order to respond to Franklin's assertion that it made a good-faith counteroffer to the City's Ask in the neutral evaluation process. Specifically, the City asserts that Franklin "attempts to paint a one-sided picture of the AB 506 Process" by noting in its Summary Objection to confirmation that Franklin made "good-faith settlement offers both *prior to* and during the bankruptcy case." *Id.* at 3 (quoting Summary Objection at 5) (emphasis in original). The City complains that, as consequence of the protective order, it is "handcuffed in its response" to the Summary Objection. *Id.*

In fact, however, Franklin has done nothing more than cite evidence of its good faith that already has been disclosed by the City and already is in evidence for purposes of the confirmation hearing. Specifically, in his Declaration filed on March 21, 2013, the City's bankruptcy counsel, Marc Levinson, specifically testified that "Franklin Advisers[] actually did make a counterproposal that the City concedes was made in good faith."[2] That Declaration was admitted into evidence in connection with proceedings regarding the City's eligibility to be a debtor in this case and, pursuant to the Scheduling Order, "remains in evidence for purposes" of the confirmation hearing.[3] In its opinion regarding eligibility, the Court took Mr. Levinson at his word and found that "Objector

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[1] Capitalized terms not otherwise defined have the meanings given to them in the Motion or the *Order Governing The Disclosure And Use Of Discovery Information And Scheduling Dates Related To The Trial In The Adversary Proceeding And Any Evidentiary Hearing Regarding Confirmation Of Proposed Plan Of Adjustment* [Docket No. 1224] (as amended, the "Scheduling Order").

[2] *Supplemental Declaration Of Marc A. Levinson* [City Trial Ex. 1398; Docket No. 824] ¶ 6 (emphasis added); *see also* Tr. 4/1/13 at 573:2-4.

[3] Scheduling Order ¶ 48.

Franklin Advisors [made] a counterproposal regarding a different bond issue, which the City concedes was made in good faith but which was too far removed from the relief the City needed on that bond issue to open a path for exploration." *In re City of Stockton, California*, 493 B.R. 772, 783 (Bankr. E.D. Cal. 2013).

It is hard to see how Franklin's recitation of the established fact that it made a good faith counteroffer prior to bankruptcy "handcuffs" the City in any way. Indeed, it appears that the City actually is concerned that Franklin's Summary Objection "is replete with references to the Ask." Motion at 2. Indeed it is. But the point of those references is not to "have the Court believe that [Franklin]'s own AB506 counteroffer was entirely reasonable, while the City's offer was not." *Id.* Rather, as the Summary Objection makes crystal clear, Franklin cites the City's pre-bankruptcy offer in the "Ask" – which the City affirmatively sought to (and did) make public in connection with the eligibility proceedings – to demonstrate the stark disparity between what the City offered Franklin before bankruptcy (valued by the City as a net present value recovery of 54.5% payable from restricted public facility fees that the City cannot use to satisfy other general fund liabilities) and what the City proposes to pay Franklin in the Plan (a recovery of ¼% without application of any of those restricted fees).[4] In its Summary objection, Franklin also notes that, in contrast, the City's treatment of all other bondholders under the Plan is far superior to that offered to them in the pre-bankruptcy Ask.[5]

The terms and conditions of Franklin's pre-bankruptcy counteroffer are wholly irrelevant to the point that Franklin makes in the Summary Objection, and the City certainly need not disclose the counteroffer – much less offer "deposition and other testimony relating to it" – in order to respond.

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[4] Summary Objection at 1 ("In the ensuing pre-bankruptcy 'neutral evaluation' process, the City offered to restructure and extend Franklin's Bonds through a proposal that it claimed would enable Franklin to recover all scheduled principal and interest over the next forty years and ultimately obtain a net present value recovery of 54.5%. Now, however, the City seeks to cram down a plan of adjustment that essentially provides Franklin with no recovery whatsoever. By the Plan, the City asks the Court to permanently discharge Franklin's claim through a one-time payment of less than $94,000 – a recovery of approximately one-quarter of one percent (¼%) of Franklin's principal."); *id.* at 3 ("Prior to bankruptcy, the City offered to use PFFs to provide Franklin a 54.5% recovery, and the Long-Range Financial Plan on which the Plan is based 'assumes a conservative $500,000' in annual available PFF revenues to be used to pay Franklin, but the City now punitively withholds every single dollar of them.")

[5] Summary Objection at 2 ("the Plan provides treatment for all bondholders – other than Franklin – superior to that offered in the pre-bankruptcy neutral evaluation process, highlighting the punitively discriminatory treatment that the City seeks to impose on Franklin").

If, however, the Court decides to crack open the door with respect to the substance of the negotiations between Franklin and the City, the door should be opened wide enough to permit the entirety of the back and forth among the parties to be introduced into evidence. It would be demonstratively unfair to enable the City to shut the book on the history of those discussions after the first chapter when the balance of the book is readily available to tell the story of how and why the City moved from a pre-bankruptcy offer of an alleged 54.5% recovery to the Plan's cramdown treatment of ¼%.[6]

The City cannot have it both ways. Either "the all-important cloak of mediation confidentiality" remains in place, Motion at 4, or that cloak is shed in order to provide for a thorough airing of the discourse among Franklin and the City. The City's request for selective disclosure of privileged information is not appropriate under the circumstances, and any lifting of the protective order should be complete to enable the entire story to be told.[7]

Procedure. There is no reason to decide the Motion now. The Scheduling Order, which governs litigation over Franklin's objection to confirmation of the Plan, already establishes a specific procedure and timetable for resolving evidentiary matters like that raised by the Motion. Specifically, the Scheduling Order specifies a deadline for filing objections to the admissibility of evidence and motions in limine (currently April 25), a deadline for responding to such objections and motions (currently May 6), and a date and time for hearing on those and related pre-trial matters (currently May 12 at 9:30 a.m.).

The City claims that it needs relief now so that it can address Franklin's counteroffer in its supplemental brief in support of confirmation to be filed on April 28. This is pretext. As noted above, that fact that Franklin made a good faith counteroffer already is in evidence. Should the City

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[6] Nothing about disclosure of the postpetition negotiations among the City and Franklin would "open a Pandora's box." Motion at 4. Indeed, the Court could minimize whatever minimal burden that might ensue by limiting disclosure to the written offers and counteroffers exchanged between the parties. Compiling that written record would take far less time and result in far less expense than the City incurred in preparing the Motion.

[7] It is worth noting that the City consistently has refused to disclose information to Franklin regarding basic aspects of various compromises reached with other creditors – including fundamental details like the projected recoveries of those creditors. The City's current effort to seek selective relief from the protective order – to disclose one limited aspect of its mediation communications – reveals gamesmanship at work.

wish to respond to the actual argument made by Franklin regarding the pre-bankruptcy Ask – namely, that the Plan represents a massive step backward from the City's offer in the neutral evaluation process – it can do so without describing the terms and conditions of Franklin's pre-bankruptcy counteroffer, which are irrelevant to the nature of the City's proposed treatment of Franklin in the Plan.

Based on the foregoing, Franklin requests that the Court deny the Motion or, alternatively, either permit disclosure of all offers and counteroffers made between the City and Franklin to date or delay a ruling until May 12 as contemplated by the Scheduling Order.

Dated: April 7, 2014

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