



ALERT

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SETTLING MAY ENHANCE A CREDITOR'S STANDING IN A MUNICIPAL BANKRUPTCY, NINTH CIRCUIT HOLDS

By Michael Viscount

Amid the continuing buzz of a potential municipal bankruptcy filing by Atlantic City, anyone that might find themselves in the position of creditor would be wise to take a few lessons from the still unfolding municipal bankruptcy in Stockton, CA.

One important lesson came in a recent opinion from the U.S. Bankruptcy Appellate Panel of the Ninth Circuit that addressed the appeal of a capital markets/bond creditor.

The takeaway — creditors who choose to settle may be treated better in the end and objections from non-settling creditors about the disparity in treatment just might fall on deaf ears.

In the appeal, Franklin Funds complained that the unsecured portion of its claim was treated differently than that of other capital market/bond creditors who settled. The unsecured portion of Franklin's claim was classified with those of other general unsecured creditors who were paid a penny on the dollar, while other settling creditors, including capital markets creditors and pension claimants who did settle, arguably did better. Unsatisfied, Franklin opposed confirmation of the plan and appealed to the Ninth Circuit.

Notably, the Ninth Circuit concluded that different creditors with the same kinds of claims can legally be treated differently depending upon whether they had settled. The court rejected Franklin's argument that its unsecured claim has to be given the same treatment as those of the creditors that settled and whose claims were classified separately from the body of general unsecured claims.

The court said settlements can legally be incorporated into the plan in each instance as a separate class for claim treatment purposes, provided that the municipality can establish that each settlement made "legitimate business and economic sense."

In addition, because Franklin was merely a dissenting creditor in an accepting class, the court said, there was no need to for a cram-down analysis to determine whether the plan was fair and equitable as to Franklin.

Readers may wish to skip over pages 18-30 in the ruling in [Franklin High Yield Tax-Free Income Fund v. City of Stockton](#) to avoid the court's lengthy discussion of the city's equitable mootness argument.

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