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NYT: Detroit Is Ruled Eligible for Bankruptcy.

DETROIT — The struggling metropolis of Detroit, overwhelmed by debt and groping for a path forward, on Tuesday became the largest American city ever to qualify for bankruptcy protection.

Judge Steven W. Rhodes of the United States Bankruptcy Court, found that Detroit was insolvent and that the pension checks of retirees could be cut during a bankruptcy proceeding, a crucial part of his decision.

Under the ruling, the vastly diminished city, once the nation's fourth largest and the cradle of the American auto industry, will now be allowed to search for a way to pay off some portion of its debts and restore essential services to tolerable levels under court supervision. The goal, according to an emergency manager appointed by the state of Michigan, is to emerge next year from court protection with a formal plan for starting over.

"This once proud and prosperous city cannot pay its debts. It is insolvent. It's eligible for bankruptcy," Judge Rhodes said Tuesday. "But it also has an opportunity for a fresh start."

The decision was an essential step in municipal bankruptcy proceedings, which are extremely rare. Lawyers for the city's public sector unions and retirees, who contend that Detroit's request for bankruptcy protection earlier this year came before city officials truly tried to negotiate deals with city workers and creditors, have said they intend to appeal.

The city needs help, he said. As the proceedings unfolded, protesters with signs gathered outside and the police blocked the street to traffic in front of federal courthouse.

Detroit filed for municipal bankruptcy protection in July, with approval from Gov. Rick Snyder, , making it the largest city in the nation's history to take such a rare step. The filing was also the largest ever in terms of municipal debt; the emergency manager, Kevyn Orr, says the city carries about $18 billion in debt, including $3.5 billion in unfunded pension obligations.

Most agreed the situation was dire: annual operating deficits since 2008, a pattern of new borrowing to pay for old borrowing, a shrunken population and tax base, and miserably diminished city services. But under federal bankruptcy provisions for municipalities, known as Chapter 9, a city must first prove its eligibility for protection before it can proceed with a plan to pay diminished sums to creditors.

Under the law, a city must not only be deemed insolvent, but also must negotiate in "good faith" with its creditors, who expect to be offered far less than they are owed, or be unable to negotiate with them because such talks are unworkable. For months, municipal bankruptcy experts have said it might be difficult to prove that city and state officials had failed to meet such a standard. "There isn't a bright-line definition of 'good faith' in this context," Douglas C. Bernstein, a Michigan lawyer and bankruptcy expert, said.

Detroit's public workers and retirees had hoped to keep the city out of federal bankruptcy court, for fear that the proceedings there would allow for cuts in their benefits, especially pensions. Other than in bankruptcy, the state constitution prohibits reducing pensions that public workers have already earned. But there appears to be too little money set aside in Detroit's pension fund to cover the full cost of those accruals.

Judge Rhodes ruled Tuesday that Michigan's protections for public pensions "do not apply to the federal bankruptcy court," adding that pensions are not entitled to "any extraordinary attention" compared with other debts.

Labor agreements, including pensions, are subject to changes during a bankruptcy proceeding, the judge said, but the court "will not lightly or casually exercise the power to impair pensions."

Those objecting to the city's pursuit of bankruptcy protection, including Detroit's employee unions and representatives of its retirees, say Mr. Orr, who was appointed by Governor Snyder, failed to negotiate with them in good faith. During nine days of heated and sometimes emotional testimony in recent weeks, the opponents had suggested that Mr. Snyder and Mr. Orr had forced the city into bankruptcy without truly searching for some other solution. They said that the officials were seeking a way around the state's constitutional protection of pensions without giving workers and retirees a chance to negotiate concessions.

Lawyers for the state and for Detroit, in turn, said that the city's slide into insolvency had been years in the making, and that state officials had tried for more than a year to find some alternative approach to solving the financial crisis, — through efforts by elected leaders at Detroit's city hall and later a consent agreement with the city. They said that the city could no longer afford its current pension plan and must replace it with a less costly one. Representatives for city workers and retirees had never suggested some way to solve the problem without cutting pensions, the lawyers said. In a deposition, Mr. Snyder, a Republican whose first term as governor has been defined by the bankruptcy filing by the state's most populous city, said good faith negotiations over the issue had broken down, and that officials found themselves "at that last resort point."

Regardless of the court's eligibility decision, some experts said the task ahead for Detroit remained largely the same — whether in or out of the courts. "Ultimately the creditors have to come together with the debtor and realize that they need to work together to come up with a solution," said James E. Spiotto, a Chicago lawyer and an expert on municipal bankruptcy. "No matter what, at some point, that reality needs to sink in."