Keynote Luncheon: A Conversation with Hon. Steven W. Rhodes

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ABI 33d Annual Meeting
April 18, 2015

The State of Affairs (City View)

- Declining population: 1.8 million in 1950 – 685,000 in 2012
- High unemployment: 18.3% as of June 2012
- Eroding tax base and reduced state revenue sharing
  - Property values plummeted during recession
  - Income taxes decreased @ 30% since 2002
  - State revenue sharing decreased by @ 48% since 2002
- Highest taxes in state – maximums under state law
- 78,000 blighted structures and 66,000 blighted and vacant lots
- 40% of street lights inoperable
- High crime: 5x national average in 2012

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The State of Affairs (City View)

- Annual budget deficits: $326 million at end of FY 2012; without borrowings, would have been @ $700 million at end of FY 2013
- Every single City department was fundamentally broken in terms of operations, fiscal controls, IT
- Infrastructure and equipment completely outdated: public safety forces, IT, transportation
- Legacy costs were 42.5% of annual revenues in FY 2012 -- and projected to grow to 64.6% of revenues by FY 2017

The City's Goals

- Fiscal stability and sustainability
  - Stabilize key revenue streams and forecast revenues that the City can reasonably achieve
  - Reduce burden of debt, pension and healthcare related (OPEB) liabilities and address prior malfeasance, while providing restructured benefits to actives and retirees
  - Improve controls and management of daily operations
- Revitalization of City of Detroit / Improvement of services for citizens and businesses
  - Provide City with resources in order to reinvest, reinvent and grow within its own means
  - Improve infrastructure
  - Eliminate residential blight
  - Public safety – reduce crime and improve response times
  - Essential services – reinvest in street lighting and other City services
  - Create the foundation to allow for a sustainable outcome for the City, residents and stakeholders

The Reinvestment Initiatives

- **<u>$1.7 billion</u>** in revenues will be reinvested in the City to improve public services and ameliorate residential blight over the next decade
  - Nearly half funded through @ $483 million in identified revenue enhancement opportunities and @ $358 million of efficiency and cost savings opportunities
- Blight Initiatives
  - Remove all residential blight (88,000 buildings and lots); commercial blight will still need to be addressed
  - Worked with Blight Initiative Task Force
  - Repurpose Detroit Land Bank
  - TARP (Hardest Hit Funds) – Michigan was first state in country to use Hardest Hit Funds for blight removal; several states have since adopted similar practices

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The Reinvestment Initiatives

- Public Safety Initiatives
  - Includes Detroit Police Department and Detroit Fire Department
  - Cross-train; civilianize forces
  - Monthly dashboard to monitor performance; metrics/benchmarking
  - Reduce response times for Priority 1 calls, EMS and Fire divisions
  - Increase case clearance rates for police
  - Upgrade equipment, facilities, training, IT
  - CBA negotiations – new wages, benefits work rules
  - Consolidate staffing
  - Ensure grant funds spent, reported and tracked

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The Reinvestment Initiatives

- Resident Service Initiatives
  - Includes Departments of Transportation, Health & Wellness Promotion, Ombudsperson, Public Works & Recreation
    - Add 4 million miles of bus service (33% increase) by 2023 with addition of buses through federal grants
    - Implementation of 311 system to allow residents to report issues and complaints
    - Complete outsourcing of solid waste pickup, addition of recycling and bulk pickup

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The Reinvestment Initiatives

- Business Service Initiatives
  - Includes Municipal Airport, Buildings, Safety Engineering & Environmental Department, Board of Zoning Appeals, Department of Administrative Hearings, Municipal Parking Department and Planning & Development Department
    - Centralization of all planning functions and updating of City's master plan to align with "Detroit Future City"
- Organizational Efficiency Initiatives
  - Includes Departments of Auditor General, Elections, Finance, General Services, Human Resources, Human Rights, Inspector General, IT and Law
  - Complete Finance and HR overhaul, including implementation of "Office of the CFO" for consolidation of financial functions across City
  - Implementation of new enterprise resource planning (ERP) system
  - Transfer of Income Tax division to State of Michigan

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The Reinvestment Initiatives

- Management Initiatives
  - Mayor's Office, City Council, City Clerk
  - Significant reduction in redundancies
- Non-Departmental Initiatives: 36th District Court (Detroit's municipal court)
  - Significant improvement in collections

Treatment of Bond Debt in Chapter 9

The Species (generally)

- Special revenue debt (debt secured by "special revenues")
- Debt secured by collateral other than special revenues (general obligation debt that is secured and general fund debt that is secured)
- Unsecured debt

Special Revenues Get Special Treatment

- Special revenue debt means debt secured by one of the following:
  - Receipts derived from projects or systems primarily used for transportation, utility, or other services; OR
  - Special excise taxes imposed on particular activities or transactions; OR

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Special Revenues Get Special Treatment (Cont'd)

- Incremental tax receipts in the case of a tax increment financing (TIF); OR
- Other revenues or receipts derived from particular functions of the debtor, whether or not the debtor has other functions; OR
- Taxes specifically levied to finance one or more projects or systems
  - **EXCLUDES** general property, sales, or income taxes (other than TIF) levied to finance the general purposes of the debtor.

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Special Revenues Get Special Treatment (Cont'd)

- Special revenue debt should generally continue (and historically has continued) to get paid during the bankruptcy
  - No automatic stay for special revenues (Section 922(d))
  - Liens apply against special revenues generated after the filing date (Section 928(a))
  - Continued payment of special revenue debt is supported by clear legislative history
- But: Liens on special revenues are subject to the "necessary operating expenses" of such project or system (i.e., becomes a "net revenue lien")

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Is it Special Revenue Debt?

- Utility debt is easy.
- Little case law.
- The two part test of Section 902(2)(e).

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The "Necessary Operating Expense" Issue

- **<u>Jeffco No. 2 (June 29, 2012)</u>**

  "The review by application of the business judgment rule is one in gross, not particulate. *The Indenture payment scheme for Operating Expenses is one that the parties agreed would be sufficient to keep the County's sewer system in good operating condition and good repair. This Court need not second guess that determination for § 928(b)'s application.* Even more, what was agreed to in the Indenture has enabled the sewer system to keep operating along with payment of all of the Operating Expenses plus payments of interest and principal on the warrants. The evidence is clear that this has been the case for the over fifteen years the Indenture's calculation of Operating Expenses has been utilized to determine what costs and expenses were to be paid."

  <u>*Bank of N.Y. Mellon v. Jefferson County (In re Jefferson County)*</u>, 482 B.R. 404, 453 (Bankr. N.D. Ala. 2012) (emphasis added)

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The "Necessary Operating Expense" Issue (Cont'd)

- **<u>Jeffco No. 3 (July 3, 2013)</u>**

  "Net Revenues that is preserved during the period following the <u>County's</u> chapter 9 filing by <u>11 U.S.C. § 928(a)</u> is subjected by <u>11 U.S.C. § 928(b)</u> to payment of this part of the categories of the Professional Fees as "necessary operating expenses" of the Sewer System. The summary is that for the Joint Submission categories as either Operating Expenses under the Indenture or as "necessary operating expenses" for <u>§ 928(b)</u> subordination purposes, *all of the Joint Submission categories of Professional Fees are permitted to be paid ahead of interest and principal to the Parity Security Holders.*"

  <u>*Bank of N.Y. Mellon v. Jefferson County (In re Jefferson County)*</u>, 503 B.R. 849, 903 (Bankr. N.D. Ala. 2013) (emphasis added)

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What's Collateral, What's Covenant?

- Is a rate covenant a property interest?
- What does it mean to not be impaired?

The "Can You Cramdown on Special Revenue Debt" Issue

- Some representative legislative history:

  "Finally, the amendments insure that revenue bondholders receive the benefit of their bargain with the municipal issuer, namely, they will have unimpaired rights to the project revenue pledge to them." S. Rep. No. 100-506 at 12 (1988), Report to Accompany § 1863.

- Pretty good for bondholders!
- But see arguments based on Code Sections 502(b), 1129(b)(2)(A).

The "Can You Cramdown on Special Revenue Debt" Issue (Cont'd)

- 928(a) – Lien extends to post-filing special revenues
- 922(d) – Automatic stay does not stay application of pledged special revenues
  - Non-recourse
  - Closed Loop/Enterprise Funds. It can't be used for anything else!
  - Should mean – from a bondholders' perspective – at the very least "every dime" of net revenues during the case and no modification on exit.
  - But see arguments in Jeffco and Detroit.

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The "Can You Cramdown on Special Revenue Debt" Issue (Cont'd)

- Jeffco and Detroit: "That tells us what we have to do during the case, but what about on exit?"
  - "Legislative history not so clear (and in any event we can ignore it if statute is clear)."
  - "Special Revenue Debt is not exempt from Section 1129(b)(2)(A) which allows us to modify the terms of secured debt in a plan of adjustment."

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The "Is General Obligation Debt Always Secured" Issue

- Is a "full-faith and credit" pledge the grant of a lien?
- Bankruptcy Code Section 101(37) – The term "lien means a charge against or interest in property to secure payment."

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The "Is General Obligation Debt Always Secured" Issue (Cont'd)

- Statutory Lien

  Bankruptcy Code 101(53):

  "The term 'statutory lien' means lien arising solely by force of a statute on specified circumstances or conditions, or lien of distress for rent, whether or not statutory, but does not include security interest or judicial lien, whether or not such interest or lien is provided by or is dependent on a statute and whether or not such interest or lien is made fully effective by statute."

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The "Is General Obligation Debt Always Secured" Issue (Cont'd)

- Security Interest

  <u>Bankruptcy Code 101(51):</u>

  "The term 'security interest' means lien created by an agreement."

- So, are you secured?

- If you are secured, are you perfected?

The "Why is General Obligation Debt Not Always Secured" Issue

- All liens are ultimately entitled to the present value of their collateral.

  1. What is your lien on?

     The Section 552(a) cutoff - but not for statutory or judicial liens, and not for liens on special revenues

  2. How is present value measured?

- (That's why special revenues should be different in Chapter 9.)

The Settlements

LTGO Bonds (Class 7)

	Claim	Settlement	
Description	LTGO Series: 2004; 2005-A(1); 2005-A(2); 2005-B; 2008-A(1); 2008-A(2)	Either "New LTGO Bonds" or Cash	"New B Notes" from COPs reserve
Amount	$163.5M	$55.0M	$17.3M[1]
Interest	Various (3.5%-8.0%)	n/a (Due upon effective date)	4.0%-6.0% (4.0% in first 20 years, 6.0% in last 10 years)
Maturity	Various (all by 2025)	n/a (Due upon effective date)	30 years (by 2045)
Other		City to pay $55M cash at effective date with exit financing proceeds in lieu of the New LTGO Bonds	

Recovery (illustrative)
41%

1 Amount of "Excess New B Notes" based on proposed Syncora and FGIC settlements

Source: Report

UTGO Bonds (Class 8)

	Claim	Settlement
Description	UTGO Series: 1999A; 2001A(1); 2001B; 2002; 2003A; 2004A(1); 2004B(1); 2004B(2); 2005B; 2005C; 2008A; 2008B(1)	"Restructured UTGO Bonds"
Amount	$388M	$288M
Interest	Various (3.7%-5.375%)	Various (3.7%-5.375%) (unchanged)
Maturity	Various (all by 2028)	Various (all by 2028) (unchanged)
Other		Stub UTGO Bonds reinstated; holders retain ownership, assign proceeds to fund Income Stabilization Fund

Recovery (illustrative)
74%

Source: Report

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Syncora Settlement – COPs (Class 9)

	Claim	Settlement	
Description	Certificates of Participation ("COPs") Series 2005-A; Series 2006-B	"New B Notes"	"New C Notes"
Amount	$354M (24.055% of total COPs principal and pre-petition interest)	$23.5M	$21.3M
Interest	Series 2005-A – 4.00% - 4.95% Series 2006-B – variable	4.0%-6.0% (4.0% in first 20 years, 6.0% in last 10 years)	5.0%
Maturity	Series 2005-A – 2025 Series 2006-B – 2035	30 years (by 2045)	12 years (by 2027)
Other		Syncora also to receive settlement credits in the nominal amount of $6.3M[1]	

Recovery (illustrative)
13%[1]

1 Recovery includes value from settlement credits

Source: Report

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FGIC Settlement – COPs (Class 9)

	Claim	Settlement	
Description	Certificates of Participation ("COPs") Series 2005-A; Series 2006-A; Series 2006-B	"New B Notes"	"New C Notes"
Amount	$1,119M (75.945% of total COPs principal and pre-petition interest)	$74.2M	$67.2M
Interest	Series 2005-A – 4.00% - 4.95% Series 2006-B – variable	4.0%-6.0% (4.0% in first 20 years, 6.0% in last 10 years)	5.0%
Maturity	Series 2005-A – 2025 Series 2006-B – 2035	30 years (by 2045)	12 years (by 2027)
Other		FGIC also to receive settlement credits in the nominal amount of $19.75M[1]	

Recovery (illustrative)
13%[1]

Source: Report

1 Recovery includes value from settlement credits

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Pension Settlements (Classes 10 & 11): Changes in Pension Terms Under the Plan

	GRS	PFRS
Assumed Rate of Return		
Pre-petition (June 2013)	7.9%	8.0%
POA	6.75%	6.75%
UAAL		
Pre-petition (June 2013)	$1,879M	$1,250M
POA	$894M	$553M
Target 2023	$695M	$681M
Funding Status		
Pre-petition (June 2013)	53%	71%
Target 2023	70%	78%
Target 2053	100%	100%
POA Liability Reduction		
Plan Freeze	Yes	Yes
Monthly Pension Reduction	4.5%	None
COLA	Eliminated	Reduced by 55%
ASF Recoupment	Equivalent to 8.8% reduction in liability	N/A
Future Contributions		
Through 2023	$719M	$261M
2024-2053	$1,422M	$1,393M
Total	$2,141M	$1,654M

Source: Report

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"Grand Bargain"

	GRS	PFRS
State Contribution Agreement		
• State to contribute $194.8M in cash prior to the Effective Date (equal to the PV of $350M over 20 years at a 6.75% discount rate)	$98.8M	$96.0M
• Income Stabilization Payments: No less than $20M over 14 years from UTGO proceeds (prevents pension reductions from lowering household income below 105% of the Federal Poverty Level)		
• Conditions to State's participation are listed in the State Contribution Agreement		
DIA Settlement		
• DIA Assets to remain in trust in perpetuity and to remain available for the benefit of the residents of the City and the Counties and the citizens of the State	$183M $50M	$183M $50M
• Foundations to contribute nominal amount of $366M over 20 yrs		
• DIA to contribute nominal amount of $100M over 20 yrs		
• Certain conditions need to be met for the Foundations' participation		

Source: Report

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OPEB (Class 12)

	Claim	Settlement	
Description	Variety of healthcare plans offered to retirees sponsored by City of Detroit	"New B Notes" contributed to GRS & PFRS VEBAs	"New B Notes" from COPs reserve contributed to GRS & PFRS VEBAs
Amount	PFRS: $2,208M GRS: $2,095M Total: $4,303M[1]	$450M ($232M to PFRS; $218M to GRS)	$42.7M[2]
Interest	n/a	4.0%-6.0% (4.0% in first 20 years, 6.0% in last 10 years)	4.0%-6.0% (4.0% in first 20 years, 6.0% in last 10 years)
Maturity	Open ended	30 years (by 2045)	30 years (by 2045)
Other		VEBA start-up costs funded by: (i) $8M from Rate Stabilization Fund (ii) Approximately $3.5M from charitable contributions (iii) Advance of October 2015 interest on Excess New B Notes from the Syncora Settlement	

Recovery (illustrative)
11.5%

Source: Report

1 Negotiated amount pursuant to the OPEB Settlement
2 Amount of "Excess New B Notes" based on proposed Syncora and FGIC settlements

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36th District Court (Class 17)

	Claim	Settlement
Description	Employment related claims against the 36th District Court, held by: (a) Locals 917 and 3308 of AFSCME, and (b) Certain individual claimants	Claims <$100K: 33% of claim in cash Claims >$100K: 33% of claim payable in 5 equal annual installments
Amount	$6M[1]	$2M
Interest	n/a	5% interest on claims paid via annual installment
Maturity	n/a	Fourth anniversary of the Effective Date

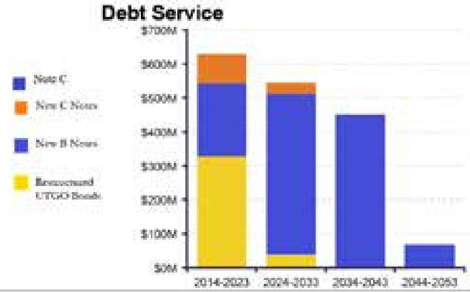
Recovery (illustrative)
33%

New Notes Issued Under the 8th Amended Plan

	Face Value	Term	Interest	Holders
Restructured UTGO Notes	$288M	14 years	Various (3.7% – 5.375%)	UTGO
New B Notes	$632M	30 years	4%, 4%, 6%	OPEB, LTGO, COPs & Other Unsec.
New C Notes	$88M	12 years	5.0%	Syncora, FGIC
Total	$1,008M			

Face Value

Debt Service



Source:

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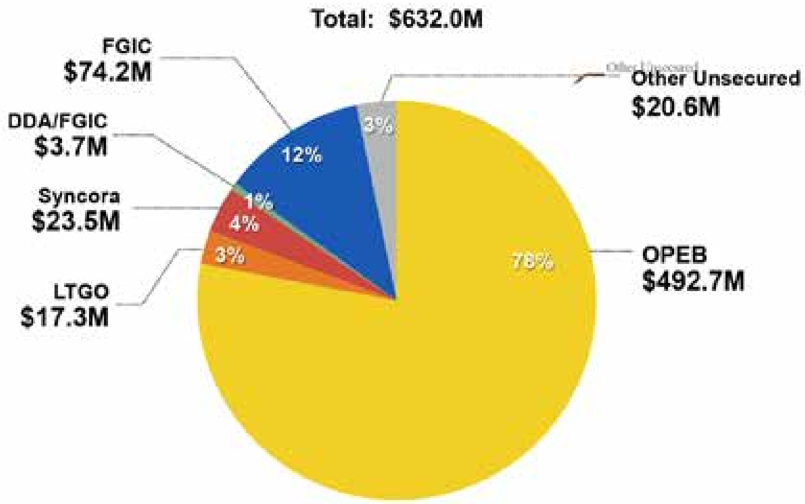
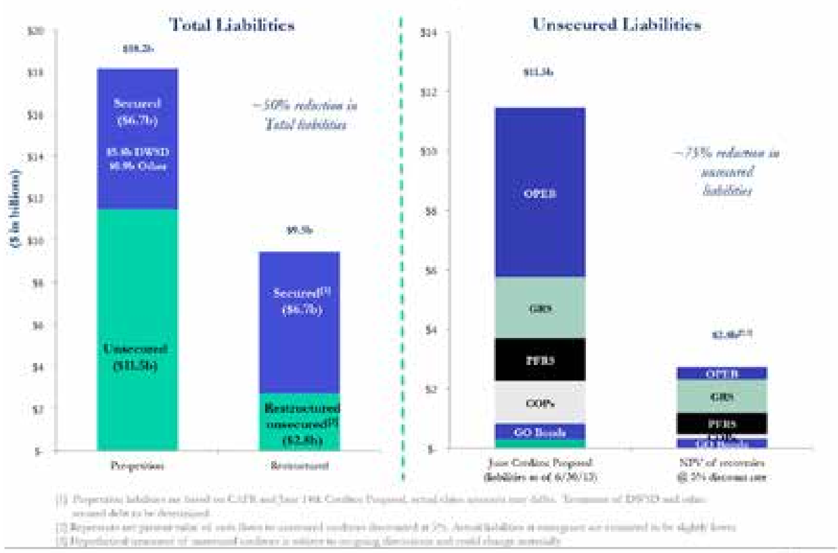
Distribution of New B Notes Under the 8th Amended Plan



THE RESULTS: ~50% reduction in total liabilities; ~75% reduction in unsecured liabilities



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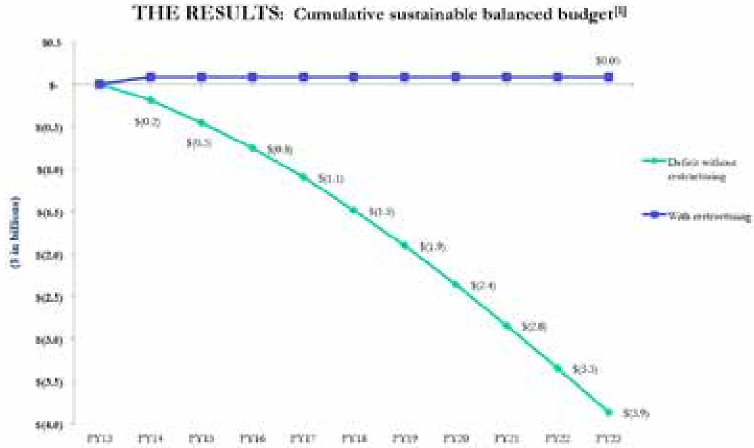
THE RESULTS: Projected ten year deficit of $3.9b absent restructuring is avoided

Accumulated deficit would be $3.9b over ten year period absent restructuring

THE RESULTS: Cumulative sustainable balanced budget[1]



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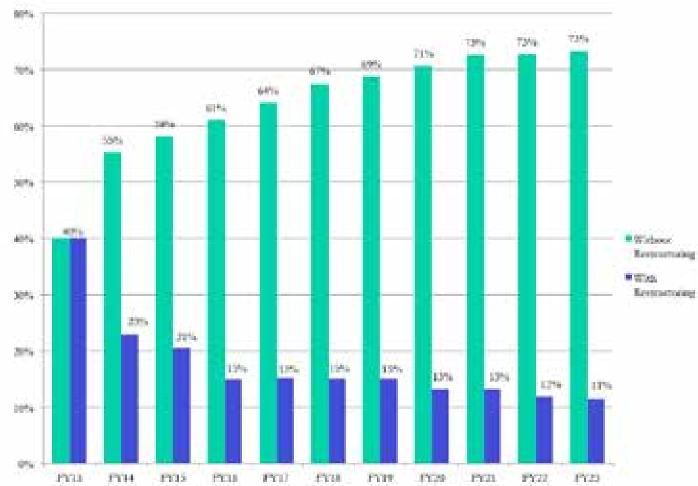
THE RESULTS: Legacy Costs (% of General Fund)



The Results (City View)

- The City's debt burden was reduced by **<u>$7 billion</u>**
- Residential blight is being addressed (demolition/land bank)
- Response times for police and fire have both improved
- Priority 1 crimes (criminal homicides, sexual assault, robbery, larceny, aggravated assault, burglary, vehicle theft and arson) were down 16% in 2014; homicides were lowest since 1967
- Lights are coming back on; trash is being removed
- DIA assets contributed to charitable trust, thus preserving a key cultural asset for the region
- Financial Review Commission monitors City fiscal health
- DWSD (water & sewer department) achieved $130 million in long-term savings and assets to be transferred into a regional water and sewer authority, with governance that encompasses Detroit and its three surrounding counties
- FGIC and Syncora have development opportunities in the City

The Results (City View)

- Pension cuts were ameliorated through Grand Bargain (4.5% + COLA for GRS; half of COLA for PFRS)
- Pension plans now have independent investment committees that oversee investment and distribution decisions for both pension plans; arrangement stays in place for at least 20 years
- CBAs with all unions (other than DDOT) were achieved (@ 40 new contracts) that included modest raises for those who had taken 10% pay cuts, work rule changes and additional healthcare cost sharing (80/20) (estimated to save 18% in annual healthcare spending by the City)
- Utilization of VEBAs for retirees cut annual retiree healthcare spending by @ 88%
- Bondholders received relative recoveries commensurate with relative legal positions/arguments
- General unsecured creditors (which included tort claimants, vendors, 1983 claimants, other local governments) will receive projected 10% recoveries
- Plan was fully consensual with the exception of several individual pensioners and a handful of 1983 claimants
- Plan was confirmed in record time – 16 months from filing

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Lessons Learned/Questions Presented

- The case concluded in a record amount of time (16 months from filing). What were costs/benefits of moving expeditiously?
- How did the mediation structure used in Detroit differ from structures used in other chapter 9 or chapter 11 cases? What are advantages and disadvantages? What will be the precedential effect of bringing third parties in to assist in achieving settlements?
- Could the Detroit restructuring have been accomplished through the elected officials and without the office of an emergency manager? How can (or should) the exigencies of righting a failing municipality be balanced with some citizens' views that an emergency manager deprives them of the right to elected representation?
- Can/should the Detroit experience be the blueprint for municipal restructurings?
- Creditors have fewer protections in chapter 9 than in chapter 11. Should they?

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Lessons Learned/Questions Presented

- When should GO bonds be treated as secured obligations? Even if bonds are secured, should they be immune from impairment in chapter 9 when they can be impaired in chapter 11?
  - Make sure your promise of a "lien" comes with a grant of an interest in property.
  - Special revenues offer special protection to creditors in Chapter 9; more protection than for GO debt.
- Where a municipality cannot provide essential, basic public services, the need to do so may well come before the interests of GO bondholders and other creditors. Should that be the balance?
  - Differences in treatment of unsecured creditors does not necessarily lead to a finding of "unfair discrimination"
  - The confirmation decision adopts a new test for "unfair discrimination," which vests a fair amount of discretion with the bankruptcy court. Will this extend to chapter 11 cases? What effects could this have for the municipal or corporate debt markets?

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Lessons Learned/Questions Presented

- Several courts have ruled that state constitutional (contractual) protections for pensions, funded debt and other liabilities will give way to federal bankruptcy power. How will that affect negotiations for other financially troubled municipalities?
- Historical and widely accepted assumptions for public pension accounting and funding were challenged in Detroit. What kinds of changes will/should be made in light of these challenges?
- Detroit generated new law for uniquely municipal-type debts: constitutional tort claims and Takings Clause claims. How will these holdings impact other municipal restructurings?
- Borrowing structures to avoid state-imposed debt limits are ripe for challenge in chapter 9 cases.

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Lessons Learned/Questions Presented

- Hot-button issues (pensions) can best be resolved when all creditors sacrifice
- Hot-button and precedent-setting issues can best be resolved in a mediated setting
- "Best interests" involve the best interests of creditors as a whole – is the plan better than dismissal?
- Highly prized civic assets may well be able to be protected

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The City of Detroit Case, and What It Means for Municipalities Everywhere

Overview of Chapter 9 and Recent Developments

"Panic" In Detroit

American Bankruptcy Institute Annual Meeting

April 18, 2015

Heather Lennox
Partner, Jones Day

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The following materials provide a primer on chapter 9 of title 11 of the United States Code (the "Bankruptcy Code") with a particular focus on the chapter 9 case of the City of Detroit (the "City" or "Detroit") that was filed in the United States Bankruptcy Court for the Eastern District of Michigan (Case No. 13-53846) and the potential impact of Detroit's case on future chapter 9 bankruptcies.

I. Introduction: Events Preceding the City of Detroit's Chapter 9 Filing

On July 18, 2013, Detroit took on the unfortunate status of becoming the largest municipal bankruptcy in history. It did so only after decades of fiscal mismanagement, population decline, high unemployment, shrinking revenues, decaying infrastructure and excessive borrowing that provided short term liquidity at the cost of deepening insolvency. Prior to filing its chapter 9 petition, Detroit was unable to provide reasonable levels of basic and essential services to its residents. Crime in Detroit was endemic, and urban blight was rampant. As a result, the State of Michigan (the "State" or "Michigan"), led by Governor Rick Snyder (the "Governor"), implemented emergency financial management procedures, ultimately resulting in the appointment of Kevyn D. Orr as Emergency Manager of the City of Detroit (the "Emergency Manager") pursuant to Michigan Public Act 436 of 2012 ("PA 436"), the Local Financial Stability and Choice Act, MCL §§ 141.1541 *et seq.* Significant restructuring and reinvestment was required to enable Detroit to begin its recovery by: (a) providing basic, essential services to current residents; and (b) attracting new residents and businesses to foster growth and redevelopment.

The depth and complexity of Detroit's financial obligations prevented it from effecting its recovery outside of bankruptcy. As of its petition date (July 18, 2013), Detroit estimated that it had approximately $18 billion in prepetition obligations, including approximately $12 billion in unsecured obligations to lenders and retirees and over $6.4 billion in obligations backed by enterprise revenues or that were otherwise secured. More than $0.38 of every tax dollar that Detroit collected went to service legacy debt and related obligations; absent restructuring, that number was expected to grow to almost $0.65 of every dollar by 2017.

Detroit had been insolvent for some time prior to its bankruptcy. Excluding the proceeds of debt issuances, Detroit had incurred operating deficits for each of the six years preceding and including its 2013 fiscal year. Its accumulated general fund deficit stood at approximately $327 million at the end of its 2012 fiscal year and $217 million at the end of its 2013 fiscal year. Excluding the effect of recent debt issuances, Detroit's accumulated general fund deficit would have been over $650 million for its 2012 fiscal year and approximately $700 million for its 2013 fiscal year. Detroit had negative cash flows of $115.5 million in its 2012 fiscal year, and preliminary estimates showed positive cash flows of $31.5 million (excluding the impact of borrowings) for its 2013 fiscal year, but only as a result of, among other things, the deferral of nearly $108 million in pension contributions and the decision, in June 2013, not to make $39.7 million in payments on obligations related to Detroit's refinancing of its pension underfunding. Absent restructuring, Detroit projected cash flows of negative $198.5 million for its 2014 fiscal year and negative $260.4 million for its 2015 fiscal year.

During the years immediately preceding the filing of its chapter 9 case, Detroit took aggressive steps to address its financial distress. These measures included: (a) entering into a consent agreement with the State and the resulting creation of a financial advisory board to oversee Detroit's operations and conduct limited reforms; (b) reducing the number of city employees by more than 22% since fiscal year 2010; (c) implementing revised "city employment terms" for non-union employees and union employees under expired collective bargaining agreements; (d) increasing certain tax and utility rates; (e) enhancing tax collection initiatives; and (f) reducing other expenditures, including deferring payments to the City's pension systems. These reforms allowed Detroit to realize more than $200 million in annual savings, but it was still unable to balance its budget.

Detroit inappropriately continued to incur excessive debt (e.g., the issuance of approximately $1.4 billion of certificates of participation (the "COPs") as a method of refinancing pension underfunding, see Section III.D, below) during an extended period in which its tax revenue base significantly plummeted (over the course of several decades, Detroit's population dropped from 1.8 million to under 700,000). Detroit was – and continues to be – unable to meaningfully increase revenues by raising taxes. Detroit currently levies all taxes at the statutory maximum levels. The *per capita* tax burden on Detroit residents is one of the highest in Michigan, which burden is exacerbated by residents' relative inability to pay given their level of *per capita* income. Increasing Detroit's already high tax rates would deter individuals and businesses from relocating to, or remaining in, Detroit at precisely the time at which it most needs to retain and attract taxpayers and capital investment.

After initial efforts, in which the Emergency Manager saw no possibility of negotiating an out-of-court resolution with its vast and diverse body of creditors, Detroit filed its chapter 9 bankruptcy petition on July 18, 2013.

II. Overview of Certain Unique Features of Chapter 9

A. Limited Role of the Bankruptcy Court Due to Federalism Considerations

Chapter 9 differs from other chapters of the Bankruptcy Code in many important respects. Perhaps most fundamentally, the role and authority of the bankruptcy court in a chapter 9 case is limited due to considerations of federalism and state sovereignty. The Tenth Amendment to the United States Constitution guarantees that certain powers will be reserved to the States with respect to the management of their affairs. Chapter 9 of the Bankruptcy Code recognizes this reservation of power and limits the bankruptcy court's power to regulate the day-to-day activities and operations of a municipal debtor, as described below:

- The Bankruptcy Code "does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise[.]" 11 U.S.C. § 903.

- The bankruptcy court cannot, without the consent of the debtor or pursuant to a provision in a confirmed plan, interfere with (1) "any of the political or governmental powers of the debtor;" (2) "any of the property or revenues of the debtor; or" (3) "the debtor's use or enjoyment of any income-producing property." 11 U.S.C. §§ 904(1)-(3).

- The bankruptcy court cannot control the debtor's use, sale or lease of property during the case. Section 363 of the Bankruptcy Code does not apply in chapter 9. See 11 U.S.C. § 901(a).

- The court cannot appoint a trustee to administer the debtor's estate (in part, because no "estate" exists in chapter 9, as discussed below). See 11 U.S.C. §§ 902(5), 926(a).

- Chapter 11 debtors may not retain or pay professionals to assist with the administration of a bankruptcy case without bankruptcy court authority. Save for a review of the reasonableness of professionals' fees by the bankruptcy court, as discussed in the context of the Detroit case below, municipal debtors are not subject to such restrictions. As a result, a municipality may retain professionals to assist in its chapter 9 case without the need for bankruptcy court approval.

B. Case Administration[1]

- A chapter 9 case cannot be filed involuntarily.

- No bankruptcy estate is created in chapter 9. Rather, when the Bankruptcy Code refers to "property of the estate," in the context of chapter 9 that means "property of the debtor." 11 U.S.C. § 902(1).

- Chapter 9 debtors are free to pay creditors and perform normal government functions during the pendency of the chapter 9 case without bankruptcy court oversight, and municipal debtors usually do continue paying e.g., trade creditors and employees.

- Chapter 9 debtors are exempted from the requirement to file schedules, see Federal Rule of Bankruptcy Procedure ("Bankruptcy Rule") 1007(b)(1), and there is no meeting of creditors pursuant to section 341 of the Bankruptcy Code in chapter 9 cases. See § 901(a), Fed. R. Bankr. P. 2003(a).

- The role of the U.S. Trustee in chapter 9 cases is limited, and the U.S. Trustee does not have a general supervisory role in such cases.

C. Other Unique Aspects of Chapter 9

- Eligibility.[2] Before the bankruptcy court may enter an order for relief, the municipality must prove that it is eligible for such relief by establishing that it:

  (1) is a municipality (11 U.S.C. § 109(c)(1));

  (2) was specifically authorized to be a debtor by state law (11 U.S.C. § 109(c)(2));

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1 For a discussion of the role of facilitative mediation in chapter 9 and in Detroit's case, see Sections V.E and VII, below.

2 For a discussion of eligibility in the Detroit matter, see Section IV, below.

(3) was insolvent as of the petition date (11 U.S.C. § 109(c)(3));

(4) desires to effectuate a plan to adjust its debts (11 U.S.C. § 109(c)(4));

(5) either (a) has obtained the consent of creditors holding at least a majority in amount of claims in classes that will be impaired under the plan; (b) has failed to obtain such consent after negotiating with creditors in good faith; (c) is unable to negotiate with creditors because negotiation is "impracticable;" or (d) reasonably believes that a "creditor may attempt to obtain" a transfer that is avoidable as a preference (11 U.S.C. § 109(c)(5)); and

(6) filed its petition in good faith (11 U.S.C. § 921(c)).

- Rejection of Collective Bargaining Agreements. In chapter 11, section 1113 of the Bankruptcy Code provides special procedures that must be followed before a debtor may reject a collective bargaining agreement (a "CBA"). That provision does not apply in chapter 9. See 11 U.S.C. § 901(a). As a result, a chapter 9 debtor generally need only meet the less stringent standard of NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984), in order to reject a CBA. Under Bildisco, a debtor may reject a CBA if (1) the labor agreement burdens the estate; (2) after careful scrutiny, the equities balance in favor of contract rejection; and (3) "reasonable efforts to negotiate a voluntary modification have been made, and are not likely to produce a prompt and satisfactory solution." Id. at 526. (Most of Detroit's CBAs had expired by the time of the bankruptcy filing.)

- Modification of Retiree Healthcare Benefits. With respect to retiree healthcare benefits (also known as "other post-employment" benefits – or "OPEB"), in chapter 11 cases, section 1114 of the Bankruptcy Code generally requires a debtor to continue making payments for OPEB benefits in a timely manner until the court approves a modification. Section 1114 of the Bankruptcy Code does not apply in chapter 9 cases (see 11 U.S.C. § 901(a)), however, meaning that chapter 9 debtors generally may unilaterally modify or suspend OPEB benefits during a chapter 9 case.

- Protection of Special Revenue Bonds. Chapter 9 of the Bankruptcy Code provides special protection to creditors holding liens on “special revenues” of a municipal debtor. Specifically, section 928 of the Bankruptcy Code provides that the "special revenues" remain subject to the liens of the bondholders, except that "necessary operating expenses of such project" may be deducted from the special revenues. See Section V.B.1, below, for further information regarding "special revenues."

- Plan of Adjustment and Confirmation. In a chapter 11 case, the debtor has a limited period of time during which it has the exclusive right to file and obtain approval of a plan of reorganization or liquidation, after which creditors or other parties in interest may propose their own plan(s). By contrast, in a chapter 9 case, *only the municipality* may propose a plan of adjustment. See 11 U.S.C. § 941. Moreover, it is not subject to any statutory time constraints relating to the filing and confirmation of a plan of adjustment (although the Bankruptcy Rules empower bankruptcy courts to establish such deadlines). Although the confirmation requirements for a plan of adjustment generally are similar to those that apply to a chapter 11 plan of reorganization, there are certain important differences, discussed in Section VI below. Because liquidation is not an option for municipalities, the only alternative to confirmation of a chapter 9 debtor's plan is dismissal of the case.

III. Drivers of Municipal Distress

A. Common Factors

During the last few years, while the private sector has shown signs of a steady, albeit slow, recovery from the financial crisis and recession of 2007-09, many municipalities remain mired in an extended cycle of declining revenues driven by, among other things:

- Shrinking tax revenues, exacerbated in many cases by the loss of jobs and population,
- Poor municipal services;
- Rising costs of labor, employee benefits and infrastructure maintenance and improvements;
- Reduced levels of state and federal support; and
- Over-leveraging.
    - Municipalities have borrowed heavily to fund infrastructure and development costs and to avoid funding pension and other costs from current revenues.
    - Borrowing is a way to pay for services and facilities, and attract popular projects, without raising taxes.

B. The Growing Cost of Issuing Municipal Debt

The growing cost of issuing municipal debt has compounded these problems. The low interest rates traditionally enjoyed by municipalities are rising because credit markets have tightened in the wake of the financial crisis, and because investors have taken notice of the financial problems facing many municipalities. In addition, the monoline insurance companies that provided relatively inexpensive credit enhancement for tax-exempt debt have largely exited the market after suffering significant losses relating to municipal debt. The traditional view of municipal debt as a relatively "risk-free" investment is largely a thing of the past.

C. Additional Factors Driving Public Pension Underfunding

Perhaps the single most acute problem facing municipalities today is the dramatic and growing shortfall in public pension funds. Unlike private pensions, public pensions are not regulated by the Employee Retirement Income Security Act of 1974 ("ERISA") and, therefore, are not subject to the rigorous vesting and funding rules imposed by ERISA. Similarly, public pension participants do not enjoy the insurance-like protection of the Pension Benefit Guaranty Corporation.

Thus, municipalities generally have been free to make their own choices about vesting, benefits, qualifications and funding. This unregulated atmosphere has resulted in several decades of increasingly rich benefits packages, largely as a result of negotiations with collective bargaining units, coupled with a less-than-rigid fiscal approach to paying for those benefits. As a result, there are few rules or oversight agencies ensuring that public officials adequately fund their public pension plans and refrain from diverting money intended to fund public pensions to other uses. The pension crisis has been exacerbated by the accounting practices employed by some municipalities, which, in some cases, have applied unrealistic benchmark figures, such as inflated rates of return.

In 2012, the Governmental Accounting Standards Board promulgated new standards for the accounting and financial reporting of public pension plans. Among other things, these new standards require municipalities that participate in defined benefit pension plans to report the unfunded actuarial accrued liabilities of such pension plans, and certain related information, in their financial reports. The requirement that municipalities more clearly report their pension liabilities may encourage distressed municipalities to confront pension underfunding, and address deepening insolvency, sooner rather than later.

D. Drivers of Detroit's Financial Distress

Several of the factors described in this section contributed to Detroit's financial distress and prevented Detroit from successfully addressing its financial difficulties outside of bankruptcy. Between 1950 and 2012, Detroit lost approximately 63% of its population and a significant portion of its once-thriving manufacturing base. As jobs became scarce, *per capita* income fell precipitously which, in turn, led to a sharp decline in municipal tax revenues. For example, as of its petition date, Detroit's municipal income tax receipts – traditionally Detroit's largest source of revenue – had decreased by approximately $95 million (or 30%) since 2002 and by $43 million (or more than 15%) since 2008. In addition, Detroit's share of distributed state revenue declined by nearly half between 2002 and 2013. As its revenues plummeted, Detroit's labor costs increased. Due to the increasing cost of providing employee benefits and the impact of employee headcount reductions upon pension underfunding levels, benefit and pension costs per active employee increased by approximately 33% in just thirteen years, from approximately $18,000 in fiscal year 2000 to approximately $24,000 in fiscal year 2013. Detroit estimated that, in aggregate, its pension systems were underfunded by $3.474 billion. During the last decade, Detroit refinanced its pension underfunding debt through a series of complex transactions involving the issuance of approximately $1.4 billion of certificates of participation and certain related interest rate swaps transactions. Ultimately, those transactions only made matters worse because Detroit's payments on the obligations arising from such transactions increased sharply when interest rates fell during the financial crisis, and the payments on those obligations became unmanageable for Detroit as interest rates remained historically low during the years immediately preceding its bankruptcy filing.

IV. Eligibility

As noted above, chapter 9 imposes the unique requirement that, before an order for relief may be entered, a municipal debtor must prove that certain statutory requirements are satisfied. A municipality is eligible to be a chapter 9 debtor only if and when such requirements are met.

Because the powers of a bankruptcy court are relatively limited once a municipality is found to be eligible to be a chapter 9 debtor, the eligibility determination often is hotly contested, as it was in Detroit's chapter 9 case. Approximately 110 objections to eligibility were filed in Detroit's case, and the process of determining whether Detroit was eligible for chapter 9 relief involved extensive discovery. The bankruptcy court conducted a series of hearings on contested eligibility issues, culminating in a nine-day bench trial during October and November of 2013. Sixteen witnesses – including the Governor, the former Michigan State Treasurer and the Emergency Manager – testified at the eligibility trial and 310 exhibits were introduced into evidence. On December 3, 2013, the bankruptcy court issued a bench decision determining that Detroit was eligible to be a chapter 9 debtor, which decision was memorialized in an order issued on December 5, 2013 (the "Eligibility Order"). See In re City of Detroit, 504 B.R. 97 (Bankr. E.D. Mich. 2013). Seven parties – including the Official Committee of Retirees, Detroit's pension systems and certain entities representing active and retired City employees – filed motions for certification of direct appeal of the Eligibility Order to the Sixth Circuit Court of Appeals.

On December 20, 2013, the bankruptcy court issued an order certifying to the Sixth Circuit Court of Appeals that the eligibility appeals "involve a 'matter of public importance.'" On that same day, however, the bankruptcy court also issued an opinion recommending, among other things, that the Sixth Circuit Court of Appeals (a) deny any petitions for direct appeal and (b) decline to expedite any such direct appeals that were permitted to proceed. Petitions for direct appeal of the Eligibility Order were filed with the Sixth Circuit Court of Appeals by each of the entities that filed a notice of appeal of the Eligibility Order with the bankruptcy court. On February 21, 2014, the Sixth Circuit Court of Appeals entered an order granting all of these petitions for direct appeal, on a non-expedited basis.

As a result of the confirmation of the City's Plan for the Adjustment of Debts of the City of Detroit (as further amended, modified and supplemented and approved by the bankruptcy court, the "Plan") and related settlements, as discussed in greater detail below, all the appeals of the Eligibility Order have been dismissed.

A. Only a "Municipality" Can Be a Chapter 9 Debtor

Access to chapter 9 is limited to municipalities. See 11 U.S.C. § 109(c)(1). A "municipality" is defined by section 101(40) of the Bankruptcy Code as a "political subdivision or public agency or instrumentality of a State." Although not defined in the Bankruptcy Code, "public agencies or instrumentalities of a State" refers, in general, to any state-sponsored or controlled entity that raises revenues through taxes or user fees to construct or operate public projects. Accordingly, the definition of "municipality" includes certain obvious examples, such as cities, townships and villages, and section 109(c)(1) is often lightly contested in large chapter 9 cases, if at all (as was the case with respect to Detroit). Historically, however, a large majority of chapter 9 debtors has consisted of "special purpose" entities such as school districts, hospitals, sanitary districts, irrigation districts, public utility boards, public improvement districts and bridge and highway authorities, rather than cities or towns. Occasionally, where the municipal status of an entity has been unclear, section 109(c)(1) of the Bankruptcy Code has been the focus of litigation. See, e.g., In re Las Vegas Monorail Co., 429 B.R. 770, 800 (Bankr. D. Nev. 2010) (holding that monorail was eligible for chapter 11, rejecting arguments that monorail constituted a "municipality" eligible only for chapter 9 based upon certain language of the formation documents identifying monorail as an instrumentality of the state and the significant control the state maintained over the monorail).

B. The Municipality Must Be Specifically Authorized Under State Law to Be a Chapter 9 Debtor

Pursuant to section 109(c)(2) of the Bankruptcy Code, to be eligible to be a chapter 9 debtor, a municipality must be specifically authorized by state law to file a bankruptcy case. As the bankruptcy court explained in In re County of Orange, 183 B.R. 594 (Bankr. C.D. Cal. 1995), the provision granting such authority must be "exact, plain, and direct with well-defined limits so that nothing is left to inference or implication." Id. at 604. States have taken widely divergent approaches in allowing municipalities to seek chapter 9 relief. Some states have broad statutes that give municipalities almost blanket authority to file while others, like the State of Georgia, expressly prohibit chapter 9 relief. Other states place conditions on the right to file, like Michigan, such as approval by the governor or other political body. Approximately half of the states require that a municipality must first obtain authorizing legislation from the state legislature before it is permitted to commence a chapter 9 case. Some states that permit municipalities to seek chapter 9 protection recently have restricted such access. For example, California recently enacted a law that imposes new requirements, including mediation, on municipalities seeking to file a chapter 9 petition. See Cal. Gov't Code § 53760 (2011).

The issue of whether Detroit was authorized under state law to be a chapter 9 debtor was hotly contested. Section 18 of PA 436 sets forth the process by which a Michigan municipality may receive authorization to file a chapter 9 petition, as follows:

> If, in the judgment of the emergency manager, no reasonable alternative to rectifying the financial emergency of the local government which is in receivership exists, then the emergency manager may recommend to the governor and the state treasurer that the local government be authorized to proceed under chapter 9. If the governor approves of the recommendation, the governor shall inform the state treasurer and the emergency manager in writing of the decision.… The governor may place contingencies on a local government in order to proceed under chapter 9. Upon receipt of written approval, the emergency manager is authorized to proceed under chapter 9. This section empowers the local government for which an emergency manager has been appointed to become a debtor under title 11 of the United States Code, 11 USC 101 to 1532, as required by section 109 of title 11 of the United States Code, 11 USC 109, and empowers the emergency

> manager to act exclusively on the local government's behalf in any such case under chapter 9.

MCL § 141.1551(1). On July 16, 2013, the Emergency Manager provided his written recommendation to the Governor and State Treasurer that Detroit be authorized to file for chapter 9 relief. The recommendation was based on, among other things, the Emergency Manager's (1) determination that Detroit was unable to adopt a feasible financial plan that could have satisfactorily rectified its financial emergency in a timely manner and (2) judgment that no reasonable alternative to chapter 9 would allow the Emergency Manager to rectify Detroit's financial emergency in a timely manner. Thereafter, on July 18, 2013, the Governor approved in writing the Emergency Manager's recommendation to commence a chapter 9 case, and Detroit filed its chapter 9 petition on that same day.

Several objectors to Detroit's eligibility to be a chapter 9 debtor argued that Detroit's authorization to file a chapter 9 petition was invalid because PA 436 – which, among other things, sets forth procedures for the emergency management of municipalities under certain circumstances – violates the Michigan Constitution of 1963 (the "Michigan Constitution"). These objections asserted, among other things, that (1) the Michigan Legislature was constitutionally prohibited from enacting PA 436 because a predecessor statute of PA 436 (containing certain provisions that were similar to those in PA 436) had been rejected by voter referendum six weeks prior to the enactment of PA 436; (2) the Michigan Legislature unconstitutionally included an appropriations provision in PA 436 for the sole purpose of immunizing PA 436 from rejection by referendum (in Michigan, statutes containing appropriations provisions are not subject to referendum); (3) PA 436 violates "home rule" provisions of the Michigan Constitution by temporarily vesting local executive and legislative authority in a state-appointed emergency manager; (4) PA 436 violates article IX, section 24 of the Michigan Constitution (the "Pensions Clause") (which provides that "[t]he 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") because the Pensions Clause protects public pensions from impairment in bankruptcy; (5) the Emergency Manager lacked constitutional authority to file Detroit's chapter 9 petition because he is not an elected official; and (6) the Governor's authorization of Detroit's chapter 9 filing was unconstitutional because such authorization should have been conditioned upon the non-impairment of pension rights.

The bankruptcy court rejected each of these arguments and found that nothing in the Michigan Constitution prohibited Detroit's chapter 9 filing or rendered the filing, or the authorizations for such filing by the Governor and the Emergency Manager, invalid. See Detroit, 504 B.R. at 157-67. Although objections regarding Detroit's authorization to commence its chapter 9 case focused primarily upon provisions of the Michigan Constitution, certain aspects of the court's ruling on this issue may be relevant in future chapter 9 cases generally. For example, in holding that "the failure of P.A. 436 to protect pension rights in a municipal bankruptcy does not make that law inconsistent with the pension clause of the Michigan Constitution," the court explained that when a state authorizes a municipality to commence a chapter 9 case, it necessarily consents to the application of the totality of chapter 9 within the context of such case. Thus, if PA 436 had purported to limit the bankruptcy court's ability to impair pensions in chapter 9, such limitation would have been ineffective. According to the court, "state law cannot reorder the distributional priorities of the bankruptcy code." Id. at 161. Thus, "[i]f the state consents to a municipal bankruptcy, it consents to the application of chapter 9 of the bankruptcy code." Id. The court quoted Association of Retired Employees v. City of Stockton (In re City of Stockton), 478 B.R. 8, 16-17 (Bankr. E.D. Cal. 2012), for the following proposition:

> A state cannot rely on the § 903 reservation of state power to condition or to qualify, i.e. to 'cherry pick,' the application of the Bankruptcy Code provisions that apply in chapter 9 cases after such a case has been filed. While a state may control prerequisites for consenting to permit one of its municipalities (which is an arm of the state cloaked in the state's sovereignty) to file a chapter 9 case, it cannot revise chapter 9.

Detroit, 504 B.R. at 161 (internal citations omitted). The court further explained that had the Governor's authorization been conditioned upon the non-impairment of pensions, "any such contingency in the governor's authorization letter would have been invalid, and may have rendered the authorization itself invalid under 11 U.S.C. § 109(c)." Id. at 162.

C. The Municipality Must Be Insolvent

1. Cash Insolvency

To be eligible for chapter 9 relief, a municipality must demonstrate that it is "insolvent." See 11 U.S.C. § 109(c)(3). Because of the difficulty in accurately valuing the assets of a municipality, the standard "balance-sheet test" for determining solvency generally is not employed in chapter 9 cases. Rather, whether a municipality is insolvent is analyzed on a cash-flow basis, meaning that the relevant standard is whether a municipal debtor generally is unable to pay its debts as they become due. Section 101(32)(C) of the Bankruptcy Code provides that "with reference to a municipality," "insolvent" means a "financial condition such that the municipality is – (i) generally not paying its debts as they come due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due." 11 U.S.C. § 101(32)(C)(i), (ii). A municipality generally can satisfy the first prong of section 101(32)(C) by showing that it has deferred payments that are currently due and owing. See, e.g., In re New York City Off-Track Betting Corp., 427 B.R. 256, 272 (Bankr. S.D.N.Y. 2010) (finding deferral of current payments evidence of debtor's insolvency).

The second prong of section 101(32)(C) of the Bankruptcy Code refers to what courts have called "cash insolvency," or the inability of the municipality to meet its financial obligations on a going-forward basis. The test for cash insolvency under section 101(32)(C)(ii) is prospective, meaning that a municipality need not totally deplete all of its available cash in order to be eligible for chapter 9 relief. See, e.g., Detroit, 504 B.R. at 168 ("The test under [section] 101(32)(C)(ii) is a prospective one, which requires the petitioner to prove as of the petition date an inability to pay its debts as they become due in its current fiscal year, or, based on an adopted budget, in its next fiscal year.") (citation and quotation marks omitted); In re City of Bridgeport, 129 B.R. 332, 339 (Bankr. D. Conn. 1991) ("[A] city should not have to wait until it runs out of money in order to qualify for bankruptcy protection.").

Although courts have not settled on how far into the future such a prospective analysis should reach, it is clear that a projected exhaustion of cash within the municipality's current or succeeding fiscal year will serve to demonstrate cash insolvency. E.g., In re City of Stockton, 493 B.R. 772, 789 (Bankr. E.D. Cal. 2013) ("[W]hen a municipality lacks the funds to pay its contractual obligations within the current or the next succeeding fiscal year, it is unable to pay its debts as they become due within the meaning of § 101(32)(C)(ii)."); In re Pierce Cnty. Hous. Auth., 414 B.R. 702, 711 (Bankr. W.D. Wash. 2009) (finding that the debtor had demonstrated its cash insolvency when, among other things, the debtor's financial expert "properly evaluated the current fiscal year and the next fiscal year"); Bridgeport, 129 B.R. at 338 ("[T]o be found insolvent a city must prove that it will be unable to pay its debts as they become due in its current fiscal year or, based on an adopted budget, in its next fiscal year.").

2. "Budget Insolvency" and "Service Delivery Insolvency"

In the chapter 9 case of Stockton, California, the bankruptcy court determined that "[t]hree types of insolvency inform the [section] 109(c)(3) analysis: cash insolvency; budget insolvency; and service delivery insolvency." Stockton, 493 B.R. at 788. The concepts of "budget insolvency" and "service delivery insolvency" inform the test for cash insolvency, described above. An inquiry into "service delivery insolvency" focuses on a municipality's ability to provide basic municipal services – especially those required to maintain public safety – to its residents. Id. at 790 (identifying spiking crime rates as a "paradigm example of service delivery insolvency" demonstrating that the debtor's cash insolvency was not a technical or "chimer[ical]" default). "Budget insolvency" analyzes a municipality's ability to draft a balanced budget and generate sufficient revenue to cover expenses in the absence of restructuring initiatives. Id. (determining that the debtor was "budget insolvent" where steady-state projections demonstrated budget imbalances that would persist for decades).

3. No Need to Pursue All Possible Means of Raising and Conserving Revenue

A municipality need not cease all spending or sell off its assets to satisfy the insolvency requirement of section 109(c)(3) of the Bankruptcy Code. A municipality can be cash insolvent without having tapped every available resource, especially where short-term and short-sighted revenue generation ultimately would exacerbate the municipality's financial crisis or cause a recurrence of the financial difficulties that led to the municipality's chapter 9 filing. E.g., Detroit, 504 B.R. at 171 (holding that Detroit was insolvent notwithstanding its decision to retain, rather than monetize, many of its assets; "When the expenses of an enterprise exceed its revenue, a one-time infusion of cash, whether from an asset sale or a borrowing, only delays the inevitable failure, unless in the meantime the enterprise sufficiently reduces its expenses and enhances its income.… In any event, when considering selling an asset, the enterprise must take extreme care that the asset is truly unnecessary in enhancing its operational revenue."); Stockton, 493 B.R. at 790 (rejecting objectors' arguments that the debtor was ineligible for relief for failure to have sought tax increases prior to filing where raising taxes was subject to numerous practical and legal obstacles and may not have produced the desired revenue in any event); Int'l Ass'n of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo), 408 B.R. 280, 293 (B.A.P. 9th Cir. 2009) (affirming bankruptcy court's rejection of unions' argument that debtor was solvent because it could "pillage[] all of its component agency funds … to subsidize its

General Fund;" affirming bankruptcy court's finding of insolvency where raiding Vallejo's other funds to satisfy short term cash needs "would leave Vallejo more debilitated tomorrow than it is today"); In re McCurtain Mun. Auth., No. 07-80363, 2007 WL 4287604, at *6 (Bankr. E.D. Okla. Dec. 4, 2007) (finding that the failure to impose assessments is not a factor in a determination of the debtor's solvency); In re Vills. at Castle Rock Metro. Dist. No. 4, 145 B.R. 76, 84 (Bankr. D. Colo. 1990) (noting that creditor's argument that taxes could theoretically be raised would not render the municipality solvent and would result in a "death spiral"); In re Pleasant View Util. Dist., 24 B.R. 632, 639 (Bankr. M.D. Tenn. 1982) ("[T]he mere contingency that the District could improve its financial situation by increasing its rates does not alter the fact that at the present time the District cannot meet its debts as they mature.").

4. Nature and Magnitude of Detroit's Insolvency

In the Eligibility Order, the Detroit bankruptcy court held that Detroit was "insolvent" within the meaning of section 109(c)(3) of the Bankruptcy Code. See Detroit, 504 B.R. at 171. In so ruling, the court noted in particular Detroit's acute service delivery insolvency manifested in, among other things, Detroit's inability to reduce its high crime rate. Id. at 170. The Detroit court adopted the reasoning of Stockton, 478 B.R. 8, in holding that the concept of service delivery insolvency informs the analysis of whether a debtor is "unable to pay its debts as they become due." "Service delivery insolvency," the court stated, "focuses on the municipality's ability to pay for all costs of providing services at the level and quality that are required for the health, safety, and welfare of the community." Id. (quoting Stockton, 478 B.R. at 789). The court emphasized the importance of service delivery insolvency to the court's eligibility determination, as follows: "Indeed, while the City's tumbling credit rating, its utter lack of liquidity, and the disastrous COPs and swaps deal might more neatly establish the City's 'insolvency' under 11 U.S.C. § 101(32)(C), it is the City's service delivery insolvency that the Court finds most strikingly disturbing in this case." Id. Although the concept of service delivery insolvency does not appear in the Bankruptcy Code, the fact that both the Stockton and Detroit bankruptcy courts employed that concept and stressed its importance in analyzing whether section 109(c)(3) of the Bankruptcy Code was satisfied suggests that service delivery insolvency will prove important in future chapter 9 cases.

In addition to holding that Detroit was "unable to pay its debts as they become due," the bankruptcy court also found that Detroit was "generally not paying its debts as they became due," as evidenced by the fact that Detroit had deferred certain scheduled payments on its pension obligations and failed to make a $40 million payment on pension-related certificates of participation, which failure jeopardized Detroit's ability to access certain casino tax revenues. Id. at 169.

Detroit's inability to meet its financial obligations and provide a reasonable level of municipal services was symptomatic of its dire cash position. Detroit's cash crisis had become particularly acute in the weeks preceding its bankruptcy filing. As of June 30, 2013, Detroit had only $36 million in cash on hand (net of accumulated property tax distributions), but had outstanding deferrals and other amounts due totaling approximately $274.3 million. Detroit also was unlikely to be able to service its debts in the foreseeable future. Detroit had negative cash flows of $115.5 million during its 2012 fiscal year. Absent restructuring, Detroit projected cash flows of *negative* $198.5 million for its 2014 fiscal year and negative $260.4 million for its 2015 fiscal year.

D. The Municipality Must Desire to Effect a Plan to Adjust Its Debts

Section 109(c)(4) of the Bankruptcy Code requires that a municipality must desire to effect a plan to adjust its debts to be eligible to be a chapter 9 debtor. Courts have noted that "no bright-line test for determining whether a debtor desires to effect a plan" exists because of the "highly subjective nature of the inquiry." New York City Off-Track Betting, 427 B.R. at 272 (quoting Vallejo, 408 B.R. at 295). A putative debtor need only show that the "purpose of the filing of the chapter 9 petition [is] not simply … to buy time or evade creditors." Vallejo, 408 B.R. at 295 (quoting 2 Collier on Bankruptcy ¶ 109.04[3][d] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.)); New York City Off-Track Betting, 427 B.R. at 272 (same).

A municipality may satisfy section 109(c)(4) of the Bankruptcy Code by attempting to resolve claims, submitting a draft plan or producing other direct or circumstantial evidence customarily submitted to show intent. Vallejo, 408 B.R. at 295; see also Detroit, 504 B.R. at 172 (evidence "overwhelmingly established that Detroit does desire to effectuate a plan" where, prepetition, the municipality submitted a detailed debt-adjustment proposal to its creditors; rejecting arguments that section 109(c)(4) of the Bankruptcy Code was not satisfied because such prepetition proposal may not have constituted a confirmable chapter 9 plan); New York City Off-Track Betting, 427 B.R. at 272 (municipality satisfied section 109(c)(4) requirement where its statement of qualifications provided it "desires to effect a plan to adjust its debts" and it was drafting and negotiating a plan of adjustment); Pierce Cnty., 414 B.R. at 710 (debtor satisfied section 109(c)(4) of the Bankruptcy Code where it had stated its intention to effect, and had begun negotiating and drafting, a plan of adjustment); Cnty. of Orange, 183 B.R. at 607 (finding that debtor's proposal of a global settlement to its creditors months after the commencement of its chapter 9 case evidenced a desire to effect a plan of adjustment); Pleasant View, 24 B.R. at 639 ("Nor can there be any doubt that the debtor desires to effect a plan to adjust its debts since the debtor has already submitted such a plan for the court's approval."). Satisfaction of section 109(c)(4) of the Bankruptcy Code generally has not proved controversial in chapter 9.

E. At Least One of the Section 109(c)(5) Factors Must Be Satisfied

1. The Section 109(c)(5) Factors

Section 109(c)(5) of the Bankruptcy Code requires a municipality to either (a) have negotiated with its creditors unsuccessfully prior to seeking relief, (b) demonstrate that such negotiation was impracticable or (c) meet certain other statutory criteria. See 11 U.S.C. § 109(c)(5). Specifically, a municipal debtor may satisfy the disjunctive test set forth at section 109(c)(5) of the Bankruptcy Code by demonstrating that it:

> (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

> (B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;
>
> (C) is unable to negotiate with creditors because such negotiation is impracticable; or
>
> (D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

11 U.S.C. § 109(c)(5). Sections 109(c)(5)(A) and 109(c)(5)(D) of the Bankruptcy Code generally have little impact in large chapter 9 cases. A large chapter 9 debtor generally will attempt to establish either that (a) it negotiated in good faith with its creditors prior to commencing its chapter 9 case or (b) such negotiations were impracticable.

2. Impracticability of Negotiations

For a large municipality, the size and disparate nature of such municipality's creditor body can render prepetition attempts to negotiate a consensual resolution to the municipality's ongoing financial difficulties "impracticable" within the meaning of section 109(c)(5)(C) of the Bankruptcy Code. Congress passed the 1976 amendments to chapter 9 of the Bankruptcy Code – which amendments revised certain requirements for eligibility including those set forth at section 109(c)(5) of the Bankruptcy Code – largely in response to the financial crises afflicting New York City and other large American cities. H.R. Rep. 94-686, at 4 (1975), reprinted in 1978 U.S.C.C.A.N. 539, 541-42 (the "1975 House Report"). The 1975 House Report explained that the prior municipal bankruptcy law was unworkable for all but the smallest municipalities. Id. Among other changes, the 1976 amendments added a provision that a municipality could seek chapter 9 relief when negotiation with creditors was "impracticable."

Section 109(c)(5)(C) of the Bankruptcy Code was inserted to address the difficult problems created by the insolvency of large municipalities, which had numerous known and unknown creditors. See Detroit, 504 B.R. at 177 ("Congress adopted § 109(c)(5)(C) specifically 'to cover situations in which a very large body of creditors would render prefiling negotiations impracticable.' … 'The impracticality requirement may be satisfied based on the sheer number of creditors involved.'") (quoting Cnty. of Orange, 183 B.R. at 607); New York City Off-Track Betting, 427 B.R. at 276 ("Congress added this mechanism to satisfy section 109's negotiation requirement in response to possible large municipality bankruptcy cases that could involve vast numbers of creditors."); Cnty. of Orange, 183 B.R. at 607 n.3 ("Section 109(c)(5)(C) was necessary because it was otherwise impossible for a large municipality, such as New York, to identify all creditors, form the proper committees, and obtain the necessary consent in a short period of time."). "[I]mpracticability of negotiations is a fact-sensitive inquiry that 'depends upon the circumstances of the case.'" Detroit, 504 B.R. at 176-77 (quoting New York City Off-Track Betting, 427 B.R. at 277). Moreover, "[t]here is nothing in the language of section 109(c)(5)(C) that requires a debtor to either engage in good faith pre-petition negotiations with its creditors to an impasse or to satisfy a numerosity requirement before determining that negotiation is impracticable under the specific facts and circumstances of a case." Id. at 177 (quoting In re Valley Health Sys., 383 B.R. 156, 162-63 (Bankr. C.D. Cal. 2008)).

In Detroit's chapter 9 case, the bankruptcy court agreed with Detroit's argument that the sheer size and diversity of the creditor body – consisting of more than 100,000 creditors – rendered prepetition negotiations impracticable, especially in light of the facts that (a) no entity had the ability to negotiate on behalf of all City retirees or to bind such retirees to any agreement and (b) many of the organizations representing City retirees had taken the position that pensions are fully protected under the Michigan Constitution and thus were unwilling to enter into meaningful negotiations with Detroit. See id. at 176-79. Certain unions and voluntary associations (the "Retiree Associations") argued that they were the "natural representatives" of Detroit's retired employees. Id. at 178. The court noted, however, that (a) the unions represented only current employees and not retirees, and (b) none of the Retiree Associations "assert[ed] that they can bind individual retirees absent some sort of complex class action litigation." Id. Additionally, the court found that representatives of the Retiree Associations had "made it clear that they would not have negotiated a reduction in accrued pension benefits because they consider them to be fully protected by state law." Detroit, 504 B.R. at 178. Because of this, the court concluded "that the position of the several retiree associations that they would never negotiate a reduction in accrued pension benefits made negotiations with them impracticable." Id. at 179. In short, the court stated, "[i]t is impracticable to negotiate with a group that asserts that their position is immutable." Id.

In addition, the court noted that a large proportion of Detroit's debt consisted of "several series of bonds where the individual bondholders are not identified. Many of these bondholders are not represented by any organization." Id. at 178. The court thus held that "[n]egotiations with retirees and bondholders" – which groups together hold a majority of Detroit's debt – "were impracticable due to the sheer number of creditors, and because many of the retirees and bondholders have no formal representatives who could bind them, or even truly negotiate on their behalf." Id. at 179. In view of Detroit's vast creditor body and the difficulty of conducting meaningful negotiations with many thousands of individual creditors, the bankruptcy court concluded that it was "satisfied that when Congress enacted the impracticability section, it foresaw precisely the situation facing the City of Detroit." Detroit, 504 B.R. at 178. According to the court, "[i]t has been widely reported that Detroit is the largest municipality ever to file bankruptcy.… The sheer size of the debt and number of individual creditors made pre-bankruptcy negotiation impracticable – impossible, really." Id.

3. Good Faith Negotiations

Where meaningful prepetition negotiations with creditors are not impracticable, a municipality can satisfy section 109(c)(5) of the Bankruptcy Code by proving that it "has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under [chapter 9]." 11 U.S.C. § 109(c)(5)(B). Most courts that have analyzed section 109(c)(5)(B) of the Bankruptcy Code have held that, to satisfy the requirement of good faith negotiations, a municipality must show that, prior to filing its chapter 9 petition, it presented to, and negotiated with creditors over, what may be fairly characterized as a potential plan of adjustment. See, e.g., Detroit, 504 B.R. at 173 ("Section 109(c)(5)(B) requires municipalities not just to negotiate generally in good faith with their creditors, but also to negotiate in good faith with creditors over a proposed plan, at least in concept, for bankruptcy under Chapter 9.") (quoting Westamerica Bank v. Mendocino Coast Recreation & Park Dist. (In re Mendocino Coast Recreation & Park Dist.), No. 12-CV-02591, 2013 WL 5423788, at *5 (N.D. Cal. Sept. 27, 2013)); In re Cottonwood Water & Sanitation Dist., 138 B.R. 973, 979 (Bankr. D. Colo. 1992) (analyzing the legislative history of section 109(c)(5) of the Bankruptcy Code in holding that "in order for this Debtor to be entitled to the entry of an order for relief, it must be prepared to show that it engaged in good faith negotiations with its creditors concerning the possible terms of a plan to be effected pursuant to section 941 of the Bankruptcy Code").

In Detroit's case, the bankruptcy court noted that "a determination of what qualifies as a good-faith effort to begin negotiation can depend on several factors," but focused on three primary factors identified by the court in Mendocino Coast, as follows:

> First, the greater the disclosure about the proposed bankruptcy plan, the stronger the debtor's claim to have attempted to negotiate in good faith. A creditor might be justified in rejecting the overture of a debtor proposing a frivolous or unclearly described adjustment plan, but a creditor is less justified in ignoring a substantive proposal.…
>
> Second, the municipality's need to immediately disclose classes of creditors and their treatment in the first communication will depend upon how material that information would be to the creditor's decision about whether to negotiate.…
>
> Third, the creditor's response, and the amount of time the creditor has had to respond, may also be factors. If a creditor has had a relatively short time to respond to the municipality's offer to negotiate, a lack of detail in the opening communication might weigh against a municipality rushing to file. On the other hand, where a creditor has been apprised of the possibility of a debt adjustment and declined to respond after a reasonable period of time, or where the creditor has explicitly responded with a refusal to negotiate, its position as an objector is significantly weakened.

Detroit, 504 B.R. at 174 (quoting Mendocino Coast, 2013 WL 5423788, at **8-9). Applying these factors, the bankruptcy court found that Detroit did not negotiate in good faith with its creditors prior to commencing its chapter 9 case. Detroit argued that it met the requirements of section 109(c)(5)(B) of the Bankruptcy Code by (a) distributing a 128-page restructuring proposal to creditors in June 2013, (b) providing additional information in an online data room, (c) holding various meetings with certain of its creditors and (d) inviting creditors to submit counterproposals. Id. at 174-76. The court disagreed, finding that (a) Detroit's restructuring proposal lacked "enough information for creditors to start meaningful negotiations," which deficiency was not remedied by the availability of additional information in the data room; (b) Detroit's meetings with creditors did not constitute "negotiations" because such meetings were "primarily presentational" in nature and "gave little opportunity for creditor input or substantive discussion;" and (c) inadequate time was given for creditors to consider and respond to Detroit's proposals. Id. at 175-76. Although this portion of the Eligibility Order provides some insight into how courts may apply section 109(c)(5)(B) of the Bankruptcy Code in future chapter 9 cases, the court's ruling did not frustrate Detroit's eligibility because, as discussed above, the court found that section 109(c)(5)(C) of the Bankruptcy Code was satisfied, as "negotiations were in fact, impracticable, even if Detroit had attempted good faith negotiations." Id. at 176.

F. The Municipality's Chapter 9 Petition Must Have Been Filed in Good Faith

Even where the eligibility requirements of section 109(c) of the Bankruptcy Code are satisfied, the court may, pursuant to section 921(c) of the Bankruptcy Code, "dismiss the petition if the debtor did not file the petition in good faith or if the petition does not meet the requirements of this title." 11 U.S.C. § 921(c). If a chapter 9 debtor has satisfied the requirements of section 109(c) of the Bankruptcy Code, however, a "strong presumption" arises that a municipality's chapter 9 petition was filed in good faith. See Detroit, 504 B.R. at 180; Stockton, 493 B.R. at 795. Factors that may be relevant in determining whether a chapter 9 petition has been filed in good faith include: (1) the debtor's subjective beliefs; (2) whether the debtor's financial problems can be addressed by chapter 9; (3) whether the debtor's motivation for filing is consistent with the purposes of chapter 9; (4) the extent of the debtor's prepetition negotiations, if practicable; (5) the extent to which the debtor considered alternatives to chapter 9; and (6) the scope and nature of the debtor's financial problems. New York City Off-Track Betting, 427 B.R. at 279. Standing alone, a municipal debtor's refusal to impose or increase taxes or to borrow funds is not sufficient to warrant a finding of bad faith. See id. at 280 ("Petitions are only dismissed where the delay is an attempt 'to deter and harass creditors in their bona fide efforts' to enforce their rights.") (citation omitted). "The essence of this good faith requirement is to prevent abuse of the bankruptcy process." Detroit, 504 B.R. at 180 (quoting Castle Rock, 145 B.R. at 81). Dismissal of a chapter 9 case is the only option if the debtor does not seek chapter 9 relief in good faith or cannot confirm a plan; the assets of a chapter 9 debtor cannot be liquidated.

In Detroit's case, certain objectors asserted that Detroit did not file its chapter 9 petition in good faith because (as such arguments were summarized by the court), "the bankruptcy was the intended consequence of a years-long, strategic plan" by certain State officials and professional advisors, the goal of which was "the impairment of pension rights through a bankruptcy filing by the City." Id. at 181. Although the court found that "in some particulars, the record does support the objectors' view of the reality that led to this bankruptcy filing," such view was "not nearly supported in enough particulars for the Court to find that the filing was in bad faith." Id. at 183. In holding that Detroit filed its chapter 9 petition in good faith, the court identified four factors that were "most relevant in establishing the City's good faith," as follows: (1) "[t]he City's problems are of a type contemplated for chapter 9 relief;" (2) the reasons for Detroit's chapter 9 filing were "consistent with the remedial purpose of chapter 9;" (3) "[t]he City made efforts to improve the state of its finances prior to filing, to no avail;" and (4) "[t]he City's residents will be severely prejudiced if the case is dismissed." Id. at 187.

V. Treatment of Different Types of Municipal Debt and Creditor Constituencies in Chapter 9

A. Trade Debt and Other Unsecured Debt

Unlike a chapter 11 debtor, a municipal debtor in chapter 9 may continue to pay prepetition claims without bankruptcy court approval. As noted above, the bankruptcy court may not interfere with property or revenues of the debtor under section 904(2) of the Bankruptcy Code. Most chapter 9 debtors, during the pendency of the chapter 9 case, endeavor to pay general operating expenses, such as debts to trade vendors, as they come due. This common approach tends to diminish the role of trade creditors in chapter 9 cases.

B. Bond Debt

1. Special Revenue Bonds

Chapter 9 of the Bankruptcy Code expressly provides protection to creditors holding liens on special revenues of a municipal debtor. Municipalities often finance special projects, such as water and sewer infrastructure, with bonds that are collateralized with the revenues and fees earned by such projects. Under section 552(a) of the Bankruptcy Code, revenues and other property acquired after the commencement of the bankruptcy case may not be subject to a prepetition lien. By contrast, section 928 of the Bankruptcy Code states that the "special revenues" remain subject to the liens of the bondholders, except that "necessary operating expenses of such project" may be deducted from the special revenues.

What constitutes "necessary operating expenses of such project" recently was litigated in the chapter 9 case of Jefferson County, Alabama. The prepetition indenture that created the special revenue pledge excluded "capital expenses" (as determined by Generally Accepted Accounting Principles) from the definition of operating expenses for purposes of the net revenue pledge. The debtor argued section 928(b) of the Bankruptcy Code allowed the debtor to charge against system revenues expenses necessary to operate the system, even if an accountant would capitalize the expense. The bankruptcy court ruled that the language of the indenture applied post-petition. In re Jefferson County., Ala., 474 B.R. 725 (Bankr. N.D. Ala. 2012). In a later opinion, the court ruled that attorneys' fees can be necessary operating expenses under section 928(b) and clarified its earlier opinion, suggesting that while debtors cannot deduct reserves or depreciation for capital expenditures, debtors may charge against system revenues actual capital expenditures necessary to operate the system. See In re Jefferson County, Ala., 503 B.R. 849 (Bankr. N.D. Ala. 2013).

Thus, section 928 of the Bankruptcy Code places a restriction on chapter 9 debtors not applicable in chapter 11 cases. Under section 552 of the Bankruptcy Code, a chapter 11 debtor's future revenues generally will not be burdened by prepetition liens, making this revenue available for other purposes and expenses. As Jefferson County demonstrates, however, a municipality may not use special revenues to fund its general expenses during a chapter 9 proceeding and, moreover, may have a difficult time re-allocating this revenue under the auspices of "necessary operating expenses."

2. General Obligation Bonds

(a) General Obligation Bonds in Chapter 9

General obligation bonds issued by a municipality are backed by the "full faith and credit" of the municipality, but generally are not expressly secured by assets or a specific revenue stream. Consequently, the holders of general obligation bonds arguably are unsecured creditors. Typically, holders of general obligation bonds are among the largest creditor constituencies of a chapter 9 debtor. The automatic stay imposed by sections 362 and 922(a) of the Bankruptcy Code precludes such bondholders from commencing actions to force a municipal debtor to take action to satisfy bond claims, such as by levying taxes. *Section 922(a) extends the stay to protect officers and inhabitants of the municipality. Accordingly, creditors of the municipality are stayed from seeking a writ of mandamus or taking other action against municipal officials to force payment of debt.* Although many investors and traders have regarded bonds backed by the "full faith and credit" of a municipality as nearly immune from default or modification – in part because of state and federal protections of contract rights –general obligation bonds that are unsecured are subject to impairment in chapter 9.

(b) Litigation Regarding General Obligation Bonds in the Detroit Case

Prior to filing its petition, the City issued two types of general obligation bonds: "unlimited tax" general obligation (the "UTGO") bonds and "limited tax" general obligation (the "LTGO") bonds . Both types of bonds are backed by the "full faith and credit" of Detroit and its pledge to levy taxes necessary to ensure payment of such bonds. With respect to LTGO bonds, such pledge is limited to the amount of taxation Detroit is statutorily permitted to levy. There is no such limit on the pledge regarding UTGO bonds, i.e., theoretically, outside of bankruptcy, Detroit arguably would be obligated to impose taxes of up to 100% of the outstanding debt to guarantee the payment of such bonds.

On November 8, 2013, certain insurers of unlimited tax general obligation bonds issued by Detroit – National Public Finance Guarantee Corporation ("NPFG"), Assured Guaranty Municipal Corporation ("Assured") and Ambac Assurance Corporation ("Ambac") – filed adversary complaints (the "National/Assured Complaint" and the "Ambac Complaint") against Detroit. The National/Assured Complaint and the Ambac Complaint each allege that Detroit's unlimited tax general obligation bond debt is entitled to special treatment in Detroit's chapter 9 case (the "UTGO Litigation"). The insurers sought declaratory judgments and orders that Detroit must segregate certain tax revenues from Detroit's other sources of revenue and apply them solely for the purpose of servicing Detroit's obligations under the UTGO bonds. The insurers alleged that the UTGO bonds are secured obligations of Detroit.

Detroit has disputed the plaintiffs' characterization of Detroit's obligations with respect to the UTGO bonds, arguing that such debt is a general unsecured obligation. Detroit argued that (i) the UTGO bonds are backed only by a promise to repay them either from general revenue or *ad valorem* taxes, and that this does not grant the bondholders a lien on tax revenue and (ii) the plaintiffs has no actual property interest in Detroit's *ad valorem* tax revenues. Detroit also took the position that the bondholders are precluded from seeking relief because (i) there is no private right of action under applicable Michigan law and (ii) section 904 of the Bankruptcy Code bars the bankruptcy court from entering an order that would interfere with Detroit's political or governmental powers or with its property or revenues. As discussed below, on March 25, 2014, Detroit and the insurers agreed to a settlement concerning Detroit's treatment of the UTGO bond claims that was incorporated into the Plan.

The Ambac Complaint also alleged that, under Michigan law, Detroit was obligated to use general tax revenues to service LTGO bonds. Detroit disputed Ambac's characterization of its obligations with respect to such bonds, in part because, to the extent that applicable State law would require Detroit to use general tax revenues to service the LTGO bonds, such law would create a priority inconsistent with chapter 9 distribution rules and, therefore, would be ineffective in chapter 9. As discussed below, Detroit and Ambac agreed to a settlement concerning Detroit's treatment of the LTGO bond claims that was incorporated into the Plan.

C. Executory Contract Claims

1. Rejection of Executory Contracts in Chapter 9

Because section 365 of the Bankruptcy Code is incorporated into chapter 9 by operation of section 901(a) of the Bankruptcy Code, chapter 9 debtors may assume or reject executory contracts and leases. As under other chapters of the Bankruptcy Code, rejection of an executory contract constitutes a breach of such contract, and rejection damages are liquidated as general unsecured claims.

2. Rejection of CBAs

Because employee payroll compensation and other employee benefits typically make up a substantial portion of a municipality's budget, some of the most significant contracts that a municipality must consider in any restructuring are CBAs with its unionized workforce.
As noted above, section 1113 of the Bankruptcy Code, which imposes special rules for rejecting CBAs in chapter 11, does not apply in chapter 9. Accordingly, Bildisco provides the baseline standard for the rejection of CBAs in chapter 9 cases. Under Bildisco, a debtor may reject a CBA if (a) the labor agreement burdens the estate; (b) after careful scrutiny, the equities balance in favor of contract rejection; and (c) "reasonable efforts to negotiate a voluntary modification have been made, and are not likely to produce a prompt and satisfactory solution." Id. at 526.

Two decisions by California bankruptcy courts provide different interpretations of the consequences of Congress' decision not to incorporate section 1113 of the Bankruptcy Code into chapter 9. In Orange County Employees Association v. County of Orange (In re County of Orange), 179 B.R. 177, 179 (Bankr. C.D. Cal. 1995), a coalition of county employee organizations sued the debtor to enforce their CBAs and sought an emergency injunction preventing the debtor from conducting layoffs. Orange County argued that it was entitled to make unilateral changes to its CBAs under Bildisco because section 1113 is inapplicable in chapter 9 cases. Id. at 181. The plaintiffs argued that the debtor should be required to satisfy the strict standard for emergency modification of labor contracts provided under California law, consistent with the balance of power between the federal government and the states embodied in sections 903 and 904 of the Bankruptcy Code. Id. at 181-82. The bankruptcy court granted the injunction and held that, although the proper standard for rejection of the CBAs was that articulated by the Supreme Court in Bildisco, the debtor should also be required to satisfy the standard of California law "if not as a legal matter, certainly from an equitable standpoint." Id. at 184. The court stated that, even under the relatively permissive Bildisco standard, municipalities must view unilateral modification of their labor contracts as a last resort. Id.

More recently, in In re City of Vallejo, 403 B.R. 72, 74 (Bankr. E.D. Cal. 2009), aff'd, Int'l Bhd. of Elec. Workers v. City of Vallejo (In re City of Vallejo), 432 B.R. 262 (E.D. Cal. 2010), the City of Vallejo moved to reject its CBAs less than one month after filing its chapter 9 petition. Consistent with Orange County, the court held that section 1113 was inapplicable to a chapter 9 debtor's rejection of CBAs and that the Bildisco standard should govern. Id. at 78. The Vallejo court was less deferential to California state labor law than was the Orange County court, however. The Vallejo court held that section 903 of the Bankruptcy Code permits states to "act as gatekeepers to their municipalities' access to relief under the Bankruptcy Code." Id. at 76. Once a state authorizes its municipalities to file for relief under the Bankruptcy Code, however, "it declares that the benefits of chapter 9 are more important than state control over its municipalities." Id. This means that any state authorizing access to chapter 9 "must accept chapter 9 in its totality." Id. Consequently, if a municipality is authorized by the state to file a petition under chapter 9 of the Bankruptcy Code, it "is entitled to fully utilize section 365 of the Bankruptcy Code to accept or reject its executory contracts." Id. Further, the Vallejo court noted that, although no California law purported to impose pre-filing restrictions on a municipal debtor requiring it to comply with state labor laws, any such attempted limitation on section 365 of the Bankruptcy Code would be preempted by the Supremacy Clause and the Contracts Clause of the United States Constitution. Id. at 76-77.

The Vallejo court, however, stopped short of addressing the merits of the debtor's motion. Vallejo, 403 B.R. at 78. Instead, the court deferred ruling "to give the parties every opportunity" to reach a settlement. Id. Despite a clear shifting of leverage from the unions to the debtor, one of the unions was unable to come to terms with the debtor, and, approximately five months after its initial decision on the matter, the court authorized rejection of the applicable CBA. See In re City of Vallejo, Order Granting Motion for Approval of Rejection of Collective Bargaining Agreements, No. 08-26813 (Bankr. E.D. Cal. Sept. 4, 2009) (Docket No. 526).

Vallejo suggests that a chapter 9 debtor should be able to reject its CBAs pursuant to the test set forth in Bildisco, and without consideration of section 1113 of the Bankruptcy Code or otherwise applicable state law. The ramifications of the Vallejo ruling, however, may not be universally positive for chapter 9 debtors. Rejection of an executory contract under section 365 of the Bankruptcy Code, for example, gives rise to an unsecured prepetition claim for damages against the debtor by operation of section 502(g) of the Bankruptcy Code. Bankruptcy courts that have authorized the rejection of CBAs under section 1113 of the Bankruptcy Code have disagreed with respect to whether such rejection gives rise to a claim for damages. Compare S. Labor Union, Local 188 v. Blue Diamond Coal Co. (In re Blue Diamond Coal Co.), 160 B.R. 574, 577 (E.D. Tenn. 1993) (stating that "when Congress enacted [section] 1113, it intended that no claim for damages for rejection of such an agreement would be allowed") with Adventure Res. Inc. v. Holland, 137 F.3d 786, 798 n.17 (4th Cir. 1998) (stating that, if a CBA is rejected, "the resulting damages … constitute general, unsecured claims against the estate"). Accordingly, although, under Vallejo, a chapter 9 debtor may more easily reject a CBA than can a debtor in chapter 11, the potential consequences of doing so may prove to be a significant deterrent for chapter 9 debtors, in light of the uncertainty as to whether such rejection would give rise to a claim for damages.

D. Retiree Benefits Obligations

Chapter 9 also empowers municipalities to modify the pension and OPEB benefits of retired municipal employees. Outside of bankruptcy, a municipality's ability to alter contractual benefits promised to retirees will often be limited by the Contracts Clause of the United States Constitution and comparable provisions in state constitutions. See U.S. Const. art. I, § 10. However, the Bankruptcy Clause and the Supremacy Clause of the United States Constitution give municipalities in chapter 9 the ability to modify existing contractual relationships notwithstanding state and federal constitutional protections of contracts. See, e.g., Detroit, 504 B.R. at 150 ("The state constitutional provisions prohibiting the impairment of contracts and pensions impose no constraint on the bankruptcy process. The Bankruptcy Clause of the United States Constitution, and the bankruptcy code enacted pursuant thereto, explicitly empower the bankruptcy court to impair contracts and to impair contractual rights relating to accrued vested pension benefits. Impairing contracts is what the bankruptcy process does."); Stockton, 478 B.R. at 16 ("The federal bankruptcy power also, by operation of the Supremacy Clause, trumps the similar contracts clause in the California state constitution."); Vallejo, 432 B.R. at 268-70 (holding that federal bankruptcy laws preempt state labor laws).

1. Pension Obligations and the Detroit Case

Prior to the Detroit bankruptcy court's issuance of the Eligibility Order, no chapter 9 ruling had directly addressed the question of whether state constitutional protections of public pensions restrict a chapter 9 debtor's ability to impair pension benefits in chapter 9. During the eligibility stage of the Detroit case, numerous City retirees, employees, their representatives (including the Official Committee of Retirees, Detroit's pension systems, certain labor unions and certain retiree organizations) and other parties (including the Attorney General of the State of Michigan) advanced the argument that the bankruptcy court may not impair accrued pension benefits because they are protected under the Pensions Clause. As noted above, the Pensions Clause provides that "[t]he 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." Mich. Const. art. IX, § 24. In the Eligibility Order, the bankruptcy court ruled, among other things, that Detroit's pension obligations are subject to impairment in chapter 9 notwithstanding the Pensions Clause.

The Detroit court held that, while the Pensions Clause prohibits the *state* from impairing vested pension benefits, "[t]he federal bankruptcy court, however, is not so constrained." Detroit, 504 B.R. at 150. The court rejected arguments that the Tenth Amendment to the United States Constitution diminished the bankruptcy court's power to impair contract rights, stating that "for Tenth Amendment and state sovereignty purposes, nothing distinguishes pension debt in a municipal bankruptcy case from any other debt." Id. The court further held that Detroit's pension obligations are contractual in nature, rejecting the argument of certain objectors to Detroit's eligibility that pension obligations were entitled to special treatment. Id. at 153-54. The court concluded that, "[b]ecause under the Michigan Constitution, pension rights are contractual rights, they are subject to impairment in a federal bankruptcy proceeding. Moreover, when, as here, the state consents, that impairment does not violate the Tenth Amendment." Id. at 154. Several parties obtained permission to appeal the Eligibility Order directly to the United States Court of Appeals for the Sixth Circuit, but these appeals have all been dismissed. The Detroit court's holding regarding the impairment of municipal pensions in chapter 9 is likely to have far-reaching consequences for financially-strapped municipalities and their employees and retirees.

2. OPEB Liabilities

A chapter 9 debtor has greater flexibility to seek relief with respect to retiree OPEB obligations than does a corporate debtor in chapter 11. As noted above, in chapter 11 cases, section 1114 of the Bankruptcy Code generally requires a debtor to continue making retiree benefits payments in a timely manner until the court approves a modification. See 11 U.S.C. § 1114. Like section 1113 of the Bankruptcy Code, however, section 1114 of the Bankruptcy Code does not apply in chapter 9 cases.

The recent Stockton case illustrates the power of a municipality to reduce retiree health benefits in chapter 9. After filing its chapter 9 petition, the City of Stockton adopted a balanced budget, as required by state law, which budget sought to cut costs by unilaterally reducing retiree health benefits. Stockton, 478 B.R. at 13-14. The city's retirees argued that such benefits were contractual in nature under state law, and that the contracts clauses of the state and federal constitutions, among other things, prohibited Stockton from altering their benefits. Id. at 16. In holding in favor of the city, the bankruptcy court reasoned that although the Contracts Clause of the United States Constitution prevents a *state* from impairing contracts, it does not prevent *Congress* from doing so through the Bankruptcy Code, the main purpose of which is to alter contractual relationships. Id. The Court thus held that, even if the retirees' benefits were vested contractual interests under state law, the city's commencement of a chapter 9 case permitted it to modify these contractual obligations without running afoul of the federal or state contracts clauses. Id. The Stockton court further refused to impose requirements similar to those set forth in section 1114 of the Bankruptcy Code, noting that Congress had deliberately declined to make section 1114 applicable in chapter 9 cases. Id. at 23. Finally, because section 904 of the Bankruptcy Code forbids a court from interfering with a municipality's property or revenues, the court held that it lacked the authority to order the city to reinstate the prior benefits level, which would have required the payment of money by the city. Id. at 20-21.

In the Detroit case, Detroit unilaterally altered the health benefits provided to retirees and employees during the case. The Official Committee of Retirees commenced an adversary proceeding, seeking to enjoin Detroit's actions. Detroit moved to dismiss the Committee's complaint, based on, among other things, the Stockton court's ruling and section 904 of the Bankruptcy Code. The parties reached a settlement prior to the court's issuance of a ruling on Detroit's motion to dismiss.

E. Role of Facilitative Mediation

The structure of chapter 9 encourages mediation, not least because the only alternative to confirmation of a chapter 9 debtor's plan of adjustment is dismissal of the case. Thus, in the chapter 9 context, municipal debtors and parties in interest generally have a strong incentive to negotiate settlements.

Mediation has figured prominently in many chapter 9 cases, including Detroit. The Detroit bankruptcy court ordered the City and representatives of various creditor constituencies to participate in mediation under the supervision of the Chief Judge of the United States District Court for the Eastern District of Michigan, who in turn designated five other federal judges and a prominent trial lawyer in specific substantive areas, regarding, among other things, (1) general restructuring issues, (2) disputes relating to labor and the modification of OPEB benefits, (3) treatment of UTGO and LTGO bonds, (4) the settlement of certain obligations related to interest rate swaps and (5) the potential creation of a regional water authority. Among other positive developments, mediation in the Detroit case yielded a settlement between Detroit, certain charitable foundations and the non-profit entity that operates the Detroit Institute of Arts (the "DIA") that, as discussed below, (1) shields the DIA's art collection from potential sales to satisfy creditors of Detroit, (2) reduces the underfunding of Detroit's pension systems and (3) significantly enhances creditor recoveries under the Plan. This settlement provided the foundation for Detroit's Plan and subsequent settlements.

Mediation in the Detroit matter also has resulted in a court-approved settlement between Detroit and certain counterparties to interest rate swaps, which settlement reduced the amount payable by the City on such obligations by 70% and resolved a dispute regarding Detroit's ability to access its substantial casino tax revenues going forward. Through mediation, Detroit also reached a settlement with holders of claims relating to UTGO and LTGO bonds, the terms of which settlement are reflected in the Plan. Mediation also led to settlements between the City and (1) the Official Committee of Retirees and certain voluntary associations representing retired employees of the City, regarding the treatment of pension and OPEB claims under Detroit's plan of adjustment; (2) Detroit's pension systems, regarding pension claims; (3) certain public safety unions, regarding pension, wage and healthcare issues; and (4) the monoline insurers, Syncora Guarantee Inc. and Syncora Capital Assurance Inc. (together, "Syncora") and Financial Guaranty Insurance Company ("FGIC") for the COPs. In the Detroit case, mediation facilitated the resolution of numerous complicated restructuring disputes.

VI. The Plan of Adjustment and Confirmation

A. The Plan of Adjustment

The central purpose of chapter 9 is for the municipality to emerge with a successful plan of debt adjustment. In a chapter 11 case, the debtor has a limited period of time during which it has the exclusive right to file and obtain approval of a plan of reorganization or liquidation, after which creditors or other parties in interest may propose their own plan(s). By contrast, in a chapter 9 case, only the municipality may propose a plan of adjustment. Although the Bankruptcy Code technically imposes no time limits regarding the filing and confirmation of a plan of adjustment, various Bankruptcy Rules empower bankruptcy courts to establish certain plan-related time limits. See, e.g., Fed. R. Bankr. P. 3017(c) ("On or before approval of the disclosure statement, the court shall fix a time within which the holders of claims and interests may accept or reject the plan and may fix a date for the hearing on confirmation."). If a municipality does not file a plan of adjustment contemporaneously with its chapter 9 petition, the court will determine the date by which the municipality must file its plan. 11 U.S.C. § 941. In Detroit, for example, the bankruptcy court issued an order requiring Detroit to file its plan of adjustment no later than March 1, 2014, a date that was approximately 7 months and two weeks after the filing of its chapter 9 petition. The City filed its first Plan and related disclosure statement on February 21, 2014.

The plan of adjustment itself is a document that provides for the treatment of the various classes of creditors' claims against the municipality. The procedures for the filing, solicitation and confirmation of a plan in chapter 9 are similar to those that apply in chapter 11. Sections 1123(a)(1) through 1123(a)(5) of the Bankruptcy Code apply in chapter 9 (see 11 U.S.C. § 901(a)), meaning that many of the statutory requirements regarding the classification of claims and treatment of classes in chapter 11 cases also apply in chapter 9. These subsections provide that a plan must: (1) designate certain classes of claims; (2) specify any unimpaired classes; (3) specify the treatment of any impaired classes; (4) "provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;" and (5) "provide adequate means for the plan's implementation." 11 U.S.C. §§ 1123(a)(1)-(5). In addition, as in chapter 11, a chapter 9 plan may impair classes of secured or unsecured claims (11 U.S.C. § 1123(b)(1)) and/or provide for, among other things, (1) the assumption, rejection or assignment of executory contracts and unexpired leases (11 U.S.C. § 1123(b)(2)); (2) the settlement or enforcement of claims (11 U.S.C. § 1123(b)(3)); and (3) the sale of property of the debtor and distribution of the proceeds of such a sale to holders of claims (11 U.S.C. § 1123(b)(4)). Section 901 of the Bankruptcy Code also incorporates into chapter 9 certain other chapter 11 provisions regarding plan contents and confirmation, including the entirety of Bankruptcy Code sections 1124 (regarding the impairment of claims), 1125 (regarding postpetition disclosure and the solicitation of votes) and 1128 (regarding the confirmation hearing), as well as portions of sections 1126, 1127 and 1129 of the Bankruptcy Code, dealing with, respectively, the acceptance, modification and confirmation of a plan. See 11 U.S.C. § 901(a).

In addition to the requirements described above, chapter 9 contains several other requirements that a plan of adjustment must meet to be confirmed by the bankruptcy court. These requirements include, but are not limited to, the following: (1) the municipal debtor must not be prohibited by law from taking any action necessary to carry out the plan (§ 943(b)(4)); (2) all postpetition administrative claims must be paid in full (§ 943(b)(5)); and (3) all regulatory and electoral approvals necessary to consummate the plan must have been obtained (§ 943(b)(6)).

B. Plan Confirmation

1. Acceptance

A plan is accepted by an impaired class of claims if holders of two-thirds in dollar amount and a majority in number of allowed claims of that class vote to accept the plan. Only those holders of claims who actually vote to accept or reject the plan count in the tabulation. The impaired classes must accept the plan in order for the plan to be confirmed without application of the "cramdown" test contained in sections 1129(b)(i), (b)(2)(A) and (b)(2)(B) of the Bankruptcy Code.

2. Confirmation Requirements Regarding the Impairment of Claims

(a) The "Best Interests of Creditors" Test

Notwithstanding acceptance of the plan by each impaired class of claims, for a chapter 9 debtor's plan to be confirmed, the bankruptcy court must determine that the plan of adjustment is in the best interests of creditors pursuant to section 943(b)(7) of the Bankruptcy Code. In chapter 11, a plan is in the "best interests of creditors" if, under such plan, each holder of a claim or interest in an impaired class "will receive or retain under the plan … property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date." 11 U.S.C. § 1129(a)(7). Because a chapter 9 debtor cannot be liquidated, this analysis is meaningless in chapter 9 cases and, accordingly, section 1129(a)(7) of the Bankruptcy Code is not incorporated into chapter 9. See 11 U.S.C. § 901(a). The "best interests of creditors" test does apply in chapter 9, however, in a manner that differs from its chapter 11 formulation.

To satisfy the chapter 9 version of the "best interests of creditors" test, a chapter 9 debtor must establish that confirmation of its proposed plan of adjustment, more likely than not, would leave the debtor's creditors in a better position than would dismissal of the debtor's chapter 9 bankruptcy case. See In re Sanitary & Improvement Dist., No. 7, 98 B.R. 970, 974 (Bankr. D. Neb. 1989) (the "best interests of creditors" test "simply requires the Court to make a determination of whether or not the plan as proposed is better than the alternatives"); In re Mount Carbon Metro. Dist., 242 B.R. 18, 34 (Bankr. D. Colo. 1999) ("The 'best interest' requirement of § 943(b)(7) is generally regarded as requiring that a proposed plan provide a better alternative for creditors than what they already have. This is often easy to establish."). Because the failure of plan confirmation and dismissal of a chapter 9 debtor's bankruptcy case, in most instances, would result in a race to the courthouse that would leave many creditors with no recovery at all, the best interests of creditors test is a flexible standard that is less stringent than a test requiring that a plan be "fair and equitable." See 6 Collier on Bankruptcy ¶ 943.03[7][a].

A chapter 9 debtor satisfies the best interests of creditors test if its plan of adjustment makes a reasonable effort to provide a recovery for creditors; the test does not require a chapter 9 debtor to increase taxes above reasonable levels to maximize creditor recoveries. See id. Similarly, the best interest of creditors test does not prohibit a municipal debtor from retaining sufficient levels of cash and other assets that it may reasonably require to (i) provide adequate levels of services, (ii) make necessary improvements and (iii) maintain its property and continue normal operations. See, e.g., Mount Carbon, 242 B.R. at 34 (denying confirmation of proposed chapter 9 plan that likely would not have enabled the debtor to provide a reasonable level of future services; "Since insolvency is the foundation of Chapter 9 eligibility, it would make little sense to confirm a reorganization plan which does not remedy the problem. Stated differently – there is no purpose in confirming a Chapter 9 plan if the municipality will be unable to provide future governmental services."). Although the debtor bears the burden of proving, by a preponderance of the evidence, that its plan of adjustment satisfies the best interests of creditors test set forth at section 943(b)(7) of the Bankruptcy Code, the bankruptcy court must limit any examination of a municipal debtor's ability to pay creditors so as to not "interfere with" the "political or governmental powers of the debtor," the debtor's "property or revenues" or "the debtor's use or enjoyment of any income producing property," as directed by section 904 of the Bankruptcy Code. See 11 U.S.C. § 904; 6 Collier on Bankruptcy ¶ 943.03[7][a].

In the Detroit case, the bankruptcy court determined that the Plan was in the best interests of creditors by framing the issue before the court as "whether the available state law remedies could result in a greater recovery for the City's creditors than confirmation of the plan. This analysis will also point out that losing the benefits of the plan will actually impair creditors' recoveries under these state law remedies." See December 31, 2014 Supplemental Opinion Regarding Plan Confirmation, Approving Settlements, and Approving Exit Financing (Docket No. 8993) (the "December 31 Confirmation Order" and in conjunction with the Order Confirming Eighth Amended Plan for the Adjustment of Debts of the City of Detroit (Docket No. 8272), the "Confirmation Order") at 97. Relying on evidence from the City's expert witnesses, the bankruptcy court determined that Michigan's state-law remedies (i.e., requiring the City to raise taxes to satisfy judgments) available to creditors outside of chapter 9 would amount to an "empty right to litigate," id. at 100, because "raising taxes is not a viable option for the City, legally or practically." Id. at 101. Such action would "produce very little additional revenue" and would "add to the [City's] population decline." Id. The bankruptcy court further determined that Plan "[c]onfirmation may not be denied simply because some creditors may do better upon dismissal" by 'winning' the race to the courthouse outside chapter 9. Id. at 103. Indeed, the bankruptcy court determined that creditors' recoveries would be "substantially impaired" if the Plan were not confirmed because, among other things, the City would lose the benefit of the various settlements embodied in the Plan, and the City would be required to finance expensive litigation against sophisticated parties in certain ongoing matters, such as the City-initiated litigation regarding the validity of the $1.4 billion COPs issuance. Id. at 104. Most importantly, however, the bankruptcy court placed significant weight on what would be lost if the Plan were dismissed: the benefits to the City and its residents stemming from $1.7 billion in restructuring and reinvestment initiatives that would not otherwise occur outside of the negotiated Plan settlements. Id. at 105

(b) Feasibility

Section 943(b)(7) of the Bankruptcy Code further requires that a plan of adjustment be "feasible." While the best interests of creditors test establishes a "floor" with respect to how much a chapter 9 debtor can be expected to pay creditors under a plan of adjustment, the feasibility requirement imposes a "ceiling" on creditor recoveries under such a plan. See Mount Carbon, 242 B.R. at 34; Pierce Cnty., 414 B.R. at 718. To satisfy the feasibility requirement, a chapter 9 debtor must demonstrate, by a preponderance of the evidence, that it has the ability to make the payments set forth in the proposed plan of adjustment while also maintaining sufficient assets to (i) provide adequate levels of municipal services, (ii) fund normal municipal operations and (iii) remain financially viable after the conclusion of the chapter 9 case and during the contemplated payment period. See, e.g., Mount Carbon, 242 B.R. at 34-35 ("The Court must, in the course of determining feasibility, evaluate whether it is probable that the debtor can both pay pre-petition debt and provide future public services at the level necessary to its viability as a municipality.… A plan should offer a reasonable prospect of success and be workable. In Chapter 9, this requires a practical analysis of whether the debtor can accomplish what the plan proposes and provide governmental services.").

To determine whether a proposed plan of adjustment satisfies the feasibility standard of section 943(b)(7) of the Bankruptcy Code, a bankruptcy court must analyze the debtor's income and expense projections. See id. at 35 ("The probability of future success will depend upon reasonable income and expense projections."). Such projections must be realistic, reliable and not unreasonably optimistic, and also must show that the plan is workable and appears to have a reasonable prospect of success, i.e., that it appears reasonably probable that the debtor will be able to make the payments to creditors contemplated in the plan of adjustment while maintaining adequate levels of municipal services. Cf. id. at 35, 38 ("As with plans proposed under Chapter 11, if performance of a Chapter 9 plan is based upon deferred payments, projections of future income and expenses must be based upon reasonable assumptions and must not be speculative or conjectural;" holding that "inflexible, overly optimistic" projections that were "based upon unreasonable and conjectural assumptions" were insufficient to establish the feasibility of debtor's proposed chapter 9 plan) (citation and quotation marks omitted).

As with the determination of whether a plan of adjustment satisfies the best interests of creditors test, the scope of the bankruptcy court's inquiry into the feasibility of a plan of adjustment is limited by section 904 of the Bankruptcy Code. Accordingly, the feasibility inquiry is relatively narrow. The bankruptcy court simply must (i) determine whether the debtor's projected revenues and expenses are reasonable and (ii) if so, decide whether the debtor will be able to make the contemplated payments while providing adequate services to residents and avoiding a recurrence of the type of financial distress that caused the debtor to commence its chapter 9 case. See 6 Collier on Bankruptcy ¶ 943.03[7][b] ("The court's role [in assessing feasibility] will be limited to determining whether the revenue and expense projections that the debtor submits are reasonable forecasts and whether, based on those numbers, the debtor sill be able to make the payments called for under the plan.").

In the Detroit case, the bankruptcy court pointed out the difficulties in examining the feasibility of the City's Plan stemming from the enormity of Detroit's debt, the length of the financial projections (40 years) and the complications associated revitalizing public services. Nevertheless, in reliance on the testimony of numerous expert witnesses (including the bankruptcy court-appointed feasibility expert), the bankruptcy court determined that the Plan was feasible. December 31 Confirmation Order at 108 to 154. This determination was premised upon, among other things, the finding that the Plan (i) facilitates the City's ability to fix and maintain its broken governmental operations, (ii) enables the City to provide sustainable municipal services to businesses and residents, (iii) minimizes the risks associated with maintaining pension plans for City employees and (iv) is premised upon reasonable revenue and expense projections. The bankruptcy court reached these conclusions after adopting the standard for measuring the feasibility of the Plan as articulated by its own feasibility expert:

> Is it likely that the City of Detroit, after confirmation of the Plan of Adjustment, will be able to sustainably provide basic municipal services to the citizens of Detroit and to meet the obligations contemplated in the Plan without significant probability of default?

This standard closely tracks what was articulated in Mount Carbon, 242 B.R. at 35. Of particular significance to the bankruptcy court in evaluating the feasibility of the Plan was "whether the City is committed to implement the plan and whether it has sufficient resources to monitor its performance under the plan." December 31 Confirmation Order at 114. The bankruptcy court determined, after hearing testimony from both City leaders and State officials, that the City was, indeed, committed to adhering to the terms and conditions of the Plan and that the post-bankruptcy oversight of the City, as discussed in detail below, "enhances the feasibility of the plan." Id. at 152.

Notwithstanding its finding of feasibility, the bankruptcy court noted that "significant risks remain." Id. at 153. The Detroit court noted that most of these risks are "beyond the City's control" but implored the City's interested parties – labor unions, retiree associations and the State – to take "longer-term and broader view[s]" of the City's pensions and to work together to "vigorously supervise and regulate" them to "assure adequate pension funding." Id. at 154.

3. Cramdown

The Bankruptcy Code provides that the bankruptcy court may confirm a plan that is not accepted by all impaired classes if at least one impaired class of claims accepts the plan and the so-called "cramdown" provisions set forth in sections 1129(b)(l), (b)(2)(A) and (b)(2)(B) of the Bankruptcy Code are satisfied. The plan may be confirmed under the cramdown provisions if, in addition to satisfying the other requirements of section 943(b) of the Bankruptcy Code, it (a) is "fair and equitable" and (b) does not discriminate unfairly with respect to each class of claims that is impaired under and has not accepted the plan.

(a) "Fair and Equitable"

Notwithstanding the Detroit case, a certain amount of uncertainty exists as to the precise contours of the "fair and equitable" requirement in chapter 9. Outside of the chapter 9 context, the "fair and equitable" requirement generally requires, among other things, that, unless a dissenting unsecured class of claims receives payment in full for its allowed claims, no holder of allowed claims in any class junior to that class may receive or retain any property on account of such claims. This is known as the "absolute priority rule." Outside the Detroit case, few published opinions have addressed the meaning of the "fair and equitable" requirement in chapter 9 cases. Some courts have suggested that, because there are no equity holders in chapter 9 cases (who, in theory, would be junior in priority to a municipal debtor's general unsecured creditors), the absolute priority rule serves no function in chapter 9 cases and, thus, in chapter 9 cases, the "fair and equitable" requirement should not be interpreted as synonymous with the absolute priority rule. See In re Corcoran Hosp. Dist., 233 B.R. 449, 451, 457-58 (Bankr. E.D. Cal. 1999) ("In a typical Chapter 11 case, [the "fair and equitable" requirement] means that equity holders may not retain their interest unless the unsecured class either accepts the plan or is paid in full. In a reorganization of a municipality under Chapter 9 … the requirement must be interpreted somewhat differently. … [T]here are no holders of equity interests in the debtor here. Thus, what is commonly referred to as the "absolute priority rule" embodied by § 1129(b)(2)(B) does not prevent the debtor here from continuing to operate the hospital."). In light of the scarcity of case law addressing the "fair and equitable" requirement in chapter 9, a leading commentator has suggested that, in chapter 9, the "fair and equitable" requirement is properly understood as requiring that, where a municipal debtor seeks nonconsensual confirmation of a plan of adjustment, the impaired creditors of such debtor, under the proposed plan, will receive "all that they can reasonably expect under the circumstances." See 6 Collier on Bankruptcy ¶ 943.03[1][f][i][B].

With respect to a class of secured claims, section 901 incorporates section 506 of the Bankruptcy Code. Accordingly, as a general rule, a creditor's secured claim is limited to the value of the creditor's interest in the debtor's interest in the collateral. Secured creditors in chapter 9 often are the holders of special revenue bonds. In the Detroit case, the bondholders for the water and sewer department held special revenue bonds. There was a difference of opinion between these bondholders and the City as to whether special revenue bonds could be crammed down.

It was the DWSD Bondholders' view, in summary, that holders of special revenue bonds could not be impaired or "crammed down" in a chapter 9 proceeding because the special provisions of the Bankruptcy Code applicable to debt secured by special revenues required that they receive the benefit of their bargain. Accordingly, they believed that: (i) issues of valuation of the net revenue stream and market rates of interest are irrelevant in a chapter 9 case with respect to special revenue bonds; (ii) the holders of special revenue bonds are entitled to receive payment in full and all of the revenues are to be used for such payment according to the terms of the underlying documents given the "closed-loop" nature of special revenue financing; and (iii) if the system or project that generates the revenues is simply unable economically to generate sufficient revenues to pay all of the principal and interest on the special revenue bonds as it comes due, the bondholders are, nevertheless, entitled to receive all available net revenues from the system or project and if the debtor seeks to refinance the bonds, or sell the system or project, the existing bonds and any accrued interest will have to be paid in full.

On the other hand, it was the City's view that the lien extends only to the revenues of the system, net of "operating expenses," and not to the underlying physical assets that generate the revenue. The City, therefore, argued that, in a cramdown under section 1129(b)(2)(A)(i) of the Bankruptcy Code, the bankruptcy court must determine the present value of the revenue stream securing the bonds. The methodologies and assumptions to apply in this analysis may be subject to dispute. Without limitation, the debtor and creditors may litigate the extent to which the debtor should or can (under state law, or under the laws of economics) increase rates, taxes and other charges, and the amounts and types of "operating expenses" that may be carved out of the lien under section 928(b) of the Bankruptcy Code. See Section V.B.1, above. Ratepayers, taxpayers and other interested parties – including state and federal officials and regulatory agencies – may have standing to challenge proposed rates and the proper level of operating expenditures. If the court finds the value of the revenue stream is less than the outstanding principal amount of the bonds, a cramdown plan could meet the fair and equitable standard by paying bondholders less than the full amount of the debt, or with interest lower than the contract rate. Because net revenue bonds normally are non-recourse to the debtor, the bondholders may not retain an unsecured claim for any deficiency under section 506 of the Bankruptcy Code. The plan of adjustment also could provide for the sale of the collateral, subject to the creditors' rights to credit bid, under section 1129(b)(2)(A)(ii) of the Bankruptcy Code. Markets may be limited for traditional municipal assets, such as town halls and courthouses, but many net revenue bonds are secured by utilities or other projects with strong cash flow that may have substantial value if de-leveraged and sold or leased to private operators. Section 1129(b)(2)(A)(iii) of the Bankruptcy Code allows the debtor to provide the secured class with the "indubitable equivalent" of the secured claims, suggesting cramdown could entail the surrender of the underlying assets or providing a lien on replacement collateral. State law, as well as practical and political concerns, may limit these alternatives.

The parties eventually settled (as described below) and the DWSD bonds were treated as unimpaired under the Plan.

In the Detroit case the bankruptcy court determined that "it is fair and equitable to impose the plan on dissenting creditors against their stated will." December 31 Confirmation Order at 184. After noting that the voting margins for those classes that voted to reject the plan were very small, the bankruptcy court determined that "[t]here really is no choice [in the Detroit case]. There are no viable alternatives to [the Plan] that will solve the City's problems and at the same time pay more to classes 14 and 15 [(the other unsecured and convenience claims, respectively)] to obtain their support. To revitalize itself for the good of all of its stakeholders, the City desperately needs the shared sacrifice that this plan will impose on all of its creditors, even these few rejecting creditors, and the City needs it now." Id. at 185. In reaching this conclusion, as discussed below, the bankruptcy court essentially applied new standard: the 'judgment of conscience' test.

(b) Unfair Discrimination

Section 1129(b)(1) of the Bankruptcy Code requires that, in addition to being fair and equitable, to be confirmed, a nonconsensual plan of adjustment also must not "discriminate unfairly … with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). The unfair discrimination standard is a discrete legal requirement which demands proof of compliance separate from that required as part of the fair and equitable analysis. See 7 Collier on Bankruptcy ¶ 1129.03[3] ("The [unfair discrimination] requirement is separate and independent of the more-often litigated 'fair and equitable' rule.").

Courts generally apply one of two prevailing tests (or variations of such tests) in analyzing whether a plan unfairly discriminates against a dissenting class. The Aztec test – which is perhaps the most widely-applied of the unfair discrimination tests – considers "(1) whether the discrimination is supported by a reasonable basis; (2) whether the debtor can confirm and consummate a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) the treatment of the classes discriminated against." In re Aztec Co., 107 B.R. 585, 590 (Bankr. M.D. Tenn. 1989). In recent years, a more stringent test has been adopted by several courts that have found the Aztec test to be overly subjective. That test, as articulated by Professor Bruce Markell in his article, A New Perspective on Unfair Discrimination in Chapter 11, 72 Am. Bankr. L.J. 227 (Spring 1998) and as applied in Dow Corning (the "Markell Test"), demands an assessment of the materiality of discrimination between similarly-situated classes, as follows:

> [A] rebuttable presumption that a plan is unfairly discriminatory will arise when there is: (1) a dissenting class; (2) another class of the same priority; and (3) a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage

> recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.

In re Dow Corning Corp., 244 B.R. 705, 710 (Bankr. E.D. Mich. 1999), aff'd, 255 B.R. 445 (E.D. Mich. 2000). In the companion case of In re Dow Corning, 244 B.R. 696 (Bankr. E.D. Mich. 1999), the court described circumstances under which the Dow Corning presumption may be rebutted:

> The plan proponent could rebut the presumption of unfairness established by a significant recovery differential by showing that, outside of bankruptcy, the dissenting class would similarly receive less than the class receiving a greater recovery, or that the alleged preferred class had infused new value into the reorganization which offset its gain. The plan proponent could overcome the presumption of unfair treatment based on different risk allocation by showing that such allocation was consistent with the risk assumed by the parties before the bankruptcy.

Id. at 702. According to the court, "a holder of an unsecured claim [should start] out with the assumption that he or she will get what every other unsecured creditor gets." Id. at 702 n.6. The Dow Corning court further stated that "[t]his notion is protected by the general equality principle in bankruptcy as given effect by the strong-arm powers, preferences, and the requirement that each creditor be paid pro rata along with all other creditors." Id.

Determining whether a plan's proposed distribution scheme unfairly discriminates between similarly-situated creditor classes requires a fact-intensive inquiry and an exercise of the court's sound discretion, given that "there is no bright line test which establishes whether a given difference in percentage recovery results in unfair discrimination." In re Greate Bay Hotel & Casino, Inc., 251 B.R. 213, 231 (Bankr. D.N.J. 2000).

In its analysis of this issue in the Detroit case, bankruptcy court rejected the approach taken in Aztec and the Markell Test. December 31 Confirmation Order at 173 – 75. Instead, the Detroit bankruptcy court concluded that "determining fairness is a matter of relying upon the judgment of conscience." Id. at 175. This standard is most analogous to the one articulated by the Seventh Circuit in In re Crawford, 324 F.3d 539, 542 (7th Cir. 2003) where the Seventh Circuit stated: "We haven't been able to think of a good test ourselves…[so we instruct] the first-line decision maker, the bankruptcy judge, to seek a result that is reasonable in light of the purposes of the relevant law, which in this case is Chapter 13 of the Bankruptcy Code[.]" Id. at 174. The Detroit bankruptcy court found that the Aztec, Dow Corning, and Crawford cases articulated a standard that was not "faithful to the language of § 1129(b)." Id. Thus, to provide guidance on what to consider when applying the 'judgment of conscience' standard, the Detroit bankruptcy court evaluated the Plan's treatment of creditors by looking to (i) the "purpose of chapter 9[, which] is to restructure the municipality's debt so that it can provide adequate municipal services"; and (ii) "the Court's experience and sense of morality." Id. at 175.

Applying the 'judgment of conscience' standard, the Detroit bankruptcy court determined that, with respect to the two dissenting classes (14 and 15), the Plan does not discriminate unfairly and is fair and equitable. December 31 Confirmation Order at 169 – 185. The court noted that the discrimination in favor of the pension classes was appropriate because, among other things, the City has a "strong interest in preserving its relationships with its employees, in enhancing their motivation, and in attracting skilled new employees, consistent with its financial resources." Id. at 176. Also, the bankruptcy court pointed out that the discrimination is not unfair: "[t]he Court has already observed that the City's plan is largely a collection of interconnected settlements…[and] that if each of the settlements in the plan is reasonable, then the resulting discrimination in the plan must be fair."[3] Id. at 177.

C. Detroit's Confirmed Plan of Adjustment

On February 21, 2014, the City filed its first Plan (Docket No. 2708) and related Disclosure Statement (Docket No. 2709) (as further amended, modified and supplemented and approved by the bankruptcy court the "Disclosure Statement"). At the time the City filed the first Plan the City had no approved settlements with its creditors and every creditor group filed objections to the City's Plan. Thereafter, through court-ordered mediation and legal arguments over confirmation issues, Detroit achieved settlements with every creditor group that was represented by counsel except for certain creditors holding purported 42 U.S.C. § 1983 claims. As the City reached settlements with various creditors, it filed amended Plans to reflect the terms of those settlements and their overall impact on the Plan. In total, between February 21, 2014 and October 22, 2014, the City filed eight Plans. As discussed in more detail below, after a lengthy Plan confirmation trial, the bankruptcy court published the Confirmation Order.

1. Plan Disclosure Statement and Vote Solicitation

On May 5, 2014, the bankruptcy court entered an order approving the Fourth Amended Disclosure Statement (Docket No. 4401).[4] This Disclosure Statement was used to solicit votes for the Plan and contained detailed information about the terms of the Plan, projected recoveries to creditors thereunder, certain of the settlements incorporated into the Plan, the risk factors associated with the Plan, the tax consequences of the restructuring contemplated by the Plan and various other matters. The Disclosure Statement also provides detail about the events leading up

[3] The bankruptcy court did not consider the "financial needs of retirees" in evaluating the unfair discrimination issue. December 31 Confirmation Order at 178. Here, the Detroit case judged the "fairness of the discrimination not in the abstract, but informed by the goals and purposes of the chapter 9 case…[which] necessarily excludes the relative needs of the creditors in disparately treated classes." Id. Indeed, the bankruptcy court "further note[d] that no case law in any of the rehabilitative chapters [of the Bankruptcy Code] suggests that creditors' needs are an appropriate consideration in determining whether a plan unfairly discriminates." Id.

[4] Between February 21, 2014, and the approval of the Fourth Amended Disclosure Statement amended versions of the Plan and Disclosure Statement were filed as follows: (a) first amended versions on March 31, 2014 (Docket Nos. 3380 and 3382, respectively); (b) second amended versions April 16, 2014 (Docket Nos. 4140 and 4141, respectively); (c) third amended versions on April 25, 2014 (Docket Nos. 4271 and 4272, respectively); and (d) fourth amended versions on May 5, 2014 (Docket Nos. 4391 and 4392, respectively).

to, and activities in, the Detroit case. Also, as required by the bankruptcy court, the Disclosure Statement included a 'plain language' insert that was drafted specifically for Detroit's 32,000-plus retirees. This insert explained how pension and retiree health benefits for current and former city employees would change under the Plan if it was accepted or rejected.

Solicitation packages that included, among other things, the Disclosure Statement were mailed parties entitled to vote on the Plan on May 12, 2014. The deadline for voting on the Plan was July 11, 2014. Subsequent to this deadline the City achieved additional settlements – those with Syncora, and FGIC being most prominent – that resulted in the retabulation of votes to change votes that were cast to reject the Plan to votes cast to accept the Plan. The final vote tabulation, including all retabulated votes, for Detroit's various creditor classes is:

Class Name	Class Description	% Members Accepted	% Members Rejected	% $ Accepted	% $ Rejected	Source
5	COP Swap Claims	100.00%	0.00%	100.00%	0.00%	Second Supplemental Declaration [DN 8072]
7	Limited Tax General Obligation Bonds	62.98%	37.02%	83.39%	16.61%	Second Supplemental Declaration [DN 8072]
8	Unlimited Tax General Obligation Bond Claims	87.26%	12.74%	97.35%	2.65%	Second Supplemental Declaration [DN 8072]
9	COP Claims	92.50%	7.50%	96.61%	3.39%	Second Supplemental Declaration [DN 8072]
10	PFRS Pension Claims	82.17%	17.83%	82.10%	17.90%	Voting Declaration [DN 6179]
11	GRS Pension Claims	73.15%	26.85%	72.94%	27.06%	Voting Declaration [DN 6179]
12	OPEB Claims	88.25%	11.75%	84.62%	15.38%	Voting Declaration [DN 6179]
13	Downtown Development Authority Claims	100.00%	0.00%	100.00%	0.00%	Second Supplemental Declaration [DN 8072]
14	Other Unsecured Claims	48.95%	51.05%	42.51%	57.49%	Second Supplemental Declaration [DN 8072]
15	Convenience Claims	44.74%	55.26%	42.08%	57.92%	Second Supplemental Declaration [DN 8072]
17	Indirect 36th District Court Claims	100.00%	0.00%	100.00%	0.00%	Second Supplemental Declaration [DN 8072]

2. Claim Treatment and Class Recoveries

The Plan provides for the resolution, through reinvestment, of a variety of complex financial and operational issues faced by the City. Except in the case of subordinated claims (which receive no recovery), the Plan provides a recovery to all classes of claims consistent with the legal rights and priorities of each creditor group. Below is a summary of the claim treatment as set forth in greater detail in the Plan:

- Holders of allowed secured claims (other than separately classified "COP Swap Claims") either had their claims reinstated or received new bonds in an amount equal to the principal amount of bonds held.

- Pursuant to the settlement with the swap counterparties, holders of certain "COP Swap Claims" received an early termination payment allegedly owing under the contracts governing the swap transactions.

- Holders of allowed unsecured claims other than pension claims and claims arising from UTGO claims are entitled to their pro rata share of certain new "B" notes to be issued pursuant to the Plan.

- OPEB claims will receive their recovery through the issuance of new "B" notes that will fund two voluntary employee beneficiary associations created pursuant to the Plan (one for police and fire retirees and the other for general retirees). This includes using a portion of the new "B" notes that were previously set aside for a COPs litigation reserve.

- LTGO claims received (i) $55 million in cash from the City from its exit financing and (ii) a portion of the new "B" notes that were previously set aside for a COPs litigation reserve.

- The COPs class of Detroit debt, consisting of Syncora and FGIC, received:

    - New "B" notes;

    - New "C" notes; and

    - Settlement credits designed to offset the purchase of certain City-owned property subject to certain bidding requirements and restrictions.

- UTGO claims received a pro rata share of certain "Restructured UTGO Bonds" and also retained ownership of "Reinstated Stub UTGO Bonds." These holders assigned the proceeds of the Restructured Stub UTGO Bonds to fund an "income stabilization fund" to ensure that pension reductions do not force City retirees into poverty.

- The Plan classifies in two separate classes pension claims relating to (a) the Police and Fire Retirement System of the City of Detroit ("PFRS") and (b) the General Retirement System of the City of Detroit ("GRS") (together, the "Retirement Systems"). Pursuant to the Confirmation Order:

    - Each holder of a PFRS pension claim will receive 100% of his or her current pension amount and 45% of annual cost-of-living adjustments ("COLAs"). Each holder of a GRS pension claim will receive 95.5% of his or her current pension amount and no future COLAs.

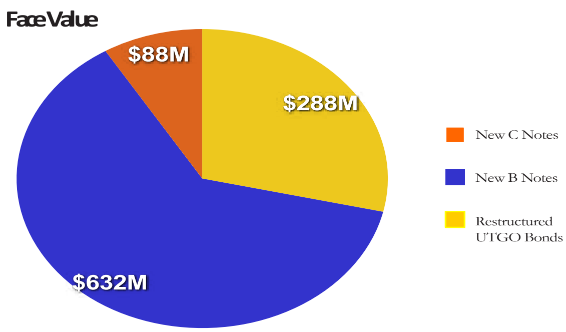
        - Some GRS members participated in an annuity savings fund established by GRS during a time period when GRS credited excess interest to annuity savings fund accounts. Under the Plan, a portion of such excess interest will be recouped and allocated to enhance the recoveries of GRS pension claim holders generally ("ASF Recoupment").

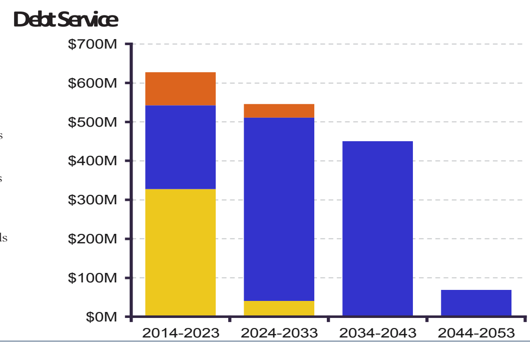
    - The pension benefit reductions described above may be restored, in whole or in part, for holders of PFRS claims and/or holders of GRS claims, if the funding level of PFRS and/or GRS, as applicable, significantly improves such that certain funding thresholds are met and the trustees of the PFRS and/or GRS, as applicable, have complied with certain requirements.

As referenced above, the below reflects the new notes to be issued under the Eighth Amended Plan to various creditor groups and the debt service associated with such notes:

New Notes Issued Under the 8th Amended Plan

	Face Value	Term	Interest	Holders
Restructured UTGO Notes	$288M	14 years	Various (3.7% - 5.375%)	UTGO
New B Notes	$632M	30 years	4%, 4%, 6%	OPEB, LTGO, COPs & Other Unsec.
New C Notes	$88M	12 years	5.0%	Syncora, FGIC
Total	$1,008M			





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As a result of the aforementioned treatment, the chart below reflects the anticipated recoveries for each class of Detroit debt under the Eighth Amended Plan:

Class(es)	Type of Debt	Recovery
1, 2, 3, 4 and 6	DWSD Bonds, Secured GO Bonds, Other Secured Debt, HUD Notes, Parking Bonds (Secured)	100%
5	Settled COP Swap (Secured)	30%
7	Settled LTGO	47%
8	Settled UTGO	74%
9	Settled COPs	13%
10	PFRS Pension	39-59%
11	GRS Pension	48-60%
12	Settled OPEB	11%
13	DDA Notes	10-13%
14	Other Unsecured	10-13%
15	Convenience Claims	25%
16	Subordinated Claims	0%
17	36th District Court Claims	33%

3. Plan Confirmation Discovery, Litigation, and Hearing

Contemporaneous with the solicitation of votes, the City, objecting creditors and other parties in interest engaged in extensive discovery efforts and related activities in preparation for the evidentiary hearing on confirmation of the Plan. Between Spring 2014 and August 2014:

- The City expended countless hours addressing Plan related discovery requests including, among others, the following:
  - 1,146 discovery requests of the City that included 902 requests for documents and 240 interrogatories;
  - The collection of over 1.2 million documents from over 80 custodians; and
  - The production of over 250,000 pages of material responsive to discovery requests.
- More than 70 parties were deposed over a five-week period, including the Detroit Emergency Manager, Mayor, Council President, and community and business leaders such as Messrs. Roger Penske and Dan Gilbert;
- Over a dozen expert reports were prepared to address, among other things, the feasibility of the Plan. This included the report of Martha E. M. Kopacz of Phoenix Management Services, the bankruptcy court's feasibility expert;
- The City prepared and filed nearly 1,000 pages of legal briefs in response to, among other things, discovery objections, legal objections to the Plan, motions *in limie* (and responses to Plan objectors' motions *in limine*), and other discrete legal

arguments raised by parties in interest throughout the Plan solicitation and confirmation process; and

- The Court and representatives from the City and objecting creditors participated in a 59-mile, five hour tour of the City through many neighborhoods that included, among other things, both well maintained and blighted houses, a police precinct, and the Detroit Institute of Arts.

Following these comprehensive discovery and legal briefing efforts, the hearing on confirmation of the Plan commenced on August 29, 2014 and continued for 24 trial days. Closing arguments took place on October 27, 2014, and the bankruptcy court read its bench decision confirming the Plan on November 12, 2014, with the written Confirmation Order following thereafter. During the evidentiary hearing the bankruptcy court heard testimony from over 30 witnesses in addition to numerous unrepresented individuals (who were also given the opportunity to cross examine witnesses, including the City's counsel) and admitted over 1,000 exhibits into evidence.

4. The "Cornerstone" of the Plan: the "Grand Bargain"

In the Confirmation Order the bankruptcy court stated: "The cornerstone of the plan is the Grand Bargain. It is a collection of settlements among a number of parties with an interest in the City's two pension plans and in protecting the City's art at the DIA." December 31 Confirmation Order at 18. The formulation of the Grand Bargain began during Fall 2013 and resulted in the January 13, 2014, announcement by the mediators in the Detroit case that certain local Detroit and national charitable foundations (collectively, the "Foundations") had agreed in principle to pledge certain funds as part of a potential multiparty settlement that would (a) shield the art collection housed at the DIA from potential sales to satisfy Detroit's creditors and (b) reduce the Retirement Systems' current levels of underfunding. Twelve Foundations pledged funds – totaling at least $366 million over twenty years – toward this effort. On January 22, 2014, the Governor announced a plan pursuant to which the State would pledge up to $350 million over twenty years (or make a single lump sum payment of $194.8 million, representing the net present value of this twenty-year contribution) in State funds in support of the Grand Bargain and certain creditor recoveries in exchange for certain releases contained in the Plan. In addition, the nonprofit corporation that operates the Detroit Institute of Arts ("DIA Corp.") has pledged to raise $100 million over twenty years – and has received sufficient commitments from private individuals and other entities to fulfill this pledge – to support the Grand Bargain. Collectively, the potential contributions of the Foundations, Michigan and DIA Corp. constitute what the Disclosure Statement refers to as the "Outside Funding" and what the various parties involved informally refer to as the "Grand Bargain". All the conditions precedent to the consummation of the Grand Bargain have been satisfied including, among others, the following: (i) the vote by classes 10 and 11 to accept the plan; (ii) the passage and enactment of legislation by the State to fund its portion—the lump sum payment option—of the Grand Bargain; and (iii) confirmation of the Plan by the bankruptcy court. With these conditions satisfied, the first Grand Bargain payment – $23.3 million – was sent to the City's two retirement systems on December 10, 2014.[5] The State's lump sum payment is expected on February 9, 2015.[6]

[5] This marks the first of twenty annual installments and includes the first contributions made by the Foundations ($18.3 million) and the DIA ($5 million). See Jennifer Chambers, First payment made toward

a) Post Bankruptcy Oversight

A component of the State's Grand Bargain legislation is the creation of a nine-member financial review commission to monitor the City's finances and budgets in an attempt to ensure that the City adheres to the Plan and continues to implement the various financial and operational reforms contemplated under the Plan. See Mich. Comp. Laws. § 141.1631 *et seq.* Commission members include, among others, Detroit Mayor Duggan and Council President Jones in addition to individuals from the private sector and certain State officials. Also included in the State's Grand Bargain legislation is the requirement that both the PFRS and GRS create investment committees to review, recommend and approve certain actions by each respective retirement systems' board designed to minimize investment risks. See Mich. Comp. Laws § 38.1133g.

5. Restructuring and Reinvestment Initiatives

With the confirmation of the Plan and the resulting adjustments to the City's financial obligations going forward, the City now has the opportunity to devote substantial resources to address its service delivery insolvency. Over the next ten years the City will spend over $1.7 billion on various restructuring and reinvestment initiatives (collectively, the "RRIs"). As outlined in the Confirmation Order, the RRIs can be broken down into seven categories:

1. Blight initiatives, which focus on the remediation of primarily residential blight;
2. Public safety initiatives, which focus on police and fire services to improve overall public safety;
3. Resident service initiatives, which focus on departments that primarily interact with residents (such as the Department of Transportation);
4. Business service initiatives, which focuses on departments that interact with businesses (such as Buildings, Safety Engineering and Environmental Department);
5. Organizational initiatives, which focus on the departments that serve primarily to support City operations (such as the Finance Department and General Services);
6. Management initiatives, which relate to the Mayor's office, City Council and the City Clerk; and
7. Non-departmental initiatives, which relate to the 36th District Court.

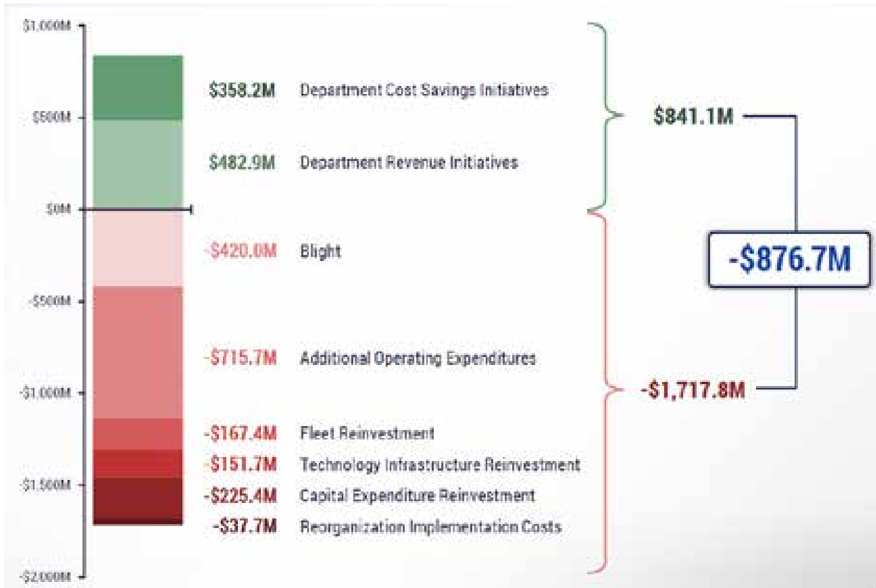
December 31 Confirmation Order at 134-35.

(continued…)

Detroit's 'grand bargain', The Detroit News, Dec. 11, 2014, available at http://www.detroitnews.com/story/news/local/wayne-county/2014/12/11/first-payment-made-toward-detroits-grand-bargain/20240369/.

[6] Paul Egan, State gives final OK to Detroit 'grand bargain' payment, Lansing State Journal, Dec. 22, 2014, available at http://www.lansingstatejournal.com/story/news/local/michigan/2014/12/22/state-gives-final-ok-detroit-grand-bargain-payment/20755579/.

These RRIs will improve service at all levels to Detroit's citizens and generate incremental revenue and result in cost savings for the City over the next ten years as shown in the below chart:



6. Great Lakes Water Authority

With the benefit of the mediation process established in the Detroit case, the City and its surrounding counties – Macomb, Oakland, and Wayne – were able to reach an agreement regarding the creation of a regional water and sewer authority, the Great Lakes Water Authority ("GLWA"). The GLWA will govern the operations of the Detroit Water and Sewerage Department (the "DWSD"), which provides water and sewer maintenance and service to the City and its surrounding counties. The creation of the GLWA, which was announced in September 2014, allows Detroit to retain ownership of the water and sewer system but gives the counties greater control over its operations. The City allowed the counties to have this additional oversight power in exchange for a $50 million per year lease payment for the next 40 years. These funds will, among other things, help the DWSD make necessary repairs to its infrastructure and assist with future capital costs.

This historical achievement was the result of mediation and facilitated the withdrawal of various objections to the Plan.[7]

[7] As noted in the December 31 Confirmation Order at 72, "this agreement…involved the transfer of City assets [but] the City exercised its right under § 904 [of the Bankruptcy Code] not to request Court approval of the" creation of the Great Lakes Water Authority.

a) DWSD Bondholder Settlement and Tender Offer

Important to the creation of the Great Lakes Water Authority was the resolution of various objections and opposition to the Plan by DWSD bondholders. The Plan proposed to impair these bonds and, as such, the class (1A) voted to reject the Plan. A settlement was reached in early August 2014 that resolved the objections and would leave this class unimpaired if DWSD achieved sufficient cash flow savings from a tender offer that was made during the bankruptcy case and prior to confirmation. To effect the tender proces and the related financing, the City filed a motion to approve the settlement and a secured financing transaction. The City launched the tender offer on August 7, 2014 and on August 22, 2014, the City announced the success of the tender offer in the market. With its success, DWSD was able to sell about $1.8 billion of refinancing bonds to raise money to, among other things, pay for the tendered bonds and construction projects totaling approximately $162 million. The refinancing bonds carried a lower interest rate and are likely to save DWSD over $100 million in debt service expenses over the next 20-plus years. On August 25, 2014, following a bankruptcy court hearing, the bankruptcy court granted the City's motion and this settlement was incorporated in the Sixth Plan (Docket No. 6908). As a result of the tender offer's success, this Plan version left class 1A unimpaired.

7. Transition of City Governance from Emergency Manager to City Leaders and Cessation of Financial Emergency

On September 25, 2014, in accordance with Section 9(6)(c) of PA 436, the Detroit City Council voted unanimously to remove the Emergency Manager as of the effective date of the Plan. By letter to the Governor the same day, the Mayor approved of the Council's vote in accordance with Section 9(6)(c) of PA 436. Also on September 25, 2014, in connection with the vote of City Council and the Mayor's approval of the Emergency Manager's removal, the Emergency Manager issued Emergency Manager Order No. 42. This order, among other things, (a) restored the authority of the Mayor and City Council over the City's day-to-day operations and activities effective immediately, (b) reflected an agreement between the Mayor, Council, and Emergency Manager that the Emergency Manager would only exercise powers through the Effective Date only with respect to any action (or the prevention of any action) that is necessary or convenient for the management of the Detroit case and related bankruptcy proceedings and the implementation of the Plan.

Thereafter, prior to the effective date, the Emergency Manager issued Emergency Manager Order No. 44, the "Final Emergency Manager Order," on December 8, 2014. This order essentially restored all remaining governance powers to the Mayor and City Council and, among other things, required the City take certain steps to implement and adhere to the Plan, adopted various labor agreements and a two-year budget, and reaffirmed previously issued Emergency Manager and bond-related orders.

Also on December 8, 2014, the Emergency Manager notified the Governor and Treasurer by letter of the Emergency Manager's determination that the financial emergency he was appointed to manage will have been rectified as of the Effective Date of the Plan and recommended that the City be removed from receivership on the same date. By letter dated December 9, 2014, the Governor accepted the Emergency Manager's recommendation. The Effective Date occurred on December 10, 2014, see Notice of (i) Entry of Order Confirming Eighth Amended Plan for the Adjustment of Debts of the City of Detroit and (ii) Occurrence of

Effective Date (Docket No. 8649), resulting in the removal of the Emergency Manager and the end of the State receivership of the City.

8. Bankruptcy Court Review of Professional Fees

In Detroit's chapter 9 case, the bankruptcy court took the unusual step of appointing a fee examiner to review professional fees for reasonableness on an ongoing basis. An order negotiated and proposed by Detroit and the fee examiner, and ultimately entered by the bankruptcy court, established procedures for, among other things, (1) Detroit to publicly disclose its professional fee expenses, (2) the fee examiner to review Detroit's professional fee expenses and to file reports addressing whether such expenses have been fully disclosed and are reasonable and (3) periodically disclosing and paying the fee examiner's fees and expenses. Pursuant to such order, Detroit agreed to pay the reasonable fees and expenses of the professionals retained by the Official Committee of Retirees appointed by the court. It is uncertain whether other courts will follow the Detroit model with respect to professional fees in chapter 9 cases.

Section 943(b)(3) requires that "all amounts to be paid by the debtor or by any person for services or expenses in the case or incident to the plan have been fully disclosed and are reasonable." In the December 31, 2014 Confirmation Order the bankruptcy court determined that, notwithstanding the appointment of a fee examiner and his review of the reasonableness of fees paid to professionals by the City, that it was "not appropriate to accept, without further judicial review, the fee examiner's findings that the fees [paid and to be paid in the Detroit case] have been reasonable." December 31 Confirmation Order at 85. Accordingly, on January 5, 2015 the bankruptcy court entered an Order Regarding Process to Determine the Reasonableness of Fees Under 11 U.S.C. § 943(b)(3) (Docket No. 8999) whereby parties were given the opportunity to submit statements regarding the reasonableness of their fees and expenses on or before January 16, 2015. Numerous parties filed such statements and articulated reasons why, when taking into account all agreed-upon reductions, the total charges paid for work performed in the Detroit case was reasonable in accordance with section 943(b)(3) and the cases interpreting that provision. See, e.g., Docket Nos. 9068 (Clark Hill); 9074 (Pepper Hamilton); 9075 (Segal Company); 9076 (Jones Day); 9078 (Miller Buckfire); 9080 and 81 (Dentons). On February 12, 2015, the Bankruptcy Court entered an order finding that the fees paid in Detroit's case were reasonable under section 943(b)(3) of the Bankruptcy Code. See Docket No. 9256.