



PENSIONS AND MUNICIPAL BANKRUPTCY – Important Concepts and Issues For Public Pension Attorneys (Plus the Detroit Perspective)

**National Association of Public Pension
Attorneys (NAPPA) Conference**

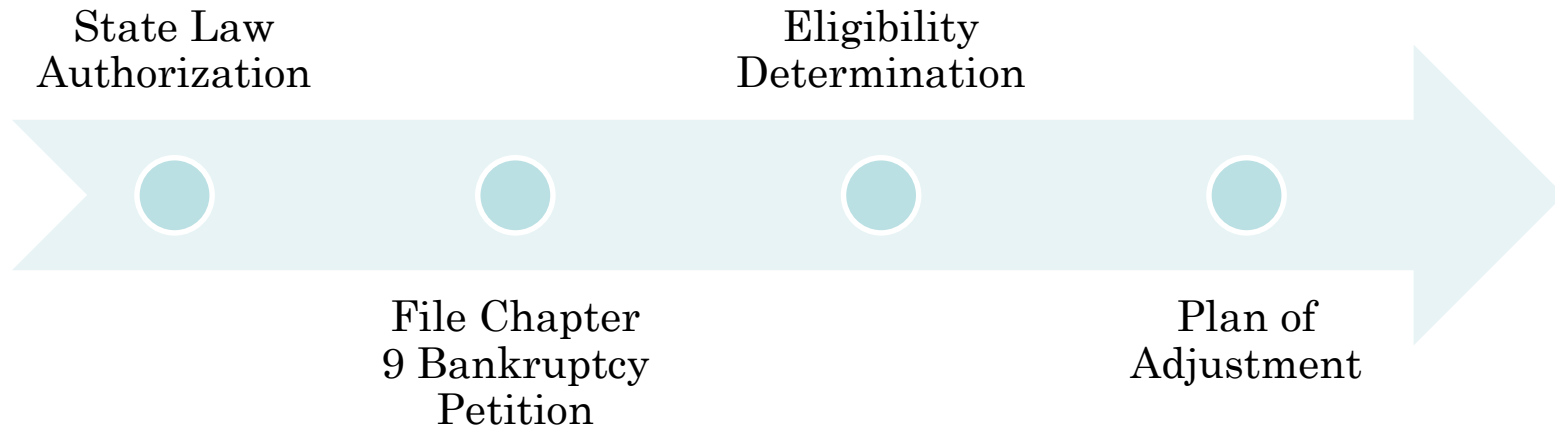
**June 26, 2015
Austin, Texas**

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CLARK HILL

I. The Chapter 9 Municipal Bankruptcy Process



II. Eligibility Requirements

To be eligible to be a debtor under Chapter 9 an entity must:

- 1) Be a municipality;**
- 2) Be specifically authorized to be a debtor by State law;**
- 3) Be insolvent;**
- 4) Desire to effect a plan to adjust its debts; and,**
- 5) (A) obtain the agreement of creditors holding at least a majority in amount of claims in each class the entity intend to impair; or
(B) have negotiated in good faith with creditors and failed to reach an agreement; or
(C) be unable to negotiate with creditors because negotiations are impracticable; or
(D) reasonably believe that a creditor may attempt to obtain an avoidable transfer.**

III. Authorization

States with Statutes Authorizing Chapter 9 Filing (Some Impose Conditions)

- Alabama
- Arizona
- Arkansas
- California
- Colorado
- Connecticut
- Florida
- Idaho
- Illinois
- Iowa

- Kentucky
- Louisiana
- Michigan
- Minnesota
- Missouri
- Montana
- Nebraska
- New Jersey
- New York

- North Carolina
- Ohio
- Oklahoma
- Oregon
- Pennsylvania
- Rhode Island
- South Carolina
- Texas
- Washington

III. Authorization (cont'd)

States with No Authorizing Statute or with Statute Prohibiting Filing

- Alaska
- Delaware
- District of Columbia
- Georgia (Prohibited)
- Hawaii
- Indiana
- Kansas
- Maine

- Maryland
- Massachusetts
- Mississippi
- Nevada
- New Hampshire
- New Mexico
- North Dakota
- South Dakota

- Tennessee
- Utah
- Vermont
- Virginia
- West Virginia
- Wisconsin
- Wyoming

IV. The Contracts Clause and Chapter 9 Bankruptcy

- **Federal and State Contracts Clauses prohibit a State’s legislature from passing laws “impairing the obligation of contract.”**
- **However, this prohibition is not absolute and must be “accommodated to the inherent police power of the State ‘to safeguard the vital interest of its people.’”** *Romein v. General Motors Corp.*, 462 N.W.2d 555, 565 (Mich. 1990) (quoting *Energy Reserves Group v. Kansas Power & Light*, 459 US. 400, 410 (1983)). **Accordingly, the Contracts Clause is subject to the State’s “essential reserve power” and “[t]he necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city’s debt is implied in every such obligation.”** *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502, 511 (1942).
- **As a result, the Contracts Clause does not bar a State from exercising such police or reserve power in appropriate circumstances to consent to submit a State subdivision to the jurisdiction of the Bankruptcy Court to impair contracts. See, e.g., *United States v. Bekins*, 304 U.S. 27 (1938).**

V. Collective Bargaining Agreements in Chapter 9

- **Section 1113 of the Bankruptcy Code, which governs the rejection of collective bargaining agreements, was not incorporated into Chapter 9.**
- **Section 365 of the Bankruptcy Code, which governs the rejection of executory contracts generally, was incorporated into Chapter 9.**
 - A chapter 9 debtor may reject collective bargaining agreements under section 365 of the Bankruptcy Code and federal law preempts state labor law. *See IBEW, Local 2376 v. City of Vallejo (In re City of Vallejo)*, 432 B.R. 262 (E.D. Cal. 2010) (affirming *In re City of Vallejo*, 403 B.R. 72 (Bankr. E.D. Cal. 2009)).
 - Less stringent procedural requirements must be satisfied to reject collective bargaining agreements under section 365, which standards were articulated by the United States Supreme Court in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984).



VI. City of Detroit, Michigan

- **Filed Chapter 9 on July 18, 2013.**
- **Eligibility. The Retirement Systems argued, among other things, that the protection of accrued pension benefits under the Pensions Clause of Michigan’s Constitution could not be abrogated in a Chapter 9 bankruptcy.**
 - **Article IX, Section 24 of the Michigan Constitution provides:**

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.

Financial benefits, annual funding. Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities.



VI. City of Detroit, Michigan (cont'd)

- **After a 9-day trial, Detroit determined eligible to be a Chapter 9 debtor. Eligibility Opinion issued December 5, 2013. Equated the Pensions Clause with the Contracts Clause, which does not bar the State from authorizing a bankruptcy.**
- **The Detroit Retirement Systems and others appealed the eligibility determination and requested direct certification to the Sixth Circuit Court of Appeals, which was granted. The appeals were dismissed in connection with the confirmed Plan of Adjustment.**

VI. City of Detroit, Michigan (cont'd)

- **Mediation.** Numerous, intensive sessions between the City, the Retirement Systems, the Retiree Committee, the unions, and various financial creditors, as well as the State.
 - **The “Grand Bargain”.** Charitable foundations, the Detroit Institute of Arts, and the State of Michigan agree to contribute an aggregate of approximately \$816 Million over 20 years to support accrued pension benefits and preserve the art collection of the DIA. The proposal contains conditions, including the release of litigation claims against the City and State.
 - **Settlements with Unlimited Tax General Obligation and Limited Tax General Obligation bondholders.**
 - **Settlements with COPs holders and COPs insurers.**



VI. City of Detroit, Michigan (cont'd)

- **Settlement Terms – Police and Fire Retirement System Pension Claims**
 - Allowed in an aggregate amount of \$1,250,000,000.
 - From Effective Date through June 30, 2023 contributions to fund accrued pension benefits shall be made exclusively from DIA Proceeds and portion of State Contribution.
 - After June 30, 2023, additional DIA Proceeds shall be contributed, and the City shall contribute amounts necessary to pay adjusted pension benefits at the levels set forth in the Plan.
 - Investment Return Assumption set at 6.75% through June 30, 2023.
 - Provisions for restoration of cut benefits (both variable and permanent restoration).
 - Creation of Investment Committee for each Retirement System.
 - Hard freeze of existing PFRS Pension Plan.
 - For service on or after July 1, 2014, active employees receive, in addition to PFRS Adjusted Pension Amount, additional pension benefits consistent with New PFRS Active Pension Plan Formula and New PFRS Active Pension Plan.



VI. City of Detroit, Michigan (cont'd)

- **Settlement Terms – Police and Fire Retirement System Pension Claims**
 - If Holders of PFRS Pension Claims (Class 10) and Holders of GRS Pension Claims (Class 11) accept the Plan (which they did) and if DIA Proceeds and State Contribution are made (which they were), Holders of PFRS Pension Claims receive 100% of current pension and 45% of future COLAs.
 - If Class 10 or Class 11 had rejected the Plan, Holders of PFRS Pension Claims would receive 100% of current annual pension and no future COLAs.



VI. City of Detroit, Michigan (cont'd)

- **Settlement Terms – General Retirement System Pension Claims**
 - Allowed in an aggregate amount of \$1,879,000,000.
 - From Effective Date through June 30, 2023 contributions to fund accrued pension benefits shall be made primarily from DWSD in the approximate amount of \$428.5 million, a portion of DIA Proceeds, and a portion of State Contribution.
 - After June 30, 2023, additional DIA Proceeds shall be contributed, and the City shall contribute amounts necessary to pay adjusted pension benefits at the levels set forth in the Plan.
 - Investment Return Assumption shall be set at 6.75% through June 30, 2023.
 - Provisions for restoration of cut benefits (both variable and permanent restoration).
 - Creation of Investment Committee for each Retirement System.
 - Hard freeze of existing GRS Pension Plan.
 - For service on or after July 1, 2014, active employees receive, in addition to GRS Adjusted Pension Amount, additional pension benefits consistent with New GRS Active Pension Plan Formula and New GRS Active Pension Plan.



VI. City of Detroit, Michigan (cont'd)

- **Settlement Terms – General Retirement System Pension Claims**
 - If Holders of PFRS Pension Claims (Class 10) and Holders of GRS Pension Claims (Class 11) accept the Plan (which they did) and if DIA Proceeds and State Contribution are made (which they were), Holders of GRS Pension Claims receive 95.5% of current pension and no future COLAs and are subject to Annuity Savings Fund Recoupment.
 - If Class 10 or Class 11 had rejected the Plan, Holders of GRS Pension Claims would receive 73% of current pension and no future COLAs and be subject to Annuity Savings Fund Recoupment.



VI. City of Detroit, Michigan (cont'd)

- **Settlement Terms – OPEB Claims**

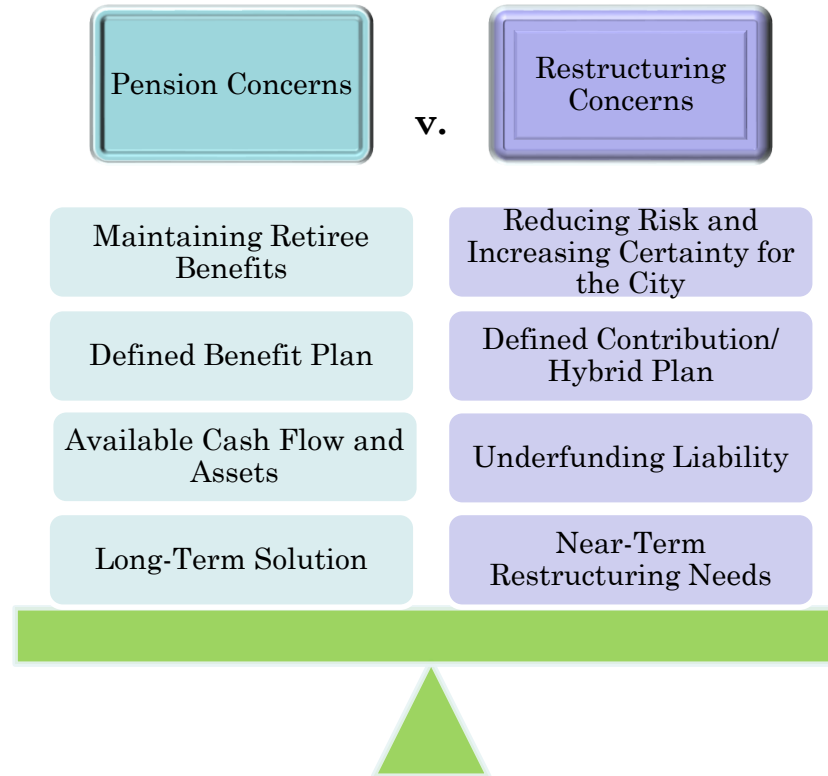
- Allowed in the aggregate amount of \$4,303,000,000.
- On or as soon as practicable after the Effective Date, the City will establish the Detroit General VEBA to provide health benefits to Detroit General VEBA Beneficiaries and certain of their dependents.
- On or as soon as practicable after the Effective Date, the City will establish the Detroit Police and Fire VEBA to provide health benefits to Detroit Police and Fire VEBA beneficiaries and certain of their dependents.
- Both VEBAs will be governed by a seven-member board of trustees.



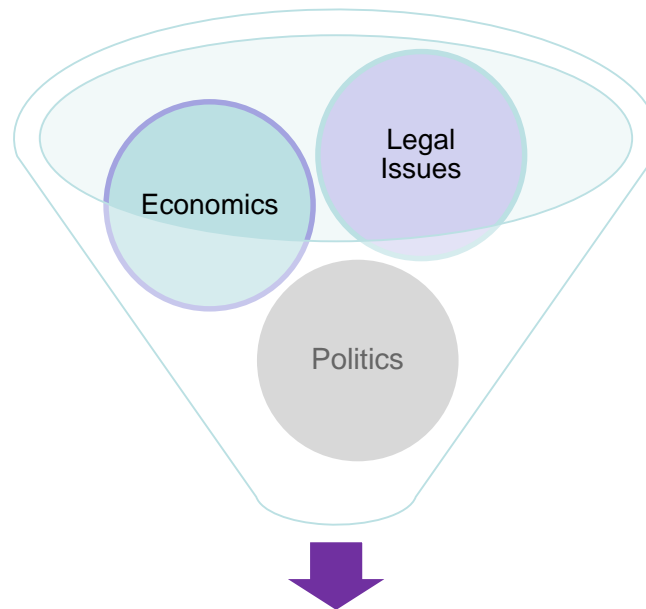
VI. City of Detroit, Michigan (cont'd)

- **Settlement Terms – OPEB Claims, Cont'd.**
 - On the Effective Date, the City will distribute to the Detroit General VEBA New B Notes in the aggregate principal amount of \$218,000,000 in satisfaction of Allowed OPEB Claims held by Detroit General VEBA Beneficiaries.
 - On the Effective Date, the City will distribute to the Detroit Police and Fire VEBA New B Notes in the aggregate principal amount of \$232,000,000 in satisfaction of Allowed OPEB Claims held by Detroit Police and Fire VEBA Beneficiaries.
 - Both VEBAs shall be entitled to contingent additional distributions from the Disputed COP Claims Reserve as set forth in the Plan.
 - Class 12 (OPEB Claims) also voted to accept the Plan.

VII. Balancing Competing Considerations in Negotiations



VIII. In the Chapter 9 Context, Different Outcomes May Turn On:



Different Results: Vallejo; Central Falls; Detroit; Stockton and San Bernardino

IX. What to Do at the First Signs of Trouble



X. Hire the Right Professionals

Attorneys

- Experience with municipal bankruptcy and financial restructuring, retirement benefits, municipal finance, governmental relations, and litigation
- Select counsel capable of both facilitating discussions at the negotiation tables and protecting your interests in the courtroom

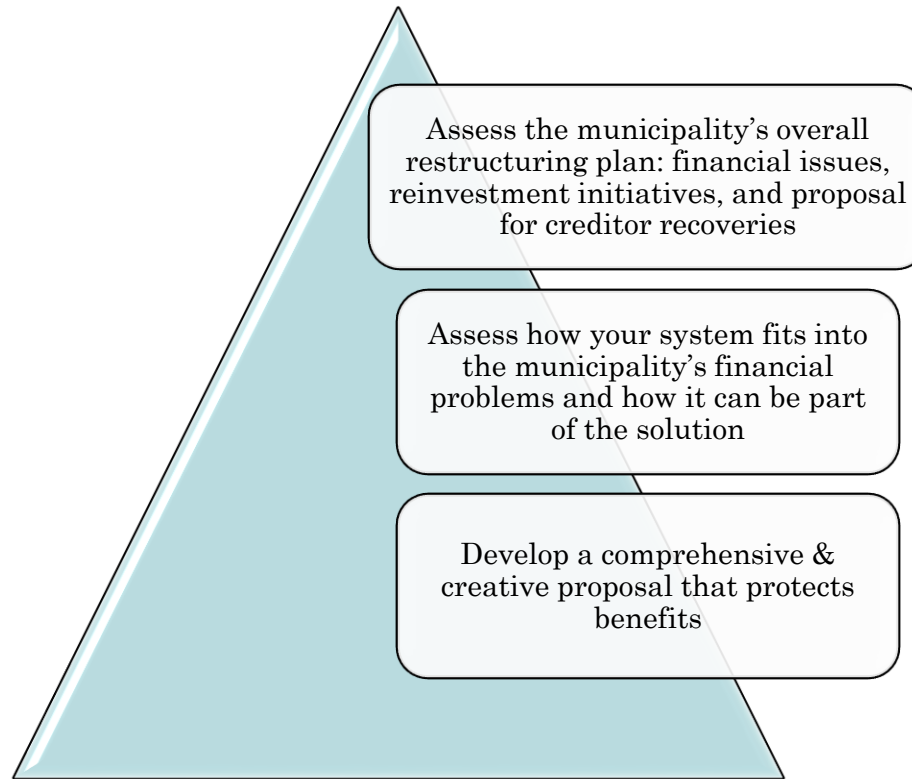
Financial Professionals

- Actuaries that understand your system and that can assist in developing creative plan re-design
- Financial Advisors to assist in understanding the municipality's financial situation and developing alternative restructuring strategies

Public Relations/ Lobbyists

- Proactive vs. Reactive
- Court of Public Opinion vs. Court of Law – Choose Wisely
- Not a normal environment; consider specifically crisis-communications experts
- Legislative initiatives may be necessary

XI. Understand the Overall Restructuring Plan



XII. Outlook for Future Municipal Bankruptcies



More Bankruptcy Filings?

- Increasing municipal liabilities (particularly OPEB) coupled with stagnant or decreasing revenues
- Stigma washes away as more cases are filed
- Rapidly developing Chapter 9 case law leads to greater certainty of outcome



Less Bankruptcy Filings?

- Fear of Inability to Obtain Future Municipal Financing
- Expenses Associated with Chapter 9 Bankruptcy
- Certainty and/or Uncertainty of Outcome May Encourage Out-of-Court Solutions

