Bloomberg BNA

BNA's
Bankruptcy Law Reporter™

Detroit Faces Challenges to Eligibility for Bankruptcy Relief

By Stephen Selbst

Like Cadillacs in days of yore, everything about the Chapter 9 case filed on July 18, 2013 in the United States Bankruptcy Court for the Eastern District of Michigan (the ''Bankruptcy Court'') by the City of Detroit (''Detroit'' or the ''City'') is outsized. At approximately $18 billion in debt, the case ranks as the largest Chapter 9 ever filed. Although the case is still in its early days, a battle has developed over whether the City qualifies for relief under Chapter 9 and whether Chapter 9 is constitutional.[1] More than 100 parties filed objections to the City's eligibility, raising diverse legal and factual issues; many of the objections were filed by unions, retiree groups and other City employees. This article focuses on the legal challenges to the City's eligibility as a Chapter 9 debtor.

Although the immediate question before the Bankruptcy Court is Detroit's eligibility for Chapter 9, the underlying issue is the City's stated plan[2] to use Chapter 9 to reduce accrued and future pension and other post-employment benefits (''OPEB''). The proposed treatment of pension and OPEB benefits has drawn the wrath of the City's unions and retirees, who contend that, at a minimum, the accrued pension benefits are protected by Article IX, Chapter 24 of the Michigan Constitution. The anger of the unions and retirees is understandable: the amounts owed for pension and OPEB benefits make them, in the aggregate, the largest creditors in the case. In Detroit's Chapter 9 petition, the amount owed for pension and OPEB benefit claims is estimated at $9.2-$9.9 billion, a number that the City contends is likely understated.[3]

Several unions, led by the Local 25 of the American Federation of Federal, State, County and Municipal Employees (''AFSCME''), filed challenges to the constitutionality of Chapter 9 and also questioned the jurisdiction of the Bankruptcy Court to hear such a challenge. Other objections have challenged the validity of the law known as Michigan PA 436,[4] pursuant to which Kevyn Orr was appointed as emergency manager (the ''Emergency Manager'') for the City of Detroit. Some objections argued that the City's Chapter 9 filing could only be valid if the Bankruptcy Court ruled that the City had no authority in its Chapter 9 case to reduce or impair in

[1] In a municipal bankruptcy case the alleged Chapter 9 debtor must establish its eligibility for relief.

The cases hold that the debtor bears the burden of proof under § 109(c). I*n re City of Stockton, Cal.*, 493 B.R. 772 (Bankr. E.D. Cal. 2013*); Int'l Ass'n of Firefighters, Local 1186 v. City of Vallejo (In re Vallejo)*, 408 B.R. 280 (B.A.P. 9th Cir. 2009).

Stephen Selbst is the Chair of Herrick, Feinstein's Bankruptcy Practice Group. He has more than 30 years of experience representing debtors, creditors, official committees, distressed investors and asset purchasers in bankruptcies and out-of-court restructurings.

[2] On June 14, 2013, Kevyn Orr, the emergency manager for the City appointed by Michigan Governor Richard Snyder circulated a document titled ''Proposal for Creditors,'' (the ''Creditor Proposal''), which called for reductions in accrued and future pension and OPEB benefits. The Creditor Proposal was attached to Declaration of Kevyn D. Orr (''Orr Declaration'') in Support of City of Detroit, Michigan's Statement of Qualifications Pursuant to Section 109(c) of the Bankruptcy Code, case 13-53846, Bankr. E.D. Mich., Docket 11, Exhibit A at 109 (subsequent references to pleadings will be cited as Docket __); *See, also*, Q&A with Kevyn Orr: Detroit's Emergency Manager Talks About City's Future, Detroit Free Press (June 16, 2013), available at http://www.freep.com/article/20130616/OPINION05/306160052/kevyn-orr-detroit-*emergency-manager-creditors-fiscal-crisis* (visited August 27, 2013).

[3] *See*, Orr Declaration at ¶ 9, note 3, which lists post-employment benefits at $5.7-6.4 billion, and $3.5 billion in underfunded pension liabilities. The Creditor Proposal suggests that the pension underfunding may be higher. *See,* Creditor Proposal at 23.

[4] Michigan Public Act 436 of 2012, the Local Financial Stability and Choice Act, MCL § 141.1541 et seq. (''PA 436'').

 ISSN 1044-7474

any way the accrued pension benefits protected by the Michigan Constitution.

Due to the large number of objections, on August 23, 2013, the Bankruptcy Court entered an order (the ''Procedures Order'') bifurcating the hearing on the City's eligibility, which was originally scheduled to be heard on October 23, 2013.[5] Instead, the Bankruptcy Court identified five key legal issues and determined that it would hear those arguments on September 18, 2013:[6]

- Whether the Bankruptcy Code is constitutional;
- Whether the Bankruptcy Court lacks jurisdiction to consider the constitutionality of the Bankruptcy Code;
- Whether Michigan PA 436, which the City relied on as authorization for its Chapter 9 filing, is constitutional;
- Whether the Bankruptcy Court lacks jurisdiction to consider the constitutionality of Michigan PA 436; and
- Whether the state's authorization statute, PA 436, improperly failed to require that the City not impair pension rights in violation of Article IX, Section 24 of the Michigan Constitution.

But the extensive discovery being taken in connection with the eligibility hearing has led the Bankruptcy Court to push back the opening of the eligibility hearing until October 15, 2013.

Given the size of the financial issues, and because the prospect for settlement currently appears dim, it seems certain that the losing parties in Bankruptcy Court will appeal. There have been very few Chapter 9 cases[7], and none the size of Detroit's, and there are few precedents. Due to the importance of the legal issues raised — particularly the constitutional challenges — it is conceivable that the United States Supreme Court will hear appeals from this case. While the circumstances that led to Detroit's bankruptcy are unique, many other American cities face similar problems in terms of underfunded pension and OPEB costs.[8] Thus, what happens in Detroit may well have implications far beyond its city limits.

Pension Issue Deferred

The treatment of the City's pension and OPEB benefits will likely be the hardest legal and financial issue in the case, both because of the size of the City's obligations and its limited resources to meet them, but also due to Michigan's constitutional protection for accrued pensions. Many objecting parties argued that Detroit was ineligible for Chapter 9 relief because, they alleged, the Emergency Manager intends to propose a plan of adjustment that violates those pension rights. In the Procedures Order, the Bankruptcy Court deferred ruling on that issue, ruling that the City was not obligated, establishing its eligibility, to ''prove that any plan that it might later propose is confirmable,'' merely that ''the City need only prove more generally that it desires 'to effect a plan to adjust such debts.' ''[9] The decision to defer ruling on the pension issue is right for several reasons: first, the Bankruptcy Court has no factual record on which to base any ruling other than out-of-court expressions of intent by the City. Second, bankruptcy judges are well aware that what a debtor says that it intends to accomplish at the outset of a case is often different from the final result. Ruling on the pension issue in the absence of a plan of adjustment filed in the Bankruptcy Court would have amounted to issuing an advisory opinion.

Challenge to Constitutionality of Chapter 9

The boldest challenge to Detroit's eligibility as a Chapter 9 debtor comes in the form of the claim that Chapter 9 of the Bankruptcy Code violates the Constitution because it impermissibly invades state sovereignty and violates the rights of individual citizens. Although the cases the constitutionality objectors rely on largely date from the rebirth of Tenth Amendment and federalism jurisprudence in the last 20 years, the debate about the constitutionality of municipal bankruptcies is not new, having been addressed twice previously by the Supreme Court.

The current Chapter 9 provisions of the Bankruptcy Code have their origins in the Great Depression. At that time, thousands of cities and municipal districts found themselves unable to repay or refinance their municipal bonds.[10] The predecessor to Chapter 9 was enacted because the state law remedies available to municipal bondholders were inefficient and inadequate. The principal remedies were execution, the seizure of municipal-owned property, and mandamus, an order of a court directing a municipality to raise taxes by an amount sufficient to raise funds to pay the defaulted obligations.[11] But execution proved to have little practical value because courts consistently ruled that property used in the provision of essential services were exempt

---

[5] Order Regarding Eligibility Objections Notices and Hearings And Certifications Pursuant to 28 U.S.C. § 2403(a) and (b) (Docket 642).

[6] The Bankruptcy Court also said it would hear legal argument on (1) whether Detroit's Emergency Manager is not an elected official, and therefore unauthorized to file a Chapter 9 petition on behalf of the City; and (2) whether the City is collaterally estopped from asserting its authorization was valid because that issue had been adversely determined in prepetition state court litigation. These issues are likely to be more easily dealt with: the language of the Bankruptcy Code does not support the argument that the City's filing was unauthorized because the Emergency Manager is an appointed official. On the collateral estoppel point, the parties in the state court litigation are not the same as the parties in the Chapter 9 case. In particular, the parties to the state court action did not include the City or the Emergency Manager, making it unlikely that the Bankruptcy Court would apply collateral estoppel.

[7] The total number of Chapter 9 cases filed has been estimated at approximately 650. http://en.wikipedia.org/wiki/Chapter_9,_Title_11,_United_States_Code, visited August 29, 2013.

[8] According to a report prepared by the Pew Charitable Trusts, as of the end of 2009, for 61 major cities (the largest city in each state and each city with a population over 500,000), the aggregate underfunding for pensions and other non-pension employment benefits (''OPEB''), was $217 billion, a figure that includes Detroit. *The Pew Charitable Trusts, A Widening Gap in Cities, available at* http://www.pewstates.org/research/reports/a-widening-gap-in-cities-85899442341, visited August 22, 2013.

[9] Procedures Order at 6.

[10] See, *Ashton v. Cameron County Water Imp. Dist. No. 1,* 298 U.S. 513 (1936) at 533 (Cardozo, J, dissenting).

[11] Note, *Creditor Remedies in Municipal Default*, 1976 Duke L.J. 1363 (1976).

  BBLR ISSN 1044-7474

from execution. Experience had also shown that the mandamus remedy was often equally ineffective: as taxes were increased, taxpayers simply failed to pay or moved away.[12]

Against that backdrop, Congress enacted the original Chapter IX as temporary legislation in 1934 to address the ''national emergency'' in municipal finance.[13] Chapter IX required that the debtor file its plan of adjustment with its Chapter 9 petition, which had to be supported by the consent of at least two-thirds of the bondholders. Section 79(k) of Chapter IX contained language reflecting Congress's concern that the law not interfere with or diminish the political sovereignty of any municipal debtor.[14] But in 1936, the Supreme Court struck down Chapter IX in *Ashton v. Cameron County Water Imp. Dist. No. 1*.[15] A 5-4 majority of the Supreme Court held that because the states could not impair the validity of bonds issued by a municipality under Article I, section 10 of the Constitution (the ''Contracts Clause'')[16], they could not accomplish that result by consenting to federal legislation that provided for such treatment. As the Court explained:

> The Constitution was careful to provide that ''no State shall . . . pass any . . .Law impairing the Obligation of Contracts.'' This she may not do under the form of a bankruptcy act or otherwise. Nor do we think she can accomplish the same end by granting any permission necessary to enable Congress so to do. Neither consent nor submission by the states can enlarge the powers of Congress; none can exist except those which are granted. The sovereignty of the state essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation.

298 U.S. at 531 (internal citations omitted).

After *Ashton* was decided, Congress enacted Chapter X, which was substantially similar to the prior law, except that it incorporated additional language deferential to states' rights. In *United States v. Bekins*, the Supreme Court heard an appeal of a California district court decision that had held the new version invalid under the authority of *Ashton*.[17] Although Chapter X was crafted to address the *Ashton*, the differences between the statutory schemes were not significant, except that Chapter X survived Supreme Court scrutiny.[18]

The challenges to the constitutionality of Chapter 9 in the Detroit case argue that, based on recent decisions, Chapter 9 is fatally deficient for the reasons first identified in *Ashton*: it impermissibly compromises state sovereignty. The objectors also argue that Chapter 9 also disenfranchises individual citizens. The core of this argument is that over the past two decades, the Supreme Court has strengthened the rights of individual states in our federal system, and that under these cases, *Bekins* has been effectively overruled. The AFSCME objection argues that the key decision is *New York v. United States*,[19] where the Supreme Court held that any federal statute that purported to exercise federal control over ''an attribute of state sovereignty'' is ''an exercise of ''a power the Constitution has not conferred on Congress'' and is therefore unconstitutional.[20]

The constitutionality objections also argue that individuals have the right to invalidate federal law if the challenged statute exceeds Congress's grant of legislative jurisdiction, relying on *Bond v. United States*, 131 S. Ct. 2355 (2011), 564 U.S. ____ (2011). In *Bond*, the defendant was convicted for violating the Chemical Weapons Implementation Act of 1898 when she was videotaped putting poison in the muffler of the car of a woman who was having an affair with her husband. Her appeal argued that applying the chemical weapons treaty to her violated the Tenth Amendment, which the Supreme Court agreed with, holding unanimously that individuals may pursue their own constitutional claims when Congress enacts laws that invade rights protected by federalism. AFSCME's *Bond* argument is that its individuals have personal rights to challenge the constitutionality of Chapter 9.

The AFSCME objection argues that bankruptcy jurisdiction over Detroit's case is unnecessary because Michigan has the right to enact a state municipal insolvency law to address Detroit's financial problems. Were Michigan to do so, AFSCME argues, it would be required to honor the protection given to pension benefits under the Michigan constitution. Michigan clearly has

---

[12] *Id*. at 1379-83; Kenneth Klee, *An Overview of Municipal Bankruptcy*, unpublished manuscript, at p. 4, available at https://www.law.ucla.edu/workshops-colloquia/Documents/KleeColloquium.pdf, visited August 26, 2013.

[13] The Act of May 24, 1934 (48 Stat. 798), amended the Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, by adding Chapter 9 (three sections, 78, 79, 80), captioned ''Provisions for the Emergency Temporary Aid of Insolvent Public Debtors and to Preserve the Assets Thereof and for other Related Purposes.''

[14] Section 79(k) provided:

> Nothing contained in this chapter shall be construed to limit or impair the power of any State to control, by legislation or otherwise, any political subdivision thereof in the exercise of its political or governmental powers, including expenditures therefor, and including the power to require the approval by any governmental agency of the filing of any petition hereunder and of any plan of readjustment, and whenever there shall exist or shall hereafter be created under the law of any State any agency of such State authorized to exercise supervision or control over the fiscal affairs of all or any political subdivisions thereof, and whenever such agency has assumed such supervision or control over any political subdivision, then no petition of such political subdivision may be received hereunder unless accompanied by the written approval of such agency, and no plan of readjustment shall be put into temporary effect or finally confirmed without the written approval of such agency of such plans.

48 Stat. 798 at 79(k).

[15] 298 U.S. 513 (1936)

[16] Article I, section 10, clause 1of the United States Constitution provides:

> No State shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility.

[17] 304 U.S. 27 (1938).

[18] *See*, Klee, *An Overview of Municipal Bankruptcy* at 8; It is worth noting that *Bekins* was decided at a time when President Franklin Roosevelt's plan to increase the number of Supreme Court justices was being debated. *See*, Shesol, *Supreme Power: Franklin Roosevelt vs. the Supreme Court* (2010).

[19] *New York v. United States*, 505 U.S. 144 (1992).

[20] *Id*. at 156.

the right to enact such legislation despite the existence of Chapter 9 of the Bankruptcy Code; the Supreme Court approved a New Jersey statute that provided for a municipal restructuring scheme in *Faitoute Iron & Steel Co. v. City of Asbury Park, N.J.*, 326 U.S. 516 (1942). In *Faitoute*, when Asbury Park was unable to repay its municipal bonds, a restructuring plan was developed by a state agency given jurisdiction over municipal defaults. The plan called for a mandatory refinancing of the bonds; the new bonds carried a reduced interest rate and their maturity was substantially extended. Objecting bondholders challenged the New Jersey law as pre-empted by the Bankruptcy Act and as an improper means of circumventing the Contracts Clause.

The Court swept aside the preemption argument: the New Jersey statute had been enacted in the interval between when the Supreme Court had invalidated Chapter IX in *Ashton* and its subsequent re-enactment as Chapter X. Moreover, the Court noted, the Bankruptcy Act had always required municipalities to obtain governmental approval to commence a bankruptcy case, and New Jersey had never authorized its municipalities to seek such relief. The Court concluded that New Jersey had demonstrated its substantial and undiminished sovereignty interests, and that Congress, in enacting Chapter X, had not intended to pre-empt state schemes such as New Jersey's.

On the Contracts Clause issue, the Court justified the New Jersey restructuring law by invoking what amounted to a necessity defense. The Court observed that in the Great Depression, many municipalities had been unable to repay their borrowings. The Court took note of the scholarly literature and observed that voluntary tax increases and judicial remedies such as mandamus had proven ineffective. Under those circumstances, the Court ruled, New Jersey had inherent sovereign power to develop a state plan to deal with municipal insolvency. The Court reasoned that the state program did not run afoul of the Contracts Clause because it was effectively involuntary: New Jersey was reacting to rectify a difficult situation, not intentionally reneging on the commitments of its municipalities.[21] While *Faitoute* is an old case, it demonstrates judicial pragmatism. The Court acknowledged that faced with a situation that was otherwise irremediable, New Jersey had to act; the Court was prepared to approve a state law that otherwise appeared to conflict with the Contracts Clause.[22]

In the Detroit case, application of the same practical approach would not augur well for constitutional challenges to Chapter 9. While AFSCME and others argue that recent case law has effectively overruled *Bekins*, none of those cases dealt with the constitutionality of Chapter 9 and the Bankruptcy Court is likely to believe that it continues to be bound by *Bekins*. The argument that Michigan could validly have enacted its own municipal bankruptcy law is also likely to be rejected. PA 436, which was enacted by the Michigan legislature to address municipal financial emergencies, rejects a state law remedy and authorizes resort to Chapter 9. Thus, the Bankruptcy Court could easily find AFSCME's argument unsupported by the facts. Finally, the judicial pragmatism of *Faitoute* and other contract impairment cases could lead the Bankruptcy Court to conclude that the choice upholding Chapter 9 – a statutory scheme that has existed in some form for 75 years – is straightforward because there is no existing state law alternative.

The City can also defend the constitutionality of Chapter 9 based on Article VI, clause 2 of the United States constitution (the ''Supremacy Clause'')'': if a state law irreconcilably conflicts with applicable federal law, state law must yield. In at least two major cases, the United States Supreme Court has upheld the Bankruptcy Code's fresh start policy when confronted with conflicting federal and state statutes.

The Supreme Court considered the interplay between the Bankruptcy Code and state law for preemption purposes in *Perez v. Campbell*.[23] In *Perez*, an uninsured motorist got into an accident that injured a passenger in another vehicle. A claim was brought and judgment was entered against the driver, who later filed a Chapter 7 case in which the claims against him, including the accident judgment, were discharged. Arizona law provided that if a judgment against an uninsured driver was not promptly satisfied, the driver's license would be suspended and would not be reinstated until the debt was paid. The law further provided that a discharge in bankruptcy did not relieve the obligation to pay the judgment. The driver brought suit to invalidate the statute and recover his driver's license and the Supreme Court held the Arizona motor vehicle law invalid on Supremacy Clause grounds.

In its analysis of the Supremacy Clause issue, the Supreme Court explained that: ''Deciding whether a state statute is in conflict with a federal statute and hence invalid under the Supremacy Clause is essentially a two-step process of first ascertaining the construction of the two statutes and then determining the constitutional question whether they are in conflict.'' [24] The Supreme Court reviewed Arizona law and determined that: ''The sole emphasis in the Act is one of providing leverage for the collection of damages from drivers who either admit that they are at fault or are adjudged negligent.''[25] The Supreme Court framed the preemption issue as whether ''a state statute that protects judgment creditors from financially irresponsible persons is in conflict with a federal statute that gives discharged debtors a new start 'unhampered by the pressure and discouragement of preexisting debt.' ''[26] In striking down the Arizona statute, the Supreme Court held that:

> Turning to the federal statute, the construction of the Bankruptcy Act is similarly clear. This Court on numerous occasions has stated that ''[o]ne of the primary purposes of the bankruptcy act'' is to give debtors ''a new opportunity in life and a clear field for future effort, un-

[21] 432 U.S. 1 (1977)

[22] Other cases have also approved state impairments of contracts in cases of exigent circumstances. See, *Subway-Surface Supervisors Ass'n v. N.Y. City Transit Auth. & State of New York* (law passed in wake of New York City fiscal emergency eliminating wage increases in collective bargaining agreement upheld against Contracts Clause challenge); *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362 (2nd Cir. 2006) (law rescinding future wage increases under collective agreements upheld against Contracts Clause challenge).

[23] *Perez v. Campbell*, 402 U.S. 637 (1971).

[24] *Id.* at 644.

[25] *Id.* at 645.

[26] *Id.* at 649.

  BBLR ISSN 1044-7474

> hampered by the pressure and discouragement of pre-existing debt.'' . . . (citations omitted).[27]

The Supreme Court showed similar regard for the fresh start principle in a conflict between the Bankruptcy Code and other federal law. In *Federal Communications Commission v. NextWave Personal Communications Inc.* (''NextWave''), the Supreme Court invalided regulations issued by the Federal Communications Commission (the ''FCC'') that provided for the cancellation of telecommunications licenses when the licensee failed to make full payment for them.[28] NextWave had been granted licenses in 1996 at an FCC auction, but had been unable to make full payment for the licenses. When it filed for Chapter 11, the FCC cancelled its licenses. NextWave argued that the FCC's actions violated Section 525(a) of the Bankruptcy Code, which prohibits governmental entities ''from revoking debtors' licenses solely for failure to pay debts dischargeable in bankruptcy.'' The FCC argued that it was not acting as a commercial creditor to collect a debt, but rather exercising its regulatory capacity in to ensure that FCC licenses were being fully utilized by licensees. In an 8-1 decision, the Supreme Court rejected the FCC's argument that section 525 did not apply because the FCC had a valid regulatory purpose in cancelling the licenses. These cases illustrate that the Supreme Court has shown a high level of sensitivity to the policy considerations underlying the Bankruptcy Code, even in light of strong countervailing governmental interests.

Finally, although it has not happened frequently, the Supreme Court has also invalidated state constitutional provisions on Supremacy Clause grounds. In *Capital Cities Cable, Inc. v. Crisp*, the Supreme Court struck down a provision of the Oklahoma constitution that barred television advertisements for sale of alcoholic beverages because it conflicted with FCC regulations.[29] The plaintiffs in *Capital Cities* were cable television system operators who retransmitted broadcasts originating outside Oklahoma that contained wine advertisements. Under the FCC's ''must-carry'' regulations, the cable operators were required to air programming from over-the-air broadcast stations located within 35 miles of cable systems, and were precluded from altering these broadcasts in any way. The record showed that it would be burdensome or perhaps impossible for the cable operators to delete the wine advertisements before they aired.[30]

In defending its constitutional provision, Oklahoma argued that under the Twenty-First Amendment to the United States Constitution, regulation of liquor sales was left to the states, and for that reason, its state interests — and not pre-emption analysis — should control. Oklahoma argued that its ban on television advertising of alcohol sales was a reasonable means of enforcing its regulatory scheme. The Supreme Court did not summarily dismiss Oklahoma's defense; it recognized the deference paid to state regulation of the sale of alcoholic beverages. But it noted that Oklahoma's ban on alcohol advertising permitted print advertisements of beer and wine sales while prohibiting television advertising. Moreover, *Capital Cities* was decided when the cable television industry was young, and the FCC was seeking to encourage its growth. To that end, the Supreme Court noted, the FCC had determined that there was a strong national interest in uniform cable television regulations, which could be undermined if individual states enacted inconsistent regulatory frameworks. The Supreme Court acknowledged the need to balance the state and federal interests, but concluded that Oklahoma's ban on televised alcohol sales had to yield in favor of the federal policy in favor of uniform cable television rules. *Capital Cities* demonstrates that although the Supreme Court remains sensitive to federalism concerns, it is also keenly mindful of the practical impact of its rulings.

Bankruptcy Court Has No Jurisdiction to Hear Constitutionality Challenge

The claim that the Bankruptcy Court lacks jurisdiction to consider the challenge to the constitutionality of Chapter 9 rests on *Stern v. Marshall* grounds.[31] The parties asserting this objection have asked the Bankruptcy Court to refer this issue to the United States District Court for the Eastern District of Michigan. In the Procedures Order, the Bankruptcy Court ruled that it would hear legal argument on the issue, which is not surprising. Courts typically hear challenges to their own jurisdiction.

The issue in *Stern* was whether the bankruptcy court could adjudicate a counterclaim brought by the estate of a bankrupt decedent against a creditor. *Stern* held that bankruptcy courts had no right to determine any legal claim ''independent of federal bankruptcy law and not necessarily resolvable by a ruling on the creditor's proof of claim in bankruptcy.'' 131 S.Ct. at 2611. While the holding in *Stern* is narrow, its reach is broad because it addresses an issue the Supreme Court and Congress have struggled with for 30 years, the extent of bankruptcy court jurisdiction. *Stern* suggests that the constitutional limitations on a bankruptcy court's jurisdiction are limited to matters where the bankruptcy courts would have ''summary'' or *in rem* jurisdiction under the Bankruptcy Act of 1898.[32] Under *Stern*, there is a strong argument that the Bankruptcy Court has no jurisdiction to hear the constitutional challenge.

The argument for the Bankruptcy Court's jurisdiction is that 28 U.S.C. § 1334(b) provides that ''the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.'' Thus, so long as the claims are ''related to'' the City's Chapter 9 case, the Bankruptcy Court may have jurisdiction. A claim is ''related to'' a bankruptcy case if the ''outcome of that [claim] could conceivably have any effect on the estate being administered in bankruptcy.'' *Lindsey v. O'Brien, Tanski, Tanzer and Young Health Care Providers of Conn. (In re Dow Corning Corp.)*, 86 F.3d 482, 489 (6th Cir. 1996) (quoting *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984)). However, even where ''related to'' jurisdiction exists, Congress granted bankruptcy judges differing authority depending on whether a claim in

[27] *Id.* at 648.

[28] *FCC v. NextWave Personal Communications, Inc.,* 537 U.S. 293 (2003).

[29] *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691 (1984)

[30] 467 U.S. at 697-702.

[31] *Stern v. Marshall*, 131 S. Ct. 2594, 563 U.S. 2 (2011)(23 BBLR 815, 6/30/11).

[32] *See*, Brubaker, *A ''Summary'' Statutory and Constitutional Theory of Bankruptcy Judges' Core Jurisdiction After Stern v. Marshall*, 86 Am. Bankr. L.J. 121 (2012).

bankruptcy is ''core'' or not. 28 U.S.C. § 157. In ''core proceedings,'' a bankruptcy judge ''may enter appropriate orders and judgments,'' subject to appellate review in the district court. Id.§ 157(b)(1). In non-core proceedings, the bankruptcy judge ''shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after. . . reviewing de novo'' the objections of either party. *Id.* § 157(c)(1). Thus, it is possible that the Bankruptcy Court will hear argument and submit proposed findings to the district court, but it seems likely that only the district court can enter a final judgment on these issues.

PA 436 Violates the Michigan Constitution; the Bankruptcy Court Lacks Jurisdiction to Hear the Challenge

The PA 436 constitutionality objections argue that PA 436 violates the Michigan Constitution because it replaces Detroit's elected Mayor and City Council with the Emergency Manager appointed by Governor Snyder. Michigan is a strong ''home rule'' state, in which cities or elected officials have broad powers. Article VII of the Michigan Constitution enumerates the powers of those elected officials, including budgets, incurring debt, and providing services.[33] The argument against the constitutionality of PA 436 is that it displaces that constitutional framework by vesting in the Emergency Manager the authority granted by the constitution to elected officials, depriving the citizens of Detroit of the right of self-government.

Prior to the commencement of the City's Chapter 9 case, certain unions (including AFSCME), retirees and current employees of the City (collectively, the ''Litigants'') commenced lawsuits against the Emergency Manager, the Governor, and the Michigan state treasurer in state court challenging the City's Chapter 9 petition and the constitutionality of PA 436. The Litigants sought orders from the state court (the ''State Court'') enjoining the Governor and the Emergency Manager from authorizing a chapter 9 filing and ''taking any further action with respect to any filing which has already occurred.'' The Litigants also sought to enjoin any actions that might impair vested pension benefits. Some of the Litigants also sought a declaratory judgment that PA 436 violated the Michigan constitution to the extent that it purported to authorize a Chapter 9 case in which vested pension benefits could be modified or impaired.

On the day that the City filed its Chapter 9 petition, the State Court entered the temporary restraining orders sought by the Litigants. The State Court enjoined the defendants from filing a ''plan of adjustment or any other filing'' that might adversely affect pension benefits in a Chapter 9 case. The State Court also entered a declaratory judgment (i) finding that PA 436 is unconstitutional to the extent that it permitted the Governor to proceed under Chapter 9 in a manner that impairs pension benefits, and (ii) ordering the Governor to direct the Emergency Manager to ''immediately withdraw the chapter 9 petition.''

In response, the City filed motions in the Bankruptcy Court seeking confirmation of the automatic stay and seeking to extend the automatic stay to the Emergency Manager and certain City and State officials (the ''Stay Motions''). Various parties objected to the Stay Motions, arguing that (i) the Bankruptcy Court could not decide the Stay Motions until a state court determined that the City was authorized to file under Michigan law, (ii) any determination by the Bankruptcy Court on the constitutionality of the City's petition would violate the Tenth Amendment, (iii) the Stay Motions were procedurally deficient, and (iv) the City could not use section 105(a) to create rights that did not otherwise exist under the Bankruptcy Code. On July 24, 2013, the Bankruptcy Court approved the Stay Motions, stopping the state law challenge.[34]

The argument that the Bankruptcy Court lacks jurisdiction to determine the state law constitutionality of PA 436 proceeds from the same *Stern* base: under *Stern*, such jurisdiction not encompassed by the Bankruptcy Court's power to determine claims in and against a bankrupt debtor. The disposition of this issue is likely to be resolved together with the question of whether the Bankruptcy Court has jurisdiction to hear the federal constitutionality challenge to Chapter 9.

Whether PA 436 Is Invalid Because It Fails to Protect Pensions Protected Under Michigan Law

Several parties argued that the City's reliance on PA 436's authorization was invalid to the extent that PA 436 expressly failed to protect accrued pension benefits in accordance with Article IX, Chapter 24 of the Michigan Constitution. The argument proceeds from the premise that the City intends to reduce both accrued and future pension and OPEB benefits.[35] These objectors argue that because Michigan law protects accrued pension benefits,[36] Governor Snyder should have expressly limited the City's authorization to seek Chapter 9 by requiring that it not seek to impair protected pension benefits. Section 18 of PA 436 allows the Governor to place limitations on a municipality's utilization of Chapter 9; because he did not do so, they argue, the authorization is invalid. In the alternative, they argue, the Bankruptcy Court should rule that the City is eligible for Chapter 9 relief only if it complies with this limitation. In the Procedures Order, the Bankruptcy Court recognized the importance of pension and OPEB benefits in this case, but it ruled that it would not issue an advisory opinion on the treatment of pensions. While these objections clearly raise legal issues about the interpretation of PA 436, the Bankruptcy Court could still determine that it will defer this issue until it is presented with an actual controversy regarding the treatment of accrued pensions protected by Article IX, Chapter 24 of the Michigan Constitution.

Conclusion

The City's Chapter 9 case combines large and difficult financial and political problems with complex legal issues, all set against a background of limited prec-

[33] See, Michigan Constitution, Art. VII.

[34] Order Pursuant to Section 105(a) of the Bankruptcy Code Extending the Chapter 9 Stay to Certain (A) State Entities, (B) Non Officer Employees and (C) Agents and Representatives of the Debtor, Docket 166.

[35] *See,* note 2, supra.

[36] *See*, *Seitz v. Probate Judges Retirement System*, 189 Mich. App. 445, 474 N.W.2d 125 (1991); *APTE v. Detroit*, 154 Mich. App. 440, 398 N.W.2d 436 (1986).

  BBLR ISSN 1044-7474

edent. Battle had been fully joined over many of these problems before the City commenced its Chapter 9 case on July 18, 2013. The dispute over eligibility demonstrates that the opponents to using Chapter 9 are prepared to fight over every issue on the battlefield. The size of the stakes and the novel legal questions ensure that the rulings of the Bankruptcy Court are unlikely to be the last word on many of these issues. It therefore seems highly likely that the City's case will set landmark precedents on many Chapter 9 issues.