

FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

RIVERSIDE DIVISION

FILED & ENTERED

MAR 07 2017

CLERK U.S. BANKRUPTCY COURT
Central District of California
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In re:

CITY OF SAN BERNARDINO,
CALIFORNIA,

Debtor.

Case No. 6:12-bk-28006-MJ

Chapter 9

**MEMORANDUM OF DECISION RE
ISSUANCE OF THIRD PARTY
INJUNCTION IN CONJUNCTION WITH
CONFIRMATION OF CHAPTER 9 PLAN**

Confirmation Hearing

Date: December 6, 2016

Time: 1:30 p.m.

Courtroom: 302

Facing a cash flow crisis of significant magnitude in the summer of 2012 with no end in sight, the City of San Bernardino (“City”) declared an emergency under state law and filed a petition under Chapter 9¹ in the Bankruptcy Court on August 1, 2012. After a hard-fought battle over eligibility which resulted in this court finding the City was eligible because it had filed its chapter 9 petition in good faith and desired to propose a plan to adjust its debt², the City set about to propose such a plan. It began by shoring up its financial records so that its income and expense projections were reliable. This gave it an accurate picture of how it must impair its creditor body in order to achieve restructuring of its debt and revitalization of City services. It mediated where possible and litigated where necessary to eventually be able to propose its Third Amended Plan of Adjustment (“Plan”) which was by and large a consensual plan. After multiple

¹ Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and “Rule” references are to the Federal Bankruptcy Procedure.

² See In re City of San Bernardino, California, 499 B.R. 778, 779 (Bankr. C.D. Cal. 2013) (the “Eligibility Opinion”).

1 confirmation hearings to resolve the few but significant objections to the Plan, on December 6,
2 2016, this court overruled the remaining objections and confirmed the Plan.

3 A lynchpin of the Plan was payment of 1% on the dollar on the allowed claims in Class
4 13, the class of general unsecured creditors. In support of confirmation, the City presented
5 substantial unrefuted evidence which justified the necessity of such a low percentage payment to
6 this creditor body so that the City could move forward with its 20 year Financial Model, which
7 over time would bolster City services, revitalize the aging infrastructure, and substantially
8 improve safety, in particular police services. A significant component of Class 13 were litigation
9 claimants (“Claimants”), who had either filed suit or made claims against the City based on its
10 alleged wrongdoings, including Civil Rights Claimants who alleged claims under the Civil
11 Rights Act.³ Many of these Claimants asserted litigation claims not only against the City but also
12 against its employees acting in the normal course of their employment, in particular members of
13 the Police Department. Under California law, the City is obligated to indemnify its employees
14 for claims against them for acts arising within the scope of their employment. Unless the claims
15 against these employees were addressed in the Plan, the indemnification requirement made the
16 City face significant risk of an obligation to pay damages awarded against these employees at
17 100% on the dollar, payments which the City could not afford and still be able to perform under
18 its Financial Model, its roadmap to revitalization.

19 The City addressed this risk by including in the Plan an injunction (“Plan Injunction”)
20 which would prevent Claimants from collecting damages awarded against certain Indemnified
21 Parties⁴ from those parties’ assets or earnings, thereby insulating the City from the uncapped
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³ 42 U.S.C. §§ 1983 – 1988.

⁴ Indemnified Parties are defined in the Plan as “the current and former officers and employees of the City who are entitled to indemnification.”

1 indemnification claims which would arise under California law. Certain Claimants objected to
2 inclusion of the Plan Injunction in the confirmed Plan; such objections were argued and
3 overruled when the court confirmed the Plan. The court found that the Plan Injunction was a
4 critical and essential element in the revitalization efforts of the City and that, without such, the
5 City's opportunity to reorganize would be severely impacted. This Memorandum of Decision
6 explains why the Plan Injunction is vital to the City's reorganization and proper under the law.⁵
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8 I. BACKGROUND

9 The Plan at Section XI.C provides injunctive relief which prevents pre-confirmation
10 creditors from pursuing debt collection activities after confirmation not only against the City but
11 also against "Indemnified Parties", defined in the Plan as "the current and former officers and
12 employees of the City who are entitled to Indemnification"⁶ (the "Plan Injunction"). Specifically,
13 the Plan provided in pertinent part:
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15 Except as otherwise expressly provided in this Plan, all Entities who have held,
16 hold, or may hold Pre-Confirmation Date Claims shall be permanently enjoined
17 from and after the Confirmation Date, with respect to such Pre-Confirmation Date
18 Claims, from: (i) commencing or continuing in any manner, directly or indirectly,
19 any suit, action or other proceeding of any kind against the City or its property or
any or all of the Indemnified parties or any of their property⁷

20 ⁵ This Memorandum of Decision supplements the Court's oral rulings on December 6, 2016, and earlier dates and
21 the findings and conclusions contained in the Order Confirming Third Amended Plan entered on February 7, 2017.
If this Memorandum or the Order are inconsistent with the oral rulings, the written documents will prevail.

22 ⁶ Indemnification means "rights of indemnity, defense, reimbursement, and advancement of fees and expenses of
23 current and former officers and employees of the City with respect to any claims or lawsuits brought against such
officers and employees by third parties, in each case arising out of an act or omission occurring within the scope of
such officer's or employee's employment as an employee of the City." Plan, I.B.72.

24 ⁷ The full text of the Plan Injunction provides: "Except as otherwise expressly provided in this Plan, all Entities who
25 have held, hold, or may hold Pre-Confirmation Date Claims shall be permanently enjoined from and after the
Confirmation Date, with respect to such Pre-Confirmation Date Claims, from: (i) commencing or continuing in any
26 manner, directly or indirectly, any suit, action or other proceeding of any kind against the City or its property or any
or all of the Indemnified Parties or any of their property; (ii) enforcing, levying, attaching, collecting, or recovering
27 by any manner or means any judgment, award, decree, or order against the City or its property or any or all of the
Indemnified Parties or any of their property; (iii) creating, perfecting, or enforcing any lien or encumbrance of any
28 kind against the City or its property or any or all of the Indemnified Parties or any of their property; (iv) asserting
any right of setoff, subrogation, or recoupment of any kind against any obligation due to the City or any or all of the
Indemnified Parties, except as otherwise permitted by Bankruptcy Code section 553; (v) proceeding in any manner
in any place whatsoever that does not conform to or comply with the provisions of this Plan or the settlements

1 Plan, XI.C. On September 30, 2016, the City filed modifications to the Third Amended Plan,
2 which were approved by the Court in the Confirmation Order, which limited the Plan Injunction
3 such that it only enjoined enforcement, not liquidation of the Litigation Claims, and allowed
4 Claimants to recover from any applicable insurer. New Section XI.G stated:
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6 Litigation Claims means (a) those lawsuits against the City that are still pending
7 as of the Confirmation Date, including those listed in Exhibit 6 to the Appendix;
8 (b) those lawsuits against the City that are filed on or after the Confirmation Date
9 based on acts, claims or omissions that occurred or arose prior to the
10 Confirmation Date; and (c) those lawsuits against any of the Indemnified Parties,
11 whether filed prior to the Confirmation Date or on or after the Confirmation Date
12 based on acts, claims or omissions that occurred or arose prior to the
13 Confirmation Date, as to which lawsuits the City has assumed or will assume the
14 defense thereof and became or becomes obligated to pay any judgment arising
15 therefrom pursuant to Cal. Government Code §§ 825, 970, 995 and 996 and any
16 other applicable law or rule.

17 Plan, XI.G.

18 Although written in generic terms, the primary purpose of the Plan Injunction was to
19 shield the City's employees, specifically its police officers, from litigation exposure and liability
20 for damages of Claimants who alleged the officers had violated their civil rights, as protected by
21 42 U.S.C. §1983. Under the California Government Code, all municipalities are obligated to
22 indemnify their employees for claims against them arising from the scope of their employment,
23 such indemnification to cover both the costs of defense and any damage award against the
24 employee ("Section 825 indemnification"). See Cal. Gov't Code §§ 825, 970, 995, and 996. At
25 the time of confirmation in this case, the City had approximately 115 lawsuits pending against it
26 and more than 200 other Claimants who had given notice of a claim but had not yet initiated
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28 provided for in this Plan Documents; and (vi) taking any actions to interfere with implementation or consummation
of this Plan." Plan, XI.C.

1 litigation. More than half of the lawsuits and many of the other Claimants asserted claims against
2 the Indemnified Parties.

3 The Plan placed the Claimants in Class 13, a class comprised of all unsecured claims
4 against the City that arose prior to confirmation of the Plan. Class 13 also included the claims of
5 employees, retirees, and general trade creditors, among others, all of which totaled an estimated
6 \$200 million.⁸ The Plan proposed to pay 1% on the dollar to all allowed claims in Class 13. As
7 discussed more thoroughly below, the City asserted in its Disclosure Statement and submitted
8 evidence at confirmation which demonstrated that the City could not afford to pay more than the
9 specified 1% and still be financially able to pay all other preconfirmation debts pursuant to terms
10 in the Plan as well as provide an acceptable level of services to its citizens as outlined in the
11 Financial Model.⁹

14 The obligation of the City to provide § 825 indemnification to its employees is not a
15 discharged preconfirmation claim under the terms of the Plan. The settlements the City
16 negotiated with its employee unions and the operative collective bargaining agreements required
17 the City to reaffirm its obligation to indemnify the employees. The City honored this
18 commitment by reaffirming the obligation in the Plan at Section VII.D.

20 During the course of the Plan confirmation process, several of the civil rights Claimants
21 objected to confirmation on multiple grounds, including the provision calling for the Plan
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25 ⁸ By necessity, the estimate is preliminary, because no formal claims objection/allowance procedure was undertaken
26 prior to Plan confirmation.

27 ⁹ Judge Christopher Klein in In re City of Stockton, California, 493 B.R. 772 (Bankr. E.D. Cal. 2013) presented a
28 thorough analysis of the term “service delivery insolvency.” In simple terms it means the inability of a municipality
to “pay for all the costs of providing services at the level and quality required for the health, safety, and welfare of
the community.” Id. at 781. One goal of municipalities in filing Chapter 9 is to take steps to lessen service
insolvency. In keeping with this purpose, the Plan here sought to lessen the substantial service insolvency which
the City had experienced for many years prior to filing its petition and continuing to the confirmation date.

1 Injunction.¹⁰ They argued that they should be able to pursue their litigation claims against City
2 employees, allowing them not only to obtain a judgment or mediated resolution, but also to
3 exercise all enforcement and collection rights against such employees. The court entertained both
4 written and oral argument on these objections on multiple dates, culminating at the final hearing
5 on Plan confirmation on December 6, 2016. At the December 6 hearing, the court overruled all
6 outstanding objections to confirmation, including those of the civil rights Claimants, and
7 confirmed the Plan, including the requested Plan Injunction.¹¹

9 II. DISCUSSION

10 A. Arguments against Plan Injunction

11 Citing Ninth Circuit cases and other authorities, the civil rights Claimants assert that the
12 bankruptcy court has neither the jurisdiction nor the authority to control preconfirmation
13 creditors' actions against third parties. They argue that in American Hardwoods, Inc. v.
14 Deutsche Credit Corporation (In re American Hardwoods, Inc.), 885 F.2d 621 (9th Cir. 1989) the
15 court determined that § 105(a) did not provide jurisdiction to the court because such injunctive
16 relief did not arise under Title 11, nor was it arising in or related to a case under Title 11, the
17 parameters set for the bankruptcy courts' subject matter jurisdiction in 28 U.S.C. §1334(b).
18 Moreover, they assert that even if the court has jurisdiction, it lacks the authority to essentially
19 grant a discharge to nondebtors, i.e. the Indemnified Parties, by ruling that the preconfirmation
20 creditors could not enforce judgments against them. The discharge is governed by §§ 524(a) and
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25 ¹⁰ Among the other arguments made by the Civil Rights Claimants were (1) they should be separately classified and
26 not in Class 13 with the other unsecured creditors; (2) debts arising under the Civil Rights Act (28 U.S.C. §§ 1983 -
27 1988) were not subject to discharge in a Chapter 9 plan; and (3) the payment of only 1% to Class 13 claimants was a
28 violation of other applicable provisions of §1129 and § 943. The court addressed and overruled these other
objections in its open court oral rulings. The Confirmation Order also has extensive findings and conclusions which
establish the reasons for overruling all the objections. This memorandum is not intended to address those other
grounds for objection.

¹¹ The Confirmation Order was entered on February 7, 2017, making the court's ruling binding and effective.

1 (b), which empower the court to only discharge the debtor, not others. Since §105(d) states that
2 the court's powers may not be exercised in a manner which is inconsistent with the provisions of
3 the Bankruptcy Code, the Claimants argue that granting a discharge to the Indemnified Parties is
4 inconsistent with the provisions of §§ 524(a) and (b), and, therefore, the court lacks authority to
5 issue the Injunctive relief.
6

7 In additional objections, the Claimants assert that Ninth Circuit authority has definitively
8 prevented debtors in chapter 11 proceedings from seeking third party injunctive relief. In Resorts
9 International, Inc. v. Lowenschuss (In re Lowenschuss), 67 F.3d 1394 (9th Cir. 1995), the court
10 rejected third party injunctive relief sought in the Chapter 11 plan because such relief was
11 inconsistent with § 524(e).¹² Since § 1129(a)(1) requires a plan to comply with the applicable
12 provisions of the Bankruptcy Code, the Lowenschuss court reasoned that a plan which was
13 inconsistent with § 524(e) was patently unconfirmable.
14

15 Claimants recognize there is a split in circuit authority on the availability of third party
16 injunctive relief, citing to Fourth and Sixth Circuit decisions in Menard-Sanford v. Mabey (In re
17 A.H.Robbins Co.), 880 F.2d 694 (4th Cir. 1989) and Class Five Ne. Claimants v. Dow Corning
18 Corp. (In re Dow Corning Corp.), 280 F.3d 848 (6th Cir. 2002), both of which found such relief
19 was available in certain circumstances. Notwithstanding these authorities, however, they assert
20 only extraordinary circumstances should lead to granting an injunction, such as when the
21 protected parties contributed substantial assets to the reorganization process and would not so
22 contribute unless they were protected under the plan, making the injunctive relief critical to the
23 reorganization efforts. Here, the Indemnified Parties are not adding monetary value to the asset
24 pool and the Plan does not hinge on their participation. In similar circumstances, courts have
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28 ¹² Section 524(e) states "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."

1 rejected the injunctive relief. In re Boston Harbor Marina Co., 157 B.R. 726, 730 (Bankr. D.
2 Mass. 1993); In re Wash. Mut., Inc., 442 B.R. 314, 348 (Bankr. D. Del. 2011); In re 710 Long
3 Ridge Rd. Operating Co., II, LLC, 505 B.R. 163, 165 (Bankr. D.N.J. 2014).

4 At least one Claimant asserts that the Anti-Injunction Act, 28 U.S.C. § 2283, prohibits a
5 “court of the United States” from granting an injunction to stay proceedings in a state court
6 “except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction,
7 or to protect or effectuate its judgments.” The Claimant argues that no such authorization exists
8 which would allow this court to stay state court civil rights litigation.
9

10 Finally, several Claimants submit that, in requesting the third party injunction, the Plan
11 seeks to circumvent the statutory scheme and protections of the Bankruptcy Code, running afoul
12 of the Supreme Court’s decision in Law v. Siegel, 134 S. Ct. 1188 (2014). Per their argument, a
13 bankruptcy court may not use equitable doctrines (injunctive relief arises in equity) to overcome
14 or circumvent statutory requirements or proscriptions. The Claimants have rights and remedies
15 accorded to them under § 1983 which the bankruptcy court cannot circumvent with an injunction
16 preventing them from proceeding against the wrongdoers.
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19 B. The City’s responses justifying injunctive relief

20 The City refutes Claimant’s objections to the Plan Injunction.

21 First, it asserts that the question of whether third party injunctive relief is available under
22 a Chapter 9 plan is an open question under Ninth Circuit authority. The City cites to the recent
23 case Deocampo v. Potts, 836 F.3d 1134 (9th Cir. 2016), which found that the rationale relied
24 upon by the court in Lowenschuss does not apply in Chapter 9 proceedings; such prohibition was
25 based on § 524(e) which was not incorporated into Chapter 9 proceedings under § 901. Because
26 the ability of the bankruptcy court to grant such relief was not at issue in Deocampo, the court
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1 did not answer that question. Therefore, the analogies made to Chapter 11 cases are inapposite
2 in this proceeding.

3 Second, it submits that the Ninth Circuit cases which prohibit injunctive relief in Chapter
4 11's nevertheless found as a preliminary matter that bankruptcy courts would have both
5 jurisdiction and authority to grant the relief if not prohibited by § 524(e). In American
6 Hardwoods, Inc., the bankruptcy court ruled that the court had related to jurisdiction because the
7 recovery on a judgment against the closely related party could have an effect on the
8 administration of the debtor's bankruptcy estate. 885 F.2d at 623. The jurisdiction in this case
9 clearly exists: if the City is required to pay 100% on claims against the Indemnified Parties, the
10 necessary dollars to do so will far exceed the City's budget for paying claims and at the same
11 time provide necessary services to its citizens. The administration of the Plan will be
12 significantly impacted.

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15 Section 105 provides the court with authority to approve the Plan Injunction. Such relief
16 is necessary to protect the debtor and the administration of the estate after confirmation. The
17 inapplicability of § 524(e) means such exercise of § 105 power is proper and in keeping with
18 carrying out the provisions of the Bankruptcy Code.

19
20 Having established the court has both jurisdiction and authority to issue a third party
21 injunction, the City turns its argument to the imperative need for such relief in this case. For an
22 injunctive to be permissible, at a minimum it must be expressed and be supported by specific
23 factual findings. Similar injunctive relief was sought but denied in the recent City of Detroit
24 Chapter 9. In adjudicating the Detroit Chapter 9 plan, Judge Stephen Rhodes sustained the
25 Section 1983 claimants' objections to the city indemnifying its police officers. This ruling was
26 not based on lack of jurisdiction or authority, which Judge Rhodes found existed, but because
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1 “the record is devoid of any evidence suggesting that the additional protection of a third-party
2 release for these officers is necessary to the City’s efficient and effective functioning, to its
3 revitalization, or to the success of its plan.” In re City of Detroit, 524 B.R. 147, 265-67 (Bankr.
4 E.D. Mich. 2014).

5 The City embraces the standards enunciated in City of Detroit and recites its own, drawn
6 from the Deocampo decision: an injunction is permissible if (i) the injunction is express; (ii) the
7 injunction is an integral part of the reorganization; and (iii) the injunction is supported by
8 specific factual findings regarding the necessity of the injunction to the City’s efficient and
9 effective functioning, to its revitalization, or to the success of the Plan. The City’s brief then cites
10 to the evidentiary record presented to this court, which shows that absent the injunction, the City
11 will be unable to make the projected investments in its revitalization as reflected in the Financial
12 Model and as needed to support the Police Resources Plan which is part and parcel of the Model.
13 Additionally, unless the City restricts its payments on the unsecured claims to the proposed 1%,
14 it will not have the funds necessary for the reinvestment in it infrastructure and other services.
15

16 The City responds to the Anti-Injunction Act arguments on two grounds: first, the
17 Bankruptcy Code read as whole is exactly the “Act authorized by Congress” which allows a
18 bankruptcy court to stay proceedings in a state court; and second, the Ninth Circuit has
19 determined that bankruptcy courts are not “courts of the United States” which would be subject
20 to the Anti-Injunction Act.
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22 In response to the Law v. Siegel arguments, the City points out that the holding of the
23 Supreme Court in that case limited the use of equitable powers only when such exercise was in
24 direct contravention of specific provisions of the Bankruptcy Code. No part of the Bankruptcy
25 Code prohibits third party injunctive relief in a Chapter 9.
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III. ANALYSIS

This court rules that it has both the jurisdiction and the authority to grant third party injunctive relief and that the exercise of this power is not precluded by the Bankruptcy Code or by precedential Ninth Circuit law. Moreover, based on the legal standard for granting such relief, as developed by the case law and proposed as the applicable standard by the City, and the evidentiary record filed in this confirmation proceeding, granting the Plan Injunction to protect the Indemnified Parties is not only warranted, but necessary for the administration of the confirmed Plan.

A. The City’s Statutory Obligation to Pay the Judgments against its Employees

The Plan Injunction arises from the City’s state law obligations under California Government Code §§ 825, 970, 995 and 996 to indemnify its employees for judgments against the employees based upon employee acts or omissions arising within the scope of employment, and which act or omission was not due to actual malice, actual fraud or corruption. Acts or omissions outside the scope of employment, or due to actual malice, actual fraud or corruption, are referred to as the “Exceptions.” Thus, subject to the Exceptions, the City is obligated to pay the debts created by entry of judgments against its employees. Pursuant to Government Code § 970.2, a court may issue a writ of mandate to compel the City to pay a judgment against one of its employees based on acts or omissions within the scope of employment. The statutory scheme imposes this duty on the City to ensure the “the zealous execution of official duties by public employees.” Johnson v. California, 69 Cal. 2d 782, 792 (1968).

The City’s obligation to indemnify typically arises in two circumstances. The first and most common circumstance is where the City assumes the defense of the employee at an initial stage of the lawsuit, well before a judgment is issued. Government Code § 995 requires the City

1 to assume the defense unless one of the Exceptions applies, and Government Code § 825
2 requires that the City pay any ensuing judgment entered in favor of a third party plaintiff. See
3 L.A. Police Protective League v. City of L.A., 27 Cal. App. 4th 168, 174-76 (1994). The second
4 more unusual circumstance is where the City refuses to assume the defense (presumably because
5 the City believes an Exception applies), a judgment is subsequently entered against the
6 employee, and it is judicially determined that none of the Exceptions apply. In that second fact
7 pattern, Government Code §§ 825.2 and 996.4 require that the City pay the judgment and all of
8 the employee's defense costs, and Government Code § 970.2 provides that a writ of mandate is
9 an appropriate remedy to compel the City to pay. See Pelayo v. City of Downey, 570 F. Supp. 2d
10 1183, 1195 (C.D. Cal. 2008); Farmers Ins. Grp. v. Cty. of Santa Clara, 11 Cal. 4th 992, 1002
11 (1995); Rivas v. City of Kerman, 10 Cal. App. 4th 1110, 1116 (1992); see also DeGrassi v. City
12 of Glendora, 207 F.3d 636, 641-42 (9th Cir. 2000) (explaining the operation of the applicable
13 Government Code provisions on municipal employee indemnification). Municipal employee
14 indemnity provisions of the Government Code also apply to claims against police officers arising
15 under 42 U.S.C. § 1983. Williams v. Horvath, 16 Cal. 3d 834, 845 (1976).

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19 The State of California has long recognized that indemnification of police officers, in
20 particular, is a public good:

21 The reason for the [police officer indemnification] rule is: The duties of
22 policemen are performed for the benefit of the public, and the public is directly
23 concerned in preserving and protecting these officers from the hazard of death or
24 bodily injuries to which the performance of their official duties expose them.
25 Aside from any considerations purely personal to the officer, it is for the public
26 good that these officers, as instruments through which the city performs its
27 functions, shall be shielded from the personal hazards [of litigation] which attend
28 the discharge of their official duties. With such protection afforded, the public can
expect that its laws will be zealously enforced without any hesitation occasioned
by considerations of possible personal involvement in defending resulting
litigation.

1 Sinclair v. Arnebergh, 224 Cal. App. 2d 595, 599 (1964) (internal citations omitted); see also
2 Monell v. Dep't of Soc. Servs., 436 U.S. 658, 713 n.9 (1978) (Powell, J., concurring) (finding
3 that the policy of municipalities to indemnify officials sued for conduct within the scope of their
4 authority “furthers the important interest of attracting and retaining competent officers, board
5 members, and employees.”).

6
7 The indemnification of municipal employees, and particularly police officers, plays an
8 important role in the efficient and effective functioning of the City and its departments and
9 agencies, including the Police Department.¹³ The City’s Chief of Police, Jarrod Burguan,
10 testified that if the City was at risk of being unable to indemnify police officers in full for
11 liability against lawsuits alleging harms committed during the performance of their job duties as
12 officers, and the officers were thus exposed to personal liability and potential financial ruin, the
13 City would not be able to hire new police officers, many police officers would leave for more
14 financially stable municipalities or federal, state or county law enforcement agencies, and the
15 crime rate in the City would increase. Per Burguan’s testimony, the City’s Police Department has
16 already been hit hard because the opportunities for qualified candidates to serve in other agencies
17 with more financial stability and better equipment has made it difficult for the City to retain and
18 recruit officers. Impairing the City’s indemnification obligations to the officers would pose
19 severe challenges to retention of existing officers and recruitment of new and lateral officers.
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23 Despite the clear state law statutory obligation to indemnify officers and the practical
24 necessity of indemnifying officers to ensure officer morale and retention, the unrefuted evidence
25 provided by the declaration testimony of Michael Busch¹⁴ and the exhibits attached thereto
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28 ¹³ Decl. of Jarrod Burguan. September 30, 2016, ECF No. 1982.

¹⁴ Michael Busch is the President and CEO of Urban Futures, Inc., engaged by the City to provide financial advisory services in all areas of the City’s operations and throughout the entire Chapter 9 procedure. Mr. Busch’s financial

1 shows that the City does not and will not have the funds necessary to both pay the judgments
2 against the City's employees and invest in the Police Resources Plan, among other things.¹⁵ To
3 ensure the efficient and effective functioning of the City and its departments, and in particular
4 the City Police Department, the Plan provides for payment of judgments against the City, and
5 payment of judgments against the Indemnified Parties that the City is required under state law to
6 pay, in the same manner, i.e., as Class 13 Claims that receive a 1% payment on the allowed
7 claim. The Plan Injunction – which allows holders of Litigation Claims against the Indemnified
8 Parties to liquidate their claims to judgment in the state and federal courts, but enjoins collection
9 of any such judgment against the Indemnified Parties' personal assets – is the tool that allows the
10 City to implement its Plan.
11

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13 Without the relief provided by the Plan Injunction, the City would not have the funds to
14 both pay creditors pursuant to the Plan and effect the necessary revitalization of municipal
15 services for its residents. The City has demonstrated that it has the funds to implement the 1%
16 distribution to creditors, and no evidence has been presented by anyone that there is more money
17 available to pay a higher distribution, including to holders of Litigation Claims that may obtain
18 judgments against the Indemnified Parties.
19

20 B. The Court has the Jurisdiction and the Authority to Approve the Plan Injunction and
21 the Evidence Supports Approval.

22 (1) Jurisdiction
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24 This Court has jurisdiction to approve a chapter 9 plan that addresses the claims against
25 the Indemnified Parties. Under 28 U.S.C. § 1334(b), the court is granted jurisdiction over all civil
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27 reports and projections have been submitted to the court regularly during this case and have never been seriously
28 challenged by any of the highly sophisticated and well-funded creditors actively involved in the case. The court has
substantial confidence in Mr. Busch's financial reports and his competency.

¹⁵ Decl. of Michael Busch, September 30, 2016, ECF No. 1983.

1 proceedings arising under title 11, or arising in or related to cases under title 11. “Proceedings
2 related to the bankruptcy include . . . suits between third parties which have an effect on the
3 bankruptcy.” Celotex Corp. v. Edwards, 514 U.S. 300, 307 (1995). In the Ninth Circuit,
4 bankruptcy court “related to” jurisdiction exists over enforcement of a judgment against a non-
5 debtor that could conceivably have an effect on the administration of the debtor’s bankruptcy. In
6 re American Hardwoods, Inc., 885 F.2d at 623 (explaining that a bankruptcy court has subject
7 matter jurisdiction to permanently enjoin a creditor from enforcing a state court judgment against
8 non-debtor guarantors because the enforcement of the state court judgment could conceivably
9 affect the administration of the debtor’s plan). The ability of Claimants to enforce their claims
10 against the Indemnified Parties will certainly have a material effect on the City and its assets, its
11 payment obligations under the Plan, and the City’s ability to devote post-confirmation assets to
12 the revitalization of municipal services.

15 Here, the combined effect of California Government Code §§ 825, 825.2, 995 and 996.4
16 is that the City must pay a judgment against its employees as long as none of the Exceptions
17 apply. The judgment is a debt of the City, enforceable by writ of mandate. See Government Code
18 § 970.2. “The general rule is that relief sought nominally against an officer [of a public entity] is
19 in fact against the sovereign if the decree would operate against the latter.” Hawaii v. Gordon,
20 373 U.S. 57, 58 (1963). Similarly, the “general rule is that a suit is against the sovereign ‘if the
21 judgment sought would expend itself on the public treasury or domain, or interfere with the
22 public administration,’ or if the effect of the judgment would be to ‘restrain the Government
23 from acting, or to compel it to act.’” Dugan v. Rank, 372 U.S. 609, 620 (1963) (citing Land v.
24 Dollar, 330 U.S. 731, 738 (1947)). Under Hawaii v. Gordon and Dugan v. Rank, the City’s
25 statutory Government Code § 825 obligation to pay the judgment makes the judgment a claim on
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1 the City's treasury and certainly a "related to" claim under 28 U.S.C. § 1334. Therefore, the
2 Court has jurisdiction over such claims against the Indemnified Parties.

3 (2) Authority for the Plan Injunction

4 Section 105(a) provides that the Court may issue any order that is necessary or
5 appropriate to carry out the provisions of Title 11. The Ninth Circuit has previously declined to
6 approve third-party injunctions in chapter 11 cases on the basis that § 524(e) limits the court's
7 equitable power under § 105 to order the discharge of the liabilities of nondebtors. In re
8 American Hardwoods, Inc., 885 F.2d at 626. Section 524(e), however, is inapplicable in chapter
9 9 cases, and thus the holdings of American Hardwoods Inc. and its progeny do not control the
10 outcome here. See 11 U.S.C. § 901(a) (not including § 524(e) in chapter 9); Deocampo v. Potts,
11 836 F.3d at 1143 ("Chapter 9, unlike Chapter 11, does not incorporate Section 524(e) . . . As
12 such, the rationale relied upon by Lowenschuss [that, in a Chapter 11 proceeding, § 524(e)
13 precludes bankruptcy courts from discharging the liabilities of nondebtors] does not apply in
14 Chapter 9 proceedings.").

15 The circumstance under which a municipal debtor may include a third-party release and
16 injunction in its plan of adjustment is a matter of first impression in the Ninth Circuit. In the two
17 recent municipal insolvencies of large California cities, Vallejo and Stockton, this relief was not
18 sought. In the Detroit chapter 9 case, Judge Rhodes held that § 524(e) is not a bar to a third-party
19 release or injunction in a chapter 9 case, but the proponent still must show that the injunction is
20 necessary or appropriate under § 105(a).

21 A bankruptcy court's power to order a third party release is based on its power to
22 reorder creditor-debtor relations needed to achieve a successful reorganization
23 . . . [and] the release [must be] essential to reorganization [because] the
24 reorganization hinges on the debtor being free from indirect suits against parties
25 who would have indemnity or contribution claims against the debtor.
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1 In re City of Detroit, Michigan, 524 B.R. 147, 266 (Bankr. E.D. Mich. 2014) (citations omitted).

2 Judge Rhodes explained that to gain approval of such a release, the debtor-city must
3 show that the release of officers is “necessary to the [c]ity’s efficient and effective functioning,
4 to its revitalization, or the success of the plan.” Id. The record of the Detroit chapter 9 case was
5 devoid of any evidence substantiating the need, and the debtor’s requested third party release
6 was not approved. Id. at 297.

7
8 So too in the City of Vallejo chapter 9 case. See Deocampo v. Potts, 836 F.3d at 1134. In
9 Deocampo, after confirmation of its plan of adjustment, the City of Vallejo, defending its
10 officers in a district court action, attempted to shoehorn a third party release/injunction into its
11 confirmed plan by arguing that the plan discharged claims against the officers along with claims
12 against the city. The Ninth Circuit recognized that a third-party injunction is not precluded by the
13 existing jurisprudence in the Ninth Circuit because § 524(e) does not apply in chapter 9, but
14 found on the facts that the Vallejo plan did not discharge or enjoin claims against the officers.
15

16 The Deocampo court recognized that where an injunction is permissible, it at a minimum
17 must be express and be supported by “specific factual findings.” Id. at 1144; see also Rule 3016
18 (“If a plan provides for an injunction against conduct not otherwise enjoined under the Code, the
19 plan and disclosure statement shall describe in specific and conspicuous language (bold, italic, or
20 underlined text) all acts to be enjoined and identify the entities that would be subject to the
21 injunction.”). The Vallejo plan did not expressly provide for such an injunction. Id. at 1144-45.
22 There was no mention of an injunction of third-party claims. Id. Moreover, because the plan did
23 not provide for an injunction there were no specific factual findings that such an injunction was
24 necessary or appropriate to the plan of adjustment. Id. Finally, as noted by the court in City of
25 Detroit, the proponent of a third party injunction must show “that the additional protection of a
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1 third-party release is necessary to the City’s efficient and effective functioning, to its
2 revitalization, or to the success of its plan.” Deocampo v. Potts, 836 F.3d at 1144 n.14 (citing In
3 re City of Detroit, 524 B.R. at 265–67). The Vallejo confirmation order did not include a judicial
4 finding that the third-party discharge or adjustment was an integral part of the reorganization. Id.
5 at 1145.

6
7 Applying the considerations identified by the Deocampo court, an injunction may be
8 permissible if (i) the injunction is express; (ii) the injunction is an integral part of the
9 reorganization; and (iii) the injunction is supported by specific factual findings regarding the
10 necessity of the injunction to the City’s efficient and effective functioning, to its revitalization, or
11 to the success of the plan. Id. at 1144 n.14. In this case, the Plan Injunction is necessary because
12 the City cannot afford to pay the judgments of the Claimants against the Indemnified Parties and,
13 absent the injunction, the City would be unable to provide municipal services in accordance with
14 the annual budgets contemplated in the City’s Financial Model, including not being able to
15 implement the Police Resources Plan or make the payments required by the Plan.
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18 (3) The Necessity for and Propriety of the Plan Injunction to the City’s Plan
19 Implementation

20 The first factor in the three-prong test is satisfied because the Plan Injunction was
21 expressly set forth in the Plan, the Disclosure Statement and the applicable notices as required by
22 the Federal Rules of Bankruptcy Procedure applicable to third-party injunctions. Rule 3016(c)
23 provides that “[i]f a plan provides for an injunction against conduct not otherwise enjoined under
24 the Code, the plan and disclosure statement shall describe in specific and conspicuous language
25 (bold, italic, or underlined text) all acts to be enjoined and specify the entities that would be
26 subject to the injunction.” The City satisfied this rule because the Plan Injunction set forth in
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1 Section XI.C of the Plan was printed in bold-faced type and specified the acts to be enjoined and
2 the entities that would be subject to the injunction.

3 In addition, Rule 2002(c)(3), entitled “Notice of Hearing on Confirmation when Plan
4 Provides for an Injunction,” provides: “If a plan provides for an injunction against conduct not
5 otherwise enjoined under the Code, the notice required under Rule 2002(b)(2) shall: (A) include
6 in conspicuous language (bold, italic or underlined text) a statement that the plan proposes an
7 injunction; (B) describe briefly the nature of the injunction; and (C) identify the entities that
8 would be subject to the injunction.” As reflected in the Confirmation Hearing Notice,¹⁶ the City
9 satisfied the requirements of Rule 2002(c) (3). The Confirmation Hearing Notice includes in bold
10 text a statement that the Plan includes an injunction and describes that injunction. In addition the
11 entities that are subject to the injunction are identified. Accordingly, the City complied with the
12 requirements of the Federal Rules of Bankruptcy Procedure. Cf. Deocampo, 836 F.3d at 1144-46
13 (explaining Vallejo’s chapter 9 plan did not contain any express third party injunction, and no
14 notice of a third party injunction was provided). In contrast to Deocampo, the City complied with
15 the detailed requirements of the Rules, gave notice to all creditors, and published notice so that
16 any potentially affected creditors would have notice and the opportunity to be heard. There is no
17 question that the City made the Plan Injunction a linchpin of the Plan and the effect of the Plan
18 Injunction was highly publicized. Accordingly, this first factor is satisfied.

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22 The second and third factors are also satisfied. The circumstances surrounding the City’s
23 slide into insolvency are described in the prior opinions of this Court. See Eligibility Opinion,
24 499 B.R. at 778-79. In summary, the Great Recession and the burst of the housing bubble in
25 2007 negatively affected the City like many other cities in California and the entire country. The
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¹⁶ ECF No. 1884, filed July 29, 2016.

1 drop in housing prices and increase in foreclosures of single family residences resulted in
2 significantly lower property tax revenues, a prime source of revenue for California cities. The
3 City was particularly hard hit by these phenomena because, due to the cheaper housing and
4 available financing, an influx of people moved to the Inland Empire during the boom, and the
5 consequent bust led to unprecedented foreclosures – one of the highest rates in the country.
6
7 Along with the foreclosures came substantial unemployment, as much of the population had been
8 employed in the housing industry, from construction workers to realtors to mortgage brokers,
9 resulting in a significant drop in household income. This decline led to less consumer sales and
10 consequently smaller sales tax revenues, another major component of the City’s revenues.
11

12 The City’s unemployment rate was 16.9% as of June 2012, more than double the national
13 rate of 8.2%. The City was impacted not only on the revenue side but also by escalating
14 expenses. The influx of population created a greater demand for public services, from public
15 safety (police and fire) to more mundane matters such as street repair and infrastructure
16 maintenance. As the economy worsened and revenues decreased, the City took some stop gap
17 measures to try to stop the bleeding. It implemented a hiring freeze and down-sized departments,
18 reducing the workforce by 20%. It negotiated and imposed concessions on its unions, saving
19 about \$10 million per year. It exhausted its general fund reserves and sold excess assets to
20 provide cash to fund ongoing operations.
21

22 In May 2012, the then new Director of Finance, Jason Simpson, began analyzing the
23 City’s financial condition, while attempting to formulate a budget for 2012-13. In doing so,
24 Simpson determined that the budget projection for 2012-13 resulted in a \$45.9 million cash
25 deficit with no general fund reserves; the cash balances for the prior two fiscal years had been
26 overstated; the beginning cash deficit for the next fiscal year was over \$18.2 million; and the
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1 City did not have enough unrestricted cash or reserves to pay its current financial obligations,
2 those obligations to become due beginning in July 2012, and continuing indefinitely. Id. at 780;
3 see also San Bernardino City Professional Firefighters Local 891 v. City of San Bernardino,
4 California (In re City of San Bernardino, California), 530 B.R. 474, 477 (C.D. Cal. 2015)(“The
5 City’s financial situation deteriorated quickly in the summer of 2012. The City ran out of cash to
6 pay its creditors and employees, and had a projected budget deficit of \$45.8 million. Personnel
7 costs alone were projected to exceed all of the City’s General Fund revenue.”).

9 During the pendency of the Chapter 9, as described above, the City dramatically reduced
10 expenses and worked diligently to increase revenues. Yet, per the declaration testimony and
11 attached exhibits of Mr. Busch, if the City were to move forward without restructuring its debts
12 through the Plan, the City would still operate at a deficit of nearly \$4 million beginning in fiscal
13 year 2018-19, and this operating deficit would increase each year to a peak of nearly \$20.5
14 million in fiscal year 2025-26. Thus, the City must restructure its debts through the Plan in order
15 to continue as a viable municipality and provide basic essential services to the City’s residents.
16 By contrast, with the restructuring and fiscal and service stabilization components of the
17 Financial Model, the City will be a viable municipal service provider for its residents.

18 The record before the Court demonstrates that the City must allocate its very limited
19 resources to providing municipal services to its residents and rehabilitating the City’s vital
20 infrastructure. Even given the 1% payment of claims under the Plan, including on Litigation
21 Claims against the City and the Indemnified Parties, the City cannot afford to fully fund the
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1 City's critical needs. The unrefuted testimony of Mr. Busch and current City Manager Mark
2 Scott¹⁷ substantiated this reality.

3 Public safety is a major concern of the City. The declaration testimony of Police Chief
4 Burguan shows that the City's high violent crime rates exceed state and national averages. In
5 2015, the City, led by Chief Burguan, prepared the Police Services Five Year Resources Plan
6 ("Police Resources Plan"), which was approved at a regularly noticed public meeting of the
7 Mayor and Common Council on November 16, 2015. The Police Resources Plan as proposed
8 and adopted by the Mayor and Common Council requires additional funds of \$56.5 million over
9 five years to implement.
10

11 Chief Burguan's testimony also demonstrated that during the bankruptcy case, crime
12 further increased in the City. As of June 2016, there have been significant increases in the
13 number of violent crimes over 2015, such as criminal homicide (a 100% increase), forcible rape
14 (a 15.56% increase) and aggravated assault (a 17.96% increase). There were 50 homicides in San
15 Bernardino in 2016 as of September 27, which is more than the total number of homicides for all
16 of 2015. The City has a significantly higher homicide rate this year per 100,000 residents than
17 Chicago or Oakland.
18

19 Under the Financial Model, only approximately 15% of the funds needed are allocated
20 for infrastructure repair and maintenance, and the City can afford just 40% of what is necessary
21 to fund the critical needs identified in the Police Resources Plan. That 40% allocation is
22 sufficient for the City to provide basic essential services to its residents, but the City will not be
23 able to afford much beyond those basic services. The City's critical need for funding police
24 services will not be fully addressed in the foreseeable future. If the City is required to pay more
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¹⁷ Decl. of Mark Scott, September 30, 2016, ECF No. 1988.

1 than 1% under the Plan, the City would be required to further reduce funding for the Police
2 Resources Plan and infrastructure repair and maintenance. Mr. Scott testified, consistent with Dr.
3 McCrary's¹⁸ expert testimony, that decreasing funding for the Police Resources Plan would
4 result in an increase in violent crime, less services to City residents, even greater challenges to
5 attracting businesses, and the impairment of economic growth and investment in the City. Under
6 those circumstances, and given the realities of the City's indemnification obligations, it is
7 necessary and appropriate to enjoin the holders of Litigation Claims against Indemnified Parties
8 from recovering from City employees personally for harms that occurred within the scope of
9 employment.
10

11 In addition, the City's police officers and other employees are contributing an indirect
12 economic benefit to the adjustment of debts under the Plan. The City's police officers and other
13 employees agreed to the City's modified terms and conditions of employment under their new
14 collective bargaining agreements and as part of that process agreed to a 1% distribution on their
15 claims, which claims have been valued at \$130 million. The police officers alone agreed to a 1%
16 distribution on their claims valued by the parties at \$74 million, principally claims for reduction
17 of pension and retiree health benefits. The employees had credible arguments under state law
18 regarding the legality of the modifications of the benefits, the litigation of which would certainly
19 have dramatically disrupted the City's momentum toward a substantially consensual plan.
20 Moreover, had the police officers prevailed in any such litigation, the resulting inability of the
21 City to impair up to \$130 million of claims would have stopped the City's reorganization dead in
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28 ¹⁸ Dr. McCrary is an economist retained by the City to provide expert testimony regarding the impact of the City's financial crisis on the Police Department and provision of police services to the residents. The Court finds Dr. McCrary well-qualified to opine on the impact of underfunding the Police Resources Plan.

1 its tracks. The police officers and other City employees made a substantial financial contribution
2 to the reorganization in agreeing that their unsecured claims could be paid in the 1% class.

3 Another factor in favor of approving the Plan Injunction is that the Plan Injunction is
4 narrowly tailored. First, at the request of certain Claimants, the City revised the Plan Injunction
5 to clarify that claims against Indemnified Parties can be litigated and can proceed to judgment.¹⁹
6 Only collection of those judgments will be enjoined, and only to the extent of the City's
7 indemnification obligation. The plaintiffs will still be able to recover from any available
8 insurance. If not satisfied with applicable insurance, claims against employees that are
9 indemnified by the City (the Indemnified Parties) will be satisfied as General Unsecured Class
10 13 Claims under the Plan. The Plan Injunction is narrowly tailored to achieve the specific
11 purposes of the Plan, namely that the City can operate after the Confirmation Date in accordance
12 with the Financial Model and provide basic municipal service to its residents.
13

14
15 A final factor but critical factor that the Court weighed in favor of approving the Plan
16 Injunction was the settlement achieved by the City and BICEP,²⁰ which settlement kept in place
17 the excess liability coverage provided for in the BICEP Agreements even though the City will
18 pay the self-insured retention ("SIR") in accordance with the treatment of Class 13 claims under
19 the Plan. Thus, for the Litigation Claims allowed in an amount in excess of the \$1 million SIR
20 under the BICEP Agreements, the City will utilize the coverage available under the BICEP
21 Agreements to pay the portion of the claim in excess of \$1 million. For Claimants with allowed
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28 ¹⁹ As noted above, the City modified the Plan to add Section XI.G on September 30, 2016.

²⁰ ECF No. 2096.

1 claims based on catastrophic injuries, the BICEP excess coverage may provide substantial
2 monetary recourse.²¹

3 (4) The Anti-Injunction Act and Law v. Siegel do not Prohibit the Injunction.

4 The Anti-Injunction Act, 28 U.S.C. § 2283, provides that “[a] court of the United States
5 may not grant an injunction to stay proceedings in a State court except as expressly authorized by
6 Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its
7 judgments.” The Act prohibits courts of the United State from enjoining state court proceedings²²
8 except in three circumstances: (i) if expressly authorized by an Act of Congress, or (ii) where
9 necessary in aid of its jurisdiction, or (iii) to protect or effectuate its judgment. Section 105(a) is
10 an expressly authorized exception to the Anti-Injunction Act as shown by the legislative history
11 and case law. Huse v. Huse–Sporsem (In re Birting Fisheries, Inc.), 300 B.R. 489, 497 n.7 (9th
12 Cir. BAP 2003); H.R.Rep. No. 95–959, 95th Cong., 1st Sess., at 316–17 (1977), reprinted in,
13 1978 U.S.C.C.A.N. 5787, 5815 (stating that § 105 is “an authorization, as required under 28
14 U.S.C. 2283, for a court of the United States to stay the action of a State court”); H.R.Rep. No.
15 95–959, 95th Cong., 1st Sess., at 316–17 (1977), reprinted in, 1978 U.S.C.C.A.N. 5787, 5815
16 (stating that § 105 is “an authorization, as required under 28 U.S.C. 2283, for a court of the
17 United States to stay the action of a State court”).
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24 ²¹ The dispute between the City and BICEP was presented to the Court in a Motion to Assume Executory Contract
25 filed by the City and opposed by BICEP. Several Civil Rights Claimants joined in the City’s motion, recognizing the
26 potential benefit to the Claimants. The settlement achieved by the City through mediation with BICEP exceeded the
27 relief the court could have granted, even if the City had prevailed on its Motion. In particular, BICEP’s recognition
28 that the City could satisfy the SIR with Plan 1% dollars was a significant benefit to any Claimant with an allowed
claim in excess of one million dollars.

²² In other contexts, courts have held that bankruptcy courts are not “courts of the United States,” so the Anti-
Injunction Act may not apply at all to this proceeding. See Perroton v. Gray (In re Perroton), 958 F.2d 889, 891 (9th
Cir. 1992); In re G.S.F. Corp., 938 F.2d 1467, 1478 (1st Cir. 1991). In addition, the majority of the civil right cases
are brought in federal, not state courts.

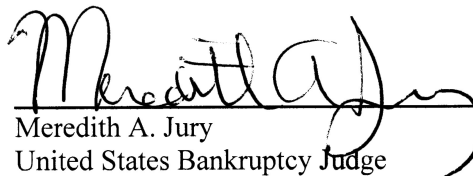
1 In addition to the authority of § 105, the Plan is a necessary aid to this Court's
2 jurisdiction to confirm an effective and feasible plan which will lead to an adjustment of the
3 City's debt. Therefore, the Anti-Injunction Act does not create a ban to the Plan Injunction.

4 The ruling in Law v. Siegel is also inapplicable to the Plan Injunction. In Law v. Siegel,
5 the Supreme Court held that a bankruptcy court may not enter an order under § 105(a) to
6 circumvent or "override explicit mandates of other sections of the Bankruptcy Code." 134 S.Ct at
7 1194. The mandate referred to by the Court was § 522(k), which expressly prohibited surcharge
8 of an exemption to pay administrative expenses, the exact relief Trustee Siegel received against
9 Law's homestead exemption. There is no similar "explicit mandate" of the Code which prohibits
10 third party injunctive relief. Section 524(e) does not apply in a Chapter 9 and no other section of
11 the code addresses this type of relief. See Deocampo v. Potts, 836 F.3d at 1143. Because the Plan
12 Injunction does not circumvent any other applicable part of the Code, Law v. Siegel does not
13 compel the prohibition of such injunction.
14
15

16 III. CONCLUSION

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18 The confirmation of the Plan provides the most hopeful outlook for this financially
19 struggling City to turn around its fiscal crisis, provide sufficient municipal services to its
20 residents, and make the streets safe for economic development and greater personal prosperity.
21 The Plan Injunction is a needed and necessary tool for the success of the Plan and the
22 revitalization of San Bernardino. For that reason, and all those stated above, it is approved as part
23 of the Plan.
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27 Date: March 7, 2017

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Meredith A. Jury
United States Bankruptcy Judge