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Stockton, Calif., Bankruptcy Plan Faces March Trial.

Creditors Expected to Object to Bankruptcy-Exit Blueprint for Central California Town

After more than a year of cost-cutting and debt negotiations, Stockton, Calif., leaders can now focus their efforts on a March courtroom trial that could be the final hurdle to getting the 300,000-resident city out of bankruptcy.

At a hearing Monday in U.S. Bankruptcy Court in Sacramento, Judge Christopher Klein designated March 5 as the starting date for a trial that will allow the city's bondholders and other creditors to protest its bankruptcy-exit plan. Federal bankruptcy rules state that the city's plan must be "fair and equitable."

The city's bondholders and others haven't raised specific concerns yet over the 199-page bankruptcy-exit summary, which Judge Klein said on Monday can be sent to those creditors for a vote. The city's confirmation hearing could take a little as a few hours if no objections are raised, but a lawyer for the city said at Monday's hearing that they're bracing for challenges that will require a courtroom battle.

"We're anticipating that there would be a trial," said Stockton bankruptcy attorney Marc Levinson during the hearing, joking that he hoped that the trial would finish up before Easter.

Earlier this year, bondholder groups criticized Stockton leaders for not trying to lower payments to California Public Employees' Retirement System, which collects millions of dollars' worth of retirement money each year for city workers. The fund was expected to collect about \$245 million from the city over the next decade—a large burden that bondholders have argued shouldn't be shielded as city officials press others for cuts.

Bondholders who are being repaid different amounts might also protest the deal. One pair of municipal-bond investors—Franklin High Yield Tax-Free Income Fund and Franklin California High Yield Municipal Fund, which are owed about \$35 million—complained in court papers that many of the city's bondholder groups are expected to recover more than half of their debt, while the pair's debt—which is backed by two public golf courses and a park—might only get repaid a fraction of what they are owed.

Stockton's bankruptcy-exit plan calls for both cost cutting and revenue increases.

The city's largest debt, about \$125 million in pension bonds, would be repaid over a longer period. The city also said that its roughly 1,300 workers and retirees who had \$538 million in claims against the city agreed to accept a \$5.1 million payment.

Stockton is also counting on more tax money to help repair its finances. Earlier this month, voters approved a 3/4-cent sales-tax to pay for more police officers in a city that is often criticized for being unsafe. The tax is also meant to cover legal fees and other bankruptcy-related costs that have topped \$10 million since the case was filed last year.

Stockton's leaders put the city into bankruptcy on June 28, 2012, blaming the real estate crash that crippled its tax revenue.

The city, located about 80 miles inland from San Francisco, was declared "ground zero" for the subprime-mortgage crisis by Judge Klein. He has also blamed the city's financial woes on former leaders who offered overly generous pay to city workers and took on debt for new projects that the city couldn't afford.

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