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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re: CITY OF STOCKTON, CALIFORNIA, Debtor.	Case No. 2012-32118 D.C. No. OHS-15 Chapter 9 **TRIAL EXHIBITS AND TRANSCRIPTS CITED IN CITY'S SUPPLEMENTAL BRIEF IN SUPPORT OF CONFIRMATION OF THE FIRST AMENDED PLAN OF ADJUSTMENT, AS MODIFIED (AUGUST 8, 2014)** Date: October 1, 2014 Time: 10:00 a.m. Dept: Courtroom 35 Judge: Hon. Christopher M. Klein

For the convenience of the Court and parties in interest, the City of Stockton, California ("City") hereby submits copies of the excerpts of the trial exhibits and transcripts cited in the City's Supplemental Brief In Support Of Confirmation Of The First Amended Plan Of Adjustment, As Modified (August 8, 2014) [Dkt. No. 1657] ("Brief") filed on August 11, 2014. In the case of transcripts, the City has attached copies of only the pages cited in the Brief, along with surrounding pages for context as necessary. In the case of declarations, the City has attached only the pages of the declaration (and, where applicable, exhibits to the declaration) referred to in the Brief, along with surrounding pages for context as necessary.

The documents are attached in the order in which they are cited in the Brief. Pages are Bates numbered in the lower right corner. Where a citation appears more than once, the cited document is attached only once, with later citations referring back to the Bates range for the first citation. Abbreviations have the meanings ascribed to them in the Brief.

The column headed "Location in Brief" lists the page and line of the Brief where the citation to the exhibit or transcript may be found.

Citation	Location in Brief	Description	Bates range
1	2:9-10	Conf. Tr., July 8, 2014, at 47:20-25 (comments of the Court)	City Supp. 000001-00002
2	4:16	Lamoureux DTD, ¶ 38	City Supp. 000003-000004
3	4:19	Lamoureux DTD, ¶¶ 41, 43	City Supp. 000005-000007
4	4:19-20	Leland DTD, ¶ 17	City Supp. 000008
5	4:23	Conf. Tr., June 4, 2014, at 17:11-17 (testimony of Kim Nicholl)	City Supp. 000009-000010
6	5:3	Conf. Tr., May 14, 2014, at 180:24-181:5 (testimony of David Lamoureux)	City Supp. 000011-000012
7	5:14	Conf. Tr., June 4, 2014, at 198:12-25 (Franklin closing argument)	City Supp. 000013-000015
8	5:19	Haase Elig. Decl., ¶ 5	City Supp. 000016-000017
9	5:25	Lamoureux DTD, ¶ 46	City Supp. 000006-000007
10	6:1	Conf. Tr., May 14, 2014, at 184:8-11 (testimony of David Lamoureux)	City Supp. 000018-000021

Citation	Location in Brief	Description	Bates range
11	6:9-10	Conf. Tr., June 4, 2014, at 21:11-23 (testimony of Kim Nicholl)	City Supp. 000022-000024
12	6:15	*Id.*, at 49:6-7	City Supp. 000025
13	6:16	*Id.*, at 19:16-22	City Supp. 000026
14	6:21	Conf. Tr., June 4, 2014, at 39:4-12 (testimony of Kim Nicholl)	City Supp. 000027-000028
15	6:23	*Id.*, at 19:16-22	City Supp. 000026
16	6:25	*Id.*	City Supp. 000026
17	7:9-10	Leland DTD, ¶ 17	City Supp. 000008
18	7, fn. 9	Lamoureux DTD, Ex. 6 at 28	City Supp. 000029
19	7, fn. 9	Lamoureux DTD, Ex. 7 at 28	City Supp. 000030
20	7:20	Wilson DTD, ¶ 15	City Supp. 000031
21	8:1	Deis DTD, ¶ 29	City Supp. 000032-000034
22	8:2	Deis DTD, ¶ 29	City Supp. 000032-000034
23	8:4	Wilson DTD, ¶ 15	City Supp. 000031
24	8:7	Elig. Tr., March 25, 2013 AM, at 60:2-7 (testimony of Robert Deis)	City Supp. 000035-000036
25	8:8-9	Deis DTD, ¶ 29	City Supp. 000032-000034
26	8:9	Wilson DTD, ¶ 15	City Supp. 000031

Citation	Location in Brief	Description	Bates range
27	8:13-14	Conf. Tr., July 8, 2014, at 29:2-30:2 (comments by the Court)	City Supp. 000037-000040
28	8:18	Conf. Tr., June 4, 2014, at 9:16-10:3 (testimony of Kim Nicholl)	City Supp. 000041-000042
29	8:22	Lamoureux DTD, ¶ 13	City Supp. 000043
30	8:22-23	Conf. Tr., May 14, 2014, at 188:17-22, 195:5-17 (testimony of David Lamoureux)	City Supp. 000044-000047
31	9:8-9	Conf. Tr., June 4, 2014, at 26:19-27:16 (testimony of Kim Nicholl)	City Supp. 000048-000049
32	9:9	Moore Report, at 21	City Supp. 000050
33	9:12-13	Conf. Tr., June 4, 2014, at 26:19-27:16, 50:15-21 (testimony of Kim Nicholl)	City Supp. 000048-000049, City Supp. 000051
34	9:14-15	*Id.*, at 26:19-27:16	City Supp. 000048-000049
35	9:17	*Id.*	City Supp. 000048-000049
36	9:19	Lamoureux DTD, ¶ 13	City Supp. 000043
37	10:5	Conf. Tr., June 4, 2014, at 20:8-21:10 (testimony of Kim Nicholl)	City Supp. 000022-000023
38	10:8	*Id.*	City Supp. 000022-000023
39	10:10	*Id.*	City Supp. 000022-000023
40	10:11	*Id.*	City Supp. 000022-000023
41	10:14	*Id.*	City Supp. 000022-000023

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42	10:15-16	*Id.*, at 21:11-23	City Supp. 000023
43	10:19	Conf. Tr., June 4, 2014, at 23:25-24:14 (testimony of Kim Nicholl)	City Supp. 000052-000053
44	10:22-23	Conf. Tr., June 4, 2014, at 38:20-39:12, 49:8-13, 52:25-53:1 (testimony of Kim Nicholl)	City Supp. 000027-000028, City Supp. 000025, City Supp. 000054-000055
45	10, fn 15	Conf. Tr., May 14, 2014, at 184:15-21 (testimony of David Lamoureux)	City Supp. 000019
46	11:5-6	Conf. Tr., May 14, 2014, at 184:15-185:25 (testimony of David Lamoureux)	City Supp. 000019-000021
47	11:10	*Id.*	City Supp. 000019-000021
48	11:14-15	Conf. Tr., June 4, 2014, at 28:15-21 (testimony of Kim Nicholl)	City Supp. 000056-000057
49	11:17	*Id.*, at 28:22-29:8	City Supp. 000056-000057
50	12, fn 17	Conf. Tr., July 8, 2014, at 29:21-30:24 (comments of the Court)	City Supp. 000038-000040
51	12:24	Conf. Tr., July 8, 2014, at 29:2-13 (comments of the Court)	City Supp. 000037-000038
52	13:3	*Id.*	City Supp. 000037-000038
53	13:7	Conf. Tr., May 14, 2014, at 191:5-17 (testimony of David Lamoureux)	City Supp. 000066
54	13:9	*Id.*	City Supp. 000066
55	13:11-12	Conf. Tr., June 4, 2014, at 21:24-22:21 (testimony of Kim Nicholl)	City Supp. 000023-000024
56	13:14	*Id.*	City Supp. 000023-000024

Citation	Location in Brief	Description	Bates range
57	13:23	Wilson DTD, ¶ 15	City Supp. 000031
58	13:23-24	Deis DTD, ¶ 29	City Supp. 000032-000034
59	13:27	Conf. Tr., June 4, 2014, at 189:18-190:8 (Franklin closing argument)	City Supp. 000067-000068
60	14:1	*Id.*	City Supp. 000067-000068
61	14:20	Jones Elig. Reply Decl., ¶ 15	City Supp. 000069-000070
62	14:20-21	Jones Elig. Reply Decl., ¶ 14	City Supp. 000069-000070
63	14:25	Jones Elig. Reply Decl., ¶ 13	City Supp. 000069-000070
64	15:2	*Id.*	City Supp. 000069-000070
65	15:7	McCrary Decl., ¶¶ 5, 6	City Supp. 000071-000074
66	15:10	Jones Elig. Decl., ¶ 15	City Supp. 000075-000077
67	15:15	Jones DTD, ¶ 7	City Supp. 000078-000080
68	15:18	Jones DTD, ¶ 5	City Supp. 000078-000080
69	15:20	*Id.*	City Supp. 000078-000080
70	15:22	*Id.*, ¶ 7	City Supp. 000078-000080
71	16:1	*Id.*, ¶ 5	City Supp. 000078-000080
72	16:5	Jones Elig. Decl., ¶ 15	City Supp. 000075-000077

Citation	Location in Brief	Description	Bates range
73	16:8-9	Jones Elig. Decl., ¶¶ 9-11	City Supp. 000075-000077
74	16:10	Montes Elig. Decl., ¶ 28	City Supp. 000081-000082
75	16:14	Jones DTD, ¶¶ 4, 8	City Supp. 000078-000080
76	16:15	*Id.*, ¶ 4	City Supp. 000078
77	16:17	*Id.*, ¶ 8	City Supp. 000080
78	16:17	*Id.*, ¶ 4	City Supp. 000078
79	17, fn 24	Conf. Tr., May 14, 2014, at 83:16-85:2 (testimony of Charles Moore)	City Supp. 000083-000085
80	17, fn 25	*Id.* at 88:9-13	City Supp. 000086
81	17, fn 26	*Id.* at 103:13-105:8	City Supp. 000087-000089
82	17:17-18	Conf. Tr., May 14, 2014, at 78:13-79:25 (testimony of Charles Moore)	City Supp. 000090-000092
83	17:21	Conf. Tr. June 4, 2014, at 194:22-196:15 (Franklin closing argument)	City Supp. 000093-000095
84	17:23	*Id.*, at 171:19-23	City Supp. 000096-000097
85	18:4	Conf. Tr., June 4, 2014, at 29:20-37:1	City Supp. 000056-000065
86	18:10-11	Conf. Tr., June 4, 2014, at 38:20-39:12, 49:8-13, 52:25-53:1 (testimony of Kim Nicholl)	City Supp. 000027-000028, City Supp. 000025, City Supp. 000054-000055
87	18:26	Conf. Tr., June 4, 2014, at 196:4-8 (Franklin closing argument)	City Supp. 000093-000095

Citation	Location in Brief	Description	Bates range
88	19:2	Conf Tr., May 14, 2014, at 79:7-12 (testimony of Charles Moore)	City Supp. 000090-000092
89	19:15-16	Elig. Tr., March 25, 2013, AM, at 55:14-21 (testimony of Robert Deis)	City Supp. 000098-000099
90	19:17	Elig. Tr., March 27, 2013, at 438:10-21 (City closing argument)	City Supp. 000100-000101
91	19:19-20	Conf. Tr., July 8, 2014, at 39:19-40:10 (comments of the Court)	City Supp. 000102-000103
92	19:27	Montes Elig. Decl., ¶ 20	City Supp. 000104-000106
93	19:27-20:1	Deis Elig. Decl., ¶ 39	City Supp. 000107
94	20:2	Montes Elig. Decl., ¶ 26	City Supp. 000081
95	20:4	Goodrich Elig. Reply Decl., ¶ 8	City Supp. 000108-000109
96	20:10-11	Trial Ex. 2044, at 2044_0005-2044_0006	City Supp. 000110-000111
97	20:16	Deis DTD, ¶ 32	City Supp. 000033-000034
98	20:17	Deis Elig. Decl., ¶ 39	City Supp. 000107
99	20:18-19	Elig. Tr., March 25, 2013, AM, at 72:18-73:7 (testimony of Robert Deis)	City Supp. 000112-000113
100	20:24	Montes Elig. Decl., ¶ 20	City Supp. 000104-000106
101	21:10-11	Conf. Tr., July 8, 2014, at 48:1-9 (comments of the Court)	City Supp. 000001-00002
102	21:16	Deis DTD, ¶ 32	City Supp. 000033-000034
103	21:17	Haase Elig. Decl., ¶ 5	City Supp. 000016-000017

Citation	Location in Brief	Description	Bates range
104	21:17	Millican Decl., Ex. A at 40, Figure 1	City Supp. 000114-000115
105	21:19	Deis DTD, ¶ 31	City Supp. 000033
106	21:23-24	Conf. Tr., June 4, 2014, at 75:21-76:6, 76:24-77:10 (testimony of Andrew Belknap)	City Supp. 000116-000118
107	21:24	Trial Ex. 3086	City Supp. 000119-000129
108	22, fn 30	Direct Testimony Declaration of Catherine Nownes-Whitaker in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. No. 1380, Trial Ex. 3065], ¶ 10	City Supp. 000130-000133
109	22:16-17	Conf. Tr., May 13, 2014, at 184:25-185:1 (comments of the Retirees Committee)	City Supp. 000134-000135
110	22:18-19	Conf. Tr., June 4, 2014, at 149:8-9 (SPOA closing argument)	City Supp. 000136
111	25, fn 33	Direct Testimony Declaration of Kenneth Dieker in Support of Confirmation of First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013) [Dkt. No. 1369, Trial Ex. 3047], ¶ 22	City Supp. 000137-000138

when you get into exemptions, and the California legislature has taken over exemptions in individual bankruptcy cases, but that's specifically authorized by the Bankruptcy Code.

I look at this and I just am in wonderment. Does anybody think this is valid and why? So that's another question that I need answered. Okay. So that's from 50,000 feet my summary of the picture that's emerging as I put the pieces in this puzzle together.

Now, one of the implications is that I might very well conclude that, in fact, the CalPERS contract could be rejected, that I might conclude that the $1.5 billion lien is not enforceable, and then -- but that does not necessarily mean that this plan of adjustment which is proposed without any adjustment -- without any change to pensions is necessarily not confirmable. It might be perfectly well be confirmable even if we accept that this is the state of the California Public Employee law.

So it might be helpful if the City provided somewhat more focused analysis on why I should be confirming this plan in its current form if one assumes that what I've been hearing about CalPERS -- about the viability of the CalPERS contract and the lien and all that is actually not accurate.

I guess it comes back to a point I think I made in my findings at the time of the eligibility determination and that was when the protesting bond creditors were complaining that there was no haircut being offered to CalPERS. I pointed out that there was a de facto haircut associated with the reduction of employment and the various concessions that had been made in collective bargaining agreements that ratcheted down some of the why's and obligations of the City.

Looking back on it, I am convinced -- I think I'm even more convinced that my analysis was correct at the time. And I don't know that, in that sense, CalPERS really is correct. In the case, certainly there are reasons why it qualifies as a party of interest, but it's maybe a debatable point whether they're really a creditor. Certainly the real party in interest with respect to any given pension is the individual who is going to get that pension and nobody else.

So, City, you may want to, in light of the picture that's emerging here with CalPERS and anticipating that Franklin might want to weigh in its analysis in light of the way I'm going, brief that. Franklin, you can do anything you want. So I'm just saying it would be helpful to hear from CalPERS about where I'm off base and where I'm not.

of money needed to fund the unfunded liability that resulted from the 2008/2009 investment losses. The CalPERS Board determined that, because of the 2008/2009 losses, employers should retire the unfunded liability on a more accelerated basis. This policy decision has the effect of front loading the payments necessary to fund benefits such that contributions will increase and be higher than under the previous approved amortization policies for a period of about 25 years following which the contribution amounts will begin to decline and be lower than they would have been under the old amortization policies. Ex. 9 depicts the forecasted trend of contributions amounts over the next thirty years.

37. Stockton's valuation results are similar in volatility to those of other California municipalities. For all plans, volatility occurs when actuarial assumptions are not met. Volatility could come in the form of investment returns being higher or lower than expected and also in the form of members retiring earlier than anticipated, members living longer than assumed or members receiving larger salary increases than assumed. In any year, contribution requirements are as likely to either increase or decrease as a result of actual experience being different than assumed. If focusing on contribution *rates* instead of contribution amounts, hirings and layoffs, which are in the City's control, are a major driver of contribution rate volatility. Projected rates are based on payroll increasing at 3% per year. The rates included in the 2010 valuation were based on that assumption but, because payroll was lower a year later, CalPERS revised the rates upward to reflect the lower payroll and the higher rates necessary to generate the same amount of contributions toward the unfunded liability. The following year, the rates again increased to reflect the Board's changes to amortization. This year, CalPERS will once again revise the projected rates to reflect the change in actuarial assumptions adopted this February. It is not true that contribution rates constantly increase. Contribution rates have declined for various reasons over the years and going forward they are as likely to either increase or decrease from their current projected levels.

VI. Termination

38. The PERL allows for voluntary termination by a contracting agency and in certain circumstances, CalPERS may unilaterally terminate its relationship with a contracting agency. In the

event of termination, a terminated agency is required to make a payment to CalPERS in an amount determined by the CalPERS Board (based on actuarial information) to be sufficient to ensure payment of all vested pension rights of the terminated agency's employees accrued through the termination date ("Termination Payment"). The Termination Payment goes into the "Terminated Agency Pool." Once the Termination Payment is made, CalPERS has no further recourse to a terminating employer. If a terminated agency the size of the City fails to pay the Termination Payment, benefits may have to be reduced pro rata based on the amount of the Termination Payment that is not funded. Once the terminated agency's assets and liabilities have been merged into the Terminated Agency Pool, no further benefit adjustments are permitted under the PERL. As a result, the pool is subject to actuarial risk.

39. When determining the Termination Payment, CalPERS is subject to actuarial risks including longevity risk, investment risk, inflation and wage-growth risk associated with the future payment of the terminated agency's benefits. Ex. 10, (Dec. 2012 Agenda Item). Unlike in an ongoing plan, these risks cannot be addressed by adjusting contribution rates in future years. Because there is no mechanism for receiving additional payments should the actuarial assumptions not be met, the investments in the Terminated Agency Pool, and the assumptions to determine the Termination Payment, must be more conservative. To address the longevity risk, the Termination Payment calculation includes an increase to the liabilities to address mortality fluctuations. To address investment risk, inflation and wage-growth risk, the CalPERS Board has adopted a policy to determine the discount rate, inflation assumption and wage growth assumption for termination calculations. Ex. 11 (CalPERS Circular Letter No. 200-058-11 (August 19, 2011)); Ex. 12 (August 2011 Agenda Item). In addition, the CalPERS Board recently adopted a conservative asset allocation for the Terminated Agency Pool, providing that assets will be invested in treasury bonds. Ex. 10 (Dec. 2012 Agenda Item).

40. A primary driver in determining the amount of the Termination Payment is the setting of the discount rate, which is a reflection of the asset policy or how the assets are invested. Given the conservative nature of the investments in the Terminated Agency Pool, the discount rate related to a

Termination Payment is low when compared with the actuarial rate for the portfolio for ongoing participating agencies. The cumulative effect of these policies is that a terminated agency's actuarial liability upon termination is larger than the actuarial liability on an ongoing basis.[2]

41. Stockton's Annual Valuation Reports each provide a line item for "unfunded termination liability," which is an estimate of how much Stockton would owe to CalPERS if its contracts had been terminated as of *June 30, 2012*. The Miscellaneous Plan lists this unfunded termination liability at $575,931,065 and the Safety Plan lists this unfunded termination liability at $1,042,390,452, for a total of more than $1.6 billion. Exs. 6 & 7, Safety Valuation Report at 28 & Miscellaneous Valuation Report at 28. If a terminated agency fails to pay the Termination Payment, benefits to employees must be reduced pro rata based on the amount of the Termination Payment that is not funded.[3] Cal. Gov. Code § 20577. CalPERS may reduce the benefits payable under the terminated contract only once. *Id*. After the terminated agency's assets and liabilities have been merged into the Terminated Agency Pool account, the PERL permits no further benefit adjustments. *Id.* § 20578.

42. When a plan is terminated, the PERL imposes a lien in favor of CalPERS "on the assets of a terminated contracting agency, subject only to a prior lien for wages." Cal. Gov. Code § 20574. Legislative history confirms that this section immediately provides CalPERS with the rights of a senior secured creditor as a matter of law. The legislature expressly intended to "grant PERS a lien against the assets of public agencies who have terminated their membership in the system, usually as a result of agency dissolution and bankruptcy who have unfunded liabilities owed to PERS for vested employee benefits and have no ability to pay such liabilities." Ex. 13 at 35 (relevant portions of Legislative History of California Government Code § 20574).

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[2] Furthermore, a terminating agency owes CalPERS the costs of collection, including attorneys' fees. Cal. Gov. Code § 20574.

[3] CalPERS may choose to make no reduction or a lesser reduction if the CalPERS Board has made reasonable efforts to the collect the payment and the CalPERS Board determines that failure to make a reduction will not impact the actuarial soundness of the Terminated Agency Pool account. Cal. Gov. Code § 20577.5.

43. If Stockton chose to terminate its relationship with CalPERS, the City would be faced with an immediately due and owing massive termination liability secured by a senior lien on all its assets. The estimated combined unfunded termination liability for both of the City's plans as of 2012, net of the value of assets in the plans, is approximately $1.6 billion, as more particularly described in paragraph 41 above.

44. I have read the "Reply of Franklin High Yield Tax-Free Income Fund and Franklin California High Yield Municipal Fund to the CalPERS Brief Regarding Pension Liabilities (the "Reply"). The Reply argues that a large portion of a termination claim "would not be an allowed claim because it would exceed the City's actual pension liability." Reply, 9:4-5. That is not correct because, in a termination situation, the termination claim is the actual unfunded pension liability. The Reply misapprehends the meaning of actuarial liability and the difference between an ongoing plan and a terminated plan. In an ongoing plan, adjustments can be made to future contributions as the actuarial results differ from actuarial assumptions and as assumptions change over time. In a terminated plan, there are no future contributions and no ability to make adjustments. Consequently, the actuarial liability for a terminated plan is necessarily greater than the actuarial liability for an ongoing plan, and the unfunded actuarial liability on termination is the amount that would be needed to fully fund the plan because there will be no further contributions and would therefore be the amount of the claim.

45. In a termination, CalPERS would continue benefits without reduction only if the Board were to find that benefit continuation will not impact the actuarial soundness of the Terminated Agency Pool. Cal. Gov. Code § 20577.5. As a result, because Stockton could not fund its shortfall following a hypothetical termination, in the event that Stockton did not fund a material amount of its contribution obligations, CalPERS would be required to reduce benefits before merging Stockton's assets into the Terminated Agency Pool.

46. Further, if the City chooses to terminate its relationship with CalPERS, the City could not enter into a new relationship with CalPERS for at least three years from the date of termination. *Id.* § 20460. Although the City's existing employees that had benefits accrued as of the termination

date in CalPERS would retain their benefits (albeit likely reduced dramatically), they would earn no additional benefits, and new employees would have no retirement system in which to participate.

VII. Portability

47. Generally, benefits accrued by an employee while working for one agency participating in CalPERS are portable should that employee move to another CalPERS participating employer. This is also true for employers who enjoy reciprocity with CalPERS. This means that benefits will continue to accrue uninterrupted when an employee transfers to another employer albeit under the benefits formulas and other ancillary benefits provided for under employment agreements for each employer during the time of service for that employer. Each agency will bear responsibility for payment for the benefits accrued during the service of the employee. For example, for an employee who works for Stockton for fifteen years and then works for the City of Davis for five years, the benefits will be funded by Stockton for the fifteen year period and by Davis for the five year period. If the Stockton plan were to be terminated, the benefits for Stockton employees would likely be reduced for the period of their service with Stockton if Stockton failed to pay a substantial portion of its termination liability. For employees that transfer to another employer that was also part of the CalPERS system, they would continue to accrue benefits that would not be subject to reduction on account of the termination of the Stockton plans.

VIII. Policy Reasons for Enforcing the State's Strict Requirements for Timely Employer Contributions

48. CalPERS' principal responsibility is to maintain the integrity of the California Public Employees' Retirement System. The ability of the sponsor of a defined benefit pension plan to maintain an orderly and reliable schedule of benefit payments is the principal factor in providing benefit security for retirees and in the maintenance of an actuarially sound plan. If a City like Stockton does not timely make its required payments, the actuarial soundness of the fund will be negatively impacted. The actuarial calculations are premised on the assumption that contributions will be made when required and invested when made. When contributions are delayed beyond the required date, the plan falls out of actuarial balance and actuarial soundness is put in jeopardy. By

the City Council's overarching policy objective starting with the AB 506 process initiated in early 2012. This is in the best interests of the City and its residents. Raiding these reserves for payments to Franklin would imperil the City's financial viability.

17. Similarly, if the City were to substitute Franklin's business judgment for its own by submitting a plan that impaired CalPERS, Franklin would fare worse than it would under the City's Plan. If the City were to impair CalPERS, then CalPERS would have an immediate unsecured claim worth approximately $1.62 billion.[5] The claim from CalPERS would represent 73.3% of the unsecured claims pool, compared with a roughly 24.7% share for Retiree Health Benefit Claimants ($545 million) and an approximate 1.58% share for Franklin (even assuming the Franklin claim is in the amount of $35 million as opposed to $10.4 million).

The City's Projections Of Its CalPERS Obligations Are Sound

18. On the expense side, the City's projections of its CalPERS obligations are sound. In September 2013, the City received a long-range projection of CalPERS employer rates[6] for its Safety and Miscellaneous employee plans from its actuary, The Segal Company ("Segal"), using the CalPERS June 30, 2011 valuation, the latest then available, and taking into account the following anticipated changes[7]:

a. Rate smoothing and unfunded liability amortization changes phased in over five years. These changes would result in significant short-term increases in rates, but with fixed periods for amortization, rates would drop as various "layers" of unfunded liability become fully amortized, ultimately leaving only the levy of a rate for "normal" costs with prior unfunded liabilities completely paid off and all employees under the Public Employees' Pension Reform

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[5] This $1.62 billion is the amount which CalPERS claims it would be due as the total of the "Unfunded Termination Liability" for the combined Safety and Miscellaneous plans, using the "Termination Liability Discount Rate" of 2.98%, the yield of the 30-year US Treasury Separate Trading of Registered Interest and Principal of Securities (STRIPS) as of June 30, 2012. Attached hereto as **Exhibits N** and **O** are true and correct copies of excerpts from the CalPERS Annual Valuation Reports as of June 30, 2012 for the Miscellaneous and Safety Plans for the City of Stockton, respectively. See page 28 of Exhibit N and page 28 of Exhibit O for CalPERS' calculation of the "Unfunded Termination Liability" for the Miscellaneous and Safety Plans, respectively. Because the City intends not to terminate the CalPERS contracts, the City has not researched this number and thus does neither agrees nor disagrees with this amount.

[6] The employer rate consists of a "normal cost" rate to pay the cost of service accrued for active employees for the upcoming fiscal year, and an "unfunded rate" to pay the fiscal year's amortized portion of unfunded liability (the amount by which accrued liabilities exceed the actuarial value of assets). These rates are applied to the "PERSable income" of active employees to generate the amounts payable to CalPERS.

[7] A true and correct copy of Segal's rate forecast, with assumptions, is attached hereto as **Exhibit P**.

for CalPERS, testified?

A. Ah, yes, I was.

Q. And did you hear his testimony about what would happen if the City failed to perform under its CalPERS contract?

A. Yes, I did.

Q. Let me ask you some questions about that.

What is your understanding of what would happen if the City were not to make its pension contribution payments to CalPERS, how long would it take for the City to perhaps lose the CalPERS contract?

A. Mr. Lamoureux testified that within 60 days CalPERS could assess a termination liability on the City of Stockton if they failed to make contributions, and so Stockton then would be asked to contribute this $1.6 billion that I referred to.

And if Stockton did not make that contribution, then the CalPERS board has the authority to vote to move the City of Stockton into its termination liability pool and to assess -- and basically to reduce benefits for the current and former members of the Stockton pension plan which would include retirees. So the value of the benefits that would be paid to these members would be equal to the assets that were on hand, absent the $1.6 billion contribution.

Q. Have you calculated approximately what type of cut that would mean with respect to pensions paid by CalPERS to current and employees and retirees?

A. Yes.

MR. JOHNSTON: Objection. Lack of foundation.

THE COURT: Mr. Hile ....

MR. HILE:

Q. Can you describe for the Court briefly what your calculation is based upon?

A. In the CalPERS report, CalPERS for Stockton, CalPERS discloses the termination liability and the assets that are on hand to come up with this $1.6 billion shortfall.

It's a very simple calculation. If you take the assets, divided by the total termination liability, absent the assets that are on hand, then that results in a fraction that is 40 percent so that, in other words, there are assets in the City of Stockton pension plans equal to 40 percent of the liabilities of those plans. So that would mean that the benefits would be cut by approximately 60 percent.

Q. If the City were to be terminated by CalPERS or it were to terminate its contract with CalPERS, would it be able to offer CalPERS pensions?

A. No, it would not. If the City were to terminate its contract with CalPERS or CalPERS terminated its contract then the employees would have no future accruals from CalPERS, because they are in the termination liability pool.

And, in fact, the City of Stockton would not be able risk, that longer term, investment returns, and that would be adequate to cover it?

THE WITNESS: That's a correct statement. You have a good understanding, which I would like to point out, which is also one of the reason the manner in which the assets are invested for the terminated agency pool, it's invested in a much more conservative fashion than it is for some of the other plans at CalPERS.

THE COURT: Now, let's change one fact. If the terminating agency does not pay the $576 million, then what happens?

THE WITNESS: So again in accordance with the PERL it would require our chief actuary to bring a decision in front of our board. The PERL basically provides authority to the CalPERS Board to reduce the members benefits in an event when an employer cannot fully fund the unfunded liability at termination, so there's a decision that our board would have to make.

So in this case, the board would be faced with the decision to potentially reduce the benefits by an amount of 57.2 percent, and again that's a decision the board would have to make.

THE COURT: So the accurate statement is in that situation, if the termination liability is not paid, the CalPERS board has the authority to reduce pension benefits, I take it, across the board by a pro rata amount equally, approximately equal to the amount that was not paid --

THE WITNESS: Correct.

THE COURT: -- or the proportions thereof.

Okay, go ahead.

MR. RYAN: Thank you.

Q. I wanted to talk to you a little bit about there's another way that an employer can be terminated, other than them opting out.

A. Correct, and that's the situation we were talking about before. The law provides that if an employer does not -- if you obey by the rules set out in the PERL, which is one of them, once they agree to have CalPERS administer their retirement benefits they are required to pay what we believe is the necessary amount to fund the benefits.

So if an employer was unable to make the contribution or refused to make the contributions, CalPERS would have the ability to step in and tell the employer "As a result of you not, you know, following the rules of your agreement with us, we are terminating our agreement." And in such cases the termination date would be effective 60 days after we have informed them of our wish to terminate that agreement.

Q. And just real quick, since you mentioned it, I wanted you to take a look at Exhibit 8 which is the Stockton contract.

perhaps 100 pensions of -- a little more than 100 pensions above $100,000 a year in Stockton. But I think I heard the basic pension for the basic worker is very much in the mid to low five digit numbers.

MR. JOHNSTON: I don't recall the evidence from the eligibility specifically, and we didn't develop it here in confirmation because what's relevant from Franklin's perspective is the size of the aggregate liability, and the fact that even if it's only a few outliers the pension spikers if you will, by assuming pensions the City is paying a great deal of money for those outliers, which are very --

THE COURT: Then the question becomes argumentatively, "Why should you punish the person that's drawing a $20,000 pension because some character managed to get himself from $90,000 to $140,000"?

MR. JOHNSTON: We have no desire to punish those pensioners. We have no desire to punish people who are pension spikers.

THE COURT: How would you craft a solution that got at your problem without a lot of -- what the military used to say -- "collateral damage"?

MR. JOHNSTON: Well, when you ask me how we would propose to deal with the problem, earlier I gave you one of two broad options.

The second broad option is the City can do what it's doing in this case, but it also has to come up with the money to pay Franklin more than a penny on the dollar.

And I think the evidence shows that in fact the City easily could do that, if it wanted to. Our fundamental point is the City can't say "We're going to unimpair pensions, we're going to pay for the pension spiking because it would be inequitable to all the people who didn't spike their pensions and they are not getting a large pension," and then turn to Franklin and say "Sorry, we have nothing left for you." That is our beef with respect to the pension liabilities.

THE COURT: But what I'm still not getting is whether you have a solution for remedying past pension spiking that does not amount to getting so angry at a pension spiker that you are going to take a non-pension spiker out and shoot them.

MR. JOHNSTON: I think that we heard Mr. Lamoureux testify that if there's an impairment of pension, the impairment applies ratably.

THE COURT: That means across the board.

MR. JOHNSTON: Yeah. So I don't know that there is a solution that says you can pick and choose among people with vested benefits and say you're not touched and you're touched. I don't believe that that can be done, at least according to Mr. Lamoureux's testimony.

THE COURT: Well, I'm just testing your theory.

MR. JOHNSTON: Uh-huh.

THE COURT: So Franklin's theory is you could not identify pensioners by name and treat them separately based on whether they were spikers or not?

MR. JOHNSTON: I know of no way to do that, correct. If pensions are impaired, I understand that the impairment has to be across the board.

Moving back to best interest. We went through the three categories of evidence, the ability to pay under the Long-Range Financial Plan, the ability to pay from PFFs, and the ability to impair pensions.

We submit the City's plan is not in the best interest of creditors, certainly not in the best interest of Franklin. As a consequence, we submit the City hasn't cleared the first and most basic hurdle toward confirmation.

Let's turn to the second one, which is classification, unfair discrimination. We assert that the plan unfairly discriminates against Franklin by providing other creditors with recoveries that are 50 to 100 times greater than Franklin's recovery.

This one is more straightforward from a legal sense, in the sense that there really isn't a unique Chapter 9 overlay like in the best interest test. But it is a bit nuanced due to the way that the City classified plans under

I, Teresia Haase, hereby declare:

1. I am the Human Resources Director in Stockton, California ("the City"). I make this declaration in support of the City's Statement Of Qualifications Under Section 109(c). In my capacity as Human Resources Director, I am responsible for administering the City's human resources, labor relations, workforce planning, equal employment, risk management, and benefits administration functions. Some of my duties include administering all Memoranda of Understanding with the City's labor organizations, maintaining employee databases, and directing compensation and benefits administration activities.

2. I have served in my present role with since May 2011. Prior to joining the City of Stockton, I served as the Human Resources Director for Mendocino County from October 2009 to May 2011, for the City of Eureka from November 2008 to October 2009, and for the City of Fort Bragg from February 2003 to October 2008. Before entering public service, I worked over an eight-year period as a consultant and manager for Oracle Corporation and Deloitte & Touche Consulting Group. I hold a Batchelor of Science degree in Information and Computer Science from the University of California, Irvine. I also hold a Master's in Business Administration degree from California State University, Northridge.

3. On or around May 22, 2012, I prepared a memorandum recommending that the City Council accept the actuarial valuation for the City's retiree healthcare plan as of June 30, 2011. The Segal Company, outside consultants to the City, prepared the actuarial valuation. A true and correct copy of the memorandum I prepared is attached hereto as Exhibit A. Attached in turn to the memorandum is a true and correct copy of the Segal Company's valuation report. Consistent with my recommendation, the City Council accepted the actuarial valuation.

4. As summarized in the memorandum, in the 1990s, the City greatly expanded its retiree health insurance commitments to levels well beyond what other cities offered. By and large, the benefits were uncapped and the City instituted no minimum service requirements. This meant that an employee could work in Stockton for a few months and obtain uncapped health benefits for the rest of his or her life.

5. Moreover, the approximately 1,100 of Stockton's 2,400 retirees who receive this benefit are the most recent retirees. They retired after the City added retirement enhancements in the late 1990s and early 2000s. Therefore, the average pension received by retirees without medical benefits is \$24,029. The average pension for retirees with medical benefits is \$50,687 a year.

6. The problem with conferring such a benefit was that the City did not fund it on an actuarially sound basis. The City set aside no money to fund this future liability, which the Segal Company calculates will be approximately \$417 million as of the end of fiscal year 2011-12. Instead, it has been paying retiree medical costs on a pay-as-you-go basis. In the upcoming fiscal year, pay-as-you-go retiree medical costs for all funds will total approximately \$16.7 million (of which \$9.2 million is attributable to the General Fund).

7. According to the Segal Company, to adequately prefund its obligations and current obligations, the City should be, but is not, spending nearly double what it has budgeted for retiree health care. For fiscal year 2012-13, this comes out to approximately \$31 million, or 30% of the City's payroll. By comparison with 16 comparable jurisdictions, none has retiree medical obligations much greater than 15% of payroll.

Executed this 27 day of June 2012, at Stockton, California. I declare under penalty of perjury under the laws of the State of California and the United States of America that the foregoing is true and correct.

Teresia Haase

Teresia Haase

dollars in pension obligations.

So as you can see, it's not very -- it's fairly small, especially when you compare in size to like a plan, like the City of Stockton. If you add up numbers for the City of Stockton, they have about 2.6 billion dollars of pension obligation at termination that would more than eat up the entire pool of 170 -- of 89 million dollars of liabilities.

Q. Has there ever been a City the size of Stockton that's terminated its relationship and gone into the terminated agency pool?

A. No.

Q. So if a termination claim is not paid, and pensions are reduced, where does the actuarial value shift, or the actuarial risk shift?

A. So basically, at termination, basically the actuarial risk shifts to CalPERS. And you could make the argument that maybe it shifts to the other employers of CalPERS, because you have to keep in mind that even though we have, I believe, close to 280 billion dollars at CalPERS, it does not belong to CalPERS. Its members -- it really belongs to the members of CalPERS, the employers.

So to the extent at one point the terminated agency pool were to run out of money, or the actuarial risk pool runs out of money, as I stated earlier, in order to pay those members' benefits, the money would have to come from somewhere, most likely from the rest of the Public Employee Retirement Fund.

Q. And if the City terminated its relationship with CalPERS, would CalPERS administer another benefit plan for the City --

A. No --

Q. -- or pension plan?

A. -- and we cannot. By law, they would have to wait three years before recontracting with us. And even if they did, the law requires that they take back all of their prior liabilities that they had prior to termination.

Q. Can benefits be reduced other than through a termination of the plan?

A. Not under current law in the PERL.

Q. Now, one concept that is -- that hasn't been discussed is the concept of portability, whether or not, for example, a CalPERS benefit can go from one City to another City, so it makes it easy for people to leave. Can you explain the concept of portability as it applies to CalPERS pensions?

A. Sure. It's often referred to in CalPERS as "reciprocity." So if you have someone working for the City of Stockton, and they decide I'm going to go work for the City of Davis, for example, every employer within CalPERS has what we call reciprocity.

So earlier I mentioned that the benefits of CalPERS are all based on the final salary, either in the last year of employment or the last three years of employment. And what happens with reciprocity is that if someone is currently working for the City of Stockton that's been there for 10 years, and they're now earning $60,000 a year, and they leave City of Stockton today to go to work for City of Davis and they stay there for the next 20 years, and by the time they retire, their salary is now $100,000. When they retire from CalPERS, City of Davis would pay for the 20 years of benefits that were earned while the person worked at Davis. And City of Stockton is still responsible for the benefits the person earned while working there.

With reciprocity, what happens is the hundred thousand dollar salary the person has with City of Davis would also apply to the years of service with Stockton, making it much easier for employees to change employment to go from one employer to the next, knowing that at least, from a pension benefit perspective, the salary they get with that new employer will also apply to all benefits earned in the past.

So that reciprocity applies to all employers that participate in CalPERS, but also applies to most public employers in California, whether it's a 37 -- whether it's CalPERS, or whether it's a 1937 Act retirement county system or City system, CalPERS has several reciprocity agreements with other retirement systems in California.

Q. You mentioned '37 Act county; can you just explain what that means?

A. It's basically -- again, they have their own section of the law. I believe it's called the 1937 Act.

So remember before, when I mentioned the State does not really have a contract, that all of the benefits that members of the State get are set in the PERL. For members that are under 37 Act retirement system, again all of the benefits that these members get are stated in that retirement law.

THE COURT: Is Sonoma County an example of the 1937 Act?

THE WITNESS: No, because Sonoma County participates in CalPERS. But the City and County of San Francisco has its own retirement system, Stanislaus County I believe has its own retirement system.

MR. RYAN: Actually, I don't think Sonoma County is in CalPERS.

MS. GOODRICH: Sonoma County is not in the Act.

MR. RYAN:

Q. How many agencies are currently with CalPERS today?

A. Roughly about 1600 separate contracting agencies. On top of that we have all the school districts, which have over -- over 2000, and all of the State agencies.

Q. Easy to get confused?

Just briefly, what are the steps the City would have to take to set up its own pension plan?

A. Well, there's quite a few steps the City would need to take. Now remember that CalPERS has its own -- the only reason that CalPERS is in existence is basically to administer the pension benefits of the members of CalPERS, so they have got everything to set up to administer this plan.

The City of Stockton, if it were to start its own pension plan, they would need to get up-to-speed to administer a brand-new plan. So they'd have to, for example, they'd have to hire an actuary. They'd have to hire legal help to help them set up the plan terms. They would need to put in a pension administration system.

And the pension administration system would track the employees, the active employees, the retired employees, and basically keep all of the data that would be needed to pay the benefits.

They would need to hire staff in order to run this administration system and basically run their new pension plan, they would have to establish a board of trustees who would be responsible for making decisions about the pension plan and set up board meetings and responsibilities, they'd need to find a trustee to hold assets, they'd need to as part of that develop an investment policy to determine how they are going to invest the assets.

As part of the pension administration system they would need to have the ability to cut checks to retirees once members become retired, they'd also need to track the deaths of future retirees, they would need to -- most importantly they'd need to bargain with the employees as to what the level of benefits would be because they would have to have an agreement with employees about the level of benefits, and all of that would need to be done in advance of setting up the administration system because the administration system would need to know what benefits should be valued.

Q. How long would it take, in your view, for the City to set up such a plan?

A. I would say that it would be a minimum of six months and really, more realistically, at least a year. The collective bargaining would take quite awhile, I would suspect, and then finding an administrator and setting up this administration system would also take quite a bit of time as well. So I would say, you know, a year plus would be a good estimate.

Q. Would City employees be covered by a pension plan while all of that was being done?

A. No, they would not. They would be, instead, covered by Social Security.

Q. Now, you also talked about a third-party administrator to the pension plan.

Are there any, to your knowledge, who could act in that role, that is, acting as the pension plan administrator for a City like Stockton?

A. I'm not aware of any third-party administrators that administer public sector pension plans. You know, it's pretty common, in the private sector, for a third-party administrator to take over a corporate sector pension plan, but I'm not aware of any in the public sector.

And the reason is that in the private sector, the benefits and the rules surrounding private sector pension plans are all very well-defined. So private sector pension plans look pretty similar to each other.

So there's an economy of scale that third-party administrators can rely on in this business for the private sector; but in the public sector, pension plans are all across the board very different.

There are no rules necessarily accepting state statute, for example, about funding, and those are all different across the country and across cities. So there hasn't been a market for a third-party administrator to take on this business in the public sector.

Q. Let me turn to the question of planned costs compared to CalPERS.

How would the benefits or the costs of such a plan, if the City were to do it itself, compare to CalPERS' costs?

need to be covered by Social Security if the CalPERS contract were impaired. So part of that would go toward Social Security coverage.

Q. And Social Security is a retirement benefit for employees; right?

A. That's supposedly. But Social Security is not like a retirement benefit really, realistically.

Q. And that 1.3 billion dollars could be used to defray the costs of setting up a new plan; right?

A. It could be used to set up a new plan. But as I testified earlier, this new plan would not provide benefits that would be comparable to CalPERS just for all the reasons that I stated earlier.

Q. Right. But the City would have a substantial amount of money to play around with there.

In fact, Stockton might even be able to offer a more lucrative plan, if it was freed from the burden of paying for pension-spiking and the sins of the past that had been the subject of this case, wouldn't it?

A. I don't necessarily agree with that. I don't have any basis for that conclusion.

Q. And your analysis also doesn't take into account the fact that the Stockton employee, who stayed on with Stockton, might have higher take-home pay because he's not paying into CalPERS; correct?

of a pension plan which would mean determining how that plan would operate and so forth, we could pin down the details of that. That would be one option.

The City also, instead of putting in a defined benefit program, put in a defined contribution program.

The third option would be to negotiate with San Joaquin County to enter into the 1937 Act plan that San Joaquin County is currently in.

However, these three options are all secondary to the fact that once the City of Stockton employees are not covered by CalPERS, then they wouldn't be covered by any pension plan or any defined benefit or defined contribution plan and they are currently not covered by Social Security.

And the reason that they are able to not be covered by Social Security is because they have a defined benefit plan. Once that defined benefit plan or any plan is not offered, the employees would need to enter Social Security and to start paying the contributions towards Social Security, which are 6.2 percent that the member pays and 6.2 percent that the employer would pay, for a total of 12.4 percent.

Once you get into Social Security, you can never come out.

Q. All right. I'll come back to that for a second, but let me ask you a couple of questions about the first option. You said setting up the City's own independent pension plan.

that certain people are going to die sooner than other people, so we can advance funds for that and in fact take credit for the dollars that we save by people dying early to pay for those who will live longer.

In a defined contribution plan, as an individual, you don't know how long you are going to live. So you will have to basically assume that you will achieve maximum life expectancy and you manage your money that way, which as you can imagine would be a challenge.

Q. How do investment returns typically compare between defined contribution plans and defined benefit plans?

A. Well, defined benefit plans are generally invested and managed by professionals. And so there have been a number of studies that have been undertaken regarding investment returns in defined contribution versus defined benefit.

And generally there's a 1 to 2 percent spread difference between investment returns long-run, between the two plans, with defined benefit plans earning 1 to 2 percent more each year on average than defined contribution plans do.

Q. Taking into consideration all of the differences that you've just discussed, would Stockton be able to set up a separate pension plan of any kind that was equivalent to CalPERS in your opinion?

A. I don't think so. And the reason is, as I mentioned, all the administrative costs associated with the new stand-alone pension plan, that that would add to the costs of the plan, along with the lower discount rate which would make this plan more costly.

And then Social Security, the fact that these employees would be covered by Social Security and would have to continue to pay into Social Security, that would mean that the total benefits paid for Social Security in the new Stockton plan would not be equivalent to the CalPERS plan.

Social Security is funded differently than a typical public sector pension plan is and the employees would receive less from their money from Social Security than they would if they were contributing to CalPERS.

MR. HILE: Thank you.

Your Honor, at this time, I have no more questions.

THE COURT: Cross-examination.

MR. JOHNSTON: Your Honor, this might be a good time for a break. We have been going about 55 minutes.

THE COURT: All right.

MR. JOHNSTON: No question she'll be out of here before lunch.

THE COURT: I'll disagree with the time statement. I have no problem with taking a break, but she was not on the stand for 55 minutes.

MR. HILE: That's correct. She was more like 40 minutes, is what I can calculated.

Hypothetical Termination Liability

Below is an estimate of the financial position of your plan if you had terminated your contract with CalPERS as of June 30, 2012 using the discount rates shown below. Your plan liability on a termination basis is calculated differently compared to the plan's ongoing funding liability. In December 2012, the CalPERS Board adopted a more conservative investment policy and asset allocation strategy for the Terminated Agency Pool. Since the Terminated Agency Pool has limited funding sources, expected benefit payments are secured by risk-free assets. With this change, CalPERS increased benefit security for members while limiting its funding risk. This asset allocation has a lower expected rate of return than the PERF. Consequently, the lower discount rate for the Terminated Agency pool results in higher liabilities for terminated plans.

In order to terminate your plan, you must first contact our Retirement Services Contract Unit to initiate a Resolution of Intent to Terminate. The completed Resolution will allow your plan actuary to give you a preliminary termination valuation with a more up-to-date estimate of your plan liabilities. CalPERS advises you to consult with your plan actuary before beginning this process.

Valuation Date	Hypothetical Termination Liability[1]	Market Value of Assets (MVA)	Unfunded Termination Liability	Termination Funded Ratio	Termination Liability Discount Rate[2]
06/30/11	$ 1,186,712,063	$ 598,289,135	$ 588,422,928	50.4%	4.82%
06/30/12	1,614,069,650	571,679,198	1,042,390,452	35.4%	2.98%

[1] The hypothetical liabilities calculated above include a 7 percent mortality contingency load in accordance with Board policy. Other actuarial assumptions, such as wage and inflation assumptions, can be found in appendix A.

[2] The discount rate assumption used for termination valuations is a weighted average of the 10 and 30-year US Treasury yields in effect on the valuation date that equal the duration of the pension liabilities. For purposes of this hypothetical termination liability estimate, the discount rate used, 2.98 percent, is the yield on the 30-year US Treasury Separate Trading of Registered Interest and Principal of Securities (STRIPS) as of June 30, 2012. In last year's report the May 2012 rate of 2.87 percent was inadvertently shown rather than the June rate of 2.98 percent. Please note, as of June 30, 2013 the 30-year STRIPS yield was 3.72 percent.

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Valuation Date	Hypothetical Termination Liability[1]	Market Value of Assets (MVA)	Unfunded Termination Liability	Termination Funded Ratio	Termination Liability Discount Rate[2]
06/30/11	$ 808,560,358	$ 450,853,223	$ 357,707,135	55.8%	4.82%
06/30/12	1,007,118,560	431,187,495	575,931,065	42.8%	2.98%

[1] The hypothetical liabilities calculated above include a 7 percent mortality contingency load in accordance with Board policy. Other actuarial assumptions, such as wage and inflation assumptions, can be found in appendix A.

[2] The discount rate assumption used for termination valuations is a weighted average of the 10 and 30-year US Treasury yields in effect on the valuation date that equal the duration of the pension liabilities. For purposes of this hypothetical termination liability estimate, the discount rate used, 2.98 percent, is the yield on the 30-year US Treasury Separate Trading of Registered Interest and Principal of Securities (STRIPS) as of June 30, 2012. In last year's report the May 2012 rate of 2.87 percent was inadvertently shown rather than the June rate of 2.98 percent. Please note, as of June 30, 2013 the 30-year STRIPS yield was 3.72 percent.

The City Cannot Reject Its Contract With CalPERS

15. Franklin criticizes the City's decision not to impair CalPERS, which is the market standard for government employee pensions in California. The point Franklin misses or ignores is that there is not much in the way of a decision involved. A "decision" implies a choice between two or more options. But there is, in reality, no feasible alternative to CalPERS for Stockton, and Franklin fails to propose one. If the City wishes to retain its employees, and wishes to avoid the $1.6 billion[2] judgment that would immediately result from rejecting its CalPERS obligations, it must honor its debts to CalPERS as the trustee for the City's retirees. The City's ability to retain and attract a qualified workforce is dependent, among other things, on the competitiveness of its total compensation package. We have witnessed the negative impact on recruitment and retention within the police department, for example, that can be caused by even the hint of losing the ability to provide a competitive compensation package. Other departments are experiencing similar challenges. As an example, the City is currently unable to fully operate its new Delta Water Supply Project because of an inability to attract and retain qualified employees. In the absence of CalPERS or an equivalent plan, the City would be unable to compete with other employers. The search for a comparable plan that also produces a cost savings for the City has not identified any options. Even if such an option did exist, however, the termination liability that the City would owe to CalPERS would more than offset any hypothetical savings.

16. However, while the City's Plan does not impair CalPERS, the City *has* reduced its CalPERS obligation through other means. The City's CalPERS obligation is based on a variety of factors, such as the number of employees enrolled in the system, the amount of pay received by those employees, the tier in which they are enrolled, who pays for the employee share of the obligation, the ability to spike pay, etc. The City has taken actions to reduce costs in each of these areas, and these actions have resulted in a dramatic decrease in the City's long-term

[2] Unfunded termination liability for the Safety Plan is $1.042 billion and for the Miscellaneous Plan is $576 million, for a total of $1.618 billion, according to the 6/30/12 actuarial valuation by CalPERS (page 28 of each plan's report).

contingency of $2 million. As described in detail in the Leland DTD, both of these aspects of the LRFP are critical to the City's long-term fiscal stability. The 16.67% unrestricted fund balance is recommended by the Government Finance Officers Association, and will provide a buffer for the City in typical economic cycles. Moreover, it must be noted that over the next decade, the unrestricted fund balance will remain low, and will not reach its target for several decades. The $2 million annual contingency is also critical. It is also important to understand that every year, the City must forecast approximately $160 million in revenues and roughly another $160 million in expenditures. To cushion against the potential impact of deviations in these projections, the City is setting aside only $2 million. If staff was short just 1 percent in revenues and 1 percent over in expenditures in a given year (totaling $3.2 million), the annual contingency will be more than consumed. Moreover, the LRFP maintains a $2 million annual contingency well into future years, when annual budgets are expected to increase to $300 million, at which time the contingency will account for less than 1 percent of the budget. Contrary to Moore's contention, this is a very small cushion to address surprises throughout the year. When planning a General Fund budget over multiple years, city governments must set aside funds – in the form of unrestricted fund balances, annual contingencies, or other mechanisms – to protect against unexpected, and often catastrophic, events, such as uninsured lawsuits, floods, economic crashes, etc. The City's inclusion of these items in its LRFP is good business.

The City's CalPERS Contracts

29. While the City has limited control over its CalPERS obligation, the simple fact is that the City cannot simply cut and run from the CalPERS program. Ninety-nine percent of government employees in California are in the CalPERS program or something very similar. Thus, CalPERS is the market standard. No viable, less-expensive alternative exists. However, while the City cannot cut its CalPERS contract directly without risking the loss of essential personnel, the City *has* lowered its pension obligations indirectly, by aggressively reducing employee compensation by 7-23% depending on the position. Factoring in reduced benefits, some employees, such as police, have lost as much as 30% of their take home pay. These compensation reductions were, and continue to be, a severe burden on City employees.

30. These reductions already have led to the departure of a large number of police officers, who either retired early or left for positions in other cities. If the City were to impair its CalPERS contract on top of all of the other compensation benefits already imposed on its employees, more employees will leave. This is simply not a viable option given the City's existing difficulty in recruiting and retaining qualified employees, and in particular its difficulty in maintaining an adequate and experienced police force in light of continued crime and public safety issues. The standards for police officers are very high in California. The labor market for police officers is very competitive amongst California cities. There are typically 100 applicants for every officer who makes it through the rigorous testing process.

31. It should not be ignored that impairing CalPERS would cause the immediate reduction of benefits to current and future retirees by the unpaid shortfall. This would leave many of the City's retirees living below the poverty line. Moreover, it would make Stockton extremely unattractive to prospective employees.

32. The City believes that current and future retirees have paid their fair share of the City's restructuring. It just wasn't in the way the pundits wanted or expected. Those retirees without City paid medical insurance are receiving an average pension of $24,000. Given California's high cost of living, the City felt this was a modest amount, and did not change their benefits. However, retirees that benefitted from enhanced retirement benefits, including City paid retiree medical benefits, received a 34% cut in their compensation package. This group is receiving an average pension of $51,000, and was receiving a retiree medical plan worth $26,000. The Plan eliminates the retiree medical plan. Most of these employees are not eligible for social security benefits. Most current employees have lost their ability for 7 to 9 percent spiking, and they have seen reductions in pay, which by Council policy will not be recovered in the future. The City estimates the impact on current employees' retirement package to be a 30-50% reduction. When the State's recent retirement reform package for new employees is taken into account, employees hired after January 1, 2013, will experience a 50-70% reduction in their retirement package.

Service Solvency

33. In addition to putting the City on a path of cash and budget solvency, the Plan also allows the City to restore its service solvency. The most critical issue that had to be addressed from a service solvency standpoint was the City's crime problem, both real and perceived. The City's reputation for unsafe streets has seriously impacted business investment in the City, as well as citizens' perception of personal safety. The Marshall Plan On Crime, which will be funded with proceeds from the passage of Measure A, will increase the number of officers to 1.6 per 1,000 population and will provide another needed support to a strained police department.

34. While the City's fire, library, public works and recreation programs also have suffered enormous cuts, the City's recovery under the Plan, though slow, will allow the eventual restoration of some (but not all) of these services. However, even now, the City is still providing a basic level of services in these areas. Further investments in the future will depend on the City's financial and economic performance.

35. If the City was to experience additional revenues, as the former City Manager, I would recommend they consider more robustly addressing of the City's capital improvement needs for roads, parks, etc. However, it is the City Council's right and duty to set priorities for the City, not Mr. Moore or Franklin.

The City's Plan Is Feasible

36. Bankruptcy is not just a budget and finance issue. It is a reflection on, and a result of, senior management decisions, political decisions by the governing body, and the organizational and cultural capacity of city leaders. In other words, for a city to recover, it must repair the entire organization, and not just produce budgets that balance. It must look itself in the mirror, admit its mistakes, and make amends.

37. To this end, the City Council adopted four main goals three years ago: "Get Our Fiscal House In Order"; "Increase Public Safety"; "Facilitate Investment and Job Creation"; and "Increase Organizational Capacity." The City Council approved 37 detailed strategic initiatives or projects to effectuate these goals, and they have guided the City's recovery efforts. The result

A. I had some meetings, yes.
Q. To your knowledge, has the City ever prepared ten-year projections before preparing the ten-year projections that are part of this Ask?
A. No. Typically, we would prepare three- to five-year projections.
Q. Typically? How often has the City done that?
A. Every year that I've been there.
Q. Has the City been working on updated projections?
A. Constantly.
Q. Are you aware that Assured Guaranty has requested a copy of updated projections from the City?
A. No, I'm not.
Q. Are you aware the City won't produce those updated projections to Assured Guaranty or any of the other Capital Markets Creditors?
A. I'm unfamiliar with the request or our response.
Q. Do you know that under these projections that are part of this Ask -- if we could turn to page 67. Do you see the second to last line, the ending available balance, sir?
A. Yes.
Q. Are you aware that under these projections, the City projects to have a $100 million deficit at the end of ten years, even if it's successful in impairing its bond debt?

A. I am.
Q. Based on the City's own projections, the City can't afford to pay CalPERS, can it?
A. The City, under our projections, will have to pay CalPERS. It's a benchmark retirement program. In order for us to be a viable employer, we're going to have to pay CalPERS.
Q. Prior to filing for chapter 9 relief, the City did not explore whether there was an alternative, less expensive defined benefit plan for its employees, did it?
A. Could you repeat that question, please?
Q. Certainly. Prior to seeking chapter 9 relief, the City did not explore whether there was an alternative, less expensive defined benefit plan for its employees?
A. I would say that's factually correct. We discussed some options to reduce the costs. In fact, we negotiated and implemented reduced retirement benefits for future employees. We discussed -- in fact, I think we applied for a request to consider reducing the cost of living increase that was embedded in our contract. And then we didn't ask, but we discussed briefly the pros and cons of asking PERS for a hardship request in order to reamortize the unfunded liability.
Q. And, sir, I will get to your requests of CalPERS, but you agree that you did not look to any non CalPERS-based

rhetoric. I'm going to cover several different aspects of the situation.

The pieces of the puzzle that I'm looking at start with -- primarily with the Public Employee Retirement law section 20460, which I gather is the California Government Code -- part of the California Government Code. So it's California Government Code 20460 through 20593. Those are the pieces of the puzzle I've been rooting around with.

It looks to me like the situation is this. California Public Employee Retirement system is two different pieces, two completely different natures. As to the State of California and the employees of the State of California, CalPERS is the retirement system period. That's it. It's the only show in town. But that only goes to the employees of the State of California.

When one gets to Chapter 5 of CalPERS, one moves into a subject called contract members of the system and that's the different aspect of CalPERS. As I understand it, California municipality or, I guess, the public employees' retirement law is the term public agency or, as the Bankruptcy Code would use the term, municipality. I think there's -- probably the meaning is essentially the same thing. For our purposes, I'll just speak in terms of City, but I could be speaking about other types of public agencies as well as municipalities.

The City participates in CalPERS as a matter -- by virtue of contract and the City does not have to do that. The City can join a county system. There are county retirement systems authorized under California law, as Mr. Lamoureux put it, the 1937 act, and pointed to several counties that have their own county system. And there can be just a local system. The City could have its own system and the City can contract with a private pension provider. Recalling back to Mr. Lamoureux's testimony, he used as an example the City of San Clemente, California has apparently a private pension.

Well, in that aspect, it looks like CalPERS is merely a pension provider like other pension providers that is competing with the private sector to -- given the fact that if you go to any private pension system. And then there are other conjoined -- joined with the local system or have its own system and can join a county system.

And when I look at the various provisions here, it looks like there's a number of situations that are provided for whereby an entity, public agency, municipality, a city can move from one to another, move from a county system to a private, from a private to

CalPERS, move from CalPERS to a private, and the statute seems fairly well constructed to permit that.

And it looks like it creates an obligation, when an entity wants to make a move and to make a move out of CalPERS, that CalPERS is required to negotiate over how much is to be turned over, that is, by way of pension assets, to the new system or to the new pension provider. And it looks like it would be a huge amount of negotiation to do and calculation of how much -- to what extent, if there were to be a move away from CalPERS, CalPERS would retain responsibility for any particular types of pensions. One could imagine only some moving or one could imagine the whole amount going. There's a provision for CalPERS to turn over the various contributions that have been collected. Now, that's the first aspect of this.

It also -- and I want to make sure that I understand. I'm mindful that there are likely to be significant administrative barriers in terms of costs, both in terms of dollars and just effort and complexity if such a move were made. But, in principle, it looks to me like a city could bow out of CalPERS without necessarily being thrown out of CalPERS by way of CalPERS' termination for some form of default.

So, for example, Section 20573, Liabilities of

Terminating Agency. Notwithstanding any other provision of law, the board may negotiate with the governing board if the terminating agency or the governing board of any agency or agencies which may be assuming any portion of the liabilities of the terminating agency as to the effective date of termination, terms and conditions of termination and payment of unfunded liabilities.

That goes to -- 20570 goes to termination by governing body and talks about how to do it and then it goes on to deal with -- then it also addresses problems associated with nonpayment. But let me just note that, as I understand the situation, and this comes much from the Lamoureux testimony as from the statute, CalPERS' sources of funds are as follows.

There are contributions that are made by the employer at the time wages are paid and principal. There's a so-called members' contribution made that's an employee contribution made that is also payable at the same time, much the way federal Social Security gives half to the employer and half to the employee. CalPERS seems to be set up the same way.

There is a differential that's available on a member employee rate depending upon whether the employer has elected to have -- for that public agency or that municipality, the city to participate in the federal

DIRECT EXAMINATION

BY MR. HILE:

Q. Ms. Nicholl, we've set out on the podium in front of you, among other things, Exhibit 3064. That's to your right.
Do you see it there?

A. I do.

Q. And is this your direct testimony declaration?

A. Yes, it is.

Q. And taking a look at the last page of the declaration part, is that your signature?

A. Yes, it is.

Q. And take a look at what is there as Exhibit A to Exhibit 3064. Is that the rebuttal report that you submitted in this case?

A. Yes, it is.

Q. Before I offer Exhibit 3064 into evidence, could you briefly describe your background and credentials for the Court, as explained in Exhibit 1 to Exhibit A to your report?

A. Yes. I am senior vice-president and a consulting actuary with the Segal Company. I'm also Segal's national public sector practice leader. I am a fellow of the Society of Actuaries and enrolled actuary, and a member of the American Academy of Actuaries.
And my focus, during the past 25 years of my career, has been strictly working with public sector retirement

systems, doing actuarial valuations and plan design studies, as well as I have done some litigation support with public sector plans as well over my career.

Q. Thank you.

MR. HILE: Your Honor, at this time, I offer into evidence Exhibit 3064.

MR. JOHNSTON: No objection.

THE COURT: Without objection, Exhibit 3064 is admitted for its full probative value.

(City's Exhibit 3064 was received in evidence.)

MR. HILE:

Q. Ms. Nicholl, I'd like you to turn to page 3 of your report which is in Exhibit 3064, and you have set out a number of conclusions there that I'd like to ask you about. The first one reads that you disagree with Mr. Moore with respect to his ability on making pension valuations.

Can you read that first conclusion for us, please?

A. Yes. I state that based on his analysis, Moore does not appear to understand how contributions to pension plans are determined. This makes all his analyses and conclusions suspect.

Q. Why do you conclude that Mr. Moore doesn't understand how contributions to pension plans are determined?

A. I believe that to be the case based upon Mr. Moore's expert report. Mr. Moore talked about the contributions to but are entitled to a deferred retirement benefit. By comparison, the termination liability for the Stockton plans alone would affect approximately 2,518 members that have not yet retired but are entitled to a deferred retirement benefit and 2,075 members and/or beneficiaries currently receiving a benefit, and would result in termination obligations exceeding $2.6 billion for both plans while the assets as of June 30, 2012 totaled about $1 billion.

12. Of the more than 1500 public agencies that contract for pension services with CalPERS, none of them (other than the bankrupt City of San Bernardino) were delinquent by an amount in excess of $150,000 as of March 31, 2013.

III. Pension Funding in California

13. The basic premise of a defined benefit pension plan is to defer compensation received during employees' peak earning years to their lowest earning years. The amounts of such deferred payments are determined based on actuarial assumptions and calculations, and the risk is pooled among the participants in the plan. For a homogeneous population, predictions for larger groups are more accurate than for smaller groups. Accordingly, as a pool is made smaller and smaller, the volatility of the cost per member increases because the risk is pooled among a smaller group.

14. The sources of funds used to provide the pension benefits are employee contributions, employer contributions and investment income. Employee contributions are set by statute and vary by benefit level. Under pension reform enacted by the California legislature in 2011, new employees must pay half of the "Normal Cost," which is the annual cost of service accrual for the upcoming fiscal year for active employees in the absence of any unfunded or overfunded liability to be amortized. Normal Cost is expressed as a percentage of the employer's covered payroll.

15. A city's contribution obligations to CalPERS are determined on an actuarial basis, taking into account investment returns, mortality rates, projected retirement pattern, projected compensation and other factors. All actuarial calculations are based on a number of assumptions about the future such as demographic assumptions including the percentage of employees that will terminate, die, become disabled and retire each future year and economic assumptions including

The other thing, too, at CalPERS is we also have what we call a compensation review unit where, when someone retires at retirement, they will, if you want to flag individuals for which the final compensation, let's say, has increased by more than 10 percent in the last year, they would look at that individual to find out, is this allegedly a pay increase, or was that an attempt for pension-spiking?

In many cases we put a stamp of approval on it, and it goes through. In other cases, we deny it and calculate the retirement benefit on a lower salary than originally reported to CalPERS. So we do have a mechanism in place.

I cannot say here, tell you, that pension-spiking does not exist at CalPERS. But we do have, just because of the types of compensation that are allowable at CalPERS to be reported, we believe that at CalPERS we have -- it is less likely that this will be an issue.

Q. Now, with respect to reciprocity, does CalPERS have reciprocity with any private pension funds or pension administrators?

A. No.

Q. So it's only other governmental?

A. Only governmental agencies in California.

Q. Do me a quick favor and go to Exhibit 8, which is the contract. And I believe the first page of it, which is page 240 of Exhibit 4015 --

A. Yes.

Q. -- it's kind of an ancient looking document -- but this at least this first page is the first page of the original agreement between CalPERS and Stockton; correct?

A. Correct.

Q. Could you take a look at paragraph number 1?

A. Yes, I have it in front of me.

Q. Sure. And could you just read that for me, please.

A. Yes. It says "City is to participate in the state employees Retirement System subject to the provisions of the state employees Retirement Act."

Q. All right. And keep going.

A. "Said retirement act is attached hereto marked Exhibit A and by such reference is hereby made a part of this agreement as though herein set out in full."

THE COURT: I can't really tell from the quality of the Xerox, but it looks like that second sentence is lined out.

MR. RYAN: Actually, I don't know. We can get you -- I don't know if we have the original, but we can get that. I don't think it's been lined out, but it may be the quality of the Xerox.

THE COURT: Well --

MR. RYAN:

Q. Has that been lined out?

changing benefits and Stockton's ability to do that, the change in those benefits is within the contours of the PERL itself; correct?

A. Correct.

MR. RYAN: Okay, thank you.

MR. JOHNSTON: May I begin?

THE COURT: You may.

CROSS-EXAMINATION

BY MR. JOHNSTON:

Q. Mr. Lamoureux, the City of Stockton's contribution rates for its payments to CalPERS are set by CalPERS; correct?

A. Yes.

Q. And those payments, those contribution rates are based on things like investment returns; correct?

A. In part, it's one of the many assumptions we use.

Q. And also in part on mortality rates?

A. Yes.

Q. And projected retirement patterns?

A. And salary increases, and so on and so on.

Q. And demographic assumptions, including assumptions about the percentage of employees who may die or become disabled or retire in the future; right?

A. Correct.

Q. And those are all things that are outside the control

of the City of Stockton; correct?
A. Correct. All assumptions are set and adopted by the CalPERS board.
Q. And returning to investment returns CalPERS investment returns, in fact, can be very volatile, can't they?
A. It depends on how you define "volatile." But ....
Q. That's a fair answer. I think it makes sense to look at Exhibit 4 to your declaration.
What does Exhibit 4 represent?
A. It represents the actual investment return earned by CalPERS every year since 1983-84. So about 30 years worth of investment returns.
Q. And by really volatile, I was observing that sometimes these investment returns can swing more than 20 percent in a single year; correct?
A. Correct.
Q. And there have been a couple of occasions where they have swung by even 30 percent in a single year; right?
A. Yes.
Q. And those both up and down?
A. Correct.
Q. And CalPERS changes its assumptions that go into the contribution rates from time to time; correct?
A. Yes, we review our assumptions once every four years to see if they need to be changed.

Then you add to that what you think your inflation will be long-term. And let's say that in today's economy and projected forward that might be 2 and a half percent. So 2 and a half percent added to 5 percent would be 7 and a half percent in my example.

Q. All right. Mr. Lamoureux testified about what he called "reciprocity" that was also termed "portability."

First of all, can you tell us what that concept means with respect to CalPERS?

A. You know, I'm not sure I finished my last response to your last question.

Q. Go right ahead.

A. Okay.

Q. I apologize.

A. So I talked about how we set the discount rate assumption for public sector plan. And for the example that I gave this plan had assets, 50 percent in stocks and 50 percent in bonds.

The new Stockton plan would have zero assets when it starts out. It would start out with zero assets and it would collect contributions eventually, so the assets would start to accumulate.

But at the outset it would have nothing in the trust and would have a very small amounts until it builds up some assets. So you necessarily couldn't have this 50 percent in stocks and 50 percent in bonds type of allocation, you might have 100 percent in bonds for a few years while you built up your assets.

The return on bonds long-term is lower in my example than it would be for the return on stocks. So that would mean that the discount rate for the Stockton stand-alone pension plan would need to be -- assumed to be lower than 7 and a half percent, because the assets on hand to start with would earn 7 and a half percent.

So the lower the discount rate, that means the less that this pension plan can earn on investments to pay for benefits. As a result, that means the contributions toward the benefits need to be greater to make up for that difference. So that would cause the City of Stockton stand-alone pension plan to have costs that would be greater than the CalPERS pension plan.

Q. All right. And again, I apologize for interrupting your answer. I'd like to move ahead, however, to that issue of reciprocity, as Mr. Lamoureux called it, or portability for a second.

Would you just briefly describe for the Court how that concept fits in with Stockton perhaps trying to start its own new pension plan?

A. So the way that reciprocity works in California is that an employee can move from one employer to another actually lower than the forecast contained in the most recent CalPERS valuation report (as shown in the table above). If future increases in the contribution rate rise above what the City has forecast, it could call the feasibility of the Plan and future viability of the City into question.

C. Pension Expense As A Percentage Of General Fund Expenditures Is Unsustainably High.

The City's forecast pension expenditure as a percentage of total general fund expenditures is also unsustainably high. For FY2012-13, the City projected in its LRFP that pension expenses would constitute approximately 10.0% of its general fund. However, the rapid growth in the City's projected pension expense, as noted above, results in this figure increasing to 18.1% in just six years (FY2018-19). The projected pension expense then remains above 18.0% for the next twelve years (until FY2030-31) and above 16.0% until FY2034-35 (see Exhibit 14). From a historical perspective, these figures are extremely high. From FY1998-1999 (as far back as data was readily available) through FY2011-12, the City's pension expense as a percentage of total general fund expenditures averaged approximately 9.6%, with a low of 2.7% in FY2001-02 and a high of 16.2% in FY2005-06 (see Exhibit 15).

D. Vallejo's Failure To Contain Pension Expenses Presents A Cautionary Tale.

The City of Vallejo ("Vallejo") is facing another budget crisis less than two years after exiting bankruptcy, providing a case study in the risks of failing to address pension obligations while in Chapter 9. Vallejo projects budget deficits for this fiscal year and next (FY2013-14 and FY2014-15), with ballooning obligations to CalPERS a key part of the challenge, and a dwindling cash balance of approximately 4.5% of general fund expenditures (for FY 2013-14; see Exhibit 16). Vallejo's CalPERS Safety Plan contribution rate for FY2014-15 is 50.8% (compared to 41.4% for the City and a 37.9% peer average), and is forecast to grow to 65.5% in FY2019-20 (compared to 57.1% for the City and a 48.5% peer average) (see Exhibit 17).[16] Vallejo's Safety Plan contribution rate is higher than all of the peer cities for FY2014-15 and second only to El Monte in FY2019-20. Vallejo's forecast CalPERS contribution rates, as well as Stockton's CalPERS and Segal contribution rates, are shown on the table below.

[16] Peer group for Vallejo includes California cities with populations of 110,000 – 130,000.

A. This chart, as I said before, shows the incentive for an employee to leave Stockton if the CalPERS contract is impaired. That's the point of this chart.

Q. And you talked about the fact that a new single employer plan wouldn't have, single employer defined benefit plan, wouldn't have a pool of assets to start with like CalPERS has a massive pool of assets; right?

A. Correct.

Q. And your takeaway from that is that the new single employer defined benefit plan would have to invest its assets more conservatively; right?

A. Yes, at the outset it would.

Q. It wouldn't be able to match prudently the CalPERS mix of stocks and bonds; right?

A. It wouldn't have the ability to invest in some of the investments that CalPERS is able to invest in like real estate and alternative investments either.

Q. That's not necessarily a bad thing, is it?

A. I think that being able to invest your assets so you can achieve a higher investment return is a good thing, because that reduces the costs of contributions.

Q. CalPERS investment returns have been pretty volatile, haven't they?

A. The Stockton market is volatile. So, yes, there are some years when they earned more than the assumption of 7 and

MR. JOHNSTON: Objection. Foundation.

THE COURT: Mr. Hile?

MR. HILE: Your Honor, the witness has testified and her CV shows she's somebody who has worked with CalPERS, and she has done calculations for entities, including Stockton, that are part of CalPERS system. So she has a lot of background as to how the costs fit in.

I'm not asking what CalPERS' costs are. I'm just saying a comparison from her experience, between what it would cost for the City to administer a plan and to have CalPERS doing what it does.

MR. JOHNSTON: And, Your Honor, I don't think we have heard any testimony about her experience on the other side of the coin, which is private sector administration of a plan and what that might cost or not cost.

MR. HILE: And I'm not asking private sector administration, I'm just talking about if the City would have its own plan versus a having CalPERS do what has to be done.

MR. JOHNSTON: I don't think we have any testimony about her experience in that regard either.

THE COURT: Why don't you get some more foundation --

MR. HILE: All right.

THE COURT: -- for her experience in that regard.

MR. HILE:

Q. Based upon your experience as an actuary working with public entities who are working with CalPERS, what costs does the City currently have with respect to administration of the pension plans when it is a CalPERS member?

A. The City, as part of its contribution rate, pays toward the administration of the CalPERS system. It's included in -- the administrative costs for CalPERS are funded from the trust, from the CalPERS trust, and so as part of that then each City is assessed a piece of the administrative costs.

And since CalPERS is so large and has so many dollars in it, that percentage of administrative costs to the City of Stockton would be much lower, is much lower than it would be if it were to have its own pension plan with it's own administration system and it's own staff and so forth.

Q. Let me ask you about what Mr. Lamoureux talked about the discount rate for purposes of CalPERS.

How would the discount rate that CalPERS has compared to what a City run plan would be?

MR. JOHNSTON: Objection, lack of foundation.

THE COURT: Mr. Hile?

MR. HILE: I'll lay some more foundation, although I think there's plenty there, Your Honor.

Q. How is the discount rate for a private pension plan or a non-CalPERS plan determined?

A. A discount rate -- when you say "private plan," I want it.

Q. So a rational employee's only consideration regarding retirement benefits would be what future opportunity offers the best overall compensation for that employee, whether it's in Stockton or some other City.

Do you agree with that?

A. Can you say it again?

Q. Sure. Given that upon termination there's nothing that an employee can do with respect to benefits earned through the date of termination, a rational employee looking at the situation at the time of termination would consider what future job opportunity offers the best, call it, compensation package to the employee going forward?

A. Yes. If you are an employee whose CalPERS contract has been impaired and you are looking at what your total compensation would be, including retirement benefits, then clearly -- it's obvious to me, at least, that you would want, that an employee would want to get into a job quickly to be in the CalPERS classic tier so that at least they could, for future service, have a higher, have a comparable benefit to what they had been earning at the City of Stockton before the impairment.

Q. And thus the City of Stockton could offer them a better package?

A. Well, I think that -- I don't think the City of

Stockton could offer them a better package. But I also think the fact of the impairment would cause employees a lot of angst and wanting to get away from that situation so that it might not happen again.

Q. Right, got it.

Another major assumption that you make is that upon termination vested benefits would be reduced by 60 percent; right?

A. I said benefits would reduce by approximately 60 percent, yes.

Q. I think the chart says 60 percent; right?

A. Yes.

Q. And that's because the CalPERS -- the Stockton/CalPERS plan, right now, is 60 percent underfunded?

A. On a termination basis it is, not on an ongoing plan basis. And Mr. Lamoureux testified that if in fact the contribution is stopped and so the CalPERS contract is impaired, then the assets and liabilities for the Stockton plan would go into the termination pool, and the assets in that pool are invested much more conservatively then they are in the regular CalPERS pool.

So the liabilities are valued at a much lower discount rate, somewhere in the neighborhood of 3 to 4 percent, it might even be lower than that, and that's why the funded status on a termination basis is so much lower than the employer, from city to city, or county to county, and not lose his or her pension benefit, so that when the employee ultimately retires its as if that employee had worked with one employer for his or her entire career, and each entity pays for a piece of that benefit.

And the reason this is important is because as you work through your career you get salary increases and without reciprocity your pension benefit at your first employer would be based on your earnings at that first employer, and if you work for another 15 or 20 years you could imagine that your earnings are going to grow.

So your benefit would be much lower from that first employer without reciprocity, so it's a very valuable benefit.

Q. All right. If Stockton were to have its own pension plan, would it be able to be portable to CalPERS?

A. It would need to negotiate reciprocity with CalPERS. And I could see reasons why CalPERS would not want to negotiate reciprocity with Stockton.

First of all, in our example here, Stockton has terminated its contract with CalPERS.

Secondly, the benefits that Stockton would be able to have to its employees who are in the Stockton plan, would likely be lower than the CalPERS benefits, because I mentioned that these employees would be covered by Social

Security, and therefore 12.4 percent of payroll would be going towards Social Security benefits and not toward the new Stockton pension plan. So that would mean that the benefits from Stockton would need to be lower to account for that difference.

So for those reasons, I would I think it would be unlikely that CalPERS would allow reciprocity with the City of Stockton's new pension plan.

Q. Now, I'd like to turn to a demonstrative, if I may.

And, Your Honor, I'm going to -- this has already been shown to counsel, but I'm going to give a copy to counsel and a copy for the Court to look at.

Do you have a copy up there? This would be the Annual Pension Four Scenarios For Safety Employees. If you don't, I'll hand one up to you.

A. I don't see it, unless it's in one of these tabs.

Q. You are probably the most important person to have one.

A. Thank you.

Q. The first page of this demonstrative is entitled Annual Pension Four Scenarios For Safety Employees.

Do you have that in front of you?

A. I do.

Q. And can you describe what the bar chart is that appears on the first page of this demonstrative?

A. This bar chart shows the pension that would be paid from CalPERS under four different scenarios.

The first bar is if the CalPERS pension is unimpaired and the employee stays with the City of Stockton.

And I should point out that this is a sample employee, who is assumed to retire as a safety employee, simply retire at age 50 with 25 years of service, ten years completed with the City of Stockton and 15 years post City of Stockton, with the final number salary of 91,200.

Q. All right. And in that scenario as you have presented it with these assumptions, what is the amount of the pension, annual pension that would be received by that employee, if employee stays with Stockton and CalPERS is the pension administrator for the City of Stockton?

A. This employee who works for 25 years with the City of Stockton, with the final average salary of 91,200, would be entitled to 75 percent of that amount, 75 percent of that final average salary at retirement, and 75 percent of 91,200 is 68,400.

Q. All right. Now, would you please describe for the Court what your scenario two is here?

A. Scenario two is if the CalPERS pension is impaired and then the employee leaves the City of Stockton within six months and retains his or her classic status with the new agency under PEPRA.

And what that means by retaining classic status that for future accruals they continue to earn benefits under the formula they were earning benefits under in Stockton.

And in this scenario, this employee had worked ten years with the City of Stockton. So ten years at 3 percent is 30 percent. Thirty percent of the final average salary is $27,360. However, that's going to be reduced by 60 percent, because the City of Stockton is now in the CalPERS termination pool. So that pension piece will be reduced to 10,944.

And then the future service with the CalPERS, or another 1937 Act plan, would be 15 years at 3 percent, so that's 45 percent. Forty-five percent of high-labored salary is 41,040. So you add that to the 10,944, and that's a total of $51,984.

So for the same employees, 25 years of service with a CalPERS contract impaired, they are going to receive 76 percent of what they would have received had the Stockton contract not been impaired.

Q. And the condition there of leaving within six months, why did you pick that or why is that a scenario?

A. As part of PEPRA, the law is enacted such that if an employee leaves from one position to another within a six-month time period, they retain classic status, which means that their formula multiplier remains the same.

If they leave after a six-month time to another agency, they wait more than six months from terminating from one employer to another then they become a new hire under PEPRA.

Q. All right.

A. And when you --

Q. And is that scenario three?

A. That's scenario three.

Q. All right. Could we, on the screen at least, expand it back the entire month. Great. All right. So that's scenario three.

Could you just briefly explain then what that shows?

A. So scenario three in this case, we have the same situation where this employee worked ten years with the City of Stockton, and then the contract was impaired.

So they are going to get $10,944, just like under scenario two from the City, and another 15 years with another CalPERS or a 1937 Act agency; but instead of accruing at 3 percent, they are going to accrue at 2 percent, because that's the new PEPRA formula, new hire PEPRA formula.

So that is 30 percent of high-labored salary, as opposed to 45 percent of high-labored salary, so that is $27,360. And when you add that to the 10,944, the total pension now for 25 years of service is 38,304.

Q. And I forgot to ask a question a minute ago.

In scenarios two and three, the demonstrative talks about after six months. And let me ask: Six months after what?

A. Six months after terminating employment with -- terminating the contract basically with CalPERS. So if you, if the contract with CalPERS is terminated then the employee is no longer accruing under CalPERS, the formula, so they have six months to get to another agency in order to retain the classic status.

Q. So that would be the six months in scenario two where the employee successfully left; is that correct?

A. The employee successfully left within six months and they retain their classic status.

In scenario three, they waited more than six months, so they became a new hire under PEPRA, so they have lost their classic status.

Q. Okay. Now would you briefly explain for us what scenario four is?

A. Scenario four is what the CalPERS pension would be for the same employee if the contract is impaired, and that's the $10,944 figure that we talked about, which is just 16 percent of the unimpaired pension, and this would be the pension that would be paid from CalPERS.

Q. All right. So under scenario four, the employee that has stayed with Stockton after CalPERS has been impaired;

correct?

A. Correct.

Q. Now, in the assumptions on this first page of the demonstrative it assumes no salary increases.

Why did you make that assumption?

A. We basically made that assumption because it just makes the math easier. If we could have included a 25-year history of salaries, but the end result would be that the bars, the scale and bars would be the same.

So just to make the math easier to explain, we assume that there's no salary increased throughout their career.

Q. All right. Thank you.

Let me ask you to look at the second page of the demonstrative, please.

A. You know, there's one other thing I failed to mention about this page 2, is that under scenario three when the employee loses classic status and is a new hire under PEPRA, not only is their pension reduced, but they also have to pay more toward their pension --

Q. Why is that?

A. -- so the member contribution is increased under the new hire tier of PEPRA. And in this case this employee would need to pay for those 15 years that they are working as a new hire under PEPRA, they would pay an additional $27,360.

Q. Is that reflected on the last line of the first page of the demonstrative?

A. Yes, it is.

Q. Okay. So I apologize. Let me go on to the second page of the demonstrative.

What is this bar chart for -- it says Annual Pension Four Scenarios For Miscellaneous Employees.

Can you describe what you did here?

A. This is the same analysis as we just went over for the safety employee. But instead it's for a miscellaneous employee. The rules for retirement for a miscellaneous employee are different than they are for a safety employee.

So in our example here, this is a miscellaneous employee who would retire at age 55 with 30 years of service, ten of which was already completed with Stockton and a final average salary of $82,000. So basically the scenarios are the same.

Scenario one is CalPERS contract is unimpaired and the employer remains with the City of Stockton, and in that case this employee would receive $49,200.

Scenario two is that the CalPERS pension is impaired, the employee is going to leave Stockton within six months to retain classic status. And in this case the employee's pension would be $39,360, which is 80 percent of the unimpaired amount.

Scenario three is where this employee leaves Stockton after six months have elapsed, and so he or she receives the new hire status under PEPRA. So total of pension after 30 years would be $27,880, which is 55 percent of the unimpaired pension.

And then finally scenario four is the CalPERS pension impaired, which is $6,560.

Q. Now for both of these charts, one for safety employees and one for miscellaneous employees, the assumption here is a mid-level employee; is that correct?

A. Yes. This is a mid-level nonmanagement employee, and for public safety it's the salary for a mid-level sergeant.

Q. Using the same assumptions, what is the impact for an employee who is a higher paid person than for the mid-range per persons that are on these two pages?

A. So the bar charts would look very similar, the dollar amounts would be greater, but the actual shape of the chart would be the same.

For a person, if you look at the footnotes on the bottom of the page, there's a salary cap of 136,440 for a non-Social Security agency.

So that cap might come into play here, although I'm not sure that it would, because as I mentioned earlier these people would probably have to be covered by Social Security, at least since the plan -- there would be no plan in place for the time period while they are working at Stockton, unless they immediately shifted over to another plan.

Q. All right. Thank you. You mentioned one option that I just want to ask you one or two questions about for the City as an alternative being a defined contribution plan.

Would it be possible for the City to establish a defined contribution plan?

A. Yes, it would.

Q. How would that compare to what the City now has through CalPERS?

A. Well, a defined contribution plan is different than a defined benefit plan, and it's all in the name.

In a defined benefit plan, the benefit is defined and then the contribution changes depending upon how the benefit needs to be funded. So the contribution is not fixed, but if it is ....

In a defined contribution plan the contribution is fixed, but the benefit is not. So in a defined contribution plan, you get what your comp out is worth.

And basically in a defined contribution plan, all the risks of the plan have been shifted from the employer to the employee and those risks include investment risks. So the employee in a defined contribution plan is responsible for investing his or her individual assets.

The mortality risk in a plan like CalPERS where mortality is pooled and the plan is funded, because we know plan. Is it possible for an entity to have no pension plan?

THE WITNESS: It is. It's an employer decision, whether or not they want to provide pension benefits to their employees or not.

THE COURT: And is it possible for a California City to contract for, to arrange a pension plan with a private pension plan?

THE WITNESS: I would say yes, I'm aware of one such City in California.

THE COURT: Which City is that?

THE WITNESS: City of San Clemente in Southern California.

And just for your information, the reason I'm aware is that City recently made the decision to join CalPERS. So they have not yet joined CalPERS, but they are looking to transfer from their private plan to CalPERS. So that's how I became knowledgeable about their current arrangement.

THE COURT: I see that there are references to -- again I'm looking here at pages 312 and 313 of your exhibit which is actually part of Exhibit 8, it's about 72, 73 pages into that exhibit -- I see the reference to Social Security and the periods of Social Security have been -- page 314 -- Social Security benefits have been applied in Stockton. So that happened and then it was effective for a period of years.

cities in a moment.

The City's pension liabilities are almost completely disproportionate to the size of its workforce. You heard this morning, according to CalPERS, Stockton's safety plan contributions, currently 34.6 percent of payroll, and they are projected to rise to an astounding 57 percent of payroll in Fiscal Year 2019-20. You can see that from Table 7 in Mr. Moore's report.

And it's no secret why the City's pension contributions are so high. The City has admitted that its past practices enabled employees to turn pension spiking into a, quote, unquote, art form, and thus get much larger pensions for the rest of their lives. That's right there in Exhibit 410.

In this case, by assuming pension liabilities in full and not restructuring them, the City will continue to pay for its past mistakes for the next three decades or more.

THE COURT: So what do you contend should be done with the pension liabilities?

MR. JOHNSTON: One of two things, Your Honor. First, the City could impair its pension liabilities. And we can talk about how that's legal under the Bankruptcy Code and the supremacy clause of the constitution, it can treat pension creditors on a fair, equitable, and nondiscriminatory basis with other creditors, or it can roll the dice, it can swallow hard and say it's going to assume its pension liabilities and at the same time give Franklin a fair share of the probable estimated future revenues.

That's the choice that the City faces. The City can't say "We're going to assume our pension liabilities, our largest liability in full, and we have nothing left over for anybody. I don't believe that that's how the best interest tests works.

You heard some testimony this morning --

THE COURT: So it's your contention that pensions can and should be impaired?

MR. JOHNSTON: Yes. And I'll turn to that right now, why not, briefly. We heard the argument from Mr. Gearin a little bit and we read it in the CalPERS brief that there's really no opportunity for the City here, because pensions can't be impaired, period, end of story.

I submit that that's just wrong, Your Honor. We did file a separate brief on this very subject, which I think goes into it in some detail. And, frankly, Your Honor's opinion on retiree health benefits comes pretty close to deciding the issue as is, but I will hit some highlights for you.

To start, as you held in the retiree decision and as many cases before you have held, state law that runs contrary to the Bankruptcy Code is preempted, even in Chapter 9 cases.

RSVP'd to the physical agility test. Less than half that number actually showed up. Many were quickly disqualified.

11. Both Neumark and Brann make much of the fact that the Department hired roughly 70 new officers in 2012. Neumark Report, at 20; Brann Report, at 18. Using this figure to argue the Department is in good shape in terms of hiring is off-base for two reasons. First, despite these hires, the Department still cannot reach its budgeted number of sworn officers. As a consequence, drawing attention to this figure actually emphasizes how many officers the Department has been losing. Second, hiring roughly 70 new officers in one year—something the Department had no other choice but to do—is dangerous for a city like Stockton, which needs not just officers, but experienced officers. Neither Neumark nor Brann takes into account the danger to public safety and the Department itself of having too many new officers on the force.

12. Brann calls into doubt the fact that the Department has difficulty recruiting qualified lateral candidates. Brann Report, at 16. To do this, he cites the 164 lateral transfer applications the Department received in 2011 and 2012. Even though he correctly notes, "[i]t appears that the SPD did not elect to hire any of these lateral transfer candidates," he states the fact they applied "is an indication of interest by lateral candidates." *Id.* Brann has no knowledge of the quality of these applicants, and if he did, he would see why the Department hired none of them. Simply put, each applicant was unqualified. Brann fails to appreciate the idea that the number of applicants does not matter if none of them are qualified.

__The Reasons Officers Left__

13. Neumark and Brann argue that because Stockton police officers transferred to Departments located in cities like Oceanside, CA and Monterey, CA, they did not leave Stockton for monetary reasons, but because they wanted lifestyle changes. Neumark Report, at 8; Brann Report, at 13. I do not believe this is the case, and believe that monetary reasons are at least significant factors in why these officers left. As I stated in my deposition, I conducted exit interviews with the officers who transferred out of the Department in 2012 while I was Chief. Neumark and Brann did not take part in any of these interviews. All of the officers told me that monetary issues were the primary reason they were leaving. Since fiscal year 2008, many of

these officers experienced cuts in their pay and benefits as high as 20% and 30%. The Department had very few officers leaving to other departments before these cuts happened. Since my deposition, I was able to reflect on the exit interviews I conducted. I specifically recall 20 of these interviews. All 20 of the officers I interviewed told me they left for monetary reasons. Many had difficulty paying bills. Others worried about retirement. And even more just wanted financial stability, something they believed the Department could not offer them.

14. On January 23, 2013, I attended a Stockton Police Department alumni dinner. At that dinner, I spoke with six former Stockton officers individually who transferred to different agencies in 2012. All six reiterated what they told me in their exit interviews: they left because of cuts in their pay and/or benefits.

15. As Chief of Police, it is my job to keep a pulse on department morale. I frequently communicate with my officers on many issues, including the City's current financial situation and the bankruptcy case. One of the most frequently expressed concerns by my officers regards compensation and benefits, and how the City's financial situation will affect them. During these conversations, many of my officers have said they will depart to another agency if the Department's PERS contract is broken. Others have stated that they will leave the Department if any additional compensation or benefits cuts occur, no matter how slight.

Officers-per-thousand

16. Brann states "it is a fallacy to attempt to establish a causal relationship between crime and police staffing levels." Brann Report, at 7. I disagree, and other reports disagree as well. For example, the University of California Berkeley report, "The Effect of Police on Crime: New Evidence from U.S. Cities, 1960-2010" finds a link between staffing levels and crime. And this is a contemporary report published on November 11, 2012. There is also a 2010 RAND Research Center on Quality Policing report, "Hidden in Plain Sight: What Cost-of-Crime Research Can Tell Us About Investing in Police" that summarizes contemporary research also finding such a link. Additionally, San Jose's Independent Police Auditor, Judge LaDoris Cordell, stated she believes San Jose's rising crime and homicide rates are due to cuts in police staffing. Mike Colgan, *San Jose's Police Auditor Blames Officer Cuts For Rising Homicide Rate*, CBS SF

I, Justin McCrary, hereby declare:

1. I am a law professor and co-director of the Law and Economics Program at the University of California, Berkeley. I am also co-director of the Crime Working Group of the National Bureau of Economic Research. I make this declaration in support of the City's Reply to Objections to Statement of Qualifications Under Section 109(c).

2. I have been engaged by the City of Stockton's counsel, Orrick, Herrington & Sutcliffe LLP, to assess the opinions, conclusions, and analysis set forth in the declarations and expert reports of David Neumark and Joseph Brann, as clarified in their depositions, and to provide my opinions regarding their reports, declarations, and testimony.

3. I have reviewed the declarations and reports of Mr. Brann and Professor Neumark, filed by the so-called Capital Markets Creditors on December 14, 2012. I also attended Mr. Brann's deposition on January 24, 2013, and Professor Neumark's deposition on February 5, 2013. While Mr. Brann has significant experience in policing and Professor Neumark in labor economics, neither has an expertise that bridges crime and labor economics, the two subject areas I believe are most germane to analyzing the City's concerns regarding the reduction of pension benefits. By contrast, I received my Ph.D. in Economics in 2003, with a specialty in labor economics and econometrics from the University of California, Berkeley, and have published articles on crime, police departments, and statistical methodology in leading economics journals such as the *American Economic Review* and the *Journal of Econometrics*. Furthermore, the Crime Working Group of the National Bureau of Economic Research that I co-direct currently holds the highest quality annual scholarly meetings in the United States regarding crime, policing, and crime policy. Together with my co-directors in the group, I co-edited the book *Controlling Crime: Strategies and Tradeoffs*, published by the University of Chicago Press in 2011. A true and correct copy of my curriculum vitae is attached hereto as Exhibit A.

4. I disagree with Mr. Brann and Professor Neumark's opinion that a modest pension benefit reduction would not lead to a mass exodus of experienced officers, and their opinion that the City of Stockton's evidence on this question is insufficient. Brann Decl., ¶ 4; Neumark Decl., ¶ 5. Given the evidence I have reviewed for this engagement, my background knowledge of

crime, policing, crime policy, police hiring, and the internal functioning of police departments, and my background knowledge of labor economics, it is my opinion that the City of Stockton ("the City") is at a crisis point in regards to police department staffing. Further downgrades to compensation and benefits, such as the modest pension benefit reductions contemplated by Mr. Brann and Professor Neumark, in my opinion, are likely to push the City over the precipice, leading to a further acceleration of police department departures, including departures of some of the most able officers, and to worsened morale among those officers who remain with the department.

5. My disagreement with Mr. Brann and Professor Neumark in this regard is primarily based on the reasons set forth below, and more fully explained in my report ("the Report"), a true and correct copy of which is attached as Exhibit B:

a. The Stockton Police Department ("the Department") has already downgraded compensation and benefits over the past four years, which has accelerated the normal process of attrition at the Department.

b. Mr. Brann and Professor Neumark's alternative explanations for why officers have been departing Stockton neither account for the timing of the departures nor comport with the findings of contemporary economic literature.

c. Police officers, young and old, value their pensions highly, as is obvious by virtue of the fact that nearly every police department nationally offers a pension.

d. As a matter of common sense and economic theory, virtually every worker in the economy has a "trigger point," that is, a sufficiently severe downgrade to compensation and benefits at which he or she will seek employment elsewhere or simply stop working.

e. Given the downgrades in compensation and benefits since 2008 and the reductions in police staffing since 2008, which has left the same or more work to be done by fewer officers, a modest pension reduction would likely bring a significant number of Stockton police officers to their "trigger point."

6. I also disagree with Mr. Brann's conclusion that a modest pension benefit reduction would not lead to increased crime. A pension downgrade would likely lead to a significant number of officer departures, which in turn would compromise the safety of the citizens of Stockton.

7. My disagreement with Mr. Brann in this regard arises from my extensive econometric research on the effect of police on crime and my associated review of the literature in economics and criminology on the effect of police on crime and the monetization of safety. My disagreement is primarily based upon the following, and is more fully explained in the Report:

a. Contrary to Mr. Brann's position, there is extensive, multi-decade literature establishing a causal connection between crime and police staffing levels.

b. In a paper I co-authored, "The Effect of Police on Crime: New Evidence from U.S. Cities, 1960-2010,"[1] my co-author and I concluded that as of 2010, Stockton was the number 2 most under-policed city among California cities with a population of 200,000 or more. Updating our rankings for the purposes of this case, I concluded that as of 2011, Stockton was the number 1 most under-policed city among California cities with a population of 200,000 or more, surpassing the previous leader, Oakland, California.

c. The conclusion that, as of 2011, Stockton was the single most under-policed city among California cities with a population of 200,000 or more is based on my empirical estimation that every $1 less spent on police costs would result in over $3 in crime costs for Stockton residents. I predict this result will be more extreme once complete crime and police staffing data

[1] Chalfin and McCrary (2013), NBER Working Paper 18815, attached hereto as Exhibit C.

for 2012 become available given that Stockton crime rates in 2012 were relatively high compared to other California cities.

d. My methodology for monetizing safety is widely accepted by state and federal governments as well as the economics and criminology literature. This acceptance is further detailed in the Report. Moreover, my methodology for calculating Stockton's cost-benefit-ratio for police hiring and crime costs is uncontroversial and further described in the Report and my paper, Chalfin and McCrary (2013) referenced above.

8. Thus, it is my opinion as an expert in labor economics and criminology that, in the interest of public safety, Stockton has legitimate concerns that modestly reducing pensions would exacerbate its police department's present retention and recruitment problems. Indeed, taking such a measure would not be cost-effective for Stockton, as I further describe in the Report.

Executed this 14 day of February 2013, at Kensington, California. I declare under penalty of perjury under the laws of the State of California and the United States of America that the foregoing is true and correct.

Justin McCrary

d. The elimination of the Narcotics Enforcement Team has resulted in an increase of drug trafficking within the City and also reduces the funds received through disposition of asset forfeiture proceeds. These proceeds are used to fund capital equipment and other one-time needs such as tactical gear, weapons and protective equipment critical to equipping sworn staff.

e. Elimination of the Police equestrian program and Downtown Bike Patrol, except by contract, has reduced the visible presence of law enforcement in the downtown core and at events. As a result, vagrants are returning to the downtown and several purse and jewelry snatchings have occurred. When the patrols were in effect, virtually no crimes of this nature were committed downtown, especially in broad daylight.

f. Reduction of Community Service Officers has severely limited the ability of the Police Department to attend community meetings and respond to non-emergency accidents and calls for service including traffic control and parking enforcement (which has also reduced traffic violation revenue).

g. Reduction of security camera monitoring from full-time to part-time has negatively impacted investigations as valuable "eyes in the sky" are sometimes not available to spot crimes in progress or follow pursuits in downtown and 66 other target areas in Stockton.

9. These reductions have significantly and adversely affected the community at a time when a much higher service level in terms of police protection is needed. The City has the highest total crime rate per capita for any city with a population of 100,000 or greater in California. While violent crime rates dropped 5.5% nationwide in 2010, that year they were up in Stockton[2], which ranked 10th in the U.S. with 13.81 violent crimes per 1,000 residents.[3]

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[2] Stockton Police Department Crime Comparison and Police Activity Highlights December 2010, a true and correct copy of which is attached hereto as Exhibit C.

[3] Among large cities. *See* U.S. DOJ Crime in the United States, 2010 Table 8: http://www.fbi.gov/about-us/cjis/ucr/crime-in-the-u.s/2010/crime-in-the-u.s.-2010/tables/10tbl08.xls/view . A true and correct copy of this webpage, as accessed June 28, 2012, is attached hereto as Exhibit D.

10. In 2011, there were 58 homicides in Stockton, an all-time record. As of June 25, there have been 31 homicides in calendar year 2012. Thus, the City is on pace to exceed the 2011 rate.

11. Gun violence is up 30% in 2012, compared to last year. As tracked by the department, the number of Aggravated Assaults with a Firearm nearly doubled from 99 in 2009 to 196 in 2011.

12. I believe that further cuts to police protection would imperil the City's residents. As part of the City's analysis leading up to the February 28, 2012 City Council action authorizing the commencement of the AB 506 mediation process, City departments were asked to submit plans demonstrating what reductions would have been necessary in order to balance the budget absent entry into the AB 506 process. Each department was directed to assume that an average of 15% in department reductions would be required.

13. I prepared and submitted my analysis to City staff, describing the effect of a 15% reduction in police services. According to my analysis, a 15% reduction would necessitate the elimination of all 30 of the department's community service officer positions, an additional 64 sworn officer positions, and a range of support staff positions.

14. The consequences of a 15% reduction in police services would be significant. Police officers would only be able to respond to the most serious violent crimes in progress. The number of cases investigated would be reduced to only those mandated and significantly lengthen the time to solve crimes. Such a reduction would require near outright elimination of all special teams including Gang Violence Suppression, Vice, FBI Task Force, METRO/Narcotics, Parolee and Corrections Team, and the newly formed Community Response Team. The department would be unable to provide basic traffic control for events or attend any neighborhood meetings. Animal Services and Graffiti Abatement would be eliminated. It also would be unable to respond to traffic accidents unless fatalities occurred. Significant reductions to records and telecommunications staff would result in dispatching delays and a reduction of public hours for customer service.

15. In my opinion, with respect to police services, continuing to reduce employee compensation and benefits beyond the reductions imposed over the last several years will not provide a comprehensive long-term solution to the City's financial troubles. With respect to hiring and retaining police officers, the City is an employer in a competitive marketplace. Reducing total compensation and benefits to below market rates has already resulted in and would continue to hasten the departure of employees to other police departments. As noted above, although we have authorization to have 343 sworn positions, for the last year our filled staffing has averaged 320. This requires the department to hire back officers to cover shifts, placing an extra burden for an extended period of time on our remaining staff. This is particularly true for a city like Stockton, due to its location and historical crime profile. Though a competitive employer, for some potential recruits Stockton might be considered a less desirable location than coastal cities with less crime.

Executed this 28 day of June 2012, at 3:15 p.m. I declare under penalty of perjury under the laws of the State of California and the United States of America that the foregoing is true and correct.

Eric Jones

I, Eric Jones, hereby declare:

1. I am the Chief of Police in the City of Stockton, California ("the City" or "Stockton"). I make this declaration in support of confirmation of the City of Stockton, California's ("City") First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013).

2. I have served in the Stockton Police Department in some capacity for over 20 years. I became the Chief of Police in March of 2012. Prior to becoming Chief, I served as Assistant Chief from September 2011 to March 2012 and as Deputy Chief from March 2008 to September 2011. I hold a bachelor's degree in Criminal Justice from California State University, Sacramento, and a Masters of Public Administration from National University. I am a member of the Central Sierra Police Chiefs Association, California Police Chiefs Association, and the International Association of Chiefs of Police. I hold certificates from the Commission on Peace Officer Standards and Training, and am a member of the FBI's National Academy Law Enforcement Executive Development Association and Police Executive Research Forum.

3. On June 28, 2012, I executed a declaration in support of the Statement of Qualifications the City filed on June 29, 2012 (the "June Declaration" or "June Decl."). On February 15, 2013, I submitted a declaration in support of the City's Reply to Objections to Statement of Qualifications Under Section 109(c) (the "Reply Declaration" or "Reply Decl.").

The Continuing Challenges To Public Safety In Stockton

4. As of the date of this Declaration, all of my testimony in the June Declaration and Reply Declaration continues to be true and accurate to the best of my knowledge. The City of Stockton continues to suffer from a disproportionately high crime rate and low number of police officers. Violent crime, despite a reduction in 2013, is still extremely high in Stockton. Already in 2014 (as of March 25), there have been 12 homicides, compared to six homicides at this time last year. Further, although violent crime reduced in 2013, overall crime did not.

5. Another major challenge is the continually understaffed police department. Not including positions funded by Measures A and B, as of today the Stockton Police Department has 365 budgeted positions (which include the recent COPS hiring grant). Although we have made

some incremental progress in our hiring outpacing our attrition, the police department has so far been able to fill only 351 of these positions. This is partly because hiring has outpaced attrition at an extremely slow pace. From January 2012 to date (March 25, 2014), the Stockton Police Department has hired 134 police officers; during the same time period, 104 police officers have left the department through attrition. This attrition itself is a major challenge to public safety, because it takes with it vast experience that is difficult to replace. In fact, the average tenure of the Stockton Police Department's officers has dropped markedly. Comparing the 366 police officers and sergeants (not including police managers and commanders) that the Stockton Police Department had in July of 2009, and the 328 officers and sergeants Stockton has as of March 2014, the average tenure has dropped from 14.22 years in 2009 to 9.34 years in 2014.

6. Once the current 365 budgeted positions are filled, under Measures A and B the authorized budgeted positions for the police department will increase to 485. The police department believes that if aggressive hiring were to take place, we could potentially reach the 485 police officer level about three years from now. But even at the level of 485 police officers, the officer-per-thousand-resident ratio would be only 1.6. This is still far from the 2.0 ratio recommended in 2006 for the City of Stockton by Dr. Anthony Braga, as well as the 2.0 ratio recommended in 2013 by criminal justice consultants David Bennett and Donna Lattin as part of their Marshall Plan report. Stockton needs about 600 police officers to reach the recommended 2.0 officer-per-thousand-resident, and even at 485 officers, Stockton will be nowhere near this level.

7. Additionally problematic is the fact that police officers are still leaving the Stockton Police Department for other police departments. The Stockton Police Department is not competitive in the marketplace with other police departments and this is drastically affecting our retention and recruitment. Of the 104 police officers that left the department from January 2012 through March 25, 2014, 44 left for other police departments. I continue to speak with exiting staff as well as various members of the department to keep a pulse on department morale. Most officers, as well as my managers and commanders, continue to tell me that if the Department's CalPERS contract is broken, they will depart to another agency. Others continue to say that they

will leave the Department if any additional compensation or benefit cuts occur, or even if they fail to get any of their previous 20-30% cuts restored. The Department morale is fragile, and the continued instability is causing police officers to depart or apply to other law enforcement agencies. And all of this is happening at a time when Stockton most needs experienced, high-quality police officers.

Importance Of Measure A

8. The passage of Measure A was critical for public safety in Stockton. Proceeds from Measure A will fund the Marshall Plan, which will bring 120 additional police officers over an approximate three year period and fund the Office of Violence Prevention and Neighborhood Blitz teams. The proceeds will fund Stockton crime-fighting strategies that have been touted by national experts like Stewart Wakeling of California Partnerships for Safe Communities, United States Attorney for the Eastern District of California Benjamin Wagner, and COPS Office Director Ronald Davis. Without the passage of Measure A and its future addition of staff, we would not be able to combat crime effectively where we are the second-most violent City in the State of California. Violent crime is still a very serious issue for Stockton, and although Stockton experienced significant violent crime reductions in 2013, as of March 2014, Stockton is currently on pace with the record-breaking homicide rate of 2012. Unfortunately, as explained above, even with the passage of Measure A we will continue to be an understaffed police department.

Executed this 21st day of April 2014, at Stockton, California. I declare under penalty of perjury under the laws of the State of California and the United States of America that the foregoing is true and correct.

Eric Jones

increases in pension contribution rates required by CalPERS, and potential state budget effects. Staff also warned the Council concerning the unfunded retiree healthcare liability: "In order to properly fund this liability the City should be setting aside an additional $27 million on an annual basis. The City has not been setting these funds aside."

24. Following this update, staff returned to the City Council in May 2011 to work out a mechanism for balancing the fiscal year 2011-12 budget. The good news was that the prior years' steep decline was expected to level off (a forecast that proved inaccurate). Despite this, the same structural imbalance that bedeviled the budget process the prior year remained: costs were still significantly greater than revenue.

25. As staff presented on May 17, 2011, the City was facing another staggering deficit of $37 million in fiscal year 2011-12 in the face of the "restoration of previously withheld salary increases, new scheduled salary increase for 2011-12, and soaring health and pension costs." Balancing the budget just by service reductions was deemed an unacceptable approach, though some service reductions would be necessary. The reason was that the health, safety, and welfare of City residents would have been jeopardized by significant staffing reductions.

26. Accordingly, in May 2011, staff proposed, and the City Council adopted, resolutions continuing the City's fiscal emergency. True and correct copies of the May 17, 2011 staff report and the resolution adopted on May 17 by the City Council are attached collectively hereto as Exhibit M. With the City Manager exercising his authority under the fiscal emergency, the City balanced the fiscal year 2011-12 budget, but only by continuing the prior year's fiscal emergency and obtaining an additional $25 million in compensation reductions and $12 million in staffing reductions, mainly in the Fire Department. This was the fourth consecutive year in which some form of compensation reduction or service reduction was adopted, and the second year in a row in which severe cuts to compensation and services occurred.

Severe Service Reductions Have Harmed The Community

27. As noted above and captured in the chart in Paragraph 20, in addition to significant reductions in labor costs, in order to balance its General Fund over the last several years the City has been forced to make severe reductions in staffing and services, with serious repercussions to

the safety and welfare of the City's residents. The primary form of service reductions has been the elimination of City positions, either through layoffs or through not filling vacancies. These staff reductions have necessarily translated into service reductions.

28. This can be seen most markedly with respect to public safety, which has been a necessary target of reductions because it accounts for such a large proportion of the General Fund. As described in the declaration of Eric Jones being filed concurrently, over the last five years the City has been forced to remove 22% of the sworn police force in a city with an already high crime rate. Similarly, the Fire Department now responds to many more calls per firefighter than do departments in comparable jurisdictions. Due to reductions in the number of trucks on duty on account of personnel reductions, the arrival of a second truck at structure fires is often delayed, potentially placing people and structures at greater risk. Alarmingly, the Fire Department has been forced to dispatch mechanics with its crews in the event that aged equipment breaks down at a major fire.

29. Nor have the effects of the City's budget crisis been limited to public safety. The General Fund also is the source of payment for public works, libraries, recreation, and other quality-of-life programs on which the City's residents rely. The City has been compelled to drastically cut back these expenditures through elimination of positions and work hours, reduction in operational hours, and the outright shutdown of certain programs. As shown above, it has eliminated almost half—43%—of non-safety positions since fiscal year 2008-09.

30. For public works, these reductions have meant sharp drops in maintenance, repair, and replacement budgets. As of today, approximately 172 City vehicles are past their useful life. Even for police and fire vehicles, no future reserves exist, and it is likely that aging fleets will not be replaced on a timely basis in the future. Though the City's roads currently score as "fair" based on the commonly used Pavement Condition Index metric, they are expected to deteriorate going forward as the City lacks the funding to maintain them. Tree and parks maintenance has been deferred. Library renovations have been cancelled. Applicants for permits and other approvals, along with those seeking information, endure longer wait times. City Hall itself is

Q. In fact, no one at your firm Conway MacKenzie is an actuary, are they?

A. That's correct.

Q. Now, looking at your resume, which is Exhibit 1 to your report, I think you have that up there, correct?

A. Yes.

Q. It's current and accurate, sir?

A. Yes.

Q. And so I can take it from your resume that you, sir, are not an actuary?

A. That's correct. And that's what I've testified before.

Q. And you have no formal training at all in actuarial sciences, do you?

A. That's correct.

Q. Now, from looking at your resume, I see that since you graduated from Michigan State University, your employment has been entirely working in the private sector; is that fair to say?

A. How do you define private sector?

Q. Well, let's go through it. You worked at Deloitte & Touche, did you not?

A. I did.

Q. And that's in the private sector, correct?

A. I'm just wondering how are you defining private sector?

Q. It's not a government agency, is it?

A. It's not a government agency.

Q. And when you were the CFO of Horizon Technology LLC, the automotive supply company, you were not working for a governmental agency, were you?

A. That's correct. That is not a governmental agency.

Q. And when you began working as a consultant in Conway MacKenzie, you were again working in the private sector, correct?

A. It was not a governmental agency, correct.

Q. Now, let me ask you then about your experience with respect to commenting upon the long-range financial plan. You have never been a chief financial officer for a City, have you?

A. I have not.

Q. You've never been the budget director for a City, have you?

A. I have not.

Q. You have never directly managed or tried to create a budget for a California City, have you?

A. Manage or create a budget for a California City?

Q. Yes?

A. In what regard? As part of my analysis, or for the City itself?

Q. For a City itself?
A. Not that I'm aware of.
Q. Now, you heard that Mr. Leland, whose testimony you heard the other day, was the Director of Finance for the City of Fairfield for 26 years; did you hear that testimony?
A. I did, yes.
Q. And based upon that, you would credit him for having experience in actually preparing budgets and projections for California cities, would you not?
A. I don't know specifically what Mr. Leland did in that role.
Q. Now, in the firm's work of Conway MacKenzie that you've been doing for the City of Detroit, you have been involved in analyzing pension liabilities for the City, correct?
A. Yes, along with a team that makes up what we refer to as "the pension task force."
Q. And that team of pension task force people includes actuaries, correct?
A. It does, yes.
Q. The Milliman firm is the actuary firm that works as part of your team to develop with your team for some of Detroit's pension obligations?
A. Yes, Milliman is engaged by the City of Detroit and works on the pension task force.

Q. You mentioned that you visited the City of Stockton in your testimony earlier today; that's the only time that you have personally visited the City of Stockton, correct?

A. Yes.

Q. And although you say you visited the Swenson and Van Buskirk Golf Courses and Oak Park, and toured downtown Stockton, it's true, is it not, you didn't go into City hall?

A. I did not go into City hall, correct.

Q. You didn't talk to any Stockton City employees, did you?

A. That's correct, I did not.

Q. You didn't talk to any Stockton department heads?

A. I did not.

Q. Now, in the City of Detroit case however, you do have access to department heads in Detroit, correct?

A. Yes.

Q. And you do have the opportunity to talk to them about ways that that the City of Detroit can improve the operations, correct?

A. Yes.

Q. But in this case, you didn't have that opportunity, correct?

A. I did not have that opportunity, that's correct.

Q. You didn't talk to any Stockton City Council members, did you?

A. No. This is a data point that supports the City's characterization that the forecast is conservative.

Q. And as a conservative plan versus a plan that is aggressive, it is more likely to be feasible than the aggressive plan, correct?

A. Mr. Hile, I thought we've already had this conversation. I take no position on being feasible, and the City defines what it means by a conservative forecast in that the variances are more likely to be good news than bad news.

Q. And if they are, more likely to be good news than bad news, this plan is more likely to be feasible, correct?

A. I don't have an opinion on that.

Q. Now, I want to ask you a couple of things about what you were aware of when you wrote your report, particularly with respect to this first opinion section of your report. At the time that you wrote your report, you were not factoring in certain California laws and propositions that affect municipal tax collections, were you?

A. Could you clarify what you're referring to?

Q. Sure. For instance, at your deposition, I asked you if you could tell me what Proposition 13 was. Do you remember me asking that question?

A. You asked me about several California statutes.

Q. And do you remember that you testified that you heard of Proposition 13 but you couldn't tell me what the specifics were?

A. I think that could have been my answer, yes.

Q. And you also heard Mr. Leland testify yesterday about the -- Monday, about the effect of Prop 13 and Prop 8 on short-term and long-term property tax growth; did you hear that testimony?

A. I certainly heard his testimony about property taxes, yes.

Q. And those considerations that Mr. Leland testified about on Monday were not things that you were aware of when you did your report, were they?

A. I'm not sure that I understand your question.

Q. Well, if you didn't know any of the specifics of Prop 13, you certainly weren't able to factor that into your report when you wrote it; isn't that true?

A. I think what you're referring to is that I would not have been able to factor those into projections, and I didn't develop projections.

Q. And at your deposition, when I asked you, you didn't know what Proposition 4, the gambling initiative, was; isn't that correct?

A. As I indicated, you asked me about several California statutes that I wasn't aware of.

Q. Another one was Article 16 Section 18 California Constitution, debt limit; you weren't aware of that specifics, again, were you?

A. Again, I don't recall all of these statutes that you asked me about, but certainly that could be the case.

Q. And you weren't aware of what the special fund doctrine was, were you?

A. Same answer, Mr. Hile.

Q. And you didn't know what Prop 218 was, did you?

A. Again, same answer.

Q. Let's move to the minimum cash balance and the contingency issue for a minute. Let's look at page 4 of your report. In that report on page 4, you claim that the City is, quote, "hoarding cash in the long-range financial plan." Do you see that?

A. Could you point me exactly where?

Q. Yes. I'll find it in a minute. Take a look at the bottom of page 9, the last two sentences on that page. The last two lines say:

"**Q.** And the conservatism embedded in the City's long-range financial plan obscure that the City is actually hoarding cash in its long-range financial plan."

Do you see that?

A. I do.

Q. Now, I think that it's fair to say that one of the bases for that assertion is the fact that the City is maintaining both a minimum cash balance, expressed as a

A. No, certainly not.

Q. What is your opinion in that regard?

A. Again I think the primary point, first of all, I have never used anywhere close to those words and I don't know how anyone could make that assumption based on my report.

Secondly, Ms. Nicholl, in her rebuttal report, I think actually right after that sentence, pretty much goes on to confirm my point, which is this is out of the City's control.

And I don't have Ms. Nicholl's rebuttal report up here, but that essentially goes on to confirm that there are numerous factors that go into contributions, and in the end CalPERS would be the one making those determinations.

Q. We've heard a lot from the City in this case about its belief that it has no alternative but to assume the pension liabilities. Do you have an opinion about that?

A. I do.

Q. All right. Can you please explain it?

A. Well, I'm living with it firsthand right now in the City of Detroit bankruptcy. The City of Detroit made a decision that after years of not putting money towards services and investment because it had to devote so much towards pension and OPEB liabilities, that it needed to get those under control, and in order to put adequate funding towards services and investment that residents and businesses expect it needed to adjust those accrued benefits for both pension and OPEB.

What I saw in that process, certainly I'm hearing a lot of here, based on comments yesterday, there was a strong belief that if anyone tried to touch accrued benefits, especially pension benefits, that all of the employees would leave. We have not seen that.

As has been publicly reported, the City's plan does come up to the plate in adjustment to accrued pension benefits, there are numerous organizations or parties that are impacted by that, that have actually supported that, including the retiree committee for the City of Detroit, and we have not seen any impact from an employment standpoint.

And the reason why is because I think that similar to a lot of situations when you are in distress, there's an emotional aspect; however, leaving is not going to change anything.

And what we have done specifically with the City of Detroit, is we have made sure that we have a package that is going to attract employees going forward, and certainly in this regard I understand there are a lot of elements that would go into adjusting or impairing accrued pension benefits.

My experience, my firsthand experience with the situation that's going on right now, where this is happening, has not resulted in what has been expressed.

Q. So in your opinion, how is the City's decision not to impair pensions relevant to the treatment of Franklin's claim under the plan?

A. Well, if the City's position is it can't pay Franklin more than a penny on the dollar because it has no money, I find that inconsistent with assuming as unimpaired this liability relates to pensions, especially given the nature of that liability.

MR. JOHNSTON: Thank you for your indulgence this morning, Mr. Moore, I know I had you on the stand for a long time. Your Honor, I would tender the witness.

THE COURT: Cross-examination.

CROSS-EXAMINATION

BY MR. HILE:

Q. Mr. Moore, let me go back to the beginning to start with. I think you testified that you are working with the Jones Day firm in your assignment for the City of Detroit; is that correct?

A. Jones Day is one of the advisers that's involved in the City of Detroit restructuring, yes.

Q. And so it's one of the firms, law firms that you are working with there; correct?

A. Yes.

Q. And this is your third assignment, is it not, with the Jones Day firm, the first being the Jefferson County case

Year 2019-20. That's just incredible.

We can see that in Exhibit 2985, which was the demonstrative I showed earlier today, which summarizes the data from Exhibit 12 of Mr. Moore's report.

And unlike all of the other employee retirement costs or post-employment benefits cited by Mr. Belknap, the City's contributions to CalPERS cannot be modified outside of the bankruptcy case and they are completely outside of its control.

The City's wholesale assumption of pension liabilities also makes it very difficult to plan for a stable future. You heard Mr. Lamoureux. CalPERS calls all the shots, sets the discount rates, sets the mortality assumptions, sets the demographic assumptions. That's his testimony from day three at 195, and I think Ms. Nicholl confirmed that point this morning.

In the liability in any given year owing in part to the very volatile nature of CalPERS' investment returns can swing greatly, and you can see the investment returns in Exhibit 4 to Mr. Lamoureux's declaration, and that's Exhibit 4015.

Despite this, we heard over and over about the Pension Armageddon, which Mr. Levinson referenced in his opening statement, if the pensions are impaired. I suggest, Your Honor, that Mr. Lamoureux put the lie to that.

We heard him explain that if the City were to impair pension liabilities, all vested beneficiaries of the Stockton pension plan, whether they retired 20 years ago or still working for the City or somewhere else would share ratably in a reduction in benefits. Moving to another job would not help them. The loss as to vested benefits would occur, period, and that's the testimony from Mr. Lamoureux at day three, page 204 to 207. That was compelling testimony and Ms. Nicholl confirmed the point.

Also compelling was Mr. Moore's testimony about his firsthand experiences in Detroit, where employees have not fled in response to pension impairment. You can see that in his testimony at day three, pages 78 to 80.

He said that they haven't seen employees leaving, and he said that what Detroit is doing is offering competitive compensation packages going forward, and employees are making the rational business decision.

Mr. Moore has real life firsthand experience of how this plays out in the event of pension determination.

I think equally compelling was Mr. Lamoureux's testimony that vested pension benefits can't be changed retroactively absent termination or impairment in the bankruptcy case. That's his testimony on day three, starting at page 207.

In response to a question from Mr. Rios, Mr. Lamoureux said that the City cannot do anything about vested pension benefits, absent termination. I think you heard that from Mr. Rios again this morning.

We did hear this morning from Ms. Nicholl the scary hypotheticals about employee pensions being drastically reduced. But when you peel back the skin of the onion, I think it's pretty clear that those hypotheticals are based on unrealistic assumptions, major assumptions.

There's no evidence that the City could not offer competitive retirement benefits if it's able to rid itself of the sins of the past and to stop paying for all of the pension spiking and the above market practices that it now says it's discontinued. The City could do exactly as Detroit has done, offer competitive benefits. With no incentive to leave, employees would stay.

So what does that mean?

THE COURT: Refresh my recollection in the record of just how significant pension spiking was. There are a few examples that were provided particularly here in the eligibility trial.

People with pretty high incomes who played some games that produced some significant numbers, but I didn't hear, that I recall, testimony about the "garden variety pension."

We do have evidence that the garden variety pension out there is not a six digit number, although there are

And in its own roundabout way, Mr. Leland confirmed Mr. Moore's testimony. He never disagreed with the numbers. He just said the City would like to have reserve that's essentially unprecedented, a reserve that far exceeds the City's historical practice, and the City's own recommended guidelines, and even the guidelines set by the Government Finance Officers' Association, the self-described arbiter of best practices.

Would it be nice for the City to have such a mega reserve? Absolutely. But not at the same time that the City is trying to bury Franklin with a one cent recovery, not at the same time that the City decides to forego it's one opportunity to discuss pension liabilities and actually do something about the problem that put it into this bankruptcy case in the first place; and certainly not in the face of Mr. Lamoureux's testimony which discredits completely the City's alleged business justification for not attempting to impair pensions.

What we will discuss today is that there won't be a mass exodus from the City if pensions are forced to share the burden of this restructuring. Mr. Lamoureux made it clear that employees have no incentive whatsoever to leave the City in the face of pension impairment.

The burden of impairment would be shared by all those who have vested benefits, whether they worked for the City or another agency. There's no incentive to say displace that. That's just pretext.

I'll touch on all of that, as well as evidence establishing the value of Franklin's secured claim. But before we dive into the evidence, I'd like to step back and talk a little bit about the law so we can have some context when considering the facts.

On the second day of trial, you described confirmation as the series of hurdles that the City has to get over, and you noted that the duty of the Court to be independently persuaded of all of the essential elements of confirmation is amplified in Chapter 9.

Those elements or hurdles are right there in the Bankruptcy Code, in Section 943 and 1121. We focused on four of them in our briefing. First the requirement under Section 943(b)(7), that the plan be in the best interest of creditors and feasible.

Second, the interlocking requirements -- and I'll touch on that -- of Sections 1122(a), 1123(a)(4) and 1129(b), that a plan not classify claims in a way to gerrymandering, that the plan provide the same treatment to claims that are classified together and that the plan not discriminate unfairly.

Third, the requirement of Section 1129(a)(3), that the plan be proposed in good faith.

A. It appears so.
Q. And the others refers to the City's creditors, correct?
A. Others would be anybody that's not an employee or a citizen, if you will, that C&C services reduced.
Q. So that would include the City's bond holders, bond insurers, correct?
A. Retirees.
Q. And retirees as it relates to the retiree health care, correct?
A. At that point in time, that's right.
Q. Others does not refer to CalPERS, correct?
A. At that time, likely not.
Q. Under the City's proposal to its creditors, CalPERS does not bear any part of the, quote, brunt -- to use your language -- of the City's restructuring efforts, right?
A. Well, I think referring to CalPERS as a creditor is kind of a misnomer. We're just a conduit. They collect money from the City and then give it to retirees. So referring to CalPERS is like referring to the retirees.
Q. The City pays money to CalPERS, correct?
A. In order for them to turn around and invest it and pay it to retirees.
Q. The City has a contract with CalPERS, correct, or

a series of contracts?
A. Yes.
Q. And the City's single largest creditor under those contracts is CalPERS, correct?
A. As I mentioned, they're kind of a unique status. They're not going to -- they don't create or generate money. They take money from us, they invest it and they give it to our retirees. They're not going to earn a profit from some other employer and use it to subsidize ours. So our retirees votes vote or sink based on what we contribute to CalPERS.
Q. How much does the City contribute to CalPERS?
A. I don't have the current figure.
Q. Do you have the figure for last fiscal year?
A. That would be details I'd rely on other staff to recall.
Q. And who would you rely on?
A. Our CFO/Deputy City Manager.
Q. You're an active member of CalPERS, correct?
A. Active member in what sense?
Q. That's CalPERS' terminology. Are you familiar with it?
A. Not entirely to be honest with you.
Q. All right. You're part of a public agency, the City of Stockton -- correct?

that was before the Court was that when the City asked for a hardship exemption, it was denied.

The Objectors do not refute the City's showing that unilateral impairment of CalPERS through failing to make payments would have resulted in a 1 million -- sorry, 1 billion with a "B" -- dollar termination liability for the City, and the City would have faced that. That is in my declaration, Exhibit R and Exhibit S.

As you heard from Bob Deis, the Stockton City Manager, CalPERS really isn't technically a creditor. It is a trustee for the City's employees. CalPERS holds money for those employees in trust having been deposited for their retirement payments when they retire. And Mr. Deis's testimony about that is on the Monday transcript, page 55. So if CalPERS were to be impaired, whatever that means, it is the employees who would suffer, not CalPERS. CalPERS does not have a big fund from other cities that it can use to backfill a breach by the City of Stockton. The funds it has are held in trust.

Now, you've heard the testimony -- this is in Teresia Haase's reply declaration.

THE COURT: I just want to make sure I understand the problem in your argument.

MR. HILE: Yes, Your Honor.

THE COURT: So every dollar that you take away from CalPERS is a dollar that is in fact taken away from an actual pension?

MR. HILE: Of -- yes.

THE COURT: An actual pension of the City employee's retirement?

MR. HILE: Of the City of Stockton. That's exactly right. Now, there's been no evidence that CalPERS can take money from some other city's funds and put them in to backfill for the City of Stockton, or for its employees, to be more precise.

Ms. Haase's reply declaration, paragraph 2 to 6, show that the City has reduced its pension obligations where it legally could. It's Exhibit 1382.

We expect the Objectors to say that the City's "Ask" didn't go far enough with respect to labor concessions. But for the City as a competitive employer, the labor market, not the City's ability to pay, determines whether the City can recruit and retain any given employee. Mr. Deis testified with respect to this on Monday. It's on page 71 and 72 of the transcript, beginning on line 21 of page 71.

"And that's true to this date that the City has never attempted to reduce base pay, correct?"

under-funding. 2077.5 provides a lesser consequence if the board thinks that it will be able to go ahead and pay the pensions without impairing the actuarial soundness of the terminated agency pool.

Of course, that gets me back to the terminated agency pool. I said the general funds of CalPERS appear to be just part of the general investment pool and that's -- Mr. Lamoureux testified that was about assuming a return in the seven percent range, but he pointed out that the terminated agency pool -- approximately 70 terminated agencies in the pool, all of which he said are relatively small -- he said that pool fund is invested in a much more conservative basis, so assume a return of about three percent. That means that the shortfall is even greater because that's what the actuarial analysis of the need for additional contributions is at the time of termination and that pool is a relatively small amount of money.

So the standard solution appears to be that CalPERS, to the extent it does not have accumulated contributions, reduces pensions by that amount. That leads to the interesting question of, well, what is CalPERS then in relation to a case like this? Who is the real creditor? It seems to me that, if you're going to take an individual's pension or part of an individual's pension, the individual employee is the creditor and CalPERS is, in effect, kind of a servicing agency. Kind of like in the mortgage world we have the owner of the note and deed of trust and the mortgage servicer who collects a very small fee for collecting the money and passing it on to the owner of the note and deed of trust.

It looks to me like CalPERS does not bear the financial risk of a shortfall in payments. Instead, the structure of the Public Employee Retirement law places that risk on the employee. So if I'm getting that wrong, I need to know that as well. I do see under Section 20577.5 the board could elect to pay more than it's obligated to pay but, again, subject to the limitation that it would not impact the actuarial soundness of the terminated agency pool.

If a large California city were to go into that pool, the gravamen of Mr. Lamoureux's testimony would lead to the inference that it might affect the actuarial of the terminated agency pool. That's another puzzle running around in my brain.

Another puzzle running around in my brain is with respect to this lien on assets. Section 20574, it's a pretty interesting provision, and this is the so-called $1.5 billion lien. I mean, everybody has assumed this lien is valid. I don't know if everybody has assumed it,

14. The City's unemployment rate steadily rose from early 2007, peaking in early 2011 at over 22%, as reflected in Exhibit D. Unemployment remains in the 20% range, over double the national rate of 8.2%.

15. Stockton's poverty rate of 22.3% is half again as high as the California average of 14.9%, and the City ranks 11th highest of the 122 largest cities in California surveyed by the U.S. Census Bureau in 2009. The City's median household income of $45,730 is three-quarters of the California average of $59,500, ranking 15th lowest of the 122 metropolitan areas in the same Census study, which is attached hereto as Exhibit H.

16. As Stockton residents lost their jobs and houses, they spent less. As seen in Exhibit C, sales and use taxes collected by the City fell from a peak in fiscal 2005-06 of $47.0 million to $32.7 million in fiscal 2009-10, a decline of $14.3 million or 30%. Other revenue streams likewise were adversely affected. Attached hereto collectively as Exhibit I are charts and tables showing the City's historical utility users tax receipts, franchise tax receipts, and business license tax receipts. The City obtained this information from its records.

The City Has Been Forced To Reduce Employee Positions And Reduce Employee Compensation, Either Unilaterally Or Through Renegotiation

17. These adverse economic circumstances left the City with a structural imbalance between its plummeting revenues and increasing expenses, as described more fully in the Declaration of Vanessa Burke. Beginning in 2008, as the effects of the Great Recession were being felt, the City began to evaluate strategies for filling this revenue gap.

18. Because labor costs have been and remain by far the City's largest General Fund expenditure, over the last few years, the City looked primarily to balance its budget through two strategies: (1) negotiating or imposing reductions in employee costs, with the goal of continuing to provide critical, albeit reduced, services to the public; and (2) eliminating many City positions, which necessarily resulted in significant reductions to service levels provided to the community.

19. Accordingly, beginning in 2008, the City began to reduce pay and benefits costs and impose furloughs. In the following years, the City offered early retirement incentives, and as the fiscal situation grew more desperate, furlough hours grew. It then began to negotiate for

voluntary reductions in employee compensation and benefits, imposed a hiring freeze, and reduced City operational hours in many departments. It also laid off employees, including police officers.

20. Despite attempting to minimize layoffs through furloughs, contract re-negotiation, and early retirement offers, between fiscal years 2008-09 and the 2011-12, the City reduced its total full-time workforce by approximately 25%—from 1,886 employees to 1,414 employees, a drop of 472 positions. The percentage reduction to General Fund full-time positions was higher, at 31%, or 424 positions. Those cut included 98 sworn police positions (a 25% reduction), 47 non-sworn police positions (a 20% reduction), 76 fire positions (a 30% reduction), and 203 non-safety positions (a 43% reduction). The following chart, prepared by City staff and consultants, summarizes the extent of the City's service reductions:

City of Stockton Personnel by Fund

General Fund	08-09	09-10	10-11	11-12	Chng frm 08-09	Percent Change
Police-sworn	398	312	292	300	(98)	-25%
Police-non sworn	232	207	199	185	(47)	-20%
Fire	253	265	226	177	(76)	-30%
Subtotal Safety	883	784	717	662	(221)	-25%
Public Works	163	78	59	62	(101)	-62%
Library	105	69	57	57	(48)	-46%
Recreation	46	32	27	26	(20)	-43%
Administration	157	123	125	124	(33)	-21%
Subtotal Non-Safety	471	302	268	269	(202)	-43%
Total General Fund	1,354	1,086	985	931	(423)	-31%
Other Funds						
Police-Grants	6	17	31	25	19	317%
Police-Measure W	28	23	20	21	(7)	-25%
Fire-Measure W	40	22	21	20	(20)	-50%
Fire-Emergency Communica	17	-	-	-	(17)	-100%
Development Services	98	53	50	42	(56)	-57%
Street Maint/Gas Tax*	24	65	66	64	40	167%
Other Special Rev/Districts	48	46	37	29	(19)	-40%
Enterprises	171	189	199	200	29	17%
Internal Service	100	83	84	82	(18)	-18%
Total Other Funds	532	498	508	483	(49)	-9%
Total All Funds	1,886	1,584	1,493	1,414	(472)	-25%

*Gas Tax absorbed employees shifted from General Fund

21. Despite these efforts, by May 2010, the City still faced a projected $23 million budget deficit in fiscal year 2010-2011. On May 26, 2010, staff presented to the City Council a bleak picture of the City's financial situation. Even though the City already had reduced employee positions, re-negotiated some contracts, and cut funding to community services, low revenues and high labor and retiree costs still left the City unable to balance its budget. Based on staff's recommendation, in the May 26 meeting, the City Council declared a state of fiscal emergency and authorized the City Manager to "take appropriate and lawful measures that will achieve a balanced budget for fiscal year 2010-2011." True and correct copies of the May 26, 2010 staff report and the resolution adopted on May 26 by the City Council are attached collectively hereto as Exhibit J.

22. A month later, on June 22, 2010, acting under the fiscal emergency, the City Council unilaterally imposed terms that diverged from the terms of existing police and fire collective bargaining agreements. In particular, among other things the emergency measures temporarily suspended scheduled pay increases from taking effect during fiscal year 2010-11, restricted time off, and closed a fire truck company. True and correct copies of the June 22, 2010 staff report and the resolution adopted on June 22 by the City Council are attached collectively hereto as Exhibit K. By taking these actions, the City obtained approximately $23 million in savings and was able to limp into another fiscal year with a balanced budget.

23. Despite such radical surgery, the long-term structural challenges remained. Revenues remained low and labor costs, though reduced markedly, were still higher than the City could afford to pay. Retiree medical and debt service costs also were set to increase. Thus, on February 15, 2011, as part of an update on the fiscal emergency, staff recommended that the City Council continue the fiscal emergency. A true and correct copy of the February 15, 2011 staff report is attached hereto as Exhibit L. Staff concluded that without the continuation of the emergency measures, the City would have had a negative cash balance by the end of the fiscal year. Staff also alerted the City Council that "the City continues to face dramatic fiscal challenges." Another deficit was projected, with the main drivers being scheduled wage increases for four of the City's largest labor groups, increasing health care costs for employees and retirees,

suggests in his report that he even "Enact[ed] Broad Pension Reform Measures" in Oakland. Bobb Decl., Ex. B, p. 17. However, as discussed in footnote 5 of the Reply, the record suggests that under Bobb's administration, Oakland increased public safety pensions by 50 percent, did not achieve any police employee contributions, achieved only modest contributions from other employees, and then eliminated the impact of those modest contributions by increasing wages. I hear my father's admonition to "do as I say, not as I do." The declaration being submitted concurrently by Ann Goodrich establishes that Stockton imposed the full employee contribution (7-9 percent), eliminated contracted raises, decreased other pays, created lower pension tiers, and required employees to contribute to medical costs for the first time. *See* Reply Declaration of Ann Goodrich. If Bobb and Zielke were at all familiar with the history of painful concessions the City has imposed on its employees, *see* Goodrich Decl., ¶¶ 5 *et seq.*, they would recognize the absurdity of their argument.

39. The City's cuts to its employees have strained its relationship with its employees and have caused huge heartache to employee's and retiree families. Pay has been cut by as much as 23 percent, along with increased employee medical contributions, and the City has wiped out any future chance of getting retiree medical insurance. And all this has happened at a time when the City's employees—public safety employees in particular—are working harder than ever. The preponderance of police calls are prioritized on crimes in progress. The City has some of the busiest fire stations in the country. Because of the City's extremely low police staffing levels, a vacancy in Stockton has more of an impact than in other cities. I firmly believe that impairing the CalPERS pension—a benefit that is offered by all our neighboring cities and is a benchmark in the state — will be the proverbial "straw that breaks the camel's back".

40. The declarants have not offered any "social science research," or any research at all, that is analogous to the Stockton situation where the employees have experienced a long list of concessions or indignities. We do not have 6 months and $500,000 to validate what we all know: impairing CalPERS will greatly damage our ability to staff a very busy public safety function, with potential catastrophic consequences. Thus, it comes back to my stated priority as

5. With respect to the use of comparable cities, I agree with Mr. Bobb's deposition testimony that labor market surveys are "important information to have" and are "a standard part of negotiations." Bobb Dep., pp. 161:3-162:15. Based on my 29 years as a Human Resources Director in several different California counties, it is an industry standard practice for California cities and counties to commission surveys to determine where the wages and benefits of their employees are relative to similarly situated employees in comparable jurisdictions. Having such surveys enables jurisdictions to determine how much they need (or don't need) to offer in wages and benefits to recruit and retain sufficiently qualified employees.

6. In Stockton's case, for the last few years, the City has retained Doug Johnson of Ralph Anderson & Associates to prepare its compensation surveys. My team has relied on the information provided us by Mr. Johnson during every round of negotiations with every bargaining group, including during the AB 506 process.

7. Recently, Mr. Johnson completed a salary survey which evaluated where Stockton's wages and benefits were relative to other jurisdictions, following the recent adoption of the nine labor agreements. Attached collectively as Exhibit A are true and correct copies of the salary surveys Mr. Johnson prepared. Attached as Exhibit B is a true and correct copy of a memorandum Mr. Johnson prepared for the City in order to explain the rationale behind his decision to treat certain cities as "comparable" to Stockton.

8. Following years of reductions, it is no longer accurate to characterize Stockton's employee wages and benefits as "above-market." During the AB 506 process, one of the City's goals in formulating the Labor Ask was to continue the work it had begun of bringing down its employee wages and benefits to rates similar to those in comparable cities. The City largely achieved this goal in the nine new agreements it signed during and after the AB 506 process. Each of the nine agreements resembled the deals that the City sought from each group in the Ask, the terms of which included but were not limited to: elimination of certain premium or "add" pays and reductions in longevity pay, reductions in life insurance, reductions in Long Term Disability Insurance, elimination of retiree medical benefits, reductions in holidays, holiday pay, sick leave and vacation benefits, elimination or reduction of sick leave cash outs at separation, deferral of

vacation cash outs at separation, elimination of annual cash outs of unused vacation, changes in overtime practices that reduced standby pay, the rate that overtime was paid at and the number of hours overtime was based on.

9. The recent Doug Johnson survey has confirmed that following the adoption of the City's most recent labor agreements, the vast majority of City employees receive wages and benefits at or below the median of similarly situated positions in comparable cities. Over 130 different classifications were surveyed as to their base salaries, other pays, and benefits. With very few exceptions, the City's employees are below the average or median of the labor market. For example, for the City's Police Officer class, the survey shows that in Total Cash (i.e. wages received by the individual), the City is 5.8% below the average or 8% below the median. When factoring in the value of benefits (health, dental, vision, life and long-term disability) which affect an employee's take home pay and which with cash are considered an employees' "total compensation," the City is 5.3% below the average and 6.9% below the median. When adding in the value of the agency's retirement contribution and the cash value of time off (through holiday, vacation, and sick pay), the City's relative position improves slightly to 1.2% below the average and 2.6% below the median. This is offset, though, by the City's recent phase out of retiree medical benefits, which in conjunction with all the other measures depressed a Police Officer's total compensation and benefits to 2.4% below the average and 4.7% below the median.

10. In the June Declaration, I described the City's drastic cuts to employee compensation and benefits since 2008, and attached as Exhibit A a chart summarizing many of the changes negotiated or imposed over the past four years for all of the City's labor groups. Attached hereto as Exhibit C is a revised version of Exhibit A to the June Declaration, both in clean and blacklined format. This revised version shows additional reductions subsequent to June 29, 2012.

11. An example demonstrates starkly the reductions experienced by Stockton employees over the past four years. Attached hereto as Exhibit D is a document prepared under my supervision by the City's Human Resources and Finance departments. The exhibit contains true and correct descriptions of the contents of actual paychecks of several individual City

Summary of the Agreement between the City of Stockton and the Official Committee of Retirees

The City and the Official Committee of Retirees appointed by the Office of the United States Trustee to represent and to serve as a fiduciary for the interests of the City's 2,400 retirees ("Committee"), agree as follows:

The City agrees to propose a plan of adjustment that contains, among others, the following provisions, and the Committee agrees, subject to mutual agreement on the language with respect to the retiree health benefit claimants (as defined in (3) below) in the City's plan of adjustment and disclosure statement, to recommend that retirees vote to accept any such plan of adjustment and to use reasonable efforts to obtain retiree support of the plan. The required plan provisions are:

(1) The City pays "retiree health benefits claimants" a total of $5.1 million in cash on the date that the plan of adjustment becomes effective and binding on the City and its creditors. This payment is in full satisfaction of all retiree health benefits claims, and no other retiree health benefits will be provided by the City.

(2) If required by state or federal law, the City will withhold from the aggregate $5.1 million payment any taxes or other deductions to be withheld from the individual payment to each claimant. The individual recipient is responsible for any tax liability for this payment, and the City is not providing any advice to any recipient as to the taxable impact of this payment.

(3) A retiree health benefit claimant is defined as a retiree who was eligible for retiree health benefits based on his or her collective bargaining agreement at the time of retirement and;

- Who was receiving City retiree health benefits as of June 30,2012 (which includes any retiree who had waived coverage prior to that date but was otherwise eligible, or any retiree who had exceeded the 15-year cap for under 65 retiree health benefits, but who was eligible for a City retiree benefit for an over 65 retiree), or

- Who retired prior to July 1, 2012 with their last day on payroll having occurred on or before June 30, 2012, or
- Who was a surviving spouse of deceased retiree who was receiving retiree benefits on June 30, 2012.

(4) Calculates such claims based on the loss each claimant suffered on account of the loss of future health benefits based on the claimant's projected life expectancy as determined by the United States government's 2009 social security tables for males and females. The calculation of future projected benefits will be adjusted in the case of retirees who retired under age 50 and who are under age 65 at this time that have exhausted or would have exhausted their 15 years of under age 65 retiree health benefits prior to age 65. In these cases, the "gap" between the two benefits owed (no benefit was owed to the retiree for this time period), will be calculated into determining the retiree's full health claim amount.

(5) The Plan does not impair in any way the provisions of the existing pension benefit plans under which employees retired, including pension amounts and the capped annual cost-of-living adjustment.

components to other cities, and base pay was consistent with the other cities, if not a little bit less.

It was the premium pays that were problematic. So that's what we pursued in very aggressive negotiations with labor, was to seek reductions in the premium pays because, at the end of the day, I have to have a work force. And if I go below the labor market average in total compensation, then I'm going to start losing people, and I'm going to have a very hard time attracting people.

So I was seeking out ways to reduce costs dramatically, quickly, unlike anybody's tried before. And we found it in the premium pay area. So that's what we went after.

Q. And you believe that the City has made deep cuts to employee compensation and benefits in recent years, right?

A. Massive cuts.

Q. And you believe that those massive cuts have left the City, for the most part, at the labor market average, correct?

A. I would say less than the labor market average now.

Q. What these massive cuts have done and what these employees have given up is largely a continuation in inflated pay, correct?

A. What they have given up is unsupported premium pays. But with respect to the individual employee, one check is 24 percent less than the previous check they just received. It's like falling over a financial cliff for them personally. Some employees lost their homes. Some employees filed for bankruptcy. For them, it was a dramatic falling over a cliff.

Q. Under the City's Ask, the employees get to keep all the above-market compensation and benefits that was paid in years prior, correct?

A. I'm not quite sure I understand the question.

Q. Sure. Let me restate. The City has made no effort to clawback any of the above-market benefits, including any of the above-market pension benefits that were driven by years of above-market compensation, correct?

MR. HILE: Objection. Compound.

THE COURT: The objection is sustained.

BY MR. NEAL:

Q. Let's start with the Ask. Pursuant to the City's Ask, the City does not propose that any employee has to give back any above-market compensation, correct?

A. That was given to them in the last five, ten, fifteen years, no.

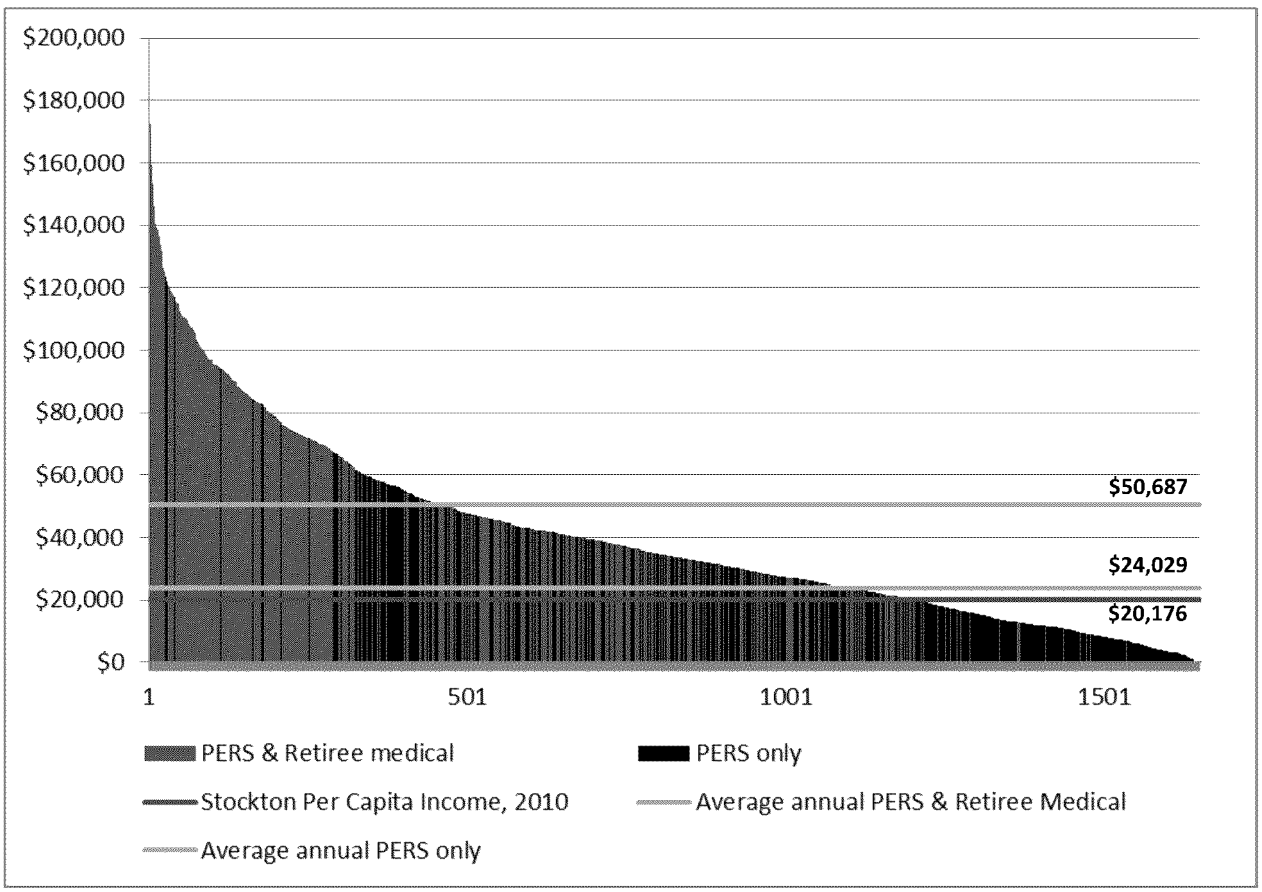
Q. And, similarly, there's no request that employees give back any above-market benefits that led to any higher benefit.) Even agencies that give an ongoing contribution for life make a fixed dollar contribution, are more modest and usually are dependent on the number of years of service.

The City's most recent Other Post-Employment Benefits (OPEB) study calculates the City's unfunded OPEB liability at $417 million for retiree medical. The City has never prefunded any retiree medical benefit and pays the annual cost as a pay as you go basis.

The FY11-12 City expenditure for retiree medical is $15 million, of which $9 million is a General Fund cost. Segal, the City's actuary, projects that the City annual pay-as-you-go costs for retiree medical will double in 10 years.

It is also important to note that the retirees with medical coverage receive higher pensions, on average, than those without. This is because those with medical coverage retired more recently at higher salaries and with enhanced retirement benefits. The graph below shows annual pension amounts for retirees with and without retiree medical coverage.

Figure 1. Annual Pension for Retirees with and without Retiree Medical



Notes:

1. Graph is based on the most complete and current data which CalPERS was able to provide. CalPERS is currently merging 56 separate databases and will not have capability to run better reports until this project is completed
2. Data does include all known retirees with medical retirement benefits. Data also includes many older retirees, but not all, since the total number of data points is less than total reported beneficiaries. Some beneficiaries with and without retiree medical may have limited Stockton service time or be contingent beneficiaries of one type or another.

AB 506 Proposals

1. Effective July 1, 2012, eliminate all Retiree Dental benefits to current and retired department heads and some City Manager office management employees. The benefit is only provided to department heads and some management employees in the City Manager's Office when they retire until age 65. Savings is $30,000 total ($16,000 General Fund) annually.

2. Eliminate all Retiree Medical Benefits for current and future retirees.

   A. Effective July 1, 2012, reduce the City contribution towards the cost of retiree medical for current and future retirees. Reduce City 's contribution retiree medical benefits for current retirees and employees to a fixed dollar amount of:
      - $450 per month for retirees with at least 30 years of City service
      - $300 a month for retirees with at least 20 years of City service
      - $150 a month for retirees with at least 10 years of City Service
      - Current retirees and employees with less than 10 years of City service would not receive any retiree medical benefits.
      - City Contribution is to retiree only, and no survivor benefits are provided. Current survivors (approximately 50) would be treated the same as current retirees, but any new survivors would not receive a City contribution.
      - Survivors of Management employees who died while employed and who are receiving lifetime family medical from the City will be treated the same as retirees. This change would not apply to public safety employees killed in the line of duty where state law requires survivor benefits and the State of California reimburses the City for these expenses.

   Cost: In FY12-13 the cost would be $3.3 million (all funds) or General Fund $2.1 million. General Fund savings in FY12-13 would be $7.1 million.

   B. Effective July 1, 2013, all retiree medical benefits for current retirees and employees are eliminated.

   Projected City cost $0. General Fund savings in FY13-14 would increase by $2.4 million, to a total of $9.5 million. In addition the City would avoid significant cost increases that would otherwise occur in future years.

3. Since the City operates a self-funded medical plan and has risk and exposure to claims costs, retiree enrollment at their own expense in City sponsored medical plans will not be allowed after July 1, 2013.

See Attachment 3 for labor unit MOUs incorporating proposed retiree changes.

A. Yeah.

MR. HILE: Your Honor, I offer 3086 into evidence.

MR. JOHNSTON: Your Honor, we object, and ask you at least defer ruling on that. As you will see in cross-examination, I think we'll be able to establish that this chart is in fact completely unreliable and does not reflect the data that's actually in the footnotes.

THE COURT: All right. I'll defer ruling until we get to cross-examination.

MR. HILE: All right. And I have Evidence Code Sections to cite you, but we'll wait for that part of the evidence.

THE COURT: You mean the Federal Rules of Evidence?

MR. HILE: Yes.

THE COURT: No, I think I'm familiar with the rules. I can anticipate also concluding that the problems that outweigh admissibility --

MR. HILE: Now --

THE COURT: -- but I'll wait and see how bad it is.

MR. HILE:

Q. Based upon the chart, let's start with the first page of Exhibit 3086, Mr. Belknap, and the safety employee comparison.

How does Stockton rank, according to this chart, with respect to the peer cities that Mr. Moore chose, with respect to its total retirement costs as a percentage of payroll?

A. Total retirement costs as a percent of payroll, it's just about average, it's not an outlier. That was really one of the key issues for us, was the Moore report sort of attempt to establish that Stockton was an outlier when it comes to costs, and this pretty much shows it's average.

Q. And looking at the middle bar on this chart, which says "mean," can you describe the Court what that is?

A. Just the arithmetic average.

Q. And is that for all of the cities listed here?

A. Yes.

Q. By the way, are there any cities that Stockton considers peer cities for purposes of its financials that don't appear on Mr. Moore's collection of cities?

A. Well, we have done a lot of benchmarking for Stockton as part of this whole rebuilding and restructuring process. So it's important for us to understand where they need to be so that they are in a service solvent position.

And we generally look at cities as much as possible in the central valley. The one omission here I think would be Fresno, and I think the reason that's not on the list is because it's slightly larger than 500,000, but we would typically consider Fresno a peer jurisdiction to Stockton.

Q. All right. We've looked at the safety employee comparison for total retirement costs as a percentage of payroll. Let's look at the miscellaneous employee comparison.

And what does that show with respect to how Stockton ranks with respect to the cities that Mr. Moore chose as peer cities?

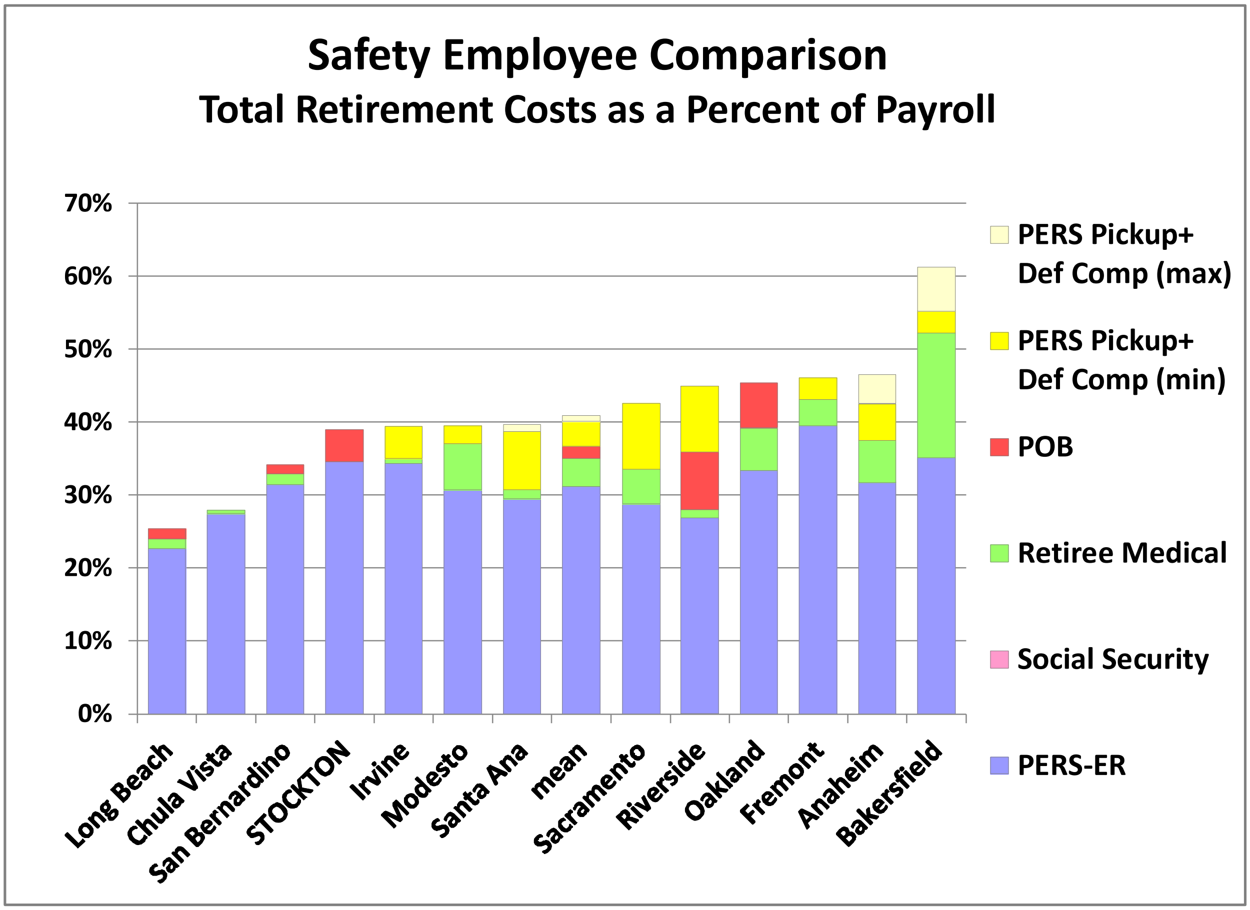
A. Well, when you adjust for these other factors Stockton is -- again it's not an outlier. And when you adjust for these other factors, it's actually below the mean in terms of miscellaneous employees. It's actually the third lowest on the list.

Q. Now, in order to keep the City's post-employment compensation costs as low as they are, what has the City done to make sure that it is not being swallowed up by its total retirement costs?

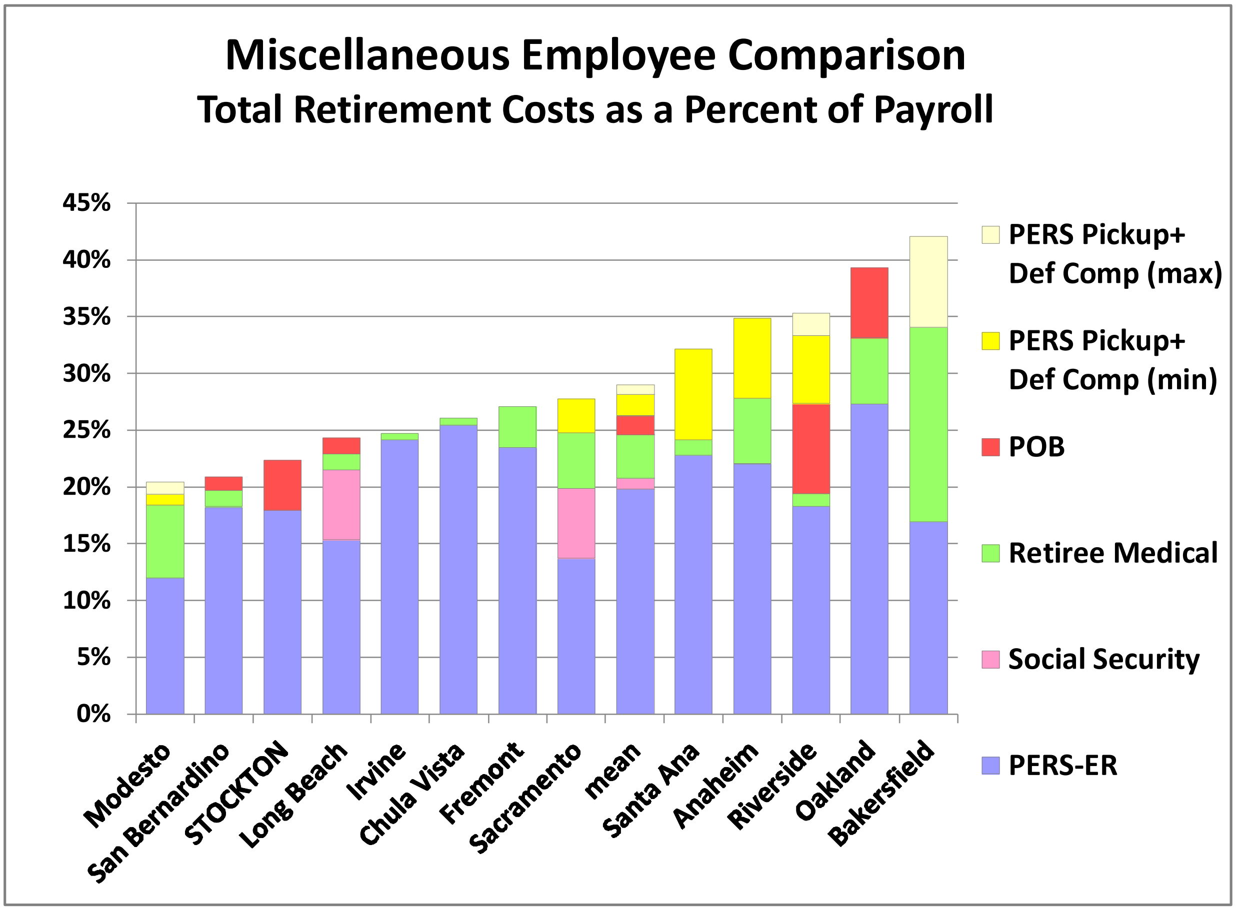
A. Well, the two biggest things that Stockton has done is, number one, they have eliminated retiree medical coverage for not only retirees, but current employees. So that's a huge reduction in costs for the City.

The other thing that it has done is negotiated that the employees pay their share of the CalPERS contribution costs, in other words, the employee's share. So they are no longer picking up a portion of the employee's share of the CalPERS' costs.

And those are the two -- and they were never in Social Security, so that really wasn't a factor, but those are the



City	PERS Rate Employer	Social Security	Retiree Medical	POBs	PERS Pickup+DefComp Minimum	PERS Pickup+DefComp Max Added	Total
Long Beach	22.623%	0.000%	1.400%	1.400%	0.000%	0.000%	25.423%
Chula Vista	27.316%	0.000%	0.600%	0.000%	0.000%	0.000%	27.916%
San Bernardino	31.455%	0.000%	1.500%	1.200%	0.000%	0.000%	34.155%
STOCKTON	**34.605%**	**0.000%**	**0.000%**	**4.400%**	**0.000%**	**0.000%**	**39.005%**
Irvine	34.309%	0.000%	0.600%	0.000%	4.500%	0.000%	39.409%
Modesto	30.607%	0.000%	6.400%	0.000%	2.500%	0.000%	39.507%
Santa Ana	29.406%	0.000%	1.300%	0.000%	8.000%	1.000%	39.706%
mean	*31.190%*	*0.000%*	*3.854%*	*1.623%*	*3.385%*	*0.846%*	*40.898%*
Sacramento	28.675%	0.000%	4.900%	0.000%	9.000%	0.000%	42.575%
Riverside	26.894%	0.000%	1.100%	7.900%	9.000%	0.000%	44.894%
Oakland	33.346%	0.000%	5.800%	6.200%	0.000%	0.000%	45.346%
Fremont	39.450%	0.000%	3.600%	0.000%	3.000%	0.000%	46.050%
Anaheim	31.696%	0.000%	5.800%	0.000%	5.000%	4.000%	46.496%
Bakersfield	35.094%	0.000%	17.100%	0.000%	3.000%	6.000%	61.194%



City	PERS Rate Employer	Social Security	Retiree Medical	POBs	PERS Pickup+DefComp Minimum	PERS Pickup+DefComp Max Added	Total
Modesto	11.984%	0.000%	6.400%	0.000%	1.000%	1.000%	20.384%
San Bernardino	18.186%	0.000%	1.500%	1.200%	0.000%	0.000%	20.886%
STOCKTON	**17.939%**	**0.000%**	**0.000%**	**4.400%**	**0.000%**	**0.000%**	**22.339%**
Long Beach	15.324%	6.200%	1.400%	1.400%	0.000%	0.000%	24.324%
Irvine	24.138%	0.000%	0.600%	0.000%	0.000%	0.000%	24.738%
Chula Vista	25.437%	0.000%	0.600%	0.000%	0.000%	0.000%	26.037%
Fremont	23.461%	0.000%	3.600%	0.000%	0.000%	0.000%	27.061%
Sacramento	13.645%	6.200%	4.900%	0.000%	3.000%	0.000%	27.745%
mean	*19.809%*	*0.954%*	*3.854%*	*1.623%*	*1.923%*	*0.846%*	*29.009%*
Santa Ana	22.824%	0.000%	1.300%	0.000%	8.000%	0.000%	32.124%
Anaheim	22.031%	0.000%	5.800%	0.000%	7.000%	0.000%	34.831%
Riverside	18.314%	0.000%	1.100%	7.900%	6.000%	2.000%	35.314%
Oakland	27.295%	0.000%	5.800%	6.200%	0.000%	0.000%	39.295%
Bakersfield	16.939%	0.000%	17.100%	0.000%	0.000%	8.000%	42.039%

Explanatory Footnotes Accompanying Comparison Charts of Safety and Miscellaneous Pension Costs in Select California Cities

[1]**Anaheim:**

Data derived from City of Anaheim FY 2013-14 Full-Time CalPERS Rates.

For those Miscellaneous employees hired before 1/1/2013, the City of Anaheim contributes 7 percent of the employee's CalPERS contribution (also known as the Employer Paid Member Contribution or EPMC). Similarly, Safety employees that are members of the Police Management APMA or APA employee groups and were hired before 1/1/2013 receive either a 5 or 9 percent City contribution toward the employee share. Classic APMA or APA employees hired on or after 1/1/2013 also receive either a 5 or 9 percent City contribution. New CalPERS members hired into any employee group after 1/1/2013 do not receive a City contribution. Employees hired on or after 7/6/01 are not eligible for any post-retirement medical benefits.

Sources:
FY 2012-13 CAFR: http://www.anaheim.net/images/articles/29/AnaheimCAFR.pdf
FY 2013-14 FT CalPERS rates: http://www.anaheim.net/jobs_opp/CalPERS_Rates.pdf
Police Association: http://www.anaheim.net/title/Human+Resources/Labor+Contracts/#APA
SEIU Agreement: http://www.anaheim.net/title/Human+Resources/Labor+Contracts/#SEIU

[2]**Bakersfield:**

Data derived from the Memorandum of Understanding Between the City of Bakersfield and SEIU, Local 521 – January 1, 2013 to December 31, 2014 for Miscellaneous employees: *"At the beginning of the Miscellaneous employee's sixth (6th) cumulative year of service, the City will pay the full portion of the normal contributions required to be paid by the employee to the Public Employees' Retirement System. Effective with the implementation of the 3% at 60 retirement program, City agrees to pay one (1%) percent of the employee's retirement contribution for employees with less than six (6) cumulative years of service. The City will pay the full portion of the contribution at the beginning of the employee's sixth 6th) cumulative year of service. Employees hired subsequent to February 22, 2006 will not receive this one (1%) percent contribution."*

Data derived from the Memorandum of Understanding Between the City of Bakersfield and Bakersfield Police Officer's Association – December 11, 2013 to June 30, 2014 for Safety employees: *"The City's contribution shall be nine percent (9%) for Safety employees hired prior to July 1, 1983, four percent (4%) for those hired on or after July 1, 1983, and three (3%) percent for those employees hired after June 1, 2006. Employees hired on or after July 1, 1983 (including those hired after June 1, 2006), will be eligible to receive the nine percent (9%) payment effective the beginning of their sixth (6th) uninterrupted year of service."*

The City of Bakersfield's Comprehensive Annual Financial Report indicates that the Other Post-Employment Benefits (OPEB) payment in FY 2012-13 represents a payment in excess of the Annual Required Contribution.

Sources:
FY 2012-13
CAFR: http://www.bakersfieldcity.us/administration/financialservices/FlipBooks/2013_revCAFR/index.html

MOUs: http://www.bakersfieldcity.us/administration/citymanager/humanresources/mou.html
Police Association: http://www.bakersfieldcity.us/administration/citymanager/humanresources/memos_of_understanding/2014_mou_RES%20NO%20150-13.pdf
SEIU Agreement: http://www.bakersfieldcity.us/administration/citymanager/humanresources/memos_of_understanding/2013_RES%20NO%20079-13.pdf

[3]**Chula Vista:**

Data derived from the Memorandum of Understanding Between the City of Chula Vista and SEIU Local 221 \ Chula Vista Employee's Association – July 1, 2013 to June 30, 2015 for Miscellaneous employees.

The City of Chula Vista's Miscellaneous employees are divided into three tiers:

- Tier 1 Local Miscellaneous 3% @ 60
- Tier 2 Local Miscellaneous 2% @ 60 (New CalPERS members on or after 4/22/2011 through 12/31/2012)
- Tier 3 Local Miscellaneous 2% @ 62 (New CalPERS members on or after 1/1/2013)

The EPMC reported here reflects only the City's contribution for Tier 1 employees.

Data derived from the Memorandum of Understanding Between the City of Chula Vista and Chula Vista Police Officer's Association – FY 2005/06 to FY 2009/10 and amended FY 2011 for Safety employees.

The Police Officer's Association has an agreement whereby the City provides a 9% EPMC that is contributed by the employee through the City. Therefore, no City funds are used to provide the POA EPMC. The actual POA MOU language is as follows:

> *CVPOA "represented employees (hereinafter "Employee(s)") shall make contributions, that shall be applied to the City's (employer side) contribution to CalPERS under Government Code section 20516 for optional benefits, in the total amount of nine percent (9%) for Employees in the "Local Police Officers" CalPERS member category phased in as follows: 3% on January 14, 2011, 1.5% on July 1, 2011, 2.25% on January 1, 2012, and 2.25% on July 1, 2012. The aforementioned contributions will be made on a pre-tax basis to the extent permitted by Internal Revenue Code section 414(h)(2). The City shall report, as presently done, the Employer Paid Member Contribution (EPMC) to CalPERS as compensation earnable."*

Sources:
FY 2012-13
CAFR: http://www.chulavistaca.gov/City_Services/Administrative_Services/Finance/documents/ChulaVista_CAFR2013FINAL.pdf
MOUs: https://www.chulavistaca.gov/city_services/administrative_services/human_resources/Bargaining/MOUs.asp
Police: http://www.chulavistaca.gov/City_Services/Administrative_Services/Human_Resources/PDFs/POAMOU-PensionContributionandMisc01-21-11.pdf

SEIU: http://www.chulavistaca.gov/City_Services/Administrative_Services/Human_Resources/PDFs/CVEAMOU2013FINALVERSIONss9-4-13.pdf

[4]**Fremont:**

Data derived from the Memorandum of Understanding Between the City of Fremont and Fremont Association of City Employees (FACE) – July 1, 2011 to June 30, 2013 for Miscellaneous employees. Effective 06/30/13, the City of Fremont eliminated the Employee paid Employer CalPERS 5.29% Contribution for FACE members.

Data derived from the Memorandum of Understanding Between the City of Fremont and Fremont Police Association – July 1, 2011 to June 30, 2013 for Safety employees. Three percent Employer Paid Member Contribution applies only to Battalion Chiefs IAFF Local 1689 and Fire Safety IAFF Local 1689. Effective 7/1/13, Fremont Police Association members received 4.25% pay increase, and no Employer Paid Member Contribution.

Sources:
FY 2012-13 CAFR: http://www.fremont.gov/DocumentCenter/View/21162
MOUs: http://www.fremont.gov/index.aspx?nid=452
Police: http://www.fremont.gov/DocumentCenter/Home/View/3371
Miscellaneous Employees: http://fremont.gov/DocumentCenter/View/18834
CalPERS rates: http://www.fremont.gov/documentcenter/view/18704

[5]**Irvine:**

Per the City's most recent agreement with the Irvine Police Association, employees who are members of the City's 3% at 50 CalPERS plan effective November 1, 2013 through August 10, 2014, the cost of the 9% employee contribution will be paid one-half (4.5%) by the City and one-half (4.5%) by the employee through pre-tax payroll deduction.

No Employer Paid Member Contribution is paid on behalf of Miscellaneous staff.

Retiree health benefits for police are employee-paid and administered through the Irvine Employee's Benefit Trust Fund.

Sources:
FY 2012-13 CAFR: http://www.cityofirvine.org/civica/filebank/blobdload.asp?BlobID=24045
MOUs: http://www.cityofirvine.org/cityhall/as/hr/mous_resolutions.asp
Police: http://www.cityofirvine.org/civica/filebank/blobdload.asp?BlobID=10836
Miscellaneous Employees:
http://www.cityofirvine.org/civica/filebank/blobdload.asp?BlobID=18051

Explanatory Footnotes Accompanying Comparison Charts of Safety and Miscellaneous Pension Costs in Select California Cities

[6]**Long Beach:**

Long Beach Human Resources personnel report that all municipal non-sworn employees are covered under Social Security, including seasonal and part-time employees when they reach 1,000 reportable hours. Until 1980, sworn Safety personnel were also covered by Social Security when Police opted out of Social Security.

Employer Paid Member Contributions as shown as of the most recent labor agreements, which do not include an employer contribution on behalf of the employee. Prior to September 30, 2013 Miscellaneous staff received the following EPMC:

- 4 percent (Unrepresented Management within the City Auditor's Office and those staff represented by the City Attorney's Association),
- 4.2 percent (Elected Officials and City Clerk),
- 6 percent (Unrepresented management and non-management, Confidential Employees, Engineering Employees, Machinists, and those represented by the Long Beach Management Association), and
- 7 percent (Lifeguards and Safety Managers).

However, effective October 1, 2013, the most recent Miscellaneous MOU amendments eliminated the Employer Paid Member Contribution for Miscellaneous staff. EPMC contributions for police were eliminated as of October 2011.

The City of Long Beach operates an Employee Benefits Internal Service Fund. As of September 30, 2013, the noncurrent liability for bonds payable is $40.9 million. Due within one year, the City owes $4.8 million. The total outstanding pension obligation liability is thus $45.7 million.

It should be noted that due to contract changes, this analysis has been updated from previous versions.

Sources:
FY 2012-13 CAFR (page 97 includes Employer Paid Member Contribution Rates for Miscellaneous
employees: http://www.longbeach.gov/civica/filebank/blobdload.asp?BlobID=40391
MOUs: http://www.longbeach.gov/hr/lr/mous.asp
Police: MOU: http://www.longbeach.gov/civica/filebank/blobdload.asp?BlobID=23900
Amendment: http://www.longbeach.gov/civica/filebank/blobdload.asp?BlobID=32836
Miscellaneous: http://www.longbeach.gov/civica/filebank/blobdload.asp?BlobID=18711
http://www.longbeach.gov/civica/filebank/blobdload.asp?BlobID=31972
Miscellaneous
Amendment: http://www.longbeach.gov/civica/filebank/blobdload.asp?BlobID=36070
http://www.longbeach.gov/civica/filebank/blobdload.asp?BlobID=38606

[7]**Modesto:**

Data derived from the Memorandum of Understanding Between the City of Modesto and Modesto Association of City Employee's Association – September 24, 2013 to May 30, 2014 for Miscellaneous employees. Effective October 23, 2012 employees increased their portion of the employee contribution from four-tenths percent (0.4%) by six and six tenths percent (6.6%) for a total of seven percent (7%) employee contribution.

Explanatory Footnotes Accompanying Comparison Charts of Safety and Miscellaneous Pension Costs in Select California Cities

Data derived from the MPOA contract extension and amendment dated October 10, 2012 and extending the prior contract with a term of March 28, 2011 - July 15, 2013 and again extended through June 30, 2014: For employees hired prior to September 11, 2012, the pension benefit shall be as follows: As soon as administratively possible but no later than December 18, 2012, Pursuant to the provisions of Section 20691 of the California Government Code the CITY shall pay two and one-half (2.5%) of the nine (9%) percent employee contribution in the employee's name of the Public Employee's Retirement System. Such payments shall be implemented pursuant to the provisions of Section 20636(c)(4) of the California Government Code, and reported to Public Employees' Retirement System as compensation earnable.

All full-time employees hired before January 1, 2011, except firefighters who receive a cash payout, are eligible to set aside a percentage of accumulated sick leave upon retirement to be used for payment of future health care premiums to a choice of four insurance plans. The City has no obligation to pay the health insurance allowance for retirees with no accumulated sick leave. (1 month per 8 hours of converted sick leave)

Per the MPOA MOU, City of Modesto Safety employees who waive medical, dental and vision benefits receive deferred compensation in-lieu contributions from the City of $425 per month, which totals $5,100 per year. According to the City's salary schedule, the maximum monthly base salary for a Modesto Police Officer is $6250.98 or $75,011.76 annually. Assuming an officer receives the maximum monthly base salary and waives City-provided health insurance, the City would pay an additional 7% of base salary annually in deferred compensation to those Safety employees waiving health coverage provided by the City. This potential 7% added cost is excluded from the total retirement percent depicted in the Safety Employee Comparison chart, but may apply as an additional cost to select Modesto Safety employees who waive this benefit.

Per the MCEA MOU, the City shall match deferred compensation contributions on behalf of a participating Miscellaneous employee in a regular position one percent (1%) of an employee's regular rate of pay on a bi-weekly basis; provided, the employee is contributing at least one percent (1%). For such employees who have been continuously employed by the City for fifteen (15) or more years, the City shall contribute two percent (2%), provided the employee is contributing at least two percent (2%).

It should be noted that due to contract changes, this analysis has been updated from previous versions.

Sources:
FY 2012-13
CAFR: https://www.modestogov.com/fin/docs/financials/Comprehensive%20Annual%20Report%202013.pdf
MOUS: https://www.modestogov.com/hr/mou/mou.asp
Police: https://www.modestogov.com/hr/mou/docs/MPOA/MPOA_MOU.pdf
Police
Amended: https://www.modestogov.com/hr/mou/docs/MPOA/MPOA%20LOA%20Contract%20Extension%20to%206.30.14.pdf

Retiree health amendment: https://www.modestogov.com/hr/mou/docs/MPOA/MPOA%20Article%2012%20Retiree%20Health%20Insurance%206.10.2013.pdf
Miscellaneous Employees: https://www.modestogov.com/hr/mou/docs/MCEA/MCEA.pdf
Salary Schedule/Typical Salary for Modesto Police officer:
http://agency.governmentjobs.com/modesto/default.cfm?action=viewclassspec&ClassSpecID=913725&ViewBenefits=Yes

[8]**Oakland:**

Data derived from the Memorandum of Understanding Between the City of Oakland and Oakland Police Officer's Association – July 1, 2006 to June 30, 2015 for Safety employees.

Data derived from the Memorandum of Understanding Between the City of Oakland and Oakland SEIU Local 1021– July 1, 2013 to June 30, 2015 for Miscellaneous employees.

Oakland Payroll staff report that the only fraction of Oakland municipal employees receiving an employer Social Security contribution are part of a federally funded Senior AIDES program. Miscellaneous and Safety staff are not covered by Social Security.

There is a voter approved parcel tax that contributes to the City of Oakland's Pension Obligations. However, we are unable to determine how much of the annual POB it supports.

Sources:
FY 2012-13 CAFR: http://www2.oaklandnet.com/w/OAK044620
MOUs: http://www2.oaklandnet.com/Government/o/CityAdministration/d/EmployeeRelations/MOUsandCivilServiceRules/
Police: http://www2.oaklandnet.com/oakca1/groups/hrm/documents/agenda/oak030399.pdf
SEIU: http://www2.oaklandnet.com/oakca1/groups/hrm/documents/memorandum/oak046252.pdf
PERS Rates:
http://www2.oaklandnet.com/oakca1/groups/hrm/documents/webcontent/oak046325.pdf

[9]**Riverside:**

The Employer Paid Member Contribution applies only to First Tier employees (for Safety employees, this includes police employees under the retirement formula of 3 percent at age 50 if hired before 2/16/2012. For local fire safety employees, to receive the Employer Paid Member Contribution, they must have been hired before 6/10/11). Per the MOU in effect from July 1, 2009 – December 1, 2014, Riverside Police Officer Association bargaining unit employees hired on or after February 17, 2012 shall pay 100% of the employee's normal contribution (currently 9%) to PERS.

First Tier miscellaneous staff are those under the 2.7% at 55 retirement formula, who were hired prior to June 7, 2011. All Second (hired on or after June 7, 2011 but prior to January 1, 2013) and Third Tier (hired on or after January 1, 2013) employees must pay varying portions of the employee share, which varies by employee group and date of hire.

City retiree health contributions for active employees on monthly basis varies by employee group MOU and date of hire. According to Riverside Human Resources staff, retiree health contributions by the City are for SEIU members only. The labor agreement specifies that City contributions are not a guarantee of coverage or specified benefit levels. To receive these retiree health benefits, employees must have been hired prior to dates specified in either July or December 2011.

The City issued a series of Pension Obligation Bonds, which total $122,005,000 in outstanding debt. The City's $42.5 million contribution for FY 2013-14 (28.5% of covered payroll) is abnormally high at $37.2 million of principal payments and $5.3 million of interest, due to debt restructuring issues unique to this year, while in FY 2014-15, according to the City's Annual Financial Review, the annual contribution will decrease to $11.8 million (7.9% of covered payroll). Therefore, the 2014-15 debt service was used for this comparison.

Three select employee groups receive deferred contribution funds paid by the City, provided their members contribute at least $25.00 per pay period. The value of this additional benefit is not depicted as a retirement cost in the Safety Employee Comparison chart. Affected employee groups receiving this benefit include:

- IBEW Supervisory employees may receive up to $3,000 annually in City deferred contributions
- Fire-Safety Management employees may receive up to $2,400 annually if enrolled in long-term disability (LTD), or up to $2,520 annually if not enrolled in LTD
- Police-Safety Management and Supervisory employees may receive up to $2,400 annually if enrolled in long-term disability (LTD), or up to $2,580 annually if not enrolled in LTD

Sources:
FY 2012-13 CAFR: http://www.riversideca.gov/finance/cafr/2013.asp
MOUs: http://www.riversideca.gov/human/labor/
Police: http://www.riversideca.gov/human/comp/compforms/RPOA-Police.pdf
SEIU: http://www.riversideca.gov/human/comp/compforms/SEIU_MOU.PDF
Benefits chart: http://www.riversideca.gov/human/benefits/benefitforms/COR_BenefitsChart.pdf
Fringe Benefits and Salary Plan:
http://www.riversideca.gov/human/comp/compforms/FB-SP.pdf
CalPERS Rates: http://www.riversideca.gov/human/benefits/benefit-retiree-calpers.asp
Deferred compensation: http://www.riversideca.gov/human/benefits/benefit-defcomp-457.asp

[10]**Sacramento:**

According to Sacramento human resources staff, all non-sworn employees are covered by Social Security. The Employer Paid Member Contribution rate of 3% applies only to certain Miscellaneous employees, which include the majority of clerical and paraprofessional staff.

Sources:
FY 2012-13 CAFR (Page 103 indicates CalPERS Employer Paid Member Contribution Rates): http://portal.cityofsacramento.org/Finance/Accounting/Reporting

MOUs for Police and Miscellaneous staff: http://portal.cityofsacramento.org/HR/Divisions/Labor-Relations/Labor-Agreements
Social Security:
http://portal.cityofsacramento.org/HR/Divisions/Benefits-Retirement/Retirement

[11]**San Bernardino:**

Information shown here is extracted from the most recent Comprehensive Annual Financial Review publicly available on the City's website, which is for FY 2010-11.

Data derived from the Memorandum of Understanding Between the City of San Bernardino and San Bernardino General Unit Employees – January 1, 2011 to June 30, 2012 for Miscellaneous employees: *"Effective June 1, 2011, all newly hired Miscellaneous members will pay the full 7 percent employee contribution amount to PERS."*

Data derived from the Memorandum of Understanding Between the City of San Bernardino and San Bernardino Police Officer's Association – January 1, 2006 to December 31, 2009 for Safety employees: *"The City will increase the base salary of all Safety employees covered by this agreement by converting the nine percent (9%) Employer Paid Member Contribution (EPMC) to base salary."* However, according to San Bernardino Human Resources staff, the City Council has imposed new terms to suspend the 9% base salary increase. The San Bernardino POA is presently engaged in mediation to address this issue.

Note 2 of the FY 2010-11 CAFR explains that the City had triggered a default under the Pension Obligation Bond, as the City was unable to deposit the FY 2012-13 debt service payment due to the trustee. Additional information was not provided by the City's Finance department.

Sources:
FY 2010-11 CAFR (most recent available):
http://www.ci.san-bernardino.ca.us/civicax/filebank/blobdload.aspx?BlobID=14569
MOUs: http://www.ci.san-bernardino.ca.us/cityhall/city_managers_office/hr/mous.asp
Police: http://www.ci.san-bernardino.ca.us/civicax/filebank/blobdload.aspx?BlobID=2562
Miscellaneous Employees:
http://www.ci.san-bernardino.ca.us/civicax/filebank/blobdload.aspx?BlobID=2559
Miscellaneous Employees Amendment:
http://www.ci.san-bernardino.ca.us/civicax/filebank/blobdload.aspx?BlobID=16516

[12]**Santa Ana:**

As of July 1, 2013, the City reports a 9% contribution for Safety (sworn) CalPERS members under the 3% at 50 plan. Non-sworn members of the Santa Ana Police Officers Association receive an 8% City paid contribution.

For SEIU members under the 2.7% at 55 plan, there is an 8% Miscellaneous contribution paid by the City.

The City's contribution to its Retirement Health Benefit Subsidy Plan varies from .75-1.75% by bargaining unit for active employees.

Sources:
FY 2012-13 CAFR: http://www.ci.santa-ana.ca.us/finance/cafr/cafr_12-13.asp
MOUs for Police and SEIU staff: http://www.santa-ana.org/personnel/documents.asp
CalPERS FY 2013-14 rates: http://www.santa-ana.org/personnel/documents/CalPERSContributionsforallemployeesforinternetFY13-14Rates.pdf

[13]**Stockton:**

Information shown here is extracted from the most recent Comprehensive Annual Financial Review publicly available on the City of Stockton's website, which is for FY 2011-12. Data from this CAFR predates any agreements and/or adjustments negotiated during the bankruptcy process. For the purpose of this comparison, the FY 2011-12 estimated annual covered payroll of $102 million was used to calculate the actual OPEB expenditures as a percent of covered payroll and the POB contribution as a percent of covered payroll.

The City of Stockton's FY 2012-13 expenditure of $2 million for other post-employment benefits represents the phasing-out of retiree medical coverage. Expenditures in Fiscal Year 2013-14 and beyond will be $0. A one-time lump sum payment of $5.1 million is part of the proposed plan of adjustment bankruptcy settlement.

The City of Stockton's pension obligation bond preliminary settlement information estimates an annual debt service contribution of $4.5 million. This amount is estimated as of 2015, and is pending bankruptcy court approval. This payment includes consideration/partial settlement with respect to the 2007, $40.4 million office building lease revenue bond, also insured by Assured Guarantee.

Sources:
FY 2011-12 CAFR: http://www.stocktongov.com/files/2012_CAFR.pdf
LRFP: Disclosure Statement With Respect To First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California (November 15, 2013), Ex. B (Long-Range Financial Plan Of City Of Stockton)

were served on December 16, 2013. The overwhelming majority of the Solicitation Packages were served on December 6, 2013.

6. The Plan Solicitation Order required that all completed Ballots be received by Rust Omni by the Voting Deadline, at: the City of Stockton Ballot Tabulator, Rust Consulting/Omni Bankruptcy, 5955 DeSoto Avenue, Suite 100, Woodland Hills, California, 91367, (818) 906-8300, facsimile (818) 783-2737. Such address, telephone number, and fax number were expressly set forth on the Ballots. *See* Plan Solicitation Order, ¶ 11.

7. At the request of the City, I followed the following procedures for tabulating and validating the Ballots (the "Voting Procedures"):

a. Ballots received by the City in the following categories were not counted as an acceptance or a rejection of the Plan:

i. Ballots where the creditor or the creditor's representative did not use the authorized form, or use a form of Ballot substantially similar to such authorized form;

ii. Ballots not received by the City's agent (i.e., Rust Omni) on or before the Voting Deadline; and

iii. Ballots not signed by the creditor or the creditor's authorized representative.

b. Ballots were tabulated as follows:

i. Ballots where the creditor or the creditor's authorized representative did not check a box indicating acceptance or rejection of the Plan were not counted as an acceptance or a rejection of the Plan; and

ii. If a holder of a claim cast more than one Ballot for the same claim prior to the Voting Deadline, the last properly completed Ballot received prior to the Voting Deadline was deemed to reflect such voter's intent and to supersede any prior Ballot.

8. I was responsible for supervising the employees of Rust Omni in connection with the tabulation and validation of the Ballots in accordance with the Voting Procedures.

9. The pertinent information from the Ballots received from holders of Claims in Classes 1A, 1B, 3, 4, 5, 6, 7, 12, 14, and 18 ("Submitted Ballots") were recorded on ballot tally reports ("Ballot Tally Reports"). The Ballot Tally Reports for Classes 1A, 1B, 3, 4, 5, 6, 7, 14,

and 18 are attached hereto as collective Exhibit A. The Ballot Tally Report for Class 12 is attached hereto as Exhibit B. True and correct copies of the Submitted Ballots (of which there are approximately 1,044) will be made available for inspection upon request.

10. The results regarding the acceptance or rejection of the Plan are tabulated on the Ballot Tally Reports annexed hereto and summarized below:

Class 1a – Claims of Ambac		**Result**
Ballots Received	**1** votes accepting the Plan **0** votes rejecting the Plan	**ACCEPT**
Acceptance	**100%** in number of votes accepting the Plan **100%** in dollar amount accepting the Plan ($12,265,000.00)	
Rejection	**0%** in number of votes rejecting the Plan **0%** in dollar amount rejecting Plan	
Class 1b – Claims of Holders of 2003 Fire/Police/Library Certificates		
Ballots Received	**1** votes accepting the Plan **0** votes rejecting the Plan	**ACCEPT**
Acceptance	**100%** in number of votes accepting the Plan **100%** in dollar amount accepting the Plan ($12,265,000.00)	
Rejection	**0%** in number of votes rejecting the Plan **0%** in dollar amount rejecting Plan	
Class 3 – Arena Claims of the 2004 Arena Bond		**Result**
Ballots Received	**1** vote accepting the Plan **0** votes rejecting the Plan	**ACCEPT**
Acceptance	**100%** in number of votes accepting the Plan **100%** in dollar amount accepting the Plan ($45,135,000.00)	
Rejection	**0%** in number of votes rejecting the Plan **0%** in dollar amount rejecting Plan	
Class 4 – Parking Structure Claims of the 2004 Parking Bond		**Result**
Ballots Received	**1** vote accepting the Plan **0** votes rejecting the Plan	**ACCEPT**
Acceptance	**100%** in number of votes accepting the Plan **100%** in dollar amount accepting the Plan ($31,640,000.00)	
Rejection	**0%** in number of votes rejecting the Plan **0%** in dollar amount rejecting Plan	
Class 5 – Office Building Claims of the 2007 Office Building Bond		**Result**
Ballots Received	**1** vote accepting the Plan **0** votes rejecting the Plan	**ACCEPT**
Acceptance	**100%** in number of votes accepting the Plan **100%** in dollar amount accepting the Plan ($40,770,000.00)	
Rejection	**0%** in number of votes rejecting the Plan	

	0% in dollar amount rejecting Plan	
Class 6 – Pension Obligation Bonds Claims of Assured Guaranty		**Result**
Ballots Received	**1** vote accepting the Plan **0** votes rejecting the Plan	**ACCEPT**
Acceptance	**100%** in number of votes accepting the Plan **100%** in dollar amount accepting the Plan ($125,310,000.00)	
Rejection	**0%** in number of votes rejecting the Plan **0%** in dollar amount rejecting Plan	
Class 7 – Claims of DBW (California Dept. of Boating and Waterways)		**Result**
Ballots Received	**1** vote accepting the Plan **0** votes rejecting the Plan	**ACCEPT**
Acceptance	**100%** in number of votes accepting the Plan **100%** in dollar amount accepting the Plan ($10,870,821.00)	
Rejection	**0%** in number of votes rejecting the Plan **0%** in dollar amount rejecting Plan	
Class 9 – Thunder Claims		**Result**
Ballots Received	No Valid Votes Received	**NOT APPLICABLE**
Class 12 – General Unsecured Claims		**Result**
Ballots Received	**977** votes accepting the Plan **16** votes rejecting the Plan	**ACCEPT**
Acceptance	**98.39%** in number of votes accepting the Plan **91.25%** in dollar amount accepting the Plan ($478,247,334.89)	
Rejection	**1.61%** in number of votes rejecting the Plan **8.75%** in dollar amount rejecting Plan ($45,881,279.54)	
Class 14 – Claims of Certain Tort Claimants		**Result**
Ballots Received	**8** votes accepting the Plan **12** votes rejecting the Plan	**REJECT**
Acceptance	**40%** in number of votes accepting the Plan **76.65%** in dollar amount accepting the Plan ($21,902,857.55)	
Rejection	**60%** in number of votes rejecting the Plan **23.35%** in dollar amount rejecting Plan ($6,673,851.22)	
Class 18 – SPOA Claims		**Result**
Ballots Received	**5** votes accepting the Plan **0** votes rejecting the Plan	**ACCEPT**
Acceptance	**100%** in number of votes accepting the Plan **100%** in dollar amount accepting the Plan ($183,560.75)	
Rejection	**0%** in number of votes rejecting the Plan **0%** in dollar amount rejecting Plan	
Class 19 – Price Claims		**Result**

Ballots Received	No Valid Votes Received	**NOT APPLICABLE**

11. As reflected above and by the Ballot Tally Reports, the Submitted Ballots received reflect that (i) Classes 1A, 1B, 3, 4, 5, 6, 7, 12, and 18 each accepted the Plan, and (ii) Class 14 rejected the Plan.

12. As reflected above and by the Ballot Tally Reports, no valid votes were received in Classes 9 or 19.

Executed this 21st day of April 2014, at Woodland Hills, California. I declare under penalty of perjury under the laws of the State of California and the United States of America that the foregoing is true and correct.

Catherine Nownes-Whitaker

MR. LEVINSON: And, Your Honor, I don't contest your authority or the need for you to independently examine the plan. I fully expect you to do that; we want you to do that.

THE COURT: Mr. Rios is on his feet on behalf of the retired employees.

MR. RIOS: Yes, Your Honor. For the retirees committee, I'll be brief because the comments that have already been presented to the Court I would duplicate, so I don't want to do that.

But I do want to impress upon the Court that the retirees committee has agreed to support the plan and the retirees have voted overwhelmingly to support the plan with the plan that's before the Court, which does not propose to impair pensions.

And so we don't see this as a plan that puts at issue the impairment of pensions. The issue the Court has claimed, the question is whether the CalPERS contract can be impaired and whether CalPERS' interest can be affected here.

But obviously it's not just CalPERS interests that are at issue, it's the interests of the retirees of the City of Stockton, and those retirees have already agreed to a substantial impairment of the retirement health benefit claims where they are standing to receive less than 1 percent of their claims on the retiree health benefit claims.

The pension, putting that into play, into the case, I believe would create a change in the game. And so the committee and the retirees do support the plan that the City has proposed and the City is not proposing to modify the pensions.

THE COURT: No, I understand there's an enormous amount of time and effort that's been spent in mediation of both the pre-filing mediation and the mediation of Judge Perris, and I'm also mindful of the obligation to take a hard look at that which has been put together, and make sure that it stands up.

MR. RIOS: Thank you.

THE COURT: Okay. We really are now at 5:00 o'clock. So come back at 9:30 in the morning.

(Evening recess.)

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Margaret Garms on behalf of Stockton Police Officers Association and Stockton Police Managers Association.

The City has negotiated agreements with the police unions that have resulted in very significant cuts to police pay. Some of that was before the petition was filed. There was also extensive mediation after the petition was filed resulting in a new Memorandum of Understanding.

The market for police officers is not going to bear any further cuts. The department has not been able to raise the count of police personnel above 350, even though it's authorized to have up to 480, because as fast as they hire new police officers, people leave, and this has resulted in the number of years of experience that the average police officer sinking to only two and a half years.

And as Ms. Nicholl testified today, if the City were to cut CalPERS or terminate the CalPERS relationship, the employees would basically have six months to get out in order to preserve as much as possible, not all of their CalPERS accrued benefits.

And there would be a huge incentive to police officers to leave the City and move to another CalPERS city or agency within six months in order to maintain as much as possible of their CalPERS pension. So it would create havoc if the City were to terminate CalPERS pension right now.

The City has done a lot already to impair pensions,

<u>NPFG Parking Settlement</u>. NPFG Parking Bonds aka Lease Revenue Bonds, Series 2004 (Parking and Capital Projects). These bonds were sold as a standard lease transaction with three parking garages (Arena, Ed Coy and Market Street) serving as the leased premises. The City and NPFG agreed to form a new Parking Authority, the City agreed to move all of the City's parking assets into the new Parking Authority, and NPFG agreed to a reduced payment schedule in exchange for a gross revenue pledge from the new Parking Authority revenues. The leased assets remain the same, and the City anticipates that the parking revenues—as opposed to the General Fund—will pay the debt service on the restructured obligation.

<u>Assured Guaranty Settlement</u>. The Assured Guaranty Settlement affects both the Pension Obligation Bonds, aka 2007 Taxable Pension Obligation Bonds, Series A and Series B (the "POBs"), and the Assured Office Bonds, aka the Variable Rate Demand Lease Revenue Bonds, 2007 Series A and Taxable 2007 Series B (Building Acquisition Financing Project) (the "VRDOs"). Assured Guaranty has asserted that the POBs have special status because they represent the same underlying liability as the City's other pension funding obligations (which are being assumed under the Plan) and are thus obligations imposed by law (which City confirmed at the time of issuance of the POBs through a validation action under California Code of Civil Procedure section 860 et seq.). The Assured Guaranty Settlement shifts the proposed "Ask" payments originally slated for the Assured Office Bonds to the POBs along with $250,000 of additional payments each year starting in 2023. The City also agreed to pay the portion of debt service payable on the POBs from restricted funds to the POBs. These restricted fund payments would otherwise go to pay pension benefits or to repay the POBs; these restricted funds are not part of the General Fund.

At the time of the "Ask", the restricted fund payments were estimated at 17.38%, consisting primarily of water/sewer, gas tax, and Measure W funds. The ratio of City employees compensated solely or partially from the General Fund and those compensated from Restricted Funds varies from year to year, depending on, among other things, the number of employees paid from each fund. Based on historical and projected data, a reasonable estimate of the amount of pension obligations that are funded from Restricted Funds is about 17%. Assured and the City agreed on this percentage as a fixed amount each year. Because approximately 17% of City's pension obligations may lawfully be funded by special fund revenue, such revenues may be used to pay 17% of the debt service obligations on the POBs.

The VRDOs were sold as a standard General Fund lease with 400 E. Main serving as the leased premises. In exchange for shifting the "Ask" payments from the VRDOs to the POBs, Assured agreed to terminate the lease payments under the VRDOs. The City also entered into a near-term lease for office space in the building to turn such space into City Hall. Although from the City's perspective the VRDOs obligation was terminated, the City agreed to possession by Assured of 400 E. Main with title to shift at some future date.

The Assured POBs settlement was an essential part of the overall deal struck between the City and Assured, overseen by Judge Perris, which was necessary to ensure the City's continued use of 400 E. Main for the next 12 years. The Assured POBs settlement provides for payments from the City's restricted funds, which the City believes will be available to make those payments. The POBs funded payment of pension benefits for City employees, including current and retired City employees whose compensation and benefits were paid by monies from the General Fund as well as those whose compensation and benefits were paid by monies from Restricted Funds. As explained in the declaration of Vanessa Burke in support of the City's eligibility for bankruptcy relief [Dkt. No. 62], such Restricted Funds may not be used to pay General Fund obligations unrelated to such Restricted Funds. They may, however, be used to pay obligations related to the Restricted Funds.

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