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# Detroit Ch. 9 may set pension precedent

Orr: Law doesn't shield retirees from cuts

By [Chad Halcom](#) and [Kirk Pinho](#)

A new committee will take shape in the coming weeks to represent more than 23,000 retirees in court and negotiate their future benefits as a class of creditors in Detroit's Chapter 9 bankruptcy.

But do the retirees have any special legal claims that set them apart as creditors?

Detroit Emergency Manager Kevyn Orr told *Crain's* in an interview last week that he believes federal bankruptcy doctrine prohibits the city from treating its 9,750 employees and 23,500 retirees differently from any other unsecured creditors -- or even from each other.

"We don't see any doctrine in the bankruptcy code that allows you to discriminate," he said. "In fact, most of the doctrine of the code prohibits you from discriminating against classes of creditors unless their behavior is unreasonable. So we treated them as we think federal law requires them to be treated. We are not discriminating."

That means Judge Steven Rhodes, who ordered the retiree committee formation on Friday, may well make the call that sets the new legal standard on retirees' creditor rights at U.S. Bankruptcy Court. No other municipal bankruptcies have advanced to a court precedent for Detroit or others to follow when it comes to pensions, although retirees preserve contractual rights under a reorganization plan in Jefferson County, Ala., that's up for court review this week.

Orr is awaiting a new actuarial analysis of the city's two employee pension fund obligations from Seattle-based **Milliman Inc.** and said he hopes to have completed reports in hand later this month. His attorneys said in court Friday that they could submit a reorganization plan by year's end, three months ahead of Rhodes' schedule.

The city has two employee pension funds, the General Retirement System and Police and Fire, with an estimated \$3.5 billion in unfunded claims. But this unfunded debt figure could change based on the Milliman review.

An analysis last Thursday of the pension funds by **Morningstar Municipal Research** in Chicago estimated the two funds actually had slightly under \$1 billion

NATHAN SKID/CDB



"We are trying to be fair, but we are trying to deal with the realities that have been coming here for a long time.": Kevyn Orr

### HIGHLIGHTS OF KEVYN ORR'S PLANS

- The city is working to restructure all debt, with health care and pension liabilities at the top of the pile.
- Negotiations with creditor groups are ongoing and a cram-down plan (involuntary imposition of a reorganization plan over the objection of some classes of creditors) so far isn't planned.
- Preserving funding for public safety, IT, blight removal and economic development remain priorities.
- The city plans to secure a contract or multiple contracts to outsource trash collection, recycling and waste disposal. Proposals are due by Sept. 10.
- A plan to regionalize the **Detroit Water and Sewerage Department** under a new authority remains under development by the city and surrounding counties.
- The city is switching employees to a high-deductible health plan.

in unfunded liability in 2012, are about 91 percent funded, and that actuarial assumptions are "not conservative" but within industry norms.

The General Retirement System pays an average annual retirement benefit of \$19,000 per employee, according to a valuation by **Gabriel Roeder Smith & Co.**, while the police and fire pension annuity is about \$30,000, said Bruce Babiarz, owner of **BAB Associates LLC** and spokesman for the pension funds.

The pension debt is the second-biggest pot of unsecured debt for Detroit, trailing health care liabilities of an estimated \$5.7 billion. But fixing health care debt and not dealing with pensions wouldn't help the city, Orr said.

"I'd be kicking the can down the road, sweeping the dirt under the rug," he said. "I'd be doing the very thing -- avoiding the issue, the very irresponsibility, that I've said has gotten us to (this) point."

The pensions, for their part, objected to the formation of a retiree committee in part because it could marginalize the funds themselves in negotiation. Babiarz said late Friday the pensions were still reviewing Rhodes' order and deciding whether to appeal.

The committee replaces the pension fund board and labor unions in court, and Orr helps the U.S. bankruptcy court trustee select candidates for the committee, according to the order.

The pension funds oppose the retiree committee.

"It is important the appointment of a retiree committee should not be used by the city ... as some sort of surrogate or straw person to avoid its obligations to negotiate earnestly and in good faith with other significant creditor constituencies whose interests may overlap," the funds stated in a court motion last week.

Attorney General Bill Schuette, who said last week he was heading to court "on behalf of Southeast Michigan pensioners who may be at risk," will not seek to become the attorney for the new retiree committee, but he "welcomes the opportunity to give struggling retirees a seat at the table," his communications director, Joy Yearout, said Friday.

### **Legal issues**

While both the General Retirement System and Police and Fire pension funds have assets in them, previous mismanagement hasn't left them properly funded, Orr said. The new actuarial review will paint a clearer picture on how accurate the \$3.5 billion figure is and what cuts are needed to pension plans.

Pension experts say determining where pensions and labor unions fall in the creditor hierarchy among bondholders and vendors is not totally clear.

"I think that issue is still going to be fought out," said Sharon Almonrode, a pension fund litigation attorney and partner at **The Miller Law Firm PC** in Rochester.

Almonrode said current retirees could be considered protected because they are being paid under a completed contract, but "the current employee can have benefits cut" in the city's reorganization.

The U.S. Court of Appeals generally upholds the contractual rights of retirees, she said.

Orr could be approaching the case based on private sector bankruptcy precedent, or may realize he could get hamstrung in court if he creates categories of retirees before he turns in his own reorganization plan, said Douglas Bernstein, managing partner of the banking, bankruptcy and creditors rights practice group at **Plunkett Cooney PC** in Bloomfield Hills.

"If the judge finds that the plan doesn't discriminate, the plan can get confirmed easier. You have to treat similarly situated creditors the same way," he said. "But one of the things he has also got to demonstrate is that the plan is feasible. The point here is to trade promises that he can't keep (on the city's behalf) for promises that he can."

### Limited case law

Other municipalities either negotiated settlements or haven't made it far enough in bankruptcy proceedings for a judge to rule on pensions.

Bankrupt San Bernardino, Calif., just resumed making payments in July to the **California Public Employees' Retirement System** after suspending them nearly a year. Meanwhile, Stockton, Calif. -- previously the largest city in Chapter 9 until Detroit filed on July 18 -- has been paying CalPERS, and the pension fund in return has not challenged Stockton's eligibility to file bankruptcy as it has done with San Bernardino.

Neither of those cases has advanced far enough for court approval of a reorganization plan, and a proposed reorganization in Jefferson County, Ala.'s 2011 bankruptcy still awaits a court hearing this week. That plan puts the county's retirees into a class of "unimpaired claims" or those whose contractual rights are unaffected.

### So far, no cram-down

Orr said the city is not considering a "cram-down" contingency plan, or one that relies on court enforcement over creditor objections, suggesting he holds out hope for agreements with the pension funds or bondholders.

Typically, a reorganization plan needs approval from a majority of creditors representing at least two-thirds of the restructured debt, to gain court approval in a Chapter 9 case, meaning in Detroit's case some bondholders or insurers would have to give support. A cram-down plan generally needs the approval of just one class of "impaired" creditors who agree to take a hit on what they're owed.

"We have proposals outstanding," Orr said of the creditor discussions. "Even before we get to that point (of a reorganization plan), we have to understand what the hard positions are. We are hoping that some of these positions (are just positions that) people have to take for points of advocacy."

Regarding the pension fund mismanagement, Orr said 30 percent of investments were in private equity, real estate and other deals without advisers, and he believes are below the 80 percent-funded threshold.

One local money manager, who asked not to be named because his firm is seeking future fund management work for the city, said Detroit and other public pension systems also suffered historically from employees and their supervisors gaming the system.

Some employees have been able to stockpile large chunks of vacation and sick time over the years, then getting paid for all of it in the last year of service, or by getting promotions to high-paid positions immediately before retirement, since pension benefits were computed in part on wages in the last year of service.

"It was a multiplier effect, and because of it you had a lot of workers making almost the same in retirement as their regular pay. And thanks to generous collective bargaining, they were able to collect that kind of pay when they were in their late 40s or early 50s and then go out and get another job," he said.

"That's not what the founding city fathers had in mind when they wanted to reward those who had opted for public service."

Orr said he empathizes with the other kinds of retirees, too.

"I understand that to the 83-year-old retiree none of this makes sense or seems to be very fair...my mother was at a church conference and ran into a Detroit pensioner in this very circumstance. She came up to her and, here's the catch, said, 'I should be mad at you, but I'm not. He's doing what needs to be done. I'm concerned and I'm afraid, but it's the right thing.'

"Even people who are right square in the bull's eye on this issue, even they have the lucidity to step back and say, 'Look, this is no surprise.' We are trying to be fair, but we are trying to deal with the realities that have been coming here for a long time. It's very, very difficult."

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