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WSJ: A Calpers Comeuppance.

A judge says the giant public pension isn't above bankruptcy law.

A major political battle line these days is between public-union pension funds and taxpayers who pay the bills. Taxpayers won a major victory late last week when federal judge Christopher Klein ruled that the California Public Employees' Retirement System (Calpers) isn't protected from cuts in the city of Stockton's bankruptcy trial.

This is big and hopeful news because pension costs are partly responsible for driving Stockton broke. Pensions equal nearly 40% of the city payroll and are growing. The San Joaquin Valley city will spend \$28 million next year on pensions—twice as much as in 2012 when it declared bankruptcy—and \$36 million by 2020. That's one in every five tax dollars.

Yet everyone is taking a hit in bankruptcy except Calpers. The city last year raised its sales tax by 0.75% to cover rising labor costs and hire more police. Creditors are taking big haircuts. Assured Guaranty, which insures about \$121 million in pension obligation bonds, will recover about 50%. Franklin Templeton Investments has been offered a penny on the dollar for \$35 million in bonds for public works.

Calpers has nonetheless threatened to foreclose on Stockton if it isn't paid in full. When municipalities default on their pension bills, state law lets Calpers freeze worker benefits and charge a "termination fee" to cover their unfunded liability. The law also gives Calpers a lien on municipal assets. Lo, Calpers is demanding a \$1.6 billion termination fee if Stockton breaks its pension contract. Yes, billion.

In 2011 Calpers adopted a policy of discounting the termination fee at a rate tied to 10- and 30-year Treasuries in lieu of the 7.5% rate it ordinarily uses to calculate unfunded liabilities. This sleight-of-hand blows Stockton's \$212 million unfunded pension liability up to \$1.6 billion. Welcome to the Hotel Calpers. You can check out anytime you want, but you can never leave.

Judge Klein called Calpers's extortionist ploy a "golden handcuff," adding that "the city's contract with CalPERS could be rejected" and the "lien can be avoided." Once California lets a municipality file for Chapter 9, federal bankruptcy law under the U.S. Constitution's Supremacy Clause overrides state statutes. Otherwise, the judge noted, "the California Legislature can edit the federal law."

Alas, Stockton appears to prefer being handcuffed. City attorneys argue that severing ties with Calpers or reducing pension benefits would cause a "mass exodus" of workers and "irreparably damage" its ability to recruit. But despite cutting pensions for future workers, Stockton in 2012 reported a record number of police recruits—1,300 for 17 positions.

The truth is that city politicians are handcuffed by the public unions that control Calpers, and bankruptcy does not void the city's requirement under state law to collectively bargain with the unions. Calpers quickly dismissed the judge's ruling as "not legally binding" in Stockton or precedential "in any other bankruptcy proceeding." Translation: Forget you, Klein. We own the

politicians.

Yet other bankruptcy judges will likely reach the same conclusions. And later this month Judge Klein must still determine whether Stockton's bankruptcy plan is "fair and equitable." How is it fair for Stockton to pay Calpers 100 cents on the dollar while scalping Franklin and slashing payments to bondholders who financed the city's pensions?

Calpers warns that workers will be at risk if insolvent cities can use bankruptcy to impair pensions, but the bigger danger is if politicians are allowed to use Chapter 9 to protect unions while shorting other creditors. Judge Klein has it right.

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