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NYT: Detroit Bankruptcy Deadline May Be Missed, Imperiling State Funds.

The federal judge handling Detroit's bankruptcy indicated on Thursday that the current timetable for finishing the case might be unrealistic given the many disputes outstanding, raising questions about whether Detroit can exit bankruptcy before the end of its emergency manager's term.

Judge Steven Rhodes made the observation in a hearing after saying he had heard that the state had promised to give Detroit some money — but only if the city could get him to approve its bankruptcy exit plan by the end of September. He said state lawmakers needed to understand he could not guarantee meeting that deadline.

"There are a bazillion things that could happen between now and Sept. 30," the judge said.

Judge Rhodes seemed to be alluding to the thick stack of objections to Detroit's bankruptcy plan that piled up in the courthouse this week in response to a deadline. For months, a team of mediators has been trying to negotiate out-of-court settlements to Detroit's many obligations, and until recently it seemed to be having remarkable success, particularly with the so-called grand bargain, which proposed to use the city's famous art collection to raise $816 million for retirees' pensions. The grand bargain calls for $466 million from private foundations and the Detroit Institute of Arts and a $350 million appropriation from the state — with the contingency that Judge Rhodes said he heard about through the grapevine.

Many of the new objections complain that Detroit is improperly proposing to treat its pensioners more favorably than its investors, and some of them cite the art deal as an example of what is wrong. Bankruptcy law requires debtors to treat similarly situated creditors equitably, and now creditors are arguing that Detroit's proposal must be rejected because it fails to do so.

"The debtor's plan is hopelessly defective," said one creditor, Syncora Capital Assurance, in a filing that arrived on Monday. "If it were an automobile, it would be pronounced a lemon and promptly sent to the scrapyard."

Detroit's plan of debt adjustment, which lays out the terms it wants to use to settle its various debts, is scheduled to go to trial in July, when Judge Rhodes will have to decide how to handle any remaining objections. Even before the judge warned that the timetable might be unrealistic, bankruptcy experts said they were taken aback by the number and complexity of objections to the plan and wondered how the judge would manage it all.

"This case is a law school exam," said David Skeel, a bankruptcy law professor at the University of Pennsylvania. "Every issue you could possibly want to ask about a recovery plan is being raised. Even teachers who teach this over and over don't know all the issues."

Some of the new objections come from investors that had not complained about Detroit's approach until now. In addition to their concerns about equitable treatment, some go to great length to explain the laws underlying municipal securities, which can be very different from those governing the corporate debts that turn up in Chapter 11 bankruptcies. Some of Detroit's bonds fall into a

category that has never been impaired in bankruptcy before, and the holders are resolute that it cannot happen in Detroit.

Mr. Skeel and other bankruptcy experts said it would be difficult, though not impossible, to negotiate settlements to so many disputes before the all-important confirmation hearing in July. Most parties to a bankruptcy prefer to settle before the final trial, even if it means bearing a loss, because they know that if they go to trial the judge may leave them with an even bigger loss, and an unfavorable legal precedent to boot.

“Everybody wants to go into July with as few major objections left as possible,” Mr. Skeel said. “No one wants to be surprised. If the plan is fatally flawed, that has to be discovered now, and not in July. There’s a possibility that if you’ve got a battle royale, the whole thing gets derailed.”

Officials have been pushing Detroit to get everything squared away by September, when the term of its emergency manager, Kevyn Orr, expires and the city’s elected leaders will regain their full powers. Now, though, backup plans are being prepared to bring in a new emergency manager if the city is still mired in bankruptcy when Mr. Orr departs.

The hearing on Thursday was originally scheduled to hear the arguments of two bond insurers that stand behind Detroit’s shakiest debt — about $1.4 billion of certificates issued in 2005 and 2006 to raise money for Detroit’s pension system. Not only has Detroit stopped making its payments on the certificates, it has filed a lawsuit arguing that the borrowing was illegal to begin with and that the certificates are unenforceable.

Detroit’s plan of adjustment says the two insurers — Syncora and the Financial Guaranty Insurance Company — have no valid claim in the bankruptcy and that it does not owe them a cent. But it offers to accept 40 percent of the certificates as valid if the creditors in this group will vote for its overall plan of adjustment. The result would be a small recovery, perhaps about 5 cents on the dollar of the certificates’ face value. Along with the two insurers are several European banks that bought certificates that were not insured.

Financial Guaranty has responded with a counterclaim to Detroit’s lawsuit. It argues that the 2005 deal was perfectly legal, but that if Judge Rhodes finds that it was not, then the city’s pension system will have to disgorge the $1.4 billion and send it back to the investors. Such an outcome would severely undermine Detroit’s hopes of getting its books balanced and coming back to normal.

Judge Rhodes questioned Financial Guaranty’s lawyer, Alfredo Perez, about its counterclaim and said he would issue a written opinion later on whether the insurer could proceed.

He also granted limited permission to the insurer’s request to determine whether investment bankers can improve on Detroit’s proposal to raise money connected to the city’s art collection, a crucial part of the grand bargain. Judge Rhodes said Financial Guaranty could work with officials of the Detroit Institute of Arts on evaluating artwork that the museum now has in storage, but barred it from removing any of the works on display to have them appraised. He also denied the creditors’ motion seeking detailed records of how the art came to be in the museum’s collection. The creditors had said the records would show which artwork was given to the institute free and clear, and which was given with instructions that might make it hard to sell.

Before the hearing on Thursday, Financial Guaranty went out and tested the market appetite for Detroit’s collection and came back with four bids for some or all of the artwork. The bids differ widely, but the insurer contends they show that Detroit could raise a lot more money by simply marketing even some of the artwork than it has by tying it up in the grand bargain.

No one can force Detroit to sell its art collection, but Financial Guaranty says that if Detroit does decide to sell the art, then the terms must meet the requirements of bankruptcy law: The sale must be an arms-length transaction, and the proceeds must be distributed equitably, not channeled to a single, favored group of creditors. The insurer says the grand bargain fails these tests because the terms are not arms-length, and all the proceeds would be used to pay pensions, shutting out the bondholders.

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