
WSJ: Creditor Objects to Stockton, Calif., Bankruptcy Plan.

Bond Investors Who Loaned $35 Million Say They Wouldn't Be Paid Fairly

Municipal-bond investors who lent $35 million to Stockton, Calif., for city improvements are protesting its Chapter 9 exit plan. They contend that, if approved by a bankruptcy judge, the plan would unfairly pay them less than a penny on the dollar.

The Franklin High Yield Tax-Free Income Fund and the Franklin California High Yield Municipal Fund, both managed by Franklin Templeton Investments, filed an objection Wednesday with the U.S. Bankruptcy Court in Sacramento requesting that Judge Christopher Klein not approve the city's restructuring plan.

Franklin—which is slated to recover $94,000, or 0.25% of its investment, under Stockton's plan—said it is being treated unfairly. The firm said Stockton's other creditors would recover 52% to over 100% of their claims from future revenues over the next 40 years. Federal bankruptcy rules state the city's plan must be "fair and equitable."

For its part, Stockton said it has reduced its general workforce by an aggregate of 30% during the years leading up to its bankruptcy. The city has also stated that retiree health benefits worth about $1 billion have been eliminated as a result of negotiations.

"The plan is a Spartan one," the city said in documents filed with the court. "It returns the city to financial and public service provider solvency," but without a deal with creditors, Stockton's lawyers said the city could lose control of two golf courses and a park.

The city's chief information officer said Friday the city wouldn't be in a position to provide comments until next week, when it had further reviewed the objection.

In 2009, Franklin lent $35 million to Stockton, a city of 300,000, to build and equip a fire station, modernize another fire station, relocate the police communications center, acquire land for and construct seven city parks, and complete numerous street-improvement projects.

"Franklin's funds were put to good civic use," Franklin said in documents filed with the court.

Stockton made four interest payments before defaulting on the 30-year loan, when it missed a payment on March 1, 2012, several months before the city filed for bankruptcy.

The city, in an evaluation of its finances before filing for bankruptcy, initially offered to restructure and extend Franklin's loan through a proposal in which the fund would ultimately recover 54.5%. Now, Franklin alleges that Stockton is trying to force through a plan that wouldn't use any future revenue to pay down the loan, providing a much smaller recovery, according to court documents.

Franklin criticized city leaders for not demanding lower payments to the California Public Employees' Retirement System. The city owes about $125 million in pension bonds, its largest debt. In total, Stockton's reorganization plan involves nearly $300 million in claims.

Additionally, much of Franklin's argument centers on the use of public facilities fees, called PFFs. PFFs are essentially a tax on the issuance of building permits, which are used to pay for municipally owned facilities. In court documents, Franklin said the Stockton plan's estimate of $500,000 in annual fees is enough to service its loan.

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.

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—Katy Stech contributed to this article.