

## Detroit Bankruptcy Will Be A Clinic For Struggling Cities

By **Maria Chutchian**

*Law360, New York (July 19, 2013, 7:07 PM ET)* -- With Detroit's historic bankruptcy filing Thursday, other financially strapped cities, towns and counties across the country will be watching closely to how the once vibrant city addresses its pension obligations and bond debt, among other issues, before they dive into Chapter 9, experts said.

If Detroit is able to take control of its staggering debt — at least \$18 billion, according to the city's emergency financial manager Kevyn Orr — it will be a watershed moment for municipal bankruptcies. The city of approximately 700,000 has been struggling to keep itself afloat for years, and its Chapter 9 petition is an acknowledgement that city leaders could not make peace with creditors on their own.

Detroit's bankruptcy — which was ruled unconstitutional Friday but is seen by many as the only viable option — will allow the city to take its time negotiating with union representatives, retirees and bondholders, who collectively hold billions of Detroit's debt and from whom Orr has already sought enormous concessions.

But the handful of cities and towns that have entered bankruptcy in the U.S. have mainly used Chapter 9 to restructure their debt, meaning Detroit has the opportunity to become a model for other struggling municipalities if it can successfully drag concessions out of its creditors by implementing Chapter 11 techniques, specifically in negotiating reductions to creditor recoveries, in its Chapter 9 case, according to Kenneth E. Noble of Katten Muchin Rosenman LLP.

"If Detroit can go in and show you it can reduce its balance sheet effectively, there will be a number of other municipalities that will follow suit," Noble said.

Perhaps the most prominent issue cities and towns will be paying attention to in the Detroit bankruptcy will be to what extent it can finagle a way out of its pension obligations, which account for a large chunk of its debt, bankruptcy experts say. Michigan's state Constitution provides protection to pension funds, which will raise the question of whether a federal bankruptcy court will be willing to sidestep that provision for the sake of Detroit's economic viability.

“If Detroit is allowed to write down its obligation to its retirees ... that could have an impact on other municipalities seeking Chapter 9,” Patton Hahn of Baker Donelson LLP said.

Other municipalities will be watching how Detroit negotiates with bondholders. While each state has its own constitution governing these matters, cities and towns will still want to see how much a city with such massive debt can reduce its obligations. Orr has said some creditors may only see a 20 percent recovery on the debt they hold.

“Clearly what happens in Detroit will affect the thought processes in other jurisdictions,” Andrew Gottfried of Morgan Lewis & Bockius LLP said.

Another significant issue surrounding Detroit’s bankruptcy that other cities and towns will likely be paying close attention to is the long-term impact on its ability to borrow. Some experts say the bankruptcy filing will be detrimental to the trust a municipality needs in order to issue bonds that fund its basic services like police and fire departments.

The most likely impact of this will be a rise in costs for other cities and towns to access the capital market, William G. Hamm of Berkeley Research Group said. It will cause potential purchasers of municipal bonds to weigh political risk as well as economic risk because they will be uncertain about how much to trust the officials who oversaw a municipality’s financial decline, he said.

“Whenever you bring risk into the equation, you have to add a risk premium to the interest rate,” Hamm said.

“I think this could have a significant impact by raising the amount cities are going to have to pay for the credit they need,” he added.

On the other hand, some experts argue that the city's effort to take control of its dire situation will be a boon for its ability to borrow down the road. Though New York City never actually entered bankruptcy, it endured a debt crisis in the 1970s but ultimately managed to get its finances back on track and its credit rating stabilized, Gottfried said.

Additionally, famous bankrupt corporate companies such as Chrysler and General Motors actually improved their credit rating and access to borrowing as a result of their Chapter 11 cases, and if Detroit handles its bankruptcy properly, it can do the same through Chapter 9, according to Noble.

“Chapter 9 gives you all of the tools and more in Chapter 11, it’s just that nobody’s ever used them,” he said.

--Editing by John Quinn and Chris Yates.

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