13

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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO DIVISION

In re:	Case No. 12-32118
CITY OF STOCKTON, CALIFORNIA,	D.C. No. JD-1
Debtor.	Chapter 9
	FRANKLIN'S MOTION FOR STAY PENDING APPEAL OF CONFIRMATION ORDER
	Date: December 10, 2014 Time: 11:00 a.m. Dept: C, Courtroom 35 Judge: Hon. Christopher M. Klein

Franklin High Yield Tax-Free Income Fund and Franklin California High Yield Municipal Fund (collectively, "Franklin") hereby move for a stay pending appeal of the Court's forthcoming order confirming the *First Amended Plan For The Adjustment Of Debts Of City Of Stockton, California, As Modified (August 8, 2014)* [DN 1645] (the "Plan").[1]

I. PRELIMINARY STATEMENT

Franklin has initiated an appeal of the Court's confirmation of the Plan. By this Motion, Franklin seeks to protect its right to pursue and obtain effective relief in that appeal.

Absent a stay of confirmation, the City undoubtedly will argue that Franklin's appeal is equitably moot. Although any such argument would be without merit, the absence of a stay will subject Franklin to unnecessary litigation over the mootness issue and the small risk that its appellate rights might be foreclosed by a finding of mootness. Under the circumstances described below, that risk is sufficient to warrant a stay pending Franklin's appeal.

II. BACKGROUND

The underlying facts of this case are well known to all involved. Franklin is the beneficial owner of the 2009 Golf Course/Park Bonds. Pursuant to the Plan, Franklin has an allowed secured claim of $4,052,000 and an allowed unsecured claim of $32,551,625.93 in respect of those bonds. The Plan provides for Franklin to be paid in cash for the full amount of its secured claim and for less than 1% of its unsecured claim. The Plan does not provide for any other payments, compensation, or distributions to Franklin, now or in the future.

[1] The Court confirmed the Plan on the record at the hearing held on October 30, 2014, as to which a minute order [DN 1747] also was entered on October 30, 2014. The Court has stated its intention to enter a formal order of confirmation, but no such order has yet been lodged. Franklin has filed a notice of appeal of confirmation of the Plan and all findings, conclusions, and rulings incorporated into or made in connection with the forthcoming confirmation order, including the minute order and the findings, conclusions, and rulings set forth on the record at the hearing held on October 30, 2014. Capitalized terms not defined in this Motion have the meanings given to them in the Plan.

Franklin voted to reject the Plan and objected to its confirmation on numerous grounds, including that the Plan (a) is not "in the best interests of creditors" as required by section 943(b)(7) of the Bankruptcy Code; (b) improperly classifies, disparately treats, and unfairly discriminates against Franklin's unsecured claim, in violation of the requirements of sections 1122(a), 1123(a)(4), and 1129(b) of the Bankruptcy Code; (c) was not "proposed in good faith" pursuant to section 1129(a)(3) of the Bankruptcy Code; and (d) violates section 943(b)(3) of the Bankruptcy Code because the City has not provided information sufficient to enable the Court to conclude that "all amounts to be paid by the debtor or by any person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable."

At the hearing held on October 30, 2014, the Court overruled Franklin's objections and stated that it would enter an order confirming the Plan. Franklin filed a notice of appeal on November 12, 2014.

III. A STAY PENDING APPEAL IS WARRANTED

Rule 8005 of the Federal Rules of Bankruptcy Procedure provides that a court "may suspend or order the continuation of other proceedings in the case under the Code or make any other appropriate order during the pendency of an appeal on such terms as will protect the rights of all parties in interest." Fed. R. Bankr. P. 8005. When deciding whether to issue a stay, courts consider the same four factors that are required for the issuance of a preliminary injunction, namely: (1) the movant's likelihood of success on appeal; (2) significant and/or irreparable harm that will come to the movant absent a stay; (3) harm to the adverse party if a stay is granted; and (4) the public interest. *See, e.g.*, *In re N. Plaza, LLC*, 395 B.R. 113, 119 (S.D. Cal. 2008) (citing *Hilton v. Braunskill*, 481 U.S. 770, 776 (1987)). The Ninth Circuit employs a balancing test in weighing those four factors, such that "a stronger showing of one element may offset a weaker showing of another." *Alliance for the Wild Rockies v. Cottrell*, 632 F.3d 1127, 1131 (9th Cir. 2011).

Franklin has a compelling case for relief on the merits of its appeal. Respectfully, Franklin submits that the Court made several fundamental errors of law in concluding that the Plan satisfied

the Bankruptcy Code's confirmation requirements. Those errors will be reviewed on a *de novo* basis and are likely to lead to reversal. Because Franklin's likelihood of prevailing is high, Franklin need not demonstrate a certainty of irreparable harm in order to obtain a stay pending appeal. The delay and expense of defending against a baseless equitable mootness argument by the City, and the risk of dismissal due to mootness (albeit a small one), is sufficient.

Moreover, there is little risk of harm to the City or other parties in interest if a stay is imposed. As a chapter 9 debtor, the City has full control over its assets and affairs, and will be able to continue on with its operations as it has for the nearly two-and-one-half years it already has spent during the pendency of this bankruptcy case. Among other things, just as it has done throughout the case, the City will remain free to pay the creditors it wants to pay, to continue to fund its unfunded pensions, and to honor its collective bargaining agreements and obligations to employees. A stay will merely preserve the *status quo*, which has been quite beneficial to the City. Finally, the public interest weighs strongly in favor of a stay in light of the importance of an appellate-level decision on the significant issues of first impression raised by Franklin.

A. Franklin Has A Substantial Likelihood Of Success On The Merits

In order to show likelihood of success on the merits, an appellant seeking a stay pending appeal generally need not "demonstrate that it is more likely than not that [he or she] will win on the merits." *Leiva-Perez v. Holder*, 640 F.3d 962, 966 (9th Cir. 2011). Instead, the movant ordinarily must show only "that she has a substantial case for relief on the merits." *Id*. at 968. Where it can be shown that the movant <u>is</u> more likely than not to prevail on the merits, the movant then need only show a <u>possibility</u> of irreparable harm. *Lopez v. Heckler*, 713 F.2d 1432, 1435 (9th Cir. 1983) ("At one end of the continuum, the moving party is required to show both a probability of success on the merits and the possibility of irreparable injury. . . . At the other end of the continuum, the moving party must demonstrate that serious legal questions are raised and that the balance of hardships tips sharply in its favor."), *rev'd in part on other grounds*, 463 U.S. 1328 (1983).

Here, Franklin's appeal raises several legal questions, or mixed questions of law and fact, that will be reviewed on a *de novo* basis by the appellate court. *See, e.g.*, *United States v.*

Hinkson, 585 F.3d 1247, 1262 (9th Cir. 2009) (*en banc*) (appellate court first "determines *de novo* whether the [bankruptcy] court identified the correct legal rule to apply to the relief requested"); *In re BCE W., L.P.*, 319 F.3d 1166, 1170 (9th Cir. 2003) (applying *de novo* standard of review to bankruptcy court's conclusions of law, decisions with respect to mixed questions of law and fact, and interpretation of the Bankruptcy Code). Franklin believes that, on *de novo* review, one or more of the Court's conclusions with respect to the disputed confirmation issues are likely to be reversed.

Best Interests Test. For example, the Court erred in its interpretation of the best interests of creditors test established by section 943(b)(7) of the Bankruptcy Code. The Court found that the Plan satisfies this requirement based upon its determination that the Plan "is about the best that can be done – or is the best that can be done in terms of the restructuring and adjustments of the debts of the City of Stockton." 10/30/14 Tr. at 41:9-12.

In so holding, the Court did not identify or apply the correct legal rule for determining whether a chapter 9 plan of adjustment satisfies section 943(b)(7). As demonstrated by the cases and legislative history discussed in Franklin's briefs and at argument, the requirement that a municipal plan of adjustment be in the "best interests of creditors" goes far beyond a rudimentary conclusion that a plan is "about the best that can be done" for a majority of creditors.

Rather, the test in chapter 9 protects the interests of individual dissenting creditors, not merely the interests of creditors as a whole. *Kelley v. Everglades Drainage Dist.*, 319 U.S. 415, 418 (1943) ("[M]inorities under the various reorganization sections of the Bankruptcy Act cannot be deprived of the benefits of the statute by reason of a waiver, acquiescence or approval by the other members of the class. The applicability of that rule to proceedings under Ch. IX is plain.") (quotation omitted). The "best interests" test protects the interests of individual creditors and minorities even when they conflict with the preferences of the majority of creditors. *See, e.g.*, *Fano v. Newport Heights Irrigation Dist.*, 114 F.2d 563 (9th Cir. 1940) (reversing confirmation on the grounds that plan was not in the "best interests" of a dissenting bondholder despite the fact that 90% of bondholders had accepted the plan). The Court's conclusion that the Plan satisfies section 943(b)(7) merely because it purportedly is "the best that can be done in terms of the

restructuring" – without any analysis or consideration of the interests of Franklin and the sub-1% payment on Franklin's unsecured claim – is error as a matter of law and more likely than not to be reversed on appeal.

Moreover, the Court also erred by failing to make the necessary factual findings to support its conclusion that the Plan is in the best interests of creditors – particularly Franklin. The Court, in fact, made no findings whatsoever regarding the treatment of Franklin. The legislative history of section 943(b)(7), however, is crystal clear on this point: the bankruptcy court must "make findings as detailed as possible to support a conclusion that this test has been met." 124 Cong. Rec. H 11,100 (Sept. 28, 1978), S 17,417 (Oct. 6, 1978). *Fano* and *Kelley*, which are specifically cited in the legislative history, point to the type of factual findings that must be made, including "the revenues which have in the past been received from each source of taxation," the "probable effect on future revenues" of any impending changes to the existing tax structure, the "extent of past tax delinquencies," and "any general economic conditions" that may bear on the future delinquency rate. *Kelley*, 319 U.S. at 420-21.

The ultimate purpose of such detailed factual findings is to support the court's determination that creditors will receive under the plan "all that could reasonably be expected in all the existing circumstances," *i.e.*, that the plan constitutes a reasonable effort by the debtor to pay the claims of each creditor over time based upon its probable future revenues. *Kelley*, 319 U.S. at 420 (bankruptcy court must determine whether the plan dedicates a "fair" amount of "probable future revenues" for "satisfaction of creditors"); *see W. Coast Life Ins. Co. v. Merced Irrigation Dist.*, 114 F.2d 654, 678 (9th Cir. 1940) ("[T]he only question before this court is whether or not the 51.501 [cents] on the dollar is all that could reasonably be expected in all the existing circumstances."); *Bekins v. Lindsay-Strathmore Irrigation Dist.*, 114 F.2d 680, 685 (9th Cir. 1940) ("It seems clear to us that the 59.978 cents on the dollar of principal amount of their bonds is all that the bondholders can reasonably expect in the circumstances.").

The Court made virtually no findings to support such a conclusion, which is directly contrary to the wealth of evidence establishing that the City in fact can pay far more to Franklin on its

unsecured claim, over time from future revenues, than the sub-1% payment called for under the Plan. Indeed, there are no facts establishing that a one-cent recovery for Franklin is "all that could reasonably be expected" or that the amount of the City's probable future revenues devoted to the payment of Franklin's claim under the Plan – *i.e.*, $0 – is "fair." This is particularly true given the evidence that the City's initial "Ask" proposed future payments representing a present value recovery of more than 50% to Franklin, that the future payments to be received by all other material creditors under the Plan have a present value exceeding 50%, and that Franklin is the only material creditor in this case – or to Franklin's knowledge, any other successful chapter 9 case – to receive no meaningful recovery at all.

The Court's failure to make the necessary findings in this regard constitutes independent reversible error.

Disparate And Discriminatory Classification And Treatment. Franklin also established that the Plan's classification scheme – in which Franklin's unsecured claim was classified together with part of the claims of City retirees (health benefit claims but not pension claims) and separately from the claims of all of the City's other bondholders – had only one purpose: to enable the City to avoid the "cramdown" requirements of section 1129(b)(1) of the Bankruptcy Code. By improperly gerrymandering Franklin's unsecured claim into a class whose other members (the retirees) had committed to vote to accept the Plan due to the promise of unimpaired pensions, the Plan violates the strictures of section 1122(a) of the Bankruptcy Code. *In re Barakat*, 99 F.3d 1520, 1525 (9th Cir. 1996) (plan violates section 1122 where "the classifications are designed to manipulate class voting") (quoting *In re Holywell Corp.*, 913 F.2d 873, 880 (11th Cir. 1990)). The Court erred in concluding otherwise.

The Court also erred in disregarding the disparate treatment of Class 12 claims and creditors holding Class 12 claims. Specifically, the Court turned a blind eye to the direct linkage under the Retirees Settlement between the retirees' recovery in Class 12 and the City's agreement to leave the retirees' pensions unimpaired. While nominally providing a sub-1% recovery to all claims within Class 12, the Plan actually provides retirees with a recovery of somewhere between 53% and 70%

due to the fact that, as *quid pro quo* for the sub-1% "settlement" of Retiree Health Benefit Claims, the City agreed to pay pensions in full. As many cases cited by Franklin establish, that treatment violates section 1123(a)(4), which requires that claims and creditors in the same class receive the same treatment. The Court erred by disregarding that authority.

Finally, the Court erred by failing to consider the undeniably unfair discrimination against Franklin's unsecured claim. Had the Court properly rejected the City's gerrymandered classification and disparate treatment of Franklin's unsecured claim, it would have concluded that the sub-1% payment on that claim unfairly discriminated against Franklin in comparison to the Plan's 50%-70% payment of retiree claims and 52% to 100% payment of other City bonds, including the wholly-unsecured Pension Obligation Bonds. This legal error is likely to lead independently to reversal.

Bad Faith. The Court also erred in concluding that the Plan was proposed and prosecuted in good faith. Contrary to the Court's conclusion, the evidence established that the City acted in bad faith in imposing a punitive one-time recovery of less than 1% on Franklin's unsecured claim, apparently because Franklin did not acquiesce in the City's settlement demands like other material creditors. The City's bad faith is made apparent by its refusal to use a single dollar of restricted public facility fees – which may not be applied to other general fund liabilities – to pay Franklin's claim, despite the fact that it sold the Franklin's bonds on the premise that PFFs would be sufficient to pay all scheduled debt service, proposed to use PFFs to pay Franklin in the pre-bankruptcy neutral evaluation, and assumed in its own Long-Range Financial Plan that available PFFs would be paid to Franklin over the entire projection period. The City's bad faith also is apparent in its refusal to make – or even attempt to make – a single payment over time, from future revenues, in satisfaction of Franklin's claim, despite the fact that all other material creditors are receiving substantial payments for the next thirty or forty years and pension holders remain unimpaired.

Ignoring Franklin's arguments altogether, the Court focused on the fact that the City had reached settlements with substantially all of its other material creditors, which the Court found to be evidence of good faith. The Court also held that the Plan provided for Franklin to share in "more than 20 percent" of a contingent fund and that, because Franklin "elected" not to "take advantage" of

the "opportunity" to access that fund prior to the time of confirmation, the City's good faith had been established. 10/30/14 Tr. at 36:13-21.

This is clear, reversible error. For one thing, the fact that the City reached settlements with other material creditors is not evidence that the Plan was proposed in good faith as to Franklin. Considering the City's refusal to devote any future revenues to the satisfaction of Franklin's claim over time (just as it is paying the claims of other creditors over time), the opposite is true. For another, there simply was no "contingent fund" made available to Franklin under the Plan. At no time in any draft of the Plan did the City ever make a contingent fund available to Franklin. To the contrary, each and every draft of the Plan provided for Franklin's unsecured claim to receive a single payment of less than 1%, all while other creditors were able to benefit from future payments over time. In fact, the contingent note provided to Assured as part of the treatment afforded its Pension Obligation Bonds (apparently the "contingent fund" to which the Court referred) included a carve out, which could have been (but was not) earmarked for Franklin. The fact that the City had the ability to provide Franklin with a portion of that contingent note but chose not to is illustrative of the City's bad faith, not the converse.

Section 943(b)(3). The Court also committed legal error in concluding that the Plan complies with section 943(b)(3) of the Bankruptcy Code, which requires the Court to find that "all amounts to be paid by the debtor or by any person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable." 11 U.S.C. § 943(b)(3). Although there is limited legal authority interpreting section 943(b)(3), COLLIER confirms that its purpose is to allow "[t]he courts [to] monitor the payment of fees and the reimbursement of expenses in or in connection with a chapter 9 case to insure that the fees and expenses are reasonable, that there is no overreaching by attorneys or agents either of the debtor or of creditors, and that there is full disclosure so that those whose rights are affected directly by the plan and directly or indirectly by compensation arrangements are aware of the practice in a particular case and can determine whether the plan is being proposed for the benefit of the debtor and its creditors or is a scheme to benefit

private interests at the expense of the debtor and/or its creditors." 6 COLLIER ON BANKRUPTCY ¶ 943.03[3] (16th ed. 2013) (emphasis added).

The City failed to make the full disclosure required by section 943(b)(3). Instead, it submitted a summary "chart" with line items showing aggregate amounts paid to professionals. That is not remotely adequate to enable the Court (or Franklin) to determine whether the fees paid by the City "have been fully disclosed and are reasonable." The Court first did not apprehend that Franklin had objected on section 943(b)(3) and then, upon being reminded of the objection, compounded that error by concluding that section 943(b)(3) only applied to prospective payments to be made by the City in the future. 10/30/14 Tr. at 38:5-23; 51:16-53:22.

Franklin submits that such ruling will not stand appellate scrutiny. The Plan cannot be confirmed unless and until the City fully discloses all amounts "for services or expenses in the case or incident to the plan" – not just an aggregate amount – and the Court then determines that those amounts are "reasonable" as required by the statute. That did not happen here and there is no basis for the Court's ruling that the Plan complies with section 943(b)(3).

B. There Is A Possibility Of Irreparable Harm Absent A Stay.

"If it 'is apparent that absent a stay pending appeal . . . the appeal will be rendered moot," that circumstance is . . . 'the quintessential form of prejudice' justifying a stay." *In re Pac. Gas & Elec. Co.*, No. C-02-1550 VRW, 2002 U.S. Dist. LEXIS 27549, at *8 (N.D. Cal. Nov. 14, 2002) (quoting *In re Country Squire Associates of Carle Place, LP*, 203 B.R. 182, 183 (2d Cir. BAP 1996)); *see also Mt. Paradise Vill., Inc. v. Fannie Mae*, No. 2:13-CV-01813-GMN, 2013 U.S. Dist. LEXIS 148837, at *5 (D. Nev. Oct. 15, 2013) (crediting movant's argument that "the loss of appellate review itself is a form of irreparable injury"). To invoke the risk of dismissal for mootness as a form of irreparable injury, the party seeking a stay "must make apparent to the court the imminent danger that the issues [it] seek[s] to raise on appeal will become moot." *Pac. Gas & Elec.*, 2002 U.S. Dist. LEXIS 27549, at *8-9.

Given the City's history of scorched earth tactics, it is all but inevitable that the City will seek to dismiss Franklin's appeal on equitable mootness grounds if Franklin fails to obtain a stay,

and Franklin clearly would suffer irreparable injury if the appeal were to be dismissed before a decision on the merits. Admittedly, Franklin does not believe that its appeal can or should be dismissed. Recent authority confirms that the doctrine of "equitable mootness does not apply to challenges to a Confirmation Order in Chapter 9 proceedings" because "it is based on Chapter 11 concepts that may by inapplicable to or inappropriate for [a] Chapter 9 case." *Bennett v. Jefferson Cnty.*, Case No. 2:14-CV-0213-SLB, 2014 U.S. Dist. LEXIS 139655, at *52 (N.D. Ala. Sept. 30, 2014). Moreover, even if theoretically available in a chapter 9 case, Franklin's appeal is not equitably moot because, among other things, there are many effective and equitable remedies that an appellate court can and will craft to protect Franklin's rights. Indeed, because the City will have sufficient future resources with which it can make payments that will provide Franklin with a reasonable recovery over time even if the Plan is consummated, there can be no equitable mootness here. *See, e.g.*, *In re Dynamic Brokers, Inc.*, 293 B.R. 489, 494 (9th Cir. BAP 2003) (no equitable mootness where "future payments [under the plan] could be adjusted if" the appeal is successful).

Nonetheless, because there is at least some small possibility that an appellate court could dismiss the appeal on mootness grounds if Franklin fails to obtain a stay, under the Ninth Circuit's flexible, "sliding scale" test that possibility combined with the delay and expense of responding to the City's mootness argument (no matter how frivolous) is sufficient to satisfy the requirement of irreparable harm for purposes of a stay pending appeal.

C. Delayed Implementation Of The Plan Will Not Seriously Harm The City Or Its Other Creditors.

Any alleged harm resulting from a stay of confirmation would come only in the form of delay. Specifically, a stay of the Confirmation Order will result in a delay in the City's exit from chapter 9 and delay in implementation of the Plan.

In the typical complex chapter 11 case, delay can be synonymous with irreparable harm because the debtor is unable to implement transactions and business opportunities while in bankruptcy. Here, however, the City is a debtor under chapter 9 of the Bankruptcy Code and therefore free to conduct "business as usual," as it has done for the last two-and-one-half years. *See,*

e.g., *In re City of Stockton*, 486 B.R. 194, 199 (Bankr. E.D. Cal. 2013) (the City "can expend its property and revenues during the chapter 9 case as it wishes"). Indeed, during the bankruptcy case the City has paid all of its prepetition trade debt, honored all of its obligations to employees, continued to fund its pensions and payments to CalPERS, and settled claims and litigation in the ordinary course of business.

The only theoretical harm to the City and certain other creditors if a stay is imposed is the passage of additional time before distributions under the Plan can commence if the City chooses not to make payments earlier. Because the City proposes to make payments to those creditors over the next twenty to forty years, with minimal payments called for in the next several years, that is not serious harm, particularly when considering that the Plan provides for Franklin to receive, on account of its unsecured claim, a single payment of less than one cent on the dollar and no future payments at all. The relatively brief delay associated with a stay is nothing more than the "cost" of ensuring that confirmation of the Plan is legally appropriate.

D. The Public Interest Favors A Stay.

Finally, under the unique circumstances of this case, the public interest also would be served by a stay. It is in the interest of California municipalities, and municipal bondholders everywhere, for Franklin's appeal to be heard. The appeal raises important questions regarding the nature, extent and scope of a municipality's ability to impose an adjustment of bond debt upon a dissenting creditor in a chapter 9 proceeding, while at the same time leaving vastly-larger liabilities for unfunded pensions left untouched and unadjusted. If the Confirmation Order is allowed to stand without any review by an appellate court, those important questions will remain unanswered now and, with a mootness precedent, may never be addressed. The potential consequences of this are unpredictable, but potentially significant. It is well worth the wait of a few additional months to ensure that whatever those consequences may be, they are the result of a legally sound decision regarding confirmation of the Plan.

IV. CONCLUSION

Franklin is more likely than not to prevail on its appeal of the Confirmation Order. The City, however, no doubt will argue that Franklin's appeal should never be heard absent this Court's stay of the Confirmation Order. For that reason, and for all of the other reasons discussed above, Franklin requests that this Court issue a stay pending appeal of the Confirmation Order until such time as Franklin's appeal is adjudicated on a final basis.

Dated: November 12, 2014

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