

This draft disclosure statement has not been approved by the Bankruptcy Court. The distribution of this draft and of the accompanying draft plan of adjustment is not intended as, and should not be construed to be, the solicitation of a vote on such draft plan or on any other plan.

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9/27/13 DRAFT

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UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF CALIFORNIA  
SACRAMENTO DIVISION

18 In re:

19 CITY OF STOCKTON, CALIFORNIA,  
20 Debtor.

Case No. 2012-32118

D.C. No. OHS-11

Chapter 9

**DISCLOSURE STATEMENT  
WITH RESPECT TO PLAN FOR  
THE ADJUSTMENT OF DEBTS  
OF CITY OF STOCKTON,  
CALIFORNIA**

Date: November 18, 2013

Time: 1:00 p.m.

Judge: Hon. Christopher M. Klein

28

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DRAFT/City Council Review

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## SUMMARY

The following pages summarize certain important information set forth elsewhere in this Disclosure Statement. Capitalized terms are defined in the text of this Disclosure Statement and in the Plan, and any capitalized term used but not defined in the Disclosure Statement shall have the meaning ascribed to it in the Plan. Unless otherwise noted, all references to a “section” are references to a section of title 11 of the United States Code (the “**Bankruptcy Code**”).

The Disclosure Statement contains important information that is not summarized in this Summary and that may influence your decision regarding whether to accept or reject the Plan or may otherwise affect your rights. Please do not rely on this Summary standing alone, and please thoroughly read this entire document and the accompanying materials.

\* \* \* \*

The City of Stockton, California (the “**City**”), filed a petition under chapter 9 of the Bankruptcy Code on June 28, 2012 (the “**Petition Date**”), which was designated Case Number 2012-32118 (the “**Chapter 9 Case**”). The United States Bankruptcy Court for the Eastern District of California, Sacramento Division (the “**Bankruptcy Court**”), Chief Judge Christopher M. Klein presiding, entered an order for relief in the Chapter 9 Case on April 1, 2013, as docket no. 843, and the Chapter 9 Case currently is pending before the Bankruptcy Court.

The Plan For The Adjustment Of Debts Of City Of Stockton, California (the “**Plan**” proposed by the City), involves claims of approximately \$299,505,000 of publicly held securities, certain of which evidence and represent undivided fractional interests in General Fund leases of many of the City’s capital assets. Some of these assets are important or even essential to municipal operations. The Plan also addresses and resolves the City’s obligations to current and former employees and various other claims. While the Plan permits the City to continue to maintain minimally acceptable levels of vital municipal services for its residents and businesses, and while it devotes substantial resources to the repayment of the City’s creditors, it nevertheless further defers infrastructure maintenance as well as the optimal staffing of City service units such as police and fire.

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1           Importantly, while the Plan significantly impairs the interests of former employees and  
2 retirees with respect to health benefits, it does not impair the City's obligations to CalPERS in its  
3 capacity as trustee for the City's pension trust for the City's retired workers and their dependents  
4 who are the beneficiaries of this trust as well as current employees and their dependents (the City  
5 has one contract with CalPERS, but there are three contract groups: police, fire, and  
6 miscellaneous). In other words, current and future pension CalPERS payments to such persons  
7 will not be altered by the Plan. However, outside of the Plan, retirement benefits for current and  
8 future employees have been impacted by negotiated changes in the City's labor agreements.  
9 Retiree health benefits worth approximately \$1 billion for current employees have been  
10 eliminated as a result of negotiated agreements. This loss of retiree health benefits constitutes an  
11 approximate reduction in pension benefits, which along with certain compensation changes for  
12 these employees amounts to a 30-50% reduction from what they otherwise would have received.  
13 Additionally, pension benefits for new employees hired after January 1, 2013 have been reduced  
14 by approximately 50-70% (including lost retiree health benefits) for all employees and in some  
15 cases higher for certain types of employees as a result of changes in state law and changes in  
16 labor agreements that the City has negotiated. New hires are also required to pay a greater share  
17 of their future pension benefits. Additionally, because of compensation reductions of up to 30%  
18 in pensionable income negotiated in 2011 and 2012, the future pensions of employees will be  
19 lower than they otherwise would have been, though no further reduction is imposed by the Plan.

20           Payment to holders of General Unsecured Claims—which holders include, but are not  
21 limited to, institutions that are exposed to bondholders for any shortfall in the payment by the  
22 City of certain bond issuances, the Retiree Health Benefit Claimants, and the holders of Leave  
23 Buyout Claims—shall receive cash payment on the Effective Date in an amount equal to a set  
24 percentage of the Allowed amount of such Claims. The percentage of the Allowed amount paid  
25 on such claims will be the Unsecured Claim Payout Percentage (unless the amount of the Retiree  
26 Health Benefit Claims changes, that percentage will be  $\$5,100,000/\$538,000,000 = 0.94796\%$ ) or  
27 such other amount as is determined by the Bankruptcy Court before confirmation of the Plan to  
28 constitute a pro-rata payment on such other General Unsecured Claims. While the City regrets

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that it cannot pay a higher dividend to holders of General Unsecured Claims, the fact is that the City lacks the revenues to do so if it is to maintain an adequate level of municipal services such as the provision of fire and police protection, the maintenance and repair of the City's streets and other public facilities, and the continued availability of important municipal services such as library, recreation, and parks.

The Plan does not alter the obligations of those City funds that are restricted by grants, by federal law, or by California law; pursuant to the Tenth Amendment to the United States Constitution and the provisions of the Bankruptcy Code that implement the Tenth Amendment, such funds cannot be impacted in the Chapter 9 Case. Thus, securities payable solely from restricted funds are not altered by the Plan.

The following chart summarizes key information, including the proposed treatment of the various classes of claims:

<b><u>Debtor</u></b>	City of Stockton, California.
<b><u>Bankruptcy Court</u></b>	United States Bankruptcy Court for the Eastern District of California, Sacramento Division, The Honorable Chief Judge Christopher M. Klein presiding.
<b><u>Plan</u></b>	Plan for the Adjustment of Debts of City of Stockton, California.
<b><u>Purpose of the Disclosure Statement</u></b>	To provide information of a kind, and in sufficient detail, that would enable a typical holder of claims in a Class Impaired under the Plan to make an informed judgment with respect to voting on the Plan.
<b><u>Balloting Information</u></b>	Ballots have been provided with this Disclosure Statement to creditors known to have claims that are Impaired under the Plan. Ballots must be returned to and received by the Ballot Tabulator by no later than 4:30 p.m., Pacific Time, on [____], 2013. Objections to confirmation also must be filed and served by no later than [____], 2013.
<b><u>Ballot Tabulator</u></b>	Rust Consulting/Omni Bankruptcy, 5955 DeSoto Avenue, Suite 100, Woodland Hills, CA 91367.
<b><u>Confirmation Hearing and Confirmation Objections</u></b>	A hearing regarding confirmation of the Plan will be held by the Bankruptcy Court on [____], 2014, commencing at [____] a.m., Pacific Time.
<b><u>Treatment of Claims</u></b>	If the Court confirms the Plan and the Plan becomes effective, claims will be treated as follows:

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Administrative Claims

Postpetition claims meeting the definition of Administrative Claims will be paid in full, except to the extent that the holder of an Administrative Claim agrees to different treatment.

Class 1A  
Claims of Ambac –  
2003  
Fire/Police/Library  
Certificates

**Impaired.** Ambac's Claims shall receive the treatment set forth in the Ambac Settlement Agreement, which is attached as Exhibit A to the Declaration Of Robert Deis In Support Of The City Of Stockton's Motion Under Bankruptcy Rule 9019 For Approval Of Its Settlement With Ambac Assurance Corporation, filed in the Chapter 9 Case on February 26, 2013 [Dkt. No. 725].

Class 1B  
Claims of Holders of  
2003  
Fire/Police/Library  
Certificates

**Impaired.** The treatment of the Class 1B claimants, the 2003 Fire/Police/Library Certificates holders, is identical to the treatment of Ambac, the Class 1A claimant.

Class 2  
SEB Claims of the  
2006 SEB Bond  
Trustee/NPFG – 2006  
SEB Bonds

**Impaired.** The City will assume the SEB Lease Back and the SEB Lease Out under section 365(a) pursuant to the Assumption Motion. No later than 60 days after the Effective Date or 60 days after approval of the Lease Assumption Motion, whichever is later, the City will make the payments to the 2006 SEB Bond Trustee necessary to cure past defaults under the SEB Lease Back and the SEB Lease Out, if any, as well as any actual pecuniary loss suffered by the 2006 SEB Bond Trustee as a result of the City's default of the SEB Lease Back and the SEB Lease Out, if any, but, pursuant to the terms of the NPFG Settlement, the City will not pay any attorneys' fees or other professional expenses incurred by the 2006 SEB Bond Trustee. Further, the finding by the Bankruptcy Court that the Plan is feasible shall constitute adequate assurance of future performance of the SEB Lease Back and the SEB Lease Out.

Class 3  
Arena Claims of the  
2004 Arena Bond  
Trustee/NPFG – 2004  
Arena Bonds

**Impaired.** The treatment of the Class 3 Claims will be as set forth in the NPFG Settlement.

Class 4  
Parking Structure  
Claims of the 2004  
Parking Bond  
Trustee/NPFG – 2004  
Parking Bonds

**Impaired.** The treatment of the Class 4 Claims will be as set forth in the NPFG Settlement.

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Class 5  
Office Building Claims  
of the 2007 Office  
Building Bond  
Trustee/Assured  
Guaranty – 2007  
Office Building Bonds

**Impaired.** The treatment of the Class 5 Claims will be as set forth in the Assured Guaranty Settlement.

Class 6  
Pension Obligation  
Bonds Claims of  
Assured Guaranty

**Impaired.** The treatment of the Class 6 Claims will be as set forth in the Assured Guaranty Settlement.

Class 7  
Claims of DBW

**Impaired.** The General Fund will not be required to pay debt service on this obligation or to reimburse operating expenses to DBW should DBW take over operations of the Marina Project. DBW will retain its pledge of rents and leases generated from the Marina Project. However, the pledge of gross revenues will be converted to a pledge of revenues net of all reasonable and direct operating expense of the Marina Project, calculated on a fiscal year basis ending June 30 of each year. Should DBW decide to take over operations of the Marina Project, DBW will be responsible for payment of all operating expenses of the Marina Project and the City will have the right to ensure that the Marina Project is operated in a responsible and safe manner, including providing adequate security, and the City shall have the right to compel DBW to alter its manner of operations if such operations pose a threat to the public welfare or if such operations abet a public nuisance. The General Fund shall have no liability, directly or indirectly, for the Claims of DBW, and the City may decide at any time to cease subsidizing the operating deficits of the operation of the Marina Project. DBW has stated to the City an interest in exercising its remedy of taking possession of the Marina Project.

Class 8  
SCC 16 Secured  
Claims

**Impaired.** The treatment of the Class 8 Claims will be as set forth in the SCC 16 Settlement.

Class 9  
Thunder Claims

**Impaired.** The treatment of the Class 9 Claims will be as set forth in the Thunder Settlement.

Class 10  
Claims of Holders of  
Restricted Revenue  
Bond and Note Payable  
Obligations

**Unimpaired.** The City's Restricted Revenue Bond and Notes Payable Obligations are secured by a pledge of and lien on revenues of various of the City's systems and enterprises, which are restricted revenues pursuant to the California Constitution, and are "special revenues" as defined in section 902(2). These revenues are not a part of or available to the General Fund, and the General Fund is not obligated to make any payment on the Restricted Revenue Bond and Notes Payable Obligations. The

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City may transfer amounts from the restricted revenues to the General Fund only to pay costs which are incurred by the General Fund to provide facility or enterprise-related services and are allocated to the enterprises on a reasonable basis in accordance with the City's accounting and allocation policies. Such transfers are treated by the facility or enterprise as operation and maintenance expenses. The City will continue to apply restricted revenues to pay the Restricted Revenue Bond and Notes Payable Obligations as required by the terms of such obligations.

Class 11  
Claims of Holders of  
Special Assessment  
and Special Tax  
Obligations

**Unimpaired.** The City's special assessment and special tax obligations are secured by certain special assessments and special taxes levied on specific real property within the respective districts for which these obligations were issued. These special assessment and special tax revenues are legally restricted to the payment of debt service on the special assessment and special tax obligations under California statutes and the California Constitution, are "special revenues" as defined in section 902(2), and cannot be used for any other purpose or be transferred to the General Fund. The General Fund is not obligated to pay debt service on the special assessment and special tax obligations. The City will continue to apply revenues from the applicable special assessments and special taxes to pay the special assessment and special tax obligations as required by the terms of such obligations.

Class 12  
General Unsecured  
Claims

**Impaired.** The major claims in this Class include without limitation: (1) the Retiree Health Benefit Claims; (2) the **Claims of Dexia under the Office Building Standby Agreement;** (3) the Golf Course/Park Claims of the 2009 Golf Course/Park Bond Trustee/Franklin; (4) the Leave Buyout Claims; (5) the Price Claims; and (6) Other Postpetition Claims.

The Retiree Health Benefit Claims are held by approximately 1,100 of the City's former employees plus their dependents. The Retirees Committee maintains that the aggregate amount of the Retiree Health Benefit Claims is approximately \$538,000,000 (this does not include the retiree health benefit claims of employees employed as of July 1, 2012, who waived their claims of approximately \$1 billion of previously earned benefits for no additional compensation, as part of memorandums of understanding negotiated in 2012). Pursuant to the Retirees Settlement, on the Effective Date, the City will pay the Retirees an aggregate amount of \$5,100,000 in full satisfaction of Allowed Retiree Health Benefit Claims, and no other retiree health benefits will be provided by the City. If required by state or federal law, the City will withhold from the aggregate \$5,100,000 payment any taxes or other deductions to be withheld from the individual payment to each Retiree Health Benefit Claimant. The individual recipient is responsible for any tax liability for this payment, and the City will not provide any advice to any recipient as to the taxable impact of this payment.

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All other General Unsecured Claims shall receive cash payment on the Effective Date in the amount equal to a percentage of the Allowed Amount of such Claims, which such percentage equals the Unsecured Claim Payout Percentage (unless the amount of the Retiree Health Benefit Claims changes, that percentage will be  $\$5,100,000/\$538,000,000 = 0.94796\%$ ), or such other amount as is determined by the Bankruptcy Court before confirmation of this Plan to constitute a pro-rata payment on such other General Unsecured Claims; *provided, however*, that the dollar amount to be paid shall not exceed in the aggregate \$[ ]; and *provided further*, if such amount is in excess of \$[ ], the City retains the right to and intends to modify this Plan to provide alternative treatment to such General Unsecured Claims, which alternative treatment may involve payment over a number of years on account of such General Unsecured Claims.

Class 13  
Convenience Class  
Claims

**Impaired.** Holders of Convenience Class Claims will receive cash on the Effective Date in the amount of their Allowed Convenience Class Claim, but not to exceed \$100.

Class 14  
Claims of Certain Tort  
Claimants

**Impaired.** The SIR Claim Portion of each Allowed General Liability Claim will be paid on the Effective Date from the Risk Management Internal Service Fund, and will receive the same percentage payment on the dollar of Allowed Claim as will the holders of Allowed Class 12 Claims. The Insured Portion of each Allowed General Liability Claim is not Impaired, and shall be paid by the applicable excess risk-sharing pool.

Class 15  
Claims of CalPERS  
with Respect to the  
CalPERS Pension Plan,  
as Trustee under the  
CalPERS Pension Plan  
for the Benefit of  
CalPERS Pension Plan  
Participants

**Unimpaired.** The City will continue to honor its obligations to fund employee retirement benefits under the CalPERS Pension Plan, and CalPERS as trustee and the CalPERS Pension Plan Participants retain all of their rights and remedies under applicable nonbankruptcy law. Thus, CalPERS and the CalPERS Pension Plan Participants will be entitled to the same rights and benefits to which they are currently entitled under the CalPERS Pension Plan (as a result of negotiated labor contracts that changed certain pension provisions, as well as changes in state law, pension benefits for new hires effective January 2013 have been reduced by 50-70% (including loss of retiree health benefits) and in some cases higher for some types of new hires; new hires are also required to pay a greater share of their future pensions; additionally, while the loss of retiree health benefits and the loss of "pension spiking" will reduce the postemployment retirement benefits of current employees 30-50%; and lastly, employee compensation reductions that occurred in 2011 and 2012, which ranged up to 30% in pensionable compensation in some cases, will further reduce their future pension benefit that they otherwise would have received; these concessions are unaffected by the Plan). CalPERS, pursuant to the CalPERS Pension Plan, will continue to be made available to provide pension benefits for participants in the manner indicated under the provisions of the CalPERS Pension Plan and remedies under applicable nonbankruptcy



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law.

**Class 16**  
**Claims of Equipment**  
**Lessors**

**Unimpaired.** Any equipment leases not specifically rejected by the Rejection Motion will be assumed under this Plan. The City believes that it is current on all such equipment leases and therefore no cure payments are required.

**Class 17**  
**Workers Compensation**  
**Claims**

**Unimpaired.** The City must pay Allowed SIR Claim Portions related to Workers Compensation Claims in full. If not, the City will lose its State workers compensation insurance for those claims in excess of the SIR Claim Portions, exposing the City's current and former workers to grave risk. The City will pay the SIR Claim Portions related to Worker Compensation Claims from the Workers' Compensation Internal Service Fund.

**Class 18**  
**SPOA Claims**

**Impaired.** The City will honor the SPOA Claims held by SPOA members on the terms and conditions set forth in the SPOA MOU, which in general provides each SPOA member with 44 hours of additional paid leave time through fiscal year 2014-15.

**Questions:**

Questions can be submitted electronically on the City's chapter 9 website (stocktonchapter9.com) or by calling 866-205-3144 and leaving a message. All questions will receive a prompt response.

To the extent that there is any inconsistency between the Plan (including the exhibits and any supplements to the Plan) and the description in the Disclosure Statement, the terms of the Plan (including the exhibits to the Plan) will govern.

**I. INTRODUCTION**

The City of Stockton, California, filed this Chapter 9 Case on June 28, 2012, less than a week prior to the beginning of its 2012-13 fiscal year. As a result of prior poor fiscal management by the City, overspending on downtown improvement construction projects, the general economic turndown that began in 2008, the resulting decline in real estate transactions and values, high unemployment rates, and generally lower collections of tax revenues and user fees, the City had virtually no General Fund reserves as of the Petition Date. It had slashed its General Fund workforce by an aggregate of 30% during the preceding three years: sworn police officers were cut by 25%, non-sworn police staffing by 20%, fire staffing by 30%, and non-safety staffing by 43%. It had also reduced compensation by \$52 million and cut staffing and service

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1 levels by \$38 million, for an overall General Fund budget reduction of approximately \$90 million  
2 during fiscal years 2009-10, 2010-11, and 2012-13.

3 The City reduced or ceased funding of community-based organizations, stopped replacing  
4 outworn vehicles (including police cars), was sending mechanics in separate vehicles to follow  
5 fire engines on emergency calls, and was patching rather than repairing its streets. The City also  
6 reduced compensation for all employees from 2008 through 2012. Employee compensation  
7 reductions varied, but averaged 10% to 33%, of which 7% to 30% was in pensionable income  
8 reductions that would impact future pensions as well as current income. Changes in overtime  
9 calculation, health, and other insurance benefits and leave time also occurred. The reduction in  
10 compensation resulted in litigation against the City by labor organizations, and labor relations  
11 were at an all-time low.

12 Despite having taken these desperate measures, as of June 2012 the City's General Fund  
13 budget for the impending fiscal year was still \$25.9 million underwater.<sup>1</sup> The negative budget  
14 meant that the General Fund was prohibited from borrowing from the City's restricted funds and  
15 that the City therefore could not pay the first payroll of the fiscal year, which was due in July  
16 2012. The City was instead forced to enact its Pendency Plan budget, which enabled it to meet  
17 payroll and debt obligations during the Chapter 9 Case.

18 The City entered bankruptcy only after unsuccessful mediation with its major creditors,  
19 although the mediation did produce agreements with the City's labor organizations. The  
20 Chapter 9 Case was contentious from the outset, with the so-called capital markets creditors  
21 contending that the City was ineligible for bankruptcy relief. Their objections were overruled by  
22 the Bankruptcy Court, but only after many months of costly discovery, briefing, legal  
23 maneuvering, and ultimately a trial on the City's eligibility to be a chapter 9 debtor. But prior to  
24 filing the Chapter 9 Case, during the case, and even during the litigation phase, the City and its  
25 creditors were engaging in mediation under the auspices of a court-appointed mediator—a United  
26 States Bankruptcy Judge from Oregon. The mediation is ongoing and has resulted in several

27 \_\_\_\_\_  
28 <sup>1</sup> See City of Stockton Annual Budget, 2012-13, p. D-1, available at [http://www.stocktongov.com/files/COS\\_2012\\_2013\\_ProposedAnnualBudget\\_2012\\_5\\_15.pdf](http://www.stocktongov.com/files/COS_2012_2013_ProposedAnnualBudget_2012_5_15.pdf).

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1 settlements, the key one relating to retiree health benefits that was negotiated with the Retirees  
2 Committee that represents the interests of the retirees. The City has reached settlement  
3 agreements with Ambac, NPMG, and Assured Guaranty [if and when finalized], but has not  
4 reached agreement with Franklin, the holder of approximately \$35,080,000 of bond debt.

5 The Plan, a copy of which is attached hereto as **Exhibit A**, represents the City's proposed  
6 adjustment of its debts. The Plan is a spartan one. It returns the City to financial and public  
7 service provider solvency, but, in the absence of agreements with City creditors whose  
8 obligations are secured by leases of City real estate, the Plan includes the potential loss of City  
9 control of certain City properties.

10 Unsecured creditors, including retiree health benefit claimants, will be paid a percentage  
11 of their claims equal to the Unsecured Claim Payout Percentage (unless the amount of the Retiree  
12 Health Benefit Claims changes, that percentage will be  $\$5,100,000/\$538,000,000 = 0.94796\%$ ) or  
13 such other amount as is determined by the Bankruptcy Court before confirmation of the Plan to  
14 constitute a pro-rata payment on such other general unsecured claims. That is all the City can  
15 afford to pay and still maintain even a bare minimum level of City services. In fact, the  
16 constituencies that will bear the greatest burden as a result of the City's inability to meet its  
17 financing obligations are its current employees, and its retirees who collectively hold  
18 approximately \$538 million in claims against the City, but who have agreed, after months of  
19 negotiations, to accept \$5.1 million in satisfaction of those claims. Retirees who are receiving a  
20 CalPERS pension but no health benefits from the City will not be affected by the Plan. Retirees  
21 who are receiving a CalPERS pension plus health benefits will have their health benefits  
22 eliminated.

23 Current employees of the City have also agreed to forgo health benefits in retirement,  
24 which along with changes in compensation results in the loss of their retirement "spike" and  
25 reduces their postemployment benefits by 30-50%. The loss of retiree health benefits is a  
26 substantial concession of approximately \$1 billion that has already been agreed to without  
27 compensation for this loss. In addition, most current employees hired before January 1, 2013  
28

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1 have also agreed to a 7-30% reduction in pensionable compensation, which will reduce their  
2 future CalPERS pension from what it otherwise would have been.

3 The Plan will enable the City to pay its future bills, including the reduced compensation  
4 payable to its employees, and including its obligations to CalPERS, which will fund pension  
5 contributions for its current and former employees. The maintenance of pensions is critical to the  
6 City in order to retain employees—particularly police officers—rather than losing them to other  
7 local governments, all of which have defined benefit pension plans, and the overwhelming  
8 majority of which have pension plans administered by CalPERS.

9 The Plan is premised on the passage on November 5, 2013, of Measure A, which will  
10 impose a 3/4 cent sales tax increase. Should Measure A fail, the projections attached to this  
11 Disclosure Statement, upon which the Plan is premised, will not be achievable. Not only will the  
12 City be unable to fund the Plan, but it will be unable to pay its current operating costs. The result  
13 will be further and significant staff and service reductions, reaching across virtually all City  
14 departments.

15 Unlike a corporate chapter 11 debtor, a city in chapter 9 simply cannot afford to fail. It  
16 must continue to provide police and fire protection to its residents, to maintain streets and  
17 highways, to treat its employees and retirees fairly, and generally to create an environment in  
18 which its residents can prosper. Unlike a corporation, its assets cannot be liquidated or sold to a  
19 competitor in order to satisfy its debts. The City believes that the financial restructuring set forth  
20 in its Plan is its current best option for achieving such goals. It will continue to negotiate with its  
21 creditors in an attempt to achieve settlements that provide better returns for creditors and better  
22 economics for the City. If any additional agreements are reached, the Plan and Disclosure  
23 Statement will be modified to reflect those agreements.

24 As described more fully herein, the City believes that the Plan provides the greatest and  
25 earliest possible recoveries to holders of claims while preserving necessary City services and  
26 operations. The City thus believes that acceptance of the Plan is in the best interests of creditors  
27 and parties in interest, as well as in the best interests of the City's residents and businesses, and  
28 that any alternative debt adjustment or restructuring would result in additional delay, uncertainty,

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expense, litigation, and, ultimately, smaller or no distributions to creditors. Accordingly, **the City urges that you cast your ballot in favor of the Plan.**

**A. The Purpose of This Disclosure Statement.**

The Bankruptcy Code requires that the proponent of a plan of adjustment in a chapter 9 case prepare and file a “disclosure statement” that provides information of a kind, and in sufficient detail, that would enable a typical holder of claims in a class Impaired under that plan to make an informed judgment with respect to the plan. *See* 11 U.S.C. § 1125. This Disclosure Statement provides such information. ***Creditors and parties in interest should read this Disclosure Statement, the Plan, and all of the exhibits accompanying these documents in their entirety in order to ascertain:***

1. How the Plan will affect their claims against the City;
2. Their rights with respect to voting for or against the Plan;
3. Their rights with respect to objecting to confirmation of the Plan; and
4. How and when to cast a ballot with respect to the Plan.

This Disclosure Statement, however, cannot and does not provide creditors with legal or other advice or inform such parties of all aspects of their rights. Claimants are advised to consult with their attorneys and/or financial advisors to obtain more specific advice regarding how the Plan will affect them and regarding their best course of action with respect to the Plan. As noted below, retirees are advised to consult with the Retirees Committee, which was appointed in April 2013 by the Office of the United States Trustee to represent the interests of the City’s approximately 2,400 retirees in the Chapter 9 Case.

This Disclosure Statement has been prepared in good faith and in compliance with applicable provisions of the Bankruptcy Code. Based upon information currently available, the City believes that the information contained in this Disclosure Statement is correct as of the date of its filing. This Disclosure Statement, however, does not and will not reflect some events that occur after October [\_\_\_], 2013 (and, where indicated, specified earlier dates), and the City assumes no duty and presently does not intend to prepare or distribute any amendments or supplements to reflect such events.

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**B. Summary of Entities Entitled to Vote on the Plan and of Certain Requirements Necessary for Confirmation of the Plan.**

Holders of Allowed Claims in the following Classes are entitled to vote on the Plan because the Claims in each such Class are “impaired” under the Plan within the meaning of section 1124: 1A, 1B, 2, 3, 4, 5, 6, 7, 8, 9, 12, 13, 14, and 18.

The Bankruptcy Court may confirm the Plan only if at least one Class of Impaired Claims has voted to accept the Plan (without counting the votes of any insiders whose claims are classified within that Class) and if certain statutory requirements are met as to both nonconsenting members within a consenting Class and as to any dissenting Classes. A Class of claims has accepted the Plan only when at least more than one-half in number **and** at least two-thirds in amount of the Allowed Claims actually voting in that Class vote in favor of the Plan.

In the event of a rejection of the Plan by any of the voting Classes, the City will request that the Bankruptcy Court confirm the Plan in accordance with those portions of section 1129(b) that are applicable to the Chapter 9 Case, which provisions permit confirmation by a process known as “cram down” notwithstanding such rejection if the Bankruptcy Court finds, among other things, that the Plan “does not discriminate unfairly” and is “fair and equitable” with respect to each rejecting Class. Other sections of this Disclosure Statement provide a more detailed description of the requirements for acceptance and confirmation of the Plan.

**C. Voting Procedures, Balloting Deadline, Confirmation Hearing, and Other Important Dates, Deadlines, and Procedures.**

**1. Voting Procedures and Deadlines.**

The City has provided copies of this Disclosure Statement and ballots to all known holders of Impaired Claims in the voting Classes. Those holders of an Allowed Claim in each of the voting Classes who seek to vote to accept or reject the Plan **must** complete a ballot and return it to the Court-appointed ballot tabulator, Rust Consulting/Omni Bankruptcy, 5955 DeSoto Avenue, Suite 100, Woodland Hills, CA 91367 (the “**Ballot Tabulator**”)—so that their ballots actually are received by no later than the Balloting Deadline (as defined in the following

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paragraph), and must be returned directly to the Ballot Tabulator, **not** to the Bankruptcy Court.

Note that Ballots do not constitute proofs of claim.

*All ballots, including ballots transmitted by facsimile, must be completed, signed, returned to, and actually received by the Ballot Tabulator by not later than [\_\_\_\_], 2013, at 4:30 p.m. Pacific Time (the “Balloting Deadline”). Neither Ballots received after the Balloting Deadline, nor ballots returned directly to the Bankruptcy Court rather than to the Ballot Tabulator, shall be counted in connection with confirmation of the Plan.*

**2. Date of the Confirmation Hearing and Deadlines for Objection to Confirmation of the Plan.**

The hearing to determine whether the Bankruptcy Court will confirm the Plan (the “Confirmation Hearing”) will commence on [\_\_\_\_], 2014, at [\_\_] a.m. Pacific Time in the Courtroom of the Honorable Christopher M. Klein, Chief United States Bankruptcy Judge for the Eastern District of California, in his Courtroom on the 6th floor of the United States Courthouse, 501 I Street, Sacramento, CA 95814. The Confirmation Hearing may be continued from time to time, including by announcement in open court, without further notice.

Any objections to confirmation of the Plan must be filed with the Bankruptcy Court and served on the following entities so as to be **actually received** by no later than [\_\_\_\_] 2014: (a) John M. Luebberke, City Attorney’s Office, 425 N. El Dorado Street, 2nd Floor, Stockton, CA 95202; (b) Marc A. Levinson, Orrick, Herrington & Sutcliffe LLP, 400 Capitol Mall, Suite 3000, Sacramento, CA 95814-4497 (counsel to the City); (c) Steven H. Felderstein, Felderstein, Fitzgerald, Willoughby & Pascuzzi LLP, 400 Capitol Mall, Suite 1750, Sacramento, CA 95814 (counsel to the Retirees Committee); (d) Debra A. Dandeneau, Weil, Gotshal & Manges LLP, 767 Fifth Avenue, New York, NY 10153 (counsel to NPMF); and (e) Jeffrey E. Bjork, Sidley Austin LLP, 555 West Fifth Street, Los Angeles, CA 90013 (counsel to Assured Guaranty). Objections that are not timely filed and served may not be considered by the Bankruptcy Court. *Please refer to the accompanying notice of the Confirmation Hearing for specific requirements regarding the form and nature of objections to confirmation of the Plan.*

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**D. Important Notices and Cautionary Statements.**

The historical financial data relied upon in preparing the Plan and this Disclosure Statement is based upon the City's books and records. Although certain professional advisors of the City assisted in the preparation of this Disclosure Statement, in doing so such professionals relied upon factual information and assumptions regarding financial, business, and accounting data provided by the City and third parties, much of which has not been audited. The City's most recent audited financial statement (i.e., its Comprehensive Annual Financial Report, or CAFR), which covers the fiscal year ended June 30, 2011, is 282 pages in length, and is not attached hereto. However, it is available on the City's website or upon written request.<sup>2</sup>

*The City's professional advisors have not independently verified the financial information provided in this Disclosure Statement, and, accordingly, make no representations or warranties as to its accuracy.* Moreover, although reasonable efforts have been made to provide accurate information, the City does not warrant or represent that the information in this Disclosure Statement, including any and all financial information and projections, is without inaccuracy or omissions, or that actual values or distributions will comport with the estimates set forth herein.

*No entity may rely upon the Plan or this Disclosure Statement or any of the accompanying exhibits for any purpose other than to determine whether to vote in favor of or against the Plan.* Nothing contained in such documents constitutes an admission of any fact or liability by any party, and no such information will be admissible in any proceeding involving the City or any other party, nor will this Disclosure Statement be deemed evidence of the tax or other legal effects of the Plan on holders of claims in the Chapter 9 Case. This Disclosure Statement is not intended to be a disclosure communication to the public capital markets and should not be

<sup>2</sup> To locate the CAFR go to [http://www.stocktongov.com/files/2011\\_CAFR.pdf](http://www.stocktongov.com/files/2011_CAFR.pdf). Alternatively, from the City's website, <http://www.stocktongov.com>: (1) click "Administrative Services"; (2) then click "Financial Reporting"; (3) then click "Financial Reports"; and (4) then click "CAFR 2011". A printed copy will be mailed to you upon your request mailed to the following address: [City of Stockton, Attn: \_\_\_\_ or Rust Consulting/Omni Bankruptcy]. More current unaudited financial statements for the City are available on the Electronic Municipal Market Access website maintained by the Municipal Securities Rulemaking Board, available at: <http://emma.msrb.org>.



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relied upon by investors as such in determining whether to buy, hold, or sell any securities of the City or related entities.

Certain information included in this Disclosure Statement and its exhibits contains forward-looking statements. The words “believe,” “expect,” “anticipate,” and similar expressions identify such forward-looking statements. The forward-looking statements are based upon information available when such statements are made and are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the statements. A number of those risks and uncertainties are described below. Readers therefore are cautioned not to place undue reliance on the forward-looking statements in this Disclosure Statement. The City undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise.

Neither the Securities and Exchange Commission nor any other regulatory agency has approved or disapproved this Disclosure Statement. Nor has any such agency determined whether this Disclosure Statement is accurate, truthful, or complete.

**E. Additional Information.**

If you have any questions about the procedures for voting on the Plan, desire another copy of a ballot, or seek further information about the timing and deadlines with respect to confirmation of the Plan, please write to Rust Consulting/Omni Bankruptcy as follows: Rust Consulting/Omni Bankruptcy, 5955 DeSoto Avenue, Suite 100, Woodland Hills, CA 91367 (facsimile: 818-783-2737), or write to counsel for the City as follows: Marc A. Levinson, Orrick, Herrington & Sutcliffe LLP, 400 Capitol Mall, Suite 3000, Sacramento, CA 95814-4497 (facsimile: 916-329-4900, email malevinson@orrick.com). Please note that counsel for the City cannot and will not provide creditors with any legal advice, including advice regarding how to vote on the Plan or the effect that confirmation of the Plan will have upon claims against the City. For additional information, City retirees should contact the Retirees Committee. The primary contact for the Retirees Committee is its chairperson, Dwane Milnes, 209-467-0224, dwane.milnes@sbcglobal.net. The secondary contact for the Retirees Committee is Retirees Committee member Gary Ingraham, 209-403-0076, gcingraham@comcast.net.

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## **II. BACKGROUND INFORMATION**

### **A. The City.**

The City is a municipal corporation and charter city formed and organized under its charter and the California Constitution. Its governing body is a seven-member City Council (including the position of Mayor, who is elected by popular vote rather than appointed by the City Council). The City encompasses approximately 65 square miles in northern San Joaquin County. Approximately 300,000 people reside within the City.

### **B. The City's Financial Problems.**

Over the past several years, the City has struggled with massive budget deficits. These deficits have been the result of a combination of plummeting revenues and increasing costs. In the wake of the Great Recession, housing prices plunged while unemployment skyrocketed, which led to substantial declines in the City's property tax and sales tax revenues. Stockton has been among the top-ranked American cities in terms of foreclosures and declines in home prices for the past several years. The median home price has dropped from \$397,000 in 2006 to \$109,000 as of 2012, a decline of 72%. This collapse in property values and the flood of foreclosures reduced the City's gross property tax collections by roughly 29%, from \$61.1 million in fiscal year 2007-08 to \$43.6 million in fiscal year 2012-13. Because of California tax laws under Proposition 13, also known as the Jarvis-Gann Amendment, changes in ownership that occurred at the bottom of the market due to foreclosures and short sales will suppress property values for many years into the future. Adverse economic conditions also caused a drop in the City's income from assessments and development fees.

As the economy suffered, so too did the City's residents, as the City saw its unemployment rate rise steadily from 2007, peaking in early 2011 at 22%. The unemployment rate within the City was 15.5% as of July 2013, and the unemployment rate for the Stockton Metropolitan Area (including San Joaquin County) ranks ninth worst among 372 metropolitan areas nationwide at 12.8%, compared to the national unemployment rate of 7.7%. Partially as a result of the City's employment troubles, the City's sales tax revenues also plummeted, from a peak of \$47.0 million in fiscal year 2005-06 to \$32.7 million in 2009-10 (a drop of roughly 30%).

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1 In addition, the fiscal crisis had an impact on public safety. As Judge Klein recounted,  
2 “[i]n 2010, Stockton’s violent crime rate bucked a nationwide drop and rose to rank it 10th  
3 nationally, with 13.81 violent crimes per 1,000 residents. Homicides were at an all-time record.”  
4 *In re City of Stockton, California*, 493 B.R. 772, 780 (Bankr. E.D. Cal. 2013). Yet, while  
5 homicides increased from 28 in 2008 to 71 in 2012, budget reductions carved away the Stockton  
6 Police Department: 99 police officers, 50 civilian positions, 40 part-time positions, and the  
7 narcotics unit have been eliminated since 2009.<sup>3</sup> In response, in 2012 the City began the planning  
8 process for the “Marshall Plan.” Named after the original Marshall Plan that guided Europe’s  
9 economic recovery after World War II, the City’s Marshall Plan aims to reduce homicides and  
10 gun violence in the City. One of the Marshall Plan’s recommendations is to increase the Stockton  
11 Police Department staffing ratio of sworn officers to population, which is well below the average  
12 for cities of its size.<sup>4</sup> However, implementation of the Marshall Plan, including the hiring of  
13 additional police officers, will require new funding.

14 While the City’s revenues have been dwindling, its expenses have either remained  
15 constant or increased as a result of the City’s population boom. Between 2000 and 2007, the  
16 City’s population grew from roughly 243,000 to 285,000, an increase of around 17%. Since  
17 2007, there has been a more moderate increase to approximately 300,000 today. Not only did the  
18 additional number of residents put an increased demand on existing City services during that  
19 period, but the City also took on substantial financial obligations to expand infrastructure and  
20 essential public services. Moreover, as discussed above, the City is also subject to significant  
21 ongoing obligations in the form of pensions, health care, compensation, and other benefits for its  
22 current and former employees.

23 A large part of the City’s current economic difficulties are the result of imprudent fiscal  
24 decisions and poor accounting practices during better economic times. When the City was flush  
25 with cash, it made financial decisions and commitments based on the assumption that its

26 \_\_\_\_\_  
27 <sup>3</sup> David M. Bennett and Donna D. Lattin, *The Marshall Plan: Violence Reduction Strategy, Stockton, California*,  
28 March 7, 2013, submitted to Stockton City Council, at 50, available at [http://www.stocktongov.com/files/CouncilAgenda\\_2013\\_4\\_02\\_item\\_15\\_01\\_MarshallPlan.pdf](http://www.stocktongov.com/files/CouncilAgenda_2013_4_02_item_15_01_MarshallPlan.pdf).

<sup>4</sup> *Id.* at 53-54.

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economic growth would continue indefinitely. These commitments included unsustainable labor costs, retiree health benefits, and public debt. Past inadequate accounting practices also obscured the severity of the City's impending financial difficulties and in some cases resulted in additional unrecognized liabilities to the City's General Fund. As a result, when the Great Recession hit, the City found its financial obligations quickly outpacing its revenues. Compounding these economic challenges, the City—like all California cities—is limited by law in its ability to generate new revenues. Under California law, the City was unable to increase tax revenues without voter approval. As described herein, by placing a 3/4 cent sales tax measure on the November 5, 2013 ballot, the City is attempting to generate necessary revenues that will enable it to both continue to provide services to its residents and to fund its obligations to its employees and creditors.

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

The City's employee and retiree pensions are managed through the California Public Employees' Retirement System ("**CalPERS**"). The City's General Fund CalPERS obligation for the funding of retirement benefits for its employees in fiscal year 2012-13 was \$14.2 million (9.3% of total General Fund expenditures), and it has forecast its pension obligations from fiscal year 2012-13 through fiscal year 2020-21 (including the impact of additional staffing under the Marshall Plan for improved public safety services) to be approximately \$273.7 million (15.6% of total General Fund expenditures).<sup>5</sup> A CalPERS defined benefit pension is the industry standard for city employees throughout California. Over 97% of California cities contract with CalPERS for pension benefits, and more than 99% of California city employees are covered by CalPERS or a similar defined benefit plan. Additionally, all county employees in California receive a defined benefit plan from CalPERS or another similar system, and all state employees receive a CalPERS pension. Moreover, of the 26 new cities created in California since 1990, almost all have contracted with CalPERS (92%) or a similar plan. When it comes to public employee pensions in California, CalPERS is the primary, and often only, option. This has provided a consistent pension benefit package available to persons employed in public-sector jobs.

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

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As a result, the City has no ready, feasible, and cost-effective alternative to the CalPERS system. Nor can the City reduce its CalPERS obligations without serious consequences. City leadership believes that rejecting its CalPERS contract would impose a significant reduction in the City's pension benefits to current retirees—by approximately two-thirds, according to CalPERS. This would result in many retirees receiving benefits below the poverty level. Meanwhile, current employees would likely lose approximately two-thirds of their current-to-date earned benefit. Moreover, such pension cuts would be in addition to the elimination of retiree health benefits that the City has already imposed: the City has completely eliminated retiree health benefits for those approximately 1,100 retirees who were receiving retiree health benefits. The elimination of City-paid health benefits for current retirees and their dependents on average amounted to 30% of their total postemployment benefits (the loss of City-paid health benefits given up by current employees will reduce their future total postemployment benefits 28-41%).

The City's recent labor agreements also made substantial cuts to compensation and benefit packages for current employees, including eliminating their future retirement health coverage (worth approximately \$26,000 per employee per year), requiring current employees to pay 100% of the employee share of their CalPERS contribution (7-9% of salary), and imposing compensation reductions that varied, but averaged 10% to 33%, of which 7% to 30% was in pensionable income reductions that would impact future pensions as well as current income.

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

In light of the severe cuts that City employees and retirees already have experienced, the City believes that any significant reduction in pension benefits would almost certainly lead to a mass exodus of City employees, as well as leaving the City hampered in its future recruitment of

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new employees—especially experienced police officers—on account of the noncompetitive compensation package it would be offering new hires. Moreover, due to recent changes in California law, the exodus of City employees would be massive and sudden. In order to preserve their pension benefit levels under new state law, Stockton employees would need to leave the City’s employ and obtain employment with another public agency with CalPERS benefits within six months of the rejection of the City’s CalPERS contract. Such a sudden loss of trained and experienced staff would be catastrophic and would seriously jeopardize the City’s ability to provide even the most basic of essential public protections.

The City is unwilling to reduce or eliminate pensions and, in effect, roll the dice to see if employees flee. In addition to critically impairing the City’s ability to recruit new employees, were the City to reject its CalPERS contract, California state law provides that such rejection would also trigger a termination penalty, which CalPERS calculates at \$946 million. Even then, the City would still have to fund and operate an alternate pension plan providing market-level benefits in order to remain a competitive employer. The City believes that even if it could locate or establish such a plan, it could not do so at a cost materially lower than the cost of remaining in the CalPERS plan. Additionally, because the City has not participated in the federal Social Security program since 1978, City employees receive no federal pension benefits from that source, and their CalPERS pension is the only “retirement” provided by the City. The City thus cannot unilaterally abandon the CalPERS system without incurring additional obligations and seriously jeopardizing its ability to recruit qualified employees. The current CalPERS benefits are 85-90% funded according to CalPERS and can be contrasted to the City’s retiree health program, which was 0% funded.

**D. The City’s Attempts to Avoid Insolvency.**

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

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

Despite these heroic efforts, however, the City continued to project annual deficits in the tens of millions of dollars. Revenues remained low, and labor costs, though markedly reduced, were still higher than the City could afford to pay, and were expected to increase. And after four consecutive years of reducing employee staffing, the City could not continue to make additional service reductions without jeopardizing the health, safety, and welfare of its residents. As a result, the City was forced to take further radical steps to balance its budget for fiscal year 2011-12, which included sweeping its remaining available unrestricted funds into its General Fund, suspending some payments to separating employees, and electing not to pay over \$2 million in debt service owed between March 2012 and June 2012. These measures were necessary for the City to maintain sufficient liquidity to continue to operate through June 30, 2012 (the end of fiscal year 2011-12). Even with such measures, however, as of the June 28, 2012, filing of its bankruptcy petition, the City effectively had no remaining reserves, and was facing a projected budget shortfall of almost \$26 million in fiscal year 2012-13.

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

Pursuant to Assembly Bill 506 ("**AB 506**"), codified at California Government Code section 53760 *et seq.*, the City participated in a "neutral evaluation process" with most of its largest creditors prior to seeking bankruptcy relief. These negotiations occurred over a three-month span, from March 27, 2012 through June 25, 2012, and were conducted under the auspices

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

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of the Honorable Ralph Mabey, a former bankruptcy judge and highly accomplished bankruptcy lawyer and mediator. Judge Mabey was selected jointly by the City and its creditors.

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

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

### **III. ADMINISTRATION OF THE CHAPTER 9 CASE**

#### **A. Pendency Plans.**

On June 26, 2012, the City Council adopted a “Pendency Plan” budget based on the assumption that it would file its chapter 9 petition prior to the start of the 2012-13 fiscal year less than a week later. The Pendency Plan provided for balanced General Fund expenditures in fiscal year 2012-13, but only by unilaterally modifying the City’s financial obligations in ways that, outside of bankruptcy, would otherwise violate the City’s contractual obligations or state law. Specifically, the City was able to impose further cuts in health care benefits and payments to retirees, as well as suspend General Fund payments on bonds. While these cuts allowed the City

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



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to continue operating under a “balanced” budget, the effectiveness of the reductions made under the Pendency Plan ultimately depend upon the confirmation of a plan of adjustment. The City has continued to operate under subsequent versions of the Pendency Plan during the Chapter 9 Case.

**B. Eligibility Litigation.**

On June 5, 2012, the City Council voted to authorize the City to file a petition for relief under chapter 9 of the Bankruptcy Code in the event that its pre-bankruptcy negotiations did not enable it to avoid insolvency. Following the conclusion of the pre-bankruptcy negotiations, the City filed its chapter 9 petition on June 28, 2012.

Certain of the City’s creditors—National Public Finance Guaranty Corporation, Assured Guaranty Corporation, Assured Guaranty Municipal Corporation, Franklin High Yield Tax Free Income Fund, and Franklin California High Yield Municipal Fund—objected to the City’s petition for an order for relief under chapter 9. Their objections were joined by Wells Fargo Bank in its capacity as indenture trustee. Following nine months of discovery and briefing, on March 25-27, 2013, the Bankruptcy Court conducted a trial to determine whether the City was eligible for bankruptcy protection. On April 1, 2013, the Bankruptcy Court delivered its oral ruling that the City had established its eligibility, and the Bankruptcy Court entered an order for chapter 9 relief later that day. On June 12, 2013, the Bankruptcy Court issued a written Opinion Regarding Chapter 9 Order for Relief, elaborating on its reasons for its ruling. *In re City of Stockton*, 493 B.R. 772 (Bankr. E.D. Cal. 2013).

**C. Post-Bankruptcy Negotiations Conducted by Judge Elizabeth L. Perris.**

In July 2012, the Honorable Alex Kozinski, Chief Judge of the United States Court of Appeals for the Ninth Circuit, appointed the Honorable Elizabeth L. Perris, a United States Bankruptcy Judge for the District of Oregon, to serve as a judicial mediator in the Chapter 9 Case [Dkt. Nos. 384, 385]. Judge Perris conducted an initial meeting on August 30, 2012, inviting key creditors and the City. Thereafter, and continuing through the date hereof, Judge Perris has devoted countless (but certainly hundreds of) hours conducting face-to-face negotiations among the parties to the Chapter 9 Case. Such negotiations are confidential, and cannot be revealed, but the City can and does represent that it continues to believe that if it is able to reach agreement

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with certain key creditors hereafter, such agreement will occur only with the continued proactive participation of Judge Perris.

One of the parties with which the City reached agreement in the mediation conducted by Judge Perris is the SPOA. On December 11, 2012, the City Council adopted the Memorandum of Understanding between the City of Stockton and the SPOA. For further discussion of the relevant terms of the SPOA MOU, see Section V(A)(2) below.

Judge Perris brokered the settlement between Ambac and the City, the terms of which are reflected in the Plan.

After long and arduous negotiations, concluding just before the City first went public with the Plan, Judge Perris also successfully guided the parties to an extremely complex settlement between the City and NPMF, involving no less than three bond issues and three sets of financing leases involving numerous City properties.

Judge Perris continues to preside over the mediation between the City and Assured Guaranty.

**D. Formation of an Official Committee to Represent Retirees.**

On April 1, 2013, with the support of the City, the United States Trustee appointed the members of the Official Committee of Retirees (“**Retirees Committee**”). As the name indicates, the Retirees Committee represents only the interests of retirees from the City. The Retirees Committee does not represent current City employees or any other creditors. The Retirees Committee consists of retired City employees—namely Dwane Milnes (Chair), Robert Sivell, L. Patrick Samsell, Mark Anderson, Larry Long, Mary Morley, Cynthia Neely, Morris Allen, Rick Butterworth, Anthony Delgado, Shelley Green, Gary Ingraham, and Frank Johnston. The Retirees Committee is represented by Felderstein, Fitzgerald, Willoughby & Pascuzzi LLP.

Since its appointment, the Retirees Committee has met with the City and discussed the claims of its constituencies. The overwhelming majority of such claims in dollar amount relate to two categories of claims: (1) health benefits promised by the City and then reduced in the first Pendency Plan for fiscal year 2012-13 and eliminated for the following fiscal year and thereafter (which the City and the Retirees Committee estimate to amount to approximately \$538 million

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for the approximately 1,100 retirees and dependents eligible for health benefits); and (2) pension benefits paid through the CalPERS Pension Plan. As discussed below, the Plan proposes to pay \$5.1 million on the Effective Date in full satisfaction of the health benefit claims, and the Plan assumes the City's obligations to CalPERS, preserving in full the pension benefits of the approximately 2,400 current recipients thereof and of current employees who are participating in CalPERS. The Retirees Committee has agreed to support the Plan and recommends that retirees vote to accept the Plan.

**E. Motions for Relief from Stay to Pursue or Commence Litigation.**

Pursuant to sections 362 and 922, the filing of the Chapter 9 Case imposed an automatic stay, which, among other things, prohibits the commencement or continuation of actions against the City on account of claims that arose prior to the commencement of the Chapter 9 Case. The automatic stay provisions also bar any actions to obtain possession of or control over City property. Section 922 extends the automatic stay to actions against officers or inhabitants of the City that seek to enforce claims against the City. The Bankruptcy Court specifically addressed the application of the automatic stay to suits against City officers in *In re City of Stockton*, 484 B.R. 372 (Bankr. E.D. Cal. 2012) ("*Hittle*"). In *Hittle*, the City's former Fire Chief sued the City, City Manager, and Deputy City Manager for wrongful termination. The Court, however, ruled that the stay imposed by section 922 prevented the suit against the officers as an indirect means of suing the City, which is required by state law to indemnify its officers. *Id.* at 376, 378; CAL. GOV'T CODE §§ 825, 825.2 (requiring indemnification of officers).

Several motions requesting relief from the automatic stay have been filed by plaintiffs in lawsuits pending in other courts in which damages have been sought based on allegations of civil rights violations and other General Liability Claims. The City stipulated to relief from the stay being granted in those cases in which the movant agreed to liquidate its claims in another forum, agreed not to enforce any claim so liquidated against City assets or property, agreed to look exclusively to insurance proceeds, or agreed to proceed with its underlying lawsuit but seek further leave of the court should it obtain a monetary award (but only in cases in which the continuance of the underlying action would not impose a burden on the Office of the City

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Attorney). The City has not opposed relief from the automatic stay for parties with claims strictly against City Restricted Funds, which are not a part of the Chapter 9 Case (*e.g.*, Preston Pipelines, Dkt. Nos. 1045, 1092). Nor has the City opposed relief from the automatic stay for the Indenture Trustee to distribute funds it has collected acting pursuant to a state court receivership order [Dkt. Nos. 506, 533, 695, 721, 1080, 1097]. The City has also not opposed the commencement or continuation of actions challenging certain political processes, on the grounds that such actions are not within the scope of the automatic stay (Ralph Lee White [Dkt. No. 560], Dean Andal [Dkt. No. 1035]). The Bankruptcy Court agreed with the City's position on such cases in an opinion rendered in connection with the Dean Andal motion [Dkt. No. 1110]. The City has successfully opposed other motions for relief from the automatic stay, including motions brought in *Hittle*, the Association of Retired Employees of the City of Stockton (*see Association of Retired Employees of the City of Stockton v. City of Stockton, California (In re City of Stockton, California)*), 478 B.R. 8 (Bankr. E.D. Cal. 2012)), Greg and Beverly Kent [Dkt. No. 892], and Salvador Benavides [Dkt. No. 622].

#### **IV. THE CITY'S LIABILITIES AND ASSETS**

As noted in Section I(D) and in footnote 2 above, the City's CAFR for its fiscal year ending June 30, 2011, is not attached, but is available online or by written request. The CAFR provides all manner of information and financial data and includes the City's independently audited financial statements. Set forth below is a summary of the liabilities and assets that are relevant to the Plan.

##### **A. Liabilities.**

##### **1. Liabilities Listed by the City in Its Filings on the Petition Date.**

As required by sections 924 and 925, Bankruptcy Rules 1007(a) and 1007(d), and Rule 1007-1 of the Local Rules of Bankruptcy Procedure, on the Petition Date the City filed a list of creditors and claims (the "**Creditors' List**") [Dkt. No. 2] and a list of creditors holding the 20 largest unsecured claims against the City (the "**20 Largest List**") [Dkt. No. 4]. The cover sheet to the Creditors' List disclosed as follows:

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The Creditors' List represents obligations of the City's General Fund as well as obligations of the City's designated special use funds, for example the Municipal Water Utility Fund. Such obligations are included on the Creditors' List for purposes of full disclosure. The City maintains that California or federal law prohibits the use of such special use funds to pay General Fund obligations. Moreover, certain of such obligations are payable only from such special use funds. Thus, such special use funds are beyond the scope of this chapter 9 case pursuant to Bankruptcy Code §§ 903 and 904.

While the City believes that the Creditors' List and 20 Largest List were accurate at the time they were filed, subsequent events have negated if not eliminated the relevance of the amounts disclosed therein. For example, in the Plan, the City assumes the retiree pension obligations to CalPERS listed in the 20 Largest List. And the over \$255 million listed in the 20 Largest List as amounts owed to the Indenture Trustee is being adjusted under the Plan. In short, the City submits that while the Creditors' List and 20 Largest List may have been helpful tools at the outset of this case, they are largely irrelevant for purposes of the Plan and the Disclosure Statement.

## 2. Liabilities Listed by the City in Its Updated Creditors' List.

On October [\_\_\_], 2013, the City will file an updated list of creditors and claims ("Updated Creditors' List"). The Updated Creditors' List includes new (or newly discovered) claims and updated contact addresses for certain creditors. Although the Updated Creditors' List discloses new estimated claim amounts, many of these estimates are rough. For example, where the value of a liability claim is unknown but is estimated to be more than \$25,000 (the threshold established by Cal. Gov't Code § 85 for unlimited civil claims), its estimated value is listed as \$25,000. Thus, while the Updated Creditors' List should serve as a helpful tool for purposes of identifying the universe of the City's creditors, it is not the final word on the amount of the City's liabilities.

## 3. Proofs of Claim.

The Bankruptcy Court established three deadlines for filing proofs of claim against the City. The first bar date, August 16, 2013, applied to all claims except those specifically excluded

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by the relevant order [Dkt. No. 960]. The excluded claims were primarily those relating to pension benefits and the loss of retiree healthcare benefits. The second bar date, September 30, 2013, which was set by the same order, was limited to claims of governmental units. The third bar date, [\_\_\_\_], 2013, which was established by an order filed on [\_\_\_\_], 2013 [Dkt. No. \_\_\_\_], was limited to claims relating to the loss of retiree healthcare benefits.

Approximately 241 proofs of claim were filed on or prior to the August 16, 2013, bar date. Though many of the proofs of claim did not specify their classification as general unsecured, priority, secured, etc., the City classified these claims to the best of its ability based on other groups of claims received and on the City's knowledge of property pledged to secure certain claims. Accordingly, the City catalogued approximately 104 General Unsecured Claims, 16 Unsecured Priority Claims, and 69 Secured Claims. Approximately 34 of the proofs of claim, rather than listing a specific amount being sought, were filed with amounts shown as "unknown," "to be determined," or "unliquidated." The proofs of claim listing a specific amount aggregate approximately \$1.181 billion, comprised of approximately \$158 million of General Unsecured Claims as calculated by the filing entities, \$2.8 million of Unsecured Priority Claims, and \$1.021 billion of Secured Claims.

[Placeholder for government claims filed before 9/30 and retiree health claims filed before [\_\_\_\_] (the Retiree Health Bar Date).]

In furtherance of its continuing claims analysis and resolution process, the City will be filing a series of omnibus objections and specific objections to various classes of Claims. Such objections will be both on the merits as well as to claims based on obligations for which the City contends it is not liable.

Finally, General Liability Claims, as filed, amount to an aggregate of \$156 million. The \$1 million SIR Claim Portions of such Claims will be Class 14 Claims under the Plan and will receive the same pro-rata payment received by General Unsecured Creditors in Class 12.

Note that although the City is confident in its defenses to the disputed Claims, there is no assurance that the City will succeed in eliminating or reducing any or all of these claims.

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#### 4. General Unsecured Claims, Including General Liability Claims.

Through August 16, 2013, a total of 104 proofs of claim were filed as General Unsecured Claims. The General Unsecured Claims include, but are not limited to: (1) the Retiree Health Benefit Claims; (2) the Claims of Dexia under the Office Building Standby Agreement; (3) the Golf Course/Park Claims of the 2009 Golf Course/Park Bond Trustee/Franklin; (4) the Leave Buyout Claims; (5) the Price Claims; and (6) Other Postpetition Claims.

By its analysis and calculations, the City believes that the Allowed amount of General Unsecured Claims in Class 12 will aggregate approximately \$675 million to \$700 million. This estimate is comprised of Claims for (1) loss of retiree healthcare benefits of approximately \$538 million; (2) approximately \$806,000 related to leave buyouts; (3) approximately \$10 million [or approximately \$20 million if rejection of the Office Building leases are included in the absence of a settlement with Assured] for lease rejection claims for the Golf Course/Park leases, as capped by Bankruptcy Code section 502(b)(6); (4) approximately \$125 million for claims related to the Pension Obligation Bonds; and (5) miscellaneous other claims.

The General Unsecured Claims, as filed, greatly exceed the high end of such range, and, as noted above, the City has engaged in a process aimed at ascertaining the differences between the amounts asserted in the proofs of claim and the amounts reflected as owing to the claimants in the City's books and records or as otherwise evaluated by the City.

If the City's estimate of the allowable amounts of the General Unsecured Claims is too low, the City would likely need to amend the Plan to, among other possibilities, provide for a payout over a term of years as opposed to payment in cash on the Effective Date as is proposed in the Plan.

#### 5. Priority Unsecured Claims.

Sixteen proofs of claim were filed as priority unsecured Claims, which assert an aggregate of approximately \$2.8 million in obligations against the City.

The City believes that most, if not all, of these claims are properly characterized as General Unsecured Claims and treats them as such in this Disclosure Statement. Moreover, because chapter 9 incorporates only those administrative claims allowed under section 507(a)(2),

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as discussed in Section V(A)(1)(a) below, the City submits that virtually all Claims filed as priority Claims are not entitled to priority status under chapter 9. Accordingly, the City intends to object to the characterization of virtually every Claim filed as a priority Claim. The City expects that this objection and reclassification will substantially reduce the priority claim pool, if not eliminate it altogether.

#### **6. Secured Claims.**

The City has categorized one proof of claim as a Secured Claim: the SCC 16 Secured Claims. The SCC 16 Secured Claims relate to any Claim of SCC 16 arising out of that certain “Agreement Regarding Construction Costs,” dated as of April 29, 2008, among SCC 16, the City, and the Redevelopment Agency, relating to the City’s obligation to reimburse SCC 16 for construction costs paid by SCC 16 that the City was otherwise liable to pay, for the construction of improvements to certain premises located in the Edmund S. Coy Parking Structure to be leased by SCC 16, to the extent that any such Claim is secured by the right to offset rent and any other monies owing from SCC 16 to the City.

SCC 16 asserts a Secured Claim against the City in the amount of \$455,123.99. A settlement with SCC 16 is being discussed regarding the treatment under the Plan of the SCC Secured Claims and certain other matters, as set forth in that certain “Settlement Term Sheet, SCC 16 Claims” dated as of September [\_\_\_], 2013, and attached to the Plan as **Exhibit E**. [if and when finalized]

#### **7. Workers Compensation Liabilities.**

As of June 30, 2013 (the most recent date for which data is available), the City had an outstanding liability of approximately \$51,087,000 in workers compensation claims. Pursuant to the Plan, such claims will be paid in the ordinary course of business as holders of Class 17 claims. Accordingly, no proofs of claim were required for members of Class 17.

#### **8. Claims Relating to the Lease Out/Lease Back Transactions.**

##### **a. Background.**

The City has a number of outstanding General Fund financing lease obligations. The lease financing transactions involving Ambac and NPMF as insurers of the related bond issues



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1 have been compromised and settled during the case (the terms of which are incorporated in the  
2 Plan), one will be assumed and thus will be Unimpaired, and the financing leases involving  
3 Franklin as the sole holder of the related bonds will be rejected.

4 In general, the financing lease obligations have a similar structure: a lease out of City-  
5 owned property to either the Financing Authority or the Redevelopment Agency, and the  
6 simultaneous lease back of the same property to the City by the Financing Authority or the  
7 Redevelopment Agency. The lease out generally involved pre-paid rent for the entire term of the  
8 lease or a token payment of rent plus delivery of the related bond proceeds to the Financing  
9 Authority or the Redevelopment Agency. The lease back involved the City paying rent semi-  
10 annually for the leased premises.

11 The Financing Authority or the Redevelopment Agency then assigned its right to receive  
12 rental payments (along with certain other rights relevant to the enforcement of remedies) under  
13 the applicable lease back to an Indenture Trustee. Finally, the Financing Authority or the  
14 Redevelopment Agency issued bonds, or the Indenture Trustee executed and delivered certificates  
15 of participation, and transferred the proceeds to the City for expenditure on capital improvements.  
16 Payment of the principal of and interest on the bonds and certificates is made through the  
17 applicable Indenture Trustee, pursuant to, *inter alia*, the terms of the related indenture or trust  
18 agreement, from the proceeds of rental payments received from the City pursuant to the terms of  
19 the applicable lease back and related assignment.

20 For transactions involving certificates of participation, the lease payments are divided into  
21 “principal components” and “interest components,” the sum of which in each rental period make  
22 up the rent payable for that rental period. This allocation is required in order for the interest  
23 components to be treated as tax-exempt under federal tax law. The sum of the principal  
24 components is referred to as the principal amount of the transaction. Transactions such as the  
25 ones into which the City entered are structured this way to comply with the so-called “lease  
26 exception” to the indebtedness limitations in article XVI, section 18 of the California  
27 Constitution, as described in *City of Los Angeles v. Offner*, 19 Cal. 2d 483 (1942) and *Dean v.*  
28 *Kuchel*, 35 Cal. 2d 444 (1950), the California Supreme Court cases that establish the lease

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exception. These types of leases are often referred to as “Offner-Dean” leases (referred to herein as financing leases).<sup>8</sup>

An important feature of these leases is that they cannot be accelerated, which is a corollary to the requirement of the *Offner* and *Dean* cases that the City’s obligation to pay rent under the leases back is limited to payment for beneficial use and occupancy of the leased premises during the rental period for which payment is due.

**b. 2003 Fire/Police/Library Leases.**

The Ambac Settlement Agreement restructures the City’s obligations under the 2003 Fire/Police/Library Certificates and provides additional liquidity for the City.

**(i) *Financial Instruments Involved.***

The financial instruments involved in this transaction are the City of Stockton Certificates of Participation (Redevelopment Housing Projects) Series 2003A, issued on June 27, 2003, in the original principal amount of \$1,160,000 (the “**2003A Fire/Police/Library Certificates**”) and the Certificates of Participation (Redevelopment Housing Projects) Taxable Series 2003B, issued on June 27, 2003, in the original principal amount of \$12,140,000 (the “**2003B Fire/Police/Library Certificates**”, and together with the 2003A Fire/Police/Library Certificates, the “**2003 Fire/Police/Library Certificates**”). Wells Fargo is the trustee under the 2003 Fire/Police/Library Certificates Trust Agreement (together with any successor trustee, the “**2003 Fire/Police/Library Certificates Trustee**”). A reserve fund exists for the 2003A Fire/Police/Library Certificates with a balance as of September 1, 2013 of \$59,746.48 and for the 2003B Fire/Police/Library Certificates with a balance as of September 1, 2013 of \$706,781.35 (together, the “**2003 Fire/Police/Library Certificates Reserve Fund**”). The funds in the 2003 Fire/Police/Library Certificates Reserve Fund are pledged to support payment of the lease payments under the Fire/Police/Library Lease Out evidenced and represented by the 2003 Fire/Police/Library Certificates. The 2003 Fire/Police/Library Certificates are insured by Ambac.

<sup>8</sup> Were the obligations to stretch over more than one year, they would require voter approval as per Article XVI, Section 18.

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(ii) *Leased Properties.*

As described in more detail below, the properties that are involved in this transaction are three fire stations, the City's Main Police Facility, and the Maya Angelou Southeast Branch Library (collectively, the "**Fire/Police/Library Properties**"). In order to facilitate the financing to be provided by the 2003 Fire/Police/Library Certificates, the City, as owner of the Fire/Police/Library Properties, leased the properties to the Financing Authority pursuant to that certain Site and Facility Lease dated as of June 1, 2003, for a term ending on June 1, 2033, with a possible extension of the term to the date upon which the 2003 Fire/Police/Library Certificates are paid in full (the "**Fire/Police/Library Lease Out**"). Pursuant to section 510 of the City Charter, the term of the Fire/Police/Library Lease Out cannot extend for more than 55 years or to May 31, 2058. The City contemporaneously leased the Fire/Police/Library Properties back from the Financing Authority for the same number of years pursuant to the terms of a Lease Agreement dated as of June 1, 2003 (the "**Fire/Police/Library Lease Back**"). Thus, the City is the lessor and the Financing Authority is the tenant under the Fire/Police/Library Lease Out, and the Financing Authority is the lessor and the City is the tenant in the Fire/Police/Library Lease Back.

As tenant under the Fire/Police/Library Lease Out, the Financing Authority paid rent for the entire lease term in a lump sum payment in the amount of \$11,838,678.30, being the net proceeds of the 2003 Fire/Police/Library Bonds. As tenant under the Fire/Police/Library Lease Back, the City agreed to make semi-annual rental payments in varying amounts (the "**Fire/Police/Library Lease Back Rental Payments**"). The Financing Authority assigned to the 2003 Fire/Police/Library Certificates Trustee its rights under the Fire/Police/Library Lease Back, including the rights to enforce the lease after default by the City, and including the stream of Fire/Police/Library Lease Back Rental Payments from the City, to support the repayment of the 2003 Fire/Police/Library Certificates. No other revenues or assets are pledged to support the repayment of the 2003 Fire/Police/Library Certificates, the repayment obligation is non-recourse to the Financing Authority, and the 2003 Fire/Police/Library Certificates are payable solely from the 2003 Fire/Police/Library Certificates Reserve Fund and the Fire/Police/Library Lease Back Rental Payments.

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The subject properties are the Fire/Police/Library Properties, which consist of City's Main Police Facility, located at 22 E. Market Street; the Maya Angelou Southeast Branch Library, located at 2324 Pock Lane; Fire Station No. 1, located at 1818 Fresno Avenue; Fire Station No. 5, located at 3499 Manthey Road; and Fire Station No. 14, located at 3019 McNabb Street.

- **Fire Stations.** The City owns 13 fire stations, of which 12 are operating. Fire Stations No. 1, 5, and 14 were built in 1995-96. Each station primarily serves the neighborhood in which it is located and occupies a half-acre site with a building of approximately 5,000 square feet. Station No. 1 is located in the south area of the City in the South Stockton Redevelopment Project Area; it was closed as a result of budget cuts. Station No. 5 is located in the south area off Interstate 5 in the Weston Ranch Subdivision. Station No. 14 is located in the north area in a newer residential community commonly referred to as Spanos Park located off Interstate 5 and Eight Mile Road.
- **Main Police Facility.** The Main Police Facility is located in the downtown area of the City. It was built in 1970 on a two-acre site and includes approximately 44,000 square feet of building space with 140 parking spaces.
- **Library.** The Maya Angelou Southeast Branch Library is located in the south area of the City. It was built in 1996 on a 1.8-acre site and includes approximately 20,000 square feet of building space. The library serves the residents of both the City and San Joaquin County in multiple South Stockton neighborhoods and is one of 10 libraries that comprise the Stockton-San Joaquin County Library System.

*(iii) Ambac Settlement Agreement.*

On February 26, 2013, the City filed a motion with the Bankruptcy Court in which it requested the Bankruptcy Court to enter an order approving the Ambac Settlement Agreement [Dkt. No. 723]. A copy of the Ambac Settlement Agreement is attached as Exhibit A to the Declaration of Robert Deis in Support of the City of Stockton's Motion Under Bankruptcy Rule 9019 for Approval of Its Settlement with Ambac Assurance Corporation, filed on February 26, 2013 [Dkt. No. 725]. On April 24, 2013, the Bankruptcy Court entered its order

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granting the Ambac Settlement Agreement Motion in its entirety and approving the Ambac Settlement Agreement in its entirety [Dkt. No. 888].

Pursuant to the Ambac Settlement Agreement, Ambac and the 2003 Fire/Police/Library Certificates Trustee will forbear from exercising their rights under the 2003 Fire/Police/Library Certificates in exchange for payment of their attorneys' fees, certain General Fund payments towards the principal of and interest on the Certificates, the assignment to the 2003 Fire/Police/Library Certificates Trustee of the City's rights under the Certificates, and the sale of certain City and Successor Agency (i.e., the City as successor to the Redevelopment Agency as per California Assembly Bill AB x1 26 (2011-12), which dissolved California's redevelopment agencies as of February 1, 2012) properties for proceeds that will be paid toward the principal of and interest on the Certificates. It also requires that the 2003 Fire/Police/Library Certificates Reserve Fund be distributed toward the principal of and interest on the Certificates. Finally, the agreement requires that Ambac support and vote in favor of the Plan so long as it is consistent with the agreement approved by the Bankruptcy Court.

**c. 2004 Arena Leases.**

Pursuant to the terms of the NPMF Settlement and the Plan, the City will assume the Arena Lease Out and the Arena Lease Back as modified by the NPMF Settlement.

**(i) *Financial Instruments Involved.***

The financial instruments involved in this transaction are the Redevelopment Agency of the City of Stockton Revenue Bonds, Series 2004, (Stockton Events Center – Arena Project) issued on March 16, 2004, in the aggregate principal amount of \$47,000,000 (the “**2004 Arena Bonds**”). Wells Fargo is the indenture trustee under the 2004 Arena Bonds Indenture (together with any successor trustee, the “**2004 Arena Bond Trustee**”). A reserve fund exists for the 2004 Arena Bonds with a balance as of September 1, 2013, of \$3,511,392.02 (the “**2004 Arena Bond Reserve Fund**”). The funds in the 2004 Arena Bond Reserve Fund are pledged to support repayment of the 2004 Arena Bonds. The 2004 Arena Bonds are insured by NPMF.

As described in more detail below, the property and facility involved in this transaction is the Stockton Arena (as more particularly described below, the “**Arena**”). In order to facilitate the

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1 financing provided by the 2004 Arena Bonds, the City, as owner of the Arena, leased the Arena to  
 2 the Redevelopment Agency pursuant to that certain Site Lease dated as of March 1, 2004, for a  
 3 term ending on September 1, 2036, with a possible extension of the term, or reduction in term, to  
 4 the date upon which the 2004 Arena Bonds are paid in full (the “**Arena Lease Out**”). Under  
 5 section 510 of the City Charter, the Arena Lease Out may not extend for more than 55 years, or  
 6 until February 28, 2059. The City contemporaneously leased the Arena back from the  
 7 Redevelopment Agency for the same number of years (but the lease term cannot extend beyond  
 8 September 1, 2046) pursuant to the terms of that certain Lease Agreement dated as of March 1,  
 9 2004 (the “**Arena Lease Back**”). Thus, the City is the lessor and the Redevelopment Agency is  
 10 the tenant under the Arena Lease Out transaction, and the Redevelopment Agency is the lessor  
 11 and the City is the tenant in the Arena Lease Back transaction.

12 As tenant under the Arena Lease Out, the Redevelopment Agency paid rent for the entire  
 13 lease term in the amount of \$1.00. The Redevelopment Agency agreed under the Arena Lease  
 14 Back to allow the City to use the proceeds of the 2004 Arena Bonds to construct the Arena  
 15 facilities. As tenant under the Arena Lease Back, the City agreed to make semi-annual rental  
 16 payments in varying amounts (\$2,570,687 for fiscal year 2012-13, \$2,621,346 for fiscal year  
 17 2013-14, \$2,673,221 for fiscal year 2014-15, etc.) (the “**Arena Lease Back Rental Payments**”).  
 18 The Redevelopment Agency assigned its rights under the Arena Lease Back, including the rights  
 19 to enforce the lease after default by the City, and including the stream of Arena Lease Back  
 20 Rental Payments from the City, to support the repayment of the 2004 Arena Bonds. In addition,  
 21 pursuant to the terms of that certain Pledge Agreement between the City as pledgor and the  
 22 Redevelopment Agency as pledgee dated as of March 1, 2004 (the “**Arena Pledge Agreement**”),  
 23 the City pledged certain incremental tax revenues (the “**Pledged Tax Increment**”) expected to be  
 24 collected from the West End Urban Renewal Project No. 1, a former development project area  
 25 consisting of 642 acres surrounding and including the Arena, located in the heart of downtown  
 26 Stockton, just north of the City’s Crosstown Freeway and east of Interstate 5, containing a mix of  
 27 commercial, industrial, and residential uses (the “**West End Project Area**”). No other revenues  
 28 or assets are pledged to support the repayment of the 2004 Arena Bonds, the repayment

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obligation is non-recourse to the Redevelopment Agency, and the 2004 Arena Bonds are payable solely from the 2004 Arena Bond Reserve Fund, the Arena Lease Back Rental Payments, and the Pledged Tax Increment.

(ii) *Leased Property.*

The subject property is the land described as Parcel 4, as shown on the Parcel Map filed for record in the office of the Recorder of the County of San Joaquin, State of California, on March 4, 2003, in Book 23 of Maps, Page 15, and the Arena located thereon, an indoor facility capable of hosting events such as ice hockey, indoor football, indoor soccer, concerts, boxing events, rodeos, and other such indoor events, and located at 248 West Fremont Street in downtown Stockton. The Arena includes officials' facilities, media facilities, food services facilities, 24 luxury suites for approximately 288 patrons, the Record Press Club Level with 344 Club Seats, 5,000 square feet of conference space, and ample backstage amenities. The Arena can be configured for 8,600 to 12,000 seats, based upon the nature of the event. The Arena sports an 85 by 200 foot NHL regulation ice sheet and is home to the Stockton Thunder ice hockey team.

The Arena is part of the Stockton Events Center project (the "**Events Center Project**"), which also includes a baseball stadium with a seating capacity of approximately 5,000 people, the University Plaza Waterfront Hotel and University Lofts, the Stockton Events Center Parking Structure, and approximately 60,000 square feet of retail/commercial space. The Events Center Project, including the Arena, is located in downtown Stockton on approximately 24 acres immediately north of and adjacent to the Stockton Channel and within the West End Project Area.

The Arena currently operates at a net loss before debt service and requires a General Fund subsidy to support operations.

(iii) *NPFG Settlement as Applicable to the Arena.*

The City has reached an agreement with NPFG and the 2004 Arena Bond Trustee regarding the Arena Lease Out, the Arena Lease Back and the Pledged Tax Increment. The terms are contained in the NPFG Settlement. In general, with respect to the Arena, the NPFG Settlement provides that, after modification of the payment terms of the Arena Lease Back that

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will reduce the exposure of the General Fund for making Lease Back Rental Payments, the City will assume the Arena Lease Back, and as a result, the City will continue to remain in possession, custody and control of the Arena.

**d. 2004 Parking Structure Leases.**

Pursuant to the terms of the NPFG Settlement and the Plan, the City will assume the Parking Structure Lease Out and the Parking Structure Lease Back as modified by the NPFG Settlement.

**(i) *Financial Instruments Involved.***

The financial instruments involved in this transaction are the Stockton Public Financing Authority Lease Revenue Bonds, Series 2004, (Parking and Capital Projects) issued on June 25, 2004, in the aggregate principal amount of \$32,785,000 (the “**2004 Parking Bonds**”). Wells Fargo is the indenture trustee under the 2004 Parking Bonds Indenture (together with any successor trustee, the “**2004 Parking Bond Trustee**”). A reserve fund exists for the 2004 Parking Bonds with a balance as of September 1, 2013, of \$78,693.23 (the “**2004 Parking Bond Reserve Fund**”). The funds in the 2004 Parking Bond Reserve Fund are pledged to support repayment of the 2004 Parking Bonds. The 2004 Parking Bonds are insured by NPFG.

As described in more detail below, the properties and facilities involved in this transaction are the Edmund S. Coy Parking Structure, the Stockton Events Center Parking Structure, and the Market Street Garage (as more particularly defined below, the “**Parking Structure Properties**”). In order to facilitate the financing provided by the 2004 Parking Bonds, the City, as owner of the Parking Structure Properties, leased the properties to the Financing Authority, pursuant to a site and facility lease dated as of June 1, 2004, for a term ending on September 1, 2034, with a possible extension of the term to the date upon which the 2004 Parking Bonds are paid in full (the “**Parking Structure Lease Out**”). Pursuant to section 510 of the City Charter, the term of the Parking Structure Lease Out cannot extend for more than 55 years or to May 31, 2059. The City contemporaneously leased the properties back from the Financing Authority for the same number of years pursuant to the terms of the Lease Agreement dated as of September 1, 2004 (the “**Parking Structure Lease Back**”). Thus, the City is the lessor and the Financing Authority is



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the tenant under the Parking Structure Lease Out transaction, and the Financing Authority is the lessor and the City is the tenant in the Parking Structure Lease Back transaction.

As tenant under the Parking Structure Lease Out, the Financing Authority paid rent for the entire lease term in the amount of \$1.00. Pursuant to the Parking Structure Lease Back, the Financing Authority agreed to provide to the City the net proceeds of the 2004 Parking Bonds (with gross proceeds equal to \$32,785,000), which were used by the City to fund the construction of the Edmund S. Coy Parking Structure (described below) and other capital improvements. As tenant under the Parking Structure Lease Back, the City agreed to make semi-annual rental payments in varying amounts (\$1,960,916 for fiscal year 2012-13) (the “**Parking Structure Lease Back Rental Payments**”). The Financing Authority assigned its rights under the Parking Structure Lease Back, including the rights to enforce the lease after default by the City, and including the stream of Parking Structure Lease Back Rental Payments from the City, to support the repayment of the 2004 Parking Bonds. No other revenues or assets are pledged to support the repayment of the 2004 Parking Bonds, the repayment obligation is non-recourse to the Financing Authority, and the 2004 Parking Bonds are payable solely from the Parking Structure Lease Back Rental Payments.

Even before filing the Chapter 9 Case, due to a lack of revenues generated by the Parking Structure Properties, and as a result of the deteriorating finances of the City, the City defaulted in the payment of the Parking Structure Lease Back Rental Payments. As a result of these circumstances, the 2004 Parking Bond Trustee filed suit to enforce the Parking Structure Lease Back, with the result that the Superior Court of the State of California for the County of San Joaquin issued two decisions on April 19, 2012, one granting the 2004 Parking Bond Trustee “Judgment of Possession After Unlawful Detainer” and also appointing a receiver for the Parking Structure Properties under an “Order Appointing Receiver.” *See Wells Fargo Bank, National Association v. City of Stockton*, Superior Court of the State of California, County of San Joaquin, case no. 39-2012-00277622-CU-UD-STK.

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(ii) *Leased Properties.*

The subject properties consist of three parking structures that continue to be owned by the City (subject to the Parking Structure Lease Out to the Financing Authority and the Parking Structure Lease Back from the Financing Authority) (the “**Parking Structure Properties**”).

(a) **Edmund S. Coy Parking Structure.**

This structure is located in the vicinity of Harbor and Channel Streets in downtown Stockton. The six-story parking structure provides approximately 575 parking spaces to the Central Business District to accommodate parking for existing retail, commercial, and office development. The structure has approximately 7,500 square feet of ground-level commercial/retail fronting Harbor Street and was constructed using a single-threaded helix design. The total cost of construction was originally estimated at \$9,540,000, with all such amounts provided by proceeds of the 2004 Parking Bonds.

(b) **Stockton Events Center Parking Structure.**

This structure is located in the vicinity of Fremont and Van Buren Streets in downtown Stockton. The seven-story parking structure provides approximately 600 parking spaces on the north shore of the Stockton Channel to accommodate sports fans, concert goers, and event attendees. The structure has approximately 7,500 square feet of ground-level commercial/retail fronting Fremont Street and was constructed using a single-threaded helix design. The total cost of construction was originally estimated at \$9,595,000, with all such amounts provided by proceeds of the 2004 Parking Bonds.

(c) **Market Street Garage.**

This structure is located within the City’s Central Parking District on Market Street between Sutter and California Streets and was constructed in 1989. The four-story parking structure provides approximately 780 parking spaces and provides both monthly parking for employees of downtown businesses and hourly parking for patrons of downtown businesses. The structure also houses the Central Parking District management offices.

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(iii) *NPFG Settlement as Applicable to the Parking Structure*

*Properties.*

The City has reached an agreement with NPFG and the 2004 Parking Structure Bond Trustee regarding the Parking Structure Lease Out and the Parking Structure Lease Back. The terms are contained in the NPFG Settlement. In general, with respect to the Parking Structures, the NPFG Settlement provides that the City will create a new parking authority for the City of Stockton that will be comprised of the Parking Structure Properties plus other downtown parking structures and lots, and downtown parking meters and parking enforcement revenues; that revenues from the newly created parking authority will be pledged to the 2004 Parking Bond Trustee in support of a modified schedule of payments on the Parking Structure Lease Back, and the City's General Fund will have no liability for the modified payment schedule. As a result, the City will regain possession, custody and control of the Parking Structure Properties.

e. **2006 SEB Leases.**

The City will assume the SEB Lease Back and the SEB Lease Out under section 365(a). No later than 60 days after the Effective Date or 60 days after entry of an order approving the Assumption Motion, whichever is later, the City will make the payments to the 2006 Bond Trustee necessary to cure past defaults under the SEB Lease Back, if any, as well as any actual pecuniary loss suffered by the 2006 Bond Trustee as a result of the City's default of the SEB Lease Back, if any.

(i) *Financial Instruments Involved.*

The financial instruments involved in this transaction are the Stockton Public Financing Authority 2006 Lease Revenue Refunding Bonds, Series A, issued on April 6, 2006, in the aggregate principal amount of \$13,965,000 (the "**2006 SEB Bonds**"). Wells Fargo is the indenture trustee under the 2006 SEB Bonds Indenture (together with any successor trustee, the "**2006 Bond Trustee**"). A reserve fund exists for the 2006 SEB Bonds in an amount equal to the initial reserve requirement funded by a surety policy for the reserve fund issued by NPFG, which such initial reserve requirement equals \$919,093.75 (the "**2006 SEB Bond Reserve Fund**"). The

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funds in the 2006 Bond Reserve Fund are pledged to support repayment of the 2006 SEB Bonds. The 2006 SEB Bonds are insured by NPMG.

As described in more detail below, the properties that are involved in this transaction are the Stewart/Eberhardt Building and the adjacent parking facility (the “**SEB Properties**”). In order to facilitate the financing to be provided by the 2006 SEB Bonds, the City, as owner of the SEB Properties, leased the properties to the Financing Authority pursuant to that certain Ground Lease dated as of March 1, 2006, for a term ending on August 1, 2031, with a possible extension of the term to the date upon which the 2006 SEB Bonds are paid in full, but in any event no later than August 1, 2041 (the “**SEB Lease Out**”). The City contemporaneously leased the SEB Properties back from the Financing Authority for the same number of years pursuant to the terms of Lease Agreement dated as of March 1, 2006 (the “**SEB Lease Back**”). Thus, the City is the lessor and the Financing Authority is the tenant under the SEB Lease Out transaction, and the Financing Authority is the lessor and the City is the tenant in the SEB Lease Back transaction.

As tenant under the SEB Lease Out, the Financing Authority paid rent for the entire lease term in the amount of \$1.00. As tenant under the SEB Lease Back, the City agreed to make semi-annual rental payments in varying amounts (\$907,494 for fiscal year 2012-13, \$906,194 for fiscal year 2013-14, \$909,194 for fiscal year 2014-15, etc.) (the “**SEB Lease Back Rental Payments**”). The Financing Authority assigned to the 2006 SEB Bond Trustee its rights under the SEB Lease Back, including the rights to enforce the lease after default by the City, and including the stream of SEB Lease Back Rental Payments from the City, to support the repayment of the 2006 SEB Bonds. No other revenues or assets are pledged to support the repayment of the 2006 SEB Bonds, the repayment obligation is non-recourse to the Financing Authority, and the 2006 SEB Bonds are payable solely from the 2006 Bond Reserve Fund and the SEB Lease Back Rental Payments. The City is not in default under the SEB Lease Back, and to date all amounts due on the 2006 SEB Bonds have been paid in full and on time.

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(ii) *Leased Properties.*

The subject properties consist of the Stewart/Eberhardt Building (the “**Eberhardt Building**”) located at 22 East Weber Avenue and the adjacent public parking facility located at 15 North El Dorado Street in downtown Stockton, both of which continue to be owned by the City (subject to the SEB Lease Out to the Financing Authority and the SEB Lease Back from the Financing Authority) (as described below, the “**SEB Properties**”).

(a) **Stewart/Eberhardt Building.**

The Eberhardt Building is a four-story, 99,792-square-foot, steel and precast concrete-clad office building constructed in 2001. It was designed to meet the standard for, and is certified as, an Essential Services Building, as defined in the Essential Services Buildings Seismic Safety Act of 1986, commencing with section 16000 of the California Health and Safety Code. It currently houses several city departments including Human Resources, Police Investigations, Public Works, and the Police Crime Lab.

(b) **SEB Parking Facility.**

The SEB public parking facility is a 284,423-square-foot, eight-level, reinforced masonry and cast-in-place concrete structure with approximately 780 parking spaces. Constructed in 2001, it also includes approximately 7,000 square feet for Police Department property storage and a “sally port” exclusively for police functions on the ground floor.

(iii) *Lease Assumption; NPMFG Settlement as Applicable to the SEB Properties.*

The City has determined that the SEB Properties constitute mission-critical facilities for the continued operations of City departments housed in the SEB Properties, and that rejection of the SEB Lease Back and the SEB Lease Out and the resulting need for the City to provide alternative facilities for the City departments located at the SEB Properties, would result in serious jeopardy to the uninterrupted provision of essential services to the citizens of the City, and would cause the City to incur significant relocation expenses and alternative facility expenses. As a result, the City has decided to assume the SEB Lease Back and the SEB Lease Out under section 365(a).

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The City has reached an agreement with NPMG and the 2006 SEB Bond Trustee regarding the SEB Lease Out and the SEB Lease Back. The terms are contained in the NPMG Settlement. In general, with respect to the SEB Properties, the NPMG Settlement provides that the City will assume the SEB Lease Back, and as a result, the City will continue to remain in possession, custody and control of the SEB Properties.

No later than 60 days after the Effective Date or 60 days after entry of an order approving the Assumption Motion, whichever is later, the City will make the payments to the 2006 SEB Bond Trustee necessary to cure past defaults under the SEB Lease Back and the SEB Lease Out, if any, as well as any actual pecuniary loss suffered by the 2006 Bond Trustee as a result of the City's default of the SEB Lease Back and the SEB Lease Out, if any.

**f. 2007 Office Building Leases.**

**(i) *Financial Instruments Involved.***

The financial instruments involved in this transaction are the Stockton Public Financing Authority Variable Rate Demand Lease Revenue Bonds, 2007 Series A (Building Acquisition Financing Project), issued on November 29, 2007, in the aggregate principal amount of \$36,500,000 (the "**2007 Series A Bonds**") and the Stockton Public Financing Authority Variable Rate Demand Lease Revenue Bonds, 2007 Series B (Building Acquisition Financing Project), issued on November 29, 2007, in the aggregate principal amount of \$4,270,000 (the "**2007 Series B Bonds**") and together with the 2007 Series A Bonds, the "**2007 Office Building Bonds**"). Wells Fargo is the indenture trustee under the 2007 Office Building Bonds Indenture (together with any successor trustee, the "**2007 Office Building Bond Trustee**"). A reserve fund exists for the 2007 Office Building Bonds in an amount equal to the initial reserve requirement funded by a surety policy for the reserve fund issued by Assured Guaranty, which such initial reserve requirement equals \$2,973,431.75 (the "**2007 Office Building Bond Reserve Fund**"). The funds in the 2007 Office Building Bond Reserve Fund are pledged to support repayment of the 2007 Office Building Bonds. The 2007 Office Building Bonds are insured by Assured Guaranty.

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As described in more detail below, the property that is involved in this transaction is an office building that was purchased with the net proceeds of the 2007 Office Building Bonds and located at 400 E. Main Street in Stockton (the “**400 E. Main Office Building Property**”). In order to facilitate the financing to be provided by the 2007 Office Building Bonds, the City, as prospective owner of the 400 E. Main Office Building Property, leased the property to the Financing Authority pursuant to that certain Site and Facility Lease dated as of November 1, 2007, for a term ending on September 1, 2048, with a possible extension of the term to the date upon which the 2007 Office Building Bonds are paid in full, but in any event no later than September 1, 2058 (the “**Office Building Lease Out**”). The City contemporaneously leased the 400 E. Main Office Building Property back from the Financing Authority for the same number of years pursuant to the terms of the Lease Agreement dated as of November 1, 2007 (the “**Office Building Lease Back**”). Thus, the City is the lessor and the Financing Authority is the tenant under the Office Building Lease Out transaction, and the Financing Authority is the lessor and the City is the tenant in the Office Building Lease Back transaction.

As tenant under the Office Building Lease Out, the Financing Authority paid rent for the entire lease term in the amount of \$1.00. Pursuant to the Office Building Lease Back, the Financing Authority agreed to provide to the City the net proceeds of the 2007 Office Building Bonds (with gross proceeds equal to \$40,355,000), which the City then used to acquire the 400 E. Main Office Building Property. As tenant under the Office Building Lease Back, the City agreed to make annual rental payments in the amount of interest accruing on the 2007 Office Building Bonds plus principal amortization specified in the Office Building Lease Back (such principal amortization is scheduled as \$155,000 due on September 1, 2012, \$165,000 due on September 1, 2013, and \$175,000 due on September 1, 2014) (the “**Office Building Lease Back Rental Payments**”). The Financing Authority assigned its rights under the Office Building Lease Back, including the rights to enforce the lease after default by the City, and including the stream of Office Building Lease Back Rental Payments from the City, to support the repayment of the 2007 Office Building Bonds. No other revenues or assets are pledged to support the repayment of the 2007 Office Building Bonds, the repayment obligation is non-recourse to the Financing

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Authority, and the 2007 Office Building Bonds are payable solely from the Office Building Lease Back Rental Payments. Even before filing its Chapter 9 Case, due to a lack of revenues generated by the 400 E. Main Office Building Property, and as a result of the deteriorating finances of the City, the City defaulted in the payment of the Office Building Lease Back Rental Payments. As a result, the 2007 Office Building Bond Trustee filed suit to enforce the Office Building Lease Back, with the result that the Superior Court of the State of California for the County of San Joaquin entered an order authorizing the 2007 Office Building Bond Trustee to take over the management of the 400 E. Main Office Building Property, which was accomplished by tasking the existing property management company to manage the property for the benefit of and at the direction of the 2007 Office Building Bond Trustee. *See Judgment of Possession, Wells Fargo Bank, National Association v. City of Stockton*, Superior Court of California, County of San Joaquin, case no. 39-2012-00280741-CU-UD-STK.

The 2007 Office Building Bonds were issued as variable rate demand bonds under the terms of which the interest rate was reset on a weekly basis. Holders of the 2007 Office Building Bonds had the right to tender their bonds for purchase by the 2007 Office Building Bonds Trustee, acting as tender agent, on any date. Tendered bonds were to be remarketed to other investors pursuant to a remarketing agreement between the Financing Authority and a registered broker dealer. In order to provide liquidity to holders of the 2007 Office Building Bonds in the event that the tendered bonds could not be so remarketed, the Financing Authority and the City entered into a Standby Bond Purchase Agreement, dated as of November 29, 2007 (the “**Office Building Standby Agreement**”), with Dexia. Under the Office Building Standby Agreement, Dexia agreed to purchase any 2007 Office Building Bonds that could not be remarketed. In the event of such a purchase, the bonds so purchased (“**Bank Bonds**”) were subject to adjustments to their terms so long as they were held by Dexia. On February 28, 2012, the City Council voted to commence the AB 506 process, and on May 1, 2012 an event of default occurred in the payment by the City of the amounts due under the Office Building Lease Back. As a result of the announcement of the commencement of the AB 506 process, the occurrence of the default, and the filing of the Chapter 9 Case, all of the 2007 Office Building Bonds were tendered for



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purchase and were unable to be remarketed (the final notice of tender for the 2007 Series A Bonds is dated February 29, 2012, and the final tender date for the 2007 Series B Bonds is September 14, 2012). Accordingly, Dexia purchased the 2007 Office Building Bonds and is now the sole holder thereof. As Bank Bonds, the 2007 Office Building Bonds now bear interest at the Default Rate under the Office Building Standby Agreement, which is equal to the Base Rate plus 3% (currently, 6.25%).<sup>9</sup> In addition, the Bank Bonds are subject to mandatory early redemption over a seven-year period.

(ii) *Leased Property.*

The 400 E. Main Office Building Property is located at 400 East Main Street, Stockton. It consists of a Class A, eight-story, steel-framed office building totaling approximately 246,541 square feet. The office building is situated on a 2.07-acre site, which is a square block fronting on East Main Street, Market Street, South California Street, and South Sutter Street. The building has an “H”-shaped floor plate with office wings flanking a central lobby on the first floor. The lower three floors step back successively to form terraces extending around the building at Floors 2, 3, and 4, while the tower above Floor 4 has planar walls. The building’s exterior consists of polished granite walls with tinted single-pane glass window and painted bronze aluminum sections. It was constructed in 1988 and is supported by a foundation of cast-in-place concrete pile in the form of a two-floor subterranean parking garage, which offers a parking ratio of approximately 2.1 per 1,000 square feet, for a total of approximately 518 stalls. The 400 E. Main Office Building Property continues to be owned by the City (subject to the Office Building Lease Out to the Financing Authority and the Office Building Lease Back from the Financing Authority).

The City entered into the Office Building Lease Back in the expectation of making the 400 E. Main Office Building Property its new City Hall—replacing the outdated and crumbling

<sup>9</sup> As defined in the Office Building Standby Agreement, Default Rate “means a rate per annum equal to the Base Rate plus an amount equal to three hundred basis points (3.00%).” Base Rate “means the higher of (a) the fluctuating rate per annum equal to the ‘prime rate’ listed daily in the ‘Money Rate’ section of *The Wall Street Journal*, or if *The Wall Street Journal* is not published on a particular Business Day, then, the ‘prime rate’ published in any other national financial journal or newspaper selected by Dexia, and if more than one such rate is listed in the applicable publication, the highest such rate shall be used or (b) the Fed Funds Rate plus fifty basis points (0.5%). Any change in the Base Rate shall take effect on the date specified in the announcement of such change.”

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City Hall built over 100 years ago. While the 400 E. Main Office Building Property did not become the new City Hall, the City did move certain of its operations there, including its information technology, and invested approximately several million dollars in upgrades to provide the necessary cabling and chillers for its main computer servers and related equipment.

Because of this investment, after the 2007 Office Building Bond Trustee took possession of the 400 E. Main Office Building Property, the City and the 2007 Office Building Bond Trustee entered into a short-term lease pursuant to which the City occupies the fourth floor of the building (the “**Fourth Floor Lease of 400 E. Main**”). The treatment of the Fourth Floor Lease of 400 E. Main is specified in the Assured Guaranty Settlement [to be finalized]. The City currently occupies (and pays above market rent for) only the fourth floor of the 400 E. Main Office Building Property. Including the City’s occupancy, the 400 E. Main Office Building Property is approximately 60% vacant as of September 2013, and barely breaks even on an operating basis before debt service.

(iii) *Assured Guaranty Settlement as Applicable to the 400 E. Main Office Building Property.*

The City has reached an agreement with the 2007 Office Building Bond Trustee, the Pension Obligation Bonds Trustee, and Assured Guaranty regarding the treatment under the Plan of the Claims arising out of the Office Building Lease Back Transaction (as well as the Pension Obligation Bonds). The terms are contained in the Assured Guaranty Settlement. [major terms to be inserted when finalized]

**g. 2009 Golf Course/Park Leases.**

(i) *Financial Instruments Involved.*

The financial instruments involved in this transaction are the Stockton Public Financing Authority Lease Revenue Bonds, 2009 Series A (Capital Improvement Projects), issued on September 9, 2009, in the aggregate principal amount of \$35,080,000 (the “**2009 Golf Course/Park Bonds**”). Wells Fargo is the indenture trustee under the 2009 Golf Course/Park Bonds Indenture (together with any successor trustee, the “**2009 Golf Course/Park Bond Trustee**”). A reserve fund exists for the 2009 Golf Course/Park Bonds with a balance as of

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September 1, 2013, of \$904,380.81 (the “**2009 Golf Course/Park Bond Reserve Fund**”). The funds in the 2009 Golf Course/Park Bond Reserve Fund are pledged to support repayment of the 2009 Golf Course/Park Bonds. The 2009 Golf Course/Park Bonds are not insured; however, Franklin is the sole holder of the bonds.

(ii) *Leased Properties.*

As described in more detail below, the properties that are involved in this transaction are Oak Park, the Van Buskirk Golf Course, and the Swenson Golf Course (as defined below, the “**Golf Course/Park Properties**”). In order to facilitate the financing to be provided by the 2009 Golf Course/Park Bonds, the City, as owner of the Golf Course/Park Properties, leased the properties to the Financing Authority, pursuant to a site and facility lease dated as of September 1, 2009, for a term ending on September 1, 2038, with a possible extension of the term to the date upon which the 2009 Golf Course/Park Bonds are paid in full. Pursuant to section 510 of the City Charter, the term of the lease cannot extend for more than 55 years or to August 31, 2064 (the “**Golf Course/Park Lease Out**”). The City contemporaneously leased the properties back from the Financing Authority for the same number of years pursuant to the terms of the Lease Agreement dated as of September 1, 2009 (the “**Golf Course/Park Lease Back**”). Thus, the City is the lessor and the Financing Authority is the tenant under the Golf Course/Park Lease Out transaction, and the Financing Authority is the lessor and the City is the tenant in the Golf Course/Park Lease Back transaction.

As tenant under the Golf Course/Park Lease Out, the Financing Authority paid rent for the entire lease term in a lump sum payment in the amount of \$1.00. Pursuant to the terms of the Golf Course/Park Lease Back, the Financing Authority agreed to provide the net proceeds of the 2009 Golf Course/Park Bonds (with gross proceeds equal to \$35,080,000) to the City for the purpose of financing various capital projects. As tenant under the Golf Course/Park Lease Back, the City agreed to make semi-annual rental payments in varying amounts (\$2,415,838 fiscal year 2012-13, \$2,923,119 for fiscal year 2013-14, \$2,926,332 for fiscal year 2014-15, etc.) (the “**Golf Course/Park Lease Back Rental Payments**”). The Financing Authority assigned to the 2009 Golf Course/Park Bond Trust its rights under the Golf Course/Park Lease Back, including the

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rights to enforce the lease after default by the City, and including the stream of Golf Lease Back Rental Payments from the City, to support the repayment of the 2009 Golf Course/Park Bonds. No other revenues or assets are pledged to support the repayment of the 2009 Golf Course/Park Bonds, the repayment obligation is non-recourse to the Financing Authority, and the 2009 Golf Course/Park Bonds are payable solely from the Golf Lease Back Rental Payments. A default occurred on March 1, 2012 in the payment by the City of amounts due under the Golf Course/Park Lease Back.

The subject properties consist of three separate properties, each of which continues to be owned by the City (subject to the Golf Course/Park Lease Out to the Financing Authority and the Golf Course/Park Lease Back from the Financing Authority) (as described below, the “**Golf Course/Park Properties**”).

(a) **Oak Park.**

This property is a public park of approximately 61.2 acres, bounded on the east by Union Pacific railroad tracks, on the north by East Fulton Street, on the south by East Alpine Street, and on the west by North Sutter and Alvarado Streets. This park features group picnic areas, 20 picnic tables, two tot lots, 15 barbecue pits, and four restrooms. In addition, Oak Park features 11 tennis courts; two regulation softball fields; the Billy Hebert Field; a 6,000 seat, regulation professional minor league baseball field (renovated in 2002); a multi-use field; a community swimming pool complex with changing facilities; and an approximately 13,875-square-foot ice-rink facility with seating for 350. A one-story senior center of approximately 5,000 square feet, which is available for rental to the public is also located at Oak Park.

(b) **Swenson Golf Course.**

This property was opened in 1952 and is located on approximately 219 acres at 6803 Alexandria Place. Swenson Golf Course features a classic championship 18-hole, par 72 course; a nine-hole executive, par three course; a 15-station driving range; two putting greens and a practice bunker; and paved cart paths. Also located on this property is a clubhouse, an approximately 2,000-square-foot pro shop, an approximately 5,000-square-foot maintenance and storage facility, and an approximately 2,500-square-foot café with seating.

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(c) **Van Buskirk Golf Course.**

This property was opened in 1962 and is located on approximately 214.0 acres at 1740 Houston Avenue. The Van Buskirk Golf Course features a classically designed par 72, 18-hole course, an all-grass driving range with 15 stations, two practice greens, and partially paved cart paths. Also located on this Property is a clubhouse, an approximately 2,000-square-foot pro shop, an approximately 5,000-square-foot maintenance and storage facility, and an approximately 2,500-square-foot cafe with seating. The Van Buskirk real property is subject to a senior reversionary interest, and if it were to be converted from a public recreational use it may revert to private parties.

All three properties are zoned for their current use, and it would be unlikely that the zoning could be changed for commercial development, even assuming that commercial development of any of the properties would be economically viable given Stockton's current real estate market.

(iii) *Operating Revenue Shortfalls Experienced for the Golf Course/Park Properties.*

The Golf Course/Park Properties generate revenues, but these revenues have historically been short of the amounts necessary to cover operating expenses.

The table below lists revenues, expenses, and operating deficits for the two golf courses:<sup>10</sup>

<sup>10</sup> Data from "Community Services Department, Golf – 481, 2013-14 Adopted Budget," in *City of Stockton 2013-2014 Annual Budget* (2013) at H-23, available at [http://www.stocktongov.com/files/2013-2014\\_Adopted\\_Budget.pdf](http://www.stocktongov.com/files/2013-2014_Adopted_Budget.pdf).

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	FY 2010-11 Actual (\$)	FY 2011-12 Unaudited Actual (\$)	FY 2012-13 Projected (\$)
<b>Revenues</b>			
Swenson Golf Course	1,126,374	1,260,192	1,073,415
Van Buskirk Golf Course	532,091	597,066	495,366
<b>Expenses</b>			
Swenson Golf Course	1,195,093	1,390,097	1,289,120
Van Buskirk Golf Course	802,591	816,755	702,248
<b>Operating Deficit</b>			
Swenson Golf Course	(68,719)	(129,905)	(215,705)
Van Buskirk Golf Course	(270,500)	(219,689)	(206,882)

Operating deficits for Oak Park are difficult to calculate with precision because revenues for certain facilities, such as the pool, the softball fields, and the senior center, are pooled with revenues from related City facilities. For the past three years, however, these operating deficits are estimated to be approximately \$400,000 per year.

As a result, each of the properties generates no revenues at all to service the debt obligations of the 2009 Golf Course/Park Bonds. Instead, the City has historically utilized certain non-pledged revenues and made expenditures from the General Fund to cover the operating shortfalls of the Golf Course/Park Properties and to pay debt service on the 2009 Golf Course/Park Bonds.

*(iv) Lease Rejection by City.*

The City has determined that it cannot afford to pay the debt service on the 2009 Golf Course/Park Bonds from General Fund revenues or from other unpledged revenues. As a result, the City has decided to reject the Golf Course/Park Lease Out and the Golf Course/Park Lease Back under section 365(a).

The practical consequences of such lease rejection are difficult to predict. As a result of the rejection by the City of the Golf Course/Park Lease Out, the 2009 Golf Course/Park Bond Trustee, as the tenant pursuant to the assignment from the Financing Authority of all of its rights under the Golf Course/Park Lease Out, may have the option under section 365(h) to remain in possession of the Golf Course/Park Properties for the balance of the term of the Golf Course/Park Lease Out so long as the rent is paid and other amounts to be paid by it under the Golf Course/Park Lease Out are paid (and the City reserves its rights to contest or place limitations

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upon such election), or to treat the rejection of the Golf Course/Park Lease Out as a termination of the same and thereby allow possession and control of the Golf Course/Park Properties to remain with the City. Should the 2009 Golf Course/Park Bond Trustee succeed in remaining in possession and control of the Golf Course/Park Properties, the City would be relieved of the obligation under the Golf Course/Park Lease Back to pay for expenses associated with the Golf Course/Park Properties, including utilities, insurance, and maintenance expenses, all of which would instead be borne by the 2009 Golf Course/Park Bond Trustee. The rent under the Golf Course/Park Lease Out was paid in a lump sum from the proceeds of the 2009 Golf Course/Park Bonds. The City would, however, continue to ensure that the Golf Course/Park Properties are run in a professional manner.

The actual decision will likely be made by Franklin, as the current holder of the 2009 Golf Course/Park Bonds, or its successor(s) should Franklin transfer ownership of the bonds. Franklin would have at least these options: (1) treat the rejection as a breach of the lease, make a claim for damages for breach of lease and allow possession and control of the Golf Course/Park Properties to remain with the City (and the City would then need to make the decision of whether to continue to operate the Golf Course/Park Properties and underwrite the operating losses or close the Golf Course/Park Properties and pay for the closure, maintenance and other holding costs); (2) attempt to exercise the option under section 365(h) to remain in possession and either operate the Golf Course/Park Properties (and underwrite the operating deficits, likely in the hope that such operating deficits can be converted into operating profits), or hold the Golf Course/Park Properties without operating them (and underwrite the closure, maintenance and other holding costs) in order to sell the rights to the remaining term of the Golf Course/Park Lease Out to a third party. Although theoretically possible, the City believes it is unlikely that Franklin would decide to remain in possession of the Golf Course/Park Properties for the balance of the term of the Golf Course/Park Lease Out and shut the properties down, which would obligate Franklin to pay all of the holding costs of the Golf Course/Park Properties without realizing any revenue at all from the operation of the properties.

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The City is party to executory contracts with vendors, managers and operators of services and facilities located at the Golf Course/Park Properties (e.g., the Golf Courses are operated by a management company, as is the ice rink, etc.). Should the City not be in a position to continue to operate the Golf Course/Park Properties (because Franklin is successful in causing the 2009 Golf Course/Park Bond Trustee to remain in possession), the City will likely reject the executory contracts related to the properties. However, if the City remains in possession and control of the properties, the City will likely re-negotiate such contracts or may assume such executory contracts.

At this time the City does not know whether the 2009 Golf Course/Park Bond Trustee/Franklin would decide to attempt to remain in possession (which the City may contest or attempt to impose conditions upon). When the City is in a position to make such decisions, the City will decide to reject, assume or renegotiate executory contracts with such vendors and other parties.

Should the 2009 Golf Course/Park Bond Trustee/Franklin be successful in remaining in possession of the Golf Course/Park Properties, at the end of the term of the Golf Course/Park Lease Out, possession, custody and control of the Golf Course/Park Properties will revert to the City as the owner of the Golf Course/Park Properties.

#### **9. Pension Obligation Bonds.**

The Pension Obligation Bonds are the City of Stockton 2007 Taxable Pension Obligation Bonds issued on April 5, 2007 in the aggregate principal amount of \$125,310,000 pursuant in part to an Indenture of Trust, dated as of April 1, 2007, by and between the City and the Pension Obligation Bonds Trustee, to refinance the obligation of the City to make payments to CalPERS for retirement benefits accruing to the City's employees and retirees. The Pension Obligation Bonds are insured by Assured Guaranty. The unpaid principal balance of the Pension Obligation Bonds is approximately \$124,280,000.

The City has reached an agreement with the 2007 Office Building Bond Trustee, the Pension Obligation Bonds Trustee, and Assured Guaranty regarding the treatment under the Plan of the Claims arising out of the Pension Obligation Bonds (as well as the Office Building Lease



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Back Transaction). The terms are contained in the Assured Guaranty Settlement. In general, with respect to the Pension Obligation Bonds, this agreement provides as follows: [major terms to be inserted when finalized].

#### 10. Statement Regarding Liabilities.

While the City's review and analysis of Claims is ongoing, the City disputes a number of the Claims that have been asserted against it. Given the inherent uncertainty of litigation, no assurance can be given regarding the successful outcome of any litigation that may be initiated in objection to Claims or regarding the ultimate amount of unsecured Claims that will be allowed against the City.

As described below, the Plan enables the City to file objections to Claims at any time within 180 days after the Effective Date. The Plan also provides for the City to retain any and all defenses, offset and recoupment rights, and counterclaims that may exist with respect to any disputed Claim, whether under the Bankruptcy Code or otherwise. The City reserves all rights with respect to the allowance and disallowance of any and all Claims. **In voting on the Plan, creditors may not rely on the absence of a reference in this Disclosure Statement or the Plan or the absence of an objection to their proof(s) of claim as any indication that the City ultimately will not object to the amount, priority, security, or allowance of their Claims.**

#### B. Assets.

##### 1. Capital Assets; Valuation and Sale Thereof.

The City owns numerous and varied capital assets, including buildings, roads, infrastructure and utility improvements, parks, undeveloped real property and service vehicles (such as fire trucks, police cars and street equipment). Virtually all of these municipal assets are used daily in the performance of public functions and cannot be easily liquidated, particularly in current market conditions. They are valued in the City's books and records at depreciated historical cost, which does not represent the cash value that could be recognized by the City in a voluntary sale. California law does not permit the levy on or sale of a city's assets in order to satisfy a court judgment. CAL. GOV'T CODE § 900 *et seq.* Thus, the City has not sought a valuation of or attempted to sell its necessary capital assets. It has valued its structures for

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insurance purposes. Such values, however, do not and cannot reflect the value to the City and its residents of, for example, fire and police stations or libraries.

On May 21, 2013, the City Council authorized the City Manager to approve the sale within predetermined guidelines of certain surplus real properties owned by the City. The surplus properties approved for sale do not relate to core City functions, and include older residential properties, vacant commercial buildings, vacant parcel remnants with potential reuse value, and grazing pasture. The guidelines authorized by the City Council permit the City Manager to approve the sale of a surplus property without formal bidding procedures so long as the sale price is 85% of the property's appraised value or greater. Individual sales of \$500,000 or more must also be approved by the City Council. The City Manager's authority to approve sales of these surplus properties under the guidelines approved by the City Council ends on May 21, 2015 unless otherwise extended by the City Council.

The City's property broker, CBRE, Inc., has provided broker's opinions of value for the surplus properties approved for sale. The aggregated broker's opinions of value total from \$2.3 million to \$3 million. The City has sold one of these surplus properties for \$65,000. Five of the surplus properties, valued collectively at \$973,500, were transferred as part of the City's settlement with Marina Towers, LLC, pursuant to which Marina Towers, LLC agreed to withdraw its proof of claim for \$1,875,000. The settlement with Marina Towers, LLC puts these five properties back on the tax roll in the hands of a capable developer. In addition, it resolves a legal issue of first impression regarding the interplay between eminent domain and bankruptcy law.

## **2. Claims and Causes of Action Against Third Parties.**

Parties in interest may not rely on the absence of a reference in this Disclosure Statement or in the Plan as any indication that the City ultimately will not pursue any and all available claims, rights and causes of action against them. **All parties who previously dealt with the City are hereby on notice** that the Plan preserves the City's rights, claims, causes of action, interests and defenses. The City expects that any and all meritorious claims will be pursued and litigated after the Effective Date to the extent they remain vested in the City.

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**C. Financial Projections Regarding City Finances.**

Under the auspices of Judge Perris, the City has engaged in lengthy negotiations with representatives of Franklin and the Indenture Trustee in attempts to gain support for a consensual plan of adjustment, which to date, has not been forthcoming. Although the City cannot discuss in any detail the content of privileged settlement negotiations, it is clear to the City that reaching agreement with such parties on a consensual plan of adjustment will greatly increase the payments that must be made out of the General Fund in the coming years, and should the City achieve its goal of reaching agreement on a consensual plan of adjustment with such creditors, the passage of Measure A would become even more important than under this Plan.

There can be no assurances that the finances of the City in future years will be consistent with any of the financial projections submitted herewith and creditors should review such financial statements with this caveat in mind (see the discussion of risk factors associated with the Plan in Section VII below).

**D. Impact of Measure A upon Future City Finances and Ability of City to Confirm the Plan.**

The City believes that passage on November 5, 2013 of Measure A will produce approximately \$30 million per year in new revenue from a 3/4 of one percent increase in sales taxes (from 8.25% to 9%), and that such revenue is critical to the viability of the Plan. Measure A may be difficult for some Stocktonians to accept, but it is not unusual in California's current financial environment. According to California State Board of Equalization's website, [www.boe.ca.gov](http://www.boe.ca.gov):

- 18 California cities have higher sales tax rates than Stockton's proposed 9%.
- 125 California cities are already at 9%.

The Plan Financial Projections assume that Measure A will pass. The City expects that approximately 65% of the revenue generated by Measure A will be used over time to enhance depleted police services under the Marshall Plan, and the remainder will be used to fund the City's ongoing expenses, including the cost of implementing the Plan. Conversely, as discussed in the "Risk Factors" below and in the graphs included with the Plan Financial Projections, the

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failure of Measure A would mean that the City would continue to incur a substantial structural operating deficit even if the additional hires of police and other safety officers contemplated by the Marshall Plan do not take place. Moreover, the City would be incapable of fulfilling its obligations under the Plan, and the City would be required to make significant additional cuts to existing City services, including cuts to the fire department. The City cannot predict whether it would be able to continue to function under such a scenario and does not have detailed plans in place at this point to deal with such across the board additional staffing and service reductions.

Assuming the cram-down level of savings envisioned by adoption of this Plan, without the tax and without the Marshall Plan expenditures, the City would have to reduce annual projected General Fund expenditures by \$8 million on an ongoing basis effective with fiscal year 2014-15 in order for a minimal level of balance averaging 2.9% to be maintained through fiscal year 2020-21. If negotiated agreements produced a lesser amount of savings, the required ongoing General Fund expenditure reduction could increase to \$11 million.<sup>11</sup>

In addition, at the time of preparation of this Disclosure Statement, the City is still involved in intense negotiations with Franklin and the Indenture Trustee and is hopeful that those negotiations will culminate in agreements with such creditors on the terms of a consensual plan of adjustment that would retain City control of the affected properties. However, no such plan will be financially feasible unless additional funds flow to the General Fund through Measure A.

In short, the City believes that Measure A is necessary to address the depleted ranks of Stockton's police, fire and other safety officers, and is necessary to confirm the Plan or any other plan of adjustment that incorporates agreements hoped to be reached with all or some of the capital markets creditors that preserve or return City real estate assets.

## **V. SUMMARY OF THE PLAN OF ADJUSTMENT**

The discussion of the Plan set forth below is qualified in its entirety by reference to the more detailed provisions set forth in the Plan and its exhibits, the terms of which are controlling. Holders of claims and other interested parties are urged to read the Plan and its exhibits, copies of

<sup>11</sup> See "Alternative Scenarios" on pp. B-17 and B-18 of Exhibit B ("Long Range Financial Plan of City of Stockton") to this Disclosure Statement.

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which are attached to this Disclosure Statement as **Exhibit A**, in their entirety so that they may make an informed judgment regarding the Plan.

The Plan involves claims of approximately \$299,505,000 of publicly held securities, certain of which evidence and represent undivided fractional interests in General Fund leases of many of the City's capital assets. Some of these assets are important or even essential to municipal operations. The Plan also addresses and resolves the City's obligations to current and former employees and various other claims. While the Plan permits the City to continue to maintain minimally acceptable levels of vital municipal services for its residents and businesses, and while it devotes substantial resources to the repayment of the City's creditors, it nevertheless further defers infrastructure maintenance as well as the optimal staffing of City service units such as police and fire.

Importantly, while the Plan significantly impairs the interests of former employees and retirees with respect to health benefits, it does not impair the City's obligations to CalPERS in its capacity as trustee for the City's pension trust for the City's retired workers and their dependents who are the beneficiaries of this trust as well as current employees and their dependents (the City has one contract with CalPERS, but there are three contract groups: police, fire, and miscellaneous). In other words, current and future pension CalPERS payments to such persons will not be altered by the Plan. However, outside of the Plan, retirement benefits for current and future employees have been impacted by negotiated changes in the City's labor agreements. Retiree health benefits worth approximately \$1 billion for current employees have been eliminated as a result of negotiated agreements. This loss of retiree health benefits constitutes an approximate reduction in pension benefits, which along with certain compensation changes for these employees, amounts to a 30-50% reduction from what they otherwise would have received. Additionally, pension benefits for new employees hired after January 1, 2013 have been reduced by approximately 50-70% (including lost retiree health benefits) for all employees and in some cases higher for certain types of employees as a result of changes in state law and changes in labor agreements that the City has negotiated. New hires are also required to pay a greater share of their future pension benefits. Additionally, because of compensation reductions of up to 30%

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in pensionable income negotiated in 2011 and 2012, the future pensions of employees will be lower than they otherwise would have been, though no further reduction is imposed by the Plan.

Payment to holders of General Unsecured Claims—which holders include, but are not limited to, institutions that are exposed to bondholders for any shortfall in the payment by the City of six bond issuances, the Retiree Health Benefit Claimants, the holders of Leave Buyout Claims, and the holders of Pension Obligation Bond Claims—shall receive cash payment on the Effective Date in an amount equal to a set percentage of the Allowed amount of such Claims. The percentage of the Allowed amount paid on such claims will be the Unsecured Claim Payout Percentage or such other amount as is determined by the Bankruptcy Court before confirmation of the Plan to constitute a pro-rata payment on such other General Unsecured Claims. While the City regrets that it cannot pay a higher dividend to holders of General Unsecured Claims, the fact is that the City lacks the revenues to do so if it is to maintain an adequate level of municipal services such as the provision of fire and police protection, the maintenance and repair of the City's streets and other public facilities, and the continued availability of important municipal services such as library, recreation, and parks.

The Plan does not alter the obligations of those City funds that are restricted by grants, by federal law, or by California law; pursuant to the Tenth Amendment to the United States Constitution and the provisions of the Bankruptcy Code that implement the Tenth Amendment, such funds cannot be impacted in the Chapter 9 Case. Thus, securities payable solely from restricted funds are not altered by the Plan.

#### **A. Classification and Treatment of Claims.**

##### **1. Unclassified Claims.**

Section II of the Plan governs the treatment of certain claims that are not classified into Classes under the Plan.

##### **a. Administrative Claims.**

Administrative Claims, as defined in the Plan, are dealt with in Section II(A) of the Plan. Throughout the course of the Chapter 9 Case, the City has endeavored to satisfy postpetition expenses as they became due. Accordingly, the City believes that most claims that otherwise

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would constitute Allowed Administrative Claims previously have been or will be satisfied in the ordinary course of business prior to and after the Effective Date.

(i) *Treatment of All Other Administrative Claims Other Than Professional Claims.*

The Plan provides that, except as provided in Section II(B) of the Plan, with respect to Professional Claims, or to the extent that the holder of an Allowed Administrative Claim agrees to a different treatment, the City or its agent will pay to each holder of an Allowed Administrative Claim, in full satisfaction, release, and discharge of such claim, cash in an amount equal to such Allowed Administrative Claim on the later of (i) the Effective Date or (ii) the date on which such Claim becomes an Allowed Administrative Claim, or as soon thereafter as is practicable.

Professional Claims are claims of professionals for services and costs during the Chapter 9 Case or incident to the Plan to be paid by the City. Section II(B) of the Plan provides that pursuant to section 943(a)(3), all amounts paid following the Effective Date or to be paid following the Effective Date for services or expenses in the Chapter 9 Case or incident to the Plan must be disclosed to the Bankruptcy Court and must be reasonable. There shall be paid to each holder of a Professional Claim, in full satisfaction, release, and discharge of such Claim, Cash in an amount equal to that portion of such Claim that the Bankruptcy Court approves as reasonable, on or as soon as reasonably practicable following the date on which the Bankruptcy Court enters a Final Order determining such reasonableness. The City, in the ordinary course of its business, and without the requirement for Bankruptcy Court approval, may pay for professional services rendered and costs incurred following the Effective Date.

During the course of the Chapter 9 Case, the City has, in the ordinary course of business, paid the fees (and reimbursed the costs) of its various counsel (including bankruptcy counsel, labor counsel, litigation counsel, and elections counsel). The City has also paid the fees of management and financial professionals, as well as the fees of counsel for the Retirees Committee, on a regular basis during the Chapter 9 Case.

The fees described in the preceding paragraph **are not** Professional Fees because they have been paid prior to the Effective Date. Nor are such fees subject to Bankruptcy Court review

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or approval, as sections 326 *et seq.* do not apply in chapter 9 cases. As of the date of this Disclosure Statement, the City is not aware of any Claims for Professional Fees.

**b. Bar Date for Assertion of Requests for Payment of Administrative Claims (Other Than Ordinary Course Administrative Claims) and Professional Claims.**

Section II(D) of the Plan provides that all requests for approval of Administrative Expense and Professional Claims must be filed with the Bankruptcy Court and served upon the City no later than 30 days after the date on which the Notice of Effective Date is mailed pursuant to the Plan.

*Any request for payment of an Administrative Claim, and any request for a finding that a Professional Claim is reasonable, that is not timely filed by that deadline will be forever barred, and holders of such claims will be barred from asserting such claims in any manner against the City.*

**2. Classified Claims**

**a. Class 1A – Claims of Ambac – 2003 Fire/Police/Library Certificates.**

Ambac's Claims shall receive the treatment set forth in the Ambac Settlement Agreement, which is attached as Exhibit A to the Declaration of Robert Deis in Support of the City of Stockton's Motion under Bankruptcy Rule 9019 for Approval of Its Settlement with Ambac Assurance Corporation, filed in the Chapter 9 Case on February 26, 2013 [Dkt. No. 725].

**b. Class 1B – Claims of Holders of 2003 Fire/Police/Library Certificates.**

The treatment of the Class 1B claimants, the 2003 Fire/Police/Library Certificates holders, is identical to the treatment of Ambac, the Class 1A claimant.

**c. Class 2 – SEB Claims of the 2006 SEB Bond Trustee/NPFG – 2006 SEB Bonds.**

The City will assume the SEB Lease Back and the SEB Lease Out under section 365(a) pursuant to the Assumption Motion and the NPFG Settlement. No later than 60 days after the Effective Date or 60 days after approval of the Lease Assumption Motion, whichever is later, the City will make the payments to the 2006 SEB Bond Trustee necessary to cure past defaults under



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the SEB Lease Back and the SEB Lease Out, if any, as well as any actual pecuniary loss suffered by the 2006 SEB Bond Trustee as a result of the City's default of the SEB Lease Back and the SEB Lease Out, if any, but, pursuant to the terms of the NPFG Settlement, not any attorneys' fees or other professional expenses incurred by the 2006 SEB Bond Trustee. Further, the finding by the Bankruptcy Court that the Plan is feasible shall constitute adequate assurance of future performance of the SEB Lease Back and the SEB Lease Out.

**d. Class 3 – Arena Claims of the 2004 Arena Bond Trustee/NPFG – 2004 Arena Bonds.**

The treatment of the Class 3 Claims will be as set forth in the NPFG Settlement.

**e. Class 4 – Parking Structure Claims of the 2004 Parking Bond Trustee/NPFG – 2004 Parking Bonds.**

The treatment of the Class 4 Claims will be as set forth in the NPFG Settlement.

**f. Class 5 – Office Building Claims of the 2007 Office Building Bond Trustee/Assured Guaranty**

The treatment of the Class 5 Claims will be as set forth in the Assured Guaranty Settlement.

**g. Class 6 – Pension Obligation Bonds Claims of Assured Guaranty**

The treatment of the Class 6 Claims will be as set forth in the Assured Guaranty Settlement.

**h. Class 7 – Claims of DBW.**

The General Fund will not be required to pay debt service on this obligation, or to reimburse operating expenses to DBW should DBW take over operations of the Marina Project. DBW will retain its pledge of rents and leases generated from the Marina Project. However, the pledge of gross revenues will be converted to a pledge of revenues net of all reasonable and direct operating expense of the Marina Project, calculated on a fiscal year basis ending June 30 of each year. Should DBW decide to take over operations of the Marina Project, DBW will be responsible for payment of all operating expenses of the Marina Project and the City will have the right to ensure that the Marina Project is operated in a responsible and safe manner, including providing adequate security, and the City shall have the right to compel DBW to alter its manner

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of operations if such operations pose a threat to the public welfare or if such operations abet a public nuisance. The General Fund shall have no liability, directly or indirectly, for the Claims of DBW, and the City may decide at any time to cease subsidizing the operating deficits of the operation of the Marina Project. DBW has stated to the City an interest in exercising its remedy of taking possession of the Marina Project.

**i. Class 8 – SCC 16 Secured Claims.**

The treatment of the Class 8 Claims will be as set forth in the SCC 16 Settlement.

**j. Class 9 – Thunder Claims.**

The treatment of the Class 9 Claims will be as set forth in the Thunder Settlement.

**k. Class 10 – Claims of Holders of Restricted Revenue Bond and Note Payable Obligations.**

The City's Restricted Revenue Bond and Notes Payable Obligations are secured by a pledge of and lien on revenues of various of the City's systems and enterprises, which are restricted revenues pursuant to the California Constitution, and are "special revenues" as defined in section 902(2). These revenues are not a part of or available to the General Fund, and the General Fund is not obligated to make any payment on the Restricted Revenue Bond and Notes Payable Obligations. The City may transfer amounts from the restricted revenues to the General Fund only to pay costs which are incurred by the General Fund to provide the facility or enterprise-related services and are allocated to the enterprises on a reasonable basis in accordance with the City's accounting and allocation policies. Such transfers are treated by the facility or enterprise as operation and maintenance expenses. The City will continue to apply restricted revenues to pay the Restricted Revenue Bond and Notes Payable Obligations as required by the terms of such obligations.

**l. Class 11 – Claims of Holders of Special Assessment and Special Tax Obligations.**

The City's Special Assessment and Special Tax Obligations are secured by certain special assessments and special taxes levied on specific real property within the respective districts for which these obligations were issued. These special assessment and special tax revenues are legally restricted to the payment of debt service on the Special Assessment and Special Tax

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Obligations under California statutes and the California Constitution, are “special revenues” as defined in section 902(2), and cannot be used for any other purpose or be transferred to the General Fund. The General Fund is not obligated to pay debt service on the Special Assessment and Special Tax Obligations. The City will continue to apply revenues from the applicable special assessments and special taxes to pay the Special Assessment and Special Tax Obligations as required by the terms of such obligations.

**m. Class 12 – General Unsecured Claims.**

The major claims in this Class include without limitation: (1) the Retiree Health Benefit Claims; (2) the Claims of Dexia under the Office Building Standby Agreement; (3) the Golf Course/Park Claims of the 2009 Golf Course/Park Bond Trustee/Franklin; (4) the Leave Buyout Claims; (5) the Price Claims; and (6) Other Postpetition Claims.

The Retiree Health Benefit Claims are held by approximately 1,100 of the City’s former employees plus their dependents. The Retirees Committee maintains that the aggregate amount of the Retiree Health Benefit Claims is approximately \$538,000,000.<sup>12</sup> Pursuant to the Retirees Settlement, on the Effective Date, the City will pay the Retirees an aggregate amount of \$5,100,000 in full satisfaction of Allowed Retiree Health Benefit Claims, and no other retiree health benefits will be provided by the City. If required by state or federal law, the City will withhold from the aggregate \$5,100,000 payment any taxes or other deductions to be withheld from the individual payment to each Retiree Health Benefit Claimant. The individual recipient is responsible for any tax liability for this payment, and the City will not provide any advice to any recipient as to the taxable impact of this payment.

All other General Unsecured Claims shall receive cash payment on the Effective Date in the amount equal to a percentage of the Allowed Amount of such Claims, which such percentage equals the Unsecured Claim Payout Percentage, or such other amount as is determined by the Bankruptcy Court before confirmation of this Plan to constitute a pro-rata payment on such other General Unsecured Claims; *provided, however*, that the dollar amount to be paid shall not exceed

<sup>12</sup> This does not include the retiree health benefit claims of employees employed as of July 1, 2012, who waived their claims of approximately \$1 billion of previously earned benefits for no additional compensation, as part of memoranda of understanding negotiated in 2012.

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in the aggregate \$[\_\_\_\_\_]; and *provided further*, if such amount is in excess of \$[\_\_\_\_\_], the City retains the right to and intends to modify this Plan to provide alternative treatment to such General Unsecured Claims, which alternative treatment may involve payment over a number of years on account of such General Unsecured Claims.

**n. Class 13 – Convenience Class Claims.**

Holders of Convenience Class Claims will receive cash on the Effective Date in the amount of their Allowed Convenience Class Claim, but not to exceed \$100.

**o. Class 14 – Claims of Certain Tort Claimants.**

The SIR Claim Portion of each Allowed General Liability Claim will be paid on the Effective Date from the Risk Management Internal Service Fund, and will receive the same percentage payment on the dollar of Allowed Claim as will the holders of Allowed Class 12 Claims. The Insured Portion of each Allowed General Liability Claim is not Impaired, and shall be paid by the applicable excess risk-sharing pool.

**p. Class 15 – Claims of CalPERS with Respect to the CalPERS Pension Plan, as Trustee under the CalPERS Pension Plan for the Benefit of CalPERS Pension Plan Participants.**

The City will continue to honor its obligations to fund employee retirement benefits under the CalPERS Pension Plan, and CalPERS as trustee and the CalPERS Pension Plan Participants retain all of their rights and remedies under applicable nonbankruptcy law. Thus, CalPERS and the CalPERS Pension Plan Participants will be entitled to the same rights and benefits to which they are currently entitled under the CalPERS Pension Plan.<sup>13</sup> CalPERS, pursuant to the CalPERS Pension Plan, will continue to be made available to provide pension benefits for participants in the manner indicated under the provisions of the CalPERS Pension Plan and remedies under applicable nonbankruptcy law.

<sup>13</sup> As a result of negotiated labor contracts that changed certain pension provisions, as well as changes in state law, pension benefits for new hires effective January 2013 have been reduced by 50-70% (including loss of retiree health benefits) and in some cases higher for some types of new hires; new hires are also required to pay a greater share of their future pensions; additionally, while the loss of retiree health benefits and the loss of “pension spiking” will reduce the postemployment retirement benefits of current employees 30-50%; and lastly, employee compensation reductions that occurred in 2011 and 2012, which ranged up to 30% in pensionable compensation in some cases, will further reduce their future pension benefit that they otherwise would have received; these concessions are unaffected by the Plan.

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1                                    **q.        Class 16 – Claims of Equipment Lessors.**

2                    Any equipment leases not specifically rejected by the Rejection Motion will be assumed  
3 under this Plan. The City believes that it is current on all such equipment leases and no cure  
4 payments are therefore required.

5                                    **r.        Class 17 – Workers Compensation Claims.**

6                    The City must pay Allowed SIR Claim Portions related to Workers Compensation Claims  
7 in full. If not, the City will lose its State workers compensation insurance for those claims in  
8 excess of the SIR Claim Portions, exposing the City's current and former workers to grave risk.  
9 The City will pay the SIR Claim Portions related to Worker Compensation Claims from the  
10 Workers' Compensation Internal Service Fund.

11                                   **s.        Class 18 – SPOA Claims.**

12                   The City will honor the SPOA Claims held by SPOA members on the terms and  
13 conditions set forth in the SPOA MOU, which in general provides each SPOA member with  
14 44 hours of additional paid leave time through fiscal year 2014-15.

15                   Specifically, the SPOA MOU provides as follows:

16                                2. SPOA's Claims. SPOA alleges that its members have claims in the  
17 bankruptcy case against the City relating to the City's modification of its 2009  
18 Memorandum of Understanding ("2009 MOU"), pursuant to Declarations of  
19 Fiscal Emergency beginning on or about May 26, 2010 and continuing in effect  
20 thereafter, and in connection with the treatment of the claims of SPOA and its  
21 members under the Pendency Plan (collectively, the "Claims"), and that, in the  
22 aggregate, the Claims exceed thirteen million dollars (\$13,000,000). The City  
23 disputes the Claims and contends that the Claims would not be allowed in the  
24 chapter 9 case. It further asserts that, if the Claims were allowed, they would be  
25 allowed in an amount aggregating less than thirteen million dollars (\$13,000,000).

26                   In consideration of resolving the above differences and agreement on the  
27 MOU, the City agrees that the Claims shall be provided for in the Plan as follows:

28                                (a) The Claims will be deemed allowed in the chapter 9 case in the  
aggregate amount of eight million, five hundred thousand dollars (\$8,500,000)  
(the "Allowed Claims"). In consideration for the reduction in the amount of the  
Claims SPOA members employed during fiscal year 2010-2011 and/or 2011-2012  
shall be credited, upon final approval of the MOU by the Parties and, if necessary,  
by the Bankruptcy Court, twenty-two (22) additional hours of paid leave in fiscal  
year 2012-2013. These additional hours of paid leave shall have no cash value  
and shall be utilized any time prior to the date upon which the SPOA member

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leaves employment with the City. Only those employees who were employed during some portion of the period July 1, 2010 and July 1, 2012 and who were still current employees upon the effective date of this Agreement shall be entitled to this treatment.

(b) The Allowed Claims shall be satisfied under the Plan by the City by crediting SPOA members employed during fiscal year 2010-2011 and/or 2011-2012 eleven (11) additional paid leave hours in the fiscal year of approval of the Plan and eleven (11) additional paid leave hours in the fiscal year after approval of the Plan. This benefit shall only apply to those employees who were employed during some portion of the period July 1, 2010 and July 1, 2012 and who are current employees as of the date the Plan is approved by the Bankruptcy Court. The total additional paid leave per SPOA member under paragraphs 2(a) and 2(b) of this article shall equal forty-four (44) hours. These additional paid leave hours shall have no cash value, and shall be utilized any time prior to the date upon which the SPOA member leaves employment with the City. It is understood that the provision of these hours shall be the sole compensation for the Claims of SPOA and its members. The additional twenty-two (22) hours additional paid leave credit contained in this paragraph 2(b) shall be contingent upon confirmation of the Plan and on the Plan becoming effective.

(c) Notwithstanding the foregoing, in the event that the Plan is not confirmed and does not become effective, the Claims shall not be allowed as specified herein, and both SPOA and the City agree that the Claims will be considered unresolved, with each Party reserving the right to assert or contest the Claims; provided, however, that the monetary equivalent of any paid leave hours taken pursuant to this Article shall serve as a credit against the Claims.

SPOA MOU at 55-56.

## **B. Treatment of Executory Contracts and Unexpired Leases.**

### **1. Generally.**

The Bankruptcy Code empowers debtors, subject to the approval of the Bankruptcy Court, to assume or reject their executory contracts and unexpired leases. An “executory contract” generally means a contract under which material performance other than the payment of money is due by the parties. An “unexpired lease” is a lease the term of which has not matured as of the date of the filing of the Chapter 9 Case.

A debtor’s assumption of an executory contract or unexpired lease means that it will and must continue to honor its obligations under such agreement. In other words, as to such agreement, it is business as usual. **As described in the next section, the City will assume almost all of its executory contracts and unexpired leases except for a number of financing**

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leases, which it will reject. Rejection of an executory contract or unexpired lease constitutes a prepetition breach of such agreement, excusing the debtor's future performance but creating a claim for the breach.

## 2. Assumption.

The City is a party to hundreds of executory contracts and unexpired leases. Significant agreements include: (1) its collective bargaining agreements with its nine unions, most of which were reached before or not long after the Petition Date; (2) numerous equipment and vehicle leases; (3) agreements with contractors and other vendors to the City; (4) the City's obligations to CalPERS in its capacity as trustee for the City's pension trust for the City's retired workers and their dependents who are the beneficiaries of this trust (the City has one contract with CalPERS, but there are three contract groups: police, fire, and miscellaneous); and (5) the financing leases. Save for the financing leases, which are discussed separately below, the City has elected to assume virtually all of its executory contracts and unexpired leases, and will do so pursuant to the Assumption Motion. The City will not seek to assign any of the agreements that it assumes and has no current intention to assign such agreements in the future.

The City believes that it is current in its payments and other obligations under the executory contracts and unexpired leases that it will assume via the Assumption Motion. However, after the provision of notice and the opportunity for a hearing on the Assumption Motion, the Bankruptcy Court will resolve any disputes regarding whether the City is in default and, if so, both the amount of any cure payment to be made in connection with the assumption of any contract or lease, and any other matter pertaining to such assumption.

## 3. Rejection.

The City will file the Rejection Motion, pursuant to section 365(a), to seek approval and authorization for the rejection of those executory contracts and unexpired leases that it does not elect to assume. Such agreements are those that the City, in the exercise of its business judgment, deems burdensome. The City anticipates rejecting few executory contracts or unexpired leases. As described above, the City will reject, among other leases, the Office Building Standby Agreement, the Golf Course/Park Lease Out, and the Golf Course/Park Lease Back.

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The City will terminate the Office Building Lease Out and the Office Building Lease Back, and the City will assume the Fourth Floor Lease of 400 E. Main (alternatively, it will reject the Office Building Lease Out and the Office Building Lease Back, and it will assume the Fourth Floor Lease of 400 E. Main). [treatment is not finalized]

**4. Deadline for the Assertion of Rejection Damage Claims; Treatment of Rejection Damage Claims.**

All proofs of claim on account of Claims arising from the rejection of executory contracts or unexpired leases must be filed with the Bankruptcy Court and served on the City no later than 30 days after the date on which notice of entry of the order approving the Rejection Motion is served on the parties to the executory contracts and expired leases subject to the Rejection Motion. Any Claim for which a proof of claim is not filed and served within such time will be forever barred and shall not be enforceable against the City or its assets, properties, or interests in property. Unless otherwise ordered by the Bankruptcy Court, all such Claims that are timely filed as provided herein shall be classified into Class 12 (General Unsecured Claims) and treated accordingly.

**C. Means for Execution and Implementation of the Plan.**

Following the Effective Date, the City will continue to operate under its Charter, the California Constitution, and other applicable laws. It will continue to collect real property tax revenues, sales tax revenues, the user utility tax, and other taxes, fees, and revenues following the Effective Date, spending such revenues on municipal services such as providing fire and police protection, paving roads, and facilitating the provision of general municipal services.

The Plan provides that the City retains all of its claims, causes of action, rights of recovery, rights of offset, recoupment rights to refunds, and similar rights after the Effective Date. The failure to list in this Disclosure Statement any potential or existing Right of Action retained by the City is not intended to and shall not limit the rights of the City to pursue any such action. Unless a Right of Action is expressly waived, relinquished, released, compromised, or settled in the Plan, the City expressly reserves all Rights of Action for later adjudication and, as a result, no preclusion doctrine, including the doctrines of res judicata, collateral estoppel, issue preclusion,



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claim preclusion, estoppel (judicial, equitable, or otherwise), or laches, shall apply to such Rights of Action upon or after the confirmation or consummation of the Plan or the Effective Date. In addition, the City expressly reserves the right to pursue or adopt against any other entity any claims alleged in any lawsuit in which the City is a defendant or an interested party.

#### **D. Distributions.**

The City may retain one or more agents (including Rust Consulting/Omni Bankruptcy) to perform or assist it in performing the distributions to be made pursuant to the Plan, which agents may serve without bond. The City may provide reasonable compensation to any such agent(s) without further notice or Bankruptcy Court approval.

##### **1. Delivery of Distributions.**

All distributions to any holder of an Allowed Claim shall be made at the address of such holder as set forth in the books and records of the City or its agents, unless the City has been notified by such holder in a writing that contains an address for such holder different from the address reflected in the City's books and records. All such notifications of address changes and all address confirmations should be mailed to: City of Stockton, Attn: [\_\_\_\_], [insert address]. All distributions to the Indenture Trustee shall be made in accordance with the relevant indenture, as applicable.

##### **2. Undeliverable Distributions.**

###### **a. Holding of Undeliverable Distributions.**

If any distribution to any holder of a Claim is returned to the City or its agent as undeliverable, no further distributions shall be made to such holder unless and until the City is notified in writing of such holder's then-current address. Unless and until the City is so notified, such distribution shall be deemed to be "Unclaimed Property" and shall be dealt with in accordance with Section IX(C)(2) of the Plan.

###### **b. Unclaimed Property.**

If any entity entitled to receive distributions pursuant to the Plan does not present itself on the Effective Date or on such other date on which such entity becomes eligible for distribution, such distributions shall be deemed to be "Unclaimed Property." Unclaimed Property shall be set

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aside and held in a segregated account to be maintained by the City pursuant to the terms of the Plan.

### 3. Notification and Forfeiture of Unclaimed Property.

No later than 60 days after the date of the first distributions under the Plan, the City will file with the Bankruptcy Court a list of Unclaimed Property, together with a schedule that identifies the name and last-known address of holders of the Unclaimed Property; the City otherwise will not be required to attempt to locate any such entity. On the 60th day following the date of the first distributions made under the Plan, all remaining Unclaimed Property and accrued interest or dividends earned thereon will be remitted to and vest in the City for any such use as the City sees fit.

### 4. Distributions of Cash.

Any payment of Cash to be made by the City or its agent pursuant to the Plan shall be made by check drawn on a domestic bank or by wire transfer, at the sole option of the City.

### 5. Timeliness of Payments.

Any payments or distributions to be made pursuant to the Plan shall be deemed to be timely made if made within 14 days after the dates specified in the Plan. Whenever any distribution to be made under the Plan shall be due on a day that is a Saturday, Sunday, or legal holiday, such distribution instead shall be made, without interest, on the immediately succeeding day that is not a Saturday, Sunday, or legal holiday, but shall be deemed to have been made on the date due.

### 6. Compliance with Tax, Withholding, and Reporting Requirements.

The City shall comply with all tax, withholding, reporting, and like requirements imposed on it by any government unit, including without limitation, payments related to CalPERS's required pension obligations, and all distributions pursuant to this Plan shall be subject to such withholding and reporting requirements. In connection with each distribution with respect to which the filing of an information return (such as Internal Revenue Service Forms W-2, 1099, or 1042) or withholding is required, the City shall file such information return with the Internal Revenue Service and provide any required statements in connection therewith to the recipients of

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such distribution, or effect any such withholding and deposit all moneys so withheld to the extent required by law. With respect to any entity from whom a tax identification number, certified tax identification number, or other tax information which is required by law to avoid withholding has not been received by the City, the City at its sole option may withhold the amount required and distribute the balance to such entity or decline to make such distribution until the information is received.

**7. Time Bar to Cash Payments.**

Checks issued by the City on account of Allowed Claims will be null and void if not negotiated within 90 days from and after the date of issuance thereof. Requests for reissuance of any check shall be made directly to the City by the holder of the Allowed Claim with respect to which such check originally was issued. Any claim in respect of such a voided check must be made on or before the second anniversary of the Effective Date. After such date, all Claims in respect of voided checks will be discharged and forever barred and the City will retain all moneys related thereto.

**8. No De Minimis Distributions.**

Notwithstanding any other provision of the Plan, no payment of less than \$10.00 will be made by the City on account of any Allowed Claim.

**9. No Distributions on Account of Disputed Claims.**

Notwithstanding anything to the contrary in the Plan, no distributions shall be made on account of any part of any Disputed Claim until such Claim becomes Allowed (and then only to the extent so Allowed). Distributions made after the Effective Date in respect of Claims that were not Allowed as of the Effective Date (but which later became Allowed) shall be deemed to have been made as of the Effective Date.

**10. No Postpetition Accrual.**

Unless otherwise specifically provided in the Plan or Allowed by order of the Bankruptcy Court, the City will not be required to pay to any holder of a Claim any interest, penalty, or late charge accruing with respect to such claim on or after the Petition Date.

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**E. Disputed Claims.**

**1. Claims Objection Deadline; Prosecution of Objections.**

The City will have the right to object to the allowance of Claims filed with the Bankruptcy Court with respect to which liability or allowance is disputed in whole or in part. Unless otherwise ordered by the Bankruptcy Court, the City must file and serve any such objections to Claims by not later than 180 days after the Effective Date (or, in the case of Claims lawfully filed after the Effective Date, by not later than 180 days after the date of filing of such Claims).

**2. Reserves, Payments, and Distributions with Respect to Disputed Claims.**

After the Effective Date has occurred, at such time as a Disputed Claim becomes an Allowed Claim, in whole or in part, the City or its agent will distribute to the holder thereof the distributions, if any, to which such holder is then entitled under the Plan. Such distributions, if any, will be made as soon as practicable after the date that the order or judgment of the Bankruptcy Court allowing such Disputed Claim becomes a Final Order (or such other date as the Claim becomes an Allowed Claim), but in no event more than 60 days thereafter. Unless otherwise specifically provided in the Plan or Allowed by order of the Bankruptcy Court, no interest will be paid on Disputed Claims that later become Allowed Claims.

**F. Continuing Jurisdiction of the Bankruptcy Court.**

The Plan provides for the Bankruptcy Court to retain jurisdiction over a broad range of matters relating to the Chapter 9 Case, the Plan, and other related items. Readers are encouraged to review the Plan carefully to ascertain the nature of the Bankruptcy Court's continuing post-Effective Date jurisdiction.

**VI. CONFIRMATION AND EFFECTIVENESS OF THE PLAN**

**Because the law with respect to confirmation of a plan of adjustment is complex, creditors concerned with issues regarding confirmation of the Plan should consult with their own attorneys and financial advisors.** The following discussion is intended solely for the purpose of providing basic information concerning certain confirmation issues. The City cannot

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and does not represent that the discussion contained below is a complete summary of the law on this topic.

Many requirements must be met before the Bankruptcy Court may confirm the Plan. Some of the requirements discussed in this Disclosure Statement include acceptance of the Plan by the requisite number of creditors, and the determination of whether the Plan is in the “best interests” of creditors. These requirements, however, are not the only requirements for confirmation, and the Bankruptcy Court will not confirm the Plan unless and until it determines that the Plan satisfies all applicable requirements, including requirements not referenced in this Disclosure Statement.

**A. Voting and Right to Be Heard at Confirmation.**

**1. Who May Support or Object to Confirmation of the Plan?**

Any party in interest may support or object to the confirmation of the Plan. Even entities who may not have a right to vote (e.g., entities whose claims are classified into an Unimpaired Class) may still have a right to support or object to confirmation of the Plan. (*See* Section I(C)(2) for information regarding the applicable deadlines for objecting to confirmation of the Plan).

**2. Who May Vote to Accept or Reject the Plan?**

A creditor generally has a right to vote for or against the Plan if its Claim is both Allowed for purposes of voting and is classified in an Impaired Class. Generally, a Claim is deemed allowed if a proof of claim was timely filed; *provided, however*, that if an objection to a claim has been filed, the claimant cannot vote unless the Bankruptcy Court, after notice and hearing, either overrules the objection or allows the claim for voting purposes. Thus, **the definition of “Allowed Claim” used in the Plan for purpose of determining whether creditors are entitled to receive distributions is different from that used by the Bankruptcy Court to determine whether a particular claim is “allowed” for purposes of voting. Holders of claims are advised to review the definitions of “Allowed,” “Claim,” and “Disputed Claim” set forth in Section I(A) of the Plan to determine whether they may be entitled to vote on, and/or receive distributions under, the Plan.**

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### 3. Who Is Not Entitled to Vote?

The holders of the following types of claims are not entitled to vote on the Plan:

- (a) Claims that have been disallowed; (b) Claims that are subject to a pending objection and which have not been allowed for voting purposes; (c) Claims that are not Impaired; and
- (d) Administrative Expense Claims, since such Claims are not placed in Classes and are required to receive certain treatment specified by the Bankruptcy Code.

### 4. Vote Necessary to Confirm the Plan.

The Bankruptcy Court cannot confirm the Plan unless, among other things, (a) at least one Impaired Class has accepted the Plan without counting the votes of any insiders within that Class; and (b) either all Impaired Classes have voted to accept the Plan, or the Plan is eligible to be confirmed by “cram down” with respect to any dissenting Impaired Class.

A Class of claims is considered to have accepted the Plan when more than one-half in number and at least two-thirds in dollar amount of the claims that actually voted in that Class have voted in favor of the Plan.

### B. The “Best Interests” Test.

The Bankruptcy Court also must determine that the Plan is in the “best interests of creditors” pursuant to section 943(b)(7), which in the chapter 9 context means that treatment under the Plan must be better than the only alternative available, which is dismissal of the case. Dismissal permits every creditor to fend for itself in the race to the courthouse, since a municipality such as the City is not eligible under the Bankruptcy Code for a court-supervised liquidation under chapter 7.

The City submits that the Plan is in the best interests of all creditors because the payments that will be made to holders of Allowed Claims in all Impaired Classes will be greater than those the creditors would receive were the Chapter 9 Case dismissed.

In contrast, in the absence of the financial adjustments made in Plan, the City’s creditors would be left to “fend for themselves.” Individual creditor collection actions likely would aggregate, through lawsuits, attempts at attachments, and writs of mandate, to make continued operation of the City untenable. Massive litigation costs would burden the City, its creditors, and

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all parties in interest, although creditors financially equipped to pursue litigation most quickly (and thus win “the race to the courthouse”) would benefit disproportionately. And even the swiftest of creditors would likely find its ability to collect on a judgment stymied by the inability of the City to pay without violating provisions of California law by raiding Restricted Funds. For example, were retirees to sue collectively for the \$538 million of health benefits the City promised them for life, the result would be a judgment that could never be paid, even were the City to lock the doors of each City building, sell the building and any undeveloped real estate. If the City were to attempt to pay the proceeds to retirees, the City would still be unable to pay its CalPERS obligations, and the City’s obligations to CalPERS in its capacity as trustee for the City’s pension trust for the City’s retired workers and their dependents who are the beneficiaries of such trust would be terminated—resulting in a claim of over \$1 billion that CalPERS contends would be secured by a lien that primes existing liens pursuant to California Government Code section 20574. In short, the City cannot afford to pay its creditors absent the debt relief afforded by the Plan, and dismissal of the Chapter 9 Case likely would result in chaos, with few if any creditors emerging safely from the blizzard of inevitable litigation.

**C. Feasibility.**

To satisfy the requirement set forth in section 943(b)(7) that the Plan be feasible, the City must demonstrate the ability to make the payments required under the Plan and still maintain its operations at the level that it deems necessary to the continued viability of the City. The City submits that the Plan is feasible. The financial underpinning of the Plan, the City’s General Fund Long-Range Financial Plan (the “**Financial Plan**”), attached as **Exhibit B**, constitutes a sustainable matching of revenues and expenses, including the expenses created by or modified in the Plan. The Plan Financial Projections make certain assumptions regarding the effect of the rejection by the City of the financing leases to be rejected as noted therein and also assume that Measure A will pass.

The Financial Plan projects revenues and expenditures over a 20-year period and analyzes, among other things, the resulting unrestricted General Fund balance at the end of each fiscal year covered by the Financial Plan. The Financial Plan shows that, assuming confirmation of the Plan

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and passage of Measure A, the City will be able to maintain reserves at an average of 9.0% of General Fund expenses over the first 10 years of the Financial Plan, with such balance achieving 15% of General Fund expenses starting in the fifteenth year of the Financial Plan.<sup>14</sup> The Government Finance Officers Association recommends that cities maintain “an unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures” (equivalent to 16.67% of total expenditures).<sup>15</sup> In the event that Measure A does not pass, the Financial Plan will not be valid, and the City will be required to make significant additional cuts to existing City’s services. (See “Risk Factors” below).

#### **D. Cram Down.**

The Bankruptcy Code provides that the Bankruptcy Court may confirm a plan of adjustment that is not accepted by all Impaired classes if at least one Impaired Class of claims accepts the Plan and the so-called “cram down” provisions set forth in sections 1129(b)(1), (b)(2)(A) and (b)(2)(B) are satisfied. The Plan may be confirmed under the cram down provisions if, in addition to satisfying the other requirements of section 943(b), it (a) is “fair and equitable,” and (b) does not discriminate unfairly with respect to each Class of claims that is Impaired under and has not accepted the Plan.

The “fair and equitable” standard, also known as the “absolute priority rule,” requires, among other things, that unless a dissenting unsecured Class of claims receives payment in full for its allowed claims, no holder of allowed claims in any Class junior to that Class may receive or retain any property on account of such claims. The “fair and equitable” standard also has been interpreted to prohibit any class senior to a dissenting Class from receiving more than 100% of its allowed claims under a plan. The City believes that the Plan satisfies the “fair and equitable” standard because, among other things, no classes junior to the classes of unsecured claims are receiving or retaining any property under the Plan.

<sup>14</sup> Of course, the further out the projections go, the less reliable they will be.

<sup>15</sup> See Government Finance Officers Association, “Best Practice: Appropriate Level of Unrestricted Fund Balance in General Fund (2002, 2009),” available at [http://www.gfoa.org/index.php?option=com\\_content&task=view&id=1450](http://www.gfoa.org/index.php?option=com_content&task=view&id=1450).



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The requirement that the plan not “discriminate unfairly” means, among other things, that a dissenting Class must be treated substantially equally with respect to other Classes of equal rank. The City does not believe that the Plan unfairly discriminates against any Class that may not accept or otherwise consent to the Plan.

As noted above, the City has reserved the right to request the Bankruptcy Court to confirm the Plan by “cram down” in accordance with sections 1129(b)(1), (b)(2)(a) and (b)(2)(b). The City also has reserved the right to modify the Plan to the extent, if any, that confirmation of the Plan under sections 943 and 1129(b) requires such modifications.

**E. Effective Date.**

**1. Conditions to the Occurrence of the Effective Date.**

The Plan will not become effective and operative unless and until the Effective Date occurs. Section XII of the Plan sets forth certain conditions to the occurrence of the Effective Date. The City may waive in whole or in part the condition regarding agreements and instruments contemplated by, or to be entered into pursuant to, the Plan. Any such waiver of a condition may be effected at any time, without notice or leave or order of the Bankruptcy Court and without any formal action, other than the filing of a notice of such waiver with the Bankruptcy Court.

The Effective Date will occur on the first Business Day after which the conditions set forth in Section XII of the Plan are satisfied or waived; *provided* that the Effective Date must occur by no later than six months after the Confirmation Date.

**2. Non-Occurrence of Effective Date.**

The Plan provides that, if confirmation occurs but the Effective Date does not occur within six months after the Confirmation Date, upon notification submitted by the City to the Bankruptcy Court: (a) the Confirmation Order shall be vacated; (b) no distributions under this Plan shall be made; (c) the City and all holders of Claims shall be restored to the *status quo* as of the day immediately preceding the Confirmation Date as though the Confirmation Date never occurred; and (d) all of the City’s obligations with respect to the Claims shall remain unchanged, and nothing contained herein shall be deemed to constitute a waiver or release of any claims by or

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against the City or any other entity or to prejudice in any manner the rights of the City or any entity in any further proceedings involving the City. The failure of the Effective Date to occur, however, will not affect the validity of any order entered in the Chapter 9 Case other than the Confirmation Order.

#### **F. Effect of Confirmation.**

Section XI of the Plan provides that confirmation of the Plan and the occurrence of the Effective Date will have a number of important and binding effects, some of which are summarized below. Readers are encouraged to review Section XI of the Plan carefully and in its entirety to assess the various consequences of confirmation of the Plan.

##### **1. Discharge of the City.**

Pursuant to section 944, upon the Effective Date, the City will be discharged from all debts (as defined in the Bankruptcy Code) of the City and Claims against the City other than (a) any debt specifically and expressly excepted from discharge by the Plan or the Confirmation Order, or (b) any debt owed to an entity that, before the Confirmation Date, had neither notice nor actual knowledge of the Chapter 9 Case.

The rights afforded in the Plan and the treatment of holders of Claims, be they Claims Impaired or Unimpaired under the Plan, will be in exchange for and in complete satisfaction, discharge, and release of all Claims of any nature whatsoever arising on or before the Effective Date, known or unknown, including any interest accrued or expenses incurred thereon from and after the Petition Date, whether against the City or any of its properties, assets, or interests in property. Except as otherwise provided in the Plan, upon the Effective Date all Claims against the City that arose prior to the Confirmation Date (the “**Pre-Confirmation Date Claims**”) will be and will be deemed to be satisfied, discharged, and released in full, be they Impaired or Unimpaired under the Plan.

##### **2. Injunction.**

The Plan provides that all entities who have held, hold, or may hold Pre-Confirmation Date Claims will be permanently enjoined, from and after the Confirmation Date from (a) commencing or continuing in any manner any action or other proceeding of any kind with

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respect to any such Pre-Confirmation Date Claim against the City; (b) enforcing, attaching, collecting, or recovering by any manner or means any judgment, award, decree, or order against the City with respect to such Pre-Confirmation Date Claims; (c) creating, perfecting, or enforcing any lien or encumbrance of any kind against the City or its property or interests in property; and (d) asserting any right of setoff, subrogation, or recoupment of any kind against any obligation due to the City with respect to any such Pre-Confirmation Date Claim, except as otherwise permitted by section 553.

### **3. Term of Existing Injunctions and Stays.**

The Plan provides that all injunctions or stays provided for in the Chapter 9 Case pursuant to sections 105, 362, or 922, or otherwise, and in existence on the Confirmation Date, will remain in full force and effect until the Effective Date.

## **VII. CERTAIN RISK FACTORS TO BE CONSIDERED**

Confirmation of the Plan and the occurrence of the Effective Date are not without risk to the City and its creditors in that the sources of revenue projected over the next 20 years in the General Fund's Long-Range Financial Plan could contract. The reality is that there are economic cycles over time that can negatively affect revenue growth, but the timing of these cycles is very difficult to predict. Thus, while the City devoted considerable time and effort in formulating the Plan Financial Projections, there can be no guaranty that the predicted results will be achieved. For example, few California cities, if any, predicted the length and depth of the economic downturn that saw real property values (and thus real property tax revenues) plummet. Nor did city financial planners predict the high unemployment and underemployment that accompanied the burst of the housing bubble and reduced the amount of sales tax revenues to state and local governments. Conversely, while the General Fund expenditures projected in the Plan Financial Projections are the City's best and most reasoned estimate of costs, the occurrence of higher inflation, state or federal law changes that increase or shift costs to local government, or a natural or human-caused disaster—all of these could and likely would cause costs to rise, if not to spike. These risk factors should not, however, be regarded as constituting the only risks involved in connection with the Plan and its implementation.

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Moreover, the Plan Financial Projections and the City's plans for ongoing operational and financial stability after confirmation of the Plan rely on the passage of Measure A, which is estimated to produce approximately \$28 million per year in new revenue. In the event that Measure A fails, not only would the City be unable to fund the Marshall Plan and provide desperately needed additional police services, but it would have to cut even more deeply into existing service levels. The City cannot predict whether it would be able to continue to function under such a scenario, and does not have detailed plans in place at this point to identify the draconian additional cuts that would be required.

**The City submits, though, that the risk to creditors and parties in interest is greater if the Plan is not confirmed and consummated than if it is.**

#### **VIII. CERTAIN FEDERAL INCOME TAX CONSEQUENCES**

The implementation of the Plan may have federal, state, local and foreign tax consequences to the City and its creditors. No tax opinion has been sought or will be obtained with respect to any tax consequences of the Plan. However, because the City is a municipal corporation duly organized and existing under its Charter and the California Constitution, and is treated as a political subdivision of the State of California for federal income tax purposes, the City believes that it will not be subject to any federal income tax liability from implementation of the Plan. The City anticipates that, in conformity with past practice, it will not file any federal corporate income tax returns with respect to the periods in which the Plan is implemented nor report any income for federal income tax purposes as a result of implementing the Plan.

Because individual circumstances may differ, and the income tax consequence of a chapter 9 case are complex and uncertain, this summary does not address the federal income tax consequences that may be relevant to the creditors of the City as a result of the Plan.

Accordingly, the creditors should consult with their own tax advisors regarding the income tax consequences of the Plan to them, including the effect, if any, the Plan may have on prior outstanding obligations the interest components of which the creditors were treating as excludable from gross income for federal income tax purposes.

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To ensure compliance with requirements imposed by the Internal Revenue Service, you are hereby notified that any discussion of tax matters contained herein (including any attachments) contained in this summary is not intended or written to be used by any taxpayer, and cannot be used by any taxpayer, for the purpose of avoiding tax-related penalties that otherwise may be imposed under the Internal Revenue Code on the taxpayer. Such discussion of tax matters was written in connection with the solicitation of votes in favor of the Plan. The City and its creditors should seek tax advice regarding the tax consequences to them of the Plan based on their particular circumstances from an independent tax advisor.

#### **IX. RECOMMENDATION AND CONCLUSION**

The City believes that confirmation and implementation of the Plan is preferable to all other available and feasible alternatives. Accordingly, **the City urges holders of Impaired claims to vote to accept the Plan by so indicating on their ballots and returning them as specified in this Disclosure Statement and on their ballots.**

DATED: October [\_\_\_], 2013

CITY OF STOCKTON, CALIFORNIA

By: /s/ Robert Deis

Robert Deis  
City Manager

Submitted By:

ORRICK, HERRINGTON & SUTCLIFFE LLP

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**EXHIBITS TO DISCLOSURE STATEMENT WITH RESPECT TO THE  
PLAN FOR THE ADJUSTMENT OF DEBTS OF CITY OF STOCKTON,  
CALIFORNIA, DATED OCTOBER \_\_, 2013**

Exhibit A      Plan For The Adjustment Of Debts Of City Of Stockton, California, Dated  
October [\_\_], 2013

Exhibit B      Long-Range Financial Plan of City of Stockton