

# **Bond Case Briefs**

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## **Fitch: Stockton Bankruptcy Ruling Opens Door to Pension Cuts.**

Fitch Ratings-New York-02 October 2014: A federal judge's verbal ruling yesterday that Stockton's payments to the California Public Employees' Retirement System (CalPERS) may be impaired is consistent with our view of pension liabilities in the bankruptcy of a municipality, Fitch Ratings says. Payments to pensions may be protected by anti-impairment language in state law, but in a federal bankruptcy proceeding they are at risk for impairment like any other liability. The ability to impair otherwise protected obligations to reset a debtor's financial profile is a key premise of municipal bankruptcy law. Bankruptcy protection provided to special revenue obligations and the preservation of statutory liens under the federal law are not affected by this outcome.

If established as a precedent, the Stockton ruling may increase incentives for distressed municipalities to seek pension cuts in bankruptcy court. However, Fitch believes those seeking bankruptcy protection will do so whether or not they can be certain of their ability to impair pensions. More likely in Fitch's view is that the ruling may encourage labor and management to negotiate pension cuts to avoid the uncertainties of bankruptcy court.

Our basic approach to ratings is therefore unaffected. The ruling supports our view that unfunded pension liabilities and high and increasing pension contributions are a risk that must be accounted for in any credit evaluation.

The impact of the ruling for Stockton's employees may be minimal, as the city has proposed no pension benefit reductions for CalPERS members. Local officials contend that previously enacted reductions to employee and retiree health benefits have already been substantial, and that further retirement benefit cuts would hurt Stockton's ability to attract and retain employees. In contrast, Detroit has proposed to reduce benefit payments to pension system members although to a lesser extent than for general government debt holders. The Stockton ruling might raise the bar for bankruptcy plan confirmation as the court must determine it is fair and equitable without pension impairment despite other creditor objection.

The Stockton ruling follows several attempts by well-functioning California municipalities with large long-term liabilities to reduce pension costs. Efforts to impose pension cuts through voter initiatives in San Jose and San Diego have been delayed by litigation and the legality of such reductions outside of bankruptcy under California and other state constitutions remains unclear.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article, which may include hyperlinks to companies and current ratings, can be accessed at [www.fitchratings.com](http://www.fitchratings.com). All opinions expressed are those of Fitch Ratings.

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