

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

IN RE: CITY OF DETROIT, . Docket No. 13-53846
MICHIGAN, .
. Detroit, Michigan
. December 3, 2013
Debtor. . 10:00 a.m.
.

HEARING RE. BENCH OPINION RE. ELIGIBILITY
BEFORE THE HONORABLE STEVEN W. RHODES
UNITED STATES BANKRUPTCY COURT JUDGE

APPEARANCES:

For the Debtor: Jones Day
By: DAVID G. HEIMAN
North Point
901 Lakeside Avenue
Cleveland, OH 44144-1190
(216) 586-7175

Jones Day
By: BRUCE BENNETT
555 South Flower Street
Fiftieth Floor
Los Angeles, CA 90071-2452
(213) 243-2382

Jones Day
By: HEATHER LENNOX
222 East 41st Street
New York, NY 10017
(212) 326-3837

Pepper Hamilton, LLP
By: ROBERT S. HERTZBERG
DEBORAH KOVSKY-APAP
4000 Town Center, Suite 1800
Southfield, MI 48075-1505
(248) 359-7333

For the State of Michigan: Dickinson Wright, PLLC
By: STEVEN G. HOWELL
500 Woodward Avenue, Suite 4000
Detroit, MI 48226-3425
(313) 223-3033

APPEARANCES (continued):

| | |
|---|---|
| For the Official Committee of Retirees: | Dentons By: CLAUDE MONTGOMERY CAROLE NEVILLE 1221 Avenue of the Americas New York, NY 10020-1089 (312) 632-8390 Dentons US, LLP By: SAM J. ALBERTS 1301 K Street, NW Suite 600, East Tower Washington, DC 20005-3364 (202) 408-7004 Brooks, Wilkins, Sharkey & Turco, PLLC By: MATTHEW E. WILKINS 401 South Old Woodward, Suite 400 Birmingham, MI 48009 (248) 971-1711 |
| For Detroit Retired City Employees Association, Retired Detroit Police and Fire Fighters Associa- tion, Shirley V. Lightsey, and Donald Taylor: | Lippitt O'Keefe, PLLC By: RYAN C. PLECHA 370 East Maple Road, 3rd Floor Birmingham, MI 48009 (248) 723-6263 |
| For AFSCME, AFL-CIO, and Sub- Chapter 98, City of Detroit Retirees: | Lowenstein Sandler, LLP By: SHARON L. LEVINE 65 Livingston Avenue Roseland, NJ 07068 (973) 597-2374 |
| For Detroit Retirement Systems- General Retirement System of Detroit, Police and Fire Retirement System of the City of Detroit: | Clark Hill, PLC By: ROBERT GORDON 151 South Old Woodward, Suite 200 Birmingham, MI 48009 (248) 988-5882 |

APPEARANCES (continued):

For the Detroit Fire Fighters Association, the Detroit Police Officers Association and the Detroit Police Lieutenants & Sergeants Association:

Erman, Teicher, Miller, Zucker & Freedman, P.C.
 By: BARBARA A. PATEK
 CRAIG E. ZUCKER
 EARLE I. ERMAN
 400 Galleria Officentre, Suite 444
 Southfield, MI 48034
 (248) 827-4100

For Retired Detroit Police Members Association:

Strobl & Sharp, PC
 By: LYNN M. BRIMER
 MEREDITH E. TAUNT
 MALLORY A. FIELD
 300 East Long Lake Road, Suite 200
 Bloomfield Hills, MI 48304-2376
 (248) 540-2300

Court Recorder: Letrice Calloway
 United States Bankruptcy Court
 211 West Fort Street
 21st Floor
 Detroit, MI 48226-3211
 (313) 234-0068

Transcribed By: Lois Garrett
 1290 West Barnes Road
 Leslie, MI 49251
 (517) 676-5092

Proceedings recorded by electronic sound recording,
 transcript produced by transcription service.

1 THE CLERK: All rise. Court is in session. Please
2 be seated. Case Number 13-53846, City of Detroit, Michigan.

3 THE COURT: Counsel, would you like to put your
4 appearances on the record, please?

5 MR. HEIMAN: David Heiman, Jones Day, on behalf of
6 debtors, and with me today are Bruce Bennett and Heather
7 Lennox and Bob Hertzberg as well.

8 MR. HOWELL: Good morning, your Honor. Steven G.
9 Howell, Dickinson Wright, special assistant attorney general,
10 appearing on behalf of the State of Michigan.

11 MR. MONTGOMERY: Good morning, your Honor. Claude
12 Montgomery of Dentons, and with me are Carole Neville and Sam
13 Alberts from Dentons and Matt Wilkins as local counsel.

14 MR. PLECHA: Good morning, your Honor. Ryan Plecha
15 from Lippitt O'Keefe on behalf of the retiree association
16 parties.

17 MS. LEVINE: Good morning, your Honor. Sharon
18 Levine, Lowenstein Sandler, for AFSCME.

19 MR. GORDON: Good morning, your Honor. Robert
20 Gordon of Clark Hill on behalf of the Detroit Retirement
21 Systems.

22 MS. PATEK: Good morning, your Honor. Barbara Patek
23 of Erman, Teicher, Miller, Zucker & Freedman, and with me are
24 Craig Zucker and Earle Erman on behalf of Detroit public
25 safety unions.

1 MS. BRIMER: Good morning, your Honor. Lynn M.
2 Brimer appearing on behalf of the Retired Detroit Police
3 Members Association. With me this morning are Meredith Taunt
4 and Mallory Field.

5 THE COURT: The Court decided to provide this
6 summary of its written opinion, which it will issue shortly,
7 because it is important to give the people of the City of
8 Detroit the best opportunity to understand what the Court is
9 ruling and why. I would not call this a brief summary. It's
10 a bit extended, so settle in, please. The written opinion
11 will be over 140 pages, and it will address in more detail
12 and with more legal and factual support all of the arguments
13 that have been made regarding eligibility. I thought this
14 summary would be more accessible. It is critical to the
15 process, indeed, to any judicial process, that those who are
16 impacted by the Court's ruling have confidence that they were
17 heard and that their arguments and concerns were fully and
18 fairly considered.

19 The matter is before the Court on the parties'
20 objections to the eligibility of the city to be a debtor in
21 this Chapter 9 case under Section 109(c) of the Bankruptcy
22 Code. The City of Detroit was once a hard-working, diverse,
23 vital city, the home of the automobile industry, proud of its
24 nickname, The Motor City. It was rightfully known as the
25 birthplace of the American automobile industry. In 1952, at

1 the height of its prosperity and prestige, it had a
2 population of 1,850,000 residents. It was building half of
3 the world's cars.

4 The evidence establishes, however, that for decades
5 the City of Detroit has experienced dwindling population,
6 employment, and revenues. This has led to decaying
7 infrastructure, excessive borrowing, mounting crime rates,
8 spreading blight, and a deteriorating quality of life. The
9 city no longer has the resources to provide its residents
10 with basic police, fire, and emergency medical services that
11 its residents need for their basic health and safety. To
12 reverse this decline in basic services and to attract new
13 residents and businesses and to revitalize and reinvigorate
14 itself, the city needs help.

15 The city estimates that its debt is \$18 billion.
16 This consists of 11.9 billion in unsecured debt and 6.4
17 billion in secured debt. It has more than 100,000 creditors.
18 According to the city, this unsecured debt includes \$5.7
19 billion for other post-employment benefits through June of
20 2011, which is the most recent actuarial data available; 3.5
21 billion in unfunded pension obligations; \$650 million in
22 general bond obligations; \$1.43 billion for certificates of
23 participation related to the pensions; \$346.6 million for
24 swap contracts, liabilities related to the certificates of
25 participation; and \$300 million of other liabilities. Except

1 for the unfunded pension liability, the parties -- the
2 objecting parties do not seriously challenge the city's
3 estimates of this debt. The pension plans and others have
4 suggested a much lower pension underfunding amount, perhaps
5 even below \$1 billion. However, the Court concludes that it
6 is not necessary to resolve this issue at this time.
7 Otherwise, the Court is satisfied that the city's estimates
8 of its other liabilities are accurate enough for purposes of
9 determining eligibility, and the Court so finds.

10 For the five years ending with fiscal year 2012,
11 pension payments exceeded contributions and investment income
12 by approximately \$1.7 billion for the General Retirement
13 Systems and \$1.6 billion for the Police and Fire Retirement
14 Systems. This, of course, resulted in the liquidation of
15 pension trust principal.

16 Using current actuarial assumptions, the city's
17 required pension contributions as a percentage of eligible
18 payroll expenses are projected to grow from 25 percent for
19 the GRS and 30 percent for the PFRS in 2012 to 30 percent for
20 the GRS and 60 percent for the PFRS by 2017. Changes in
21 actuarial assumptions would further increase the city's
22 required pension contributions. During 2012, 39 percent of
23 the city's revenue was used to service legacy liabilities.
24 The forecasts for subsequent years, assuming no
25 restructuring, are 43 percent for 2013 going up to 65 percent

1 for 2017.

2 The Court will now address the transactions referred
3 to as the certificates of participation, often called the
4 COP's, and the swaps associated with them. These
5 transactions are complex and confusing, and so is the
6 resulting litigation. The Court will provide only the
7 briefest summary of them at this time.

8 In 2005 and 2006, the city decided to raise \$1.4
9 billion for its underfunded pension funds. A substantial
10 part of this funding was at an interest rate that would float
11 with the market. If the market interest rate went up, so did
12 the rate on the COP's and vice versa. As part of the
13 transaction, therefore, the city decided to try to protect
14 itself against interest rates going up, so it entered into a
15 wager. The more common name for this is a swap, but it's
16 nothing more than a common bet. If the rate went up, someone
17 would pay the city to help cover the increased interest
18 expense. If the rate went down, the city would have to pay.
19 In 2008 interest rates dropped dramatically. As a result,
20 the city lost on the swaps bet. Actually, it lost
21 catastrophically on the swaps bet. The city estimates that
22 the damage will be approximately \$45 million per year for the
23 next ten years. The result has been complex and expensive
24 litigation. In any event, the city estimates that as of June
25 30, 2013, it may owe \$480 million from the 2005 COP's and

1 \$949 million on the 2006 COP's. It also has a potential
2 liability in excess of \$300 million on the swaps, although
3 the city has serious and substantial challenges to those
4 amounts.

5 Debt service from the city's general fund related to
6 limited tax and unlimited general obligation debt and the
7 COP's was \$225 million for fiscal year 2012 and is projected
8 to exceed \$247 million in 2013. The city estimates that 38
9 percent of tax revenues go to debt service rather than city
10 services. It further estimates that without changes, this
11 will increase to 65 percent within five years. At the same
12 time, however, tax revenues are going down. State revenue
13 sharing is also going down. It has decreased by \$161
14 million, 48 percent, since 2002 and by \$67 million, 31
15 percent, since 2008.

16 The city has experienced large operating deficits
17 for each of the past seven years. Through 2013, it has an
18 accumulated general fund deficit of \$237 million. However,
19 this includes the effect of recent debt issuances. The city
20 borrowed \$75 million in 2008, \$250 million in 2010, and \$129
21 million in 2013. If the city had not borrowed these amounts,
22 the city's accumulated general fund deficit would have been
23 \$700 million through 2013. In 2012, the city had a negative
24 cash flow of \$115 million excluding the proceeds from
25 borrowings. In March of 2012, to avoid running out of cash,

1 the city borrowed \$80 million. In 2013, the city deferred
2 payments on certain of its obligations totaling \$120 million
3 for current and prior year pension contributions and other
4 payments.

5 Absent restructuring, the city projects it will have
6 negative cash flows of \$190 million for 2014 increasing to
7 \$346 million for 2017. The city further estimates that by
8 2017 its accumulated deficit will grow to approximately \$1.3
9 billion. The city is not making its pension contributions as
10 they become due. As of May 2013, the city had deferred
11 approximately \$54 million in pension contributions and
12 approximately \$50 million on June 30th, 2013, for current
13 year pension contributions.

14 Also, the city did not make the scheduled \$39.7
15 million payment on its COP's that were due on June 14, 2013.
16 If the city had not deferred these payments, it would have
17 run out of cash by June 30th, 2013. Let me repeat that. If
18 the city had not deferred these payments, it would have run
19 out of cash by June 30th, 2013. It filed for bankruptcy 18
20 days later.

21 The city will -- the Court will now review the
22 causes and consequences of this. These are discussed
23 together because it can be hard to tell which is a cause and
24 which is a consequence. Detroit's population declined to
25 684,800 in December of 2012. This is a 63-percent decline in

1 population from its peak in 1950. In June 2000, Detroit's
2 unemployment rate was 6.3 percent. In June 2010, it was 23.4
3 percent. In June 2012, it was 18.3 percent. The number of
4 employed Detroit residents fell from approximately 353,000 in
5 2000 to 280,000 in 2012.

6 The city's credit ratings are below investment
7 grade. In calendar year 2012, 136,00 crimes were reported in
8 the city. Of these, 15,200 were violent crimes. The city's
9 case clearance rate for violent crimes is 18.6 percent. The
10 clearance rate for all crimes is 8.7 percent. These rates
11 are substantially below those of comparable municipalities
12 nationally and surrounding local communities.

13 As of April 2013, about 40 percent of the city's
14 88,000 streetlights were not working. There are
15 approximately 78,000 abandoned and blighted structures in the
16 city. Of these, 38,000 are considered dangerous buildings.
17 The city experiences 11 to 12,000 fires each year for the
18 past decade. Approximately 60 percent of these were in
19 blighted or unoccupied buildings. In 2012 the average
20 priority one response time for the police department was 30
21 minutes. In 2013 it was 58 minutes. The national average is
22 11 minutes. The police department staffing has been reduced
23 by approximately 40 percent over the last ten years. It has
24 not invested in or maintained its facility infrastructure for
25 many years and has closed or consolidated many precincts. It

1 operates with a fleet of 1,291 vehicles, most of which have
2 reached the replacement age of three years and lack modern
3 information technology. The average age of the city's 35
4 fire stations is 80 years. The fire department's fleet has
5 many mechanical issues, contains no reserve vehicles, and
6 lacks equipment ordinarily considered standard. During the
7 first quarter of 2013, frequently only ten to fourteen of the
8 city's 36 ambulances were in service. The city's information
9 technology infrastructure and software is obsolete and is not
10 integrated between departments or even within departments.
11 The city has reduced the number of its employees by about
12 2,700 since 2011. As of May 31st, 2013, it has approximately
13 9,560 employees.

14 The city's union employees are represented by 47 or
15 48 discrete bargaining units. The collective bargaining
16 agreements covering all of these bargaining units expired
17 before the case was filed. The city has implemented revised
18 employment terms called City Employment Terms for
19 nonunionized employees and for unionized employees under
20 expired collective bargaining agreements.

21 It has also increased revenues and reduced expenses
22 in other ways. It estimates that these measures have
23 resulted in annual savings of \$200 million. The city cannot
24 legally increase its tax revenues nor can it reduce its
25 employee expenses without further endangering public health

1 and safety.

2 Before reviewing the events leading to the filing of
3 this case, a brief review of the winding history of the
4 Michigan statutes on point is necessary. In 1990 the
5 Michigan legislature enacted Public Act 72 of 1990, the Local
6 Government Fiscal Responsibility Act. This act empowered the
7 state to intervene with respect to municipalities that faced
8 financial crisis through the appointment of an emergency
9 financial manager, who would assume many of the powers
10 ordinarily held by local public officials. Effective March
11 16, 2011, PA 72 was repealed and replaced with Public Act 4
12 of 2011, the Local Government and School District Fiscal
13 Accountability Act. On November 5th, 2012, however, the
14 Michigan voters rejected PA 4 by referendum. In Davis v.
15 Roberts, the Michigan Court of Appeals held that this
16 rejection revived Public Act 72. Public Act 72 remained in
17 effect until March 28, 2013, when Public Act 436, the Local
18 Financial Stability and Choice Act, became effective. The
19 legislature had enacted that law on December 13, 2012, and
20 the governor had signed it on December 26, 2012.

21 On February 19, 2013, a financial review team
22 appointed by the governor submitted its report regarding the
23 city. That report concluded that a local government
24 financial emergency exists within the City of Detroit because
25 no satisfactory plan exists to resolve a serious financial

1 problem. On March 1st, 2013, after receiving that report,
2 the governor announced his determination that a financial
3 emergency existed within the city. On March 12, 2013,
4 Governor Snyder conducted a public hearing to consider the
5 City Council's appeal of his determination. On March 14,
6 2013, the governor confirmed his determination of a financial
7 emergency within the city and requested that the Local
8 Emergency Financial Assistance Loan Board appoint an
9 emergency financial manager under PA 72. On March 15, 2013,
10 the Loan Board appointed Kevyn Orr as the emergency financial
11 manager for the City of Detroit. On March 15, Mr. Orr took
12 office formally. On March 18, which was the effective date
13 of PA 436, PA 72 was repealed, and Mr. Orr became the
14 emergency manager of the city under PA 436.

15 Under law, the emergency manager acts for and in the
16 place and stead of the governing body and the office of the
17 chief administrator -- administrative officer of the local
18 government. He has broad powers in receivership to rectify
19 the financial emergency and to assure the fiscal
20 accountability of the local government and the local
21 government's capacity to provide or cause to be provided
22 necessary government services essential to the public health,
23 safety, and welfare.

24 On June 14, 2013, Mr. Orr organized a meeting with
25 approximately 150 representatives of the city's creditors.

1 Mr. Orr presented the June 14 creditor proposal, Exhibit 43,
2 and answered questions. At the conclusion of the meeting,
3 Mr. Orr invited creditor representatives to provide feedback
4 to the city regarding the proposal. This proposal described
5 the economic circumstances that resulted in Detroit's
6 financial condition. It also offered a restructuring of the
7 city's operations, financing, and capital structure. It also
8 offered recoveries for each creditor group.

9 Regarding creditor recoveries, the city proposed,
10 (a) treatment of secured debt adequate to the value of the
11 collateral; (b) the pro rata distribution of \$2 billion in
12 principal amount of interest only limited recourse
13 participation notes to holders of unsecured claims -- that
14 is, the unsecured bondholders, the COP's, the pension
15 systems, retirees, and other unsecured claims -- and (c) a
16 Dutch auction process for the city to purchase or pay the
17 notes.

18 Following the June 14, 2013, meeting at which the
19 proposal to creditors was presented, Mr. Orr and his staff
20 had several other meetings. On June 3, 2013, two lawsuits
21 were filed against the governor and the treasurer in state
22 court. These suits sought a declaratory judgment that PA 436
23 violated the Michigan Constitution to the extent that the law
24 purported to authorize bankruptcy proceedings in which vested
25 pension benefits might be impaired. The suits also sought an

1 injunction preventing the governor from authorizing a
2 bankruptcy proceeding for the City of Detroit in which
3 pension -- vested pension benefits might be impaired. The
4 two cases were Flowers v. Snyder and Webster v. Snyder. On
5 July 17, 2013, the GRS commenced a similar lawsuit, General
6 Retirement System of the City of Detroit v. Orr. On the day
7 before, July 16, 2013, Mr. Orr had recommended to the
8 governor and the treasurer that the city file for Chapter 9
9 relief. On July 18, Governor Snyder authorized the City of
10 Detroit to file a Chapter 9 bankruptcy case. At 4:06 p.m. on
11 July 18, 2013, the City of Detroit filed this Chapter 9
12 bankruptcy case.

13 Before turning to the filed objections in this case,
14 it is necessary to point out that the city bears the burden
15 to establish by a preponderance of the evidence each of the
16 elements of eligibility under Section 109(c). As the Court
17 commented at the conclusion of the hearing on September 19,
18 2013, the individuals' presentations on that day were moving,
19 passionate, thoughtful, compelling, and well-articulated.
20 These presentations demonstrated an extraordinary depth of
21 concern for the City of Detroit, for the adequate level of
22 services that their city government provides, and for the
23 personal hardships that that creates, and most clearly for
24 the pensions of the city retirees and employees. These
25 individuals expressed another deeply held concern and even

1 anger that became a major theme of the hearing, the concern
2 and anger that the state's appointment of an emergency
3 manager over the City of Detroit violated their fundamental
4 democratic right to self-governance.

5 The Court's role here is to evaluate how these
6 concerns might impact the city's eligibility for bankruptcy.
7 In making that evaluation, of course, the Court can only
8 consider the specific requirements of applicable law. The
9 popularity of the decision to appoint an emergency manager is
10 not a matter of eligibility under the federal bankruptcy
11 laws. The Court has carefully considered the concerns of the
12 individuals that filed eligibility objections, including
13 those that addressed the Court on September 19 of this year.
14 Those concerns are addressed throughout the Court's opinion
15 but are primarily addressed in the context of whether this
16 case was filed in good faith.

17 The Court will now begin its findings and
18 conclusions. The City of Detroit is a municipality as
19 defined in the Bankruptcy Code. The parties agree to that.
20 Several objecting parties challenge the constitutionality of
21 Chapter 9 of the Bankruptcy Code under the United States
22 Constitution. Citing the United States Supreme Court's
23 decision in Stern versus Marshall, these parties also assert
24 that this Court does not have the authority to determine the
25 constitutionality of Chapter 9. Several objecting parties

1 also challenge the constitutionality of Public Act 436 under
2 the Michigan Constitution. Some of these parties also assert
3 that this Court does not have the authority to determine the
4 constitutionality of PA 436.

5 The Official Committee of Retirees previously filed
6 a motion to withdraw the reference to the District Court on
7 the grounds that this Court does not have the authority to
8 determine the constitutionality of either Chapter 9 or PA
9 436. It also filed a motion for stay of the eligibility
10 proceedings pending the District Court's resolution of that
11 motion. In this Court's denial of the stay motion, it
12 concluded that the committee was unlikely to succeed on its
13 arguments regarding this Court's lack of authority under
14 Stern. For the reasons stated in that opinion, the Court
15 concludes that it has the authority to determine the
16 constitutionality of Chapter 9 and PA 436.

17 The objecting parties argue that Chapter 9 of the
18 Bankruptcy Code violates several provisions of the United
19 States Constitution both on its face and as applied in this
20 bankruptcy case. Article I, Section 8, of the United States
21 Constitution provides the Congress shall have the power to
22 establish uniform laws on the subject of bankruptcies
23 throughout the United States. The objecting parties assert
24 that Chapter 9 violates the uniformity requirement of the
25 United States Constitution because Chapter 9 cedes to each

1 state the ability to define its own qualifications for a
2 municipality to declare bankruptcy, and, therefore, Chapter 9
3 permits the promulgation of nonuniform bankruptcies within
4 the states. The Supreme Court has addressed the uniformity
5 requirement in several cases. Most notably, in Hanover
6 National Bank v. Moyses in 1902 the Supreme Court held that
7 the incorporation into the bankruptcy law of state laws that
8 relate to exemptions did not violate the uniformity
9 requirement of the Constitution. The Court stated, "The
10 general operation of the law is uniform although it may
11 result in certain peculiarities differently in different
12 States" -- I'm sorry -- "certain particulars differently in
13 different States."

14 The Court concludes that Chapter 9 does exactly what
15 the Supreme Court cases require to meet the uniformity
16 requirement. The defined class of debtors to which Chapter 9
17 applies is the class of entities that meet the eligibility
18 requirements. One such class qualification is that the
19 entity is specifically authorized to be a debtor under
20 Chapter 9 by state law. As Moyes held, it is of no
21 consequence in the uniformity analysis that this requirement
22 of state authorization to file a Chapter 9 case may lead to
23 different results in different states. Accordingly, the
24 Court concludes that Chapter 9 satisfies the uniformity
25 requirement of the bankruptcy clause of the United States

1 Constitution.

2 The contracts clause of the United States
3 Constitution provides, quote, "No State shall pass any law
4 impairing the Obligation of Contracts," close quote. It is
5 argued that Chapter 9 violates the contracts clause. This
6 argument is rejected. Chapter 9 is a federal law, not a
7 state law. Article I, Section 10, does not prohibit Congress
8 from enacting a law impairing the obligation of contracts.

9 The Tenth Amendment challenge to Chapter 9 is the
10 most strenuously argued here. That amendment provides,
11 quote, "The powers not delegated to the United States by the
12 Constitution, nor prohibited by it to the States are reserved
13 to the States respectively, or to the people," close quote.
14 The objecting parties argue that Chapter 9 of the Bankruptcy
15 Code violates the principles of federalism that are reflected
16 in this amendment. The argument is that through Chapter 9,
17 Congress has established rules that control state fiscal
18 self-management, which is an area of exclusive state
19 sovereignty. This argument is a facial challenge to the
20 constitutionality of Chapter 9. The as applied challenge is
21 that if the State of Michigan can properly authorize the City
22 of Detroit to file for Chapter 9 relief without the explicit
23 protection of pension rights for retired city employees, then
24 Chapter 9 is unconstitutional because that would violate
25 Michigan's sovereignty.

1 Before addressing the merits of these arguments,
2 however, the Court must first address two preliminary issues
3 that the United States raised, standing and ripeness. First,
4 the Court concludes that the objecting parties do have
5 standing. Section 1109(b) of the Bankruptcy Code provides,
6 quote, "A party in interest, including a creditor, may raise
7 and appear and be heard on any issue in a case under this
8 chapter," close quote. Section 901(a) makes this provision
9 applicable in a Chapter 9 case. Accordingly, the objecting
10 parties who are creditors with pension claims against the
11 city have standing to assert their constitutional challenges
12 as part of their objections to this bankruptcy case.

13 The United States further argues that the issue of
14 whether Chapter 9 is constitutional as applied in this case
15 is not ripe for determination at this time. The city joins
16 in this argument. Early on in this case, the Court expressed
17 its own doubts about this thinking that the issue of whether
18 pension rights can be impaired in bankruptcy applied more to
19 confirmation than to eligibility. The Court finds now that
20 these issues are ripe for decision. At the request of the
21 objecting parties, the Court, therefore -- excuse me --
22 reconsidered that position and now agrees that the issue is
23 ripe at this point.

24 The premise of the argument that the United States
25 makes is that the filing of the case did not result in the

1 impairment of any pensions, thus the United States argues
2 that this issue will be ripe only when the city proposes a
3 plan that would impair pensions if it were confirmed. Until
4 then, it argues their injury is speculative. Although the
5 argument of the United States has some appeal, as the Court
6 itself initially concluded, the Court must now reject it.

7 The ultimate issue before the Court at this time is
8 whether the city is eligible to be a debtor in Chapter 9.
9 This dispute arises in the concrete factual context of the
10 City of Detroit's filing this bankruptcy case under Chapter 9
11 of the Bankruptcy Code and the objecting parties challenging
12 the constitutionality of that very law. This dispute is not
13 an abstract disagreement that is ungrounded in the here and
14 now. It is here, and it is now. The Court further concludes
15 that as a matter of judicial prudence resolving this issue
16 now will likely expedite the resolution of this bankruptcy
17 case. The parties have fully briefed and argued the merits.
18 Further, if the Tenth Amendment challenge to Chapter 9 is
19 resolved now, the parties and the Court can then focus on
20 whether the Court -- whether the city's plan will meet the
21 confirmation requirements of the Bankruptcy Code.
22 Accordingly, the Court concludes that the objecting parties'
23 challenge to Chapter 9 of the Bankruptcy Code as applied in
24 this case is ripe for determination at this time.

25 The Court concludes that the United States Supreme

1 Court has already decided the question of whether a federal
2 municipal bankruptcy act can be administered consistent with
3 the principles of federalism reflected in the Tenth
4 Amendment. In United States versus Bekins, the Supreme Court
5 specifically upheld the Municipal Corporation Bankruptcy Act
6 of 1937 over the objections that the statute violated the
7 Tenth Amendment. It is well-settled that this Court is bound
8 by the decisions of the United States Supreme Court.

9 Nevertheless, the objecting parties assert that
10 Bekins is no longer good law because of amendments to the
11 municipal bankruptcy statute after Bekins was decided and
12 because of two more recent Supreme Court decisions regarding
13 the Tenth Amendment. However, the Court concludes first that
14 changes to the municipal bankruptcy law since 1937 have been
15 minor and do not undermine the continuing validity of Bekins.
16 Second, changes to the Supreme Court's Tenth Amendment law do
17 not undermine the continuing validity of Bekins. In its
18 recent cases deciding issues under the Tenth Amendment, New
19 York versus United States and Printz versus United States,
20 the Supreme Court has upheld laws that encourage states to
21 regulate according to federal policies so long as the states
22 consent. On the other hand, laws that compel or commandeer
23 state resources do violate the Tenth Amendment. The key is
24 state consent. Chapter 9 simply does not raise a consent
25 issue. As the Supreme Court emphasized in Bekins, Chapter 9

1 is limited to voluntary proceedings. The federal government
2 cannot and does not compel states to authorize municipalities
3 to file for Chapter 9 relief, and municipalities are not
4 permitted to seek Chapter 9 relief without specific state
5 authorization. There is simply no commandeering or
6 compulsion involved. Therefore, the Court concludes that
7 Chapter 9 is not facially unconstitutional under the Tenth
8 Amendment of the United States Constitution.

9 Several of the objecting parties also raise as
10 applied challenges to the constitutionality of Chapter 9
11 under the Tenth Amendment. The primary point of these
12 arguments is that if Chapter 9 permits the State of Michigan
13 to authorize a city to file a petition for Chapter 9 relief
14 without explicitly providing for protection of
15 constitutionally protected pension rights, then the Tenth
16 Amendment is violated. The State of Michigan itself cannot
17 legally provide for the adjustment of pension debts or any
18 debts of the City of Detroit. That is so because the United
19 States Constitution and the Michigan Constitution both
20 prohibit the State of Michigan from impairing contracts. It
21 is also because the Michigan Constitution prohibits the
22 impairing of the -- of accrued pension benefits. These
23 prohibitions, however, do not apply in the federal Bankruptcy
24 Court. As the Bankruptcy Court in the City of Stockton
25 Chapter 9 case said, the bankruptcy clause of the United

1 States Constitution necessarily authorizes Congress to make
2 laws that would impair contracts, so it has long been
3 understood that bankruptcy law entails impairment of
4 contracts. For purposes of the Tenth Amendment and state
5 sovereignty, nothing distinguishes pension debt in a
6 municipal bankruptcy case from any other debt. If the Tenth
7 Amendment prohibits the impairment of pension benefits in
8 this case, then it would also prohibit the adjustment of any
9 other debt in the case like bond debt. Bekins makes it
10 clear, however, that with state consent the adjustment of
11 municipal debts does not impermissibly intrude on state
12 sovereignty. This Court is bound to follow that Supreme
13 Court holding.

14 The plans and other objecting parties counter that
15 result by asserting that under the Michigan Constitution
16 pension debt has greater protection than ordinary contract
17 debt. The argument is premised on the slim read that in the
18 Michigan Constitution the pension clause provides that
19 pension rights may not be, quote, "impaired or diminished"
20 whereas the contracts clause in the Michigan Constitution
21 only prohibits impairing contract rights. There are several
22 reasons why the slight difference between the language that
23 protects contracts, no impairment, and the language that
24 protects pensions, no impairment or diminishment, does not
25 demonstrate that pensions are entitled to any extraordinary

1 protection. At common law, before the adoption of the
2 Michigan Constitution in 1963, public pensions in Michigan
3 were viewed as gratuitous allowances that could be revoked at
4 will because a retiree lacked any vested right in their
5 continuation. In 1963, this new provision enhancing the
6 protection for pensions was included, quote, "The accrued
7 financial benefits of each pension plan and retirement system
8 of the state and its political subdivisions shall be a
9 contractual obligation thereof which shall not be diminished
10 or impaired thereby," close quote. That's Article IX,
11 Section 24, of the Michigan Constitution of 1963.

12 So here are the reasons why pension rights are
13 contract rights under the Michigan Constitution. First, as
14 noted, the language of Article IX, Section 24, gives pension
15 benefits the status of a, quote, "contractual obligation,"
16 close quote. That's the language that it uses.

17 Second, if the Michigan Constitution were meant to
18 give the kind of higher or even absolute protection for which
19 the plans argue here, that language simply would not have
20 referred to pension benefits as a, quote, "contractual
21 obligation," close quote.

22 Third, linguistically there is no functional
23 difference in meaning between "impair" and "impair or
24 diminish." Now, there certainly is a preference, if not a
25 mandate, to give every -- to give meaning to every word in

1 written law. At the same time, however, we give undefined
2 statutory terms their plain and ordinary meanings. If this
3 Court gives these terms, "diminish" and "impair," their plain
4 and ordinary meanings, those meanings would not be
5 substantially different from each other. The terms are not
6 synonyms, but they cannot honestly be given meanings so
7 different as to compel the result that the plans now seek,
8 the protection of pension rights in bankruptcy. "Diminish"
9 adds nothing material to "impair." All diminishment is
10 impairment, and "impair" includes "diminish."

11 Fourth, the argument for a greater protection is
12 inconsistent with the Michigan Supreme Court's interpretation
13 of this constitutional language in two cases, Kosa versus
14 Treasury -- Treasurer of the State of Michigan and In re.
15 Constitutionality of 2011 PA 38. In Kosa in 1980 the
16 Michigan Supreme Court quoted the history from the
17 Constitutional Convention regarding Article IX, Section 24.
18 Several times that history refers to pension rights as
19 contractual rights. The Court in Kosa also itself used
20 contractual language when referring to pension rights. More
21 recently in In re. Constitutionality of 2011 PA 38 in 2011,
22 the Michigan Supreme Court stated, quote, "The obvious intent
23 of Section 24, however, was to ensure that public pensions be
24 treated as contractual obligations that, once earned, could
25 not be diminished," close quote.

1 Fifth, an even greater narrative must be considered
2 here focusing on 1963. At that time, Michigan law allowed
3 municipalities to file a bankruptcy, and Bekins had long
4 since held that that was constitutional, so when the new
5 Michigan Constitution was negotiated and proposed and
6 ratified in 1963, it explicitly gave accrued pension benefits
7 only the status of contractual obligations. That new
8 Constitution could have given pensions protection from
9 impairment in bankruptcy in several ways, but it did not. It
10 could have simply prohibited Michigan municipalities from
11 filing bankruptcy. It could have somehow created a property
12 interest that bankruptcy would be required to respect, or it
13 could have established some sort of a secured interest in the
14 municipality's property. It could have even required the
15 state to guarantee pension benefits, but it did none of
16 those. Instead, both the history from the Constitutional
17 Convention and the very language of the pension provision
18 itself, it is made clear municipal pension rights are
19 contract rights. Because under the Michigan Constitution
20 pension rights are contractual rights, they are subject to
21 impairment in a federal bankruptcy proceeding. Moreover,
22 where, as here, the state consents, that impairment does not
23 violate the Tenth Amendment. Therefore, as applied in this
24 case, Chapter 9 is Constitutional.

25 Nevertheless, the Court is compelled to comment. No

1 one should interpret this holding that pension rights are
2 contract rights and subject to impairment in this bankruptcy
3 case to mean that this Court necessarily will confirm any
4 plan of adjustment that impairs pensions. The Court
5 emphasizes that it will not lightly or casually exercise the
6 power under federal bankruptcy law to impair pensions.
7 Before the Court confirms any plan that the city submits, the
8 Court must find that the plan fully meets the requirements of
9 Section 943(b) of the Bankruptcy Code and the other
10 applicable provisions of the Bankruptcy Code. Together these
11 provisions of law demand this Court's judicious, legal, and
12 equitable consideration of the interests of the city and the
13 interests of all of its creditors, including retirees, as
14 well as the laws of the State of Michigan.

15 Section 109(c) (2) of the Bankruptcy Code requires
16 that a municipality be specifically authorized to be a debtor
17 under such chapter. The evidence establishes that the city
18 was authorized to file this case. The issue is whether that
19 authorization was proper under the Michigan Constitution.
20 Several objectors argue that the authorization is not valid
21 because Public Act 436, the statute establishing the
22 underlying procedure for a municipality to obtain
23 authorization, is unconstitutional. The validity of Public
24 Act 436 under the Michigan Constitution is a question of
25 state law. The Michigan Supreme Court has not ruled on the

1 validity of Public Act 436. As a result, this Court must
2 attempt to ascertain how that Court would rule if it were
3 faced with this issue.

4 As discussed earlier, on March 16th, 2011, the
5 governor signed Public Act 4 into law, but Public Act 4 was
6 repealed by Public Act 72. However, the voters rejected
7 Public Act 4 by referendum in the November 6, 2012, election.
8 Shortly after that election on December 26th, 2012, the
9 governor signed PA 436 into law, and it took effect on March
10 28th, 2013. It is argued here that Public Act 436 is
11 unconstitutional because it is essentially a reenactment of
12 the rejected Public Act 4 in violation of the people's
13 referendum rights. The city and the State of Michigan assert
14 that there are several differences between Public Act 436 and
15 Public Act 4 such that they are not the same law. In
16 Reynolds versus Bureau of State Lottery in 2000, the Michigan
17 Court of Appeals held that nothing in the Michigan
18 Constitution suggests that a referendum has any broader
19 effect than the nullification of the rejected act. This
20 Michigan Court of Appeals decision strongly suggests that the
21 referendum rejection of Public Act 4 did not prohibit the
22 Michigan legislature from enacting Public Act 436 even though
23 Public Act 436 addressed the same subject matter as Public
24 Act 4 and did contain very few changes. Accordingly, the
25 challenge on this ground must be rejected.

1 It is also contended that Public Act 436 is
2 unconstitutional because the Michigan legislature included
3 appropriations provisions in Public Act 436 for the sole
4 purpose of shielding the act from referendum. There
5 certainly was some credible evidence in support of the
6 assertion that the appropriations provision in Public Act 436
7 were intended to immunize it from referendum. For example,
8 Howard Ryan, the legislative assistant in the Michigan
9 Department of Treasury, so testified in his deposition. The
10 Court must conclude, however, that if faced with this issue,
11 the Michigan Supreme Court would not hold Public Act 436
12 unconstitutional on this grounds. In Michigan United
13 Conservation Clubs versus Secretary of State in 2001, the
14 Court concisely held that a public act with an appropriations
15 provision is not subject to referendum regardless of the
16 motive of the appropriation. To the same effect was Houston
17 v. Governor decided by the Michigan Supreme Court in 2012.
18 Accordingly, the Court concludes that PA 436 is not
19 unconstitutional on the grounds that the appropriations
20 provisions of it improperly shielded it from the people's
21 right of referendum.

22 Certain objectors also argue that Public Act 436
23 violates the home rule provision of the Michigan
24 Constitution, which recognizes the right of the electors to
25 adopt and amend the city charter and the city's right to

1 adopt ordinances. The argument is that the appointment of an
2 emergency manager for a municipality under PA 436 is
3 inconsistent with those rights. This argument fails for the
4 simple reason that this authority that the Michigan
5 Constitution grants to municipalities is subject to state
6 laws enacted by the legislature. The constitutional
7 provision specifically says so. It states, quote, "Each city
8 and village shall have the power to adopt resolutions and
9 ordinances relating to its municipal concerns, property and
10 government, subject to the constitution and law," close
11 quote. Indeed, Section 1-102 of the city -- excuse me -- of
12 the charter of the City of Detroit states, quote, "The City
13 has the comprehensive home rule power conferred upon it by
14 the Michigan Constitution, subject only to the limitations on
15 the exercise of that power contained in the Constitution or
16 this Charter or imposed by statute," close quote.
17 Accordingly, the Court finds that PA 436 does not violate the
18 home rule provisions of the Michigan Constitution.

19 Many objectors argue that the bankruptcy
20 authorization section of PA 436 itself does not comply with
21 the heightened requirements for protecting pensions in the
22 Michigan Constitution and, therefore, that PA 436 is
23 unconstitutional. Accordingly, the objectors argue that PA
24 436 cannot provide a valid basis for authorization to file a
25 bankruptcy. The Court has already explained that pension

1 benefits are a contractual obligation of the municipality and
2 not entitled to any heightened protection in bankruptcy. It
3 follows that if a state consents to a municipal bankruptcy,
4 no state law can protect pension rights that are merely
5 contractual rights from impairment in bankruptcy just as no
6 law could protect any other type of contract rights like
7 bonds. Accordingly, the failure of PA 436 to protect pension
8 rights in a municipal bankruptcy does not make that law
9 inconsistent with the pension clause of the Michigan
10 Constitution any more than the failure of PA 436 to protect,
11 for example, bond debt in bankruptcy is inconsistent with the
12 contracts clause of Michigan Constitution. For this purpose,
13 the parallel is perfect. For these reasons, the Court
14 concludes that PA 436 does not violate the pension clause of
15 the Michigan Constitution.

16 PA 436 permits the governor to place contingencies
17 on a local government in order to proceed under Chapter 9.
18 The governor chose not to impose a contingency requiring the
19 City of Detroit to protect pensions in bankruptcy. Several
20 objectors argue that the pension clause of the Michigan
21 Constitution obligated the governor to include such a
22 condition in his authorization. The Court concluded earlier
23 that any such condition in PA 436 itself would be ineffective
24 and potentially invalid under federal law. For the same
25 reason, any such contingency in the governor's authorization

1 letter would have been invalid and may have rendered the
2 authorization itself invalid under Section 109(c).
3 Accordingly, this objection is overruled. The Court
4 concludes that the governor's authorization to file this
5 bankruptcy case under PA 436 was valid under the Michigan
6 Constitution.

7 On July 3, 2013, Gracie Webster and Veronica Thomas
8 filed a complaint against the State of Michigan, Governor
9 Snyder, and Treasurer Dillon in the Ingham County Circuit
10 Court. They sought a declaratory judgment that PA 436 is
11 unconstitutional because it permits accrued pension benefits
12 to be diminished or impaired in violation of Article IX,
13 Section 24, of the Michigan Constitution. The complaint also
14 sought a preliminary and permanent injunction enjoining the
15 governor and the treasurer from authorizing the Detroit
16 emergency manager to commence proceedings under Chapter 9 of
17 the Bankruptcy Code.

18 On Thursday, July 18th, 2013, just minutes after the
19 city filed its bankruptcy petition, the state court held a
20 hearing. During that hearing, the state court confirmed that
21 the bankruptcy case had been filed. Nevertheless, the state
22 court granted the relief enjoining the governor and the
23 emergency manager -- excuse me -- enjoining the governor from
24 taking any further action in the bankruptcy proceeding.

25 A further hearing was held the next day on the

1 plaintiff's request to amend the order of the previous
2 afternoon. At the conclusion of that hearing, the judge then
3 stated her decision to grant the declaratory relief that the
4 plaintiffs had requested. Later that day on July 19th, 2013,
5 the court entered a declaratory -- an order of declaratory
6 relief. It states that PA 436 is unconstitutional and in
7 violation of Article IX, Section 24, of the Michigan
8 Constitution. It also states that PA 436 is to that extent
9 of no force and effect. In their objections in this case,
10 several of the objectors assert that this judgment precludes
11 or prevents the city from asserting that PA 436 is
12 constitutional or that the governor properly authorized this
13 bankruptcy filing.

14 There are, however, two main reasons why this Court
15 is not required to honor the Webster judgment in this
16 bankruptcy case. First, upon the city's bankruptcy filing,
17 federal law gave this Court exclusive jurisdiction to
18 determine all issues relating to the city's eligibility to be
19 a Chapter 9 debtor. At that moment, the state court no
20 longer had jurisdiction. Accordingly, the state court's
21 order of declaratory judgment on which the objectors rely is
22 void and of no effect. It does not preclude the city from
23 asserting its eligibility to file bankruptcy in this case.

24 Second, bankruptcy law provides that when a
25 bankruptcy petition is filed, it operates as a stay of any

1 act to exercise control over property of the estate. The
2 main objectives of the plaintiff's case in Webster v.
3 Michigan was to protect the plaintiff's pension rights by
4 prohibiting a bankruptcy case which might allow the city to
5 use its property in a way that might impair pensions. It
6 does not matter that neither the city nor its officers were
7 defendants. The suit was clearly an act to exercise control
8 over the city's property. Accordingly, it was stayed under
9 the bankruptcy law. The state court's order of declaratory
10 relief was entered in violation of the stay. For those two
11 reasons, the Court concludes that the judgment in Webster is
12 void, and this objection to the city's eligibility is
13 rejected.

14 To be eligible for relief under Chapter 9, the city
15 must establish that it is insolvent. A few objectors contest
16 this requirement of eligibility under Section 109(c)(3). For
17 a municipality, the Bankruptcy Code defines insolvent as,
18 quote, "a financial condition such that the municipality is:
19 (i) generally not paying its debts as they become due unless
20 such debts are the subject of a bona fide dispute; or (ii) is
21 unable to pay its debts as they become due." The Court finds
22 that the City of Detroit was and is insolvent under both
23 definitions. The Court has already detailed the enormous
24 financial distress that the city faced as of July 18th, 2013,
25 and will not repeat it here. The Court finds that the city

1 was generally not paying its debts as they became due.

2 In May 2013 the city deferred payments on \$54
3 million in pension contributions. On July 30th it deferred
4 an additional \$5 million fiscal year-end payment. The city
5 also did not make a scheduled \$39.7 million payment on its
6 COP's on June 14th. It was also spending more money than it
7 was receiving and only making up the difference through
8 expensive and even catastrophic borrowings. These facts
9 establish that the city was generally not paying its debts as
10 they became due as of the time of filing.

11 The evidence also overwhelmingly establishes that
12 the city is unable to pay its debts as they become due. The
13 evidence established that as a result of the city's financial
14 state, there are many, many services in the city which do not
15 function properly. The facts found earlier firmly support
16 this conclusion.

17 Most powerfully, however, the testimony of Chief
18 Craig established that the city is in a state of service
19 delivery insolvency as of July 18th and will continue to be
20 for the foreseeable future. He testified that the conditions
21 in the local precincts were deplorable. He said, quote, "if
22 I just might summarize it in a very short way, that
23 everything is broken, deplorable conditions, crime is high --
24 extremely high, morale is low, the absence of leadership,"
25 close quote. He described the city as, quote, "extremely

1 violent," close quote, based on the high rate of violent
2 crime and the low rate of clearance of violent crimes. He
3 stated that their facilities, equipment, and vehicles were in
4 various states of disrepair and obsolescence. Service
5 delivery insolvency focuses on the municipality's inability
6 to pay for all costs of providing services at the level and
7 quality that are required for the health, safety, and welfare
8 of the community.

9 The objecting parties assert that the city could
10 have and should have monetized a number of its assets in
11 order to make up for its severe cash flow insolvency. Most
12 directly, this objection targets the city's valuable art
13 collection. However, the city's witnesses credibly
14 established that sales of city assets would not address the
15 long-term operational structural financial imbalance facing
16 the city, and this makes sense. When the expenses of an
17 enterprise exceed its revenue, a one-time infusion of cash,
18 whether from an asset sale or from a borrowing, only delays
19 the inevitable financial failure unless, in the meantime, the
20 enterprise sufficiently reduces its expenses or enhances its
21 income. The City of Detroit itself has proven the reality of
22 this many, many times. In any event, when considering
23 selling an asset, the enterprise must take extreme care that
24 the asset is truly unnecessary in pursuing its mission and
25 unnecessary in enhancing its operational revenue. For these

1 reasons, the Court finds that the city has established that
2 it is insolvent.

3 The city must also establish that it desires to
4 effect a plan to adjust its debts under Section 109(c)(4).
5 In the City of Stockton case, the Bankruptcy Court explained
6 the cases equate desire with intent and make clear that this
7 element is highly subjective. At the first level, the
8 question is whether the Chapter 9 case was filed for some
9 ulterior motive such as to buy time or to evade creditors
10 rather than to restructure the city's finances. Several
11 objectors assert that the city does not desire to effect a
12 plan to adjust its debts. The Court concludes that the
13 evidence overwhelmingly establishes that the city does desire
14 to effect a plan in this case. Mr. Orr so testified. More
15 importantly, before filing this case, Mr. Orr did submit to
16 creditors a plan to adjust the city's debts. Plainly, that
17 plan was not acceptable to any of the city's creditors. It
18 may not have even been confirmable under the Bankruptcy Code,
19 although that is not necessary to resolve at this time.
20 Still, it was evidence of the city's desire and intent to
21 effectuate a plan. There is simply no evidence that the city
22 has an ulterior motive in pursuing Chapter 9 such as to buy
23 time or to evade creditors. Indeed, the objecting creditors
24 do not really contend that there was any such ulterior
25 motive. Rather, their argument is that the plan that the

1 emergency manager has stated he intends to propose in this
2 case is not a confirmable plan. It is not confirmable, they
3 argue, because it will impair pensions in violation of the
4 Michigan Constitution. Certainly the evidence does
5 establish -- certainly the evidence does establish that the
6 emergency manager intends to propose a plan that impairs
7 pensions. The Court has already so found. Nevertheless, the
8 objectors' argument must be rejected. As established
9 earlier, a Chapter 9 plan may impair pension rights. The
10 emergency manager's stated intent to propose a plan that
11 impairs pensions is, therefore, not inconsistent with a
12 desire to effect a plan. Accordingly, the Court finds that
13 the city does desire to effect a plan.

14 The fifth element for eligibility is found in
15 Section 109(c)(5). Under that section an entity may be a
16 debtor under Chapter 9 if such entity has either negotiated
17 in good faith with creditors or is unable to negotiate with
18 creditors because such negotiation is impracticable. In the
19 present case, the City of Detroit argues that the June 14,
20 2013, proposal to creditors along with its follow-up meetings
21 was a good faith effort to begin negotiations to which
22 creditors refused to respond. The Court concludes, however,
23 that the June 14 proposal to creditors and the follow-up
24 meetings were not sufficient to satisfy the requirements of
25 good faith negotiations under law. The proposal to creditors

1 did not provide creditors with sufficient information to make
2 meaningful counterproposals, especially in the very short
3 amount of time that the city allowed for the, quote,
4 "discussion," close quote, period. Charitably stated, the
5 proposal is very summary in nature. There was simply not
6 enough information for creditors to start meaningful
7 negotiations. For example, Brad Robins of Greenhill &
8 Company, the financial advisor for the Retirement Systems,
9 testified, quote, "The note itself I thought was not really a
10 serious proposal but may be a placeholder, no maturity, no
11 obligation for the city to pay," close quote. The city
12 asserts that it provided supporting data in an electronic
13 data room. However, several witnesses testified that the
14 data room did not contain the necessary data to make a
15 meaningful evaluation of the proposal to creditors.
16 Moreover, the city conditioned access to the data room on the
17 signing of a confidentiality and release agreement. This
18 created an unnecessary hurdle for creditors. The creditors
19 simply cannot be faulted for failing to offer
20 counterproposals when they did not have the necessary
21 information to evaluate the city's vague initial proposal.
22 The proposal for creditors provided a calendar. It allotted
23 one week, June 17 to 24, for requests for additional
24 information. The initial rounds of discussions were
25 scheduled for July 17 -- sorry -- June 17 to July 12, and the

1 evaluation period was scheduled to be July 15 to July 19.
2 This calendar was very tight and did not request
3 counterproposals or even provide a deadline for submitting
4 them. The total time available under this schedule for
5 creditor negotiations was approximately 30 days. Given the
6 extraordinary complexities of the case and the 100,000
7 creditors, that amount of time is simply far too short to
8 conclude that such a vague proposal to creditors rises to the
9 level required to shift the burden to objectors to make
10 counterproposals.

11 In addition, the city affirmatively stated that the
12 meetings were not negotiations. The city asserts that this
13 was to clarify that the city was not waiving the suspension
14 of collective bargaining under Public Act 436, but the city
15 cannot announce to creditors that the meetings were not
16 negotiations and then assert to this Court that those same
17 meetings amounted to good faith negotiations.

18 Finally, the format of the meetings were primarily
19 presentational, informational, to different groups of
20 creditors with different issues and gave little opportunity
21 for creditor input or substantive discussion.

22 Accordingly, the Court concludes that the city has
23 not established by a preponderance of the evidence that it
24 has satisfied the requirements for good faith negotiations.

25 Congress adopted Section 109(c) (5) (C) specifically

1 to cover situations in which a very large body of creditors
2 would render pre-filing negotiations impracticable. Several
3 cases suggest that the impracticability requirement must be
4 satisfied based -- or excuse me -- may be satisfied based on
5 the sheer number of creditors involved. The list of
6 creditors of the City of Detroit is over 3,500 pages. It
7 lists over 100,000 creditors. The city estimates over 20,000
8 individual retirees are owed pension funds. The Court is
9 satisfied that when Congress enacted the impracticability
10 section, it foresaw precisely a situation like that which
11 faces the City of Detroit. The sheer size of the debt and
12 the number of individual creditors made pre-bankruptcy
13 negotiation impracticable, impossible really.

14 There are, however, several other circumstances that
15 also support a finding of impracticability. First, although
16 several unions have now come forward that they are the
17 natural representatives of the retirees, these same unions
18 asserted in response to the city's pre-filing inquiries that
19 they could not and did not represent retirees. These
20 responses sent a clear message to the city that the unions
21 would not negotiate on behalf of retirees.

22 Several voluntary associations of retirees also
23 assert that they are the natural representatives of retirees.
24 However, none assert that they can bind individual retirees
25 absent some sort of cumbersome class action litigation. As

1 Donald Taylor testified, ultimately it would be up to the
2 individual members of the association to decide if they would
3 accept or reject an offer.

4 Further, several witnesses who testified on behalf
5 of the retiree associations made their positions clear that
6 they would not have negotiated a reduction in accrued pension
7 benefits because they consider them to be fully protected by
8 state law. It is impracticable to negotiate with a group
9 that asserts that their position is immutable. As the Court
10 stated in Stockton, "It is impracticable to negotiate with a
11 stone wall."

12 Finally, the city has demonstrated that time was
13 quickly running out on its liquidity. Accordingly, the Court
14 finds that pre-filing negotiations were impracticable.

15 The last requirement for eligibility is set forth in
16 Bankruptcy Code Section 921(c). That section provides,
17 quote, "After any objection to the petition, the court, after
18 notice and a hearing, may dismiss the petition if the debtor
19 did not file the petition in bad faith -- excuse me -- in
20 good faith," close quote. The city's alleged bad faith in
21 filing its Chapter 9 petition was a central issue in the
22 eligibility trial. Indeed, in one form or another all of the
23 objecting parties have taken the position that the city did
24 not file its Chapter 9 petition in good faith and that this
25 Court should exercise its discretion to dismiss this case.

1 As will be explained, the Court finds that the totality of
2 circumstances coupled with the presumption of good faith
3 which arises because the city has proven each of the elements
4 of eligibility under Section 109(c) establishes that the city
5 filed its petition in good faith under 921(c).

6 In a moment, the Court will review the factors upon
7 which it relies in finding that the city filed this case in
8 bad -- in good faith. First, however, the Court considers it
9 crucial to this process to give voice to what it understands
10 is the narrative supporting the objecting parties' argument
11 that the City of Detroit did not file this case in good
12 faith. The Court will then explain why there is some support
13 in the record for this narrative. After that, the Court will
14 then explain why it still finds that the city filed this
15 petition in good faith. It must be recognized that the
16 narrative that the Court describes here is a composite of the
17 objecting parties' presentation on this issue. No single
18 objecting party neatly laid out this precise version with all
19 of its features described here. Moreover, it includes the
20 perceptions of not only several of the objecting parties
21 whose objections were filed by attorneys, but also many of
22 the individual objecting parties. This description does not
23 contain the Court's findings. It is only the Court's
24 perception of a compositive narrative -- excuse me --
25 composite narrative that appears to ground the objectors'

1 various bad faith arguments.

2 According to this composite narrative of the lead-up
3 to the bankruptcy filing on July 18, 2013, the City of
4 Detroit's bankruptcy was the intended consequence of a long-
5 term strategic plan. The goal of this bankruptcy, according
6 to this narrative, was the impairment of pension rights
7 through a bankruptcy filing by the city. Its genesis, the
8 narrative goes, was hatched in a Law Review article that two
9 Jones Day attorneys wrote. This is significant because Jones
10 Day later became not only the city's attorneys in the case
11 but the law firm from which the city's emergency manager was
12 hired. The article laid out in detail the legal road map for
13 using bankruptcy to impair municipal pensions. The objectors
14 believe that the plan was executed by the top officials of
15 the State of Michigan and the state's legal and financial
16 consultants. The goals of the plan included also lining the
17 professionals' pockets while extending the power of the state
18 government at the expense of the people of the City of
19 Detroit. In this narrative, there may even be a racial
20 element to the plan. The plan participants foresaw the
21 rejection of PA 4, according to this narrative, coming in the
22 November 2012 election, and so work began on PA 436 even
23 before that. As a result, it only took 14 days to enact PA
24 436 after it was introduced in the legislature's post-
25 election lame duck session. PA 436 was also enacted contrary

1 to the will of the people of the State of Michigan, as just
2 expressed in their rejection of PA 4. The plan included
3 inserting into PA 436 two very minor appropriations
4 provisions so that the law would not be subject to the
5 people's right of referendum and would not risk the same fate
6 as PA 4 had just experienced. The plan also saw the value in
7 enticing a bankruptcy attorney to become the emergency
8 manager even though he did not have the qualifications
9 required by PA 436. Another important part of the plan,
10 according to this narrative, was for the state government to
11 starve the city of cash by reducing its revenue sharing, by
12 refusing to pay the city millions of promised dollars, and by
13 imposing on the city a heavy financial burden of expensive
14 professionals. It also included suppressing information
15 about the value of the city's assets. The narrative
16 continues that this plan also required active concealment and
17 even deception. One purpose was to deny creditors,
18 especially those whose retirement benefits would be at risk
19 from such a filing, from effectively acting to protect those
20 interests. This concealment and deception were accomplished,
21 the narrative goes, through a public relations campaign that
22 deliberately misstated the ultimate objective of PA 436,
23 downplayed the likelihood of bankruptcy, asserted an unfunded
24 pension liability amount that was based on misleading and
25 incomplete data and analysis, understated the city's ability

1 to meet that liability, and obscured the vulnerability of
2 pensions in bankruptcy. It also included imposing an
3 improper requirement to sign a confidentiality and release
4 agreement as a condition of accessing financial information
5 in the data room. As the bankruptcy filing approached, the
6 narrative states that a necessary part of the plan became to
7 engage with creditors only the minimum necessary so that the
8 Court could later assert in -- so that the city could later
9 assert in Bankruptcy Court that it attempted to negotiate in
10 good faith. The plan, however, was not to engage in
11 meaningful pre-petition negotiations with the creditors
12 because successful negotiation might thwart the plan to file
13 a bankruptcy. "Check a box" was the phrase that some
14 objecting parties used for this.

15 The penultimate moment that represented the
16 successful culmination of the plan was the bankruptcy filing
17 itself. In this narrative, this was accomplished in secrecy
18 and a day before the planned date in order to prevent the
19 retirees who were at that moment in state court pursuing
20 their available state law remedies to protect their
21 constitutional pension rights. "In the dark of the night"
22 was the phrase used to describe the actual timing of the
23 filing. The phrase refers to the secrecy surrounding the
24 filing and captures in shorthand the assertion that the
25 petition was filed to avoid an imminent adverse ruling in the

1 Webster case in state court.

2 The oft repeated phrase that was important to the
3 objectors' theory of the city's bad faith was "foregone
4 conclusion." This was used in the assertion that Detroit's
5 bankruptcy case was a foregone conclusion perhaps as early as
6 January 2013, perhaps even earlier.

7 Finally, post-petition the plan also necessitated
8 the assertion of the common interest privilege to protect it
9 and its participants from disclosure. The Court must
10 emphasize again now that what the Court just summarized is
11 what it believes is the viewpoint of the objecting parties.
12 Those were not the Court's findings.

13 The Court will now, however, turn to its evaluation
14 of this viewpoint of bad faith on the city's part in filing
15 this case. The Court acknowledges that many people in
16 Detroit hold to this narrative or at least to substantial
17 parts of it. The Court further recognizes, on the other
18 hand, that state and city officials vehemently deny any such
19 improper motives or tactics as this theory attributes to
20 them. They contend that this case was filed for the proper
21 desire and necessary purpose of restructuring the city's
22 debts, including its pension debt, through a plan of
23 adjustment. Indeed, the Court has already found that the
24 city does desire to effect a plan of adjustment. The Court
25 finds, however, that in some particulars the record does

1 support the objectors' view of the reality that led to this
2 bankruptcy filing. It is, however, not nearly supported
3 enough -- in enough particulars for this Court to find that
4 the filing was in bad faith. For example, Howard Ryan
5 testified that the appropriations provision of PA 436 was
6 added to evade a referendum. An e-mail from Kevyn Orr was to
7 the same effect. The Jones Day pitch book from January 2013
8 laid out the scenario for this bankruptcy case, and Mr. Orr
9 was, after all, a bankruptcy lawyer, and his associates at
10 Jones Day did write the legal road map for this back in 2011.
11 And at the June 10 public meeting, Mr. Orr did mislead the
12 public about the status of pensions in bankruptcy as well as
13 about the chances of filing bankruptcy. The issue that such
14 evidence presents, however, is how to evaluate it in the
15 context of the good faith issue. One important question
16 raised, for example, is during the lead-up, was the City of
17 Detroit's bankruptcy filing a foregone conclusion as the
18 objecting parties assert. The answer is, yes, of course it
19 was, for a long time. Even if it was a foregone conclusion,
20 experience with both individuals and businesses in financial
21 distress establish that they often wait longer to file a
22 bankruptcy than is in their interests. Detroit was no
23 exception. Its financial crisis had been worsening for
24 decades, and it could have and should have filed bankruptcy
25 long before it did, perhaps even years before. Certainly the

1 Court must conclude that the bankruptcy -- that the
2 bankruptcy filing by the City of Detroit was a foregone
3 conclusion during all of 2013, but waiting too long does not
4 suggest bad faith.

5 Perhaps it would have been more consistent with our
6 democratic ideals and with the economic and social needs of
7 the city if its officials and state officials had openly and
8 forthrightly recognized the need for filing bankruptcy when
9 that need first arose. It is, after all, not bad faith to
10 file bankruptcy when it is needed, and city officials could
11 also avoided the appearances of pretext negotiations and the
12 resulting mistrust by simply announcing honestly that the
13 city is insolvent, that it needs to file bankruptcy, and that
14 negotiations would not even be attempted because it would be
15 impracticable. The law clearly permits that and for good
16 reason. It avoids the very delay and worse the very
17 suspicion and bad feeling that resulted here. The Court must
18 acknowledge some truth in the factual basis of the objectors'
19 claim that this case was not filed in good faith.

20 Nevertheless, for strong reasons that the Court will state
21 next, it finds that this case was filed in good faith and
22 should not be dismissed.

23 Number one, the Court finds that the city's
24 financial problems are of a type contemplated for Chapter 9
25 relief. The Court's finding here is based on its finding

1 that the city is insolvent and that the city was unable to
2 negotiate with creditors because that negotiation was
3 impracticable.

4 Number two, the city's filings are consistent with
5 the remedial purpose of Chapter 9. The Court's analysis on
6 this factor is based on its finding that the city desires to
7 effect a plan to adjust its debts. To show bad faith on this
8 factor, the evidence must establish that the purpose of the
9 filing of the Chapter 9 was not simply to buy time or --
10 excuse me -- to show good faith on this factor, the evidence
11 must establish that the purpose of the filing was not simply
12 to buy time or evade creditors. Notably, this argument was
13 not raised by the objectors in any pleadings or at trial, and
14 there's no evidence. The objectors do assert that the city
15 filed this petition to avoid a bad state court ruling in the
16 Webster litigation. They argue this is indicative of bad
17 faith. This argument is also rejected. It is quite common
18 for creditor lawsuits to precipitate bankruptcy filings.
19 That the lawsuits were in vindication of an important right
20 under the state Constitution does not change this result.
21 They were still suits to enforce creditors' claims against a
22 debtor that could not pay those claims. The objectors also
23 argue that the city filed the petition so that its pension
24 obligations could be impaired, and this is inconsistent with
25 the remedial purpose of bankruptcy. Again, discharging debt

1 is what motivates every debtor that files bankruptcy, and
2 that motivation does not suggest bad faith.

3 Three, the city made efforts to improve the state of
4 its finances prior to filing to no avail. Although the Court
5 finds that the city did not engage in good faith negotiations
6 with its creditors, the Court does find that the city did
7 make some efforts to improve its financial condition before
8 filing its Chapter 9 petition, which resulted in some
9 savings, as stated earlier. No objecting parties have
10 suggested any other measure that the city could have taken to
11 relieve its financial stress other than selling assets, but,
12 as stated earlier, that would not have solved any long-term
13 financial problems. The fact that the city did not consider
14 any alternatives to Chapter 9 in the period leading up to the
15 filing does not indicate bad faith either. By that time, all
16 of the measures that the city had attempted had largely
17 failed to resolve the problem of the city's cash flow
18 insolvency.

19 Four, the residents of the City of Detroit will be
20 severely prejudiced if this case is dismissed. The Court
21 concludes that this factor is of paramount importance in this
22 case. The city's debt and cash flow insolvency is causing
23 its nearly 700,000 residents to suffer hardship. As already
24 discussed at length, the city is service delivery insolvent.
25 Without the protection of Chapter 9, the city will be forced

1 to continue on the path that it was on until it filed this
2 case. In order to free up cash for day-to-day operations,
3 the city would have to continue to borrow money, defer
4 capital investments, and shrink its workforce. This solution
5 has proven unworkable. It is also dangerous for its
6 residents. This factor weighs heavily in favor of finding
7 good faith.

8 Accordingly, the Court concludes that the city's
9 petition was filed in good faith and the petition is not
10 subject to dismissal under Section 921(c). The Court
11 accordingly concludes that under Section 109(c) the City of
12 Detroit may be a debtor under Chapter 9 of the Bankruptcy
13 Code. The Court will enter an order for relief forthwith as
14 required by Section 921(d). The Court reminds all interested
15 parties that this eligibility determination is merely a
16 preliminary matter in this bankruptcy case. The city's
17 ultimate objective is the confirmation of a plan of
18 adjustment. It has stated on the record its intent to
19 achieve that objective with all deliberate speed and to file
20 a plan shortly. Accordingly, the Court strongly encourages
21 the parties to begin to negotiate or, if they have already
22 begun, to continue to negotiate with a view toward a
23 consensual plan.

24 The Court recognizes and understands, to the extent
25 it can, the widespread anguish and distress that this

1 decision to permit the city's bankruptcy to proceed may cause
2 to the city's employees and retirees as well as their
3 families. The Court, therefore, implores with all urgency
4 those who administer our social safety net, our governor who
5 authorized this case, our state government leaders, our civic
6 and business leaders, our religious and charitable
7 organizations, to focus yet greater attention on the real
8 human needs that will arise because of the city's bankruptcy.

9 The message of this bankruptcy is that the city does
10 not have enough money to properly care for its residents let
11 alone to pay its debts, and, unfortunately, that economic
12 fact would be true even if pensions did have the legal
13 protection that the city's employees and retirees seek here,
14 and that's the very wisdom of the bankruptcy law. It
15 recognizes that people, businesses, and even municipalities
16 can't print money, and it tries to provide an equitable and
17 hopeful solution.

18 It is, indeed, a momentous day. We have here a
19 judicial finding that this once proud and prosperous city
20 can't pay its debts. It's insolvent. It's eligible for
21 bankruptcy. At the same time, it also has an opportunity for
22 a fresh start. I hope that everyone associated with the city
23 will embrace that opportunity.

24 Under Section 921(e) of the Bankruptcy Code, there
25 is no stay of this finding. The Court understands that one

1 or more parties may seek an appeal of this directly to the
2 Court of Appeals. The Court would ask that any such request
3 be made promptly by motion.

4 Is it still the city's intent to file a plan by
5 year-end?

6 MR. HEIMAN: Your Honor, we're not quite certain.
7 I'm sorry. David Heiman for the city. We're still working
8 on our timeline but obviously mindful of your prior request
9 that we file before March 1, so we hope to be well within
10 that request.

11 THE COURT: All right. Thank you, sir.

12 MR. HEIMAN: Thank you.

13 THE COURT: Is there anything else that anyone would
14 like to raise at this time? No. We'll be in recess.

15 THE CLERK: All rise. Court is in recess.

16 (Proceedings concluded at 11:33 a.m.)

INDEX

WITNESSES:

None

EXHIBITS:

None

I certify that the foregoing is a correct transcript from the sound recording of the proceedings in the above-entitled matter.

/s/ Lois Garrett

December 5, 2013

Lois Garrett

