

**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION**

In re)	
)	Case No. 13-53846
CITY OF DETROIT, MICHIGAN,)	
)	In Proceedings Under
Debtor.)	Chapter 9
)	
)	Hon. Steven W. Rhodes
AMBAC ASSURANCE CORPORATION,)	
)	
Plaintiff,)	
)	
v.)	Adversary Proceeding
)	No. 13-05310-swr
CITY OF DETROIT, MICHIGAN,)	
KEVYN D. ORR, in his official capacity)	
as EMERGENCY MANAGER,)	Hon. Steven W. Rhodes
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.)	
)	

**AMENDED COMPLAINT OF AMBAC ASSURANCE CORPORATION
FOR DECLARATORY JUDGMENT**

Plaintiff Ambac Assurance Corporation (“Ambac”), a creditor and/or party in interest in the above-captioned case, by and through its undersigned counsel, pursuant to Federal Rule of Bankruptcy Procedure 7001(2) and (9), seeks a

declaratory judgment to determine Ambac’s property rights and interests in, and Defendants’ obligations with respect to, *ad valorem* taxes the City of Detroit (the “City”) must levy, collect, and use for the sole purpose of paying principal and interest on the Unlimited Tax Bonds and the Limited Tax Bonds (as defined below).

INTRODUCTION

1. Having issued hundreds of millions of dollars of unlimited tax general obligation bonds (the “Unlimited Tax Bonds”) and limited tax general obligation bonds (the “Limited Tax Bonds,” and collectively with the Unlimited Tax Bonds, the “Bonds”) to fund vital capital improvements identified by the Mayor and the City Council of Detroit (the “City Council”), the City is now unlawfully diverting *ad valorem* taxes the City must levy, collect, and use for the sole purpose of paying principal of and interest on the Bonds.

2. Unique among the City’s financial obligations, the Unlimited Tax Bonds and the Limited Tax Bonds benefit from strict statutory controls over, and pledges of, certain tax revenues earmarked by law for their payment. These statutory provisions and pledges of tax revenue create Ambac’s and the Bondholders’ property interests in the tax revenues.¹

¹ Ambac is the Bondholders’ subrogee and assignee, and has the exclusive entitlement to direct rights and remedies on behalf of the Bondholders. *See* ¶ 8,

3. The Unlimited Tax Bonds were issued only after the enactment of authorizing resolutions by the City Council, the legislative body of the City, and approval by a majority of the voters in city-wide elections establishing a pledge of *ad valorem* taxes, as security, to pay debt service on these obligations exclusively. Attached as Exhibit A are copies of five ballot questions seeking voter approval of the specific capital projects that were financed with a portion of the proceeds of the Unlimited Tax Bonds. Similar ballot questions were approved for each capital or financial project that the City financed with Unlimited Tax Bonds.

4. In approving each bond referendum, the City's voters authorized the City to exceed the otherwise applicable maximum rate for *ad valorem* taxes contained in Article IX, Section 6 of the Michigan Constitution (a copy of which is attached hereto as Exhibit B), state statutes, and the City's Charter (a copy of which is attached hereto as Exhibit R). Because the City had reached the constitutional, statutory, and charter tax rate limitations at the time the Unlimited Tax Bonds were issued, the City, in the absence of voter approval, would have had no authority to levy and collect these *ad valorem* taxes. By issuing the Unlimited Tax Bonds, the City became obligated by law to assess an amount of *ad valorem* taxes (above such limitations) sufficient to pay debt service on the Unlimited Tax Bonds, and to apply the assessed taxes for this purpose.

infra. Accordingly, Ambac's and the Bondholders' rights and property interests are referred to interchangeably in this Amended Complaint.

5. Likewise, the City issued the Limited Tax Bonds only after the City Council passed resolutions enumerating the specific capital and financial projects to be financed with the proceeds of the Limited Tax Bonds. The City pledged as security for the payment of debt service on the Limited Tax Bonds the first *ad valorem* taxes collected within the constitutional, statutory, and charter tax rate limits. By issuing the Limited Tax Bonds, the City became obligated by law to assess an amount of *ad valorem taxes* (within such limit) sufficient to pay debt service on the Limited Tax Bonds, and to apply the assessed taxes for this purpose.

6. Pursuant to Chapter 141 of the Michigan Public Acts, including, but not limited to, Act 34 of the 2001 Revised Municipal Finance Act, Mich. Comp. Laws § 141.2101 *et seq.* (“Act 34,” a copy of which is attached hereto as Exhibit C), and Act 189 of the 1979 Unlimited Tax Election Act, Mich. Comp. Laws § 141.161 *et seq.* (“Unlimited Tax Election Act,” a copy of which is attached hereto as Exhibit D), and three resolutions adopted by the City Council on June 14, 2004 (the “2004 Unlimited Tax Resolution” or the “Unlimited Tax Resolution”), May 26, 2004 (the “2004 Limited Tax Resolution”), and May 6, 2005 (the “2005 Limited Tax Resolution;” collectively with the 2004 Limited Tax Resolution, the “Limited Tax Resolutions;” and collectively with the 2004 Unlimited Tax Resolution and the 2004 Limited Tax Resolution, the “Resolutions,” copies of which are attached hereto as Exhibit E), Michigan law requires the City to:

- levy and collect the full amount of *ad valorem* taxes, without limitation as to rate or amount, necessary to pay debt service on the Unlimited Tax Bonds, which are separate from and in addition to other *ad valorem* taxes the City is authorized to levy and collect (the “Restricted Unlimited Bond Taxes”), and to levy and collect an amount of *ad valorem* taxes within the City’s constitutional, statutory, and charter limits sufficient to pay debt service on the Limited Tax Bonds as a first budget obligation (the “Restricted Limited Bond Taxes,” and collectively with the Restricted Unlimited Bond Taxes, the “Restricted Bond Taxes”);
- deposit the Restricted Bond Taxes in segregated debt retirement funds (the “Debt Retirement Funds”);² and
- use the Restricted Bond Taxes only to pay debt service on the Bonds.

By virtue of these statutory requirements, the Bondholders have an equitable and beneficial interest in the Restricted Bond Taxes.

7. Under Michigan law, the City has no equitable or beneficial property interest in the Restricted Bond Taxes, which are earmarked by law for the payment of debt service on the Bonds. These *ad valorem* tax revenues, designated by state statutes for payment of debt service on the Bonds, are restricted by law and cannot

² The individual Debt Retirement Funds consist of a group of financial accounts that the City has established with Paying Agents to pay debt service owed for individual series of Bonds.

be used by the City for any other purpose except to satisfy the City's payment obligations with respect to outstanding Bonds. Further, the Restricted Bond Taxes are impressed with a statutory lien as defined in 11 U.S.C. § 101(53) or alternatively, a lien within the meaning of 11 U.S.C. § 101(37). In addition, the Restricted Unlimited Bond Taxes constitute "special revenues" as defined in 11 U.S.C. § 902(2)(E).

8. On October 1, 2013, the City defaulted on its obligation to make interest payments on the Unlimited Tax Bonds in the amount of \$9,372,275, including \$1,994,281 insured by Ambac. The City also defaulted on its obligation to make interest payments on the Limited Tax Bonds in the amount of \$4,348,211, including \$2,266,586 insured by Ambac. Ambac duly paid the resulting claims under the respective financial guaranty insurance policies in such amounts. Upon payment, Ambac received an assignment from each registered holder of the Bonds of its right to the payments owed by the City and other related rights. Thus, Ambac is subrogated to, and is an assignee of the rights of, the holders of the Ambac-insured Unlimited Tax Bonds and Limited Tax Bonds (the "Bondholders") and holds direct claims against the City in the total amount of \$4,260,867. If the City continues to default on future payments, the amount of Ambac's claim will increase. In addition, under the bond documents, Ambac has the exclusive right to

control and direct enforcement of all of the Bondholders' rights and remedies upon the City's insolvency or an occurrence of an event of default.

9. The City has stated publicly that it intends to continue to levy and collect the Restricted Bond Taxes postpetition, but that it will not segregate the Restricted Bond Taxes. The City has also indicated that postpetition it will not use the Restricted Bond Taxes to pay debt service on the Bonds and has or may instead use them for other purposes. This conduct violates Michigan law (including the express terms of Act 34) and the Resolutions, as well as the Takings Clause of the Fifth Amendment to the United States Constitution, which is made applicable to the City through the Fourteenth Amendment to the United States Constitution.

10. Ambac commences this adversary proceeding pursuant to Federal Rule of Bankruptcy Procedure 7001(9) to determine that the Bondholders and Ambac, and not the City, have property rights and interests in the Restricted Bond Taxes. Accordingly, in Count One, Ambac seeks a declaratory judgment that, under Michigan law, (i) the Restricted Bond Taxes are restricted funds by law that cannot be used by the City for any purpose except to satisfy the City's payment obligations with respect to outstanding Bonds, (ii) as *ad valorem* taxes are collected, Defendants are required to segregate and deposit the Restricted Bond Taxes allocable to each series of Bonds into the related Debt Retirement Funds, and (iii) Defendants are prohibited from commingling the Restricted Bond Taxes

with funds of the City or using the Restricted Bond Taxes for any purpose other than paying the Bondholders. In Count Two, Ambac seeks a declaratory judgment that the City is a mere conduit for the Restricted Bond Taxes and lacks any equitable or beneficial property interest in the Restricted Bond Taxes. In Count Three, Ambac seeks a declaratory judgment that the Bondholders have equitable and beneficial property interests in the Restricted Bond Taxes.

11. Additionally, Ambac seeks to determine “the validity, priority, [and] extent of [its] lien or other interest” in the Restricted Bond Taxes pursuant to Federal Rule of Bankruptcy Procedure 7001(2) and (9). Accordingly, in Count Four, Ambac seeks a declaratory judgment that the Bonds are secured by, and the Bondholders have, a statutory lien on the Restricted Bond Taxes within the meaning of 11 U.S.C. § 101(53), or in the alternative, a lien within the meaning of § 101(37). In Count Five, Ambac seeks a declaratory judgment that the Bondholders’ lien on the Restricted Unlimited Bond Taxes is a lien on special revenues within the meaning of 11 U.S.C. § 902(2)(E) and that the Restricted Unlimited Bond Taxes must be applied in accordance with 11 U.S.C. §§ 922(d) and 928. In Count Six, Ambac seeks a declaratory judgment that the City’s diversion of the Restricted Bond Taxes or grant of any postpetition interest in the Restricted Bond Taxes to any other person, without just compensation, is an unlawful taking under the Takings Clause of the Fifth Amendment to the United

States Constitution, which is made applicable to the City through the Fourteenth Amendment to the United States Constitution.

12. Because Ambac is simply asking the Court to declare the parties' property interests in, and Defendants' legal obligations with respect to, the Restricted Bond Taxes as determined by state law and the United States Constitution, and because the City has no equitable or beneficial property interest in the Restricted Bond Taxes, 11 U.S.C. § 904 ("Section 904") is not implicated by this Complaint, and this Court has subject matter jurisdiction and the authority to enter the declaratory judgment Ambac is requesting. Moreover, Section 904 does not prohibit the Court from entering a declaratory judgment against any Individual Defendants (as defined below).

PARTIES

13. Plaintiff Ambac is a Wisconsin corporation with its principal place of business at One State Street Plaza, New York, NY 10004. Ambac is a monoline bond insurer that provides financial guarantees to, among others, the U.S. public finance market. Ambac insures approximately \$170 million of Bonds issued by the City.

14. Defendant City is a home rule city under Act 279 of 1909, as amended, the Home Rule City Act, Mich. Comp. Laws § 117.1 *et seq.* ("Act 279," a copy of which is attached hereto as Exhibit F). The City is a municipality that

commenced a chapter 9 proceeding in the United States Bankruptcy Court for the Eastern District of Michigan on July 18, 2013.

15. Defendant Kevyn D. Orr, named solely in his official capacity, is the Emergency Manager for the City (the “Emergency Manager”), as authorized by Act 436 of the 2012 Local Financial Stability and Choice Act, Mich. Comp. Laws §§ 141.1541 – 141.1575 (“Act 436,” a copy of which is attached hereto as Exhibit G), his appointment to the position having been made effective on March 28, 2013.

16. Defendant John Naglick, named solely in his official capacity, is the Finance Director of the City (the “Finance Director”), having served in that position since October 7, 2013.

17. Defendant Michael Jamison, named solely in his official capacity, is the Deputy Finance Director of the City (the “Deputy Finance Director”), having served in that position since August 2012.

18. Defendant Cheryl Johnson, named solely in her official capacity, is the former Finance Director and current Treasurer of the City (the “Treasurer,” and collectively with the Emergency Manager, Finance Director, and Deputy Finance Director, the “Individual Defendants”).

19. Joinder of all Defendants is proper under Rule 20 of the Federal Rules of Civil Procedure, made applicable to this action by Bankruptcy Rule 7020.

JURISDICTION AND VENUE

20. This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. § 1334(b) and the Standing Order of Reference to the Bankruptcy Court in the Eastern District of Michigan, E.D. Mich. L.R. 83.50(a), pursuant to 28 U.S.C. § 157(a). Subject matter jurisdiction exists pursuant to 28 U.S.C. § 157(b) as a case under Title 11 of the United States Code (the “Bankruptcy Code” or “Title 11”) and a core proceeding arising under Title 11, or arising in a case under Title 11 in accordance with 28 U.S.C. § 157(b)(2).

21. As described in greater detail herein, there exists an actual case and controversy under 28 U.S.C. § 2201(a).

22. Venue is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409.

23. For the reasons articulated in paragraph 12 above, nothing in Section 904 deprives this Court of the authority to award the relief Ambac is requesting.

GENERAL ALLEGATIONS

A. The Bonds Insured by Ambac.

24. According to the City’s Proposal to Creditors, dated June 14, 2013 (the “Prepetition Proposal,” a copy of which is attached hereto as Exhibit H), the City estimates that, as of the close of Fiscal Year 2013 (*i.e.*, June 30, 2013), it had \$369.1 million in outstanding principal amount of Unlimited Tax Bonds (excluding

\$100 million of bonds purported to be secured by a second lien on distributable state aid), and \$161 million in outstanding principal amount of Limited Tax Bonds (excluding \$249.8 million of bonds purported to be secured by a first lien on distributable state aid, and \$129.5 million of bonds purported to be secured by a third lien on distributable state aid). On a net basis, Ambac insures \$77,635,000 of the City's Unlimited Tax Bonds and \$92,705,000 of the City's Limited Tax Bonds.

25. As a monoline bond insurer, as required by its bond insurance policies, Ambac is obligated to pay to owners of Ambac-insured Bonds the full scheduled principal of and interest on the Ambac-insured Bonds when due to the extent the City does not make the payments under the insured Bonds. Under relevant provisions of the applicable bond documents, bond insurance policies, and law, to the extent Ambac makes payments under its policies, it receives an assignment of rights from each registered owner of the Bonds and is subrogated to the rights of the Bondholders, thus effectively stepping into the shoes of the Bondholders.

26. Pursuant to the 2004 Unlimited Tax Resolution and a Sale Order issued by the City's then finance director dated August 27, 2004 (the "2004 Unlimited Tax Sale Order"), the City issued General Obligation Bonds (Unlimited Tax) Series 2004-A(1) (the "2004-A(1) Bonds"), General Obligation Bonds (Unlimited Tax) Series 2004-A(2) (the "2004-A(2) Bonds"), General Obligation

Bonds (Unlimited Tax) Series 2004-B(1) (the “2004-B(1) Bonds”), and General Obligation Bonds (Unlimited Tax) Series 2004-B(2) (the “2004-B(2) Bonds” and, collectively with the 2004-A(1) Bonds, the 2004-A(2) Bonds, and the 2004-B(1) Bonds, the “2004 Unlimited Tax Bonds”).

27. Pursuant to the 2004 Limited Tax Resolution and a Sale Order issued by the City’s then Finance Director dated August 27, 2004 (the “2004 Limited Tax Sale Order”), the City issued General Obligation Bonds (Limited Tax) Series 2004 (the “2004 Limited Tax Bonds”).

28. Pursuant to the 2005 Limited Tax Resolution and a Sale Order issued by the City’s then finance director dated June 24, 2005 (the “2005 Limited Tax Sale Order”), the City issued General Obligation Bonds (Limited Tax) Series 2005-A(1) (the “2005-A(1) Bonds”), General Obligation Bonds (Limited Tax) Series 2005-A(2) (the “2005-A(2) Bonds”), and General Obligation Bonds (Limited Tax) Series 2005-B (the “2005-B Bonds” and, collectively with the 2005-A(1) Bonds and the 2005-A(2) Bonds, the “2005 Bonds”). Specimens of Unlimited Tax Bonds and Limited Tax Bonds insured by Ambac are attached hereto as Exhibit I. Copies of the 2004 Unlimited Tax Sale Order, the 2004 Limited Tax Sale Order, and the 2005 Limited Tax Sale Order are attached hereto as Exhibit J.

29. Ambac issued Financial Guaranty Insurance Policies numbers 22980BE and 22981BE, each effective September 9, 2004, insuring the City's payment obligations under the 2004 Unlimited Tax Bonds and the 2004 Limited Tax Bonds, respectively. Ambac issued Financial Guaranty Insurance Policy number 24218BE, effective June 29, 2005, insuring the City's payment obligations under the 2005 Bonds (collectively with Policy numbers 22980BE and 22981BE, the "Ambac Policies," copies of which are attached hereto as Exhibit K).

30. On October 1, 2013, the City defaulted on its obligation to make interest payments on its Unlimited Tax Bonds in the amount of \$9,372,275, including \$1,994,281.25 insured by Ambac. The City also defaulted on its obligation to make interest payments on its Limited Tax Bonds in the amount of \$4,348,211, including \$2,266,586 insured by Ambac. The failures to make these payments are events of default under the respective Bonds.

31. As a result of the City's failures to make the interest payments due on the Bonds on October 1, 2013, Ambac was required to – and did – make the interest payments on the Ambac-insured Bonds pursuant to the terms of the Ambac Policies, totaling \$4,260,867.

B. The City is Statutorily Required to Levy and Collect the Restricted Bond Taxes and Deposit Them in Segregated Debt Retirement Funds for the Sole Benefit of the Bondholders, Who Also Have a Lien on the Restricted Bond Taxes.

32. The City’s issuance of the Bonds is authorized and governed by Act 34, Act 189, Act 279, and the Michigan Constitution. Under Act 34, municipal securities such as the Unlimited Tax Bonds and Limited Tax Bonds may be “payable from or secured by” any of the following: (i) *ad valorem* real and personal property taxes, (ii) special assessments, (iii) the limited or unlimited full faith and credit pledge of the municipality, or (iv) other sources of revenue described in Act 34 for debt or securities authorized by Act 34. Mich. Comp. Laws § 141.2103(l); *see also* Mich. Comp. Laws § 141.2315(1)(c)(i), (2) (authorizing the City to issue municipal securities “payable from . . . [t]axes and other revenues of the municipality,” and referring to these municipal securities as “additionally secured.”).

33. The proceeds of the Bonds financed certain City projects and systems, including, but not limited to, projects relating to Detroit Institute of Arts Facilities improvements; the acquisition, construction, and equipping of several 800 MHz radio frequency towers and related communication facilities within the City; neighborhood and economic development; public safety facilities improvements; municipal facilities improvements; public lighting system improvements and

extensions; recreation, zoo, and cultural facility improvements; improvements to the Detroit Historical Museum, the Charles H. Wright Museum of African-American History; and to refund previously-issued General Obligation Bonds.³

The specific projects are described in the official statements of the City prepared in connection with the sale and issuance of the Unlimited Tax Bonds and Limited Tax Bonds and, with respect to the Unlimited Tax Bonds, are separately described and voted upon in the related bond referenda.

34. At the time the Unlimited Tax Bonds were issued, the City had already reached the applicable constitutional, statutory, and charter tax rate limitations for *ad valorem* taxes. Because of voter approval for the Unlimited Tax Bonds, however, the otherwise applicable limitations on millage do not apply to the Restricted Unlimited Bond Taxes. Accordingly, the City has relied on this special millage rate exemption to levy a separate stream of *ad valorem* taxes in excess of the applicable constitutional, statutory, and charter tax rate limitations for the sole purpose of paying debt service on the Unlimited Tax Bonds.

35. Similarly, when the City issued the Limited Tax Bonds, it became required to levy *ad valorem* taxes (within the applicable constitutional, statutory,

³ The proceeds of refunding Bonds were specifically designated to be, and were, used by the City to refinance (*i.e.*, refund or defease) other Bonds that financed capital projects. Under Act 34, the Restricted Bond Taxes originally pledged as security for payment of the refunded or defeased Unlimited Tax Bonds are pledged as security for payment of the refunding Unlimited Tax Bonds.

and charter tax rate limitations) in an amount sufficient to pay debt service on the Limited Tax Bonds, and to use those taxes to pay debt service on the Limited Tax Bonds as a “first budget obligation.”

36. Michigan law and the Resolutions provide strict controls over and limitations upon the use of the *ad valorem* taxes levied to secure payment of debt service on both the Unlimited Tax Bonds and the Limited Tax Bonds. *See, e.g.*, Act 34 §§ 701(1)-(3), 705; Resolutions § 301(a). These Restricted Bond Taxes are earmarked by law and pledged to pay the debt service on the Bonds that financed specific projects and systems.

37. Section 701(1)(a) of Act 34 provides that the City is required to include in the amount of *ad valorem* taxes levied each year “[a]n amount such that the estimated collections will be sufficient to promptly pay, when due, the interest on [the Bonds] and the portion of the principal falling due whether by maturity or by mandatory redemption before the time of the following year’s tax collection.” Act 34 § 701(1)(a). In addition, Section 701(3) of Act 34 requires that the City “levy the full amount of taxes required . . . for the payment of the [Unlimited Tax Bonds] without limitation as to rate or amount and in addition to other taxes that the municipality may be authorized to levy.” Act 34 § 701(3). This section further requires the City to “set aside each year from the levy and collection of *ad valorem* taxes as required by this section as *a first budget obligation* for the payment of the

[Limited Tax Bonds].” *Id.* (emphasis added). Thus, state law requires that the portion of *ad valorem* taxes earmarked by law to pay debt service on the Bonds must continue to be levied and collected while the Bonds are outstanding.

38. Act 34 then requires that the *ad valorem* taxes necessary to pay debt service on both the Unlimited Tax Bonds and the Limited Tax Bonds be deposited in segregated Debt Retirement Funds as they are collected: “As taxes are collected, there shall be set aside that portion of the collections that is allocable to the payment of the principal and interest on [the Bonds]. The portion [of the taxes] set aside shall be divided pro rata among the various sinking funds and debt retirement funds in accordance with the amount levied for that purpose.” Act 34 § 701(6).

39. Section 701(1)(d)(i) of Act 34 further provides that the taxes specifically collected and pledged for the payment of debt service on the Bonds must be deposited in the applicable Debt Retirement Funds and used for no purpose other than to pay the debt service on the Bonds. As applicable here, Section 701(1)(d)(i) requires that the proceeds of the tax levy be “[d]eposit[ed] in the debt retirement fund[s] established for the [Bonds] and used to pay debt service charges or obligations on [the Bonds].” Mich. Comp. Laws § 141.2701(1)(d)(i).

40. Section 705 of Act 34 states, in relevant part, that each Debt Retirement Fund “shall be accounted for separately.” Section 705 further provides

that the “debt retirement funds . . . shall be used only to retire the municipal securities of the municipality for which the debt retirement fund was created,” and that they cannot be used for other purposes until after those municipal securities have been retired. Mich. Comp. Laws § 141.2705.

41. In addition, the proceeds of all taxes levied to pay debt service on the Bonds shall be “placed in the Debt Retirement Fund[s].” Resolutions § 502. Further, so long as principal and interest on the Bonds remain unpaid, the amounts in the Debt Retirement Funds are to be used only to pay principal and interest on the Bonds, and “no moneys shall be withdrawn from the Debt Retirement Fund[s] *except* to pay such principal and interest.” *Id.* (emphasis added).

42. The limitations set forth under Michigan law and the Resolutions were recognized in a State of Michigan Attorney General Opinion, dated February 19, 1982 (attached hereto as Exhibit L), which states that the taxes levied for the payment of principal and interest on bonds must “be placed in a segregated account,” “may only be used to pay principal and interest on the bonds for which the millage was levied while the bonds are outstanding,” and may not be transferred out of the segregated fund while the bonds are outstanding. 1981-1982 Mich. Op. Att’y Gen. 575 (1982).

43. In summary, because the City is prohibited by law (i) from levying, collecting, and using the Restricted Unlimited Bond Taxes except to pay debt

service on the Unlimited Tax Bonds; and (ii) from using the Restricted Limited Bond Taxes except to pay debt service on the Limited Tax Bonds, the Bondholders have, and the City lacks, equitable and beneficial property interests in the Restricted Bond Taxes. Nothing in chapter 9 or elsewhere in bankruptcy law allows the City to disregard the state law restrictions imposed on the Restricted Bond Taxes and use the funds for unauthorized purposes.

44. In addition, the Resolutions provide that all taxes levied to pay debt service on the Bonds are pledged as security for the timely payment of principal and interest on the Bonds when due. Section 301(a) of the Unlimited Tax Resolution states that the Unlimited Tax Bonds are

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 [Unlimited Tax Bonds]. The City pledges to pay the principal of and interest on the [Unlimited Tax Bonds] from the proceeds of an annual levy of ad valorem taxes on all taxable property in the City without limitation as to rate or amount for the payment thereof.

Section 301(a) of the Limited Tax Resolutions states that the Limited Tax Bonds are

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 [Limited Tax Bonds]. The City pledges to pay the principal of and interest on the [Limited Tax Bonds] as a first budget obligation from its general fund 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.

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.

45. A Michigan statute independently reinforces the Bondholders’ lien on the Restricted Unlimited Bond Taxes. The Unlimited Tax Election Act was specifically enacted to regulate the imposition of *ad valorem* tax levies and the use of taxes for the payment of Unlimited Tax Bonds. Mich. Comp. Laws § 141.161 *et seq.* The Unlimited Tax Election Act provides that the voters of the City “may make 1 or more binding unlimited tax pledges for the payment of 1 or more tax obligations referred to in the ballot . . . [h]owever, the tax which may be levied shall not be excess of a rate or amount sufficient for payment of the obligations.” Mich. Comp. Laws § 141.164(3). These “binding unlimited tax pledges,” *id.*, “secure” the payment of the debt service on the Unlimited Tax Bonds. Mich. Comp. Laws §§ 141.162(d) (defining “Unlimited Tax Pledge” as an undertaking “to secure” a tax obligation from *ad valorem* taxes).

C. The City Historically Has Administered the Unlimited Tax Bonds and Limited Tax Bonds Consistent with Michigan Law.

46. In a series of bond referenda held between 1978 and 2004, voters provided the City with the authority required by Michigan law to issue the Unlimited Tax Bonds by giving their consent to unlimited *ad valorem* taxation solely for the purpose of paying debt service on the Unlimited Tax Bonds, in exchange for the financing of capital improvement projects to benefit voters. Voter ballots for proposed Unlimited Tax Bond referenda include the estimated first-year millage, the estimated millage over the Unlimited Tax Bonds' life, and the specific capital improvement projects to be financed by the Unlimited Tax Bonds. *See* App. A; Mich. Comp. Laws § 211.24f (establishing ballot requirements for proposed bond referenda). The Limited Tax Bonds, also used to fund capital improvement projects, were issued after the City Council enacted the Limited Tax Resolutions and pledged the Restricted Limited Bond Taxes as security for payment of debt service on the Limited Tax Bonds.

47. For each fiscal year since the issuance of the outstanding Unlimited Tax Bonds, the City, through its annual budget approval process, has set the annual millage rate for the Restricted Unlimited Bond Taxes such that available money in the City's Debt Retirement Funds is sufficient to fund the debt service on the Unlimited Tax Bonds for the year. The annual budget also shows the amount of

Restricted Unlimited Bond Taxes expected to be collected under the levy. The City annually adjusts the millage rate for the Restricted Unlimited Bond Taxes because of, among other reasons, changes in the City's assessment of real property values, changes in debt service amounts, and changes in prior years' collection rates.

48. The City annually sends taxpayers a summer *ad valorem* tax bill, which reflects the millage for the Restricted Unlimited Bond Taxes as a separate line item described as "Debt Service." There is also a separate line reflecting millage for "General City Operating." The City also uses the summer bill to levy *ad valorem* tax millage on behalf of other taxing authorities, such as the State of Michigan, Detroit Public School System, and County of Wayne.

49. The property taxes from the summer billing are due and payable on July 1 of each year and payable in full without penalty by August 31. Taxpayers may also pay in installments without penalty if they pay one-half of their taxes by August 15 and the balance by January 15. Most taxpayers choose to pay their *ad valorem* taxes in semi-annual installments. Consequently, the City collects the majority of *ad valorem* taxes in the months of August and January.

50. The City is obligated to deposit the Restricted Unlimited Bond Taxes and the Restricted Limited Bond Taxes into the Debt Retirement Funds. The Restricted Bond Taxes in the Debt Retirement Funds are the source of payment of

debt service on the Bonds. *See, e.g.*, City of Detroit, Audited Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2012 (“FY2012 CAFR,” a copy of which is attached hereto as Exhibit M), at 150. “Debt Service Fund” is the term used by the City to refer to the Debt Retirement Funds required and governed by Act 34. The City describes the Debt Service Fund as a “separate fund for debt retirement moneys” required “by State law.” 2005 Limited Tax Bonds Official Statement (a copy of which is attached hereto as Exhibit N), at A-32; 2004 Unlimited Tax Bonds and Limited Tax Bonds Official Statement (a copy of which is attached hereto as Exhibit O, referenced collectively with the 2005 Limited Tax Bonds Official Statement as the “Official Statements”), at A-30.

51. In its Official Statements for the Bonds, the City has represented to investors that the City Treasurer deposits the Restricted Bond Taxes into the applicable Debt Service Fund: “All general City property taxes are collected by the Treasurer and deposited in the general and debt service accounts according to the proper distribution percentage.” 2005 Limited Tax Bonds Official Statement at A-32; 2004 Unlimited Tax Bonds and Limited Tax Bonds Official Statement at A-30.

52. The City’s CAFRs confirm that the City’s accounting similarly reflects the segregation of Restricted Bond Taxes. The CAFRs report that the millage for the City’s general operations, the millage for the Restricted Limited

Bond Taxes as the City's first budget obligation, and the millage for the Restricted Unlimited Bond Taxes "are recognized in the respective General Fund and Debt Service Fund financial statements as tax revenue." *See, e.g.*, FY2012 CAFR at 75.

53. In the FY 2012 CAFR, the City reported that the Debt Service Fund for the Unlimited Tax Bonds had a balance of \$4,561,750 at the beginning of the fiscal year and, following debt service payments on the Unlimited Tax Bonds, an ending balance of \$6,314,687. FY2012 CAFR at 174.

54. Disbursements from the applicable Debt Service Fund are used to pay debt service owed on Bonds as it becomes due. The City has stated that Unlimited Tax Bonds "are repaid from a specific source[,] the Debt Service property tax levy." City of Detroit, Proposed Capital Agenda for Fiscal Years 2013-14 to 2017-18, a copy of which is attached hereto as Exhibit P, at 6. And under state law and the Limited Tax Resolutions, the Limited Tax Bonds are payable as a "first budget obligation" of the City. Act 34 §§ 701(1), (3); Limited Tax Resolutions § 301.

55. The Restricted Bond Taxes are to be held in individual Debt Retirement Funds for each series of Unlimited Tax Bonds and Limited Tax Bonds and are to be disbursed from those accounts only to pay the debt service on the Bonds. The City's Resolutions require that the funds be held by the Paying Agent, and "so long as the principal of or interest on the Bonds shall remain unpaid, no

moneys shall be withdrawn from the Debt Retirement Fund[s] except to pay such principal and interest.” Resolutions § 502.

D. The Individual Defendants Have Failed to Comply with Their Nondiscretionary Duties Under Act 34.

56. Based on the City’s representations, and the duties and responsibilities of the Emergency Manager, the Finance Director, the Deputy Finance Director, and the Treasurer, the Individual Defendants have failed to perform their duties under Act 34. Even though Act 34 imposes personal liability on the Individual Defendants based on their failure to carry out the duties required by Act 34, Ambac does not seek such personal liability at this time. The sought relief directed to the Individual Defendants is limited to a request for declaratory judgment to confirm their duties under state law.

57. Act 436 establishes the Emergency Manager as an officer whose duties include ensuring the City’s compliance with Act 34’s procedures for payment of debt service on the Bonds, including the segregation of Restricted Bond Taxes. Act 436 requires Mr. Orr, as the Emergency Manager, to develop a written financial and operating plan for the City that provides for “[t]he payment in full of the scheduled debt service requirements on all bonds, notes, and municipal securities of the local government, contract obligations in anticipation of which bonds, notes, and municipal securities are issued, and all other uncontested legal obligations.” Mich. Comp. Laws § 141.1551(1)(b). To effectuate this mandate, it

is within the Emergency Manager's powers to "[r]eceive and disburse on behalf of the local government all . . . local funds earmarked for the local government.

These funds may include, but are not limited to, funds for . . . retirement of debt."

Mich. Comp. Laws § 141.1552(1)(c).

58. On July 10, 2013, eight days before the City filed its chapter 9 petition, Mr. Orr issued Emergency Manager Order No. 12, ("Order No. 12," a copy of which is attached hereto as Exhibit Q), which established the City's legal operating budget for Fiscal Year 2013-14. Order No. 12 required that the City's Fiscal Year 2014 budget conform to the City's Prepetition Proposal, which provided for the collection of millage for the Restricted Unlimited Bond Taxes, but failed to allocate the Restricted Unlimited Bond Taxes to fund debt service on the Unlimited Tax Bonds due in Fiscal Year 2013-14. The City's Prepetition Proposal similarly did not allocate the Restricted Limited Bond Taxes to pay the debt service on the Limited Tax Bonds, and thus contemplated that the City would not pay the principal and interest on Limited Tax Bonds as a first budget obligation. Thus, contrary to Acts 34 and 436, Mr. Orr's financial and operating plan, as adopted in the City's operating budget, provides for the continued collection and diversion of the Restricted Bond Taxes for purposes other than retirement of the Bonds and fails to provide for the payment of the annual debt service due on the Bonds.

59. Mr. Orr has also authorized the City to divert more than \$95 million in Restricted Limited Bond Taxes to pay more than a dozen law firms and consultants retained to assist the City with its restructuring.

60. Mr. Orr's conduct exceeded the scope of his executive authority under Act 436. He has violated and is violating Act 34 by authorizing and implementing a prepetition financial and operating plan that unlawfully diverted, and continues to divert, funds in violation of Michigan law, and has failed to provide for the full payment of debt service on the Bonds.

61. The City's Charter establishes the Finance Director as an officer who must perform the duties required by Act 34 with respect to the Restricted Bond Taxes. The nondiscretionary duties of the Finance Director under the City's Charter and City Code require Mr. Naglick as the Finance Director, and required Ms. Johnson as former Finance Director, to:

- a. "secure and maintain compliance *with all laws* pertaining to financial controls for the protection of public funds";
- b. "direct and coordinate the financial activities of the accounts division, the assessments division, the treasury, and the purchasing division";
- c. oversee and manage the Treasurer, who "serves at the pleasure of the Finance Director"; and
- d. issue "a document *authorizing or requiring . . . payments*" to be disbursed by the Treasurer that "*specif[ies] the particular fund or agency out of which it is payable* and [is]

accompanied by a check register indicating the names of the payees.”

City Charter §§ 6-302, 6-305; City of Detroit Municipal Code (“City Code,” a copy of excerpts of which is attached hereto as Exhibit S) § 18-1-3 (emphasis added).

62. The City’s Charter establishes the Deputy Finance Director as an officer who must perform the duties required by Act 34 with respect to the Restricted Bond Taxes. Mr. Jamison as Deputy Finance Director has the same nondiscretionary duties as the Finance Director under the City Charter. The City Charter requires that the “Deputy in each department of the executive branch shall, under the Director’s supervision, during the director’s absence or disability, or while the director’s position is vacant, exercise all the powers and perform all the duties of the director to the full extent permitted by law.” City Charter § 5-107.

63. The City Charter and City Code establish the Treasurer as an officer who must perform the duties required by Act 34 with respect to the Restricted Bond Taxes. The nondiscretionary duties of the Treasurer under the City’s Charter and City Code require Ms. Johnson as Treasurer to:

- a. “Collect all moneys of the city and receive from other officers and employees all moneys of the city collected by them”;
- b. “Have custody of all moneys, funds and securities of the city, keep accounts of them and deposit them *as directed by law or ordinance*”;

- c. “Disburse all city funds *in accordance with law*, this Charter or ordinance”;
- d. “Except as otherwise provided by this Charter or ordinance, have such powers and immunities for the collection of taxes *as provided by law*”;
- e. “[D]eposit, daily, his entire receipts from all sources and all money and checks on hand to the credit of the city in such banks as may be designated by the city council as the depository of the funds of the city”;
- f. Designate an account in which certain banks shall deposit all such tax money that the banks have accepted as deposits from taxpayers to the credit of the City for payment of “real and personal property taxes that are levied by the City each fiscal year”;
- g. Receive from banks collecting real and personal property tax payments “all duplicate paid tax bills for which the[] [banks] have received payment, together with a duplicate deposit slip for the full amount of taxes paid on the preceding banking business day” and “a list showing the tax bill item number appearing on each paid tax bill and the amount paid for which such tax receipt was issued”;
- h. “[P]ay out no money except by his check on the banks specified by the city council. Such check shall be issued only upon the issuance by the finance director of a document authorizing or requiring the payment of the sum specified therein. Such document shall specify the particular fund or agency out of which it is payable and be accompanied by a check register indicating the names of the payees”; and
- i. “[T]ransmit by mail, unless otherwise directed by the owner, to each owner of registered bonds of the city, at his last known post office address, a draft or check payable in New York at par for the amount of interest due thereon, which draft

or check shall be mailed at least twenty-four (24) hours prior to the maturity of the interest.”

City Charter § 6-305; City Code §§ 18-1-2 to -1-3, 18-7-8, 18-9-71, 18-9-74 to -9-75 (emphasis added).

64. Notwithstanding their respective non-discretionary legal duties, Messrs. Orr, Naglick, and Jamison and Ms. Johnson, acting in their official capacities, each failed (i) to collect and use the Restricted Unlimited Bond Taxes solely for the purpose allowed by law and communicated to taxpayers, which is to pay debt service on the Unlimited Tax Bonds, (ii) to set aside and pay the Restricted Bond Taxes into the appropriate Debt Retirement Funds in accordance with the amounts levied and/or earmarked for the payment of debt service on the Unlimited Tax Bonds and the Limited Tax Bonds; and (iii) to use the Restricted Bond Taxes only for the purpose of paying debt service on the Bonds.

65. In addition, Messrs. Orr, Naglick, and Jamison and Ms. Johnson, acting in their official capacities, each intended to divert the Restricted Bond Taxes in violation of Act 34’s order of priority for the restricted use of the Restricted Bond Taxes, beginning with “the retirement of all municipal securities payable from [a debt retirement] fund.” Mich. Comp. Laws § 141.2704(5).

E. The Bondholders Have Property Interests in the Restricted Bond Taxes.

66. Under Michigan law, the Bondholders and Ambac have, and the City lacks, equitable and beneficial property interests in the Restricted Bond Taxes. Further, the Restricted Bond Taxes are impressed with a statutory lien as defined in 11 U.S.C. § 101(53), or alternatively, a lien within the meaning of 11 U.S.C. § 101(37). In addition, the Restricted Unlimited Bond Taxes constitute “special revenues” as defined in 11 U.S.C. § 902(2)(E).

1. The Bondholders Have Equitable and Beneficial Property Interests in the Restricted Bond Taxes.

67. The Bondholders have property interests in the Restricted Bond Taxes. By law, the Restricted Bond Taxes collected by the City must be segregated and can be used only to pay debt service on the Bonds that fund specific capital projects and systems. These controls imposed by Act 34 and the Resolutions make clear that the City lacks any equitable or beneficial property interest in the Restricted Bond Taxes.

68. The City is a mere conduit for transferring the Restricted Unlimited Bond Taxes – earmarked by law to pay debt service on the Unlimited Tax Bonds – and the Restricted Limited Bond Taxes – earmarked by law to pay debt service on the Limited Tax Bonds as a “first budget obligation” – from taxpayers to the Bondholders.

69. Although Michigan law requires the City to collect and segregate the Restricted Bond Taxes, no provision of Michigan law vests the City with any equitable or beneficial property interest in the Restricted Bond Taxes.

70. Any control the City exercises by collecting the Restricted Bond Taxes, segregating them in Debt Retirement Funds, and transferring them to the Paying Agent is for the exclusive purpose of paying debt service on the Bonds. This control is merely incidental to the protections imposed by state law for the benefit of the Bondholders. Accordingly, the Bondholders, and not the City, hold equitable and beneficial property interests in the Restricted Bond Taxes.

71. State law requires that these specific *ad valorem* tax revenues not be used for any purpose other than paying the Bondholders. Accordingly, the earmarked streams of *ad valorem* taxes are wholly dedicated to payment of debt service on outstanding Unlimited Tax Bonds and Limited Tax Bonds and are not otherwise available to fund operating expenses of the City or distributions to creditors under a plan of adjustment.

2. The Bonds Are Secured by a Statutory Lien on the Restricted Bond Taxes.

72. By operation of state law and by virtue of the authorizing Resolutions for each issuance of Unlimited Tax Bonds and Limited Tax Bonds, a statutory lien was created in the Restricted Bond Taxes for payment of debt service on the Bonds within the meaning of 11 U.S.C. § 101(53).

73. First, as to the Unlimited Tax Bonds, contingent on voter approval, Michigan law authorizes the City to make a binding unlimited tax pledge, which is an “undertaking by a public corporation *to secure* and pay a tax obligation from ad valorem taxes to be levied on all taxable property within the boundaries of the public corporation without limitation as to rate or amount and in addition to other taxes which the public corporation may be authorized to levy.” Mich. Comp. Laws § 141.162(d) (emphasis added).

74. Second, Act 34 requires that the outstanding series of Limited Tax Bonds be paid as first budget obligations of the City, and the Limited Tax Resolutions *pledge* the stream of first *ad valorem* tax dollars sufficient to pay the principal and interest due to the Bondholders of the Limited Tax Bonds. Act 34 §§ 701(1), (3); Limited Tax Resolutions § 301.

75. Accordingly, the Resolutions related to both the Unlimited Tax Bonds and the Limited Tax Bonds state that “the [limited / unlimited] tax, full faith, credit, and resources of the City are hereby irrevocably pledged for the prompt payment of” principal and interest on the Bonds. The City pledged the Restricted Unlimited Bond Taxes, as approved by voters, to pay debt service on the Unlimited Tax Bonds, and pledged the Restricted Limited Bond Taxes to pay debt service on the Limited Tax Bonds as a “first budget obligation.” Resolutions § 301. The City Council explicitly recognized the creation of a statutory lien by using the phrase,

the “lien of this Resolution for the benefit of such Bonds,” in each Resolution for both the Unlimited Tax Bonds and the Limited Tax Bonds. Resolutions § 801. Moreover, Section 202 of the Resolutions characterizes the Bonds as “secured,” and Section 701 of the Resolutions makes clear that the City may not unilaterally diminish or adversely affect the security of the Bonds. Resolutions §§ 202, 701.

76. Therefore, the Bondholders have a lien on the Restricted Bond Taxes. Based on the foregoing, this is a statutory lien arising under Michigan law and the Resolutions, within the meaning of 11 U.S.C. § 101(53). In the alternative, the Bondholders have a lien on the Restricted Bond Taxes pursuant to the Resolutions, within the meaning of 11 U.S.C. § 101(37).

3. The Unlimited Tax Bonds Are Secured by a Lien on Special Revenues.

77. The special stream of *ad valorem* taxes levied and pledged to pay for the Unlimited Tax Bonds – the Restricted Unlimited Bond Taxes – are also special revenues within the meaning of 11 U.S.C. § 902(2)(E) (defining special revenues as “taxes specifically levied to finance one or more projects or systems”). These *ad valorem* taxes were exclusively levied to pay debt service on Unlimited Tax Bonds issued to finance capital improvements and are distinguishable and separate from *ad valorem* taxes that the City levies for its general or operating purposes. *See, e.g.*, Mich. Comp. Laws § 211.24e (defining “operating purposes” as “all purposes for which *ad valorem* property taxes are levied by the taxing unit other

than the levy of *ad valorem* property taxes . . . to pay principal and interest due on a bond or note if and to the extent the *ad valorem* taxes levied for this purpose are in addition to charter or statutory limitations, as authorized by [Act 34]”). Upon information and belief, no proceeds of Unlimited Tax Bonds were used for the purpose of paying the City’s operating expenses or for general purposes. Because the Restricted Unlimited Bond Taxes are special revenues, they are excepted from the automatic stay by 11 U.S.C. §§ 362(b)(18) and 922(d), and must be applied by the City in a manner consistent with 11 U.S.C. § 928.

F. The Prepetition Proposal Makes Clear the Defendants’ Intent to Disregard the Bondholders’ Property Interests.

78. In both the City’s FY2012 CAFR, which is independently audited by KPMG LLP pursuant to Michigan law, and the City’s Ten-Year Plan, dated June 26, 2013 (the “Ten-Year Plan,” a copy of which is attached hereto as Exhibit T), the City reports that it levied and collected *ad valorem* taxes in an amount sufficient to pay the debt service owed on the Limited Tax Bonds and the Unlimited Tax Bonds, excluding the Series 2010E Bonds which are payable from distributable state aid.

79. For Fiscal Year 2013-14, the City’s Ten-Year Plan forecasts that the City will levy and collect *ad valorem* taxes in an amount sufficient to pay the debt service owed on the Limited Tax Bonds and the Unlimited Tax Bonds, excluding the Series 2010E Bonds which are payable from distributable state aid. On

information and belief, in the current fiscal year, the City budgeted, levied, and has been collecting Restricted Bond Taxes sufficient to pay debt service on the Bonds.

80. As evidenced in its Prepetition Proposal, prior to its chapter 9 filing, the City collected and set aside the portion of the *ad valorem* taxes specified for payment of debt service on the Unlimited Tax Bonds, as required by Michigan law. On information and belief, prior to its chapter 9 filing, the City also set aside the first *ad valorem* property taxes collected, within the constitutional, statutory, and charter limits, in the amount necessary to pay debt service on the Limited Tax Bonds as the City's "first budget obligation," also as required by Michigan law.

81. In its Prepetition Proposal, while the City indicated that it would continue to collect the Restricted Bond Taxes under its restructuring scenario, there were no line items for payments of debt service on the Unlimited Tax Bonds and the Limited Tax Bonds. Thus, the City indicated that it would use the Restricted Bond Taxes for purposes other than to pay principal and interest on the Bonds, in direct violation of Michigan law and the Takings Clause of the Fifth Amendment to the United States Constitution, which is made applicable to the City through the Fourteenth Amendment to the United States Constitution.

82. In fact, as alleged above, on October 1, 2013, the City failed to make debt service payments due on the Bonds.

83. Also, as described above, Mr. Orr has directed the City to divert more than \$95 million in Restricted Limited Bond Taxes to pay lawyers and consultants retained to assist the City with restructuring. Principal and interest on the Limited Tax Bonds accordingly will not be paid as a “first budget obligation” of the City.

84. The City’s use of the Restricted Bond Taxes for purposes other than payment of debt service on the Bonds, or grant of any postpetition interest in the Restricted Bond Taxes to any other person, constitutes a taking of the Bondholders’ equitable and beneficial property interests. The City has not provided any compensation for this taking.

85. If the City, pursuant to its stated intention, continues to use the Restricted Bond Taxes for purposes other than payment of debt service on the Bonds, the Bondholders’ and Ambac’s property interests will continue to be taken without just compensation.

86. The relief sought in this Complaint is ripe for adjudication by this Court because, among other reasons, (1) the City is not segregating the Restricted Bond Taxes as required by Michigan law and is operating under a budget that provides the same, (2) on October 1, 2013, the City defaulted on its obligation to make debt service payments due on the Bonds, notwithstanding that it had collected sufficient *ad valorem* tax proceeds to pay the Bondholders, and it apparently intends to default on principal and interest payments due on the Bonds

on April 1, 2014, and (3) the City has diverted, and apparently intends to continue to divert, the Restricted Bond Taxes to unauthorized uses.

COUNT ONE

Declaratory Judgment that Under Michigan Law the Restricted Bond Taxes Are Restricted Funds, that Defendants Are Required to Segregate and Deposit the Restricted Bond Taxes into the Debt Retirement Funds, and that Defendants Are Prohibited From Commingling or Using the Restricted Bond Taxes for Any Purpose Other Than Paying the Bondholders

87. Ambac repeats and realleges each of the allegations contained in paragraphs 1-86 above, as if fully set forth herein.

88. An actual, ripe, and justiciable controversy has arisen between the parties regarding whether Michigan law requires Defendants to segregate the Restricted Bond Taxes and not divert them for purposes other than payment of debt service on the Unlimited Tax Bonds and the Limited Tax Bonds. Defendants have made clear to Ambac that they will not segregate the Restricted Bond Taxes and have already used, and intend to continue to use, the Restricted Bond Taxes for purposes other than payment of debt service on the Bonds, in contravention of Michigan law and in derogation of Ambac's rights.

89. For the reasons stated above, Ambac is entitled to a declaratory judgment that, under Michigan law (i) the Restricted Bond Taxes are restricted funds by law that cannot be used by the City for any purpose except to satisfy the City's payment obligations with respect to outstanding Bonds, (ii) as *ad valorem*

taxes are collected, Defendants are required to segregate and deposit the Restricted Bond Taxes allocable to each series of Bonds into the related Debt Retirement Funds, and (iii) Defendants are prohibited from commingling the Restricted Bond Taxes with funds of the City or using the Restricted Bond Taxes for any purpose other than paying the Bondholders.

COUNT TWO

Declaratory Judgment that the City Lacks Any Equitable or Beneficial Property Interest in the Restricted Bond Taxes

90. Ambac repeats and realleges each of the averments contained in paragraphs 1-89 above, as if fully set forth herein.

91. An actual, ripe, and justiciable controversy has arisen between the parties regarding whether Michigan law requires Defendants to segregate the Restricted Bond Taxes and not divert them for purposes other than payment of debt service on the Unlimited Tax Bonds and the Limited Tax Bonds. Defendants have made clear to Ambac that they will not segregate the Restricted Bond Taxes and have already used, and intend to continue to use, the Restricted Bond Taxes for purposes other than payment of debt service on the Bonds, in contravention of Michigan law and in derogation of Ambac's rights.

92. For the reasons stated above, Ambac is entitled to a declaratory judgment that the City is a mere conduit for the Restricted Bond Taxes and lacks any equitable or beneficial property interest in the Restricted Bond Taxes.

COUNT THREE

Declaratory Judgment that the Bondholders Have Equitable and Beneficial Property Interests in the Restricted Bond Taxes

93. Ambac repeats and realleges each of the averments contained in paragraphs 1-92 above, as if fully set forth herein.

94. An actual, ripe, and justiciable controversy has arisen between the parties regarding whether Michigan law requires Defendants to segregate the Restricted Bond Taxes and not divert them for purposes other than payment of debt service on the Unlimited Tax Bonds and the Limited Tax Bonds. Defendants have made clear to Ambac that they will not segregate the Restricted Bond Taxes and have already used, and intend to continue to use, the Restricted Bond Taxes for purposes other than payment of debt service on the Bonds, in contravention of Michigan law and in derogation of Ambac's rights.

95. For the reasons stated above, Ambac is entitled to a declaratory judgment that the Bondholders have equitable and beneficial property interests in the Restricted Bond Taxes.

COUNT FOUR

Declaratory Judgment that the Bonds Are Secured by a Statutory Lien, or in the Alternative, a Lien, on the Restricted Bond Taxes

96. Ambac repeats and realleges each of the averments contained in paragraphs 1-95 above, as if fully set forth herein.

97. An actual, ripe, and justiciable controversy has arisen between the parties regarding the validity, priority, and extent of the Bondholders' lien or other interest in the Restricted Bond Taxes.

98. The Bondholders have a statutory lien on the Restricted Bond Taxes within the meaning of 11 U.S.C. § 101(53) because, by force of Michigan law and the City's Resolutions, the City's pledge of the Restricted Bond Taxes constitutes a charge against or interest in the Restricted Bond Taxes to secure payment of the debt service on the Bonds. 11 U.S.C. § 101(53).

99. In the alternative, the Bondholders have a lien on the Restricted Bond Taxes created by virtue of the Resolutions, within the meaning of § 101(37).

100. For the reasons stated above, Ambac is entitled to a declaratory judgment that the Unlimited Tax Bonds and the Limited Tax Bonds are secured by a statutory lien, or in the alternative, a lien, on the Restricted Bond Taxes.

COUNT FIVE

Declaratory Judgment that the Bondholders' Lien on the Restricted Unlimited Bond Taxes Is a Lien on Special Revenues

101. Ambac repeats and realleges each of the averments contained in paragraphs 1-100 above, as if fully set forth herein.

102. An actual, ripe, and justiciable controversy has arisen between the parties regarding whether the Bondholders' lien on the Restricted Unlimited Bond

Taxes constitutes a lien on special revenues within the meaning of 11 U.S.C. §§ 902(2)(E), 928.

103. The Restricted Unlimited Bond Taxes constitute special revenues because they are pledged *ad valorem* taxes specifically levied and collected only to finance one or more capital projects or systems, and not to finance the general purposes of the City. *See* 11 U.S.C. § 902(2)(E) (defining special revenues as “taxes specifically levied to finance one or more projects or systems, excluding receipts from general property, sales, or income taxes (other than tax-increment financing) levied to finance the general purposes of the debtor”); H.R. Rep. No. 100-1011, at 6 (1988) (explaining that § 902(2)(E) “define[s] special revenues to include the revenue derived . . . from a specific tax levy, where such revenues are meant to serve as security to the bondholders,” and identifying that Congress intended for § 902 to cover “pledged property tax revenues that state law bars the debtor from using . . . for any purpose other than paying the revenue bondholders”).

104. Under 11 U.S.C. § 922(d), the automatic stay does not operate as a stay of the application of the Restricted Unlimited Bond Taxes to payment of debt service on the Unlimited Tax Bonds during the City’s chapter 9 case.

105. Under 11 U.S.C. § 928, any Restricted Unlimited Bond Taxes acquired by the City after the commencement of its chapter 9 case shall remain

subject to any lien on the Restricted Unlimited Bond Taxes that existed before the commencement of the City's chapter 9 case.

106. For the reasons stated above, Ambac is entitled to a declaratory judgment that the Restricted Unlimited Bond Taxes are special revenues within the meaning of 11 U.S.C. § 902(2)(E) and must be applied in accordance with 11 U.S.C. §§ 922(d) and 928.

COUNT SIX

Declaratory Judgment that the City's Diversion of the Restricted Bond Taxes or Grant of Any Postpetition Interest in the Restricted Bond Taxes to Any Other Person, Without Just Compensation to the Bondholders, Is an Unlawful Taking Under the Fifth Amendment to the United States Constitution

107. Ambac repeats and realleges each of the averments contained in paragraphs 1-106 above, as if fully set forth herein.

108. An actual, ripe, and justiciable controversy has arisen between the parties regarding whether there has been an unlawful taking of the Bondholders' and Ambac's property under the Fifth Amendment to the United States Constitution, which is made applicable to the City through the Fourteenth Amendment to the United States Constitution, because the City is using the Restricted Bond Taxes for purposes other than payment of debt service on the Unlimited Tax Bonds and the Limited Tax Bonds.

109. The City has made clear to Ambac that it will not segregate the Restricted Bond Taxes, will not use the Restricted Bond Taxes to pay debt service

on the Bonds, and may use the Restricted Bond Taxes for purposes other than payment of debt service on the Bonds. The City has not offered the Bondholders compensation for this taking.

110. The City's actions as described in the preceding paragraphs constitute an unlawful taking of the Bondholders' property interests without just compensation.

111. For the reasons stated above, Ambac is entitled to a declaratory judgment that the City's use of the Restricted Bond Taxes for any purpose other than payment of debt service on the Bonds or grant of any postpetition interest in the Restricted Bond Taxes to any other person, without just compensation, would constitute an unlawful taking of property under the Takings Clause of the Fifth Amendment to the United States Constitution, which is made applicable to the City through the Fourteenth Amendment to the United States Constitution.

REQUESTS FOR RELIEF

WHEREFORE, Ambac respectfully requests entry of a declaratory judgment:

- (1) On Count 1, declaring that, under Michigan law (i) the Restricted Bond Taxes are restricted funds by law that cannot be used by the City for any purpose except to satisfy the City's payment obligations with respect to outstanding Bonds, (ii) as *ad valorem* taxes are

collected, Defendants are required to segregate and deposit the Restricted Bond Taxes allocable to each series of Bonds into the related Debt Retirement Funds, and (iii) Defendants are prohibited from commingling the Restricted Bond Taxes with funds of the City or using the Restricted Bond Taxes for any purpose other than paying the Bondholders.

- (2) On Count 2, declaring that the City is a mere a conduit for the Restricted Bond Taxes and lacks any equitable or beneficial property interest in the Restricted Bond Taxes;
- (3) On Count 3, declaring that the Bondholders have equitable and beneficial property interests in the Restricted Bond Taxes;
- (4) On Count 4, declaring that the Unlimited Tax Bonds and the Limited Tax Bonds are secured by a statutory lien, or in the alternative, a lien, on the Restricted Bond Taxes;
- (5) On Count 5, declaring that the Restricted Unlimited Bond Taxes are special revenues within the meaning of 11 U.S.C. § 902(2)(E) and must be applied in accordance with 11 U.S.C. §§ 922(d) and 928;
- (6) On Count 6, declaring that the City's use of the Restricted Bond Taxes for any purpose other than payment of debt service on the Bonds or grant of any postpetition interest in the Restricted Bond

Taxes to any other person, without just compensation, would constitute an unlawful taking of property under the Takings Clause of the Fifth Amendment to the United States Constitution, which is made applicable to the City through the Fourteenth Amendment to the United States Constitution; and

- (7) On all Counts, such other and further relief to Ambac as the Court may deem proper.⁴

Respectfully Submitted,

ARENT FOX LLP

Dated: December 23, 2013

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⁴ Ambac seeks only declaratory relief in this Amended Complaint to establish Ambac's property interests in, and the City's obligations with respect to, the Restricted Bond Taxes under Michigan law and the United States Constitution. Consequently, the disposition of Ambac's claims in this adversary proceeding does not require this Court to determine at this time whether Ambac is entitled to remedial relief, including adequate protection, although Ambac reserves the right to seek such remedial relief based upon the Court's rulings.

and

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EXHIBITS

- Exhibit A** City of Detroit Proposals to Voters (Proposals P,R,S,N,T)
- Exhibit B** Michigan Constitution of 1963, Article IX, Section 6
- Exhibit C** Revised Municipal Finance Act (Act 34 of 2001)
- Exhibit D** The Unlimited Tax Election Act (Act 189 of 1979)
- Exhibit E** The Bond Resolutions
- Exhibit F** The Home Rule City Act (Act 279 of 1909)
- Exhibit G** Local Financial Stability and Choice Act (Act 436 of 2012)
- Exhibit H** City of Detroit Proposal for Creditors (June 14, 2013)
- Exhibit I** Specimens of the Ambac-Insured Bonds
- Exhibit J** The Sale Orders
- Exhibit K** The Ambac Policies
- Exhibit L** State of Michigan Attorney General Opinion (February 19, 1982)
- Exhibit M** City of Detroit Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2012
- Exhibit N** 2005 Limited Tax Bonds Official Statement
- Exhibit O** 2004 Unlimited Tax Bonds and Limited Tax Bonds Official Statement
- Exhibit P** City of Detroit, Proposed Capital Agenda for Fiscal Years 2013-14 to 2017-18
- Exhibit Q** Emergency Manager Order No. 12
- Exhibit R** Charter of the City of Detroit

Exhibit S City of Detroit Municipal Code excerpts

Exhibit T City of Detroit Ten-Year Plan