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NYT: Detroit Ruling on Bankruptcy Lifts Pension Protections.

DETROIT — In a ruling that could reverberate far beyond Detroit, a federal judge held on Tuesday that this battered city could formally enter bankruptcy and asserted that Detroit's obligation to pay pensions in full was not untouchable.

The judge, Steven W. Rhodes, dealt a major blow to the widely held belief that state laws preserve public pensions, and his ruling is likely to resonate in Chicago, Los Angeles, Philadelphia and many other American cities where the rising cost of pensions has been crowding out spending for public schools, police departments and other services.

The judge made it clear that public employee pensions were not protected in a federal Chapter 9 bankruptcy, even though the Michigan Constitution expressly protects them. "Pension benefits are a contractual right and are not entitled to any heightened protection in a municipal bankruptcy," he said.

James E. Spiotto, a lawyer with the firm Chapman & Cutler in Chicago who specializes in municipal bankruptcy and was not involved in the case, said: "No bankruptcy court had ruled that before. It will be instructive."

For people in Detroit, the birthplace of the Motown sound and of the American auto industry, Judge Rhodes's decision that the city qualified for bankruptcy amounted to one more miserable, if expected, assessment of its woeful circumstances. The city has lost hundreds of thousands of residents, the judge said, only a third of its ambulances function, and its Police Department closes less than 9 percent of cases.

"This once proud and prosperous city can't pay its debts," said the judge, who sits in United States Bankruptcy Court for the Eastern District of Michigan. "It's insolvent. It's eligible for bankruptcy. But it also has an opportunity for a fresh start."

Appeals were expected to be filed quickly. At least one union filed a notice of appeal on Tuesday, and other unions and pension fund representatives said they were considering contesting the outcome as well. But the ruling also allows Kevyn D. Orr, an emergency manager assigned in March by the state to oversee Detroit's finances, to proceed swiftly with a formal plan for starting over — a proposal to pay off only a portion of its $18 billion in debts and to restore essential services, like streetlights, to tolerable levels.

Mr. Orr said he intended to file the formal blueprint, known as a "plan of adjustment," by the first week of 2014. That plan could include efforts to spin off city departments to outside entities, to sell city assets and to reinvest in failing city services. Mr. Orr has said his goal is to bring Detroit, the nation's largest city ever to find itself in bankruptcy, out of the court process by next fall.

"We have some heavy work ahead of us," Mr. Orr said Tuesday.

Around Detroit, leaders sounded somber but mildly hopeful tones. Mayor-elect Mike Duggan said that Tuesday was a day no one wanted to see, but that the city now needed to move forward. And Dave Bing, the departing mayor, whose tenure in office has been consumed by the financial distress, said it was inevitable that Detroit would ultimately be found insolvent. “We are now starting from Square 1,” he said.

Municipal workers and retirees said they were shaken by the developments, and unsure what to expect. Any cut to pensions, many said, would be crushing.

“The impact of this is going to be catastrophic on families like mine on fixed income,” said Brendan Milewski, 34, a Detroit firefighter who was seriously injured in an arson in 2010 and said he received a pension of $2,800 a month from the city. “Retirees are going to be put out of house and home. They’re not going to be able to afford a car, food or medicine.”

Bruce Babiarz, a spokesman for the Detroit Police and Fire Retirement System, was blunt in his assessment. “This is one of the strongest protected pension obligations in the country here in Michigan,” he said. “If this ruling is upheld, this is the canary in a coal mine for protected pension benefits across the country. They’re gone.”

Since July, Mr. Orr, with approval from Gov. Rick Snyder, a Republican, has sought bankruptcy protection, and most here agree that the city’s situation is dire: Annual operating deficits since 2008, a pattern of new borrowing to pay for old borrowing, miserably diminished city services, and the earmarking of about 38 percent of tax revenues for debt service. A city that was once the nation’s fourth largest has dropped to 18th, losing more than half of its population since 1950. The city was once home to 1.8 million people but now has closer to 700,000.

Judge Rhodes rejected arguments by unions and other opponents that the bankruptcy filing was the result of secret and unconstitutional decisions made by Mr. Snyder and others. He agreed with opponents of the bankruptcy that the city had failed to make “good faith” attempts to negotiate with creditors, but said that such negotiations had been “impracticable.”

In perhaps the most contested portion of the case, the judge made it clear that federal bankruptcy law trumps the state law when it comes to protections for public employees’ pensions, making the pensions of 23,000 retirees fair game for the city to include in its plan of adjustment. But while the judge said pensions could not be treated differently from other unsecured debt, he said the court would be careful before approving any cuts in monthly payments to retirees.

That seemed to be of little comfort to union leaders, who denounced the ruling as illegal and immoral.

Lee Saunders, the president of the American Federation of State, County and Municipal Employees, said the ruling, in essence, put a “bull’s eye” on the backs of municipal workers and retirees by saying pensions are vulnerable. “It sets a bad precedent for cities that are under economic distress to look at doing the easy thing: to attack the workers and attack the retirees,” Mr. Saunders said.

Experts said the decision seemed unlikely to prompt a rush of bankruptcy filings by cities, but was likely to give cities more leverage over pensions in negotiations before bankruptcies. Detroit has included $3.5 billion in unfunded pension liabilities in its larger mound of debt, and city lawyers say it can simply no longer afford its pension plan.

For his part, Mr. Orr said he had a difficult reality to present to retirees. “There’s not enough money to address the situation no matter what we do,” he said. “That is clear.” At another point, he said of the pension question, “We’re trying to be very thoughtful, measured and humane about what we have to do.

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