

U.S. House of Representatives

Committee on the Judiciary

Washington, DC 20515-6216

One Hundred Thirteenth Congress

July 19, 2013

Chairman Bob Goodlatte
House Committee on the Judiciary
U.S. House of Representatives
2138 Rayburn Building
Washington, D.C. 20515

Dear Chairman Goodlatte:

I write to request that the Committee hold hearings on the increasing use of chapter 9 bankruptcy relief by municipalities and other jurisdictions facing financial distress and the ramifications such bankruptcy filings are having on impacted jurisdictions and the Nation as a whole. This is of somewhat urgent interest given that a Michigan court today ruled that the Detroit bankruptcy petition is unconstitutional because of its impact on worker's pensions (Circuit Court for the County of Ingham, Case no. 13-734-CZ).

Among other things, I am concerned that the bankruptcy process is being misused to unilaterally abrogate obligations otherwise protected under law, such as pension, health care and other legal obligations, without sufficient legal safeguards or checks and balances, and that the process is anti-democratic and has the potential to be rife with conflicts of interest. This represents a potentially troubling trend which could not only have a dangerous and irreversible impact on stakeholders – including residents, workers, retirees, and bondholders – but could have a deleterious effect in Michigan and nationwide. Certainly, I believe that interested stakeholders are eager to ensure that Detroit and other jurisdictions are able to get their financial houses in order, but it needs to be done in a manner consistent with our laws and our principles.

There have recently been a series of significant chapter 9 filings, including Jefferson County, Alabama; San Bernardino, California; and Stockton, California. Although only 302 chapter 9 cases have been filed since 1954, 25 chapter 9 cases were filed just during the last two years alone.¹ Yesterday's chapter 9 filing by the Detroit Emergency Financial Manager (EFM) Kevyn Orr, if accepted and approved by the federal court, would constitute by far the largest municipal bankruptcy in United States history.

The issues presented by these municipal bankruptcies are of vital concern to the Committee which has jurisdiction over Chapter 9. As you may recall, the Committee has

¹Claire Zillman, *Jones Day Steers Detroit to Chapter 9 Bankruptcy Filing*, AM. LAW DAILY, July 19, 2013, available at http://www.americanlawyer.com/PubArticleALD.jsp?id=1202611566061&Jones_Day_Steers_Detroit_to_Chapter_9_Bankruptcy_Filing&slreturn=20130619115914.

conducted a series of oversight hearings on the ramifications of the chapter 11 reorganization bankruptcies of General Motors and Chrysler during the 110th Congress.² Similarly, the Committee held a hearing in the last Congress about the consequences extending chapter 9 relief to states.³ The Committee, however, has not held a hearing that solely focused on chapter 9 since 1988.⁴

I have a number of very serious concerns about the filing in Detroit as well as the recent and increasing trend of municipal bankruptcy filings, which include the following:

- Whether the filing of a chapter 9 petition can be used to override state constitutional pension guarantees – As you know, many state constitutions enumerate critical protections for their citizens. In the case of Michigan, for example, Section 24, Article IX of the state constitution specifically provides that “The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof and shall not be diminished or impaired thereby.” Nevertheless, it is possible that the chapter 9 filing by Mr. Orr will be used to override such protections guaranteed to the state’s citizens under its constitution. As a matter of fact, a State court today ruled that Mr. Orr’s petition violates the state constitution and must be withdrawn because of Michigan’s constitutional prohibition against reducing public employee’s pension benefits. The Committee could consider the ramifications of this constitutional stand off and the appropriate balance between protecting states’ rights and chapter 9 bankruptcy relief.
- Whether chapter 9 cases are being made in “good faith” – As a related matter, at the time of yesterday’s filing, Mr. Orr was purportedly still in the midst of negotiations with various interested parties, including pension representatives, when he resorted to filing the chapter 9 case. As reported by the *Detroit Free Press*, counsel for certain pension funds that were seeking a temporary restraining order to block a possible chapter 9 filing on behalf of Detroit (which as noted above was granted today) agreed to delay the hearing on the TRO at the request of the Governor’s attorneys for five minutes, during which time the chapter 9 case commenced.⁵ The counsel for the pension funds claims

²*Ramifications of Auto Industry Bankruptcies: Hearing Before the H. Comm. on the Judiciary, 110th Cong. (2009); Ramifications of Auto Industry Bankruptcies, Part II: Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary, 110th Cong. (2009); Ramifications of Auto Industry Bankruptcies, Part III: Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary, 110th Cong. (2009).*

³*The Role of Public Employee Pensions in Contributing to State Insolvency and the Possibility of a State Bankruptcy Chapter: Hearing Before the Subcomm. on Courts, Commercial and Administrative Law of the H. Comm. on the Judiciary, 112th Cong. (2011).*

⁴*See, e.g., Legislation to Amend Chapter 9 of the Bankruptcy Code: Hearing on H.R. 3845 Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary, 100th Cong. (1988).*

⁵*Matt Helms et al., Detroit Files for Bankruptcy, Setting Off Battles with Creditors, Pensions, Unions, DETROIT FREE PRESS, July 19, 2013 [hereinafter “DETROIT FREE PRESS”], available at <http://www.freep.com/article/20130718/NEWS01/307180107/Detroit-bankruptcy-filing-Kevyn-Orr-emergency-manager>.*

that he was “blindsided” by the filing and that the requested delay was “not in good faith.”⁶ *The Wall Street Journal* reports that because the filing was “so rushed” the signature date on the order approving the filing had to be changed from “July 18 to July 19.”⁷ Bankruptcy is an equitable process that requires all who seek relief to have clean hands. In particular, section 103(f) of the Bankruptcy Code, which in turn makes section 105 applicable to chapter 9, which generally has been interpreted to require parties act in good faith in bankruptcy cases and which specifically authorizes the court to “prevent an abuse of process.”⁸ I have serious concerns that filings of this nature, under the facts presented, may not meet such good faith standard, which would invalidate the entire bankruptcy process.

- Whether citizens of a municipality are denied their constitutional rights when an unelected entity such as an EFM commences a chapter 9 filing on their behalf – I am not aware of another instance where an EFM has commenced a chapter 9 filing for a municipality. In the present case, not only is there the concern that Mr. Orr himself was not elected, but that the entire emergency manager law was rejected by voters of the State of Michigan in the November, 2012 election. The constitutional issues presented by an unelected individual exercising such extraordinary powers warrants close scrutiny by the Committee.
- The impact of the chapter 9 filing on legal and other responsibilities by a state to a municipality – In recent years, the State of Michigan has routinely enacted a series of significant cuts in its budget, which have had a disproportionate impact on cities. Cuts in revenue sharing, education and public safety have particularly harmed local governments. Detroit has lost approximately \$220 million in funds previously promised by the state and foregone approximately \$450 million in city income tax receipts, obligations which may be actionable.⁹ The manner in which these potential obligations are treated in a chapter 9 bankruptcy presents several novel and important questions.

⁶*Id.*

⁷Matthew Dolan, *Record Bankruptcy for Detroit*, WALL ST. J., July 19, 2013 [hereinafter “WALL ST. J.”], available at <http://online.wsj.com/article/SB10001424127887323993804578614144173709204.html>.

⁸11 U.S.C. § 105(a) (2013).

⁹ The revenue loss faced by Detroit as a result of the unilateral actions taken by the State of Michigan, PA 140 of 1971 established Michigan’s state revenue sharing scheme, but for more than a decade, Michigan municipalities have watched revenue streams decline, resulting in bare-bone cuts to staffing and the elimination of services on which residents have come to rely. In 1998, State legislators and Detroit city officials passed a measure to shrink the city tax rate for workers (PA 500 and PA 532). The move called for the reduction from 3 percent to 2 percent for Detroit residents and from 1.5 percent to 1 percent for nonresidents. In exchange, legislators agreed not to reduce the money Detroit received in revenue sharing, an expected annual amount of \$339.9 million for the years 1999-2007. It was also agreed in the statute that if state sales and revenues declined, Detroit would be subject to relatively modest reductions in revenue sharing. When sales tax revenue declined, instead of reducing Detroit’s payment by \$720,000 in 2007 and \$3.5 million in 2008 as the agreement provided, for example, the state law was changed to reduce Detroit’s revenues by an aggregate amount of \$220 million. However, the state did not allow Detroit to increase its income tax, costing the City \$50 million per year, or approximately \$450 million since 2004.

In the case of Detroit, the issue is compounded by the fact that Mr. Orr owes his position entirely to Governor Snyder, who has an adverse legal position to the City on these issues. An additional conflict is presented by the fact that Mr. Orr has opted to retain his former law firm, Jones Day, to serve as counsel for the City and signed a \$3 million contract with them and paid them \$1.37 million in their first six weeks.¹⁰ Needless to say these series of conflicts go to the heart of the bankruptcy filing and present complex and novel legal and policy questions.

- The impact of chapter 9 and related legal proceedings on privatization efforts – There are also serious legal and policy implications posed by a municipal bankruptcy on the scale of Detroit and other recent jurisdictions that have sought bankruptcy protections in terms of how public services are delivered. In recent years, municipalities in financial distress have often outsourced essential government services to private entities in an attempt to achieve short-term fiscal savings. In many cases, these outsourcing decisions are rushed and lack necessary transparency.¹¹ Given the unprecedented size of Detroit's bankruptcy, the potential for mismanagement and unnecessary outsourcing of public services is of significant concern.¹²
- As such, I am hopeful the Committee would consider how the Chapter 9 process can protect the public interest by ensuring that public-private partnerships are pursued in a transparent, public, and deliberative way.

¹⁰ Sara Randazzo, *Jones Day Bills Detroit \$1.4 Million in First Six Weeks*, THE AM LAW DAILY., July 3, 2013, available at http://www.americanlawyer.com/PubArticleALD.jsp?id=1202609710961&Jones_Day_Bills_Detroit_14_Million_in_First_Six_Weeks.

¹¹ A recent example of this phenomenon was the deal struck between the City of Chicago and Chicago Parking Meters LLC in February 2009. In response to a budget crisis in the city, Chicago Parking Meters signed a 75-year concession agreement for the long term lease of Chicago's 36,000 parking meters. In exchange, the City of Chicago received an upfront payment of approximately \$1.2 billion. Within months, parking rates soared and many meters were malfunctioning or mislabeled. A report from the city's Inspector General ultimately found that "the City was paid, conservatively, \$974 million less for this 75-year lease than the City would have received from 75 years of parking meter revenue." See Report of Inspector General's Findings and Recommendations: An Analysis of the City's Parking Meters, June 2, 2009, available at <http://chicagoinspectorgeneral.org/wp-content/uploads/2011/03/Parking-Meter-Report.pdf>.

¹² Concerns have long been expressed that the EM Law would be used as a vehicle allowing for the privatization of public services. The Michigan Emergency Manager law has itself raised serious questions about privatization. For example, the Mackinac Center for Public Policy, along with the American Legislative Exchange Council "has been supporting laws like Michigan's EM Law as a way to ... identify privatization opportunities." See "Michigan's Hostile Takeover," MOTHER JONES, Feb. 15, 2012. *New York Times* author Jonathan Maller has also written, "I have seen the training materials for the training sessions held for potential E.M.'s, and they contain nothing that would help an E.M. develop academic and educational plans. In fact, the trainings were run primarily by representatives from companies who stand to benefit financially as E.M.'s outsource many of the tasks normally handled by a municipality or school district. This is a big red flag for those of us who worry that PA 4 is a not-so-subtle vehicle for forcing privatization of our governments and schools." By way of specific example, Chris Savage' February 15, 2012 Nation article noted, "In Pontiac EFM Michael Stampfer outsourced the city's wastewater treatment to United Water just months after the Justice Department announced a twenty-six-count indictment against the company for violating the Clean Water Act."

A broader concern pertains to the nationwide consequences and precedential implications of large municipalities using chapter 9 to reduce or possibly eliminate their obligations owed to creditors, such as bondholders and pensions. Given the amount of debt at issue in the Detroit chapter 9 bankruptcy filing, financial experts have observed that it could potentially set “national precedents on matters ranging from whether bondholders get repaid when cities run out of money to whether public pensions, previously thought to be sacrosanct under the Michigan Constitution, are protected in municipal bankruptcies and that “[f]inancially troubled cities around the nation will be watching what happens in the Motor City for lessons that could apply to them.”¹³ Analysts are already predicting that Detroit’s chapter 9 filing “could drive up bond costs for cities statewide” and “potentially the U.S. market.”¹⁴

Certainly, these issues are of tremendous significance not only to the financial community, but to all Americans who transact business with, work for, and live in municipalities across the United States.

Thank you for your attention to this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "John Conyers, Jr.", written in a cursive style.

John Conyers, Jr
Ranking Member

cc:

President Barack Obama

Honorable Rick Snyder, Governor, State of Michigan

Honorable Dave Bing, Mayor, City of Detroit

Mr. Kevyn Orr, Emergency Financial Manager, City of Detroit

¹³ DETROIT FREE PRESS, *supra* note 5.

¹⁴ WALL ST. J., *supra* note 7.