

# The Detroit News

## Detroit's bankruptcy case draws national spotlight



Amid other discussions at the Atlanta event, several bankruptcy experts said they are following Detroit's case closely. (Dave Tulis / AP)

*Atlanta* — The looming legal question in Detroit's bankruptcy case of whether pension benefits can be slashed despite state constitutional protections was a prominent topic of debate here Thursday at a national bankruptcy judges' meeting.

The nation's bankruptcy heavyweights — gathered for the annual meeting of the National Conference of Bankruptcy Judges — are watching Detroit's Chapter 9 case closely and its potentially far-reaching impact on whether municipalities can use federal courts to walk away from pensions and general debt.

Constitutional issues of whether pensions are property or contractual rights are a central issue in Detroit's historic attempt to shed billions of dollars in debt accumulated over six decades of decline.

Detroit Emergency Manager Kevyn Orr's team argues pensions are a contract that can be altered in bankruptcy, while retirees and unions have asserted past and present employees have a property right backed by U.S. constitutional protections.

"Ultimately, there's going to have to be a Supreme Court decision that resolves that," said U.S. Bankruptcy Judge Christopher Klein, the California jurist handling the ongoing bankruptcy case of Stockton, Calif., which has proposed paying the pensioners in full.

Given the complexity and size of Detroit's filing, which claims \$3.5 billion in pension obligations among \$11.5 billion in unsecured debts, bankruptcy experts expect the Motor City's case to test the bounds of a federal bankruptcy court's authority.

"Whatever the reason, there's not enough money to pay everybody, so why should the pensions come first?" said Kenneth Klee, a Los Angeles bankruptcy attorney working on the ongoing Jefferson County, Ala., case.

Whether Detroit or other municipalities can use the bankruptcy court to wipe out contractual pension and retiree health care benefits remains the "holy grail issue" of the "alien territory" of rare municipal bankruptcy cases, said Gary Klausner, a Los Angeles bankruptcy attorney who moderated the discussion.

Klausner called Detroit's \$5.7 billion in unfunded retiree health insurance "enormous, if not back-breaking."

Orr was supposed to speak during the forum, but canceled his appearance Wednesday because he remains an active witness in the city's bankruptcy eligibility trial, which resumes Monday.

Jeffrey Ellman, an Atlanta attorney at Jones Day, Detroit's bankruptcy counsel, also "decided it wouldn't be appropriate" to speak on the issue and canceled, Klausner said.

Detroit's bankruptcy eligibility trial has focused on factual issues surrounding good-faith negotiations with creditors and whether Michigan Gov. Rick Snyder properly authorized the filing under the state's emergency manager law, which the Legislature hurriedly passed in December to replace a statute voters repealed in November 2012.

"Those are central to the present eligibility dispute that's going on in Detroit right now," said Michael Gearin, a Washington, D.C., attorney at K&L Gates who represents the California pension system in the Stockton and San Bernardino, Calif., bankruptcy cases.

## **Rhodes on Ponzi schemes**

While the top bankruptcy experts considered the issues surrounding Detroit's case, the judge who will decide whether Detroit is eligible to be in bankruptcy court was speaking about a different subject.

In a rare public appearance, U.S. Bankruptcy Judge Steven Rhodes spoke on a separate panel about Ponzi schemes in complex bankruptcy litigation, a subject on which he has written a book. Rhodes, a veteran Detroit-based jurist, has been fast-tracking the city's case and prodding along Orr and other witnesses in the 5-day-old eligibility trial.

The bankruptcy panelists were split on whether Rhodes' implementation of court-ordered mediation would lead to creditors and the city reaching a consensual debt-cutting plan.

One of the mediators leading the closed-door discussions is Oregon bankruptcy Judge Elizabeth Perris, who has mediated in three California bankruptcies.

"Mediation in Detroit?" asked Klee, noting the city's historically hostile labor unions. "I just cannot imagine this is going to be anything but a waste of resources."

Without speaking about unresolved issues in the Stockton case, Klein said Perris' presence has been helpful in bringing together the adversarial parties in California.

"Yes, you can have a cram-down plan and you may need it," Klein said about when courts impose a bankruptcy reorganization plan on objecting creditors. "You really need agreement and a mediator, particularly a judicial mediator, is a great way to get people to re-examine their positions."

## **Detroit followed closely**

Several bankruptcy attorneys and government restructuring specialists attending the annual meeting said they are following Detroit's case closely because of the potential precedent it could set for the treatment of public pensions and municipal bonds. Before filing the petition July 18, Orr proposed giving retirees and bondholders \$2 billion to split up among \$11.5 billion in unsecured claims, amounting to less than 18 cents for every dollar owed.

But not all are convinced Detroit's bankruptcy could set the stage for a string of municipal bankruptcies, as some bond analysts have predicted. One government restructuring consultant said Detroit's case is unique in that it was politically facilitated by Snyder.

"Threatening (bankruptcy) is one issue and doing it is another," said Joseph Luzinski, senior vice president of Development Specialists Inc. in Miami. "It's a threat you can't make unless you have the (political) capacity to follow through."

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