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
AMBAC ASSURANCE CORPORATION,	:	Chapter 9
Plaintiff,	:	Adv. Pro. No. 13-05310
v.	:	Hon. Steven W. Rhodes
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

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

INTRODUCTION

The amended complaint (the "Amended Complaint" [Adv. Docket No. 57]) of Ambac Assurance Corporation ("Plaintiff" or "Ambac") should be dismissed with prejudice because (1) neither the obligations evidenced by Ambac's unlimited tax general obligation bonds nor the obligations evidenced by Ambac's limited tax general obligation bonds are secured by a lien on any collateral; (2) 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 (3) 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.

BACKGROUND

I. 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 four series of Unlimited Tax General Obligation Bonds ("UTGOs") in 2004 in an aggregate principal amount of $111.7 million. *See* 2004 Unlimited Tax

Resolution; 2004 Unlimited Tax Sale Order.[1] 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.[2] *See* 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.

[2]See the first "Whereas" clause of the 2004 Unlimited Tax Resolution referencing elections held on November 7, 1978, August 5, 1980, November 4, 1986, August 2, 1988, August 4, 1992, August 5, 1996, November 4, 1997, November 7, 2000, November 6, 2001 and April 29, 2003.

II. LIMITED TAX GENERAL OBLIGATION BONDS

The RMFA also provides for the issuance of Limited Tax General Obligation Bonds ("LTGOs"). LTGOs, unlike UTGOs, may be issued by the City without voter approval. The payment of the principal and interest on the LTGOs is not connected to any particular real estate tax. Instead, the City is required to pay the bonds' principal and interest from the levy of real estate taxes generally, "subject to applicable charter, statutory, or constitutional rate limitations." RMFA §701(3).

The City issued four series of LTGOs in 2004 and 2005 totaling $161.1 million in aggregate principal.[3] Issuance of the LTGOs was authorized by resolutions of the Detroit City Council (the "LTGO Resolutions" and together with the UTGO Resolutions, collectively, the "Resolutions"). The LTGO Resolutions are also attached to the Amended Complaint as Exhibit E.

The LTGO Resolutions, like the UTGO Resolutions, specify that the resolutions are contracts "between the City, the Paying Agent, the Bond Insurer, if any, and the Bondowners." *See* 2004 Limited Tax Resolution §918 and 2005 Limited Tax Resolution §1120.

[3] *See* 2004 Limited Tax Resolution; 2004 Limited Tax Sale Order; 2005 Limited Tax Resolution; 2005 Limited Tax Sale Order.

III. THIS LAWSUIT

On October 1, 2013, the City did not make scheduled interest payments of approximately $9.3 million on the UTGOs and $4.3 million on the LTGOs. Plaintiff alleges that it had insured interest payments of $1,994,281 on the UTGOs and $2,266,586 on the LTGOs. Plaintiff also alleges that it paid claims in these amounts, and thus became subrogated to the rights of the bondholders. On November 8, 2013, Plaintiff brought this action for declaratory judgment and injunctive relief against the City and four of its officers (the "Individual Defendants") under the RMFA and the Resolutions. In its original complaint filed on that date (the "Original Complaint"), Plaintiff essentially sought the relief now contained in Count I 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 Plaintiff's sole benefit and not use those taxes other than for payment of its claims in this chapter 9 case.[4]

On December 9, 2013, the City and the Individual Defendants filed motions to dismiss the Original Complaint (the "Motions to Dismiss" [Adv. Docket Nos. 53, 54 respectively]) on the grounds, among others, that Plaintiff: (i) does not have

[4]In addition, while not explicitly seeking a money judgment against the Individual Defendants, the Original Complaint did sue them in their individual capacities, repeatedly cited a subsection of the RMFA making an "officer who willfully fails to perform duties required by" § 701 "personally liable" to certain persons, and alleged that they had committed. See [Docket. No. 1], ¶¶ 6, 47 (citing MCL § 141.2701(7)).

a private right of action under the RMFA to bring the claims sought in the Original Complaint; (ii) was essentially seeking a form of adequate protection (by seeking segregation of funds) without asserting the existence of collateral to secure its claims, which claims in any case are unsecured so that no adequate protection is appropriate; and (iii) was barred from bringing this action by Bankruptcy Code §904.

Rather than respond to the Motions to Dismiss, on December 23, 2013, Plaintiff filed the Amended Complaint. Plaintiff no longer expressly requests injunctive relief and is no longer suing the Individual Defendants in their individual capacities.[5] Yet Plaintiff clearly intends to try to bind the Individual Defendants and to compel the City to act in accordance with Plaintiff's view of the RMFA.

The Amended Complaint newly alleges (in Counts IV and V) that a lien of one variation or another secures its claims, and asserts (in Count VI) a constitutional takings claim. While the six counts of the Amended Complaint raise several issues, the central substantive issue in the Amended Complaint is

[5]However, Plaintiff leaves no doubt that it is keeping its options open, and that the revised allegations may well be just a first step against the Individual Defendants. Plaintiff alleges that the Individual Defendants have failed to perform their duties under the RMFA and cautions that it "does not seek . . . personal liability *at this time*." Am. Compl. ¶ 56 (emphasis added). The Individual Defendants will, of course, oppose any effort by Plaintiff to again amend its Complaint so as to reassert the initial, broad claims against them.

Plaintiff's assertion of a lien. That is in fact the only substantive issue that the Court must now address. The remainder of the Amended Complaint must be dismissed because all of Plaintiff's other allegations ultimately seek enforcement of state statutes for which no private right of action exists under Michigan law.

Whether or not the LTGOs and 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 and collect taxes from its residents is limited. If compelled to levy and collect taxes solely for the benefit of UTGO or LTGO 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 Plaintiff truly were a secured creditor, then that reallocation of the value would simply represent the application of the provisions of the Bankruptcy Code. But it is clear that Plaintiff is not a secured creditor, and Plaintiff's attempt to assert otherwise should fail.

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.[6]

I. COUNTS I-III MUST BE DISMISSED BECAUSE PLAINTIFF HAS NO PRIVATE RIGHT OF ACTION UNDER THE REVISED MUNICIPAL FINANCE ACT

At the outset, Counts I-III 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

[6]This motion refers to bond resolutions and other documents relating to the issuance of the LTGOs and 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. *See Commercial Money Center, Inc. v. Ill. Union Ins. Co.*, 508 F.3d 327, 335-36 (6th Cir. 2007).

enforced by the Michigan Department of Treasury. Thus, under Michigan law, private parties have no standing to sue under the statute. Yet Counts I-III of the Amended Complaint explicitly rest on, and seek to enforce, the RMFA. *See* Am. Compl. ¶¶ 88, 89 (Count I); *id*. ¶ 91 (Count II); *id*. ¶ 94 (Count III); *see also id*. ¶¶ 56-65 (allegations relating to Count I); *id*. ¶¶ 66-71 (allegations relating to Counts II and III). Moreover, even if private plaintiffs did have a cause of action under the RMFA, those Counts would fail on the merits.

A. 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, which 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:

> enforce 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. County 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). 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*).

B. Plaintiff Cannot Circumvent the RMFA's Comprehensive Enforcement Scheme by Seeking a Declaratory Judgment

Plaintiff's attempt to re-cast the relief it seeks in Counts I-III 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).

Plaintiff's 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 plaintiffs, 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'").

Plaintiff here cannot seriously contend that it does 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). Plaintiff is surely aware of this, and its 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, Plaintiff's attempt to do indirectly what it cannot do directly must fail.

C. Plaintiff Has Not Pled a Private Cause of Action Against the Individual Defendants

To the extent that Plaintiff may seek to rely on § 701(7) of the RMFA as the basis for a private right of action against the Individual Defendants, its claim still fails. 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 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, 1158 (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 Plaintiff 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 Plaintiff—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[7] 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);

[7]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).

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).

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

D. Alternatively, Counts I-III Also Fail on the Merits

Even if this Court determined that Plaintiff had a private right of action under the RMFA, Counts I-III 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 claims of Plaintiff are general unsecured claims in the City's chapter 9 case. Nevertheless, Count I seeks a declaratory judgment that under Michigan law the City is required to segregate the Alleged Collateral for the sole benefit of the UTGOs and LTGOs and not to use those taxes for any purpose other than to pay the UTGO and LTGO 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 claims and debts, including the provisions of the Michigan Constitution that purport to require

payment in full of certain pension claims.[8] Indeed, the City would not 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

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

> the automatic stay, and (2) the ability to adjust debts of claimants through the plan process.

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

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." *County of Orange v. Merrill Lynch & Co. (In re County 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. *See 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.").[9]

[9] The bankruptcy court in *Sanitary & Improvement District* also expressly found that the bondholders held unsecured claims against the municipality, stating that, "[o]utside of bankruptcy, bondholders may have certain rights concerning the

It should be noted that preemption of state law priorities that are inconsistent with the distribution rules contained in the Bankruptcy Code is not only a feature of chapter 9. The Bankruptcy Code preempts state law priorities in cases under all pertinent chapters of the Code.[10] The RMFA might as well, like these other non-bankruptcy laws, simply state that the City must pay the UTGOs and LTGOs 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.

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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." 98 B.R. at 973.

[10] *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).

Counts II and III likewise must be dismissed. Those counts seek a declaratory judgment that only Plaintiff—and not the City—holds an interest in the Alleged Collateral on the theory that the City is a "mere conduit," or agent, for the collection of real estate taxes that are really owned by Plaintiff. 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. *See 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 cannot be regarded as a mere conduit between bondholders and taxpayers).

Plaintiff's conduit theory has been rejected before. In an analogous case, the Fifth Circuit found that funds collected by a municipality pursuant to a tax levy for the sole purpose of establishing a fund for the payment of principal and interest on certain bonds were subject to the municipality's control and were property of the municipality. *See Ware v. R.E. Crummer & Co.*, 128 F.2d 114 (5th Cir. 1942). Indeed, the Fifth Circuit came to this conclusion even though the resolutions authorizing the issuance of the bonds stated that, when collected, the taxes were to be deposited in a special fund and distributed for the stated purpose and no other purpose. *Id.* at 117. The same result applies here.

II. COUNT IV MUST BE DISMISSED BECAUSE PLAINTIFF IS NOT A SECURED CREDITOR

Count IV seeks a declaratory judgment that, pursuant to Bankruptcy Code §101(53) (or, alternatively, a "lien" under Bankruptcy Code §101(37)), the UTGOs and the LTGOs are each secured by a "statutory lien" in unspecified real estate taxes the City collects. In support of Count IV, Plaintiff argues that a disparate collection of provisions both in various Michigan statutes and in the Resolutions create this right by using the words "pledge," "secured" or "security." These provisions, however, are not a substitute for an actual grant of a lien to Plaintiff, and no such grant exists in either the statutes or the Resolutions.

A. 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 specified triggering events and not by reason of an agreement between a debtor and a creditor. Thus, the term is not properly applied to a municipal financing that is evidenced by a contract or agreement among the parties. This is the case even if the purported lien created by agreement is dependent on, authorized by, or otherwise made effective, by a statute. *See* 11 U.S.C. §101(53); 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. 27 (1978), reprinted in 1978 U.S.C.C.A.N. 5813, 6271.

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." *Id.* "[T]he distinguishing feature of a statutory lien is that it arises solely by force of a

statute." *In re County 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.").

By a plain reading of the Bankruptcy Code, the UTGOs and LTGOs are not secured by a "statutory lien." In fact, Plaintiff has failed to cite any Michigan statute that grants Plaintiff a lien in the Alleged Collateral. This is in direct contrast to the *Orange County* decision where the court cited a state statute that specifically imposed a "lien" in determining a "statutory lien" existed.

The fact that the UTGOs and LTGOs were authorized in part by statute does not grant to Plaintiff a statutory lien within the definition of the Bankruptcy Code. *See In re Seel*, 22 B.R. 692, 695-96 (Bankr. D. Kan. 1982) (noting that if a "contract provision is a necessary condition precedent for the existence of the lien . . . the lien is not a statutory lien"). 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 consensual financing arrangements like the UTGOs and LTGOs, which were created by contracts negotiated among the parties. *See* Resolutions, §§1019; 918 ("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."). As such, no "statutory lien" exists with respect to the Bonds.

B. There Is No Grant of a Lien Under Michigan Law

More fundamentally, it is clear that Michigan law cannot be read as to grant Plaintiff a lien in the 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 94, which are secured by revenue generated by the City's water and sewer systems, respectively. MCL §141.101 *et seq*. The language of Act 94 permitting the City to grant such a lien is explicit and unambiguous: 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 series of UTGOs and LTGOs that are not involved in this litigation. 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).[11]

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 actually granted general obligation bondholders a first lien in the City's tax revenues, then there would have been no need for the Michigan Legislature to amend the Fiscal Stabilization Act, as quoted above, to enable the collateralization of the same type of bonds through 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

[11]Excerpts of MCL §141.107(4) and MCL §141.1009(3), (4) are attached hereto as Exhibit 6-A.

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.[12] 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), attached hereto as Exhibit 6-C.

The Rhode Island statute then went on to provide that:

> The pledge[13] **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.

See id. § 45-12-1(b)(4) (emphasis added).

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[12] *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, attached hereto as Exhibit 6-B.

[13] "Pledge" is defined 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).

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."[14] The Rhode Island Legislature clearly knew the general obligation bonds, like the UTGOs and LTGOs in this case, were unsecured. Otherwise, there would have been no need to enact legislation. Rhode Island clearly understood that Central Falls' "pledge" of its full faith and credit was not a grant of a lien to general obligation bondholders.

Similarly, the City's water and sewer bonds, and general obligation bonds secured by distributable state aid (*see* Am. Compl. ¶ 24), are secured not by implication but by a clearly and expressly granted lien. Thus, those bonds represent secured claims to the extent of the value of the collateral under the Bankruptcy Code. The UTGOs and LTGOs, by contrast, do not have secured status. Despite Plaintiff's efforts to manufacture some sort of statute-based security here, the legal reality is that none exists.

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

Plaintiff alleges, in the alternative, that the City granted Plaintiff liens in the City's Resolutions, and thus, Plaintiff has a lien for purposes of Bankruptcy Code §101(37). This contention is equally without support, however, as the Resolutions,

[14] *See supra* note 9.

which are the mechanism the City utilized to issue the UTGOs and LTGOs, grant no such lien.

The Resolutions provide, with respect to the UTGOs, 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 Unlimited Tax Resolutions §301.

Similarly, the Resolutions governing the LTGOs provide that:

> The Bonds shall be general obligations of the City, and the limited 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 Limited Tax Resolutions §301.

The Resolutions for the UTGOs 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.

The Resolutions governing the LTGOs further provide that the "City pledges to pay the principal of and interest on the Bonds as a first budget obligation from its general funds and in the case of insufficiency thereof, from the proceeds of an annual levy of ad valorem taxes on all taxable property in the City, subject to

applicable constitutional, statutory and charter tax rate limitations." *See* Limited Tax Resolutions §301.

Nothing in these "pledges" grants Plaintiff a lien in specified 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 and LTGOs grant no such interest, and thus do not grant or convey 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 thereof." (emphasis added). This language clearly is no more than a covenant to pay those bonds using such taxes. Moreover, nothing in the Resolutions or any statute gives Plaintiff any remedies that ordinarily accompany a grant of a lien (such as a cash trapping mechanism or other element of control). While the Resolutions could have contained language granting a security interest in the taxes, they did not. Instead, the "pledge" made in the Resolutions is the same as for all other general obligation bonds that are not secured by distributable state aid—namely, covenants 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. This language also memorializes a covenant by the City to take specified steps to pay bonds, and not a grant of a security interest in property to collateralize the bonds. These terms are 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. *See* Opinion Regarding Eligibility at 75-80 [Docket No. 1945] (rejecting notion that protections afforded to certain pension claims under Michigan Constitution provided pension claimants with priority status in the context of a chapter 9 case).

Plaintiff is less than candid when it purports to quote from the Resolutions. At the end of paragraph 44 of the Amended Complaint, Plaintiff sums up its argument by stating as follows:

> The plain language of Section 301 of the Resolutions ("the [unlimited/limited] tax . . . [is] hereby irrevocably

> pledged for the prompt payment of the principal of and interest on the [Bonds]") thus creates an irrevocable pledge of the City's **ad valorem** taxes as security for the payment of debt service on the Bonds.

In fact, Resolution § 301 states that "the [unlimited/limited] tax, **full, faith, credit and resources of the City are** hereby irrevocably pledged for the prompt payment of the principle of and interest on the [Bonds]." While Plaintiff would like the Resolutions to state that they grant a lien in specified property to Plaintiff, they simply do not. Instead, they simply pledge the full faith and credit of the City to pay the bonds.

Finally, the other provisions of the Resolutions cited by Plaintiff are irrelevant to the issue of whether there is a lien in favor of Plaintiff. For example, Resolution § 701 sets forth instruction on how the Resolution may be supplemented, and Resolution § 202 sets forth the procedure for refunding the Bonds. Neither of these provisions provides for the grant of a security interest.

In fact, only Resolution § 801 even mentions the word "lien." Section 801, however, merely provides that the Bonds are "deemed paid in full" upon the payment of principal of, and interest on, the Bonds at the times and in the manner provided for in the Resolutions. *See* Resolutions § 801. Furthermore, § 801 goes on to set forth the administrative process of redeeming the Bonds, and, ultimately, provides that Bondholders are no longer entitled to the benefits of the Resolutions following redemption. Reference to the term "lien" has no more legal consequence

in this section than do the terms "security" or "pledge" in any of the other statutes or Resolution provisions cited by Plaintiff.

Thus, contrary to Plaintiff's position, the Resolutions provide no grant of a lien in the Alleged Collateral. Furthermore, there exist no documents or relevant law, including Michigan law, the Bankruptcy Code or other documents relevant to the issuance of the Bonds, that provide Plaintiff with a lien in the Alleged Collateral.

III. COUNT V, REGARDING "SPECIAL REVENUE," IS IRRELEVANT BECAUSE PLAINTIFF IS NOT A SECURED CREDITOR

Count V 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 and LTGOs. Count V of the Amended Complaint is irrelevant, as the bonds are not secured for the reasons noted above. Further, even if Plaintiff possessed liens (which it does not), Plaintiff's own position in this case would support the notion that the real estate 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, two of the larger bond issues (the 2004-B(1) Bonds and 2004-(B)2

Bonds) were refunding issues, where the City used the bond proceeds to refinance existing bonds.[15] 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 were used to refinance other bonds, however, Plaintiff's own position in this case supports the idea that the real estate taxes are not "special revenues." Plaintiff's position was taken in connection with the City's proposed settlement of certain swap obligations secured by a casino-related tax.[16] There, Plaintiff argued that the meaning of "special revenue" under the Bankruptcy Code must take into account the limited purpose for which Congress intended the "special revenue" provisions of the Bankruptcy Code to apply. The logic of

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[15]Proceeds of the Series 2004-B(1) Bonds were used to refund the General Obligation Bonds (Unlimited Tax), Series 1996A, General Obligation Bonds (Unlimited Tax), Series 1999B, General Obligation Bonds (Unlimited Tax), Series 2001A, General Obligation Refunding Bonds (Unlimited Tax), Series 2001B and General Obligation Bonds (Unlimited Tax), Series 2002. Proceeds of the Series 2004-B(2) Bonds were used to refund the General Obligation Refunding Bonds (Unlimited Tax), Series 1997B and General Obligation Bonds, Series 2000A(AMT), General Obligation Bonds (Unlimited Tax), Series 2001A. *See* 2004 Unlimited Tax Sale Order, Pl. Ex. J.

[16]*See Objection of Ambac Assurance Corporation to Motion for Entry of an Order (I) Authorizing the Assumption of That Certain Forbearance and Optional Termination Agreement Pursuant to Section 365(a) of the Bankruptcy Code, (II) Approving Such Agreement Pursuant to Rule 9019 and (III) Granting Related Relief* at 27-33 [Docket No. 348] (arguing that revenues generated from casino-related taxes are not special revenues, because the City obligations that the revenues secured were general obligations and not special revenue bonds).

Plaintiff's position is that it is far from clear that the casino-related tax revenues at issue would be "special revenue" if a party had a security interest in such revenue.

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) & 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 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 (1988) ("[I]t would be quite problematic and contrary to state law if a bankruptcy filing resulted in **revenue bonds** being **converted into general obligation 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 they only apply to "revenue bonds." *See, e.g.*, *Alliance Capital Mgmt. LP v. County of Orange (In re County 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 and LTGOs are not revenue bonds. Instead, they are general obligations of the City, as their names so indicate. As Plaintiff has previously stated: "The . . . legislative history establishes unequivocally that the provisions of §§ 922(d) and 928(a) apply only to special revenues pledged in connection with special revenue bonds." *See* Swap Settlement Objection at ¶ 60. Thus, at least under one interpretation of the special revenue provisions of the Bankruptcy Code,

and the one asserted by Plaintiff, those provisions could never apply to the UTGOs and the LTGO, even if it had security.

IV. COUNT VI IS GROUNDLESS, AS PLAINTIFF IS UNSECURED

Plaintiff's takings claim, alleged in Count VI, also must also be dismissed for failure to state a claim. Initially, Plaintiff alleges a taking that arises solely from the City's alleged violation of the RMFA and related state laws. *See* Am. Compl. ¶ 86 (alleging that the City "is not segregating the Restricted Bond Taxes as required by Michigan law" and "has diverted, and apparently intends to continue to divert, the Restricted Bond Taxes to unauthorized uses"); *id.* ¶¶ 81, 108-09 (similar). 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), Plaintiff's "takings" claim here is merely another vehicle to privately enforce those municipal finance laws. Yet, as detailed above, Michigan has refused any private right of action to enforce those laws against a municipality, instead entrusting such actions to the Michigan Treasury. Count VI thus fails for the same reasons as the other counts seeking to enforce those state laws as a private right of action.

Count VI also fails on its own terms. Plaintiff cannot state a claim for a taking because it has 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. Radford*, 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, Plaintiff has no lien in the City's tax revenues. Its entirely unsecured status is fatal to Count VI.

V. FINALLY, MOST OF THE RELIEF SOUGHT BY PLAINTIFF IS IN ANY CASE PROHIBITED BY BANKRUPTCY CODE § 904

While Plaintiff's allegations in the Amended Complaint are meritless for the reasons noted above, it should not go unsaid that much of the relief sought by Plaintiff 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).

Notwithstanding the protections afforded chapter 9 debtors and their officials, however, Plaintiff seeks at least in part an order from this Court directing the City to divert certain revenues for Plaintiff's benefit. *See* Am. Compl. ¶¶ 10, 89. 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).

Section 904 likewise bars Plaintiff's 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 (Bankr. 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 Restricted Bond Taxes as determined by state law," Am. Compl. ¶ 12, just as it does such an order with respect to the City.

CONCLUSION

For the foregoing reasons, Defendants submit that the Amended Complaint should be dismissed with prejudice.

[signature page follows]

Dated: January 17, 2014

Respectfully submitted,

Bruce Bennett (CA 105430)
Jones Day
555 South Flower Street
Fiftieth Floor
Los Angeles, CA 90071
Telephone: (213) 243-2382
bbennett@jonesday.com

Brad B. Erens (IL 6206864)
Jones Day
77 West Wacker
Chicago, Illinois 60601-1692
Telephone: (312) 269-4050
bberens@jonesday.com

Geoffrey S. Stewart (DC 287979)
JONES DAY
51 Louisiana Ave., N.W.
Washington, D.C. 20001
Telephone: (202) 879-3939
Facsimile: (202) 626-1700
gstewart@jonesday.com

/s/ Deborah Kovsky-Apap
Robert S. Hertzberg (P30261)
Deborah Kovsky-Apap (P68258)
PEPPER HAMILTON LLP
4000 Town Center, Suite 1800
Southfield, MI 48075
Telephone: (248) 359-7300
Facsimile: (248) 359-7700
hertzbergr@pepperlaw.com
kovskyd@pepperlaw.com

ATTORNEYS FOR THE DEFENDANTS