UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re CITY OF DETROIT, MICHIGAN, Debtor, ________________________________ WILLIAM OCHADLEUS, *et. al.*, Appellants, CITY OF DETROIT, MICHIGAN, *et. al.*, Appellees	Chapter 9 Case No. 14-CV-14872 Lower Case No. 13-53846 Hon. Bernard A. Friedman Magistrate Judge R. Steven Whalen

APPELLANTS' OPENING BRIEF

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ORAL ARGUMENT REQUESTED

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STATEMENT OF APPELLATE JURISDICTION

This is an appeal of the Order (Dkt 8272) Confirming the Eighth Plan of the Adjustment of Debts of the City of Detroit (Dkt 8045) entered by the United States Bankruptcy Court for the Eastern District of Michigan on November 12, 2014. The appellants herein have standing under 11 U.S.C. § 1109(b). The jurisdiction of this Court is invoked under 28 U.S.C. § 158(a) (1) and Fed. R. Bankr. P. 8001, *et seq*.

ISSUES PRESENTED

1. Did the bankruptcy court err by deciding the constitutional question of whether pensions could be impaired, when consistent with the Tenth Amendment, that question should have been avoided?

2. Did the bankruptcy court's "consent" analysis conflict with 11 U.S.C. § 903 of the bankruptcy code and the Supreme Court's decision in *Bond v. United States*?

3. Did the bankruptcy court err as a matter of law by confirming the plan, when dismissal of the case, would have resulted in a greater recovery for retirees under state law remedies?

4. Did the bankruptcy court err as a matter of law by confirming the plan even though, by attempting to impose the ASF recoupment on claims whose retiree holders have not individually agreed to its application to their claims, the plan imposes non-consensual less favorable treatment on those claims than on other claims in class 11, in violation of § 1123(a) (4)?

5. Did the bankruptcy court err as a matter of law by confirming the plan even though it purports to adjust not only the city's liability, if any, on pension claims, but also the retirement system's liability on those claims, in violation of 11 U.S.C. § 941?

STANDARD OF APPELLATE REVIEW

In an appeal from an order of the bankruptcy court the district court conducts a plenary review of legal conclusions. Conclusions of law and statutory interpretations are reviewed *de novo. See United States v. Springer*, 609 F.3d 885 (6th Cir. 2010).

STATEMENT OF THE CASE

On July 18, 2013 the City filed a petition for relief under chapter 9 of the bankruptcy code ("code"). On December 3, 2013 the court held that the City met all of the statutory requirements of 11 U.S.C. §109(c). The court ruled that the City could enter chapter 9 bankruptcy and could impair pensions without violating the Mich. Const. *See In re city of Detroit*, 504 B.R. 97, 110 (2013) (Dkt 1945).

The court concluded that art. IX, § 24 of the Mich. Const. prevents the City or the state from reducing pension benefits. But the court held that it was not subject to those restrictions. The court reasoned that bankruptcy courts are authorized by the code to impair contracts. Thus, "(impairing) contracts is what the bankruptcy process does;" and pursuant to the Mich. Const., pension obligations have "the status of contractual obligations;" and are not entitled to "greater protection than ordinary contract debt." *Id.*, at 150. The court concluded, that if the bankruptcy process can impair contracts and pension obligations are contractual obligations, it follows that the City can impair pensions through chapter 9 bankruptcy. *Id.*, at 154.

STATEMENT OF FACTS

This case is about whether the Governor can consent to a violation of the Michigan Constitution by the state or its officials. This case, is also about, the more than 22,000 people who came to work for the City as young men and women; and in the words of Winston Churchill: "(had) nothing to offer but blood, toil and tears;" they worked hard - as police officers, firefighters, bus drivers, among others - proud to serve their City and gratified to provide a modest standard of living for their families. Exit interviews ended with a handshake and the passing of an envelope with pension promises. They thought that their pensions were secure.

Though, they were not necessarily familiar with the state's constitutional pension clause, they believed that the state would protect them - not only because it was the right thing to do - but because the City is a creature of the state, and if the City was financially unable to protect their interests, surely the state would. They earned their retirement. They paid into the retirement system, over a lifetime of hard work, and now relied on the pensions that they have been promised to retire with dignity.

Chapter 9 is about shared sacrifice and retirees have sacrificed. In the early 1970's, Detroit's public safety workers were well paid, only behind those in New York and Chicago. As time passed, City workers accepted IOU's for their pensions and retiree healthcare in exchange for lower wages. The City deducted the cost of providing the insurance from wages and reminded workers that pensions and retiree healthcare, were part of their overall compensation package. The concessions have extracted a toll. For example, the city of Seattle, recently enacted a $15 per hour minimum wage ordinance. A barista, in a Seattle Starbucks, now earns the same wage as a starting police officer in Detroit, who has taken an oath to protect the lives; defend the civil liberties; and to secure the safety of their fellow citizens.

Sacrifices are necessary because the City is insolvent, and desperately needs to fix its future. But, it's possible for the City to fix its future, and to keep the promises it made to those who gave so much, including the survivors of retirees who gave their last full measure of devotion to the City. Not only is it possible - it is legally required.

SUMMARY OF THE ARGUMENT

The bankruptcy court's decision eviscerates retiree's rights. It frustrates those who have invested a substantial portion of their lives in serving the public, only to see the fruits of their labors, snatched away. History teaches that at one point Rome burned while the Emperor fiddled. The state's first EM law (PA 72) enacted in 1990 was intended to be a proactive approach by the state to prevent cities from financial distress. But the state, sat passively watching, as the City's finances deteriorated. Rather than throw the City a life-preserver, the state held the City's head under the water - slashing 732 million dollars in revenue sharing from its budget since 2003. A drop in population accounts for some revenue loss, but 64 percent of the cuts were at the state legislature's discretion. The City, was not faultless, since 2008 it overspent its budget by 100 million dollars annually. Yet the legislature allowed the City to raise its debt level in order to borrow 250 million dollars to close its 2009 budget deficit.

The court's holding, that federal bankruptcy law, does not respect state pension protections is a *non sequitur*. The court held, that PA 436, the state law that authorizes municipal bankruptcy was constitutional, and as a consequence the Governor's authorization of the City's chapter 9 petition was valid. But the court's syllogism is flawed. Even, if PA 436 is constitutional on its face, a constitutional law cannot be applied in an unconstitutional manner. If the state's authorization was not valid, the issue of whether pensions can be reduced, is moot.

But even if the state's authorization was valid (which it was not), the issue of "pension rights" was not ripe for adjudication. Yet, even if the question of "pension rights" was ripe for adjudication, the court's conclusion that "(the) state constitutional provisions prohibiting the impairment of pensions impose no constraint on the bankruptcy process" was wrong.

If the City, is able to overcome the significant jurisdictional and federalism issues inherent in this case, the plan still must be in the "best interest" of creditors. In the chapter 9 context, this compares a plan's proposed reallocation of risk, to the hypothetical state of affairs if the bankruptcy had never taken place. The measure of fairness in the best interests test is that of state law; and forces comparison, of a plan's proposed state of affairs, to the "what if" of state law resolution. Under state law, pensions have absolute constitutional protection; more than fifty years of *stare decisis* and; legislative history, reinforcing those protections.

The City's plan also violates 11 U.S.C. §1123(a) (4), which requires that claims and creditors in the same class, receive the same treatment. Some retirees on the plan's effective date, were left substantially impaired, while others of the same classes were left unimpaired in violation of §1123(a) (4) of the bankruptcy code.

The City's retirement system, consists of two separate pension trusts that are independent from the City, and are legal entities with the power to sue and be sued. They were also creditors of the City in its chapter 9 proceeding. Section 941 of the code only allows the City to adjust its own debts. The City's plan proposes to adjust the debts of the non-debtor pension funds which is improper.

The City is sure to argue that this appeal should be dismissed on the grounds of equitable mootness. As discussed below, there is no merit in that argument.

ARGUMENT

I. The Bankruptcy Court Erred in Concluding that Pensions could be Impaired Prior to the City Proposing to Impair Pensions.

A. The Case or Controversy Requirement of Article III Admonishes Federal Courts to Avoid Premature Adjudication.

Assuming, without conceding, that the Governor's authorization of the City's chapter 9 petition was valid, the court was required to avoid the constitutional issue of "pension rights," until and if, the issue was properly before the court. Initially the court agreed stating: [("the) court will not consider the issue of the treatment of pension rights when considering the eligibility objections"] (Dkt 642) at 6 (¶ VI.).

The court changed its mind explaining: "Early in the case, the Court expressed its doubts about the ripeness of this constitutional issue in the eligibility context. The Court was concerned that the issue of whether pension rights can be impaired in bankruptcy would be more appropriately considered a confirmation issue, as the United States argues now……. the Court reconsidered that position and now agrees that the issue is ripe at this point." (Dkt 1945) n.21.

The United States and the State of Michigan had correctly argued that the issue was not ripe; that the Governor's authorization "had not caused or compelled a diminishment or impairment of accrued pension benefits" and that the possibility of a future plan being proposed to impair pensions was "too conjectural or hypothetical to give rise to an injury in fact." (Dkt 1149; 1547). *See e.g., Poe Ullman*, 367 U.S. 497, 503 (1961) [("we) have admonished courts not to entertain constitutional questions in advance of the strictest necessity"].

The court explained that its ruling in the eligibility context allowed the parties and the court to now "focus" on whether a future plan can be confirmed. *See In re Detroit* at 141-142. The court said that the arguments that the issue was not ripe had "some appeal," however, that the dispute was "not an abstract disagreement……. It is here and it is now." (Dkt 1945) at 58.

But "convenience cannot justify a departure from the settled rules of law." *See Ashwander v. TVA*, 297 U.S. 288, 347 (1936); *see also Valley Forge College v Americans United,* 454 U.S (1982) ["to establish an Art. III case or controversy, a litigant first must clearly (show) that he has suffered an "injury in fact"]; *Texas v United States,* 523 U.S. 296, 301 (1998). [(A claim is not ripe) "if it rests upon contingent future events that may not occur as anticipated, or indeed may not occur at all"]; *Rescue Army v. Municipal Court*, 331 U.S. 549 (1947) [a dispute is ripe only if the issues are presented in a "clean-cut and concrete form"].

The doctrine of ripeness arises from Article III constitutional requirements that federal courts are only empowered to decide cases and controversies and from prudential concerns for not exercising jurisdiction. *See Reno v. Catholic Soc. Services* 509 U.S. 43, 57 (1993). Thus, ripeness acts "to prevent the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements." *See Abbott Laboratories v. Gardner,* 387 U.S. 136, 148-49 (1967).

However, ripeness necessarily involves more than merely avoiding "abstract disagreements." A court must also "evaluate both the fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration." *Id.* at 149. Neither party would have suffered any prejudice from the court "withholding consideration." Allowing the advocates to fully develop an issue, prior to deciding, benefits the parties and the court. In answering the pension question, before the question was asked, the court weakened the retiree's bargaining position, and likely de-incentivized the City's willingness to compromise.

B. In Order to Affirm Confirmation of their Plan, the City must Persuade this Court, that there is a Reasonable basis to Interpret the Language of Article IX § 24 of the Michigan Constitution, to mean the Opposite of what it says.

Article IX § 24: "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby." It cannot "be presumed that any clause in [a] constitution is intended to be without effect." *See Marbury v. Madison,* 5 U.S. (1 Cranch) 137, 174 (1803); *see also Koontz v. Ameritech,* 466 Mich. 304, 312 (2002). Meaning must be given “[to every word, phrase, and clause..... (to avoid rendering) any part of the statute surplusage or nugatory"].

If the clause had only intended to bring pension debt within the protection of the contracts clause, it could have simply read: "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof.” But, that is not where the clause ends; it goes on to conclude: "which shall not be diminished or impaired thereby."

Art. I, § 10 of the Mich. Const. protects all contractual obligations against impairment. Art. IX, § 24 of the Mich. Const. separately prohibits impairment of pensions. The logical conclusion, is that this separate treatment, signals the legislature's intention to give pension obligations additional protection against impairment, not afforded to other sorts of contract obligations.

After all, if the legislature had wanted to merely protect pensions to the same extent that contracts are protected under Art. I, § 10, it need only have deemed pensions to be contracts. Art. I, § 10 then would have provided that protection. The fact that Art. IX, § 24 separately prohibits the impairment of pensions as contractual obligations indicates an intention to give them additional protection against impairment by the state.

C. Federal Bankruptcy Law and Article IX, § 24 of the Michigan Constitution Peacefully Coexist.

As we explain below, the plain language and legislative history of the Bankruptcy Act, make clear that federal bankruptcy law defers to the states on many issues. And bankruptcy courts have absolutely no authority to second-guess a state determination that - like Michigan – is based on its state constitution. Congress's decision to make the states the arbiters of when a City is specifically authorized to be a chapter 9 debtor; and numerous other instances where federal bankruptcy law defers to state law is consistent with Congress's overall approach.

Like numerous other federal statutory schemes, the Bankruptcy Act is based on the principle of "cooperative federalism." *See, e.g., New York v. United States,* 505 U.S. 144, 167-168 (1992). All pre-emption cases, start with the assumption that the historic police powers of the states, are not to be superseded by federal law, unless that was the clear and manifest purpose of Congress. *See Medtronic Inc., v. Lohr,* 518 U.S. 470, 485 (1996) *quoting Retail Clerks* v. *Schermerhorn,* 375 U. S. 96, 103 (1963) [("the) purpose of Congress is the ultimate touchstone"].

According, to the Bankruptcy Act's legislative history "bankruptcy is mainly a procedural device, prescribing the method of accomplishing rehabilitation or liquidation, but generally leaving undisturbed legal relationships that existed before bankruptcy [and] incorporates state and general federal law in many important areas." *See H.R. REP. No. 95-595*, at 309, 310 (1977), (1978 U.S.C.C.A.N 5971).

Thus, the issue of preemption, must turn on something more than "generalized notions of congressional purposes" that are not contained within the text of federal law. *See Wyeth v. Levine*, 555 U.S. 555, 575 (2009) *quoting In re Applebaum*, 422 B.R. 722 (9th Cir. 2009) ("The case for federal pre-emption is particularly weak where Congress has indicated its awareness of the operation of state law in a field of federal interest, and has nonetheless decided to stand by both concepts and to tolerate whatever tension there is between them"). In *Wyeth* the Court rejected the argument that because the federal government had long regulated drugs the presumption should not apply. The Supreme Court said it "misunderstands" the presumption which "accounts for the historic presence of state law, but does not rely on the absence of federal regulation." *Id.*, at 1195.

Federal bankruptcy law recognizes that "property interests are created and defined by state law. *See Butner v. United States*, 440 U.S. 48, 55 (1979). *Butner* was decided after the code was enacted, but it's consistent with public policy before the code was enacted. *See e.g., Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 161 (1946) [("valid obligations) at the time a petition in bankruptcy is filed is a question which, in the absence of overruling federal law, is to be determined by reference to state law"]. *See also Richardson v Schafer*, 689 F3d 601 (2012) ("bankruptcy law is not so pervasive, nor is the federal interest so dominant, as to wholly preclude state legislation in the area").

In fact, the code looks constantly to state law to characterize property, determine its owner, and serve as the starting point for the bankruptcy estate. Thus, it is reasonable to think that given its respect for state law, chapter 9 would also look to state law, and accept that pension benefits cannot be reduced because it represents a special form of property in Michigan.

For example, 11 U.S.C. § 522(b) (2) (incorporating state personal exemptions); § 544(b) (making state law on voidable transfers available to the bankruptcy trustee); § 523(a) (5) (15) (whether a domestic support payment will be treated as support or distribution of property) and; § 365(c) (whether breach of contract has occurred looks to state law even in bankruptcy); *See In re Supreme Beef Processors*, 468 F.3d 248, 255 (5th Cir. 2006) "[(... the code does not define property rights... (but look to) such rights as provided in non-bankruptcy law). Federal law establishes a baseline of protections, which the states may go beyond. *See e.g., State Constitutions and Individual Rights, 90 Harvard L. Rev*. 489, 491 (1977).

D. **The Governor's Recourse Was Not to Unilaterally Disregard Art. IX, § 24 of The Mich. Const., But To Challenge It Through Legally Available Channels**

We begin with first principles. The City is "a creature of the state" and possesses only the power and authority granted by the Michigan Constitution and state statutes. *See Sinas v City of Lansing*, 382 Mich 407, 411 (1969). The City literally has no power to act unless and until the state confers power upon it. Accordingly, if the Governor or the City lack authority to take particular action under the Michigan Constitution then their action is plainly contrary to law and cannot stand.

The Governor only has the authority that the state constitution grants. PA 436 cannot enlarge those powers. The Governor said, "I took an oath to support and defend our state constitution, without exceptions. My obligation to carry out that oath is not a matter of personal preference." [In response to the Sixth Circuit's decision in *DeBoer v Gov. Snyder*] (Detroit News 11- 4–2014). The Governor was merely restating a long-standing fundamental of American jurisprudence as explained by the Supreme Court: "All the officers of the government, from the highest to the lowest, are creatures of the law, and are bound to obey it." *United States* v. *Lee,* 106 U. S. 196, 220 (1882). The Detroit Free Press was blunter imploring the Governor to uphold Article IX, § 24 of the Mich. Const. "[The Governor] took an oath to uphold that constitution. And now he must. That's the thing about oaths. You have to keep them, even when it's difficult, or inconvenient. Or not politically expedient… [It is not a trivial matter. If the Governor] blows through a constitutional obligation, enshrined in the very document that gives him the authority to govern – or comes up with a cowardly way to avoid it, it would de-legitimize his authority as the state's chief executive……"]. (12–5- 2013).

The Michigan Supreme Court has long-held that the Governor has no authority outside of his legal boundaries. *See Dullam v. Willson*, 19 N.W. 112 (Mich. 1884); *see also Richardson v Jackson Co*, 432 Mich 377, 381 (1989) ("if the Governor acts outside the scope of his authority, his actions are *ultra vires*"). In a chapter 9 context if the official authorizing the bankruptcy is acting *ultra vires*, then the bankruptcy filing is not "specifically authorized," and the petition must be dismissed. *See Suffolk Off-Track Betting Corp.*, 462 B.R. 397, 420-21 (2011) [("authorization) exceeded *Suffolk County's* authority and is unconstitutional and void. Accordingly, *Suffolk OTB* has not complied with § 109(c) (2), and is therefore ineligible to be a chapter 9 debtor"].

If PA 436, made the Governor's authorization valid, it renders all other state constitutional provisions that carefully delimit the governor's powers superfluous. It's conceivable that anything involving state officials could be circumvented by legislative action or executive fiat.

II. The Bankruptcy Court's Analysis, that simply because Michigan Expressly Authorized the City to Enter Chapter 9 it accordingly consented to All Bankruptcy Court Actions Is Wrong Because the State Cannot Consent To a Violation of Its Constitution.

A. Constitutional Principles of State Sovereignty Limit the Power of the Bankruptcy Court in a Chapter 9 Proceeding.

In a chapter 9 case, the bankruptcy court's role, is significantly more limited than in a chapter 11 case. *See Ashton v. Cameron County Water Improvement Dist. No. 1*, 298 US 513 (1936) (held municipal bankruptcy legislation was unconstitutional because it infringed upon the sovereign powers of the states).

The Supreme Court, in upholding the subsequent Bankruptcy Act, found: "The statute is carefully drawn so as not to impinge upon the sovereignty of the State." *See United States v. Bekins*, 304 U.S. 27, 58 (1938).

The Court also noted that Congress, had been "especially solicitous" in enacting legislation to prevent bankruptcy court action from interfering with state control over municipalities. *Id.* at 49-50. *See e.g., Hightower v. Tex. Hosp. Ass'n*, 65 F.3d 443, 448 (5th Cir. 1995). Congress did not extend federal Employment Retirement Income Security Act (ERISA) requirements to public pensions, because '[Congress was reluctant to interfere with.... public pension plans due to the resulting federalism implications"].

B. A State's Consent or Acquiescence to Unconstitutional Intrusions on its Sovereignty does not nullify its Citizen's Right to Challenge Arbitrary Governmental Power.

The bankruptcy court suggested, that by simply authorizing a municipality to file for chapter 9, a state waives its sovereignty. *See In re Detroit* at 150. This conclusion is contrary to the Supreme Court which held, "the departure from the constitutional plan cannot be ratified by the "consent" of state officials." *See New York v United States*, 505 U.S. 144, 182 (1992). The bankruptcy court said: ("states can consent to the enlargement of the powers of Congress beyond those enumerated in the Constitution") (*quoting New York*, but changing "cannot" to "can"). *Detroit* at 149.

Inherent in this view, is an unsupportable assumption that rights emanating from the Tenth Amendment, belong to the states and to the states alone. Not only, did *New York* reject this view, but the Supreme Court unanimously rejected an identical argument that "states and states alone" can assert a challenge that "state sovereignty" has been violated under the Tenth Amendment. *See Bond v. United States*, 131 S. Ct. 2355, 2363 (2011) ["Fidelity to principles of federalism is not for the States alone to vindicate"]. *See also Shelby v Holder*, 570 U.S. ___ (2013) ["outside the strictures of the Supremacy Clause, States retain broad autonomy in structuring their governments and pursuing legislative objectives"].

In light of *Bond*, the bankruptcy court's dismissal of certain "puzzling language in *New York*" is wrong. *See Detroit* at 148. *New York*, when read in light of *Bond,* stands for the proposition, that because federalism's protections are not designed solely to protect the states alone, those rights cannot be consented away by the state. A state cannot give something away that it does not solely possess. It is too simplistic to say that, by authorizing one of its cities to file for chapter 9, a state waives its right to enforce constitutional law protecting individuals within the state.

Assuming, that the protections of federalism can be consented away (which they cannot), any analysis of federalism predicated on consent must consider the scope of such consent. The City argued that *Bond* "does not delineate the line between federal and state power and merely holds that an individual who is a party to an otherwise justiciable case or controversy has standing to challenge a federal statute on grounds that it intrudes on powers reserved to the states." (Dkt 7143) at 66 *et seq*.

This is a distinction without a difference, a matter of semantics. In *New York* at 159, Justice O'Connor noted: ("In the end, just as a cup may be half empty or half full, it makes no difference whether one views the question at issue in these cases as one of ascertaining the limits of the power delegated to the Federal Government under the affirmative provisions of the constitution or one of discerning the core of sovereignty retained by the states under the Tenth Amendment"). This respect for state sovereignty is an integral mechanism of securing individual liberty. *Id*. at 181.

The idea that the state impliedly "consented" to a violation of its constitution has also been repudiated by the Michigan Attorney General who said "….nothing supports the court's broad view of consent (and) it should be rejected…under Mich. law, neither the Governor nor the City's Emergency Manager: have the authority to (place a contingency in the city's Chapter 9 authorization) that supports a particular religion or violates an individual's right to religious liberty. Mich. Const. art. I, § 4. Nor, could the City propose a plan that limits citizens from petitioning the City for redress. Mich. Const. art. I, § 3. Similarly, the City cannot propose a plan that diminishes or impairs accrued pension rights of public employees. Mich. Const. art. IX, § 24." (Dkt 481). The assertion that simply because the state of Michigan expressly authorized the City to file chapter 9 it accordingly consented to all bankruptcy court actions, is wrong.

Because, §109(c) (2) provides that state consent is a prerequisite to any chapter 9 case, any such argument, renders § 903's limitations inapplicable to bankruptcy court action. The state's authorization of the City's bankruptcy does not render valid court action that would otherwise violate the Tenth Amendment and § 903.

III. The Plan is not in the Best Interests of Retirees Because Dismissal of the Case would Result in a Greater Recovery under State Law.

A chapter 9 plan must be in the "best interests" of creditors. *See In re Sanitary & Improvement Dist. No.* 7, 98 B.R. 970 (D. Neb. 1989) [11 U.S.C. § 943(b) (7) ("simply requires the court to make a determination of whether or not the plan as proposed is better than the alternatives")] (**"Creditors are given guarantees as individual creditors under the best interests test")**, *Id.*, (emphasis in original). *See In re Adelphia Communications Corp.*, 361 B.R. 337 (N.Y. 2007) "[(if) even one dissenting member of an impaired class would get less under the plan than in a hypothetical liquidation, the fact that the class as a whole approved the plan is immaterial"]. *See also Kelley v. Everglades Drainage Dist.*, 319 U.S. 415, 418 (1940).

B. Michigan Law Gives Municipal Retirees the Extraordinary Remedy to Foreclose on Municipal Assets to Compel Payment in the Event of a Municipality's Default on its Pension Obligations.

The pre-code common law view, treated the municipal debtor as having few physical assets available for creditors, and instead focused almost exclusively on the ability to tax. In order to carry out their responsibilities a municipal corporation must possess physical assets such as buildings, fire engines, police cars, etc. Such property is held for public purposes, and to allow such assets to be executed upon would impair the municipality's ability to carry out its duties.

The delegates to the Michigan Constitutional Convention had two pension concerns: First, to ensure that pension funds were sound. *See e.g. Shelby Twp. Police and Fire Ret. Board v Charter Twp. of Shelby,* 438 Mich 247, 264 (1991). [We conclude that (state law) mandates the township to annually contribute to the retirement system an actuarially determined amount, which will ensure that funds are available to cover pensions"]; and second, to ensure if a municipality defaulted on its pension obligations that retirees had recourse as evident by the following constitutional convention debate exchange:

MR. SHACKLETON: Mr. Chairman, a question to one of the Committee, if I may. If a new fund were created by a present political subdivision, or should in the future a new political subdivision be created and want to set up a pension fund, would they have to that first year put in funds sufficient to take care of past service? If not how would past service funds be accumulated?

CHAIRMAN MARTIN: Mr. Van Dusen.

MR. VAN DUSEN: The answer, Mr. Chairman to Mr. Shackeltons's first question is no, they would not have to immediately fund past service benefits. They would have to put in enough to currently fund current service benefits……The only constitutional requirement would be the current funding of current service benefits.

MR. SHACKLETON: If they did not properly take care of the past service then, where would your contractual obligation come out?

MR. VAN DUSEN: An employee who continued in service of the public employer in reliance upon the benefits the plan says he would receive would have the contractual right to receive those benefits and, ***would have the entire assets of the employer at his disposal from which to realize those benefits***. 1 Official Record, Constitutional Convention 1961, pg. 774. (Emphasis added by Michigan Attorney General, Frank Kelley). *Attorney General Opinion* Number 5076, August 9, 1976.[1]

Constitutional debates have been found relevant to determine the meaning of particular constitutional provisions. *See County of Wayne v. Hathcock,* 471 Mich. 445, 468-469 (2004) ("The primary objective .... is to determine the text's original meaning to the ratifiers, the people, at the time of ratification........"). *See also Frey v Dep't of Management and Budget*, 429 Mich 315, 338 (1987) [("We cannot ignore the constitutional convention (debates)"]. It should also be noted that Attorney General Opinions are binding on state officials unless overturned by a court, and are often relied on by courts as authoritative. *See Macomb Prosecutor v Murphy*, 464 Mich 149 (2001) [("Attorney General's) opinions while not precedentially binding, can be persuasive authority"].

Article IX, § 24 of the Michigan Constitution, known as Proposal 40 during the convention, was adopted by the constitutional convention delegates in a 117-1 vote.

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[1] Jack Faxon, a delegate to the Mich. Const. Convention stated in a 2014 interview that "(during the convention) we argued over a lot of issues, but that wasn't controversial at all. Getting people to agree that pensions should be protected was like getting them to agree that Sunday is Sunday." Toledo Blade, Jack Lessenberry, (February 7, 2014).

It is clear that the DIA is the City's most valuable asset.

<u>The Detroit Institute of Art (DIA)</u> - This case is not about, and never has been, about whether the DIA is important for the City's future. Many great cities do not own a publicly funded art museum. The many legal issues surrounding the DIA presented a Gordian knot for the court. Unfortunately, as will be shown below, the court in the cutting of the knot, also severed some basic legal principles.

The City argues that it cannot be compelled to monetize the DIA. But, that argument fails in the face of two important facts. First, the City chose to monetize the museum assets ("the DIA Settlement"). Second, the entire settlement was predicated on the notion that pension claim holders have at least a colorable claim against those assets. Initially, the City recognized its unique circumstances:

> Let me take the Devil's position on this. What if I said, so what? We told [the DIA] they are vulnerable. ***Our job is not to protect art, but to save Detroit. We have said ALL options are on the table and being considered. We meant it. This is a financial emergency and financial emergencies require extraordinary measures, including, maybe, selling art.*** Ike's job was to win the war. He knew that to win the war he had to take Normandy. He also knew that signing the invasion order was tantamount to signing 50,000 death certificates. His job was to win the war. I think we are trying to cut too fine a line. I don't want to pack up the art, but I wasn't hired to protect it and neither were you. We have a job to do and we can't afford to get bogged down with side issues that are essentially moot. ***Our responsibility is to statute and the citizens of Detroit.*** If Al Taubman, Keith Crain don't like it . . . . They can buy the art and gift it back to the DIA or they can roll the dice and take their chances……. (Email from B. Nowling to K. Orr re: Thoughts on DIA, dated May 28, 2013, (emphasis added) (Dkt) (main case).

The DIA as a "Charitable Trust" - The DIA, was created in 1885, as a nonprofit corporation for the purpose of establishing a public art institute. *See Detroit Museum of Art v. Engel*, 153 N.W. 700, 701, (Mich. 1915). The DIA could not sell or dispose of its general art collection, absent authorization by the Michigan Legislature. *Id.* The state legislature also authorized the City to issue bonds pledging the City's full faith and credit to raise the funds to erect additional buildings for the DIA. But, the City's ability to use funds to support the private museum was challenged, and the DIA transferred its art and remaining assets to the City in 1919. (Dkt 7272).

The Attorney General contends that while the City was vested with ownership of the artwork, it is in trust, and cannot be sold. The Attorney General asserted that the art collection was placed in trust pursuant to explicit agreements; and the City is the trustee with legal title to the art collection, but without beneficial or equitable interest. (Dkt 5338). The Attorney General further argued that as a legal entity holding assets for a charitable purpose, the DIA is a charitable trust, and its charitable purpose is the exhibition of art for the public.

At first blush, the Attorney General's arguments are persuasive, but there are considerations that ultimately call into question the charitable trust conclusion. First, there is no evidence revealing that the instruments of conveyance related to the transfer of the DIA property to the City, expressly provide that the property should be held as restricted charitable-trust property. Even, if a charitable trust was created in 1885, the charitable trust was converted or dissolved by the nonprofit's act of conveying title of the art collection and other property of the DIA to the City without specifying that a restricted trust was being created.

Second, most charitable trusts are created through a private individual's outright testamentary or inter vivos gift to a municipality or other entity. In the case of the City, the art collection and other DIA assets that might be sold, were originally acquired through acquisitions made by a private nonprofit corporation or by the City using public funds. This factual distinction which was overlooked by the Attorney General is relevant in reaching any legal conclusions.

Interestingly, the Attorney General did not articulate an alternative constructive-trust argument, which does not require an agreement or intention to create a trust. This may be due to the fact that in the Sixth Circuit, bankruptcy courts may not impose constructive trusts on property of the estate, unless a constructive trust was deemed to be impressed upon the property before the bankruptcy petition was filed. *See In re Morris*, 260 F.3d 654 (6th Cir. 2001).

Museums May Sell Art - The Association of Art Museum Directors (AAMD) disapproves of museums selling artwork (what is referred to as deaccession) for any other reason than to “enhance” its collection. But a museum that chooses to sell its art collection is not violating the law. If a museum closes because of financial distress, it often auctions off all of its collections [(30 museums closed in 2009)]. The legal standard, for permissible deaccessioning, is generally determined with reference to the method of acquisition. If the pieces were acquired by gift, and if the donor imposed a restriction on the alienability of the gift, either by requiring that the museum keep or display the piece in perpetuity, or denying the museum the right to sell the piece, the museum has a duty to abide by the donor's wishes. But, despite contrary donor agreements, courts often allow a museum to sell the object by reforming the gift instrument under the doctrine of *cy pres*. But it's likely that retirees can be made whole by selling only City purchased art, thus, an examination of donor imposed restrictions, or any discussion of the Rule against Perpetuities or the *cy pres* doctrine, can be avoided.

For example, less than 5 percent of the total DIA collection was appraised and valued from 452 to 866 million dollars (Reuters, 12-4-2013). All of the City purchased art was not appraised. Another city-commissioned report valued the collection much higher ($2.76 to $4.6 billion), although, the report estimated that in liquidation, the collection would sell from between $850 million and $1.8 billion. And another report, commissioned by the bond insurer FGIC, estimated the value of the collection at $8.5 billion.

The DIA director said "we believe (selling art) would not be in the (DIA's) long-term interest" (Art Beats Magazine, 5-24-2013). That sounds like a "shouldn't" statement, not a "can't" statement. The works absolutely can be sold; as we've seen repeatedly, museums (including the DIA) sell art objects all the time.

For example, the DIA sold a flag used by George Custer's 7th Calvary at the Battle of the Little Big Horn in 1876 for 2.2 million dollars in 2010. In 2014 the Georgia O'Keeffe Museum sold one "classic flower painting" for $44.4 million. In 2014 the Delaware Art Museum, sold a painting for $4.25 million dollars to pay museum debts. The Edsel and Eleanor Ford House in Grosse Pointe, Michigan is a non-profit museum. Upon Eleanor Ford's death in 1976, it was her wish that the property be used for "the benefit of the public." But, that did not stop the museum from selling a Cézanne in 2013 to a private buyer for $100 million. The museum did not publicize the sale, which only became public as the result of a tax return, because "(they did not want to) cause any issues with the city's bankruptcy." (Det. News, 12-19-2014).

The DIA has over 50,000 Artworks in Storage - In 1988, the average annual cost of keeping an object in storage was estimated to be $30 per square foot. *See 20 S. Cal. L.J., Let Them Sell Art: Why a Broader Deaccession Policy Today Could Save Museums Tomorrow*, 365, 366 (2011). It's also expensive to safeguard art not on display. For example, in 1982, four 17th Century European paintings (including a Rembrandt) in

DIA storage were stolen and in 1979, a DIA employee was convicted of stealing a number of Picasso and Rueben's drawings.

<u>The DIA is a City Department</u> - In 1919 the DIA became a City department. During, the city's financial problems in the 1970s, the state took over its funding. But, the museum's reliance on government funding was a Faustian Bargain. The museum never seriously invested in its endowment until the late 1990s, long after it was clear that no "white knight" was going to save it. Now the "chickens have come home to roost." The DIA should be made to face the consequences. The DIA can't, when convenient be a City department using taxpayer monies to buy art, and then when it's inconvenient claim that all of its art is held in a charitable trust. If anyone believes that a Monet is worth more to future generations than its sale would be to current retirees, they should make their case. But they should not be able to merely chant the words "public trust" and end the discussion.

IV. The Plan Improperly Imposes Non-Consensual Less Favorable Treatment on Retirees Who Have Not Individually Agreed To Its Applications to their Claims in Violation of 11 U.S.C. § 1123(a) (4).

Whether "unfair discrimination" is looked at through the lens of § 1123(a) (4) (requiring the same treatment of similar claims); § 1122(a) (requiring that claims must be substantially similar to the other claims in the same class) or the "best interest test" (retirees are given guarantees as individuals regardless of the class vote), any distinction, in this case, between classes and claimants is a matter of semantics.

As Justice Douglas indicated in *Avon Park*, the origins of unfair discrimination are partly in the bankruptcy goal of equality of treatment, that each claimant receives substantively the same treatment. And the starting point for unfair discrimination analysis is in equality of treatment. *See Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) [("one of the) prime purposes of bankruptcy law.....a ratable distribution among creditors of a bankrupt's assets......"). *See e.g., In re Greater Bay Hotel & Casino, Inc.*, 251 B.R. 213, 231 (Bankr. D.N.J. 2000) [rejecting confirmation on the basis of unfair discrimination 50% or more between similarly situated creditors]. *Id.* at 231.

Those that face greater impairment should have a greater voice. *See also In re D & W Realty Corp.,* 165 B.R. 127, 129 (S.D.N.Y. 1994) ['(A) rule that (gives) unsecured creditors who hold a very small proportion of the unsecured debt the ability to control the voting process..... over the objection of a creditor who has a much greater interest in the assets of the debtor.... undermines the democratic process that is intrinsic to Chapter 11"]. In this case, class 10, 11 and 12 voting was controlled by "unimpaired" class members. Unimpaired creditors do not get to vote and are deemed to have accepted the plan.

ASF Recoupment - The Annuity Savings Fund (ASF) recoupment is directed at General Retirement System (GRS) participants that contributed 3%, 5%, or 7% of their gross pay after tax. Upon retirement, the contributions and the interest accrued, was paid in either one lump sum or a regular payment on a retiree's pension check. Such programs are not uncommon (e.g., State Employees Retirement System, etc.). The City argued that ASF was a violation of Michigan PA 314 (1965) Public Employee Retirement System Investment Act (PERSIA); *ultra vires*; and was a breach of the trustee's fiduciary duties. (Dkt 5034) at 172.

The City's remedy is class based restitution from the recipients of the ASF payments. (Dkt 4392) at 24. The Mayor, a City Council member, and the City Treasurer were GRS trustees. Despite the City's assertions that the ASF was somehow nefarious; the City plan restores ASF monies recouped from retirees if the GRS trust reaches certain funding levels. (Dkt 8045) (Exhibit II.B.3.r.ii.C).

For 30 years the GRS, by mutual agreement with the City, distributed ASF payments that can best be described as being a rainy-day fund designed to aid retirees whose pensions on average are $19,000, with annual ASF payments on average of $250. The bankruptcy court said: "(It) does not rule on the merits of the City's claim to recoup ASF monies or the merits of the GRS participant's defenses (but) finds that the defenses to ASF Recoupment asserted by the objecting GRS participants likely have little merit." (Dkt 8993) at 50-51. But, an administrative law judge that conducted a full evidentiary hearing, reached a contrary conclusion:

> The City asserts that (the ASF program) wasn't mutual - an assertion I find frivolous given the prior litigation, given the City's concession in the prior litigation that it was an established prior practice. It's also -- I also find it frivolous based on the exhibits produced by the City in this case. The (City of Detroit's Fiscal Analyst Letter), which was an advice letter to City Council by its own staff which recounts in very specific terms that there was an existing prior practice that was well recognized....." (12-000-777-MERC) at 7.

The funds in a pension trust belong to their beneficiaries. The retiree maintains an equitable property interest in the trust *corpus* and any investment gain generated therefrom. The City cannot use the fund's assets for anything but their intended purpose. *See* MCL 38.133(8). *See e.g., Best v. Cyrus*, 310 F.3d 932 (6th Cir. 2002) ("A trustee's failure to attempt to collect contributions owed to a plan has been a breach of the duty to ensure that the plan receives the funds to which it is entitled").

The trustees are the ultimate arbiters of the pension trust, as long as they are acting within the law. The ASF program was legal. The pension trustees only owe their fiduciary duties to the retirement system's beneficiaries, not to the City. The Michigan Court of Appeals addressed this very issue in a decision holding that pension trustees could use 25 million dollars in "excess earnings" to reduce the City's required annual contribution. The court held that the ["the statutory language is unequivocal that the (trustees) determine the amount the employer contributes annually to the retirement system and that the employer, in turn, is "required" to make the contribution"]. *See RDPFFA v DPOA* (No. 293998) (unpublished) (2010).

The court held that "[given that the employer cannot challenge the trustees in regard to the amortization period during a period of underfunding, it follows that (there is no legal basis) to challenge an offset granted during a period of overfunding"]. Thus, the City has no legal basis to arbitrarily "recoup" ASF monies retroactively to 2003, for a program that was within the GRS trustee's authority.

The bankruptcy court said that retirees would have an action for pension benefits from the City and not the retirement system in the case of a default. (Dkt 8993) at 210. That is not true. There are many instances where a retiree has maintained a successful action for pension benefits solely against one of the pension funds not naming the City. S*ee e.g., Rhoades v Bd. of Trustees of the General Retirement System of the City of Detroit,* Mich. COA #312081 (unpublished) (2014).

Class 10 (PFRS) - consists of three different treatments. 1) "substantial impairment:" those receiving cost of living adjustments (COLA) of 2.25% annually would have their COLA reduced to 1.04% The effect of reducing COLA would be cumulative and substantial over time. Beneficiaries, particularly women who generally collect benefits over a longer period of time would be disproportionately impacted. 2) "unimpaired:" those receiving "stabilization" funds that have household income less than a threshold amount tied to a percentage of federal poverty levels." 3) "unimpaired:" those also referred to as "Pre-69" retirees, which were left unimpaired on the effective date of the plan because they retired under a collective bargaining agreement that receive COLA based on active raises (they will not be eligible for any increase until ***at least*** 2016). As, the following chart illustrates "unimpaired" retirees comprised the majority of Class 10 voters.

Total	Pre-69 "Unimpaired"	Income Stabilized "Unimpaired"
7,800	3,587	2,000
The numbers are approximates based on court filings. But, the unimpaired voters, were able to control the outcome. The "income stabilization" numbers are at the low-end of the State Treasury's estimate of 6,000 – 8,000 for Class 10 and 11.		

Class 11: consist of three different proposed treatments. 1) "substantial impairment:" those that are subject to ASF Recoupment plus a reduction of pensions in the amount of 4.5% plus the elimination of COLA. 2) "substantial (but less so) impairment:" those that had their pensions reduced 4.5% plus elimination of COLA. 3) "unimpaired:" those receiving "income stabilization" funds."

Members	Subject to ASF Recoupment	Income Stabilization
20,200	9,900	4,000
The numbers are approximates based on court filings. But, the unimpaired voters, were able to control the outcome. The "income stabilization" numbers are at the low-end of the State Treasury's estimate of 6,000 – 8,000 in Class - 11.		

Class 12 (OPEB) - contained all retiree healthcare claims and consisted of two vastly different treatments. 1) Medicare eligible: retirees who the City covered virtually the same post-effective date as pre-petition date. 2) Non-Medicare eligible: retirees who generally, were forced to buy insurance on the open market ($6,000 - $14,000 annually). As, the following chart illustrates, the "Medicare eligible" retirees were able to control the vote to the detriment of substantially "impaired" retirees.

Members		Medicare	Non-Medicare
GRS	10,882	6,677	4,205
PFRS	8,272	4,469	8,008
Total	19,154	11,146	12,213
The numbers are approximates based on court filings. But, the unimpaired voters, were able to control the outcome. The numbers do not equal the above chart numbers because some retirees are not eligible for a healthcare "stipend" because either they receive healthcare by virtue of other employment or coverage on a spouse's policy.			

The "2014 OBEP Settlement" was Never Approved by the Court - When the City entered into bankruptcy it was current on its costs for retiree healthcare. Assuming, but not conceding, that healthcare benefits, normally shielded by the contracts clause, crumbles under the sword of bankruptcy law, it still cannot be terminated without due process. *See Perry v Sindermann*, 408 U.S. 593, 601 (1972) ("A person's interest in a benefit is a property interest for due process purposes...").

The "2014 OPEB Settlement" was never approved by the court. We did not have an opportunity to evaluate the settlement or to determine if there was a way to achieve the same proposed cost savings, with less onerous consequences to retirees. *See United States Trust Co. of NY v New Jersey*, 431 U.S. 1, 25 [("Not free) to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well").

The City should not be able to short circuit the [code] requirements .... by establishing the terms of the plan *sub rosa* ......"]. *See In re Braniff Airlines* 700 F.2d 935, 940 (5th Cir. 1993). The court noted that the transaction left little to be reorganized and was "in fact a reorganization." *Id. See e.g., Rule 9019 Settlements and the Confirmation Process: Favored Negotiation or the New Cram Down?* A.B.I (2008).

The fact, that a "Global" settlement, was approved by the court pursuant to its Confirmation Order, does not vindicate the absence of the court's approval of the "2014 OPEB Settlement." This is especially true, since the settlement, provided the foundation for the City to terminate its future liabilities for retiree healthcare.

The City will likely argue that class 10, 11, and 12 voted to accept the plan and thereby accepted the plan's treatment. This is too facile. The City gerrymandered class 10, 11, and 12 specifically to avoid the unfair discrimination test. *See, e.g., In re Barakat*, 99 F.3d 1520, 1525 (9th Cir. 1996) ("if the classifications are designed to manipulate class voting . . . the plan cannot be confirmed").

The improper classification disenfranchised certain retirees whose vote could have otherwise blocked confirmation. *See In re LeBlanc*, 622 F.2d 872, 878 (5th Cir. 1980) ("as a general rule the classification in a plan should not do substantial violence to any claimant's interest..."). To treat retirees vastly differently within same class (some entitled to 100% payment while others were left substantially impaired), but mandating that the class 10, 11, and 12 vote together violates the equal treatment mandate of § 1123(a) (4).

Treating pension claims as impaired, when they will be paid in full, is somewhat odd even in a system that employs a liberal notion of impairment. *See In re ACandS, Inc.* 311 B.R. 36, 43, (D. Del. 2004). [("It's) fundamentally unfair that one (claim) will be paid in full, while (another risks) receiving nothing... The court is informed that other judges have confirmed plans with such discriminatory classifications. This judge cannot do so in good conscience"].

V. The Bankruptcy Court Erred as a Matter of Law by Confirming the Plan Because it Purports to adjust not only the City's Liability, if any, on Pension Claims but also the Retirement System's Liability on Those Claims, in Violation of 11 U.S.C. § 941.

Section § 941 only allows a debtor to file a plan to adjust its own debts. The City's plan attempts to adjust the debts of the non-debtor pension funds. As previously discussed, it is well established, that a pension trust is independent from the City and owes it fiduciary duties to its beneficiaries and not the City. The most important determinant of a pension trust's health is its sponsor's willingness to make its annual required contribution. Over 60% of future pension payments are only possible because of the retirement system's investment earnings. The City has proposed not to pay anything to the retirement system from the City's general fund until 2023. And to provide much less than is required from outside funding sources (e.g., DIA Settlement). This violate state law and § 943 (b) (4) of the code.

In a 2012 case, illustrative of the tenuous position of pension trustees as the result of a plan's sponsor's failure to make its annual required contribution, the Northern Mariana Islands (CNMI), a United States territory, retirement system filed for chapter 11 bankruptcy. The bankruptcy court denied the petition because it found that the retirement system did not meet the code's definition of a "person," and therefore was not eligible for protection under chapter 11. The Northern Mariana Islands had refused to pay their required contributions; defaulted on a judgment; and as a consequence the pension fund had less than two years of assets available. The bankruptcy court stated: "The trustees attempt to find a solution to this dilemma is creative and praiseworthy………. The dismissal of this case will leave the Fund and its beneficiaries at the mercy of the Commonwealth…" *See In re Northern Mariana Islands Retirement Fund* (Case no. 12-00003) (2014).

GRS and PFRS are relatively well-funded because both funds have successfully implemented legal proceedings to enforce state law and require the City to make its annual "normal" cost contribution to the retirement system. GRS and PFRS have combined assets of 5.4 billion dollars (June 30, 2013). If invested in treasuries, without another contribution from the City, their assets would last 10-12 years at its pre-petition payment rate. And based on the plan's assumed rate of return (which is 6.75%) would last over 30 years. Any current GRS or PFRS liabilities are largely attributable to the City failing to make their required cost contribution since 2011.

One reason why the City's plan brings legacy costs down from a projected 70% of general fund revenues in 2020 to close to 10% is because of the proposed pension holiday. The City's proposal to adjust the debts of the retirement system, not only compounds its problems, it is illegal. *See In re City of Colorado Springs Spring Creek General Improvement Dist.*, 177 B.R. 684, 694 (Bankr. D. Colo. 1995) ("Where a plan proposes action not authorized by state law, or without satisfying state law requirements, the plan cannot be confirmed"). *See also Western Michigan University Bd of Control v State,* 455 Mich 531, 539 (1997) [annual employer contribution must take place when an employee earned the benefit]. Section 943(b) (4)'s requirement that any confirmable plan must, not be inconsistent with state law acts as an additional protection of state sovereignty].

Thus, sections 109(c) (2), 903, 904 and 943(b) (4) work in harmony to protect state sovereignty and the states' control over their political subdivisions. The city's plan proposed nonpayment of obligations owed to GRS and PFRS violates MCL 38.1140m and § 943(b) (4).

While there is a dispute over the amount of the pension funds liabilities, despite the City's assertions to the contrary, the amount of underfunding is not relevant. It only ***becomes*** relevant if the City had decided to terminate their relationship with the pension funds. It is analogous to an individual that terminates their relationship with their mortgage holder. The "unfunded" mortgage balance would be due at the time the individual "terminated." But, if the relationship was not terminated, and the mortgagor continued to make the required payments there are no concerns.

Similarly, if the City makes their required annual contribution to the retirement system, the retirement system is sound. Although the goal of any pension system is 100% funding, gaps are a normal process of retirement systems, and are addressed over very long time frames (state law allows retirement systems a thirty year amortization period). The City's approach to pensions has been like drawing a line in the sand with an "etch-a-sketch." It is a moving target. When one line is "washed out" another line is drawn. The City has never said how much it needed to save on pension obligations and its justifications for any proposed changes.

The average pension fund return over the last twenty-five years is 8.8% (even including the great recession of 2008-09). And the City has taken steps to address future legacy costs (e.g., higher contributions for new employees, freezing the system, raising the retirement age and lowering the assumed rate of return).

If the bankruptcy were to be reversed today the City would not owe what, has been purported to be a 3 billion dollar liability, it would owe 106.8 million dollars. The City is in arrears to its pension funds in the following amounts:

<u>PFRS</u>: According to the 2013 Independent Audit Reports for the PFRS, the Debtor failed to make 2012 and 2013 payments to the PFRS totaling $71 million.

<u>GRS</u>: According to the 2013 Independent Audit Reports for the GRS, the Debtor failed to make 2013 payments to the GRS of approximately $35.8 million. The City proposes to pay nothing from its general fund nor annually contribute

VI. This Court Should Rule that the Release and Exculpation Provisions in the City's Plan of Adjustment Do Not Extinguish the Rights of Retirees to Assert Claims against the State.

A. The Plan's Third-Party Non-Consensual Release of the State is Improper because it is Impermissibly Broad and Encompassing.

Relying on the Supreme Court's holding in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988), that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code," a number of circuits have construed § 105(a) as "not authorizing bankruptcy courts to create substantive rights [non-consensual third-party non-debtor releases] that are otherwise unavailable under applicable law, or constitute a roving commission to do equity." *See United States* v. *Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986); *accord In re Dairy Mart Convenience Stores, Inc*., 351 F.3d 86, 92 (2d Cir. 2003) [("the language of 105 'suggests' that power be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective." 2 *Collier on Bankruptcy* ¶ 105.01[1]"]; *see also In re Morristown & Erie R.R. Co.,* 885 F.2d 98, 100 (3d Cir. 1989).

These circuits have interpreted § 105(a) as a mechanism only used to enforce other, specific provisions in the code. *See,* e.g., *In re Ludlow Hosp. Soc., Inc*., 124 F.3d 22, 28 (1st Cir. 1997) ["since section 105 itself is not a source of new substantive rights, the court may invoke section 105(a) only if the equitable remedy utilized is demonstrably necessary to preserve a right elsewhere provided in the Code"].

The Sixth Circuit does permit non-consensual third-party non-debtor releases. *See In re Dow Corning Corp*., 280 F.3d 648, 656 (6th Cir. 2002). But *Dow*, and the cases it was explicitly modeled after, were in the context of a chapter 11 business reorganization of a debtor beset by mass tort claims. *See e.g., In re Drexel Burnham Lambert Group*, Inc., 960 F.2d 285, 293 (2nd Cir. 1992); *In re A.H. Robins* Co., 880 F.2d 694, 702 (4th Cir. 1989); *In re Johns-Manville Corp*., 837 F.2d 89, 93-94 (2nd Cir. 1988).

Non-consensual non-debtor third-party releases may very well make sense, in a mass-tort case, where debtors and nondebtors alike are facing massive liabilities, and pool their resources to satisfy tort claimants. Before we discuss *Dow's* applicability to this case, it is necessary, to first determine whether the court has "related to jurisdiction" over the attempt to enjoin the party's unasserted claims.

As one court stated: "related to" jurisdiction to enjoin a third party dispute exists where the subject of the third party dispute is property of the estate, or the dispute would have an effect on the estate. *See In re Dreier*, 429 B.R. 112 (Bankr. S.D.N.Y.) (2010). The Third Circuit affirmed a ruling of the bankruptcy court that it lacked "related to" jurisdiction over proceedings brought by individuals against the state of Montana from exposure to asbestos in the debtor's mining operation stating: "While 105 (a) of the bankruptcy code allows a bankruptcy court to carry out the provisions of the plan it does not provide an independent source of federal subject matter jurisdiction……Thus before considering the merits of any 105 (a) injunction a court must first establish that it has subject matter jurisdiction to enter the injunction." *See In re WR Grace & Co.*, 91 F.3d 164, 170 (3d. Cir. 2009).

The court reasoned that because *Grace* would not be bound by any judgment against Montana (but, rather that Montana would have to be first found liable in the state court, and then would have to successfully bring an indemnification or contribution claim against *Grace*), the claims against Montana did not have any impact on the bankruptcy estate and the bankruptcy court lacked jurisdiction to expand the preliminary injunction that had been entered in the case to include state court negligence claims. *Id.* 172-173.

The plan's proposed state release immunizes the state, from essentially anything, including the intentional violations of state constitutional rights. One circuit in denying a similarly broad categorical release commented: **"The scope of this permanent injunction is breathtaking"** (emphasis added). *See In re Artra Grp, Inc.*, 300 B.R. 699, 704 (Bankr. N.D. Ill. 2003). *See e.g. Harlow v Fitzgerald*, 457 U. S., 800, 818 (1982) [(the premise that federal officials are) "absolutely immune from any liability for damages even if in the course of enforcing the relevant statutes they infringed respondent's constitutional rights and even if the violation was knowing and deliberate... is unsound and (we) consequently reject it"].

The Sixth Circuit formulated a seven-factor test to determine the appropriateness of third-party release provisions. *Dow* at 648. The bankruptcy court did not find all of the seven *Dow* factors in the present case. The court, relying on a Fourth Circuit case, said that all of the *Dow* factors did not need to be present for such a release to be approved. *See, Nat'l Heritage Foundation Inc., v. Highbourne Found.*, (4th Cir. 2014).

That may be true in the Fourth Circuit but that does not mean it is true in the Sixth Circuit. The *Dow* court stated: "We hold that when the following seven factors are present, the bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor." The language is unambiguous. Dictionary.com defines "the" especially when used before a noun, as it is here, with a "specifying or particularizing effect, as opposed to an indefinite or generalizing force of the indefinite article." The word "the" is used as a function word in prepositional phrases to indicate that the noun in the phrase serves as a basis for computation (e.g., sold by *the* dozen).

Thus, *Dow's* plain language does not support the notion that all seven *Dow* factors do not have to apply. If the *Dow* Court had so intended, it is logical, they would have simply said so. The seven required *Dow* factors are as follow:

1. **<u>Identity of Interests between the Debtor and the Third Party</u>** - The court said "there is an identity of interests between the City and the State. The City is a political arm of the State…" (Dkt 8993) at 33. That is a misreading of the first factor, which is meant to ensure, that a lawsuit against the state does not risk depleting the *res* of the City. If there is an identity of interests, usually an indemnity obligation, between the debtor and the released parties a non-debtor release may be appropriate. Because a suit against the non-debtor may ["in essence, (might be) a suit against the

debtor (and) risks depleting the assets of the estate"]. *Dow* at 658. A lawsuit against the state in this case will not deplete the assets of the City.

2. <u>A non-debtor has contributed substantial assets to the reorganization</u> -

The court said that the state's 194.8 million contribution was "perhaps at the lowest point of reasonableness" (Dkt 8993) at 28. If the debtor is financially able to meet its obligations......under the plan without the third party non-debtor's contribution, courts will sometimes deny confirmation of third party non-debtor discharge plans. *See Robins*, at 701-02. Without the state's contribution ***and*** allowing the City to avoid its normal cost contribution to its retirement system until 2023 the retirement system can pay out at its current benefits for over a ten year even if the stock market was stagnant. But factoring in the stock market average gains, over any ten year period during the last 60 years, the retirement system would be able to pay full benefits for over twenty-five years. While, not a situation we are advocating, it illustrates that the state contribution was not essential for the City's reorganization.

A nondebtor release is "not adequately supported by consideration simply because the nondebtor contributed something to the reorganization and the enjoined creditor took something out." *See Metromedia Fiber Network, Inc.*, 416 F.3d 136, 145 (2005).

3. The City's reorganization does not hinge on it being free from indirect suits against parties who would have indemnity or contribution claims against it.

The City's plan does not depend on it being free from indirect suits against the state because the state would have no indemnity or contribution claims against it.

4. Did the impacted class, or classes, overwhelmingly vote to accept the plan?

Yes (we argue that the "yes" vote was due to improper "gerrymandering"). At, the very least, those who voted "no" on the plan should not be subject to the release provisions. *See e.g. In re Specialty Equip. Cos.*, 3 F.3d 1043, 1047 (7th Cir. 1993) ("a creditor who . . . abstains from voting may still pursue any claims against third-party non-debtors").

5. Does the plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction?

Since class 12 (healthcare) had to vote to accept the plan to receive the benefits of the DIA settlement relative to their pension claims (class 10, 11). Thus, class 12 is not severable from class 10 and 11. This factor has typically been used to justify release provisions where the reorganization plan includes a mechanism such as a dedicated settlement fund to pay the claims. In this case, retiree class 12 claims, have not been "channeled" anywhere; they have simply been extinguished.

6. Is there an opportunity for those who choose not to settle to recover in full?

The bankruptcy court held that "this element was not met." (Dkt 8993) at 35.

7. **Did the bankruptcy court make a record of specific factual findings that support its conclusions?**

The court's findings is essentially a recap, concluding that the state's contribution is "essential," or the deals will "fall apart" without the specificity required by *Dow*.

VII. The Appeal is Not Equitably Moot under Because Fair and Effective Relief can be fashioned that will Not Impair the Plan's Success.

An egg cream is a fountain drink whose ingredients include neither egg nor cream. As explained by the Third Circuit, "equitable mootness" is a doctrine that involves neither equity nor mootness. Federal courts have a ["'virtually unflagging obligation' . . . to exercise the jurisdiction conferred on them"] *See In re Semcrude,* 728 F.3d at 320 (3d. Cir. 2013) [(quoting *Colo. River Water Conservation Dist. v. United States*, 424 U.S. 800, 817 (1976)]; *see also* ("federal courts have a strict duty to exercise the jurisdiction that is conferred upon them by Congress"]. *Quackenbush v. Allstate Ins. Co.*, 517 U.S. 706, 716 (1996).

A case becomes moot only when it is impossible for a court to grant any effectual relief whatever to the prevailing party. *See Knox v. Serv. Employees Int'l Union, Local 1000*, 132 S. Ct. 2277, 2287 (2012) ("As long as the parties have a concrete interest, however small the case is not moot") *Id.*

The City has filed a motion to file a consolidated response to appeals. We would urge the Court to analyze whether each appeal is equitably moot separately because awarding relief to the appellant in one appeal may threaten the equitable disposition of the bankruptcy estate, but awarding relief in another may pose no harm to the estate or third parties.

A court may also consider the merits of an appeal before deciding whether it is equitably moot. *See In re Metromedia Fiber Network, Inc.*, at 144 ("Because equitable mootness bears only upon the proper remedy, and does not raise a threshold question of our power to rule, a court is not inhibited from considering the merits before considering equitable mootness") ("often, an appraisal of the merits is essential to the framing of an equitable remedy") *Id.*

In the Sixth Circuit the question of equitable mootness is reviewed *de novo*. *See In re United Producers, Inc.*, 526 F.3d 942 (6th Cir. 2008). Issues relating to equitable mootness have rarely been decided in the Sixth Circuit. Id. 946-47. This Circuit's leading case on equitable mootness issues is *In re American HomePatient* 420 F.3d 559 (6th Cir. 2005) [(*adopting* factors espoused by the Fifth Circuit in *In re Manges*, 29 F.3d 1034 (5th Cir. 1994)]. In *American HomePatient*, the Sixth Circuit said a bankruptcy court must weigh the following three factors:

1. **Whether there was a stay:** Several parties sought stays (Dkt 8426; 8429) that were denied (Dkt 8533). But neither the code nor any other statute predicates the ability to appeal a bankruptcy court's ruling on obtaining a stay.

2. **Whether the plan has been substantially consummated:** Allowing, GRS and PFRS, to receive 100% of the funds that the City contributed; their investments earned; and their employee contribution that were set aside for their retirement does not entitle any other creditor to enhanced treatment of their claims. Retirees can be made whole with a scalpel – not a knife – for the following reasons:

- The plan reduces the pension system's assumed rate of return to 6.75%. Out of the 126 largest retirement systems in the country there are only 4 systems that have a rate less than 7%. An investment return assumption that is set too low will overstate liabilities and costs, causing current taxpayers to be overcharged and future taxpayers to be undercharged. The City proposes to "adjust" the pension system's liabilities (which is prohibited by § 941 of the code). And to not make its "normal" contribution until 2023. The City has one of the lowest, if not the lowest, risk of any City in the country, because of this unprecedented pension holiday.
- Nationally 60% of benefits are from system investments and 13% are from employee contributions. Even, if the City makes no contribution until, 2023, GRS and PFRS with over 5.4 billion dollars in assets, are self-sustaining until 2023.

3. If affects the rights of parties not before the court or the success of the plan:

The most important factor this Court must consider is "whether the relief requested would affect either the rights of parties not before the court or the success of the plan." *See In re American HomePatient* at 564; *see also In re Manges* at 1042-43. There are no parties, not currently before the Court, that would be affected by the exempting of pensions. Making retirees' whole, is equitable; what the law requires; and doing so would not impinge on the plan's success or the City's future viability.

CONCLUSION

For the forgoing reasons, the appellants' respectfully request that this Court (i) Consider this appeal on the merits (ii) strike the state release provision (iii) Remand with instructions to exempt pensions; and (iv) Remand for further proceedings consistent with such order.

Dated: January 27, 2014 RESPECTFULLY SUBMITTED,

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CERTIFICATE OF SERVICE

I hereby certify that on January 27, 2015 I electronically filed *Ochadleus Appellants' Brief Appealing the Order Confirming the Eighth Plan of the Adjustment of Debts of the City of Detroit* entered by the United States Bankruptcy Court for the Eastern District of Michigan on November 12, 2014 with the clerk of the Court for the United States District Court for the Eastern District of Michigan Southern Division using the ECF System, which will send notification of such filing to all attorneys and parties of record registered electronically.

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