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Detroit's Bankruptcy and Market Reentry

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DETROIT’S BANKRUPTCY AND MARKET REENTRY

*James L. Tatum III**

ABSTRACT

In 2018, four years after the Motor City went bankrupt, Detroit reentered the municipal securities market and issued new debt. The bond offer is both indicative of the city’s financial turnaround and is counter to the theory that bankrupted municipalities will be punished by markets with prohibitively expensive interest rates post-bankruptcy. This Article examines chapter 9 of the Bankruptcy Code, and the ramifications for bankrupted municipalities as they reenter the municipal securities market.

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INTRODUCTION

On December 4, 2018, Detroit increased its initial offer of \$111 million in general obligation bonds to \$135 million.¹ The initial offer was oversubscribed.² In other words, there was more demand for the bankrupted city's debt than there was debt to offer.³ The City was able to increase the amount of debt offered and decrease the interest rate from the initial offer.⁴ Predominant views on chapter 9 of the Code posited that the City should have been shunned from the marketplace.⁵ Not only should the City have paid a market penalty—an exorbitant rate of interest—when it reentered the market, it should not have been able to reenter so quickly.⁶ The City issued new debt at terms comparable to other insolvent (yet not bankrupted) municipalities,⁷ which is an invitation for further analysis. This Article takes up that invitation to examine Detroit's case and to provide investors, citizens and elected officials information on municipal bankruptcy.

For the purposes of this Article, it is important to elaborate on the obstacles to analyzing municipal bankruptcy. One, municipal default—failure by the debtor to pay principal or interest—is rare.⁸ Two, of the small number of municipalities that default on their debts, an even smaller number petition a bankruptcy court for debt adjustment under chapter 9 of the Code.⁹ Moreover, petitions do not always result in a case. Boise County, Idaho had its petition

¹ Karen Pierog, *Post-Bankruptcy Detroit Returns to Hungry Muni Bond Market*, REUTERS (Dec. 4, 2018), <https://www.reuters.com/article/us-detroit-bonds/post-bankruptcy-detroit-returns-to-yield-hungry-muni-bond-market-idUSKBN1O400Z>.

² See Gunjan Banerji, *Detroit Sees Big Demand in Muni Market Return*, WALL ST. J. (Dec. 4, 2018, 5:40 PM), <https://www.wsj.com/articles/how-forgiving-is-the-muni-market-detroit-will-find-out-1543886307>.

³ *Id.*

⁴ *Id.*

⁵ See generally LEON R. BARSON, ET AL., CHAPTER 9 BANKRUPTCY STRATEGIES: LEADING LAWYERS ON NAVIGATING THE CHAPTER 9 FILING PROCESS, COUNSELING MUNICIPALITIES, AND ANALYZING RECENT TRENDS AND CASES 11 (INSIDE THE MINDS) (Jo Alice Darden ed., 2011) (“Municipalities that seek bankruptcy relief should expect a negative effect on their credit ratings, at least for a period.”).

⁶ See *id.*

⁷ See BD. OF EDUC. OF THE CITY OF CHI., UNLIMITED TAX GENERAL OBLIGATION BONDS, SERIES 2018C, 2018D (2018), <https://emma.msrb.org/ES1222772-ES954787-ES1355739.pdf>.

⁸ See John E. Petersen, *Municipal Defaults: Eighty Years Make a Big Difference*, 34 MUN. FIN. J. 27, 45 (2013).

⁹ David A. Skeel, Jr., *Is Bankruptcy the Answer for Troubled Cities and States?*, 50 HOUS. L. REV. 1063, 1080–84 (2013).

rejected by the Bankruptcy Court in 2011.¹⁰ Harrisburg, Pennsylvania was ordered to rescind its petition by Governor Tom Corbett that same year.¹¹

Even the word “municipality” must be analyzed to fully illustrate the difficulty inherent in any analysis of municipal bankruptcy. “Municipality” describes all manner of creatures—counties, cities, towns, and special districts like school districts, water and sewer districts, public utilities and development authorities.¹² Special districts represent the majority of municipal bankruptcies.¹³ However, those municipal units are not the focus of this analysis and have not been the focus of market analysts or bankruptcy experts in their commentaries on the impact of chapter 9 on creditworthiness.¹⁴

Detroit’s case was chosen for analysis for three reasons. One, the City filed for bankruptcy.¹⁵ Two, pre-bankruptcy, the City was financially and economically distressed.¹⁶ Three, the City issued new debt within a few years post-bankruptcy.¹⁷

Once more, there is insufficient data to use statistical analyses to evaluate theories related to municipal bankruptcy because municipal default and bankruptcy are rare occurrences. In lieu of statistical analyses, limited theories and information can be derived from the limited number of cases in existence. Despite these limitations, cases such as Detroit’s bankruptcy offer an opportunity to better understand chapter 9 of the Code.

This Article will proceed in seven parts. Part One is an overview of the municipal securities market. Part Two chronicles Detroit’s financial distress and

¹⁰ See ROBERT S. AMDURSKY, CLAYTON P. GILLETTE & G. ALLEN BASS, *MUNICIPAL DEBT FINANCE LAW: THEORY AND PRACTICE* 429 (2d ed. 2013) (discussing *In re Boise County*, 465 B.R. 156 (Bankr. D. Idaho 2011)).

¹¹ See Sabrina Tavernise, *Governor Moves to Take Fiscal Control of Pennsylvania’s Capital*, N.Y. TIMES (Oct. 20, 2011), <https://www.nytimes.com/2011/10/21/us/governor-corbett-of-pennsylvania-moves-to-take-control-of-harrisburg.html>.

¹² Fred L. Morrison, *The Insolvency of Public Entities in the United States*, 50 AM. J. COMP. L. Supp. 567, 567–68 (2002).

¹³ AMDURSKY, GILLETTE & BASS, *supra* note 10, at 417 (“For the most part, recent defaults have occurred as a function of idiosyncratic events or financial failures in special districts rather than as a result of systemic problems that affect a broad category of general purpose municipalities.”).

¹⁴ See John F. Wasik, *In Uncertain Times, Municipal Bonds Call for Caution*, N.Y. TIMES (Oct. 18, 2011), <https://www.nytimes.com/2011/10/19/business/buying-municipal-bonds-calls-for-caution.html>.

¹⁵ Monica Davey & Mary Williams Walsh, *Billions in Debt, Detroit Tumbles into Insolvency*, N.Y. TIMES (July 1, 2013), <https://www.nytimes.com/2013/07/19/us/detroit-files-for-bankruptcy.html>.

¹⁶ See generally THOMAS J. SUGRUE, *THE ORIGINS OF THE URBAN CRISIS: RACE AND INEQUALITY IN POSTWAR DETROIT* (1996) (describing the narrative of Detroit’s decline as a city).

¹⁷ Quinn Klinefelter, *Detroit’s Big Comeback: Out of Bankruptcy, a Rebirth*, NPR (Dec. 28, 2018, 7:24 AM), <https://www.npr.org/2018/12/28/680629749/out-of-bankruptcy-detroit-reaches-financial-milestone>.

economic decline. Part Three intersperses details from Detroit's case with a history of municipal bankruptcy and a review of its form and function. Part Four briefly discusses the City's financial turnaround and the theory that bankruptcy provides a "fresh start." Part Five details the City's offer of new debt. Part Six provides an overview of the market conditions—or economic environment in which the City made its offer. Part Seven evaluates the theory that bankrupted municipalities will face stiff market penalties upon reentry.

I. MUNICIPAL SECURITIES MARKET

States and municipalities levy taxes on the incomes, property and purchases of the citizens within their boundaries.¹⁸ The resources from those levies are expended for services like police and fire safety, parks and recreation, and trash removal.¹⁹ However, demands for safe and reliable infrastructure—roads, water and sewer systems, and other capital projects—often exceed annual tax collections.²⁰ In an alternative to tax collection, states and municipalities issue bonds.²¹ A bond is a debt instrument that represents a liability on the part of the bond's issuer or debtor and an asset on the part of the bond's purchaser or creditor.²² Bonds can be structured in many ways.²³ The bond's indenture or contract will specify the amount borrowed (principal), cost to borrow (interest rate), method of repayment (security interest) and when the borrowed money must be repaid (maturity date).²⁴

For municipal bonds, the debt instruments are typically structured either as general obligation bonds ("general obligations") or revenue bonds ("special obligations").²⁵ The main difference between the two is the method of repayment.²⁶ General obligations are supported by the borrower's "full faith and credit."²⁷ In layman's terms, full faith and credit means the borrower's power to

¹⁸ See generally BYRON LUTZ, RAVEN MOLLOY & HUI SHAN, *THE HOUSING CRISIS AND STATE AND LOCAL GOVERNMENT TAX REVENUE: FIVE CHANNELS* 1, 1–2 (2010), <https://www.federalreserve.gov/pubs/feds/2010/201049/201049pap.pdf> (describing the ways municipalities can supplement tax revenues).

¹⁹ See Morrison, *supra* note 12, at 567–70.

²⁰ See Morrison, *supra* note 12, at 569.

²¹ See DAVID SCOTT, *INVESTING IN BONDS* 52 (2004).

²² *Id.* at 1.

²³ See generally Robert Doty, *Diversity and Default Risks of Municipal Bonds*, 34 *MUN. FIN. J.* 55, 59 n. 11 (2013) (describing what can be included under the term "general obligation bond").

²⁴ SCOTT, *supra* note 21, at 5–7.

²⁵ Morrison, *supra* note 12, at 569–71.

²⁶ See Morrison, *supra* note 12, at 569–71.

²⁷ See David M. Eisenberg, Note, *Creditors' Remedies in Municipal Default*, 1976 *DUKE L.J.* 1363, 1373 (1976).

levy taxes.²⁸ Because tax payments are compulsory and the power to tax is in some ways inexhaustible, general obligations are viewed as safe assets (at low risk for default).²⁹ Revenue bonds are riskier, however: municipal units that operate in a business-like manner—a municipal airport, water and sewer district, or port authority—use revenue bonds to raise money for capital projects. The revenues from proprietary activities are the method of repayment, hence the name “revenue bonds”.³⁰ Unlike the near inexhaustible power to tax, public projects sometimes fail.³¹ If revenues from the public project are insufficient to service debt, creditors have no recourse and cannot compel the debtor to pay them with other resources.³² In any case, even the riskier special obligations are safe assets relative to corporate bonds issued by private companies.³³

In total, the market for those debt instruments—municipal securities market—was measured at \$3.8 trillion in 2018.³⁴ That market also includes financial derivatives.³⁵ These are the complex instruments—options, swaps and futures—that came to the public’s attention in the midst of the Wall Street crash of 2007.³⁶ Such instruments also had a role in both Detroit’s bankruptcy in 2013, and the bankruptcy of Jefferson County, Alabama in 2011.³⁷ However, those securities have a much smaller role in the municipal securities market compared to traditional bonds.³⁸

Investors in the municipal securities market often desire to purchase safe and secure assets with a tax preference. The tax preference comes in the form of accrued interest paid out to owners of municipal bonds and is mostly exempt from federal income tax.³⁹ Vanguard, the mutual fund and financial advisory firm, for example, offers thirteen investment funds that exclusively invest in

²⁸ Morrison, *supra* note 12, at 569–71.

²⁹ See Morrison, *supra* note 12, at 569–70.

³⁰ See Morrison, *supra* note 12, at 570.

³¹ See Morrison, *supra* note 12, at 571.

³² David A. Skeel, Jr., *What Is a Lien? Lessons from Municipal Bankruptcy*, 2015 U. ILL. L. REV. 675, 684–85 (2015).

³³ See Doty, *supra* note 23, at 70.

³⁴ Bd. of Governors of the Fed. Rsr. Sys., *Domestic Nonfinancial Sectors, Municipal Securities, Liability*, FED. RSRV. ECON. DATA, <https://fred.stlouisfed.org/series/DNSMSL> (last visited Sept. 16, 2020).

³⁵ SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET 91–92 (July 31, 2012), <https://www.sec.gov/files/munireport073112.pdf>.

³⁶ See DEUTSCHE BÖRSE GROUP, THE GLOBAL DERIVATES MARKET 10–11 (2008), https://www.math.nyu.edu/faculty/avellane/global_derivatives_market.pdf.

³⁷ *In re Jefferson Cnty.*, 474 B.R. 228, 237 (Bankr. N.D. Ala. 2012).

³⁸ See SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET 92 (July 31, 2012), <https://www.sec.gov/files/munireport073112.pdf>.

³⁹ See SCOTT, *supra* note 21, at 57–58.

municipal bonds to its customers.⁴⁰ Fidelity,⁴¹ Charles Schwab,⁴² and other mutual fund and financial advisory firms have similar investment options promoted on the basis of their low risk and tax benefits. Because of the low default risk and tax benefits, the municipal securities market attracts institutional and individual investors alike.⁴³ Low default risk does not mean a zero-default risk, however.

II. DETROIT'S DECLINE AND BANKRUPTCY FILING

Thomas Sugrue's *Origins of the Urban Crisis* is an unparalleled treatise on the entropy that has occurred in so many American cities.⁴⁴ The book details how Detroit, the "Arsenal of Democracy," known to produce tanks for World War II as easily as it produced Cadillacs, shrank from a population of 1.8 million in 1950 to approximately 1 million in the 1990s at the time the book was published.⁴⁵ In short, the City was subjected to the same forces that left Buffalo, Cleveland, and Pittsburgh equally desolate.⁴⁶ Suburbanization—a trend incentivized by racially exclusive federal home loans and local land use restrictions—pushed white urban residents to suburban areas with lush lawns and white picket fences.⁴⁷ Deindustrialization followed.⁴⁸ Vertical development, a feature of cities, was suboptimal for snake-like assembly lines that could spread out on wider and cheaper land in the suburbs.⁴⁹ Equally important, competition from abroad incentivized companies to not only move factories out

⁴⁰ *Vanguard Mutual Funds*, VANGUARD, <https://investor.vanguard.com/mutual-funds/list?assetclass=bond&taxeff=xmpt#/mutual-funds/asset-class/month-end-returns> (last visited Oct. 3, 2020).

⁴¹ *Fidelity Mutual Funds*, FIDELITY, <https://www.fidelity.com/mutual-funds/fidelity-funds/overview> (last visited Oct. 3, 2020).

⁴² *Tax-Free Bond Funds*, SCHWAB, <https://www.schwab.com/mutual-funds/schwab-mutual-funds/fixed-income/tax-exempt> (last visited Aug. 13, 2020) (explaining Schwab's tax-free bond funds investment option).

⁴³ See generally SEC, REPORT ON THE MUNICIPAL SECURITIES MARKET 92 (July 31, 2012), <https://www.sec.gov/files/munireport073112.pdf>. (discussing and recommending improvements to the municipal securities market).

⁴⁴ SUGRUE, *supra* note 16, at 1–17 (examining the role race, housing, and job discrimination played in the decline of Detroit).

⁴⁵ SUGRUE, *supra* note 16, at xlii, 18; BUREAU OF THE CENSUS, 1990 CENSUS POPULATION, SOCIAL AND ECONOMIC CHARACTERISTICS, MICHIGAN (July 14, 1993), <https://www2.census.gov/library/publications/deccennial/1990/cp-2/cp-2-24-1.pdf>.

⁴⁶ Daniel Hartley, *Urban Decline in Rust-Belt Cities*, FED. RSRV. BANK OF CLEVELAND (May 20, 2013), <https://www.clevelandfed.org/newsroom-and-events/publications/economic-commentary/2013-economic-commentaries/ec-201306-urban-decline-in-rust-belt-cities.aspx> (examining patterns that characterize the process of urban decline in cities such as Buffalo, Cleveland, Detroit, and Pittsburgh).

⁴⁷ See SUGRUE, *supra* note 16, at xv–xvi (discussing the "long process of white flight" that plagued Detroit).

⁴⁸ See SUGRUE, *supra* note 16, at 125–52.

⁴⁹ See SUGRUE, *supra* note 16, at 125–52.

of Detroit, but out of the United States to countries where far-off laborers could be paid cents on the American laborer's dollar.⁵⁰

An exodus of people and jobs corresponded to a loss in property tax revenue.⁵¹ In response, Detroit's local elected officials attempted to capture the remaining income and wealth with new taxes.⁵² Mayor Jerome Cavanagh instituted a personal and corporate income tax in 1962.⁵³ Utility user's taxes were instituted by Mayor Roman Gribbs in 1971.⁵⁴ Casino revenue taxes were instituted under Mayor Dennis Archer in 1999.⁵⁵ However, all of these taxes could not recapture the riches that the City once enjoyed.⁵⁶

By 2009, auto sector employment in the Detroit metropolitan area had fallen to approximately 80,000 from 180,000 in 2000.⁵⁷ The "Big Three" car companies—General Motors, Chrysler, and Ford Motor Company—employed fewer people and had a lower market share at the time the City went bankrupt.⁵⁸ General Motors and Chrysler, in perhaps a precursor to the City's own doom, filed for bankruptcy in 2009.⁵⁹

In his 1995 article in *The Atlantic*, Witold Rybczynski, captured *the* problem for American cities like Detroit when he wrote:

[A]lthough a city is often said to be shrinking, its physical area remains the same. The same number of streets must be policed and repaired, sewers and water lines maintained, and transit systems operated. With fewer taxpayers, revenues are lower, often leading to higher taxes per

⁵⁰ See SUGRUE, *supra* note 16, at 138–40.

⁵¹ Nathan Bomey & John Gallagher, *How Detroit Went Broke: The Answers May Surprise You—and Don't Blame Coleman Young*, DET. FREE PRESS (Sept. 15, 2013), <https://www.freep.com/story/news/local/michigan/detroit/2013/09/15/how-detroit-went-broke-the-answers-may-surprise-you-and/77152028/> (discussing how the "amid huge exodus of residents, plummeting tax revenues and skyrocketing home abandonment, Detroit's leaders engaged in a billion-dollar borrowing binge, created new taxes and failed to cut expenses when they needed to.").

⁵² *Id.* ("City leaders tried repeatedly to reverse sliding revenue through new taxes.").

⁵³ *Id.* ("[T]he city turned for the first time in 1962 to an income tax: 1% for residents, nonresidents and corporations.").

⁵⁴ *Id.* ("[T]he city also instituted a new utility tax in 1971 and a wagering tax when casinos began operation here in 1999.").

⁵⁵ *Id.*

⁵⁶ *Id.* (explaining that "using taxes to raise revenue was that it made the City a more expensive—and less attractive—place to live and do business").

⁵⁷ Yu Peng Lin, *The Fall of Detroit: A Financial Economist's Point of View*, 6 INT'L J. ECON. AND FIN. 43, 48 (2014) (analyzing trends in Detroit's auto sector employment from 1990 to 2013).

⁵⁸ *Id.* at 46–47 (analyzing the market share of the Big Three versus their international competitors).

⁵⁹ See David A. Skeel, Jr., *From Chrysler and General Motors to Detroit*, 24 WIDENER L.J. 121, 121 (2015) (examining the aftereffects of Chrysler and General Motors bankruptcies on Detroit).

capita, an overall deterioration of services, or both. More people depart, and the downward spiral continues.⁶⁰

The depths of the City's poverty even led it to subvert the social contract: the City's cuts to police and fire protection—the public safety response time was said to be an hour in 2013—left murder (316 in 2013)⁶¹ and arson (611 in 2013)⁶² undeterred.

The City's pre-bankruptcy financial condition was explicitly detailed in a report by the State Treasurer to Governor Rick Snyder in early 2013.⁶³ The report concluded that “a local government financial emergency exists within the City of Detroit because no satisfactory plan exists to resolve a serious financial problem.”⁶⁴ Of the City's problems, the State Treasurer noted that the City suffered from a “Cash Crisis,” “General Fund Deficits,” “Long-Term Liabilities,” and a “Bureaucratic Structure” that “makes it extremely difficult for City officials to restructure the City's operations in any meaningful and timely manner.”⁶⁵ Michigan Treasurer Andy Dillon's involvement was the first step in the state's response to financial trouble in its constituent municipalities—a response that some have called anti-democratic.⁶⁶ Under Michigan state law at the time, financially troubled municipalities were appointed a state receiver known as an “emergency financial manager”⁶⁷ and later simply as an “emergency manager,”⁶⁸ who would temporarily assume the powers of the mayor and city council.

More popularly, in a *Detroit Free Press* feature titled *How Detroit Went Broke*, the authors elaborately detailed the City's history—its decline from its

⁶⁰ Witold Rybczynski, *Downsizing Cities*, THE ATLANTIC (Oct. 1995), <https://www.theatlantic.com/past/docs/issues/95oct/rybczyns.htm>.

⁶¹ FBI, UNIFORM CRIME REPORT (2013), https://ucr.fbi.gov/crime-in-the-u.s/2013/crime-in-the-u.s.-2013/tables/table-8/table-8-state-cuts/table_8_offenses_known_to_law_enforcement_michigan_by_city_2013.xls (displaying crime statistics of offenses known to law enforcement in Michigan by city).

⁶² *Id.* (displaying crime statistics of offenses known to law enforcement in Michigan by city).

⁶³ See MICH. DEP'T OF TREASURY, REPORT OF THE DETROIT FINANCIAL REVIEW TEAM (Feb. 19, 2013), https://www.michigan.gov/documents/treasury/Review-Team-Report-2-19-13_415662_7.pdf (discussing Detroit's pre-bankruptcy financial condition).

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ See Jason Stanley, *Detroit's Drought of Democracy*, N.Y. TIMES: OPINIONATOR (July 29, 2014), <https://opinionator.blogs.nytimes.com/2014/07/29/detroits-drought-of-democracy/>.

⁶⁷ See generally CITIZENS RSCH. COUNCIL OF MICH., AN ANALYSIS OF THE EFFECTIVENESS OF THE LOCAL GOVERNMENT FISCAL RESPONSIBILITY ACT (PUBLIC ACT 72 OF 1990, FORMERLY PUBLIC ACT 101 OF 1988) 1 (1990), <https://crcmich.org/wp-content/uploads/pa72analysis.pdf> (examining the extent of the authority and the length of time required for the appointment of an emergency financial manager).

⁶⁸ See MICH. COMP. LAWS ANN. § 141.1542(e) (West 2020) (defining emergency manager).

industrial heyday and a disastrous financial deal orchestrated by former Mayor Kwame Kilpatrick (currently in prison for corruption).⁶⁹ For years, even before Mayor Kilpatrick's tenure, the City borrowed money for operational expenditures.⁷⁰ Unable to borrow any more on its own credit, the City created two shell entities or "service corporations" that issued securities known as certificates of participation—debt by another name.⁷¹ The proceeds from that debt issuance were used to make payments to the City's underfunded pension systems, the General Retirement System, and Police and Fire Retirement System.⁷² That debt structure was further complicated by multiple layers of bond insurance and interest rate swaps.⁷³ The deal blew up.⁷⁴ Many factors led to the City's bankruptcy, like the 48% decline in state shared revenue between 1998 and 2012, but the deal orchestrated by the now-incarcerated mayor added a hefty burden to the City's balance sheet.⁷⁵

On March 14, 2013, over the protest of the City's local elected officials, an emergency manager was appointed.⁷⁶ Kevyn Orr, a bankruptcy attorney from Jones Day, was appointed to oversee the City's financial recovery—or bankruptcy.⁷⁷ Shortly after his appointment, Orr halted payments on the City's debts.⁷⁸ On June 14, 2013, Detroit missed a \$39.7 million payment owed to the shell entities created under Mayor Kilpatrick.⁷⁹ That same day, Orr released the City's "Proposal for Creditors."⁸⁰ The plan, had it been implemented, would have adjusted the City's bonded debts and other liabilities outside of bankruptcy court.⁸¹ Creditors rejected the plan.⁸² In the absence of an ability to force losses

⁶⁹ Bomey & Gallagher, *supra* note 51.

⁷⁰ See Fourth Amended Disclosure Statement with Respect to Fourth Amended Plan for the Adjustment of Debts of the City of Detroit, at 118–20, *In re City of Detroit*, No. 13-53846 (Bankr. E.D. Mich. May 5, 2014) [hereinafter Detroit's Fourth Amended Disclosure Statement].

⁷¹ *Id.* at 140.

⁷² *Id.* at 103–05.

⁷³ *Id.* at 104.

⁷⁴ *Id.* at 136–39.

⁷⁵ Bomey & Gallagher, *supra* note 51 ("Lansing politicians reduced Detroit's state-shared revenue by 48% from 1998 to 2012, withholding \$172 million from the city, according to state records.")

⁷⁶ Monica Davey, *Bankruptcy Lawyer Is Named to Manage an Ailing Detroit*, N.Y. TIMES (Mar. 14, 2013), <https://www.nytimes.com/2013/03/15/us/gov-rick-snyder-kevyn-orr-emergency-manager-detroit.html> ("Michigan officials on Thursday appointed the lawyer, Kevyn Orr, a partner in the Jones Day law firm, as an emergency manager to oversee operations in Detroit, one of the largest cities to ever receive such intervention.")

⁷⁷ *Id.*

⁷⁸ See Detroit's Fourth Amended Disclosure Statement, *supra* note 70, at 129.

⁷⁹ Detroit's Fourth Amended Disclosure Statement, *supra* note 70, at 132.

⁸⁰ CITY OF DETROIT, PROPOSAL FOR CREDITORS 1 (2013), <https://detroitmi.gov/sites/detroitmi.localhost/files/2018-05/City%20of%20Detroit%20Proposal%20for%20Creditors1.pdf>.

⁸¹ Detroit's Fourth Amended Disclosure Statement, *supra* note 70, at 131.

⁸² See Detroit's Fourth Amended Disclosure Statement, *supra* note 70, at 132.

onto creditors and bind those creditors to a settlement, the City petitioned a forum where it could achieve such ends: bankruptcy court.⁸³

Of the approximately \$18 billion in total liabilities at the time of the City's bankruptcy, \$3.5 billion was owed to the City's retirees in the form of pension promises and \$5.7 billion in other post-employment benefits; \$6.4 billion owed to bondholders secured by revenues from the City's water and sewer system; \$651 million owed to bondholders supposedly protected by the City's full faith and credit and \$2.1 billion owed to other creditors.⁸⁴ It took approximately a year and three months to unwind the City's bonded debts and other liabilities.⁸⁵ From July 18, 2013 to November 7, 2014, the City battled with creditors in bankruptcy court—most notably over whether Matisse and Cézanne from the Detroit Institute of Arts (“DIA”) would be sold to make creditors whole.⁸⁶

III. CHAPTER 9 OF THE BANKRUPTCY CODE

In the eyes of some, “Detroit” already went bankrupt when General Motors filed for bankruptcy on June 1, 2009.⁸⁷ In its bankruptcy, the automaker adjusted its debts and sold off its unprofitable divisions: Hummer, Pontiac, Saab, and Saturn.⁸⁸ Detroit, the city, on the other hand, did not sell off its fire stations, parks or City Hall. In this respect, municipal bankruptcy substantially differs from commercial and personal bankruptcy.⁸⁹ Governments do not conduct fire sales, nor can local politics cease to deliver on their part of the social contract.⁹⁰

⁸³ See Davey & Walsh, *supra* note 15.

⁸⁴ *In re* City of Detroit, 504 B.R. 191, 207–08 (Bankr. E.D. Mich. 2013).

⁸⁵ See *id.*

⁸⁶ See Randy Kennedy & Monica Davey, *Detroit's Creditors Eye Its Art Collection*, N.Y. TIMES (July 19, 2013), <https://www.nytimes.com/2013/07/20/arts/design/detroits-creditors-eye-its-art-collection.html>. See generally Michigan Radio Newsroom, *DIA Displays More Than 100 Works by Picasso and Matisse in New Exhibit*, MICH. RADIO (July, 12, 2012), <https://www.michiganradio.org/post/dia-displays-more-100-works-picasso-and-matisse-new-exhibit> (as of 2012, the DIA continues to have a large selection of works by Matisse, Cézanne, and Picasso); Steven Gray, *Detroit: 10 Things to Do*, TIME (June 4, 2010), http://content.time.com/time/travel/cityguide/printout/0,31522,1994456_1994357_1994239,00.html (mentioning the Cézanne collection and ranking the DIA as Detroit's top attraction).

⁸⁷ See generally Mitt Romney, *Let Detroit Go Bankrupt*, N.Y. TIMES (Nov. 18, 2008), <https://www.nytimes.com/2008/11/19/opinion/19romney.html> (advocating for General Motors, Ford, and Chrysler to file for bankruptcy to restructure the industry).

⁸⁸ Micheline Maynard, *A Painful Departure for G.M. Brands*, N.Y. TIMES (Feb. 17, 2009), <https://www.nytimes.com/2009/02/18/business/18brands.html>.

⁸⁹ See generally Lotta Moberg & Richard E. Wagner, *Default Without Capital Account: The Economics of Municipal Bankruptcy*, 14 PUB. FIN. & MGMT. 30, 34 (2014) (comparing corporate bankruptcy to municipal bankruptcy).

⁹⁰ See Michelle Wilde Anderson, *Dissolving Cities*, 121 YALE L.J. 1364, 1384 (2012).

This Section uses Detroit's bankruptcy to expound on the form and function of municipal bankruptcy, what occurs when a case is filed, and how the disposition of assets and liabilities is handled. Additionally, this Section briefly comments on the Great Depression and resulting drop in municipal revenues, thus necessitating federal intervention into local affairs in the first place. Lastly, this Section compares and contrasts the power of the bankruptcy court and the recourse of creditors in a municipal bankruptcy versus commercial bankruptcy.

A. *Great Depression and Municipal Finance*

Congress first provided municipalities access to bankruptcy court in 1934 after hundreds of defaults—a previously rare phenomena:

Estimated municipal bond defaults rapidly jumped from 678 in November, 1932, to 1,729 by January 1, 1934. As of March 1, 1934, thirty-seven municipalities or 11.93 per cent of those in the class with a population of more than 30,000 were in default. Defaults by municipalities had become a national problem.⁹¹

The Great Depression made it as difficult for cities and towns to pay their debts as it did for households and businesses.⁹² Moreover, if municipal default appeared imminent, creditors had an incentive to race to the courthouse.⁹³ In each case, creditors hoped to have their individual claims validated by a court with jurisdiction to secure payment on their bonds, irrespective of how writs of mandamus—court ordered tax increases—could be injurious to the debtor's local economy.⁹⁴ Even if debtors avoided adversarial lawsuits and reached a consensual settlement with the majority of creditors to adjust or refund debts, those settlements could not be consummated.⁹⁵ If, for example, a debtor reached a settlement with 51% of creditors, the other 49% were not bound by the settlement terms and could demand payment under the terms that the bonds were first issued.⁹⁶

State law was, and still is, impotent. The Contracts Clause says that “[n]o State shall . . . pass any . . . [l]aw impairing the Obligation of Contracts.”⁹⁷ In previous economic crises, states attempted to provide relief to their constituent

⁹¹ Henry W. Lehmann, *The Federal Municipal Bankruptcy Act*, 5 J. FIN. 241, 241 (1950) (footnotes omitted).

⁹² *See id.*

⁹³ *See id.* at 241–42.

⁹⁴ *Id.* at 242.

⁹⁵ *See id.*

⁹⁶ *See id.* at 241–42.

⁹⁷ U.S. CONST. ART. 1 § 10, cl. 1.

municipalities, often creatively.⁹⁸ For example, the Alabama State Legislature’s response to the City of Mobile’s indebtedness in 1879 was to disappear the City and its debts.⁹⁹ State law revoked the City’s charter and erased its boundaries.¹⁰⁰ The state then reconstituted the former City as the Port of Mobile, more or less with the same boundaries as the former city, absent the City of Mobile’s debts.¹⁰¹ Bondholders sued.¹⁰² The Supreme Court struck down the state law and reversed the attempted Houdini act.¹⁰³ Similar tricks were revealed and repealed by the Supreme Court around that same time.¹⁰⁴

Congress’s decision to confer bankruptcy power—the power to break contracts—was complicated by the fact that municipalities are “creatures of the state.”¹⁰⁵ The law was declared unconstitutional in 1936 in *Ashton v. Cameron County Water Improvement District*.¹⁰⁶ In *Ashton*, the Supreme Court held that the law interfered with state power over their “creatures” as expressed by the Tenth Amendment to the Constitution.¹⁰⁷ Congress rewrote the law in 1937.¹⁰⁸ The law’s second incarnation survived the Supreme Court in *United States v. Bekins* in 1938.¹⁰⁹

Since the Great Depression, few municipalities have availed themselves of the power to break contracts under court supervision as provided by chapter 9 of

⁹⁸ Professor Gillette has discussed some of these approaches, noting:

Ultimately, animosity towards bond issues spilled over from judicial willingness to invalidate outstanding indebtedness and into an unwillingness to permit municipalities to incur obligations in the first instance, even if nullification required some judicial creativity. The Wisconsin Supreme Court, for example, enjoined one issue of bonds that was to be used to aid a railroad on the grounds that residents had signed the authorizing petition on a Sunday.

Clayton P. Gillette, *Bondholders and Financially Stressed Municipalities*, 39 *FORDHAM URB. L.J.* 639, 643 (2012).

⁹⁹ Richard W. Flournoy, Jr., *The Rights of Creditors of a Municipal Corporation When the State Has Passed a Law to Abolish or Alter It*, 12 *VA. L. REG.* 175, 175–77 (1906) (citing *Mobile v. Watson*, 116 U.S. 289 (1886)).

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 175–80; see *Von Hoffman v. Quincy*, 71 U.S. 535 (1867); *Broughton v. Pensacola*, 93 U.S. 266 (1876); *Mt. Pleasant v. Beckwith*, 100 U.S. 514 (1879); *O’Connor v. Memphis*, 74 *Tenn.* 730 (1881); *Graham v. Folsom*, 200 U.S. 248 (1906).

¹⁰⁵ See *Hunter v. Pittsburg*, 207 U.S. 161, 178 (1907) (stating that municipalities are “political subdivisions of the State”).

¹⁰⁶ *Lehmann*, *supra* note 91, at 245.

¹⁰⁷ *Lehmann*, *supra* note 91, at 245.

¹⁰⁸ *Lehmann*, *supra* note 91, at 245.

¹⁰⁹ *Lehmann*, *supra* note 91, at 247–48.

the Code.¹¹⁰ Between 1937 and 2013, it is estimated that approximately 650 municipalities have filed for bankruptcy.¹¹¹ The majority of those bankruptcies were filed by special districts: water and sewer districts, public utilities, development authorities.¹¹² Rarely have major cities filed for bankruptcy.¹¹³ In the 1970s, both Cleveland, Ohio,¹¹⁴ and New York, New York,¹¹⁵ teetered on the precipice of bankruptcy but were able to resolve their insolvencies with state and federal intervention. The Great Recession, however, featured a similar plummet in tax revenues as the Great Depression,¹¹⁶ but with less financial support for municipalities from the states and Federal Government.¹¹⁷ Distressed and out of other options, municipal bankruptcy—still a rarity—became a more popular choice: Vallejo, California, filed in 2008,¹¹⁸ Prichard, Alabama, filed in 2009,¹¹⁹ Central Falls, Rhode Island, filed in 2011,¹²⁰ Jefferson County, Alabama, filed in 2011,¹²¹ Stockton, California, filed in 2012,¹²² San Bernardino, California, filed in 2012,¹²³ and Detroit filed in 2013.¹²⁴

B. Filing for Bankruptcy

To file for municipal bankruptcy, a debtor must meet these criteria from section 109(c)(2):

- (1) is a municipality;
- (2) is specifically authorized, in its capacity as a municipality or by

¹¹⁰ Skeel, *supra* note 9, at 1080.

¹¹¹ Skeel, *supra* note 9, at 1080.

¹¹² Skeel, *supra* note 9, at 1080.

¹¹³ See Skeel, *supra* note 9, at 1082 (suggesting that there was a “conventional wisdom that significant municipalities do not file for Chapter 9”).

¹¹⁴ See generally Letter from Michael Brostek, Assoc. Dir., Fed. Mgmt. & Workforce Issues, to Peter J. Visclosky, U.S. Rep., House of Reps. (Aug. 21, 1996) (on file with U.S. Gov’t Accountability Off.) (a letter requesting information on the fiscal crisis and subsequent financial recovery of the City of Cleveland in the 1970s).

¹¹⁵ See generally Cong. Budget Off., *The Causes of New York City’s Fiscal Crisis*, 90 POL. SCI. QUARTERLY 659, 659 (Winter 1975–76) (discussing how New York City’s budget problems were precipitated by its inability to borrow money in the municipal bond market).

¹¹⁶ See LUTZ, MOLLOY & SHAN, *supra* note 18, at 5.

¹¹⁷ See Michelle Wilde Anderson, *Democratic Dissolution: Radical Experimentation in State Takeovers of Local Governments*, 39 FORDHAM URB. L.J. 577, 585 (2011) (“Given the current degree of state fiscal stress and falling levels of state aid for local governments . . . states are loathe [sic] to send bailout funding to even the most troubled local governments.”).

¹¹⁸ *In re City of Vallejo*, 408 B.R. 280, 288 (B.A.P. 9th Cir. 2009).

¹¹⁹ *In re City of Prichard*, No. 1:10-00622-KD-M, 2011 U.S. Dist. LEXIS 68747, at *1 (S.D. Ala. 2011).

¹²⁰ *In re City of Cent. Falls*, No. 11-13105-FJB, 2011 Bankr. LEXIS 5432, at *2–3 (Bankr. D.R.I. 2011).

¹²¹ *In re Jefferson Cnty.*, 474 B.R. 228, 236 (Bankr. N.D. Ala. 2012).

¹²² *In re City of Stockton*, 493 B.R. 772, 783 (Bankr. E.D. Cal. 2013).

¹²³ *In re City of San Bernardino, Cal.*, 499 B.R. 776, 780 (Bankr. C.D. Cal. 2013).

¹²⁴ *In re City of Detroit*, 501 B.R. 702, 705 (Bankr. E.D. Mich. 2013).

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;

(3) is insolvent;

(4) desires to effect a plan to adjust such debts; and

(5)(A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;

(C) is unable to negotiate with creditors because such negotiation is impracticable; or

(D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.¹²⁵

The City of Detroit is a “municipal corporation” or “municipality” as defined by section 101(40) of the Code.¹²⁶ Once that obvious matter had been adjudicated, Detroit had to prove it had state authorization to file a case—authority that was provided on July 18, 2013 by Governor Snyder.¹²⁷ Third, the City had to prove that it was insolvent or as it is worded in the Code “unable to pay its debts as they become due.”¹²⁸

Detroit’s petition was approved by Judge Steven Rhodes of the Bankruptcy Court for the Eastern District of Michigan on December 3, 2013.¹²⁹ Curiously, Judge Rhodes ruled that the City had not negotiated with its creditors in good faith. Judge Rhodes ruled the issue was moot because negotiations were impracticable; the city’s creditors were said to number over 100,000.¹³⁰

Outside of bankruptcy court, this ramshackle mess of 100,000 creditors would have been left to race to the courthouse.¹³¹ Instead, the City’s bankruptcy petition initiated an automatic stay whereby creditor lawsuits outside of bankruptcy court were halted.¹³² The City’s decision to file for bankruptcy

¹²⁵ 11 U.S.C. § 109(c)(2) (2019).

¹²⁶ *Id.* § 101(40) (“The term ‘municipality’ means political subdivision or public agency or instrumentality of a State.”).

¹²⁷ Davey & Walsh, *supra* note 15.

¹²⁸ 11 U.S.C. § 101(32)(C)(ii).

¹²⁹ *In re City of Detroit*, 501 B.R. 191, 230 (Bankr. E.D. Mich. 2013).

¹³⁰ *Id.* at 221.

¹³¹ See Lehmann, *supra* note 91, at 140 (discussing the “lack of any orderly legal procedure” for municipalities in bankruptcy).

¹³² See AMDURSKY, GILLETTE & BASS, *supra* note 10, at 432. The automatic stay is meant to provide the

transformed what likely would have been a disorderly default—whereby creditors sued the City to obtain compensation for their individual claims—into an orderly default, where compensation for creditors and recovery for the City were adjudicated simultaneously and finally.¹³³

C. *Disposition of Assets and Liabilities*

Due to the enormity of its liabilities, \$18 billion in total, and the types of liabilities, the case moved into uncharted territory. Specifically, the City owed a lot of money, \$3.5 billion, related to promises to provide retirees with pension income.¹³⁴ To further complicate matters, Michigan's Constitution has a provision that protects public pensions from impairment.¹³⁵ “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,” says Article IX, section 24 of Michigan's Constitution.¹³⁶ Shockingly, on December 3, 2013, Judge Rhodes ruled that the pensions of city retirees could be impaired in bankruptcy.¹³⁷ That decision marked the first time a state constitutional provision was overridden in a bankruptcy court.¹³⁸

The City owed money to banks and bondholders, too.¹³⁹ In 2006, the City entered into complicated deals that involved financial derivatives known as interest rate swaps.¹⁴⁰ Detroit entered into the deals with Bank of America and UBS to protect itself from potential interest rate shocks from the certificates of participation issued with a variable interest rate.¹⁴¹ In short, the City “bet” that interest rates would rise—a bet the City lost as the Federal Reserve System lowered interest rates in response to the Great Recession.¹⁴² The Federal

debtor time to maneuver and potentially reach a settlement with creditors free from duress. *See* 11 U.S.C. § 362; AMDURSKY, GILLETTE & BASS, *supra* note 10, at 432.

¹³³ *See, e.g., In re City of Detroit*, 501 B.R. at 205–06.

¹³⁴ *Id.* at 207.

¹³⁵ *See* MICH. CONST. art. IX, § 24.

¹³⁶ *See* MICH. CONST. art. IX, § 24.

¹³⁷ *In re City of Detroit*, 501 B.R. at 205–06.

¹³⁸ *See* Nathan Bomey, *Judge: Detroit Can Cut Employee Pensions*, USA TODAY (Dec. 3, 2013, 11:28 AM), <https://www.usatoday.com/story/news/nation/2013/12/03/detroit-bankruptcy-pensions/3852377/>.

¹³⁹ *See In re City of Detroit*, 501 B.R. at 207–08.

¹⁴⁰ *See* Steven Raphael & Steven Church, *Detroit Allowed to Pay UBS, BofA \$85 Million to End Swaps* BLOOMBERG NEWS (Apr. 11, 2014), <http://www.bloomberg.com/news/2014-04-11/detroit-wins-approval-of-swaps-deal-with-ubs-bofa.html>.

¹⁴¹ *See In re City of Detroit*, 501 B.R. at 209–10.

¹⁴² *See* Edmund L. Andrews & Jackie Calmes, *Fed Cuts Key Rate to a Record Low*, N.Y. TIMES (Dec. 16, 2008), <https://www.nytimes.com/2008/12/17/business/economy/17fed.html> (discussing the Federal Reserve “lowering its benchmark interest rate virtually to zero” to fight the recession).

Reserve's actions and downward drift of interest rates activated a component to the swaps deal that mandated the City make hefty payments to the banks that were on the other side of the bet.¹⁴³ The City was on the hook for up to \$288 million.¹⁴⁴ General bondholders were owed even more: \$651 million.¹⁴⁵

Of the City's many assets—the DIA collection, Joe Louis Arena, and the Coleman A. Young Municipal Airport—that could be used to satisfy creditor claims, the DIA collection was the most valuable. Founded in 1885, the DIA collection includes 66,000 works, and is widely considered to be the City's cultural jewel.¹⁴⁶ That such a jewel could be stolen away by creditors attracted a lot of attention. Not only was the collection's proposed sale covered in the *Detroit Free Press*¹⁴⁷ and *Detroit News*,¹⁴⁸ but also in the *New York Times*,¹⁴⁹ *Washington Post*,¹⁵⁰ and across the pond in *The Guardian*.¹⁵¹

Formerly populous and wealthy, the City had been able to not only provide its citizens with parks and public safety, but with splendid art by famous artists. So while the museum operated as a separate nonprofit entity, much of the art was owned directly by the City.¹⁵² In an appraisal order by the City and conducted by Christie's, the auction house estimated that the collection was worth between \$454 million and \$867 million.¹⁵³ To respond to public outcry

¹⁴³ See *In re City of Detroit*, 501 B.R. at 210.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at 207.

¹⁴⁶ *Id.*

¹⁴⁷ See Joe Guillen & Brent Snavely, *Rhodes Signals DIA is Crucial for Detroit's Viability*, DETROIT FREE PRESS (Sept. 18, 2014, 6:00 AM), <https://www.freep.com/story/news/local/detroit-bankruptcy/2014/09/17/bankruptcy-dia-plummer/15799233/> (“The question of whether the City of Detroit owns the museum and whether the city should sell some or all of the museum's most valuable works to pay off creditors, has been among the central and most controversial questions of the city's bankruptcy.”).

¹⁴⁸ See Chad Livengood, *Detroit Offered \$4B Loan if It Uses DIA Art as Collateral*, THE DETROIT NEWS (Aug. 27, 2014, 12:46 PM), <https://www.detroitnews.com/story/news/local/wayne-county/2014/08/27/detroit-offered-4b-loan-if-it-uses-dia-art-as-collateral/14685065/>.

¹⁴⁹ See Randy Kennedy, *Fate of Detroit's Art Hangs in the Balance*, N.Y. TIMES (Dec. 3, 2013), <https://www.nytimes.com/2013/12/04/us/fate-of-detroits-art-hangs-in-the-balance.html>.

¹⁵⁰ See Katherine Boyle, *Donors Pledge \$330 Million to Save Detroit Art Museum Collection*, WASH. POST (Jan. 13, 2014), https://www.washingtonpost.com/entertainment/museums/donors-pledge-330-million-to-save-detroit-art-museum-collection/2014/01/13/564c664e-7c83-11e3-9556-4a4bf7bc8d84_story.html.

¹⁵¹ See Jonathan Jones, *Will the Detroit Institute of Arts Be Forced to Sell Its Treasures?*, THE GUARDIAN (Dec. 4, 2013, 11:16 AM), <https://www.theguardian.com/artanddesign/jonathanjonesblog/2013/dec/04/detroit-institute-arts-bankruptcy-sale> (“With Detroit official bankrupt, creditors are pressuring the city to sell of some of the [DIA's] first-rate art . . . Can Detroit's art museum survive?”).

¹⁵² See Randy Kennedy, *A Bruegel, a Rembrandt, a van Gogh: Appraisal Puts Prices on the Priceless in Detroit*, N.Y. TIMES (Dec. 19, 2013), <https://www.nytimes.com/2013/12/20/arts/design/report-sets-values-on-detroit-institute-artworks.html>.

¹⁵³ See *id.*

over the collection's potential sale, a concerted effort was made by state and city officials and the philanthropic community to save the art.¹⁵⁴

Members of the philanthropic community raised money to save the art. Michigan Attorney General Bill Schuette issued an opinion that said any sale would be prohibited by state law.¹⁵⁵ On June 20, 2014, two statutes signed into law by the Governor added \$195 million from the state to \$366 million already pledged by the philanthropic community and \$100 million from the DIA.¹⁵⁶ Often referred to as the "Grand Bargain" in the media, the deal saved the collection from a fire sale.¹⁵⁷ However, despite the near completion of the Grand Bargain, Financial Guaranty Insurance Company and Syncora Guarantee Inc., two creditors that insured the City's now-defaulted securities, pushed for the collection's sale to stem their losses.¹⁵⁸

D. Governments in Bankruptcy vs. Companies in Bankruptcy

Notably, neither the bankruptcy court nor creditors could force the City to sell the collection.¹⁵⁹ To appreciate why Detroit could not be forced to sell the collection, one must appreciate that municipalities are unique in their political status. The Code does not treat municipal debtors the same as commercial debtors.¹⁶⁰ For one, the bankruptcy court does not appoint a trustee to oversee

¹⁵⁴ See generally Brittney Kohn, Note, *Detroit Institute of Arts: A Cultural Gem or Detroit's Piggy Bank*, 60 WAYNE L. REV. 515, 542 (2014) (describing the community's efforts to transfer the DIA's art to a charitable trust, thereby preventing future liquidation).

¹⁵⁵ Mich. Att'y Gen., Opinion Letter (June 13, 2013) ("It is my opinion, therefore, that the art collection of the Detroit Institute of Arts is held by the City of Detroit in charitable trust for the people of Michigan, and no piece in the collection may thus be sold, conveyed, or transferred to satisfy City debts or obligations").

¹⁵⁶ *Snyder Signs Detroit Bankruptcy Bills, Says 'There's More Work To Be Done'*, MANISTEE NEWS ADVOCATE (June 20, 2014, 11:27 PM), <https://www.manisteenews.com/state-news/article/Snyder-signs-Detroit-bankruptcy-bills-says-14224711.php> (noting the "grand bargain" legislation provided \$195 million from the state to the Detroit Institute of Arts); *'Grand Bargain' in Detroit Exemplifies New Kind of Philanthropy*, PHILANTHROPY NEWS DIGEST (Nov. 17, 2014), <https://philanthropynewsdigest.org/news/grand-bargain-in-detroit-exemplifies-new-kind-of-philanthropy>.

¹⁵⁷ See, e.g., Randy Kennedy, *'Grand Bargain' Saves the Detroit Institute of Arts*, N.Y. TIMES (Nov. 7, 2014), <https://www.nytimes.com/2014/11/08/arts/design/grand-bargain-saves-the-detroit-institute-of-arts.html>.

¹⁵⁸ See *In re City of Detroit*, 2014 Bankr. LEXIS 4061, at *2 (Bankr. E.D. Mich. Aug. 28, 2014); see Karen Pierog, *Bond Insurer Syncora is Stubborn City Rival in Detroit's Bankruptcy*, REUTERS (June 26, 2014, 7:01 AM), <https://www.reuters.com/article/us-usa-detroit-bankruptcy-syncora-guaran/bond-insurer-syncora-is-stubborn-city-rival-in-detroits-bankruptcy-idUSKBN0F10CQ20140626> (noting that Syncora and Financial Guaranty Insurance Co. "objected to the 'grand bargain' in which philanthropic foundations and the state of Michigan have pledged millions of dollars to ease pension cuts on city retirees and protect parts of the Detroit Institute of Arts' collection from being sold.").

¹⁵⁹ See 11 U.S.C. § 904 (2019).

¹⁶⁰ See generally *id.* §§ 901–46 (evident by the fact that municipalities are required to file under chapter 9 of the Code, but treatment under chapter 9 provisions for municipal debtors, too, is quite different from corporate debtors).

the debtor's estate as it would in a commercial bankruptcy.¹⁶¹ Local elected officials (or state appointees in Detroit's case) remain in control of a municipal debtor and its operations as prescribed by section 904 of the Code.¹⁶² The bankruptcy court cannot issue writs of mandamus, order the sale of assets, remove local elected officials (even those who may have mishandled public monies) or enact public policy.¹⁶³ Equally important, commercial debtors can be liquidated. If their rehabilitation is not deemed feasible, commercial debtors have their assets sold off to satisfy creditor claims.¹⁶⁴ In contrast, a bankruptcy court cannot order a municipal debtor to disincorporate—revoke its local charter and erase its boundaries for purposes of liquidation.¹⁶⁵

E. Plan of Adjustment

On February 21, 2014, the City filed its plan of adjustment.¹⁶⁶ The plan of adjustment is a municipal debtor's settlement proposal; it says who will be paid, how much they will be paid and who will not be paid at all.¹⁶⁷ City retirees, a majority of whom supported the City's plan, received most of what they were owed.¹⁶⁸ General retirees' pension income was impaired by approximately 26%.¹⁶⁹ Retired police and fire employees had their pension income impaired by approximately 4%.¹⁷⁰ Monies from the Grand Bargain were used to lessen the cuts to pensioners.¹⁷¹ On the other hand, creditors such as bondholders were cut

¹⁶¹ See *id.* § 904.

¹⁶² *Id.*

¹⁶³ See *id.* § 904(1)–(3).

¹⁶⁴ See Anderson, *supra* note 90, at 1385–86 (noting that “Chapter 9 of the Bankruptcy Code . . . does not require dissolution if a municipality files for bankruptcy”). Anderson later notes that dissolution is almost never the superior option, compared to bankruptcy, because dissolution offers no promise of a fresh start for a municipality, indeed, “in most states[,] a dissolving city will take its debt with it in the form of a special taxing district.” Anderson, *supra* note 90, at 1385–86.

¹⁶⁵ See Anderson, *supra* note 90, at 1385 (noting the Code cannot force a city to dissolve or more toward dissolution).

¹⁶⁶ *In re City of Detroit*, 524 B.R. 147, 161 (Bankr. E.D. Mich. 2014).

¹⁶⁷ 11 U.S.C. § 943(b).

¹⁶⁸ See Susan Tompor, *Even Five Years Later, Retirees Feel the Effects of Detroit's Bankruptcy*, DETROIT FREE PRESS (July 18, 2018, 6:00 AM), <https://www.freep.com/story/money/personal-finance/susan-tompor/2018/07/18/detroit-bankruptcy-retirees-pension/759446002/> (noting that City retirees had pensions cut by 4.5%); Skeel, *supra* note 59, at 145–46.

¹⁶⁹ See Skeel, *supra* note 59, at 145.

¹⁷⁰ See *Detroit's Bankruptcy: Cram Down*, THE ECONOMIST (Mar. 1, 2014), <https://www.economist.com/united-states/2014/03/01/cram-down>.

¹⁷¹ The Detroit Historical Society has noted this effect, too:

Under the terms of the bargain, \$816 million was donated by multiple foundations (consolidated into the Foundation for Detroit's Future), Detroit Institute of Arts donors, and the State of Michigan. The funds were to be dispersed over twenty years to the General Retirement System and the Police and Fire Retirement System to help ameliorate retiree pension cuts necessitated

much deeper. Under the plan, investors who purchased City bonds only received sixty-four cents back for every dollar that they lent the City.¹⁷²

The Code provides creditors the opportunity to review a plan of adjustment. However, in municipal bankruptcy, creditors cannot submit an alternate plan for consideration as they could in commercial bankruptcy.¹⁷³ Still, creditor support is needed for a plan of adjustment to be consummated in most circumstances; specifically, plan confirmation requires the consent of creditors who hold at least two-thirds of the amount of claims per creditor class and 51% or more of the number of claims per creditor class.¹⁷⁴ But if even one creditor class—such as pensioners or bondholders—consents to a plan, the plan may be forced onto other creditors who do not consent.¹⁷⁵ This is known as a “cramdown”, and this is the method by which Detroit’s case came to a conclusion on November 7, 2014.¹⁷⁶ The Bankruptcy Court’s confirmation of the plan of adjustment consummated the Grand Bargain and reduced the City’s liabilities by \$7 billion.¹⁷⁷

IV. FINANCIAL TURNAROUND—A “FRESH START”

In the ten years that preceded the City’s bankruptcy, the City lost population and tax revenue.¹⁷⁸ Between Fiscal Year (“FY”) 2004 and FY 2013, the City’s General Fund—the City’s primary account for tax receipts and operational disbursements—ran a deficit (expenditures exceeded revenues) in FY 2004, FY

by the bankruptcy. With the bargain in place, Detroit city retirees voted to accept the pension cuts and the DIA was allowed to become an independent institution, owned by a charitable trust, forever protecting its masterpieces from being considered city-owned assets.

DETROIT HISTORICAL SOCIETY, GRAND BARGAIN (2020) (Online Encyclopedia), <https://detroithistorical.org/learn/encyclopedia-of-detroit/grand-bargain>

¹⁷² *Id.*

¹⁷³ See AMDURSKY, GILLETTE & BASS, *supra* note 10, at 439.

¹⁷⁴ See 11 U.S.C. § 901(a) (2019) (incorporating § 1126(a)–(c); (e)–(g) into chapter 9); Richard M. Hynes & Steven D. Walt, *Fair and Unfair Discrimination in Municipal Bankruptcy*, 37 CAMPBELL L. REV. 25, 59 (2015); see also Lawrence P. King, *Municipal Insolvency: The New Chapter IX of the Bankruptcy Act*, 1976 DUKE L.J. 1157, 1172 (1977) (discussing the analogous provision, 11 U.S.C. § 92(b), in the 1970 Code).

¹⁷⁵ See 11 U.S.C. § 901(a) (incorporating § 1129(b)(2)(A)–(B) into chapter 9).

¹⁷⁶ See *In re City of Detroit*, 524 B.R. 147, 260 (Bankr. E.D. Mich. 2014); AMDURSKY, GILLETTE & BASS, *supra* note 10, at 437–38.

¹⁷⁷ See *In re City of Detroit*, 524 B.R. at 162.

¹⁷⁸ See John F. McDonald, *A Declining Population and City Revenues Meant that Detroit’s Bankruptcy Could Not Have Been Avoided*, LONDON SCHOOL OF ECONOMICS—U.S. CENTRE (Feb. 5, 2014), <https://blogs.lse.ac.uk/usappblog/2014/02/05/a-declining-population-and-city-revenues-meant-that-detroits-bankruptcy-could-not-have-been-avoided/>. See generally John F. McDonald, *What Happened to and in Detroit?*, 51 URB. STUD. 3309 (2014) (examining the various factors that drove Detroit to bankruptcy, finding that population and tax revenue decline led the City to fiscal insolvency).

2005, FY 2006, FY 2008, FY 2009, FY 2011 and FY 2012—seven out of ten years.¹⁷⁹ The account balance of the General Fund, the public sector equivalent of net worth, fell and remained below zero between FY 2004 and FY 2013.¹⁸⁰

From FY 2004 to FY 2013, General Fund revenue fell from \$1.4 billion to \$1 billion—a 29% decline.¹⁸¹ In FY 2013, the fiscal year that ended immediately before the City filed for bankruptcy, the City had \$82.4 million in cash on hand.¹⁸² Over the period of FY 2004 to FY 2013, the City borrowed to obtain cash for operational needs—to pay employees, vendors and bondholders—and still often found itself short.¹⁸³

General Fund revenue remained relatively flat between FY 2015, which marked the end of the City's bankruptcy, and FY 2018.¹⁸⁴ Yet, the City has been able to run operational surpluses each year.¹⁸⁵ The accumulation of this prior years' surplus has allowed the City to substantially increase its cash on hand.¹⁸⁶ In FY 2018, the City ended the year with \$472.4 million in cash on hand—a \$390 million increase over FY 2013.¹⁸⁷

¹⁷⁹ MICH. DEP'T OF TREASURY, CITY OF DETROIT COMPREHENSIVE ANN. FIN. REP. FOR THE FISCAL YEAR ENDED JUNE 30, 2004, at 35 (2005), https://treas-secure.state.mi.us/lafdocsearch/t141r01.aspx?&lu_id=5431&doc_yr=2004&doc_code=; MICH. DEP'T OF TREASURY, CITY OF DETROIT COMPREHENSIVE ANN. FIN. REP. FOR THE FISCAL YEAR ENDED JUNE 30, 2005, at 35 (2006), https://treas-secure.state.mi.us/lafdocsearch/t141r01.aspx?&lu_id=5431&doc_yr=2005&doc_code=AUD; MICH. DEP'T OF TREASURY, CITY OF DETROIT COMPREHENSIVE ANN. FIN. REP. FOR THE FISCAL YEAR ENDED JUNE 30, 2006, at 35 (2008), https://Treas-Secure.State.Mi.Us/Lafdocsearch/T141r01.Aspx?&Lu_Id=5431&Doc_Yr=2006&Doc_Code=AUD; MICH. DEP'T OF TREASURY, CITY OF DETROIT COMPREHENSIVE ANN. FIN. REP. FOR THE FISCAL YEAR ENDED JUNE 30, 2008, at 35 (2009), https://Treas-Secure.State.Mi.Us/Lafdocsearch/T141r01.Aspx?&Lu_Id=5431&Doc_Yr=2008&Doc_Code=AUD; MICH. DEP'T OF TREASURY, CITY OF DETROIT COMPREHENSIVE ANN. FIN. REP. FOR THE FISCAL YEAR ENDED JUNE 30, 2009, at 35 (2010), https://Treas-Secure.State.Mi.Us/Lafdocsearch/T141r01.Aspx?&Lu_Id=5431&Doc_Yr=2009&Doc_Code=AUD; MICH. DEP'T OF TREASURY, CITY OF DETROIT COMPREHENSIVE ANN. FIN. REP. FOR THE FISCAL YEAR ENDED JUNE 30, 2011, at 43 (2011), https://Treas-Secure.State.Mi.Us/Lafdocsearch/T141r01.Aspx?&Lu_Id=5431&Doc_Yr=2011&Doc_Code=AUD; MICH. DEP'T OF TREASURY, CITY OF DETROIT COMPREHENSIVE ANN. FIN. REP. FOR THE FISCAL YEAR ENDED JUNE 30, 2012, at 47 (2012), https://Treas-Secure.State.Mi.Us/Lafdocsearch/T141r01.Aspx?&Lu_Id=5431&Doc_Yr=2012&Doc_Code=AUD; MICH. DEP'T OF TREASURY, CITY OF DETROIT COMPREHENSIVE ANN. FIN. REP. FOR THE FISCAL YEAR ENDED JUNE 30, 2013, at 47 (2014), https://Treas-Secure.State.Mi.Us/Lafdocsearch/T141r01.Aspx?&Lu_Id=5431&Doc_Yr=2013&Doc_Code=AUD.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.*

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

¹⁸⁷ *Id.*

In the post-bankruptcy period of FY 2015 to FY 2018, the City has been able to build up cash reserves, make public investments to improve quality of life, and spur economic development.¹⁸⁸ By all accounts, the City appears to have achieved a fresh start. Under the fresh start theory, a previously insolvent debtor—in this case a municipality—unable to keep its promises to either creditors or citizens, starts anew after its debts are reduced in bankruptcy court.¹⁸⁹ The formerly bankrupt municipality can now use the resources that otherwise would have been directed to debt service toward public investments needed to attract new citizens and businesses.¹⁹⁰ Much like General Motor's profitability post-bankruptcy, Detroit has run impressive surpluses and improved its operations.¹⁹¹

V. CITY'S BOND OFFER

In 2018, nearly four years post-bankruptcy, the City was ready to reenter the municipal securities market. The City initially offered \$110,915,000 in "Unlimited Tax General Obligation Bonds," bonds that were "payable from the general funds of the city, and secured by a pledge of the full faith, credit and resources of the City."¹⁹² The preliminary official statement—or initial offer—

¹⁸⁸ See City of Detroit Mayor's Off., *City and Business Partners Announce Historic \$35M Corporate Commitment to Detroit Neighborhoods*, CITY OF DETROIT (Dec. 10, 2008), <https://detroitmi.gov/news/city-and-business-partners-announce-historic-35m-corporate-commitment-detroit-neighborhoods> (noting that "Detroit's neighborhoods are getting a record \$35 million boost to spur development and physical improvements").

¹⁸⁹ See Laura Napoli Cordes, *Restructuring Municipal Bankruptcy*, 2016 UTAH L. REV. 307, 348 n. 268 (2016) (noting that some scholars have compared a municipality's fresh start as "more akin to individual bankruptcy than business bankruptcy" because the fresh start does not encumber the municipality in the way that a typical restructuring might) (citing to Clayton P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. CHI. L. REV. 281, 292 (2012)).

¹⁹⁰ Professor Kimhi has discussed the theory undergirding Detroit's use of bankruptcy as a means of recovery, noting:

Using bankruptcy, the locality can decrease its debt burden and reduce its local taxes. The relatively low tax rates promote productivity, improve local economic performance, and help the locality recover. The underlying assumption is that mitigating the city's financial hardship provides the locality with a fresh start and enables its rehabilitation, to the benefit of both residents and creditors.

Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B.U. L. REV. 633, 653–54 (2008).

¹⁹¹ Compare Nick Bunkley, *Resurgent G.M. Posts 2010 Profit of \$4.7 Billion*, N.Y. TIMES (Feb. 25, 2011), <https://www.nytimes.com/2011/02/25/business/25auto.html>, with Christine Ferretti, *After Detroit Bankruptcy: Optimism, But 'Challenges are Real'*, THE DETROIT NEWS (July 19, 2018, 8:34 PM), <https://www.detroitnews.com/story/news/local/detroit-city/2018/07/18/detroit-bankruptcy-optimism-but-challenges-real/772729002/>.

¹⁹² CITY OF DETROIT, CNTY. OF WAYNE, STATE OF MICH. UNLIMITED TAX GENERAL OBLIGATION BONDS, SERIES 2018 (2018), <https://emma.msrb.org/ES1222098-ES954190-ES1355147.pdf>; see Chad Livengood, *Detroit Sells \$135 Million in Bonds with Its Own Credit*, CRAIN'S DETROIT BUS. (Dec. 5, 2018, 9:39 AM), <https://www.craindetroit.com/government/detroit-sells-135-million-bonds-its-own-credit> (noting that the City

was dated November 16, 2018 and did not include an amortization schedule or interest rate.¹⁹³

The Detroit city council passed a resolution on October 23, 2018 to support the new bond issuance so that the City could pay for capital projects.¹⁹⁴ Because the City's offer was oversubscribed, the City was able to increase its offer amount by \$24,085,000 to \$135,000,000 at a 5% interest rate per the official statement dated December 4, 2018.¹⁹⁵ The additional bond proceeds will be used to expand the list of capital projects that the City can undertake to continue its post-bankruptcy recovery.

VI. MARKET CONDITIONS

Market participants anticipated a decline in municipal borrowing after a rush to the market by municipal units in December 2017.¹⁹⁶ This anticipated decline was, at least in part, motivated by the Tax Cut and Jobs Act of 2017.¹⁹⁷ The Tax Cut and Jobs Act made a number of reforms to the federal tax code, most notably a reduction in the top rate for the corporate income tax to 21% from 35%.¹⁹⁸ Municipal issuers became concerned that those reforms would reduce the attractiveness of municipal bonds.¹⁹⁹ However, the tax law had little impact on the municipal securities market.²⁰⁰ Still, the Federal Reserve indicated that it would raise the federal funds rate or discount rate, threatening the value of municipal bonds.²⁰¹ Like all bonds, the value of municipal bonds has an inverse relationship with the interest rate.²⁰² If interest rates rise, the value of bonds decrease because, theoretically investors could have put their money in another asset and earned more interest.²⁰³ Declines in interest rates have the opposite

would raise between \$110–135 million from their first bond offering post-bankruptcy).

¹⁹³ See CITY OF DETROIT, CNTY. OF WAYNE, STATE OF MICH. UNLIMITED TAX GENERAL OBLIGATION BONDS, SERIES 2018 (2018), <https://emma.msrb.org/ES1222098-ES954190-ES1355147.pdf>.

¹⁹⁴ See *id.*

¹⁹⁵ See *id.*

¹⁹⁶ See, e.g., David Hammer & Sean McCarthy, *Munis in Focus: 2018 Municipal Market Outlook*, PIMCO (Feb. 1, 2018), <https://www.pimco.com/en-us/insights/investment-strategies/featured-solutions/munis-in-focus-2018-municipal-market-outlook>.

¹⁹⁷ See Heather Gillers, *Tax Bill Jolts Municipal-Bond Market*, WALL ST. J. (Dec. 18, 2017, 11:22 AM), <https://www.wsj.com/articles/tax-bill-jolts-municipal-bond-market-1513593001>.

¹⁹⁸ See Hammer & McCarthy, *supra* note 196 (“The reduction in corporate tax rates to 21% from 35% is quite meaningful for muni yields on a taxable-equivalent basis”); Gillers, *supra* note 197.

¹⁹⁹ See Gillers, *supra* note 197.

²⁰⁰ See Hammer & McCarthy, *supra* note 196.

²⁰¹ See Hammer & McCarthy, *supra* note 196.

²⁰² See SCOTT, *supra* note 21, at 128–31.

²⁰³ See SCOTT, *supra* note 21, at 128–31.

effect.²⁰⁴ In 2018, the Federal Reserve raised the federal funds rate four times. Rates were raised on March 22, June 14, September 27, and December 20.²⁰⁵

Stock market volatility, driven by federal funds rate increases and President Donald Trump's enactment of tariffs on trade partners, made municipal bonds more attractive to investors.²⁰⁶ Standard and Poor's 500, an American stock market index, peaked at 2,930.75 on September 20, 2018 and ended the year at 2,506.85.²⁰⁷ On December 4, the day the bonds was issued, the Dow Jones Industrial Average, another market index, fell by 799.36 points.²⁰⁸ Standard and Poor's 500 fell to 2,700 and the NASDAQ fell by 283.09 points to 7,158.43.²⁰⁹ In response, investors flocked to U.S. treasuries and municipal bonds.²¹⁰

Prior to the City's bond issuance, both Moody's Investor Service and Standard and Poor's rated the City's creditworthiness. On November 2, 2018, Moody's issued a report that rated the City's debt at Ba3, one notch above junk status.²¹¹ In its report, Moody's said the City's economic base "remains weak relative to peers and carries high recession risk stemming from low diversity" and "a volatile revenue structure and very high overlapping debt and capital needs."²¹² To justify its stable outlook in the presence of these weaknesses, Moody's cited the City's "strong preparation for challenges ahead including the need to make capital investments and absorb pending spikes to fixed cost."²¹³

²⁰⁴ See SCOTT, *supra* note 21, at 128–31.

²⁰⁵ See FED. RES. SYS., OPEN MKT. OPERATIONS (2020), <https://www.federalreserve.gov/monetarypolicy/openmarket.htm>. (The "FOMC's target federal funds rate or range, change (basis points) and level" section indicates there was a twenty-five-basis-point increase in the federal funds rate on March 22, June 14, September 27, and December 30, 2018, a 100-basis-point increase over the year.)

²⁰⁶ See Emily Flitter, *Stocks Rise as Wall St.'s Roller Coaster Stages Late-Date Rally*, N.Y. TIMES (Dec. 27, 2018), <https://www.nytimes.com/2018/12/27/business/global-stock-markets.html>; Stephen Shultz, *Muni Bonds: Winners in 2018 and Bright Skies for 2019*, BROWN ADVISORY (Feb. 7, 2019), <https://www.brownadvisory.com/us/muni-bonds-winners-2018-and-bright-skies-ahead-2019>.

²⁰⁷ *S&P 500 Index*, WALL ST. J. (last visited Oct. 3, 2020), <https://quotes.wsj.com/index/SPX> (search "September 20, 2018" as the date of the index).

²⁰⁸ Michael Wursthorn & David Hodari, *Dow Tumbles Nearly 800 Points as Trade Jitters Return*, WALL ST. J. (Dec. 4, 2018, 6:38 PM), <https://www.wsj.com/articles/dow-tumbles-nearly-800-points-as-trade-jitters-return-1543959007>.

²⁰⁹ *Id.*

²¹⁰ See Daniel Kruger, *U.S. Government Bonds Gain as Stocks Sink*, WALL ST. J. (Dec. 4, 2018, 5:40 PM), https://www.wsj.com/articles/u-s-government-bonds-gain-yield-curve-flattens-1543938831?mod=article_inline.

²¹¹ Moody's Investors Service, *Rating Action: Moody's Assigns Ba3 to Detroit, MI's GO Bonds; Outlook Stable*, MOODY'S (Nov. 2, 2018), <https://www.cityofdetroitbonds.com/detroit-mi-investor-relations-mi/documents/view-file/i1383?mediaId=249209>.

²¹² *Id.*

²¹³ *Id.*

In a credit rating approximate to that used by Moody's, Standard and Poor's rated the City's debt at B+ with a stable outlook on February 7, 2019.²¹⁴ Like Moody's, Standard and Poor's cited the City's weak economy and noted that the City's "pension plans are poorly funded and represent a significant unfunded long-term liability and source of budgetary pressure."²¹⁵ Yet, the report also commended the City for the development of cash reserves and financial management reforms such as the adoption of multi-year budgeting, revenue estimating conferences, and centralization of financial operations in the newly created Office of the Chief Financial Officer.²¹⁶ In both reports, the credit rating agencies were cautiously optimistic about the City's recovery and ability to repay its debts.²¹⁷

VII. MARKET CONDITIONS

Municipal bankruptcy is rare. In part, that rarity can be explained by the infrequency of municipal default: it is rare for a municipal debtor to fail to pay its debts in full and on time. Of those few defaults, an even smaller number of cases will be resolved in bankruptcy court. However, scholars have offered another reason: the threat of reputational harm.²¹⁸ Simply put, a bankrupted debtor will be seen as a deadbeat—even after a "successful" bankruptcy where debt has been adjusted and the debtor better able to meet both its commitments to creditors and citizens.²¹⁹ Detroit's reentry into the municipal securities market is not, in and of itself, cause to reject that theory, but it is a reason to question the theory of reputational harm more deeply than it has been before.

Detroit's case offers an entryway to discussion for a few reasons. First, the City is an unfortunate example of economic decline²²⁰ and "financial embarrassment."²²¹ Detroit's bankruptcy was widely publicized. Second, the

²¹⁴ John Sauter & Jane H. Ridley, *Detroit: General Obligation*, S&P GLOBAL RATINGS 2 (Feb. 7, 2019), <https://www.cityofdetroitbonds.com/detroit-mi-investor-relations-mi/documents/view-file/i1383?mediaId=307761>.

²¹⁵ *Id.* at 9.

²¹⁶ *Id.* at 11.

²¹⁷ *Id.*; Moody's Investors Service, *Rating Action: Moody's Assigns Ba3 to Detroit, MI's GO Bonds; Outlook Stable*, MOODY'S (Nov. 2, 2018), <https://www.cityofdetroitbonds.com/detroit-mi-investor-relations-mi/documents/view-file/i1383?mediaId=249209>.

²¹⁸ See Omer Kimhi, *Chapter 9 of the Bankruptcy Code: A Solution in Search of a Problem*, 27 YALE J. ON REG. 351, 382 (2010).

²¹⁹ *Id.*

²²⁰ Scott Beyer, *Why Has Detroit Continued to Decline?*, FORBES (July 31, 2018, 11:58 PM), <https://www.forbes.com/sites/scottbeyer/2018/07/31/why-has-detroit-continued-to-decline/#23b9a1e13f8e>.

²²¹ See generally Edward J. Dimock, *Legal Problems of Financially Embarrassed Municipalities*, 22 VA. L. REV. 39, 39 (1936) (discussing the issues that financially embarrassed municipalities face).

City's market reentry occurred only a few years after its bankruptcy case concluded.²²² In all likelihood, the City's default and bankruptcy were still on the minds of potential investors. Also, while the issuance of general obligations is not the first issuance by the City after it concluded its case, it is the first issuance based on the City's own creditworthiness.²²³ In other words, the City's full faith and credit is all that assures repayment.²²⁴ This is another area where the City's case is special and different from others.

Up until the City's case, it was believed that a municipal debtor's pledge of its full faith and credit was an unbreakable vow—even in bankruptcy.²²⁵ This belief was not merely an extension of debtor and creditor law, but rather the ethos of the municipal securities market.²²⁶ Orange County, California, which filed for bankruptcy after a disastrous investment ploy by its treasurer-tax collector, Robert Citron, held bondholders harmless.²²⁷ Central Falls, Rhode Island, held bondholders harmless too, even as it asked some of its pensioners to sacrifice up to 55% of the pension income promised to them by the City.²²⁸ Detroit broke that vow.²²⁹

²²² CITY OF DETROIT, CNTY. OF WAYNE, STATE OF MICH. UNLIMITED TAX GENERAL OBLIGATION BONDS, SERIES 2018 (2018), <https://emma.msrb.org/ES1222098-ES954190-ES1355147.pdf>.

²²³ See CITY OF DETROIT, CNTY. OF WAYNE, STATE OF MICH. UNLIMITED TAX GENERAL OBLIGATION BONDS, SERIES 2018 (2018), <https://emma.msrb.org/ES1222098-ES954190-ES1355147.pdf>.

²²⁴ *Detroit Sees Little Bankruptcy Penalty as It Sells Muni Bonds*, DETROIT NEWS (Dec. 5, 2018, 9:26 AM), <https://www.detroitnews.com/story/news/local/detroit-city/2018/12/04/detroit-municipal-muni-bonds-bond-market/38673439/>.

²²⁵ Randle Pollard, *Feeling Insecure—A State View of Whether Investors in Municipal General Obligation Bonds Have a Mere Promise to Pay or a Binding Obligation*, 24 WIDENER L. J. 19, 35–39 (2015) (“Historically, investors generally assumed that UTGO bonds investors and pension benefits received the highest priority treatment, followed by LTGO bonds, pension obligation investment instruments, other general fund claims, and lastly retiree healthcare obligations”).

²²⁶ See *id.* at 21.

²²⁷ *In re Cty. of Orange*, 179 B.R. 185, 192 (Bankr. C.D. Cal. 1995), *rev'd* 189 B.R. 499 (Bankr. C.D. Cal. 1995) (“Section 928 was narrowly crafted to apply only to special revenue bonds. Congress could have made § 928 applicable to all municipal bonds, but it chose to limit its application. Section 552(a) is, therefore, still applicable to general revenue bonds”).

²²⁸ *In re City of Cent. Falls*, 2011 Bankr. LEXIS 5432, at *2 (Bankr. D.R.I. Nov. 2, 2011). The bondholders' escape in the City of Central Falls case was widely publicized. Maria O'Brien Hylton, *Central Falls Retirees v. Bondholders: Assessing Fear of Contagion in Chapter 9 Proceedings*, 59 WAYNE L. REV. 525, 526 (2013) (“Central Falls' bondholders' rights were well protected; the restructuring that was ultimately approved imposed virtually all of the costs onto current and former municipal employees and taxpayers”); Hilary Russ, *Bankruptcy Saves Tiny Rhode Island City, But Leaves Scars*, REUTERS (Sept. 3, 2012, 8:10 PM), <https://www.reuters.com/article/us-usa-rhodeisland-centralfalls-bankrupt/bankruptcy-saves-tiny-rhode-island-city-but-leaves-scars-idUSBRE88300220120904>.

²²⁹ See *In re City of Detroit*, 524 B.R. 147, 198 (Bankr. E.D. Mich. 2014) (confirming the bondholder-city settlement where bondholders' interest was impaired).

Debt, and by extension, the holder of that debt, is either secured or unsecured. Debt is secured when the debtor has promised collateral to the creditor. Upon default, a creditor may then exercise their claim and hold or sell the collateral to make themselves whole. Unsecured debt is the opposite. Unsecured debt is unprotected and is therefore subject to impairment in bankruptcy.²³⁰ Bondholders believed themselves to be secured creditors.²³¹ Rather than bear any cost, bondholders believed that City retirees via reduced pension income, and residents via reduced services, would bear the cost of bankruptcy.²³² Instead, the City insisted that general obligation bondholders were treated as any other unsecured creditor.²³³ While the matter was not fully adjudicated, the City's plan of adjustment repaid bondholders less than they were owed.²³⁴ The results of Detroit's case not only upended market assumptions and theories of bankruptcy law, but further makes the case for analysis of the City's reentry into the municipal securities market.

Evidence from Orange County's bankruptcy provides some empirical support to the existence of a market penalty.²³⁵ Research published in *The Financial Review* in 2004 found at the time that there was a penalty to be paid or "contagion" that spread to the municipal securities market at least in the immediacy of the county's bankruptcy filing.²³⁶ More precisely, the researchers found "contagion in the bond market with significantly negative abnormal returns for municipal bond funds without direct exposure to Orange County and for non-Orange County municipal bonds."²³⁷ Similarly, Genesee County, Michigan halted the issuance of \$54.2 million in bonds two weeks after Detroit filed for bankruptcy under the belief it would pay a market penalty.²³⁸ The case for a market penalty is not conclusive, however. But since there is at least some evidence of a market penalty for bankruptcy, it must then be asked why Detroit

²³⁰ See generally Skeel, *supra* note 32, at 676–77 (describing liens, security statuses in the context of municipal bankruptcies, and particularly, the Detroit bankruptcy).

²³¹ See Skeel, *supra* note 32, at 694 ("There also are strong normative grounds for the conclusion that pensions can be restructured, at least under some circumstances").

²³² Karen Pierog, *Detroit's Bankruptcy Plan Spares Pensions from Deepest Cuts*, REUTERS (Feb. 21, 2014, 8:35 PM) <https://www.reuters.com/article/us-usa-detroit-bankruptcy/detroits-bankruptcy-plan-spare-pensions-from-deepest-cuts-idUSBREA1K1G520140222>.

²³³ *Id.*; see Skeel, *supra* note 32, at 694–98.

²³⁴ See *In re City of Detroit*, 524 B.R. at 198.

²³⁵ John M. Halstead, Shantaram Hegde & Linda Schmid Klein, *Orange County Bankruptcy: Financial Contagion in the Municipal Bond and Bank Equity Markets*, 39 FIN. REV. 293, 302–06 (2004).

²³⁶ *Id.* at 303–06.

²³⁷ *Id.* at 293.

²³⁸ Brian Chappatta, *Michigan County Puts Off Bond Sale Amid Detroit Penalty*, BLOOMBERG NEWS (Aug. 2, 2013, 12:01 AM), <https://www.bloomberg.com/news/articles/2013-08-02/michigan-county-puts-off-bond-sale-amid-detroit-penalty>.

does not appear to have paid it? Phrased another way: why was there excess demand for Detroit's bond issuance when the City had impaired contracts with bondholders only a few years back?

As stated earlier, municipal bonds are an investment made by the bond purchasers.²³⁹ Individuals and institutions lend money via bond purchases to the municipal bond issuers.²⁴⁰ The bondholder's primary concern is to be repaid their initial investment and profit from the interest paid by the borrower.²⁴¹ Ostensibly \$7.4 billion less indebted than it was pre-bankruptcy, Detroit had fewer claims on its limited resources post-bankruptcy.²⁴² Moreover, a number of Detroit's financial metrics improved between 2013 and 2018.²⁴³ For example, debt as a percent of taxable value (value of the City's tax base) fell from 26% in FY 2013 to 22% in FY 2018 in spite of a citywide reassessment that lowered the taxable value between those years.²⁴⁴ Simply put, Detroit has less debt. The City has fewer liabilities to compromise its financial condition and is more likely to pay back what it owes (satisfying bondholders) post-bankruptcy.

Consider other financially distressed municipalities, such as the Chicago Public Schools (CPS), that have not had the benefit of debt adjustment. CPS debt is rated as junk.²⁴⁵ The school district's pension fund for teachers is underfunded, and the demand to fulfill its promises to retirees has diminished its ability to fulfill its promises to students.²⁴⁶ In 2018, CPS issued \$1.3 billion in "Unlimited Tax General Obligation Refunding Bonds."²⁴⁷ On November 30, 2018, CPS's last issuance, CPS issued \$763,395,000 in bonds supported by the "full faith and credit and the taxing power" of the Chicago Board of Education.²⁴⁸ Like Detroit, CPS had run annual deficits in prior years, cut services, and is at risk of insolvency. Like Detroit, the debt issued by CPS carried an interest rate of 5%.²⁴⁹

²³⁹ SCOTT, *supra* note 21, at 2.

²⁴⁰ SCOTT, *supra* note 21, at 2.

²⁴¹ SCOTT, *supra* note 21, at 5–7.

²⁴² See *In re City of Detroit*, 524 B.R. 147, 162 (Bankr. E.D. Mich. 2014).

²⁴³ Klinefelter, *supra* note 17.

²⁴⁴ CITY OF DETROIT COMPREHENSIVE ANN. FIN. REP. FOR THE FISCAL YEAR ENDED JUNE 30, 2018 (2018), https://detroitmi.gov/sites/detroitmi.localhost/files/2019-10/FY_2018_CAFR.pdf (on file with the Michigan Secretary of State).

²⁴⁵ Banerji, *supra* note 2 (noting Detroit's new bond offerings "priced with yields about 0.2 percentage points lower than five-year debt sold recently by the Chicago Board of Education . . .").

²⁴⁶ See Juan Perez, Jr., *Chicago Public Schools' Huge Pension Debt Just Got \$1 Billion Deeper, New Estimates Show*, THE CHI. TRIB. (Mar. 27, 2018, 6:45 AM), <https://www.chicagotribune.com/news/ct-met-chicago-teachers-pension-fund-update-20180313-story.html>.

²⁴⁷ See *id.*

²⁴⁸ BD. OF EDUC. OF THE CITY OF CHI., UNLIMITED TAX GEN. OBLIGATION REFUNDING BONDS, SERIES 2018C, 2018D (2018), <https://emma.msrb.org/ES1222772-ES954787-ES1355739.pdf>.

²⁴⁹ *Id.*

Yet unlike Detroit, CPS is not yet insolvent and has not declared bankruptcy. So, what then was the market penalty for Detroit?

CONCLUSION

This Article does not mean to insinuate that there is no market penalty for bankruptcy. Detroit and any other bankrupted debtor would still be assumed to pay more in interest than a municipality that had never defaulted. Rather, this Article asks and attempts to answer why Detroit does not appear to have paid an explicit market penalty as some theorized it would.²⁵⁰ Either one or a combination of two alternative theories may explain the absence of a more explicit market penalty. The first is the “fresh start” theory. In short, investors determined that Detroit had rehabilitated post-bankruptcy. Because the main interest of investors is to be repaid, investors may understandably look more favorably on a city like Detroit that is in better financial condition post-bankruptcy.

The second theory is that market conditions caused investors to overlook elements of the City’s profile that otherwise would have disqualified it from borrowing. In 2018, the year Detroit issued its bonds, investors’ attention was unusually drawn to the municipal securities market.²⁵¹ This was because stock market volatility led investors to focus on fixed-income securities like municipal bonds.²⁵² These market conditions may have led investors to overlook the City’s demerits, and had the City offered debt on a different occasion it may have attracted more scrutiny and found the market less receptive.

Bankruptcy is the last resort for insolvent municipalities and should remain so, irrespective of the conclusions of this Article. The process can be expensive,²⁵³ not merely in monetary terms, the cost of attorneys and financial advisors, but in time. Detroit’s case was resolved relatively quickly compared to Jefferson County—the county spent nearly three years in bankruptcy court.²⁵⁴ Moreover, the process is uncertain. Few cases mean little precedent. Lastly, the implicit cost to a community’s reputation may be extensive.²⁵⁵

²⁵⁰ See BARSON, ET AL., *supra* note 5, at 11.

²⁵¹ See Gillers, *supra* note 197.

²⁵² See Gillers, *supra* note 197.

²⁵³ See Monica Davey & Mary Williams Walsh, *Plan to Exit Bankruptcy Is Approved for Detroit*, N.Y. TIMES (Nov. 7, 2014), <https://www.nytimes.com/2014/11/08/us/detroit-bankruptcy-plan-ruling.html>.

²⁵⁴ Compare *In re City of Detroit*, 524 B.R. 147, 162 (Bankr. E.D. Mich. 2014) (showing a municipality bankruptcy case lasting just over one year), with *In re Jefferson Cnty.*, 474 B.R. 228, 245 (Bankr. N.D. Ala. 2012) (showing a municipality bankruptcy case lasting three years).

²⁵⁵ See BARSON, ET AL., *supra* note 5, at 11–12.

Detroit's successful reentry to the municipal securities market is reason to believe that the implicit cost may be less than assumed, however. Moreover, if participants in the municipal securities market do not distinguish between bankrupted municipalities and financially distressed municipalities, then those latter entities may deem bankruptcy to be an attractive option. If there is no reward for having avoided bankruptcy, why should distressed entities suffer a potentially disorderly default or the punitive austerity needed to pay creditors with limited revenues?²⁵⁶ In other words, market participants may unintentionally make bankruptcy, a process by which their investments are imperiled, more attractive to insolvent municipalities.

²⁵⁶ See generally Michelle Wilde Anderson, *The New Minimal Cities*, 123 YALE L.J. 1118, 1128–29 (2014) (juxtaposing bankruptcy with fiscal austerity to overcome municipal finance troubles.).