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8 UNITED STATES BANKRUPTCY COURT  
9 EASTERN DISTRICT OF CALIFORNIA  
10 SACRAMENTO DIVISION

11 In re:

12 CITY OF VALLEJO,  
13 CALIFORNIA,

14 Debtor.

CHAPTER 9 CASE

CASE NO. 08-26813-A-9

DC No.: OHS-4

Date: February 3, 2009

Time: 9:00 a.m.

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18  
19 **OBJECTION BY CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM TO**  
20 **THE CITY OF VALLEJO'S MOTION FOR APPROVAL OF REJECTION OF**  
21 **COLLECTIVE BARGAINING AGREEMENTS**

**TABLE OF CONTENTS**

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28

INTRODUCTION ..... 1

BACKGROUND ..... 2

    A.    CalPERS Administers Public Pension and Health Benefits for the City’s  
          Union Employees ..... 3

        1.    The Public Employees’ Medical and Hospital Care Act (PEMHCA) ..... 5

        2.    The Public Employees’ Retirement Law (PERL) ..... 6

    B.    Statutory Obligations of the City in Contracting with CalPERS ..... 6

    C.    Statutory Termination Procedures for the City’s CalPERS Contracts ..... 7

        1.    Termination of a CalPERS Retirement Plan Contract ..... 7

        2.    Termination of a CalPERS Health Benefits Contract ..... 8

DISCUSSION ..... 9

    A.    The City’s CalPERS Contracts Cannot be Implicitly Rejected Through the  
          City’s 11 U.S.C. § 365 Rejection of its Collective Bargaining Agreements ..... 9

    B.    Rejection of the CBAs is Not Preclusive of Any Subsequent Attempt by  
          the City to Reject the CalPERS Contracts ..... 12

CONCLUSION ..... 18

**TABLE OF AUTHORITIES**

**CASES**

1

2

3 *Alley v. Resolution Trust Corp.*  
299 U.S. App. D.C. 363 (1993) ..... 17

4

5 *Betts v. Board of Administration*  
21 Cal. 3d 859 (1978) ..... 11

6 *Board of Regents v. Roth*  
408 U.S. 564, 92 S. Ct. 2701 (1972)..... 11

7

8 *Board of Retirement of the Santa Barbara County Employees Retirement System v.*  
*Santa Barbara County Grand Jury*  
58 Cal. App. 4th 1185 (1997) ..... 4

9

10 *Brown v. Felsen*  
442 U.S. 127 (1979)..... 14

11 *California Ass’n of Prof’l Scientists v. Schwarzenegger*  
137 Cal. App. 4th 371 (2006) ..... 3, 11

12

13 *Carman v. Alvord*  
31 Cal. 3d 318 (1982) ..... 11

14 *City of Oakland v. Pub. Employees’ Retirement Sys.*  
95 Cal. App. 4th 29 (2002)..... 3, 4

15

16 *Feinstein v. Lewis*  
477 F. Supp. 1256 (S.D.N.Y. 1979)..... 13, 17

17 *Garcia v. Mortimer*  
704 F. Supp. 984 (N.D. Cal. 1988) ..... 11

18

19 *Grogan v. Garner*  
498 U.S. 279, 112 L. Ed. 2d 755, 111 S. Ct. 654 (1991)..... 14

20 *In re Cedar Rapids Meats, Inc.*  
117 B.R. 448 (Bankr. N.D. Iowa. 1990) ..... 10

21

22 *In re County of Orange*  
179 B.R. 185 (Bankr. C.D. Cal. 1995)..... 14

23 *In re Gardinier, Inc.*  
831 F.2d 974 (11th Cir. 1987)..... 12

24

25 *In re Paine*  
283 B.R. 33 (9th Cir. BAP 2002)..... 14, 15

26 *In re Philip Services Corp.*  
310 B.R. 802, 808 (Bankr. S.D. Tex. 2004)..... 14

27

28 *In re Sanitary and Improvement Dist.*  
98 B.R. 970 (Bankr. D. Neb. 1989) ..... 16

1	<i>In re Wright Air Lines, Inc.</i>	
	44 B.R. 744 (Bankr. N.D. Ohio 1984) .....	10
2		
3	<i>Legislature v. Eu</i>	
	54 Cal. 3d 492 (1991) .....	11
4	<i>Memphis Light, Gas and Water Division v. Craft</i>	
	436 U.S. 1, 98 S. Ct. 1554 (1978) .....	11
5		
6	<i>NLRB v. Bildisco &amp; Bildisco</i>	
	465 U.S. 513 (1983) .....	2, 15
7	<i>Owens v. Kaiser Found. Health Plan</i>	
	244 F.3d 708 (9th Cir. 2001) .....	14
8		
9	<i>Pierson v. Continental Casualty Co.</i>	
	2000 U.S. Dist. LEXIS 21380 (C.D. Cal. 2000) .....	17
10	<i>Rein v. Providian Fin. Corp.</i>	
	252 F.3d 1095 (9th Cir. 2001) .....	13, 14
11		
12	<i>Robi v. Five Platters, Inc.</i>	
	838 F.2d 318 (9th Cir. 1988) .....	15
13	<i>Ropico, Inc. v. City of New York</i>	
	425 F. Supp. 970 (S.D.N.Y. 1976) .....	16
14		
15	<i>Rose v. Long Island Railroad Pension Plan</i>	
	828 F.2d 910 (2d Cir. 1987) .....	3, 13
16	<i>Roy v. Teachers Ins. and Annuity Assoc.</i>	
	878 F.2d 47 (2d Cir. 1989) .....	13
17		
18	<i>Thomas v. City of Los Angeles</i>	
	676 F. Supp. 976 (C.D. Cal. 1987) .....	11
19	<i>Thorning v. Hollister School Dist.</i>	
	11 Cal. App. 4th 1598 (1992) .....	11
20		
21	<i>Truck Drivers Local 807 v. Carey Transportation, Inc.</i>	
	816 F.2d 82 (2nd Cir. 1986) .....	9
22	<i>United Steelworkers of America v. Unimet Corp. (In re Unimet Corp.)</i>	
	842 F.2d 879 (6th Cir. 1988) .....	10
23		
24	<b><u>STATUTES AND CONSTITUTIONS</u></b>	
25	11 U.S.C. § 1113 .....	9, 10
26	11 U.S.C. § 365 .....	9, 10, 14, 15
27	11 U.S.C. § 903 .....	passim
28	11 U.S.C. § 904 .....	passim

1	11 U.S.C. § 943 .....	16
2	11 U.S.C. § 944 .....	16
3	29 U.S.C. § 1002 .....	3
4	29 U.S.C. § 1003 .....	3
5	Bankruptcy Act, Chapter IX, Section 83 .....	16
6	U.S. Constitution	
7	Tenth Amendment.....	12
8	California Constitution	
9	Article XVI .....	4
10	California Government Code § 20000 .....	3, 6
11	California Government Code § 20001 .....	6
12	California Government Code § 20002 .....	6
13	California Government Code § 20120 .....	6
14	California Government Code § 20460 .....	6, 8
15	California Government Code § 20471 .....	6
16	California Government Code § 20487 .....	14, 17
17	California Government Code § 20532 .....	6
18	California Government Code § 20535 .....	6
19	California Government Code § 20536 .....	6
20	California Government Code § 20570 .....	7, 17, 18
21	California Government Code § 20572 .....	7
22	California Government Code § 20574 .....	6
23	California Government Code § 20577 .....	6, 8, 11
24	California Government Code § 22750 .....	3
25	California Government Code § 22751 .....	5
26	California Government Code § 22892 .....	7
27	California Government Code § 22922 .....	5, 7
28	California Government Code § 22938 .....	8
	California Government Code § 22939 .....	8

1	2 CCR § 599.515 .....	7, 8, 17, 18
2	Federal Rule of Bankruptcy Procedure 6006 .....	10
3	Federal Rule of Bankruptcy Procedure 9014 .....	10
4	H.R. Rep. No. 533, 1974 U.S. Code Cong. & Ad. News) .....	14
5	H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 397-398 (1977) .....	12

6

7

**OTHER AUTHORITIES**

8

6 Collier on Bankruptcy § 903.02[1] .....	16
---	----

9

6 Collier on Bankruptcy § 903.02[3] .....	14
---	----

10

6 Collier on Bankruptcy § 904.01 .....	16
--	----

11

6 Collier on Bankruptcy § 904.02[1][a] .....	16
--	----

12

California Public Employees' Retirement System, Office of Public Affairs, Facts at a Glance: General (2008) .....	3, 5
--	------

13

The California Pension Protection Act of 1992 (Proposition 162) .....	4
---	---

14

Restatement (Second) of Judgments § 27 .....	15
--	----

15

Richard Krolak, Public Employee Post-Employment Benefits Commission, Public Employees' Medical And Hospital Care Act (PEMHCA) And Contracting Agencies (2007) .....	5
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1 California Public Employees' Retirement System ("CalPERS"), a party in interest, hereby  
2 files this objection to the City of Vallejo's ("City") Motion for Approval of Rejection of  
3 Collective Bargaining Agreements ("Motion").

#### 4 INTRODUCTION

5 In its Motion, the City alleges it is "taking an important step" toward resolving its  
6 financial difficulties by rejecting collective bargaining agreements ("CBAs") entered into with  
7 the Vallejo Police Officers' Association ("VPOA"), International Association of Firefighters  
8 Local 1186 ("IAFF"), and International Brotherhood of Electrical Workers, Local 2376  
9 ("IBEW"), and the Confidential, Administrative, Managerial and Professional Association of  
10 Vallejo ("CAMP") (collectively, "Unions"). See Memorandum of Points and Authorities in  
11 Support of Motion for Approval of Rejection of Collective Bargaining Agreements ("MPA") pp.  
12 1-2. The "cost of labor is by far the largest General Fund expenditure the City incurs in each  
13 fiscal year." Decl. of Susan Mayer in Supp. of Mot. for Approval of Rejection of Collective  
14 Bargaining Agreements ("Mayer Declaration"), p. 7. Accordingly, the City intends to determine  
15 "an appropriate adjustment for each of its debts" in bankruptcy. Mayer Declaration, p. 7.

16 Although CalPERS is not a party to the CBAs, CalPERS is a party to separate retirement  
17 and health benefits contracts with the City that are required by the CBAs the City seeks to reject.  
18 As California's public employee retirement system is shaped by the legislative process, the  
19 City's obligations to CalPERS are derived from both contract and the California Government  
20 Code. At the time of the filing of its Motion, the City has not taken any state statutory actions to  
21 terminate or modify its contracts with the CalPERS system.

22 CalPERS files this objection to the Motion to the extent that it seeks to implicitly reject  
23 the City's CalPERS health and retirement contracts as part of rejection of the CBAs. Any  
24 attempt to reject the CalPERS retirement and health benefits contracts must be by separate  
25 motion with due notice of the specific relief sought to the affected parties. Because California  
26 municipal employees are accorded certain court-mandated constitutional rights in employment  
27 terms, the City's Motion must comply with due process considerations.

28 In the event that the Court authorizes rejection of the CBAs, any rulings made by the

1 Court do not apply to any subsequent attempt by the City to reject the CalPERS contracts to the  
2 extent they constitute executory contractual obligations. The Unions and CalPERS are not the  
3 same parties or parties in privity. An attempted rejection of the CalPERS Contracts would raise  
4 different issues since the *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1983) collective bargaining  
5 agreement rejection standards, which the City contends are controlling in its Motion, are not  
6 applicable to a municipality's contracts entered into with a state retirement system, expressly  
7 governed and regulated by state law under principles of federalism. CalPERS is not a party to the  
8 CBAs, which is all the City can be authorized to reject by its Motion.

### 9 **BACKGROUND**

10 The City's CBAs each provide that the City shall contract with CalPERS for retirement  
11 and health benefits.

12 The City's July 1, 2000 labor agreement with the VPOA at Section 22 provides that the  
13 City "shall provide to all employees and eligible dependents, and to retiree-annuitants, the PERS  
14 Health Benefits Program." Further, the labor agreement with the VPOA at Section 27 requires  
15 the City to provide various CalPERS retirement programs. *See Exhibits A & B in Support of*  
16 *Declaration of Debora Boutte in Support of Motion for Approval of Rejection of Collective*  
17 *Bargaining Agreements ("Boutte Declaration"), Exhibit A (Docket No. 77).*

18 The City's July 1, 2000 agreement with the IAFF at Section 13 requires the City to  
19 provide "to all employees and eligible dependents and to all eligible retiree-annuitants the PERS  
20 Health Benefits Program." Further, the agreement with the IAFF at Section 39 requires the City  
21 to provide to all employees the CalPERS retirement plan. *See Exhibits A & B in Support of the*  
22 *Boutte Declaration, Exhibit B.*

23 The City's July 1, 1998 agreement with the IBEW at Section 3.2 requires the City to  
24 provide "to all employees and eligible dependents and to all eligible retiree-annuitants the PERS  
25 Health Benefits Program." Further, the contract with the IBEW at Section 3.1 requires the City  
26 to participate in the CalPERS retirement plan for members of the IBEW. *See Exhibits C & D in*  
27 *Support of the Boutte Declaration, Exhibit C.*

28 The City's July 1, 1999 agreement with the CAMP at Section 7.1 requires the City to

1 continue to offer “all eligible employees, eligible dependents of employees, eligible retiree-  
2 annuitants, and eligible dependents of retiree-annuitants the health benefits under the Public  
3 Employees Medical and Hospital Care Act.” Further, the agreement with the CAMP at Section  
4 7.2 requires the City to continue to participate in the CalPERS retirement plan. *See Exhibits C*  
5 *& D in Support of the Boutte Declaration, Exhibit D.*

6 Pursuant to the above agreements, the City entered into contracts and contract  
7 amendments with the CalPERS Board of Administration for the City’s participation in  
8 CalPERS, and adopted multiple resolutions electing to be subject to the Public Employees’  
9 Medical and Hospital Care Act.

10 **A. CalPERS Administers Public Pension and Health Benefits for the City’s Union**  
11 **Employees**

12 The Public Employees’ Retirement Law (California Gov. Code, § 20000 *et seq.*)  
13 establishes a retirement system for certain state and local government employees.<sup>1</sup> *City of*  
14 *Oakland v. Pub. Employees’ Retirement Sys.*, 95 Cal. App. 4th 29, 33 (2002). The Public  
15 Employees’ Medical and Hospital Care Act (California Gov. Code § 22750 *et seq.*) provides  
16 health benefit plans for eligible state, school and local government employees.

17 The California Legislature established CalPERS in 1931, and it became operational in  
18 1932, when it began providing California state employees retirement benefits. California Public  
19 Employees’ Retirement System, Office of Public Affairs, Facts at a Glance: General (2008).<sup>2</sup>  
20 CalPERS provides pension fund and healthcare services for approximately 1.5 million  
21 California public employees, retirees, and their families. *Id.* A “state employee generally  
22 becomes a member of the Public Employees’ Retirement System . . . ‘upon his or her entry into  
23 employment.’” *California Ass’n of Prof’l Scientists v. Schwarzenegger*, 137 Cal. App. 4th 371,  
24 375 (2006). Local government employers may contract with CalPERS to provide pension and

25  
26 <sup>1</sup> The administration of California’s public retirement system is exempt from the Employee Retirement Income  
27 Security Act (ERISA) based on principles of federalism, especially due to the fact that state public employee  
28 retirement systems are shaped, in part, by the legislative process. *See Rose v. Long Island Railroad Pension Plan*,  
828 F.2d 910 (2d Cir. 1987). This exemption of governmental plans from ERISA is codified in 29 U.S.C. §§  
1002(32), 1003(b)(1).

<sup>2</sup> Available at <http://www.calpers.ca.gov/eip-docs/about/facts/general.pdf>.

1 retirement benefits to their employees. Members of CalPERS are grouped according to member  
2 classifications miscellaneous (e.g., local miscellaneous for city employees) and safety (local fire,  
3 local police, local safety for city employees) and the benefit levels available to the various  
4 member classifications are defined by statute. Each contracting agency's contract makes  
5 specific the benefit level being provided by that agency to each of its various member  
6 classifications.

7 Proposition 162, which gave the CalPERS Board of Administration ("CalPERS Board")  
8 exclusive authority over the administration and investment of pension funds, was approved by  
9 voters in 1992. *Id.* In enacting Proposition 162, the electorate in California amended article  
10 XVI, section 17 of the California Constitution, to read, in part:

11 Notwithstanding any other provisions of law or this Constitution to the contrary,  
12 the retirement board of a public pension or retirement system shall have **plenary**  
13 authority and fiduciary responsibility for investment of moneys and administration  
14 of the system, subject to . . . the following: [P] . . . The retirement board shall . . .  
15 have sole and exclusive responsibility to administer the system in a manner that  
will assure prompt delivery of benefits and related services to the participants and  
their beneficiaries.

16 *Board of Retirement of the Santa Barbara County Employees Retirement System v. Santa*  
17 *Barbara County Grand Jury*, 58 Cal. App. 4th 1185, 1192 (1997) (emphasis added).  
18 Proposition 162 serves to prevent the legislative and executive branches from "raiding" pension  
19 funds to balance the state budget. *Id.* at 1193.

20 The CalPERS Board is thus governed by the California Constitution and statutes, such as  
21 Cal. Const., art. XVI, § 17 subd. (b), which mandates that the CalPERS Board ensure the rights  
22 of CalPERS members and retirees to their full earned benefits.<sup>3</sup> *City of Oakland*, 95 Cal. App.  
23 4th at 29, 39. Accordingly, the CalPERS Board has institutional expertise in investment  
24 decisions and making determinations about the classifications of employees based on tasks and  
25 duties, among other subjects. *Id.* at 40 (explaining that "local safety" members, as opposed to  
26 "miscellaneous" members receive greater retirement benefits).

27  
28 <sup>3</sup> The ballot pamphlet accompanying Proposition 162 explained that pension system boards should give "highest  
priority" to providing benefits to members and their beneficiaries. *City of Oakland*, 95 Cal. App. 4th at 54.

1 In addition, CalPERS itself works as a multiple-employer defined benefit retirement  
2 plan, and provides retirement benefits based on a member's years of service, age, and highest  
3 compensation.<sup>4</sup> Further, the CalPERS health benefits program offers members and contracting  
4 employers health maintenance organization (HMO) plans, preferred provider organization (PPO)  
5 plans, and special health plans for members who belong to specific employee associations.  
6 California Public Employees' Retirement System, Office of Public Affairs, Facts at a Glance:  
7 General (2008).<sup>5</sup>

8 **1. The Public Employees' Medical and Hospital Care Act (PEMHCA)**

9 To participate in the health benefits program under the Public Employees' Medical and  
10 Hospital Care Act ("PEMHCA"), public agencies are required to contract with CalPERS, which  
11 acts as administrator. *See* Cal Gov't Code § 22922. A public agency becomes a contracting  
12 agency upon the proper and timely filing with CalPERS of a "resolution of its governing body  
13 electing to be so subject." Cal. Gov't Code § 22922.

14 The purpose of PEMHCA is to:

- 15 (a) Promote increased economy and efficiency in state service.
- 16 (b) Enable the state to attract and retain qualified employees by providing  
17 health benefit plans similar to those commonly provided in private  
18 industry.
- 19 (c) Recognize and protect the state's investment in each permanent employee  
20 by promoting and preserving good health among state employees.

21 Cal. Gov't Code § 22751. The City is one of many public agencies participating in the PEMHCA  
22 program for access to group health insurance.

23 By contracting with CalPERS, public agencies, such as the City, have access to relatively  
24 stable premium pricing by accepting the benefit designs, provider networks, and premium  
25 structures set by CalPERS. *See* Richard Krolak, Public Employee Post-Employment Benefits  
26 Commission, Public Employees' Medical And Hospital Care Act (PEMHCA) And Contracting  
27 Agencies (2007).<sup>6</sup>

28 <sup>4</sup> Retirement benefits are calculated using the years of service multiplied by a benefit factor for an individual's age at retirement. The resulting percentage is multiplied by the highest average monthly compensation. The highest average monthly compensation is based on 12 or 36 consecutive months, depending on the contract provisions.

<sup>5</sup> Available at <http://www.calpers.ca.gov/eip-docs/about/facts/general.pdf>.

<sup>6</sup> Available at <http://www.pebc.ca.gov/images/files/backgrounder.pdf>.

1           **2. The Public Employees' Retirement Law (PERL)**

2           The City also is a contracting agency with the CalPERS Board under the Public  
3 Employees' Retirement Law ("PERL"). Cal Gov't Code § 20000 et seq.

4           Any public agency may participate in this retirement system by contract entered into by  
5 the agency's governing body, and the CalPERS Board. Cal. Gov't Code § 20460. Approval of  
6 the contract "shall be by ordinance adopted by the affirmative vote of a majority of the members  
7 of the governing body, not less than 20 days after the adoption of the resolution of intention, or  
8 by ordinance adopted by a majority vote of the electorate of the public agency voting thereon."  
9 Cal. Gov't Code § 20471.

10           The purpose of PERL is to "effect economy and efficiency in the public service by  
11 providing a means whereby employees who become superannuated or otherwise incapacitated  
12 may, without hardship or prejudice, be replaced by more capable employees, and to that end  
13 provide a retirement system consisting of retirement compensation and death benefits." Cal.  
14 Gov't Code § 20001. The Public Employees' Retirement System is "a unit of the State and  
15 Consumer Services Agency." Cal. Gov't Code § 20002. Management and control of this  
16 retirement system is vested in the CalPERS Board of Administration. Cal. Gov't Code § 20120.

17           **B. Statutory Obligations of the City in Contracting with CalPERS**

18           Under PERL, a contracting agency with CalPERS is required to make contributions for  
19 employees in amounts as recommended by CalPERS' actuary, and approved by its Board. Cal.  
20 Gov't Code § 20532. A contracting agency also is responsible to CalPERS for the expenses of  
21 determining the approximate and actual contributions, as well as the expenses of administering  
22 the CalPERS system. Cal. Gov't Code §§ 20535 and 20536. Because the retirement system  
23 contains funding requirements for contracting agencies, a "terminated agency shall be liable to  
24 the system for any deficit in funding for earned benefits, as determined pursuant to section  
25 20577, interest at the actuarial rate from the date of termination to the date the agency pays the  
26 system, and for reasonable and necessary costs of collection, including attorney's fees." Cal.  
27 Gov't Code § 20574.

28           Under PEMHCA, the employer contribution of a contracting agency toward health

1 benefits generally is equal for both employees and annuitants. Cal. Gov't Code § 22892. The  
2 contracting agency's contribution levels are set forth in the resolution of its governing body,  
3 adopted by a majority vote, and filed with CalPERS. Cal. Gov't Code § 22922. A contracting  
4 agency's contributions for health care premiums are due by the tenth day of each month. 2 CCR  
5 § 599.515(d)(1). Unlike public pension benefits, the health care plan benefits are paid for as  
6 incurred (pay-as-you-go) and do not contain minimum funding requirements.

7 In its List of Creditors Holding 20 Largest Unsecured Claims filed on May 23, 2008, the  
8 City discloses its contingent liabilities for health care and pension benefits as its largest claims.  
9 The City stated that it has an actuarial liability of \$135,396,000 for potential future retiree health  
10 benefits, and \$83,904,816 in unfunded pension plan benefits for defined benefit pension plans  
11 (Safety Plan of the City of Vallejo, and Miscellaneous Plan of the City of Vallejo) administered  
12 by CalPERS.<sup>7</sup> True and correct copies of the City's List of Creditors Holding 20 Largest  
13 Unsecured Claims, and List of Creditors Holding 20 Largest Unsecured Retiree Health Benefit  
14 Claims are attached as **Exhibit "A"** to the Request for Judicial Notice in Support of Objection  
15 by California Public Employees' Retirement System to the City of Vallejo's Motion for  
16 Approval of Rejection of Collective Bargaining Agreements filed herewith.

17 **C. Statutory Termination Procedures for the City's CalPERS Contracts**

18 **1. Termination of a CalPERS Retirement Plan Contract**

19 California Government Code §§ 20570 and 20572 establish the exclusive means under  
20 California law of terminating a CalPERS retirement plan contract. Under section 20570, a  
21 contracting agency may voluntarily terminate its CalPERS retirement plan contract by providing  
22 statutorily required notice in two steps. The agency's governing body first adopts an ordinance  
23 or resolution to provide one year's notice to CalPERS of the intent to terminate the contract.  
24 After the passage of one year, the agency's CalPERS contract is effectively terminated by an  
25 affirmative two-thirds vote by the members of the governing body of an ordinance or resolution  
26 terminating the contract. Additionally, under section 20572, a contracting agency's CalPERS

27 <sup>7</sup> The City later amended its list of 20 Largest Unsecured Claims to eliminate the \$135,396,000 claim for potential  
28 future health benefits, and filed a List of Creditors Holding 20 Largest Unsecured Retiree Health Benefit Claims on  
August 29, 2008.

1 retirement plan contract may be involuntarily terminated upon the agency's failure to remit  
2 required contributions within thirty (30) days of CalPERS' demand. A contracting agency's  
3 CalPERS retirement plan contract may also be involuntarily terminated upon the agency's  
4 failure for three (3) months after demand to submit any information required for administration  
5 of this system with respect to the agency employees, or if the Board determines that the agency  
6 has ceased to exist. The CalPERS Board may terminate such contract by a resolution adopted  
7 by a majority vote of the CalPERS Board, which becomes effective sixty (60) days after mailing  
8 notice of the adoption of the resolution to the contracting agency by registered mail. Further, the  
9 contracting agency is responsible for interest assessed on delinquent contributions, plus costs  
10 and fees.

11 After termination, CalPERS merges the terminated agency's plan assets and liabilities  
12 into a single pooled account to provide for payment of benefits to all members of terminated  
13 plans. If the contracting agency's accumulated contributions credited to employees fall short of  
14 the actuarial equivalent required to pay benefits, then the contracting agency is liable for the  
15 shortfall. Cal. Gov't Code § 20577. If the contracting agency fails to pay the difference,  
16 CalPERS may reduce the benefits paid to the affected agency's retirees, beneficiaries and/or  
17 survivors accordingly. Finally, a public agency, whose previous contract for participation in the  
18 retirement system has terminated, may not enter into another CalPERS retirement plan contract  
19 within three (3) years of termination. Cal. Gov't Code § 20460.

20 To date, the City has not adopted an ordinance or resolution providing one year's notice  
21 of any intent to terminate the CalPERS retirement plan contract.

## 22 **2. Termination of a CalPERS Health Benefits Contract**

23 California Government Code § 22938 establishes the means under California law for  
24 voluntary termination of a CalPERS health benefits contract. To do so, a contracting agency  
25 must adopt and file a resolution by a majority of its governing body no later than 60 days after  
26 CalPERS' annual announcement of health plan rates. 2 CCR § 599.515(e). If such a resolution  
27 is passed, the contracting agency's termination resolution becomes effective at the end of the  
28 contract year. 2 CCR § 599.515(e). Additionally, under California Government Code § 22939,

1 a contracting agency's CalPERS health benefits plan may be involuntarily terminated upon the  
2 agency's failure for three months to perform any act required by PEMCHA, Board rules or  
3 regulations, after CalPERS' issuance of a performance demand. Here, there is no indication that  
4 the City filed a termination resolution of its CalPERS health benefits contract within sixty days  
5 of June 2008 when health rates were announced. Thus, the City cannot terminate the health  
6 benefits contract until at the earliest, upon proper notice, for the 2010 year.

## 7 DISCUSSION

### 8 A. The City's CalPERS Contracts Cannot be Implicitly Rejected Through the City's 9 11 U.S.C. § 365 Rejection of its Collective Bargaining Agreements

10 As discussed *supra*, the City's retirement and health benefits contracts with the CalPERS  
11 system (the "CalPERS Contracts") were established pursuant to the CBAs. The City has not  
12 taken any state statutory actions to terminate or modify its CalPERS Contracts.

13 In its Motion, the City contends that it is authorized to reject the CBAs as executory  
14 contracts because they are burdensome to the estate, and the balancing of the equities favor  
15 rejection. In support of its arguments, the City alleges that "the CBAs with the City's police and  
16 firefighters provide some of the highest compensation available in the surrounding communities.  
17 Compared to fifteen area cities, the salary, retirement, separation, health and medical benefits  
18 City police and firefighters receive under the CBAs rank at or near the top in every category."  
19 MPA at p. 20. However, 11 U.S.C. § 365 requires rejection of the entire executory contract or  
20 unexpired lease, and by proposing to reject the CBAs and all of their provisions, the City's  
21 Motion fails to identify the specific provisions it seeks to reject in its CBAs, causing CalPERS  
22 concern that the City may be implicitly attempting to reject the CalPERS Contracts.

23 Although easily distinguishable, a few debtor employers in chapter 11 cases have argued  
24 that they may employ 11 U.S.C. § 1113 (a narrowly-tailored provision for the rejection of  
25 chapter 11 CBAs) to reject their CBA and, at the same time, affect certain of the attendant health  
26 and employee welfare benefits conferred by their CBA.<sup>8</sup> In such cases, the debtor employers

27 <sup>8</sup> During a chapter 11 reorganization, some debtor employers have attempted to utilize 11 U.S.C. § 1113 to reject a  
28 collective bargaining agreement, and the attendant health and retirement benefits thereto. For example, in *Truck  
Drivers Local 807 v. Carey Transportation, Inc.*, 816 F.2d 82, 86 (2nd Cir. 1986), the debtor employer sought to

1 expressly proposed a reduction in or termination of health and pension benefit contributions as  
2 necessary in arguing for a § 1113 rejection. Because these cases are distinguishable due to the  
3 inapplicability of § 1113 to chapter 9, to the extent that the City's Motion seeks to implicitly  
4 reject the CalPERS Contracts which are tied to the CBAs, the City's Motion should be denied  
5 for lack of notice.

6 Any proposed rejection of the CalPERS Contracts requires a separately noticed motion  
7 and hearing. Federal Rule of Bankruptcy Procedure 6006 requires that the other party to a  
8 contract that is the subject of a motion to reject under 11 U.S.C. § 365 be provided notice of the  
9 motion. Fed. R. Bankr. Proc. 6006; *see also* Fed. R. Bankr. Proc. 9014 (requiring that relief be  
10 requested by motion, and reasonable notice and opportunity for hearing to the party against  
11 whom relief is sought). The Motion states that the City is rejecting the CBAs with its unions,  
12 but nowhere in the Motion or the notice is there any mention of the CalPERS Contracts or their  
13 rejection. Providing CalPERS with the notice of the Motion to reject the CBAs without stating  
14 that the City is seeking relief against CalPERS, if that is the case, is not sufficient. If relief is  
15 being sought against CalPERS, the City's Motion must state that it is seeking rejection of the  
16 CalPERS Contracts and the basis therefor. *See e.g., In re Wright Air Lines, Inc.*, 44 B.R. 744  
17 (Bankr. N.D. Ohio 1984) (opining that the debtor's failure to specify in its application the  
18 "specific provisions" in the collective bargaining agreement from which the debtor seeks interim  
19 relief, does not meet 11 U.S.C. § 1113's notice requirements); *In re Cedar Rapids Meats, Inc.*,  
20 117 B.R. 448, 449 (Bankr. N.D. Iowa. 1990) (evaluating the debtor's request for 11 U.S.C. §  
21 1113 interim relief from certain specified provisions, i.e., welfare benefits and pension  
22 contributions, in its collective bargaining agreements).

23 Importantly, California municipal employees, in particular, hold certain court-mandated

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24 achieve labor savings by rejecting its collective bargaining agreements under 11 U.S.C. § 1113 in order to: (1) freeze  
25 wages, (2) reduce health and pension benefit contributions, (3) eliminate sick days, (4) modify overtime, (5) change  
26 scheduling rules, etc. As another example, in *United Steelworkers of America v. Unimet Corp. (In re Unimet Corp.)*,  
27 842 F.2d 879, 885 (6th Cir. 1988), the debtor employer, whose only remaining obligation under the collective  
28 bargaining agreement was the payment of retiree health insurance premiums, moved to reject the collective  
bargaining agreement under § 1113 when negotiations with the retirees broke down. These chapter 11 cases suggest  
that § 1113 encompasses health and retirement benefits. However, these cases are distinguishable in that § 1113 does  
not apply in chapter 9, and the City, in its Motion at bar, has not expressly disclosed that any modifications to health  
and retirement benefits are a necessary component in the City's proposed rejection of the CBAs.

1 constitutional rights. As mentioned above, if the CalPERS retirement plan contract is terminated  
2 by virtue of rejection of the CBAs, such termination may affect the amount retirees receive,  
3 depriving those affected of their pension rights. *See* Cal. Gov't Code § 20577. This implicates  
4 due process requirements for the retirees because “public employment gives rise to certain  
5 obligations which are protected by the contract clause of the Constitution .... Such obligations  
6 include pension rights.” *California Ass'n of Prof'l Scientists*, 137 Cal. App. 4th at 375. “[B]oth  
7 the federal and state contract clauses protect the vested pension rights of public officers and  
8 employees from unreasonable impairment.” *Id.* at 382; *Legislature v. Eu*, 54 Cal. 3d 492, 528  
9 (1991); *Betts v. Board of Administration*, 21 Cal. 3d 859, 863 (1978); *Carman v. Alford*, 31 Cal.  
10 3d 318, 325 (1982). These pension rights arising from California’s explicit state policy extend  
11 to retirement health and welfare benefits as part of compensation under California law. That is,  
12 vested post-retirement health and welfare benefits which are fundamental to the elements of  
13 compensation for public employees, also are constitutionally protected from unreasonable  
14 impairment. *Thorning v. Hollister School Dist.*, 11 Cal. App. 4th 1598, 1607 (1992).

15 Public employees also may hold constitutionally-protected property interests in the terms  
16 and conditions of their employment, and such an interest triggers procedural due process  
17 considerations. A “public employee has a due process property right in continued employment  
18 only if the individual has a legitimate claim of entitlement to the position created by ‘existing  
19 rules or understandings that stem from an independent source such as state law.’” *Garcia v.*  
20 *Mortimer*, 704 F. Supp. 984, (N.D. Cal. 1988) (citing *Board of Regents v. Roth*, 408 U.S. 564,  
21 577, 92 S. Ct. 2701 (1972)). In *Board of Regents*, the United States Supreme Court indicated  
22 that “property interests do not arise from the Constitution but ‘are created and their dimensions  
23 are defined by existing rules or understandings that stem from an independent source such as  
24 state law—rules or understandings that secure certain benefits and that support claims of  
25 entitlement to those benefits.’” *Thomas v. City of Los Angeles*, 676 F. Supp. 976, 980 (C.D. Cal.  
26 1987) (citations omitted). “Federal constitutional law, however, ‘determines whether that  
27 interest rises to the level of a legitimate claim to entitlement protected by the Due Process  
28 Clause.’” *Thomas v. City of Los Angeles*, 676 F. Supp. at 980 (citing *Memphis Light, Gas and*

1 *Water Division v. Craft*, 436 U.S. 1, 9, 98 S. Ct. 1554 (1978)).

2 Further, there is no contention that the CalPERS Contracts are part of the CBAs such that  
3 they are in fact one indivisible contract. *See e.g., In re Gardinier, Inc.*, 831 F.2d 974, 975 (11th  
4 Cir. 1987). None of the parties have taken such a position in this case. Even if they did, the test  
5 for treating several writings as one contract is not met here. *Gardinier*, 831 F.2d at 976  
6 (explaining that in the composition of an executory contract, the court will look to (1) whether  
7 the nature and purpose of the obligations differ; (2) whether the consideration for the obligations  
8 is separate and distinct; and (3) whether the obligations of the parties are interrelated). The City  
9 has not provided any notice to CalPERS that this particular issue was raised in its Motion.

10 In sum, without a proper motion or notice seeking to reject the CalPERS Contracts, the  
11 City cannot implicitly reject the CalPERS Contracts by its Motion. Rejection or suspension of  
12 the CBAs does not relieve the City of its statutory funding and termination obligations under the  
13 CalPERS Contracts, which are separate and apart from the CBAs.

14 **B. Rejection of the CBAs is Not Preclusive of Any Subsequent Attempt by the City to**  
15 **Reject the CalPERS Contracts**

16 Assuming *arguendo* that the Court authorizes the rejection of the CBAs, none of the  
17 essential findings for such authorization would be entitled to preclusive effect as to any  
18 subsequent attempt by the City to reject the CalPERS Contracts, to the extent that they constitute  
19 executory contractual obligations.

20 This is true because the CalPERS Contracts fall within the purview of 11 U.S.C. §§ 903  
21 and 904. These statutes, based on the Tenth Amendment, make it clear that bankruptcy law  
22 cannot interfere with a state's control over its municipalities.<sup>9</sup> Section 903 recognizes that  
23 during a chapter 9 bankruptcy case, there is a danger of too much federal court intervention in  
24 the governmental affairs of a state municipality. House Report No. 95-595, 95th Cong., 1st  
25 Sess. 397-398 (1977). Section 904 similarly underlines the need for a limitation on the  
26 bankruptcy court's powers. House Report No. 95-595, 95th Cong., 1st Sess. 398 (1977).

27 \_\_\_\_\_  
28 <sup>9</sup> The Tenth Amendment of the Constitution provides that the powers not delegated to the United States by the  
Constitution, nor prohibited by it to the states, are reserved to the states respectively.

1 The State of California has a distinctive, centrally-managed, and actuarially-sound public  
2 employee pension and benefit scheme (PERL and PEMHCA), and Congress has opted to refrain  
3 from interfering with state and local government operations of employee benefit systems,  
4 mindful of principles of federalism. *See Roy v. Teachers Ins. and Annuity Assoc.*, 878 F.2d 47,  
5 49 (2d Cir. 1989). In *Feinstein v. Lewis*, 477 F. Supp. 1256, 1261 (S.D.N.Y. 1979), the district  
6 court reviewed the legislative history of ERISA in reaching a determination that the  
7 governmental plans in question were exempt from ERISA coverage. The court noted that:

8 Plans established by state and local governments are generally excluded from  
9 coverage under ERISA because of concerns of federalism. In a summary of the  
10 major provisions of a predecessor bill, Senator Lloyd Bentsen commented that:  
11 **‘State and local governments must be allowed to make their own**  
12 **determination of the best method to protect the pension rights of municipal**  
13 **and state employees. These are questions of state and local sovereignty and**  
14 **the Federal Government should not interfere.’** 1 Legislative History of the  
15 Employee Retirement Income Security Act of 1974 220 (1976) (hereinafter cited  
16 as Legislative History)...In commenting on the fact that a provision including  
17 state and local public employee benefit plans under the ambit of the reporting and  
18 disclosure sections of H.R. 2 had been dropped from the final draft, Representative  
19 John H. Erlenborn stated that ‘the Committee missed the opportunity . . . to foster  
20 honesty in government and to give Public employees the comprehensive  
21 protections and guarantees . . . deem(ed) vital to private employees.’ H.R.Rep.  
22 93-553, at 44, U.S.Code Cong. & Admin.News, p. 4668 (emphasis added). See Id.  
23 at 9, 43. These discussions clearly demonstrate that Congress, in exempting  
24 governmental plans, was **concerned more with the governmental nature of**  
25 **public employees and public employers** than with the details of how a plan was  
26 established or maintained.

27  
28 *Feinstein*, 477 F. Supp. at 1261-62 (emphasis added). The governmental nature of public  
benefit plans was emphasized in the legislative record detailing Congress’ reluctance to interfere  
with the administration of public retirement plans:

There are literally thousands of public retirement systems operated by towns,  
counties, authorities and cities in addition to the state and Federal plans.  
Eligibility, vesting and funding provisions are at least as diverse as those in the  
private sector with the added **uniqueness added by the legislative process**. For  
this reason the Committee is convinced that additional data and study is necessary  
before any attempt is made to address the issues of vesting and funding with  
respect to public plans.

*Rose v. Long Island*, 828 F.2d at 914 (emphasis added) (reviewing the report of the House

1 Committee on Education and Labor and citing H.R. Rep. No. 533, 1974 U.S. Code Cong. & Ad.  
2 News at 4647).

3 Accordingly, the State of California has enacted legislation that prohibits a contracting  
4 agency's 11 U.S.C. § 365 unilateral rejection of contracts to which CalPERS is a party.<sup>10</sup> Such  
5 legislation reflects the special need of state government and pension plans to pursue state law  
6 remedies to protect pensioners. California Government Code § 20487 provides:

7 Notwithstanding any other provision of law, no contracting agency or public  
8 agency that becomes the subject of a case under the bankruptcy provisions of  
9 Chapter 9 (commencing with Section 901) of Title 11 of the United States Code  
10 shall reject any contract or agreement between that agency and the board pursuant  
11 to Section 365 of Title 11 of the United States Code or any similar provision of  
law; nor shall the agency, without the prior written consent of the board, assume or  
assign any contract or agreement between that agency and the board pursuant to  
Section 365 of Title 11 of the United States Code or any similar provision of law.

12 See Cal. Gov't Code § 20487. Such statutory protections for pension and benefit plans from  
13 unilateral rejection, as seen in ERISA distress termination provisions, are routinely respected in  
14 bankruptcy. See *In re Philip Services, Corp.*, 310 B.R. 802, 808 (Bankr. S.D. Tex. 2004)  
15 (holding that ERISA's comprehensive set of rules to deal with underfunded pension plans govern  
16 in bankruptcy).

17 Claim and issue preclusion apply in bankruptcy. *Brown v. Felsen*, 442 U.S. 127, 134-39  
18 (1979); *Grogan v. Garner*, 498 U.S. 279, 285, 112 L. Ed. 2d 755, 111 S. Ct. 654 (1991); see  
19 also *In re Paine*, 283 B.R. 33, 39 (9th Cir. BAP 2002). Claim preclusion generally requires that  
20 there be: (1) parties either identical or in privity; (2) a judgment rendered by a court of  
21 competent jurisdiction; (3) a prior action concluded to final judgment on merits; and (4) the  
22 same claim or cause of action involved in both actions. *Rein v. Providian Fin. Corp.*, 252 F.3d  
23 1095, 1098 (9th Cir. 2001); *Owens v. Kaiser Found. Health Plan*, 244 F.3d 708, 713 (9th Cir.  
24 2001); see also *In re Paine*, 283 B.R. at 39.

25 Issue preclusion generally requires that there be: (1) the same issue; (2) actually litigated  
26 and determined; (3) by a valid and final judgment; (4) as to which the determination is essential

27 <sup>10</sup> The State of California, by and through CalPERS, has standing to assert that section 903 operates to limit the  
28 actions of a chapter 9 debtor. See 6 COLLIER ON BANKRUPTCY § 903.02[3] (15th rev. ed. 2007) (citing *In re County  
of Orange*, 179 B.R. 185 (Bankr. C.D. Cal.) *aff'd in part, rev'd in part, remanded* 189 B.R. 499 (C.D. Cal. 1995)).

1 to the judgment. Restatement (Second) of Judgments § 27; *Robi v. Five Platters, Inc.*, 838 F.2d  
2 318, 322 (9th Cir. 1988); *see also In re Paine*, 283 B.R. at 39.

3 Here, all of the prerequisites for claim or issue preclusion do not exist. The City's  
4 Motion seeks to reject its CBAs with the Unions, and CalPERS and the Unions are not the same  
5 parties nor are they in privity with each other as is required for claim preclusion. For that reason  
6 alone, claim preclusion would not apply.

7 Importantly, the Motion does not raise the same claim, cause of action or issue that a  
8 hypothetical 11 U.S.C. § 365 motion to reject the CalPERS Contracts would involve. The  
9 Motion contends that the seminal case of *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1983)  
10 governs the City's authority to reject the CBAs. *Bildisco* was a chapter 11 case. While this  
11 distinction may or may not matter as to a proposed rejection of the CBAs in this chapter 9 case,  
12 it does matter when examining whether to authorize the rejection of a municipality's contract  
13 with a state retirement system because of the constraints of sections 903 and 904 of the  
14 Bankruptcy Code. Unlike the labor agreement that was at issue in *Bildisco*, the CalPERS  
15 Contracts are contracts between a municipality and a state agency for the administration of  
16 benefits promised by the municipality to its public employees, and governed by state law. Due  
17 to the disparity of issues and parties, the rejection standards set forth in *Bildisco*, as proposed in  
18 the City's Motion, have little if any application to a hypothetical attempt to reject the CalPERS  
19 Contracts.

20 Specifically, sections 903 and 904 in conjunction, curtail the power of the federal court's  
21 interference into municipal affairs. Bankruptcy courts may not interfere with the governance or  
22 management of a municipal debtor. Section 903, entitled "Reservation of State power to control  
23 municipalities" provides,

24 This chapter does not limit or impair the power of a State to control, by legislation  
25 or otherwise, a municipality of or in such State in the exercise of the political or  
26 governmental powers of such municipality, including expenditures for such  
exercise, but---

27 (1) a State law prescribing a method of composition of indebtedness of such  
28 municipality may not bind a creditor that does not consent to such  
composition; and

1 (2) a judgment entered under such a law may not bind a creditor that does not  
2 consent to such composition.

3 11 U.S.C. § 903.

4 The purpose of this language is to remove any inference that chapter 9 accomplishes  
5 anything more than providing a procedure under which municipalities may adjust their debts. 6  
6 COLLIER ON BANKRUPTCY § 903.02[1] (15th rev. ed. 2007). The structure and substance of  
7 chapter 9 support the proposition that by enacting chapter 9 Congress did not intend to interfere  
8 with a state's control over its municipalities. See e.g., 11 U.S.C. § 943(b)(4) (prohibiting  
9 confirmation if a plan proposes any action that the debtor is prohibited from taking under  
10 applicable law); § 943(b)(6) (court's power to confirm a plan does not override any power of  
11 electorate to veto action proposed to be taken if the electorate would have a veto outside of  
12 chapter 9); and § 944(b)(3) (requiring court to determine that any securities issued under a plan  
13 are in compliance with state law). By enacting section 903, Congress intended to "negate any  
14 inference that any other provision of chapter 9, or any other provision of the Bankruptcy Code  
15 made applicable in chapter 9, in any way interfered with a state's control over its municipalities."  
16 6 COLLIER ON BANKRUPTCY § 903.02[1] (15th rev. ed. 2007); see also *Ropico, Inc. v. City of*  
17 *New York*, 425 F. Supp. 970, 983 (S.D.N.Y. 1976) (reviewing section 83 of Chapter IX of the  
18 Bankruptcy Act, from which section 903 is derived, and noting that while the Supreme Court has  
19 invalidated state laws which were found to conflict with the Bankruptcy Act, it has also in other  
20 cases sustained provisions affecting the bankruptcy power where the state laws were not directly  
21 in conflict with the Bankruptcy Act).

22 Section 904 works with section 903 to ensure the constitutionality of chapter 9 in light of  
23 the Tenth Amendment. *In re Sanitary and Improvement Dist.*, 98 B.R. 970, 972 (Bankr. D. Neb.  
24 1989). However, while section 903 prohibits a bankruptcy court from interfering with a state's  
25 control over its municipality, section 904 sets forth limits on the court's ability to interfere with  
26 the municipality itself. 6 COLLIER ON BANKRUPTCY § 904.01 (15th rev. ed. 2007). One  
27 exception to the limitation in section 904 is that the municipality can consent. But, such consent  
28 cannot run afoul of section 903. 6 COLLIER ON BANKRUPTCY § 904.02[1][a] (15th rev. ed. 2007).

1 Public employee benefit plans established by state and local governments exhibit a  
2 “governmental nature,” and necessarily implicate state sovereignty which the federal government  
3 should not interfere with.<sup>11</sup> See *Feinstein v. Lewis*, 477 F. Supp. at 1261-62 (adding that public  
4 benefit plans established pursuant to collective bargaining are still governmental plans); *Pierson*  
5 *v. Continental Casualty Co.*, 2000 U.S. Dist. LEXIS 21380, \*43 (C.D. Cal. 2000). The Tenth  
6 Amendment and sections 903 and 904 prohibit a chapter 9 debtor from exercising executory  
7 contract rejection rights under the Bankruptcy Code against a municipality’s contracts with a  
8 state agency without reference to applicable state law.

9 Sections 903 and 904 are relevant here to the extent the City is implicitly seeking in its  
10 Motion, or may seek in the future, to reject the CalPERS Contracts. There are several areas  
11 where the State of California has elected to control its municipalities through legislation that  
12 applies to the City and the CalPERS Contracts, resulting in the prohibition of the exercise of  
13 executory contract rejection rights against the CalPERS Contracts. First, California law  
14 specifically addresses a municipality’s ability to terminate a CalPERS retirement plan contract.  
15 Government Code § 20570 requires the municipality to adopt a resolution to terminate the  
16 contract, but such termination is not effective for one year. Cal. Gov’t Code § 20570. Second,  
17 California law specifically addresses a municipality’s ability to terminate a CalPERS health  
18 benefits contract. Title 2 of the California Code of Regulations § 599.515(e), provides that a  
19 municipality must adopt and file a resolution no later than 60 days after CalPERS publishes its  
20 yearly announcement of health plan rates. If the municipality does elect to terminate, the  
21 termination, by operation of law, becomes effective at the end of the contract year. 2 CCR §  
22 599.515(e). Finally, Government Code § 20487 expressly prohibits the unilateral rejection of an  
23 executory contract with CalPERS by a municipality in a chapter 9 case.

24 Each of the above California statutes are examples of what sections 903 and 904 were  
25 intended to preserve for the state. The distinction is that the relevant statutes deal with the  
26 relationship between a state agency, here CalPERS, and the state’s municipality, here the City.

27 <sup>11</sup> The level of state pension regulation widely varies from state to state, with some states having more  
28 comprehensive systems, while others have embodied constitutional principles. See e.g., *Alley v. Resolution Trust*  
*Corp.*, 299 U.S. App. D.C. 363 (1993). Hence, the legal standards to be applied to state pension plans will differ.

1 By legislation, California has elected to require certain procedures for termination of the  
2 CalPERS Contracts. Section 903 prohibits the Court from setting aside those statutes. Nor can  
3 the City elect to have the Court interfere with the State's control of its municipality through  
4 section 904. Thus, in the event the City seeks to terminate the CalPERS Contracts, it must  
5 comply with California Government Code § 20570 and Title 2 of the California Code of  
6 Regulations § 599.515(e).

7 **CONCLUSION**

8 For the reasons stated above, rejection of the CBAs by the City, if authorized by the  
9 Court, cannot operate as an implicit rejection of the CalPERS Contracts. In the event that the  
10 Court authorizes rejection of the CBAs, any rulings made by the Court do not apply to any  
11 subsequent attempt by the City to reject the CalPERS Contracts to the extent they constitute  
12 executory contractual obligations. Rejection of the CBAs does not relieve the City of its statutory  
13 funding and termination obligations for the CalPERS Contracts.

14 Dated: December 11, 2008

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