LifeHealthPRO

May 13, 2015

By Steven Church, Romy Varghese

FILED UNDER: ANNUITIES, SALES STRATEGIES

Calpers' pension hammer forces 'unfair' bond ruling by judge

(Bloomberg) -- California's public retirement fund holds so much power over local officials that pension-bond investors can't expect equal treatment when a city goes bankrupt, a judge said in a ruling that she acknowledged seems "unfair."

U.S. Bankruptcy Judge Meredith Jury on Monday threw out a lawsuit in which investors had claimed their pension bonds must be paid off at the same rate as the California Public Employees' Retirement System in the San Bernardino bankruptcy. The $304 billion fund is the biggest in the U.S.

Clark Hill attorney **Robert D. Gordon**

California's public retirement fund holds so much power over local officials that pension-bond investors can't expect equal treatment when a city goes bankrupt, a judge said in a ruling that she acknowledged seems "unfair."

U.S. Bankruptcy Judge Meredith Jury on Monday threw out a lawsuit in which investors had claimed their pension bonds must be paid off at the same rate as the California Public Employees' Retirement System in the San Bernardino bankruptcy. The $304 billion fund is the biggest in the U.S.

Jury acknowledged that her decision may discourage investors from buying pension-obligation bonds in the future.

"What I see as unfair, and might seem unfair to the outside world, does not matter under law," Jury said, referring in part to the powerful remedies Calpers can seek if the city doesn't honor its contract.

'New Template'

"That's the new template," said Cohen, who recommends that her clients buy revenue bonds and avoid municipalities with high pension obligations.

San Bernardino filed for bankruptcy in 2012, blaming the high cost of fire and police labor contracts, including pensions. At first, officials balked at paying Calpers before other creditors. After months of mediation, the city agreed to repay Calpers in full and maintain normal monthly contributions on behalf of its employees.

By the end of the month, San Bernardino must file its debt-reduction plan, which will give bondholders an idea of how much they may recover. Any proposal must go to creditors for a vote before Jury makes a final decision.

Jury's ruling on the pension debt wasn't a surprise, said Robert D. Gordon, an attorney at Clark Hill PLC. Gordon represented pension systems in Detroit's record-setting municipal bankruptcy.

Contract Rights

Calpers has a contract to provide services to San Bernardino, which gives it different legal rights than the debt contract with bondholders, Gordon said.

In Detroit, pension bondholders owed about $1.4 billion and were

continued on page 2

continued from page 1

forced to take deeper cuts than city workers and retirees, some of whom recovered more than 90 percent of what they were owed.

Even before the ruling, the municipal bond market had begun treating an agency's decision to issue a pension-obligation bonds as an act of desperation, said Howard Cure, director of municipal credit research in New York for Evercore Wealth Management LLC, which oversees $5.9 billion.

Bank Sues

Pension-bond holder Erste Europaische Pfandbrief- & Kommunalkreditbank AG sued San Bernardino, claiming it should be on equal footing with Calpers. The Luxembourg bank holds about $50 million in pension-obligation bonds.

To get permission to issue the pension bonds in 2005, the city obtained a court ruling that it wasn't creating new debt but simply using the bonds to repay an existing Calpers liability, bondholder attorney Vincent J. Marriott told Jury Monday. That ruling means the bond debt should be treated the same as any debt owed to Calpers, Marriott said.

> Calpers has a contract to provide services to San Bernardino, which gives it different legal rights than the debt contract with bondholders, Gordon said.

The bankruptcy cases show there's little security for pension bondholders, Cure said. Unlike lease-revenue bonds, there's no collateral, he said.

Investors are "on the verge" of making decisions based on whether a state allows its cities or counties to file bankruptcy and the existence of state-mandated bondholder protections, Cure said.

Jury disagreed.

One of the biggest differences between pension bondholders and Calpers is simple power, Jury said. If Calpers isn't paid, it can reduce pension payments to a city's employees, she told Marriott. Bondholders don't have that kind of recourse, according to the judge.

'Right Decision'

"We feel the judge made the absolute right decision," Calpers spokeswoman Rosanna Westmoreland said in a phone interview. "Now San Bernardino can get on to working on their path forward."

In Stockton's bankruptcy, a federal judge approved cuts to bondholders, while allowing the city to fully repay Calpers. The judge ruled that Stockton could have tried to reduce its obligation to Calpers also, since pension debt has the same general priority as other debt that's not backed by collateral.

The city argued that fighting Calpers would take too long and could endanger employee pensions.

The San Bernardino case is Erste Europaische Pfandbrief und Kommunalkreditbank AG v. City of San Bernardino 15-ap-01004. The bankruptcy case is In re San Bernardino, 12-bk-28006, U.S. Bankruptcy Court, Central District of California (Riverside).

Robert D. Gordon leads Clark Hill's Corporate Restructuring & Bankruptcy Practice Group. Robert focuses his practice in the areas of corporate reorganization, bankruptcy and insolvency-related matters, debtor and creditor rights, workouts, and related commercial litigation. **Contact him via phone: (248) 988-5882 or email: rgordon@clarkhill.com.**