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NATIONAL PUBLIC FINANCE  
10 GUARANTEE CORPORATION

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12 **UNITED STATES BANKRUPTCY COURT**  
13 **EASTERN DISTRICT OF CALIFORNIA, SACRAMENTO DIVISION**

14 In re:  
15 CITY OF STOCKTON, CALIFORNIA,  
16 Debtor.

) Case No. 12-32118  
) D.C. No. OHS-1  
) Chapter 9

) **NATIONAL PUBLIC FINANCE**  
) **GUARANTEE CORPORATION'S**  
) **MOTION *IN LIMINE* #1 TO**  
) **EXCLUDE ANY EVIDENCE OR**  
) **ARGUMENT CONCERNING THE**  
) **RATIONALE FOR THE CITY OF**  
) **STOCKTON, CALIFORNIA'S**  
) **DECISION NOT TO NEGOTIATE**  
) **WITH OR TO SEEK TO IMPAIR**  
) **THE CALIFORNIA PUBLIC**  
) **EMPLOYEES' RETIREMENT**  
) **SYSTEM PRIOR TO THE FILING**  
) **OF THIS CHAPTER 9 PETITION**

) Date: March 20, 2013  
) Time: 9:30 a.m.  
) Dept: Courtroom 35  
) Judge: Hon. Christopher M. Klein

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1 National Public Finance Guarantee Corporation (“National”), a creditor and party in interest,<sup>1</sup>  
2 hereby requests that the Court exclude any evidence or argument concerning the rationale for the  
3 City of Stockton, California’s (the “City”) decision not to negotiate with or to seek to impair the  
4 California Public Employees’ Retirement System (“CalPERS”) prior to the filing of this chapter 9  
5 petition.<sup>2</sup> In support of this Motion, National states as follows:

6 **I. INTRODUCTION**

7 1. It is well-accepted that a party cannot bar an opponent from conducting discovery on  
8 a critical issue and then turn around at trial and introduce that same hidden evidence to support its  
9 claims. Nor can a party make available just a portion of that evidence – selectively disclosed to  
10 benefit the party’s case and leaving the impression that the entire story has been told – while keeping  
11 under shroud the remaining, related evidence that the disclosing party deems not as favorable. That  
12 is precisely what the City intends to do here.

13 2. In this eligibility dispute, National asserts the City failed both to negotiate in good  
14 faith under section 109(c)(5) of the Bankruptcy Code and to file its petition in good faith under  
15 section 921(c) because, among other things, the City failed to negotiate with or to seek any  
16 concessions from CalPERS, its largest creditor. Over the course of a month of depositions, counsel  
17 for the Objecting Parties<sup>3</sup> asked seven separate City witnesses twenty-six different times for the  
18 rationale behind the City’s prepetition decision not to negotiate with or to seek to impair CalPERS.  
19 Twenty-six times the City’s attorneys asserted the attorney-client privilege, barring National and the  
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21 <sup>1</sup> As detailed in National’s Joinder of Creditor National Public Finance Guarantee Corporation to  
22 Indenture Trustee’s Limited Objection to the Debtor’s Emergency Motion for Leave to Introduce  
23 Evidence Relating to Neutral Evaluation Process under Government Code Section 53760.3(Q) [Dkt.  
No. 78], National is a secured creditor of the City and party in interest in this case.

24 <sup>2</sup> In conjunction with this Motion, National has also filed its Motion *in Limine* #2, which seeks to  
25 exclude the City from introducing any evidence of postpetition actions, conduct, deliberations, or  
26 documents concerning the City’s rationale for its decision not to negotiate with or to seek to impair  
CalPERS on the ground that such postpetition evidence is not relevant to the matters at issue in the  
upcoming eligibility trial. This Motion serves as an independent basis for excluding such evidence,  
whether it is concerning prepetition or postpetition actions.

27 <sup>3</sup> The Objecting Parties include National, Assured Guaranty Corp., Assured Guaranty Municipal  
28 Corp., Wells Fargo Bank, National Association as Indenture Trustee, and Franklin High Yield Tax-  
Free Income Fund and Franklin California High Yield Municipal Fund.

1 other Objecting Parties from discovering crucial information at the heart of this eligibility dispute.  
2 While the City, of course, has the right to assert privilege when appropriate,<sup>4</sup> its decision to do so  
3 during depositions and discovery precludes the City from introducing any such evidence at trial to  
4 support its arguments that it negotiated or filed in good faith. In other words, the City cannot use the  
5 attorney-client privilege as both a sword and a shield. Accordingly, National requests that this Court  
6 enter an Order excluding the introduction of any evidence or argument concerning the City's  
7 rationale for its decision not to negotiate with or to seek to impair CalPERS prior to the filing of this  
8 case.

## 9 **II. BACKGROUND**

10 3. On August 8, 2012, National submitted its Objection to the City of Stockton's  
11 Qualifications Under Section 109(c) [Dkt. No. 477] (the "Objection").<sup>5</sup> Among other things, the  
12 Objection asserts that (a) the City did not meet its obligation under section 109(c)(5)(B) to negotiate  
13 in good faith with its creditors because it failed to negotiate with CalPERS, the holder of the largest  
14 unsecured claim against the City, (b) negotiations with CalPERS were not impracticable under  
15 section 109(c)(5)(C), and (c) the City did not meet its obligation under section 921(c) to file its  
16 petition in good faith.

17 4. Pursuant to the Court's Scheduling Order [Dkt. No. 558], Stipulation and Order  
18 Modifying Eligibility Scheduling Order [Dkt. No. 579], and Stipulation and Order Modifying  
19 Eligibility Scheduling Order [Dkt. No. 623], the Objecting Parties conducted discovery and took  
20 depositions of the City and of CalPERS. In particular, the Objecting Parties took depositions of nine  
21 City witnesses over the course of a month, including David N. Millican, Laurie Montes, Ann  
22 Goodrich, Eric Jones, Michael Locke, Katherine Miller, Teresia Haase, Vanessa Burke, and Robert  
23 Deis.<sup>6</sup>

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24  
25 <sup>4</sup> If, on the other hand, the City's assertion of privilege in this respect was overly broad or otherwise  
26 inappropriately shielded discoverable information, the City's repeated objections would be  
27 sanctionable and provide an independent ground to exclude this evidence at trial.

<sup>5</sup> Capitalized terms not otherwise defined herein shall have the meaning ascribed to them in the  
27 Objection.

<sup>6</sup> Excerpts of the deposition testimony referenced herein are attached as Exhibits A-G to the  
28 Declaration of Matthew M. Walsh in Support of National's Motion ("Walsh Decl.") filed herewith.

1           5.       On December 14, 2012, based on this discovery, National submitted its Supplemental  
2 Objection to the City of Stockton's Qualifications Under Sections 109(c) and 921(c) [Dkt. No. 635]  
3 (the "Supplemental Objection").

4           6.       On February 15, 2013, the City submitted its Reply to Objections to its Statement of  
5 Qualifications Under Section 109(c) of the United States Bankruptcy Code [Dkt. No. 707] (the  
6 "Reply").

7           7.       A trial on the City's eligibility to be a debtor under chapter 9 of the Bankruptcy Code  
8 is set to begin on March 25, 2013.

### 9 **III. DISCUSSION**

10           8.       This Court held recently that "[t]he burden of proof, at least as to the five § 109(c)  
11 elements, is on[] the municipality as the proponent of voluntary relief." *In re City of Stockton*, 475  
12 B.R. 720, 725 (Bankr. E.D. Cal. 2012) [*Stockton I*]; *see also Int'l Ass'n of Firefighters, Local 1186*  
13 *v. City of Vallejo (In re City of Vallejo)*, 408 B.R. 280, 289 (9th Cir. BAP 2009). As relevant here,  
14 the City must show that, before filing its petition, either it negotiated in good faith with its creditors  
15 but was unable to reach appropriate agreement, or that it was unable to negotiate with its creditors  
16 because such negotiations were impracticable. 11 U.S.C. § 109(c)(5).

17           9.       To show that it negotiated in good faith, a debtor must prove that it brought into the  
18 negotiations *all* its assets and liabilities while negotiating with creditors. *See In re Sullivan Cnty.*  
19 *Reg'l Refuse Disposal Dist.*, 165 B.R. 60, 78 (Bankr. D.N.H. 1994) ("A commercial party can hardly  
20 'negotiate in good faith' regarding unpaid obligations if it chooses to ignore clear, unambiguous  
21 contractual rights of the other party and, more importantly, refuses to acknowledge or throw into the  
22 negotiating equations a large and significant asset that it holds.").

23           10.       Furthermore, to show that it negotiated in good faith, a debtor must also prove that it  
24 actually engaged in meaningful negotiations with its creditors. *See In re Ellicott Sch. Bldg. Auth.*,  
25 150 B.R. 261, 266 (Bankr. D. Colo. 1992) ("take it or leave it" proposal in which "the substantive  
26 terms of a proposal were not open to discussion" does not constitute good faith negotiations); *see*  
27 *also Vallejo*, 408 B.R. at 297 (finding that the City of Vallejo did not satisfy section 109(c)(5)(B))

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1 because it “never negotiated with Unions or any of its creditors over the possible terms of a plan of  
2 adjustment”).

3 11. Finally, section 921(c) of the Bankruptcy Code provides an independent requirement  
4 for the debtor to prove the bankruptcy petition was filed in good faith and, among other things,  
5 requires a court to dismiss a chapter 9 petition if the debtor fails to satisfy the requirements under  
6 section 109(c). *See In re City of Vallejo*, 408 B.R. at 289; *In re Valley Health Sys.*, 383 B.R. 156,  
7 160 (Bankr. C.D. Cal. 2008).

8 12. In this case, the Objecting Parties will establish at trial that the City cannot meet its  
9 burden because it failed in several respects to negotiate and file in good faith. *First*, the City failed  
10 to meaningfully negotiate with the Objecting Parties, instead presenting and maintaining throughout  
11 the AB 506 Process that the City’s Ask was a “take it or leave it” proposal not open to discussion  
12 either as to the treatment proposed for the Objecting Parties or as to other revenues the City might  
13 explore to enlarge the pie for all creditors. *Second*, the City did not negotiate with or seek to impair  
14 CalPERS, its single largest unsecured creditor. In fact, the City’s 790-page Ask did not contain a  
15 single dollar of reductions in obligations to CalPERS. Notably, the evidence will show the City  
16 continued to refuse to negotiate with or seek concessions from CalPERS even after the Objecting  
17 Parties demanded, during the AB 506 Process, that the City approach CalPERS to discuss  
18 impairment and any other options. *Finally*, the City will be unable to show it negotiated or filed in  
19 good faith because the City employees and officials that participated in and made the decision not to  
20 impair CalPERS themselves held pensions administered by CalPERS, generating an incurable  
21 conflict of interest that tainted the decision not to impair CalPERS and now precludes the City from  
22 establishing its prepetition negotiations or its filing were conducted in good faith.<sup>7</sup>

23 13. The City argues in its Reply that it had good reasons not to negotiate with or seek to  
24 impair CalPERS. *See, e.g.*, Reply at 46 (The City could not “unilaterally stop making its pension

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26 <sup>7</sup> The evidence will show that the City’s “Strategic Direction Team” or “SDT” was led by City  
27 Manager Bob Deis. The SDT worked with outside consultants and lawyers to develop the Ask,  
28 which the SDT then recommended to the City Council. The City Council approved the Ask in its  
entirety without modification.

1 payments, either for already-retired employees (to the extent that their prefunded portion was  
2 insufficient) or for current employees.”), 48 (“[W]ithdrawing from CalPERS would have exposed  
3 the City to a massive ‘termination liability’ that it would have had no hope of satisfying outside of  
4 chapter 9.”), 53 (“Impairing CalPERS pensions or otherwise lowering police compensation much  
5 below market rates presented a risk to the health and safety of its citizens, a risk the City was not  
6 willing to take when it prepared the Ask.”).

7 14. Despite the City putting this matter at issue, when the Objecting Parties inquired at  
8 deposition into the rationale and deliberations underlying the City’s decision not to negotiate with or  
9 to seek to impair CalPERS, the City repeatedly asserted the attorney-client privilege to bar access to  
10 this discovery. For instance:

11 MR. WALSH: So, for clarity, you’re going to be asserting  
12 attorney-client privilege with respect to my questions regarding the  
13 decision whether or not to reduce the City’s pension obligations as it was  
made by the SDT?

14 MR. HILE: The decision has already been disclosed that the City  
15 decided not to do it. But, yes, as to what the discussions were that came to  
16 that conclusion and what Mr. Deis might have said to the group that  
17 included the attorneys or the attorneys might have said to him, I am  
asserting the privilege.

18 *See Millican Dep. 226:17-228:21.*

19 MR. WALSH: I do have a number of questions also regarding  
20 SDT meetings, and I understand that – is it correct, Counsel, that you will  
21 assert objections based on privilege if I asked those questions about what  
happened at those meetings?

22 MR. RIDDELL: I believe generally. But, I mean, I don’t know  
23 what all the questions would be. But, yeah, I mean, the same blanket  
objection that we have interposed previously would apply here.

24 MR. WALSH: I would like to discuss with the witness what  
25 happened at the SDT meetings in which it was discussed whether or not  
CalPERS should be asked for a reduction in the liability.

26 MR. RIDDELL: Yeah, based on counsel’s presence and  
27 communications with counsel and the advice given by counsel in the  
28 context of those meetings, I would interpose those same objections that we  
have done previously.

1 See Haase Dep. 139:10-140:6.

2 MR. WALSH: I want to state for the record that this issue has  
3 come up in every deposition so far. We have been frustrated ever[y] time  
4 with respect to our ability to discover this information.

5 I think that to the extent -- to the extent the City wishes to rely on  
6 its decision, we are entitled to this discovery and want the City to give it to  
7 us.

8 Is it fair to say that if I ask additional questions about what  
9 occurred in the SDT meetings she attended, that you will be instructing  
10 her not to answer?

11 MR. HILE: Yes.

12 MR. WALSH: On the basis of the attorney-client privilege?

13 MR. HILE: Yes.

14 See Burke Dep. 145:2-146:1.

15 MR. WALSH: I have a number of questions -- and I will direct this  
16 one to you, Mr. Hile, and Mr. Deis -- about the conversations at the SDT  
17 level as well as the closed council level with respect to the decision not to  
18 request an impairment of the CalPERS liability.

19 In prior depositions I know that you have asserted the privilege. I  
20 would like to get into this, and I think I'm entitled to it. But I'd like to  
21 know, Mr. Hile, whether the privilege will continue to be asserted with  
22 respect to these questions?

23 MR. HILE: Yes.

24 MR. WALSH: Okay. I continue to lodge my objection, as I have in  
25 the past. I won't belabor the record with it. I think we are entitled to this.  
26 But I will not go into those questions based on that, and I will reserve  
27 rights and move on.

28 See Deis Dep. 225:1-18.

15. Indeed, over the course of a month, counsel for the Objecting Parties asked seven  
different City witnesses twenty-six times about the deliberations underlying the City's decision not  
to impair CalPERS, and the City's attorneys asserted the attorney-client privilege time and time  
again. See Millican Dep. 219:6-22, 226:17-228:21, 228:23-229:7, 229:9-230:11, 230:12-20, 235:2-  
10, 235:12-24; Montes Dep. 189:9-22, 191:5-10, 196:13-197:7, 212:8-23; Goodrich Dep. 259:10-18;  
Miller Dep. 58:14-22, 59:16-24, 62:8-63:7, 75:11-76:21, 86:1-7, 91:15-20; Haase Dep. 138:12-17,



1 139:10-140:6, 162:14-22; Burke Dep. 145:4-146:1, 146:3-16, 146:18-25, 147:21-148:6; Deis Dep.  
2 225:1-18.<sup>8</sup> Similarly, the City failed to produce documents referencing the SDT or City Council  
3 decision-making process on this important matter.<sup>9</sup>

4 16. While the City may assert the attorney-client privilege as to any material that is so  
5 privileged, it cannot do so to block the discovery of information it later wishes to rely upon at trial.  
6 But that is precisely what the City did here by, on the one hand arguing that it had good reasons not  
7 to negotiate with or to seek to impair CalPERS, while, on the other hand, asserting privilege to  
8 prohibit the Objecting Parties from conducting fulsome discovery on this issue. Nor can the City  
9 disclose some carefully chosen portion of its rationale – as it attempts to do in its papers – while  
10 keeping the remainder under wraps.

11 17. The City’s “hide the ball” strategy runs afoul of the Federal Rules of Civil Procedure.  
12 Specifically, Rule 37(c)(1) of the Federal Rules of Civil Procedure, made applicable here by Rule  
13 7037 of the Federal Rules of Bankruptcy Procedure, states that a party who fails to disclose  
14 information may not be permitted to use such information at trial. Fed. R. Civ. Proc. 37(c)(1) (“If a  
15 party fails to provide information or identify a witness as required by Rule 26(a) or (e), the party is  
16 not allowed to use that information or witness to supply evidence on a motion, at a hearing, or at a  
17 trial, unless the failure was substantially justified or is harmless.”).

18 18. Moreover, as the District Court for the Western District of Washington explained:

19 The privilege which protects attorney-client communications may not be  
20 used both as a sword and a shield. . . . [A] party cannot introduce a  
21 document as evidence while denying the opponent sufficient discovery  
22 with respect to the surrounding circumstances and substance of the  
document. A privilege-holder may elect to withhold or disclose, but after  
a certain point his election must remain final.

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23 <sup>8</sup> In total, there were nine depositions of City witnesses. Two of those witnesses – Mr. Jones and  
24 Mr. Locke – had no participation on the SDT or the City Council with respect to the decision not to  
negotiate with or to seek to impair CalPERS.

25 <sup>9</sup> Indeed, on November 21, 2012, the City’s counsel sent a letter to the Objecting Parties requesting  
26 the return of certain inadvertently produced privileged documents pursuant to the governing  
Stipulation and Protective Order. Several of the clawed-back documents pertained to SDT-related  
27 communications. The Objecting Parties complied with the City’s request as required under the  
Protective Order. *See* Walsh Decl., Ex. H (Letter from J. Killeen to Objecting Parties, dated  
28 November 21, 2012, regarding “Request for Return of Inadvertently Produced Privileged  
Documents”); Stipulation and Protective Order, ¶ 16, entered September 28, 2012 [Dkt. No. 564].



1 *Turner v. Univ. of Wash.*, No. C05-1575RSL, 2007 WL 2984685, at \*1 (W.D. Wash. Oct. 10, 2007)  
 2 (citations omitted); *see also Manning v. Buchan*, 372 F. Supp. 2d 1036, 1048 (N.D. Ill. 2004) (“[I]t  
 3 is unfair to allow a party to make selective use of information helpful to him while blocking inquiry  
 4 into other aspects of the information that might be unhelpful.”) (citation omitted); *Cary Oil Co., Inc.*  
 5 *v. MG Ref. & Mktg., Inc.*, 257 F. Supp. 2d 751, 761 (S.D.N.Y. 2003) (“the Court is prepared to  
 6 exclude any testimony or evidentiary presentations by the Defendants at trial if that same testimony  
 7 or evidence was withheld from Plaintiffs during discovery based on attorney-client privilege”); *Int’l*  
 8 *Tel. & Tel. Corp. v. United Tel. Co. of Fla.*, 60 F.R.D. 177, 186 (M.D. Fla. 1973) (“[T]he failure of a  
 9 party to allow pre-trial discovery of confidential matter which that party intends to introduce at trial  
 10 will preclude the introduction of that evidence.”).

11 19. Accordingly, by preventing discovery into the rationale behind the City’s decision not  
 12 to negotiate with or to seek to impair CalPERS, the City should be barred at trial from introducing  
 13 any evidence or argument concerning or reflecting the content of those deliberations and discussions.

14 WHEREFORE, National respectfully requests that this Court enter an order excluding at trial  
 15 any evidence or argument concerning the rationale or deliberations underlying the City’s decision  
 16 not to negotiate with or to seek to impair CalPERS prior to the filing of the City’s chapter 9 petition.

17 Dated: March 13, 2013

WINSTON & STRAWN LLP

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