



CITY OF STOCKTON

OFFICE OF THE CITY MANAGER

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City of Stockton AB 506 Restructuring Proposal

July 20, 2012

Members of the Community and Interested Parties:

On June 28, 2012, the City of Stockton filed for bankruptcy protection in United States Bankruptcy Court, Eastern District of California, Sacramento Division. Due to the huge investment of public funds to support this process, the City Council requested that information relating to the confidential neutral evaluation process used by the City to try and avoid bankruptcy, known as AB 506, be disclosed to the public. Chief Bankruptcy Judge Christopher M. Klein, who is overseeing this case, granted permission for limited disclosure. Today, the City filed this information with the Court. The purpose of this letter is to share this information with members of the community and other interested parties.

The Court has allowed the City to release information relating to the City's restructuring proposal, sometimes referred to as the "ASK." This was the key document in the negotiations with creditors and interested parties, along with a record of the mediation sessions. We are not permitted to release details on other communications or counteroffers from City creditors.

In addition to the City's restructuring proposal¹, a list of the mediation sessions and other relevant information such as who participated, the issues discussed, the duration of the meetings², and the results of the mediation³ have been filed in the Bankruptcy Court. The restructuring proposal is 790 pages, and contains a wealth of data and analysis on Stockton's financial situation, along with a comprehensive proposal that delineates what was requested from each creditor for the City to become a "going concern" again. This shows how seriously and thoughtfully the City approached this matter. The list of mediation sessions along with the results documents how seriously some creditors took this process.

As detailed in the restructuring proposal, the City invested a great deal of time and resources supporting the state-mandated AB 506 mediation process. The City set up a secure website accessible by the participants and provided extensive information regarding

¹ www.stocktongov.com/files/Stockton_RestructuringProposal_01_79pages.pdf
www.stocktongov.com/files/Stockton_RestructuringProposal_02_667pages.pdf
www.stocktongov.com/files/Stockton_RestructuringProposal_03_44pages.pdf
² www.stocktongov.com/files/AB506_Mediation_Sessions.pdf
³ www.stocktongov.com/files/AB506_Mediation_Outcome.pdf

the City's financial condition, including an interactive financial model and other documents to inform the process. Over 100 individuals were provided access to a secure website which contained a total of 2,816 documents. In addition, the City created a special web page on its public website for AB 506 documents that are not confidential

This work resulted in a shared understanding of the City's finances and the difficult choices this situation presents. It also provided a forum for a sharing of ideas and strategies for addressing these challenges. And, most importantly, it resulted in several agreements with labor groups that will shorten the City's time in bankruptcy and the attendant costs.

Unfortunately, even with these efforts, as we entered fiscal year 2012-13, the City was clearly insolvent. The City Council was forced to seek bankruptcy protection to enable us to continue to deliver the current modest level of services. This occurred despite vigorous efforts over the last three years to cut \$90 million in expenditures, which resulted in drastic reductions in City staffing, unprecedented compensation reductions for the remaining employees, and painful service reductions. Unfortunately, as the restructuring proposal makes clear, no amount of cutting service expenditures can achieve a sustainable balanced budget without also addressing some of the contractual obligations the City has made. These obligations consist mostly of debt payments, lifetime retiree medical premiums and certain other commitments to City employees and others, which cannot be permanently reduced outside of the AB 506 mediation process or bankruptcy without substantial litigation costs and risk. While the City was able to reach agreement with the majority of our employee organizations, we were not able to do so with respect to our largest creditors, such as bond insurers and representatives of City retirees that receive fully-paid, lifetime medical insurance premiums for the retiree plus a dependent.

In our restructuring proposal, we lay out in detail the framework and principles which shaped our ASK. Most importantly, the City must concentrate its limited resources on sustaining basic service delivery, primarily police and fire services. This includes providing a market-neutral compensation structure, so the City can retain quality employees to provide essential public services. We already have made huge reductions in compensation, more so than other governmental agencies. We simply cannot go below the average of the labor market. Significant further erosion in staffing and service levels, even to pay for past debt and other commitments, is simply inconsistent with this priority.

During the AB 506 process the City engaged in earnest and good faith mediation with all creditors willing to engage in the process. We detail in this letter the significant efforts made by the City and numerous interested parties under the direction of the Honorable Ralph Mabey, the mediator jointly selected by the City and its creditors. As mentioned above, we achieved some notable successes as a result of mediation.

Unfortunately, the outcome of mediation did not meet our financial goals. As fiscal year 2012-13 approached, the City needed to comply with state law and adopt a balanced

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budget. On June 5, 2012, after a lengthy public hearing, the Council authorized the City Manager to file a petition seeking protection under chapter 9 of the United States Bankruptcy Code only if the AB 506 process currently underway at the time did not result in agreements that both prevented insolvency for fiscal year 2012-13 and met the City Council's objective of financial sustainability. On June 26, the Council approved a "Pendency Plan" budget for fiscal year 2012-13 that closely tracked the restructuring plan, but included marginal refinements as a result of mediation discussions and new information.

Despite drastic cuts in City staff, compensation adjustments and difficult service reductions over the last three years, the City is insolvent from both a service delivery and budget perspective. The City needed to concentrate its limited resources on preserving basic services and providing for public health and safety. Therefore, a petition seeking bankruptcy protection was filed on June 28, 2012.

We are committed to continue to participate in good faith negotiations with our creditors going forward in the bankruptcy process. Additionally, the City's elected leadership and its management remain committed to getting Stockton back on its feet financially such that it will remain able to deliver essential services.

The dilemma facing Stockton is that it has already cut \$90 million from its General Fund over the past three years, and faces a formidable \$26 million deficit in the current fiscal year. The City ranks at the top in violent crime and at the bottom in police officer staffing levels among major cities in the country. It has some of the busiest fire stations in the country. Further draconian service cuts are not an option for this community.

The information released by the City on the AB 506 Process shows that we are committed to transparency and the very difficult restructuring necessary for the recovery of Stockton. As our restructuring plan makes clear, a city is not an entity whose assets can be divided up among creditors and then dissolved. This City must remain a viable entity, capable of supplying an appropriate level of public services to the community on an ongoing basis. Our actions to date respect this priority and we are committed to protecting basic services as we go forward.

Respectfully,



BOB DEIS
CITY MANAGER

c: City Council
City Attorney