

## THE UNRAVELING OF AN AMERICAN CITY: PENSIONS, MUNICIPAL DEBT, AND CHAPTER 9 BANKRUPTCY

*Vaneeta Chintamaneni*

*The city of Detroit, in its unprecedented filing for Chapter 9 bankruptcy, called into question its handling of public pension liabilities. The author evaluates the relationship between how such pensions are structured and how cities restructure through municipal bankruptcy, with the aim of charting a course for the reform of public pension systems and long-term municipal planning. Pensions, important for maintaining one's livelihood in retirement, can increase a city's debt load. However, pension debt cannot be considered the main factor in Detroit's bankruptcy, which was primarily caused by unwise development decisions, suburban flight, loss of employment, and risky financial ventures. Further, the author finds that pension mismanagement was merely symptomatic of generally irresponsible fiscal behavior by Detroit officials, and that pension plans are protected by state and local law. Based on these findings, the author identifies potential solutions, including judicial protection of current pensioners, increased funding of pension funds, recording pensions as long-term debt, and promoting sustainability through more conservative assumptions regarding continued economic growth.*

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Vaneeta Chintamaneni is Associate Editor 2014-2015, Member 2013-2014, The Elder Law Journal; J.D. 2014, University of Illinois, Urbana-Champaign; M.U.P. 2014, University of Illinois, Urbana-Champaign; B.A. 2008 in Urban Studies and Architecture, University of California, Berkeley. I would like to thank my parents, Mani Neni and Venkat Neni, for their love and support.

## I. Introduction

On July 18, 2013, Detroit, Michigan filed for Chapter 9 bankruptcy.<sup>1</sup> The bankruptcy by Detroit is the largest ever filed by a U.S. city, and the implications for Detroit are great.<sup>2</sup> Bankruptcy will require a restructuring of the city's various obligations and debts, including valuable social services.<sup>3</sup> Bankruptcy may also have a large impact on existing city debts, including pensions, bonds, and other investments. These changes will impact not only the many people in and around Detroit, but also the region and state.

Until recent years, municipal bankruptcies were largely unprecedented. Between 1940 and 2010, there were over 14,000 corporate Chapter 11 bankruptcies, but only 301 municipal Chapter 9 bankruptcies.<sup>4</sup> Following the 2008 financial collapse, however, cities increasingly faced fiscal crises. Chapter 9 of the Bankruptcy Code applies to municipal bankruptcy, but, because it was rarely used until recent years, the implications of Chapter 9 bankruptcy on cities, creditors, and residents are ambiguous and open to judicial interpretation.<sup>5</sup>

The roots of municipal bankruptcies are complicated and diverse. One of the potential causes of municipal bankruptcies is long-term debt and, possibly, pension debt. In many municipalities, including Detroit, pension debt makes up a significant amount of municipal debt, and, according to many, contributes to municipal bankruptcy.<sup>6</sup> Despite the importance of pension debt to municipalities,

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1. Steven Church, *Detroit Awaits Ruling on Bankruptcy Eligibility*, BLOOMBERG (Nov. 8, 2013), <http://www.bloomberg.com/news/2013-11-08/detroit-bankruptcy-trial-ends-today-with-final-arguments.html> [hereinafter *Detroit Awaits Ruling on Bankruptcy*].

2. Detroit is a large and historic city. In 2012, even after decades of population decline, Detroit had a population of 701,475. United States Census Bureau, *State & County Quickfacts*, U.S. CENSUS BUREAU, <http://quickfacts.census.gov/qfd/states/26/2622000.html> (last visited Sept. 22, 2014). At that time, its ethnic composition was 82.7% African American and 10.6% Caucasian. *Id.*

3. See Daniel Fisher, *Muni Bankruptcies Set Up War Between Pensioners and Bondholders*, FORBES (Apr. 3, 2013), <http://www.forbes.com/sites/danielfisher/2013/04/03/muni-bankruptcies-set-up-war-between-pensioners-and-bondholders>.

4. Christine Williamson, *Motor City as a Motivator*, PENSIONS AND INVS. (Aug. 5, 2013), <http://www.pionline.com/article/20130805/PRINTSUB/130809965>.

5. *Id.*

6. Fisher, *supra* note 3.

Chapter 9 bankruptcy does not directly address pension holders.<sup>7</sup> While some states provide protections of pensions, it is possible Chapter 9 gives municipalities the power to discharge pension debt, raising important pre-emption issues.<sup>8</sup>

A public pension is a retirement plan typically paid out in installments, sometimes taking into account service and compensation, which means pensioners are predominantly elderly.<sup>9</sup> For retirees across the United States, pensions are also an important source of income.<sup>10</sup> As the nation continues to gray and older populations increase in proportion, the importance of pensions will only grow.<sup>11</sup> As such, pensions may increasingly impact communities in peril, such as Detroit.<sup>12</sup>

It is important that, throughout this Note, it is assumed there are some problems with pensions; it is assumed that pensions have contributed to the financial struggles of municipalities (at least in part) and, more importantly, pensions will present challenges to municipal bankruptcies in the future. The author recognizes that some have disputed that pensions are a source of municipal problems.<sup>13</sup> Some of the proponents of this idea believe that pensions and pensioners have become scape-goats of the otherwise problematic financial decision making of municipalities and governments.<sup>14</sup> While it may seem as if disproportionate emphasis is placed on the role of pensions in municipal crises, it is still important to examine the future of pension debt, both as a factor in municipal bankruptcy and as a source of contention in bankruptcy proceedings.

Overall, this Note examines the existing structure of pensions in relation to municipal bankruptcy. It first looks at the current fiscal crisis of municipalities. The Note then explores the current structure of municipal bankruptcy, comparing pension protections in municipal

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7. Hannah Heck, *Solving Insolvent Public Pensions: The Limitations of the Current Bankruptcy Option*, 28 EMORY BANKR. DEV. J. 89, 90 (2011).

8. Carlos Borrero, *Municipal Bankruptcies, Pensions, and New Dimensions of Class Struggle in the United States*, MONTHLY REVIEW ZINE (Jan. 8, 2013), <http://mrzine.monthlyreview.org/2013/borrero010813.html>.

9. See Jeffrey M. Jones, *Pensions are Top Income Source for Wealthier U.S. Retirees*, GALLUP ECONOMY (May 21, 2013), <http://www.gallup.com/poll/162713/pensions-top-income-source-wealthier-retirees.aspx>.

10. *Id.*

11. Fisher, *supra* note 3.

12. *Id.*

13. Borrero, *supra* note 8.

14. *Id.*

bankruptcy to pension protection in corporate settings. This discussion is anchored by an analysis of the current bankruptcy in Detroit, Michigan. Finally, this Note ends with recommendations for pensions in Detroit and other cities' long-term planning.

## II. Background

### A. Pensions, an important source of income for elder households, are threatened by municipal bankruptcy

Municipal bankruptcies, and its treatment of pensions, are murky. As mentioned, it is unclear whether the courts have authority to reduce pension commitments in municipal bankruptcy.<sup>15</sup> In Detroit, for instance, state-appointed emergency manager Kevyn D. Orr proposed significant cuts to Detroit's pension obligations in June 2013 and February 2014.<sup>16</sup> These included reductions in existing pension obligations, converting certain employees' benefits plans to defined benefit plans in which assets would be frozen, ending cost-of-living adjustments (COLAs) and increasing contributions from employees.<sup>17</sup> More recently, the state legislature and voters passed the "grand bargain," a plan to reduce planned pension cuts with additional financial assistance from state and philanthropic funds.<sup>18</sup>

In Michigan, the state Constitution explicitly protects pensions in Section 10, which states that "[n]o bill of attainder, ex post facto law, or law impairing the obligation of contract shall be enacted."<sup>19</sup> Despite these protections, Detroit's bankruptcy judge may be able to reduce pensions, which would raise significant pre-emption and fed-

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15. Williamson, *supra* note 4.

16. *Id.*; *Detroit's Bankruptcy Cram Down*, THE ECONOMIST (Mar. 1, 2014), <http://www.economist.com/news/united-states/21597929-bondholders-choke-citys-restructuring-proposals-cram-down>.

17. Williamson, *supra* note 4; *Detroit's Bankruptcy Cram Down*, *supra* note 16 (detailing Mr. Orr's 2014 plan for providing sixty-six cents on the dollar to pensioners).

18. Anne VanderMey, *Detroit Pensioners Approve Bankruptcy Haircut in Landslide*, FORTUNE (July 22, 2014), <http://fortune.com/2014/07/22/detroit-pension-bankruptcy/>; Johnathan Oosting, *Snyder hails 'historic day for Michigan's future,' urges Detroit retirees approve bankruptcy plan* MICHIGAN LIVE (June 3, 2014), [http://www.mlive.com/lansing-news/index.ssf/2014/06/snyder\\_hails\\_historic\\_day\\_for.html](http://www.mlive.com/lansing-news/index.ssf/2014/06/snyder_hails_historic_day_for.html).

19. MICH. CONST. art. I, § 10.

eralism issues.<sup>20</sup> After a December ruling by U.S. Bankruptcy Judge Steven W. Rhodes that pensions could be reduced in Detroit's bankruptcy, seven appeals were filed in the Sixth Circuit challenging Detroit's bankruptcy proceedings.<sup>21</sup> The Sixth Circuit Court of Appeals initially agreed to hear the cases, but these were suspended pending Detroit's upcoming bankruptcy trial.<sup>22</sup> This suspension could be lifted, and the bankruptcy decisions challenged up to the Supreme Court, however, if the planned bargains fall through.

For retirees across the United States, pensions are an important source of income.<sup>23</sup> According to the National Institute on Retirement Security, in 2006 about half of all older households (with one head sixty years of age or older) in the United States received income from defined benefit pensions.<sup>24</sup> Of these households, 9.4 million households had private pensions, 6.2 million had public pensions, and 1.7 million had both private and public pension income.<sup>25</sup> In a Gallup poll of retirees in 2013, 36% of retirees relied on pensions as a "major source" of income.<sup>26</sup> Twenty-seven percent of retirees with an income less than \$50,000 and fifty-five percent of retirees with incomes over \$50,000 relied on pensions as a "major source" of income.<sup>27</sup> These facts demonstrate something important: that elderly households significantly rely on pensions, and the potential threat to public pensions by bankruptcy threatens the livelihood of millions of elderly individuals and families across the United States.

Relatedly, research demonstrates that pensions, in particular public pensions, dramatically reduce elder poverty. According to a 2010 study published by the National Institute on Retirement Security, which drew from a representative national sample of civilians, "[r]ates

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20. Williamson, *supra* note 4.

21. *Federal Court Asked to Suspend Detroit Bankruptcy Appeals*, REUTERS, July 31, 2014, available at <http://www.reuters.com/article/2014/07/31/usa-detroit-bankruptcy-appeals-idUSL2N0Q63DH20140731>.

22. *Federal Court Agrees to Suspend Detroit Bankruptcy Appeals*, REUTERS, Aug. 1, 2014, available at <http://www.reuters.com/article/2014/08/01/usa-detroit-bankruptcy-appeals-idUSL2N0Q724E20140801>.

23. Jones, *supra* note 9.

24. NATIONAL INSTITUTE ON RETIREMENT SECURITY, WHO HAS A PENSION? 1 (2014), available at [http://www.nirsonline.org/storage/nirs/documents/fianl\\_fact\\_sheet\\_who\\_has\\_a\\_pension.pdf](http://www.nirsonline.org/storage/nirs/documents/fianl_fact_sheet_who_has_a_pension.pdf) (last visited Sept. 22, 2014) [hereinafter WHO HAS A PENSION].

25. *Id.*

26. Jones, *supra* note 9.

27. *Id.*

of poverty among older households without [defined benefit] pension income [are] approximately nine times greater than the rates among older households with [defined benefit] pension income."<sup>28</sup> In addition, households with pensions experienced fewer financial hardships, relied less on public assistance, and were better protected from the 2008 financial crisis.<sup>29</sup>

**B. Causes of fiscal crises of municipalities vary, but they include historical forces, broader financial trends, unwise municipal practices, and pension debt**

The reasons for current municipal fiscal crises are varied but include historical trends, systemic processes, and many practices of municipal governments. Historical trends, such as decreasing populations and changing market forces, contributed to fiscal woes in cities like Detroit.<sup>30</sup> Decreasing populations reduce demand for land and consumer goods, which negatively impacts a city's economic vitality.<sup>31</sup>

This, in turn, can encourage further emigration out of the city, further reduce real estate values, and lead to increased divestment of businesses from cities, leading to a vicious cycle of depopulation and disinvestment in neighborhoods across the United States.<sup>32</sup>

In addition, in recent decades municipalities used overly optimistic projections for rates of return and economic forecasts.<sup>33</sup> Municipalities also failed to plan for alternative economic scenarios.<sup>34</sup> In doing so, cities did not account for futures in which there would be little, or negative, growth. In recent years, especially after the 2008 financial collapse, cities increasingly faced declining real estate values, declin-

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28. FRANK PORELL & DIANE OAKLEY, *THE PENSION FACTOR 2012 1* (2012), available at [http://www.nirsonline.org/storage/nirs/documents/Pension%20Factor%202012/pensionfactor2012\\_final.pdf](http://www.nirsonline.org/storage/nirs/documents/Pension%20Factor%202012/pensionfactor2012_final.pdf).

29. *Id.* at 13-15.

30. Jeffrey B. Ellman & Daniel J. Merrett, *Pensions and Chapter 9: Can Municipalities Use Bankruptcy to Solve Their Pension Woes?*, 27 *EMORY BANKR. DEV. J.* 365, 367 (2011).

31. See NEW COMMUNITIES PROGRAM, *A FIRST REPORT ON LISC/CHICAGO'S NEW COMMUNITIES PROGRAM 4-5* (2004), available at <http://www.newcommunities.org/cmadoocs/NCP-FirstReport04.pdf> [hereinafter *NEW COMMUNITIES PROGRAM*] (noting population shifts and consequences of these shifts in the South Side of Chicago); *Id.* at 14-23 (containing population data for communities in the South Side of Chicago).

32. See NEW COMMUNITIES PROGRAM, *supra* note 31, at 4-5.

33. Ellman & Merrett, *supra* note 30, at 369.

34. *Id.*

ing revenue, and declining funds from state and federal government sources.<sup>35</sup> Municipal governments are often highly dependent on tax revenues from property values, so significant decreases in these funding streams can greatly damage a city's financial health.<sup>36</sup> Decreasing real estate values, along with increased foreclosures, dramatically reduced tax revenues for city governments.<sup>37</sup> At the same time, municipal debt is subject to tighter credit markets and credit default swaps, a contributor to the global financial downturn.<sup>38</sup>

While historical forces and economic circumstances contributed to fiscal crises of cities, some cite pensions as one of the most significant factors in municipal bankruptcy.<sup>39</sup> Some estimate pensions total three trillion dollars in debt nationwide, with states such as California exceeding five hundred billion dollars alone.<sup>40</sup>

There is some debate, however, on the role of pension debt in relation to overall municipal health. The cause of large pension debt may be reckless and short-term thinking on the parts of politicians, city employees, and organized labor.<sup>41</sup> Indeed, some argue pensions are a "fiscal time bomb" that threaten state and municipal governments.<sup>42</sup> While most contend that high levels of pension debt hurt cities' economic growth, some disagree.<sup>43</sup> Some contend pensions are, in fact, unfairly targeted in the face of municipal fiscal troubles: that small numbers of pensioners receiving low annual annuities are being targeted in lieu of financial and other responsible institutions.<sup>44</sup>

In 2007, the Government Accountability Office (GAO), acknowledging the potential importance of pensions in the future, looked into city pension health.<sup>45</sup> The study examined pensions in

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35. *Id.* at 366-67.

36. Heck, *supra* note 7, at 93.

37. Ellman & Merrett, *supra* note 30, at 366-67.

38. *Id.* at 367.

39. *Id.*

40. *Id.* at 367-68.

41. See Maria O'Brien Hylton, *Combating Moral Hazard: The Case for Rationalizing Public Employee Benefits*, 45 IND. L. REV. 413, 473 (2012).

42. Jack M. Beerman, *The Public Pension Crisis*, 70 WASH. & LEE L. REV. 3, 4 (2013).

43. Borrero, *supra* note 8.

44. *Id.*

45. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-983T, STATE AND LOCAL GOVERNMENT PENSION PLANS: CURRENT STRUCTURE AND FUNDED STATUS 1 (2007), available at <http://www.gao.gov/new.items/d08983t.pdf> [hereinafter STATE AND LOCAL GOVERNMENT PENSIONS]

states across the United States, analyzed how well-funded pension debt was, and looked at the threat pension debt posed.<sup>46</sup> The GAO found that most states had traditional defined benefit plans, though some had elements of contribution plans.<sup>47</sup> In a defined benefit plan, benefit payments are established using a formula “based on the retiree’s years of service and final average salary, and is most often provided as a lifetime annuity.”<sup>48</sup> These pensions are given COLAs, which are increases in benefits to account for increasing living costs.<sup>49</sup> In defined contributions plans, a less common type of city pension, the employee makes contributions and assumes the risk.<sup>50</sup> “[T]he key determinants of the benefit amount are the employee’s and employer’s contribution rates, and the rate of return achieved on the amounts contributed to an individual’s account over time.”<sup>51</sup> COLAs are typically not given.<sup>52</sup> State statutes and local ordinances often provide some protection of pensions, with the highest protection in state constitutions.<sup>53</sup> Under state constitutions and statutes, pensions are usually managed as trusts and run by boards of trustees.<sup>54</sup>

The GAO’s study looked at the funded status of various pension plans, but these could not be easily ascertained because of the variation in actuarial methods used to calculate pensions.<sup>55</sup> These approaches calculate different normal costs (or the portion of benefits assigned to a year), make different assumptions about how to evaluate the funded status, and calculate the value of current assets differently.<sup>56</sup> According to the GAO, “most state and local government pension plans have enough invested resources set aside to fund the benefits they are scheduled to pay over the next several decades.”<sup>57</sup> Despite these positive overall findings, the GAO reported that overall funding levels of pensions decreased significantly in the last decade.<sup>58</sup>

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46. *Id.*

47. *Id.*

48. *Id.* at 3.

49. *Id.*

50. STATE AND LOCAL GOVERNMENT PENSIONS, *supra* note 45, at 3-4.

51. *Id.*

52. *Id.* at 4.

53. *Id.* at 3.

54. *Id.*

55. *Id.* at 6.

56. *Id.*

57. *Id.*

58. *Id.*

Looking at sixty-five large pensions in 2006, the GAO found 58% of the pensions were funded at a level of 80% or more (the ratio considered a “funded ratio”).<sup>59</sup> This was a decrease from 2000, when 90% of these pensions met the funded ratio.<sup>60</sup> Further, many city governments, in their maintenance of pensions, under-contributed to pension funds.<sup>61</sup> The GAO findings concluded that “[t]he ability to maintain current levels of public sector retiree benefits will depend, in large part, on the nature and extent of the fiscal challenges these governments face in the years ahead.”<sup>62</sup> The report, published in 2007, foreshadowed the troubles pensions would face in the wake of the global financial recession.<sup>63</sup>

In addition to pensions, other types of costs negatively impact municipal health and finances. These include growing healthcare costs, especially for programs like Medicaid and state and local employee health insurance.<sup>64</sup> According to the 2007 GAO report, “growth in health-related costs is a primary driver of these fiscal challenges.”<sup>65</sup> Bonds are also likely a contributing factor. Cities sell bonds to finance projects, and, while interest rates on these funds were traditionally low and reliable in the past, more volatile markets and credit swaps have recently eroded the success of some city bonds.<sup>66</sup>

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59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.* at 24.

63. *Id.*

64. *Id.* at 7.

65. *Id.*

66. Matthew Craft & Christina Rexrode, *Detroit Bonds: Municipal Bonds and How Detroit Bankruptcy Impacts Bondholders*, HUFFPOST DETROIT, Aug. 4, 2013, [http://www.huffingtonpost.com/2013/08/04/detroit-bonds\\_n\\_3704098.html](http://www.huffingtonpost.com/2013/08/04/detroit-bonds_n_3704098.html); Darrell Preston & Steven Church, *Detroit Swap Banks Go First as Bankruptcy Looms: Muni Credit*, BLOOMBERG (June 20, 2013), <http://www.bloomberg.com/news/2013-06-21/detroit-swap-banks-go-first-as-bankruptcy-looms-muni-credit.html>.

**C. Causes of Detroit's bankruptcy are varied but include unwise development decisions, suburban flight, loss of employment, and risky financial ventures**

On July 18, 2013, Detroit, Michigan filed for bankruptcy.<sup>67</sup> This filing is the largest municipal bankruptcy in the history of the United States.<sup>68</sup> Yet, that very same week, Michigan Governor, Rick Snyder, approved a plan for a \$650 million hockey arena for the Detroit Red Wings.<sup>69</sup> The hockey arena is simply the latest example in a string of poor financial decisions made by Detroit. These decisions, in conjunction with decades of suburban flight and decreasing employment opportunities (in large part due to the loss of the auto industry), have led Detroit to its current crisis.<sup>70</sup>

The overall impact of pensions on Detroit is, as mentioned above, contested. When Detroit filed for bankruptcy in 2013, many officials pointed to pension debt as the cause. The average pension in Detroit was \$19,213, but, with about 12,000 retired workers, payments per year often exceeded \$100 million.<sup>71</sup> Overall, the city failed to contribute enough to the pension fund, and was forced to borrow \$1.44 billion in public bonds.<sup>72</sup> Several estimates place the overall bond shortfall at approximately \$3.5 billion.<sup>73</sup>

A recent report, however, released in November 2013 by the New York-based think tank Demos, contradicts the idea that Detroit's eighteen-billion-dollar, long-term debt (including a high proportion of pension debt) is to blame.<sup>74</sup> Instead, it contends Detroit's degradation was caused by plummeting revenues as a result of long-term trends such as depopulation and long-term unemployment caused by job loss.<sup>75</sup> Between 1950 and 2010, Detroit's population decreased from a high of two million to only 714,000.<sup>76</sup> At the same time, Michigan drastically decreased revenue sharing with Detroit, reducing its city

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67. *Detroit Awaits Ruling on Bankruptcy*, *supra* note 1.

68. *Id.*

69. Borrero, *supra* note 8.

70. WALLACE C. TUBERVILLE, *THE DETROIT BANKRUPTCY 1* (2013).

71. Mary Williams Walsh, *Detroit Spent Billions Extra on Pensions*, *NY TIMES*, Sept. 25, 2013, [http://dealbook.nytimes.com/2013/09/25/undisclosed-payments-cost-detroit-pension-plan-billions/?\\_r=0](http://dealbook.nytimes.com/2013/09/25/undisclosed-payments-cost-detroit-pension-plan-billions/?_r=0).

72. *Id.*

73. *Id.*

74. TUBERVILLE, *supra* note 70, at 1.

75. *Id.*

76. *Id.* at 2.

revenue.<sup>77</sup> While pensions are often blamed for Detroit's bankruptcy, the report states it was the city's financial deals, not pension benefits, that drove Detroit's "legacy expenses" up.<sup>78</sup> Regardless of these findings, however, Detroit still faces significant pension debt in the future.<sup>79</sup> Exacerbating the stated \$3.5 billion unfunded pension liability is the fact that Detroit, in recent years, borrowed on its bonds.<sup>80</sup>

In addition to pension mismanagement and debt, the city engaged in risky investment and financing. Prior to the 2008 financial crisis, the city followed financial advisors' advice and entered into complex borrowing packages with interest-rate swaps.<sup>81</sup> Many of these interest-rate swaps were related to Detroit pensions.<sup>82</sup> Many of these deals broke down after 2008 and Detroit ended up paying ballooning variable rates.<sup>83</sup> These swaps, made with Bank of America Corporation and UBS AG, have cost Detroit taxpayers an estimated \$202 million since 2009.<sup>84</sup> Mr. Orr and the city dispute the legitimacy of these swaps, but this will be determined at a later proceeding.<sup>85</sup> The city was not able to get out of these deals because buying out the contract, the only option, was prohibitively expensive at millions of dollars.<sup>86</sup>

Last, there is evidence of mismanagement of city funds and generally irresponsible fiscal behavior by the city. According to a recent audit, Detroit pension funds were gravely mismanaged.<sup>87</sup> For years, Detroit distributed payments above the normal benefit levels to

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77. *See id.* at 3.

78. *See id.* at 4-5.

79. *See* John Gallagher & Nathan Bomey, *The Truth About Detroit: Bankruptcy More than a Revenue Problem*, DETROIT FREE PRESS, Nov. 20, 2013, <http://www.freep.com/article/20131120/BUSINESS06/311200175/Demos-Detroit-bankruptcy>.

80. *Id.*

81. *See* Joseph Lichterman, *U.S. Treasury Official Named Lead on Detroit Bankruptcy*, REUTERS, Sept. 27, 2013, *available at* <http://www.reuters.com/article/2013/09/27/us-usa-detroit-official-idUSBRE98Q12020130927>.

82. *See* Steven Church, *Detroit Suit Challenges \$1.44 Billion Pension-Debt Deal*, BLOOMBERG, Feb. 1, 2014, <http://www.bloomberg.com/news/2014-02-01/detroit-suit-challenges-1-4-billion-pension-debt-deal.html>.

83. Lichterman, *supra* note 81.

84. Chris Christoff & Brian Chappatta, *Detroit Bankruptcy Exit Plan Threatens Munis as Pensions Favored*, BLOOMBERG (Jan. 31, 2014), <http://www.bloomberg.com/news/2014-01-31/detroit-bankruptcy-exit-plan-favors-pensioners-over-bondholders.html>.

85. *Id.*

86. Lichterman, *supra* note 81.

87. *See generally* Walsh, *supra* note 71.

various individuals, costing the city billions of dollars:<sup>88</sup> “The payments, which were not publicly disclosed, included bonuses to retirees, supplements to workers not yet retired and cash to the families of workers who died before becoming eligible to collect a pension, according to reports by an outside actuary and other people with knowledge of the matter.”<sup>89</sup> As the city became cash strapped, it turned to other uncertain revenue streams, such as gambling and a sports arena costing hundreds of millions of dollars.<sup>90</sup>

After Detroit declared bankruptcy, the status of pension debt quickly came into question. The city found itself in a dire situation, slashing services such as firefighting and emergency medical care.<sup>91</sup> Soon after filing for bankruptcy, the emergency city manager, Mr. Orr, proposed pension reductions, which raised important and ambiguous questions of pre-emption, federalism, and pensioners’ rights.<sup>92</sup> In response, pensioners filed suit and protested.<sup>93</sup> The Sixth Circuit Court of Appeals initially agreed to hear these appeals, but they were later suspended once parties reached the grand bargain.<sup>94</sup>

### III. Analysis

As mentioned above, municipal bankruptcies are largely uncharted territory. There have only been fifty-four defaults of municipal bonds since 1970 and only four defaults of general obligation debt.<sup>95</sup> Chapter 9 provides an option for municipalities to file bankruptcy, but it does not explicitly recognize how or if pensions can be

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88. *Id.*

89. *Id.*

90. Dave Zirin, *On Vultures and Red Wings: Billionaire Gets New Sports Arena in Bankrupt Detroit*, THE NATION (July 29, 2013), <http://www.thenation.com/blog/175467/vultures-and-red-wings-billionaire-gets-new-sports-arena-bankrupt-detroit#>.

91. *Id.*

92. See Steven Church & Chris Christoff, *Detroit Pensions Should Consider Benefit Cuts, Orr Says*, BLOOMBERG (Dec. 10, 2013), <http://www.bloomberg.com/news/2013-12-10/detroit-pensions-should-consider-cuts-orr-says.html>.

93. Dan Walters, *Bankruptcy Zeroes in on Pensions*, SACRAMENTO BEE (July 23, 2013, 2:20 AM), <http://www.sacbee.com/2013/07/22/5584556/dan-walters-bankruptcy-zeroes.html>.

94. *Federal Court Asked to Suspend Detroit Bankruptcy Appeals*, REUTERS, July 31, 2014, available at <http://www.reuters.com/article/2014/07/31/usa-detroit-bankruptcy-appeals-idUSL2N0Q63DH20140731>.

95. Heck, *supra* note 7, at 92.

reduced.<sup>96</sup> There are few instances in which cities have tried to reduce pensions as overtly as Detroit. Prichard, Alabama filed for bankruptcy in 2009 (for a second time), and its bankruptcy court confirmed plan of adjustment suggested pension reduction was feasible in Chapter 9 bankruptcy.<sup>97</sup> In Prichard, pension funds were underfunded and depleted, and its adjustment plan changed pension obligations.<sup>98</sup>

## A. Pensions

### 1. Pensions Are a Type of Retirement Plan

Pension plans are defined as “[a] type of retirement plan . . . wherein an employer makes contributions toward a pool of funds set aside for an employee’s future benefit. The pool of funds is then invested on the employee’s behalf, allowing the employee to receive benefits upon retirement.”<sup>99</sup> The Organisation for Economic Co-operation and Development, an international forum that helps develop economic and social policies, defines a pension plan as “[a] legally binding contract having an explicit retirement objective” which is often “part of a broad employment contract.”<sup>100</sup> Pension accrual ages vary. In Michigan, for instance, state police are eligible for pensions at age fifty-five with twenty-five years of service or age sixty with ten years of service.<sup>101</sup>

There are various types of pensions in the United States. Defined benefits plans generally do not require full funding prior to accrual of costs under state law.<sup>102</sup> Therefore, cities have been able to underfund pension funds without violation of any law.<sup>103</sup> In defined contribution plans, unlike defined benefits plans, employers (in this case, the city) contribute a fixed amount to a plan, and the employee gets a payment based on how these fixed amounts’ investments per-

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96. *Id.*

97. Ellman & Merrett, *supra* note 30, at 411.

98. *Id.*

99. *Pension Plan*, INVESTOPEDIA, <http://www.investopedia.com/terms/p/pensionplan.asp> (last visited Sept. 22, 2014).

100. *About the OECD*, OECD, <http://www.oecd.org/about> (last visited Sept. 22, 2014); OECD, *Pension Plan*, <http://stats.oecd.org/glossary/detail.asp?ID=5271> (last visited Sept. 22, 2014).

101. *Leaving Employment*, PENSION PLUS, [http://www.mipensionplus.org/statepolice/leaving\\_employment.html](http://www.mipensionplus.org/statepolice/leaving_employment.html) (last visited Oct. 2, 2014).

102. Beerman, *supra* note 42, at 5.

103. *Id.*

form; this places more risk on the employee.<sup>104</sup> Public pension funds are overwhelmingly defined benefit plans, while the private sector has embraced defined contribution plans.<sup>105</sup> With recent economic pressures and decreased funding, pressure has increased for cities and states to switch to defined contribution plans.<sup>106</sup>

## 2. Pensions Are Protected by State and Local Law

Public pensions are created and maintained by state and local law.<sup>107</sup> Public pension protections vary substantially from private sector pensions, and these differences are important in understanding the plight of pensioners in cities like Detroit. Pensions are protected by many state and local government laws. In the United States, thirty-one states protect pensions in their constitutions.<sup>108</sup> Many of these prohibit the reduction or elimination of pensions and specify the ways in which pensions will be managed.<sup>109</sup> Fourteen states specify standards for how pensions will be funded.<sup>110</sup> Fourteen states specify that assets in a pension trust are only to be used for pension benefits.<sup>111</sup> Thirteen states specify that pension fund assets cannot be diverted for other “nonretirement” purposes.<sup>112</sup>

## 3. Private Pensions Are More Protected Than Their Public Sector Counterparts

Generally, public pensions are less regulated and less protected than their corporate counterparts. First, provisions of the Internal Revenue Code (IRC) that apply to corporate pensions do not apply

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104. *See id.*

105. *Id.*

106. NARI RHEE & DIANE OAKLEY, ISSUE BRIEF: ON THE RIGHT TRACK? PUBLIC PENSION REFORMS IN THE WAKE OF THE FINANCIAL CRISIS 2 (2012), available at [http://www.nirsonline.org/storage/nirs/documents/Retry/final\\_ontherighttrack\\_2012.pdf](http://www.nirsonline.org/storage/nirs/documents/Retry/final_ontherighttrack_2012.pdf).

107. STATE AND LOCAL GOVERNMENT PENSIONS, *supra* note 45, at 5. *See also* Markman v. Cnty. of Los Angeles, 35 Cal. App. 3d 132, 134 (Cal. Ct. App. 1973) ([T]erms and conditions relating to employment by a public agency are strictly controlled by statute or ordinance, rather than by ordinary contractual standards . . . .).

108. STATE AND LOCAL GOVERNMENT PENSIONS, *supra* note 45, at 12.

109. *Id.* at 11.

110. *Id.* at 12.

111. *Id.*

112. *Id.*

fully to government pensions.<sup>113</sup> The IRC has higher funding requirements for private pensions than government pensions and does not require vesting of the pension right after a certain number of years.<sup>114</sup> Second, the Employee Retirement Income Security Act of 1974 (ERISA)<sup>115</sup> applies to corporate pensions but not to government pensions.<sup>116</sup> ERISA requires certain funding and vesting requirements for private pensions that do not apply to public pensions.<sup>117</sup> ERISA provisions generally protect private pensions.<sup>118</sup> Third, the Pension Benefit Guaranty Corporation insures corporate pensions, to a limit, but lacks jurisdiction over government pensions.<sup>119</sup> Overall, these differences in private pensions allow resolution of insolvency in an ordered manner in corporate bankruptcy, although the insolvency often destroys the company.<sup>120</sup>

#### 4. Many State Pensions Have Constitutional Protections

State statutes and local ordinances usually provide some protection of pensions, with the highest protection in state constitutions.<sup>121</sup> Under state constitutions or statutes, pensions are usually managed as trusts and run by boards of trustees.<sup>122</sup> According to a GAO report, twenty-four states have constitutional provisions pertaining to public pensions, though these vary.<sup>123</sup>

Further, the Contract Clause of the U.S. Constitution states that “[n]o state shall enter into any . . . Law impairing the Obligation of Contracts.”<sup>124</sup> Case law applying the Contract Clause, however, varies greatly for pensions.<sup>125</sup> Some states use a vested rights theory of pub-

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113. Mary A. Brauer, *State and Local Government Pensions: In What Circumstances Can Governments Reduce Pension Benefits?*, 20 *BENEFITS L. J.* 65, 66 (2007).

114. *Id.* at 65-66.

115. Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 5 U.S.C., 18 U.S.C., 26 U.S.C., 29 U.S.C., and 42 U.S.C.).

116. Brauer, *supra* note 113 at 66.

117. Ellman & Merrett, *supra* note 30, at 368.

118. *See generally* RHEE & OAKLEY, *supra* note 106, at 5.

119. Brauer, *supra* note 113, at 66.

120. Beerman, *supra* note 42, at 6.

121. STATE AND LOCAL GOVERNMENT PENSIONS *supra* note 45, at 3.

122. *Id.* at 3.

123. *Id.* at 13.

124. U.S. CONST. art. I, § 10, cl. 1.

125. Brauer, *supra* note 113, at 66.

lic pensions, which means pension obligations are contractual rights that can only be modified through state or federal Contract Clause interpretations.<sup>126</sup> Chapter 9 debtors may face Contract Clause challenges to modification or removal of these vested rights (public pensions).

Public pensions in bankruptcy also bring up federal-state issues. Pension alterations in Chapter 9 bankruptcy raise important pre-emption issues. Federal pre-emption holds that state law will be preempted where there is conflicting federal law.<sup>127</sup> Where there are state protections of public pensions, but debtors attempt to amend public pensions through Chapter 9, pre-emption issues are sure to arise.<sup>128</sup> Discharge or reduction in pensions also raises Tenth Amendment issues, especially where there are strong state protections of pensions.<sup>129</sup>

### 5. Views of Pension Rights and Challenges to Pension Benefits

Public pension protection issues have arisen infrequently in courts. In 1889, the Supreme Court declared what has been called a “gratuity” theory of pension.<sup>130</sup> In *Pennie*, the Court held that a municipality could amend or repeal public pensions prior to retirement because an employee’s rights to the pension do not vest (there is no contractual or property interest) until retirement.<sup>131</sup> Some states still follow *Pennie*, but many state legislatures have adopted a “vested-rights” approach to public pensions, which protects, in varying ways, against unilateral amendments and revocation of pensions.<sup>132</sup>

In the context of municipal bankruptcy, public pension issues are even rarer. As described in this Note, Chapter 9 is available to municipalities, but, until recently, was largely unused; it may also provide an avenue to reduce pensions.<sup>133</sup> Pension alterations have been increasingly debated as more municipalities filed for Chapter 9 bankruptcy.<sup>134</sup> The City of Prichard, Alabama, for instance, filed

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126. Ellman & Merrett, *supra* note 30, at 377-78.

127. Williamson, *supra* note 4.

128. Ellman & Merrett, *supra* note 30, at 397-98.

129. U.S. CONST. amend. X; *In re City of Detroit, Mich.*, 504 B.R. 97, 138, 161-62 (Bankr. E.D. Mich. 2013) (discussing Tenth Amendment in relation to Detroit’s Chapter 9 bankruptcy filing).

130. *Pennie v. Reis*, 132 U.S. 464, 471 (1889).

131. *Id.*

132. Ellman & Merrett, *supra* note 30, at 378.

133. *See, e.g., id.* at 411.

134. *Id.* at 387.

Chapter 9 bankruptcy in October 2009.<sup>135</sup> Though the bankruptcy was dismissed, the bankruptcy's automatic stay barred pensioners from filing new suits against Prichard, prevented pensioners from pursuing existing lawsuits against Prichard for mismanagement of the pension fund, and required pensioners to assert claims in a bankruptcy process (which some say favored debtors over individual creditors).<sup>136</sup> When California's City of Vallejo filed for Chapter 9 bankruptcy, the city reduced, on its own, retiree health benefits in 2010.<sup>137</sup> In California, retiree health benefits are protected rights, like pensions.<sup>138</sup> The bankruptcy court dismissed the retirees' suit to restore the full benefits because the automatic stay of the Bankruptcy Code gave Vallejo the power to reduce its benefits.<sup>139</sup>

## B. There Are Key Differences in Bankruptcy Under Chapter 9 and Chapter 11

### 1. Chapter 9 Bankruptcy

Congress first enacted statutes for municipal bankruptcy after the Great Depression of the 1930s.<sup>140</sup> The Supreme Court, in a decision two years later, held that Chapter 9 was a violation of the Tenth Amendment because it impermissibly interfered with states' ability to control cities, and Congress enacted revisions the following year.<sup>141</sup> In 1978, after a significant municipal bankruptcy, Congress instituted Chapter 9 of the Bankruptcy Reform Act.<sup>142</sup> In 1994, Congress amended Chapter 9 so that eligibility for Chapter 9 was required to be "spe-

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135. *Id.*

136. See Ellman & Merrett, *supra* note 30, n. 80 (noting "in this way, the automatic stay in Chapter 9 provides even greater protection from adverse creditor action....").

137. See August 11, 2010 Civil Minute Order Granting the Motion to Dismiss, *In re City of Vallejo*, 432 B.R. 262 (Bankr. E.D. Cal. May 6, 2010).

138. See *Thorning v. Hollister Sch. Dist.*, 15 Cal. Rptr. 2d 91, 93-96 (Cal. Ct. App. 1992) (holding that retiree medical benefits create vested right and comparing medical benefits for retirees to pension benefits).

139. See August 11, 2010 Civil Minute Order Granting the Motion to Dismiss, *supra* note 137.

140. *Historical Background*, 5 NORTON BANKR. L. & PRAC. 3d § 90:2 (2014).

141. *Id.*

142. *Id.*

cifically authorized," which means that states must explicitly permit Chapter 9 bankruptcy for cities to be eligible.<sup>143</sup>

Chapter 5 of the Bankruptcy Code sets up the structure of allowing or disallowing claims, which has been incorporated into Chapter 9.<sup>144</sup> Overall, Chapter 9 is meant to give economically distressed communities a chance to "continue to provide its residents with essential services such as police protection, fire protection, sewage and garbage removal, and schools as it works with creditors and the court to confirm a plan of adjustment."<sup>145</sup> To qualify as a debtor under Chapter 9, the petitioner must meet five requirements:<sup>146</sup> 1) it must be a municipality, which is a "political subdivision or public agency or instrumentality of a state;"<sup>147</sup> 2) state law must authorize Chapter 9 bankruptcy; 3) the petitioner has to be insolvent; 4) the petitioner has to want a plan of adjustment; and 5) the petitioner has to conduct good faith negotiations with creditors unless they are not practical or the petitioner "reasonably believes that a creditor may attempt to obtain a transfer."<sup>148</sup> Under Chapter 9, a city is insolvent if it is unable to pay its debts as they become due.<sup>149</sup> A budget deficit alone is not sufficient for bankruptcy.<sup>150</sup> As of 2011, only nineteen states authorized Chapter 9 bankruptcy.<sup>151</sup> The approach to authorization varies across states, with some authorizing blanket eligibility and some states authorizing discretionary eligibility with permission from the governor.<sup>152</sup> As mentioned before, Chapter 9 does not explicitly address public pensions.<sup>153</sup>

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143. *See id.*

144. Ellman & Merrett, *supra* note 30, at 399.

145. H.R. REP. No. 100-1011, at \*2 (1988), *reprinted in* 1988 U.S.C.C.A.N. 4115, 4116.

146. 11 U.S.C. § 109(c) (2012).

147. 11 U.S.C. § 101(40) (2012).

148. 11 U.S.C. § 101(40) (2012); 11 U.S.C. § 109(c) (2012); 11 U.S.C. § 109(c)(5) (2012); 5 NORTON BANKR. L. & PRAC. 3d § 90:5 (2014).

149. Theodore Orson, *The Basics of Municipal Bankruptcies*, 65 PLANNING & ENVTL. L. 7, 8 (2013).

150. *Id.* at 9.

151. Heck, *supra* note 7, at 99.

152. *Id.* at 99-100.

153. *Id.* at 90.

## 2. How Chapter 9 Bankruptcy Works

Chapter 9 provides the petitioner municipality with several tools for restructuring its finances. It triggers an automatic stay, permits the municipality to reject or accept executory contracts, and establishes a process for creating a plan of adjustment.<sup>154</sup> Aside from the explicit language of the statutes, there is little case law to guide how these statutes apply.<sup>155</sup> After Chapter 9 bankruptcy commences, there is an automatic stay of many claims against the debtor municipality, including new and existing liens as well as new and existing lawsuits against the city.<sup>156</sup> The stay provides a “breathing spell” to financially distressed municipalities and gives them time to negotiate with creditors.<sup>157</sup> This stays suits against municipalities to enforce pension payments.<sup>158</sup> The impact on debtors’ ability to pressure pensioners in negotiation has been varied.<sup>159</sup>

The most important function of Chapter 9 bankruptcy is to confirm a “plan of adjustment” that lays out how the municipality’s finances will be restructured.<sup>160</sup> It is the responsibility of the debtor to file the plan of adjustment either at the time of the petition or at a date later decided by the court.<sup>161</sup> Creditors are classified as “unimpaired” if they will be paid in cash in full at the time of the plan, but creditors are “impaired” if they will not be paid in full at the time of the plan.<sup>162</sup> The debtor must negotiate with creditors in good faith.<sup>163</sup> Section 1126 details how votes are calculated in deciding whether a plan is “accepted” by the “impaired” creditors.<sup>164</sup> In a plan of adjustment, creditors are divided into “classes” of creditors.<sup>165</sup> To be accepted by a class of creditors, at least two-thirds of the amount in credit and at least one-half the number of creditors must accept the plan.<sup>166</sup> Normally all clas-

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154. Ellman & Merrett, *supra* note 30, at 384.

155. *Id.*

156. 11 U.S.C. § 922 (2014); Ellman & Merrett, *supra* note 30, at 384.

157. Ellman & Merrett, *supra* note 30, at 389.

158. Heck, *supra* note 7, at 101-02.

159. Ellman & Merrett, *supra* note 30, at 391.

160. *See* 11 U.S.C. § 109(c) (2012).

161. 11 U.S.C. § 941 (2012).

162. 11 U.S.C. § 1126 (2012); Orson, *supra* note 149, at 11.

163. 11 U.S.C. § 101(40) (2012); 11 U.S.C. § 109(c) (2012); 11 U.S.C. § 109(c)(5) (2012); 5 NORTON BANKR. L. & PRAC. 3d § 90:5 (2014).

164. 11 U.S.C. § 1126 (2012). Orson, *supra* note 149, at 11.

165. Orson, *supra* note 149, at 11.

166. *Id.*

ses of impaired creditors must approve the plan, but the court can confirm the plan of adjustment if one impaired class accepts the plan and the plan satisfies the court's Fair and Equitable Rule.<sup>167</sup> According to Section 942(b)(7), a plan of adjustment must be in the "best interest of creditors," and it must be "feasible."<sup>168</sup> "The 'best interests test has been described as a 'floor requiring a reasonable effort at payment of creditors by the municipal debtor' and the 'feasibility' requirement as a 'corresponding ceiling which prevents the Chapter 9 debtor from promising more than it can deliver.'"<sup>169</sup>

While Chapter 9 does not expressly address pensions, Section 365 of the Bankruptcy Code, which details executory contracts and unexpired leases, applies to municipal bankruptcy.<sup>170</sup> By permitting debtors to assume or reject the executory contracts and unexpired leases, Section 365 gives the debtor a chance to reject the contract with the court's approval.<sup>171</sup> According to legislative history, executory contracts are "the term [intended] to mean a contract 'on which performance is due to some extent on both sides.'"<sup>172</sup> Whether a contract is executory depends often on whether the obligations of the parties are unperformed.<sup>173</sup>

Based on the Vallejo, California bankruptcy, municipalities can likely reject collective bargaining agreements and the pension obligations contained therein.<sup>174</sup> In *In Re City of Vallejo*, Vallejo filed for bankruptcy and tried to reject collective bargaining agreements.<sup>175</sup> The court held that Vallejo did not have to follow California labor law about collective bargaining agreements.<sup>176</sup> If used similarly in the context of pensions, this case could open the door to reductions or eliminations of existing pension agreements in municipalities. Last, a bankruptcy court can dismiss the bankruptcy for cause, with some reasons including "unreasonable delay by the debtor that is prejudi-

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167. *Id.*

168. 11 U.S.C. § 942(b)(7) (2012); Orson, *supra* note 149, at 10.

169. Orson, *supra* note 149, at 10.

170. 11 U.S.C. § 365 (2012).

171. *See* 11 U.S.C. § 365 (2012).

172. Nat'l Labor Relations Bd. v. Bildisco & Bildisco, 465 U.S. 513, 523 n.6 (1984).

173. Ellman & Merrett, *supra* note 30, at 392.

174. *Id.* at 395.

175. *In re City of Vallejo*, 432 B.R. 262, 269 (Bankr. E.D. Cal. 2010).

176. *Id.* at 270.

cial to creditors; . . . failure to propose a plan within the time fixed . . . [and] if a plan is not accepted within any time fixed by the court[.]”<sup>177</sup>

### 3. Chapter 11 Bankruptcy

While Chapter 9 governs the financial restructuring of a municipality, Chapter 11 governs bankruptcy filings for companies and certain individuals.<sup>178</sup> Many of the initial processes of Chapter 11 are similar to Chapter 9. For instance, the petition to file bankruptcy functions as a stay, which limits actions and suits by creditors.<sup>179</sup> Under Chapter 11, the U.S. Trustee appoints at least one committee, representing creditor interests, to assist with the development of a plan of reorganization.<sup>180</sup> Stockholders, bondholders, and creditors must accept this plan, or the court can confirm the plan over rejection by these creditors if the plan does not “discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired.”<sup>181</sup>

Chapter 11 does not contain explicit pension provisions. Instead, it requires that expenses be “actual” and “necessary.”<sup>182</sup> The courts conduct a two-part test to determine if an expense is actual and necessary: the courts ask if the expense 1) “arose from a transaction with the bankruptcy estate and 2) . . . directly and substantially benefitted the estate.”<sup>183</sup> However, as mentioned before, private protections are protected in a number of ways.

### 4. Key Differences Between Chapter 9 and Chapter 11

There are several key distinctions between Chapter 9 and Chapter 11 bankruptcy. In Chapter 11 bankruptcies, the courts are granted broad power to oversee and manage the operation of the

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177. 11 U.S.C. § 930 (2012).

178. 11 U.S.C. § 109 (2012); *Corporate Bankruptcy*, SEC.GOV, <http://www.sec.gov/investor/pubs/bankrupt.htm> (last visited Sept. 22, 2014) [hereinafter *Corporate Bankruptcy*].

179. 11 U.S.C. § 922 (2012).

180. 11 U.S.C. § 1121(c) (2012); *Corporate Bankruptcy*, *supra* note 178.

181. 11 U.S.C. § 1126 (2012); 11 U.S.C. § 1129 (2014); *Corporate Bankruptcy*, *supra* note 178.

182. 11 U.S.C. § 503(b)(1)(A) (2012); Heck, *supra* note 7, at 107.

183. *McMillan v. LTV Steel, Inc.*, 555 F.3d 218, 226 (6th Cir. 2009) (quoting *In re Eagle-Picher Indus., Inc.*, 447 F.3d 461, 464 (6th Cir. 2006)) (internal quotation marks omitted).

debtor.<sup>184</sup> In Chapter 9, however, the court is limited by the Tenth Amendment, which states “[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.”<sup>185</sup> Sovereign immunity, established by the Tenth Amendment, limits the powers of the federal government to interfere in areas of state control.<sup>186</sup> Chapter 9 explicitly reserves the ability of the state and municipality to run the city.<sup>187</sup> 11 U.S.C. § 903 states that “[t]his chapter 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 . . . .” Section 904 further states that:

Notwithstanding any power of the court, unless the debtor consents or the plan so provides, the court may not, by any stay, order, or decree, in the case or otherwise, interfere with—(1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor’s use or enjoyment of any income-producing property.

In practice, this means that courts take on a more limited role in municipal bankruptcy than corporate bankruptcy, and do not manage daily affairs of the city.<sup>188</sup> In addition, the city is not limited, like its corporate or individual counterpart, in how it can use, sell, or lease its property.<sup>189</sup>

In both Chapter 9 and Chapter 11 bankruptcy, one of the primary goals is restructuring of the debtor’s finances. The “plan of adjustment” in Chapter 9 conforms generally with Chapter 11’s plan of reorganization.<sup>190</sup> There are, however, some differences. Notably, Chapter 9 does not permit municipal governments to liquidate assets, which is permitted under Chapter 11.<sup>191</sup> Given this difference, what is

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184. Orson, *supra* note 149, at 7.

185. U.S. CONST. amend. X.

186. Orson, *supra* note 149, at 9.

187. 11 U.S.C. §§ 903-04 (2012).

188. Heck, *supra* note 7, at 101.

189. *Id.* at 101.

190. Daniel J. Merrett, *Pensions and Chapter 9: Can Municipalities Use Bankruptcy to Solve Their Pension Woes?*, 27 EMORY BANKR. DEV. J. 365, 407 (2011).

191. WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW AND PRACTICE § 90:1 (3d ed. 2014) (“[R]elief under Chapter 9 does not contemplate or permit liquidation of assets for the benefit of creditors.”).

deemed in the “best interest” under Chapter 9 bankruptcies will differ from what types of plans are feasible under Chapter 11.<sup>192</sup> Whereas Chapter 9 looks generally at whether a plan of adjustment is a best alternative, Chapter 11 plans require creditors to fare at least as well as they would in Chapter 7 liquidation.<sup>193</sup>

### C. Pension Conflict in Detroit, Michigan

Detroit, Michigan filed for bankruptcy on July 18, 2013.<sup>194</sup> The fiscal crisis in Detroit, as outlined above, arose out of a confluence of factors. These include historical trends such as depopulation, loss of the manufacturing industry, subsequent declining tax revenues, increases in crime, and increasing blight.<sup>195</sup> In addition, the city engaged in risky and complex financial deals, including interest rate swaps, and took out significant amounts of debt, including public pension debt.<sup>196</sup> Audits are being conducted, but liabilities for the city are estimated at \$18 billion dollars, with \$3.5 billion in underfunding from Detroit’s General Retirement System and Detroit’s Police and Fire Retirement System.<sup>197</sup> The retirement fund for the city is about 65% funded, below the 80% target guidelines of the GAO.<sup>198</sup>

The question of pensions in Detroit raises unique and important questions. The Michigan Constitution is one that provides explicit protections for public pensions.<sup>199</sup> The state-appointed emergency manager, Kevyn Orr, asked for reductions to public pensions in the city, inciting several protests in June 2013.<sup>200</sup> Bankruptcy Court Judge Steven W. Rhodes since accepted the Detroit bankruptcy, hold-

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192. 11 U.S.C. § 1129(a)(7) (2012) (stating best interests test).

193. Ellman & Merrett, *supra* note 30, at 408.

194. *See In re City of Detroit, Mich.*, 504 B.R. 97 (Bankr. E.D. Mich. 2013).

Steven Church, *Detroit Bankruptcy Looked Premeditated, Ex Treasurer Said*, BLOOMBERG NEWS (Nov. 5, 2013), <http://www.bloomberg.com/news/2013-11-05/detroit-bankruptcy-looked-premeditated-ex-treasurer-said.html>.

195. *In re City of Detroit, Mich.*, 504 B.R. at 119-20; TUBERVILLE, *supra* note 70, at 1.

196. *In re City of Detroit, Mich.*, 504 B.R. at 115-16; TUBERVILLE, *supra* note 70, at 1.

197. *In re City of Detroit, Mich.*, 504 B.R. at 113; Williamson, *supra* note 4.

198. STATE AND LOCAL GOVERNMENT PENSIONS, *supra* note 45, at Highlights.

199. MICH. CONST. art. I, § 10.

200. Williamson, *supra* note 4; *Detroit Firefighters Protest Bankruptcy, Pension Cuts*, WORLD SOCIALIST WEB SITE, (July 23, 2013), <http://www.wsws.org/en/articles/2013/07/23/detr-j23.html>.

ing them eligible for Chapter 9 proceedings.<sup>201</sup> Bankruptcy proceedings in Detroit are ongoing, but recent events have made the fate of pensions even more contentious.

On December 3, 2013, Judge Rhodes ruled that Detroit could, in its bankruptcy, cut its pensions plans.<sup>202</sup> In his decision, Judge Rhodes found that Detroit was a municipality that was insolvent under Chapter 9.<sup>203</sup> Judge Rhodes also found that pension reductions, contrary to objectors' claims, were not a violation of the Tenth Amendment or the Michigan Constitution's Pension Clause.<sup>204</sup> In his ruling, Judge Rhodes stated that the Michigan Constitution identified pensions as "contractual obligations."<sup>205</sup> Therefore, pensions can be treated like other contracts in bankruptcy, and can be cut.<sup>206</sup> Before the ruling, it was not clear which way Judge Rhodes would decide, but pensioners hoped the Judge would protect pensions.<sup>207</sup> Further, some believed the protections afforded to pensions by the Michigan Constitution would prohibit Judge Rhodes from permitting reductions in pensions.<sup>208</sup> In his ruling, Judge Rhodes also acknowledged that the city did not negotiate with creditors and the city's forty-eight unions.<sup>209</sup>

One day before the ruling, the American Federation of State, County and Municipal employees as well as other banks and bond insurance companies filed legal action against Detroit.<sup>210</sup> In this action, the filing organizations attempted to force the city to sell priceless work at the Detroit Institute of Arts for money, with the collection

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201. Dominic Rushe, *Detroit Granted Bankruptcy Protection After Judge Rules in City's Favour*, THE GUARDIAN, Dec. 3, 2013, <http://www.theguardian.com/world/2013/dec/03/detroit-bankruptcy-protection-judge-rules>.

202. Reid Wilson, *Judge Declares Detroit Eligible for Chapter 9 Bankruptcy*, WASH. POST (Dec. 3, 2013 12:45 PM), <http://www.washingtonpost.com/blogs/govbeat/wp/2013/12/03/judge-declares-detroit-eligible-for-chapter-9-bankruptcy>.

203. See *In re City of Detroit*, Mich., 504 B.R. 97 (Bankr. E.D. Mich. 2013).

204. *Id.* at 161.

205. Micheline Maynard, *Detroit is Eligible for Bankruptcy, and City Pensions are at Risk*, FORBES (Dec. 3, 2013), <http://www.forbes.com/sites/michelinemaynard/2013/12/03/detroit-is-eligible-for-bankruptcy-and-city-pensions-are-at-risk>.

206. *Id.*

207. Lichterman, *supra* note 81.

208. Maynard, *supra* note 205.

209. *Id.*

210. David Mildenberg, *Detroit Bankruptcy Prods Cities to Target Pensions: Muni Credit*, BLOOMBERG POLITICS (Feb. 27, 2014), <http://www.bloomberg.com/news/2014-02-28/detroit-bankruptcy-prods-cities-to-target-pensions-muni-credit.html>.

valued at between \$454 and \$867 million.<sup>211</sup> In response, supporters of the museum pledged hundreds of millions of dollars in order to stop the suit and prevent priceless works by such artists as Picasso and Van Gogh from going to auction.<sup>212</sup>

In February 2014, Mr. Orr proposed a plan for Detroit's \$18 billion debt.<sup>213</sup> Under this plan, unsecured bondholders would have received twenty cents on the dollar, and general pensioners would have received just sixty-six cents (or potentially seventy-four percent if pensioners agreed to the deal quickly) on the dollar.<sup>214</sup> Pensioners from the police and fire department were set to receive ninety cents on the dollar, or ninety-four cents if they agreed to the plan quickly.<sup>215</sup>

Since the December ruling, the city engaged in settlement negotiations and federal mediation with various creditors, including unions and pension funds. As part of the federal mediation, what is being called the "grand bargain" was struck.<sup>216</sup> Under this plan, nearly \$195 million in state funds and \$370 million of the \$466 million in philanthropic funds from foundations will be used in bankruptcy to reduce pension cuts and protect Detroit assets.<sup>217</sup> The Michigan Senate and House approved the bills in May and June 2014.<sup>218</sup> Even with the grand bargain, pensioners will lose money. Monthly pension cuts will be 4.5%.<sup>219</sup> COLAs will be eliminated for most, and fire and police's COLAs would decrease from 2.25% to 1%.<sup>220</sup> However, the plan does greatly reduce cuts from Orr's plan of cutting pensions by 27%.<sup>221</sup>

Following Judge Rhodes' ruling, multiple parties filed appeals. As of August 2014, the Sixth Circuit Court of Appeals accepted seven challenges to Judge Rhodes' ruling that Detroit could cut pensions de-

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211. Mark Stryker, *What's DIA Artwork Worth? New Christie's Report has the Numbers*, DETROIT FREE PRESS, Dec. 19, 2013, <http://www.freep.com/article/2013-12-19/ENT05/312190142/detroit-dia-christies-report>.

212. Steven Church, *Detroit Art Boosters Offer \$330 Million in Bankruptcy*, BLOOMBERG LUXURY (Jan. 13, 2014), <http://www.bloomberg.com/news/2014-01-13/detroit-art-boosters-offer-330-million-in-bankruptcy.html>.

213. *Detroit's Bankruptcy Cram Down*, *supra* note 16.

214. *Id.*

215. *Id.*

216. Oosting, *supra* note 18.

217. *Id.*

218. *Id.*

219. VanderMey, *supra* note 18.

220. *Id.*

221. Scott Cohn, *Detroit Bankruptcy Deal Would Limit Pension Costs*, CNBC (June 15, 2014), <http://www.cnbc.com/id/101760478>.

spite the state's constitutional protections.<sup>222</sup> In August 2014, however, attorneys for the state, the city, unions, and pension funds argued these cases should be suspended because allowing the suits to move forward would "significantly undermine" ongoing settlements.<sup>223</sup> The appeals were suspended until further bankruptcy hearings in August 2014.<sup>224</sup> This suspension could be lifted, and the decisions challenged up to the Supreme Court if settlements fall through.<sup>225</sup> Some suspect review would be granted by the Supreme Court, given that the issue of pensions has large implications (trillions of dollars of debt are wrapped up in public pensions) and the scenario implicates pre-emption.<sup>226</sup> The ruling also has potential consequences for other states, such as California and Illinois, which have significant pension debt.<sup>227</sup> As more cities face fiscal crises, they may look to the Detroit ruling to support arguments for the reduction of pensions.<sup>228</sup>

As mentioned earlier, Bank of America and UBS AG engaged in risky and detrimental credit swaps with Detroit.<sup>229</sup> Detroit and these banks have twice reached settlements later rejected by Judge Rhodes (as overly favorable to the banks).<sup>230</sup> In March 2014, the banks and Detroit reached a new settlement, under which Detroit would pay the banks up to \$85 million in cash, which Detroit says would help resolve \$288 million in pension-related debt.<sup>231</sup> If Judge Rhodes approves the settlement, it will be incorporated into the larger Chapter 9 plan submitted by Mr. Orr in February 2014.<sup>232</sup>

The long-term implications of pensions in Michigan are significant. This case may set precedent for other modifications of pensions. It may implicate constitutional issues such as the Tenth Amendment

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222. *Federal Court Asked to Suspend Detroit Bankruptcy Appeals*, *supra* note 21.

223. *Id.*

224. *Federal Court Agrees to Suspend Detroit Bankruptcy Appeals*, *supra* note 22.

225. VanderMey, *supra* note 18.

226. Williamson, *supra* note 4.

227. See Dan Walters, *Detroit Bankruptcy Ruling Puts Public Employee Pensions on the Table in California*, SACRAMENTO BEE, Dec. 3, 2013, <http://www.sacbee.com/2013/12/04/5967887/dan-walters-detroit-bankruptcy.html>.

228. *Id.*

229. Matthew Dolan, *Detroit Floats New Pact with Creditors*, WALL STREET J. (Mar. 3, 2012), <http://online.wsj.com/article/BT-CO-20140303-715847.html> (last visited Sept. 22, 2014).

230. *Id.*

231. *Id.*

232. *Id.*

and pre-emption. The plan of adjustment for the city will also have a long-term impact on Detroit. Even with a sound plan of adjustment, the city's inability to pay public pensions (and other debts) in full may negatively impact its bond rating.<sup>233</sup> If bond ratings change, the city's future interest rates may increase, and its ability to borrow could be negatively impacted.<sup>234</sup>

#### IV. Recommendations

The following section identifies potential solutions to the challenges discussed above. Some of the proposed recommendations pertain to pensions specifically. However, many of the recommendations approach the problem of municipal bankruptcies through a long-term lens rather than trying to solve the more imminent crises of municipal bankruptcy in cities such as Detroit.

##### A. Constitutionality of Protecting Pensions

This Note recognizes that the current fiscal crisis faced by Detroit, and cities like it, are dire. However, given the potential impacts of public pension reductions on large populations, pension debt should be prioritized by cities in their restructuring process. California and Michigan, among other states, demonstrated the importance of public pensions by protecting them through state constitutions.<sup>235</sup> Though several appellate courts have upheld pension reductions in limited situations, it is important to remember the grave impacts reductions may have on elder populations.<sup>236</sup>

The outcomes of appeals to pension reductions will likely depend on the court's interpretation of Chapter 9 and the type of pension granted (under collective bargaining versus employment contracts), as well as the court's interpretation of the term "executory."<sup>237</sup> Given the fiscal crises faced by many municipalities, it seems likely that if Detroit's pension reduction reaches the Supreme Court, it will uphold reductions. The Supreme Court may, as Judge Rhodes did in Michigan, rule that pensions are like other contracts in bankruptcy,

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233. Orson, *supra* note 149, at 10.

234. *Id.*

235. STATE AND LOCAL GOVERNMENT PENSIONS, *supra* note 45, at 13.

236. See, e.g., *Thorning v. Hollister Sch. Dist.*, 15 Cal. Rptr. 2d 91, 93-96 (Cal. Ct. App. 1992) (comparing retiree medical benefits with pension benefits).

237. Heck, *supra* note 7, at 122.

and can therefore be reduced.<sup>238</sup> Even if the Supreme Court holds that public pensions are not pragmatically like contracts, it could easily rule that federal bankruptcy law pre-empts state protections. As a matter of public policy, it may be to the benefit of long-term municipal health, and subsequently state health, to permit over-burdened municipalities to impair public pensions. Though this scenario seems likely, the author cautions against this route. Public pensions are important to many recipients, and pensioners worked for years under the belief they would be receiving relatively modest public pensions upon retirement.

### **B. Courts Should Protect the Financial Well-Being of Various Stakeholders, Including Current Pensioners in Detroit**

Detroit is facing an ongoing, severe, fiscal crisis. The decision of Judge Rhodes to permit Detroit to reduce public pensions sets a troubling precedent given the state's constitutional protections of public pensions.<sup>239</sup> In the process of bankruptcy and restructuring, it will, by necessity, have to evaluate and reassess its debt obligations, including pensions.<sup>240</sup> Detroit pensioners receive, on average, \$19,213 per year.<sup>241</sup> There are over 12,000 retirees with public pensions, totaling over \$100 million in annual payments.<sup>242</sup> Though this is a significant amount, many of these pensioners rely on public pensions as a primary source of income, and many do not receive social security.<sup>243</sup> Recent agreements between creditors reduce prior proposed pension reductions, a marked improvement over the thirty-seven percent initially proposed.<sup>244</sup> Further, if obligations and promises are carried out in Detroit, it may demonstrate a viable settlement path for other cities to address pension debt.

### **C. Public pension benefits require reform**

While the fate of public pensions in municipal bankruptcy is uncertain, the need for reform in the operation and protection of public pensions is clear from the growing number of cities with public

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238. Wilson, *supra* note 202.

239. *Id.*

240. See 11 U.S.C. § 109(c) (2012) (codifying plan of adjustment).

241. *Id.*

242. Walsh, *supra* note 71.

243. Jones, *supra* note 9.

244. VanderMey, *supra* note 18.

pension crises.<sup>245</sup> Current efforts to modify public pensions demonstrate potential avenues of pension reform. Some of these efforts endanger the future of pensioners, while others are indicative of necessary reforms.

Following the Great Recession, governments at the state and local levels increasingly faced pressure to freeze or close defined benefit pensions.<sup>246</sup> “Freezing” refers to preventing new employees from receiving pensions, while “closing” refers to limiting future accrual of pensions.<sup>247</sup> While states may feel pressure to shift to defined contribution plans, states should avoid a complete move to defined contribution plans, as these are less suited to state and local governments.<sup>248</sup> Some state and local policy makers have switched from defined benefit to defined contribution plans since the Great Recession, but most have agreed that defined contribution plans are not ideal for state and local governments.<sup>249</sup> These plans are less stable and less suited to the policy interests of local governments that want to provide stable benefits to municipal workers.<sup>250</sup> Defined contribution plans, in fact, are unstable and threaten the financial security of workers.<sup>251</sup>

Though defined contribution plans are not the most viable solution for local governments, states should make modifications to existing pension reforms. While most states have not switched wholly to defined contribution plans, forty-five states have enacted public pension reform, with the majority of these states modifying existing pension plans.<sup>252</sup>

In Illinois, for instance, public pensions pose a significant future challenge, with estimates of statewide public pension liability at close to \$100 billion.<sup>253</sup> Recognizing the need for imminent pension reform, Illinois released a Public Pension Stabilization Plan, with goals of 100% funding for public pensions by 2042 and the maintenance of

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245. See RHEE & OAKLEY, *supra* note 106, at 1 (demonstrating some of the pressures faced by state and local governments since Great Recession).

246. *Id.* at 2.

247. *Id.* at 4.

248. *Id.* at 2.

249. *Id.*

250. *Id.*

251. *Id.* at 3.

252. *Id.* at 2.

253. *Scholars Propose Six Steps Toward Pension Reform for SURS*, INST. OF GOVT AFFAIRS, UNIV. OF ILL., <http://igpa.uillinois.edu/content/scholars-propose-six-steps-toward-pension-reform-surs> (last visited Sept. 22, 2014).

defined benefit plans.<sup>254</sup> To achieve these outcomes, the Plan aims to increase employee contributions to public pensions, reduce and delay COLAs, increase the retirement age, establish a closed funding schedule, and limit the scope of public pensions to public sector employees.<sup>255</sup> California, another state facing potential pension shortfalls, has seen recent ballot measures regarding pensions; in January 2014, for instance, San Jose Mayor Chuck Reed, proposed a ballot initiative titled "Public Employees Pension and Retiree Healthcare Benefits," which "would allow government agencies to negotiate changes to current employees' future retirement benefits."<sup>256</sup>

In Michigan, reforms were adopted after the Great Recession and accompanying economic crisis.<sup>257</sup> As part of larger structural changes to the state's retirement system, Michigan implemented a new "hybrid plan . . . that combined a traditional defined benefit (DB) pension with a defined contribution (DC) plan."<sup>258</sup> In addition, the retirement age will be higher, the employer contribution will be reduced over time, and employee contributions will pay about two percent of payroll into pension funds.<sup>259</sup>

Overall, these state reforms provide examples of some necessary changes to the public pension system. First, municipalities would benefit from increased funding of pension funds. As mentioned above, public pension funding steadily decreased in recent years,<sup>260</sup> and this has exacerbated recent pension problems. Second, municipalities should develop systems for reporting long-term pension as debt, or at least recognizing it in future accounting. The efficacy of this solution may lie, in part, with state or federal legislatures; it may be up to them to require specific accounting for pensions in financial reports. Relatedly, it would be beneficial to prohibit public pension funds from risky investments or swaps, as were seen in De-

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254. *Public Pension Stabilization Plan*, ILLINOIS.GOV, <http://www2.illinois.gov/gov/documents/pensions/public%20pension%20stabilization%20plan%20-%20sh.pdf> (last visited Sept. 22, 2014).

255. *Id.*

256. Kerry Cavanaugh, *California Public Employee Pension Reform: The War Begins*, L.A. TIMES, Jan. 7, 2014, <http://articles.latimes.com/2014/jan/07/news/la-ol-fighting-words-public-employee-pension-reform-20140107>.

257. CTR. FOR RET. RESEARCH AT BOS. COLL., *THE STATE OF MICHIGAN* available at <http://crr.bc.edu/wp-content/uploads/2013/02/Michigan.pdf> (last visited Sept. 22, 2014).

258. *Id.*

259. *Id.*

260. STATE AND LOCAL GOVERNMENT PENSIONS *supra* note 45, at Highlights.

troit, but the only way to protect against these broadly may be legislative reform.<sup>261</sup> In the meantime, cities should avoid risky investment strategies with public pensions, and perhaps public funds, more broadly. Next, cities should evaluate existing pension structures and identify ways in which future pensions can be adjusted to alleviate fiscal pressure. As seen by Illinois's Public Pension Stabilization Plan, these modifications may include increases in the eligibility age, decreases in COLA and other adjustments, and increased employee contributions.<sup>262</sup> Overall, efforts should be made to increase the long-term sustainability and financial viability of public pensions.

#### **D. Long-Term Urban Development Should Place More Emphasis on Fiscal and Social Sustainability**

To prevent future municipal bankruptcy, cities should modify or stop some existing practices. First, cities need to use more accurate, and perhaps conservative, assumptions in their analyses of growth. As mentioned above, current economic analyses to examine the viability of development projects (as in cost-benefit analyses) use overly optimistic and high rates of return, which assumes economic growth.<sup>263</sup> Given the economic climate of recent years, and the financial crisis of 2008 in particular, assumptions of constant economic growth created unrealistic and unmanageable expectations for Detroit. This may require a better understanding of and planning for uncertainty in Detroit's future. Projections used to evaluate development and policies in Detroit should adequately develop models based on varying expectations and based on levels of uncertainty.

Second, Detroit faces a challenge that is becoming more common in some cities or particular areas of cities: a declining population and increasing vacancy rates. This problem is unique because, as noted above, cities typically assume some growth in both overall gross domestic product and consumer demand when trying to encourage investment and development projects.<sup>264</sup> High vacancy rates and declining populations, as seen in both Detroit and places like the South Side of Chicago, disincentivize many developers and investors because these lead to a declining tax base. This disinvestment and high

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261. *Detroit Swap Banks Go First as Bankruptcy Looms*, *supra* note 66.

262. *Public Pension Stabilization Plan*, *supra* note 254.

263. Ellman & Merrett, *supra* note 30, at 366.

264. *Id.* at 366.

vacancy rate can, in turn, lead to community problems.<sup>265</sup> High vacancy rates, in particular, may lead to decreased perceptions of safety and increased levels of crime, which has been seen in cities like Detroit as well as more localized areas such as the Chicago's South Side.<sup>266</sup> As recently as January 2013, Detroit was cited as the deadliest city for minors in the United States, among cities of comparable or larger size.<sup>267</sup> Detroit, and cities with similar challenges, needs to identify low-cost solutions that address the problem of vacancies and job loss. Some low-cost strategies for vacancies in low-income communities have been proposed in the South Side of Chicago and Philadelphia.<sup>268</sup> These solutions include the greening and transfer of vacant lots to local communities, transformation of land uses into urban farming, increased pedestrian and bicycle activity, and the reuse of abandoned or vacant buildings.<sup>269</sup>

Third, cities such as Detroit should re-examine commonly held beliefs about what spurs economic development and growth in cities, and should embrace innovative strategies. Detroit, and other cities facing municipal bankruptcy, is a city at a crossroads; its actions in the near future could have great long-term impacts on the city of Detroit and its residents. For instance, Detroit and many other cities have long embraced the idea that large development projects such as sports stadiums spur economic development and prosperity.<sup>270</sup> This belief,

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265. See NEW COMMUNITIES PROGRAM, *supra* note 31, at 4-5.

266. Erica Raleigh & George Galster, *Neighborhood Investment, Abandonment & Crime Dynamics*, DATA DRIVEN DETROIT (Feb. 2013), [http://datadrivendetroit.org/wp-content/uploads/2013/03/Raleigh\\_Galster\\_WSU\\_020713.pdf](http://datadrivendetroit.org/wp-content/uploads/2013/03/Raleigh_Galster_WSU_020713.pdf). Analysis of vacant lots and crime was conducted using data from City of Chicago, *Crimes – Map*, CITY OF CHICAGO DATA PORTAL, <https://data.cityofchicago.org/PublicSafety/Crimes-Map/dfnk-7re6> (last visited Sept. 22, 2014). During a project conducted in 2012 and 2013, the author analyzed crime in Chicago's South Side. Data was exported in ArcGis and then analyzed for relationships between crime and neighborhood vacancies.

267. Karen Bouffard, *Detroit is Deadliest City for Children Due to Prematurity, Violence*, DETROIT NEWS, Jan. 30, 2014, <http://www.detroitnews.com/article/20140130/LIFESTYLE03/301300007>.

268. John McCarron, *New South Side Plan: From Vacant Land to 'Productive Landscapes'*, LISC CHICAGO (Nov. 29, 2012), <http://www.lisc-chicago.org/news/2157>.

269. Charles C. Branas et al., *A Difference-in-Difference Analysis of Health, Safety, and Greening Vacant Urban Space*, 174 AM. J. EPIDEMIOLOGY 1296, 1296 (2011); McCarron, *supra* note 268.

270. Pat Garofalo & Travis Waldron, *If You Built It, They Might Not Come: The Risky Economics of Sports Stadiums*, THE ATLANTIC, Sept. 7, 2012, <http://www.theatlantic.com/business/archive/2012/09/if-you-build-it-they->

however, is often a fallacy; these projects often provide only short-term or low-skill, low-wage labor, revenue benefits are unequally distributed between private and public stakeholders, and subsidies for stadiums may eat away at funding for core municipal services, like public safety and public transportation.<sup>271</sup>

Overall, long-term investments and city strategies should be developed and adopted. As mentioned above, Detroit's current fiscal crisis may necessitate innovative solutions. While more traditional urban strategies such as encouraging investment and development may be beneficial to the city's growth, these should be carefully evaluated in terms of both short and long-term consequences, and in light of uncertain financial expectations.

## V. Conclusion

Public pension debt poses a serious challenge to cities and states across the United States. Pension debt has likely contributed to municipal bankruptcy, and an increasing number of Chapter 9 bankruptcies were filed after the Great Recession. As cities begin to use Chapter 9 municipal bankruptcy, their ability to alter existing pension obligations will pose an important and as-yet unresolved question.<sup>272</sup> Many states provide protections of pension funds, but the impact of Chapter 9 bankruptcy on these protections is unknown and raises pre-emption and Tenth Amendment issues.<sup>273</sup> The decision of whether pensions can be reduced in Chapter 9 bankruptcy is important because many states and cities will face pension shortfalls in coming years, and millions of elder households rely on pensions as a major source of income.<sup>274</sup>

The case of Detroit, Michigan demonstrates the many factors, including substantial pension debt, which can lead to municipal bankruptcy.<sup>275</sup> While many factors contributed to Detroit's bankruptcy filing in 2013, depopulation, disinvestment, worldwide financial trends, poor decision-making by Detroit, and pension debt were amongst the

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might-not-come-the-risky-economics-of-sports-stadiums/260900. See, e.g., Borrero, *supra* note 8.

271. Garofalo & Travis Waldron, *supra* note 270.

272. Williamson, *supra* note 4.

273. *Id.*

274. Jones, *supra* note 9.

275. TUBERVILLE, *supra* note 70, at 1.

most important.<sup>276</sup> In July 2013, Detroit filed for Chapter 9 bankruptcy.<sup>277</sup> In December 2013, Judge Rhodes ruled that pensions could be reduced.<sup>278</sup> While, Detroit's emergency manager submitted a plan of adjustment that would reduce payments to pensioners and bondholders, in February 2014,<sup>279</sup> it is still unclear what the final plan will entail.

The current and imminent crises posed by pension debt in Chapter 9 bankruptcy should be resolved in a way that protects pensioners but also allows municipalities to address fiscal crises. This may be difficult, however, given the serious underfunding of pensions and declining revenues of cities. To prevent future crises, pension reforms should be implemented, including increased funding of pension funds, elimination of risky financial investments, and perhaps increased retirement ages, reductions in COLAs, and other cost-saving modifications.<sup>280</sup> More importantly, municipalities should re-evaluate current development strategies, modify financial expectations in future planning, and implement low-cost, innovative strategies such as the re-use of vacant land.<sup>281</sup>

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276. *In re City of Detroit, Mich.*, 504 B.R. 97, 119-20 (Bankr. E.D. Mich. Dec. 5, 2013); TUBERVILLE, *supra* note 70, at 1.

277. *Detroit Awaits Ruling on Bankruptcy Eligibility*, *supra* note 1.

278. Wilson, *supra* note 202.

279. *Detroit's Bankruptcy Cram Down*, *supra* note 16.

280. See, e.g., *Public Pension Stabilization Plan*, *supra* note 254.

281. See, e.g., Branas et al., *supra* note 269, at 1296; McCarron, *supra* note 268.