

BANKRUPTCY UPDATE

Expert Analysis

City of Detroit Moves Ahead On Reorganization Plan

This article focuses on the City of Detroit's bankruptcy proceeding as it moves closer to trial on confirmation of its \$18 billion reorganization plan.

The City of Detroit sought bankruptcy protection under Chapter 9 of the Bankruptcy Code on July 18, 2013. It made history as the largest municipality to seek bankruptcy protection to date. *City of Detroit, Mich.* (Bankr. E.D. Mich. Case No. 13-53846)

As discussed in prior columns, Chapter 9 of the Bankruptcy Code establishes a procedure for voluntary bankruptcy proceedings by municipalities. While similar to Chapter 11 proceedings in many ways, Chapter 9 imposes a requirement that the municipality negotiate with creditors prior to the commencement of a Chapter 9 proceeding. From the outset, Detroit encountered staggering opposition to its eligibility to commence a Chapter 9 bankruptcy case from in excess of 100 parties in interest, including unions and retirees.

Subsequently, in December 2013 the bankruptcy court ruled that Detroit was eligible for Chapter 9 relief, despite vehement opposition from city workers and retirees who believed that they would be forced

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to make the largest concessions in the bankruptcy proceeding. While the court noted that the city did not negotiate in good faith with its creditors, it nevertheless reasoned that engaging in good faith negotiations prior to filing was not feasible in light of the multitude of parties involved.

In the months that followed this landmark decision, Detroit engaged in discussions with its various creditor constituencies and worked to develop its plan of reorganization. To that end, Detroit recently reached an \$85 million settlement with UBS AG and Merrill Lynch Capital Services with respect to its \$286 million interest-rate swap liabilities. The settlement allowed the city to gain access to critical casino revenues on which UBS and Merrill Lynch had liens.

On May 5, 2014, Detroit obtained court approval of its disclosure statement explaining the debtor's plan of reorganization. Detroit's original filed plan of reorganization included, among other things, proposed agreements with police unions and benefits plans, a plan to establish an

independent water and sewer system with half the proceeds earmarked for restoration of pension cuts, and the establishment of two trusts to manage employee health care.

Through the summer, Detroit worked to gain additional plan support from its numerous creditor constituencies and filed several amended versions of its plan of reorganization as those negotiations evolved. Detroit garnered the support of unions and pension funds which agreed to slight benefit reductions. As a result, supermajorities of police and firefighters voted to accept the plan.

On the other hand, most bondholders and insurers vehemently opposed the plan. Syncora Holdings Ltd., the city's monoline insurer (insurance company that provides guarantees to bondholders or issuers), has strenuously objected to the plan and numerous related settlements. In addition, 96 percent of limited tax general obligation bondholders and 54 percent of other general unsecured creditors voted to reject the plan.

In late July, Detroit filed its fifth amended plan which memorialized the city's settlements with certain bondholder and retiree groups. The amended plan also provided for the appointment of an independent plan monitor. The independent plan monitor would be charged with enforcing compliance with plan provisions and quarterly reporting to the bankruptcy court, and would enjoy immunity

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and subpoena power.

The proposed independent plan monitor would work together with a seven-person committee mandated by the Michigan Legislature as part of its \$195 million state aid package. Inclusive of the state aid package, Detroit projected that it must raise \$816 million from public and private sources to avoid selling its art collection, valued between \$800 million and \$8 billion according to different appraisals. Numerous financial creditors pressed for the sale of this valuable art collection to fund plan payments to creditors.

At the same time, longtime plan opponent Ambac Assurance Corp. filed court documents officially changing its rejection vote to acceptance after it reached a settlement with the debtor regarding the treatment of its claim on account of limited-tax general obligation bonds. Under the settlement, Ambac is projected to recover at least 34 percent of its \$92 million claim.

Mediation

The revised plan was largely the product of ongoing mediation proceedings authorized by the bankruptcy court at the outset of the case. Plan mediation has become increasingly prevalent in complex bankruptcy proceedings as a way to reach consensus on plan terms among parties with diverging interests. Mediation can be tailored to the needs of a particular case and focus on discrete and narrow issues or it could involve broader efforts to reach global settlement on many issues.

Judge Gerald E. Rosen, U.S. District Court Judge for the Eastern District of Michigan, was appointed to oversee a panel of mediators, each focusing on a subset of issues in the case. The mediation covered a wide range of disputes including labor, pension and other benefit issues, debt and swap treatment and municipal finance issues and is largely credited for developing the "Grand Bargain"

as Detroit's plan is often called.

As part of its supplemental objection to confirmation of the debtor's plan, Syncora recently filed pleadings with the bankruptcy court accusing two of the mediators, Judge Rosen and Eugene Driker of allowing biases to affect the plan mediation. The filing focused on plan provisions that require raising funds in the amount of \$816 million to avoid additional benefit cuts to city workers and to avoid selling the city's rare art collection at the Detroit Institute of the Arts.

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Syncora criticized the compromise as inappropriately favoring pensioners and the Detroit Institute of the Arts at the expense of other creditors and posited that Rosen's loyalty to city workers and Driker's wife's position at the Detroit Institute of the Arts created improper conflicts of interest.

Detroit retorted that Syncora's filing contained a multitude of falsehoods; it sought sanctions against Syncora. Detroit countered Syncora's accusation that Driker failed to disclose a potential conflict of interest due to his wife's position with the Detroit Institute of the Arts by pointing to a year-old email to Syncora's counsel containing the disclosure.

Trial on Confirmation

A trial on confirmation of Detroit's reorganization plan is scheduled to begin on Sept. 2, 2014. The standard for plan confirmation in a chapter 9 bankruptcy proceeding incorporates significant portions of section 1129 of the Bankruptcy Code (which sets forth requirements for confirmation of chapter 11 cases) including the

"cramdown" provision of section 1129(b) of the Bankruptcy Code. Under section 1129(b), if at least one impaired class of creditors (receiving less than full payment) consents to the plan, plan confirmation may be achieved over the objection of other classes of creditors.

In order to exercise the power to cramdown, the debtor must establish that the plan is (i) fair and equitable and (ii) does not discriminate unfairly against any class of creditors the plan is proposing to impair. A plan is fair and equitable with respect to a dissenting impaired class of creditors if holders of claims junior to such class do not receive or retain anything under the plan.

Syncora and Financial Guaranty Insurance Co., among others, argued that the plan cannot meet the cramdown requirements as it treats their claims unfairly by requiring financial creditors to bear the primary cost of the balance-sheet restructuring. To that end, Syncora argued that the plan unfairly discriminated against Syncora and other unsecured claims by treating such classes of claims worse than pension claim holders, which claims sit *pari passu* with respect to the debtor.

Detroit's landmark chapter 9 case addressed a multitude of public and private concerns and shared many features with other complex bankruptcy proceedings under chapter 11. Like its private counterparts, Detroit engaged in months of negotiations with its creditors, taking advantage of the increasingly popular plan mediation and narrowed down the contested issues for its upcoming confirmation trial.