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WSJ: Creditors Win Bid to Challenge Detroit Bankruptcy.

DETROIT—A legal challenge in Detroit's municipal bankruptcy case must be heard before a trial on the city's debt-cutting plan, a federal appeals court ruled late Wednesday.

The Sixth Circuit Court of Appeals said a lower district court judge improperly held up an appeal by municipal bond insurer Syncora questioning the city of Detroit's use of casino tax revenue during the case.

"In a bankruptcy case of such scope and complexity, that is not the proper way to adjudicate appeals that implicate legal questions of fundamental importance to the bankruptcy proceedings," the 6th Circuit Court of Appeals said in its ruling.

By ordering the lower court to act, a federal appeals court may have thrown a potential wrench in the timetable to exit the city of Detroit from municipal bankruptcy by this fall.

The appeals court ordered a federal-district court judge to rule by July 14 on a request by Syncora Guarantee Inc. and its associated Syncora Capital Assurance Inc. to stop the city from using its casino tax revenue rather than preserve the funds potentially to pay back creditors including Syncora. The city generates about $170 million a year from taxes levied on its three casinos.

"Without a final decision on that question, the city will not know what amount its coffers will contribute to the bankruptcy estate, the creditors cannot know the size of the pie they are being asked to share, and the bankruptcy court cannot be confident that it is considering a legally and financially viable plan," the appeals court said Wednesday.

A trial before a federal bankruptcy judge on the city's proposed debt-cutting plan to resolve an estimated $18 billion in long-term obligations is scheduled to begin Aug. 14. It wasn't immediately clear whether the appeals court ruling would push back the beginning of the trial in the nation's largest municipal bankruptcy case. The city's emergency manager had hoped to see the city exit Chapter 9 bankruptcy by the end of September when his term is set to end.

A representative for Syncora didn't have an immediate comment.

Bill Nowling, spokesman for Detroit Emergency Manager Kevyn Orr, said in an email Wednesday night that "it is too soon to say what impact (the ruling) could have on the length of the bankruptcy proceedings."

Detroit made ill-fated interest-rate bets known as swaps with Wall Street banks in the hopes of avoiding higher rates. They were tied to $1.4 billion in bonds the city issued from 2005 to help address funding shortfalls in its pension funds.

In 2009, to escape default on the original deal, the city pledged the casino tax revenue as collateral. When the city filed for bankruptcy, other creditors including Syncora tried to stop it from getting casino-tax revenue, which the city says it needs to stay afloat.

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