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6 Attorneys for California Public Employees'
7 Retirement System

8 UNITED STATES BANKRUPTCY COURT
9 CENTRAL DISTRICT OF CALIFORNIA
10 RIVERSIDE DIVISION

11 In re
12 CITY OF SAN BERNARDINO, CALIFORNIA,
13 Debtor.

Case No. 6:12-bk-28006 MJ

Chapter 9

CALPERS' STATUS REPORT

14 Date: June 5, 2013
15 Time: 1:30 p.m.
16 Place: United States Bankruptcy Court
3420 Twelfth Street
17 Courtroom 301
Riverside, CA 92501

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1 The California Public Employees' Retirement System ("CalPERS"), by and through its
2 undersigned attorneys, hereby submits its status report regarding the efforts of CalPERS and the City
3 of San Bernardino (the "City") to resolve issues pertaining to discovery related to the objections by
4 CalPERS to the City's petition.

5 I. INTRODUCTION

6 CalPERS' financial advisors continue to work collaboratively with Michael Busch and others
7 at Urban Futures to better understand the City's cash position and needs. The City Council has
8 approved the resumption of payment of employer contributions to CalPERS, beginning July 1.
9 However, the City has made no contributions to CalPERS for the employer's share of pension
10 benefits for employees paid for from the General Fund following the Petition Date. Further, the City
11 has not expressed any intent to pay these contributions during the pendency of its bankruptcy case.
12 The postpetition payments missed are expected to total roughly \$13 million at fiscal year end on June
13 30, 2013, exclusive of interest, penalty interest, penalties and costs of collection that have accrued
14 and will continue to accrue until these amounts have been paid in full. Nevertheless, CalPERS has
15 continued to pay benefits to the City's retirees without interruption or reduction.

16 II. NEW INFORMATION

17 At the last status conference, the City revealed that it had been inaccurately stating its cash
18 position since the case was filed and that it expected to have \$33 million in cash at fiscal year end.
19 Since the last status conference, many new facts have come to light that are concerning and call into
20 question yet again the City's good faith and desire to effect a plan of adjustment. Some of these are
21 set forth below:

22 A. *Busch Deposition*

23 The City's financial advisor, Michael Busch, was deposed on May 10, 2013. Among other
24 things, the deposition revealed the following:

- 25 • During this bankruptcy case, the City has paid the prepetition claims of certain
26 vendors without court approval or notice to creditors. This has taken place while the
27 City has said that it does not have enough funds to pay postpetition administrative
28 expenses, including CalPERS. Busch Depo, 98:6-16; 265:9-267:1.

- 1 • The City is applying postpetition receipts of the General Fund to repay prepetition
2 amounts owing to other funds. Busch Depo, 272:5-279:20. As a result, under the
3 way the City is currently accounting for its funds, prepetition obligations to other
4 funds would be paid before postpetition administrative creditors and before general
5 unsecured prepetition creditors
- 6 • The City has not, either prepetition or postpetition, developed a proposal that classifies
7 creditors into groups and proposes treatment to the different groups of creditors. In
8 fact, no one has even been tasked to do this. Busch Depo, 268:18-271:2.
- 9 • The City has commingled funds it considers “trust funds” with its other funds in a
10 single bank account. Busch Depo, 115:12-22; 254:22-255:24.
- 11 • Former Finance Director Jason Simpson expressed to Mr. Busch his concern that
12 crimes had occurred with respect to the City’s use of certain funds. Busch Depo,
13 30:14-32:3.

14 ***B. Budget Amendments***

15 The City has already adopted several budgets for fiscal year 2012/13, the latest of
16 which was adopted on April 22, 2013. Despite the significant effort and diligence that went into
17 preparing the April budget, the City has already discovered material expenses that were left out of
18 the budget. Consequently, the City now has to amend the budget that was approved less than six
19 weeks ago to reflect material adjustments (see memo re Budget Adjustments from the City
20 Manager to the Council dated May 30, 2013, a copy of which is attached hereto as Exhibit “1”):

- 21 • The City underbudgeted approximately \$1.9 million in expenses related to bankruptcy
22 services. The City has already budgeted and expended \$2.2 million for bankruptcy
23 services during this fiscal year. Since the budget was adopted in April the City has
24 discovered that it needs an additional \$1.9 million to fund bankruptcy services through
25 June 30, 2013. (CalPERS believes that this adjustment is the result of the failure of
26 the City’s departments to timely enter accrued expenses into the City’s accounting
27 system, a problem identified by Jason Simpson about a year ago. It appears that the
28 City continues to have significant accounting and internal control problems.)
- The City failed to budget approximately \$1.9 million in lease payments on various
buildings, including City Hall and the Police Station. These payments were pledged to
secure lease revenue bonds. Apparently, the City has not been making lease
payments; rather, the Successor Agency was improperly making these payments on
behalf of the City out of redevelopment funds.

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III. STATUS OF DISCOVERY

As the Court is aware, in discussions regarding informal discovery, the parties have prioritized information related to the City's financial situation and deferred other items. As the financial advisors have worked together to understand the City's financial condition, various iterations of items have been requested.

In November 2012, CalPERS provided the City with a comprehensive list of documents requested. Attached hereto as Exhibit "2" is a list of the items on the comprehensive list that the City still has not provided. CalPERS anticipates that the City will object to the production of the bulk of the items on this list. In the event that the eligibility matter is not continued, CalPERS believes that the Court will need to resolve disputes related to the production of items on this list.

IV. ELIGIBILITY

It is undisputed that the City did not attempt to negotiate with its creditors prior to declaring a fiscal emergency and commencing this bankruptcy case. It is further undisputed that, to this day, the City has not developed a proposal to creditors similar to the "Ask" in the Stockton case and has not negotiated with creditors regarding the treatment of their claims. Indeed, the City has not even tasked anyone with working on such a proposal and the City has not determined what claims, if any, it may seek to impair. The City is not talking to the three unions that do not have agreements with the City. The City has chosen not to meet with CalPERS since Andrea Travis-Miller left in February¹. It is nearly a year into this bankruptcy case. Yet, the City has not started to put together a plan of adjustment or even an outline of the general terms of such a plan, nor has it articulated how it intends to pay its postpetition administrative expenses. Because the City failed to negotiate with creditors prepetition, and has further failed to develop a plan outline and negotiate with creditors postpetition, it appears that the bankruptcy case was filed improperly for the purpose of delay. Consequently, the City *cannot* meet its burden and demonstrate it is eligible for bankruptcy protection.²

¹ The CEO of CalPERS reached out to the new City Manager, Mr. Parker, shortly following his appointment. He has not made himself available for a meeting, nor have any other City officials met with CalPERS business people since the departure of Andrea Travis-Miller and Jason Simpson.

² See, e.g., *In re Vallejo, Cal.*, 408 B.R. 280, 295 (9th Cir. BAP 2009) ("The evidence needs to show that the purpose of the filing of the chapter 9 petition not simply be to buy time or evade creditors.") (citation & quotation omitted) & *id.* at 297 ("We emphasize that while a complete plan is not required, some outline or term sheet of a plan which designates classes of creditors and their

1 Until such time as the City develops reliable numbers, formulates a proposal and sits down to
2 negotiate in good faith with its creditors, the City cannot meet the requirements of eligibility. At this
3 time, while substantial efforts have been made by the City's financial staff and advisors within the
4 constraints of the limited resources allocated by the Council, the City has not completed its analysis
5 and is not in a position to discuss proposals with creditors. CalPERS and the City have been
6 deferring the dispute regarding eligibility to avoid diversion of the City's resources (both money and
7 personnel time) away from the important work of developing meaningful information and solutions.
8 The City has now spent \$4 million on the bankruptcy case yet still has significant accounting and
9 control problems. And nearly one year after filing, the City still has no plans to develop a
10 comprehensive proposal for its creditors and thus the case is no closer to resolution.

11 CalPERS is prepared to proceed with trial on eligibility, but is mindful that such litigation will
12 divert resources from the City and will likely result in the dismissal of the case. The only practical
13 thing to do under the circumstances is for all parties and this Court to press the City to do the work it
14 should have done prior to filing its petition and which will be necessary for the City to fulfill its
15 obligations to demonstrate that it engaged in the bankruptcy process in good faith. Specifically,
16 CalPERS believes that this Court should require the following (the "Case Management
17 Requirements"):

- 18 • Require the City to complete detailed monthly reconciliations of its cash balances per
19 its books to its cash balances per corresponding bank statements within 30 days of
20 month end.

21
22 treatment is necessary."); *see also In re N.Y.C. Off-Track Betting Corp.*, 427 B.R. 256, 272 (Bankr.
23 S.D.N.Y. 2010) ("Courts examining [section 109(c)(4)] have determined that a filed statement
24 indicating intent to affect [sic] a plan of reorganization, *combined with efforts made towards*
25 *negotiating and drafting a plan*, fulfill this requirement.") (emphasis added); *In re Sullivan Cnty.*
26 *Regional Disposal Dist.*, 165 B.R. 60, 82 (Bankr. D.N.H. 1994) (even though the debtor submitted a
27 draft plan of adjustment, "debtors post-filing actions tend to confirm that the bankruptcy option was
28 chosen with no real thought or sincere intention of debt adjustment in an overall plan sense"); *accord*
In re Cottonwood Water & Sanitation Dist., 138 B.R. 973, 979 (Bankr. D. Colo. 1992) ("Important
constitutional issues arise when a municipality enters the bankruptcy arena. Recognizing these
problems, Congress consciously sought to limit the accessibility to the bankruptcy court by
municipalities. One way to do so was to require the municipal entity, before rushing to this Court, to
first seek to negotiate in good faith concerning the treatment the creditors may be expected to receive
under a plan to be filed under section 941 of the Code) (citations and quotations omitted).

- 1 • Require the City to close its books for each interim month during the fiscal year within
2 30 days of month end.
- 2 • Require the City to close its books for the fiscal year end June 30, 2013 within 45 days
3 of the fiscal year end.
- 4 • Require the City to complete its fund reconciliation for the fiscal year end June 30,
5 2013 within 45 days from the fiscal year end including, for each fund, beginning
6 balance, all interim activity by line item and ending balance.
- 7 • Require the City to take corrective action regarding any internal control deficiencies
8 raised in its most recent audit and/or provide rationale as to why such action cannot be
9 taken, along with steps to ensure reliable financial information given such
10 deficiencies.
- 11 • Require the City to take such other steps reasonably necessary to produce timely and
12 reliable financial information, including monthly cash flow forecasts on a rolling 12
13 month basis, along with rolling reconciliations of actual versus forecasted cash flows
14 for the prior twelve month period.
- 15 • Appoint a case mediator.
- 16 • Require all key constituencies to meet with the mediator with decision makers present
17 (which, for the City, would include the members of the Council).
- 18 • Set a deadline for the City to file its plan of adjustment.

18 V. CONCLUSION

19 The fact that the City is still not in a position to sit down and negotiate with its creditors is
20 evidence that this bankruptcy case was filed for the improper purpose of delay, that the City is not
21 acting in good faith and that the City lacked (and continues to lack) the desire to effectuate a plan.
22 Nevertheless, CalPERS is willing to further defer a determination of eligibility for a limited period of
23 time provided that the Court impose the Case Management Requirements described above. In the
24 event that the Court is unwilling to establish the Case Management Requirements, CalPERS requests
25 that the determination of eligibility be set for trial and an appropriate discovery schedule be set.
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Respectfully submitted,

Michael B. Lubic
Michael J. Gearin (pro hac vice)
Brett D. Bissett
K&L GATES LLP

Dated: June 3, 2013

By: /s/ Michael B. Lubic

Michael B. Lubic
Attorneys for California Public Employees'
Retirement System

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EXHIBIT 1

**Mayor and Common Council
Agenda Report**

TO: MAYOR AND COMMON COUNCIL

FROM: ALLEN PARKER, CITY MANAGER



DATE: May 30, 2013

SUBJECT: BUDGET AMENDMENTS

SUMMARY

At the conclusion of the 3rd quarter in the 2012-13 fiscal year, the City's financial health is slowly improving as the budget measures approved through the Pre-Pendency and Pendency Plan are implemented. Overall, General Fund revenues and expenses continue to reflect the budget approved by the Mayor and Common Council in April. It is staff's belief the anticipated cash and fund balances for the current fiscal year will be achieved.

Despite the anticipated performance of the City's finances, the City must make adjustments to accommodate necessary budget amendments for this fiscal year and unanticipated expenses for next fiscal year. Specifically, the budget allocation established for bankruptcy activities for the current fiscal year has been reached, and pursuant to the City's municipal code, adjustments/transfers in excess of \$25,000 require Mayor and Common Council approval. Additionally, the City has been made aware by the State Department of Finance that debts transferred to and paid for by the Economic Development Agency (EDA) and the Successor Agency have been deemed ineligible, and therefore, these obligations are to be paid by the City.

Staff Recommendation

Staff recommends that the Mayor and Common Council authorize:

- 1) Appropriation of an additional \$1.9 million to fund anticipated bankruptcy services through June 30, 2013;
- 2) The city manager to amend the Fiscal Year 2013-14 Budget to include additional debt service obligations for the following two debt obligations; i) Series 1996 Lease Revenue Refunding Bonds for the financing of City Hall improvements in the amount of \$794,892.50; and ii) Series 1999 Refunding Certificates of Participation (COP) for the financing of Police Station and South Valle 201 building improvements in the amount of \$1,142,950.

Discussion

Bankruptcy Services

To date, the City has expended \$2,174,000 on bankruptcy services. These services include those provided by the City's bankruptcy counsel, financial advisor, labor counsel, actuarial services, and other contracts which have provided support services. At the time of the City's filing, anticipated bankruptcy costs were unknown. Over the past several months, bankruptcy related costs have fluctuated based on activities required by the Bankruptcy Court process.

Attachment: Budget Amendments Report (2531 : Resolution Authorizing the Appropriation of Additional Funds for Bankruptcy Services)

Mayor and common Council

May 30, 2013

Page 2 of 2

Given the City's financial condition, staff continues to take the prudent approach to budgeting by allocating funds based on anticipated amounts necessary for essential services. Based on continued activity by the City's bankruptcy counsel these costs are necessary and required for the City to continue through the bankruptcy process. Based on services provided and anticipated activities, an additional allocation of \$1.9 million is necessary to meet the City's obligation for fiscal year 2012-13.

Debt Obligations

On May 17, 2013, the Successor Agency received correspondence from the State Department of Finance (DOF) regarding its submission of its 3rd Recognized Obligation Payment Schedule (ROPS). Following a meet and confer with the DOF, the Successor Agency has been informed debt obligations previously paid from available tax increment and redevelopment property tax trust fund (RPTTF) monies are ineligible for payment going forward from these sources. Therefore, the City must provide funding to meet these obligations.

Listed below are the specific details of the debt obligations which were determined as ineligible by DOF:

Issue Date	Purpose	Annual Payment	Est. Outstanding Debt
1996	City Hall Project	\$794,892.50	\$7,710,000
1999	Police Station / 201 South Valle Building	\$1,142,950	\$9,825,000
	Totals:	\$1,937,842.50	\$17,535,000

FINANCIAL REVIEW

The allocation of additional resources towards bankruptcy services will be off-set by anticipated reductions in General Fund expenditures for FY 2012-13.

Additional allocations for debt service payments will be drawn from anticipated General Fund revenues for FY 2013-14. The impact of the staff recommendation will result in a reduction of \$1,937,842.50 of year end cash as of June 30, 2014 in the General Fund.

Recommended General Fund Allocations

FY 2012-13	
Bankruptcy Services	\$1,900,000
FY 2013-14	
Debt Service Obligations	\$1,937,842.50
Total General Fund Allocation	\$3,837,842.50

RESOLUTION OF THE MAYOR AND COMMON COUNCIL OF THE CITY OF SAN BERNARDINO AUTHORIZING THE APPROPRIATION OF ADDITIONAL FUNDS FOR BANKRUPTCY SERVICES IN FY 2012/13 AND FOR DEBT SERVICE OBLIGATIONS FOR SERIES 1996 LEASE REVENUE REFUNDING BONDS AND SERIES 1999 REFUNDING CERTIFICATES OF PARTICIPATION (COP) FOR FY 2013/14.

I HEREBY CERTIFY that the foregoing Resolution was duly adopted by the Mayor and Common Council of the City of San Bernardino at a _____ meeting thereof, held on the _____ day of _____, 2013, by the following vote, to wit:

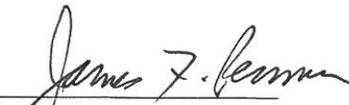
<u>Council Members:</u>	<u>AYES</u>	<u>NAYS</u>	<u>ABSTAIN</u>	<u>ABSENT</u>
MARQUEZ	_____	_____	_____	_____
JENKINS	_____	_____	_____	_____
VALDIVIA	_____	_____	_____	_____
SHORETT	_____	_____	_____	_____
KELLEY	_____	_____	_____	_____
JOHNSON	_____	_____	_____	_____
MCCAMMACK	_____	_____	_____	_____

Georgeann Hanna, City Clerk

The foregoing Resolution is hereby approved this _____ day of _____, 2013.

Patrick J. Morris, Mayor
City of San Bernardino

Approved as to form:



James F. Penman
City Attorney

EXHIBIT 2

DRAFT - Subject to Change

City of San Bernardino , California
DRAFT Document / Information Request - List of Information Not Provided
 June 3, 2013

Information Request	
Request #	Information Request
5	Schedule that breaks down all payables and other liabilities of the City between pre-petition and post petition
11	Schedule that breaks down all of the inflows and outflows between the City's fund's since June 30, 2011 and that describes the nature of each transfer (including the Water Department, the Successor Agency, and all other City departments)
12	Most recent trial balance of the City, and the trial balance as of June 30, 2012, and July 31, 2012 (including for the Water Department, the Successor Agency, and all other City Departments)
19	Schedule of all borrowings / repayments by the General Fund from other City funds since June 30, 2011, including amounts, date of borrowing, and evidence of proper authorization (if applicable)
20	Schedule of anticipated future borrowings / repayments of the General Fund from other City funds (including the Water Department, the Successor Agency, and all other City departments)
26	All Information and support pertaining to the accounting of the Water Department, and the Successor Agency payments to CalPERS assumed in the Pendency Plan
28	Audited comprehensive annual financial statements ("CAFR") for FY 2011 and draft CAFR provided to the auditors for June 30, 2012
30	List of the closing and correcting accounting adjustments proposed and made by City management and accounting department as cited in the Single Audit Report for FY 2011
31	List of the post-closing entries made for FY 2012 after closing of the June 30, 2012 financial statements to be or provided to the auditors
32	List of the proposed and the made audit adjustments for the completed audit for FY 2010 and FY 2011 (identified by the auditors) as well as any initial adjustments proposed for the FY 2012 audit (as available)
33	List of audit adjustments for FY 2011 and FY 2010 proposed by the auditors and not made by the City, please include reason for not making proposed adjustment
34	Management recommendation letters and internal control assessment letters issued to City management or the City Council (separate from the Single Audit Reports) by the auditors
35	Information regarding responses by the City to the management recommendation letters and internal control assessment letters provided by the auditors, and status of implementation by the City

DRAFT - Subject to Change

City of San Bernardino , California

DRAFT Document / Information Request - List of Information Not Provided
June 3, 2013

Information Request	
Request #	Information Request
36	Documentation that internal control issues and compliance issues identified in the Single Audit Report dated March 30, 2012 for FY 2011 have been corrected and what actions have been implemented
37	Documentation and correspondence received from or provided to the Department of Housing and Urban Development related to their response to the receipt of the Single Audit Report dated March 30, 2012 and the City's corrective plan of action
38	Documentation and correspondence received from or provided to any other grantor or funding sources related to their response to the receipt of the Single Audit Report dated March 30, 2012 and the City's corrective plan of action
40	Documentation of correspondence regarding the City's investigation of or its response to allegations of fraud or mismanagement levied against it since January 1, 2008
42	Summary of the operational costs allocated across funds and the methodology on how the costs are allocated
43	Policy (policies) on transfers / loans / inter-fund balances between funds including how year end balances should be addressed, who authorizes and/or executes inter-fund transfers of cash or loans, and the related policies and approval forms required
44	Schedule of accounts receivables, accounts payables and transfers between funds including the municipal and business type funds for FY 2011, FY 2012 and current YTD 2013 (current balances and transfers). The documents should include reconciliations between the funds
46	Schedule of assets held for resale including expected proceeds and the designated use of those proceeds, including the timing of any anticipated sales (including the Water Department, the Successor Agency, and all City Departments)
48	A listing of the current number of employees - Broken down into number covered by the Misc. Plan (CalPERS) and those covered by the Safety Plan (CalPERS) - Listing of the number of employees employed by the Water Department, and confirmation of their Plan Status with CalPERS (i.e. that they are part of the Misc. Plan) - Listing of the number of employees at the Successor Agency, and confirmation of their Plan Status
51	Schedule that breaks down all payments made by and or on behalf of the Successor Agency, and the Water Dept. to CalPERS including the dates, and amounts of any such payments - Confirmation from the City that all payments related to obligations to CalPERS on behalf of Water Department and Successor Agency employees have been remitted to CalPERS - Confirmation of the process of remitting these amounts (i.e. does the City remit payments on behalf of the Water / Successor, etc.)
59	Policies related to accruing, use and pay out of accumulated paid time-off for on-going employment, separations from employment (e.g. voluntary and non-voluntary terminations), and retirements. Identify any changes in policies since June 30, 2011 to present date

DRAFT - Subject to Change

City of San Bernardino , California

DRAFT Document / Information Request - List of Information Not Provided
June 3, 2013

Information Request	
Request #	
63	Schedule of inter-fund receivables and payables as of June 30, 2012, November 30, 2012 and as available, December 31, 2012
65	Copies of all professional insurance (or other types of insurance) for all elected City officials, members of the City Council, and other City employees
66	Summary of all insurance claims submitted by the City related to the professional insurance over the last 5 years, and all notifications made to the carrier of potential claims if a claim was not submitted
67	Financial information of the Successor Agency (or the RDA as applicable), including: 1) FY '11, '12 financials, and YTD FY '13 financials 2) All assets owned and or managed by the Successor Agency (or the RDA), the current valuation, date of the valuation, and all liabilities associated with the asset. Please include information regarding how the asset is currently used, including any leases associated with the asset 3) All debt obligations related to the Successor Agency (or RDA)
68	All internal and external communications (both electronic and other) from/to the City and/or its advisors relating to the City's Chapter 9 Bankruptcy
69	All internal and external communications (both electronic and other) from/to the City and/or its advisors relating to the City's discussion of an AB 506 process
70	All internal and external communications (both electronic and other) from/to the City and/or its advisors either to or describing a discussion with any employee or official of and/or advisor to the City of Stockton as it pertains to the City of Stockton's AB 506 process, conversations with creditors, and/or its Chapter 9 Bankruptcy
71	All Communications between Michael Busch and Bob Deis from January 1, 2012 to December 31, 2012
74	The results of the investigation by the San Bernardino County Sheriff's Department and the San Bernardino Police Department into allegations of possible criminal activity within the departments of San Bernardino city government (Reuters' article July 13, 2012), and the results of any internal investigation
75	All information pertaining to allegations made by Mr. James Penman to the City Council, reporters, or otherwise that financial documents had been falsified for years (Reuters' article July 13, 2012), and the results of any internal investigation
76	All Information provided to the SEC in its investigation of the City's Affairs since June 30, 2011
77	Information regarding all other potential sources or revenue and or cost savings the City has contemplated in the Budget Stabilization Plan or in any other manner, such as the privatization or outsourcing of certain functions such as parking meters and waste management as well as all other possible areas explored by the City
79	Schedule of all payments or transfers made since April 1, 2012