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NYT: Pension Ruling in Detroit Echoes West to California.

The ruling by Judge Steven W. Rhodes, who is presiding in Detroit's bankruptcy case, that public pensions are not protected from cuts could alter the course of bankrupt cities like Stockton and San Bernardino, Calif., that had been operating under the assumption that pensions were untouchable.

Stockton's bankruptcy case, for instance, is further along than Detroit's, and until Tuesday it seemed likely to leave public pensions fully intact. Stockton sought bankruptcy protection last year and has already filed a plan of debt adjustment with the bankruptcy court in Sacramento. Its plan, which is subject to court approval, would leave city workers' pensions unchanged: They would continue to accrue benefits at the same rate as they did before the bankruptcy. (A new state law does permit Stockton to provide smaller pensions to workers hired after Jan. 1.)

That is a better deal than workers at bankrupt companies often receive. City leaders based it on the thinking that public workers had already sacrificed enough, given that the plan of adjustment already calls for them to give up contractual pay increases and valuable retiree health benefits.

Opponents of that plan have raised concerns that it would not save enough money. They point to the city of Vallejo, Calif., which spent three years in bankruptcy, emerged in 2011 without touching its workers' pensions, and is again having trouble balancing its budget. Many cities in California are struggling with pension costs because of a big benefit increase in 1999 that has been much more expensive than anticipated. State laws make it hard for cities to raise taxes enough to keep up with the costs, and because pensions are considered untouchable, local officials have had to reduce services, like policing, to balance their budgets.

Some say the situation is unsustainable. Last month, another city, Desert Hot Springs, said that its pension costs were unaffordable and that it might have to declare bankruptcy.

Early in Stockton's bankruptcy, several financial institutions tried to block its case, arguing that it had not negotiated as required with the California Public Employees' Retirement System, known as Calpers, which administers pensions for many municipalities. Those motions were denied, and in the months since then, all but one of the institutions have reached settlements with the city and stopped arguing about pensions.

The one remaining creditor is Franklin Templeton Investments, a mutual fund company that holds about $35 million worth of Stockton's bonds. Stockton's plan of adjustment proposes to give Franklin less than a penny on the dollar for its bankruptcy claims, according to court filings. Federal bankruptcy law allows for such "cramdowns" — deals that force big losses on unwilling creditors — but for a cramdown to be approved by a bankruptcy judge, it must meet certain requirements. It must be "fair and equitable," for example, and it must not discriminate against one creditor in favor of others.

Even before Tuesday, Franklin was warning that it would challenge to Stockton's plan. Documents on file with the court suggest it was planning to argue that no plan could be "fair and equitable" if Calpers were paid in full while Franklin received less than a cent on the dollar.

“Their argument just got strengthened,” said Karol K. Denniston, a bankruptcy lawyer at Schiff Hardin in San Francisco who has been advising a taxpayers group that formed after Stockton declared bankruptcy. Referring to the judge’s decision in Detroit, she said, “Franklin Templeton is going to have a lot to say about this ruling.”

Another bankrupt city in California, San Bernardino, has taken a different tack from Stockton. It wants to reduce its pension obligations in bankruptcy and has already stopped sending its regular contributions to Calpers. That is something a company in Chapter 11 bankruptcy would normally do, but Calpers is fighting the move in San Bernardino’s Chapter 9 case. It argues that the city does not sincerely wish to adjust its debts, as required by bankruptcy law, but simply wants to “languish” in court. Calpers maintains that pensions cannot be reduced in California and that the only way for a city to freeze its plan is to pay a giant fee.

So far, San Bernardino’s bankruptcy judge, Meredith A. Jury, has ruled against Calpers and refused to grant it an expedited appeal to the United States Court of Appeals for the Ninth Circuit. The city’s creditors are now trying to come up with a settlement plan in mediation.

“This gives them clarity,” Ms. Denniston said. “It changes the dynamic at the negotiating table in a major way, because we’ve now had a bankruptcy judge say you can impair pensions. We’re going to go through a huge period of uncertainty because that’s going to be appealed, but for right now, that’s the law.”

Judge Rhodes’s decision in Detroit’s bankruptcy case was also noteworthy for what it did not say: It did not offer specific instructions for how large or small any pension cuts should be. Instead, he said the question should be resolved in mediation, which is already running in Detroit but has so far borne little fruit.

James E. Spiotto, a bankruptcy lawyer at Chapman & Cutler in Chicago, said officials in other cities might want to change course now if they worried that they might have promised more than they could deliver.

“If you’re not able to pay, the best thing to do is address it now,” Mr. Spiotto said. “Pay as much as you can without adversely affecting the future of the city.”

By MARY WILLIAMS WALSH