Bond Case Briefs

Municipal Finance Law Since 1971

Judge Says Cities in Bankruptcy May Reject Pension Contracts.

The federal judge overseeing the bankruptcy of Stockton, Calif., ruled that the city has the power to cut its pension obligations, a landmark decision that has implications for workers, investors and troubled municipalities across the country.

U.S. Bankruptcy Judge Christopher Klein ruled Wednesday bankruptcy laws give Stockton the power to cut ties with California Public Employees' Retirement System, or Calpers, which controls city workers' retirement money as the country's largest public pension fund. Judge Klein said that the section of the U.S. Bankruptcy Code that allows distressed cities and companies to break contracts is one of bankruptcy law's core powers.

"Pensions could be adjusted," Judge Klein said from his Sacramento courtroom.

Payments into pension funds are usually considered sacrosanct, but Judge Klein is the second judge to rule recently that they may be cut. In December, the judge overseeing Detroit's bankruptcy case ruled that such obligations aren't entitled to "extraordinary protection" despite state constitutional safeguards against benefit cuts.

"These rulings are going to carry a lot of weight," said Patrick O'Keefe, a Bloomfield Hills, Mich.-based financial consultant who has worked on municipal turnarounds but isn't involved in Stockton's case. If judges decide that bankrupt cities in Michigan and California can reduce their pension obligations, "what stops Chicago or Los Angeles from doing the same thing?"

The decision is a blow to the state's retirement system, which has argued pension payments are guaranteed by California law and can't be cut. Stockton contributes roughly $30 million a year to Calpers, which controls retirement money for municipal workers across California and has assets of roughly $294 billion.

In a statement, Calpers officials said they disagree with Judge Klein's ruling on pension impairment.

"This ruling is not legally binding on any of the parties in the Stockton case or as precedent in any other bankruptcy proceeding," the statement said.

Judge Klein didn't say Wednesday whether Stockton, which has 300,000 residents, can leave bankruptcy with a plan that doesn't cut the city's pension contributions. He said he would read his decision at an Oct. 30 hearing.

Stockton's bankruptcy lawyers said that Judge Klein should approve the plan, arguing after Wednesday's ruling that city workers have sacrificed enough.

The city cut its workforce by 30% before filing for bankruptcy in June 2012. Through a major deal on health care cuts, more than 1,000 workers and retirees who had $538 million in claims against the city agreed to accept one-time payments worth $5.1 million instead.

Throughout the city's bankruptcy, Stockton lawyers fought off pressure to make pension cuts to free up money to repay a bondholder's $37 million claim. Two funds managed by Franklin Templeton Investments, which extended the bonds for the city's fire stations and parks, argued that the city's long-term projections show that it could afford to repay more than the city's $4 million offer.

City lawyers argued that the Stockton would have to pay a $1.6 billion termination fee and that city workers would quickly find other jobs once the pension contract ends.

"The city cannot impair pensions and continue to function as a city," Marc Levinson, the city's bankruptcy lawyer, said at Wednesday's hearing.

During Wednesday's hearing, Judge Klein said Stockton has the option to leave the Calpers pension system and find a potentially cheaper option with another municipality or the private sector.

"The whole world is out there for a California municipality in terms of how it wants to handle its pensions," Judge Klein said.

Stockton filed for bankruptcy protection in June 2012 after losing tax revenue during the real-estate downturn—Judge Klein called the city "ground zero" for the subprime-mortgage crisis—and after borrowing money for new projects that it couldn't afford. Judge Klein also said that former leaders at the city, located about 80 miles inland from San Francisco, also offered overly generous pay to city workers.

Stockton's bankruptcy marked the second-largest financial failure by a U.S. city and one of several California cities, including San Bernardino and Vallejo, to seek Chapter 9 protection in recent years due to mounting pension obligations and the fallout from the financial crisis.

THE WALL STREET JOURNAL

By KATY STECH and DAN FITZPATRICK

Updated Oct. 1, 2014 8:04 p.m. ET

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com