EXHIBIT 3

Brief

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,	:	Chapter 9
	:	Adv. Pro. No. 13-05309
	:	Hon. Steven W. Rhodes
Plaintiffs,	:	
v.	:	
THE 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,	:	
Defendants.	:	

MEMORANDUM IN SUPPORT OF DEFENDANTS'
MOTION TO DISMISS THE FIRST AMENDED COMPLAINT

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INTRODUCTION

The first amended complaint (the "Amended Complaint") [Adv. Dkt. No. 41]) of National Public Finance Guarantee Corporation and Assured Guaranty Municipal Corp. ("National" and "Assured," respectively, or the "Plaintiffs") should be dismissed with prejudice because (1) Plaintiffs have no private right of action to enforce the provisions of the Revised Municipal Finance Act; (2) the obligations evidenced by Plaintiffs' unlimited tax general obligation bonds are not secured by a lien on any collateral; (3) any statute or ordinance that purports to grant any form of priority to the holders of the bonds or otherwise conflicts with the distribution scheme established by chapter 9 of the Bankruptcy Code is preempted by federal law and is of no effect in this case; and (4) covenants contained in the bonds, bond resolutions, or in ordinances and statutes that memorialize the City's contract with the holders of the bonds do not entitle the holders thereof to any treatment superior in any respect to the treatment accorded to other holders of unsecured claims.

I. BACKGROUND

A. Unlimited Tax General Obligation Bonds

Pursuant to, among other things, the Revised Municipal Finance Act ("RMFA"), Act 34 of 2001, as amended, MCL §141.2101 *et seq*., the City issued

eleven series of Unlimited Tax General Obligation Bonds ("UTGOs")[1] between 1999 and 2008 in an aggregate principal amount of $371.3 million. *See* Amd. Compl. Ex. G, Appx. E. The issuance of each series of UTGOs, or bonds that were refinanced by the UTGOs, was approved by a voter referendum that authorized the City to incur this debt or the refinanced debt, the proceeds of which were to be used to fund specified projects and programs, and to impose real estate taxes to fund the payment of the interest on, and principal repayment of, certain bonds. *See* Amd. Compl. Exs. A, E; RMFA §701; Unlimited Tax Election Act, MCL §141.161 *et seq*.

To actually issue the UTGOs, the Detroit City Council adopted resolutions (the "UTGO Resolutions") authorizing the issuance of the bonds and delegating power to the City's Finance Director to determine certain terms of the bonds in Orders of the Finance Director. The UTGO Resolutions obligated the City to take the steps necessary to impose the real estate taxes that had been approved by the voters. The UTGO Resolutions and related sale orders (the "Sale Orders") pertinent to Plaintiff's claims are attached to the Amended Complaint as Exhibits E and J, respectively.

[1] Terms not otherwise defined herein are as defined in the Amended Complaint.

B. This Lawsuit

On October 1, 2013, the City defaulted upon its obligations to make interest payments of nearly $9.4 million on the UTGOs. Amd. Compl., ¶ 6. National and Assured allege that they insured approximately $2.3 million and $4.2 million, respectively, of these interest payments, paid claims in these amounts, and thus are subrogated to the rights of the bondholders. *Id*.

On November 8, 2013, Plaintiffs brought this action for declaratory judgment and injunctive relief against the City and four of its officers (the "Individual Defendants"), in both their individual and official capacities, under the RMFA and the Resolutions. In their original complaint filed on that date (the "Original Complaint"), Plaintiffs essentially sought the relief now contained in Counts I and VI of the Amended Complaint – namely, that the Court require the City to segregate unspecified real estate taxes the City collects (the "Alleged Collateral") into separate bank accounts for Plaintiffs' sole benefit and not use those taxes other than for payment of its claims in this chapter 9 case.[2]

On December 9, 2013, the City and the Individual Defendants filed motions to dismiss the Original Complaint (the "Motions to Dismiss") [Dkt. Nos. 38, 39

[2] In addition, while not explicitly seeking a money judgment against the Individual Defendants, the Original Complaint repeatedly cited a subsection of the Revised Municipal Finance Act (the "RMFA") making "personally liable" to certain persons an "officer who willfully fails to perform duties required by" Section 701 of that act. *See* Adv. Dkt. No. 1, ¶ 47 (citing MCL § 141.2701(7)).

respectively] on the grounds, among others, that Plaintiffs: (i) do not have a private right of action under the RMFA to bring the claims sought in the Original Complaint; (ii) were essentially seeking a form of adequate protection (by seeking segregation of funds) without asserting the existence of collateral to secure their claims, which claims in any case are unsecured so that no adequate protection is appropriate; and (iii) were barred from bringing this action by Bankruptcy Code §904.

Rather than respond to the Motions to Dismiss, on December 23, 2013 Plaintiffs filed the Amended Complaint. Plaintiffs no longer expressly request injunctive relief and are no longer suing the Individual Defendants in their individual capacities. Yet Plaintiffs clearly intend to try to bind the Individual Defendants and to compel the City to act in accordance with Plaintiffs' view of the RMFA. *See* Amd. Compl. at 25 n.4 (explaining that Plaintiffs are seeking "declaratory relief that will bind the Individual Defendants in their official capacities to ***ensure compliance*** by the City and its pertinent officials with the dictates of Michigan law. . . .") (emphasis added). Moreover, Plaintiffs leave no doubt in the Amended Complaint that they are keeping their options open, and that the revised allegations may well be just a first step against the Individual Defendants. Plaintiffs allege that the Individual Defendants have failed to perform

their duties under § 701(7) of the RMFA, but Plaintiffs are not "***currently***" seeking personal liability against them.[3] *Id.* (emphasis added).

The Amended Complaint also newly alleges (in Count II) that the City is a mere conduit of the funds flowing from the taxpayers to the UTGO bondholders; alleges (in Counts III and IV) that a lien of one variation or another secures the UTGO obligations; and asserts (in Count V) a constitutional takings claim based on that purported lien. While the six counts of the Amended Complaint raise several issues, the central substantive issue in the Amended Complaint is Plaintiffs' assertion of a lien. That is the fundamental, and in fact only, substantive issue that the Court must now address, as the remainder of the Amended Complaint must be dismissed based on the fact that all of Plaintiffs' other substantive allegations – however artfully pled – ultimately seek enforcement of state statutes for which no private right of action exists under Michigan law.

Whether or not the UTGOs are secured by a lien is of no small consequence in this chapter 9 case. Secured creditors are entitled to receive the lesser of the value of the collateral and the allowed amount of their claims. That outcome will likely be vastly better than the distributions available to unsecured creditors in the bankruptcy case. In addition, the City's practical ability to levy

[3] The Individual Defendants will, of course, oppose any effort by Plaintiffs to again amend their Complaint so as to reassert the initial, broad claims against them that were abandoned in the Amended Complaint.

and collect taxes from its residents is limited. If compelled to levy and collect taxes solely for the benefit of UTGO bondholders, the City's ability to levy taxes for other purposes will be further limited and values available for other creditors will be diminished.

If Plaintiffs truly were secured creditors, then that reallocation of the value would simply represent the application of the provisions of the Bankruptcy Code. But it is clear that Plaintiffs are not secured creditors, and their attempt to assert otherwise should fail.

II. ARGUMENT

Federal Rule of Civil Procedure 12(b)(6), made applicable to this proceeding through Federal Rule of Bankruptcy Procedure 7012(b), requires dismissal of a complaint that fails to state a claim on which relief can be granted. "To survive a motion to dismiss, a complaint must "plead[] factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Top Flight Entm't, Ltd. v. Schuette*, 729 F.3d 623, 630 (6th. Cir. 2013) (internal quotation marks and citation omitted). A court may not "accept conclusory legal allegations that do not include specific facts necessary to establish the cause of action." *Id*. (internal quotation marks and citation omitted).

As detailed below, all six counts in Plaintiff's Amended Complaint fail that standard.[4]

A. Counts I and VI Must Be Dismissed Because Plaintiff Has No Private Right Of Action Under The Revised Municipal Finance Act

At the outset, Counts I and VI of the Amended Complaint must be dismissed because there is no private right of action under the RMFA. The RMFA makes no express provision for a private right of action, but rather states that it is to be enforced by the Michigan Department of Treasury. Thus, under Michigan law, private parties have no standing to sue under the statute. Yet Counts I and VI of the Amended Complaint explicitly rest on, and seek to enforce, the RMFA. *See* Am. Compl. ¶¶ 97-98 (Count I); *id*. ¶¶ 121-124 (Count VI). Moreover, even if private plaintiffs did have a cause of action under the RMFA, those counts would fail on the merits.

[4] This motion refers to bond resolutions and other documents relating to the issuance of the UTGOs, all of which were appended to Plaintiff's complaint as exhibits. "As a general rule, a district court, in ruling on a motion to dismiss, should look only to the allegations of the Amended Complaint. Nevertheless, a document referred to or attached to the pleadings, and integral to plaintiff's claims, may also be considered without converting a motion to dismiss into one for summary judgment." *Commercial Money Center, Inc. v. Ill. Union Ins. Co.*, 508 F.3d 327, 336 (6th Cir. 2007).

1. The RMFA May Only be Enforced by the Michigan Department of Treasury, Not Through a Private Right of Action

When it was enacted in 2001, the RMFA created a new financial and regulatory scheme for municipal financing and describes in detail how it is to be enforced. The Michigan Department of Treasury "is authorized and directed to protect the credit of this state and its municipalities, and to enforce the provisions of this act." RMFA §201(a). Specifically, the Department is given the sweeping authority to:

> [E]nforce compliance with any provision of this act or with any provisions of any law, charter, ordinance, or resolution with respect to debts or securities subject to its jurisdiction, including the levy and collection of taxes and the segregation, safekeeping, investment, and application of money for the payment of debt.

RMFA §201(d).

To carry out this broad enforcement authority, the Department may, among other things, "institute appropriate proceedings in the courts of [Michigan], including those for a writ of mandamus and injunctive relief." *Id*.; *see also* RMFA §802(2) (specifying the Department's responsibilities in the event of municipal debt defaults).

The Michigan Supreme Court has explained that "where a new right is created or a new duty is imposed by statute, **the remedy provided for enforcement of that right by the statute for its violation and nonperformance**

is exclusive." *Pompey v. General Motors Corp.*, 189 N.W.2d 243, 251 (1971) (emphasis added). Michigan courts regularly rely on *Pompey*'s rule. *See, e.g., Lynch v. Cnty. of Arenac*, 2011 Mich. App. LEXIS 1265, *7-8 (Mich. Ct. App. July 12, 2011); *Bricker v. Ausable Valley Cmty. Mental Health Servs.*, 2009 Mich. App. LEXIS 206 (Mich. Ct. App. Jan. 29, 2009) (citing *Pompey* and noting that where a statute does not expressly create a private cause of action or an exception to governmental immunity, such rights may not be read into it). This rule applies with particular force "where a statute creates a new right or imposes a new duty unknown to the common law and provides a comprehensive administrative or other enforcement mechanism or otherwise entrusts the responsibility for upholding the law to a public officer." *Claire-Ann Co. v Christenson & Christenson, Inc.*, 566 N.W.2d 4, 6 (Mich. Ct. App. 1997) (collecting cases, explaining that "a private right of action will not be inferred" and so holding with respect to statute at issue).

The RMFA creates new statutory rights for, and imposes new statutory duties upon, municipalities. These did not exist at common law, since a municipality has no right at common law to borrow money; rather, a municipality's very existence, as well as the powers reserved to it, are a creature of statute. The RMFA also "provides" a "remedy . . . for enforcement of" those rights and duties, by assigning to the Michigan Department of Treasury the responsibility for determining whether, when and how to enforce the law. *Pompey*, 189 N.W.2d at

251. Indeed, the Department is charged with enforcing the very rights Plaintiff asserts here for "the segregation, safekeeping, investment, and application of money for the payment of debt." RMFA § 201(d); *cf.* Am. Compl. ¶ 124. Thus, the Department of Treasury has exclusive jurisdiction to enforce the rights and duties created under the RMFA, and Plaintiff cannot do so. Plaintiff is barred from bringing claims for money damages or injunctive relief.

This is all the more true because the RMFA's enforcement mechanism is a "comprehensive" one. *Claire-Ann*, 566 N.W.2d at 6. In the context of a statute with a similarly broad enforcement scheme, Chief District Judge Rosen recently relied on *Claire-Ann*'s well-settled rule in determining that aggrieved teachers could not enforce Michigan's Revised School Code through an action for injunctive relief. In *Garden City Educ. Ass'n v. Sch. Dist. of Cty. of Garden City*, 2013 U.S. Dist. LEXIS 140353 (E.D. Mich. Sept. 30, 2013), the teachers contended that by unilaterally developing a new teacher evaluation system without union or teacher input, the school district violated MCL § 380.1249. They demanded, among other things, "an injunctive order directing the School District to immediately discontinue using the evaluation instruments at issue." *Id.* at *9-10.

In granting judgment on the pleadings to the school district, the court first noted that "there is no express provision in Section 1249 providing for a private cause of action. Rather, there is a general enforcement provision that

applies to the entire Revised School Code. . . . [T]he legislative mechanism created to ensure a district's compliance with the provisions of §1249 is the withholding of state funding, and not through an individual cause of action." *Id*. at *12-13. The court based its holding on the rule that "[w]here a statute 'provides a comprehensive administrative or other enforcement mechanism or otherwise entrusts the responsibility for upholding the law to a public officer, a private right of action will not be inferred.'" *Id*. at *14 (quoting *Claire-Ann*).

2. Plaintiffs Cannot Circumvent the RMFA's Comprehensive Enforcement Scheme by Seeking a Declaratory Judgment

Plaintiffs' attempt to re-cast the relief they seek in Counts I and VI as "only declaratory relief" (Am. Compl. ¶ 47 n.6) cannot circumvent the lack of a private right of action under the statute. *See, e.g., Durr v. Strickland*, 602 F.3d 788, 789 (6th Cir. 2010) (affirming district court's holding that declaratory relief was unavailable under the Controlled Substances Act because no private right of action existed under the statute); *Huron Valley Schools v. Sec'y of State*, 702 N.W.2d 862, 867 (Mich. Ct. App. 2005) (holding that where statute precluded a private cause of action in law or equity, plaintiffs' declaration judgment action was precluded). Plaintiffs' tactic is similar to that used by the plaintiffs in *Texas Med. Ass'n v. Aetna Life Ins. Co.*, 80 F.3d 153 (5th Cir. 1996). In that case, the medical groups and doctors, characterized their claim as one for declaratory relief,

but in actuality were requesting that the court apply the requirements of certain administrative regulations to invalidate their de-selection from the defendant insurer's preferred provider organization ("PPO"). *Id*. at 159. Because the PPO rules could only be enforced through the specific means set forth in the Texas Insurance Code, the Fifth Circuit found that "the appellants cannot maintain a declaratory judgment action which would in effect require this court to enforce the PPO rules." *Id*. Other courts have cautioned that allowing a private party to bring what is effectively an enforcement action in the absence of a private cause of action would "give them power not intended" by the statute. *United States* v. *Real Prop. and Improvements Located at 1840 Embarcadero, Oakland, Calif.*, 932 F. Supp. 2d 1064, 1072 (N.D. Cal. 2013); *see also Jones v. Hobbs*, 745 F. Supp. 2d 886, 892 (E.D. Ark. 2010) (stating that when the legislature decided not to provide a particular remedy, "we are not free to 'supplement' that decision in a way that makes it 'meaningless'").

Plaintiffs here cannot seriously contend that they do not seek to compel the City to comply with the provisions of the RMFA through the mechanism of its declaratory judgment action. As the Supreme Court has made clear, a court should assume that government officials are likely to conform their conduct to an authoritative construction of a statute contained in a declaratory judgment even if not coupled with a coercive injunctive order. *Franklin v. Mass.*,

505 U.S. 788, 803 (1992). Plaintiffs are surely aware of this, and their intent is evident: to evade the requirements of the RMFA through creative pleading. Since the RMFA, by its own terms, places its enforcement squarely in the hands of the Michigan Treasury Department, however, Plaintiffs' attempt to do indirectly what they cannot do directly must fail.

3. Plaintiffs Have Not Pled a Private Cause of Action Against the Individual Defendants

To the extent that Plaintiffs seek to rely on § 701(7) of the RMFA as the basis for a private right of action against the Individual Defendants, their claims still fail. Section 701(7) provides that under certain circumstances, municipal officials may be personally liable for willful failure to perform the duties required by § 701. As an initial matter, § 701(7) does not expressly grant a private parties a right to enforce its terms. Given the comprehensive enforcement regime that the legislature built into the RMFA, it is not at all clear that a private right of *action* may be inferred from the existence of a private right of *recovery*. *Cf. North Cnty. Comms. Corp. v. California Catalog & Technology*, 594 F.3d 1149 (9th Cir. 2009) (section of the Telecommunications Act granting a private right to compensation was nonetheless subject to enforcement by the FCC in the first instance; permitting a private party to sue under the section "would . . . put interpretation of a finely-tuned regulatory scheme squarely in the hands of private

parties and some 700 federal district judges, instead of in the hands of the Commission") (internal quotation marks omitted).

Furthermore, even if a private right of action for monetary damages could be inferred from the language of § 701(7), it does not follow that Plaintiffs may seek to compel the Individual Defendants' compliance with that section. The court in *Claire-Ann* explained that the rule against inference of a particular private right of action is particularly appropriate where the statute provides for a different, limited private right. Interpreting the Occupational Code, the court stated:

> . . . [T]he Legislature has explicitly provided for a limited private right of action to enjoin the unlicensed practice of an occupation subject to licensure. This makes clear that in enacting the Occupational Code the Legislature considered whether and to what extent private rights of action unknown to the common law ought to be created, and thus that the failure to provide for such private rights with respect to violations of other than the licensing requirements was advertent, an archetypal exemplar of the principle of *expressio unius est exclusio alterius*.

Claire-Ann, 566 N.W.2d at 6 (citing *Feld v Robert & Charles Beauty Salon*, 459 N.W.2d 279 (1990). Here, similarly, the existence of a private right of action for monetary damages (which the Individual Defendants do not concede) would only serve to confirm that no other private right – including the right to try to compel compliance through a declaratory judgment, which is the only relief sought by Plaintiffs – may be inferred.

Finally, even if § 701(7) were to apply based on the allegations in the Amended Complaint (which it does not), it does not apply to Kevyn Orr. Under Michigan law, "the elective or *highest appointive executive official of all levels of government* are immune from tort liability[5] for injuries to persons or damages to property if he or she is acting within the scope of his or her judicial, legislative, or executive authority." MCL § 691.1407(5) (emphasis added). Kevyn Orr falls within this statutory "grant of absolute immunity to high-ranking officials," *Odom*, 760 N.W.2d at 223, as the "highest appointive executive official" of a level of government. *See, e.g.*, *Payton v. City of Detroit*, 536 N.W.2d 233, 242 (Mich. Ct. App. 1995) (concluding that Detroit's police chief was covered by this provision); *Nalepa v. Plymouth-Canton Cmty. Sch. Dist.*, 525 N.W.2d 897, 901-02 (Mich. Ct. App. 1994) (holding that the superintendent of a school district was covered); *Bischoff v. Calhoun Co. Prosecutor*, 434 N.W.2d 249, 251 (Mich. Ct. App. 1988) (*per curiam*) (concluding that a county prosecutor was covered); *see also Grahovac v. Munising Township*, 689 N.W.2d 498, 504 (Mich. Ct. App. 2004) (Griffin, J., dissenting) (collecting cases).

[5] Section 701(7)'s "willfulness" requirement indicates that a claim brought under the provision sounds in tort. *See generally Odom v. Wayne County*, 760 N.W.2d 217, 225 (Mich. 2008) (discussing, in the context of tort liability, the meaning of willfulness).

In sum, the claims against the Individual Defendants have no basis in the RMFA and must be dismissed.

4. Alternatively, Counts I and VI Also Fail on the Merits

Even if this Court determined that Plaintiffs had a private right of action under the RMFA, Counts I and VI would still have to be dismissed. As set forth in greater detail below, there is no lien that secures the bonds or the obligations owing thereunder, and the Plaintiffs' claims are general unsecured claims in the City's chapter 9 case. Nevertheless, Counts I and VI seek a declaratory judgment that under Michigan law the City is required to segregate the Alleged Collateral for the sole benefit of the UTGOs and not to use those taxes for any purpose other than to pay the UTGO bonds. The RMFA may require that result **outside** of a chapter 9 case, but in that regard the statute is no different than numerous other state laws that require payment in full of many unsecured claims and debts, including the provisions of the Michigan Constitution that purport to require payment in full of certain pension claims.[6] Indeed, Defendants would not

[6] The Court recognized this key fact at the sole hearing that to date has been held in this action ("This morning I denied protection to pensions that they would be entitled to outside of bankruptcy under the Michigan Constitution . . . . How is this different?"). Transcript Regarding Hearing Held 4 PM on December 3, 2013 at 10-11[Docket No. 1947]; *see also* Opinion Regarding Eligibility at 79-80 [Docket No. 1945] (noting that the Michigan Constitution's pension provision did not "create[] a property interest that bankruptcy would be required to respect

be surprised if every creditor could point to one or more state statutes that, outside of a debt adjustment case, require payment in full of such creditors' claims. Many could also point to statutes that include provisions that restate or reinforce that requirement in various ways.

But when a municipality files for chapter 9 protection, state laws requiring the payment of unsecured debt no longer govern, given the preemptive force of the federal Bankruptcy Code. Courts have uniformly recognized this fact. For instance, in the Orange County chapter 9 case, bondholders filed a motion with the bankruptcy court for relief from the automatic stay so that they could file a state court action to force the county to set aside certain revenues for the payment of their notes. The bankruptcy court denied the motion, stating:

> The problem with the Movants' argument is that if they are correct, no municipality would file Chapter 9 because the benefits of filing would disappear. California specifically authorized its municipalities to seek the protection of Chapter 9. The two main benefits of a Chapter 9 filing are (1) the breathing spell provided by the automatic stay, and (2) the ability to adjust debts of claimants through the plan process.

Alliance Capital Mgmt. LP v. *Cnty. of Orange* (*In re Cnty. of Orange*), 179 B.R. 185, 191 (Bankr. C.D. Cal. 1995), *rev'd on other grounds*, 189 B.R. 499 (C.D. 1995).

(continued…)

under Butner v. United States" nor did it "establish[] some sort of a secured interest in the municipality's property.")

Later in the same chapter 9 proceeding, the bankruptcy court faced a similar issue. Orange County was involved in a separate dispute with Merrill Lynch regarding the proceeds of certain securities. The dispute turned, in part, on the potential application of state tracing rules. Merrill Lynch argued that a California statute eliminated tracing requirements. The bankruptcy court, however, found that to that extent the statute "conflicts with federal bankruptcy law" it is "preempted." *Cnty. of Orange v. Merrill Lynch & Co. (In re Cnty. of Orange)*, 191 B.R. 1005, 1016-1017 (Bankr. C.D. Cal. 1996). The court stated:

> If chapter 9 permitted states to define all properties of the debtor in bankruptcy regardless of the situation and to rewrite bankruptcy priorities, then chapter 9 would become a balkanized landscape of questionable value. Moreover, chapter 9 would violate the constitutional mandate for **uniform** bankruptcy laws. *See* U.S. Const., art. I, § 8.

Id. at 1020.

The other relevant reported decisions in chapter 9 reach the same result. *In re City of Stockton*, 478 B.R. 8, 16-17 (Bankr. E.D. Cal. 2012) ("while a state may control prerequisites for consenting to permit one of its municipalities . . to file a chapter 9 case, it cannot revise chapter 9. . . . For example, it cannot immunize bond debt held by the state from impairment.") (internal citations omitted); *In re City of Vallejo*, 403 B.R. 72, 76-77 (Bankr. E.D. Cal. 2009), *aff'd*, 432 B.R. 262 (E.D. Cal. 2010) ("[I]ncorporat[ing] state substantive law into chapter 9 to amend, modify or negate substantive provisions of chapter 9 would

violate Congress' ability to enact uniform bankruptcy laws."); *In re Cty. of Columbia Falls, Mont., Special Improvement Dists.*, 143 B.R. 750, 759-60 (Bankr. D. Mont. 1992) (rejecting bondholder position that its claims could not be impaired in chapter 9 by noting that "[h]ad the Montana legislature sought to require municipalities to pay all of their debts in full, regardless of the cost to city services, it would have merely refused to permit municipalities to file Chapter 9 petitions by not enacting the enabling legislation required by section 109(c)(2)."); *In re Sanitary & Improvement Dist. #7*, 98 B.R. 970, 974 (Bankr. D. Neb. 1987) (reaching the same result and stating that "state law already requires full payment of the bonds issued prepetition . . . . To create a federal statute based upon the theory that federal intervention was necessary to permit adjustment of a municipality's debts and then to prohibit the municipality from adjusting such debts is not, in the point of view of this Court, a logical or necessary result.").[7]

It should be noted that preemption of purported state law unsecured priorities is not only a feature of chapter 9. The Bankruptcy Code preempts state

[7] The bankruptcy court also expressly found that the bondholders held unsecured claims against the municipality, stating that that "[o]utside of bankruptcy, bondholders may have certain rights concerning the use of the taxing power of the state of Nebraska or the municipal enterprise, but bondholders have no 'lien' on any assets of the municipality." *Id.* at 973.

law priorities in cases under all pertinent chapters of the Code.[8] The RMFA might just as well, like these other non-bankruptcy laws, simply have stated that the City must pay the UTGOs in full. That is its intent and effect. And, for that reason, it is unenforceable in chapter 9 given the unsecured nature of the bonds.

B. Count II Must Be Dismissed Because Plaintiffs Cannot Demonstrate that the City Is a "Mere Conduit" for the Alleged Collateral

Count II of the Amended Complaint seeks a declaratory judgment that only Plaintiffs—and not the City—hold an interest in the Alleged Collateral on the theory that the City is a "mere conduit," or agent, for the collection of real estate

[8] *See, e.g.*, *Haber Oil Co. v. Swinehart* (*In re Haber Oil Co.*), 12 F.3d 426, 435 (5th Cir. 1994) ("We have emphasized that '[s]tate law defining property rights may not, of course, go so far as to manipulate bankruptcy priorities.'") (internal citations omitted); *Intl. Brotherhood of Teamsters v. Kitty Hawk Intl., Inc.* (*In re Kitty Hawk, Inc.*), 255 B.R. 428, 439 (Bankr. N.D. Tex. 2000) (court found that Michigan statute that purported to grant priority to the unsecured claims of employees over other unsecured creditors was "pre-empted by the [Bankruptcy] Code upon the Debtor's Chapter 11 filing"); *In re Lull Corp.*, 162 B.R. 234, 240 (Bankr. D. Minn. 1993) (court found unenforceable a Minnesota state statute that purported to grant priority in payment to certain unsecured creditors of the chapter 11 debtor, stating that "[a] state statute cannot reset bankruptcy priorities."); *In re Natl. Bickford Foremost, Inc.*, 116 B.R. 351, 352 (Bankr. D. R.I. 1990) (court found that Rhode Island statute requiring chapter 11 debtor to continue to pay certain health benefits was pre-empted, in that "'Congress may determine the priority in payment to be given wages and other claims, irrespective of any state statute, and the extent to which said power is exercised becomes exclusive.'") (internal citations omitted); *In re Redford Roofing Co.*, 54 B.R. 254, 255 (Bankr. N.D. Ill. 1985) (Illinois workers' compensation statute, which provided that claims under the statute were entitled to preference over the unsecured debts of the employer, was pre-empted in a chapter 7 case).

taxes that are really owned by Plaintiffs. But given that the City is the only entity with the right to assess and collect real estate taxes, it has a clear interest in those taxes, and thus cannot be dismissed as a "mere conduit."

The case law defines a conduit as an intermediary party who receives a transfer but does not gain actual dominion or control over the funds. *See Lippi v. City Bank*, 955 F.2d 599, 611 (9th Cir. 1992). But the City does control the real estate taxes. Indeed, the City is the only entity with the power to assess and collect the real estate taxes. *See* RMFA §701; MCL §141.164(3). And, if the taxpayers do not timely pay their real estate taxes to the City, the City will nonetheless be paid all of the now delinquent taxes that are due and payable to it from the delinquent tax revolving fund, subject to, among other things, a chargeback if Wayne County does not receive all of the delinquent taxes that are due and payable. *See* MCL §211.87b. Therefore, the City cannot be written off as a mere conduit between bondholders and taxpayers. *Cty. and Cnty. of Dallas Levee Imp. Dist. v. Indus. Props. Corp.*, 89 F.2d 731, 732-33 (5th Cir. 1937) (stating that a public district exercising governmental functions cannot be regarded as a mere conduit between bondholders and taxpayers).

C. Count III and IV Of The Amended Complaint Must Be Dismissed Because Neither the RMFA Nor the Resolutions Grant a Lien on Tax Revenues

Count III of the Amended Complaint seeks a declaration that the UTGOs are secured by a statutory lien. Count IV seeks a declaratory judgment that the UTGOs are secured by a statutory and/or consensual lien, and that such lien attaches to "special revenues." In support of these counts, Plaintiffs argue that a disparate collection of provisions both in the RMFA and in the Resolutions create this right by using the words "pledge," "secured" or "security." *See* Amd. Compl. ¶¶ 41-48. These provisions, however, are not a substitute for an actual grant of a lien to Plaintiffs, and no such grant exists in either the statute or the Resolutions.

1. Plaintiff Does Not have a Statutory Lien Under Bankruptcy Code §101(53)

Bankruptcy Code §101(53) defines the term "statutory lien" as a:

> Lien arising solely by force of a statute on specified circumstances or conditions, or lien of distress for rent, whether or not statutory, but does not include [a] security interest or judicial lien, whether or not such interest or lien is provided by or is dependent on a statute and whether or not such interest or lien is made fully effective by statute.

11 U.S.C. §101(53). A statutory lien arises solely by operation of law and automatically upon certain triggering events and not by reason of an agreement between the debtor and a creditor. The term is not implicated in a municipal financing that is evidenced by agreement among the parties, which by its terms is contractual in nature. This is the case even if the purported lien by agreement is

dependent on, or is otherwise made effective, by a statute. *See* 11 U.S.C. 2 COLLIER ON BANKRUPTCY ¶101.53 ("The fact that a statute describes the characteristics and effects of a lien does not by itself make the lien a statutory lien."). "Mechanics', Materialmen's, and Warehousemen's liens are examples" of statutory liens. S. Rep. No. 989, 95th Cong., 2d Sess. (1978).

Indeed, "[a] statutory lien is only one that arises automatically, and is not based on an agreement to give a lien or on a judicial action." S. Rep. No. 95-989, 95th Cong., 2nd Sess. (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 6271. "[T]he 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 citation omitted); *see also* 2 COLLIER ON BANKRUPTCY ¶ 101.53 ("The essence of the [statutory lien] is the need, or lack of need, for an agreement or judgment to create the lien.").

Under a plain reading of the Bankruptcy Code, the UTGOs are not secured by a "statutory lien," and the definition has no application here. The UTGOs were created by contracts negotiated among the parties. Even the Resolutions explicitly state that the relationship between the parties is contractual. *See* Resolutions, §1018 ("The provisions of this Resolution and the Sale Order shall constitute a contract between the City, the Paying Agent, the Bond Insurer, if any, and the Bondowners."). Simply because the bonds are authorized in part by

statute does not grant Plaintiffs a statutory lien within the definition of the Bankruptcy Code. Municipal finance requires authorizing legislation, but such financings remain transactions that are privately negotiated and consensual. By contrast, the term "statutory lien" is designed to encompass liens that arise automatically by operation of law, and it has no bearing on a consensual financing arrangement.

2. There Is No Grant of Lien Under Michigan Law

More fundamentally, it is clear that Michigan law cannot be read as granting Plaintiff a lien in the City's Alleged Collateral. Although the RMFA uses the word "pledge," it does so only as a synonym for "promise," as in "I pledge allegiance to the flag." By contrast, when Michigan statutes grant liens to secure debt, the granting language in the statute is express and clear. For instance, the City has issued certain water and sewer bonds pursuant to Act No. 94, Public Acts of Michigan, 1933, which are secured by revenue of the City's water and sewer systems. MCL §141.101 *et seq*. The language of Act 94 permitting the City to grant such a lien is explicit: Section 4 of Act 94 states that "[t]he governing body in the ordinance authorizing the bonds … may pledge any funds ... **and create a statutory first lien in favor of the holders of the bonds** or a party subject to the agreement." *See* MCL §141.107(4) (emphasis added). Similarly, section 9 of the Michigan Fiscal Stabilization Act currently authorizes the City to secure certain

general obligation bonds with distributable state aid, and the City has done so with respect to other series of UTGOs. In that regard, the relevant provisions of the Fiscal Stabilization Act provide that:

> (3) … the legislative body of the city or county may … pledge and **create a lien** upon any unencumbered revenues or taxes of the city or county … (4) … The distributable aid paid or to be paid to a paying agent, trustee, escrow agent or other person for the purpose of paying the principal of and interest on the bonds or obligations issued pursuant to this act **shall be subject to a lien** and trust, which for bonds or obligations issued pursuant to this act after the effective date of the 2010 amendatory act that amended this subsection and after bonds are issued **subject to the statutory lien created by this subsection, is hereby made a statutory lien and trust paramount and superior to all other liens and interests of any kind**, for the sole purpose of paying the principal of and interest on bonds and obligations issue pursuant to this act …"

See MCL §141.1009(3), (4) (emphasis added).

The statutes cited by Plaintiff in the Amended Complaint do not contain similar lien-granting language. Moreover, if a general "pledge" of the City's full faith and credit was sufficient to give general obligation bondholders a first lien in the City's general tax revenues, as alleged in the Amended Complaint, then there would have been no need for the Michigan Legislature to amend the Fiscal Stabilization Act, as quoted above, to give the same type of bondholders a lien in distributable state aid because bondholders would already have had a first priority lien in **all** of the City's tax revenue.

There is an interesting parallel in the recent chapter 9 case of *In re City of Central Falls, Rhode Island*. In that case, prior to its bankruptcy, the debtor had issued several series of bonds which were general obligation bonds to be paid from all taxable property in the City without limitation as to rate or amount, much like the UTGOs here.[9] On the eve of the debtor's bankruptcy filing in 2011, the State of Rhode Island amended an existing statute in order to secure the bonds. The amended statute provided that:

> The faith and credit ad valorem taxes, and general fund revenues of each city, town and district shall be pledged for the payment of the principal of, premium and interest on, all general obligation bonds and notes of the city or town whether or not the pledge is stated in the bonds or notes, or in the proceedings authorizing their issue and **shall constitute a first lien on such ad valorem taxes and general fund revenues**.

See R.I. Gen. Laws § 45-12-1(a) (emphasis added). The Rhode Island statute then went on to provide that:

> The pledge[10] **shall be a statutory lien** effective by operation of law and shall apply to all general obligation bonds and notes and other financing obligations of cities, towns and districts heretofore or hereafter issued and shall not require a security agreement to be effective.

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[9] *See* Fourth Amended Plan for the Adjustment of Debtors of the City of Central Falls at 13-17, *In re City of Central Falls, R.I.*, No. 11-13105 (Bankr. D. R.I. July 27, 2012), *available at* http://centralfallsri.us.

[10] Unlike the case here, "pledge" in that context was expressly defined by statute as a "first lien on, and a grant of a security interest in, ad valorem taxes and general fund revenues." *See* R.I. Gen. Laws § 45-12-1(d)(2).

See R.I. Gen. Laws § 45-12-1(b)(4) (emphasis added).

Not surprisingly, the debtor's plan of adjustment provided that the holders of these bonds would be paid in full because, "[p]ursuant to R.I. Gen. Laws § 45-12-1, [the] bonds [and] notes … are secured by a Rhode Island statutory lien on property taxes and general fund revenues."[11] The Rhode Island Legislature clearly knew the general obligation bonds, like the UTGOs in this case, were otherwise unsecured, or else there would have been no need to enact this legislation to grant them a lien. In other words, Central Falls' "pledge" of its full faith and credit was insufficient to provide its general obligation bondholders with a lien in its chapter 9 case.

Similarly, the City's water and sewer bonds, and general obligation bonds secured by distributable state aid (*see* Am. Compl. ¶ 26), are secured not by implication but by a lien clearly and expressly granted under Michigan law. Thus, those secured bonds would be entitled to recognition under the Bankruptcy Code. The UTGOs, by contrast, have no such protection. Despite Plaintiffs' efforts to manufacture some sort of statute-based security here, the legal reality is that none exists.

[11] *See supra* note 9.

3. The City's Resolutions Do Not Grant Plaintiffs a Lien Under Bankruptcy Code §101(37)

Plaintiffs allege, in the alternative, that the City granted them a lien in the City's Resolutions, and, thus, they have a lien for purposes of Bankruptcy Code §101(37). Such a contention is equally without support.

The Resolutions provide that:

> The Bonds shall be general obligations of the City, and the unlimited tax, full faith, credit and resources of the City are hereby irrevocably pledged for the prompt payment of the principal of and interest on the Bonds.

See Resolutions §301.

The Resolutions then further provide that "[t]he City pledges to pay the principal of and interest on the 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." *See* Unlimited Tax Resolutions §301.

Nothing in these "pledges" grants Plaintiff a lien in the tax revenues. Under Bankruptcy Code §101(37), a lien is a "charge against or interest in property to secure payment of a debt or performance of an obligation." The Resolutions for the UTGOs grant no such interest, and thus do not give rise to liens. While the Resolutions use the term "pledge," the term is used in the ordinary sense that the City promises, to take certain actions to cause the bonds to be paid. For instance, Resolution §301 states that the City "**pledges** to pay the principal and interest on

the Bonds from the proceeds of an annual levy of ad valorem taxes on all taxable property in the City without limitation as to the rate or amount for payment (emphasis added). This language clearly is no more than a covenant to pay those bonds using such taxes. It did not grant a lien or other property interest in the Alleged Collateral for repayment of the bonds and notably, nothing the Resolutions or any statute gives Plaintiff any recourse, right (such as a cash trapping mechanism or other element of control) or property interest against any tax revenues of the City. While the Resolutions could have contained language granting a security interest in the taxes, they did not. Instead, the "pledge" made in the Resolution is the same as for all other general obligation bonds that are not secured by distributable state aid—namely, a covenant to levy and collect taxes to pay the bonds.

The Resolutions' language that "the unlimited tax, full faith, credit and resources of the City are hereby irrevocably pledged for the prompt payment of the principal of and interest on the bonds," is no different. Again, it is a covenant by the City to take certain steps to pay bonds, and not a grant of a security interest in property to collateralize the bonds. This is analogous to terms sometimes found in unsecured debt that require a borrower to redeem debt with the proceeds of an asset sale or subsequent debt or equity issuances. Such terms do not create a security interest in the subject assets or the proceeds of subsequently

issued securities. Sometimes such provisions result in repayment of the debt supported by them, but if the covenants fail, the creditors' only claim is for repayment of the debt. Additional promises that might have the effect of enhancing the quality of the debt outside of a bankruptcy case are not grounds for distinctive treatment under the Bankruptcy Code.

Finally, the other provisions of the Resolutions cited by Plaintiffs in ¶ 47 of the Amended Complaint are irrelevant and indeed, inapposite to the issue of whether there is a lien in favor of Plaintiff. The cited provisions are administrative and simply describe the mechanics of implementing the bonds. *See* Resolution §202 (statement of the City's authorization to borrow funds); Resolution § 307 (describing the form of the bonds); Resolution § 309 (dictating the procedure for curing mutilated, destroyed, stolen or lost bonds); Resolution § 701 (establishing the mechanism for the City to supplement the Resolutions); Resolution §§ 1002 and 1004 (delegating to and authorizing parties to implement the bonds). None of these administrative provisions provides for the grant of a security interest.

4. Count IV's Claim Regarding "Special Revenues" Is Irrelevant Since Plaintiffs Have No Security Interest in the Alleged Collateral

Count IV asserts that Bankruptcy Code §§ 902(2)(E), 922(d), and 928, which collectively provide certain rights to the holders of debt instruments **secured by liens** on "special revenues," apply to the UTGOs. Count IV of the Amended

Complaint is irrelevant, as the bonds are not secured for the reasons noted above. Further, even if Plaintiffs possessed a lien (which they not), the taxes at issue are not "special revenues" as defined by the Bankruptcy Code.

Bankruptcy Code § 902 defines "special revenues" to include "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). However, several of the UTGOs were refunding issues, where the City used the bond proceeds to refinance existing bonds. *See* Amd. Compl. ¶¶ 28, 32-33. As such, the specific taxes levied to provide a source of payment for these bonds were **not** levied to "finance one or more projects or systems," but instead were levied for the purpose of refinancing already existing debt.

Even if none of the UTGOs had been used to refinance other bonds, however, the specific and limited purpose of the Bankruptcy Code's "special revenue" provisions demonstrates that "special revenues" are revenues paying revenue bonds, *not* general obligation bonds. Prior to the addition of Bankruptcy Code § 928(a), upon a chapter 9 filing, Bankruptcy Code § 552(a) cut off as of the petition date liens on specific revenues that acted as the sole source of payment for municipal revenue bonds. 11 U.S.C. § 552(a); 11 U.S.C. § 928(a); *see also* H.R. Rep. No. 100-1011, at 4 (1988). This caused such future revenues of the debtor to

flow into the municipality's general treasury and potentially to be used to pay unsecured creditors under a chapter 9 plan. *See* H.R. Rep. No. 100-1011, at 4 (1988).

The entire purpose of adding the "special revenue" provisions to chapter 9 was to avoid this specific result and ensure that the holders of revenue bonds secured by specific revenues maintained that security during the course of a chapter 9 case. S. Rep. No. 100-506, 100th Cong., 2d Sess. 4-5, at 5 (1988) ("[I]t would be quite problematic and contrary to state law if a bankruptcy filing resulted in **revenue bonds** being **converted into GO bonds**. Yet that is the potential consequence under current law.") (emphasis added). The legislative history thus clearly demonstrates that revenue bonds and GO bonds are different and are treated differently in a bankruptcy. In this regard, Collier on Bankruptcy further explains:

> One of the principal purposes behind the 1988 Amendments was the desire to protect liens on special revenues granted under **revenue bonds**, a subject on which the 1978 Act had been silent. This purpose of the legislation helps mark the contours of the definition of special revenues. Thus, the definition should not be given an expansive reading, but should be restricted to the purposes behind the principal operative section of chapter 9 added by the 1988 Amendments that uses the definition, section 928."

6 COLLIER ON BANKRUPTCY ¶ 9.02.03 (16th ed. 2013) (emphasis added and citations omitted).

As such, the better interpretation of the "special revenue" provisions of the Bankruptcy Code is that the "special revenue" provisions of the Bankruptcy Code only apply to "revenue bonds." *See*, *e.g. Alliance Capital Mgmt. LP v. Cnty. of Orange (In re Cnty. of Orange)*, 179 B.R. 185, 192 (Bankr. C.D. Cal. 1995) ("[S]ection 928 was narrowly crafted to apply only to special revenue bonds."); *In re Las Vegas Monorail Co*., 429 B.R. 770, 782 (Bankr. D. Nev. 2010) (noting that the purpose of Bankruptcy Code § 928 was "to continue the isolation of industrial revenue bond financing from general municipal bond financing").

The UTGOs are not revenue bonds. Instead, they are general obligations of the City, as their names so indicate. Thus, interpreting the special revenue provisions of the Bankruptcy Code in accordance with their purpose and legislative history, those provisions are inapplicable to the UTGOs regardless of whether or not the UTGOs were secured pre-petition.

D. Count V Of The Amended Complaint Is Groundless As Plaintiffs Are Unsecured

Plaintiffs' takings claim, alleged in Count V, also must also be dismissed for failure to state a claim. Initially, Plaintiffs allege a taking that arises solely from the City's alleged violation of the RMFA. *See* Amd. Compl. ¶ 116 (alleging that the City "has made clear to Plaintiffs that it will not segregate the Restricted Funds and has already used, and continues to use, the Restricted Funds for purposes other than repayment of the Unlimited Tax Bonds" – actions that

Plaintiffs allege violate the RMFA. Thus, although Michigan does provide an inverse-condemnation action for asserting some taking claims, *see e.g.*, *Braun v. Ann Arbor Charter Twp.*, 519 F.3d 564, 570 (6th Cir. 2008), Plaintiffs' "takings" claim here is merely another vehicle to privately enforce the RMFA. However, as detailed above, Michigan has refused any private right of action to enforce that statute against a municipality, instead entrusting such actions to the Michigan Treasury Department. Count V thus fails for the same reasons as the other counts seeking to enforce those state laws as a private right of action.

Count V also fails on its own terms. Plaintiffs cannot state a claim for a taking because they have no secured claim to be "taken." If a claim "is unsecured, it is not 'property' for purposes of the Takings Clause." *In re Treco*, 240 F.3d 148, 161 (2d Cir. 2001). Therefore, unsecured claims "do not rise to the level of a property interest afforded protection under the Takings Clause of the Fifth Amendment." *In re Varanasi*, 394 B.R. 430, 438 (Bankr. S.D. Ohio 2008). Rather, to the extent that a creditor is unsecured, it has only a contractual claim, which may be reduced or even eliminated in bankruptcy without presenting any issue under the Fifth Amendment's Takings Clause. *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 451-52 (1937); *see also Louisville Joint Stock Land Bank v.* 295 U.S. 555, 588 (1935) ("[T]he position of a secured creditor, who has rights in specific property, differs fundamentally from that of an unsecured creditor, **who**

has none.") (emphasis added). Here, as detailed above, Plaintiffs have no lien in the City's tax revenues. Their entirely unsecured status is fatal to Count V.

E. Finally, Most Of The Relief Sought By Plaintiffs Is In Any Case Prohibited By Bankruptcy Code § 904

While Plaintiffs' allegations in the Amended Complaint are meritless for the reasons noted above, it should not go unsaid that much of the relief sought by Plaintiffs is barred by Bankruptcy Code § 904. That section provides that "unless the debtor consents or the plan so provides, the court may not . . . interfere with—(1) any of the political or governmental powers of the debtor; (2) any of the property or revenues of the debtor; or (3) the debtor's use or enjoyment of any income-producing property." 11 U.S.C. § 904. "By virtue of § 904, a debtor in chapter 9 retains title to, possession of, and complete control over its property and its operations, and is not restricted in its ability to sell, use, or lease its property." *In re Valley Health Sys.*, 429 B.R. 692, 714 (Bankr. C.D. Cal. 2010).

Section 904 likewise bars Plaintiffs' claims against the Individual Defendants. A plaintiff may no more interfere with the debtor's property through an order against a municipality's official than it can through an order directly against the municipality. *Cf. In re City of Stockton, Cal.*, 484 B.R. 372, 376 E.D. Cal. 2012) (discussing "the well-known strategy of suing a sovereign by falsely pretending to sue an officer"). Thus, § 904(2) by its terms bars this Court

from entering any order defining the Individual Defendants' legal obligations with respect to the levied taxes, just as it does such an order with respect to the City.

Notwithstanding the protections afforded chapter 9 debtors and their officials, however, Plaintiffs seek at least in part an order from this Court directing the City to divert certain revenues for Plaintiff's benefit. *See* Amd. Compl. ¶¶ 98, 124. Bankruptcy Code § 904, on its face, prohibits this. Indeed, "section 904 means that the City can expend its property and revenues during the chapter 9 case as it wishes." *In re City of Stockton, Cal.*, 486 B.R. 194, 199 (Bankr. E.D. Cal. 2013); *In re City of Stockton, Cal.*, 478 B.R. 8, 21 (Bankr. E.D. Cal. 2012) (holding that section 904 prevented bankruptcy court from requiring municipal debtor to pay its retiree health benefits even if those benefits were purportedly protected under state laws).

CONCLUSION

For the foregoing reasons, Defendants respectfully request that the Court dismiss the Amended Complaint with prejudice.

Dated: January 17, 2014

Respectfully submitted,

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