

PUBLICATION

Government Employee Pensions May Now Be Fair Game for Cuts During Bankruptcy Restructuring

December 12, 2013

On Tuesday, December 2, 2013, Judge Steven Rhodes of the Eastern District of Michigan ruled that the City of Detroit, which filed for Chapter 9 bankruptcy protection in the U.S. Bankruptcy Court on July 18, 2013, met the specific legal criteria required to receive protection from its creditors and thus could formally enter bankruptcy. The district court further determined that the city's obligation to pay pensions in full was not "untouchable" while working and negotiating with creditors in restructuring its debt.

Protection under Chapter 9 of the Bankruptcy code shields municipal debtors from lawsuits and gives them power to negotiate with its creditors, in this case retirees who are owed pension benefits, along with general creditors such as bondholders, insurers and vendors who service the municipality.

The court's historic ruling directly defies constitutional provisions in a number of states, including Michigan, which protect pension benefits from such restructuring. The court opined that federal bankruptcy laws preempt those state laws prohibiting such loss or reduction of pension benefits.

Public sector employers are now on notice. A municipality's pension fund liability is not set in stone, and pension beneficiaries, like other creditors, can find their assets restructured (i.e., cut) as Detroit or any other financially troubled city travels down the same bankruptcy path.

This ruling could set the stage for a number of other municipalities, governmental entities and possibly even some states still struggling financially through a slow economic recovery, to restructure and shed unsustainable pension obligations moving forward.

Not surprisingly, local public sector unions did not take the ruling lying down. The Michigan Council of the American Federation of State, County and Municipal Employees (AFSCME) appealed the ruling to the U.S. 6th Circuit Court of Appeals. The very scope of a filing for a city the size of Detroit and the historic implications of the district court's ruling, in light of the many struggling municipal governments there are out there, may ultimately place review of this holding before the U.S. Supreme Court.