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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
SACRAMENTO DIVISION

In re
CITY OF STOCKTON, CALIFORNIA,
Debtor.

Case No. 12-32118
DC No.: JDE-05
Chapter Number: 9

**AD HOC TAXPAYERS WORKING
GROUP'S SUBMISSION OF REPLY
TO CITY'S SUBMISSION OF
RESPONSE TO JULY, 8, 2013
LETTER FROM KAROL K.
DENNISTON REQUESTING
APPOINTMENT OF OFFICIAL
TAXPAYERS' COMMITTEE**

The Ad Hoc Taxpayers Working Group (the "Working Group"), by and through their undersigned attorneys, hereby submits their reply to the City of Stockton, California's (the "Debtor") submission of response to July 8, 2013 letter from Karol K. Denniston requesting appointment of official taxpayers' committee.

Dated: August 7, 2013

/s/ Jeffrey D. Eaton
Jeffrey D. Eaton
Attorneys for Ad Hoc Taxpayers Working
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August 7, 2013

VIA U.S. MAIL AND EMAIL

Antonia.darling@usdoj.gov

Antonia Darling
Assistant U.S. Trustee
United States Department of Justice
501 "I" Street, Suite 7-500
Sacramento, California 95814

Re: *In re City of Stockton, California* ("Debtor" or "City"), United States Bankruptcy Court, Eastern District of California, Sacramento Division, Case No. 12-32118

Dear Ms. Darling:

As you know, Schiff Hardin LLP represents the ad hoc working group of Stockton taxpayers ("Working Group"), formed after the conclusion of the eligibility process. We write to formally respond to the Debtor's July 11, 2013 Letter opposing Official Committee status for the Working Group. We continue to be concerned by the Debtor's open hostility to the Working Group and its request for Official Committee status given that the Debtor apparently needs the support of the taxpayers based on its statements that the proposed tax increase is needed to "fund its bankruptcy exit".

Committee Composition

The Debtor's contention that the administrative burden of selecting the members of an Official Committee (should the U.S. Trustee decide that the members of the Working Group are not adequate representatives) is inane. There is little doubt that the U.S. Trustee has overseen the selection of Official Committees with thousands of creditors or equity security holders in the past. In fact, a Committee of retirees exists in this very case where a small group of retirees was self-appointed to speak for all of the retirees. No doubt, the Debtor supported the formation of the retiree committee because it wanted a settlement with the retirees. Obviously, at this point, the Debtor does not fully appreciate the ramifications of its hostility to the taxpayers. While the Debtor may be pessimistic about the U.S Trustee's ability to select



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representatives for an Official Committee of taxpayers, the Working Group is quite confident that despite the novel challenges, the administrative burden is more than manageable given the U.S. Trustee's expertise in managing the committee appointment process.

Debtor's Plan of Adjustment

It is quite surprising to see the Debtor freely admit that a plan of adjustment does not yet exist. What is most surprising about this fact is that for much of a 5 hour emergency City Council meeting on July 9, 2013, the discussion centered around how the proposed $\frac{3}{4}$ cent tax increase (now on the ballot for the November 5th election) was necessary for it to exit bankruptcy. How is it that the Debtor can know that this tax increase is necessary for the approval of a plan of adjustment when the Debtor claims not to even have a plan of adjustment, or finished its ongoing negotiation with its creditors? How can representatives of the Debtor assure the Working Group or anyone else involved in this process that proceeds will be used for any particular purpose, much less be sufficient to hire additional police and pay for its "bankruptcy exit."

A careful review of the Debtor's statements to you gives the Working Group deep concerns regarding the City Manager's lack of candor with the City Council and the residents regarding the timing and costs of the City's exit from bankruptcy. It may be that our request for Official Committee status is premature and that the Working Group can and should deal with the proposed tax increase first given that the Debtor stated at the most recent status conference that its plan would be filed in September. Clearly something is out of place and it appears that dealing with the November election is necessary to establish what the taxpayers already know -- namely that the City has no credibility with the voters and, after the last letter to you, has not been candid regarding the actual status of the bankruptcy case and the City's ability to propose a feasible plan anytime soon.

This is amplified by the audit just finalized by the State Controller's Office which confirms the taxpayers' worst fears. The audit found the City's audit controls were ineffective. It further found the City illegally transferred money from dedicated accounts, mishandled cash and did not supervise the awarding of city contracts. In summary, the audit report states "We found the potential for waste, fraud and abuse of public resources is extremely high due to numerous deficiencies." Consistent with the City's response to our request for official committee status, the City's official response was defiant, asserting "the State Controller's Office is more interested in scoring political points than supporting good governance." Clearly the taxpayers of Stockton need time to consider what value they have received for the City's \$15 million investment in this chapter 9 process. The State Controller agrees as in its August 5, 2013 response letter to the City Manager, stated "We hope that these detailed corrections of your misstatements and false



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accusations will cause you to revisit your dismissive attitude regarding our audit findings and recommendations. We fear that your current posturing may prevent you and the city from learning from its past mistakes and benefitting from recommendations aimed at steering the city away from repeating them.”

Democracy vs. The Working Group

The Working Group is taken aback by the assertion that its existence would compromise democracy in the City, and jeopardize the Debtor’s proposed tax increase. The Working Group stands for transparency regarding the tax increase and the bankruptcy process -- which the residents of Stockton are not receiving and the City seems determined to prevent.

Official Committee Status for Taxpayers is a Novel Issue of Bankruptcy Law

The Working Group appreciates its request for Official Committee status poses novel questions of Chapter 9 bankruptcy law. Specifically, the Bankruptcy Code is silent as to the role of the taxpayers in a Chapter 9 where the taxpayers are being asked to fund the Debtor’s plan of adjustment and vote on a ballot measure that is under attack because it is misleading¹. In any other bankruptcy context, it would be obvious that any group who is integral to the plan process would have Committee representation.

Public Mandate

The Working Group remains puzzled as to why the Debtor is openly hostile toward its taxpayers and to providing clear, complete and accurate financial and operating information. The Controller's audit report provides significant insight and calls into question any and all accounting and financial information produced by the Debtor. It also calls into question whether the Debtor's designated representative is the appropriate person to manage this bankruptcy and whether the City Council is adequately supervising its designated representative.

At this juncture, the Working Group requests the U.S. Trustee refrain from making any decision on the Working Group's request for Official Committee status until after the November 5, 2013 election and the current City Manager has left office and an interim City Manager, who will hopefully be more responsive to the taxpayers’ legitimate concerns, is appointed. Stockton's path forward will be much clearer once the voters have spoken. The

¹ See Motion for Relief from Automatic Stay filed by Dean Andal [Dkt. No. 1035]; and Motion to Shorten Time filed by Dean Andal. [Dkt. No. 1040.]



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Working Group reserves its right to renew its request or make a revised request as appropriate based on the circumstances as they unfold.

The Working Group will continue to operate as an ad hoc working group as it believes there is little benefit to an extended fight over Official Committee status. Thank you for your time on this matter.

Best regards,

A handwritten signature in blue ink that reads 'Karol K. Denniston'.

Karol K. Denniston