

# **Bond Case Briefs**

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## **Detroit Defends Right to Enter Chapter 9.**

Detroit defended its right to enter into bankruptcy Friday in a 135-page court paper that tackles creditors' objections one by one and offers a few glimpses into arguments it may use down the road to justify proposals to cut pensions protected by the Michigan Constitution.

The filing comes ahead of the first hearing in a two-stage trial beginning later this month to determine if the city is eligible to enter into Chapter 9 bankruptcy protection. If approved by the federal courts, the case would become the largest municipal bankruptcy in U.S. history.

Also this week, U.S. Bankruptcy Judge Steven Rhodes, who is overseeing the case, is expected to hear arguments Tuesday about whether Gov. Rick Snyder, the state treasurer and other top officials can be compelled to testify in the case. The unions filed subpoenas requesting their testimony last week. Another hearing is set for Wednesday.

Creditors objecting to Detroit's filing had until Aug. 19 to file objections to the city's eligibility. No bondholders or bond insurers objected.

The city's court documents address the roughly 109 challenges filed by unions, pensions funds, and dozens of individual creditors that range from challenging the constitutionality of municipal bankruptcy to the notion that Detroit is truly insolvent.

"This Chapter 9 case is the city's sole remaining option to address its financial condition and enhance its ability to provide its citizens with core municipal services," the city argues at the conclusion of the filing.

The state also weighed in Friday with a court brief that argues the city is eligible.

Michigan's filing, which came from Attorney General Bill Schuette's office, argues as Detroit does that objections on the grounds that creditors' claims — mostly pensions — will be impaired are invalid, because the city has not yet formally proposed impairing pensions or other debts. Authorizing Chapter 9 itself does not impair pensions, the city argued.

"These are simply steps that begin the bankruptcy process, where pensions may be impaired by order of a federal bankruptcy court at some later date," Bennett wrote.

The challenge is not an obstacle to eligibility, the city and state argued, and should only be considered by the court later in the case, when the city unveils a formal restructuring plan.

Rhodes already appears to agree with that argument, ruling in August that he will not consider any pension-related constitutional challenges as part of the eligibility trial.

To enter into bankruptcy, Detroit has to prove that it is insolvent, that it negotiated in good faith with its creditors or that such negotiations were too difficult, and that it has the authority to file for Chapter 9 under state law.

The city's attorneys, led by Bruce Bennett of Jones Day, argued that it is empowered by the state's law for distressed local governments to file for Chapter 9, and each requirement under the law was met prior to the filing.

The Michigan Constitution does not bar a city from seeking bankruptcy and does not impose any conditions on the city as part of the move, the city contended.

"None of the objections contest any of the foregoing points," Bennett wrote. "Instead, the objectors invent additional requirements, not found in the Michigan Constitution, and then allege that these additional requirements have not been met," the filing says.

On the question of whether Detroit negotiated in good faith or such negotiations were too difficult, which many legal experts expect to be one of the more difficult criteria for the city to prove, attorneys argue that local officials met repeatedly with creditors, that none produced counterproposals to the city's plans, and that negotiating with "more than 100,000 holders" was impracticable.

The unions cannot represent all of Detroit's 20,000 retirees in negotiations — some even refused to do so during negotiations — and the fact that none of the thousands of bondholders objected to the eligibility support the impracticability of negotiations, the city argued.

The court documents devote nearly 14 pages to refuting one of the most surprising and wide-reaching challenges. The city's largest union, the Michigan chapter of the American Federation of State, County, and Municipal Employees, argued that Chapter 9 violates the U.S. Constitution in part by violating states' rights, and that the bankruptcy court does not have the jurisdiction to decide whether Chapter 9 is unconstitutional.

In response, city attorneys said the question has been settled for more than 70 years and objectors offer no compelling reasons for a fresh look. Further, states preserve their sovereignty rather than relinquish it by seeking the help of federal courts to impair their contracts, attorneys argued.

The documents offer a glimpse of what the city may argue down the road if it unveils a plan that calls for cutting pensions. The so-called Pensions Clause in the Michigan Constitution protects the pensions from impairment by the state, and not necessarily from the federal court, the city argues.

"Instead of adhering to the plain terms of the Pensions Clause that require the state to refrain from impairing pensions, the objectors contend that the Pensions Clause should be read to require state officials to take affirmative steps to prevent even the possibility of the federal bankruptcy court from impairing pensions in Chapter 9. This is not an interpretation of the Pensions Clause but a complete rewriting of it," Bennett argues. "While the state may act as a gatekeeper in determining whether to authorize a Chapter 9 filing, state law cannot alter or override the federal scheme for determining the tools of debt adjustment that a municipal debtor may use once it is in bankruptcy."

Rhodes has scheduled two phases for the eligibility trial.

On Sept. 18 and 19 he will hear arguments over constitutional objections to the bankruptcy, such as whether Chapter 9 is unconstitutional and whether Michigan's law for distressed local governments is valid, among others.

On Oct. 23 and 24 the judge will hear factual objections to eligibility, including whether the city is insolvent or negotiated in good faith ahead of the July 18 filing.

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