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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-5 Chapter 9 **CALPERS' MEMORANDUM REGARDING CONSTITUTIONAL, STATUTORY, AND PREEMPTION ARGUMENTS SUPPORTING THE ENFORCEABILITY OF THE PUBLIC EMPLOYEES' RETIREMENT LAW IN CHAPTER 9** Date: October 1, 2014 Time: 10:00 a.m. Place: Robert T. Matsui U.S. Courthouse, 501 I Street Department C, Fl. 6, Courtroom 35 Sacramento, CA 95814 Judge: Hon. Christopher M. Klein

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The California Public Employees' Retirement System ("CalPERS") files this memorandum concurrently with its Supplemental Brief in Support of the City of Stockton's First Amended Plan of Adjustment ("Plan"). In that memorandum, the "Supplemental PERL Brief," CalPERS addresses the interpretation of California's Public Employees' Retirement Law ("PERL"). This memorandum, on the other hand, addresses issues involving constitutional law, the Bankruptcy Code, and preemption law, responsive to the Court's request for briefing regarding the enforceability of specific provisions of the PERL.[1]

I. PRELIMINARY STATEMENT

The Court has raised questions regarding whether CalPERS can be impaired in a hypothetical chapter 9 case, or alternatively, whether pension obligations can be adjusted. The Court has also questioned whether a specific provision of the PERL, section 20487, has any effect, suggesting that provision is preempted by the Bankruptcy Code. CalPERS requests that the Court refrain from deciding these issues, because deciding them is unnecessary to confirmation of the City's Plan. If the Court believes it is necessary to decide these issues, the analysis below demonstrates that, while there are multiple avenues to reach the same conclusion, there can be but one conclusion: a municipal debtor's obligations to CalPERS cannot be impaired or adjusted in a hypothetical chapter 9 bankruptcy case, and the PERL, including section 20487, is not preempted by the Bankruptcy Code.

II. BACKGROUND

As explained in CalPERS' Supplemental PERL Brief, CalPERS is a State agency and, as such, enjoys the sovereign rights of the State of California. The PERL (Cal. Gov. Code § 20000 *et seq.*) establishes a retirement system for State and local government employees. *City of Oakland v. Pub. Emps. Ret. Sys.*, 95 Cal. App. 4th 29, 33 (2002). The purpose of the PERL is to "effect economy and efficiency in the public service" by providing a pension system to pay retirement compensation

[1] For the convenience of the Court and parties in interest, CalPERS will file a separate pleading that attaches the pertinent parts of exhibits and trial transcripts cited herein. In the case of transcripts, the pleading(s) will attach copies of only the pages cited and surrounding pages for context as necessary. In the case of declarations, the pleading(s) will attach only the declaration itself and those exhibits referred to in the brief, rather than all exhibits to the declaration.

and death benefits. Cal. Gov. Code § 20001.

The CalPERS Board of Administration ("CalPERS Board") has responsibility for the administration of the Public Employees' Retirement System (the "System"). The CalPERS Board is governed by State statutes and the California Constitution. *City of Oakland*, 95 Cal. App. 4th at 39. In 1992, California voters approved Proposition 162, which gave the CalPERS Board exclusive authority over the administration and investment of pension funds.[2] *Cal. Ass'n of Prof'l Scientists v. Schwarzenegger*, 137 Cal. App. 4th 371, 375 (2006). In enacting Proposition 162, the electorate amended article XVI, section 17 of the California Constitution, to read in part as follows:

> Notwithstanding any other provisions of law or this Constitution to the contrary, the retirement board of a public pension or retirement system shall have ***plenary authority and fiduciary responsibility*** for investment of moneys and administration of the system, subject to . . . the following: (a) . . . The retirement board shall . . . have sole and exclusive responsibility to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries.

(emphasis added). Proposition 162 also amended the California Constitution to provide that the CalPERS Board has "the sole and exclusive power to provide for actuarial services in order to assure the competency of the assets" of the System. CAL. CONST., art. XVI, § 17, subd. (e). The intent behind the measure was to protect public pension funds by vesting the authority to direct actuarial determinations solely with the governing board of the System. *See Direct Testimony Declaration Of David Lamoureux In Support Of CalPERS' Response To Franklin's Objection To Confirmation Of The City Of Stockton's First Amended Plan Of Adjustment* (the "Lamoureux Decl.") [Dkt. Nos. 1439-1444], Ex. 3 at 35 (Ballot Pamp., Analysis by the Legislative Analyst, Proposition 162, Gen. Election (November 3, 1992)). By granting the CalPERS Board sole authority to administer the System, Proposition 162 prevents the legislative and executive branches from "raiding" pension funds to balance the State budget. *Id.* at 376-37. It also prevents other outside interference with the management of the System.

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[2] The ballot pamphlet accompanying Proposition 162 explained that pension system boards should give "highest priority" to providing benefits to members and their beneficiaries. Lamoureux Decl., Ex. 3 at 35; *City of Oakland*, 95 Cal. App. 4th at 54.

Cities and other public agencies[3] may elect to participate in and make all or part of their employees members of the System. *See* Cal. Gov. Code § 20460. Once a city elects to participate in the System, the participating city is bound by the statutory provisions governing the System and the decisions of the CalPERS Board. Cal. Gov. Code § 20506; *City of Oakland*, 95 Cal. App. 4th at 55. Those provisions include a prohibition against failure to pay timely required employer contributions. Cal. Gov. Code § 20831. Participating cities cannot alter their funding obligations to CalPERS. *Bd. of Admin. v. Wilson*, 52 Cal. App. 4th 1109, 1122 (1997).[4]

The PERL requires a public agency contracting with CalPERS to make contributions for the public agency's employees in amounts recommended by CalPERS' actuary and approved by the CalPERS Board. Cal. Gov. Code § 20532. A public agency is also responsible to CalPERS for the expenses of determining the approximate and actual contributions, as well as of administering the System. Cal. Gov. Code §§ 20535, 20536. The PERL expressly prohibits rejection of any contract or agreement between a chapter 9 debtor and the CalPERS Board. Section 20487 provides:

> Notwithstanding any other provision of law, no contracting agency or public agency that becomes the subject of a case under the bankruptcy provisions of chapter 9 . . . shall reject any contract or agreement between that agency and the board pursuant to Section 365 of Title 11 of the United States Code or any similar provision of law . . . .

Accordingly, a municipal debtor that sought to reject its relationship with CalPERS through the bankruptcy process would violate express State law. A plan of adjustment proposing to do so would not be confirmable under the Bankruptcy Code. 11 U.S.C. § 943(b)(4) (confirmation allowed only if "the debtor is not prohibited by law from taking any action necessary to carry out the plan").

Stockton, in its Plan, has not proposed to modify its relationship with CalPERS. Stockton has exercised its sound business judgment in reaching the conclusion that its citizens are best served by a stable and fairly compensated employee base. However, the Court has directed the parties to address

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[3] "Public agency" is generally defined in the PERL as "any city, county, district, other local authority or public body of or within this State." Cal. Gov. Code § 20056.

[4] A participating agency may elect to terminate its participation in the retirement system prospectively, but such termination does not affect contribution obligations for benefits accrued prior to termination. *See* Cal. Gov. Code §§ 20750, 20577.

the hypothetical question of whether pension obligations can be adjusted in chapter 9.

III. ARGUMENT

A. A Chapter 9 Debtor Cannot Adjust its Statutory Pension Obligations to CalPERS, a State-Run Governmental Pension System, in Violation of State Law.

1. Unilateral Adjustment or Modification of a Debtor's Obligations to CalPERS through a Bankruptcy Plan Would Violate Section 903 of the Code.

As shown above, and in CalPERS' Supplemental PERL Brief, the PERL imposes obligations on a municipality participating in the System that are facially mandatory, whether the municipality is in or out of chapter 9. These obligations cannot be set aside in a chapter 9 case because of section 903 of the Bankruptcy Code, which says:

> **Section 903. Reservation of State power to control municipalities**
>
> This chapter does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise, but—
>
> (1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and
>
> (2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.

In section 903, Congress has expressly preserved the power of a State to control its municipal creatures during the pendency of a chapter 9 case. Section 903 is the diametrical opposite of federal preemption.[5] It is an explicit instruction by Congress to the federal courts that State laws governing municipalities cannot be set aside, even when State laws deal with municipal expenditures. It does not even qualify the laws that may apply to expenditures. State laws may limit municipal

[5] Section 903 is not unique in federal law as an anti-preemption measure. In 1945, Congress passed the McCarren-Ferguson Act, 15 U.S.C. §§ 1011-1015, to exempt the business of insurance from federal regulation. In 1972 Congress enacted § 510 of the Clean Water Act, which says, "nothing in this chapter shall . . . preclude or deny the right of any State . . . to adopt or enforce" any more stringent limitations on the discharge of pollutants. 33 U.S.C. § 1370. Other examples exist. McCarren-Fergusen underlies the policy that keeps federal bankruptcy courts from presiding over insolvency cases where insurers are the petitioners. Instead, insolvent insurers come under the supervision of State insurance commissioners in "rehabilitations" and "liquidations." *See also* 11 U.S.C. § 109(b)(2), which aligns the Bankruptcy Code with McCarren-Ferguson.

expenditures, by creating debt ceilings, for example. But State laws may also mandate expenditures, as the PERL does. Section 903 does not exclude either category from its scope. Section 903, moreover, applies to the whole of chapter 9, including 11 U.S.C. § 901, which makes other provisions of the Bankruptcy Code applicable to chapter 9 cases. Accordingly, every provision which, standing alone, might be used to impair the State's control over a municipal debtor is restricted in its application by section 903.

A State's consent to a municipal bankruptcy under 11 U.S.C. § 109(c)(2) does not negate section 903. To say that a State waives its rights under section 903 when it consents to bankruptcy would mean that section 903 would never have any effect, because State consent is required for a municipality to become a debtor in chapter 9. By consenting to a chapter 9 filing by a municipality, a State waives nothing, neither under the terms of the statutes nor by implication. Yet certain courts have equated State consent to file for bankruptcy under section 109(c)(2) with the State ceding all control over its charge during a chapter 9 case. *See, e.g.*, *In re City of Vallejo*, 403 B.R. 72, 76 (Bankr. E.D. Cal. 2009). These cases are wrong. They make section 903 a nullity, which is contrary to the canons of statutory construction.

Section 903 makes practical sense in light of 11 U.S.C. § 904, which states:

> Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—
>
> (1) any of the political or governmental powers of the debtor;
>
> (2) any of the property or revenues of the debtor; or
>
> (3) the debtor's use or enjoyment of any income-producing property.

Without the preservation of State-law controls by section 903, a municipal debtor would be freed from practically any constraints merely by filing a petition, because section 904 severely restricts a court's ability to interfere with the actions of a municipal debtor. Although a court cannot interfere with the debtor's use of its property by virtue of section 904, under section 903 the State ***can***—"by legislation or otherwise" including controlling its "expenditures."

i. Legislative History of Section 903.

This construction of the meaning and effect of section 903 is not new; it is consistent with the legislative history surrounding section 903 and its precursors. From the outset, Congress was aware that municipal bankruptcy laws created significant potential for interference in State affairs; thus, the first such law enacted in 1934 contained a provision similar to section 903. *Ashton v. Cameron Cnty. Water Improvement Dist. No. 1*, 298 U.S. 513, 526 (1936) (quoting Section 80(k)). Legislative history from the 1934 Act explains that this language was put into the law "as a further limitation upon Federal power and in respect for the rights and responsibilities of the States[.]" S. COMM. ON THE JUDICIARY, REP. NO. 407, at 2 (1934). Similar language was carried over into the 1937 Act, which the Court upheld in *United States v. Bekins*, 304 U.S. 27 (1938).

In 1946, subparts (1) and (2) were added to section 903 in an effort to overrule *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), where the Court upheld a state bankruptcy (composition) law regarding municipal bonds against Contract and Supremacy Clause challenges.[6] At that time, Congress did not amend the operative language of that is relevant here. Congress's stated concern in adding subparts (1) and (2) was one of uniformity. H.R. REP. NO. 94-686, at 19 (1975), *reprinted in* 1976 U.S.C.C.A.N. 539, 557 (discussing prior legislative history of section 83(i)). Thus, section 903's primary language, and its application, did not, at least in Congress's eyes, raise uniformity or Supremacy Clause concerns.

In the 1970s, Congress reworked federal bankruptcy laws, culminating in the creation of the Bankruptcy Code in 1978. The legislative history of section 903's precursor notes the original purpose of the provision:

> It is to prevent the statute or the court from interfering with the power constitutionally reserved to the State by the Tenth Amendment. . . . ***Any State law that governs municipalities or regulates the way in which they may conduct their***

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[6] Whether this attempted restriction on State power is constitutional given its intrusion into State affairs remains an open question. *See, e.g.*, *City of Pontiac Retired Emps. Ass'n. v. Schimmel*, 751 F.3d 427, 431 (6th Cir. 2014) (en banc) (questioning whether "principles of state sovereignty preclude application of § 903(1)").[7] Although *Usery* was overruled in part by *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 531 (1985), its holding is still important because it provides the backdrop against which Congress was legislating.

> ***affairs controls in all cases. Likewise, any State agency that has been given control over any of the affairs of a municipality will continue to control the municipality in the same way, in spite of a Chapter IX petition.***

H.R. REP. NO. 94-686, at 19 (emphasis added). Thus, Congress intended that State laws like the PERL and State constitutional provisions would continue to control the actions of a municipal debtor during a chapter 9 proceeding.

During this same period, Congress was acutely aware of the Supreme Court's decision in *National League of Cities v. Usery*, in which the Court held that there are certain "attributes of sovereignty" that "may not be impaired by Congress, not because Congress may lack an affirmative grant of legislative authority to reach the matter, but because the Constitution prohibits it from exercising the authority in that manner." 426 U.S. 833, 845 (1976).[7] Aware of the Court's "developing ideas of Federalism," Congress re-affirmed its commitment to State sovereignty by including section 903 in the Code. H.R. REP. NO. 95-598, at 262-64 (1978), *reprinted in* 1978 U.S.C.C.A.N. 4717, 6220-22.[8, 9]

Under the plain terms of section 903 and its legislative history (dating back to its inception), the States retain control over their political subdivisions even during a chapter 9 case. State control is so absolute that the legislative history indicates that "withdrawal of State consent at any time will terminate the case . . . ." H.R. REP. NO. 94-686, at 8, *reprinted in* 1976 U.S.C.C.A.N. 539, 545.

The form of control that States retain over their subdivisions varies. For example, and as explained in greater detail below, California has expressly chosen to control its municipalities in

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[7] Although *Usery* was overruled in part by *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 531 (1985), its holding is still important because it provides the backdrop against which Congress was legislating.

[8] The Court in *Usery* ultimately determined that the extension of the minimum wage and maximum hour provisions of the Fair Labor Standards Act were unconstitutional as applied to the States because "the challenged amendments operate to directly displace the States' freedom to structure integral operations in areas of traditional governmental functions . . . ." 426 U.S. at 852. During the 1970s when Congress was amending the bankruptcy laws, including section 903, the legislative history demonstrates that certain changes were made to comport with the Court's decision in *Usery*. H.R. Rep. No. 95-595, at 397-98 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6353-54.

[9] Relevant portions of legislative history cited herein will be included in the separately filed compendium described in footnote 1.

chapter 9 by preventing municipalities from rejecting their relationship with CalPERS under section 365 of the Bankruptcy Code. *See* Cal. Gov. Code § 20487. The fact that a municipality is in bankruptcy does not alter the State's control over the municipality through section 20487. Other aspects of the PERL are of equal force and effect with respect to a municipal debtor who participates in CalPERS. Congress did not intend to provide municipal debtors with a license to ignore State laws governing their conduct simply because those laws may make it harder for them to adjust their debts. Such adjustment cannot be done at the expense of State law. Section 903 of the Code makes this clear, as do other portions of chapter 9, particularly, in the context of the confirmation decision facing the court here, section 943(b)(4). By including section 903 in the Code, Congress expressed its intent that the federal bankruptcy power would not be used to upset the special relationship between a municipal debtor and its parent State. In this way, section 903 functions as a broad anti-preemption statute, ensuring that the relationship between the municipal debtor and the State, which is protected by the Tenth Amendment, is not disturbed. Section 903 ensures that state agencies like CalPERS are free from interference to enforce State law with respect to a municipal debtor because State law continues to be valid and not overridden merely because a chapter 9 case has been filed.

ii. Uniformity.

Franklin and some courts suggest that respecting State law during a chapter 9 case in connection with section 903 of the Code runs afoul of Congress's power to enact uniform laws on the subject of bankruptcies. Section 903 must be applied to protect the PERL just as it does other State laws governing a municipality. In any event, the suggestion demonstrates a fundamental misunderstanding of the Bankruptcy Clause of the United States Constitution. *See, e.g.*, Franklin's Reply Regarding Pension Liabilities [Dkt. No. 1397] (citing *In re Cnty. of Orange*, 191 B.R. 1005, 1020 (Bankr. C.D. Cal. 1996)).

The Constitution states that Congress has the power "[t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." U.S. CONST. art. I, § 8, cl. 4. "The uniformity requirement pertains ***only*** to Congress: it is an affirmative limit or restriction upon ***Congress's power, not a limitation on the states***." *In re Applebaum*, 422 B.R. 684, 692 (9th Cir. BAP 2009) (emphasis

added) (citing *Ry. Labor Executives' Ass'n v. Gibbons*, 455 U.S. 457, 468-69 (1982)); *see also Gibbons*, 455 U.S. at 472 ("Bankruptcy Clause's uniformity requirement was drafted in order to prevent Congress from enacting private bankruptcy laws."); *In re Reese*, 91 F.3d 37, 39 (7th Cir. 1996) (holding uniformity clause prohibits two things: (1) "arbitrary regional differences in the provisions of the Bankruptcy Code"; and (2) "private bankruptcy bills—that is, bankruptcy laws limited to a single debtor—or the equivalent.").

Given the uniformity requirement is a limitation imposed on Congress, any claim that section 20487 of the PERL violates the uniformity clause fails because Congress did not pass section 20487; the California Legislature did. In fact, the Supreme Court has only once invalidated an act of Congress on uniformity grounds (in *Gibbons*), and that was because the act in question singled out a particular railroad for particular treatment. *See In re Wetsby*, 473 B.R. 392, 405-06 (Bankr. D. Kan. 2012), *aff'd*, 486 B.R. 509, 515 (10th Cir. BAP 2013). By contrast, "the Uniformity Clause has never been the basis for striking down a *state* enactment." *In re Wetsby*, 473 B.R. at 407 (emphasis in original). This case should not be the first.

Enforcing section 903 as written would also not implicate the uniformity clause. "The Uniformity Clause requires that bankruptcy laws enacted by Congress be geographically uniform." *St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1531 (9th Cir. 1944) (citing *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946) & *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181 (1902)); *see also In re Schaffer*, 689 F.3d 601, 610 (6th Cir. 2012) (("Rather, the Supreme Court held that the laws passed on the subject of bankruptcy must be uniform throughout the United States, but that uniformity is geographical, and not personal, and further stated we do not think that the provision of the Bankruptcy Act as to exemptions is incompatible with this rule.") (quoting *Moyses*, 186 U.S. at 188) (quotations & internal alterations omitted)). As such, "the general rule of law laid down by the Supreme Court in *Moyses* was that the uniformity requirement is geographical and that variations resulting from differences in state law are not unconstitutional." *Schaffer*, 689 F.3d at 610. As the Sixth Circuit said: "[S]tates and the federal government 'have concurrent jurisdiction in bankruptcy, although only Congress has the power to establish a uniform system of bankruptcy. And once

Congress passes one uniform act, if that system has differing effects on citizens based on a particular state's laws, that result is acceptable.'" *Id.* at 611 (quoting *In re Wetsby*, 473 B.R. at 403).

Any complaint that applying the plain meaning of section 903 would violate uniformity concerns because of variations in the types of State laws that section 903 was designed to protect rings hollow. Congress passed a uniform law in section 903. This should end the inquiry. Section 903 applies equally in all municipal bankruptcy cases. The fact that different States may have different laws that "control" their subdivisions, and therefore the result in different cases would not be uniform, is not a concern for purposes of the Bankruptcy Clause. *See, e.g.*, *Stellwagen v. Clum*, 245 U.S. 605, 613 (1918) (holding that bankruptcy law may be uniform and yet "may recognize the laws of the State in certain particulars, although such recognition may lead to different results in different States."); *In re Applebaum*, 422 B.R. at 692 ("The concept of uniformity requires that federal bankruptcy laws apply equally in form (but not necessarily in effect) to all creditors and debtors, or to 'defined classes' of debtors and creditors.") (citations omitted).

iii. The Constitutionality of Chapter 9 Depends on Section 903.

Section 903 preserves the Bankruptcy Code from constitutional infirmity. Given the structure of our Nation's constitutional design, and the control States have over their municipalities, "any federal debt relief legislation affecting municipalities must be sufficiently narrow in scope to avoid intrusion by the federal courts on the sovereign power of the states." *In re Richmond Unified Sch. Dist.*, 133 B.R. 221, 224 (Bankr. N.D. Cal. 1991). Section 903 reflects this overriding principle by protecting the rights of States *qua* States to control the affairs of their political subdivisions even while such subdivisions are in chapter 9. Thus, section 903 honors the long-standing principle that municipalities are merely instrumentalities of the State, to which a "State may withhold, grant or withdraw powers and privileges as it sees fit." *Ysursa v. Pocatello Educ. Ass'n*, 555 U.S. 353, 362 (2009) (quotations omitted); *see also Ashton*, 298 U.S. at 529-30.

Section 903 preserves such control because it is an express limit on a municipality's ability to consent to the interference of the Federal court in the internal affairs of a municipal debtor. *In re New York City Off-Track Betting Corp.*, 434 B.R. 131, 141 (Bankr. S.D.N.Y. 2010) ("The ability of a

chapter 9 debtor to consent under section 904 is limited by section 903 of the Bankruptcy Code and federalism concerns."); *see also In re Jefferson Cnty.*, 484 B.R. 427, 463 (Bankr. N.D. Ala. 2012); *In re City of Harrisburg*, 465 B.R. 744, 755 (Bankr. M.D. Pa. 2011). In other words, a municipal debtor, as a creature of state law, cannot validly even ask permission to violate State law, because of section 903.

Bekins upheld the constitutionality of the 1937 revised law precisely because it protected State control over its municipalities. "The statute is carefully drawn so as not to impinge upon the sovereignty of the State. . . . The bankruptcy power is exercised . . . ***only*** in a case where the action of the taxing agency ***in carrying out a plan of composition*** approved by the bankruptcy court is authorized by ***state law***." 304 U.S. at 51 (emphasis added). The Court determined that "the exercise of the federal bankruptcy power ***in dealing with a composition of the debts*** of the irrigation district, upon its voluntary application and ***with the State's consent***," did not violate the essential sovereignty of the State. *Id.* at 49 (emphasis added). The State must do more than simply consent to a municipality's filing of its bankruptcy petition in order to satisfy this essential underpinning of the constitutionality of chapter 9. *Bekins* made it clear that the ***scope*** of the State's consent includes State consent to the terms of the municipality's plan for adjustment of debts. Section 903 is the reflection in the Code of this important principle, and it is backstopped by sections 943(b)(4) and (6), which preclude confirmation of a plan that is at variance with State law.

2. Unilateral Adjustment or Modification of a Municipal Debtor's Obligations to CalPERS Through a Bankruptcy Plan Would Violate the Tenth Amendment of the United States Constitution.

If this Court concludes, contrary to State law, that Stockton could impair its obligations to CalPERS, it would be interjecting the federal bankruptcy power between the State and one of its subdivisions and be interfering with the State's fiscal affairs. Thus, *in application*, chapter 9 would violate the Tenth Amendment because those two powers are reserved to the States under the Tenth Amendment.[10]

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[10] The Tenth Amendment states: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or the people." U.S. CONST. amend. X.

As a State agency, CalPERS enjoys the sovereign rights of the State of California. The Tenth Amendment reflects the "dual sovereignty" between the States and Federal government that is at the heart of our Nation's constitutional structure. *See, e.g.*, *Gregory v. Ashcroft*, 501 U.S. 452, 457 (1991). Any Federal law that interferes with a sovereign function of the State, even if exercised through a constitutionally delegated power, is subject to exacting scrutiny. *See, e.g.*, *New York v. United States*, 505 U.S. 144, 157 (1992); *Usery*, 426 U.S. at 845 (quoted above); *In re City of Harrisburg*, 465 B.R. at 753 ("where federal bankruptcy law intersects with the rights of states to regulate the activities of political subdivisions created by the state, principles of dual sovereignty as defined by the Tenth Amendment must be considered.").

The Tenth Amendment imposes an affirmative restriction on Congress's powers under the Bankruptcy Clause. The fact that California may have authorized its municipalities to file for chapter 9 protection does not mean that a federal court can interfere with the affairs between a State and one of its subdivisions. The authority of the State, through its laws or otherwise, to control its political subdivisions is a power reserved to the States under the Tenth Amendment and any interference with that control by a bankruptcy court, or any federal court for that matter, would violate the Tenth Amendment. As the Supreme Court explained:

> Congress exercises its conferred powers subject to the limitations contained in the Constitution. Thus, for example, under the Commerce Clause Congress may regulate publishers engaged in interstate commerce, but Congress is constrained in the exercise of that power by the First Amendment. ***The Tenth Amendment likewise restrains the power of Congress***, but this limit is not derived from the text of the Tenth Amendment itself, which, as we have discussed is essentially a tautology. Instead, the Tenth Amendment confirms that the power of the Federal Government is subject to limits that may, in a given instance, reserve power to the States. ***The Tenth Amendment thus directs us to determine, as in this case, whether an incident of state sovereignty is protected by a limitation on an Article I power***.

New York v. United States, 505 U.S. at 156-57 (emphasis added). In other words, simply because Congress acts pursuant to an Article I power—here, the Bankruptcy Clause—it does not mean that every action taken under that enumerated power is necessarily constitutional. *Id.* at 166 ("[E]ven where Congress has the authority under the Constitution to pass laws requiring or prohibiting certain acts, it lacks the power to directly compel the States to require or prohibit those acts."). Rather, such

acts and directives must also be consistent with the Tenth Amendment. *See, e.g.*, *Alden v. Maine*, 527 U.S. 706, 731 (1999) (noting that Supremacy Clause "enshrines as 'the supreme Law of the Land' only those Federal Acts that accord with the constitutional design.") (citing *Printz v. United States*, 521 U.S. 898, 924-25 (1997)); *see also Seminole Indian Tribe v. Florida*, 517 U.S. 44 (1996) (Article I power (Indian Commerce Clause) constrained by subsequent amendment (the Eleventh)).

It cannot be disputed that under Federal law "[p]olitical subdivisions of States—counties, cities, or whatever—never were and never have been considered as sovereign entities." *Ysursa*, 555 U.S. at 362 (quoting *Reynolds v. Sims*, 377 U.S. 533, 575 (1964)). An unbroken string of cases, dating back to the 1800s, recognize that municipalities are "subordinate governmental instrumentalities created by the State to assist in carrying out state governmental functions." *Id.*; *see also City of Trenton v. New Jersey*, 262 U.S. 182, 187-90 (1923) (discussing cases); *Hunter v. Pittsburgh*, 207 U.S. 161, 178 (1907) (citing cases); *Louisiana ex rel. Folsom v. Mayer & Administrators of New Orleans*, 109 U.S. 285, 287 (1883). Thus, controlling the actions of political subdivisions is one of the powers reserved to the States by the Tenth Amendment. As the Supreme Court recognized in *Faitoute*: "The intervention of the state in the fiscal affairs of its cities is plainly an exercise of its essential reserve power to protect the vital interest of its people . . . ." 316 U.S. at 512.

The court in *Ropico, Inc. v. City of New York*, recognized that sovereignty is ever-present in chapter 9, and that courts presiding over chapter 9 cases must constantly walk a constitutional tightrope, when it stated the following:

> In the area of municipal reorganizations the thin line between the federal bankruptcy power and state sovereignty has been particularly difficult to draw. Both Congress and the Supreme Court have thus been careful to stress that the federal municipal Bankruptcy Act is not in any way intended to infringe on the sovereign power of a state to control its political subdivisions; for as the Supreme Court held in the Ashton and Bekins cases, to the extent that the federal Bankruptcy Act does infringe on a state or municipality's function it is unconstitutional.

425 F. Supp. 970, 983 (S.D.N.Y. 1976). The provision and administration of a State pension system is an incident of sovereignty, which is protected from federal intrusion in chapter 9 by the Tenth Amendment and the federalism it reflects. *See, e.g.*, *Printz*, 521 U.S. at 928 (overturning

congressional mandate to state officers and stating "[i]t is an essential attribute of the States' retained sovereignty that they remain independent and autonomous within their proper sphere of authority."). It is for this precise reason that Congress chose to exempt governmental plans, like CalPERS pension plans, from Title I and IV of ERISA. *See* CalPERS' Supplemental PERL Brief, section II.A.1. If a bankruptcy court were to tinker with California's complex statutory scheme regarding the provision of public pensions under the auspices of the Bankruptcy Clause, it would be interfering in the fiscal affairs of the State. This is expressly forbidden under *Bekins*.

Some courts, however, have suggested that by simply authorizing municipalities to file for chapter 9, the authorizing State waived its sovereignty. *See, e.g.*, *In re City of Detroit*, 504 B.R. 97, 150 (Bankr. E.D. Mich. 2013). This conclusion, however, rests on a misreading of the relevant Supreme Court decisions. In *New York*, the Supreme Court held: "State officials thus ***cannot*** consent to the enlargement of the powers of Congress beyond those enumerated in the Constitution." 505 U.S. at 182 (emphasis added); *see also Ashton*, 298 U.S. at 531 ("The sovereignty of the state essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation."). The Supreme Court's pronouncement in *New York* followed on the heels of its acknowledgment that federalism, at its core, was designed "for the protection of individuals." *Id.* at 181. Despite the clarity of the Court's language, to get around this clear language, the *Detroit* court said the Supreme Court did not really mean what it said. *Detroit*, 504 B.R. at 149 ("states ***can*** 'consent to the enlargement of the powers of Congress beyond those enumerated in the Constitution.'") (emphasis added) (quoting *New York*, but changing "cannot" to "can").

Inherent in this view is an unsupportable assumption that rights emanating from the Tenth Amendment belong to the States and to the States alone. Not only did *New York* reject this view, but the Supreme Court recently unanimously rejected an identical argument that "States and States alone" can assert a challenge that "state sovereignty" has been violated under the Tenth Amendment. *Bond v. United States*, 131 S. Ct. 2355, 2363 (2011) ("*Bond I*") ("Fidelity to principles of federalism is not for the States alone to vindicate."). Despite *Bond I's* direct application, the *Detroit* court never addressed *Bond I*, thus, making its analysis deficient.

In light of *Bond I*, the *Detroit* court's dismissal of certain "puzzling language in *New York*" is wrong. 504 B.R. at 148-49. *New York*, when read in light of *Bond I*, could not be clearer: because federalism's protections are not designed solely to protect the States alone, those rights cannot be consented away by the State. A State cannot give something away that it does not solely possess. It is too simplistic to say that, by authorizing one of its municipalities to file for chapter 9 protection, California, or any other State, also waives its right to enforce State statutory and constitutional law protecting individuals within the State, simply to benefit a single, financially distressed municipality.

Even assuming the protections of federalism could be consented away (which they cannot), any analysis of federalism predicated on consent must consider the *scope* of such consent. Nothing in California's municipal bankruptcy authorization statute suggests a sweeping waiver of the State's sovereign control over its municipal subdivisions and its fiscal affairs. In this regard, the conclusion made by the bankruptcy court in *Vallejo*—without citation to any authority—that "[w]hen a state authorizes its municipalities to file a chapter 9 petition it declares that the benefits of chapter 9 are more important than state control over its municipalities," is particularly troubling. 403 B.R. at 76. In essence, the *Vallejo* court held that, by merely authorizing its municipalities to file for chapter 9 protection, the State of California, through some unspoken "policy," effectively gave away ***any and every*** measure of control that it has over its municipalities.

Such an interpretation improperly engrafts a "state policy" into California's authorization statute that does not appear in the statute. This conclusion makes little sense given that section 903, discussed more fully above, is part of the Bankruptcy Code. Section 903 of the Code provides for retention of the State's control over a municipal debtor in chapter 9. Thus, when California authorized its municipalities to file for chapter 9 it necessarily understood that it continued to maintain control over its municipalities under the express terms of section 903. Nothing in the authorization law provides any "clear declaration" or "unequivocal" expression that California consented to have its sovereignty displaced based on the grant of authority to adjust the financial affairs of a debtor through bankruptcy. On the contrary, the California Legislature expressly reserved its sovereign immunity in Cal. Gov. Code § 53760.7 (the "Municipal Bankruptcy Authorization

Statute"), which the Supreme Court has indicated is an attribute of sovereignty. *Puerto Rico Aqueduct & Sewer Auth. v. Metcalf & Eddy, Inc.*, 506 U.S. 139, 146 (1993) ("States, although a union, maintain certain attributes of sovereignty, including sovereign immunity").

The State of California has not consented to allow its laws regarding the administration of the System to be violated by a chapter 9 debtor. CalPERS, as the statutorily and constitutionally empowered arm of the State tasked with protecting the System, is making that lack of consent abundantly clear. The unilateral adjustment or impairment of pensions in violation of the PERL would violate the State of California's sovereignty and would be unconstitutional under the Tenth Amendment.

3. Section 943(b)(4) of the Bankruptcy Code Precludes Confirmation of a Plan that Does Not Comply with the PERL.

An attempt by a municipal debtor to alter its obligations to CalPERS through the confirmation of a plan of adjustment that does not comply with State law would run counter to section 943(b)(4) of the Bankruptcy Code, which prohibits a plan from being confirmed "if it permits a debtor to do something that is prohibited by state law . . . ." *In re Sanitary & Improvement Dist., No. 7*, 98 B.R. 970, 974 (Bankr. D. Neb. 1989); *see also In re City of Colorado Springs Spring Creek Gen. Improvement Dist.*, 177 B.R. 684, 694 (Bankr. D. Colo. 1995) ("Where a plan proposes action not authorized by state law, or without satisfying state law requirements, the plan cannot be confirmed."). Indeed, section 943(b)(4)'s requirement that any confirmable plan must not be inconsistent with State law acts as an additional protection of State sovereignty. Thus, sections 109(c)(2), 903, 904 and 943(b)(4) work in harmony to protect State sovereignty and the States' control over their political subdivisions.

Any plan of adjustment proposing nonpayment of obligations owed to CalPERS would violate Cal. Gov. Code § 20831, which states that "[n]otwithstanding any other provision of law, neither the state, any school employer, nor any contracting agency shall fail or refuse to pay the employers' contribution required by this chapter or to pay the employers' contributions required by this chapter within the applicable time limitations." Therefore, a municipal debtor's plan would

violate section 943(b)(4) to the extent it proposed to adjust its payments to CalPERS in contravention of the PERL through a plan of adjustment.

B. The PERL is not Generally Preempted by the Bankruptcy Code.

1. General Principles of Preemption.

"Federalism, central to the constitutional design, adopts the principle that both the National and State Governments have elements of sovereignty the other is bound to respect." *Arizona v. United States*, 132 S. Ct. 2492, 2500 (2012) (citing *Gregory v. Ashcroft*, 501 U.S. 452, 457 (1991) & *U.S. Term Limits, Inc. v. Thornton*, 514 U.S. 779, 838 (1995) (Kennedy, J., concurring)). Although Congress has the power to preempt State law, preemption is a delicate task in light of the dual nature of our constitutional design and structure. *Gonzalez v. Arizona*, 677 F.3d 383, 392 (9th Cir. 2012) (en banc) ("Under our system of dual sovereignty, courts deciding whether a particular state law is preempted under the Supremacy Clause must strive to maintain a 'delicate balance' between the States and the Federal Government . . . .") (citing *Gregory*, 501 U.S. at 460 & *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996)), *aff'd, Arizona v. Inter Tribal Council of Arizona, Inc.*, 133 S. Ct. 2247 (2013).

As the Supreme Court held, there are "two cornerstones" in every preemption analysis:

> First, the purpose of Congress is the ultimate touchstone in every pre-emption case. Second, in ***all*** preemption cases, and ***particularly in those*** in which Congress has legislated in a field which the States have traditionally occupied, we start with the assumption that the historic police powers of the States were not superseded by the Federal Act unless that was the clear and manifest purpose of Congress.

Wyeth v. Levine, 555 U.S. 555, 565 (2009) (internal citations, quotations & alterations omitted) (emphasis added); *see also Pac. Gas & Elec. Co. v. California*, 350 F.3d 932, 943 (9th Cir. 2003) ("*PG&E*") ("First, we presume that Congress does not undertake lightly to preempt state law, particularly in areas of traditional state regulation.") (citations omitted). After all, the conclusion that a State law is preempted is a conclusion that the State violated the Constitution's Supremacy Clause.

Just last Term, the Supreme Court reaffirmed this longstanding rule stating that "'[b]ecause States are independent sovereigns in our federal system,' the Court 'assumes that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and

manifest purpose of Congress.'" *CTS Corp. v. Waldburger*, 134 S. Ct. 2175, 2188 (2014) ((quoting *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 484-85 (1996) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)); *see also California v. ARC America. Corp.*, 490 U.S. 93, 101 (1989). "This assumption provides assurances that 'the federal-state balance' will not be disturbed unintentionally by Congress or unnecessarily by the courts." *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977) (citation omitted).

Most important here, the presumption against preemption applies with its greatest force when the Federal law in question disrupts the relationship between a State, through its duly enacted laws, and one of the State's creatures. In such cases, the Supreme Court has cautioned that Congress does not lightly, if at all, "interpos[e] federal authority between a State and its municipal subdivisions" because of the total control States have over their municipal creatures. *Nixon v. Missouri Muni. League*, 541 U.S. 125, 140 (2004); *see also Faitoute v. Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 508 (1942) ("It would offend the most settled habits in the relationship between the States and the Nation to imply such a retroactive nullification of state authority over its subordinate organs of government."); *Palmer v. Massachusetts*, 308 U.S. 79, 85 (1939) ("If this old and familiar power of the states [to regulate local, intrastate railroad services] was withdrawn when Congress gave district courts bankruptcy powers over railroads, we ought to find language fitting for so drastic a change.").

Chapter 9 cases are different than cases brought under other chapters of the Bankruptcy Code because of the relationship between a city and a State. *See e.g.*, *In re City of San Bernardino*, 2014 WL 2511096, at *12 (C.D. Cal. June 4, 2014) ("Municipal bankruptcies implicate a state's sovereignty and Tenth Amendment rights to a greater degree than other bankruptcy contexts because of the special relationship between a state and its municipalities."); *In re City of Colorado Springs Spring Creek Gen. Improvement Dist.*, 177 B.R. 684, 693 (Bankr. D. Colo. 1995) ("The bankruptcy of a public entity is different from that of a private person or concern. Unlike any other chapter of the Bankruptcy Code, Chapter 9 places federal law in juxtaposition to the rights of states to create and govern their own subdivisions."). *Cf. City of Trenton v. New Jersey*, 262 U.S. 183, 185 (1923) ("The

relations existing between the state and the water company were not the same as those between the state and the city."). Because municipalities are created by State law, and exist to perform State functions at the local level, courts must invoke a "working assumption that federal legislation threatening to trench on the States' arrangements for conducting their own government should be treated with ***great skepticism***, and read in a way that preserves a State's chosen disposition of its own power, in the absence of the plain statement *Gregory* requires." *Nixon*, 541 U.S. at 140 (emphasis added).

As for bankruptcy in general, "[e]ven though bankruptcy is one of only two federal legislative powers in Article 1, Section 8 of the Constitution in which the power to make 'uniform' law is made explicit, the presumption against displacing state law by federal bankruptcy law is just as strong in bankruptcy as in other areas of federal legislative power." *PG&E*, 350 F.3d at 943 (discussing *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot.*, 474 U.S. 494, 501 (1986) & *BFP v. Resolution Trust Corp.*, 511 U.S. 531 (1994)). As the Supreme Court explained:

> Federal statutes impinging upon important state interests cannot be construed without regard to the implications of our dual system of government. When the Federal Government takes over local radiations in the vast network of our national economic enterprise and thereby radically readjusts the balance of state and national authority, those charged with the duty of legislating must be reasonably explicit. . . . ***To displace traditional state regulation in such a manner, the federal statutory purpose must be clear and manifest***. Otherwise, the Bankruptcy Code will be construed to adopt, rather than displace, pre-existing state law.

BFP, 511 U.S. at 544-545 (citations omitted) (emphasis added); *see also Gregory*, 501 U.S. at 460-61 ("If Congress intends to alter the usual constitutional balance between the States and the Federal Government, it must make its intention to do so unmistakably clear in the language of the statute. . . . Congress should make its intention clear and manifest if it intends to pre-empt the historic powers of the States.") (quotations and citations omitted).[11]

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[11] *Gregory* is a major federalism case. In *Gregory*, one of the issues before the Court was whether the State of Missouri's mandatory retirement requirement for judges violated the Federal Age Discrimination in Employment Act ("ADEA"), which was passed pursuant to Congress's Commerce Clause power under Article 1, section 8 of the Constitution. Given the federalism concerns, the Court employed the "plain statement rule" in interpreting the ADEA to avoid a reading of the statute that would intrude upon the sovereignty of the State of Missouri. 501 U.S. at 464 ("Application of the plain statement rule thus may avoid a potential constitutional problem."); *see also id*. at 461

There are three forms of preemption: (1) express preemption, (2) field preemption, and (3) conflict preemption. *Arizona v. United States*, 132 S. Ct. 2492, 2500-01 (2012) (citations omitted). As noted, the touchstone of any preemption analysis is congressional purpose. None of these three types of Federal preemption can apply here because of the express anti-preemption provision of section 903, but the following analysis shows that preemption does not occur in any event.

With respect to express preemption, there is no language in the Bankruptcy Code that expressly preempts the PERL. *Compare* 11 U.S.C. § 365(a) *with Riegel v. Medtronic, Inc.*, 552 U.S. 312, 316 (discussing 21 U.S.C. § 360k(a), which contained an "express preemption provision" that said, in part, "no State or political subdivision of a State may establish . . .").

Equally meritless is any notion that the Bankruptcy Code amounts to "field preemption," of the PERL as confirmed by the unequivocal pronouncements of the Supreme Court and the Ninth Circuit. *Midlantic*, 474 U.S. at 505 ("Congress did not intend for the Bankruptcy Code to pre-empt all state laws."); *see also In re Tippett*, 542 F.3d 684, 689-690 (9th Cir. 2008) (concluding that Bankruptcy Code does not field-preempt a State statute protecting bona fide purchasers of real estate; *In re Miles*, 430 F.3d 1083, 1092 (9th Cir. 2005) ("it cannot be said that Congress has completely preempted all state regulation which may affect the actions of parties in bankruptcy court") (quotation and citation omitted); *In re Applebaum*, 422 B.R. at 689 (9th Cir. BAP 2009) ("Federal bankruptcy law is not so pervasive, nor is the federal interest so dominant, as to wholly preclude state legislation in the area."). Thus, there is no field preemption of the PERL.

As explained in greater detail below, there is likewise no "conflict preemption" of the PERL. The PERL does not conflict with chapter 9, nor stand as an obstacle to its purposes. Even if there were a conflict by implication or in application of one or the other, section 903 explicitly preserves State law, as discussed at other points in this brief.

(explaining that "plain statement rule" and "clear and manifest" rule are virtually the same and both derive from the recognition that "States retain substantial sovereign powers under our constitutional scheme, powers with which Congress does not readily interfere.").

C. California Government Code § 20487 is Constitutionally Valid and is Not Preempted by Section 365 of the Bankruptcy Code.

Although the City has not sought to reject, assume or assign its CalPERS contract, and Franklin has not made any real pre-enforcement challenge to section 20487 of the PERL in this case, the Court has queried whether section 20487 is valid. Hr'g Tr. 47:5-7, June 8, 2014. Section 20487 is a valid exercise of the California's Legislature's sovereign control over its political subdivisions and should be respected in a chapter 9 case.

The Court appears to direct CalPERS to address the issue of whether section 20487 is unconstitutional on its face, as preempted by federal law. An opinion of the Court on the facial validity of section 20487 would constitute a de facto declaratory judgment against the State of California with respect to the validity of one of its statutes. Both the Supreme Court and the Ninth Circuit have recognized that special care must be taken when a court issues a declaratory judgment against a sovereign defendant:

> Declaratory proceedings in the federal courts against state officials must be decided with regard to the implications of our federal system. . . . Anticipatory judgment by a federal court to frustrate action by a state agency is even less tolerable to our federalism. . . . The procedures of review usually afford ample protection to a carrier whose federal rights are actually invaded. . . . State courts are bound equally with the Federal Courts by the Federal Constitution and laws.

Exxon Shipping Co. v. Airport Depot Diner, Inc., 120 F.3d 166, 170 (9th Cir. 1997) (quoting *Pub. Serv. Comm'n v. Wycoff Co., Inc.*, 344 U.S. 237, 247-48 (1952)).

The Supreme Court has consistently acknowledged that a facial challenge to a statute is "the most difficult challenge to mount successfully" because "the challenger must establish that no set of circumstances exists under which the [statute] would be valid." *United States v. Salerno*, 481 U.S. 739, 745 (1987); *see also Anderson v. Edwards*, 514 U.S. 143, 155 n.6 (1995) (applying *Salerno* standard in a preemption case). Thus, for this Court to conclude that section 20487 is preempted and therefore facially unconstitutional, it must decide that under no set of circumstances can this law survive judicial scrutiny. As for the burden of proof, the party claiming preemption bears the

burden[12] of proving that "no set of circumstances exist." *See, e.g., Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 255 (1984). It is against these principles that any claim of preemption must be analyzed.

1. Section 20487 Is Part of the State's "Consent" to File for Chapter 9 Protection.

The Bankruptcy Code provides that "an entity may be a debtor under chapter 9 of this title if and only if such entity . . . is specifically authorized . . . to be a debtor under such chapter by State law . . . ." 11 U.S.C. § 109(c)(2). There is no inherent right of any municipality to be a chapter 9 debtor, because States act as the gatekeepers to a municipality's entry into chapter 9. *See, e.g., In re City of Harrisburg, Pa.*, 465 B.R. 744, 754-55 (Bankr. M.D. Pa. 2011); *In re City of Stockton*, 475 B.R. 720, 728-29 (Bankr. E.D. Cal. 2012) ("*Stockton I*"); *In re City of Stockton*, 478 B.R. 8, 17 (Bankr. E.D. Cal. 2012) ("*Stockton II*") (noting states "may control the prerequisites for consenting" to a chapter 9 filing). This is so because the relationship between a State and one of its subdivisions is safeguarded by the Tenth Amendment to the United States Constitution. *See In re City of Harrisburg*, 465 B.R. at 754 ("Congress amended § 109(c)(2) to clarify that a state must provide 'specific' authorization to comply with Tenth Amendment constraints."); *see also Faitoute*, 316 U.S. at 512 ("The intervention of the state in the fiscal affairs of its cities is plainly an exercise of its essential reserve power to protect the vital interests of its people . . . ."). While some States expressly prohibit their subdivisions from filing for chapter 9 or are silent on the matter,[13] other States, like California, place restrictions on the entry to chapter 9. Thus, it is undisputed that States have total control over whether or not their municipalities can file for chapter 9.

Franklin concedes as much. *See* Franklin's Reply Regarding Pension Liabilities, p. 3 [Dkt. No. 1397] ("There is no question that, absent state consent, the Tenth Amendment prohibits a municipality from seeking bankruptcy protection . . . .") (emphasis in original). While CalPERS

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[12] Here, there does not appear to be a party claiming preemption of section 20487, making it unclear who bears the burden of proof. Certainly, if the party claiming preemption were Franklin, it has not met the burden.

[13] *See, e.g.*, MARC A. LEVINSON, ET AL., MUNICIPALITIES IN PERIL, THE ABI GUIDE TO CHAPTER 9 75-88 (listing known State municipal bankruptcy authorization laws).

agrees that this is an accurate statement of the law, Franklin's citation to the Supreme Court's decision in *Ashton* as the genesis for this conclusion reveals Franklin's misunderstanding of the law.

In *Ashton*, the lack of a State "consent" mechanism was not the reason the Court struck down the first municipal bankruptcy law, contrary to Franklin's claim. The opposite is true. The act in question contained a "consent" provision and the State of Texas passed a law authorizing its municipalities to file for bankruptcy protection. *Id.* at 526 (quoting § 80(k), which provided that States had the "power to require the approval by any governmental agency of the State of the filing of any petition hereunder and of any plan of readjustment); *id*. at 527 (noting Texas law authorizing filing). Rather, the Supreme Court struck down the law because it interfered with the relationship between a State and one of its political subdivisions. The Supreme Court held:

> If obligations of states or their political subdivisions may be subjected to the interference here attempted, they are no longer free to manage their own affairs; the will of Congress prevails over them . . . . And really the sovereignty of the state, so often declared necessary to the federal system, does not exist.
>
> . . . .
>
> Neither consent nor submission by the states can enlarge the powers of Congress; none can exist except those which are granted. The sovereignty of the state essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation.

Id. at 531 (internal citations omitted).

Further, if Franklin were correct, the Supreme Court would not have upheld Congress's second attempt at a municipal bankruptcy law because that law ***did not*** have any mechanism for State consent. *United States v. Bekins*, 304 U.S. 27, 49 (1938) (discussing differences between former section 80(k) and new section 83(i)). *See also* David L. Dubrow, *Chapter 9 of the Bankruptcy Code: A Viable Option for Municipalities in Fiscal Crisis?*, 24 Urb. Law 539, 551 (1992) (arguing that the Supreme Court's composition was the key to the about-face in *Bekins* because the new "Chapter 10 was in one respect weaker than Chapter 9 with respect to state sovereignty. While Chapter 9 required state consent for a municipality to file for relief, Chapter 10 did not do so."). In fact, the *Bekins* court deemed the fact that the law did not require the consent of the parent State to file for bankruptcy to be

"immaterial." *Bekins*, 304 U.S. at 49.[14] Thus, Franklin grossly overstates the doctrinal point by claiming that State consent was the *sine qua non* of the Court's holdings in *Ashton* and *Bekins*. Franklin's Reply Regarding Pension Liabilities, p. 3.

Rather, the Court made it clear that it was upholding the revised municipal bankruptcy law not because the State had consented, but because:

> The statute is carefully drawn so as not to impinge on the sovereignty of the State. The ***State retains control of its fiscal affairs***. The bankruptcy power is exercised in relation to a matter normally within its province and ***only in a case where the action of the taxing agency in carrying out a plan of composition approved by the bankruptcy court is authorized by state law.***

Bekins, 304 U.S. at 51 (emphasis added). In other words, both *Ashton* and *Bekins* were predicated on the notion that federal courts should not interfere with the States and their creatures and that municipal debtors would continue to comply with State laws while they were in bankruptcy. *See, e.g.*, *Ropico*, 425 F. Supp. 970, 983 (S.D.N.Y. 1976). Indeed, scholars at the time noted that, far from undermining *Ashton's* non-interference principles, *Bekins* reaffirmed that principle. *See also* Giles J. Patterson, *Municipal Debt Adjustment Under the Bankruptcy Act*, 90 U. PA. L. REV. 520, 531 (1942) ("The court can make no order that will even indirectly interfere with the sovereignty of the state, nor compel action by the debtor. The *Bekins* case did not reverse this principle of constitutional law announced in the *Ashton* case. It reaffirmed it.").

There is no doubt that State limitations on a municipality's powers in bankruptcy are constitutional given that political subdivisions are mere creatures of State law. Their existence, powers, duties, constraints and attributes are functions of State law. In fact, State control is so absolute that the legislative history of chapter 9 indicates that "withdrawal of State consent at ***any time*** will terminate the case . . . ." H.R. REP. NO. 94-686, at 8, *reprinted in* 1976 U.S.C.C.A.N. 539, 545 (emphasis added). Thus, simply because a court had already determined that a municipal debtor was eligible, does not mean that the eligibility decision is not subject to revision at any time, because the State could withdraw its consent to remain in chapter 9 at any time during the pendency of the

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[14] In *Bekins* the State of California did in fact consent to the filing via an authorization statute. *Bekins*, 304 U.S. at 47.

bankruptcy proceedings. *Cf. In re Richmond Unified Sch. Dist.*, 133 B.R. 221, 223-26 (Bankr. N.D. Cal. 1991) (chapter 9 debtor, under influence of State, has unqualified right to dismiss chapter 9 case over objection of creditors). If a municipal debtor chose to reject its relationship with CalPERS under section 365, it would be in direct contravention of a specific limitation that California placed on its political subdivision's entry into chapter 9. If a municipality chose to seek to reject its relationship with CalPERS, it would no longer be eligible for chapter 9. And, as the legislative history above confirms, this would be completely consistent with Congress's intent because a State can withdraw its "consent at any time" during the pendency of the chapter 9 proceeding and doing so "will terminate the case."

2. California's Municipal Bankruptcy Authorization Statute, Cal. Gov. Code § 53760, Did Not Repeal Section 20487 of the PERL.

California's municipal bankruptcy authorization law, Cal. Gov. Code § 53760, which became effective on January 1, 2012, provides:

> A local public entity in this state may file a petition and exercise powers pursuant to applicable federal bankruptcy law if either of the following apply:
>
> (a) The local public entity has participated in a neutral evaluation process pursuant to Section 53760.3.
>
> (b) The local public entity declares a fiscal emergency and adopts a resolution by a majority vote of the governing board pursuant to Section 53760.5.

It is noteworthy that the introductory paragraph of the authorization statute does not say that a local public agency can exercise ***all*** powers under the Federal bankruptcy law. By referencing "applicable" bankruptcy law, the authorization constrains the debtor to operate within the confines of section 903 and, at plan confirmation, sections 943(b)(4) and (6). Indeed, section 53760.7 expressly notes that the State did not waive its immunity from suit in federal court by authorizing its municipalities to file for chapter 9. While the State's authorization for filing is broad, it is not a blanket delegation of authority to the State's creatures.

Section 20487 of the PERL, which was originally enacted in 1996, long before the municipal bankruptcy authorization law, states:

> ***Notwithstanding any other provision of law***, no contracting agency or public agency that becomes the subject of a case under the bankruptcy provisions of Chapter 9 (commencing with Section 901) of Title 11 of the United States Code shall reject any contract or agreement between the agency and the board pursuant to Section 365 of Title 11 of the United States Code or any similar provision of law; nor shall the agency, without prior written consent of the board, assume or assign any contract or agreement between that agency and the board pursuant to Section 365 of Title 11 of the United States Code or any similar provision of law.

(emphasis added). Given its singular focus, this statute is a ***specific*** statute. Moreover, the emphasized "notwithstanding" phrase means what it says. *Watkins v. Cnty. of Alameda*, 98 Cal. Rptr. 3d 847, 866 (2009) ("The clause means what it says."). As the California Court of Appeals said: "'Notwithstanding' means 'without prevention or obstruction from or by' or '*in spite of*'' or 'despite.'" *Klajic v. Castaic Lake Water Agency*, 16 Cal. Rptr. 3d 746, 751 (2004) (quoting dictionaries) (emphasis in original). The phrase is a "term of art that declares the legislative intent to override all contrary law. By use of this term, the Legislature expresses its intent to have the specific control despite the existence of other law which ***might*** otherwise govern." *Id.* (citations & quotations omitted) (emphasis added); *see also In re Marriage of Cutler*, 94 Cal. Rptr. 2d 156, 166 (2000) ("The phrase 'notwithstanding any other provision of law' is a very comprehensive phrase. This phrase signals a broad application ***overriding all other code sections*** unless it is specifically modified by use of a term applying it only to a particular code section or phrase.") (emphasis added).

Here, the Court must analyze the interplay between section 20487 and section 53760, two California statutes both located in the Government Code. Because it is construing two California statutes, the Court must apply California's rules regarding statutory interpretation. *Powell's Books Inc. v. Kroger*, 622 F.3d 1202, 1209 (9th Cir. 2010) (Federal courts interpreting State statutes apply State rules of statutory construction). Since no controlling decision from the California Supreme Court exists interpreting the interplay between these two statutes, this Court must "predict" how the California Supreme Court would interpret these two laws in conjunction with one another. *See, e.g.*, *In re Kirkland*, 915 F.2d 1236, 1239 (9th Cir. 1990).

There are several statutory construction rules that come into play here:

(1) The "'ultimate task' in statutory interpretation 'is to ascertain the legislature's intent.'" *In re First T.D. & Investment, Inc.*, 253 F.3d 520, 527 (9th Cir. 2001) (quoting *People v. Massie*, 19

Cal. 4th 550, 569 (1998)).

(2) "[W]hen two statutes relate to the same subject, the more specific one will control unless they can be reconciled." *Royalty Carpet Mills, Inc. v. City of Irvine*, 23 Cal. Rptr. 3d 282, 287 (2005) (collecting cases).

(3) "When the two statutes can be reconciled, they must be construed in reference to each other, so as to harmonize the two in such a way that no part of either becomes surplusage." *Id.* (quotation omitted).

(4) Repeals by implication are strongly disfavored. *W. Oil & Gas Ass'n v. Monterey Bay Unified Air Pollution Control Dist.*, 49 Cal. 3d 408, 419-20 (1989).

(5) If there is a "reasonable construction of a statute which avoids constitutional infirmity" courts applying California law "must adopt that construction." *Cent. Delta Water Agency v. State Water Res. Control Bd.*, 21 Cal. Rptr. 2d 453, 463 (1993). A corollary to this is the rule of construction providing that California courts will not decide constitutional issues unless absolutely necessary. *See, e.g., Palermo v. Stockton Theatres, Inc.*, 32 Cal. 2d 53, 65 (1948) ("We are of the view that this issue, unnecessary to our decision, should not be decided here or made the subject of dictum."). Likewise, California courts will interpret statutes to avoid even raising constitutional issues. *See id.* at 60 ("A like duty requires us to avoid a construction which raises grave and doubtful constitutional questions if the statute can reasonably be construed so as to avoid such questions.") (quotation omitted).

Applying these rules of statutory construction, it becomes apparent that section 20487 must be construed as part of the State's consent to file a chapter 9 case. The broad "notwithstanding" phrase, as a matter of California law, demonstrates that the California Legislature made its intentions clear: regardless of any other law, a California municipal debtor cannot reject its contract with CalPERS or assign or assume such a contract without the CalPERS Board's consent. Thus, while California generally authorized its municipalities to file for chapter 9, it expressly prohibited them from rejecting their contracts with CalPERS. The legislative intent is clear. Both section 20487 and section 53760 relate to the same subject: municipal bankruptcy. As a result, the more specific statute (section

20487) must control over the general (section 53760). The two statutes can easily be reconciled. Section 53760 is a general authorization statute, while section 20487 is an exception to this general authorization. In this regard, another rule of California statutory construction becomes important. The California Legislature is deemed to be aware of its own laws when enacting new laws. *Shirk v. Vista Unified Sch. Dist.*, 42 Cal. 4th 201, 212 (2007) ("The Legislature is deemed to be aware of existing statutes, and we assume that it amends a statute in light of those preexisting statutes."). Thus, if the California Legislature had desired that its creatures could use chapter 9 to reject CalPERS contracts, it would have directly repealed section 20487. There is no question it did not.

Franklin has suggested that the California Legislature implicitly repealed section 20487 when it enacted section 53760. Franklin's Reply Regarding Pension Liabilities, p. 6-7. This is contrary to California law. California law imposes a strong presumption against implied repeal. The presumption against implied repeal is so strong that, "[t]o overcome the presumption the two acts must be irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation." *W. Oil & Gas*, 49 Cal. 3d at 419 (quotations omitted). Courts are bound "to maintain the integrity of both statutes if the two may stand together. There must be *no possibility* of concurrent operation." *Id*. at 419-420 (quotations omitted) (emphasis in original). Moreover, "Courts have also noted that implied repeal should not be found unless the later provision gives *undebatable evidence* of an intent to supersede the earlier provision." *Id*. at 420 (emphasis in original) (internal quotations & alterations omitted). *Accord Morton v. Mancari*, 417 U.S. 535, 550-51 (1974). Here, there is no evidence, let alone "undeniable evidence," evincing any intent on behalf of the California Legislature that section 20487 was repealed by section 53760. Indeed, the two statutes coexist quite peacefully.

Simply predicating a political subdivision's entry into chapter 9 on a condition—that a municipal debtor cannot reject its contract with CalPERS—does not nullify section 53760. In fact, this case proves the point. The City, without seeking to reject its relationship with CalPERS, has consensually compromised with all of its creditors, save one. And, its Plan sets it on a course of fiscal stability into the foreseeable future. In that sense, section 53760 has achieved its purposes without doing violence to section 20487. Under California law, this Court must determine whether the two

statutes can "stand together." The evidence at trial demonstrates that the two laws easily "stand together" and the operation of one is not so "irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation." *W. Oil & Gas* at 419-20. Accordingly, the municipal bankruptcy authorization statute did not implicitly repeal section 20487.

The legislative history of section 20487 also makes clear that the California Legislature viewed section 20487's prohibition on rejection as part of its "consent" to allow California's political subdivisions to ***file*** for chapter 9 protection. For example, numerous portions of the legislative history of section 20487 reference how other States have placed "conditions on the right to seek bankruptcy relief." *See, e.g.*, Legislative History Research Report Regarding Cal. Gov. Code § 20487, pp. 25-27. Likewise, the legislative history of section 20487 specifically references the fact that the State has the authority to require "preconditions for filing a Chapter 9 bankruptcy." *See, e.g.*, *id*. at p. 59, 89, 97, 184. Further, the legislative history of section 20487 specifically references California's former authorization statute on several occasions. *See, e.g.*, *id.* at 26. This is all probative evidence of the California Legislature's intent and this evidence tilts sharply in favor of finding that section 20487 is part and parcel of California's authorization statute and part of the "consent" the State of California has given its municipalities to file for chapter 9.

Based on all of this, it is well within reason to construe section 20487 as part of California's consent to allow its municipalities to file for chapter 9. After all, this Court's task under the California statutory construction principles set forth above is not to conclude that such a construction is the best one, but only a "reasonable" one or one that is "fairly debatable." *Cent. Delta Water*, 21 Cal. Rptr. 2d at 463; *CalFarm Ins. Co. v. Deukmejian*, 48 Cal. 3d 805, 814-15 (1989) ("If the validity of the measure is 'fairly debatable,' it must be sustained."). This is premised on the fact that, under California law, "statutes are not presumed unconstitutional unless proven constitutional, but rather the reverse." *Cent. Delta Water*, 21 Cal. Rptr. 2d. at 463 (citing *CalFarm Ins.*). Consequently, in making its "prediction" on what the California State Supreme Court would say on the matter, this Court must conclude that section 20487 is part of the State's consent to authorize the filing of a chapter 9 petition by one of its creatures.

3. Section 20487 Is Protected by Section 903 of the Code and Is Not Preempted by the Bankruptcy Code.

Section 20487 of the PERL is the type of law that section 903 of the Bankruptcy Code was designed to protect from preemption because it reflects the State of California's control over its municipalities' governmental and political powers. As such, under the express will of Congress as reflected in section 903, section 20487 must stand. Furthermore, there is no indication that Congress, by enacting section 365, clearly and manifestly intended to preempt section 20487. In fact, given the history and context of chapter 9 the opposite is true.

i. Section 20487 Is Protected From Preemption By Section 903.

Through section 903 Congress created a constitutional boundary between the bankruptcy court, the debtor and the State. Its command could not be clearer, as it is prefaced with the phrase "This chapter does not limit or impair the power of the State . . . ." The phrase "this chapter" obviously means chapter 9, and by incorporation through section 901, section 365 of the Code. Thus, the powers granted to a municipal debtor in bankruptcy are limited by section 903. That is clear from the face of the statute. Section 20487 falls well within the ambit of the requirement that a State is able to control the "political and governmental powers of such municipalities" during a chapter 9 case.

Under Cal. Gov. Code § 45341, a city may establish a pension plan "in order to effect economy and efficiency in the public service," which are the same goals expressed by the California Legislature when it created the State retirement system. Cal. Gov. Code § 20001. The Stockton Charter mandates that the City "provide for a retirement and death benefit plan for officers and employees of the City." Stockton City Charter Art. XXVI, § 2600; *see also id.* at § 2601 ("The City Council may provide for such a plan by participation in any retirement system and death benefit plan now existing or hereafter created under the laws of the State of California which municipalities and municipal officers and employees are eligible to join."). "The authority to provide for pensions . . . [is] a municipal affair." *Richards v. Wheeler*, 10 Cal. App. 2d 108, 111 (1935) (citing cases); *see also Bellus v. City of Eureka*, 69 Cal. 2d 336, 345 (1968) ("The City here agrees that establishment of an employee pension plan is a municipal affair."). The California Supreme Court has recognized that the term "municipal affairs" encompasses "governmental activity." *Cal. Fed. Savings & Loan Ass'n v.*

City of Los Angeles, 54 Cal. 3d 1, 17-18 (1991). Thus, by providing for pension benefits, the City is exercising one of its "political or governmental powers" as envisioned in section 903. *See* M. McConnell & R. Picker, W*hen Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. Chi. L. Rev. 425, 462-63 (1993) ("The application [of § 903] to only political or governmental powers seems to recognize the traditional distinction in local government law between proprietary and nonproprietary activities of municipalities. . . . This may or may not have any practical significance, because the governmental/proprietary distinction has all but collapsed").

Stockton chose to participate in CalPERS. *See* Cal. Gov. Code § 45345. By doing so, it agreed to be bound "to all provisions of this part and all amendments thereto." Cal. Gov. Code § 20506. This, of course, includes section 20487 of the PERL. Thus, given that pensions are considered to be a governmental function as a matter of both Federal (*see* CalPERS' Supplemental PERL Brief), and State law, by agreeing to participate in CalPERS, Stockton expressly ceded this particular governmental function back to the State through its agency, CalPERS.[15] As such, it has no right to reject its relationship with CalPERS via the Bankruptcy Code because section 903 expressly prohibits interference with the State's ability to control its municipalities in the exercise of its political or governmental powers.

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[15] The concept that the provision and administration of a public pensions system is a governmental function has been recognized by several other courts. *See*, *e.g.*, *Crosby v. City of Gastonia*, 682 F. Supp. 2d 537, 546 (W.D.N.C. 2010) ("the act of funding the [Gastonia Supplementary Pension Fund] would be a governmental function rather than a proprietary one. This is because such action, purportedly required by state statute, would be more political, legislative, and performed for the public good, as opposed to commercial or proprietary in nature."); *Commerce Bank of Kansas City, N.A. v. Housing Auth. of Kansas City, Mo.*, 62 F.3d 1123, 1125 (8th Cir. 1995) (noting funds in pension plan assisting in performing "governmental function" because public agency "can only function through its employees, and to hire and retain competent employees the [agency] reasonably determined to provide a pension plan."); *Currigan v. Stone*, 317 P.2d 1044, 1049 (Colo. 1959) ("Creation of the Police Pension and Relief Fund, control and administration thereof by the City . . . are all a part of and are inextricably interwoven into the creation and maintenance of the Police Department of the City of Denver, and the exercise of control over the fund is a governmental function."); *Glassman v. Glassman*, 131 N.E.2d 721, 727 (N.Y. 1956) ("That the Retirement System is an arm or agency of the State performing the public function of providing and regulating pensions for public employees cannot be doubted."); *Bd. of Trustees of Police Pension Fund of Glen Ellyn v. Village of Glen Ellyn*, 85 N.E.2d 473, 481 (Ct. App. Ill. 1949) ("the duties imposed upon a municipality with reference to the establishment of police pension funds are government in character."); *Ayers v. City of Tacoma*, 108 P.2d 348, 352 (Wash. 1940) (holding local "pension system" is a "governmental function directed toward more effective public service, which is a benefit to the city.").

ii. In Any Event, Section 20487 Is Not Preempted by the Bankruptcy Code.

As discussed above with respect to the conclusion that the Bankruptcy Code does not generally preempt the PERL, neither express nor field preemption apply so as to render section 20487 ineffective in chapter 9. The only remaining form of preemption which could apply so as to preempt section 20487 is conflict preemption. Conflict preemption occurs only when (1) "compliance with both federal and state regulations is a physical impossibility;" or (2) in "those instances where the challenged state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Arizona v. United States*, 132 S. Ct. 2492, 2501 (2012) (quotations and citations omitted); *see also In re Thorpe Insulation Co.*, 677 F.3d 869, 889 (9th Cir. 2012), *cert. denied*, 133 S. Ct. 119 (2012). "Implied preemption analysis ***does not*** justify a 'freewheeling judicial inquiry into whether a state statute is in tension with federal objectives'; such an endeavor 'would undercut the principle that ***it is Congress rather than the courts*** that preempts state law.'" *Chamber of Commerce of the U.S. v. Whiting*, 131 S. Ct. 1968, 1985 (2011) (emphasis added) (quoting *Gade v. Nat'l Solid Wastes Mgmt. Ass'n.*, 505 U.S. 88, 111 (1992) (Kennedy, J., concurring)). "Our precedents 'establish that a high threshold must be met if state law is to be preempted for conflicting with the purposes of a federal Act.'" *Id.* at 1985 (quoting *Gade*, 505 U.S. at 110)). Under binding Supreme Court preemption precedents, section 20487 comes to this Court with a very strong presumption in favor of its constitutionality.

(a) Physical Impossibility Preemption Does Not Apply.

Any claim that "physical impossibility" applies is easily dispatched. Section 365(a) provides that a debtor "***may*** assume or reject any executory contract." 11 U.S.C. § 365(a) (emphasis added). Thus, under 365(a) the choice to assume or reject rests within the discretion of the municipal debtor. If it does neither, the contract "rides through" the bankruptcy. *See, e.g., Smith v. Hill*, 317 F.2d 539, 542 n.6 (9th Cir. 1963). However, section 20487 prohibits rejection and requires approval for assumption. There is no "physical impossibility" between the two because under section 365(a), a municipal debtor has the option of deciding what to do with its executory contracts. If the Code required otherwise—that a debtor must reject such contracts—physical impossibility might have

some role to play. Because it expressly does not, "physical impossibility" preemption does not exist because a debtor can, like Stockton, comply with both federal and State law.

(b) Obstacle Preemption Does Not Apply.

The key to "obstacle" preemption, as noted, is whether the State law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Arizona*, 132 S. Ct. at 2501 (quotations and citations omitted). Again, the "two cornerstones" of every preemption analysis are (1) Congressional intent and (2) the presumption against preemption. *Wyeth v. Levine*, 555 U.S. 555, at (2009). In assessing Congress's intent to preempt, courts must first focus on the statutory language which, of course, "contains the best evidence of Congress's pre-emptive intent." *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 664 (1993); *CTS Corp. v. Waldburger*, 134 S. Ct. 2175, 2185 (2014) ("Congressional intent is discerned primarily from the statutory text.").

Here, Congress gave no indication through the statutory text of section 365(a) into whether it intended to preempt State laws protecting pension rights in chapter 9. Section 365(a) is completely silent on that matter. Nor is CalPERS aware of any legislative history indicating whether section 365(a) was intended to displace State laws expressly precluding rejection of a debtor's relationship with its State-run pension system. Thus, it cannot be said that Congress expressed its intent in a "clear and manifest" enough manner in section 365(a) to overcome the presumption against preemption that applies to Cal. Gov. Code § 20487. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544 (1994). The administration and provision of public pensions is an area of traditional State regulation and exercise of the historic police powers of the States. *See* CalPERS' Supplemental PERL Brief, § II.A.1. As the Supreme Court made clear, absent such a "clear and manifest" expression by Congress, "the Bankruptcy Code will be construed to adopt, rather than displace, pre-existing state law." *Id.* at 544-45.

Likewise, given the relationship that exists between a municipal debtor and the laws of the State of California, which has expressly forbidden contracting agencies to reject their relationship with CalPERS, any such "liberating preemption would come only by interposing federal authority between a State and its municipal subdivision] . . . ." *Nixon v. Missouri Muni. League*, 541 U.S. 125,

140 (2004). Thus, the Supreme Court has instructed that courts apply a "working assumption that federal legislation threatening to trench on the States' arrangements for conducting their own governments should be treated with ***great skepticism*** . . . ." *Id.* Applying the required "great skepticism" leads to but one conclusion: that Congress did not intend to preempt laws like Cal. Gov. Code § 20487 by means of section 365 of the Bankruptcy Code.

Reliance on the "broad remedial purposes" of the Code as a justification for preemption of section 20487 would be inappropriate as the Supreme Court has rejected such purpose-driven statutory construction. "After all, almost every statute might be described as remedial in the sense that all statutes are designed to remedy some problem." *CTS Corp.*, 134 S. Ct. at 2185. This is so because "no legislation pursues its purposes at all costs." *Rodriguez v. United States*, 480 U.S. 522, 525-26 (1987) (per curiam); *see also In re Transcon Lines*, 58 F.3d 1432, 1437-38 (9th Cir. 1995) ("Invocation of the 'plain purpose' of legislation . . . takes no account of the processes of compromise and, in the end, prevents the effectuation of congressional intent.") (quoting *Bd. of Governors of the Fed. Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361, 373-74 (1986)). In fact, the Supreme Court has referred to the invocation of such "purposes" as the "last redoubt of losing causes" because "[e]very statute proposes, not only to achieve certain ends, but also to achieve them by particular means—and there is often a considerable legislative battle over what those means ought to be." *Dir., Office of Workers' Comp. Programs, Dep't of Labor v. Newport News Shipbuilding & Dry Dock Co.*, 514 U.S. 122, 136 (1995).

The Supreme Court has recognized that the Bankruptcy Code does not reflect any such "broad remedial purpose." In rejecting similar reasoning, the Supreme Court concluded that "the Bankruptcy Code . . . is not a remedial statute" in the sense that it is designed to protect and secure specific interests. *Florida Dep't of Revenue. v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 51 (2008); *see also Schwab v. Reilly*, 560 U.S. 770, 791 (2010) ("none of Reilly's policy arguments can overcome the Code provisions" because such an "approach threatens to convert a fresh start into a free pass."); *In re Flores*, 735 F.3d 855, 861 (9th Cir. 2013) (en banc) (noting that the "fresh start" generality is "not the end of the story")); *In re Dumont*, 581 F.3d 1104, 1111 (9th Cir. 2009) (looking to the purposes

of the Bankruptcy Code is not helpful because "Bankruptcy law serves two central but often conflicting interests"); *Myers v. TooJay's Mgmt. Corp.*, 640 F.3d 1278, 1286 (11th Cir. 2011).

Moreover, any claim that not allowing a City to reject its relationship with CalPERS might make it more difficult to reorganize in some hypothetical sense is not supported by the actual facts of this case. In any event, the Ninth Circuit has said "'[s]imply making a reorganization more difficult for a particular debtor . . . does not rise to the level of 'standing as an obstacle to the accomplishment of the full purposes and objectives of Congress.'" *In re Thorpe*, 677 F.3d at 890-91 ((quoting *In re Baker & Drake, Inc.*, 35 F.3d 1348, 1354 (9th Cir. 1994) (quoting *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 300 (1988)).[16] Thus, there is no evidence that, by not allowing the City to hypothetically reject its relationship with CalPERS, section 20487 somehow stands as an obstacle to the realization of Congress's purposes in enacting chapter 9 and there is no basis to conclude that section 20487 is preempted by the Bankruptcy Code.

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[16] Any suggestion that the Bankruptcy Code is the *only* means by which contracts may be impaired is incorrect. In upholding a New Jersey law, the Supreme Court recognized that "a state insolvency act is limited by the Contract Clause," but such limitations depended "on what is affected by such composition and what state power it brings into play. The dictum from *Sturges v. Crowninshield* [4 Wheat. 122 (1819)] is one of those ***inaccurate generalizations that has gained momentum from uncritical repetition***." *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 513 (1942) (emphasis added). Contracts may also be impaired under California law, notwithstanding California's Contracts Clause. *See, e.g., Sonoma Cnty. Org. of Pub. Emps v. Cnty of Sonoma*, 23 Cal. 3d 296, 305 (1976) ("Our inquiry, then, concerns not whether the state may in some cases impair the obligation of contracts, but the circumstances under which such impairment is permissible"). Since *Faitoute*, the Supreme Court has affirmed that the Contracts Clause should not be so broadly interpreted. *See Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 240 (1978) (stating that while the language of the Contracts Clause appears absolute, "it is not . . . the Draconian provision that its words might seem to imply"). Rather, State laws which impair contracts do not violate the clause so long as they serve "a legitimate public purpose such as remedying a general social or economic problem," and "the means chosen to accomplish this purpose [are] reasonable and necessary." *Buffalo Teachers Federation v. Tobe*, 464 F.3d 362, 368 (2d Cir. 2006) (citing *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 41-13 (1983)). Furthermore, the "Contracts Clause has been construed narrowly in order to ensure that local governments retain the flexibility to exercise their police powers effectively." *Ching Young v. City & Cnty. of Honolulu*, 639 F.3d 907, 913 (9th Cir. 2011) (quotations omitted).

D. *Mission Independent* Has No Application In this Case.

Franklin's past reliance on the enigmatic dictum in *Mission Independent School District v. Texas*, 116 F.2d 175 (1940), is misplaced. Franklin's Reply Regarding Pension Liabilities, p. 5 [Dkt. No. 1397]. In that case, the court made an alternate, albeit dispositive, ruling on the question of whether a 1939 law violated the Texas Constitution's prohibition against "deceptive and misleading" titles to legislative acts. *Id.* at 178. On that ground alone, the court could have ordered the remand (to confirm the plan) that it did, without addressing any of the federal constitutional issues, because the 1939 law did not repeal a 1935 law that authorized Texas's subdivisions to file for bankruptcy. *See id.* at 177. Under settled principles of judicial restraint at that time, this would have been the correct way to resolve this case. *See, e.g., Siler v. Louisville & Nashville R. Co.*, 213 U.S. 175, 193 (1909). At best, the portion of *Mission Independent* on which Franklin and certain courts rely is dictum, which has no precedential value. *See, e.g., Boykin v. Boeing Co.*, 128 F.3d 1279, 1282 (9th Cir. 1997) ("Because this is dictum, we accord it no precedential value.").

In any event, *Mission Independent* is distinguishable or just plain wrong under modern day jurisprudence. *First*, unlike today, the municipal bankruptcy law in effect at that time ***did not*** contain any requirement that a municipality actually have any State authorization, let alone the "specific authorization" now mandated by section 109(c)(2). *United States v. Bekins*, 304 U.S. 27, 49 (1938). The decision is therefore contrary to the current chapter 9 because the legislative history of currently applicable chapter 9 makes it clear that "withdrawal of State consent ***at any time*** will terminate the case . . . ." H.R. REP. NO. 94-686, at 8, *reprinted in* 1976 U.S.C.C.A.N. 539, 545 (emphasis added).

Second, the Fifth Circuit did not construe the 1939 law as a bankruptcy authorization statute; rather, it interpreted the law as excluding "bonds so owned [by the permanent school fund of Texas] ***from the operation*** of any composition made." 116 F.2d at 177 (emphasis added). In its view, this reading was the most "natural meaning" of the law in question. *See id.* Thus, in the Fifth Circuit's view, Texas sought to exempt its own bonds from treatment in bankruptcy independently of its authorization to be in bankruptcy. In fact, at the time *Mission Independent* was decided, Texas had two authorization laws on the books. *See id.* Thus, the case says nothing about whether or not a State

can or cannot attach conditions in an authorization statute. States obviously can do so given that the control they have over their municipal creatures is absolute. In contrast, the district court in that case construed the law in question as an authorization statute and determined that the bankruptcy case must be dismissed for lack of state authority to file. *See In re Mission Independent School Dist.*, 35 F. Supp. 37, 39 (S.D. Tex. 1940). Had the Fifth Circuit read the statute as a bankruptcy authorizing statute—which, as explained above, is how the California courts would construe section 20487—the result would have ben dismissal of the bankruptcy case.

Third, and perhaps most importantly from a factual standpoint, the Fifth Circuit said:

> The State of Texas ***bought the bonds it holds for the school fund, and paid for them just as others did***. It obtained no better right to repayment. The bonds it holds against its own subdivisions ***as an investment*** stand just as though they were municipal bonds issued in another state. The State of Texas is simply a bond creditor as others are.

116 F.2d at 178 (emphasis added). In sharp contrast, CalPERS is not appearing in this case as a holder of Stockton bonds. Nor does California, through CalPERS, hold the money in the PERF as an investment to fill the State's coffers with funds that the State is then free to spend. The exact opposite is true. The funds California holds, through CalPERS, are trust funds and they can only be used to pay out pension benefits and to administer the State-run system. *See* Cal. Gov. Code § 20170; *see also* CAL. CONST., art. XVI, § 17(a). The funds held in the PERF stand on much different footing than the bonds that Texas bought as an investment because their purpose is not to enrich the State treasury or to help pay for the educational needs of California's citizens, but to instead fulfill a core governmental objective in sustaining a viable public employee retirement system.

Fourth, nothing in the *Mission Independent* case mentions former section 83(i) of Chapter 10, which largely mirrors section 903. As a result, the decision has absolutely nothing to say about what section 903 does or does not mean. The decision is neutral on the matter. Moreover, it was only because the court ruled the 1939 law unconstitutional under ***Texas law*** (but left in place the 1935 authorization statute), that it was able to avoid having to wrestle with the question of whether the proposed plan, which it ordered to be confirmed, was consistent with State law as was required by *Bekins* and the Federal act in effect at that time. Thus, *Mission Independent* does not address whether section 943(b)(4) would prohibit a plan of adjustment that was inconsistent with State law.

Finally, the *Mission Independent* court's 30,000 foot approach to preemption is not the law today. For example, the court never discussed Congress's intent nor did it even discuss any presumption against preemption, let alone the heightened one that exists if a court is intruding into the relationship between a State and one of its municipalities. *Nixon*, 541 U.S. at 140. Rather, by simple *ipse dixit*, it declared that bankruptcy law reigned supreme. Such an approach is incompatible with the modern-day Supreme Court's preemption analysis. Had the court employed the required "working assumption that federal legislation threatening to trench on the States' arrangement for conducting their own governments should be treated with great skepticism," *id.*, the Fifth Circuit would have been compelled to come to a contrary result.

E. Congress's Attempt to Abrogate State Sovereign Immunity Pursuant to 11 U.S.C. § 106(a) is Inapposite in This Case.

During the July 8, 2014 hearing, this Court suggested that 11 U.S.C. § 106(a) had some role to play in this Court's analysis, saying:

> And another item that is listed in Section 106(a)(1) is Section 944. Of course, 944 is the effect of confirmation and includes the discharge, and the conventional analysis is that the State of California by authorizing filing the Chapter 9 invokes Section 106 on itself. And then, of course, the City of Stockton, to the extent it can avail itself of sovereign immunity, invoked Section 106 on itself when it filed this case.

Hr'g Tr. 44-45, July 8, 2014. In fact, Franklin goes so far as to claim that "California has waived whatever sovereignty protections CalPERS otherwise might possess by authorizing its municipalities to file for bankruptcy." Franklin's Reply Regarding Pension Liabilities, p. 8 (citing *Stockton II*'s citation to § 106(a)). In making this claim, Franklin misses the basic constitutional distinction between State sovereignty and sovereign immunity.

As the Second Circuit explained:

> While both Amendments protect the States, they deal with different aspects of state sovereignty. The Tenth Amendment protects states from intrusion by the federal government. It addresses state sovereignty generally and limits Congress' exercise of power pursuant to Article I. . . .
>
> The Eleventh Amendment protects States from suits by its citizens in federal court. It is concerned with judicial authority and limits the power of Article III courts over actions brought against States.

Close v. State of New York, 125 F.3d 31, 39 (2d Cir. 1997). In *Printz*, the Supreme Court made this exact point by noting that the Tenth Amendment's federalism protections are broader than the Eleventh Amendment's immunity from suit. *Printz v. United States*, 521 U.S. 898, 931 n.15 (1997). The former protects the States and their municipalities, while the latter protects only the States. It is for this reason that States and their arms have sovereign immunity, while municipalities do not. *See, e.g., Jinks v. Richland Cnty., S.C.*, 538 U.S. 456, 466 (2003) ("[M]unicipalities, unlike States, do not enjoy a constitutional immunity from suit."); *Alden v. Maine*, 527 U.S. 706, 756 (1999) ("The immunity does not extend to suits prosecuted against a municipal corporation or other governmental entity which is not an arm of the State."); *Monell v. Dep't of Social Servs. of City of New York*, 436 U.S. 658, 691 n.54 ("Our holding today is, of course, limited to local government units which are not considered part of the State for Eleventh Amendment purposes.").[17]

As explained above, while a State may waive its sovereign immunity, it may not waive the protections of federalism because the protections, unlike sovereign immunity, do not belong to the States alone. *See supra* § III.A.2 (discussing the Supreme Court's *Bond I* and *New York* decisions). Putting this question aside, even on its own terms, Franklin's argument is incorrect.

The "test for determining whether a State has waived its immunity from federal-court jurisdiction is a stringent one. A State's consent to suit must be unequivocally expressed ***in the text of the relevant statute*** [and] [w]aiver may not be implied." *Sossaman v. Texas*, 131 S. Ct. 1651, 1658 (2011) (quotations and citations omitted) (emphasis added). "There can be no consent by implication or by use of ambiguous language. Courts must indulge every reasonable presumption against waiver . . . ." *Holley v. Cal. Dep't of Corrections*, 599 F.3d 1108, 1111-12 (9th Cir. 2010) (quotations, alteration & citation omitted). Franklin's suggestion that California waived its sovereign immunity, or any aspect of its sovereignty, by merely authorizing its creatures to file for chapter 9 is wrong as a matter of constitutional law.

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[17] Under these cases, the Court's comment that the City invoked 106(a) on itself by filing this case is incorrect. Section 106(a) has no role to play with respect to the City because Congress did not need to attempt to abrogate the City's sovereign immunity because the City does not enjoy such immunity.

Nothing in the language of the Municipal Bankruptcy Authorization Statute expressly or unequivocally states that California waived anything, including its immunity from suit. Indeed, the opposite is true. Cal. Gov. Code § 53760.7 states, in pertinent part:

> No cause of action against the state, or any department, agency, entity of the state, or any officer or employee of the state acting in their official capacity may be maintained for any activity authorized by this article, or for the act of a local public entity filing under Chapter 9 of Title 11 of the United States Code, including any proceeding following a local public entity's filing.

Thus, under the authorization statute, California expressly sought to retain its immunity from being haled into federal court against its will by one of its subdivisions. And by extension, even if California could waive its sovereignty, as Franklin claims, nothing in the authorization statute does that. As a result, California waived nothing by generally authorizing its municipalities to file for chapter 9.

Nothing in section 106(a) supports a contrary result. Section 106(a) states: "Notwithstanding an assertion of sovereign immunity, sovereign immunity is abrogated as to a governmental unit to the extent set forth in this section . . . ." In enacting the Bankruptcy Reform Act of 1994, Congress sought, through section 106(a), to "overrule two Supreme Court cases that have held that the States and Federal Government are not deemed to have waived their sovereign immunity by virtue of [Congress] enacting section 106(c) of the Bankruptcy Code." H.R. Rep. No. 103-835, at *42 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3342 (discussing *Hoffman v. Connecticut Dep't of Income Maint.*, 492 U.S. 96 (1989) & *United States v. Nordic Village, Inc.*, 503 U.S. 30 (1992)). For example, in *Hoffman*, the Supreme Court held, in enacting former section 106(c), which contained the phrase "notwithstanding any assertion of sovereign immunity," that Congress did not make its intention to abrogate State sovereign immunity with respect "to over 100 Code provisions" unmistakably clear. 492 U.S. at 101-04 (plurality). As such, former 106(c) was insufficient to constitute a valid abrogation of State sovereign immunity. In his concurrence, Justice Scalia (who on this point was joined by Justice O'Connor) went even further and concluded that under the Bankruptcy Clause Congress lacked the power to abrogate State sovereign immunity. 492 U.S. at 105 (Scalia, J., concurring in the judgment).

In *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996), the Supreme Court adopted Justice Scalia's position and held that, while Congress had the authority to abrogate State sovereign immunity under Section 5 of the Fourteenth Amendment, it could not do so under its Article I powers. 517 U.S. 44, 72-73 (1996) ("The Eleventh Amendment restricts the judicial power under Article III, and Article I cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction."). The Court reaffirmed this principle several times. *Bd. of Trustees of Univ. of Alabama v. Garrett*, 531 U.S. 356, 364 (2001); *Kimel v. Florida Bd. of Regents*, 528 U.S. 62, 79 (2000); *Florida Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank*, 527 U.S. 627, 628 (1999).

Based on these precedents, the Ninth Circuit held that, although section 106(a) was sufficiently clear to demonstrate Congress's intent to abrogate State sovereign immunity, this did not matter because Congress lacked the constitutional authority to abrogate State sovereign immunity under the Bankruptcy Clause. *In re Mitchell*, 209 F.3d 1111, 1121 (9th Cir. 2000) ("Thus, we conclude that Congress did not act within the scope of its abrogation power in enacting § 106(a)."). In other words, section 106(a)'s purported abrogation of sovereign immunity is ineffective and unconstitutional. *Accord In re Death Row Records, Inc.*, 2012 WL 952292, at *5 (9th Cir. BAP Mar. 21, 2012).

Here, the question of whether pensions can be impaired does not turn on whether or not Congress validly abrogated State sovereign immunity in section 106(a). Under *Mitchell*, we know that it has not. After all, sovereign immunity is an immunity from suit and nothing more. Thus, whether or not California or CalPERS waived its sovereign immunity is beside the point.

Franklin's suggestion that the Supreme Court's decisions in *Van Huffel v. Harklerode*, 284 U.S. 225 (1931), and *New York v. Irving Trust Co.*, 288 U.S. 329 (1933), which both predate chapter 9, stand for the broad proposition that pensions can be impaired completely misses the mark. Franklin's Reply Regarding Pension Liabilities, p. 8.[18] Neither case involved a municipal debtor. As

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[18] Likewise, the Supreme Court's decision in *Gardner v. New Jersey*, 329 U.S. 565 (1947) has no application here because that case merely stands for the proposition that, if a State files a proof of claim, it waives its sovereign immunity. *See, e.g., In re Pegasus Gold Corp.*, 394 F.3d 1189, 1195-96

the district court in San Bernardino recently noted, this alone changes the analysis, given the relationship that exists between a State and one of its subdivisions. *In re City of San Bernardino*, 2014 WL 2511096, at *12 (C.D. Cal. June 4, 2014) ("Municipal bankruptcies implicate a state's sovereignty and Tenth Amendment rights to a greater degree than other bankruptcy contexts because of the special relationship between a state and its municipalities."). Also, neither case says anything about the Tenth Amendment, but only address general questions regarding the treatment of States in bankruptcy proceedings. For example, *Irving Trust* addresses only the question of whether a State is bound by a discharge order whether or not they participate in the bankruptcy. *Irving Trust*, 288 U.S. at 333. Neither of those cases address, even remotely, the substance of any of the issues that might be before this Court with respect to the power to impair or adjust pensions.

At the end of the day, while the intersection of bankruptcy and State sovereign immunity presents complex questions, the question of sovereign immunity is inapposite to the resolution of this case and the question of whether a chapter 9 plan of adjustment can impair or adjust pension obligations.

III. CONCLUSION

To the extent the Court addresses any of these issues, constitutional principles of sovereignty embodied in the Tenth Amendment to the Constitution, section 903 of the Bankruptcy Code, and State law, including the PERL, all must be given meaning, leading to the inescapable conclusion that a municipality may not impair or adjust its statutory obligations to CalPERS through a chapter 9 plan of adjustment and may not reject its relationship with CalPERS pursuant to section 365 of the Bankruptcy Code.

(9th Cir. 2005). CalPERS has not filed a proof of claim in this case, so *Gardner* cannot form the basis for any claim of waiver. Indeed, 11 U.S.C. § 106(b) merely codifies *Gardner*. *In re Jackson*, 184 F.3d 1046, 1049 (9th Cir. 1999). Similarly, the Court's decision in *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004), does not apply. There, the Court determined that a bankruptcy court's exercise of its *in rem* jurisdiction in deciding an adversary proceeding relating to an undue hardship finding was not a "suit" for purposes of the Eleventh Amendment. *Id.* at 451 ("We thus hold that the undue hardship determination sought by Hood in this case is not a suit against a State for purposes of the Eleventh Amendment.").

Respectfully submitted,

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