Emergency Financial Manager Town Hall

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By Professor Kenneth N. Klee

Qualifications

I graduated in 1971 with an A.B. with great distinction from Stanford University, and from Harvard University in 1974 with a J.D., cum laude.

I currently serve as a Professor of Law at the University of California, Los Angeles School of Law, having taught courses at that law school since 1979. Courses that I have taught include: "Professional Responsibility Issues in Business Transactions, Litigations and Reorganizations," "Business Bankruptcy Law," "Chapter 11 Business Reorganization," "Business Law Stories," "Consumer Bankruptcy Policy," "Business Deals Clinic" and "Creating Value Through Renegotiating Business Agreements." I have previously taught business reorganization law at the University of Southern California Law Center in 1983 and bankruptcy and business reorganization law as the Robert Braucher Visiting Professor from Practice at Harvard University Law School from 1995 to 1996, and as a visiting professor at Georgia State University in 2003.

Separately from my duties as a professor, I served as the associate counsel to the Committee on the Judiciary, United States House of Representatives from 1974 to 1977. In that capacity, I was one of the principal draftsmen of the 1978 Bankruptcy Code. I also serve as a member of the executive committee of the National Bankruptcy Conference, a capacity in which I previously served from 1985 to 1988, 1992 to 2000, and 2004 to 2007, and served as Chair of the National Bankruptcy Conference's legislation committee from 1992 to 2000. My testimony states my personal views and not necessarily the views of any organization or client.

In addition to my work as a professor and with Congress, I have practiced law for over thirty-five years and am admitted to practice before the bars of California, the District of Columbia, and New York, the United States Courts of Appeals for the Second, Third, Seventh, Ninth, and District of Columbia Circuits, the United States District Court for the Northern, Eastern, Southern, and Central Districts of California and the Eastern District of Wisconsin, and the United States Supreme Court. My practice areas are bankruptcy, insolvency, corporate reorganization and bankruptcy litigation. I also have rendered legal services as an expert witness, consultant, mediator, arbitrator, and examiner.

I am a founding partner of Klee, Tuchin, Bogdanoff & Stern LLP, a law firm specializing in corporate reorganization, insolvency and bankruptcy law. I have advised indenture trustees, noteholders, creditors, and debtors as clients in out-of-court restructurings and in chapter 11 reorganization cases. In addition, I have served as counsel to Orange County, California, in its Chapter 9 debt adjustment proceeding, and currently represent Jefferson County, Alabama, in its Chapter 9 debt adjustment proceeding.

My publications include Bankruptcy and the Supreme Court (Lexis-Nexis 2008), Business Reorganization in Bankruptcy (West 1996; 2d ed. 2001; 3d ed. 2006, 4th ed. 2012) and Fundamentals of Bankruptcy Law (ALI-ABA 4th Ed. 1996) as well as thirty law review articles.

Town Hall Testimony

Focus of my Testimony.

Michigan has enacted the *Local Government and School District Fiscal Accountability Act*, Act No. 4, Public Acts of 2011, MCL §§ 141.1501 et seq. (the "Act"), which enables the Governor to appoint an "Emergency Financial Manager" to oversee the rehabilitation of troubled municipalities. The Act grants broad powers to the Emergency Financial Manager, including the power to reject, modify, or terminate a collective bargaining agreement in certain circumstances. I have analyzed whether these provisions of the Act violate the "Contracts Clause" of the United States Constitution. I am not an expert on Michigan Law, and my testimony does not address whether the Act or its provisions violate the Constitution of the State of Michigan.

Relevant Provisions of the Act.

The Act permits the state treasurer to conduct a preliminary review if one or more of 17 specific events described in the Act occur. Act, § 12(1)(a)-(q). Even if none of those events occurs, the state financial authority may initiate preliminary review if, in the sole discretion of the state treasurer or superintendent of public education, other facts or circumstances indicate financial stress. *Id.*, § 12(1)(r). If the preliminary review finds probable financial stress, the governor is required to appoint a review team. *Id.*, § 12(3). The review team is limited to four conclusions, one of which is that a financial emergency exists and there is no satisfactory plan to resolve the emergency. *Id.*, § 13(4). If the governor confirms the state of emergency and that determination is upheld by the circuit court (or not appealed), the governor declares that the local government is in receivership and appoints an Emergency Financial Manager. *Id.*, § 15(4).

A local government remains in receivership until the Emergency Financial Manager declares the financial emergency to be rectified in his or her quarterly report to the state treasurer, and the state treasurer (and the superintendent of public instruction if the local government is a school district) concurs. *Id.*, § 24. Before the termination of receivership, the Emergency Financial Manager must adopt and implement a two-year budget, including all contractual and employment agreements, to start at the end of the receivership. *Id.*, § 27(1) The local government is prohibited from amending that budget without the approval of the state treasurer, and from revising any order or ordinance implemented by the Emergency Financial Manager for one year. *Id.*, § 27(2) .

Under the Act, the Emergency Financial Manager acts as the sole agent of the local government in collective bargaining with employees or representatives and approves any contract or agreement. *Id.*, § 19(1)(*l*). The Act permits an Emergency Financial Manager to reject, modify, or terminate a collective bargaining agreement in the event of a declared financial emergency and receivership (this power cannot be granted under a consent agreement) if the Emergency Financial Manager (in his or her sole discretion) meets with the bargaining unit and determines that no satisfactory agreement can be obtained. *Id.*, § 19(1)(k). The Act provides one exemption – an

Emergency Financial Manager cannot change a collective bargaining provision for the payment of a benefit on the death of a police officer or firefighter in the line of duty. *Id.*, § 20(b).

The Act also exempts the designated local government from collective bargaining requirements for five years or until the receivership is terminated. Therefore, if a contract is terminated, there is no requirement that a new contract be negotiated by the Emergency Financial Manager and the union. *Id.*, § 26(3).

The Act appears to have been drafted with an awareness of the potential for a constitutional challenge, with language attempting to set conditions for abrogating collective bargaining agreements that justify the "legitimate exercise of the state's sovereign powers." Although the language of Section 19(1)(k)(i) – (iii) is vague ("reasonable and necessary for the benefit of the public as a whole"), the language of Section 19(1)(k)(iv) ("Any plan involving the rejection, modification, or termination of one or more terms and conditions of an existing collective bargaining agreement is temporary and does not target specific classes of employees") imposes more restraints on the actions that may potentially be taken by the Emergency Financial Manager under the Act, especially in situations where a particular collective bargaining agreement might only cover a specific class of employees (i.e. police officers or firefighters).

There is also a severability clause that would preserve other provisions in the Act, even if sections allowing the rejection, modification, or termination of collective bargaining agreements are invalidated by the courts. *Id.*, § 31.

My testimony focuses particularly on the constitutionality of (i) the exemption of financially distressed municipalities from the requirement to collectively bargain, and (ii) the ability of the Emergency Financial Manager to modify, reject, or terminate provisions of a collective bargaining agreement.

Exemption From Requirement to Collectively Bargain

The provision of the Act exempting a municipality in financial distress from the requirement to collectively bargain is exclusively a Michigan state law issue, about which I am not an expert. Federal labor law, through the National Labor Relations Act ("NLRA") generally requires employers and labor organizations to bargain in good faith over "wages, hours, and other terms and conditions of employment." 29 U.S.C. §§ 158(d), 158(a)(5), 158(b)(3). However, the NLRA expressly excludes public employers, including cities, from its scope. 29 U.S.C. § 152(2). This statute states that, as used in the NLRA, "[t]he term 'employer' . . . shall not include the United States or any wholly owned Government corporation . . . or any State or political subdivision thereof . . . ." *Id*; *see also Police Dep't of Chicago v. Mosley*, 408 U.S. 92, 102 n.9 (1972) (noting that the exemption exempts cities). Consequently, any requirement on the part of Michigan municipalities to collectively bargain with its employees is strictly grounded in state law, and, as such, a purported violation of such a requirement is outside the scope of my expertise.

The Contracts Clause

The Contracts Clause provides that "No State shall . . . pass any . . . Law impairing the Obligations of Contracts . . . " *U.S. Const.* art. I, § 10, cl. 1. Despite its unequivocal language, this constitutional provision "does not make unlawful every state law that conflicts with any contract . .

." *Local Div. 589, Amalgamated Transit Union v. Massachusetts*, 666 F.2d 618, 638 (1st Cir. 1981). Rather a court's task is "to reconcile the strictures of the Contract Clause with the essential attributes of sovereign power necessarily reserved by the States to safeguard the welfare of their citizens." *U.S. Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 20 (1977).

Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934) is regarded as the leading case in the modern era of Contracts Clause interpretation. At issue in *Blaisdell* was the Minnesota Mortgage Moratorium Law, enacted in 1933 during the depth of the Great Depression, when that State was under severe economic stress. The statute was a temporary measure that allowed judicial extension of the time for redemption; a mortgagor who remained in possession during the extension period was required to pay a reasonable income or rental value to the mortgagee. The United States Supreme Court adopted a "reasonableness" approach to the Contracts Clause, observing that "emergency may furnish the occasion for the exercise of power" and that the "constitutional question presented in the light of an emergency is whether the power possessed embraces the particular exercise of it in response to particular conditions." *Id.* at 426. A closely divided Court upheld the law, finding that (1) there was adequate justification for the law (in that case, a true emergency stemming from the Great Depression), (2) the statute was enacted to protect a basic interest of society, (3) the law was appropriate to the emergency and the conditions it imposed were reasonable, and (4) the legislation was temporary and limited to the exigency which provoked the legislative response.

In a series of decisions that followed closely in the wake of *Blaisdell*, the Court made clear what was only implied in *Blaisdell*: to withstand a challenge under the Contracts Clause, legislation addressing a temporary emergency or a means to achieve an important state policy must be precisely and reasonably designed and clearly in the public interest. Indeed, only a year after *Blaisdell* was decided, the Supreme Court held that an Arkansas mortgage moratorium law which effectively provided for no payment of interest or principal to mortgage-holders for six years was a violation of the Contracts Clause in *W.B. Worthen Co. v. Kavanaugh*, 295 U.S. 56 (1935). The Court found that the Arkansas statute "with studied indifference to the interests of the mortgagee . . . [had] taken from the mortgagee the quality of an acceptable investment for a rational investor." 295 U.S. at 60. The Court also invalidated an Arkansas law that exempted the proceeds of a life insurance policy from collection by the beneficiary's judgment creditors in *W.B. Worthen Co. v. Thomas*, 292 U.S. 426 (1934) and a Louisiana law that modified the existing withdrawal rights of the members of a building and loan association in *Triegle v. Acme Homestead Assn.*, 297 U.S. 189 (1936).

The reasonableness test of *Blaisdell* has refined and evolved over time into a tripartite inquiry that looks first at the extent of the impairment, next at whether it serves a legitimate public purpose, and finally whether the impairment is reasonable and necessary:

> [T]he first inquiry must be whether the state law has, in fact, operated as a substantial impairment of a contractual relationship. The severity of the impairment measures the height of the hurdle the state legislation must clear. Minimal alteration of contractual obligations may end the inquiry at its first stage. Severe impairment, on the other hand, will push the inquiry to a careful examination of the nature and purpose of the state legislation.

Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244-45 (1978).

Factors that are relevant to this inquiry include (1) whether the law was enacted to deal with a broad, generalized, economic or social problem; (2) whether the law operates in an area already subject to state regulation at the time the contractual obligations were originally undertaken or represents a new area of regulation for the state; (3) whether the impairment is temporary or permanent; and (4) whether the impact of the regulation is broad or narrow.

There can be no argument regarding the extent of the impairment permitted by the Act. The Act permits the wholesale rejection or termination of an entire collective bargaining agreement, thereby unilaterally stripping collectively bargained-for rights of public employees. The impact of the Act is broad and wide-ranging, opting for an axe when a scalpel would have been sufficient. Aside from a limited exception for firefighters and police officers killed in the line of duty, there are no exemptions from this provision of the Act, and no requirement that other alternatives be considered before the neutering of contractual rights. Moreover, while the Act states that all rejections of collective bargaining agreements will be temporary, the Act does not cap the length of time that any changes to a collective bargaining agreement implemented by an Emergency Financial Manager could remain in effect, nor does it cap the length of time that a municipality could be in receivership. The Act, therefore, provides broad power for an Emergency Financial Manager to severely impair the bargained-for rights of public employees in a broad, indiscriminate, and indefinite manner. Regardless of whether there is a legitimate emergency or purpose that prompted the passage of the Act and the inclusion of the collective bargaining provisions by the State, the Act would very likely be deemed unconstitutional under the test outlined in *Spannaus*.

The two decisions that squarely address the intersection between a statute allowing state control over a distressed municipality and the Contracts Clause illustrate why this conclusion is warranted. In *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), the Court addressed a Contracts Clause challenge to a New Jersey statute authorizing state control over insolvent municipalities with many similarities to Michigan's law. Applying the analysis of *Blaisdell*, the Supreme Court held that a plan requiring the holders of municipal debt to exchange their bonds for new bonds did not violate the Contracts Clause. Under the specific composition plan at issue in *Faitoute*, the holders of revenue bonds received new securities bearing lower interest rates and later maturity dates. The reason was that the old bonds represented only theoretical rights; as a practical matter the city could not raise its taxes enough to pay off its creditors under the old contract terms. The composition plan enabled the city to meet its financial obligations more effectively. "The necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city's debt is implied in every such obligation for the very reason that thereby the obligation is discharged, not impaired." *Id.* at 51. Thus, the Court found that the composition plan was adopted with the purpose and effect of protecting the creditors, as evidenced by their more than 85% approval.

Faitoute is clearly distinguishable and presents little support for the Act as constitutionally sound. In *Faitoute*, the Court had no need to opine on whether economic circumstances justified an abrogation of rights, or whether certain aspects of the law—i.e. whether it was temporary, or had a broad impact—tended to justify an impairment. Rather, the Court found as a threshold matter that there was no impairment of rights and that the legislation involved actually benefited the very bondholders who had brought the action. *Id.* at 516. The court refused "[t]o call a law so beneficent in its consequences on behalf of the creditor . . . an impairment of the obligation of contract." *Id.* The Act, in contrast, contains no such benefits for public employees whose collectively bargained-

for rights can be stripped unilaterally. Indeed, as exemplified in the numerous cases in the following section involving the impairment of collective bargaining agreements, courts have overwhelmingly found that the unilateral modification of terms of a collective bargaining agreement does constitute an impairment of contract. Consequently, the holding of *Faitoute* is limited to its unique facts, and does not support a finding of constitutionality for the Act.

The Court emphasized the narrow holding of *Faitoute* in *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977), noting that although the Contracts Clause leaves room for "the 'essential attributes of sovereign power,' . . . necessarily reserved by the States to safeguard the welfare of their citizens," *id.* at 21, that power has limits when its exercise effects substantial modifications of private contracts. Despite the customary deference courts give to state laws directed to social and economic problems, "[legislation] adjusting the rights and responsibilities of contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption." *Id.* at 22. For these reasons, the Court struck down a 1974 New Jersey law that repealed a 1962 statutory covenant regarding municipal bonds and effected a much more serious impairment than occurred in *Faitoute*. There was no suggestion that New Jersey acted for the purpose of benefiting the bondholders, and there was no serious contention that the value of the bonds was enhanced by repeal of the 1962 covenant.

The second case addressing a state insolvency law, *Ropico, Inc. v. New York*, 425 F. Supp. 970 (S.D.N.Y. 1976), is similarly inapposite. The plaintiff noteholders in *Ropico* challenged the validity of the New York State Emergency Moratorium Act for the City of New York as a violation of the Contracts Clause, because it mandated that "payment of principal on short-term notes of the City otherwise due in 1975 and 1976 shall be suspended for three years." *Id.* at 972. As compensation for that impairment, however, the legislation offered two concessions to noteholders; namely, the ability to either exchange the suspended notes for longer-term obligations, or to elect a higher rate of interest on their existing notes. *Id.* Emphasizing the importance of "legislation deemed essential to the survival of [New York's] largest city" and the "pressing public emergency" the court found that the legislation was an appropriate, temporary measure that caused only a "limited adjustment of the noteholders' rights in response to the emergency situation," rather than a "total disregard of [their] rights." *Id.* at 977.

The impairment that occurs under the Act does not stop at a "limited adjustment." Instead, the Act permits a total disregard for the collectively bargained-for rights of public employees while offering no alternatives, concessions or substitutions. As currently drafted, the Act permits a collective bargaining agreement to be rejected for a an indefinite period of time. If the collective bargaining agreement expires during the "period of rejection," the employees would not be able to negotiate a new agreement, as the Act exempts a municipality that has been placed under receivership from the duty to bargain collectively for five years or until the receivership is terminated. Act, § 26(3). This result stands in stark contrast to the minimal impairment effected by the legislation at issue in *Ropico*, and the optionality provided to the noteholders as compensation for the impairment. Thus, even assuming the stakes are the same for Michigan as they were for New York (even though no specific emergency is identified in the Act), the Contracts Clause simply does not permit the "total disregard of rights" that could occur from the rejection or sustained, piecemeal modification of a collective bargaining agreement under the Act.

With this background, I now turn to an analysis of decisions involving Contracts Clause challenges to legislative modifications to collective bargaining agreements – facts nearly identical to those in this instance. This analysis produces the same conclusion – the Act as drafted runs afoul of the Contracts Clause.

Contracts Clause: Violations of Collective Bargaining Agreements

Introduction

In construing legislative violations of provisions of collective bargaining agreements, courts have employed the traditional Contracts Clause test espoused in *Spannaus* and the other cases cited above. In the collective bargaining context, the Second Circuit has stated that:

> To determine if a law trenches impermissibly on contract rights, we pose three questions to be answered in succession: (1) is the contractual impairment substantial and, if so, (2) does the law serve a legitimate public purpose such as remedying a general social or economic problem and, if such purpose is demonstrated, (3) are the means chosen to accomplish this purpose reasonable and necessary.

Buffalo Teachers Fed'n v. Tobe, 464 F.3d 362, 368 (2d Cir. 2006). In utilizing that test, courts have come to several different conclusions as to whether a piece of legislation has impermissibly impaired a collective bargaining agreement. At the outset, though, it is important to recognize that no court has had need to decide whether legislation that permits the outright termination or rejection of a collective bargaining agreement runs afoul of the Contracts Clause; rather, the cases deal simply with legislation impairing certain provisions of a collective bargaining agreement. The Act, which permits the drastic measure of permitting a complete rejection, lies far beyond the boundaries of what has heretofore been permitted outside the boundaries of the Bankruptcy Clause. Courts have dealt with all three parts of the test, and my analysis of the Act follows that format.

First Element – Substantial Impairment

The first question—whether a contractual impairment is substantial—has traditionally not generated much controversy. In assessing substantial impairment, courts look to "the extent to which reasonable expectations under the contract have been disrupted." *Sanitation & Recycling Indus. v. City of New York*, 107 F.3d 985, 993 (2d Cir. 1997). A disruption which is "wholly unexpected" and has no "gradual applicability or grace periods" will likely be found to be a substantial impairment. *Id.* In *Sonoma County Org. of Public Employees v. County of Sonoma*, 23 Cal. 3d 296 (1979), the court found legislation that "declared null and void any provision of 'a contract, agreement, or memorandum of understanding between a local public agency and an employee organization or an individual employee which provides for a cost of living wage or salary increase'" undoubtedly impaired obligations. *Id.* at 305; *see also Baltimore Teachers Union v. Mayor of Baltimore*, 6 F.3d 1012 (4th Cir. 1993) (finding substantial impairment when parties entered into valid contracts and the legislature thereafter mandated salary reductions). Similarly, in challenging the Act, a municipality will not encounter much difficulty in alleging a substantial impairment of its collective bargaining agreements. The Act, on its face, permits the Emergency Financial Manager to reject, terminate, or modify a collective bargaining agreement—a result which

certainly could not have been expected by the employees party to the collective bargaining agreements in question. Moreover, the Act provides for no gradual applicability or grace periods with respect to the power to terminate a collective bargaining agreement. Consequently, the Act certainly substantially impairs the obligation of contract.

Second Element – Legitimate Purpose

However, despite a finding of substantial impairment, "the Contracts Clause's prohibition is not the Draconian provision that its words might seem to imply." *Buffalo Teachers Fed'n*, 464 F.3d at 367. Importantly, "[i]t does not trump the police power of a state to protect the general welfare of its citizens, a power which is 'paramount to any rights under contracts between individuals.'" *Id.* Therefore, turning to the second part of the tripartite test, a substantial impairment of a contract can be constitutional only if "the legislature had a legitimate public purpose in passing the Act and providing for a wage freeze." *Id.* at 368. In other words, if the requisite fiscal crisis does not exist, then legislation that abrogates a collective bargaining agreement will be unconstitutional. However, if a legitimate public purpose does exists, then such an abrogation can be constitutional, pending satisfaction of the third element of the test. A legitimate purpose must be "aimed at remedying an important general social or economic problem rather than providing a benefit to special interests," and cannot be merely for the financial benefit of the legislating state. *Id.* In the *Buffalo* case, the court found important that Buffalo was suffering from "a fiscal crisis," which could not be "resolved absent assistance from the state." *Id.* On those facts, the court found that a legitimate purpose existed for the implementation of a wage freeze in violation of a collective bargaining agreement. *Id.* Moreover, that court noted that "courts have often held that the legislative interest in addressing a fiscal emergency is a legitimate public interest." *Id.*

Other courts, in the collective bargaining agreement context, have entertained similar propositions. In the mid-1970s, when New York City was facing severe financial distress, New York State enacted the New York State Financial Emergency Act for the City of New York, which provided for, among other things, a wage freeze, which the parties agreed was "[i]ndisputably . . . an impairment of contract rights under the collective bargaining agreement between the parties." *Subway-Surface Supervisors Assoc. v. New York City Transit Authority*, 44 N.Y.2d 101, 109 (1978). The legislative act in that case contained findings that New York City was in a fiscal crisis and required emergency assistance. *Id.* at 107. On those facts, the challenging labor union did not dispute that a fiscal emergency existed in New York City that was worthy of an impairment of contract.

However, not every budget shortfall can properly be considered a financial emergency capable of supporting otherwise unconstitutional legislation. Certain courts have struck down impairing legislation despite clams by legislators that a fiscal crisis existed. In *AFSCME, Local 2957 v. City of Benton*, 513 F.3d 874 (8th Cir. 2008), the City Council of Benton, Arkansas, enacted legislation altering health insurance coverage for retired employees, in violation of collective bargaining agreements with the city's employees. *Id.* at 878. In finding the legislation unconstitutional, the Eighth Circuit affirmed the district court's finding that "the City had not demonstrated a significant economic interest to justify its actions." *Id.* at 882. Moreover, quoting the Supreme Court in *Spannaus*, the court noted that "[a]lthough economic concerns can give rise to the City's legitimate use of the police power, such concerns must be related to 'unprecedented emergencies,' such as mass foreclosures caused by the Great Depression." *Id.* Because the City of

Benton was not facing an "unprecedented emergency," and the minutes of its City Council meetings did not reveal any "broad economic problems," the court held that its fiscal problems did not warrant the abrogation of a collective bargaining agreement. *Id.* Similarly, in *Sonoma County Org. of Public Employees v. County of Sonoma*, 23 Cal. 3d 296 (1979), a California court found legislation that impaired a collective bargaining agreement by nullifying certain wage increases to be unconstitutional, because the city had not reached the requisite level of financial emergency. The purported financial emergency in this case was precipitated by California's passage of Proposition 13, which caused local government entities to lose six percent of their anticipated revenue. *Id.* at 312. However, because the very same legislative measure which attempted to nullify wage increases also provided for the state to downstream $5 billion to local agencies, the court found that "the asserted 'fiscal emergency' relied upon by respondents as justification for the salary limitation was largely alleviated by the very same bill which contains the limitation," thus providing no need for any impairment of a collective bargaining agreement. *Id.* Consequently, the California court held that the situation was not "grave," and "the government has failed to meet its threshold burden of establishing that an emergency existed." *Id. See also Carlstrom v. State*, 103 Wn.2d 391, 397 (Wash. 1985) (suggesting that only health and safety concerns, not solely financial considerations, could justify an impairment of contracts).

The constitutionality of the Act therefore depends, in part, upon the nature of the financial emergency facing the City of Detroit—or any municipality against which the Act is used. Interestingly, though, the Act doesn't attempt to immediately abrogate any contract, or immediately usurp power from any local official. Instead, the Act becomes operative upon the existence of certain financial conditions, as described in Section 13 of the Act. Among those conditions are, for example, (i) a default in the payment of principal or interest upon securities for which insufficient funds are on hand, (ii) failure for seven days or more to pay compensation to employees or benefits to retirees, and (iii) a projection of a deficit in the general fund in excess of 5% of projected revenues. *See* Act, § 13. While they may be unpleasant, none of the aforementioned situations portends a fiscal emergency on the scale of the Great Depression. *See, e.g., Blaisdell*, 290 U.S. at 444-45. As described above, courts have required clear, specific findings of financial emergency in order to support an impairment of contracts. Further, "[t]he severity of the impairment measures the height of the hurdle the state legislation must clear." *Spannaus*, 438 U.S. at 245. The Act, which prospectively sets forth events—none of which necessarily implicate the type of financial apocalypse seemingly required by the courts—fails to meet this high burden. Consequently, the Act fails to satisfy the second part of the tripartite test.

Third Element – Reasonable and Necessary

However, even if the conditions described in section 13 of the Act are found to be a sufficient and legitimate purpose to support an impairment of contracts, the State of Michigan must still show that the Act is "reasonable and necessary," in compliance with the final element of the test. *Subway-Surface Supervisors*, 44 N.Y.2d at 109. Courts have looked to multiple factors to determine the reasonableness and necessity of legislation in the context of a collective bargaining agreement.

One factor used by courts is the availability of alternatives to the impairment of contract — meaning, that if the legislature has other options, instead of resorting to contract impairment, then the legislation will not be considered reasonable and necessary, and will be unconstitutional. Stated differently, Michigan must embrace less restrictive alternatives when available.

In *Association of Surrogates & Supreme Court Reporters v. New York*, 940 F.2d 766 (2d Cir. 1991), the Second Circuit analyzed legislation mandating a two-week payroll lag on non-judicial employees of the New York court system. *Id.* at 770. In holding that the provision was an unconstitutional impairment of a collective bargaining agreement, the court found the measure to not be reasonable and necessary, because there were alternatives available to the legislature to alleviate the financial distress other than impairing contracts. *Id.* at 773. For example, suggested the court, the legislature could have raised taxes or shifted money from other governmental programs. *Id.* Consequently, the Second Circuit found that this availability of constitutional alternatives rendered the statute at hand violative of the Contracts Clause. The Second Circuit in the *Buffalo Teachers Fed'n* case employed a similar analysis, but found that the legislation was, in fact, reasonable and necessary, because the wage freeze enacted in that case was, while certainly in violation of a collective bargaining agreement, reasonable and necessary. The court's determination was based primarily on the finding that the "wage freeze . . . [was] a last resort measure." *Buffalo Teachers Fed'n*, 464 F.3d at 371. "[T]he Board imposed the freeze only after other alternatives had been considered and tried," and "[o]nly after these more drastic steps were taken and a finding that the freeze was essential was made, did the BFSA institute the wage freeze." *Id.*

A related factor utilized by courts in determining whether an impairment is "reasonable and necessary" is whether a more moderate impairment could have been employed. *See, e.g.*, *Buffalo Teachers Fed'n*, 464 F.3d at 371 (noting that legislation would be unreasonable if a more moderate course of action was available to remedy the fiscal crisis). Similarly, in *Baltimore Teachers Union v. Mayor of Baltimore*, 6 F.3d 1012 (4th Cir. 1993), the court found that legislation reducing employee salaries by one percent, in abrogation of a collective bargaining agreement, was reasonable and necessary when "the amount of the reduction was no greater than that necessary to meet the anticipated shortfall." *Id.* at 1020. Additionally, "the city discontinued the plan immediately upon recognition that the budgetary shortfall would not be so great as anticipated." *Id.* Finally, the court found that the enacted law was less drastic than an alternative, which was additional layoffs. *Id.* This court clearly found the law in question to be a calculated, carefully-weighed measure, no harsher than was absolutely necessary, and certainly not broad license to abrogate contracts.

The provision in the Act permitting the rejection or termination of collective bargaining agreements will almost certainly fail under this analysis. First, the Act does not require the consideration of any alternatives. The rejection or termination of a collective bargaining agreement is one of a variety of alternatives open to an Emergency Financial Manager, but the Act does not mandate that any of the potential remedies must be attempted before any other remedy. The State of Michigan can certainly engage in the alternatives contemplated by the Second Circuit in *Surrogates* (raise taxes; shift funds from other programs) in an attempt to eliminate the need to terminate collective bargaining agreements. Moreover, as noted at the outset of this section, the Act is a drastic, flagrant usurpation of power, permitting the termination of an entire collective bargaining agreement. Each case cited above deals only with an abrogation of a particular provision or provisions of a collective bargaining agreement. No prior legislature has had the audacity to legislate the unilateral termination, rejection, or modification of a collective bargaining agreement. The Act has certainly not engaged in the calculated precision approved of by the *Baltimore* court, instead approving the broad impairment of collective bargaining agreements. Thus, even if this Act satisfies the second element of the tripartite test, it likely will not be found to be reasonable and necessary, and thus will be unconstitutional.

A final factor that courts look at to find reasonableness is the temporal quality of legislation. Courts react more favorably to impairments that are (i) prospective in nature, without eliminating any right already earned, and/or (ii) temporary, as opposed to permanent. *See, e.g.*, *Subway-Surface Supervisors Assoc.*, 44 N.Y.2d at 112 (approving a wage freeze when it would apply only to compensation going forward, and thus constituted only a "limited intrusion" on the collective bargaining agreement). That court noted that if the statute had impaired benefits for services already performed, the effect would have been much greater. *Id.* *See also Local Division 589, Amalgamated Transit Union v. Commonwealth of Massachusetts*, 666 F.2d 618 (1st Cir. 1981) (state statute abrogating a collective bargaining agreement by changing the arbitration process going forward was permissible, as it was prospective in nature, thus "minimizing their interference with the parties' reasonable expectations"). Temporariness is also an important consideration. *See, e.g.*, *Buffalo Teachers Fed'n*, 464 F.3d at 371-72 (finding that a temporary wage freeze which was required to be re-visited on an ongoing basis to ensure its continued necessity was reasonable and necessary). The Act is neither prospective nor temporary, despite the Act's statement, in section 19(k)(iv), that any rejection of a collective bargaining agreement must be temporary. The Act provides no guidelines for what would constitute "temporary," and, in practice, re-instating higher wages after a wage freeze, as in the *Buffalo* case, is considerably easier than reinstating an entire collective bargaining agreement. In sum, the overly broad nature of this Act ensures that it can neither be prospective nor completely temporary.

Conclusion

In conclusion, whether the impairment of a collective bargaining agreement is permitted by the Contracts Clause is a fact-specific inquiry that focuses largely on the extent of the impairment and the State's justification for the impairment. As illustrated by the foregoing cases, where a State's need is pressing and the resulting impairment is limited, legislation impairing a collective bargaining agreement has been deemed permissible. Notably, the Act is much broader in scope and in effect than any of the legislation analyzed by the permissive cases discussed above. The Act permits the wholesale, unilateral rejection of a collective bargaining agreement, rather than targeted modification of a collective bargaining agreement on an as-needed basis to address the specific financial issues of the municipality under receivership.

In addition, the Act does not clearly identify a specific financial emergency that it is attempting to alleviate. It operates prospectively, rather than identifying a true emergency that would permit impairment of a collective bargaining agreement under existing case law. *See, e.g.*, *Subway-Surface Supervisors Assoc. v. New York City Transit Authority*, 44 N.Y.2d 101, 109 (1978) (finding New York City to be in a state of fiscal emergency); *Buffalo Teachers Fed'n v. Tobe*, 464 F.3d 362, 368 (2d Cir. 2006) (finding Buffalo to be in a state of fiscal emergency); *AFSCME, Local 2957 v. City of Benton*, 513 F.3d 874 (8th Cir. 2008) (requiring an "unprecedented emergency" to justify an abrogation of contracts). Thus, as currently drafted, the Act is violative of the Contracts Clause.

Modifying the Act to (1) eliminate the power of the Emergency Financial Manager to reject collective bargaining agreements; (2) place a limit on the length of time that modifications to collective bargaining agreements made by an Emergency Financial Manager could remain in effect; and/or (3) provide greater clarity regarding the temporal aspects of the receivership could assist in remedying these defects. Finally, the Act should set a higher bar for the triggering of the non-

consensual receivership and appointment of an Emergency Financial Manager to ensure that the extraordinary powers granted to the Emergency Financial Manager are paired with truly extraordinary circumstances.