UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

RIVERSIDE DIVISION

In re

CITY OF SAN BERNARDINO, CALIFORNIA,

Debtor.

Case No. 6:12-bk-28006 MJ

Chapter 9

FINDINGS OF FACT AND CONCLUSIONS OF LAW REGARDING ORDER GRANTING IN PART AND DENYING IN PART CITY OF SAN BERNARDINO'S MOTION AUTHORIZING REJECTION OF COLLECTIVE BARGAINING AGREEMENT WITH SAN BERNARDINO CITY PROFESSIONAL FIREFIGHTERS

Hearing:
Date: September 11, 2014
Time: 1:30 p.m.
Place: United States Bankruptcy Court
3420 Twelfth Street
Courtroom 301
Riverside, CA 92501

I. INTRODUCTION

1. On April 4, 2013 and September 11, 2014, the motion entitled "Debtor City of San Bernardino's Motion Pursuant to 11 U.S.C. §§ 365, 901 and 904 for Order Approving: (A) Rejection of Collective Bargaining Agreements With San Bernardino Public Employees Assoc., San Bernardino Police Officers Assoc. and San Bernardino City Professional Firefighters; and (B) February 1, 2013 Interim Modifications to Such Collective Bargaining Agreements" ("the Rejection Motion") came on regularly for hearing in Courtroom 301 of the United States Bankruptcy Court for the Central District of California, the Honorable Meredith Jury presiding. Prior to the September 11, 2014 hearing: (a) the City and the San Bernardino Public Employees Association (SBPEA") reached an agreement pursuant to which, among other things, the City withdrew the Rejection Motion as it applied to the SBPEA; and (b) the Court bifurcated the proceedings such that the September 11, 2014 hearing, the Court's subsequent order on the Rejection Motion and these Findings of Fact and Conclusions of Law do not apply to the San Bernardino Police Officers Association ("SBPOA") and the City's Memorandum of Understanding with the SBPOA.

2. Movant City of San Bernardino ("City") appeared through its counsel, Paul R. Glassman and Fred Neufeld of Stradling Yocca Carlson & Rauth, a Professional Corporation. The San Bernardino City Professional Firefighters Local 891 ("SBCPF") appeared through its counsel, Corey W. Glave, Attorney At Law, and David M. Goodrich of Sulmeyer Kuptez, a Professional Corporation.

3. The Court reviewed numerous briefs filed in support of and in opposition to the Rejection Motion, the declarations of Michael Busch, Georgeann Hanna, Linda Daube, Diana Leibrich, Kathleen DeVaney and Richard Luczak filed by the City in support of the Rejection Motion, the declarations of Corey Glave, David Goodrich and Richard Scott Moss filed by the SBCPF in opposition to the Rejection Motion, and the numerous documents attached to the declarations. The City's evidence on the financial burden of the contract was entirely unrebutted by any admissible evidence presented by SBCPF, who chose to not present any expert testimony to counter the testimony of Michael Busch. SBCPF explicitly waived the opportunity for an evidentiary hearing during which it could have cross examined Mr. Busch and any of the other City

declarants. Based upon the evidence presented, the Court hereby makes the following findings of fact ("*FOF*") and conclusions of law. Based upon these findings of fact and conclusions of law, on September 19, 2014, the Court entered its "Order Granting In Part and Denying In Part City of San Bernardino's Motion Authorizing Rejection of Collective Bargaining Agreement With San Bernardino City Professional Firefighters" ("the Rejection Order").

4. The findings and conclusions set forth herein constitute the Court's findings of fact and conclusions of law. To the extent any of the following findings of fact are determined to be conclusions of law, they are adopted, and shall be construed and deemed, conclusions of law. To the extent any of the following conclusions of law are determined to be findings of fact, they are adopted, and shall be construed and deemed, as findings of fact.

5. The Court has jurisdiction to hear and determine the Rejection Motion and the requests for relief contained in the Rejection Motion pursuant to 28 U.S.C. §§ 157(b)(1) and 1334(b). Venue of the adversary proceeding in this district is proper under 28 U.S.C. §§ 1408 and 1409.

6. The Court, having read and considered all of the pleadings and heard oral argument, and having ruled on certain of the evidentiary objections and upon consideration of the admissible evidence, and good cause appearing therefor, the Court hereby makes the following findings of fact and conclusions of law.

II. FINDINGS OF FACT

<u>The Parties and the Memorandum of Understanding</u>

7. The City of San Bernardino ("City") is a municipal corporation and a political subdivision of the State of California.[1]

8. The City filed a voluntary petition for relief under Chapter 9 of the Bankruptcy Code on August 1, 2012 ("Petition Date").[2]

9. On September 17, 2013, this Court entered its Order for Relief Under Chapter 9 of the Bankruptcy Code.[3]

---

[1] City of San Bernardino Eligibility Opinion, [Docket No.830], at p. 18, lines 1-3. References to the "Docket" are to the pleadings filed in the above-captioned Chapter 9 case.

[2] Docket No. 1.

10. The City and the SBCPF are parties to a collective bargaining agreement entitled "Fire Safety Employees Memorandum of Understanding - January 1, 2003 to June 30, 2009" (Resolution No. 2006-66), as amended by Resolution No. 2009-140 dated June 1, 2009 (approving a Side Letter to Resolution No. 2006-66) and Resolution No. 2011-33 adopting the Terms and Conditions of Employment for the Fire Safety Employees (collectively, the "MOU").[4] The MOU provides in Section 5 of Article VII that "[u]pon expiration of the MOU and until a new MOU has been negotiated between the Union and the City, all articles in this MOU shall remain in full effect, unless otherwise stated in this MOU."[5]

<u>The City's Financial Condition</u>

11. Prior to the Petition Date, the City's Finance Department with the assistance of Andrea Travis-Miller, the City's former Acting City Manager, and Michael Busch, the president and CEO of Urban Futures, Inc., the City's financial consultant, prepared the "San Bernardino Budgetary Analysis and Recommendations for Budget Stabilization" dated July 9, 2012 (the "July 2012 Budget Report"), a Staff Report dated July 18, 2012, a "Fiscal Emergency Operating Plan – July 2012 to September 2012" (the "Fiscal Emergency Plan"), and a report entitled "City of San Bernardino Selected Monthly Cash Flow Analysis("Cash Flow Analysis").[6] The City's Finance Department and Mr. Busch, with the assistance of Ms. Travis-Miller, also prepared the Pre-Pendency Plan and Pendency Plan.[7]

---

[3] Docket No. 798.

[4] Declaration Of Diana Leibrich In Support Of Debtor City Of San Bernardino's Motion Pursuant To 11 U.S.C. §§ 365, 901 And 904 For Order Approving: (A) Rejection Of Collective Bargaining Agreements With San Bernardino Public Employees Assoc., San Bernardino Police Officers Assoc. And San Bernardino City Professional Firefighters; And (B) February 1, 2013 Interim Modifications To Such Collective Bargaining Agreements and the exhibits thereto [Docket Nos. 446 through 446-39] filed March 4, 2013 ("Leibrich Decl. 3/4/13") at ¶ 7 and Exhibits 2, 3 and 4 thereto.

[5] Leibrich Decl. 3/4/13 at Exhibit 2, p. 36.

[6] Exhibits B, C, I, L and M to Declaration of Georgeann Hanna In Support of City of San Bernardino's Memorandum of Facts and Law In Support Of The Statement of Qualifications Under Section 109(c) Of The Bankruptcy Code [Docket No. 129] filed on August 31, 2012 ("Hanna Decl. 8/31/12").

[7] Declaration Of Michael Busch In Support Of Debtor City Of San Bernardino's Motion Pursuant To 11 U.S.C. §§ 365, 901 And 904 For Order Approving: (A) Rejection Of Collective Bargaining Agreements With San Bernardino Public Employees Assoc., San Bernardino Police Officers Assoc. And San Bernardino City Professional Firefighters; And (B) February 1, 2013 Interim Modifications To Such Collective Bargaining Agreements and the exhibits thereto [Docket Nos. 445 through 445-2] filed March 4, 2013 ("Busch Decl. 3/4/13") at ¶ 6; Exhibits 1 through 3 to Declaration of Michael Busch Re City of San Bernardino's Pendency Plan [Docket No. 234] filed on November 30, 2012.

12. The Great Recession and housing bubble burst adversely affected the City of San Bernardino just like other cities in California and across the nation. Since 2007, housing prices plummeted and the foreclosure rate increased resulting in significantly lower property tax revenues. The housing construction boom of the early 2000's led to speculation in the housing market and an influx of people moving to San Bernardino to seek more affordable housing than that available in Los Angeles, Orange and San Diego Counties. Speculation in San Bernardino's housing market made it particularly vulnerable when the housing bubble burst, and the Riverside-San Bernardino-Ontario metro area had one of the nation's highest foreclosure rates. San Bernardino's foreclosure rate was 3.5 times greater than the national average. The median single family home price peaked in 2007, and was over 40% below that peak in June of 2012. In addition to declines in residential real estate prices, commercial properties dropped in value. Given continued housing market weakness and the constraints imposed by Proposition 13 on property tax increases, the July 2012 Budget Report concluded that property tax revenues likely will remain flat for years to come. The Great Recession also caused job losses for many of San Bernardino's residents. Since June of 2008, the City has suffered from double digit unemployment. The City's unemployment rate was 16.9% as of June 2012, which was notably higher than the State of California's and more than double the June 2012 national rate of 8.2%. By 2010, roughly 34.6% of the City's population was classified as poor. In 2011, the U.S. Census Bureau ranked the City as the second poorest in the nation behind only Detroit. While sales tax revenues have increased modestly since the 2009-10 low, the July 2012 Budget Report predicted that sales tax revenues were not projected to return to peak levels in the near term.[8]

13. The July 2012 Budget Report presented to the Mayor and Common Council at the July 10, 2012 Common Council meeting determined that: (1) the City faced a budget deficit preliminarily estimated to be over $45.8 million in fiscal year 2012-13 which began on July 1, 2012; (2) the City had depleted all its General Fund reserves and reserves in other internal service accounts to cover substantial budget deficits in the last four consecutive fiscal years;
(3) immediate and substantial action had to be taken to reduce spending and preserve cash for the

[8] Busch Decl. 3/4/13 at ¶ 7; Exhibits B and C to Hanna Decl. 8/31/12.

City to continue providing essential services to the City's residents; (4) reviews of the City's General Fund revealed that the balances at the start of the 2010-11 and 2011-12 fiscal years had been erroneously reported by City staff and actually totaled over $4.5 million less than reported, and the beginning General Fund balance for the current fiscal year was estimated to be a cash deficit of over $18.2 million; and (5) the City did not have enough unrestricted cash available to pay its financial obligations as and when those obligations were due or to become due and owing in July of 2012 and continuing throughout the 2012-13 fiscal year and beyond.[9]

14. As of June 30, 2012, the City's General Fund had no cash. The General Fund had spent more than it had available and the estimate of the cash deficit in the General Fund was revised from $18.2 million to $15.2 million in March 2013.[10] As the City worked to complete a backlog of accounting work, the estimated General Fund *negative* cash balance was revised to $15.3 million as of the end of fiscal year on June 30, 2012. The City's Comprehensive Annual Financial Report for fiscal year 2011-12 dated June 16, 2014 ("FY 2011-12 CAFR") confirmed that the City ended fiscal year 2011-12 with a *negative* cash position in the General Fund in the amount of $15,345,420.[11]

15. In June of 2012, as part of Mr. Busch's early analysis of the causes and depth of the City's financial crisis, it was discovered that the City had a history of either not funding or substantially under-funding its operational obligations, its internal service funds (such as workers compensation, general liability claims), and the retirement benefits the City provided to its retirees in addition to their pensions (commonly referred to as "other post employment benefits" or "OPEB"). The analysis of the City's unfunded actuarial liabilities and long-term claim liabilities prepared by employees of the City's finance department in June of 2012 showed that the City had an annual net shortfall on funding of $14.4 million dollars. For fiscal year 2011-12, Mr. Busch's analysis in June of 2012 revealed that the City under budgeted operational expenses by approximately $7.4 million. The City also was not budgeting or setting aside any funds for liabilities such as compensated

---

[9] Busch Decl. 3/4/13 at ¶ 8; Exhibits B and C to Hanna Decl. 8/31/12.

[10] Busch Decl. 3/4/13 at ¶ 15.

[11] Declaration of Michael Busch In Support of Motion to Reject Collective Bargaining Agreement With San Bernardino City Professional Firefighters Local 891 [Docket No. 1117] filed on August 18, 2014 ("Busch Decl. 8/18/14") at ¶ 5; Declaration of Georgeann Hanna In Support of Motion to Reject Collective Bargaining Agreement With San Bernardino City Professional Firefighters Local 891 [Docket No. 1120 through 1120-20] filed on August 18, 2014 ("Hanna Decl. 8/18/14") at Exhibit 20.

absences, working capital or reserves for economic uncertainties. Mr. Busch's estimation of the under-budgeting of the City's operational expenses was confirmed in the City's FY 2011-12 CAFR and determined to be $7.6 million (slightly higher than Mr. Busch's estimate). The combined under-funding of municipal operations and other liabilities led to the City's significant negative cash position in the General Fund and other internal service funds, which also was verified by the FY 2011-12 CAFR. For example, the workers compensation and general liability funds had an asset deficit of roughly $20 million combined as of June 30, 2012. Mr. Busch explained that it was for these reasons that the City increased its General Fund budget (expenditures for each department) by $26 million and budgeted another $18.3 million for line items that had not been budgeted before by the City for the 2012-13 fiscal year.[12]

16. The City funds its operations through roughly 70 individual funds which are comprised of the General Fund, discretionary funds and restricted funds. While the City had total cash and investments as of June 3, 2012 of approximately $27,000,000, all of those monies were held in restricted funds and legally unavailable for General Fund obligations.[13]

17. The July 2012 Budget Report stated that in addition to the pensions that the City provides to its employees through the California Public Employees' Retirement System ("CalPERS"), the City also provides other post-employment benefits, including retiree health insurance. Because City employees are eligible to retire at either age 50 (for police and fire) or 55 (for other employees), before such employees are eligible for Medicare, the City's costs for this health insurance benefit are significant. Unlike pension benefits which are traditionally funded through the working life of the employee, little money was set aside to fund these benefits even though an actuarial liability arose. As of June 2011, the City's unfunded liability for OPEB was estimated to be $61 million.[14]

---

[12] Declaration of Michael Busch In Support of The City of San Bernardino's Reply To The San Bernardino City Professional Firefighters Local 891's Opposition And Response [Docket No. 1157] filed on September 8, 2014 ("Busch Decl. 9/8/14") at ¶ 8 and Exhibits 2 and 3 thereto; Exhibit 20 to Hanna Decl. 8/18/14; Current Financial Condition; Declaration of Michael Busch in Support Thereof ("Busch Decl., 4/29/13") at ¶ 7 and Exhibit 3 thereto.

[13] Busch Decl. 9/8/14 at ¶ 9 and Exhibit 1 thereto.

[14] Busch Decl. 3/4/13 at ¶ 19.

18. The preliminary financial projections in the Fiscal Emergency Plan and Cash Flow Analysis presented to the Common Council and Mayor on July 24, 2012 demonstrated that the City had an estimated net cash deficit of over $11.5 million and, as such, could not pay all of its obligations due and owing or becoming due from July through September of 2012. The preliminary financial projections showed that City would end each month of its fiscal year in 2012-13 with a negative cash balance of millions of dollars in the General Fund.[15]

19. As of August 2014, the City still has no General Fund reserves nor does the City have reserves in any other funds and remains unable to budget funds for vehicle replacement or replacement of other critical equipment, including items such as computers and information technology. Despite an improvement in total cash since the Petition Date, the City's ability to respond to one significant negative event under the City's current cash position would jeopardize the substantial efforts made to date to address liquidity, budget and cash insolvency.[16]

20. Most of the City's vehicles that are used to provide public safety and other services (such as police and fire protection, animal control services, maintenance and code enforcement work) are either past their scheduled replacement date or scheduled for replacement over the next three years. It is estimated that, as of fiscal year 2013-14, the backlog for replacement of City vehicles is at least $17.7 million dollars.[17] A Fleet Liability Listing identified the City vehicles scheduled for replacement in 2014 through 2031 and the estimated cost for replacing those vehicles, and unless and until the City builds up its cash, old fire trucks, police cars and other vehicles used for essential basic services and the equipment necessary to support them cannot be replaced.[18]

21. The City also has a significant capital improvement project and public facilities backlog estimated at $200 million and the City must be able to perform this work to repair and maintain streetlights, roadways, traffic signals, sewers, bridges, storm drains, culverts and other infrastructure such as public buildings and parks which are vital to City operations and the safety of its residents. For years, the City deferred capital improvement projects and much needed public

---

[15] Busch Decl. 3/4/13 at ¶ 10; Exhibits L and M to Hanna Decl. 8/31/12.

[16] Busch Decl. 8/18/14 at ¶17.

[17] Busch Decl. 8/18/14, Exhibit 3 attached thereto.

[18] Busch Decl. 8/18/14 at ¶ 13 and Exhibits 3 and 4 thereto.

facilities improvements because the General Fund relied on non-General Fund monies, including funds for capital improvement projects, in order to pay General Fund expenses.[19]

The Pre-Pendency and Pendency Plans

22. The Pre-Pendency Plan presented to the City's Common Council in August of 2012 determined that the General Fund experienced (a) a significant revenue decline from the peak in FY 2007-08 of $89.72 million to $78.21 million in FY 2011-12 and (b) increasing operating costs primarily related to personnel costs and debt service. As set forth in the July 2012 Budget Report, personnel costs represented about 75% of total General Fund expenditures for the City's 2011-12 fiscal year. Public safety (police and fire) accounted for approximately 72% of the personnel costs in the General Fund. For the 2012-13 fiscal year, personnel costs alone were projected to exceed all of the City's annual General Fund revenues.[20]

23. The City's Common Council approved a majority of the expenditure reductions recommended in the Pre-Pendency Plan on September 17, 2012 and October 1, 2012, which significantly reduced the City's 2012-13 fiscal year budget deficit and included changes to the operations of the Fire Department.[21] The City's Pendency Plan, which incorporated and amended the Pre-Pendency Plan, was approved by the City's Common Council on November 26, 2012 as set forth in Resolution No. 2012-278.[22]

24. The modifications to the City's seven collective bargaining agreements with the City's employee unions which would support the Pendency Plan included: (a) deferral of payment of cash outs of sick, holiday and vacation leave for terminated employees; and (b) increasing the amount of each employee's share of the City's obligation to CalPERS such that the employee would pay 50% of the normal cost of the benefit.[23] As described in the Pendency Plan, all of the City's creditor constituencies were adversely affected. The Pendency Plan contemplated savings from approximately $26 million in employee salary and benefit reductions, and $35 million in continuing

---

[19] Busch Decl. 8/18/14 at ¶ 16.

[20] Busch Decl. 3/4/13 at ¶ 11; Exhibits B and C to Hanna Decl. 8/31/2012; Exhibit 2 to Busch Decl. 11/30/12.

[21] Busch Decl. 11/30/12 at ¶ 7, lines. 13-18 and Exhibits 2 and 3 thereto.

[22] Busch Decl. 11/30/12 at ¶ 5 and Exhibit 1 thereto; Leibrich Decl. 3/4/13 at ¶ 10 and Exhibit 16 thereto.

[23] Leibrich Decl. 3/4/13 at ¶ 10 and Exhibit 16 thereto.

deferrals of payments to creditors. However, the City's financial crisis was such that, even with these cuts and deferrals, the City remained in dire financial straits.[24]

25. In order to implement the Pendency Plan, four of the City's unions (the General Bargaining Unit, the Fire Management Bargaining Unit, the Police Management Bargaining Unit, and the Management/Confidential Bargaining Unit) reached agreements with the City on modifications to their respective collective bargaining agreements, and those modifications took effect on February 1, 2013 as set forth in Resolution No. 2013-22, Resolution No. 2013-23, Resolution No. 2013-24, and Resolution No. 2013-25.[25]

26. The City did not reach an agreement with three unions on the modifications of the terms and conditions of employment set forth in the City's Pendency Plan. These unions were the Fire Safety Unit, Middle Management Unit and the Police Safety Unit. On January 28, 2013, the City Council voted to impose modifications to the terms and conditions of employment on those bargaining units as set forth in Resolution No. 2013-18, Resolution No. 2013-19 and Resolution No. 2013-20.[26] On January 28, 2013, the City also adopted Resolution No. 2013-21 entitled "Resolution Of The Mayor And Common Council Of The City Of San Bernardino Adopting Modifications To The Retiree Health Insurance Payments For Police Safety And Police Management Employees In Accordance With The City's Pendency Plan, Item #8, Adopted By The Mayor And Common Council On November 26, 2012 By Resolution No. 2012-278" which reduced the City's contribution to the retiree medical plans for eligible members of the Police Safety Unit and Police Management Unit to the same percentage the City contributes for other retirees.[27]

---

[24] Busch Decl. 3/4/13 at ¶ 12.

[25] Leibrich Decl. 3/4/13 at ¶ 11 and Exhibits 17, 18, 19 and 20 thereto; Declaration Of Linda Daube In Support Of Debtor City Of San Bernardino's Motion Pursuant To 11 U.S.C. §§ 365, 901 And 904 For Order Approving: (A) Rejection Of Collective Bargaining Agreements With San Bernardino Public Employees Assoc., San Bernardino Police Officers Assoc. And San Bernardino City Professional Firefighters; And (B) February 1, 2013 Interim Modifications To Such Collective Bargaining Agreements [Docket No. 444] filed March 4, 2013 ("Daube Decl. 3/4/2013") at ¶ 12.

[26] Leibrich Decl. 3/4/13 at ¶¶ 16 through 19 and Exhibits 21 through 23 thereto.

[27] Leibrich Decl. 3/4/13 at ¶ 20 and Exhibit 24 thereto; Daube Decl. 3/4/2013 at ¶ 13.

The City's Budgets for Fiscal Years 2012-13, 2013-14 and 2014-15

27. In February 2013, the City's financial consultant prepared the City Manager's Budget Message dated February 19, 2013 ("February Budget Message") and the Fiscal Year 2012-13 and Fiscal Year 2013-14 Proposed Budget ("Proposed Budget") with the assistance of the former Acting City Manager, Andrea Travis-Miller, employees of the City's Finance Department and individuals working in the City's Finance Department under contract with UFI. As set forth in the Budget Message, the City's liquidity crisis remained extremely serious.[28] As stated in the February Budget Message, after incorporating various transfers in from other Funds and transfers out, the projected operating deficit for fiscal year 2012-13 was revised to just short of $41 million.

28. The City needed to close the 2012-13 fiscal year with sufficient cash to operate in the next fiscal year during the lean months when revenues would come in below the monthly average, and the timely implementation of the expenditure reduction measures of the Pendency Plan were vital and necessary to meet that objective. The Pendency Plan anticipated the elimination of the 9% Employer Paid Member Contribution (EPMC) for police and fire, and the payment by the employee of 50% of PERS normal costs effective January 1, 2013. These changes did not go into effect until February 1, 2013. The additional cost to the City from just this one-month delay on these items alone was estimated to be $571,125. The City was not done cutting expenses in the process of balancing its budget, but the modifications to employee benefits were a key element in that budgetary process. As of March 2013, the City still had deficits in its internal service funds, no reserves in any funds and no funds for equipment replacement. Mr. Busch stated that the cost savings were critical to the implementation of the Pendency Plan and the ability of the City to propose a confirmable plan of adjustment and that absent the rejection of the police, fire and middle management MOUs, the City could not successfully implement its Pendency Plan.[29]

29. As set forth in the City Manager's February Budget Message, in order to adjust for the City Charter Section 186 ("Section 186") salary adjustments and the delayed implementation of the Pendency Plan measures, the City Manager recommended that the Common Council consider

[28] Busch Decl. 3/4/13 at ¶¶ 5 and 15 and Exhibit 1 thereto.

[29] Busch Decl. 3/4/13 at ¶ 16.

cost reduction strategies such as closing four community centers, terminating the agreement with the Boys and Girls Club, closing two senior centers, closing the cemetery, contracting with a private company or other public agency for library services, engineering, collections and information technology services, and outsourcing refuse collection services.[30]

30. As indicated in Table 1 of the February Budget Message, budget reductions that reflect implementation of the Pre-Pendency Plan and Pendency Plan impacted nearly every City department including the Common Council, Mayor, City Clerk, City Treasurer, City Attorney, City Manager, Civil Service, Human Resources, Public Works, Parks & Recreation, and Community Development. The City stopped proposing any additional capital improvement projects. Library hours were reduced, full-time library employees reduced to part-time and a children's bookmobile project cancelled. Reductions in personnel in Public Works, Parks & Recreation and Community Development resulted in reduction of maintenance of the City's infrastructure and parks and recreational facilities.[31]

31. In April 2013, with the assistance of Mr. Busch, the City prepared a revised Budget Message dated April 15, 2013 ("April Budget Message") and a revised Fiscal Year 2012-13 and Fiscal Year 2013-14 Proposed Budget ("FY 2012-13 and 2013-14 Budget") with the assistance of employees of the City's Finance Department and individuals working in the City's Finance Department under contract with UFI. The Budget was approved and adopted by the Common Council on April 22, 2013.[32]

32. Based on the City's FY 2012-13 and 2013-14 Budget, planned continued deferrals, cash flow analysis and reconciled bank statements, the City's total cash position as of January 2013 was $26.8 million and the estimated year-end total cash positions were $33.1 million and $37.8 million for June 30, 2013 and June 30, 2014, respectively. Given the City's total deferred obligations of $33.279 million, anticipated General Fund negative cash balance as of June 30, 2014

[30] Declaration of Diana Leibrich in support of Debtor City of San Bernardino's Reply ("Leibrich Decl. 4/1/13") at ¶ 14.

[31] Leibrich Decl. 4/1/13 at ¶ 15.

[32] City Of San Bernardino's Report Respecting: (1) Approval Of Budgets For Fiscal Years 2012-13 And 2013-14 Further Implementing Pendency Plan; And (2) Supplemental update On City's Current Financial Condition; Declaration Of Michael Busch In Support Thereof [Docket No. 572] filed on April 29, 2013 ("Busch Decl. 4/29/13") at ¶ 5.

of $8,358,873 and operating capital needs, there would not be enough cash available if the City was required to pay all of the City's deferred obligations during the FY 2012-13 and 2013-14 Budget period.[33]

33. The City's estimated growth in total cash from January 2013 to June 2013 was a reflection of continued deferrals of payments to creditors, service delivery reductions to the City's residents, and savings achieved through compensation/salary negotiations and impositions. Additionally, because the City reduced its General Fund expenses through these measures, as well as continued deferral of infrastructure and equipment replacement, the General Fund became less reliant on the restricted funds for cash flow purposes, thereby increasing cash on hand in these other funds. However, as Mr. Busch explained, improvement in total cash is not a suitable measure of the City's financial health because deferred creditor obligations exceed General Fund cash on hand, and essential services, infrastructure, equipment and working capital and reserves remain unfunded.[34]

34. While the estimate made as of April 15, 2013 of a $2.3 million budget surplus for the General Fund for fiscal year 2012-2013 may appear as a financial improvement, this was accomplished through, among other things, significant reductions in service delivery to the City's residents, the deferral of obligations due to the City's creditors and the City's continuation of not funding essential services such as infrastructure and equipment replacement.[35]

35. As a result of cost-containment measures made since the Petition Date, which included the modifications to seven collective bargaining agreements that the City implemented in February 2013 (including the imposition of modifications to the MOU approved by the Mayor and Common Council in Resolution No. 2013-20 effective as of February 1, 2013), the City no longer relied on non-General Fund cash to pay for General Fund expenses. The City would have ended fiscal year 2012-13 on June 30, 2013 with a General Fund ending cash balance of between negative $5-6 million if the City had continued to make the employer contribution payments to CalPERS, but ended the 2012-13 fiscal year with estimated cash of $8.6 million because it deferred payments to CalPERS during that fiscal year. Despite the improvement in cash, the City's General Fund

[33] Busch Decl., 4/29/13 at ¶ 7, p. 6, lns. 17-23.

[34] Busch Decl. 9/8/14 at ¶ 11.

[35] Busch Decl. 9/8/14 at ¶ 10.

liabilities continue to reflect a fund balance deficit estimated to be negative $13.1 million at the end of fiscal year 2012-13.[36]

36. After holding budget workshops in May and June of 2014, the Mayor and Common Council adopted the City's general budget for fiscal year 2014-15 (which included the Fire Department budget and associated cuts)(the "FY 2014-15 Budget") on June 30, 2014.[37] The FY 2014-15 Budget included a memorandum from Paul Drasil, the Interim Fire Chief, entitled "Proposed Fire Department Budget for Fiscal Year 14/15 (the "Drasil Report"). On June 30, 2014, the City also adopted Resolution No. 2014-243, continuing the City's fiscal emergency.[38]

37. The proposed FY 2014-15 Budget was a substantially revised budget after the estimated amounts from the managers of the City's departments for necessary expenditures to operate their respective departments exceeded the City's projected revenues by $28.2 million. It is likely that further downward adjustments to the City's 2014-15 Budget will be required to address the anticipated salary increases required under Charter Section 186. In addition, the City continues to defer payments on certain liabilities, which are unbudgeted and are estimated to be approximately $14.4 million.[39] The City still has deficits of over $3 million in certain of its internal service funds. Internal services funds are necessary to provide funds for expenses such as unemployment claims, workers compensation claims, general liability and motor pool expenses (such as parts, equipment and fuel). There are no funds in the City’s FY 2014-15 Budget budgeted to address the deficits in the City's internal service funds.[40]

38. The General Fund cash balance was $4,675,838 as of the close of business on April 30, 2014. The General Fund houses the cash that the City utilizes to pay for salaries for the City's employees and other expenses of operating the City, including the operations of the Fire Department.[41] The City has no choice but to continue to focus on managing its operational costs

---

[36] Busch Decl. 8/18/14 at ¶ 6.

[37] Declaration of Georgeann Hanna In Support of Debtor City of San Bernardino's Opposition To Motion of San Bernardino City Professional Firefighters Local 891 For Relief From The Automatic Stay [Docket No. 1064] filed on July 24, 2014 (Hanna Decl. 7/24/14") at ¶ 4 and Exhibit 1 thereto.

[38] Hanna Decl. 7/24/14 at ¶ 6 and Exhibit 3 thereto.

[39] Busch Decl. 8/18/14 at ¶ 12 and Exhibit 2 thereto.

[40] Busch Decl. 8/18/14 at ¶ 15.

[41] Busch Decl. 8/18/14 at ¶ 7 and Exhibit 1 thereto.

through the continuation of the implemented cost containment measures, as well as the identification of additional cost containment measures if the City is going to be able to bring back City services to the basic levels expected of a U.S. city with more than 210,000 residents and some of the highest unemployment and poverty rates in the nation. With respect to the Fire Department, the City needs to manage total compensation and implement certain other cost containment measures, which were identified in the Drasil Report and the earlier Cooke Memorandum in order to implement the City's balanced budget, and the Fire Department budget, that the City enacted for the 2014-15 fiscal year.[42]

39. Municipalities manage their financial matters through cost recovery (revenues such as taxes and fees) and cost containment (managing expenses through staffing levels, operating efficiencies, contracting for services, and cost sharing). As of September 2014, the City's revenues remain below peak levels and the City's ability to recover costs for services continues to be impaired by a very slow recovery from the Great Recession, as well as a continued decline in the household income of City residents.[43]

<u>The Fire Department Budgets and the Burden of the MOU on the City</u>

40. Section 186 of the Charter of the City of San Bernardino contains a provision entitled "Salaries" that establishes a basic standard for fixing salaries for employees of the Police and Fire Departments.[44] The City has no ability to negotiate over Fire Safety employee salaries at this time due to the requirements of City Charter Section 186. Fire Safety employee salaries have continued to rise during this bankruptcy case. The increases in Fire Safety employee salaries from August 1, 2008 to date are shown in Resolution Nos. 2010-78, 2011-226, 2012-20, 2013-53, and 2014-2.[45] Other costs directly linked to salary compensation, such as overtime and pension costs, have also increased during the bankruptcy case.[46]

41. For fiscal year 2012-13, the average salaries for members of the SBCPF were as follows: (a) Fire Fighter (P-1) - $7,133.50 per month or $85,602 annually; (b) Paramedic/Firefighter

---

[42] Busch Decl. 8/18/14 at ¶ 7.

[43] Busch Decl. 9/8/14 at ¶ 17.

[44] Hanna Decl. 8/31/12 at ¶ 4 and Exhibit A at p. C-30 to C-33.

[45] Hanna Decl. 8/18/14 at Exhibits 8, 12, 13, 14 and 15.

[46] Busch Decl. 8/18/14 at ¶ 9.

(P-2) - $7,733.65 per month or $92,803.30 annually; (c) Engineer (P-3) - $7,929.90 per month or $95,158.80 annually; and (d) Captain & Fire Investigator (P-4) – $9,111.60 or $109,339.20 annually. In addition to this basic salary, members of the SBCPF are paid overtime and receive other fringe benefits, including health and life insurance, tuition allowance, paid sick leave, vacation and holiday leave, and pension benefits. The amount of overtime for the Fire Safety Unit budgeted for fiscal year 2012-13 (approximately $4,462,643) divided by the total number of fire safety unit employees (126) equates to approximately $35,400 per employee in overtime compensation per year. The annual amount paid by the City for medical benefits for Fire Safety Unit Employees who elect employee plus dependent coverage is $11,910.72 per employee.[47] Based on this information for basic salary, overtime and medical benefits alone (exclusive of other fringe benefits, including pension benefits), the average compensation for the Fire Safety Unit employees ranges from $132,912.72 annually for a Fire Fighter to $156,649.92 annually for a Captain & Fire Investigator for fiscal year 2012-13.[48]

42. As shown in the chart that is Exhibit 1 to the Busch Decl. of 8/18/14, for the 2013-14 fiscal year, of the approximate 115 full time Fire Safety positions, about 70% of the positions earned roughly $100,000 in salary and $40,000 in benefits. The median full time position in the chart (with half of the positions above and half below) earned approximately $140,000 in salary and $40,000 in benefits. For the 30 highest paid fire safety employees, the total compensation package ranged from $207,000 to $272,000.[49] Fire safety overtime is a substantial cost to the City, with some Fire Safety employees earning more in overtime than basic salary, others earning nearly as much in overtime as from basic salary and most earning overtime of about half of their basic salary.[50]

43. The City's overall costs for operation of the Fire Department were approximately $34.3 million in the 2011-12 fiscal year immediately before the Petition Date. It was about $29.4 million in fiscal year 2012-13 and estimated to be about $30.4 million in fiscal year 2013-14. With the implementation of the Drasil Report and the City's proposed modifications to the terms and

---

[47] Leibrich Decl. 4/1/13 at ¶ 8.

[48] Leibrich Decl. 4/1/13 at ¶ 9.

[49] Busch Decl. 8/18/14 at ¶ 9 and Exhibit 1 thereto.

[50] *Id.*

conditions of employment upon rejection of the MOU (including continuing employee sharing of the normal cost of the CalPERS pension contribution implemented on February 1, 2013), the City hopes to reduce the annual cost of operating the Fire Dept. to $28.1 million in the 2014-15 fiscal year.[51]

44. Despite the City's cost cutting efforts since the Petition Date, the City's Fire Department incurred overtime expenses substantially in excess of the Fire Department's original budgets for the 2012-13 and 2013-14 fiscal years. Specifically, the Fire Department overtime budget for fiscal year 2012-13 was $5 million and the actual overtime costs were $7 million. The Fire Department overtime budget for fiscal year 2013-14 was $4.8 million and the actual overtime was $6.3 million. Thus, the Fire Department has incurred over-budget overtime of $3.5 million during the first two years of the City's bankruptcy.[52]

45. The MOU provides at Article II Section 15 entitled Constant Staffing: “The Fire Department will maintain its authorized daily constant staffing position vacancies through off duty personnel on an overtime basis.” The "constant staffing" provision of the MOU requires the City to provide 24 hour staffing, seven days a week on all fire engines and ladder trucks with a specific number of firefighting personnel and the Chief has no discretion whether to fill a position regardless of the then existing service level demands.[53] The "constant staffing" provision of the MOU restricts the City's ability to match service levels with actual service needs when fire services are at their lowest demand and restricts the City's ability to run the Fire Department efficiently. The "constant staffing" provision in the MOU is a primary cause of approximately $4.2 million of Fire Department costs in calendar year 2013.[54] If the MOU is rejected, the City intends to replace the constant staffing model with the minimum staffing model discussed in the Drasil Report and the Cooke Memorandum.

46. Even when the City employed more firefighting personnel in years prior to the Petition Date, the Fire Department still expended between $6 and $7 million annually for overtime costs which is approximately the same amount incurred with substantially fewer firefighting

[51] Busch Decl. 8/18/14 at ¶ 11.

[52] Busch Decl. 8/18/14 at ¶ 8.

[53] Daube Decl. 9/8/14 at ¶ 14.

[54] Busch Decl. 9/8/14 at ¶ 17.

personnel after the Petition Date. Therefore, employing additional firefighting personnel does not appear to reduce overall overtime expense. This is due to the "constant staffing" provision which prevents the City from operating the Fire Department efficiently, and generates overtime costs that are difficult to control without removing firefighting equipment from service.[55] According to Mr. Busch, the City's proposed modifications to the terms and conditions of employment upon rejection of the MOU is the only way the City can get its Fire Department budget in line with the City's overall budget for fiscal year 2014-15 and the long term.[56]

47. The Fire Department initially requested an additional $5 million in its 2014-15 Fire Department budget to address its aging fleet of fire safety vehicles. It is estimated that the backlog to replace aging fire safety vehicles for the Fire Department alone is $8 million. Due to the amount necessary to pay salaries and high overtime costs of Fire Safety employees, it was not possible to include funds in the Fire Department budget for fire safety vehicle replacement.[57]

48. The cost savings the City seeks in the operations of the Fire Department are critical to the implementation of the City's FY 2014-15 Budget so that the General Fund can pay its expenses without relying on non-General Fund monies. This is important for many reasons, including that the City has been unable to perform capital improvement projects and maintain vital infrastructure for years due to the reliance on the non-General Fund revenues to support the General Fund. Absent the cost savings expected from rejection of the MOU, the City would have an unbalanced budget and would require the use of operating capital to meet its General Fund obligations.[58]

The Burden on the City of Paying the Entire Cost of Employee Pension Benefits

49. The City participates in CalPERS to provide pension benefits to the City's employees. The City's employee retirement costs have more than tripled since 2000-01 for miscellaneous employees and almost tripled for public safety employees. In absolute dollars, San Bernardino's General Fund employee pension costs have risen from $6.2 million in 2000-2001 to $19 million by 2012-2013, and were projected to reach $22.6 million by 2015-2016 absent reforms. In

---

[55] Busch Decl. 9/8/14 at ¶ 17.

[56] Busch Decl. 8/18/14 at ¶ 8.

[57] Busch Decl. 8/18/14 at ¶ 14 and Exhibit 5 thereto.

[58] Busch Decl. 8/18/14 at ¶ 18.

the Pre-Pendency Plan, the City projected that over the next five years, the City's cumulative retirement contributions will exceed $108 million unless reductions were made.[59]

50. The rates paid by the City to CalPERS for providing pension benefits to the City's employees are, pursuant to applicable law, set by CalPERS.[60] The City's total normal cost contribution as a percentage of payroll was 27.753% for safety employees and 17.979% for miscellaneous employees for fiscal year 2012-13. In fiscal year 2013-14, the City's total normal cost contribution as a percentage of payroll increased to 27.978% for safety employees and 18.608% for miscellaneous employees. In addition to the normal cost of the pension benefit, the City also pays an amount based on the unfunded actuarial liability. In fiscal year 2012-13, the amount was 11.362% of payroll. The City believes that, as of June 30, 2011, the City's unfunded actuarial liability for both the safety and miscellaneous plans was more than $255 million.[61]

51. The normal cost of the CalPERS pension benefit is divided between the City and its employees. For fiscal year 2012-2013, the employee share of the normal cost for Safety employees was 9% of payroll. However, until the City required sharing of at least the normal cost effective February 1, 2013, the City paid all of the normal cost for the SBCPF members: the employer share, plus the employee share, by the City paying the employee share as EPMC (defined in the collective bargaining agreement as the "employer paid member contribution"), plus the unfunded rate, for a total payment to CalPERS by the City each month of 39.115% of the base salary for each safety employee. For a Fire Fighter (P-1), whose annual salary is $85,602, the City was obligated to pay 39.115% for each such employee to CalPERS, or $33,483.22. For a Fire Fighter (P-1), the base salary, overtime, medical benefits and pension benefits total $166,395.94.[62]

52. The costs of the CalPERS benefit went up for fiscal year 2013-14, beginning July 1, 2013, to a total cost of 40.445% of base salary for each safety employee, with the normal cost part of that increasing to 27.978% of base salary. On February 1, 2013, the City implemented 50-50 cost sharing of the normal cost. For SBCPF members, the employee share of the normal cost was 50% of

---

[59] Busch Decl. 3/4/13 at ¶¶ 17 and 18.

[60] Leibrich Decl. 4/1/13 at ¶ 10 and Exhibit 2 thereto.

[61] Busch Decl. 3/4/13 at ¶¶ 17 and 18.

[62] Leibrich Decl. 4/1/13 at ¶ 11.

27.978%, or 13.989% of base salary.[63] The Court explicitly declined to determine whether such cost sharing is allowed by California law.

53. The City has no control over the actuarial changes that determine the annual costs for CalPERS benefits for the SBCPF members. Until the City implemented employee cost sharing in February 2013, the City was paying the full cost of the SBCPF members' pension benefit, with no employee cost sharing. In fiscal year 2012-13, that total cost was 39.15% of base salary. For fiscal year 2014-15 the total cost is now 42.8%, and the total cost is projected to rise to 46.5% of base salary in fiscal year 2015-16. According to the latest projections by the City's actuarial consultant, Bartel & Associates, it is expected that the cost of the CalPERS benefit will increase from 42.8% of base salary in fiscal year 2014-15 to 59.9% of base salary in fiscal year 2019-20 (a 29% increase in costs over just that 5 year time period), and then the rate will flatten out at roughly 59% of payroll.[64]

54. According to Mr. Busch, the post-2013 increases could make it very difficult for the City to address its insolvency. The MOU in its current form provides that the City will pay the entire amount of the cost of the CalPERS benefit, with no contributions whatsoever from the SBCPF members for their own pension benefits. For the current fiscal year, 2014-15: (a) for a Fire Safety employee holding the position of Firefighter/Paramedic (P-2) with an annual base salary of $96,036, the MOU obligates the City to pay CalPERS $41,103 for a Firefighter/Paramedic's pension benefit; and (b) for a Fire Safety employee holding the position of Fire Captain (P-4) with an annual base salary of $109,532, the MOU obligates the City to pay CalPERS $46,879 for the Fire Captain's pension benefit. Mr. Busch estimated that the cost to a Firefighter/Paramedic of sharing 50-50 in the normal cost of the CalPERS benefit would be approximately $560 per pay period and for a Fire Captain it would be $638 per pay period.[65]

55. The City estimates that by SBCPF members contributing 50% of the normal cost of the CalPERS benefit, the City will save approximately $1.6 million in fiscal year 2014-15 with the savings increasing each year thereafter to $2.25 million in fiscal year 2031-32, for a total savings of approximately $34.3 million during this time period. The City estimates it will save approximately

---

[63] Leibrich Decl. 4/1/13 at ¶ 12.

[64] Busch Decl. 8/18/14 at ¶ 10.

[65] *Id.*

$2.1 million in fiscal year 2014-15 from implementation of the Drasil Report to reduce the City's overtime costs for the Fire Department, and this amount will increase each year to about $3 million savings in fiscal year 2031-32, for a total savings of $45.3 million. Taken together, the savings from SBCPF members contributing to their own CalPERS pension benefit and operational efficiencies to reduce Fire Department overtime, the City estimates that it will save $3.7 million in fiscal year 2014-15 and more each year thereafter for a total cumulative savings of about $79.6 million by fiscal year 2031-32.[66]

The City's Efforts To Negotiate Voluntary Modifications to the MOU With The SBCPF

56. Soon after the Petition Date, the City made efforts to meet with the SBCPF to negotiate voluntary modifications to the MOU. As reflected in email correspondence between Corey Glave, counsel for the SBCPF, and City representatives, the City made efforts to meet and negotiate with the SBCPF regarding, among other things, the MOU and Resolution No. 2012-214 that the Mayor and Common Council adopted on August 6, 2012 authorizing the City Manager to suspend, and/or negotiate with employees, payouts for all employees' accrual leave bank payoffs, cash-outs, or sell-outs ("Resolution 2012-214"), which later became part of the City's Pendency Plan, and the change to Civil Service Rule 511 regarding layoffs.[67] In an email communication dated September 10, 2012, Corey Glave, counsel for the SBCPF, advised the City that unless the City was willing to reverse or modify the Common Council's August 2012 action, a meeting between the City's representatives and the SBCPF was "really just a waste of time, money and resources for both the City and the Union."[68]

57. The City's representatives, Diana Leibrich and Linda Daube, met with representatives of the SBCPF on September 26, 2012 to discuss the implementation of the Common Council's

---

[66] Busch Decl. 9/8/14 at ¶ 16 and Exhibit 5 thereto.

[67] Leibrich Decl. 3/4/13 at ¶ 22 and Exhibit 25 thereto; Exhibit O to Hanna Decl. 8/31/12; Exhibits 10, 11 and 12 to the Opposition Filed By Creditor San Bernardino City Professional Firefighters Local 891 To Debtor's Motion Pursuant To 11 U.S.C. §§ 365, 901 And 904 For Order Approving: (A) Rejection Of Collective Bargaining Agreements With San Bernardino Public Employees Assoc.; San Bernardino Police Officers Assoc.; And San Bernardino City Professional Firefighters; And (B) February 1, 2013 Interim Modifications To Such Collective Bargaining Agreements; And Declarations Of Corey Glave and David Goodrich In Support Thereof [Docket Nos. 507 and 507-1] filed on March 21, 2013 ("Glave Decl. 3/21/13").

[68] Exhibit 25 to Leibrich Decl. 3/4/13 (part 2 of 5, at p. 5 of the 12 pages).

imposition of changes to certain Civil Service Rules regarding layoffs and Resolution No. 2012-214. At the conclusion of the meeting, the City provided six possible dates to schedule negotiations. After two follow-up emails from the City to Mr. Glave, on October 2, 2012, Mr. Glave responded by email that he had been in contact with the City's bankruptcy attorneys and would get back to the negotiating team at a later date.[69]

58. On October 5, 2012, Mr. Glave sent an email to Ms. Leibrich stating that the SBCPF and the City would be entering into mediation and that the commencement of negotiations would be held in abeyance until after the mediation process was completed and requested that the City confirm that negotiations would be held in abeyance until after the mediation process was completed.[70] On October 5, 2012, Ms. Daube sent an email to Mr. Glave stating that she was unable to confirm negotiations would be held in abeyance until after the mediation process was completed.[71]

59. In October and November of 2012, City representatives and Mr. Glave communicated by email with respect to cost-saving measures for the Fire Department and modifications to the MOU set forth in the City's Pre-Pendency Plan. In an email communication sent on October 25, 2012 from Richard Luczak, a Deputy City Attorney for the City, to Mr. Glave, Mr. Luczak requested that Mr. Glave "generally advise when you are available to discuss any of the issues identified in the cost saving measures adopted by the Council on October 1, 2012." On November 15, 2012, in response to the Mr. Luczak's October 25, 2012 email, Mr. Glave did not provide any dates on which he was available to meet, stated that the SBCPF had filed a PERB charge regarding this matter and stated that "if the City is serious about resolving these issues, we would ask that all the prior changes be set aside and held in abeyance until the parties can formally meet and/or address the issues in the bankruptcy mediation process." In an email sent on November 27, 2012 from Mr. Luczak to Mr. Glave, Mr. Luczak responded that Mr. Glave's request "to rescind the pre-pendency cost-savings would only serve to make the City more insolvent and make it that much harder to reach solvency which is many months away (assuming the Pendency Plan is approved)" and was untenable, but that

---

[69] Daube Decl. 3/4/2013 at ¶ 5, lines. 9-21; Exhibit 25 to Leibrich Decl. 3/4/13(part 3 of 5 at p. 2 of 2) [Docket No. 446-27].

[70] Exhibit 12, page 123 to Glave Decl. 3/21/13.

[71] *Id.*

the "City remains willing to meet and discuss these issues should you and the SBCPF change your position."[72]

60. On November 21, 2012, this Court entered its Order approving the "Stipulation to Submit to Nonbinding Mediation Between City of San Bernardino and SBCPF."[73]

61. On January 11, 17 and 23, 2013, the City and the SBCPF participated in mediation before the Honorable Scott Clarkson.[74] The mediation did not result in any agreement between the City and the SBCPF.[75] During the time period between the Petition Date and the mediation with the Honorable Scott Clarkson, the SBCPF filed three post-petition unfair labor practice complaints against the City with the California Public Employment Relations Board.[76]

62. On January 28, 2013, Mr. Glave and Ms. Daube exchanged emails regarding proposals made by the City to the SBCPF during the mediation before the Honorable Scott Clarkson and whether City representatives were authorized to present any of those proposals to the Common Council.[77]

63. In April of 2013 after the initial hearing on the Rejection Motion, the SBCPF propounded formal discovery by serving notices of depositions and demands for the production of documents for Ms. Daube and Ms. Leibrich whose depositions were taken in April, 2013, and noticed the deposition of Mr. Busch which was taken on May 10, 2013.[78] This Court facilitated the resolution of various discovery disputes regarding document production and the depositions.

---

[72] Declaration of Richard Luczak In Support Of City Of San Bernardino's Reply [Docket No. 537] filed on April 1, 2013 ("Luczak Decl. 4/1/12") at ¶ 4 and Exhibit 1 thereto.

[73] Docket Nos. 220 and 221; Exhibit 13 to Glave Decl. 3/21/13.

[74] Daube Decl. 3/4/2013 at ¶5; Glave Decl. 3/21/13 at ¶19, lns.1-2.

[75] Daube Decl. 3/4/2013 at ¶ 5; Leibrich Decl. 3/4/13 at ¶ 22, lns. 10-13.

[76] Declaration of Jolena Grider In Support of City of San Bernardino' Opposition To Motion of SBCPF For Relief From The Automatic Stay [Docket No. 502] ("Grider Decl. 3/21/13") filed on March 21, 2013 at ¶¶ 6-8 and Exhibits 2, 3 and 4 thereto.

[77] Exhibit 1 to Declaration of Linda Daube In Support of City of San Bernardino's Opposition to Motion of SBCPF For Relief From The Automatic Stay [Docket No. 501] filed on 3/21/13.

[78] Exhibits 1 and 2 to Declaration Of Kathleen D. DeVaney In Support Of City Of San Bernardino's Opposition To The San Bernardino City Professional Firefighters Local 891's Motion To Strike Evidence [Docket No. 696]; Exhibit A to Declaration of Paul R. Glassman In Support of City of San Bernardino's Reply Brief In Support of Its Motion For Summary Judgment on Eligibility For Chapter 9 Relief [Docket No. 752].

64. On September 5, 2013, the Court entered an order appointing the Honorable Gregg W. Zive as the Case Mediator on broad terms, including negotiation of a plan of adjustment and other matters submitted jointly by parties to the mediator.[79]

65. Prior to the commencement of negotiations with the SBCPF through mediation with Judge Zive, on or about October 24, 2013, City representatives participated in a meeting with representatives of the SBCPF and the SBPOA. In November 2013, the City provided an economic proposal to the SBCPF setting forth the financial parameters for public fire safety services consistent with the City's draft term sheet for a plan of adjustment. In December of 2013, the City's negotiating team and the SBCPF met and discussed the City's proposal. On February 21, 2014, the City and the SBCPF met again and the SBCPF provided a verbal response to the City's proposal. On April 7, 2014, the City sent a written "Response to SBCPF Proposals and Proposed Agenda for an April 10, 2014 Meeting" to the SBCPF. Despite the scheduled meeting, the SBCPF failed to appear.[80]

66. On May 23, 2014, the City's negotiating team met with representatives of the SBCPF outside of the confidential mediation. At the May 23 meeting, the City provided documents such as a memorandum from Fire Department Battalion Chief Nathan Cooke to City Manager Allen Parker describing the proposed budget cuts and potential impacts to the Fire Department, the City's proposed 2014-15 Budget and the Fire Department Budget.[81]

67. On May 27, 2014, the City and the SBCPF attended mediation with Judge Zive in Los Angeles. In connection with that meeting, the City prepared and submitted a revised comprehensive proposal to the SBCPF.[82]

68. In June 2014, Mr. Glave submitted requests for documents under the California Public Records Act via the City's website and the City responded to those requests.[83] In addition,

---

[79] Docket No. 781.

[80] Declaration of Linda Daube In Support of Motion to Reject Collective Bargaining Agreement With San Bernardino City Professional Firefighters Local 891 [Docket No. 1118] filed on August 18, 2014 ("Daube Decl. 8/18/14") at ¶ 6.

[81] Daube Decl. 8/18/14 at ¶ 7.

[82] Daube Decl. 8/18/14 at ¶ 9.

[83] Hanna Decl. 8/18/14 at ¶¶ 4-7 and Exhibits 1 through 6 thereto.

Kathleen DeVaney, one of the City's outside counsel, sent documents by email to Mr. Glave on March 24, 2014 responsive to informal document requests made by Mr. Glave. On July 8, 2014, Ms. DeVaney sent documents by email to Mr. Glave and Mr. Goodrich responsive to requests for documents made by Mr. Glave at and in connection with the May 23, 2014 meeting between representatives of the City and the SBCPF.[84]

69. As part of the negotiation process with the SBCPF regarding modifications to the MOU, the City prepared a proposal regarding the implementation of the Fire Department budget adopted by the Mayor and Common Council on June 30, 2014. This proposal was delivered to the SBCPF on July 28, 2014. The City requested that the SBCPF provide available times and dates when its counsel and other representatives of the SBCPF were available to meet in the hope of reaching an agreement as to the implementation of the 2014-2015 Fire Department budget through modifications to the existing MOU. A revised proposal was delivered to the SBCPF on July 30, 2014.[85]

70. The City's negotiating team met with representatives of the SBCPF on August 13, August 25 and September 3, 2014, to continue discussions and negotiations respecting modifications to the MOU and the changes necessary to implement the City's 2014-15 Budget and the Fire Department budget. The City also requested additional and longer meetings with the SBCPF. Mr. Glave responded that the September 11 deadline was not meaningful to the SBCPF, and that the SBCPF was not amenable to the additional dates and longer meetings. At the August 13, 2014 session, Mr. Glave stated: "If it happens by September 11th, great. If not, it's no big deal . . . . So Mr. Glassman's dates are not my concern." The City and the SBCPF did not reach an agreement with respect to modifications to the MOU.[86]

---

[84] Declaration of Kathleen DeVaney In Support of Motion to Reject Collective Bargaining Agreement With San Bernardino City Professional Firefighters Local 891 [Docket No. 1119] filed on August 18, 2014 at ¶¶ 3 and 5.

[85] Daube Decl. 8/18/14 at ¶¶ 10-11 and Exhibits 1 and 2 thereto.

[86] Declaration of Linda Daube In Support of The City of San Bernardino's Reply To The San Bernardino City Professional Firefighters Local 891's Opposition And Response [Docket No. 1158] filed on September 8, 2014 ("Daube Decl. 9/8/14") at ¶ 8, 9 and 10 and Exhibits 1, 2 and 3 thereto; Exhibit 1 to Daube Decl. 9/8/14 at p. 20, line 12 to p. 21, line 8; p. 33, lines 8-14; p. 34, lines 6-11.

71. Since the delivery of the revised MOU on July 28, 2014, representatives of the City and representatives of the SBCPF met three times for a total of approximately 9 hours as part of the City's continuing efforts to negotiate modifications to the MOU necessary to implement the City's 2014-15 Budget and the Fire Department budget and the City's financial rehabilitation.[87]

72. On September 7, 2014, Ms. Daube sent an email to Mr. Glave, advising that the City intended to proceed with the Rejection Motion on September 11, 2014 and that as previously discussed it was imperative for financial reasons that the City implement its 2014-2015 Fire Department budget reductions as well as the other proposed terms and conditions modifying the MOU and the City desired to focus on implementation at the meeting scheduled for September 10, 2014.[88] The SBCPF canceled the September 10 meeting.[89]

73. Throughout the entire time that the City tried to procure concessions from the SBCPF regarding voluntary modifications to the MOU, the City provided the SBCPF with financial information and documents regarding the City's dire financial condition and the need to reduce the costs of operating the City, including reducing overall employee compensation.[90]

The Negotiations With Six Other Unions and the Agreements Reached

74. Besides the Fire Safety Unit represented by the SBCPF, the City’s other employee bargaining units are as follows: (1) Police Safety Employees represented by the San Bernardino Police Officers Association (“SBPOA”); (2); Middle Management Unit represented by the San Bernardino Public Employees Association (“SBPEA”); (3) the Management/Confidential Bargaining Unit represented by the San Bernardino Management/Confidential Association (“SBCMA”); (4) the Fire Management Bargaining Unit represented by the San Bernardino Fire Management Association (“SBFMA”); (5) the General Unit represented by the International Union Of Operating Engineers

---

[87] Daube Decl. 9/8/14 at ¶ 7.

[88] Daube Decl. 9/8/14 at ¶ 10 and Exhibit 4 thereto.

[89] *Id.*

[90] *See* the Hanna Decl. 8/31/12 at Exs. B, C, D, I, J, L, M and N; Hanna Decl. 7/24/14 at Exs. 1 and 2; Hanna Decl.8/18/14 at Exs. 1 through 6, 18 and 20; Busch Decl. 8/31/12 at ¶¶ 5 through 20; Busch Decl. 11/30/12 at ¶¶ 5 through 12 and Exs. 1 through 3; Busch Decl. 3/4/13 at ¶¶ 5 through 19 and Ex. 1; Busch Decl. 4/29/13 at ¶¶ 5 through 8 and Exs. 1 through 5; Busch Decl. 8/18/14 at ¶¶ 5 through 18 and Exs. 1 through 5; Glassman Dec. 8/16/13 at Ex. A; Daube Dec. 7/29/14 at ¶ 6 and Exs. 1 through 3; Daube Decl. 9/8/14 at Exs. 1 through 3; DeVaney Dec. 8/18/14 at ¶¶ 3 and 5.

("IUOE"); and (6) the Police Management Bargaining Unit represented by the San Bernardino Police Management Association ("SBPMA").[91] As of August 1, 2012, the City was a party to collective bargaining agreements with each of those bargaining units documented in various memoranda of understanding and attendant documents, including City Council resolutions, side letters and amendments.[92]

75. In January of 2013, four of the City's unions, representing the General Bargaining Unit, the Fire Management Bargaining Unit, the Police Management Bargaining Unit, and the Management/Confidential Bargaining Unit), reached agreements with the City on modifications to their respective collective bargaining agreements, and those modifications took effect on February 1, 2013 as set forth in Resolution No. 2013-22, Resolution No. 2013-23, Resolution No. 2013-24, and Resolution No. 2013-25.[93]

76. In addition to the SBCPF, the City did not reach an agreement with two other unions on the modifications of the terms and conditions of employment set forth in the City's Pendency Plan. These unions were the SBPOA and the SBPEA. On January 28, 2013, the City Council voted to impose modifications to the terms and conditions of employment on those three bargaining units as set forth in Resolution No. 2013-18 and Resolution No. 2013-19.[94] On January 28, 2013, the City also adopted Resolution No. 2013-21 entitled "Resolution Of The Mayor And Common Council Of The City Of San Bernardino Adopting Modifications To The Retiree Health Insurance Payments For Police Safety And Police Management Employees In Accordance With The City's Pendency Plan, Item #8, Adopted By The Mayor And Common Council On November 26, 2012 By Resolution No. 2012-278" which reduced the City's contribution to the retiree medical plans for eligible members of the Police Safety Unit and Police Management Unit to the same amount the City contributes for other retirees.[95]

---

[91] Leibrich Decl. 3/4/13 at ¶ 5.

[92] Leibrich Decl. 3/4/13 at ¶ 6.

[93] Leibrich Decl. 3/4/13 at ¶¶ 11 through 15 and Exhibits 17, 18, 19 and 20 thereto; Daube Decl. 3/4/2013 at ¶ 12.

[94] Leibrich Decl. 3/4/13 at ¶¶ 16 through 19 and Exhibits 21 and 22 thereto.

[95] Leibrich Decl. 3/4/13 at ¶ 20 and Exhibit 24 thereto; Daube Decl. 3/4/2013 at ¶ 13.

77. The City's representatives have met and negotiated with representatives of the City's six other bargaining units with respect to amendments to their respective memoranda of understanding to implement the City's FY 2014-15 Budget. The City's negotiating team met, negotiated and exchanged documents and information with representatives of the General Unit, Management/Confidential Unit and Middle Management Unit on three separate occasions which resulted in side letter agreements approved by the Common Council on July 7, 2014 as Resolution No. 2014-249.[96] The City's negotiating team also met, negotiated with and exchanged documents with representatives of the Police Management and Fire Management bargaining units on multiple occasions and negotiations are ongoing.[97] The City continues to meet with the SBPOA regarding the SBPOA MOU.

78. All of the modifications to the collective bargaining agreements with the General Employees, Middle Management Unit and Management Confidential Unit (which groups are classified as Miscellaneous Employees) in place as of May 2013 are set forth in resolutions of the City's Common Council. As a result of those modifications, the General Unit employees and Mid-Management employees were obligated to work 10% more hours than during the period when a 10% salary concession was in place, and an agreement was reached on a third tier retirement plan of 2% at age 62 for new employees. In addition, there had been no upward salary adjustments for these employees in over 8 years and members of the General Employees unit receive the lowest monthly allocation towards health care costs ($609 for a family and $459 for single). In comparison, SBCPF members received a monthly allocation of $992 for a family and $572 for single. With respect to the implementation of cost sharing of the CalPERS benefits, the negotiated concession of 50% of the normal cost of the CalPERS benefit for the Miscellaneous Employees was the same as the imposed benefit of 50% of the normal costs for the Safety Employees (including the fire safety unit). Because most members of the SBCPF enjoy a generous 3% at 50 pension benefit, the cost of this

[96] Daube Decl. 8/18/14 at ¶ 12; Exhibit 16 to Hanna Decl. 8/18/14.

[97] Daube Decl. 8/18/14 at ¶ 12.

very generous benefit is significantly higher than the lower formula pension benefit provided to the Miscellaneous Employees.[98]

79. In 2011, most all of the City's bargaining units agreed to continue a 10% reduction in pay which had been in place since 2009 for almost all bargaining units, but the SBCPF did not agree. In early July 2012, the Middle Management Unit, Management Confidential Unit and General Unit agreed to continue this 10% salary reduction to help the City as it faced bankruptcy. In addition to salary reductions, the City's other bargaining units, also agreed to the following concessions: (a) in 2011, the General Unit agreed to forego step and merit increases in pay through June 30, 2012 and a two-tiered retirement system effective September 1, 2011; (b) in 2010, the Middle Management bargaining unit agreed to a two-tiered retirement system effective January 1, 2011 and other changes to their pension benefits; and (c) in 2010, the police management bargaining unit agreed to a 10% pay reduction and other concessions with respect to pension benefits and other benefits including vacation, holiday and sick leave, and health care.[99]

CONCLUSIONS OF LAW

80. Bankruptcy Code Section 365(a)[100] provides that a debtor may assume or reject any executory contract. Section 901 provides that Section 365(a) applies in chapter 9 cases. Prior to the U.S. Supreme Court decision *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 104 S.Ct. 1188 (1984) ("*Bildisco*") every federal court of appeal that had considered the question held that collective bargaining agreements are executory contracts subject to assumption and rejection under 365(a) and Section 365(a)'s substantially identical predecessor, section 313(1) of the Bankruptcy Act, 11 U.S.C. § 713(1).[101] *See e.g., Local Joint Executive Bd., etc. v. Hotel Circle, Inc.*, 613 F.2d 210 (9th Cir. 1980), a pre-Bankruptcy Code pre-*Bildisco* collective bargaining agreement rejection case in which the Ninth Circuit concluded that

---

[98] Busch Decl. 9/8/14 at ¶ 13; Exhibits 17 through 20 to Leibrich Decl. 3/4/13; Exhibit 16 to Hanna Decl. 8/18/14.

[99] Hanna Decl. 8/18/14 at Exhibits 9 through 11 and Leibrich Decl. 3/4/13 at Exhibit 15.

[100] Unless otherwise indicated, all "Section" References are to chapter 11 of title 11 of the U.S. Code, the "Bankruptcy Code."

[101] Section 313(1) of the Bankruptcy Act provided: "Upon the filing of a petition, the court may permit the rejection of executory contracts of the debtor, upon notice to the parties to such contracts and to such other parties in interest as the court may designate." 11 U.S.C. § 713(1).

> the unique features of labor agreements do not overcome the plain language of the Bankruptcy Act and the policies embodied in Chapter XI proceedings. While we recognize that important employee interests are at stake when rejection of a labor agreement is considered, the policies of the Bankruptcy Act are designed to assist failing businesses, a goal in which employees ultimately have a stake as well. We do not believe that the power to reject labor agreements found to be onerous and burdensome to the debtor's estate is inconsistent with the policies of the labor laws.

613 F.2d at 214.[102]

81. In *Bildisco*, the debtor made post-petition unilateral modifications to the terms and conditions of employment governed by a collective bargaining agreement ("CBA"), including failing to make required contributions to pension and health plans and failing to implement contractually agreed wage increases and then, several months later, filed a motion to reject the CBA. Over the objection of the employee unions and the National Labor Relations Board, the Supreme Court held that: (a) a debtor may make unilateral changes to the terms and conditions of employment prior to bringing a motion to reject the CBA; (b) a debtor may reject a CBA under Bankruptcy Code Section 365 if the agreement is a burden on the debtor, the balance of the equities weighs in favor of rejection, and the debtor makes reasonable efforts to negotiate voluntary modifications to the CBA and those efforts are not likely to produce a prompt and satisfactory solution; and (c) applicable labor laws that require an employer to bargain to impasse, obtain the consent of the union or comply with similar procedures before rejecting the CBA do not apply when the employer makes unilateral modifications to, or seeks to reject the CBA. *See* 465 U.S. at 525-33, 104 S.Ct. at 1196-2000.

82. In 1978, when Congress first enacted the Bankruptcy Code, it considered whether Section 365(a) contemplated the rejection of municipal employee labor contracts in chapter 9 cases. In the legislative history, the Senate Report provides:

> Within the definition of executory contracts are collective bargaining agreements between the city and its employees. Such contracts may be rejected despite contrary State laws.

---

[102] *See also*, *Brotherhood of Railway Airline and Steamship Clerks v. REA Express, Inc.,* 523 F.2d 164, 169 (2d Cir. 1975), *cert. denied,* 423 U.S. 1017, 1073, 96 S. Ct. 451 (1975); *Shopmen's Local Union No. 455 v. Kevin Steel Products, Inc.,* 519 F.2d 698, 706 (2d Cir. 1975); *N.L.R.B. v. Bildisco (In re Bildisco),* 682 F.2d 72, 78 (3rd Cir. 1982), *aff'd, N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 104 S.Ct. 1188, 1196-97 (1984); *Borman's, Inc. v. Allied Supermarkets, Inc.,* 706 F.2d 187, 190 (6th Cir. 1983), *cert. denied*, 464 U.S. 908, 104 S. Ct. 263 (1983); *Local Unions 20 et al. v. Brada Miller Freight System, Inc. (In re Brada Miller Freight Systems, Inc.),* 702 F.2d 890, 897 (11th Cir. 1983).

> Courts should readily allow the rejection of such contracts where they are burdensome, the rejection will aid in the municipality's reorganization and in consideration of the equities of each case. On the last point, "[e]quities in favor of the city in chapter 9 will be far more compelling than the equities in favor of the employer in chapter 11. Onerous employment obligations may prevent a city from balancing its budget for some time. The prospect of an unbalanced budget may preclude judicial confirmation of the plan. Unless a city can reject its labor contracts, lack of funds may force cutbacks in police, fire, sanitation, and welfare services, imposing hardships on many citizens. In addition, because cities in the past have often seemed immune to the constraint of "profitability" faced by private businesses, their wage contracts may be relatively more onerous than those in the private sector."

See S. Rep. No. 95-989, 95th Cong., 2d Sess., at 112, quoted in Collier on Bankruptcy, 16th Edition, Bankruptcy Reform Act of 1978 Legislative History at App. Pt. 4(e)(i). Subsequent to the enactment of Section 365(a) and the Supreme Court decision in *Bildisco*, every federal court to have considered the question has held that Section 365(a) also authorizes the rejection of municipal employee collective bargaining agreements in chapter 9 cases. *See, In re County of Orange*, 179 B.R. 177, 183 (Bankr. C.D. Cal. 1995); *In re City of Vallejo*, 403 B.R. 72, 77 (Bankr. E.D. Cal. 2009), *aff'd*, 432 B.R. 262 (E.D. Cal. 2010) ("*Vallejo"); In re City of Stockton*, 478 B.R. 8, 23 (Bankr. E.D. Cal. 2012) ("*Stockton*") (dictum).

<u>The Evergreen Clause of the MOU</u>

83. The SBCPF argued that there is no contract to reject because the MOU expired on its own terms in 2010, two years before the City commenced its chapter 9 bankruptcy case. However, the MOU contained an evergreen clause which provided that all of the terms of the MOU remain in effect until a new MOU is negotiated between the City and the SBCPF. Evergreen provisions are common in collective bargaining agreements, including municipal employee collective bargaining agreements, and are routinely enforced. *See e.g., Eastern Enterprises v. Apfel*, 524 U.S. 498, 118 S.Ct. 2131 (1998) (discussing evergreen clauses as legitimate and enforceable contractual provisions); *Irwin v. Carpenters Health and Welfare Trust Fund for California*, 745 F.2d 553, 556 (9th Cir. 1984) (noting federal policy enforcing evergreen clauses); *Appeal of N.H. Department of Safety*, 155 N.H. 201, 203, 921 A.2d 924, 927 (2007) (evergreen clause in state troopers' collective bargaining agreement that continues agreement in effect until a new agreement is executed means that terms of contract continue in effect indefinitely until the parties negotiate a successor contract);

City of Somerville v. Somerville Police Employees Assoc., 2011 Mass. Super. Lexis 154 (Mass. Sup. 07/21/2011) (*Compendium*, Ex. 4) ("evergreen clause keeps all of the same terms of the prior CBA in effect; evergreen clause that provided for agreement to continue in full force and effect until successor agreement is executed is enforceable, subject to statutory 3-year cap). The purpose and effect of an evergreen clause is to continue in full force and effect the terms of the collective bargaining agreement. *See Carpenters v. Valentine*, 131 Cal. App. 3d 534, 542 (Cal. App. 1982); *Trustees of the B.A.C. Local 32 Insurance Fund v. Fantin Enterprises, Inc.*, 163 F.3d 965, 968-69 (6th Cir. 1998) (evergreen clause continues in effect all contractual obligations);

84. California state and federal courts enforce evergreen clauses. *See Mobil Oil Corp. v. Handley*, 76 Cal. App. 3d 956, 959-960 (Cal. App. 1978); *Starwood Corp. v. Raytheon Corp.*, 2006 Cal. App. LEXIS 2821, 12-13 (Cal. App. Apr. 5, 2006); *Operating Engineers Pension Trust v. Cecil Backhoe Service, Inc.*, 795 F.2d 1501, 1506 (9th Cir. 1986).[103] The Court concludes that the evergreen clause in the MOU is enforceable, and the MOU is subject to rejection under Section 365(a).

85. Even if the MOU expired in June 2010 without the evergreen clause, the SBCPF has argued that applicable state labor law requires that the status quo remain in place until the parties bargain to impasse. That "status quo" constitutes a contract that can be rejected under Bankruptcy Code Section 365. *In re Hoffman Bros. Packing Co., Inc.*, 173 B.R. 177, 184-86 (B.A.P. 9th Cir. 1994) (where applicable labor law required that status quo ante remain in place until an impasse has been reached, the contract continues on after termination while parties continue to bargain or the contract is rejected); *In re Karykeion*, 435 B.R. 666, 675 (Bankr. C.D. Cal. 2010) (*Bildisco* ruling gives debtor authority to reject residual obligations and effects of expired collective bargaining agreement); *Allied Pilots Assoc. v. AMR Corp., et al.(In re AMR Corp.)*, 471 B.R. 51 (Bankr. S.D.N.Y. 2012) (where applicable labor law required that the parties abide by the terms of the expired collective bargaining agreement until bargaining had been exhausted, that agreement is subject to rejection under the Bankruptcy Code).

---

[103] *See also, San Francisco Culinary, Bartenders & Serv. Employees Welfare Fund v. Lucin*, 1993 U.S. App. LEXIS 33554 (9th Cir. Dec. 7, 1993); *Bd. of Trs. of the Sheet Metal Workers Health Care Plan v. Vigil*, 2011 U.S. Dist. LEXIS 28219, 3-4 (N.D. Cal. Mar. 8, 2011); *Sheet Metal Workers' Int'l Assn., Local 206 v. West Coast Sheet Metal Co*., 1991 U.S. Dist. LEXIS 20474, 20-21 (S.D. Cal. Jan. 18, 1991); *California Butchers' Pension Trust Fund v. Frank's Quality Meats, Inc.*, 1990 U.S. Dist. LEXIS 13693, 16-18 (N.D. Cal. Sept. 28, 1990).

Therefore, the Court concludes that even if the evergreen clause were not enforceable, the terms of the MOU remained in effect until negotiation to impasse under state law or rejection under the Bankruptcy Code.

Effect of Rejection

86. The SBCPF also argued that upon rejection of the MOU, the City is not permitted to impose or implement new terms and conditions of employment until the City and the SBCPF negotiate to impasse under state labor law with respect to any new terms and conditions of employment that modify those in effect prior to rejection. This is the same argument made by the union and the National Labor Relations Board that was rejected by the U.S. Supreme Court in *Bildisco*. The very purpose of rejection of a collective bargaining agreement under Section 365 is to allow the debtor to implement changes to the terms and conditions of employment if the collective bargaining agreement is a burden on the debtor (and subject to the debtor making reasonable efforts to achieve consensual changes and showing that the balance of the equities tips in favor of rejection). For that reason, where a court approves rejection of a collective bargaining agreement under Section 365(a), the practical effect of rejection is that the debtor is permitted under the Bankruptcy Code to implement new terms and conditions of employment, notwithstanding that there may be applicable labor laws that permit such changes only after the parties have negotiated to impasse. *See e.g.*, *In re Rath Packing Co.*, 36 B.R. 979, 994 (Bankr. N.D. Iowa 1984), aff'd, 48 B.R. 315 (N.D. Iowa 1985) (rejection of CBA allowed debtor to reduce wages at the meat packing facility from $10.34 per hour to $7.24 per hour, and revise work rules; changes could not have been made unless the CBA was rejected); *In re Allied Technology, Inc.*, 8 B.R. 366, 368 (Bankr. S.D. Ohio 1980) (rejection of the CBA, allowed financially troubled debtor to avoid CBA requirement to increase the amount of the employer contribution to the employee pension plan); *In re Ateco Equipment, Inc.*, 18 B.R. 915, 915-16 (Bankr. W.D. Pa. 1982) (rejection of CBA allowed the debtor to (a) reduce benefits below what the CBA required and (b) layoff inefficient employees without regard to the seniority provisions of the CBA); *In re Yellow Limousine Service, Inc.*, 22 B.R. 807, 809 (Bankr. E.D. Pa. 1982) (rejection of the CBA enabled debtor to terminate all employees and offer re-employment only to those employees willing to purchase the taxi vehicles as independent contractors under a franchise

system); *In re Southern Electronics Co., Inc.*, 23 B.R. 348, 359 (Bankr. W.D. Tenn. 1982) (rejection of CBA allowed the debtor to lay off inefficient employees without regard to seniority system mandated by CBA and replace them with new employees); *In re Braniff Airways, Inc.*, 25 B.R. 216, 221 (Bankr. N.D. Tex. 1982) (rejection of CBA allowed debtor to recall laid off employees but pay them at a lower wage scale than CBA required).

87. The cases under Section 313(1) of the Bankruptcy Act, the substantially identical predecessor to Section 365, are of the same effect, permitting implementation of new terms and conditions of employment after rejection of the CBA notwithstanding that there may be applicable labor laws that permit such changes only after the parties have negotiated to impasse. *See*, *Brotherhood of Railway, Airline and Steamship Clerks, et al. v. REA Express, Inc.*, 523 F.2d 164, 171 (2d Cir. 1975), *cert. denied*, 423 U.S. 1017, 96 S. Ct. 451, (1975), *cert. denied*, *Int'l Ass'n of Machinists and Aerospace Workers, AFL-CIO v. REA Express, Inc.*, 423 U.S. 1073, 96 S. Ct. 855 (1976) (debtor "is not bound to follow the elaborate and protracted [contract negotiation] procedures of § 6 of the RLA [Railway Labor Act] before putting into effect its proposed terms of employment."); *Carpenters Local Union No. 2746 et al. v. Turney Wood Products Inc.* (*In re Turney Wood Products Inc.*), 289 F.Supp. 143, 149 (W.D. Ark. 1968) (upon rejection of CBA, debtor could lay off employees and reduce wages in disregard of CBA); *The Bohack Corp. v. Truck Drivers Local Union No. 807, International Brotherhood Of Teamsters, et al.*, 431 F.Supp. 646, 648 (E.D.N.Y. 1977) (rejection of CBA allowed debtor, a retail supermarket chain, to lay off warehouse employees and contract out work inconsistent with rejected CBA; "the only issue left by the rejection is damages").

88. The City asked the Court to authorize the new terms and conditions of employment that the City proposed to implement upon rejection of the MOU; however, in the order approving rejection of the MOU, the Court declined to do so.

<u>Reasonable Efforts to Negotiate Modifications</u>

89. The City made numerous efforts, over more than a two year period, to get the SBCPF to meet with the City to help the City deal with its financial crisis through modifications to the terms and conditions of employment controlled by the MOU. *See FOF*

¶¶ 56-73. The City also provided the SBCPF with financial information for the SBCPF to determine for itself that the City was in dire financial straits and needed to find ways to reduce the costs of operating the City, including reducing overall employee compensation. *See FOF* ¶¶ 68 and 73. The City also presented the SBCPF with a comprehensive set of proposals to modify the MOU. by July 28, 2014. *See FOF ¶ 69*.

90. In *In re Rath Packing Co.*, 36 B.R. 979, 995 (Bankr. N.D. Iowa 1984), *aff'd,* 48 B.R. 315 (D. Iowa 1985), where the collective bargaining agreement was rejected under Section 365(a), the debtor attempted, during six weeks of negotiation, to procure concessions that would make rejection of the collective bargaining agreement unnecessary, but agreement could not be reached. In comparison, In *In re S.A. Mechanical, Inc.*, 1986 Bankr. Lexis 6051, *4 (B.A.P. 9th Cir. May 15, 1986), the bankruptcy court denied a debtor's motion to reject a CBA under Section 365 because the debtor made no efforts at all to negotiate voluntary modifications with the union, thereby failing the *Bildisco* "reasonable efforts" rule. The B.A.P. affirmed the bankruptcy court's ruling. Here, the aggregate result of (a) the efforts made by the City in the first few months of the bankruptcy case to meet with the SBCPF, (b) the subsequent unsuccessful mediations between the City and the SBCPF involving first Judge Clarkson and then Judge Zive, and (c) the meetings between the City and the SBCPF in the five weeks after the City submitted its comprehensive set of proposals to the SBCPF on or about July 28, 2014, combine to show that the City made reasonable efforts to negotiate consensual modifications to the MOU.

91. The SBCPF had been informed that the City required modifications to the MOU in order to comply with the amount budgeted by the City to the Fire Department for fiscal year 2014-15, particularly with respect to overtime pay, but the SBCPF made no concessions on that matter, arguing instead that the City's proposed minimum staffing model would not actually reduce overtime.[104] Given the positions of the parties, and the evidence submitted by the City in support of its efforts to implement a minimum staffing model in place of the constant staffing model required

[104] *See* San Bernardino City Professional Firefighters Local 891's Opposition and Response to the City of San Bernardino's Supplement to Motion to Rejection Collective Bargaining Agreement [Docket No. 1142] ("SBCPF 8/29/2014 Opposition") at p. 11, lines 1-8.

by the MOU (*see FOF* ¶¶ 45 and 46), the Court concludes that further negotiations were not likely to lead to a prompt and satisfactory solution.

92. The SBCPF also argued that there were sufficient meetings between the parties concerning modifications to the MOU, and that the negotiations did not satisfy the state law meet and confer and impasse requirements. The Court will address the applicability of the state law rules below. The dearth of meetings, however, was partly a function of the SBCPF's reluctance to engage with the City regarding modifications to the MOU. SBCPF maintained it could not negotiate any new terms without a comprehensive proposal from the City. *Bildisco* does not require such comprehensive proposal to negotiate terms necessary for financial stability. Moreover, by July 28, 2014, the City had provided a comprehensive proposal which did not lead to consensual modifications. *See e.g., In re Karykeion*, 435 B.R. 666, 681 (Bankr. C.D. Cal. 2010) (what amounts to reasonable time to negotiate depends on the circumstances; finding that three meetings with union satisfied the requirements of Section 1113(b)(2)'s "meet, at reasonable times," requirement); *In re Chi. Constr. Specialties, Inc.*, 510 B.R. 205, 223 (Bankr. N.D. Ill. 2014) (debtor cannot be found to have failed to meet if it was the union that refused to meet, whatever were the union's reasons; the union "must be mindful of its choice to not engage with the Debtor.").

93. The SBCPF's arguments that rejection is not available until the City satisfies the requirements of state law for modifications to terms and conditions of employment are similar to those made in *Bildisco*. "The Union also contends that the debtor-in-possession must comply with the procedural requirements of § 8(d) of the NLRA, or at a minimum, bargain to impasse before it may request the Bankruptcy Court either to assume or to reject the collective bargaining agreement." *Bildisco*, 465 U.S. at 523, 104 S.Ct. at 1195. In response, the U.S. Supreme Court held that once reasonable efforts by the debtor to negotiate modifications have been made, the bankruptcy "court need not determine that the parties have bargained to impasse or make any other determination outside the field of its expertise." 465 U.S. at 526-27, 104 S.Ct. at 1196. "Our rejection of the need for full compliance with § 8(d) procedures of necessity means that any corresponding duty to bargain to impasse under § 8(a)(5) and § 8(d) before seeking rejection must also be subordinated to the exigencies of bankruptcy." 465 U.S. at 533, 104 S.Ct. at 1200. The Supreme Court explained:

> Before acting on a petition to modify or reject a collective-bargaining agreement, however, the Bankruptcy Court should be persuaded that reasonable efforts to negotiate a voluntary modification have been made and are not likely to produce a prompt and satisfactory solution. The NLRA requires no less. Not only is the debtor-in-possession under a duty to bargain with the union under § 8(a)(5) of the NLRA, but the national labor policies of avoiding labor strife and encouraging collective bargaining generally require that employers and unions reach their own agreements on terms and conditions of employment free from governmental interference. The Bankruptcy Court need step into this process only if the parties' inability to reach an agreement threatens to impede the success of the debtor's reorganization. If the parties are unable to agree, a decision on the rejection of the collective-bargaining agreement may become necessary to the reorganization process. At such a point, action by the Bankruptcy Court is required, while the policies of the NLRA have been adequately served since reasonable efforts to reach agreement have been made. That court need not determine that the parties have bargained to impasse or make any other determination outside the field of its expertise.

Bildisco, 465 U.S. at 526-27, 104 S.Ct. at 1196 (internal citations omitted). Thus, as long as the City satisfied the reasonable efforts rule of *Bildisco*, the City was not required to satisfy state law meet and confer and impasse rules in order to reject the MOU.

94. The Court is persuaded that reasonable efforts to negotiate voluntary modifications to the MOU have been made and that further negotiations are not likely to produce a prompt and satisfactory solution and, as discussed below, rejection of the MOU is necessary for the City's financial rehabilitation.

Burden of the Contract

95. The City submitted substantial evidence that the MOU was a burden on the City's ability to recover from its insolvency. *See FOF* ¶¶ 17, 22, 24, 35, 38, and 41-55. Two of the principal costs of operating the Fire Department that the City believed it could reduce were: (a) the cost of unnecessary overtime related to the fact that the MOU required a constant staffing model; and (b) the cost of paying all of the CalPERS premium, without any SBCPF member contribution, which the City paid based upon a formula that, at the time the Rejection Motion was filed, required the City to pay roughly 40 cents to CalPERS for every dollar of salary paid the employee. It is expected that the cost of the CalPERS benefit will increase from 42.8% of base salary in fiscal year 2014-15 to 59.9% of base salary in fiscal year 2019-20 (a 29% increase in costs

over just that 5 year time period), and then the rate will flatten out at roughly 59% of payroll. *See FOF* ¶ 53.[105]

96. The SBCPF would not agree to any modification to the MOU that would allow the City to require SBCPF members to pay anything at all for their pension benefits.[106]

97. The City showed that it cannot reasonably achieve a balanced budget based upon the cost reductions associated with rejecting the MOU, including the reduction in overtime. Without the long term cost savings associated with the City's rejection of the MOU, continued budget and service level insolvency remains a very real danger for the City. For example, the City currently needs $8 million to replace aging fire equipment and vehicles, but due to budgetary constraints there are no funds in the current City budget for Fire Dept. vehicle replacement. *See FOF* ¶ 19.[107]

98. The City's financial condition remains precarious because the City's budget does not fund many of the City's basic obligations. For example, the City is not currently budgeting for the following: (a) infrastructure backlog of $243 million as summarized in the Busch declarations; (b) an equipment and fleet backlog estimated to be $20 million; (c) restoration of basic levels of service within the Police, City Manager, Human Resources, Finance and Economic Development Departments, estimated to be $8.6 million annually; (d) necessary working capital equal to 60 days of General Fund revenue, estimated to be $20 million; (e) reserves equal to 10% of annual revenues, estimated to be $12 million; and (f) many millions of dollars owed to the City's creditors.[108] Mr. Busch estimates that the savings associated with the rejection of the MOU will be at least $3.7

---

[105] In its Rejection Motion and all supporting briefs, the City argued that recently enacted provisions of the California Government Code, specifically Sections 20516(h) and 20516.5, allowed the City to require its employees to pay 50% of the normal cost of the CalPERS benefit – what the statutes describe as cost-sharing. However, at the September 11, 2014 hearing on the Rejection Motion, the City read into the record a stipulation it had entered into with CalPERS (the "City/CalPERS Stipulation"), which City/CalPERS Stipulation the Court incorporated into the Rejection Order. In accordance with the intent of the City/CalPERS Stipulation, the Findings of Fact and Conclusions of Law contained herein: (a) do not make any determination regarding matters relating to California Government Code Sections 20516(h) and 20516.5. or any other provision found in Title 2, Division 5, Parts 3 through 8, Sections 20000 through 22970.89 of the California Government Code (often referred to as the Public Employees' Retirement Law or the PERL); (b) shall not apply to or be binding upon CalPERS in any way in this or any other bankruptcy case; and (c) do not in any way modify or expand the scope of the Rejection Order or modify or limit the scope of the City/CalPERS Stipulation.

[106] *See* SBCPF 8/29/2014 Opposition at p. 54, lines 6-12.

[107] *See also* Busch Decl. 8/8/14 at ¶ 14.

[108] *Id*. at ¶ 13; Busch 9/8/14 Decl., Exhibit 7.

million in the first year, and will be more than $79.7 million over the next 16 years.[109] That $79.7 million would be a substantial contribution towards the financial rehabilitation of the City. The Court concludes that the MOU is a burden on the City and its ability to reorganize.

Balance of the Equities

99. The power to reject an executory contract is one of the fundamental powers that Congress provides debtors to enable them to reorganize their financial affairs. That said, the effect of rejection on the non-debtor counterparties cannot be understated. When a bankruptcy court considers a motion to reject a collective bargaining agreement, there are equities on the side of the scale representing the non-debtor contract counterparties and their interests. Considering the facts and circumstances of this chapter 9 case, those equities ultimately must yield to the resuscitation of the City and its financial affairs and the preservation of the jobs of the City's employees, which are dependent upon the City making adjustments to its principal cost – employee compensation.

100. Over the course of the past few years, including the years immediately preceding the commencement of the chapter 9 case, the labor unions representing the City's employees, including the SBPOA (representing the City's police officers) made wage and benefit concessions requested by the City to help the City address the financial problems caused by the Great Recession. The SBCPF, however, did not make concessions to the same extent as the other unions, nor did it make the post-bankruptcy concessions made by five of the City's seven labor unions. *See FOF* ¶ 72-77.

101. In its proposed voluntary modifications to the MOU, the City did not seek to reduce SBCPF salaries, and the City did not propose to modify the pension benefits of SBCPF members. Rather, the City was primarily attempting to (a) achive control over overtime costs associated with the constant staffing model (that cost the City's Fire Department over $6.3 million of overtime pay in the last fiscal year), and (b) reduce the cost of the City's share of the CalPERS pension benefit. Compared to the compensation paid to SBCPF members (*See FOF* ¶¶ 41-42), even with reduced overtime, the cost of paying a portion of their CalPERS benefit is not an unreasonable burden for SBCPF members (*See FOF* ¶ 53). This is particularly so because, until February 1, 2013, the SBCPF members had not been paying anything at all for their pension benefits.

[109] Busch Decl. 8/8/14 at ¶ 16.

102. The balance of the equities favor rejection of the MOU, given the substantial benefit to the City and its financial rehabilitation (including retaining the jobs of the City's employees), versus the relatively modest impact on the SBCPF members associated with the City's implementation of certain new terms and conditions of employment, particularly when the other unions of the City have agreed to concessions which impact their employees' take home pay.

103. The City satisfied the test for rejection of a CBA under Section 365(a), and for that reason the Court approved the rejection of the MOU.

# # #

Date: November 4, 2014

Meredith A. Jury
United States Bankruptcy Judge