UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:	Chapter 9
CITY OF DETROIT, MICHIGAN,	Case No. 13-53846
Debtor.	Hon. Steven W. Rhodes
NATIONAL PUBLIC FINANCE GUARANTEE CORPORATION, a New York Corporation, and ASSURED GUARANTY MUNICIPAL CORP., a New York Corporation,	
Plaintiffs,	Chapter 9
v.	Adv. Pro. No. 13-05309-swr
CITY OF DETROIT, MICHIGAN, KEVYN D. ORR, in his official capacity as the EMERGENCY MANAGER, JOHN NAGLICK, in his official capacity as FINANCE DIRECTOR, MICHAEL JAMISON, in his official capacity as DEPUTY FINANCE DIRECTOR, and CHERYL JOHNSON, in her official capacity as TREASURER,	Hon. Steven W. Rhodes
Defendants.	

OPPOSITION TO DEFENDANTS' MOTION TO DISMISS PLAINTIFFS' FIRST AMENDED COMPLAINT FOR DECLARATORY JUDGMENT

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Plaintiffs National Public Finance Guarantee Corporation ("National") and Assured Guaranty Municipal Corp., formerly known as Financial Security Assurance Inc. ("Assured," and together with National, "Plaintiffs"), by and through their respective counsel, respectfully submit this memorandum of law in opposition to Defendants'[1] Motion to Dismiss the First Amended Complaint (the "Motion").

PRELIMINARY STATEMENT

Plaintiffs seek six declarations regarding their property interests in the special *ad valorem* taxes approved by the City's voters and irrevocably pledged by the City for the sole purpose of paying the Unlimited Tax Bonds (the "Restricted Funds"). Under no provision of the Bankruptcy Code may Defendants disregard those property rights.

The Amended Complaint alleges that Michigan's statutory scheme is comprehensively designed to safeguard the Bondholders' (and Plaintiffs') property interests in these special *ad valorem* taxes. Michigan law requires the City to segregate and restrict the use of these special *ad valorem* taxes and imposes personal liability upon City officials who willfully fail to safeguard the Restricted

[1] Capitalized terms used but not otherwise defined herein shall have the meanings ascribed to them in Plaintiffs' First Amended Complaint for Declaratory Judgment (the "Amended Complaint"). *See* Docket No. 41.

Funds for Bondholders. This statutory regime ensures that the City lacks any equitable or beneficial ownership interest in, and any discretion with respect to, the special *ad valorem* taxes and that the taxes may not be diverted—inside or outside of bankruptcy—to any other City uses or other creditors.

Defendants do not dispute that Plaintiffs' property rights are enforceable under Michigan law. *See* Defs.' Br. at 16 ("[Act 34] may require that result ***outside*** of a chapter 9 case"). But according to Defendants, the City's chapter 9 filing allows Defendants, by fiat, to ignore Michigan law and eliminate Plaintiffs' state-law property interests. The City's bankruptcy filing does no such thing. All of Defendants' arguments for dismissing the Amended Complaint should be rejected.

Regarding Counts One and Six, Defendants argue that "Plaintiff [sic] is barred from bringing claims for money damages or injunctive relief." *Id.* at 7, 10. But Plaintiffs have sought no such relief. Rather, Plaintiffs seek declaratory relief with respect to Defendants' obligations to levy, collect, and segregate tax revenues specifically approved by the voters for the payment of the Unlimited Tax Bonds. Am. Compl. ¶¶ 96-98, 120-24. Stated differently, Counts One and Six ask this Court to declare the restrictions that Michigan law imposes upon such special *ad valorem* taxes. And the Michigan Supreme Court has made clear, in a line of cases

that Defendants ignore, that a private right of action is not necessary to seek such declaratory relief. Plaintiffs indeed have the right to seek their requested relief.

Further, Defendants have not identified *any* Bankruptcy Code provision that expressly preempts state-law property rights with respect to the Unlimited Tax Bonds, or the state-law restrictions on the use of the special *ad valorem* taxes that secure such Bonds.[2] Specifically, Defendants mistakenly argue that Act 34 is no different from certain state laws regarding contract rights, such as the Michigan Constitution's protection of pensions, which this Court already ruled are specifically preempted by Bankruptcy Code sections regarding contracts. *See* Defs.' Br. at 16-17 & n.6. The key difference between the pension claims (and all other unsecured claims against the City) and those at issue here is that the Bondholders have ***property*** interests in the Restricted Funds created by Michigan law, and state law restricts the use of the Restricted Funds to payment of the Unlimited Tax Bonds (thus creating a restricted source of payment separate from

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[2] This Court has already rejected the City's exaggerated reliance on the preemptive power of the Bankruptcy Code. In addressing the City's argument that section 364 of the Bankruptcy Code authorized approval of postpetition financing "without regard for any state law limitations," the Court explained that "nothing in Section 364 suggests that a Court can allow a municipality to use its property in violation of state law" and held that the City "must comply with state law unless, of course, [the Code] expressly provides otherwise." *See* Hr'g Tr. at 25:21-26:12 (Jan. 16, 2014) ("The Court does conclude that offering gaming revenue as security for a loan would comply with the Gaming Control Act but only if the proceeds of the loan that are so secured are used as limited by state law.").

the City's general fund). In contrast, the holders of pension claims (and many other general debt obligations of the City) cannot assert a state-law property interest in any specific funds or revenues of the City, and can only be paid from the general fund.[3] Indeed, municipal debtors and courts in other chapter 9 cases, including *City of Vallejo*, *City of Stockton*, and *City of San Bernardino*, have recognized that municipal debtors are constrained by state-law restrictions on the use of certain funds, and those restrictions are not preempted by the Bankruptcy Code.

Defendants assert that the City is more than a "mere conduit" with respect to the Restricted Funds and, on that basis alone, argue that Count Two should be dismissed. *Id.* at 21. But that argument ignores Plaintiffs' allegations and controlling Michigan law. Plaintiffs have alleged detailed facts (which must be accepted as true for purposes of the Motion) that the City is a mere conduit under Michigan's statutory scheme and that the City holds the Restricted Funds in trust for the benefit of the Bondholders and Plaintiffs. Am. Compl. ¶¶ 76-79, 99-102.

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[3] Thus, in ruling that the pension claims may be impaired, the Court noted that the Michigan Constitution's pension provision did not "create[] a property interest that bankruptcy would be required to respect under *Butner v. United States*" nor did it "establish[] some sort of a secured interest . . . ." *See In re City of Detroit, Mich.*, No. 13-53846, 2013 WL 6331931, at *44 (Bankr. E.D. Mich. Dec. 5, 2013). Here, in stark contrast, Plaintiffs have alleged in detail both a property interest and a secured interest. *See, e.g.*, Am. Compl. ¶¶ 75-86.

Those well-pleaded allegations fully support Plaintiffs' assertion of property interests in the Restricted Funds.

Likewise deficient are Defendants' arguments regarding the allegations that Plaintiffs have a lien on the Restricted Funds (Count Three) and a lien on special revenues (Count Four). Plaintiffs have sufficiently pleaded that under Michigan law the Unlimited Tax Bonds are secured by a "pledge"[4] of special *ad valorem* taxes specifically collected for payment of the Unlimited Tax Bonds, which is distinct from the Bondholders' recourse to the City's additional pledge of its full faith and credit or general taxing authority.[5] *Id.* ¶¶ 36, 80-83. The "pledge" of special *ad valorem* taxes is not, and is not intended to be, a mere "promise."[6]

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[4] As discussed further below, a central premise of Defendants' motion—that the "pledge" of special *ad valorem* taxes to pay the Unlimited Tax Bonds is merely a "promise" that does not give rise to a lien (Defs.' Br. at 24, 28-30)—is incompatible with a position already taken by the City in this bankruptcy case. *See infra*, section III.C.

[5] In exercising this general taxing power, the City imposes several types of taxes, including those on property and income. *See, e.g.*, Am. Compl. ¶¶ 57, 61, 84 (property taxes for general operations); Detroit City Code §§ 18-10-1 *et seq.* (Uniform City Income Tax Ordinance); Mich. Const. art. VII, § 21 ("Each city and village is granted power to levy other taxes [in addition to general ad valorem taxes] for public purposes . . . .").

[6] Defendants argue that the "pledge" is similar to the "pledge of allegiance," and is therefore no more than a promise of future action. Defs.' Br. at 24. In fact, it is a pledge of specific and identifiable property—the special *ad valorem* taxes—as security for repayment of a debt. The appropriate analogy is not "I pledge allegiance to the flag," as Defendants argue, but rather "I pledge this flag for repayment of my debt."

Under Act 189, an "Unlimited Tax Pledge" means "an undertaking by a public corporation ***to secure and pay a tax obligation from ad valorem taxes*** to be levied . . . without limitation as to rate or amount and in addition to other taxes which the public corporation may be authorized to levy." MCL § 141.162(d) (emphasis added). Act 189 further provides that a city may issue municipal bonds "***secured by unlimited tax pledges*** of the public corporation if approved by its electors." MCL § 141.164(1) (emphasis added). Michigan's entire municipal finance statutory scheme, including Act 34, is structured to grant and safeguard this security for the benefit of bondholders, and it constitutes a lien as defined in the Bankruptcy Code.

Whether that lien is a statutory lien or a contractual lien, Plaintiffs have sufficiently pleaded that the Restricted Funds are "special revenues" entitled to the protections of sections 922(d) and 928 of the Bankruptcy Code. The Unlimited Tax Bonds were issued to finance specific City projects as described and voted upon in bond referenda, and such referenda authorized the City to impose special taxes dedicated to payment of the Unlimited Tax Bonds. Am. Compl. ¶¶ 40, 53.

Plaintiffs have also stated a viable Takings claim in Count Five. Plaintiffs allege that Defendants have impaired and intend to continue to impair Plaintiffs' property interests without providing just compensation. Defendants seek to dismiss Count Five based largely on the faulty argument that an unsecured claim

cannot sustain a Takings Clause cause of action. Defs.' Br. at 34. Yet Plaintiffs' property interests in the Restricted Funds exist whether or not they are characterized as secured (which they are), and such property interests can indeed sustain a Takings claim.

Finally, section 904 has no application to this proceeding. The six counts in the Amended Complaint ask the Court for declaratory relief regarding (i) Plaintiffs' property interests in the Restricted Funds and (ii) Defendants' obligations under Michigan law with respect to the Restricted Funds. The determination by the Court of the parties' respective rights under state law is entirely consistent with section 904 and the purposes and intent of chapter 9. Moreover, none of Plaintiffs' requested declaratory relief entails any interference with any of the City's powers, property, or revenues.

RELEVANT FACTUAL BACKGROUND

As part of their effort to circumvent the requirements of Michigan law, Defendants curtly and inaccurately describe the Restricted Funds (referred to by Defendants as "Alleged Collateral") as a stream of "unspecified real estate taxes the City collects," Defs.' Br. at 3, as if the City had general authority to collect and use the Restricted Funds as it does other property taxes and to commingle the Restricted Funds with other property taxes. Defendants' gross mischaracterization of the Restricted Funds is briefly corrected below.

The Proceeds of the Unlimited Tax Levy are Restricted Funds

But for the approval of City voters, the Restricted Funds would not exist. Am. Compl. ¶¶ 1-4, 39-40, 52, 54-55. The City sought and obtained such voter approval to finance specific capital improvement projects through the sale of the Unlimited Tax Bonds. *Id.*[7] In approving the Unlimited Tax Levy, the voters expressly authorized and required the City to dedicate the taxes collected to payment of the Unlimited Tax Bonds. *Id.* ¶¶ 2-4.

Voter approval was required both for the City to levy taxes without limitation as to rate or amount to pay the Unlimited Tax Bonds, and for the City irrevocably to pledge the taxes collected under the Unlimited Tax Levy as security for those Bonds. *Id.* ¶¶ 2, 3, 36, 39, 51, 52, 80. The special *ad valorem* taxes pledged by the City as security for payment of the Unlimited Tax Bonds are distinct from other taxes that the City is authorized to collect, and are dedicated for the express and exclusive purpose of paying the Unlimited Tax Bonds. *Id.* ¶¶ 4, 40, 46, 54, 57, 61, 84. The City's Resolutions confirm that the City understood

[7] Upon information and belief, the City has used the proceeds of the Unlimited Tax Bonds only to fund or finance specific capital improvement projects identified in the bond referenda approved by the voters and further described in the Official Statements of the City prepared for use in the marketing of the Unlimited Tax Bonds. Am. Compl. ¶¶ 40, 53.

that its unlimited tax pledge secured its obligation to pay the Unlimited Tax Bonds. *Id.* ¶¶ 46-48.

For each year until the Unlimited Tax Bonds are retired, and only for that duration, the City must budget for, assess, and collect the special *ad valorem* taxes under the Unlimited Tax Levy, and must use the remitted taxes only to pay the Unlimited Tax Bonds. *Id.* ¶¶ 35-45. The City's authority to collect taxes under the Unlimited Tax Levy is terminated upon the retirement of the Unlimited Tax Bonds. *See id.* ¶ 37; MCL §§ 141.2701, 141.164(3). Moreover, as further protection, the State imposes personal liability upon City officials who willfully fail to safeguard the Restricted Funds. Am. Compl. ¶ 65 n.4; MCL § 141.2701(7). This regime ensures that the City lacks any discretion with respect to the special *ad valorem* taxes and that the taxes are unavailable for any other uses.

The City's Pre-Bankruptcy Conduct was Consistent with Its Obligations Under Michigan Law

Prior to the bankruptcy, the City historically has complied with Michigan law with respect to the Restricted Funds. Am. Compl. ¶¶ 52-64; *see also* Defs.' Br. at 16 (acknowledging that Act 34 "may require" the Restricted Funds to be used solely for the benefit of Bondholders, "***outside*** of a chapter 9 case"). For each fiscal year since the issuance of the outstanding Unlimited Tax Bonds, the City, through its annual budget approval process, has set the annual millage tax rate for the Unlimited Tax Levy such that available money in the City's Debt Retirement

Funds would be sufficient to fund that year's debt service for the Unlimited Tax Bonds. Am. Compl. ¶ 56. According to City reports, for Fiscal Year 2011-12 the City levied and collected special *ad valorem* taxes under the Unlimited Tax Levy in an amount sufficient to pay the debt service owed on the Unlimited Tax Bonds. *Id*. ¶ 87. To collect these taxes, the City sends taxpayers a summer *ad valorem* tax bill each year. *Id*. ¶ 57.[8]

As required by Michigan law, the City maintains separate Debt Service Funds to account for the special *ad valorem* tax receipts collected under the Unlimited Tax Levy and for the payment of debt service for the Unlimited Tax Bonds. *Id*. ¶ 59. The Paying Agent holds the Restricted Funds in trust in individual Debt Retirement Funds for each series of Unlimited Tax Bonds and, from those accounts, disburses the debt service payments to holders of the Unlimited Tax Bonds on the bond payment dates. *Id*. ¶ 64. Until it petitioned for bankruptcy and later defaulted on its payments on the Unlimited Tax Bonds, the City had complied with each step of the process described above, all as required by Michigan law. *Id.* ¶¶ 35-64.

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[8] To aid the Court's understanding of the *ad valorem* tax bill, attached hereto as Exhibit 1 are exemplars of such bills. They reflect the millage for the Unlimited Tax Levy and have separate line items for "debt service" and the "general operating" of the City. Thus, Detroit taxpayers are directly informed about the amount and the separate nature of the assessment made for the sole purpose of paying the Unlimited Tax Bonds.

Defendants Now Assert That
Michigan Law No Longer Applies

Defendants have asserted that the bankruptcy filing permits the City to use the Restricted Funds for purposes other than paying Bondholders and, therefore, that they no longer must abide by Michigan law. *Id*. ¶¶ 6, 67, 68, 73-74, 89, 91; *see also* Defs.' Br. at 16-19. As explained below, that assertion is mistaken.

STANDARD OF REVIEW

In deciding Defendants' Motion, the Court "must construe the complaint in the light most favorable to Plaintiffs" and "accept all well-pled factual allegations as true." *Harkless v. Brunner*, 545 F.3d 445, 449 (6th Cir. 2008); *see also In re DeLorean Motor Co*., 991 F.2d 1236, 1240 (6th Cir. 1993) (reversing dismissal by bankruptcy court of adversary complaint). A complaint need not contain "detailed factual allegations" to survive a motion to dismiss, but rather only sufficient factual matter, accepted as true, to "state a claim for relief that is plausible on its face." *Gillis v. Wells Fargo Bank, N.A.*, 875 F. Supp. 2d 728, 730-31 (E.D. Mich. 2012) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555, 570 (2007)). As long as the court "can 'draw the reasonable inference that the defendant is liable for the misconduct alleged,' . . . a plaintiff's claims must survive a motion to dismiss." *Fabian v. Fulmer Helmets, Inc.*, 628 F.3d 278, 281 (6th Cir. 2010) (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 663 (2009)). Plaintiffs' claims easily satisfy this liberal pleading standard.

ARGUMENT

I. PLAINTIFFS HAVE STATED CLAIMS FOR A DECLARATION THAT MICHIGAN LAW RESTRICTS DEFENDANTS' USE OF THE PROCEEDS OF THE UNLIMITED TAX LEVY (COUNTS ONE AND SIX)

Defendants wrongly assert that Counts One and Six should be dismissed because there is no private right of action under Act 34 and therefore Plaintiffs supposedly lack standing to pursue their requested relief. Defs.' Br. at 7-11. Defendants' argument both mischaracterizes Plaintiffs' requested relief and is contrary to controlling law. Plaintiffs seek nothing through this action but declaratory relief and do not need a private right of action under Act 34 to pursue it.

A. Plaintiffs Have Statutory Standing Under Act 34

It is well settled that a plaintiff may seek declaratory relief regarding the violation of a Michigan statute unless the statute expressly deprives such plaintiff of standing to seek such relief. *See Miller v. Allstate Ins. Co*., 751 N.W.2d 463, 468 (Mich. 2008) (explaining that Michigan law allows a party to "seek enforcement of the statute through a claim for . . . declaratory judgment" even in the absence of a private right of action for money damages); *Zigmond Chiropractic, P.C. v. AAA Mich.*, No. 300643, 2013 WL 3836238, at *2 (Mich. Ct. App. July 25, 2013); *see also Lash v. City of Traverse City*, 735 N.W.2d 628, 638 (Mich. 2007) (plaintiff had no private right of action to seek damages but could

seek declaratory or injunctive relief); *Lansing Sch. Educ. Ass'n v. Lansing Bd. of Educ.*, 792 N.W.2d 686, 699-700 & n.22 (Mich. 2010) (refusing to address whether statute implied a private right of action where plaintiffs sought declaratory and injunctive relief and a writ of mandamus rather than damages); *City of S. Haven v. Van Buren Cnty. Bd. of Comm'rs*, 734 N.W.2d 533, 540-42 (Mich. 2007) (per curiam) (although plaintiff could not seek restitution for violation of road millage statute, plaintiff could seek other relief where "government official does not conform to his or her statutory duty . . . .").[9]

According to *Miller*, determining whether a plaintiff has statutory standing "necessitates an inquiry into whether a statute authorizes a plaintiff to sue at all, [and] must be distinguished from whether a statute permits an individual claim for a particular type of relief." 751 N.W.2d at 467-68. Thus, a plaintiff has statutory standing to bring a claim for declaratory relief where the statute does not contain "irrebuttable presumption language that would preclude" the plaintiff's claim.

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[9] In *Lansing*, the Michigan Supreme Court clarified the proper test for determining constitutional standing, and therefore overruled *Miller*'s holding regarding constitutional standing, but not statutory standing. *See* 792 N.W.2d at 699, 702. In any event, Defendants have not challenged Plaintiffs' constitutional standing, nor could they because Plaintiffs easily meet the criteria of Mich. Ct. R. § 2.605, which requires a showing of an actual controversy regarding Act 34. *See* Mich. Ct. R. § 2.605; *see also Lansing Sch. Educ. Ass'n*, 792 N.W.2d at 702. This constitutional standing requirement is satisfied by the extensive allegations in the Amended Complaint that Defendants' conduct violates Act 34. *See, e.g.*, Am. Compl. ¶¶ 97, 121-23.

Zigmond Chiropractic, P.C., 2013 WL 3836238, at *2 (plaintiff without private right of action to enforce statute still had statutory standing to obtain declaratory relief because statute did not have language containing irrebuttable presumption precluding relief); *see also Lighthouse Place Dev., LLC v. Moorings Ass'n*, No. 280863, 2009 WL 1139260, at *5-6 (Mich. Ct. App. Apr. 28, 2009) (non-owner had statutory standing to bring claims, including declaratory relief, under Condominium Act because right to sue vested in condominium associations was not "exclusive"); *Another Step Forward v. State Farm Auto. Ins. Co.*, No. 06-CV-15250, 2009 WL 879690, *8-*9 (E.D. Mich. Mar. 30, 2009), (no-fault insurer had statutory standing to challenge licensure of medical services providers where there was no irrebuttable presumption regarding exclusive enforcement of such challenges), *aff'd*, 367 F. App'x 648 (6th Cir. 2010).

Act 34 contains no irrebuttable presumption that the statute prohibits actions for declaratory relief. There certainly is no express language in Act 34 stating that private parties cannot seek such relief under the statute. Moreover, there is also no implicit language to that effect. Defendants do not—and cannot—identify any provision of the statute that vests enforcement powers *exclusively* with the Department of Treasury. *See* Defs.' Br. at 8-11. Section 201 of Act 34 merely enumerates the department's "general powers" without so much as a hint of

exclusivity.[10] *See* MCL § 141.2201(a)-(e). Similarly, Section 802(2) of Act 34 is non-exclusive and merely permissive. *See* MCL § 141.2802(2) ("The department ***may*** institute appropriate proceedings in the courts of this state . . . .") (emphasis added). Moreover, Act 34 envisions enforcement of certain of its provisions by the holders of municipal securities because it states that officers who willfully fail to fulfill certain duties required by the statute may be personally liable to holders of municipal securities. *See* MCL § 141.2701(7).

While Defendants repeatedly assert that Act 34 provides a "comprehensive" enforcement mechanism, this unsubstantiated claim does not support a conclusion

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[10] Among the powers being granted is the authority to "enforce compliance with . . . provisions of any . . . resolution with respect to debts or securities." MCL § 141.2201(d). If the powers granted to the Department of Treasury were in fact exclusive as Defendants suggest, bondholders would be unable to enforce the provisions of resolutions that govern their bonds. That interpretation of the Act is nonsensical because it would eviscerate private enforcement of rights under municipal bond resolutions and be at odds with the longstanding precedent holding that municipal securities are enforceable against municipal actors. *See, e.g.*, *Simonton v. City of Pontiac*, 255 N.W. 608, 608-10 (Mich. 1934) (allowing bondholders' protective committee to seek mandamus); *Hammond v. Place*, 74 N.W. 1002, 1002 (Mich. 1898) (bondholders not limited to seeking mandamus, but may sue and recover judgment for amounts due on bonds) (citing *Ralls Cnty. Ct. v. United States*, 105 U.S. 773 (1881)). Moreover, the disclosures contained in the City's Official Statements for the Unlimited Tax Bonds, which address the possibility of litigation, reference Act 34 but do not indicate that bondholders cannot bring an action regarding Act 34. Indeed, the omission from the City's Official Statements of such a material fact as the lack of a right to sue on Act 34, if true, would likely have been a substantial violation of federal securities laws. *See* 2008 Official Statement, Am. Compl. Ex. P at 2.

that the Department of Treasury has the exclusive right to bring actions regarding Act 34. Defs.' Br. at 9-11, 13. The cases Defendants rely on for this proposition construe regulatory codes bearing no resemblance to Act 34. *See Claire-Ann Co. v. Christenson & Christenson, Inc.*, 566 N.W.2d 4, 6 (Mich. Ct. App. 1997) (describing Occupational Code); *Garden City Educ. Ass'n v. Sch. Dist. of City of Garden City*, No. 12-14886, 2013 WL 5450095, at *1 (E.D. Mich. Sept. 30, 2013) (Revised School Code).[11]

Claire-Ann Co., for example, construed an occupational licensing statute that required the responsible state agency to promulgate regulations subject to an exhaustive list of criminal and administrative penalties. *See* 566 N.W.2d at 6; MCL §§ 339.205, 339.601 *et seq*. Similarly, *Garden City* addressed a statute that required school boards to develop a performance evaluation system for teachers and provided a specific penalty for their failure to do so. *See* 2013 WL 5450095, at *1; MCL §§ 380.1249, 388.1704. Unlike Act 34, recognition of an additional civil remedy under these statutes would undermine an administrative agency's

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[11] Additionally, *Garden City*'s statements regarding the viability of actions for injunctive relief are not controlling here, misconstrue *Miller*, and are contrary to the Michigan Supreme Court's ruling in *Lansing*. *See Lansing Sch. Educ. Ass'n*, 792 N.W.2d at 700 n.22 (private right of action not required to seek injunctive relief for violation of Revised School Code); *Miller*, 751 N.W.2d at 467-68 (explaining that party may seek declaratory relief in the absence of private right of action for monetary damages).

objectives and upset a "delicate balance" created by the Legislature. *Gardner v. Wood*, 414 N.W.2d 706, 712 & n.7 (Mich. 1987). Defendants do not, and cannot, point to any parallel circumstances here.

Given the absence of language in Act 34 expressing an "irrebuttable presumption" against suits by private parties, Plaintiffs have statutory standing and may seek declaratory relief without need to establish a private right of action for money damages.

B. Defendants Confuse a Claim for Monetary Relief that Requires a Private Right of Action with Plaintiffs' Claim for Declaratory Relief that Does Not

Defendants' argument that Plaintiffs need a private right of action to pursue declaratory relief is wrong; a private right of action is not required where (as here) a plaintiff seeks declaratory relief rather than damages. *See, e.g.*, *Lash*, 735 N.W.2d at 638; *Lansing Sch. Educ. Ass'n*, 792 N.W.2d at 699-700 & n.22; *City of S. Haven*, 734 N.W.2d at 540-42.[12] Therefore, the Court need not reach the

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[12] Defendants' authority is inapposite because it generally concerns non-Michigan law and involves circumstances distinct from those presented here. *See* Defs.' Br. at 11-12; *Durr v. Strickland*, 602 F.3d 788 (6th Cir. 2010) (evaluating private right of action under federal statutes); *Jones v. Hobbs*, 745 F. Supp. 2d 886 (E.D. Ark. 2010) (same); *United States v. Real Prop. & Improvements Located at 1840 Embarcadero, Oakland, Cal.*, 932 F. Supp. 2d 1064 (N.D. Cal. 2013) (same); *Tex. Med. Ass'n v. Aetna Life Ins. Co.*, 80 F.3d 153 (5th Cir. 1996) (Texas law); *Franklin v. Massachusetts*, 505 U.S. 788 (1992) (Article III of the U.S. Constitution); *Huron Valley Sch. v. Sec'y of State*, 702 N.W.2d 862, 866 (Mich. Ct.

question of whether Act 34 provides a private right of action because Plaintiffs are not seeking monetary damages but rather only declaratory relief, which can be pursued irrespective of the existence of a private right of action.[13]

C. Act 34 Provides a Private Right of Action to Sue the Individual Defendants, Including Emergency Manager Orr

Defendants also present a number of arguments seeking dismissal of the claims against the Individual Defendants. Defs.' Br. at 13-15. Notwithstanding the liability provision of section 701(7), Defendants argue that Act 34 does not provide for a private right of action to recover with respect to such liability (or to seek any other remedy). Defendants also assert that the claims against Mr. Orr should be dismissed because he is immune from liability as "the highest appointed executive official" of the City. Defs.' Br. at 15. None of these arguments has merit.

App. 2005) (claims dismissed because plaintiffs failed to exhaust administrative remedies as expressly required by statute).

[13] To the extent it may be at all relevant, Plaintiffs indeed do have a private right of action under Act 34. A statutory remedy will not be deemed exclusive if a contrary intent clearly appears or the resulting remedy is plainly inadequate. *See Pompey v. General Motors Corp*., 189 N.W.2d 243, 251 n.14 (Mich. 1971). The Department of Treasury, which played a large role in selecting Emergency Manager Orr, is aligned with Defendants. Practically, such similarity of interests makes it highly unlikely that the Department of Treasury would take any remedial action against Defendants, and therefore Plaintiffs' (non-declaratory) remedy under the statute is plainly inadequate. *See id.*

As an initial matter, the lack of an explicit statement in section 701(7) that bondholders can sue city officials does not immunize those officials from suit, nor does it limit bondholders to seeking monetary relief. To the contrary, the Michigan Supreme Court has allowed private plaintiffs to sue municipal officials for non-monetary relief under similar circumstances. In *Simonton*, for example, plaintiffs successfully relied upon a predecessor statute to section 701(7) to compel a city and its two assessors to comply with their statutory duties to levy and collect sufficient taxes to pay their bonds. *See* 255 N.W. at 608-10.[14]

Finally, there is no merit to Defendants' assertion that Emergency Manager Orr should be exempted from the provisions of Section 701(7). Defs.' Br. at 15. As Defendants acknowledge, MCL § 691.1407(5) only provides immunity from tort liability. The declaratory relief sought in Counts One and Six plainly does not seek to impose tort liability of any kind.

D. The Bankruptcy Code Does Not Preempt Counts One and Six

Defendants also seek dismissal, on the merits, of Counts One and Six, in which Plaintiffs seek a declaration that "under Michigan law the City is required to segregate the [Restricted Funds] for the sole benefit of the [Unlimited Tax Bonds]

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[14] Each of Act 34's predecessors that Plaintiffs have identified included language substantially identical to the current section 701(7). *See* Public Act 202 of 1943, § 1a(d), codified at MCL § 2689-91a(d) (1945); Public Act 273 of 1925, § 5, codified at MCL § 2694 (1929).

and not to use those taxes for any purpose other than to pay the [Unlimited Tax Bonds]." Defs.' Br. at 16. Defendants acknowledge that state law "may require that result ***outside*** of a chapter 9 case," but insist that "when a municipality files for chapter 9 protection, state laws requiring payment of unsecured debt no longer govern, given the preemptive force of the Bankruptcy Code." *Id*. at 16-17.

Defendants' reliance on the preemptive force of the Bankruptcy Code is exaggerated and misplaced. Nowhere in Counts One and Six—or in the Amended Complaint more generally—do Plaintiffs ask the Court to compel Defendants to pay their existing debts to Plaintiffs. Rather, Counts One and Six ask for declarations that Michigan law imposes specific requirements regarding the collection and use of the Restricted Funds. Consequently, Plaintiffs' request for declaratory relief does not conflict or interfere with (1) the "breathing spell" granted to Defendants through the "automatic stay" or (2) the Debtor's "ability to adjust debts . . . through the plan process." Defs.' Br. at 17 (internal quotation marks omitted). The automatic stay does not excuse Defendants from complying with applicable non-bankruptcy law governing the Restricted Funds, and the plan process must respect creditors' state-law property interests in assets of the City.

Further, nothing in the Bankruptcy Code allows Defendants to strip Plaintiffs of their property rights under state law without providing adequate

protection.[15] As this Court has explained, a state may insulate debt "from impairment in bankruptcy" by creating "a secured interest in the municipality's property" that "***bankruptcy would be required to respect*** . . . ." *See In re City of Detroit, Mich.*, No. 13-53846, 2013 WL 6331931, at *44 (Bankr. E.D. Mich. Dec. 5, 2013) (emphasis added) (citing *Butner v. United States*, 440 U.S. 48, 56-57 (1979)). "Unless some federal interest requires a different result, there is no reason why [state property] interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner*, 440 U.S. at 55; *accord Raleigh v. Ill. Dep't of Revenue*, 530 U.S. 15, 20 (2000).[16]

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[15] As discussed in detail below, *see infra*, sections II and III, Plaintiffs have property interests—created and protected by state law—in the Restricted Funds, and such state law is not preempted by any provision of the Bankruptcy Code. Indeed, the provisions of the Bankruptcy Code permitting impairment of unsecured debt are in no way at odds with Michigan law. As the Court is aware, no plan of adjustment has yet been filed, let alone confirmed, yet the City is using the Restricted Funds for general operating purposes as if the Unlimited Tax Bonds did not exist. There are numerous potential outcomes in the City's bankruptcy case, including dismissal if the City is unable to confirm a plan or if any of the numerous appellate challenges to the Order For Relief entered by this Court are granted. *See* Notices of Appeals, *In re City of Detroit, Mich.*, No. 13-53846, Docket Nos. 1956, 2057, 2070, 2096, 2111, 2165, 2253, 2351. The Bankruptcy Code does not excuse Defendants from complying with Michigan law with respect to the use of the Restricted Funds.

[16] This same principle is likewise reflected in the cases cited by Defendants. *See* Defs.' Br. at 20 n.8. *See*, *e.g.*, *Haber Oil Co. v. Swinehart*, 12 F.3d 426, 435 (5th Cir. 1994) ("[I]n the absence of controlling federal bankruptcy law, the substantive nature of the property rights held by a bankrupt and its creditors is defined by state law."); *Int'l Brotherhood of Teamsters v. Kitty Hawk Int'l, Inc.*, 255 B.R. 428, 439

Defendants' disregard of Plaintiffs' state-law property interests, including their rights and remedies under Act 34 and Act 189, is fundamentally at odds with *Butner*. In contrast, the certificates of participation, pension and OPEB claims are unquestionably unsecured obligations of the City—those creditors can only look to the City's general fund. The Unlimited Tax Bonds, however, have a different status, as the Restricted Funds are available only for their payment. Nothing in the Bankruptcy Code permits Defendants to disregard or strip Plaintiffs' property rights. Consequently, there is no merit to Defendants' preemption claim.

II. PLAINTIFFS HAVE STATED A CLAIM FOR DECLARATORY RELIEF THAT PLAINTIFFS HAVE PROPERTY INTERESTS IN THE RESTRICTED FUNDS (COUNT TWO)

Count Two requests that the Court declare that Plaintiffs, not Defendants, have an equitable and beneficial property interests in the Restricted Funds. Am. Compl. ¶¶ 99-102.[17] In arguing that this Count should be dismissed, Defendants

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(Bankr. N.D. Tex. 2000) (creditor's entitlement to property rights is determined by state law while the Bankruptcy Code determines the priority of claims); *In re Lull Corp.*, 162 B.R. 234, 240-41 (Bankr. D. Minn. 1993) (creditor may not alter priority, under state law, of "general unsecured claim"); *In re Nat'l Bickford Foremost, Inc.*, 116 B.R. 351, 352 (Bankr. D. R.I. 1990) (same); *In re Redford Roofing Co.*, 54 B.R. 254, 255 (Bankr. N.D. Ill. 1985) (unsecured workers' compensation claim not entitled to priority status under Bankruptcy Code).

[17] Equitable title refers to "the beneficial interest of one person whom equity regards as the real owner, although the legal title is vested in another." *In re Barnes*, 264 B.R. 415, 432 (Bankr. E.D. Mich. 2001) (internal quotation marks and

never directly address whether the special *ad valorem* taxes at issue here are Restricted Funds in which Plaintiffs have equitable and beneficial property interests under Michigan law. Instead, they assert only that the City is not, as alleged in the Amended Complaint, a "mere conduit" with respect to the Restricted Funds. Defs.' Br. at 20-21.

Defendants have not demonstrated that the central premise of Count Two—that Plaintiffs, not the City, have equitable and beneficial property interests in the Restricted Funds—is unfounded, nor can they. As explained below, the allegations of the Amended Complaint establish both that the City does not have such an interest and that Plaintiffs do have such an interest.

A. Under Michigan Law, the City Has No Equitable or Beneficial Property Interest in the Restricted Funds

Defendants do not dispute that if the City were a "mere conduit," the City would lack an equitable or beneficial interest in the Restricted Funds.[18] Instead, Defendants argue that the City is not a mere conduit because it has a "clear interest" in the Restricted Funds as "the only entity with the right to assess and

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citations omitted). Whether a beneficial interest exists turns on "the amount of discretion" that the legal titleholder has with respect to the property. *Id.*

[18] A debtor is a "mere conduit" with respect to money if the debtor collects money from one source for forwarding to its intended recipient. *See, e.g.*, *In re Columbia Gas Sys. Inc.*, 997 F.2d 1039, 1059-62 (3d Cir. 1993).

collect real estate taxes." Defs.' Br. at 21.[19] Defendants' argument ignores the statutory framework that governs the Restricted Funds and the nature and attributes of the parties' interests in those funds.[20]

Michigan has imposed upon the City a series of constitutional and statutory mandates governing the Unlimited Tax Levy. Under this scheme—the key elements of which are described below—the City acts as a mere conduit with no equitable or beneficial interest in the Restricted Funds.

- First, the Unlimited Tax Bonds cannot be issued except upon voter approval authorizing the City to levy and collect special *ad valorem* taxes sufficient to pay the Unlimited Tax Bonds. Mich. Const. art. IX, § 6; MCL §§ 141.164(1), 141.164 (3); Am. Compl. ¶¶ 1-4, 39-40, 52, 54-55.
- Second, after the City issues the voter-approved Unlimited Tax Bonds, the City *must* levy the full amount of taxes, without limitation as to rate or amount, necessary to pay the Unlimited Tax Bonds. MCL § 141.2701(3); Am. Compl. ¶¶ 4, 42. This levy is in addition to other

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[19] Defendants' assertion, Defs.' Br. at 21, that the City may recover delinquent property taxes is a red herring, as that power does not provide the City with any discretion with respect to the taxes, which automatically become Restricted Funds upon collection.

[20] *See, e.g.*, *Official Comm. of Unsecured Creditors v. Dow Corning Corp. (In re Dow Corning Corp.)*, 456 F.3d 668, 684 (6th Cir. 2006) ("Property interests are created and defined by state law.") (quoting *Butner*, 440 U.S. at 55).

taxes that the City may be authorized to levy, and the amount of the levy is strictly limited to the amount owed on the Unlimited Tax Bonds. MCL § 141.164(3); Am. Compl. ¶¶ 4, 36-37, 42.[21]

- Third, Defendants must deposit the proceeds of the special *ad valorem* taxes levied for Unlimited Tax Bond debt service ***as they are collected*** into segregated Debt Retirement Funds, which are held in trust by the Paying Agent. MCL §§ 141.2103(d), 141.2701(6); Am. Compl. ¶¶ 43, 49, 64.
- Fourth, the deposits to the Debt Retirement Funds can only be used to pay the bonds for which the special *ad valorem* taxes were collected. MCL § 141.2705; Am. Compl. ¶¶ 41, 45.
- Fifth, once the Unlimited Tax Bonds have been retired, the City loses its authority to levy and collect the special *ad valorem* taxes at issue here. MCL §§ 141.2701, 141.164(3); Am. Compl. ¶¶ 36-37, 50.[22]

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[21] As alleged in the Amended Complaint, "[a]t the time the Unlimited Tax Bonds were issued, the City had already reached the applicable maximum constitutional, statutory, or charter tax rate for *ad valorem* taxes levied for purposes unrelated to the payment of debt service for the Unlimited Tax Bonds." Am. Compl. ¶ 39.

[22] The Michigan Attorney General issued an Opinion declaring that taxes levied for payment of principal and interest on bonds "must be placed in a segregated account," "may only be used to pay principal and interest on the bonds for which the millage was levied while the bonds are outstanding," and may not be

As set forth in the Amended Complaint, the issuance of the Unlimited Tax Bonds pursuant to Michigan's constitutional and statutory framework denies the City any equitable or beneficial interests in the Restricted Funds. Am. Compl. ¶¶ 35-37. Further, the Resolutions restrict the City's interests in the special *ad valorem* taxes that it levies and collects solely to satisfying its obligations under the Unlimited Tax Bonds. *Id*. ¶¶ 39-40, 46-50.

In this regard, the City's interest in the Restricted Funds is no different from property interests addressed in other cases that "arise from, and are controlled by" a statutory scheme that denies the debtor equitable or beneficial interests in the property. *See In re CMC Telecom, Inc.*, 383 B.R. 52, 62 (Bankr. E.D. Mich. 2008) (debtor lacked equitable interest in reimbursements in its possession because applicable federal law and agreements required distribution of reimbursements to school districts); *accord In re LAN Tamers, Inc.*, 329 F.3d 204, 212-13 (1st Cir. 2003) (degree of regulatory control over debtor deprived debtor of beneficial interest in funds); *In re Joliet-Will Cnty. Cmty. Action Agency*, 847 F.2d 430, 432 (7th Cir. 1988) (debtor lacked beneficial title in funds where regulations imposed "minute control" such that debtor had "very little discretion" over the use of the funds).

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transferred out of segregated funds while bonds are outstanding. *See* 1981-1982 Mich. Op. Att'y Gen. 575, 1982 WL 183534, at *1 (Mich. A.G.).

As alleged in the Amended Complaint, the City functions as a "mere conduit" of the Restricted Funds—from the taxpayers to the Bondholders, via the Paying Agent as trustee of segregated Debt Retirement Funds. Am. Compl. ¶¶ 35-50. The two cases cited by Defendants, while mentioning the phrase "mere conduit," do not address the matters at issue here. Defs.' Br. at 21. First, *City and Cnty. of Dallas Levee Improvement Dist. ex rel. Simond v. Indus. Props. Corp.* involved the issue of whether a public district in Texas was or was not a nominal plaintiff for purposes of destroying diversity jurisdiction. 89 F.2d 731, 732 (5th Cir. 1937). Second, *Lippi v. City Bank* addressed whether a company was an initial transferee under section 550 of the Bankruptcy Code. 955 F.2d 599 (9th Cir. 1992). In addition, *Lippi*'s discussion of the "dominion and control" test for initial transferees does not favor Defendants, because as set forth in the Amended Complaint, under Michigan law, the City does not have "the right to put the [Restricted Funds] to [its] own purposes." *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988) (case cited by *Lippi* for initial transferee standard).[23]

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[23] Courts citing *Bonded*'s test for initial transferees use both the labels "dominion or control" and "dominion and control." *See, e.g.*, *In re Hurtado*, 342 F.3d 528, 533 (6th Cir. 2003) ("The test *Bonded* created has come to be known as the dominion-and-control test, and has been widely adopted.") (internal quotation marks omitted). Regardless of the label used, the Sixth Circuit focuses on the right

Finally, Defendants' argument that the City "controls" the Restricted Funds by virtue of its taxing power directly contradicts the position taken by the City in obtaining this Court's approval for the City's transaction with the Public Lighting Authority (the "PLA"). There, the City explained that even though it levied and collected a utility users tax, it had no control over those tax revenues under Michigan law, *see* MCL §§ 141.1152(5), 123.1281(2), 123.1285(3), and therefore such revenues could not be used for general municipal purposes or distributed to creditors under a plan of adjustment. *See, e.g.*, Hr'g Tr. at 45:19-23 (Nov. 27, 2013) ("[T]he way it works is once you establish the PLA, 12-1/2 million bucks of ***your utility tax revenues have to go to fund the PLA*** . . . and that's not reducing . . . a source of revenue available at the plan of adjustment stage."). The same logic applies here. Defendants are prevented by similar statutory restrictions from using or diverting the Restricted Funds, and therefore Defendants have no control over the Restricted Funds.

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of the alleged initial transferee with respect to transferred funds. *See id.* at 535 n.3 (adopting approach focusing on transferee's right to put funds to its own purpose, regardless of whether it may have exercised control) (citing *In re Blatstein*, 260 B.R. 698, 717 (E.D. Pa. 2001)).

B. Under Michigan Law, Plaintiffs Have Equitable and Beneficial Property Interests in the Restricted Funds

The City has no power under Michigan law to collect the Unlimited Tax Levy without the approval of its voters. *See* Mich. Const. art. IX, § 6; MCL §§ 141.164(1), 141.164 (3). By authorizing the issuance of the Unlimited Tax Bonds, the City's taxpayers consented to the Unlimited Tax Levy for the sole purpose of paying the Unlimited Tax Bonds, and disclaimed any title to, possession of, or control over the proceeds collected under the Unlimited Tax Levy. Am. Compl. ¶ 76. The City's taxpayers thereby authorized the creation of a trust for the benefit of the Bondholders. *See In re Arctic Express Inc.*, 636 F.3d 781, 792 (6th Cir. 2011) (stating that a "valid and enforceable trust exists" where one "accepts possession of . . . property with the express or implied understanding that he is not to hold it as his own absolute property, but is to hold and apply it for certain specific purposes or for the benefit of certain specified persons.") (internal quotation marks and citations omitted).[24]

Taxes specifically levied and collected to pay bonds constitute a trust for the benefit of bondholders. *See Sawicki v. City of Harper Woods*, 118 N.W.2d 293, 295 (Mich. 1962) (holding that a tax assessment levied specifically to pay bonds

[24] The defining characteristic of a trust is the parties' intention to create a trust—an intention that can be demonstrated by the surrounding circumstances. *See, e.g.*, *In re Young*, 468 B.R. 818, 826 (Bankr. E.D. Mich. 2012).

"***constituted a trust fund*** . . . designed to furnish security for the payment of the [bonds]") (emphasis added); *In re City of Columbia Falls, Mont., Special Improvement Dist. No. 25*, 143 B.R. 750, 762 (Bankr. D. Mont. 1992) ("A fund that is derived from a special levy or one created for a specific purpose is in the hands of municipal officials in trust. The municipality is merely a custodian, and its duties relative to such funds are purely ministerial. *It may not use or divert them.*") (internal citations omitted).

Here, by enacting the Resolutions, the City gave effect to Act 34 and the City's voters' intent to create a trust by pledging to levy and collect the special *ad valorem* tax revenues with the express understanding that such Restricted Funds are pledged solely to the payment of the Unlimited Tax Bonds. *See* Resolutions §§ 301(a), 502. And, as pleaded in the Amended Complaint, the City historically has complied with its duties by levying and collecting the special *ad valorem* taxes, segregating those revenues into Debt Retirement Funds, and then paying the collected amounts to the Bondholders via the Paying Agent. Am. Compl. ¶¶ 52-64. Even in a chapter 9 proceeding, the City has no discretion with respect to the use of the Restricted Funds. Instead, it acts as a trustee or agent for levying, collecting, segregating, and paying the Restricted Funds for the express benefit of the Bondholders, as intended by the voters and required by Michigan law. *See Sawicki*, 118 N.W.2d at 295. Further, the fact that officers can be held personally

liable for willful violations of their duties indicates their role as trustee. *See, e.g.*, 76 Am. Jur. 2d Trusts § 334 ("A trustee is personally liable for a breach of trust under general common-law principles."). Therefore, the Bondholders, and Plaintiffs as the Bondholders' subrogees, have equitable and beneficial property interests in the Restricted Funds.[25]

C. Bankruptcy Courts Give Effect to State-Law Restrictions on the Use of Funds

The City insists here, as it did in arguing its position on the proposed postpetition financing, that the Bankruptcy Code frees it of any state-law restrictions on its use of funds. As this Court held in its ruling on that matter, the City is incorrect. *See* Hr'g Tr. at 26:9-12 (Jan. 16, 2014) (holding that use of loan proceeds was "limited by state law").

The Court's ruling, which gave effect to Michigan's restrictions on gaming revenue, is consistent with other decisions in recent chapter 9 cases that recognize that municipal debtors are constrained by state-law restrictions on the use of funds. For instance, in *City of Vallejo*, the bankruptcy court gave effect to various state, federal, and contractual restrictions on over 100 special purpose and enterprise

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[25] Plaintiffs' property interests remain effective in bankruptcy. *See In re Cannon*, 277 F.3d 838, 851-52 (6th Cir. 2002) (debtor's clients, as beneficiaries of trust accounts, retained beneficial title to funds in debtor's accounts); *In re Arctic Express Inc.*, 636 F.3d at 796-98, 801 (plaintiff-beneficiaries of statutory trust could seek disgorgement of improperly diverted funds).

funds and ruled that such funds "are restricted by law or grant to specific uses and are not available to cover the operating expenses of the General Fund." *See* No. 08-26813, 2008 WL 4180008, at *5-*9 (Bankr. E.D. Cal. Sept. 5, 2008), *aff'd*, 408 B.R. 280, 285, 293 (B.A.P. 9th Cir. 2009). Indeed, the Bankruptcy Appellate Panel for the Ninth Circuit affirmed the bankruptcy court's decision and expressly rejected the argument that the City "should have pillaged all of its component agency funds, ignoring bond covenants, grant restrictions, and normal GASB and GAAP practices, to subsidize its General Fund." 408 B.R. at 293.

Similarly, in *City of San Bernardino*, the court found that the City was constrained by California law from using restricted funds for general fund purposes. *See* 499 B.R. 776, 789 (Bankr. C.D. Cal. 2013). That decision arose in the context of the City's eligibility dispute with the California Public Employees Retirement System, which argued that the City's failure to tap into a large cash balance in the City's water fund was evidence that the City lacked a desire to effectuate a plan. *Id*. In concluding that those funds were not available to the City, the court ruled that:

> This argument has no legal legs. It is a matter of California constitutional law that the City may not use funds belonging to the Water Department for general fund purposes. Amendments to the Constitution enacted by Proposition 218 in 1996, which added Articles XIIIC and XIIID, expanded restrictions on local government revenue-raising and imposed limitations on local government use of special fees, including water and sewer fees. Article XIIID covers water fees and prohibits the use of such fees for general governmental

> services, including police, fire and other services. Thus, the City was legally prohibited by the California Constitution from using Water Department funds for general fund purposes.

Id. at 789 (citations omitted).[26]

In sum, Defendants have not met their burden of demonstrating that Count Two fails to state a claim for declaratory relief that Plaintiffs, and not Defendants, have equitable and beneficial property interests in the Restricted Funds.

III. PLAINTIFFS HAVE STATED A CLAIM FOR DECLARATORY RELIEF THAT THE UNLIMITED TAX BONDS ARE SECURED BY STATUTORY AND/OR CONTRACTUAL LIENS ON THE SPECIAL *AD VALOREM* TAX REVENUES (COUNT THREE)

In seeking dismissal of Count Three, Defendants purposefully ignore the specific pledge of the special *ad valorem* tax revenues in the Resolutions and instead focus only on the additional, general pledge of the City's full faith and credit. Defs.' Br. at 25.[27] In addition, they assert erroneously that the word

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[26] The City of Stockton has taken the same position with respect to its special purpose and enterprise funds. *See* Modified Disclosure Statement with Respect to First Amended Plan for the Adjustment of Debts of City of Stockton, California (November 15, 2013), at 3:7-10 ("The Plan does not alter the obligations of those City funds that are restricted by grants, by federal law, or by California law; pursuant to the Tenth Amendment to the United States Constitution and the provisions of the Bankruptcy Code that implement the Tenth Amendment, such funds cannot be impacted in the Chapter 9 Case."), *In re City of Stockton, Cal.*, No. 12-32118 (Bankr. E.D. Cal. Nov. 21, 2013).

[27] Defendants acknowledge, however, that the City made two separate pledges in the Resolutions. *See* Defs.' Br. at 28 (discussing the "pledges" in section 301 of the Resolutions).

"pledge," as used in the Resolutions, Act 34, and Act 189, is merely a "synonym for 'promise." Defs.' Br. at 24. As set forth below, neither position is correct. Further, Defendants should be judicially estopped from arguing that the Unlimited Tax Bonds are not secured by a lien on the special *ad valorem* tax revenues. Finally, the liens at issue are both statutory and contractual in nature.

A. The Pledge of Special *Ad Valorem* Tax Revenues is Distinct from the Pledge of the City's Full Faith and Credit—the Unlimited Tax Bonds are "Double-Barreled"

The Unlimited Tax Bonds are not typical general obligation bonds. They are, rather, "double-barreled" bonds because they are expressly secured by a defined revenue source—the special *ad valorem* taxes specifically authorized by City voters for the sole purpose of paying the Unlimited Tax Bonds—and also subject to payment based on the general credit of the municipality. Am. Compl. ¶¶ 35-51, 80-86; *see* MCL §§ 141.162(d), 141.164(1), 141.164(3), 141.2701(3); *see also* Report of the National Bankruptcy Conference on Proposed Municipal Bankruptcy Amendments, at 21 (1988) (hereinafter, "NBC Report") (discussing double-barreled municipal bonds).[28]

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[28] *Reprinted in* Legislation to Amend Chapter 9 of the Bankruptcy Code: Hearing on H.R. 3845 Before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary, 100th Cong., 2d Sess. (1988); *see also* Sylvan G. Feldstein & Frank J. Fabozzi, THE HANDBOOK OF MUNICIPAL BONDS 74 (2011) ("When revenue bonds are backed up by a pledge to use the taxing power of the issuer if the pledged revenues are insufficient to pay the bonds, they are referred to

Defendants nevertheless conflate the distinct pledge of special *ad valorem* tax revenues that secures the Unlimited Tax Bonds with the Bondholders' separate distinct recourse to the City's pledge of its full faith and credit and, in further misleading fashion, assert that Plaintiffs claim to have a "first lien in the City's general tax revenues." Defs.' Br. at 25. In fact, as made clear in the Amended Complaint, Plaintiffs claim only to have equitable and beneficial property interests in the special *ad valorem* tax revenues pledged to, and allocated for, the payment of the Unlimited Tax Bonds. Am. Compl. ¶¶ 75-86.[29] That the Unlimited Tax Bonds are also backed by the "full faith, credit and resources of the City" does not diminish or obscure the additional, specific pledge of special *ad valorem* tax revenues. Resolutions § 301(a); *see also* MCL §§ 141.162(d), 141.164(1), 141.164(3), 141.2701(3).

The special *ad valorem* tax revenues are the primary and principal source of payment for the Unlimited Tax Bonds. *See* Am. Compl. ¶¶ 35-51. Importantly, because of the specific statutory requirements of Act 34, the special *ad valorem*

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as *double-barreled bonds*."); *Pierce Cnty. v. State*, 78 P.3d 640, 649 (Wash. 2003) (en banc) (bonds were "double-barreled" because the county "pledged both the [fee revenues] and the county's 'full faith and credit'"); *State ex rel. State Gen. Obligation Bond Comm'n v. Koontz*, 437 P.2d 72, 77 (Nev. 1968) ("'Double-barreled' repayment provisions . . . couple a pledge of ad valorem tax revenues with a conditional or unconditional pledge of other revenues . . . .").

[29] *See supra*, note 8 (discussing the separate line item on *ad valorem* tax bills for Unlimited Tax Bond "debt service").

taxes collected by the City will, absent extraordinary circumstances, be sufficient to pay the Unlimited Tax Bonds in full. *See* MCL §§ 141.2701; Am. Compl. ¶¶ 42, 56, 87. Consequently, the City would not need to resort to the second "barrel"—its general taxing power—because the first "barrel"—the special *ad valorem* tax revenue stream that secures the unlimited tax pledge—should be sufficient to pay the Unlimited Tax Bonds. *See* Am. Compl. ¶¶ 87-88.[30]

In their effort to further obfuscate the true character of the Unlimited Tax Bonds, Defendants misleadingly compare them to other types of municipal bonds, and argue that the language granting liens for those bond issuances is "express and clear." *See* Defs.' Br. at 24-25. However, Defendants ignore a crucial distinguishing point: the Unlimited Tax Bonds are secured by a revenue stream that, under the authorizing Michigan statutes, is available ***only*** to pay the Bondholders. Am. Compl. ¶¶ 35-51 (citing Act 34 and Act 189). Thus, the pertinent language need not prioritize the lien or specify that the lien is in favor of the Bondholders because the Resolutions exclusively secure the Bondholders and, as a consequence, no other creditor could ever have an interest in the special *ad*

[30] Only if the Unlimited Tax Levy were set incorrectly, or if the collection rate were lower than estimated, would Bondholders need to avail themselves of their recourse to the City's full faith and credit.

valorem tax revenues made under an unlimited tax pledge specifically levied for one dedicated purpose: to secure and pay the Unlimited Tax Bonds.

In contrast, other types of municipal bonds, such as those cited by Defendants, require different language with respect to security. For example, because other creditors may have claims to the system revenues securing the water and sewer bonds, it was necessary for the relevant statute to clarify that the pledge created a "first lien in favor of the holders of the bonds . . . ." MCL § 141.107(4). Similarly, the statutes authorizing the general obligation bonds secured by distributable state aid must provide that the lien on such state aid is "paramount and superior to all other liens and interests of any kind," MCL § 141.1009(4), because other creditors would otherwise be entitled to share in those funds.

Defendants also misleadingly compare the Unlimited Tax Bonds to other purportedly similar bond issuances. *See* Defs.' Br. at 26-27. For example, Defendants refer to certain general obligation bonds issued by the City of Central Falls, Rhode Island, but fail to point out that those bonds were supported only by a pledge of the city's full faith and credit, with a requirement in Rhode Island law that the city was merely required to "***appropriate***" sufficient funds from its general tax levy to pay the bonds. *See, e.g.*, Official Statement of the City of Central Falls, Rhode Island Relating to $8,700,000 General Obligation Bonds, at 4 (emphasis

added), attached hereto as Exhibit 2.[31] The ***appropriation*** of general tax revenues to pay bonds is fundamentally different from the Unlimited Tax Bonds, in which additional taxes were specifically ***authorized***, ***levied***, and ***collected*** to finance one or more projects and must be used to pay the Unlimited Tax Bonds. Indeed, the fact that the State of Rhode Island amended its laws prior to Central Falls's bankruptcy filing to provide a lien on general fund revenues further highlights the distinction between the "single-barreled" bonds in that case and the "double-barreled" Unlimited Tax Bonds here.

As an additional example, the State of Michigan issued certain "General Obligation Notes" in fiscal year 2010 that are supported only by a pledge of the "full faith and credit of the State" and "***undedicated*** revenues." *See* State of Michigan Official Statement Relating to $1,255,000,000 Full Faith and Credit General Obligation Notes, Fiscal Year 2010, Series A, at 1 (emphasis added),

[31] The City of Central Falls's Official Statement is subject to judicial notice as its contents "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b)(2); *see also City of Monroe Emps. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 655 n.1 (6th Cir. 2005) ("[A] court that is ruling on a Rule 12(b)(6) motion may consider materials in addition to the complaint if such materials are public records or otherwise appropriate for the taking of judicial notice.").

attached hereto as Exhibit 3. The Unlimited Tax Bonds, by comparison, are supported by an unlimited tax pledge of ***dedicated*** tax revenues.[32]

The chart below highlights the key differences in terms of the source(s) of payment for (1) "double-barreled" Unlimited Tax Bonds, (2) archetypal general obligation bonds, and (3) system revenue bonds.

[32] Michigan law also distinguishes between general obligation bonds backed only by the credit of the municipality, on the one hand, and "special obligation" bonds "retired from special tax revenues," on the other. *Schureman v. State Highway Comm'n*, 141 N.W.2d 62, 63 (Mich. 1966).

		Collateral Source	
Municipal Debt	**Example(s)**	**Dedicated Revenues**	**General Fund**
Double-Barreled Bonds	Detroit's Unlimited Tax Bonds	"[T]he proceeds of an annual levy of ad valorem taxes on all taxable property in the City without limitation as to rate or amount for the payment thereof." Resolutions § 301; *see also* Act 189; Act 34.	"[T]he full faith, credit and resources of the City." Resolutions § 301.
General Obligation Bonds	State of Michigan Full Faith and Credit Obligations; Central Falls, Rhode Island Pre-Amendment General Obligation Bonds	None	Nothing other than the "full faith and credit" of the issuer. *See* MCL § 17.451.
System Revenue Bonds	Detroit's Water and Sewer Bonds	"[T]he net revenues derived from the operation of the public improvement" financed by the bonds. *See* MCL § 141.107(2).	None

B. The Resolutions, Act 189 and Act 34 Are Explicit in Creating a Lien on the Restricted Funds

Contrary to Defendants' claim, the use of the word "pledge" in the Resolutions, Act 189 and Act 34 is not synonymous with the word "promise" but

instead means that the City granted a security interest in the special *ad valorem* tax revenues that constitutes a lien under the Bankruptcy Code.

In the Resolutions, the City "pledge[d] to pay the principal of and the interest on the [Unlimited Tax Bonds] from the proceeds of an annual levy of ad valorem taxes on all taxable property in the City without limitation as to rate or amount for the payment thereof." Resolutions § 301(a).[33] The Resolutions provide that, upon defeasance of the Unlimited Tax Bonds, the "***lien of this Resolution for the benefit of such bonds*** shall be discharged." Resolutions § 801 (emphasis added). In mischaracterizing the various sections of the Resolutions cited in the Amended Complaint as "inapposite to the issue of whether there is a lien," Defendants do not address Section 801. Defs.' Br. at 30. If Defendants' interpretation of "pledge" in the Resolutions were correct, and no lien were thereby created, then Section 801 would contemplate the discharge of a non-existent lien, rendering nonsensical the referenced language.[34]

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[33] Section 301(a) also provides a comma-delimited list of what is "irrevocably pledged" for the Unlimited Tax Bonds, and that security includes "the unlimited tax" as well as a pledge of the City's full faith and credit. Resolutions § 301(a).

[34] Other provisions of the Resolutions are similarly clear that the pledge in the Resolution grants a security interest in the Restricted Funds. *See, e.g.*, Resolutions § 701 (permitting the City to adopt supplemental resolutions "[t]o confirm or further assure the security hereof or to grant or pledge to the holders of the [b]onds any additional security"); *see also id.* §§ 202, 307, 309, 1002, 1004. Where the City intended to make only a "promise," the Resolutions use the word "covenant."

Moreover, the language of the Resolutions must be read against the relevant constitutional and statutory framework. The statutes pursuant to which the Resolutions were issued make clear that the word "pledge" was intended to—and does—provide security for payment of the Unlimited Tax Bonds through a pledge of the special *ad valorem* taxes that constitutes a lien under the Bankruptcy Code definition. Indeed, there cannot be any clearer demonstration of the meaning of "pledge" than Act 189—the Michigan statute that implements the constitutional limits on the City's taxing authority and authorizes the voter resolutions to exceed those limits in connection with the issuance of the Unlimited Tax Bonds. Act 189 unequivocally and unambiguously defines an "unlimited tax pledge" as follows:

> "Unlimited Tax Pledge" means an undertaking by a public corporation ***to secure and pay a tax obligation from ad valorem taxes*** to be levied on all taxable property within the boundaries of the public corporation without limitation as to rate or amount and in addition to other taxes which the public corporation may be authorized to levy.

MCL § 141.162(d) (emphasis added).[35]

Act 34 likewise defines a "security" to mean "evidence of debt . . . issued by a municipality, which ***pledges*** payment of the debt by the municipality ***from an***

See, e.g., Resolutions § 401 ("The City covenants that it will not take any action . . . if taking such action . . . would adversely affect the general exclusion from gross income of interest on the Bonds . . . from federal income taxation . . . ."). [35] Act 189 further provides that a city may issue municipal bonds "***secured by unlimited tax pledges*** of the public corporation if approved by its electors . . . ." MCL § 141.164(1) (emphasis added).

identified source of revenue." MCL § 141.2103(r) (emphasis added). Act 34 further provides that municipal securities such as the Unlimited Tax Bonds may be "***secured by***," among other things, *ad valorem* real and personal property taxes. MCL § 141.2103(l) (emphasis added). The only Michigan case to analyze the meaning of "pledge" in the context of Michigan municipal finance law explained that a "pledge" by a municipality is the act of providing "***security for the repayment of a debt***." *Kinder Morgan Mich., L.L.C. v. City of Jackson*, 744 N.W.2d 184, 191 (Mich. Ct. App. 2007) (emphasis added).[36]

Thus, the meaning of "pledge" under Michigan law falls squarely within the definition of "lien," defined in the Bankruptcy Code as a "charge against or interest in property ***to secure payment of a debt or performance of an obligation***." 11 U.S.C. § 101(37) (emphasis added). Read against the statutory background, the "pledge" in the Resolutions creates a lien on the special *ad valorem* tax revenues within the meaning of Bankruptcy Code section 101(37). And, as discussed above, the specific pledge of these particular tax revenues is distinct from Bondholders' further recourse to the City's full faith and credit.[37]

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[36] *See also* BLACK'S LAW DICTIONARY 1272 (9th ed.) (defining "pledge" as "[t]he act of providing something as security for a debt or obligation").

[37] To the extent the Court determines that the meaning of "pledge" is ambiguous, that issue cannot be resolved on this Motion as to which Plaintiffs' factual allegations must be assumed to be true. *See* Am. Compl. ¶¶ 80-86.

Chapter 9 of the Bankruptcy Code provides additional support for Plaintiffs' position that the pledge of special *ad valorem* tax revenues creates a lien. Section 922(d) provides that a chapter 9 petition "does not operate as a stay of application of ***pledged*** special revenues in a manner consistent with section 92[8] of this title to payment of indebtedness ***secured by*** such revenues." 11 U.S.C. § 922(d) (emphasis added). In other words, Bankruptcy Code section 922(d) uses "pledged" as a synonym for "secured by," and does not use the term "lien" because "secured by" is the very essence of the definition of "lien" under Bankruptcy Code section 101(37). Indeed, the legislative history of Chapter 9 repeatedly uses "pledge" and "lien" interchangeably, sometimes in the same sentence. *See, e.g.*, S. REP. NO. 100-506, at 12 (1988) ("Various questions have been raised that a ***pledge*** of municipal revenue and the ***lien created thereby*** will be terminated in a municipal bankruptcy due to the application of Section 552(a) to Chapter 9.") (emphasis added).

C. The City Has Already Taken the Position that a "Pledge" of Tax Revenues Creates a Lien

Defendants should be judicially estopped from arguing that the pledge of special *ad valorem* taxes for payment of the Unlimited Tax Bonds does not create a lien when based on parallel nomenclature it argued precisely the contrary with respect to—and obtained this Court's approval for—its transaction with the PLA.

The doctrine of judicial estoppel "generally prevents a party from prevailing in one phase of a case on an argument and then relying on a contradictory argument to prevail in another phase." *White v. Wyndham Vacation Ownership, Inc.*, 617 F.3d 472, 476 (6th Cir. 2010) (quoting *New Hampshire v. Maine*, 532 U.S. 742, 749 (2001)). The doctrine is meant to "preserve 'the integrity of the courts by preventing a party from abusing the judicial process through cynical gamesmanship.'" *Id.* (quoting *Browning v. Levy*, 283 F.3d 761, 775 (6th Cir. 2002)); *see also United States v. Storey*, 640 F.3d 739, 747 (6th Cir. 2011) (party was judicially estopped from making legal argument that was inconsistent with prior position).

Defendants' position that the "pledge" of special *ad valorem* tax revenues to pay the Unlimited Tax Bonds is merely a "promise," Defs.' Br. at 24, is wholly at odds with the City's characterization of a virtually identical pledge of tax revenues in the PLA transaction, as approved by the Court on December 6, 2013. *See* Order, *In re City of Detroit, Mich.*, No. 13-53846, Docket No. 1955 (Bankr. E.D. Mich. Dec. 6, 2013). There, the City and the PLA never once said in the transaction documents that the interest in the tax revenues is a "lien," instead providing that "[t]he City hereby pledges the Utility Taxes to the Utility Bonds." *See* Interlocal Agreement, *In re City of Detroit, Mich.*, No. 13-53846, Docket No. 1341, Ex. 6.1, at § 4.2 (Bankr. E.D. Mich. Oct. 23, 2013).

Nonetheless, in seeking this Court's approval of the PLA transaction, the City characterized the "pledge" as "the granting of a pledge ***and lien in***" the "existing and future revenue generated from the Utility Tax." *See* Motion, *In re City of Detroit, Mich*., No. 13-53846, Docket No. 1341, at 2, 5, 9-10 (Bankr. E.D. Mich. Oct. 23, 2013) (emphasis added); *see also* Hr'g Tr. at 11:24-25 (Nov. 27, 2013) ("[T]he ***liens that we are trying to pledge*** are not liens on any property that can be used to pay for creditor recoveries.") (emphasis added).

The City should thus be estopped from arguing now that the "pledge" of the Restricted Funds to payment of the Unlimited Tax Bonds does not create a lien, when less than three months ago it successfully argued to this Court—flatly inconsistently with its current position—that the "pledge" of tax revenues in the PLA transaction gives rise to a lien.

D. The Resolutions, Act 189 and Act 34 Have the Force of a Statute and Create Statutory Liens

Defendants argue that the Resolutions creating the Unlimited Tax Bonds are "contracts" and, therefore, cannot give rise to a statutory lien. Defs.' Br. at 23. Defendants' argument fails because it assumes, erroneously, that the Resolutions do not have the force of a statute.

The Bankruptcy Code defines a "statutory lien" as arising "by force of a statute on specified circumstances or conditions . . . whether or not such interest or lien is made fully effective by statute." 11 U.S.C. § 101(53). Notably, the

Bankruptcy Code does not require that legislation must use the phrase "statutory lien" to give rise to one. Rather, the "distinguishing feature of a statutory lien is that it arises solely by force of a statute." *In re Cnty. of Orange*, 189 B.R. 499, 502-03 (C.D. Cal. 1995) (internal quotation marks and citations omitted). Defendants ignore that, while such a lien arises by "statute," it does so "on specified circumstances or conditions." 11 U.S.C. § 101(53).

Here, Act 189, Act 34 and the Resolutions create a "statutory lien" that arises "by force of a statute on specified circumstances or conditions." 11 U.S.C. § 101(53). Act 189 authorizes the City, with approval of its electors, to make an "unlimited tax pledge" "to secure and pay a tax obligation from ad valorem taxes to be levied on all taxable property . . . without limitation as to rate or amount and in addition to other taxes which the public corporation may be authorized to levy." MCL §§ 141.162(d), 141.164(1), 141.164(3). Act 34, in turn, mandates that when the City makes such a pledge, "the [City] shall levy the full amount of taxes required by this section for the payment of the municipal securities without limitation as to rate or amount and in addition to other taxes that the municipality may be authorized to levy." MCL § 141.2701(3). Finally, the Resolutions confirm that the City has "pledge[d] to pay the principal of and the interest on the [Unlimited Tax Bonds] from the proceeds of an annual levy of ad valorem taxes on all taxable property in the City without limitation as to rate or amount for the

payment thereof." Resolutions § 301(a). As such, Plaintiffs have—by force of statute, under the circumstances and conditions alleged in the Amended Complaint—a statutory lien with regard to the special *ad valorem* taxes levied for payment of the Unlimited Tax Bonds.[38]

The Resolutions themselves establish a statutory lien within the meaning of the Bankruptcy Code. *See* 11 U.S.C. 101(53).[39] It is well established that acts of a local government may qualify as statutes that give rise to statutory liens. For example, in *Wojcik v. City of Romulus*, the Sixth Circuit explained that "municipal resolutions" may be "deemed legislative acts," and further noted that "determining whether a resolution is a legislative act depends upon its content . . . ." 257 F.3d 600, 612 (6th Cir. 2001) (citing *INS* v. *Chadha*, 462 U.S. 919 (1983) and *Yakus* v. *United States*, 321 U.S. 414, 424 (1944)). Likewise, under Michigan law, a resolution passed by a City may reflect "an exercise of a legislative function . . . ." *Kalamazoo Mun. Utils. Ass'n v. City of Kalamazoo*, 76 N.W.2d 1, 8 (Mich.

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[38] *See In re Schick*, 418 F.3d 321, 329 n.7 (3d Cir. 2005) (recognizing that statutory liens may be "created by operation of more than one statute read in conjunction").

[39] A "statute" is defined as "a law passed by a legislative body; specif., legislation enacted by ***any*** lawmaking body, including legislatures, administrative boards, and municipal courts." BLACK'S LAW DICTIONARY 1542 (9th ed. 2009) (emphasis added). Here, the Detroit City Council "is the City's legislative body." Detroit City Charter § 4-101. In passing the Resolutions, the City Council exercised its power to enact legislation.

1956).[40] Therefore, a Resolution of the Detroit City Council may give rise to a statutory lien. The question hinges on whether the Resolutions are legislative in character. The two United States Supreme Court decisions relied upon by the Sixth Circuit in *Wojcik* provide guidance regarding the requisite content of the Resolutions. In *Yakus v. United States*, the Supreme Court observed that "[t]he essentials of the legislative function are the determination of the legislative policy and its formulation and promulgation as a defined and binding rule of conduct . . . ." 321 U.S. 414, 424 (1944). The Supreme Court held that an action was an exercise of Congress's legislative power because Congress had (1) a stated legislative objective; (2) prescribed the method of achieving that objective; and (3) laid down standards to guide the administration of this method. *Id.* at 423.

In *INS v. Chadha*, the Supreme Court held that actions are an exercise of legislative power when they "contain matter which is properly to be regarded as legislative in its character and effect." 462 U.S. 919, 952 (1983) (internal quotation marks and citation omitted). There, the Supreme Court noted that an act was legislative in purpose and effect if it altered the legal rights, duties, and relations of persons outside the legislative branch. *See id.* The Supreme Court further noted that the legislative character of an action can be confirmed if the act

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[40] *See also In re Sheldahl, Inc.*, 298 B.R. 874, 875 (Bankr. D. Minn. 2003) (city code imposed a lien authorized by the state constitution and statutes).

could not have been achieved without legislation. *See id.* at 952-54. Specifically, the Supreme Court noted that the delegation of authority to the Attorney General involved determinations of policy that could only be implemented through legislation. *Id.* at 954-55.[41]

Applying these standards to the Resolutions demonstrates their legislative character. The Resolutions satisfy each of the three criteria set forth by the Supreme Court. ***First***, the City Council established its legislative objective: to issue and sell the Unlimited Tax Bonds to finance specific public capital improvements. *See* Resolutions § 201. ***Second***, the City Council prescribed the method to achieve this objective, authorizing and delegating authority to various City officers (*e.g.*, the Finance Director), altering their legal duties and obligations with respect to the issuance, administration, and sale of the Unlimited Tax Bonds. *See, e.g.*, *id*. §§ 301(b), 302(b), 310, 501, 505, 506, 1001(b), 1004(b), 1007(b)-(c), 1008, 1009, 1010, 1011. As explained in *Chadha*, such delegation of authority bears the hallmarks of a legislative act. 462 U.S. at 952. Those delegations of authority are not singular in time or provisional in nature, but rather permanent

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[41] Although there is limited case law in Michigan analyzing whether particular resolutions are "legislative" in character, the Michigan Supreme Court has noted that a city council resolution regarding the levy of "user charges" on a drainage system was "an economic legislative measure." *Downriver Plaza Grp. v. City of Southgate*, 513 N.W.2d 807, 811-12 (Mich. 1994).

legal rights vested in City officers (although permanence is not a necessary criterion).[42] ***Third***, the City Council established standards for the issuance and sale of the bonds. *See* Resolutions § 302(h).

Notably, the Resolutions provide for the repeal of all conflicting "resolutions or parts of resolutions or other proceedings of the City . . . ." Resolutions § 1017. "Repeal" is defined as the "abrogation of an existing law ***by legislative act***." BLACK'S LAW DICTIONARY 1413 (9th ed. 2009) (emphasis added). Therefore, in order to "repeal" previous acts of the City Council, the Resolutions must be legislative acts. *See Pitsch Recycling & Disposal, Inc. v. Cnty. of Ionia*, 386 F. Supp. 2d 938, 940-41 (W.D. Mich. 2005) (assuming that county resolution that repealed "any previous memorandum, contract, resolution, or ordinance" was itself a legislative act). Accordingly, the Resolutions are legislative in nature and have the force of a statute.

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[42] The Sixth Circuit does not require "permanence" for a resolution to have the force of a statute. The Sixth Circuit test for determining "whether a resolution is a legislative act" analyzes the content of the resolution but does ***not*** analyze whether the resolution is "permanent" in nature. *See Wojcik*, 257 F.3d at 612. Indeed, a *per se* rule that legislative acts must be "permanent" would invalidate statutes that are "temporary" or "provisional" and enacted in times of emergency. *See, e.g.*, Act 436 of the 2012 Local Financial Stability and Choice Act, MCL § 141.1541 *et seq*. (altering legal rights and duties only during the duration of a local government unit's financial emergency).

Finally, the fact that Section 1019 of the Resolutions provides that the Resolutions and the related Sales Orders "constitute a contract between the City, the Paying Agent, the Bond Insurer, if any, and the Bondowners," *see* Resolutions § 1019, does not undermine the statutory lien created by the Act 189, Act 34 and the Resolutions. As explained in *In re County of Orange*, if a lien "aris[es] solely by force of a statute," the fact that there is an agreement recognizing the lien does not convert the statutory lien into a consensual security interest. 189 B.R. at 502-03. Where a contract exists simultaneously with the grant of a statutory lien, the lien will be deemed statutory if "[t]he lien arose automatically, with no contract provision as a condition precedent." *Id.* at 503. Notably, here, the "creation of the lien is not dependent upon [any] agreement." *Id*. The lien arises solely by force of the pledge in Section 301 of the Resolutions, and that pledge in turn is defined by Act 34 and Act 189. As in the *Orange County* case, "the statute itself imposes the pledge, without further action by the [municipality]." *Id*.[43]

In short, the liens arising under Act 189, Act 34 and the Resolutions, are statutory liens under Bankruptcy Code section 101(53).

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[43] In addition, the practical reality is that Section 1019 was added to the Resolutions solely to establish privity between bondholders and the City. Given the unilateral nature of the Resolutions, the reference to contract was meant to ensure that bondholders would have the ability to enforce the terms of the Resolutions, including the statutory lien created therein, and would not have to rely solely on the terms of the bonds.

E. The Resolutions Give Rise to Simultaneous Separate Contractual Liens

In cases like this, where contractual language is present even though it is not a condition precedent to the creation of a statutory lien, courts have recognized the possibility that two distinct liens exist, one contractual and one statutory. *See In re Cnty. of Orange*, 189 B.R. at 504 (citation omitted). Accordingly, even if the lien of the Resolutions were determined ***not*** to be a statutory lien, the Unlimited Tax Bonds remain secured by a contractual lien as a result of the Resolutions and related Sales Orders.

Defendants argue that the Resolutions should be characterized as an agreement. *See* Defs.' Br. at 23 ("The [Unlimited Tax Bonds] were created by contracts . . . ."). As discussed above, the pledge in the Resolutions creates a lien on the special *ad valorem* tax revenues within the meaning of Bankruptcy Code section 101(37). Therefore, even if the Court were to agree with Defendants' argument, the Resolutions would still be a "security agreement" within the meaning of Bankruptcy Code section 101(50), and the pledge of the Restricted Funds provided for therein would still give rise to a "security interest" within the meaning of Bankruptcy Code section 101(51).[44]

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[44] The Bankruptcy Code defines a "security agreement" as an "agreement that creates or provides for a security interest," 11 U.S.C. § 101(50), and a "security interest" as a "lien created by an agreement." 11 U.S.C. § 101(51).

Accordingly, even if the Court were to hold (contrary to Plaintiffs' showing above) that the Resolutions alone, or in tandem with Act 189 and Act 34, do not give rise to a statutory lien, the Resolutions and related Sales Orders still constitute prepetition security agreements between the City, the Bondholders, and the bond insurers, and create or provide for a security interest in the Unlimited Tax Bonds.

IV. PLAINTIFFS HAVE STATED A CLAIM FOR DECLARATORY RELIEF THAT PLAINTIFFS HAVE A LIEN ON SPECIAL REVENUES AS DEFINED IN THE BANKRUPTCY CODE (COUNT FOUR)

Defendants argue that the special *ad valorem* tax revenues pledged to secure and pay the Unlimited Tax Bonds are not "special revenues" under Bankruptcy Code section 902(2)(E) because (1) the Unlimited Tax Bonds are "single-barreled" and special revenues cannot apply to general obligation bonds backed only by a municipality's full faith and credit, and (2) the Unlimited Tax Bonds are not secured bonds. *See* Defs.' Br. at 30-32. Defendants further contend that the Restricted Funds pledged to the subset of Unlimited Tax Bonds that "refinance" existing bonds cannot be special revenues. *See id*. at 31. None of those arguments has merit.

A. The Restricted Funds Are Special Revenues Because They Were Specifically Levied to Finance One or More Projects or Systems

Defendants' argument that the special *ad valorem* taxes are not special revenues is based, once again, on Defendants' fundamental mischaracterization of

the Unlimited Tax Bonds as backed ***only*** by the City's full faith and credit. Defs.' Br. at 30-33. As discussed above, the Unlimited Tax Bonds are double-barreled bonds secured first and foremost by the special *ad valorem* tax revenues, which are clearly special revenues as defined in the Bankruptcy Code.

Bankruptcy Code section 902(2)(E) defines "special revenues" as "taxes specifically levied to finance one or more projects or systems, excluding receipts from general property, sales, or income taxes (other than tax-increment financing) levied to finance the general purposes of the debtor." 11 U.S.C. § 902(2)(E). Further, the Bankruptcy Code does not distinguish between revenue bonds backed only by special revenues and "double-barreled" bonds. *See* NBC Report, at 21 ("[S]ection 92[8] does not distinguish between bonds backed solely by special revenues and so-called double-barrel[ed] bonds.").[45]

The special *ad valorem* tax revenues pledged to the Unlimited Tax Bonds meet that definition. At the time the Unlimited Tax Bonds were issued, the City had reached the applicable constitutional, statutory, or charter tax limits on rates

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[45] Defendants note that "[t]he entire purpose of adding the 'special revenue' provisions to chapter 9 was to . . . ensure that the holders of revenue bonds secured by specific revenues maintained that security during the course of a chapter 9 case." Defs.' Br. at 32. Plaintiffs agree. And because the "double-barreled" Unlimited Tax Bonds must be treated in the same way as revenue bonds with respect to the pledged special *ad valorem* tax revenues, chapter 9 dictates that such special revenues must be protected.

for general fund taxes. Am. Compl. ¶ 39. However, because voters approved the Unlimited Tax Bonds, the otherwise applicable maximum limitations on *ad valorem* millage rates did not apply. *Id*. Accordingly, the City relied on that special millage rate exception in Act 189 to levy a separate stream of special *ad valorem* taxes for the sole purpose of securing the payment of the Unlimited Tax Bonds. *Id*. The Unlimited Tax Bonds were then issued to finance specific City projects and systems, as described and voted upon in the applicable bond referenda. *Id.* ¶ 40. Upon information and belief, no proceeds from the Unlimited Tax Bonds were used for the purpose of paying the City's operating expenses or for general purposes. *Id*. ¶¶ 53, 84.

The treatment of the special *ad valorem* tax revenues as special revenues follows from the purpose and intent of the 1988 municipal bankruptcy amendments designed to protect such special revenues. As stated in the House Report, "the intent is to define special revenues to include the revenue derived from a project ***or from a specific tax levy***, where ***such revenues are meant to serve as security to the bondholders***." H.R. REP. NO. 100-1101, at 6 (1988) (emphasis added). The Senate Report makes clear that tax revenues specifically levied to pay for a municipal financing fall squarely within the definition of "special revenues":

> Under clause (E) an incremental sales or property tax specifically levied to pay indebtedness incurred for a capital improvement and not for the operating expenses or general purposes of the debtor would be considered special revenues. Likewise, any special tax or portion of a

> general tax specifically levied to pay for a municipal financing shall be treated as special revenues. For this purpose a project or system may or may not be revenue-producing.

S. REP. NO. 100-506, at 21 (1988). The National Bankruptcy Conference, in its report to Congress in connection with the 1988 amendments, explained:

> [W]here a special property tax is levied and collected for the specific purpose of paying principal and interest coming due on bonds issued in conjunction with the levy of the property tax, the revenues may constitute special revenues. In these cases, there is generally a prohibition under State law on using the special tax revenue for any purpose other than payment of bonds.

NBC Report, at 19.

As detailed above, Michigan law requires that the special *ad valorem* tax revenues levied for the purpose of paying the Unlimited Tax Bonds must not be used for any other purpose. Accordingly, the pledged special *ad valorem* taxes are wholly and exclusively dedicated to payment of outstanding Unlimited Tax Bonds and not otherwise available to fund distributions to creditors under a plan of adjustment or for any other purpose. They are thus squarely "special revenues" under the language and intent of the Bankruptcy Code.

Whether the Restricted Funds are secured by a statutory lien or a contractual lien, such "special revenues" are entitled to the protections of sections 922(d) and 928 of the Bankruptcy Code. Under Bankruptcy Code section 922(d), the automatic stay does not operate as a stay of the application of the Restricted Funds to payment of the Unlimited Tax Bonds during the City's chapter 9 case. *See* 11

U.S.C. § 922(d). Under Bankruptcy Code section 928, any Restricted Funds acquired by the City after the commencement of its chapter 9 case shall remain subject to any lien on the Restricted Funds that existed before the commencement of the City's chapter 9 case. *See* 11 U.S.C. § 928.

B. The Contrast of Financing and Refinancing is a Distinction Without a Difference

Defendants argue, without support and contrary to the facts pleaded in the Amended Complaint, that "the specific taxes levied to provide a source of payment for" certain series of Unlimited Tax Bonds that were used to "refinance existing bonds" are not special revenues because such taxes were not "levied to 'finance one or more projects or systems.'" Defs.' Br. at 31 (quoting 11 U.S.C. § 902(2)(E)).

Defendants' argument is legally and factually incorrect, and a misstatement of municipal finance principles and Michigan law. Act 34 includes "refunding securities" as a subset of "securities." *See* MCL §§ 141.2103(p), (r) ("'Security' means an evidence of debt such as a . . . refunding obligation . . . which pledges payment of the debt by the municipality from an identified source of revenue."). Similarly, "refinancing" is merely a subset of "financing." "Financing" is defined as "[t]he act or process of raising or providing funds," and "refinancing" is defined as "[a]n exchange of an old debt for a new debt, as by negotiating a different interest rate or term . . . ." BLACK'S LAW DICTIONARY 708 (9th ed. 2009).

Therefore, "finance" in section 902(2)(E) also encompasses "refinance," as long as the relevant tax revenues are levied to refinance one or more projects or systems. As discussed above, the central consideration in the applicability of Bankruptcy Code section 902(2)(E) "is the nature and scope of the restrictions placed on the use of the tax receipts and the specific identification of the tax receipts." *See* COLLIER ON BANKRUPTCY ¶ 902.03[5] (16th ed.).

Here, as Plaintiffs have pleaded, the proceeds from ***all*** of the outstanding series of Unlimited Tax Bonds were used only to fund or finance specific capital improvement projects. *See* Am. Compl. ¶¶ 40, 53. Indeed, the special *ad valorem* tax revenues levied to pay the refunding series of Unlimited Tax Bonds are subject to the same restrictions governing use for financing of the same specific projects as the initial funding series. *See id*. ¶ 40 n.2. The only purpose of each refunding series was to refinance the initial funding at a lower interest rate. *See* MCL § 141.2611(1) ("[A] municipality shall not refund all or any part of its outstanding securities by issuing a refunding security unless the net present value of the principal and interest to be paid on the refunding security . . . is less than the net present value of the principal and interest to be paid on the outstanding security being refunded . . . ."). Moreover, Act 34 places specific limits on the terms of the refunding series of Unlimited Tax Bonds to maintain the integrity of the voter approval that authorized the initial series. *See, e.g.*, MCL § 141.2305(5)

(prohibiting a "refunding security" from having a maturity that exceeds the maturity of the existing security). Therefore, all series of the Unlimited Tax Bonds—whether related to financing or refinancing—are secured by "special revenues" as defined in the Bankruptcy Code.

V. PLAINTIFFS HAVE STATED A CLAIM FOR DECLARATORY RELIEF THAT DEFENDANTS HAVE VIOLATED PLAINTIFFS' RIGHTS UNDER THE FIFTH AND FOURTEENTH AMENDMENTS (COUNT FIVE)

On the basis of their well-pleaded allegations, Am. Compl. ¶¶ 91-94, 114-119, Plaintiffs have stated a claim that Defendants have violated the Takings Clause under the Fifth and Fourteenth Amendments. The Fifth Amendment proscribes the taking of private property without just compensation, and the Amended Complaint alleges that Defendants have done just that. *See id*. ¶¶ 91-94.

Courts look to state law to determine the nature of a plaintiff's property interest. *See, e.g.*, *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589-90 (1935) (based on Kentucky state law, a pledge of rents, issues, and profits from a piece of land granted the plaintiff "substantive rights in specific property" sufficient to support a Takings claim). Michigan law establishes that Plaintiffs' specific and identifiable interests in the special *ad valorem* tax proceeds constitute property interests, and those property interests should be protected by the Takings Clause. *See AFT Mich. v. State*, 825 N.W.2d 595, 604 (Mich. Ct. App. 2012) ("[W]here the government . . . asserts ownership of a specific and identifiable

'parcel' of money, it does implicate the Takings Clause."); *Butler v. Mich. State Disbursement Unit*, 738 N.W.2d 269, 270 (Mich. Ct. App. 2007) (government's retention of interest on undisbursed child support payments was a taking that required just compensation); *see also Armstrong v. United States*, 364 U.S. 40, 46-49 (1960) (government's destruction of property value of lien was unconstitutional taking). As described above, Plaintiffs have property interests in the special *ad valorem* tax revenues, and Defendants have unjustifiably diverted those tax revenues without compensating Plaintiffs for the taking of that property.

Defendants' effort to dismiss Count Five is almost entirely premised on the argument that an unsecured claim cannot sustain a Takings Clause cause of action. Defs.' Br. at 34. However, as explained above, Plaintiffs *have* a secured interest in the Restricted Funds. *See supra*, section III. Consequently, the City's argument fails on this ground alone.

Moreover, even in the absence of a secured interest, Plaintiffs have property interests in the special *ad valorem* taxes created by Michigan law, *see supra*, section II. In addition, the *ad valorem* taxes are "special revenues" as defined in Bankruptcy Code section 902(2)(E), *see supra*, section IV, and thus the protections afforded to those revenues under state law constitute property interests independent

of any lien.[46] Such property interests can form the basis of a Takings claim. *See Radford*, 295 U.S. at 590 ("substantive rights in specific property" can support a Takings claim). Indeed, Defendants do not cite a single case in which a court has ruled that a plaintiff must have a secured interest to have a constitutionally protected property interest.[47]

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[46] *See* S. REP. NO. 100-506, at 6 (1988) ("The right to collect an assessed tax, where the only matter remaining outstanding is the collection of the revenue, would seem to be 'property' and the subsequent revenue would be 'proceeds' thereof."). In a chapter 9 case, the protections afforded under state law to special revenues must be preserved. *See id*. at 8-9 ("If a municipality is unable to meet its obligations for general governmental purposes, and for that reason files a bankruptcy petition, [special revenues] should not be reached to pay general creditors of the municipality unless they could be reached under applicable nonbankruptcy law."). The definition of special revenues in section 902(2)(E) does not refer to liens, and "therefore may include special revenues that are ***not*** subject to a lien." *See* COLLIER ON BANKRUPTCY ¶ 902.03[6][a] (16th ed.) (emphasis added).

[47] The cases relied on by Defendants are inapposite. In none of those cases did the court reject a Takings claim in circumstances in which a plaintiff had a property interest protected by state law. *See, e.g.*, *Radford*, 295 U.S. at 590 (finding unconstitutional a statute that would abrogate property rights of a mortgagee during bankruptcy); *Kuehner v. Irving Trust Co*., 299 U.S. 445, 451-52 (1937) (addressing "the destruction of rights conferred by the petitioners' contract" and noting "a significant difference between a property interest and a contract since the Constitution does not forbid the impairment of the obligation of the latter"); *In re Varanasi*, 394 B.R. 430, 438-39 (Bankr. S.D. Ohio 2008) (plaintiff only had a contractual right to collect payment from debtor); *In re Treco*, 240 F.3d 148, 161-62 (2d Cir. 2001) (declining to address plaintiff's Takings claim because it was moot). Because a Takings claim looks to a plaintiff's property interest as determined by state law, the distinction between secured and unsecured claims in bankruptcy does not dictate whether Plaintiffs have a property interest that gives rise to a viable Takings claim.

Thus, even if the Court were to conclude that no lien exists, the Takings claim would still be viable. The gravamen of Count Five is the determination that Plaintiffs have property interests in the special *ad valorem* tax revenues, rather than a determination regarding Plaintiffs' secured status in bankruptcy. As explained above, Plaintiffs have constitutionally protected property interests in the special *ad valorem* taxes because, under Michigan law, Plaintiffs, not Defendants, have equitable and beneficial interests in the special *ad valorem* taxes. *See supra*, section II. Finally, Defendants make a half-hearted argument that Plaintiffs' pursuit of this claim is "merely another vehicle to privately enforce the RMFA." Defs.' Br. at 34. As shown above (*see supra*, section I), there is no merit to Defendants' argument with respect to Plaintiffs' standing under Act 34. Further, the assertion that Plaintiffs' Takings claim hinges on Act 34 is unfounded. Defendants confuse a commonality of facts with a unity of legal claims. Plaintiffs' request for a declaratory judgment that Defendants' actions constitute an unlawful Taking is not tantamount to—and is not premised upon—an action to enforce Act 34.

VI. SECTION 904 DOES NOT PRECLUDE ANY REQUESTED RELIEF

Defendants state that 11 U.S.C. § 904 prohibits the Court from granting "much of the relief sought by Plaintiffs," Defs.' Br. at 35-36, but do not identify which requests for relief are so barred, or explain why those requests fall within

section 904's scope. Defendants make the broad assertion that the Court is barred "from entering any order defining [Defendants'] legal obligations with respect to the levied taxes." *Id*.

Contrary to Defendants' unsupported assertions, section 904 does not give a municipality *carte blanche* to ignore its obligations or exceed its powers under state law in a bankruptcy case. Defendants' attempt to construe section 904 as a means to avoid their obligations under Michigan law is contrary to the text and purpose of Bankruptcy Code sections 903 and 904, which lay the foundation for the constitutionality of chapter 9 by ensuring that a State's rights as a sovereign under the Tenth Amendment are protected in bankruptcy.[48]

Consistent with that purpose, although section 904 prohibits the Court from interfering with "any of the political or governmental powers of the debtor" or with "any of the property or revenues of the debtor," section 903 makes clear that the City must follow state laws concerning property rights during its bankruptcy case. *See* 11 U.S.C. §§ 903, 904(1)-(2); *In re New York City Off-Track Betting Corp.*, 434 B.R. 131, 144 (Bankr. S.D.N.Y. 2010) (municipal debtors "must follow state

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[48] *See In re City of Stockton, Cal.*, 478 B.R. 8, 16-17 (Bankr. E.D. Cal. 2012) ("Section 903 reserves to the state the power to control political and governmental powers, as well as expenditures . . . . Section 904 complements § 903 . . . . [by] impos[ing] limits on the federal court to assure that powers reserved to the states are honored . . . .").

laws" unless those laws are specifically preempted by federal law); Hr'g Tr. at 25:21-26:4 (Jan. 16, 2014) (City "must comply with state law" unless the Bankruptcy Code "expressly provides otherwise").

Here, Plaintiffs seek declarations that the City continues to be bound by certain Michigan laws notwithstanding that it commenced a chapter 9 proceeding. None of the relief sought by Plaintiffs implicates section 904, because none of the relief requests that the Court "interfere" with any property or revenue of the City or with any of its political or governmental powers. Plaintiffs do not seek to compel any use or disposition of revenues or funds. Rather, each of the six counts in the Amended Complaint asks the Court for declaratory relief regarding the parties' interests and obligations under Michigan law with respect to the Restricted Funds. Such determinations in no way violate section 904. *See* Hr'g Tr. at 27:2-5 (Jan. 16, 2014) ("Consistent with Section 904," the Bankruptcy Court will review the use of municipal property to ensure "compliance with [state law].").

Defendants fail to identify ***any*** case in which a court has held that section 904 precludes the determination of parties' rights under state law.[49] That is

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[49] The *City of Stockton* case cited by Defendants does not support their argument. In *City of Stockton*, the plaintiff-retirees sought an injunction to compel the city's payment of retiree health benefits and attorneys' fees, which the court denied under section 904. *See City of Stockton*, 478 B.R. at 21. Here, Plaintiffs do not seek to compel any payments from the City or any injunctive relief.

unsurprising. Nothing in section 904 bars the Court from interpreting Michigan law and determining the parties' respective rights and obligations with respect to the Restricted Funds. In fact, any other result would mean that section 904 in effect creates a "super-sovereign" in which the municipality (protected by the automatic stay) would be free to disregard the laws of the state sovereign that created it. Chapter 9 does not require such an absurd result.[50]

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the Court deny the Motion in its entirety.

[50] Even if any of Plaintiffs' requested relief required "interference" with the Restricted Funds by the Court (which it does not), the Court's ruling as to these matters would not implicate any City "property or revenues" because, as described above in section II, the City has no equitable or beneficial interest in the Restricted Funds. Therefore, there could not possibly be interference with City "property or revenues" under section 904.

Dated: February 11, 2014

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EXHIBITS

Exhibit 1 Exemplars of City of Detroit Property Tax Bills

Exhibit 2 Official Statement of the City of Central Falls, Rhode Island Relating to $8,700,000 General Obligation Bonds

Exhibit 3 State of Michigan Official Statement Relating to $1,255,000,000 Full Faith and Credit General Obligation Notes, Fiscal Year 2010, Series A