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Municipal Bankruptcy and Public Pensions: Detroit's Eligibility for Chapter 9 Relief and Legal Restraints on the City's Actions as a Debtor

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NOTES

MUNICIPAL BANKRUPTCY AND PUBLIC PENSIONS: DETROIT'S ELIGIBILITY FOR CHAPTER 9 RELIEF AND LEGAL RESTRAINTS ON THE CITY'S ACTIONS AS A DEBTOR

*Jackson T. Garvey**

"I'm a proponent of cities going bankrupt. Bridgeport will show the way. It's the only way out."[1]

–Richard M. Daley, Former Mayor of Chicago

INTRODUCTION

On July 18, 2013, after decades of steady economic decline, the City of Detroit, Michigan filed for bankruptcy in the Eastern District of Michigan under Chapter 9 of the United States Bankruptcy Code.[2] For years, Detroit has served as a cautionary tale for single-industry-dominated cities. Detroit is both the most populous U.S. city to declare bankruptcy and the most indebted municipality to ever file for relief.[3] Its exact debts have not yet been determined, but early estimates put the number somewhere between eighteen and twenty billion dollars.[4]

The case presents complex legal and political problems, but one group of creditors has received the bulk of media attention in the city's bankruptcy:

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1 Tom Morganthau & John McCormick, *Are Cities Obsolete?*, NEWSWEEK, Sept. 9, 1991, at 42.

2 Bankruptcy Petition, *In re* City of Detroit, No. 13-53846 (E.D. Mich. July 18, 2013).

3 Monica Davey & Mary Williams Walsh, *Billions in Debt, Detroit Tumbles into Insolvency*, N.Y. TIMES, July 18, 2013, http://www.nytimes.com/2013/07/19/us/detroit-files-for-bankruptcy.html?pagewanted=1&_r=0.

4 *Id.*

pensioners. Pension commitments to both current and future retirees represent a sizeable portion of the city's overall debts, and estimates by Detroit's state-appointed Emergency Manager Kevyn Orr and his team place the amount of underfunded pension obligations at $3.5 billion.[5] Because ERISA pension pre-funding requirements do not apply to governmental pension plans,[6] many public pension systems are paid directly out of the municipality's yearly budget instead of being pre-funded by employee earnings.[7] Many cities across the country face similarly burgeoning underfunded pension debt,[8] and some states (including Michigan) have passed statutory or constitutional protection for pension benefits once they have been earned or have vested.[9] A recent estimate from a 2010 study conducted by Northwestern University economists pegs the total deficit in public pension plans in the United States at $574 billion.[10] This means that pensioners and municipal administrators across the country will be watching Detroit's bankruptcy closely, since any legal precedent set by the case will have enormous influence on the future of municipal bankruptcy law and the retirement outcomes of many Americans.

This Note will seek to address the constitutional and statutory issues raised in the early stages of Detroit's bankruptcy. Part I will briefly address how Detroit reached the point where municipal bankruptcy became legally possible and politically attractive. It will examine population trends in the city, changes in the character of Detroit's major industries, and the deterioration of city services.

Part II will provide background information about the history of municipal bankruptcy in America and the constitutional challenges that it has faced. It will attempt to give a base from which to examine the major issues raised by Detroit's case and how they might fit into the history of municipal bankruptcy and America's system of federalism. Specifically, it will address the Supreme Court's decision in *United States v. Bekins*[11] and some of the cases that have followed.

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5 Declaration of Kevyn D. Orr in Support of City of Detroit, Michigan's Statement of Qualifications Pursuant to Section 109(c) of the Bankruptcy Code at 6 n.3, *In re* City of Detroit, No. 13-53846 (E.D. Mich. July 18, 2013).

6 29 U.S.C. § 1003(b)(1) (2006).

7 Though a pure "pay-as-you-go" system is not legally prohibited for government entities, voluntary "best practices" accounting standards put forward by the Government Accounting Standards Board have driven many municipalities to pre-fund at least a portion of their pension obligations, if not 100%. *See* Jonathan Barry Forman, *Funding Public Pension Plans*, 42 J. MARSHALL L. REV. 837, 841–42 (2009).

8 David Klepper, *Political, Popular Obstacles Block Pension Changes*, WALL ST. J. (Oct. 6, 2013, 11:40 AM), http://online.wsj.com/article/AP894799daf3ba45eaa6d1c79154fc806a.html?KEYWORDS=pension+crisis.

9 MICH. CONST. art. IX, § 24; 3 EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 12.141 & n.2 (3d ed. 2001).

10 Klepper, *supra* note 8.

11 304 U.S. 27 (1938).

Part III will dive into the issues raised by objectors to Detroit's filing. While the objectors have raised at least thirteen distinct objections to the filing, this Note will concentrate on three. First, an effort will be made to demonstrate that contrary to some of the objections raised in the Detroit case, Chapter 9 is facially constitutional. Next, it will examine Michigan's authorization of Detroit's bankruptcy petition in accordance with § 109(c) of the Bankruptcy Code.[12] It will argue that Public Act 436,[13] the Michigan law that authorizes municipal bankruptcy and sets out the procedures that must be followed to file under Chapter 9, is constitutional and that the filing in this case complied with both federal and state law. It will also argue that Chapter 9 is constitutional as applied to Detroit, and that the protections present in Chapter 9 do more than enough to overcome any potential Tenth Amendment issue in Detroit's filing.[14] Finally, it will argue that, due to the Bankruptcy Code's incorporation of state law property definitions, public sector pensions may not be reduced in Michigan by any means, including Chapter 9 bankruptcy.

I. How Detroit Reached Bankruptcy

Detroit was once the cradle of the world's automobile industry. It had a population of 1.85 million at its peak in 1952,[15] built half the world's cars in the early 1950s,[16] and experienced intense job-driven population growth for multiple decades.[17] However, the industry that spurred Detroit to become the fourth-largest city in America[18] would also prove to be the main driver of its decay. Shortly after the end of World War II, the auto industry started moving toward automated production processes, reducing the need for labor.[19] Not surprisingly, this shift led to rising unemployment in Detroit, as the number of manufacturing jobs fell by approximately 134,000 between 1947 and 1963.[20]

The problem only worsened when foreign automakers began to gain market share both abroad and in America. Between 1955 and 1980, the "Detroit Three" (Ford, Chevrolet, and Chrysler) saw their American market

12 11 U.S.C. § 109(c) (2012).

13 Mich. Comp. Laws §§ 141.1541–.1575 (2013).

14 U.S. Const. amend. X.

15 Julia Vitullo-Martin, *Detroit Fights Back*, 5 City J. 55 (1995), *available at* http://www.city-journal.org/html/5_3_detroit_fights.html.

16 *Id.*

17 Tom Bethell, *Detroit's Fate*, American, Jan.–Feb. 2008, at 36.

18 Michael A. Fletcher, *Detroit Goes Bankrupt, Largest Municipal Filing in U.S. History*, Wash. Post, July 18, 2013, http://www.washingtonpost.com/business/economy/detroit-files-largest-municipal-bankruptcy-in-us-history/2013/07/18/a8db3f0e-efe6-11e2-bed3-b9b6fe264871_story.html.

19 Kevin Boyle, *The Ruins of Detroit: Exploring the Urban Crisis in the Motor City*, 27 Mich. Hist. Rev. 109, 114 (2001).

20 *Id.*

share for new cars plummet from 95% to 75%.[21] Things did not improve with time, and in 2010, the American market share held by the "Detroit Three" had fallen to a previously unimaginable 45% combined.[22] While the troubled companies collectively saw a slight uptick in their market share between 2010 and 2011 (to 47%) following the bankruptcies of Chrysler and General Motors,[23] there are no indications of a coming turnaround.

While the decline of the American auto industry's impact on Detroit's economic fall is hard to overstate, it should not be considered the only important factor. Several other shifts contributed to the city's economic collapse. Other manufacturing-based industries declined over the same period, and between 1972 and 2007 the city saw around 80% of its manufacturing plants and 78% of its retail establishments close their doors.[24] This general economic downturn led to a colossal contraction of Detroit's labor market, and the unemployment rate rose to a much higher figure than the national average.[25]

The lack of job opportunities in Detroit likely led to another major driver of its current problems: a shrinking population. Detroit's population fell from 1.85 million in the 1950s to a little over 1 million in 1990.[26] The 2010 census revealed that Detroit's population had fallen again to 713,777 people, and the Census Bureau estimated that by 2012 only 701,475 people remained.[27] These figures reflect the stark reality that many of those with the means to leave Detroit have chosen to move rather than deal with the seemingly unstoppable contraction of jobs, population, and city services.

As a result of this economic and population contraction, Detroit has seen the bottom fall out of its tax base. Detroit's collection of municipal income tax receipts has fallen by more than $95 million since 2002 and by over $34 million since 2008.[28] The reduction is driven both by the shrinking population base and a decline in per capita income. Between 2008 and 2012, the median household income in Detroit was $26,955.[29] Over the same

21 Thomas H. Klier & James Rubenstein, *Detroit Back from the Brink? Auto Industry Crisis and Restructuring, 2008–11*, 36 ECON. PERSP. 35, 46 (2012).

22 *Id.*

23 *Id.*

24 CITIZENS RESEARCH COUNCIL OF MICH., DETROIT CITY GOVERNMENT REVENUES 19 (Apr. 2013).

25 According to Bureau of Labor Statistics data, Detroit's unemployment rate in 2012 was 18.6%. This was the highest unemployment rate among the fifty largest U.S. cities. Bureau of Labor Statistics, *Unemployment Rates for the 50 Largest Cities*, U.S. DEP'T OF LABOR (Apr. 19, 2013), http://www.bls.gov/lau/lacilg12.htm.

26 *Compare Population of the 100 Largest Urban Places: 1950*, U.S. CENSUS BUREAU tbl.18 (June 15, 1998), http://www.census.gov/population/www/documentation/twps0027/tab18.txt, *with 1990 Fast Facts*, U.S. CENSUS BUREAU, http://www.census.gov/history/www/through_the_decades/fast_facts/1990_new.html (last updated Oct. 18, 2012).

27 *State & County QuickFacts, Detroit, Michigan*, U.S. CENSUS BUREAU, http://quickfacts.census.gov/qfd/states/26/2622000.html (last updated Mar. 27, 2014).

28 CITIZENS RESEARCH COUNCIL OF MICH., *supra* note 24, at vi, 22.

29 U.S. CENSUS BUREAU, *supra* note 27.

period of time, an estimated 38.1% of residents were below the poverty line.[30] During that period, the similar national figures were $53,046 and 14.9%, respectively.[31] Absent a significant change in the city's economic and demographic trends, Detroit's tax base is unlikely to improve any time soon, as both population and incomes shrink.

City services have been hit hard by the decline. About 40% of the city's streetlights don't work.[32] Half the city's parks have closed since 2008.[33] Almost 80,000 buildings are considered blighted or have been abandoned,[34] and police response times, *even for emergency calls*, are currently at nearly an hour.[35] This lack of services most certainly makes building Detroit's tax base back up a much harder task, since people with options of where to live are unlikely to choose to live in a place where they cannot take their families to the park or count on the police to protect them. However, returning these municipal services to acceptable levels undoubtedly will be expensive, and in Detroit's current financial situation, the city can't afford to invest the necessary funds into services and infrastructure.

Detroit's situation is undeniably bleak, and more than six decades of decline convinced the governor, with the City Council's approval, to appoint Jones Day restructuring attorney Kevyn Orr as the city's Emergency Manager on March 14, 2013.[36] Mr. Orr, in his role as Emergency Manager, was granted "sweeping powers" to make decisions concerning the city's finances, many of which "trump" the will of the city's elected officials.[37] The City Council approved Governor Rick Snyder's decision to appoint an emergency manager by a close vote, and at the time of Mr. Orr's appointment, many city officials expressed a willingness to work with him to solve Detroit's problems.[38] At the time of his appointment, Mr. Orr made public statements about his desire to avoid guiding the city to file for relief.[39]

Mr. Orr and his team held negotiation sessions over the course of a few weeks with certain groups of creditors of the city, at which they proposed a plan to restructure the city's debt consensually.[40] At these meetings, the Emergency Manager and his team presented a plan for the reorganization of Detroit's debts, answered questions, and invited feedback and counter-proposals from each of the creditor constituencies that the Emergency Manager

30 *Id.*

31 *State & County QuickFacts, USA*, U.S. Census Bureau, http://quickfacts.census.gov/qfd/states/00000.html (last updated Mar. 27, 2014).

32 Davey & Walsh, *supra* note 3.

33 *Id.*

34 Fletcher, *supra* note 18.

35 *Id.*

36 Monica Davey, *Bankruptcy Lawyer Is Named to Rescue Detroit from Fiscal Disaster*, N.Y. Times, Mar. 15, 2013, at A13.

37 *Id.*

38 *Id.*

39 *Id.*

40 Declaration of Kevyn D. Orr in Support of City of Detroit, *supra* note 5, at 52–67.

and his team met with.[41] While the meetings were ongoing, creditors of the city filed a state court action seeking declaratory judgment of the unconstitutionality of PA 436,[42] the Michigan law that allows appointment of an Emergency Manager and provides the procedure by which the State of Michigan can authorize a filing for municipal bankruptcy.[43] The plaintiffs in that suit also asked for an injunction preventing the City of Detroit from filing for bankruptcy.[44] The meetings between creditors and the Emergency Manager did not lead to a consensual restructuring of the debt by contract,[45] and on July 18, 2013, the City of Detroit filed for bankruptcy.[46] On the same day, just after the bankruptcy was filed, Judge Rosemarie Aquilina, the judge in the state court proceedings, ruled that PA 436 violated article IX, section 24 of the Michigan Constitution, that it was of no force or effect, and that Governor Snyder was not legally able to authorize a bankruptcy that threatened to reduce the pensions of public workers.[47] Judge Steven Rhodes, the bank-

41 *Id.* There is disagreement between the city and Mr. Orr on one hand, and certain creditors on the other, about the tone these meetings took and how collaborative in nature they were. A large number of the city's creditors, especially certain unions, have argued that the meetings did not constitute negotiations at all and instead were nothing but an opportunity for the Emergency Manager to present a plan for restructuring the debt and threaten the use of bankruptcy law to unilaterally reduce the pensions and health benefits of their members. *See, e.g.*, The Michigan Council 25 of the American Federation of State, County & Municipal Employees, AFL-CIO and Sub-Chapter 98, City of Detroit Retirees' Objection to the City of Detroit's Eligibility to Obtain Relief under Chapter 9 of the Bankruptcy Code at 12–14, *In re* City of Detroit, No. 13-53846 (E.D. Mich. Aug. 19, 2013) (claiming that the meetings with union leaders were a sham that the Emergency Manager and the City of Detroit engaged in solely to attempt to establish good faith negotiations prior to the bankruptcy filing and establish compliance with 11 U.S.C. § 109(c)(5)(B) (2012)). A detailed examination of whether these meetings satisfy the good faith negotiation requirement of § 109(c)(5)(B) is outside the scope of this Note.

42 MICH. COMP. LAWS §§ 141.1541–.1575 (2013).

43 Webster v. Michigan, No. 13-734-CZ, slip op. at 1–2 (Ingham Cnty. Cir. Ct. July 19, 2013); *see also* Kimberly Bennett, *Michigan Judge Rules Detroit Bankruptcy Filing Unconstitutional*, JURIST (July 22, 2013, 10:44 AM), http://jurist.org/paperchase/2013/07/michigan-judge-rules-detroit-bankruptcy-filing-unconstitutional.php (summarizing Judge Aquilina's ruling).

44 *Webster*, No. 13-734-CZ, slip op. at 1–3.

45 Known within the bankruptcy profession as a "workout."

46 Bankruptcy Petition, *supra* note 2.

47 *Webster*, No. 13-734-CZ, slip op. at 2–3. There is a considerable amount of controversy surrounding the manner in which the bankruptcy petition was filed. Some sources reported that attorneys for the city, once they realized that Judge Aquilina was likely to rule against them, asked for a five-minute recess, during which other city attorneys filed the bankruptcy petition at the federal courthouse. *See Detroit Bankruptcy on Hold, Snyder Admin. Smacked Down by Judge for "Cheating Good People Who Work,"* ECLECTABLOG (July 19, 2013), http://www.eclectablog.com/2013/07/detroit-bankruptcy-on-hold-snyder-admin-smacked-down-by-judge-for-cheating-good-people-who-work.html. Others reported that the petition was filed five minutes before the hearing in Judge Aquilina's courtroom began, but made no mention of a request for delay. *See* Paul Egan, *Mich. Judge Rules Detroit Bankruptcy Unconstitutional*, WBIR (July 19, 2013, 9:07 PM), http://www.wbir.com/news/article/281141/16/Mich-judge-rules-Detroit-bankruptcy-unconstitutional. Because the automatic stay

ruptcy judge assigned to Detroit's case, subsequently ruled that questions about eligibility and constitutionality would have to be resolved in bankruptcy court rather than state court, and that the case could go forward in spite of Judge Aquilina's order.[48] Indeed, in his ruling on eligibility, Judge Rhodes stated that any attempt by Governor Snyder to authorize a bankruptcy but shield pensions would be invalid.[49] After the bankruptcy was filed, more than 100 parties filed objections to the city's eligibility to be a debtor under Chapter 9.[50] At least thirteen discrete objections were raised to the city's eligibility for bankruptcy relief.[51] In his opinion on eligibility issues, Judge Rhodes ruled that none of the eligibility objections would stop the case from going forward.[52]

II. A Brief History of Municipal Bankruptcy

Municipal bankruptcy is a relatively new facet of American law. The first municipal bankruptcy statute was enacted in 1934 during the Great Depression.[53] At the time it was enacted, over 1000 municipalities were estimated to be in default on their municipal bonds.[54] States are unable to unilaterally adjust their debts or those of their municipalities due to the plain language of the Contracts Clause.[55] Even an extension by the state of the time to pay contractual obligations is outside of a state's power.[56]

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comes into effect and prevents any judicial action that interferes with the bankruptcy case immediately upon the filing of a bankruptcy petition, the filing stopped Judge Aquilina from enjoining the city from filing a petition. She did, however, attempt to prohibit any further action by Emergency Manager Orr or Governor Snyder to move the bankruptcy forward. *Webster*, No. 13-734-CZ, slip op. at 2–3. The last paragraph of the order is handwritten and requires that a copy of the order be sent to President Obama. *Id.*

48 Matthew Dolan & Katy Stech, *Detroit Wins a Round in Bankruptcy Court*, Wall St. J., July 25, 2013, at A2.

49 Opinion Regarding Eligibility, *In re* City of Detroit, No. 13-53846, slip op. at 94 (Bankr. E.D. Mich. Dec. 5, 2013). To reach this conclusion, Judge Rhodes relied on *In re City of Stockton*, 475 B.R. 720, 727–29 (Bankr. E.D. Cal. 2012), for the proposition that state law cannot reorder the creditor repayment priorities set out in the Bankruptcy Code. *Id.* at 93.

50 City of Detroit's Consolidated Reply to Objections to the Entry of an Order for Relief at 2, *In re* City of Detroit, No. 13-53846 (E.D. Mich. Sept. 6, 2013).

51 *Id.* at Exhibit A, 1–11.

52 Opinion Regarding Eligibility, *supra* note 49, at 142–43.

53 6 Collier on Bankruptcy ¶ 900.LH[1] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2014) [hereinafter Collier].

54 *Id.*

55 U.S. Const. art. I, § 10; *see* S. Rep. No. 73-407, at 2 (1934).

56 Collier, *supra* note 53, ¶ 900.LH[1]. However, there is one narrow exception to this general rule. In *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), the Supreme Court upheld a state extension statute against a challenge based on the Contracts Clause. However, the Court made it clear that the holding was limited to the facts of that case, *id.* at 516, and that its decision was at least in part a result of the specific market price fluctuations at the time of the composition. *Id.* at 513. Congress then responded by amending the Bankruptcy Code to prevent states from enacting composition legislation

Congress passed an act providing for municipal bankruptcy in 1934,[57] which was modeled off of the era's corporate and railroad bankruptcy provisions.[58] Congress was well aware of potential federalism-based constitutional problems when drafting the law, and some members of Congress believed that such a provision was outside of the federal government's power.[59] Though the legislation was written with an eye toward potential Tenth Amendment and Contracts Clause problems, it was declared unconstitutional in *Ashton v. Cameron County Water Improvement District*.[60] The decision was the result of a 5-4 split, with a strong dissent written by Justice Cardozo.[61] The majority felt that the law threatened the states' "separate and independent existence,"[62] and that "[n]either consent nor submission by the states can enlarge the powers of Congress; none can exist except those which are granted,"[63] and so declared the law unconstitutional on federalism grounds.

Congress persevered, however, and in 1937 it enacted a revised version of the Act.[64] This time around, Congress had the benefit of the *Ashton* decision.[65] The Act was recodified as Chapter 9 of the Bankruptcy Code the following year as part of a broader reorganization of the Code.[66] It was substantially similar to its invalidated predecessor, but included increased protections of state sovereignty in several places.[67]

This Act, too, was challenged in the courts. In *United States v. Bekins*,[68] the Supreme Court upheld the Act by a vote of 6-2, with Justice Cardozo taking no part in the opinion.[69] The *Bekins* case did not explicitly rely on statutory differences between the two versions to declare the law's constitutionality, and in fact the wording of certain state sovereignty protections went unchanged between the two versions.[70] Instead, the Court supported its

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that would be binding on non-consenting bondholders. Act of July 1, 1946, Pub L. No. 79-481, § 81, 60 Stat. 409. The stated purpose of the law was to ensure uniform bankruptcy laws for municipalities throughout the United States. H.R. REP. No. 79-2246, at 4 (1946).

57 Act of May 24, 1934, Pub. L. No. 73-251, 48 Stat. 798.

58 COLLIER, *supra* note 53, ¶ 900.LH[2].

59 *See* S. REP. NO. 73-407, at 3–6 (1934).

60 298 U.S. 513 (1936), *superseded by statute*, Act of Aug. 16, 1937, Pub L. No. 75-302, 50 Stat. 653, *as recognized in In re* City of Stockton, 478 B.R. 8, 18 (Bankr. E.D. Cal. 2012).

61 *Id.* at 532 (Cardozo, J., dissenting).

62 *Id.* at 528 (majority opinion).

63 *Id.* at 531 (citing United States v. Butler, 297 U.S. 1 (1936)).

64 Act of Aug. 16, 1937, Pub L. No. 75-302, 50 Stat. 653 (codified in scattered sections of 11 U.S.C.).

65 *Id.*

66 Chandler Act, Pub. L. No. 75-695, 52 Stat. 840 (1938).

67 COLLIER, *supra* note 53, ¶ 900.LH[3]. *Compare* Act of May 24, 1934, Pub. L. No. 73-251, § 80, 48 Stat. 798 (struck down in *Ashton* because of inadequate protection for states), *with* Act of Aug. 16, 1937, § 83(i), 50 Stat. 653, 659 (upheld in *Bekins* because of greater protection for states).

68 304 U.S. 27 (1938).

69 *Id.* at 54.

70 *See* Act of May 24, 1934, § 80(k), 48 Stat. 798, 802; Act of Aug. 16, 1937, § 83(i), 50 Stat. 653, 659 ("Nothing contained in this chapter shall be construed to limit or impair the

position by pointing out the voluntariness of the petition,[71] the fact that under that Act, a majority of bondholders must agree to the filing and two-thirds of all debt holders must vote for approval of the plan,[72] and that "[t]he statute is carefully drawn so as not to impinge on the sovereignty of the State."[73] The Court also pointed out that the ability to choose to allow its municipalities to take advantage of Chapter 9 increases, rather than decreases, the power of the states.[74] The Court invoked the Tenth Amendment, stating that it "protected, and did not destroy, [the states'] right to make contracts and give consents where that action would not contravene the provisions of the Federal Constitution."[75] It also analogized Chapter 9 to the (then-recently enacted and upheld) Social Security Act,[76] endorsing "cooperation between the Nation and the States through the exercise of the power of each to the advantage of the people who are citizens of both."[77] This language indicates that the Court saw the 1937 Act as respectful enough of states' rights to be proper within the country's scheme of federalism.

The next major change to municipal bankruptcy law came in 1976, as a result of the financial trouble of large cities at the time, especially New York.[78] The amendments of 1976 removed many of the barriers that had previously prevented large cities from using Chapter 9 and granted the debtor municipality powers that were similar to many of those held by private corporation debtors in Chapter 11.[79] Additional changes to Chapter 9 that are not particularly relevant to Detroit's situation were made in 1978 and 1988.[80]

Another set of significant changes to the Bankruptcy Code were made in 1994. This round of changes included a tweak to the way states must authorize their municipalities to declare bankruptcy. Prior to the 1994 amendments, the statute required only that the municipality have "general authorization" by a state to declare bankruptcy.[81] Courts of the era often found typical home-rule statutes or other grants of power that were not bankruptcy-specific to constitute general authorization to be a debtor.[82] Since

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power of any State to control, by legislation or otherwise, any municipality or any political subdivision of or in such State in the exercise of its governmental powers, including expenditures therefor.").

71 *Bekins*, 304 U.S. at 47.

72 *Id.* at 50.

73 *Id.* at 51.

74 *Id.* at 52.

75 *Id.*

76 42 U.S.C. § 1305 (2006).

77 *Bekins*, 304 U.S. at 53.

78 Rachael E. Schwartz, *This Way to the Egress: Should Bridgeport's Chapter 9 Filing Have Been Dismissed?*, 66 AM. BANKR. L.J. 103, 116–17 (1992).

79 COLLIER, *supra* note 53, ¶ 900.LH[4–5].

80 *Id.*

81 *Id.* ¶ 900.LH[6].

82 *See, e.g.*, *In re* City of Bridgeport, 128 B.R. 688, 694 (Bankr. D. Conn. 1991) (ruling that although the statutory language of "generally authorized" was somewhat ambiguous,

1994, eligibility for municipal bankruptcy has required, among other factors, that the municipality be "specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter."[83] The requirement that states explicitly authorize access to Chapter 9 before municipalities are eligible to file gave states greater control over their municipalities and added an extra layer of protection for state control that did not exist when *Bekins* was decided. States have exercised this authority in different ways. While only one state (Georgia) explicitly denies its municipalities access to Chapter 9, many states have no statute addressing the issue and many others require municipalities to fulfill requirements that go above and beyond those in the Bankruptcy Code before they can file.[84] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[85] once again amended Chapter 9 of the Code and dealt generally with provisions concerning the automatic stay.[86]

III. Resolving Constitutional and Statutory Issues Implicated in Detroit's Bankruptcy

Detroit's bankruptcy implicates an enormous number of legal issues, both constitutional and statutory. In preparation for a trial on the eligibility issue alone, the City of Detroit's brief responded to thirteen distinct objections raised by its creditors.[87] To address all of the potential issues raised by Detroit's filing would be a monumental task. Instead, the rest of this Note will focus on three related areas that are likely to have an impact far beyond Detroit's case alone. First, it will establish that Chapter 9 is facially constitutional because it is the exercise of an explicitly enumerated power by Congress and does not violate norms of federalism. Next, it will demonstrate that Detroit is eligible to be a debtor under Chapter 9 both because Chapter 9 is constitutional as applied to Detroit's situation and because Detroit's filing complied with the Michigan Constitution and other state laws. Finally, it will examine the legal limitations on Detroit's actions as a debtor while in Chapter 9 and will argue that Detroit may not propose a plan that would reduce state workers' earned pension rights.

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the Bankruptcy Code generally favors giving maximum flexibility to the debtor, so the home-rule statute was sufficient); *In re* City of Wellston, 43 B.R. 348 (Bankr. E.D. Mo. 1984); *In re* Pleasant View Util. Dist., 24 B.R. 632, 635 (Bankr. M.D. Tenn. 1982), *appeal denied*, 27 B.R. 552 (M.D. Tenn. 1982).

83 11 U.S.C. § 109(c)(2) (2012).

84 Fed. Funds Info. for States, *How States Address Municipal Bankruptcies*, 30 State Pol. Rep. 2, 3 (2012), *available at* http://www.ffis.org/sites/ffis.org/files/public/publications/2012/V3014.pdf.

85 Pub. L. No. 109-8, 119 Stat. 23 (2005).

86 Collier, *supra* note 53, ¶ 900.LH[7].

87 City of Detroit's Consolidated Reply to Objections to the Entry of an Order for Relief, *supra* note 50, at Exhibit A.

Several statutory eligibility requirements beg for scholarly attention but will not be addressed in this Note in much detail. Included in this is the requirement that a debtor, prior to filing, make a good faith effort to bargain with its creditors with the goal of avoiding bankruptcy or establish that such negotiations are impracticable,[88] the requirement that the debtor be insolvent,[89] and the requirement that the petition be filed "in good faith."[90] There is also an interesting jurisdictional question in the case: whether the bankruptcy court has the jurisdiction to determine the constitutionality of Chapter 9 and PA 436, the Michigan statute authorizing Detroit's bankruptcy filing.[91] For the purposes of this Note, it will be assumed that all of these statutory eligibility requirements have been met by Detroit and that the bankruptcy court has jurisdiction to rule on the merits.

A. Facial Constitutionality of Chapter 11

The adjustment of debts in bankruptcy is a specifically enumerated power of the United States Constitution.[92] The objectors' contention is that municipal bankruptcy, as embodied in Chapter 9 of the Bankruptcy Code, is facially unconstitutional[93] because it impermissibly allows the federal government to control the decision making of a municipality by using the bankruptcy system in violation of the Tenth Amendment.[94]

Detroit's case is not the first time Chapter 9 has been challenged on constitutional grounds. In *United States v. Bekins*,[95] the Supreme Court upheld a precursor to the modern municipality bankruptcy statute, which was attacked on similar Tenth Amendment grounds to those asserted in the Detroit case.[96] In *Bekins*, a municipal irrigation district had issued bonds to

88 11 U.S.C. § 109(c)(5) (2012).

89 *Id.* § 109(c)(3). In Detroit's case, there is a fascinating question of which municipal assets must be included when determining the city's insolvency. The asset that has received the most attention in the media is the valuable art collection housed at the Detroit Institute of Arts. Mark Caro, *Will Detroit Have to Sell Its Art to Pay Its Bills?*, CHI. TRIB. (Oct. 18, 2013), http://articles.chicagotribune.com/2013-10-18/entertainment/chi-detroit-culture-caro-20131018_1_detroit-institute-dia-art-institute.

90 11 U.S.C. § 921(c).

91 Opinion Regarding Eligibility, *supra* note 49, at 42–43. Judge Rhodes ruled that the bankruptcy court has the jurisdiction to decide both of these issues, because they are necessary to determine an issue at the core of the bankruptcy court's jurisdiction: eligibility to be a Chapter 9 debtor. *Id.* at 49.

92 U.S. CONST. art. I, § 8, cl. 4 ("To establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . . .").

93 Objection of the Official Committee of Retirees to Eligibility of the City of Detroit, Michigan to Be a Debtor Under Chapter 9 of the Bankruptcy Code at 21–22, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. Sept. 10, 2013) ("Chapter 9 'upset[s] the constitutional balance between the National Government and the States.'" (quoting Bond v. United States, 131 S. Ct. 2355, 2364 (2011) (alteration in original))).

94 U.S. CONST. amend. X.

95 304 U.S. 27 (1938).

96 *Id.* at 54. Before *Bekins*, the previous municipal bankruptcy act, just two years before, had been struck down by the Supreme Court for violating constitutional guaranties

finance a capital project and found itself unable to pay the principal or the interest on time.[97] The district filed for bankruptcy, and its creditors challenged its eligibility to be a debtor, arguing that Chapter 9 violated the Tenth Amendment.[98] The Supreme Court acknowledged that the Tenth Amendment constrains Congress's power to enact municipal bankruptcy relief,[99] but held that where adequate protections are included in the Code to allow a state to manage its own affairs and maintain control over its municipalities, municipal bankruptcy is constitutional.[100]

The Court ruled that "[t]he bankruptcy power is competent to give relief to [municipal] debtors . . . and, if there is any obstacle to its exercise . . . it lies in the right of the State to oppose federal interference."[101] In a municipal bankruptcy proceeding, the municipality and the state that it serves take advantage of a federal power to gain a discharge of municipal debts. The exercise of that federal power is, of course, subject to the provisions of the Bankruptcy Code, but if those provisions go too far to control the operation of the debtor, the Tenth Amendment[102] or other constitutional provisions may be violated.[103] The Court in *Bekins* believed that adequate protections existed in the Code in 1938 to ensure that participation in the bankruptcy system did not violate the Tenth Amendment or any other constitutional protection of the states' right to control their municipalities.

The Court in *Bekins* relied primarily on the consent of the state to the district's filing to dismiss any potential Tenth Amendment violations. The

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of federalism because it impermissibly allowed the bankruptcy court, an arm of the federal government, to direct the political decisions of state entities. Ashton v. Cameron Cnty. Water Improvement Dist. No. One, 298 U.S. 513, 532 (1936), *superseded by statute*, Act of Aug. 16, 1937, 50 Stat. 653, *as recognized in In re* City of Stockton, 478 B.R. 8, 18 (Bankr. E.D. Cal. 2012). While the two acts were similar, some additional Tenth Amendment protections were inserted before the version of the statute at issue in *Bekins* was passed. *See supra* notes 53–77 and accompanying text.

97 *Bekins*, 304 U.S. at 45–46.

98 *Id.* at 46.

99 *Id.* at 51. This principle has been affirmed by other courts since *Bekins* as well. *See, e.g.*, *In re* N.Y.C. Off-Track Betting Corp., 427 B.R. 256, 264 (Bankr. S.D.N.Y 2010) ("Bankruptcy courts should review chapter 9 petitions with a jaded eye. Principles of dual sovereignty, deeply embedded in the fabric of this nation and commemorated in the Tenth Amendment of the United States Constitution, severely curtail the power of bankruptcy courts to compel municipalities to act once a petition is approved.").

100 *Bekins*, 304 U.S. at 51 ("The statute is carefully drawn so as not to impinge upon the sovereignty of the State. The State retains control of its fiscal affairs."); *see supra* notes 53–77 and accompanying text.

101 *Bekins*, 304 U.S. at 54.

102 U.S. CONST. amend. X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.").

103 If, for example, one of the Bankruptcy Code's eligibility rules was that only municipalities from a state that operated as a constitutional monarchy were eligible to avail themselves of the Bankruptcy Code's protections, such a provision would violate Article IV of the Constitution. U.S. CONST. art. IV, § 4 ("The United States shall guarantee to every State in this Union a Republican Form of Government . . . .").

Court opined that "[i]t is of the essence of sovereignty to be able to make contracts and give consents bearing upon the exertion of governmental power."[104] It viewed municipal bankruptcy as a cooperative venture between the state and the federal government to accomplish an objective that could be achieved by neither one acting alone.[105] The Court also made the common-sense point that the ability of the state to take advantage of the federal bankruptcy power through Chapter 9 increases, rather than impinges upon, state power, and thus striking it down on Tenth Amendment grounds would not make sense.[106] The Court's rationale relies both on the state's consent to its municipality declaring bankruptcy and on the protections built into the Code itself. Without these protections, Chapter 9 runs the risk of shifting the power to control municipalities from the states to the federal government, potentially violating the Tenth Amendment and structural principles of federalism.

Those protections are therefore crucially important to the constitutional limitations of any Chapter 9 case and indeed to the constitutionality of Chapter 9 itself. Whether Chapter 9 is constitutional, therefore, essentially comes down to the question of whether these protections are strong enough to overcome any potential Tenth Amendment issue. The objectors argue that *Bekins* has been effectively overruled by two lines of Supreme Court cases that have some overlap: those that rule that a policy impermissibly violates principles of federalism when citizens are unable to effectively keep their governments accountable due to confusion about whether the state or federal government is responsible for a given policy[107] and those that hold the federal government cannot commandeer state officials or legislators to administer or enact a federal regulatory program.[108]

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104 *Bekins*, 304 U.S. at 51–52.

105 *See id.* at 53. States are prevented from adjusting the debts of their municipalities unilaterally by the Contracts Clause of the United States Constitution. *See* U.S. CONST. art. I, § 10, cl. 1 ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ."). The federal government, of course, cannot unilaterally adjust the debts of municipalities without violating the Tenth Amendment. *See* U.S. CONST. amend. X; Energy Reserves Grp., Inc. v. Kan. Power & Light Co., 459 U.S. 400, 412 n.14 (1983) ("In almost every case, the Court has held a governmental unit to its contractual obligations when it enters financial or other markets." (citing U.S. Trust Co. v. New Jersey, 431 U.S. 1, 25–28 (1977); W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56 (1935); Murray v. Charleston, 96 U.S. 432 (1877))).

106 *Bekins*, 304 U.S. at 54 ("The State acts in aid, and not in derogation, of its sovereign powers.").

107 *See, e.g.*, Bond v. United States, 131 S. Ct. 2355, 2364 (2011) ("An individual has a direct interest in objecting to laws that upset the constitutional balance between the National Government and the States when the enforcement of those laws causes injury that is concrete, particular, and redressable."); U.S. Term Limits, Inc. v. Thornton, 514 U.S. 779, 838 (1995) (Kennedy, J., concurring) ("[O]ur citizens would have two political capacities, one state and one federal, each protected from incursion by the other.").

108 *See, e.g.*, Printz v. United States, 521 U.S. 898, 935 (1997) (holding that Congress may not commandeer state officials to enforce federal laws); New York v. United States,

The objectors' arguments are effectively undermined by several principles. First, the Supreme Court does not overrule on-point case law by implication.[109] Even if this fundamental principle of Supreme Court jurisprudence does not totally foreclose the argument being made by the objectors, the contention that *Bekins* has been overruled by implication, however, or that it violates principles of federalism in a way that makes the entire chapter unconstitutional, fails on the merits.

The Supreme Court has been clear that where state officials freely elect to participate in a federal program, there is no confusion of accountability.[110] In the Chapter 9 context, the requirement of specific authorization for bankruptcy and the ability of the state to retain control over its municipalities, even while that municipality is in bankruptcy, remove any fear that the citizens of a state will not be able to hold their government accountable.[111] Since *Bekins*, the state authorization provision has been tweaked to increase its protection for state sovereignty: since 1994, the Code has required specific authorization, rather than general authorization, from a state before a municipality of that state can declare bankruptcy.[112] This means state governments must make an explicit, conscious choice to allow their municipalities to file. The language of 11 U.S.C. § 109(c)(2) allows the state to either pass a statute that authorizes all of its municipalities to declare bankruptcy at will, set certain conditions above and beyond those in the Bankruptcy Code that must be satisfied for a municipality to qualify, or create a procedure by which state officials can approve debtors to file on a case-by-case basis.[113] Simple home-rule statutes or similar delegating legislation are not sufficient to authorize a municipality to declare bankruptcy.[114] This gives states incred-

505 U.S. 144, 188 (1992) ("The Federal Government may not compel the States to enact or administer a federal regulatory program.").

109 *See* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 484 (1989) ("If a precedent of [the Supreme] Court has direct application in a case, yet appears to rest on reasons rejected in some other line of decisions, [courts] should follow the case which directly controls, leaving to [the Supreme Court] the prerogative of overruling its own decisions.").

110 *See* Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2602–03 (2012) (plurality opinion) (reasoning that where "a State has a legitimate choice whether to" take advantage of the federal scheme or forego participation, "state officials can fairly be held politically accountable for choosing to accept or refuse the federal offer").

111 *See* 11 U.S.C. § 903 (2012) ("This chapter 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 . . . .").

112 *Compare id.* § 109(c)(2) (explaining that a municipal debtor must be "specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter"), *with In re* City of Bridgeport, 128 B.R. 688, 694 (Bankr. D. Conn. 1991) (ruling that although the statutory language of "generally authorized" was somewhat ambiguous, the Bankruptcy Code generally favors giving maximum flexibility to the debtor, so the home-rule statute was sufficient).

113 11 U.S.C. § 109(c)(2).

114 *Id.*

ible leeway and control over when and in what circumstances their municipalities can file for relief. It is hard to imagine that such a degree of control over the process by the state would create any doubt that the state is accountable for the choice to allow its municipalities to declare bankruptcy. It certainly imparts greater control to states than did the legislation at issue in *Bekins*, meaning that, at least where authorization is concerned, the current Code is even less prone to Tenth Amendment problems than the version upheld in 1938.

It is true that the Court has, since *Bekins*, significantly weakened one of the principles it relied upon in that case: that the consent of a state can remove federalism-based constitutional problems.[115] While these cases generally arise in the Commerce Clause context, they do signal a possible shift in the way the Court views the nature of the relationship between the federal government and the states. However, the protections for state sovereignty in the Bankruptcy Code have only increased since *Bekins* was decided and do more than enough to overcome the changes in Commerce Clause jurisprudence that the objectors lean on in their attempt to undermine *Bekins*.

Chief among these protections is § 903 of the Code.[116] This provision ensures that, even when a municipality is in Chapter 9 bankruptcy, the state retains control over its political and operational decisions.[117] Section 903's protection has been fleshed out in the case law since *Bekins*, and has been interpreted as having real teeth. In the largest Chapter 9 case other than that of Detroit, a bankruptcy court in the Ninth Circuit affirmed that § 904 "is so comprehensive . . . [that] a federal court can use no tool in its toolkit . . . to interfere with a municipality regarding political or governmental powers."[118] Section 903 works in tandem with § 904, which limits the jurisdiction and powers of the bankruptcy court and prevents it from interfering with, among other things, "any of the political or governmental powers of the debtor."[119] Looking at these two provisions in tandem, the court in *In re Stockton* went on

115 Bond v. United States, 131 S. Ct. 2355, 2364 (2011) ("Fidelity to principles of federalism is not for the States alone to vindicate."); New York v. United States, 505 U.S. 144, 181–82 (1992) ("[T]he Constitution divides authority between federal and state governments for the protection of individuals. . . . Where Congress exceeds its authority relative to the States, therefore, the departure from the constitutional plan cannot be ratified by the 'consent' of state officials.").

116 11 U.S.C. § 903 ("This chapter 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 . . . .").

117 *Id.*

118 *In re* City of Stockton, 478 B.R. 8, 20 (Bankr. E.D. Cal. 2012) (citing 11 U.S.C. § 904).

119 11 U.S.C. § 904 ("Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, 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."); *In re City of Stockton*, 478 B.R. at 17 (quoting § 904).

to specify, with force, that because the language of § 904 is so broad, "no inherent authority power, no implied equitable power, no Bankruptcy Code § 105 power, no writ, no stay, no order" nor any other power the bankruptcy court possesses allows it to direct the policy or management choices of a debtor in Chapter 9.[120] Such broad, sweeping statutory language, and the accordingly broad language of the court in *Stockton* interpreting the provision, certainly constrains the bankruptcy court more narrowly than the Tenth Amendment alone does. This means that in any situation where a Tenth Amendment issue is implicated, § 903 and 904's limitations on the bankruptcy court's control of a municipality will step in and require remedy of the objectionable judicial action before any constitutional rights are violated.[121]

Additionally, in Chapter 9, the debtor municipality retains the exclusive right to propose a plan throughout the whole of the proceeding.[122] This is markedly different from the Chapter 11 bankruptcy context, where the debtor enjoys a period of exclusivity, but if no plan is confirmed during that time, creditors have the opportunity to propose an alternative plan.[123] This exclusivity means that even in Chapter 9, municipal (and therefore state-controlled) officials are the ones who direct the bankruptcy: since only a plan that is proposed can be confirmed, municipal officials have the power to ensure that state law is complied with when they design the plan. This exclusivity is especially important when considered in conjunction with the § 903 protections ensuring that, even in bankruptcy, municipal officials will have to continue to comply with state law.[124] These two provisions of the Code, if given their natural meaning, require that even in bankruptcy state officials cannot propose a plan that violates state law.[125] This interpretation protects states' self-governance and respects state law while still allowing states to take advantage of a federally offered program that gives them greater power to adjust the debts of ailing municipalities.

Finally, if the debtor files a plan that complies with the provisions of Chapter 9, the court has no choice but to confirm it.[126] Section 943 of the Code places certain restrictions on what a plan must contain (for example, it

120 *See In re City of Stockton*, 478 B.R. at 17, 20.

121 Even if § 903's limitation is parallel with, rather than greater than, that of the Tenth Amendment, the constitutional avoidance doctrine of interpretation requires that any interpreting court decide the issue on statutory grounds, rather than constitutional ones. Therefore, the existence of § 903 ensures that any federalism issue can be resolved without making broad, sweeping rulings that would unravel an important insolvency tool for struggling municipalities.

122 11 U.S.C. § 941 ("The *debtor shall* file a plan for the adjustment of the debtor's debts." (emphasis added)).

123 *Id.* § 1121(b) ("Except as otherwise provided in this section, only the debtor may file a plan until after 120 days after the date of the order for relief under this chapter.").

124 *See id.* § 903; *supra* notes 110–14.

125 For a more detailed discussion on this topic in Detroit's case, see *infra* Section III.C.

126 "The court *shall* confirm the plan if . . . ." 11 U.S.C. § 943(b) (emphasis added) (listing the provisions with which the debtor's plan must comply, but stating that if those conditions are met, the plan must be approved).

cannot require the debtor municipality to break any laws in implementing the plan and the debtor must be eligible under the Code's definition of who may be a debtor), but if the plan complies with all of § 943(b)'s requirements, the bankruptcy judge must approve it.[127] This leaves the judge with two options: (1) approve the plan of the debtor as written, or (2) deny confirmation of the plan because the plan does not comply with the requirements of § 943(b). Because the debtor has exclusivity throughout the entire case, this scheme means that the bankruptcy judge has only limited ability to control the debtor in bankruptcy: the judge cannot bind the municipality to any terms it did not propose itself and has very limited ability to even shape the plan the debtor chooses to put forward.

These limitations, taken together, create a system in which states remain in control of their municipalities throughout the entire bankruptcy process. Rather than impermissibly constraining state power, Chapter 9 actually increases it by allowing the states to elect into eligibility for relief. Because of the depth and breadth of the protections in the Code for states' control of the process, no municipality can be forced by the federal government to enter into bankruptcy or be bound to terms as the result of a bankruptcy filing that it did not itself propose. Were these protections removed, there would be serious questions about whether Chapter 9 could be permitted under the Constitution, but as it stands, Chapter 9 is at a minimum facially constitutional.

In declaring Chapter 9 facially constitutional, the Michigan bankruptcy court's reasoning followed similar logic to that put forward by this Note.[128] Judge Rhodes's opinion first stated that *Bekins* is still good law and controls the facial constitutionality of Chapter 9.[129] It then identified that *New York*[130] and *Printz*[131] both upheld sections of federal statutes that allowed states to consent to participation in federal programs, while striking down those that did not allow the states a meaningful choice.[132] The eligibility opinion can be summarized to stand for the propositions that Tenth Amendment problems are avoided where states can freely choose whether or not to participate in a federal program that is being executed under an enumerated power of Congress and that municipal bankruptcy presents the states with this sort of a constitutionally permissible choice.[133]

127 *Id.*

128 Opinion Regarding Eligibility, *supra* note 49, at 59–70.

129 *Id.* at 59–61.

130 New York v. United States, 505 U.S. 144 (1992).

131 Printz v. United States, 521 U.S. 898 (1997).

132 Opinion Regarding Eligibility, *supra* note 49, at 66–69.

133 *Id.* at 69–70.

B. Detroit's Eligiblity to File for Bankruptcy

As recently as 2010, Michigan was resistant to authorize bankruptcy for its municipalities at all.[134] Because eligibility to be a Chapter 9 debtor requires specific state authorization, until the Michigan legislature passed legislation that authorized municipal filings, it was impossible for any Michigan municipality to access the bankruptcy system.[135] In 2012 the Michigan legislature passed PA 436, known as the Local Financial Stability and Choice Act,[136] which provided a path to municipal bankruptcy in Michigan.[137] The statute allows the governor, upon findings of probable financial stress when certain procedural requirements are met,[138] to declare a state of "financial emergency."[139] Upon fulfilling other procedural requirements, the governor may appoint an Emergency Manager, who "shall act for and in the place and stead of the governing body and the office of chief administrative officer of the local government."[140] Detroit declared the requisite financial emergency, and Kevyn Orr was appointed as Emergency Manager on March 13, 2013.[141]

The Act further provides that if the local government approves a resolution declaring a "financial emergency" and the governor's approval is secured in writing, the municipality may proceed as a debtor under Chapter 9 of the Bankruptcy Code.[142] The statute authorizes the governor to "place contingencies on a local government in order to proceed under chapter 9."[143] On July 18, 2013, Governor Richard D. Snyder of Michigan sent a letter to Emergency Manager Orr and State Treasurer Andrew Dillon explicitly authorizing the Chapter 9 filing and "choosing not to impose any . . . contingencies" on the filing at that time.[144] The letter also stated that "[f]ederal law already contains the most important contingency—a requirement that the plan be legally executable."[145] Detroit filed bankruptcy later the same day.[146]

Governor Snyder's authorization was challenged in Michigan state court on the theory that the Act was unconstitutional because it allowed a municipality to enter bankruptcy where pensions might be reduced, in violation of

134 Monica Davey, *Michigan Town Is Left Pleading for Bankruptcy*, N.Y. TIMES, Dec. 27, 2010, http://www.nytimes.com/2010/12/28/us/28city.html.

135 11 U.S.C. § 109(c)(2) (2012); *see supra* notes 81–84, 111–14 and accompanying text.

136 MICH. COMP. LAWS §§ 141.1541–.1575 (2013).

137 *Id.*

138 *Id.* §§ 141.1544, 141.1546.

139 *Id.*

140 *Id.* § 141.1549(2).

141 *See* Davey, *supra* note 36.

142 MICH. COMP. LAWS § 141.1566(1).

143 *Id.* § 141.1566(2).

144 Bankruptcy Petition, *supra* note 2, at Exhibit A.

145 *Id.* at Exhibit A (citing 11 U.S.C. § 943(b)(4)).

146 *See id.* at 1–3.

article IX, section 24[147] of the Michigan Constitution.[148] Judge Aquilina, who heard the case, agreed with the objectors and declared that "PA 436 [was] unconstitutional . . . to the extent that it" allowed Governor Snyder "to authorize" a bankruptcy that "threaten[ed]" vested pension obligations.[149] The rest of this Section will attempt to prove that Judge Aquilina's ruling was incorrect.

The objectors contend that the pension clause of the Michigan Constitution means that any approval of bankruptcy by the governor that does not explicitly disallow the reduction of public pensions is outside of the governor's authority as an agent of the state and therefore void.[150] Similar arguments have been made in Michigan in reference to the Michigan contracts clause.[151] The logic is similar in both the contracts clause and pension clause contexts: a provision of the state constitution arguably prohibits certain debts from being diminished in bankruptcy, so authorization of a bankruptcy that would allow reduction of those obligations violates the state constitution.

In the contracts clause context, these arguments have been rejected by the Michigan Supreme Court. In 1990, the court ruled that the contracts clause is "not absolute" and must be "accommodated to the inherent police power of the State 'to safeguard the vital interest of its people.'"[152] That challenge did not come in the bankruptcy context, but involved a challenge to a law that dealt with coordination of workers' compensation benefits.[153] Many state constitutions include a contracts clause, but most allow municipal bankruptcy.[154] If state contracts clauses categorically made any declaration

147 MICH. CONST. art. IX, § 24 ("The 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.").

148 Webster v. Michigan, No. 13-734-CZ, slip op. at 1 (Ingham Cnty. Cir. Ct. July 19, 2013).

149 *Id.* at 1–2 ("PA 436 is unconstitutional and in violation of Article IX Section 24 of the Michigan Constitution to the extent that it permits the Governor to authorize an emergency manager to proceed under Chapter 9 in any manner which threatens to diminish or impair accrued pension benefits; and PA 436 is to that extent of no force or effect . . . .").

150 Objection of the Official Committee of Retirees to Eligibility of the City of Detroit, Michigan to be a Debtor Under Chapter 9 of the Bankruptcy Code, *supra* note 93, ¶ 57, at 28 ("[T]o the extent that PA 436 does not protect pension benefits from impairment in bankruptcy, it violates the Michigan Constitution.").

151 *See* Romein v. Gen. Motors Corp., 462 N.W.2d 555 (Mich. 1990), *aff'd*, 503 U.S. 181 (1992). Michigan's contracts clause reads: "No bill of attainder, ex post facto law or law impairing the obligation of contract shall be enacted." MICH. CONST. art. I, § 10.

152 *Romein*, 462 N.W.2d at 565 (quoting Energy Reserves Grp., Inc. v. Kan. Power & Light Co., 459 U.S. 400, 410 (1983)).

153 *Id.* at 559.

154 *See* Fed. Funds Info. for States, *supra* note 84, at 3 (calculating that twenty-eight states either provide full authorization for municipal bankruptcies or allow municipal bankruptcies with conditions).

of bankruptcy unconstitutional, municipal bankruptcy would not be possible in any state with a contracts clause.[155]

Fortunately for ailing municipalities, this is not the case. Both the United States Contracts Clause and state contracts clauses prohibit only the states from impairing contracts, not the United States or its courts.[156] It is by the bankruptcy power enumerated in the United States Constitution, not by the police power of the states, that debts can be reduced, even if those debts are contracted for.[157] As stated in *In re Sanitary & Improvement District, No. 7*,

> [T]he Bankruptcy Code . . . permits the federal courts through confirmation of a Chapter 9 plan to impair contract rights . . . and . . . such impairment is not a violation by the state or the municipality of [the United States Contracts Clause] which prohibits a state from impairing such contract rights.[158]

Because the Michigan contracts clause has been determined by the Michigan Supreme Court to have the same meaning as the United States Contracts Clause,[159] it follows that the two clauses would impose the same limitations on a debtor municipality seeking bankruptcy relief, and the Michigan contracts clause is therefore no bar to municipal bankruptcy. Indeed if the Michigan Constitution attempted to constrain an enumerated power of the United States Constitution, such a clause would be preempted in any case. Michigan's Attorney General filed a brief in the Detroit case opining that the state contracts clause steps aside "as a matter of state law," not due to any federal preemption.[160]

The question remains, however, whether the Michigan pension clause is like the contracts clause in that it must bow to the general police power of the state or whether it enjoys a higher level of protection and retains its potency even in bankruptcy. Certainly, not all state constitutional rights go

155 Neither, for that matter, would individual or corporate bankruptcy be possible in any state with a contracts clause, since those cases involve the impairment of contracts just as much as does municipal bankruptcy.

156 This is evident from the language of the clauses themselves. For example, Michigan's contracts clause says that no law impairing contracts "shall be enacted." MICH. CONST. art. I, § 10. Of course, its presence in the Michigan Constitution means that it can be read instead as "shall be enacted [by the State of Michigan]." The United States Constitution is much more explicit about limiting only the states. "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ." U.S. CONST. art. I, § 10, cl. 1.

157 U.S. CONST. art. I, § 8, cl. 4.

158 98 B.R. 970, 973 (Bankr. D. Neb. 1989).

159 *See* Fun 'N Sun RV, Inc. v. Michigan (*In re* Certified Question), 527 N.W.2d 468, 473–74 (Mich. 1994) (noting that the language between the two is very similar and citing federal case law to interpret the state clause).

160 Attorney General Bill Schuette's Statement Regarding the Michigan Constitution and the Bankruptcy of the City of Detroit at 13, *In re* City of Detroit, No. 13-53846 (Bankr. E.D. Mich. Aug. 19, 2013) ("[T]he subversion of a state constitution's contracts clause does not come about as a result of bankruptcy law or the Supremacy Clause of the United States Constitution; a contracts clause steps aside as a matter of state law."). Indeed, when ruling on the eligibility of Detroit to be a debtor, Judge Rhodes went so far as to term objections based on the U.S. Contracts Clause "frivolous." Opinion Regarding Eligibility, *supra* note 49, at 52.

out the window the moment a municipality declares bankruptcy. A Michigan municipality could not propose a plan, for example, that pays people of different races different percentages of their debts[161] or takes property without just compensation.[162] No court has yet held, and it is unlikely that any would, that such protections step aside of their own volition to the needs of the state and its police power.

Whether the Michigan pension clause prevents pensions from being reduced in bankruptcy has not yet been resolved by Michigan's courts. The clause itself was passed as part of the Michigan Constitution of 1963.[163] That Constitution is still in effect in Michigan today.[164] The introduction of this constitutional provision followed a controversial judicial decision that declared that pensions, rather than being contractually vested rights, were "terminable at the will of a municipality."[165] The language of the pension clause clearly overrules this judicial decree and extends the protections of contract to pensions.[166] The question remains, however, whether the pension clause goes further than sweeping pensions into the protection of the contracts clause and instead grants them a greater level of protection. Determining the exact scope of the pension clause requires some careful statutory interpretation.

One of the best indications of the meaning of a statute is its plain language. As articulated by the Supreme Court, "a legislature says in a statute what it means and means in a statute what it says there."[167] Where a statute's plain language could indicate multiple meanings, the progression of interpretive methods is "the language itself, the specific context in which that language is used, and the broader context of the statute as a whole."[168] Additionally, it has always been the case in the interpretation of American

161 MICH. CONST. art. I, § 2 (Michigan's equal protection provision).

162 *Id.* art. X, § 2 (Michigan's takings clause).

163 Patrick J. Wright & Thomas A. Shull, *Constitutional Pension Reform, 50 Years On*, MICH. CAPITOL CONFIDENTIAL (June 6, 2012), http://www.michigancapitolconfidential.com/17042.

164 *A Brief Michigan Constitutional History*, CRC SPECIAL REP.: MICH. CONST. ISSUES (Citizens Research Council of Mich.), Feb. 2010, at 1, 3–4, *available at* http://www.crcmich.org/PUBLICAT/2010s/2010/rpt36002.pdf.

165 Brown v. City of Highland Park, 30 N.W.2d 798, 800 (Mich. 1948) ("[A] pension granted by public authorities is not a contractual obligation, that the pensioner has no vested right, and that a pension is terminable at the will of a municipality, at least while acting within reasonable limits."), *superseded by constitutional amendment as recognized in In re* Request for Advisory Op. Regarding Constitutionality of 2011 PA 38, 806 N.W.2d 683 (Mich. 2011).

166 MICH. CONST. art. IX, § 24 ("The accrued financial benefits of each pension . . . *shall be a contractual obligation* . . . ." (emphasis added)).

167 Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253–54 (1992).

168 Robinson v. Shell Oil Co., 519 U.S. 337, 341 (1997) (citing Estate of Cowart v. Nicklos Drilling Co., 505 U.S. 469, 477 (1992); McCarthy v. Bronson, 500 U.S. 136, 139 (1991)).

constitutions that "[i]t cannot be presumed that any clause in [a] constitution is intended to be without effect."[169]

Applying these principles to the pension clause suggests that it goes further to protect pensions than simply making them contractual obligations. If the clause had only intended to bring pensions within the protection of the contracts clause, it could have simply read: "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof . . . ."[170] However, that is not where the clause ends; it goes on to conclude: "which shall not be diminished or impaired thereby."[171] This additional language must add something to the meaning of the clause in order to avoid reading it out of the Michigan Constitution completely, in violation of the principles put forward by *Marbury* and *Koontz*.

To determine the correct interpretation of this additional language, we must first look to its plain meaning. The simplest and most obvious interpretation would be that the government of Michigan can take no action to "diminish[ ]" the pensions of its public sector workers whatsoever. It does not state any caveats or exceptions, or that this protection must bow to the police power of the state. Of course, the contracts clause is written in similarly absolute language, and the Michigan Supreme Court interpreted that protection as being limited by the police power of the state in the face of a financial emergency.[172] However, to interpret the clause as simply making pension obligations contractual is to read out its last six words. Since there is a reasonable interpretation of the clause that avoids this outcome, a reasonable interpretation of the clause that gives legal effect to all its language should be given great weight by the courts.

That interpretation, of course, is that the clause means just what it says: the State of Michigan cannot reduce pension obligations, whether or not in a state of financial emergency. This interpretation has several benefits. First, it avoids reading constitutional language out of the document. It also would make the clause function exactly how a layperson reading it would expect a clause with no caveats or exceptions to function. And it is a simple, bright-line interpretation that would be easy to administer judicially.

Perhaps even more convincingly, it would give the clause the effect that those who enacted it likely wanted it to have. The people of Michigan thought it so repugnant that pension obligations, once promised, would not be fulfilled that they *wrote it into their Constitution* that their government could

169 Marbury v. Madison, 5 U.S. (1 Cranch) 137, 174 (1803); *see also* People v. Perkins, 703 N.W.2d 448, 455 (Mich. 2005) (citing Koontz v. Ameritech Servs., Inc., 645 N.W.2d 34, 39 (Mich. 2002)) (requiring Michigan courts to interpret constitutions so that each word has meaning); *Koontz*, 645 N.W.2d at 39 ("Courts must give effect to every word, phrase, and clause in a statute, and must avoid an interpretation that would render any part of the statute surplusage or nugatory.").

170 MICH. CONST. art. IX, § 24.

171 *Id.*

172 *See supra* note 152 and accompanying text.

not take any action that would threaten the full satisfaction of those obligations. Such a desired result could have simply been achieved by passing a statute. Though the pension clause was inserted as a part of a broad set of changes to the document rather than spurring its own one-off amendment,[173] its inclusion in the 1963 Constitution demonstrates that the people of Michigan believed protection for public pensions was important enough to merit the highest protection available under state law.[174]

While the decision to provide such a high level of protection for public pensions may have been ill-advised given the current state of Detroit's finances, there are compelling reasons to make the pension obligations of state workers untouchable. Public workers generally receive less in salary and wages than those with similar levels of education in the private sector.[175] In exchange for receiving lower pay up front, these public sector employees generally have more lucrative pension plans than their private counterparts.[176] If viewed this way, the pensions of public workers can be seen as deferred compensation for services performed during those employees' working years. The people of Michigan could have seen that public sector employees are therefore especially vulnerable to a reduction of pension benefits and moved to give them a higher degree of protection than is provided by the contracts clause.

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173 *See supra* notes 163–66. A constitutional amendment outside the larger constitutional convention, in response to the decision in *Brown*, would perhaps have provided more compelling evidence of the complete inviolability of public pensions by the state by demonstrating an incredible level of voter outrage. The lack of such an amendment, however, does not demonstrate that the only operation of the pension clause is to provide pensions the protection of the contracts clause.

174 In its recent opinion, the bankruptcy court came to the opposite conclusion. The opinion by Judge Rhodes states that "[f]or Tenth Amendment and state sovereignty purposes, nothing distinguishes pension debt in a municipal bankruptcy case from any other debt." Opinion Regarding Eligibility, *supra* note 49, at 74. Judge Rhodes came to this conclusion by looking at the legislative history of the amendment and Michigan cases that have interpreted it and emphasizing the number of times that pension obligations are referred to as contractual. *Id.* at 75–80. He seems to be of the opinion that if the obligations were meant to be afforded greater protection than ordinary contracts, they would not be referred to as "contractual" at all. *See id.* The opinion did not address the argument put forward in this Note—namely, that while the obligations are clearly contractual under the state constitution, they are also afforded greater protection by the additional language at the end of the state pension clause. The Rhodes opinion, however, does acknowledge that Michigan has the power to define property rights in a way that would shield those rights from reduction under the Bankruptcy Code. *Id.* at 79–80. It is the suggestion of this Note that Michigan has done so in the case of municipal pension debt.

175 Jeffrey Keefe, *Debunking the Myth of the Overcompensated Public Employee: The Evidence*, EPI BRIEFING PAPER (Econ. Pol'y Inst.), Sept. 15, 2010, at 5, *available at* http://www.epi.org/files/page/-/pdf/bp276.pdf.

176 *Id.* at 7. While the percentage of total compensation that comes through a defined benefit plan ranged from 0.9% to 2.2% for private sector employees depending on the size of the employer, 7.2% of all compensation received by private sector employees came in the form of defined benefit plans.

This interpretation, however, would mean that the pension clause and the contracts clause are similar in at least one important respect: neither prevents the adjustment of debts under the federal bankruptcy power. The rationale is the same in each case: the reduction of debts is being effectuated by a federal court acting under an enumerated power of the Constitution.[177] This interpretation is even clearer in the pension clause context than it was when examining the Michigan contracts clause.[178] By its own terms, the pension clause limits only the state's ability to adjust pensions.[179] Of course, because these clauses appear in the Michigan Constitution, they are unable to reduce the power of the federal government no matter how they are worded.

Having concluded that the pension clause precludes any action whatsoever by Michigan to reduce the pensions of its employees, it must then be asked whether the authorization of Detroit's Chapter 9 bankruptcy had the effect of "diminish[ing] or impair[ing]" any such pensions.[180] Quite simply, the answer is no. Admittedly, the approval of a Chapter 9 filing is a step on the way to the impairment of pensions in bankruptcy. It is even a crucial step, given the specific authorization requirement of § 109(c)(2).[181] However, immediately upon the authorization of bankruptcy, no pensions are impaired.[182] All obligations are left in place upon the filing of a bankruptcy case and a number of procedural steps must be taken before any impairment can take place.[183]

If the bankruptcy is authorized and filed, there is no guarantee that pensions will be impacted. It could later be adjudged that the debtor was not eligible to file under § 109,[184] the debtor could choose to file a plan which does not impair the pensions, or the debtor could choose to voluntarily dismiss the case. The mere authorization of the filing will not diminish or impair the pensions.

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177 *See supra* notes 150–60 and accompanying text.

178 *See supra* note 156 and accompanying text.

179 MICH. CONST. art. IX, § 24 ("The 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*." (emphasis added)). The "thereby" at the end of the statute references the State of Michigan (whose pension plans they are), and so constrains action only by the State of Michigan.

180 *Id.*

181 11 U.S.C. § 109(c)(2) (2012) ("[A municipal debtor must be] specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter.").

182 The automatic stay, 11 U.S.C. § 362, prevents any suit to collect on a debt owed by the debtor during the term of the bankruptcy case, but such delay in an enforcement action can hardly be said to diminish or impair a pension obligation, especially if obligations continue to be paid during the course of the case.

183 For example, the debtor must get a disclosure statement approved, FED. R. BANKR. P. 3016(b), file a plan, 11 U.S.C. § 1321, and have it confirmed, *id.* § 1325.

184 11 U.S.C. § 109.

In fact, even if the debtor does not intend to impair pensions, there are good reasons that it might want to authorize and file a bankruptcy. A debtor may intend to propose a plan that complies with the requirements of § 943[185] and discharges some of its debts but does not alter its pension obligations. The debtor may not, at the time of the filing, know if it would like to reduce its pension obligations in bankruptcy or not, but it may be looking to benefit from the automatic stay,[186] which stops all litigation and attempts to collect against the debtor. The filing, and the stay that comes with it, would allow the debtor some breathing room to assess its situation without having to focus on litigation other than the bankruptcy and determine how best to get out of bankruptcy.

C. Whether Michigan's Public Pensions May Be Reduced in Bankruptcy

Some commentators have argued that, in general, pension obligations are unsecured debt, which is generally paid at the lowest percentage in a bankruptcy case.[187] Judge Steven Rhodes, the bankruptcy judge assigned to Detroit's case, has expressed similar opinions, and stated as such in his ruling on eligibility.[188] Kevyn Orr, the Emergency Manager for the city, has espoused the opinion that once the city files for bankruptcy, the Bankruptcy Code preempts the pension clause and allows the reduction of pension benefits.[189]

In bankruptcy, state officials (and, by extension, municipal officials), must continue to act in accordance with state law.[190] The Code itself explicitly states that the declaration of bankruptcy does not limit the state's ability

185 *Id.* § 943. The biggest obstacle to such a plan would probably be the absolute priority rule, laid out at *id.* § 1129(b)(2)(B). It is somewhat unclear whether, under the interpretation of the pension clause suggested by this Note, the absolute priority rule would be violated by paying pensioners in full while paying other creditors cents on the dollar. However, such a discussion is outside the scope of this Note.

186 11 U.S.C. § 362.

187 Jeffrey B. Ellman & Daniel J. Merrett, *Pensions and Chapter 9: Can Municipalities Use Bankruptcy to Solve Their Pension Woes?*, 27 EMORY BANKR. DEV. J. 365, 402 (2011) ("[A] chapter 9 debtor's postpetition obligations to its retirees arising out of prepetition contractual (or impliedly contractual) relationships arguably are entitled to nothing more than general unsecured nonpriority status and may be impaired in a plan of adjustment."). In a Chapter 11 case, equity holders would be paid a lower percentage, but because municipalities have no stockholders, equity is irrelevant in the Chapter 9 context.

188 Opinion Regarding Eligibility, *supra* note 49, at 74 ("For Tenth Amendment and state sovereignty purposes, nothing distinguishes pension debt in a municipal bankruptcy case from any other debt."); *see* Joseph Lichterman, *Protecting Detroit Pensions May Violate Bankruptcy Code—Judge*, REUTERS (Oct. 21, 2013, 7:36 PM), http://www.reuters.com/article/2013/10/21/usa-detroit-bankruptcy-idUSL1N0IB1HY20131021.

189 Nathan Bomey, *How a Chapter 9 Bankruptcy Could Affect Detroit Pensions, Health Care*, DETROIT FREE PRESS (June 21, 2013), http://www.freep.com/article/20130621/NEWS01/306200070/.

190 "Indeed, absent a specific provision in chapter 9 to the contrary, a municipality is required to continue to comply with state law during a chapter 9 case." COLLIER, *supra* note 53, ¶ 903.02.

to control the actions of its agents and employees.[191] Municipalities are "political subdivisions of states from which they derive all of their rights and powers" and "Chapter 9 does not disturb that arrangement, that is, it does not give a city rights and powers independent of the state," meaning that if a state could not take an action without violating state law, a municipality may not take that action in bankruptcy.[192]

If the pension clause is not preempted by the Code, Mr. Orr and his team may not propose a plan that reduces pension benefits. Emergency Managers qualify as "public officer[s]" of Michigan,[193] and as a result, "have and can exercise only such powers as are conferred on them by law."[194] Under this Note's suggested interpretation of the pension clause, it is against Michigan law for a public officer to take any action that would reduce or impair vested public pensions, even in the case of financial emergency.[195] Any action taken in violation of the Michigan Constitution by a public official, even the governor, is "null and void."[196] As a result, it follows that any action by a state official to reduce or impair pension obligations is null and void.

Though Governor Snyder did not place any contingencies on the filing,[197] this fact does not limit the operation of state law on Detroit during the bankruptcy process. PA 436 suggests in at least three places that the Michigan legislature was not attempting to empower the Emergency Manager to reduce pension obligations outside of the bankruptcy context.[198] It

191 11 U.S.C. § 903 ("This chapter 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, but—(1) a State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and (2) a judgment entered under such a law may not bind a creditor that does not consent to such composition.").

192 *In re* City of Bridgeport, 128 B.R. 688, 692 (Bankr. D. Conn. 1991).

193 *See* MICH. COMP. LAWS § 141.1549(9)(b) (2013).

194 Sittler v. Bd. of Control of Mich. Coll. of Mining & Tech., 53 N.W.2d 681, 684 (Mich. 1952) (citations omitted).

195 *See* Musselman v. Governor, 533 N.W.2d 237, 239–40, 243 (Mich. 1995) ("[P]ension obligations differ from nearly every other type of government spending insofar as they simply cannot be reduced or cut . . . . Michigan governmental units do not have the option . . . of not paying retirement benefits."), *aff'd on reh'g*, 545 N.W.2d 346 (Mich. 1996).

196 Dullam v. Willson, 19 N.W. 112, 120 (Mich. 1884).

197 *See supra* notes 144–45 and accompanying text.

198 First, PA 436 section 11 requires that the Emergency Manager "shall provide" for the "timely deposit of required payments to the pension fund" in which the local government participates. MICH. COMP. LAWS § 141.1551(1)(d). Section 13 of the statute allows the Emergency Manager to reduce or eliminate the salaries of top officials, including the chief administrative officer of the municipality, but "does not authorize the impairment of vested pension benefits." *Id.* § 141.1553. Finally, in section 12(m)(ii), an Emergency Manager is authorized to supplant a local pension board, but it is required that in that role the Emergency Manager "fully comply with . . . section 24 of Article IX of the state constitution." *Id.* § 141.1552(m)(ii).

follows that if the pension clause is not preempted by the Bankruptcy Code, and the statute did not give the Emergency Manager the power to adjust pensions, they may not be adjusted in bankruptcy.

It must be determined, then, whether the pension clause is preempted by the Bankruptcy Code. It is the position of this Note that it is not. In *Perez v. Campbell*,[199] the Supreme Court determined whether a state statute was preempted by using a two-part test. First, the Court looked to the structure of the two statutes to determine whether the statutes were in conflict. If so, the Court then asks whether the federal statute preempts the state statute.[200] This Note previously determined that state officials, due to the Michigan pension clause, may not take any action to reduce public workers' pensions.[201] It must be determined, then, whether the Bankruptcy Code conflicts with this reading of the pension clause.

It is clear that municipal bankruptcy is constrained by the Tenth Amendment and the principles of federalism.[202] The Supreme Court acknowledged that the Tenth Amendment limits Congress's ability to enact municipal bankruptcy legislation and upheld Chapter 9 on the back of its protections for federalism only two years after a previous version of the municipal bankruptcy statute had been struck down on federalism grounds.[203] However, federal bankruptcy law has the power to preempt similar state law regarding the rights of debtors and creditors if it can do so without violating principles of federalism: "[S]tate law that conflicts with federal law is 'without effect.' This includes state law dealing with insolvency, debtors, and the rights of creditors."[204] When determining if state law has been preempted, a court must start "with the assumption that the historic police powers of the States [are] not to be superseded by [a] Federal Act unless that [is] the clear and manifest purpose of Congress."[205]

Perhaps it is not surprising then that Congress has chosen to enact a municipal bankruptcy statute that is deferential to, and which in many places incorporates, state law. The two sovereigns, state and federal, must work together in Chapter 9 without undermining the sovereignty of one

199 402 U.S. 637 (1971).

200 *Id.* at 644.

201 *See supra* notes 161–79 and accompanying text.

202 *See In re* N.Y.C. Off-Track Betting Corp., 427 B.R. 256, 264 (Bankr. S.D.N.Y. 2010) ("Bankruptcy courts should review chapter 9 petitions with a jaded eye. Principles of dual sovereignty, deeply embedded in the fabric of this nation and commemorated in the Tenth Amendment of the United States Constitution, severely curtail the power of bankruptcy courts to compel municipalities to act once a petition is approved."); *supra* Part II.

203 *See* United States v. Bekins, 304 U.S. 27, 54 (1938); Ashton v. Cameron Cnty. Water Improvement Dist. No. One, 298 U.S. 513, 543 (1936), *superseded by statute*, Act of Aug. 16, 1937, 50 Stat. 653, *as recognized in In re* City of Stockton, 478 B.R. 8, 18 (Bankr. E.D. Cal. 2012).

204 Daniel A. Austin, *The Bankruptcy Clause and the Eleventh Amendment: An Uncertain Boundary Between Federalism and State Sovereignty*, 42 U.S.F. L. Rev. 383, 391–92 (2007) (footnote omitted).

205 Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947).

another.[206] In order to effectuate such a system, Congress has shaped Chapter 9 in a way that does not violate the sovereignty of states. Many protections for state sovereignty are written into the Code, and they often incorporate state law. For example, 11 U.S.C. § 943(b) requires that the debtor not be prohibited by law from taking the action outlined in the plan, including by state law.[207] In general, the Bankruptcy Code does not define property rights, but instead takes such rights as provided in non-bankruptcy law.[208]

The deferential and sovereignty-protecting system that Congress has established indicates that the pension clause is not preempted by the Bankruptcy Code, but rather has been incorporated by it. Commentators have argued for the incorporation of economic rights from state law by the Bankruptcy Code in other areas, such as the duty to negotiate under certain terms with collective bargaining entities.[209] Whether breach of contract has occurred is determined according to state law even when in bankruptcy,[210] as is whether a domestic support payment will be treated as support or distribution of property.[211] The Bankruptcy Code looks to state law constantly to characterize property, determine its owner, and serve as the starting point for the bankruptcy estate.

It is reasonable, therefore, to think that given its respect for state law, Chapter 9 would also look to state law and accept that pension obligations cannot be reduced because they present a special form of property in Michigan. The protection of state law in § 943(b) requires that bankruptcy law remain respectful of the limits imposed by state law and the dual sovereignty system.[212] Most debts can be adjusted in bankruptcy because the contracts clause of the Michigan Constitution and state statutes that protect property and contract rights step aside of their own volition in times of financial emergency.[213] In this way, the discharge of debts in municipal bankruptcy is not a violation of state law—it is a manifestation of the state and its municipality utilizing a power offered by the federal government to adjust its debts, in

206 *In re Stockton*, 478 B.R. at 18 ("The Supreme Court . . . reason[ed] that [the 1937 Act] was a cooperative enterprise by state and federal sovereigns that was carefully drawn so as not to infringe state sovereignty [and] emphasized that a state 'retains control of its fiscal affairs' and that no 'control or jurisdiction over that property and those revenues of the petitioning agency necessary for essential governmental purposes is conferred' on the federal court." (citations omitted)).

207 "The court shall confirm the plan if . . . the debtor is not prohibited by law from taking any action necessary to carry out the plan." 11 U.S.C. § 943(b)(4) (2012).

208 Zayler v. United States (*In re* Supreme Beef Processors, Inc.), 468 F.3d 248, 255 (5th Cir. 2006).

209 "Fairly read, congressional interpretation of the 1976 municipal bankruptcy revision requires maintenance of bargained-for contract terms, in accord with state law, before and after court-approved rejection." Barry Winograd, *San Jose Revisited: A Proposal for Negotiated Modification of Public Sector Bargaining Agreements Rejected Under Chapter 9 of the Bankruptcy Code*, 37 HASTINGS L.J. 231, 319 (1985).

210 11 U.S.C. § 365(c).

211 *Id.* § 523(a)(5), (15).

212 *Id.* § 943(b).

213 *See supra* notes 152–60 and accompanying text.

accordance with state law. However, if this Note's interpretation of the pension clause is correct, the pension clause does not step aside in the same way, and public pension debts cannot be discharged in Michigan unless the pension clause is preempted. It is unclear whether, given the protections of federalism and the Tenth Amendment, the federal government would be able to preempt the pension clause through Chapter 9 if it chose to—but as has hopefully been demonstrated at this point, the fairest reading of the Code is that such a state protection is incorporated into the definitions of property and what is dischargeable in the Code.

What sort of plan, then, may the municipality propose? It could be argued that there is no limit on what a debtor-filed plan may contain. This sort of argument would look similar to the one made earlier in this Part as to why authorization of the filing is permissible under the pension clause: it is only an intermediate step to the discharge of debts, and because there are additional steps that must be taken before pensions can be reduced, there is no limitation.[214] Such logic, however, is much less compelling in the context of filing a plan than it is when examining whether filing the case is impermissible. Two facets of the Bankruptcy Code demand that filing such a plan be considered to violate state law. First is the total exclusivity provision of § 941.[215] Because the debtor is the only entity that may file a plan in Chapter 9, it has total control over what the provisions of that plan are. This means that the debtor has the ability to shape the plan to protect pensions, and if it does not, such a plan would reflect a conscious choice by the municipality to undermine the state constitution. The second facet of the Code leading to the conclusion that Detroit may not file a plan that would reduce pensions is the bankruptcy judge's lack of discretion when confirming the plan.[216] If the plan proposed by the debtor conforms to § 943's requirements, the bankruptcy judge has no choice but to confirm it.[217] This means that the debtor municipality has incredible control over the terms of the plan: within the limits of § 943, it can shape the plan however it wants without any other entity having a discretionary check on the process. Because filing a plan is the last discretionary step for a municipality in the plan confirmation process, such a plan cannot be filed by a municipality without violating state law.[218] Detroit may not file a plan that attempts to impair pensions.

214 *See supra* notes 180–86 and accompanying text.

215 11 U.S.C. § 941 ("The *debtor shall* file a plan for the adjustment of the debtor's debts." (emphasis added)).

216 "The court *shall* confirm the plan if . . . ." *Id.* § 943(b) (emphasis added) (listing the provisions with which the debtor's plan must comply, but stating that if those conditions are met, the plan *must* be approved).

217 *Id.*

218 Were such a plan to be filed, a bankruptcy court that accepts the interpretations of the Code and pension clause set forth in this Note would have to deny such a plan anyway.

CONCLUSION

Municipal bankruptcy attempts to give much-needed relief to struggling municipalities that may have very few other options to get out from under a self-reinforcing cycle of falling revenues and rising debts. However, if the American system of dual sovereignty is to survive the bankruptcies of large and once-prosperous cities like Detroit, courts will need to give real weight to state law in the bankruptcy context. This Note provides a framework that would allow the bankruptcy system to respect state definitions of property and limit what can legally be done to change property interests while simultaneously equipping municipalities with the tools they need to rehabilitate their finances.

While this Note's interpretation of the Bankruptcy Code and pension clause of the Michigan Constitution would prevent Detroit from reducing vested pension obligations, the situation may not be as dire as one might assume. Under the proposed interpretation, the City of Detroit may still reduce or eliminate other obligations, such as non-vested pension obligations, medical benefits of its workforce and retirees, and other debts that do not receive special, constitutional protection. While the city's financial situation is undeniably distressed, the promise of bankruptcy relief provides at least a partial road to financial redemption. While the bankruptcy court has now entered judgment on the eligibility of Detroit to be a debtor, it seems highly likely that the question will be considered by a higher court before the matter is fully put to rest.