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BANKRUPTCY - CALIFORNIA

In re City of Stockton, California

**United States Bankruptcy Court, E.D. California - February 4, 2015 - B.R. - 60
Bankr.Ct.Dec. 164**

The City of Stockton sought the Bankruptcy Court's confirmation of its chapter 9 plan of adjustment of debts.

The City of Stockton plan achieved significant net reductions in total compensation (including lower pensions for new employees and elimination of up to \$550 million in unfunded health benefits) that employees accepted in exchange for preserving existing pensions.

All capital markets creditors, except Franklin Templeton - which had issued \$36 million in bonds - accepted a package of restructured bond debt in impairments reflecting their relative rights in collateral. Franklin did not fare as well because it took collateral worth only about \$4 million to support its loan.

Franklin objected to confirmation, contending that the City's failure to modify pensions meant that the plan was not proposed in good faith.

The California Public Employees' Retirement System (CalPERS), which by contract administered the City-sponsored pensions, attempted to interject itself into the case, arguing that California law insulated its contract from rejection and that the pensions themselves could not be adjusted.

So the fundamental issue in this case was whether, as matters of law and fact, the City's chapter 9 plan should be confirmed even though the plan did not directly impair the City-sponsored pensions.

The Bankruptcy Court confirmed the City's plan, holding that:

- As a matter of law, pension contracts entered into by the City, including the pension administration contract with CalPERS, may be rejected pursuant to Bankruptcy Code § 365. 11 U.S.C. § 365;
- The California statute forbidding rejection of a contract with CalPERS in a chapter 9 case is constitutionally infirm in the face of the exclusive power of Congress to enact uniform laws on the subject of bankruptcy;
- The \$1.6 billion lien granted to CalPERS by state statute in the event of termination of a pension administration contract is vulnerable to avoidance in bankruptcy as a statutory lien;
- The Contracts Clauses of the Federal and State Constitutions, as implemented by California's judge-made "Vested Rights Doctrine," did not preclude contract rejection or modification in bankruptcy; and
- Considerations of sovereignty and sovereign immunity did not dictate a different result.

The Court also noted that the authority of CalPERS to interject itself into the potential modification of a municipal pension in California under the Federal Bankruptcy Code is doubtful. As CalPERS does not guaranty payment of municipal pensions and has a connection with a municipality only if that municipality elects to contract with CalPERS to service its pensions, its standing to object to a

municipal pension modification through chapter 9 appears to be lacking.

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