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UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

In re DIABLO GRANDE COMMUNITY FACILITIES DISTRICT NO. 1, Debtor.	Case No. 25-26635-A-9 DCN RPL-1 Chapter 9 **COUNTY OF STANISLAUS'S OBJECTION TO DIABLO GRANDE COMMUNITY FACILITIES DISTRICT NO. 1'S CHAPTER 9 PETITION**

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The County of Stanislaus (the "County"), through its Board of Supervisors and the Treasurer-Tax Collector, hereby objects to the Diablo Grande Community Facilities District No. 1 (the "CFD")'s eligibility to be a Chapter 9 debtor under 11 U.S.C. § 109(c) and requests dismissal of the CFD's Chapter 9 petition under § 921(c).[1] In support thereof, the County states as follows:

I. INTRODUCTION

The CFD has filed a bankruptcy petition under Chapter 9 without complying with the applicable eligibility requirements in the Bankruptcy Code for municipalities seeking Chapter 9 relief. The CFD is thus ineligible as a Chapter 9 debtor under §§ 109(c) and 921(c) because: (1) the CFD failed to establish specific authorization under California law to file for bankruptcy by failing to do an independent neutral evaluation and establish a fiscal emergency; (2) the CFD is neither currently nor prospectively insolvent; (3) the CFD failed to negotiate in good faith with creditors prior to filing its petition; and (4) the CFD did not file its petition in good faith. For these reasons, the County requests that the CFD's Chapter 9 petition be dismissed.

II. FACTUAL AND PROCEDURAL BACKGROUND

The CFD is a community facilities district formed by the Western Hills Water District (the "WHWD") under the Mello-Roos Act to finance public facilities for a particular development known as Diablo Grande ("Diablo Grande Development" or "Diablo Grande").

A. Establishment of WHWD and CFD for the Diablo Grande Development

WHWD was formed in 1992 under California Water Code section 34000 et seq. to provide water for the Diablo Grande Development. *See* Exhibit A, WHWD Bonds Series 2014 at 24; Exhibit B, WHWD Bonds Series 2015 at 25. Diablo Grande is approximately nine miles from the City of Patterson, west of Interstate 5, in the western area of the County. *See* Exhibit A at 25; Exhibit B at 26. Diablo Grande's original developer was the sole owner of all the property within WHWD's boundaries. *See* Exhibit A at 24; Exhibit B at 25. All real estate parcels in Diablo Grande are located within the CFD, which overlaps with WHWD. *See* Exhibit A at 24; Exhibit B at 25. Pursuant to the County's Diablo Grande Specific Plan (the "Plan"), Diablo Grande comprises approximately 2,936 acres and is zoned for

[1] All statutory references are to the Bankruptcy Code, 11 U.S.C. §§ 101 et seq., unless otherwise indicated.

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both residential and commercial purposes. *See* Exhibit A at 29; Exhibit B at 31. However, only a portion of the residential units were built by Diablo Grande's original developer as provided in the Plan. *See* Exhibit A at 24; Exhibit B at 26. The original developer commenced bankruptcy proceedings in 2008. *See* Exhibit A at 31; Exhibit B at 33.

B. The Mello-Roos Act

The Mello-Roos Act, codified at California Government Code section 53311 et seq., was promulgated to provide an alternative for financing public facilities in developing areas. *See Azusa Land Partners v. Dep't of Indus. Rels.*, 120 Cal. Rptr. 3d 27, 40 (Cal. Ct. App. 2010). Under the Mello-Roos Act, any local agency, such as WHWD, may establish a community facilities district to provide for and finance the cost of eligible public facilities. *See id.* The CFD is a legally constituted governmental entity and is independent from WHWD. *See id.*; *see also* Cal. Gov't Code § 53317(b) (West 2014). Subject to approval of a two thirds vote of the electorate in the community facilities district, WHWD may issue bonds for the CFD, and WHWD may levy and collect a special tax within the CFD to pay the bonds. *See Azusa Land Partners*, 120 Cal. Rptr. 3d at 40.

WHWD established the CFD in 2000 under the Mello-Roos Act for the purposes of facilitating development and providing infrastructure improvements at Diablo Grande. *See* Exhibit A at 6, 24; Exhibit B at 7, 26. WHWD authorized the CFD to incur bonded indebtedness to achieve these purposes. *See id.* WHWD's governing body, the Board of Directors, serves as the CFD's governing body. *See Azusa Land Partners*, 120 Cal. Rptr. 3d at 40.

Pursuant to the Mello-Roos Act, WHWD issued bonds for the CFD, and a special tax was levied on the residential parcels in Diablo Grande to pay for the bonds. *See* Exhibit A at 6, 29; Exhibit B at 7, 31. **The bonds are not obligations of the CFD.** *See* Exhibit A at 11; Exhibit B at 13. The Official Statements for the 2014 Series and 2015 Series Refunding Bonds provide as follows:

> **The Bonds are special, limited obligations of the Water District [identified in the Official Statements as WHWD]**, payable and secured by the Special Tax and certain amounts held in funds under the Fiscal Agent Agreement. The Bonds do not constitute a charge against the general credit of the Water District, and under no circumstances is the Water District obligated to pay principal of or redemption premiums, if any, or interest on the Bonds except from the Special Taxes and other moneys pledged thereto under the Fiscal Agent Agreement**. Neither the State of California nor any public agency (other than the Water District) is obligated to pay the principal of or redemption premiums, if any, or**

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> **interest on the Bonds, and neither the faith and credit nor the taxing power of the Water District, the State of California or any public agency thereof is pledged to the payment of the principal of or redemption premiums, if any, or interest on the Bonds. The payment of the principal of or redemption premiums, if any, or interest on the Bonds does not constitute a debt, liability or obligation of the Water District, the State of California or any public agency (other than the Water District, to the limited extent set forth in the Fiscal Agent Agreement).**

See Exhibit A at 12; Exhibit B at 13.

C. WHWD's Foreclosure Proceedings and the County's Ad Valorem Property Taxes

The special taxes are secured by a lien on the real property. *See* Cal. Gov't Code § 53340(h) (West 2021). In the event of nonpayment of the special taxes, WHWD may initiate proceedings in state court to foreclose the lien to recover the defaulted special taxes. *See* Exhibit A at 19; Exhibit B at 20-21; *see also* Cal. Gov't Code § 53356.1 (West 2008). The CFD is considered a "nominal plaintiff" in such foreclosure proceedings, suing on behalf of bondholders. *See Cmty. Facilities Dist. No. 88 v. Harvill*, 88 Cal. Rptr. 2d 405 (Cal. Ct. App. 1999). WHWD may recover the taxes by selling the parcels at a minimum price that will either pay the taxes directly or reimburse WHWD for the amounts incurred to pay the taxes. *See* Exhibit A at 19; Exhibit B at 20-21.

WHWD has acquired 103 parcels in Diablo Grande through such foreclosure actions and similar proceedings (the "WHWD Foreclosed Properties"). *See* Dkt. 9. **In January 2026, and subsequent to the CFD's filing of this bankruptcy action, WHWD transferred title of those real properties to the CFD.** *See* Exhibit C, Grant Deed.

Prior to WHWD's foreclosure proceedings, and separate from the special taxes to secure the bonds, the County had assessed *ad valorem* property taxes on the parcels when they were under private ownership. The unpaid County property taxes are approximately $2 million. California law establishes that the County's property taxes are secured by a priority statutory lien. *See* Cal. Rev. & Tax. Code §§ 2192.1 & 2192.2.

D. The County's Intent to Recover the Unpaid Property Taxes Through a Tax Sale

To recover the unpaid property taxes, on November 4, 2025, the County Tax Collector sought approval from the County Board of Supervisors to approve the tax sale of a large number of the WHWD Foreclosed Properties (as well as other tax defaulted properties), pursuant to section 3694 of the

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California Revenue and Taxation Code. *See* Exhibit D, Stanislaus Cnty. Bd. of Sups. Mtg. Mins., Dated Nov. 4, 2025. The Board of Supervisors continued the matter to its December 9, 2025 meeting. *Id.*

E. The CFD's Declaration of a Fiscal Emergency and Bankruptcy Filing

On November 25, 2025, the CFD, through WHWD's Board of Directors, enacted a resolution ("Resolution No. 2025-13") declaring a fiscal emergency and authorizing the filing of a Chapter 9 petition. *See* Exhibit E, Res. No. 2025-13 at 1. In an accompanying press release, the CFD clarified that the filing of the petition:

> has become unavoidable due to the CFD's current inability to pay its obligations and the immediate threat of a tax sale and our concern that the Stanislaus County Board of Supervisors, based on their past actions and their upcoming vote scheduled for December 9, may not provide the protections necessary to prevent it.
>
> By declaring a Fiscal Emergency and authorizing the filing of a Chapter 9 bankruptcy, we can stay the Tax Collector's process and safeguard the CFD's publicly-owned assets, the loss of which jeopardizes the health, safety and well-being of the residents within the CFD. This measure also allows us to engage more effectively with potential developers and advance long-term efforts to stabilize the Diablo Grande community.

Exhibit F, Pub. Announcement Authorized by the WHWD Bd. of Dirs., Dated Nov. 25, 2025. The CFD further stated that the Chapter 9 petition would allow it:

> to seek court-supervised restructuring of the CFD's major outstanding obligations, including:
>
> - Approximately $38 million in bondholder principal debt
> - Approximately $1.9 million in delinquent property tax obligations
> - The $385,000 claim asserted by the HOA

Id. The CFD noted that "[a]ddressing these obligations through the bankruptcy process gives the [CFD] the legal tools needed to negotiate, restructure, or eliminate certain debts that have burdened this community for many years." *Id.* It clarified "that the proposed bankruptcy applies *only* to the Diablo Grande Community Facilities District." *Id.* (emphasis in original). The CFD stated that it hoped the bankruptcy process would "place the CFD in a far stronger position to attract a qualified master developer to assume and complete the Diablo Grande project." *Id.*

The CFD's approved budget for the 2025 fiscal year shows several revenues and expenditures for

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maintenance of the CFD properties that purportedly yield a net loss of $259,886.00. *See* Exhibit G, CFD Budget FY 2025. The approved budget for 2026 states similar revenues and expenditures amounting to a net loss of $191,450. *See* Exhibit H, CFD Budget FY 2026. Neither of the budgets lists the repayment of the bonds as an expenditure incurred by the CFD. Neither of the budgets lists the repayment of the County's property taxes as an expenditure incurred by the CFD.

On November 25, 2025, the CFD filed its Chapter 9 petition and its statement of qualifications under § 109(c). *See* Dkt. 1 & 4. On January 1, 2026, the CFD filed a list of creditors, which names the County in Schedule D as a secured creditor with a claim for $2,191,202.00 for property tax liens. *See* Dkt. 14. On February 4, 2026, this Court issued an order setting the deadline for filing objections to the Chapter 9 petition at 5:00 p.m. on April 3, 2026. *See* Dkt. 23.

III. LEGAL STANDARD

After any objection to the petition, and after notice and a hearing, the Court may dismiss the petition on one of two bases: the municipal debtor does not meet the requirements of Chapter 9; or the municipal debtor did not file the petition in good faith. *See* 11 U.S.C. § 921(c); *see also In re City of Stockton*, 475 B.R. 720, 725 (Bankr. E.D. Cal. 2012) ("Five essential elements for eligibility to be a chapter 9 debtor are set forth at 11 U.S.C. § 109(c), to which is appended a good faith filing requirement by 11 U.S.C § 921(c)").

Under § 109(c), an entity may be a debtor under Chapter 9 if and only if such entity meets five requirements. The requirements are: (1) the debtor is a municipality; (2) the debtor is specifically authorized, in its capacity as a municipality or by name, to be a debtor under Chapter 9 by state law; (3) the debtor is insolvent; (4) the debtor desires to effect a plan to adjust such debts; and (5) the debtor negotiated in good faith with creditors (or can show that negotiations are impracticable), or the debtor reasonably believes that a creditor may attempt to obtain a transfer that is voidable under § 547. *See* 11 U.S.C. § 109(c)(1)-(5).

IV. ARGUMENT

The County is identified in the bankruptcy action as a creditor of the CFD, and, as such, is a party in interest to this proceeding. *See In re de la Salle*, 461 B.R. 593, 604-605 (9th Cir. B.A.P. 2011). The County's interest is recovery of approximately $2 million in unpaid property taxes assessed on parcels

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prior to (1) their acquisition by WHWD through judicial foreclosure proceedings and (2) their subsequent transfer to the CFD post-petition.

The County objects to the CFD's Chapter 9 petition on the following grounds: (1) The CFD did not satisfy the requirements of California law to file a Chapter 9 bankruptcy petition; (2) the CFD is not insolvent; (3) the CFD failed to negotiate with creditors in good faith prior to filing the petition; and (4) the CFD did not file its Chapter 9 petition in good faith.

A. The CFD Does Not Meet Several Eligibility Requirements

If the municipal debtor is not eligible for Chapter 9 relief, dismissal is mandatory under § 921(c). *See In re City of Vallejo*, 408 B.R. 280, 289 (9th Cir. B.A.P. 2009). The burden is on the debtor to demonstrate that it meets the eligibility requirements in § 109(c). *See id.*

1. The CFD is Not Specifically Authorized to File for Bankruptcy

A municipality must be "specifically authorized by state law, . . . to be a debtor under chapter 9." *In re City of Stockton*, 475 B.R. at 727. "California Government Code § 53760 . . . authorizes any . . . district, . . . public agency, or entity that qualifies as a municipality under the Federal Bankruptcy Code . . . to be a debtor under chapter 9 but recently imposed preconditions . . . ." *Id.* "The municipality must either engage in a neutral evaluation process for a specified period or its governing board must declare a fiscal emergency pursuant to specified procedures." *Id.*; *see also* Cal. Gov't Code § 53760(a) & (b) (West 2012).

If the municipality does not satisfy section 53760 of the California Government Code, it is not "specifically authorized to file chapter 9." *In re Cnty. of Orange*, 183 B.R. 594, 605 (Bankr. C.D. Cal. 1995). The CFD fails to show that it has specific authorization under California Government Code section 53760 to file its Chapter 9 petition, and so the § 109(c)(2) eligibility requirement fails.

a. The CFD Failed to Participate in a Neutral Evaluation

The first prerequisite under California law requires the local public entity to initiate a neutral evaluation process if it is or likely will be unable to meet its financial obligations as and when those obligations are or become due. *See* Cal. Gov't Code § 53760.3(a) (West 2012); *see also In re City of Stockton*, 493 B.R. 772, 783 (Bankr. N.D. Cal. 2013) (stating that where a municipality opts for the neutral evaluation prerequisite, the "focus is on the terms that govern the process").

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The CFD's Resolution No. 2025-13 fails to show the CFD considered the neutral evaluation process prior to filing for bankruptcy and therefore lacks a basis on which to assess compliance with the neutral evaluation prerequisite. *See* Exhibit E. The CFD simply declared, in general terms, a fiscal emergency. *See id.* On the contrary, it appears that the CFD intends to use the bankruptcy process to conduct such negotiations, since one of its goals is to use "legal tools . . . to **negotiate**, . . . certain debts that have burdened this community for many years." *See* Exhibit F (emphasis added). Additionally, the CFD faces significant difficulty in establishing whether it could even negotiate the bonds and property taxes, neither of which constitutes its own legal obligations as discussed below.

The CFD has not shown that it is specifically authorized to be a Chapter 9 debtor under California Government Code section 53760.3(a).

b. The CFD Failed to Establish a Fiscal Emergency

The second prerequisite under California law provides that if a local public entity opts out of the pre-petition neutral evaluation, the entity must declare a fiscal emergency and adopt a resolution by a majority vote of the governing board at a noticed public hearing. *See* Cal. Gov't Code § 53760.5 (West 2012). The local public entity must (1) make findings that the financial state of the local public entity jeopardizes the health, safety, or well-being of the residents of the local public entity's jurisdiction or service area absent the protections of Chapter 9 and (2) make findings that the public entity is or will be unable to pay its obligations within the next 60 days. *See id.*

Resolution No 2025-13 fails to establish a fiscal emergency because it does not make the required statutory findings.

i. The Findings in Resolution No. 2025-13 Are Conclusory

The sufficiency of the local public entity's findings requires more than a resolution "speaking in the statutory language." *Cnty. of Los Angeles v. Glendora Redevelopment Project*, 111 Cal. Rptr. 3d 104, 120 (Cal. Ct. App. 2010) (internal quotations and citation omitted). Instead, its "findings must be supported by tangible proof which can be scrutinized in a meaningful way." *Id.* (internal quotations and citation omitted). "Courts properly reject . . . findings that are set forth in conclusionary and summary terms." *Id.* (internal quotations and citation omitted).

Resolution No. 2025-13 purports to characterize the CFD's fiscal emergency as the financial state

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of the CFD jeopardizing the health, safety, or well-being of the residents within its jurisdiction and a present inability to pay its obligations. *See* Exhibit E. But this emergency resolution is nothing more than a threadbare recital of the language in California Government Code section 53760.5. *See id.*

On this basis alone, the CFD failed to establish a fiscal emergency pursuant to the requirements of California Government Code section 53760.5 and thus is not specifically authorized under California law to be a Chapter 9 debtor.

ii. Resolution No. 2025-13 Lacks Findings to Justify Intruding Upon the County's Statutory Right to Collect Taxes

There is an additional basis for finding that Resolution No. 2025-13 is insufficient to establish the CFD's specific authorization under California law to file a Chapter 9 petition. Resolution 2025-13 lacks sufficient findings to justify an intrusion into the County's right to collect taxes guaranteed by statute.

California Revenue and Taxation Code section 4807 provides:

> No injunction or writ of mandate or other legal or equitable process shall issue in any suit, action, or proceeding in any court against any county, municipality, or district, or any officer thereof, to prevent or enjoin the collection of property taxes sought to be collected. In the case of a collection of taxes pursuant to a bankruptcy proceeding, the county may request a reasonable amount of attorney's fees.

Resolution 2025-13 is an attempt to intrude on the County's ability to collect taxes as guaranteed by statute. *See* Exhibit F. In order to justify such an intrusion, the CFD must demonstrate facts of a fiscal emergency beyond conclusory allegations in that resolution. The CFD cannot show it satisfied the fiscal emergency prerequisite and is not specifically authorized to file for Chapter 9 under California Government Code section 53760(b).

2. The CFD Is Not Insolvent

a. The Legal Tests for Insolvency

The CFD may only be a debtor under Chapter 9 if it is insolvent. *See* 11 U.S.C. § 109(c)(3). The term "insolvent" means, with reference to a municipality, financial condition such that the municipality is experiencing current insolvency or prospective insolvency. *See* 11 U.S.C. § 101(32)(C); *see also San Benito Health Care Dist. v. Cal. Nurses Ass'n & Nat'l Union of Healthcare Workers (In re San Benito Health Care Dist.)*, 2025 WL 885510 *1 (Bankr. N.D. Cal. 2025). "The day on which the municipality

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filed its bankruptcy petition (petition date) is the relevant time for assessing insolvency." *San Benito Health Care Dist.*, 2025 WL 885510 at *1.

Current insolvency arises when the municipality is generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute. *See* 11 U.S.C. § 101(32)(C)(i); *see also San Benito Health Care Dist.*, 2025 WL 885510 at *1. It has been held "that 'due' means 'presently, unconditionally owing *and presently enforceable*.'" *In re Ravenna Metro. Dist.*, 522 B.R. 656, 668 (Bankr. D. Colo. 2014) (citing *Hamilton Creek Metro. Dist. v. Bondholders Colo. BondShares (In re Hamilton Creek Metro. Dist.)*, 143 F.3d 1381, 1385 (10th Cir. 1998)) (original emphasis).

Prospective insolvency occurs when the municipality is unable to pay its debts as they become due. *See* 11 U.S.C. § 101(32)(C)(ii); *see also San Benito Health Care Dist.*, 2025 WL 885510 at *1. "This is a cash flow, not a budget deficit, analysis." *In re Pierce Cnty. Hous. Auth.*, 414 B.R. 702, 711 (Bankr. W.D. Wash. 2009). "Inability to pay under this test 'depends upon the inescapable quality of the obligation and the certainty that it cannot be met. Mere possibility or even speculative probability is not enough.'" *Ravenna Metro. Dist.*, 522 B.R. at 677 (quoting *In re City of Bridgeport*, 129 B.R. 332, 337 (Bankr. D. Conn. 1991)). "The maturity of the debt must be 'imminent' and the inability to pay it must be 'certain.'" *Id.*

Under either test, the debts must be (1) the debts of the CFD and (2) the debts must be "due." *Ravenna Metro. Dist.*, 522 B.R. at 667.

b. Neither the Bonds Nor the County Property Taxes are CFD's Debts

i. The Bonds Are Not the CFD's Legal Obligations

The CFD cannot show that the bonds constitute its own legal obligations. "The Code defines a 'debt' as a liability on a claim." *In re Nicholes*, 184 B.R. 82, 87 (9th Cir. B.A.P. 1995) (citing 11 U.S.C. § 101(12)). "A 'claim' is defined as a 'right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.'" *Id.* (citing 11 U.S.C. § 101(5)(A)).

"The terms 'debt' and 'claim' are coextensive." *Nicholes*, 184 B.R. at 87; *see also In re Quintana*, 107 B.R. 234, 237 (9th Cir. B.A.P. 1989). "To the extent that a creditor has a claim against the debtor, the debtor owes a debt to the creditor." *Nicholes*, 184 B.R. at 87. A debt, much like a claim,

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thus refers to a legal obligation of the debtor. "State law generally determines such legal obligations." *Ritter Ranch Dev., L.L.C. v. City of Palmdale (In re Ritter Ranch Dev., L.L.C.)*, 255 B.R. 760, 764 (9th Cir. B.A.P. 2000) (internal quotations and citations omitted).

Here, the bonds are not the CFD's legal obligations. They are, at most, special limited obligations of WHWD. *See* Exhibit A at 11, Exhibit B at 13. WHWD did not file for Chapter 9 bankruptcy protection; only the CFD did. *See* Exhibits E & F.

In short, "the Bonds are the non-recourse loans to the [WHWD]; the [WHWD's] sole source of repayment are the special taxes and their proceeds." *Ritter Ranch Dev.*, 255 B.R. at 766.

Simply because the WHWD has passed title to the parcels to the CFD, post-petition, does not mean the bonds are now the CFD's legal obligations. The bonds do not constitute personal indebtedness of any future property owner such as the CFD. *See* Exhibit A at 11, Exhibit B at 13. The special taxes are instead in rem debt: a lien is recorded on each parcel to secure payment of the bonds. *See id.*

The CFD's Chapter 9 petition attempts to restructure a limited special obligation of WHWD, a non-filing third party. Since the bonds are not its debts, the CFD cannot show that it is entitled to relief under Chapter 9.

ii. The County's Property Taxes are Not Debts of the CFD

Similarly, the County's property taxes assessed on the parcels are not obligations of the CFD. It is well settled that in California, a "property tax operates in rem against the *property*." *Helvey v. Sax,* 237 P.2d 269 at 271 (Cal. 1951) (emphasis added); *see also In re Purcell*, 362 B.R. 465, 470 (Bankr. E.D. Cal. 2007). The County's property taxes were assessed on the parcels when they were under private ownership. They only came under the CFD's ownership after (1) WHWD foreclosed on the properties to recover the delinquent special taxes to repay the bonds, and (2) WHWD subsequently transferred title of these foreclosed properties to the CFD, post-bankruptcy petition.

The fact that the CFD now holds title to the property does not make the previously assessed property taxes a personal obligation of the CFD. "The general principles that apply to property taxes in California are that they are imposed on the ownership of property as such; . . . no personal liability arises from their nonpayment, the sole security for the taxes being the property itself." *Garcia v. Cnty. of Santa Clara*, 151 Cal. Rptr. 80, 82 (Cal. Ct. App. 1978).

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It is telling that the CFD, after it had declared a fiscal emergency and filed its Chapter 9 bankruptcy petition, decided to accept a transfer of these Foreclosed Properties with the existing property tax liens on them. This fact establishes that the CFD knew that the County's sole security was the property tax liens and the CFD had no personal liability for their payment.

iii. Neither the Bonds Nor the County Property Taxes are Identified as Expenses of the CFD in its Most Recent Budgets

Neither of the CFD's approved budgets for the 2025 and 2026 fiscal year list the bond debt or the County property taxes as operating expenses. *See* Exhibits G & H. The only approved expenses are those related to the maintenance of a clubhouse as well as those related for other purposes. The CFD's approved budget for the 2025 fiscal year shows several revenues and expenditures for maintenance of the CFD properties that purportedly yield a net loss of $259,886.00. *See* Exhibit G. The approved budget for 2026 states similar revenues and expenditures amounting to a net loss of $191,450. *See* Exhibit H. Neither of the budgets lists the repayment of the bonds as an expenditure incurred by the CFD. Neither of the budgets lists the repayment of the County's property taxes as an expenditure incurred by the CFD.

While these balancing sheets demonstrate an overall loss, they do not demonstrate that the CFD is insolvent. "Chapter 9 is not available to a [municipality] simply because it is financially distressed." *City of Bridgeport*, 129 B.R. at 336.

c. Neither the Bonds nor the County Property Taxes are Considered to be "Due"

First, in connection with current insolvency, it has been held "that 'due' means 'presently, unconditionally owing *and presently enforceable*.'" *Ravenna Metro. Dist.*, 522 B.R. at 668 (quoting *Hamilton Creek Metro. Dist.*, 143 F.3d at 1385) (original emphasis).

The *Ravenna* decision is instructive on the issue of when bonds are considered a debt that is "due." The Court in *Ravenna* held that the bonds to fund a redevelopment project in that case were not considered "due" because there was a payment contingency built into their structure. The only recovery available on the bonds was to collect the taxes (the "mills") that were assessed for payment of the bonds. *See id.* at 669. "The bond owner has no remedy other than to wait until the District's tax revenues rise to a level sufficient to make the required payments." *See id.* at 670. The bonds in the *Ravenna* decision are

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similar to the bonds and the County property taxes in this proceeding, in which, as previously explained, recovery is limited to the real property that serves as the security for such obligations.

Second, the CFD has not shown that it was prospectively insolvent as of the petition date. Prospective insolvency occurs when the municipality is unable to pay its debts as they become due. *See* 11 U.S.C. § 101(32)(C)(ii); *see also San Benito Health Care Dist.*, 2025 WL 885510 at *1. "This is a cash flow, not a budget deficit, analysis." *Pierce Cnty. Hous. Auth.*, 414 B.R. at 711. "Inability to pay under this test 'depends upon the inescapable quality of the obligation and the certainty that it cannot be met. Mere possibility or even speculative probability is not enough.'" *Ravenna Metro. Dist.*, 522 B.R. at 677 (quoting *City of Bridgeport*, 129 B.R. at 337). "The maturity of the debt must be 'imminent' and the inability to pay it must be 'certain.'" *Id.*

Under this test, and similar to the bonds in the *Ravenna* decision, the bonds cannot trigger a negative cash flow for the CFD. Payment of the bonds is contingent on the availability of special tax proceeds. *See* Exhibit A at 12; Exhibit B at 13-14. For purposes of the prospective insolvency test, "'obligations that are enforceable only on a cash-flow basis cannot, by definition, render a debtor insolvent.'" *Ravenna Metro. Dist.*, 522 B.R. at 677 (quoting *Hamilton Creek Metro. Dist.*, 143 F.3d at 1386). As such, the CFD has not shown that it will—or that it can—experience prospective insolvency.

The County's property taxes also cannot trigger a negative cash flow for the CFD. The sole recourse for the County is the real property that has secured the County property taxes. Payment of the County taxes through the proceeds of selling that real property has no impact on the CFD's cash flow.

The CFD is not insolvent under either of the tests enumerated in § 101(32)(C) and so cannot qualify for Chapter 9 relief.

3. The CFD Did Not Engage in Good Faith Negotiations.

The final eligibility requirement in § 109(c)(5) requires the municipality to establish "one of four possible alternatives." *Ravenna Metro. Dist.*, 522 B.R. at 680. "Good faith requires that the District seriously explore all existing alternatives to bankruptcy before it files." *Id.* at 683. The following alternatives are implicated in this action:

(1) "Either the debtor must demonstrate good faith negotiations or that for some reason it is impracticable to attempt negotiations." *Id.* at 681 (citing 11 U.S.C. § 109(c)(5)(B), (C)); or

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(2) The debtor can show its reasonable belief that a creditor may attempt to obtain a preferential transfer." *Id*. (citing 11 U.S.C. § 109(c)(5)(D)).

CFD purportedly seeks to show in its statement of qualifications that it satisfied this requirement on both grounds. *See* Dkt. 4. Neither has evidentiary support.

The CFD baldly asserts that pre-petition negotiations were impractical, but the evidence shows otherwise. Although the CFD was concerned about the proposed tax sale, the County's Board of Supervisors did not consider or vote on the sale on November 4, 2025 and continued the matter to December 9, 2025. *See* Exhibit D. In the three weeks between the Board's November 4 meeting and the CFD's November 25 petition filing, there was ample opportunity for the CFD to negotiate with the County regarding the property tax liens. The CFD instead treated the proposed tax sale as an "immediate threat" and assumed the Board would "not provide the protections necessary to prevent it," thus necessitating the filing of its Chapter 9 petition. *See* Exhibit F. The CFD unequivocally admitted that the purpose of the petition was to "stay the Tax Collector's process and safeguard the CFD's publicly-owned assets . . . ." *Id.* Indeed, the CFD concedes that it seeks to use bankruptcy's "legal tools to **negotiate**, restructure, or eliminate certain debts that have burdened this community for many years." *Id.* (emphasis added). This evidence is sufficient to show that the CFD never seriously considered pre-petition negotiations.

Moreover, the CFD is unable to demonstrate a reasonable belief that the tax sale would be an avoidable preferential transfer. That the County proposed a tax sale to recover on the property tax liens is not enough. *See Ravenna Metro. Dist.*, 522 B.R. at 683 (noting that a demand for payment of a debt that may have been secured by a mechanic's lien "may not have been preferential."). Neither the bonds nor the County's property taxes are the legal obligations of the CFD, nor is the CFD insolvent, as discussed above. *See* 11 U.S.C. § 547(b)(2) & (3). The CFD thus cannot show a preferential transfer without those foundational requirements.

Significantly, an avoidable preferential transfer requires that the creditor receive more than such creditor would receive if--

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

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(C) such creditor received payment of such debt to the extent provided by the provisions of the Bankruptcy Code. 11 U.S.C. § 547(b)(5).

However, the Ninth Circuit has held that prepetition tax sales conducted in accordance with California state law, upon appropriate notice and with opportunity for competitive bidding, conclusively establish that the price received at tax sales is "reasonably equivalent value" for the parcels of real property that were sold. *In re Tracht Gut, LLC*, 836 F.3d 1146, 1155 (9th Cir. 2016). The Ninth Circuit noted "federal courts should pay considerable deference to state law on matters relating to real estate." (*Id*. at 1153).

The CFD cannot establish good faith pre-petition negotiations, or reasons as to why negotiations were impractical, and it also cannot show that the County's proposed tax sale is a preferential transfer. In combination with the CFD's inability to prove that it is insolvent, the CFD does not comply with the requirements of § 109(c), and it is therefore ineligible for Chapter 9 relief. The Court should dismiss the petition on this basis alone.

B. The CFD Did Not File the Petition in Good Faith.

The County further objects to the CFD's petition on the ground that the CFD lacked good faith in filing the petition. If the municipality is unable to establish that it filed its Chapter 9 petition in good faith, dismissal is permissive under § 921(c). *See Pierce Cnty. Hous. Auth.*, 414 B.R. at 714.

"'Good faith' is not defined in the Bankruptcy Code." *Ravenna Metro. Dist.*, 522 B.R. at 684. "'As in many other considerations of good faith in the context of bankruptcy, the test is a totality of the circumstances where the Court is given the power to weigh the numerous factors in light of the circumstances as a whole in determining whether good faith is lacking.'" *Id.* (quoting *In re City of San Bernardino*, 499 B.R. 776, 790 (Bankr. C.D. Cal. 2013)). "These factors include: '(i) the debtor's subjective beliefs; (ii) whether the debtor's financial problems fall within the situations contemplated by chapter 9; (iii) whether the debtor filed its chapter 9 petition for reasons consistent with the purposes of chapter 9; (iv) the extent of the debtor's prepetition negotiations, if practical; (v) the extent that alternatives to chapter 9 were considered; and (vi) the scope and nature of the debtor's financial problems.'" *Id.* (quoting *Pierce Cnty. Hous. Auth.*, 414 B.R. at 714). "Many of these factors overlap with the eligibility requirements and several focus on the debtor's economic viability." *Id.*

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Based on the above analysis regarding the Chapter 9 eligibility requirements, the CFD cannot establish the similar factors read into § 921(c) to establish good faith. *See City of Stockton*, 493 B.R. at 794. The evidence instead shows that the CFD's primary purpose for filing the Chapter 9 petition was to forestall the County's tax sale to recover delinquent property taxes that are not obligations of the CFD. *See* Exhibit F. WHWD had been accumulating the parcels at issue within Diablo Grande through foreclosure actions for several years. And yet, prior to this petition, WHWD took no action to sell the foreclosed properties and recover the unpaid special taxes (to pay the bonds) and pay the delinquent property taxes. The CFD, aware that the County's Board of Supervisors was considering a request from the Tax Collector to sell the properties at a tax sale, filed this action to prevent the sale, thus further delaying the sale of these already foreclosed properties. **WHWD transferred the parcels at issue, post-bankruptcy petition, to the CFD.**

The CFD invoked the bankruptcy process not for the purpose of adjusting its debts, but to gather the foreclosed properties as an attractive "package" for a proposed developer. *See* Exhibit F.

The CFD lacked good faith in filing its Chapter 9 petition. As such, the Court should also dismiss the petition for failure to comply with § 921(c).

V. CONCLUSION

WHEREFORE, the County respectfully requests dismissal of the CFD's Chapter 9 petition, attorney's fees pursuant to California Revenue and Taxation Code section 4807, and for such other relief as the Court deems appropriate.

Dated: April 3, 2026

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