Nos. 14-1208, 14-1209, 14-1211, 14-1212, 14-1213, 14-1214, and 14-1215

In the
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re: Police and Fire Retirement System of the City of Detroit; General Retirement System of the City of Detroit,
Petitioners.

In re: The Official Committee of Retirees of the City of Detroit,
Petitioners.

In re: Michigan Council 25 of the American Federation of State, County and Municipal Employees, AFL-CIO and Subchapter 98, City of Detroit Retirees,
Petitioners.

In re: Retired Detroit Police & Fire Fighters Association; Donald Taylor, individually and as President of RDPFFA; Detroit Retired City Employees Association; Shirley V. Lightsey, individually and as President of DRCEA,
Petitioners.

In re: International Union, United Automobile, Aerospace and Agricultural Implement Workers of America and Robbie Flowers, Michael Wells, Janet Whitson, Mary Washington and Bruce Goodman,
Petitioners.

In re: Detroit Fire Fighters Association, the Detroit Police Officers Association and the Detroit Police Command Officers Association,
Petitioners.

In re: Retired Detroit Police Members Association,
Petitioner.

Appeals from the United States Bankruptcy Court
Eastern District of Michigan, Honorable Steven W. Rhodes

MICHIGAN ATTORNEY GENERAL'S APPELLEE'S BRIEF ADDRESSING MICHIGAN'S CONSTITUTIONAL PROTECTIONS OF VESTED PENSIONS

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STATEMENT IN SUPPORT OF ORAL ARGUMENT

The Michigan Attorney General, Bill Schuette, requests oral argument. The issue about whether the City of Detroit must honor the Michigan constitution – and its protection of vested pensions – in bankruptcy is an issue of first impression within this circuit and is relevant to national bankruptcy jurisprudence. The issue presented involves principles of federalism, comity, and Chapter 9 of the Bankruptcy Code. The relationship between the Bankruptcy Code and Michigan's constitutional regulation of the City of Detroit's exercise of its governmental power regarding vested pensions directly implicates the sovereignty of the State of Michigan.

As a consequence, the Attorney General respectfully requests oral argument.

JURISDICTIONAL STATEMENT

The City of Detroit filed this case under Chapter 9 of the Bankruptcy Code pursuant to 11 U.S.C. § 301(a). The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(a). On December 5, 2013, the bankruptcy court held that, under 11 U.S.C. § 109(c), the City is eligible to discharge accrued pension benefits as a Chapter 9 debtor. R. 1945, Eligibility Op; R. 1946, Order for Relief.

This Court has jurisdiction under 28 U.S.C. § 158(d)(2)(A). On December 20, 2013, the bankruptcy court certified its eligibility decision for a direct appeal to this Court. On February 21, 2014, this Court authorized the appeal.

STATEMENT OF ISSUE PRESENTED

1. Michigan's Pension Clause is foundational State law that governs the City of Detroit by protecting vested pensions. Under the Bankruptcy Code, Congress expressly reserved State law in a municipal bankruptcy for laws that regulate a city's exercise of governmental powers. The issue therefore is whether Michigan's constitutional protection of vested pensions is a mere contract right that may be reduced in bankruptcy or is it a reserved power of the State under 11 U.S.C. § 903.

INTRODUCTION

The City of Detroit's bankruptcy filing explained the stark condition of the City's finances and the City's financial inability to provide basic services, much less to pay down the City's massive debt load. The City's filing forcefully demonstrates that the decision to authorize the bankruptcy on behalf of the City was necessary. Accordingly, the Attorney General fully supports the bankruptcy court's determination that the City was eligible to file for bankruptcy.

The Attorney General also supports the City's efforts to negotiate a plan of adjustment that can be confirmed without the need for litigation between the City and its pensioners. Any plan that ensures the City's emergence from bankruptcy increases the likelihood that the City will again become a world-class metropolis.

Negotiations have resulted in an unprecedented commitment from non-profit foundations, labor organizations, and the State of *more than $800 million* to help pay pensioners and save the City's world-class art collection. These monies will be available to fund pensions only if the so-called "grand bargain" is approved.

It is, of course, the pensioners' right to vote in favor of this plan. *See Stone v. State*, 651 N.W.2d 64, 66 (Mich. 2002) ("There is no question that a constitutional right can be contractually relinquished[.]"); *Cranford v. Wayne County,* 402 N.W.2d 64, 66 (Mich. Ct. App. 1986) (plaintiffs waived their rights under their former pension plan when they voluntary chose to seek and accept promotions that entailed membership in a different pension plan). And if they do, the Attorney General will honor their vote and that democratic decision.

If, on the other hand, the pensioners choose to reject the grand bargain and the $800+ million pension contribution, it is the Attorney General's duty to uphold and defend the Michigan Constitution. And as the Attorney General's previous filings have explained, art. IX, § 24 of Michigan's Constitution limits the City's ability to discharge vested pension liability, a limitation that the bankruptcy process incorporates under 11 U.S.C. §§ 903 and 904. Michigan's Constitution cannot be disregarded or ignored.

STATEMENT OF FACTS AND PROCEEDINGS

A. The bankruptcy court's ruling on eligibility.

In the bankruptcy court's ruling in favor of the City's eligibility to proceed in bankruptcy, the court treated the Michigan Constitution's Pension Clause as a mere contract clause that created, solely, a contractual relationship between the City and its employees and retirees that is subject to modification in bankruptcy.

Article IX, § 24 of the Michigan Constitution directs both the State and its political subdivisions to exercise their respective governmental powers to protect accrued financial benefits of governmental pensions and the concurrent funding of pension plans:

> The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.
>
> Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year and such funding shall not be used for financing unfunded accrued liabilities.

This Clause was adopted in 1963 for the purpose of changing public pensions being, at common law, gratuitous allowances that could be revoked at will. (R. 1945, Eligibility Op. at 75.) The result of the

constitutional provision was to ensure that "public pensions be treated as contractual obligations that, once earned, could not be diminished." (*Id.* at 77, quoting *In re Constitutionality of 2011 PA 38*, 806 N.W.2d 683 (Mich. 2011)).

Based on its review of Michigan law, the bankruptcy court determined that there is no protection afforded accrued financial benefits in bankruptcy. (R. 1945, Eligibility Op. at 78.) It construed Michigan law to provide only that the Pension Clause created a mere contractual relationship between the City and retirees. The bankruptcy court held that if the Michigan Supreme Court were faced with the issue of whether Chapter 9 of the Code violates the U.S. Constitution, Article X, that that Court would conclude that the Pension Clause merely affords "pension rights the protection of contract rights." (R. 2269, Certification Mem. at 5.) Similarly, the bankruptcy court held that Public Act 436 of 2012 does not violate the Pension Clause because "under the Michigan Constitution pension rights are afforded only the protections of contract rights." (*Id.* at 6.)

B. The City's plan for adjustment of its debts.

Based on the bankruptcy court's rejection of the inviolability of the Pension Clause, the City's Fourth Amended Plan filed on May 5, 2014 proposes to diminish vested accrued financial pension benefits.

There are two employee and retiree classes that relate to pensions – Classes 10 and 11, (R. 4392, 4th Am. Plan Art. II.B.3.q, and .r, pp 34 and 36, respectively.) The members of the Police and Fire Retirement System (PFRS) are classified as Class 10 claims. (*Id.*, Art. II.B.3.q, p 34.) Members who are participants of the General Retirement System (GRS) are classified as Class 11. (*Id.*, Art. II.B.3.r, p 36.) This classification is relevant for voting, confirmation, and distribution purposes. (*Id.*, Art. II, p. 27.) The City proposes to reduce the accrued financial benefits of employees and retirees within Classes 10 and 11, but these reductions will be drastically greater if these classes vote to reject the proposed plan, due to the loss of outside (i.e., non-City) funding. *Id.*

Specifically, if both Classes vote to accept the plan and funds are received from the Detroit Institute of the Arts Settlement and from the State Contribution Agreement, then Class 10 Police and Fire

Department pensioners will receive their current accrued annual pensions and a reduced cost-of-living allowance adjustment of 45% from bargained-for increases (4th Am. Plan, Art. I.A. ¶ 209, p. 19.) Class 11 City pensioners will have their monthly pension payments reduced by 4.5%, have their cost-of-living allowance eliminated, and may face a further reduction for the Annuity Savings Fund recoupment. (*Id.*, Art. I.A., ¶ 154, p. 13.)

If either of the Classes reject the plan or there is no funding from either the DIA Settlement or the State Contribution Agreement, then Class 10 pensioners will receive their current accrued annual pensions and the elimination of the cost of living allowance adjustments, (4th Am. Plan, I.A., ¶ 209, p. 19), and Class 11 pensioners will have their monthly pension payments cut by 27%, have their cost-of-living allowance adjustments eliminated, and may face further reduction for the Annuity Savings Fund recoupment. (4th Am. Plan, I.A., ¶ 154, p14.)

STANDARD OF REVIEW

The Sixth Circuit reviews a bankruptcy court's conclusion of law de novo. *In re Southern Air Transport*, 511 F.3d 526, 530 (6th Cir. 2007); *In re 5900 Associates*, 468 F.3d 326, 329 (6th Cir. 2006).

SUMMARY OF ARGUMENT

As noted above, the City's pensioners have the ability to vote for the Fourth Amended Plan and moot this litigation. Given the unprecedented ($800+ million) outside contribution to help preserve vested pension payments in the event of approval, there is much to commend about that approach, including the City's exit from bankruptcy and an ability to get started on recovery and rebuilding. The Attorney General will honor the pensioners' vote and that democratic decision if the pensioners approve it.

It is important to note that the pension obligation runs to *the City* – not the State – because in this situation the Pension Clause binds only the City for the City's retirement system. As a result, the State has *no* obligation to pay the pension deficit if the City cannot meet its obligations under its retirement system. (1976 Mich. Op. Att'y Gen. No. 5076 (Aug. 9, 1976)).

And, if the grand bargain is not approved, Michigan's Constitution cannot simply be ignored or brushed aside. Congress created a careful interplay between allowing a city to enter bankruptcy to discharge its debts while simultaneously ensuring that state law would continue to

govern the city in its exercise of governmental powers while in bankruptcy under 11 U.S.C. §§ 903 and 904. Congress did so to ensure that federal power did not interfere with the states' sovereignty, particularly the states' authority over the exercise of fiscal and governmental powers by their political subdivisions.

And here is the critical point. The protection in Michigan of vested pensions is a matter of city governance, not mere contract law. Through the Pension Clause, the Michigan Constitution regulates the City's exercise of its governmental power affecting vested pensions. It is foundational State law. The City and the emergency manager are creations of the State, and are subject to its laws. The Legislature cannot authorize either the City or the emergency manager to violate the Michigan Constitution. Consequently, both remain subject to the Constitution throughout the City's bankruptcy proceeding.

The Pension Clause binds the City in bankruptcy because it is not a mere contracts provision subject to modification in bankruptcy. Under Michigan rules of statutory construction, the ordinary words of the Pension Clause impose *two* obligations on the City with respect to its pension and retirement systems. First, the City must treat its

obligations to those systems as contractual, as the district court recognized. Second, the City must not take *any action* that unilaterally impairs or diminishes vested accrued financial benefits. Thus, the Pension Clause is different in kind from a contracts provision. Rather, the Pension Clause regulates the City's legal relationship, its fiscal responsibility, and limits the City's exercise of its governmental powers by prohibiting the impairment or diminishment of accrued financial benefits.

Significantly, the Pension Clause does not frustrate the purpose of a Chapter 9 municipal bankruptcy. The Code already recognizes that certain types of debts may not be discharged or adjusted. Consequently, the Pension Clause comports with the Code.

ARGUMENT

I. Consistent with §§ 903 and 904 of the Bankruptcy Code, Michigan's Pension Clause protecting vested pension benefits binds the City in bankruptcy.

Under the Bankruptcy Code, Congress through §§ 903 and 904 expressly allows state law to govern a city with respect to the exercise of its political and governmental powers during a Chapter 9 proceeding. These provisions both limit a city's actions in bankruptcy and limit the bankruptcy's court's authority over the city.

A. The Bankruptcy Code ensures that state law applies to the City in its exercise of governmental power.

The purpose of the Bankruptcy Code is the adjustment of debts, and indeed, for Chapter 9 filings, "[t]he general policy considerations underlying the municipal debt adjustment plan of chapter 9 are . . . to give the debtor a breathing spell from debt collection efforts and establish a repayment plan with creditors." *In re Addison Cmty Hosp. Auth.*, 175 B.R. 646, 649 (Bankr. E.D. Mich. 1994). In this process, "the law must be sensitive to the issue of the sovereignty of the states." *Id.* "The powers of the court are subject to a strict limitation[.]" *Id.*, quoting 121 Cong. Rec. H39409–10 (daily ed. Dec. 9, 1975).

"Consequently, chapter 9 avoids placing any restrictions on the powers of the states in the exercise of their sovereign rights and duties." *Id*. The United States Supreme Court has long held the same view. *United States v. Bekins,* 304 U.S. 27, 51 (1938). Chapter 9 of the Code does not violate the United States Constitution because it "expressly avoids any restriction on the powers of the States or their arms of government in the exercise of their sovereign rights and duties," including that no "interference with the fiscal or governmental affairs of a political subdivision is permitted." *Id.* at 51, quoting H. Rep. No. 517, 75th Cong., 1st Sess.)

Under § 903, the Congress provided that Chapter 9 "does not limit or impair the power of a State to control, by legislation or otherwise, a municipality of or in such State in the exercise of the political or governmental powers of such municipality, including expenditures for such exercise[.]" 11 U.S.C. § 903. Section 903 "embodies a statutory declaration that the enactment of municipal bankruptcy law pursuant to Article I, section 8 of the United States Constitution does not limit or impair the rights reserved to the states pursuant to the Tenth Amendment." 6 Collier on Bankruptcy ¶ 903.01. Courts have reached

the same conclusion, holding that "Congress did not intend for federal bankruptcy law to supersede or impair the power of the state to create, limit, authorize, or control a municipality in the exercise of its political or governmental powers." *In re City of Colo. Springs Spring Creek Gen. Improvement Dist.*, 177 B.R. 684, 693 (Bankr. D. Colo. 1995).

Under § 904, Congress shielded State law by removing from the bankruptcy court's sphere of power the use of "any stay, order, or decree, in the case or otherwise, [to] interfere with . . . any of the political and governmental powers of the debtor." 11 U.S.C. § 904(1); *see also Addison Cmty Hosp.*, 175 B.R. at 649, quoting 121 Cong. Rec. H39413–14 (daily ed. Dec. 9, 1975) (statement of Rep. Badillo) (§ 904 embodies the doctrine that the "powers of the federal government are limited by the Constitution. The powers that are not given to the federal government are reserved to the states. One of the powers reserved to the states is the power to create and govern municipalities.") As one bankruptcy court has said, §§ 903 and 904 "honor[ ] state–federal balance by reserving certain state powers and by correlatively limiting the powers of the federal court[.]" *In re City of Stockton*, 478 B.R. 8, 16 (Bankr. E.D. Cal. 2012).

These sections are *only* applicable *after* a municipality initiates a Chapter 9 proceeding by filing a petition for bankruptcy. These sections fall within Congress' federal bankruptcy power afforded under the Bankruptcy Clause, *Marine Harbor Props., Inc. v. Mfrs. Trust Co.,* 317 U.S. 78, 83 (1942); *Int'l Shoe Co. v. Pinkus*, 278 U.S. 261, 265 (1929), which "embrace[s] within its legislation whatever may be deemed important to a complete and effective bankrupt system." *United States v. Fox*, 95 U.S. 670, 672 (1878). And when Congress has withdrawn from state and federal courts a power under the Code, "its Act is the supreme law of the land which all courts – State and Federal – must observe." *Kalb v. Feuerstein*, 308 U.S. 433, 439 (1940).

B. The City and its emergency manager are bound to follow state law, including the Pension Clause.

Counties, cities, townships, villages and other governmental formations of Michigan are creatures of the state's Constitution and authorized legislative enactments. Mich. Const. art. VII, §§ 1, 17, 21, 22, and 27. The powers of any such subdivision of the state government are limited to those express powers conferred upon them by the Constitution or by state law or necessarily implied from them.

Hanselman v. Killeen, 351 N.W.2d 544, 552 (Mich. 1984). Generally, the constitutional provisions creating and imposing rights and duties upon such local units of government are not self-executing but require the aid of legislative enactment. *Oakland County Comm'rs v. Oakland County Executive*, 296 N.W.2d 621, 626 (Mich. Ct. App. 1980). Local units of government are subject to the general control of the Legislature. *Detroit v. Oakland Circuit Judge*, 212 N.W. 207, 209 (Mich. 1927). The Legislature enacted the Home Rule City Act, Public Act 279 of 1909, to authorize incorporation of cities, to revise and amend their charters, and to provide for certain powers and duties. Mich. Comp. Laws § 117.1 *et seq*.

The Home Rule City Act establishes the system of local government, its regulatory powers, and general governmental powers including employing city employees. Mich. Comp. Laws § 117.1 *et seq*. Under that law, municipalities are allowed to include in their charter provisions the creation and maintenance of a system of civil service for city employees. § 117.4i(h). The City of Detroit included within its Charter a classified civil service. Article 6, Chapter 4, the City of Detroit's Home Rule City Charter ("Detroit Charter"), §§ 6-401, 6-409,

6-417. Similarly, the City included as a charter provision a system of compensation for city employees. Mich. Comp. Laws § 117.4i(i); Detroit Charter, Art. 2, § 2-108. And the City also included within its Charter a retirement system in the exercise of its governmental powers. Detroit Charter, Art. 11, §11-101. This Charter provision tracks the language of article IX, § 24 of the Michigan Constitution – it prohibits the City from reducing or impairing the vested pension benefits of its employees and retirees. Having enacted within its Charter a retirement system, the City's exercise of this retirement system is governed by article IX, § 24.

Under Public Act 436 of 2012, the City's emergency manager acts as its receiver, and stands in the place of its governing body and chief executive officer. Mich. Comp. Laws § 141.1549(2). The manager also represents the City in bankruptcy. § 141.1558(1). He is a public officer subject to the laws applicable to public servants and officers. § 141.1549(3)(d) and (9)(a), (b), and (c). And the emergency manager has taken an oath to uphold the Michigan Constitution. § 15.151; Mich. Const. art. XI, § 1.

As a public officer, the emergency manager must comply with the Michigan Constitution and statutes enacted by the Legislature pursuant to its constitutional authority. This interplay of Michigan's Constitution and Public Act 436 requires the emergency manager to abide by all applicable laws in governing the City.

The same obligation to comply with the Michigan Constitution applies to the emergency manager during this Chapter 9 proceeding. "Indeed, absent a specific provision to the contrary, a municipality is required to continue to comply with state law during a Chapter 9 case." 6 Collier on Bankruptcy ¶ 903.02 (Alan N. Resnick and Henry J. Sommer eds. 16th ed.) This is significant because under Chapter 9, the City is the only party with authority to propose a plan of adjustment, 11 U.S.C. § 941, and therefore controls the plan process in a way that is unique to bankruptcy law.

The scope of a state's authorization of a municipal bankruptcy filing is a "question of pure state law" and thus "state law provides the rule of decision." *In re City of Stockton*, 475 B.R. 720, 728–29 (Bankr. E.D. Cal. 2012). The Michigan Legislature cannot enact laws that authorize local governments to violate the Michigan Constitution, and

the Legislature's enactment of Public Act 436 – specifically the bankruptcy authorization in § 18(1), Mich. Comp. Laws § 141.1558(1) – must thus be construed according to this basic legal principle. Thus, when the Legislature enacted Public Act 436 and empowered the City and its emergency manager to pursue bankruptcy, the City and the manager's actions in proposing a reorganization plan must comply with article IX, § 24 of Michigan's Constitution.

Moreover, the Michigan Legislature clearly intended that an emergency manager would be subject to this constitutional provision when it enacted the Emergency Manager Law, Public Act 436 of 2012, because the Act requires emergency managers appointed under the act to "fully comply with . . . section 24 of article IX of the state constitution of 1963," in the event that an emergency manager becomes the trustee for a local unit's pension fund. Mich. Comp. Laws § 141.1552(1)(m)(ii). The Legislature specified that the emergency manager would honor the Pension Clause in that regard.

C. The Pension Clause represents a limitation on the City's exercise of its government power and is not a mere contract provision without effect in bankruptcy.

Michigan's Pension Clause consists of two separate one-sentence paragraphs. The first specifies that if the State or its political subdivisions establish a pension plan or retirement system then the plan or system becomes a contractual obligation, and that neither the State nor its subdivisions may diminish or impair the accrued financial benefits. Mich. Const., art IX, § 24. The second provides that the State and its subdivisions shall fund financial benefits arising on account of service rendered in each fiscal year, during that fiscal year. *Id.*

The critical error of the bankruptcy court was to examine the Pension Clause and not give effect to all of its language. The Michigan courts give effect to the plain meaning of Michigan's Constitution. *Wayne Co. v. Hathcock,* 684 N.W.2d 765, 779 (Mich. 2004). They never fail to give language its ordinary effect, because no part of the text is mere surplusage. *Id.* Rather, they apply texts as written. *See American Federation v. City of Detroit,* 662 N.W.2d 695, 702 (Mich. 2003) ("every word should be given meaning, and we should avoid a construction that would render any part of the statute surplusage or nugatory").

The first paragraph of the Pension Clause is composed of two distinct clauses, one that establishes that "accrued financial benefits" are "contractual obligation[s]," and a second clause that provides that such obligations are not to be "*diminished* or impaired." Mich. Const. art. IX, § 24 ("[1] The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof [2] which shall not be *diminished* or impaired thereby") (emphasis added). This second clause is not mere surplusage. If the point were to create a contract obligation alone, the drafters would not have needed to further elaborate that these contractual obligations cannot be *diminished*.

Rather, this additional language ensures that the benefits will be held inviolate, elevated above ordinary contractual municipal obligations. The governmental duty to meet this financial obligation is underscored by the fact that the next paragraph requires the adequacy of funding for the obligation. Mich. Const., art. IX, § 24 ("Financial benefits arising on account of service rendered in each fiscal year shall be funded during that year [.]") These obligations are different in kind from exclusively contractual ones.

The Michigan Constitution does not require that other ordinary contractual obligations be subject to a concurrent obligation to ensure adequate funding. Necessarily, this legal duty limits the City with respect to funds already held by its retirement systems such that the City could not use such funds for other purposes. *Kosa v. State Treasurer*, 292 N.W.2d 452, 457–58 (Mich. 1980). The paragraph that requires annual funding does not reiterate the concept of a "contract" right, because such rights are not subject to such a funding obligation, but rather identifies these payments – "financial benefits" – for services already rendered. These are analogous to payments held by the municipal government in trust for these employees and retirees. The City has no authority to refuse to pay the vested accrued financial benefits that have already been effectively credited to these employees.

The entire thrust of article IX, § 24 is to safeguard a level of benefits for governmental employees who make a decision to retire. The public employees performed the work relying on a "particular level of benefits." 1 *Constitutional Convention Record* at 770–71 ("the service in reliance upon the then prescribed level of benefits"). The *post hoc* reduction of these vested rights would create an untenable position for

the retirees by reducing their compensation after the benefits have already vested. *See In re Advisory Opinion,* 209 N.W.2d 200, 202–03 (Mich. 1973) (rejecting any new conditions on accrued financial benefits that were "unreasonable and hence subversive of the constitutional protection"). It is analogous to forcing the pensioners to return deferred compensation. *See* 1 Official record of the State of Michigan Constitutional Convention of 1961, 770–71) (Delegate VanDusen) ("it is the belief of the committee that the benefits of pension plans are in a sense deferred compensation for work performed.") It is this very kind of reduction of pension payments that the constitutional provision is designed to prevent.

The Pension Clause is not simply a contract provision for purposes of the Bankruptcy Code. Rather, in regulating the conduct of the State and its subdivisions by barring them from taking unilateral action that results in the diminishment of vested pensions, the Pension Clause regulates the legal relationship of the State and its political subdivisions with respect to accrued financial benefits. Thus, this is a matter of regulating the city's governmental exercise of power with

respect to an established retirement system. The Pension Clause falls squarely within § 903's reservation of state authority.

Unlike the Contracts Clause of the Michigan Constitution, the state courts have not held that the Pension Clause must yield to other critical state interests. In contrast, it is firmly established that the Contracts Clause of the U.S. Constitution and comparable clauses found in state constitutions *may be impaired* based on the inherent police power for the safeguarding of vital interests of the people. *Energy Reserves Group v. Kansas Power & Light Co.*, 459 U.S. 400, 410 (1983); *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 434 (1934); *see also Romein v. Gen. Motors.*, 462 N.W.2d 555, 565 (Mich. 1990). No such constraint appears for Michigan's Pension Clause. It is not just a reiteration that state contracts are shielded from impairment.

The proper interpretation to be given to language similar to the Pension Clause was recently set forth by the Arizona Supreme Court in *Fields v. Elected Officials' Retirement Plan*, 320 P.3d 1160 (Ariz. 2014). The *Fields* Court analyzed Article 29, § 1(C) of the Arizona Constitution, which is substantively the same as Michigan's constitutional provision:

> Membership in a public retirement system is a contractual relationship that is subject to article II, § 25, and public retirement system benefits shall not be diminished or impaired.

The plaintiffs alleged that Arizona could not enact a law that modified the formula for calculating a pension resulting in a reduction in the amount of pension benefits. *Fields*, 320 P.3d at 1163. The Court held that Article 29, § 1(C) should not be interpreted using a Contracts Clause analysis because this would "render superfluous the latter portion of § 1(C), the Pension Clause, which prohibits diminishing or impairing public retirement benefits." *Id.* at 1164. The Court went on to hold that the latter portion of § 1(C) "confers independent protection for public retirement benefits separate and distinct from the protection afforded by the Contract Clause." *Id.* at 1164–65.

Similarly, the latter portion of Michigan's Pension Clause must be given effect, with the result that accrued financial benefits cannot be treated as ordinary contractual obligations, but are protected from *any* unilateral diminishment or impairment. Applying the text of the Pension Clause as written, the City may not ask the bankruptcy court to approve a plan of adjustment that reduces pension benefits over the objection of members. The City's duty under the Pension Clause is

underscored by the second paragraph, which directs the City to fund accruing financial obligations on a yearly basis. And it is the City alone, not the State or its taxpayers, that bears this obligation. 1976 Mich. Op. Att'y Gen. No. 5076, pp. 563, 565 (Aug. 9, 1976) ("the state is not ultimately liable for funding or paying the benefits of local government retirement programs.")

There is an additional reason why this Court must not treat Michigan's Pension Clause as if it were a mere Contracts Clause. The federal Contracts Clause prohibits states from passing laws that impair the obligation of contracts. U.S. Const., art. I, § 10, cl. 1. Michigan's Contracts Clause is substantially similar: it too bars the enactment of a law. Mich. Const. art. 1, § 10. Both of these clauses impose a disability on Michigan's Legislature – the federal Contracts Clause "is directed only against impairment by legislation and not by judgments of courts." *Tidal Oil Co. v. Flanagan*, 263 U.S. 444, 451 (1924). "[O]nly a Legislature can 'pass' a 'law' impairing contractual obligations. Thus, only state legislation implicates the contract clause." *Birkenwald Distrib. Co. v. Heublein, Inc.*, 55 Wash. App. 1, 6 (1989) (citing *Tidal Oil*, 263 U.S. at 451.)

But Michigan's Pension Clause is not so limited in scope. It does not impose a narrow restriction on the lawmaking ability of Michigan's Legislature. Rather, it states that pension benefits "shall not be diminished or impaired" by "the state [or] its political subdivisions." In other words, Michigan and its political subdivisions, including the City of Detroit, may not take *any action* that unilaterally diminishes or impairs pension benefits. This includes not only legislation, but extends to the imposition of a plan in bankruptcy that unilaterally requires members to accept anything less than they were promised. Such a plan, if accepted and implemented over the objections of the members, would "diminish" these benefits, contrary to fundamental state law.

And to the extent that this appears to create a conflict between Michigan's Constitution and the bankruptcy court's broad powers, under Chapter 9, Congress has left no doubt that such conflict must be resolved in favor of the state's fundamental law. 11 U.S.C. §§ 903, 904, 943(b)(4). For example, the City cannot propose a plan that involves the summary seizure and sale of private property to increase its assets. Mich. Const. art I, § 17. Nor could the City seek to increase revenues by raising income tax rates on its wealthiest residents. Mich. Const. art 9,

§ 7. And the City cannot jettison the "Headlee Amendment" to Michigan's Constitution that prohibits increasing property taxes and local taxes above certain limits without "direct voter approval." Mich. Const., art 9, §§ 25 and 26. Just as the City cannot exceed these constitutional restraints on its power under cover of this bankruptcy proceeding, it also cannot violate the constitutional command that restrains the City from diminishing accrued pension benefits. And the bankruptcy court cannot approve a plan that allows the City to violate this provision over the objections of the City's employees and retirees. § 943(b)(4).

Individually and combined, the Pension Clause's mandates are not contractual ones but fundamental State law that regulates the City's exercise of its governmental powers that cannot be unilaterally expanded in bankruptcy through the implementation of a plan of adjustment. 11 U.S.C. §§ 903, 943(b)(4).

D. Article IX, § 24 of the Michigan Constitution does not frustrate the Code's purposes.

Congress' respect for state sovereignty in the drafting of Chapter 9, which is embodied in §§ 903 and 904 for a city entering bankruptcy,

establishes that state laws concerning a municipality's exercise of its political and governmental powers that otherwise do not frustrate the purpose of Chapter 9 are not preempted.

Michigan's constitutional provision does not fall within any of the three types of preemption analyses. *In re Schafer*, 689 F.3d 601, 613–14, (6th Cir. 2012). First, the express language of §§ 903 and 904 negates any claim that Congress explicitly stated an intent to preempt state law for a city entering bankruptcy. *Schafer*, 689 F.3d at 613–14. Second, field preemption has not occurred where Congress expressly allows for state law to apply as in §§ 903 and 904. *Id.* at 614 (citing *Bonito Boats v. Thunder Craft Boats*, 489 U.S. 141, 166–67 (1989) ("'The case for federal pre-emption is particularly weak where Congress has indicated its awareness of the operation of state law in a field of federal interest, and has nonetheless decided to 'stand by both concepts and to tolerate whatever tension there [is] between them.' *Silkwood v. Kerr-McGee*, 464 U.S. 238, 256 (1984).")) Third, article IX, § 24 is preempted only if it *actually conflicts* with the system of the

Bankruptcy Code. *Schafer*, 689 F.3dat 614 (citing *Stellwagen v. Clum*, 245 U.S. 605, 613 (1918).)[1]

Article IX, § 24 does not actually conflict with Chapter 9 of the Code. To the extent that vested financial benefits governed by the constitutional provision constitute a debt for bankruptcy purposes, the Pension Clause prohibits the City and its emergency manager from exercising governmental power that subjects those benefits to adjustment. Throughout the Code there are exceptions to the discharge of certain debts and to the impairment of certain interests and claims. For example, Chapter 9 explicitly excludes from discharge any debt not discharged by the plan or order confirming a plan. 11 U.S.C. § 944(c)(1). Similarly, 11 U.S.C. § 1123(a)(2) and (b), made applicable to Chapter 9 by § 901, authorizes a debtor to specify and leave any class of claims or interests unimpaired under a plan.[2] And more broadly, 11 U.S.C. § 523 creates many exceptions to discharge under the other chapters of the Code.

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[1] Notably, the *Stellwagen* Court held that the uniformity requirement of the Bankruptcy Clause is not violated where the particulars of State laws lead to different results in different States. 244 U.S. 605 at 613.

[2] 11 U.S.C. § 1124(1) operates similarly with respect to legal, equitable, and contractual rights.

Moreover, this particular treatment of vested accrued financial benefits is not inimical to the best interests of either the City or other creditors. Article 9, § 24 is not a piece of economic legislation. It is premised on a broad public health and welfare policy that seeks to preserve accrued financial benefits to those public employees that retire after years of public service.

In this view, the constitutional provision is entitled to overriding importance notwithstanding this bankruptcy proceeding. *In re Pub. Serv.*, 108 B.R. 854, 870 (Bankr. N.H. 1989). These benefits are intended for those who leave the workforce due, in part, to age or disability and who need a continued stream of income to live their lives. Without the protection of the Constitution to preserve these benefits, such retirees could lose their homes, and lose the ability to pay for medications and other necessities. This is in no one's interest.

CONCLUSION AND RELIEF REQUESTED

Congress incorporated state law within Chapter 9's structure and purpose, reserving state law that regulates a city's exercise of governmental power. Michigan's Pension Clause is fundamental state law that specifically regulates the City's and emergency manager's

exercise of fiscal and governmental power with regard to vested pensions. Neither the City nor the emergency manager can impair or diminish such benefits without violating state law, and this Court should so recognize if the pensioners reject the grand bargain.

Given the grand bargain's $800+ million of outside (i.e., non-City) funding to assist pensioners, the pensioners may legitimately choose to relinquish their rights and vote in favor of the Fourth Amended Plan. In that event, the issue presented will be moot, and there will be no need for this Court to address it.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Certificate of Compliance with Type-Volume Limitation, Typeface Requirements, and Type Style Requirements

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains no more than 14,000 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). There are a total of 7,446 words.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Word 2010 in 14 point Century Schoolbook.

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CERTIFICATE OF SERVICE

I certify that on May 27, 2014, the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by placing a true and correct copy in the United States mail, postage prepaid, to their address of record (designated below).

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DESIGNATION OF RELEVANT DISTRICT COURT DOCUMENTS

The Appellee, Michigan Attorney General, per Sixth Circuit Rule 28(c), 30(b), hereby designated the following portions of the record on appeal:

Description of Entry	Date	Record Entry No.	Page Number
Opinion Regarding Eligibility	12/05/2013	R. 1945	All
Order for Relief Under Chapter 9 of the Bankruptcy Code	12/05/2013	R. 1946	All
Certification Memorandum	12/20/2013	R. 2269	5
4th Amended Chapter 9 Plan	05/05/2014	R. 4392	34; 36