

## Detroit Judge's Ch. 9 Ruling Will Fire Up Pension Dispute

By **Maria Chutchian**

*Law360, New York (December 03, 2013, 8:11 PM ET)* -- A judge's Tuesday ruling that Detroit is eligible for bankruptcy relief came as no surprise, but his finding that public pensions can be reduced during a bankruptcy was an unexpected and forceful stand that is likely the start of a hotly contested appeals process.

U.S. Bankruptcy Judge Steven W. Rhodes said the pension funds, which are protected against cuts by Michigan's Constitution, can in fact be reduced under federal bankruptcy law. The decision is a blow to retirees, who have clung tightly to their stance that under state law, their pensions cannot be touched.

Attorneys are predicting that the matter could ultimately wind up before the U.S. Supreme Court due to its fundamental issue of whether federal law or state law prevails, according to Karol Denniston of Schiff Hardin LLP. But until then, pensioners have a new reality to cope with.

"For the world of restructuring, he cleared the table and said, 'Whatever your assumptions were last night, you're in a new world. In that new world, pensions can be restructured,'" she said.

Detroit Emergency Manager Kevyn Orr filed the city's Chapter 9 petition in July in the face of \$18 billion in debt — at least \$3.5 billion of which comes from pension liabilities — and after proposing a deal to creditors in June that offered some of them pennies on the dollar. The creditors balked, and he obtained the governor's permission to commence bankruptcy proceedings.

Since then, creditors have been fighting the city's attempt to secure a favorable eligibility ruling from Judge Rhodes, saying Detroit officials did not adequately negotiate before the petition was filed. Additionally, retirees also argued that the filing was unconstitutional because it threatened their accrued benefits.

The judge's decision to go as far as he did was surprising because he could have ignored the matter altogether in his ruling and waited until the city sought confirmation of a restructuring plan. But by taking the bull by the horns for the sake of efficiency, he has kicked off the appeals process that will presumably result in a more timely decision by higher courts than if he had waited until confirmation, Denniston said.

The issue has little to no precedent, and certainly none in the Sixth Circuit, which makes it a hot button topic for other municipalities struggling with crushing pension obligations. While they may not jump on Judge Rhodes' ruling, those cities and towns will certainly be paying attention as the appeals process

moves ahead, Patton Hahn of Baker Donelson Bearman Caldwell & Berkowitz PC said.

“In cities with similar distress to Detroit that have these big unfunded pensions, they’ll be watching it very closely,” he said.

The issue pits the U.S. Constitution’s Supremacy Clause against the Tenth Amendment’s protections afforded to states, according to professor Kara Bruce, the American Bankruptcy Institute’s resident scholar.

If a higher court ultimately finds that Judge Rhodes was right and pensions are fair game in a Chapter 9 restructuring, other indebted municipalities will have a new course for dealing with their pension woes.

“Of course it has widespread repercussions because all government entities have been looking for ways to get out of their pension liabilities,” Larry Gabriel of Ezra Brutzkus Gubner LLP said. “And if a court comes down and says, ‘Oh you can just file bankruptcy and get rid of your pension liabilities,’ there’s going to be a lot more cities and municipalities looking at that issue.”

In his ruling, Judge Rhodes said he would not take the reduction of pensions lightly, pledging to review any adjustments the city proposes to retirees’ accrued benefits very carefully. Still, experts say such an assurance probably won’t change the fact that pensioners are likely going to have to swallow substantial cuts.

While it’s unclear what immediate impact Judge Rhodes’ decision could have on other pending Chapter 9 cases, attorneys say it touches on the most significant obstacle facing struggling municipalities today.

“It’s going to be the single-biggest issue, and I think the city is on the right side of that issue,” Michael Cook of Schulte Roth & Zabel LLP said.

Now that Detroit has successfully obtained its eligibility ruling and been crowned the largest municipality to ever receive bankruptcy protection, it is free to move forward with the next several stages of the restructuring process. The city’s lawyers will continue negotiations with unions, retirees and bondholders, form an adjustment plan, seek approval for debtor-in-possession financing, and battle appeals of the eligibility ruling.

Though it is almost certain that unions and retirees will challenge the portion of Judge Rhodes’ ruling pertaining to pensions, the overall conclusion that Detroit is insolvent and entitled to bankruptcy relief is probably safe because federal district judges rarely overturn decisions of bankruptcy judges that are based on findings of fact, attorneys said.

“On the eligibility piece of [the ruling], I think that’s eminently sound and a reversal on appeal is highly unlikely,” Cook said.

Some experts say the judge’s ruling on pension rights could speed up the case by eliminating one of the retirees’ main arguments, but the city still has a long road ahead. On top of negotiating with creditors and putting together a plan, the city will likely be confronted with substantial claims litigation.

Orr said Tuesday that negotiations with creditors are ongoing and that he hopes to be able to put forward a plan of adjustment before the end of the year. If Detroit can’t come to terms with its creditors, it will have to defend its proposed plan at a confirmation hearing. At the moment, Stockton

also appears to be headed toward a contested confirmation hearing. Jefferson County, Ala., narrowly avoided such a situation when it landed a deal with bondholders this summer.

--Editing by John Quinn and Philip Shea.

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