

## APPENDIX 1

1 **201**

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

8 JEFFERY D. HERMANN (STATE BAR NO. 90445)  
jhermann@orrick.com  
9 JOHN A. FARMER (STATE BAR NO. 242775)  
jfarmer@orrick.com  
10 ORRICK, HERRINGTON & SUTCLIFFE LLP  
777 South Figueroa Street, Suite 3200  
11 Los Angeles, California 90017-5855  
Telephone: +1-213-629-2020  
12 Facsimile: +1-213-612-2499

13 Attorneys for Debtor  
City of Stockton

14 UNITED STATES BANKRUPTCY COURT  
15 EASTERN DISTRICT OF CALIFORNIA  
16 SACRAMENTO DIVISION  
17

18 In re:  
19 CITY OF STOCKTON, CALIFORNIA,  
20 Debtor.

**Case No. 2012-32118**

**Chapter 9**

**MODIFIED DISCLOSURE  
STATEMENT WITH RESPECT  
TO FIRST AMENDED PLAN  
FOR THE ADJUSTMENT OF  
DEBTS OF CITY OF  
STOCKTON, CALIFORNIA  
(NOVEMBER 15, 2013)**

24  
25  
26  
27  
28

1 significant ongoing obligations in the form of pensions, health care, compensation, and other  
2 benefits for its current and former employees.

3 A large part of the City's current economic difficulties are the result of imprudent fiscal  
4 decisions and poor accounting practices during better economic times. When the City was flush  
5 with cash, it made financial decisions and commitments based on the assumption that its  
6 economic growth would continue indefinitely. These commitments included unsustainable labor  
7 costs, retiree health benefits, and public debt. Past inadequate accounting practices also obscured  
8 the severity of the City's impending financial difficulties and in some cases resulted in additional  
9 unrecognized liabilities to the City's General Fund. As a result, when the Great Recession hit, the  
10 City found its financial obligations quickly outpacing its revenues. Compounding these economic  
11 challenges, the City—like all California cities—is limited by law in its ability to generate new  
12 revenues. Under California law, the City was unable to increase tax revenues without voter  
13 approval. As described herein, on November 5, 2013, Stockton voters passed Measure A, a 3/4  
14 cent sales tax measure that the City placed on the ballot to generate necessary revenues that will  
15 enable it to both continue to provide services to its residents and to fund its obligations to its  
16 employees and creditors.

17 **C. The City's Pension Obligations.**

18 As noted elsewhere herein, the City has negotiated compensation reductions and staff  
19 reductions that in turn have reduced the City's obligations to fund contributions to the pension  
20 plans of the City's employees (although overall compensation costs and pension obligations will  
21 once again rise with the hiring of additional police officers contemplated by the Marshall Plan).  
22 Even assuming it were legally possible for the City to further reduce its pension obligations by  
23 unilaterally trimming its funding of employee pensions through CalPERS (while somehow  
24 providing City employees the level of pension benefits specified in its various labor agreements),  
25 the City does not believe underfunding of its CalPERS pension obligations would be in the best  
26 interests of either the City or its employees.

27 The City's employee and retiree pensions are managed through the California Public  
28 Employees' Retirement System ("CalPERS"). The City's General Fund CalPERS obligation for

1 the funding of retirement benefits for its employees in fiscal years 2008-09 through 2010-11,  
2 before the City's pension reforms were fully implemented, averaged 13.3% of total General Fund  
3 expenditures. By comparison, the City has forecast that its pension obligations from fiscal year  
4 2011-12 through fiscal year 2020-21 (including the CalPERS portion of costs from additional  
5 staffing under the Marshall Plan for improved public safety services) will average 15.5% of total  
6 General Fund expenditures.<sup>5</sup> A CalPERS defined benefit pension is the industry standard for city  
7 employees throughout California. Over 97% of California cities contract with CalPERS for  
8 pension benefits, and more than 99% of California city employees are covered by CalPERS or a  
9 similar defined benefit plan. Additionally, all county employees in California receive a defined  
10 benefit plan from CalPERS or another similar system, and all state employees receive a CalPERS  
11 pension. Moreover, of the 26 new cities created in California since 1990, approximately 92%  
12 have contracted with CalPERS or a similar plan. When it comes to public employee pensions in  
13 California, CalPERS is the primary, and often only, option. This has provided a consistent  
14 pension benefit package available to persons employed in public-sector jobs.

15 The City has no ready, feasible, and cost-effective alternative to the CalPERS system.  
16 The City believes that its obligations to CalPERS constitute an executory contract between the  
17 two. Under bankruptcy law, executory contracts can only be assumed or rejected (absent some  
18 consensual restructuring of the obligations of the executory contract). CalPERS's position is that,  
19 under the California statutes governing its activities and operations, it does not have any legal  
20 authority to negotiate changes to the pension plans authorized by the California State Legislature  
21 to provide reduced benefits, different payment structures for the City, or other modification that  
22 would provide material financial relief to the City. Thus, the City believes it has two paths to  
23 pursue: assumption of the CalPERS contract or rejection of the CalPERS contract. Under the  
24 Plan, the City assumes the CalPERS contract.

25 City leadership believes that rejecting its CalPERS contract would impose a significant  
26 reduction in the City's pension benefits to current retirees—by approximately two-thirds,  
27 according to CalPERS. This is in addition to the previously mentioned reductions. This would

28 <sup>5</sup> See Exhibit B ("Long Range Financial Plan of City of Stockton") to this Disclosure Statement.

1 result in many retirees receiving benefits below the poverty level. Meanwhile, current employees  
2 would likely lose approximately two-thirds of their current-to-date earned benefit. Moreover,  
3 such pension cuts would be in addition to the elimination of retiree health benefits that the City  
4 has already imposed: the City has completely eliminated retiree health benefits for those  
5 approximately 1,100 retirees who were receiving retiree health benefits. The elimination of City-  
6 paid health benefits for current retirees and their dependents on average amounted to 30% of their  
7 total postemployment benefits (the loss of City-paid health benefits given up by current  
8 employees will reduce their future total postemployment benefits 28-41%). Thus, unless the City  
9 were in a position to immediately restore approximately two-thirds of the pension benefits of all  
10 of its employees, a rejection of the CalPERS contract would violate the City's contracts with its  
11 nine labor organizations. Given the City's finances, it is no position to immediately fund two-  
12 thirds of the pension benefits of all of its employees.

13 The City believes that the only means of obtaining relief from its obligation to make  
14 contributions to CalPERS to fund the pension plans of its employees is through direct  
15 negotiations with the employees and their union representatives, which the City already has  
16 accomplished. The City's recent labor agreements made substantial cuts to compensation and  
17 benefit packages for current employees, including eliminating their future retirement health  
18 coverage (worth approximately \$26,000 per employee per year), requiring current employees to  
19 pay 100% of the employee share of their CalPERS contribution (7-9% of salary), and imposing  
20 compensation reductions that varied, but averaged 10% to 33%, of which 7% to 30% was in  
21 pensionable income reductions that would impact future pensions as well as current income.

22 The City believes that the compensation changes made over the last three years, along  
23 with the changes in pension benefits for new hires, have eliminated the excesses in its  
24 compensation/pension system. Through changes in labor agreements as well as changes in state  
25 law, the City has reduced the pension and health benefits for new hires after January 1, 2013 by  
26 50-70% for all new employees and higher for some types of new hires. The major compensation  
27 reductions that have occurred in the last three years will also reduce employee pensions from  
28 what they would have been due to reductions in pensionable income.

1           In light of the severe cuts that City employees and retirees already have experienced, the  
2 City believes that any further significant reduction in pension benefits would almost certainly lead  
3 to a mass exodus of City employees, as well as leaving the City hampered in its future  
4 recruitment of new employees—especially experienced police officers—on account of the  
5 noncompetitive compensation package it would be offering new hires. Moreover, due to recent  
6 changes in California law, the exodus of City employees would be massive and sudden. In order  
7 to preserve their pension benefit levels under new state law, Stockton employees would need to  
8 leave the City’s employ and obtain employment with another public agency with CalPERS or  
9 County Employees Retirement Act of 1937 benefits within six (6) months of the rejection of the  
10 City’s CalPERS contract. Such a sudden loss of trained and experienced staff would be  
11 catastrophic and would seriously jeopardize the City’s ability to provide even the most basic of  
12 essential public protections.

13           The City is unwilling to further reduce or eliminate pensions thereby defaulting on its  
14 contracts with its nine labor organizations, and, in effect, roll the dice to see if employees flee. In  
15 addition to critically impairing the City’s ability to recruit new employees, were the City to reject  
16 its CalPERS contract, California state law provides that such rejection would also trigger a  
17 termination penalty, which CalPERS calculates at \$946 million. Even then, the City would still  
18 have to fund and operate an alternate pension plan providing market-level benefits in order to  
19 remain a competitive employer. The City believes that even if it could locate or establish such a  
20 plan, it could not do so at a cost materially lower than the cost of remaining in the CalPERS plan.  
21 Additionally, because the City has not participated in the federal Social Security program since  
22 1978, City employees receive no federal pension benefits from that source, and their CalPERS  
23 pension is the only “retirement” provided by the City.

24           The City thus cannot unilaterally abandon the CalPERS system without incurring  
25 additional obligations and seriously jeopardizing its ability to recruit qualified employees. The  
26 current CalPERS benefits are 85-90% funded according to CalPERS and can be contrasted to the  
27 City’s retiree health program, which was 0% funded before being terminated.

28

1           **D. The City's Attempts to Avoid Insolvency.**

2           In light of its economic crisis, the City took drastic steps in an attempt to avoid  
3 insolvency, including depleting its reserves, renegotiating labor contracts, unilaterally imposing  
4 compensation reduction, cutting jobs and services, defaulting on bond payments, and deferring  
5 payouts to retiring employees, among others.

6           More specifically, the City instituted massive reductions in its workforce and employee  
7 compensation. Between fiscal years 2008-09 and 2011-12, the City reduced its General Fund  
8 full-time work force by 30%, including large reductions in sworn police positions (25%), non-  
9 sworn police positions (20%), fire positions (30%), and non-safety staffing (43%).<sup>6</sup> The City also  
10 reduced its pay and benefits to City employees, imposed furloughs, imposed a hiring freeze, and  
11 reduced City operational hours. By taking these extreme measures, the City was able to cut  
12 approximately \$90 million in General Fund expenses over three years from fiscal year 2008-09  
13 through 2011-12.

14           Despite these heroic efforts, however, the City continued to project annual deficits in the  
15 tens of millions of dollars. Revenues remained low, and labor costs, though markedly reduced,  
16 were still higher than the City could afford to pay, and were expected to increase. And after four  
17 consecutive years of reducing employee staffing, the City could not continue to make additional  
18 service reductions without jeopardizing the health, safety, and welfare of its residents. As a  
19 result, the City was forced to take further radical steps to balance its budget for fiscal year 2011-  
20 12, which included sweeping its remaining available unrestricted funds into its General Fund  
21 (thereby depleting critical funds such as workers compensation reserves, liability insurance  
22 reserves, equipment replacement funds, and the like), suspending some payments to separating  
23 employees, and electing not to pay over \$2 million in debt service owed between March 2012 and  
24 June 2012. These measures were necessary for the City to maintain sufficient liquidity to  
25 continue to operate through June 30, 2012 (the end of fiscal year 2011-12). Even with such  
26 measures, however, as of the June 28, 2012, filing of its bankruptcy petition, the City effectively

27  
28 <sup>6</sup> See City Budgets for 2008-09, 2009-10, 2010-11, and 2011-12, available on the website of the City of Stockton at  
<http://www.stocktongov.com> (from the homepage, click "City Government" and then click "Budget").

1 had no remaining reserves, and was facing a projected budget shortfall of almost \$26 million in  
2 fiscal year 2012-13.

3 **E. The City's Participation in Pre-Bankruptcy Negotiations.**

4 Pursuant to Assembly Bill 506 ("**AB 506**"), codified at California Government Code  
5 section 53760 *et seq.*, the City participated in a "neutral evaluation process" with most of its  
6 largest creditors prior to seeking bankruptcy relief. These negotiations occurred over a three (3)-  
7 month span, from March 27, 2012 through June 25, 2012, and were conducted under the auspices  
8 of the Honorable Ralph Mabey, a former bankruptcy judge and highly accomplished bankruptcy  
9 lawyer and mediator. Judge Mabey was selected jointly by the City and its creditors.

10 While the City was unable to avoid insolvency and bankruptcy through the mediation  
11 process, the City was able to reach agreements with almost all of its labor unions. The nine labor  
12 unions with which the City conducted negotiations are: (1) Operating Engineers 3 ("**OE3**")—  
13 Operations and Maintenance Unit ("**O&M**"); (2) OE3—Water Supervisory Unit; (3) OE3—  
14 Trades and Maintenance Unit ("**STAMA**"); (4) IAFF Stockton Firefighters Local 456—Fire Unit;  
15 (5) IAFF Stockton Firefighters Local 456—Fire Management Unit, (6) Stockton Police Officers'  
16 Association ("**SPOA**"); (7) Stockton Police Management Association ("**SPMA**"); (8) Stockton  
17 City Employees' Association ("**SCEA**"); and (9) Mid-Management/Supervisory Level Unit  
18 ("**B&C**").<sup>7</sup>

19 The City reached agreements with eight of these nine labor unions before or not long after  
20 the Petition Date. These agreements, in addition to providing for further compensation and  
21 benefit cuts, also eliminated retiree health benefits and other compensation claims that these  
22 groups would have had against the City in bankruptcy. An agreement with the SPOA, discussed  
23 in the section titled "Post-Bankruptcy Negotiations Conducted by Judge Elizabeth L. Perris," was  
24 reached in December 2012.

25 ///

26 ///

27 \_\_\_\_\_  
28 <sup>7</sup> In addition, the Parking Attendant Services Unit is a bargaining unit of part-time parking attendant workers, but they have little to no benefits and do not regularly negotiate. They are represented by OE3.