



Stockton, Bankruptcy, and Pensions (4/2/13)

On April 1, 2013, federal bankruptcy judge Christopher Klein asserted that Stockton's bankruptcy filing was in good faith and could proceed.

First, Some Background:

- We note that municipal bankruptcy filings are extremely rare, and will continue to be so. Over the last 50 years, the majority of local governmental and development authority bankruptcy filings were rejected by courts. Bankruptcy judges have wide discretion in approving municipal bankruptcy filings. Bankruptcy judges cannot dictate municipal bankruptcy settlements, but only help steer negotiations and opine as to the fairness of a proposed settlement.
- Bankruptcy is expensive, time consuming, and in most recent cases has proven to be not the best way to go. ***In short, bankruptcy filings, in and of themselves, will not be a preferred avenue for addressing fiscal duress. Nor will bankruptcy filings provide a path to lower debt payments or pension payments if an entity is not deemed to be insolvent.***

Stockton:

- The California state constitution conveys strong legal protection to the sanctity of pension payments, including increasing cost of living allowances.
- Stockton bondholders should be under no illusion that they will be "made whole". A better proposed settlement may conceivably be available if pension obligations are lowered.
- However, it remains unclear at this juncture whether the state constitutional protections granted to pension obligations will be challenged or amended in this bankruptcy filing.
- Judge Klein was quoted as follows: "The day of reckoning will be the day of plan confirmation. The city is going to have a difficult time confirming a plan over the objection of unfair discrimination". (We assume this implies bondholders vs. other creditors including pensions).
- Calpers' chief executive has stated that "Calpers would continue to act as a fiduciary as the bankruptcy progressed and protect and defend the integrity and soundness of the pension plan".
- It is our understanding that approximately 12 states adopted the California constitutional model that protects public pensions. Therefore any potential successful challenge might have national ramifications.



Summary

Municipal bankruptcy and default remain isolated events. Local governments in California confront issues specific to the state: the real estate debacle, local tax restrictions, and restrictive constitutional mandates. This particular “kettle of fish” is not generally found in other states. Jefferson County, Harrisburg, and Scranton (the other headliners) were triggered by unrelated specific events, including fraud and mismanagement.

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