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
CITY OF DETROIT, MICHIGAN,	Chapter 9
Plaintiff,	Adversary Proceeding No. 14-04112
vs.	Hon. Steven W. Rhodes
DETROIT GENERAL RETIREMENT SYSTEM SERVICE CORPORATION, *et al.*,	
Defendants.	

CITY OF DETROIT'S OMNIBUS REPLY IN SUPPORT OF ITS MOTIONS TO DISMISS THE COUNTERCLAIMS OF THE FUNDING TRUSTS AND FGIC

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The City respectfully submits this omnibus reply in support of its motions to dismiss in part the counterclaims of the Trusts and FGIC, and states as follows:

I. INTRODUCTION

The Trusts and FGIC repeatedly argue that they were lied to, or that the City somehow misrepresented to them the salient features of the transaction they engineered and gladly entered into. In truth, the features – large and small – of the COPs deal were described in careful detail in the 238-page Offering Circular[1], in the Service Contracts, and in other documents the Defendants were well aware of. In particular, these documents make clear that:

- The City had availability under the borrowing limit of $660 million at the time of the 2005 deal and $637 million in 2006. *See* 2005 Offering Circular at B-44; 2006 Offering Circular at B-38; *see also* 2005 Comprehensive Annual Financial Report at 144 and 2006 Comprehensive Annual Financial Report at 175 (stating the City's borrowing availability at fiscal year-end for 2005 and 2006, respectively).[2]

[1] *See* Offering Circular for $1,440,000,000 Taxable Certificates of Participation Series 2005 (May 25, 2005) ("2005 Offering Circular") (Complaint Ex. A); *see also* Offering Circular for $948,500,000 Taxable Certificates of Participation Series 2006 (June 7, 2006) ("2006 Offering Circular") (Complaint Ex. J).

[2] The City's CAFR for the year ended June 30, 2005 is available at https://www.detroitmi.gov/Portals/0/docs/finance/CAFR2005.pdf. The CAFR for the year ended June 30, 2006 is available at https://www.detroitmi.gov/Portals/0/docs/finance/CAFR/CAFR2006.pdf.

- To fund its $1.7 billion UAAL without transgressing the debt limit, the COPs transaction was structured as one where the City would pay two Service Corporations for "services" that consisted solely of helping the City close the COPs deals themselves. *See* Offering Circular at 5.

- The Service Corporations, by design, were to have no employees, and to consist only of 5 *ex-officio* members of the City government. *See id.* at 18. The Service Corporations were "not expected to have a significant active role with regard to any outstanding Certificates after the Closing Date." *Id.* at 5, 18.

- Almost immediately after the closing, the Service Corporations were to transfer their entire rights in the Service Contracts to the Trust, eliminating the only ongoing function the Corporations ostensibly had. *See id.*

- The COPs transaction was "a new financing structure which [was] being used for the first time in the State of Michigan." *See* 2005 Offering Circular at 2. The transaction was designed to avoid the limitations of Act 34 and the Home Rule City Act, MCL 117.4a ("HRCA"), and the Offering Memorandum disclosed why the Trusts did not believe those laws applied. *See id.* at 5-6, G-1–G-3.

- The City obtained a legal opinion from its counsel that this transaction would not constitute net indebtedness under § 4a of the HRCA, and thus would not cause the City to exceed its debt limit. *See id.* at G-1–G-3.

- As a result of the COPs transaction, the Retirement Systems received $1.4 billion immediately in satisfaction of the City's UAAL, and the City owed Service Payments sufficient to pay the principal and interest on the $1.4 billion for 18 to 30 years.

Tellingly, these facts were disclosed not once, but twice, that is in the original 2005 COPs transaction and again in 2006 when the COPs were reissued with longer maturities. Defendants cannot say that they were ignorant of the

operative facts, especially given the size of the transaction – the largest municipal bond deal in Michigan history – and their own exposure in it.

The picture that emerges instead from Defendants' opposition papers is one of large and sophisticated financial institutions hoping in this chapter 9 proceeding to get the windfall of a 100% recovery even though they are unsecured creditors and were knowing participants in a shady deal. No number of protestations of ignorance can mask the fact that they knew exactly what they were doing in 2005 and 2006, and they cannot now plead ignorance.

II. ARGUMENT

A. The Counterclaims Presume The Invalidity Of The Service Contracts

Both the Trusts and FGIC complain that the City's motions to dismiss wrongfully assume that the Service Contracts will be found invalid. The Trusts, for example, argue that "[i]f the facts asserted in the Counterclaims are accepted as true, as the must be for purposes of Rules 12(b)(6) and 12(c), the existence and validity of the Service Contracts must also be accepted as true." Trusts Br. at 9. This is wrong. It is the counterclaims themselves that presume the Service Contracts to be invalid. Each of the counterclaims states an alternative theory of recovery in equity that would come into existence *only if* the Service Contracts were first determined to be invalid.

Thus, the invalidity of the Service Contracts is the factual predicate for the counterclaims. There is no basis for seeking the equitable relief they allege unless the Service Contracts are invalid. And there is no way to resolve a motion to dismiss these counterclaims without taking invalidity as a given. Thus, the only question at issue in this motion to dismiss is whether, as a matter of law, a party can obtain equitable relief on an illegal contract. For the many reasons explained in the City's motions to dismiss, the answer is no.

B. The Arguments In Support Of The Validity Of The Service Contract Fail

Although it is not relevant to the City's motion dismiss whether the Service Contracts are valid, the Defendants assert that the Service Contracts cannot, as a matter of law, be void for violation of the state-law restrictions on municipal debt found in Act 34 and the HRCA. The Trusts advance the novel theory that because cities are constitutionally and statutorily obligated to maintain the actuarial integrity of their pension systems, any funds raised for that purpose need not comply with the these limitations.

As an initial matter, the Defendants' novel preemption theory leads to absurd results. In essence, the Defendants suggest that because the obligation was imposed by the State Constitution, the City was free to meet its obligations to the Retirement Systems *by any means necessary*, even if those means contravened the law. Trusts Br. at 17-23. The Defendants' theory, however, would mean that the

City was free to fund the Retirement Systems' UAAL by other illegal means, such imposing illegal taxes or selling off property it did not own. It cannot be the case that the mere existence of an obligation imposed by the State Constitution preempts any restrictions on the methods a City might use to fulfill that obligation. In fact, it that were the case, one would expect that the legislature would have mentioned this loophole in the HRCA itself.

Moreover, if it were true that the City could have borrowed as much as it liked to fund the Retirement Systems' UAALs, free from any statutory debt limit, then the very existence of the COPs transactions is inexplicable. There is no conceivable reason that the parties would have structured and executed such complex, expensive and novel transactions -- using not one but two layers of intermediaries -- if the City could simply have issued traditional bonds. The parties' contractual contortions point to the only plausible explanation: The City could not incur indebtedness to fund the UAAL, and everyone knew it.

In addition, the cases relied on by the Trusts to support this extraordinary position fall short of the mark. The Trusts cite the Michigan Supreme Court's decision in *Kuhn ex rel. McRae v. Thompson*, 134 N.W. 722 (Mich. 1912), describing the court as "finding that public school system financing was not subject to the debt limit provided for in the City's charter, adopted pursuant to the HRCA, because education financing was separately addressed in the Michigan

Constitution." Trusts Counterclaim at 18. This certainly makes it sound as though the Michigan Supreme Court exempted school financing from the HRCA's debt limit because education is a constitutional obligation – but that's not what the court held. What the court actually found was that school bonds were not subject to the city's debt limit for the simple reason that the school district was a separate municipal corporation not governed by the HRCA. *Id.* at 516, 526.

The Trusts similarly mischaracterize *American Axle* and *Simonton*. Neither of those cases suggest that the City was authorized to ignore the debt limit in order to meet its financial obligations to the Retirement Systems. *American Axle* involved the levy of taxes to pay a judgment under § 6093 of the Revised Judicature Act and the specific question of whether such levy was subject to the election requirement of the Headlee Amendment. *American Axle & Mfg., Inc. v. City of Hamtramck*, 461 Mich. 352, 354-355 (Mich. 2000). The court's holding – that the RJA pre-dated and was thus exempt from the Headlee Amendment – has no bearing at all on limitations on a city's ability to incur debt under the HRCA.

Simonton similarly involved limitations on a city's taxing authority, not its authority to incur debt. In that case, the city of Pontiac, having suffered severe population loss and property devaluation during the Great Depression, was unable to service legally-incurred debt without raising taxes above 2%. The court, in granting mandamus, noted that Michigan law provided "that no limitation in any

statute or charter shall prevent the levy and collection of the full amount of taxes required solely for the payment of debts, and made it necessary for the city to include in the amount of the taxes levied each year a sum sufficient to pay the annual interest and the installments of principal on its obligations falling due before the time of the following tax collection." Simonton v. Pontiac, 268 Mich. 11, 19 (Mich. 1934). *Simonton* thus stands for the unremarkable proposition that legal debt, once incurred, must be paid even if doing so means that taxes must be raised beyond otherwise-applicable limits. It does not, as Defendants would have it, suggest that a city has a right to incur debt illegally.

C. In Any Event, Whether The Service Contracts Are Valid Is Irrelevant To Resolution Of The City's Motions To Dismiss

At bottom, it is irrelevant to the City's motions to dismiss whether the Court ultimately finds that the Service Contracts are valid or void. The Court will never consider Counts VI-XI and XIV of the Trusts Counterclaim and the Second through Sixth Counterclaims of the FGIC Counterclaim unless and until it finds that the Service Contracts are void for violation of the debt limit. If the Court finds that the Service Contracts are void, that means that the Trusts and FGIC participated in an illegal transaction. And, as explained below, *see* Part II.D, *infra*, if the Trusts and FGIC participated in an illegal transaction, they are not entitled to recover the proceeds of that transaction.

D. The Trusts And FGIC May Not Recover The Proceeds Of Illegal Contracts Under Alternative Theories

Defendants both assert the tails-we-win-heads-you-lose argument that even if the Service Contracts are void and unenforceable, the Trusts and FGIC nonetheless are entitled to recover the proceeds of the sale of the COPs, which were transferred directly from the Trusts to the Retirement Systems. This theory has several defects. First, as the City has made clear in its motions to dismiss, the law does not allow recovery on illegal municipal debt. Second, even if equitable relief somehow were appropriate, the amount of any restitution would be limited to the amount the Defendants stand to receive in the City's bankruptcy —that is, the amount to which they are entitled by virtue of having filed Class 9 claims.

1. There Is No Recovery In Equity On Illegal Contracts

As explained extensively in the motions to dismiss, the law is clear that there can be no recovery in equity on illegal municipal debt. On this, courts have been emphatic:

> [A city] shall not become indebted. Shall not incur any pecuniary liability. It shall not do this in any manner. Neither by bonds, nor notes, nor by express or implied promises. Nor shall it be done for any purpose. No matter how urgent, how useful, how unanimous the wish. There stands the existing indebtedness to a given amount in relation to the sources of payment as an impassable obstacle to the creation of any further debt, in any manner, or for any purpose whatever.
>
> If this prohibition is worth anything it is as effectual

> against the implied as the express promise, and is as binding in a court of chancery as a court of law.

Litchfield v. Ballou, 114 U.S. 190, 192-93 (1885).

This rule is based on sound principles of law and policy. If recovery were allowed on illegal municipal debt, any restrictions on the municipality's power to incur debt—such as the debt limit—would be meaningless. City officials would be free to disregard these restrictions, and potential investors could rest easy knowing that if the debt turned out to be illegal, they could obtain restitution of the money lent. This is no small problem. Restrictions on municipal borrowing are intended "to protect the credit of the State and its municipalities," and to prevent cities from meeting their obligations by taking on more debt than they can bear. Senate Fiscal Agency Bill Analysis of SB 29/0102 (Substitute S-3) (Apr. 16, 2001) at 1. To prevent this moral hazard, the law precludes recovery in equity on illegal debt, placing the risk of dealing with the municipality on those who contract with it.

In contrast, the Defendants' theory in this case turns equity on its head. The COPs documents reveal that the parties went out of their way to structure a very profitable transaction that evaded the debt limit and the other restrictions on municipal debt. If, as the counterclaims assume, this effort failed, it should not be for the court to authorize payment on a debt that state law made illegal. The Defendants were in possession of every fact necessary to make a

judgment about the legality of the transaction and chose either to turn a blind eye to its legal validity or to press forward notwithstanding. It is for precisely this situation that the law will not enforce illegal municipal debt through equitable remedies. *See Litchfield*, 114 U.S. at 194 ("[E]quity will no more raise a resulting trust in favor of the bondholders than the law will raise an implied assumpsit against a public policy so strongly declared.").

2. The Cases Relied Upon By The Defendants Are Inapposite

The cases cited by the Trusts in support of the recoverability of the COPs proceeds are inapposite; they involve either situations where the contract was not prohibited, or where the property transferred was still held and identifiable in the defendant's hands. The Trusts cite *DiPonio v. Garden City*, 30 N.W.2d 849 (Mich. 1948), in which the court explained that "[a] municipality cannot retain the benefits of a contract which has been fully performed by the other party, **and which is neither *malum prohibitum* nor *malum in se***, and at the same time deny the validity of the contract because of defects in the manner of its execution." *Id.* at 852 (emphasis added). The court granted relief in that case because the defendant city "did have the right to enter into the contract," which was neither *malum prohibitum* nor *malum in se*. *Id.* Here, by contrast, the City did not have the right to enter into the Service Contracts, since they caused the City to incur debt beyond the legal limit and thus were *malum prohibitum*.

The Trusts also rely on the concurring opinion in *McCurdy v. Shiawassee County*, 118 N.W. 625, 633 (Mich. 1908) (Ostrander, J., concurring), to try to show that a municipal corporation may be required to restore "specific property" to a plaintiff. As an initial matter, the language that the Trusts cite is identified by Justice Ostrander himself as mere dictum: "The case at bar does *not* present the question whether a municipal corporation may not be required to restore to the owner specific property which it has attempted without authority to buy or take…." *Id.* As dictum in a concurring opinion, it is neither the holding of the case nor precedential.

Moreover, even if this Court were to follow the dictum, it is inapposite to this case as there is no "specific property" of any Defendant that the City holds or could restore to them. *Cf. Litchfield*, 114 U.S. at 193 ("The money received by the city from Ballou has long passed out of its possession, and cannot be restored to complainant. Neither the specific money nor any other money is to be found in the safe of the city or anywhere else under its control."). Rather, the situation here is precisely that in *McCurdy*: debt was illegally incurred, and Defendants can no more recover upon an implied contract (or any other theory) than they can under the express contract. *McCurdy*, 118 N.W. at 561 ("Contractors have ample means to protect themselves; and, if a township can be held on implied contract, or estopped by the acts of its officers, when there is no valid contract, it

would enable these persons to disregard the law entirely, and collude with their friends to do indirectly what, if directly done, would be a plain illegality.") (citation omitted).

Other cases cited by the Trusts are entirely off-point. *Highway Comm'rs of Sault Ste. Marie v. Van Dusan*, 40 Mich. 429 (Mich. 1879) does not – contrary to the Trusts' assertion – support the argument that funds can be recovered notwithstanding the illegality of the contract under which they were transferred. Rather, the Michigan Supreme Court in that case emphasized that a city cannot "grasp ungranted power" or by its own actions somehow ratify that which it is forbidden to do. The court's ruling, far from awarding damages to the plaintiff, *reversed* the trial court's finding that the contract was enforceable. *Id.* at 430-432. The Trusts further cite *Central Transp. Co. v. Pullman's Palace Car Co.* for the proposition that funds obtained pursuant to an illegal contract must be returned. The Supreme Court's actual holding was precisely the opposite: "This action, according to the declaration and the evidence, was brought and prosecuted for the single purpose of recovering sums which the defendant had agreed to pay by the unlawful contract, and which, for the reasons and upon the authorities above stated, the defendant is not liable for." *Id*., 139 U.S. 24, 61 (1891).

3. Even If Equitable Relief Were Permitted, Restitution Of The Full Amount Of The COPs Proceeds Would Not Be Justified

Beyond merely asserting a right to equitable relief on their illegal contracts, the Defendants also assert that the illegality allows them to recover the full $1.4 billion of proceeds from the COPs transaction. This, however, demonstrates yet another profound misunderstanding by Defendants of the nature of their case. No matter what happens in this case, the Defendants will never be able to recover more—whether from the City or the Retirement Systems—than the amount they stand to receive as Class 9 claimants in the City's bankruptcy. Any loss the Defendants suffered beyond this amount has nothing to do with the legality or illegality of the COPs; it has to do with the fact that the Defendants lent money to a nearly bankrupt City.

Indeed, notwithstanding the rhetoric, all that is at issue in this case is whether the Defendants' Class 9 claims are allowable, or instead, are "unenforceable against the debtor and property of the debtor, under . . . applicable law." 11 U.S.C. § 502(b)(1). Allowing the Defendants to recover the full COPs proceeds from the City or the Retirement Systems would lead to absurd results by permitting an admittedly unsecured creditor to obtain a full recovery to which it is not entitled, on the grounds that it was lucky enough to have participated in an illegal transaction. Such a result undermines the purpose of the claims-allowance

scheme established by section 502(b). To the extent the Defendants perceive unfairness in the fact that the City was able to benefit from the COPs transaction without having to fully repay the debt, their complaint is with the federal bankruptcy laws, not the City.

In short, even if restitution is available to the Defendants, their recovery would be limited to the amount provided by a plan of adjustment confirmed by this Court. The fact that Defendants were participants in a deal that violated state law should not result in a windfall to them.

E. As A Matter Of Law, The Trusts And FGIC Cannot Demonstrate Justifiable Reliance On The City's Representations

In its opposition to the City's motion to dismiss, FGIC argues that, in this adversary proceeding, "the City disclosed for the first time that it lied about the attributes of the Pension Funding Transactions and the due diligence it purportedly conducted." FGIC Br. at 2. This is a wild distortion of the truth and of what the City has alleged in this lawsuit. The City has not alleged that any representations that it made about the *facts* of the COPs transactions were untrue. Nor does the City deny that it performed due diligence and obtained a legal opinion that the COPs would not add to the City's net indebtedness. Rather, all the City alleges is that this legal opinion was wrong. And not only was it wrong, but its wrongness was readily apparent from the structure of the transaction disclosed on the face of

the transaction documents. Under such circumstances, it is not possible, as a matter of law, to prove justifiable reliance.

1. Representations About The Law Cannot, As A Matter Of Law, Be A Basis For Justifiable Reliance

Neither FGIC nor the Trusts have alleged a single *fact* that the City misrepresented to them upon which they could have relied. Instead, both the Trusts and FGIC focus primarily on the City's legal opinion that the COPs did not constitute "indebtedness" within the meaning of the HRCA. Such an opinion, however, cannot be the basis for a claim of justifiable reliance as a matter of law.

As discussed at length in the City's motion to dismiss the FGIC Counterclaim, and amply supported by the case law, it is not possible to prove justifiable reliance on the representations of a party on the other side of a transaction about the meaning of the law.[3] The law is publicly disclosed, and any

[3] For similar reasons, estoppel does not bar the City's assertion that the COPs transactions were invalid. Courts draw a "distinction . . . between questions of fact and questions of law." *Chemical Bank & Trust Co. v. Oakland Cnty.*, 251 N.W. 395, 399 (Mich. 1933). "If it is a question of fact, and the board or officers are authorized by law to determine the fact, then their determination is final and conclusive. And although it may be contrary to the fact, yet, if recited in the bond that the necessary and proper steps required by law to be taken have been taken, then the municipality is estopped from denying that they were taken." *Id.* (quoting *Spitzer v. Village of Blanchard*, 46 N.W. 400 (Mich. 1890)). On the other hand, "[p]urchasers of municipal bonds are bound to know the extent and limitations of the authority of the corporation to issue the bonds," and "[w]here there is a total want of power, under the law, in the officers or board who issue the bonds, then the bonds will be void in the hands of innocent holders." *Id.* This is not a situation where the City misrepresented the dollar amount of its debt limit or its net

party with access to a lawyer is able to reach its own conclusion about what the law requires. FGIC strains credulity when it suggests that it – a sophisticated financial party with over a billion dollars of exposure in the largest municipal financing in Michigan history – was absolved of any obligation to perform its own due diligence merely because the City asserted that *its* attorneys believed the transaction passed legal muster. Parties on opposite sides of a transaction accept the risks that come with relying on the legal representations of the other side.[4]

Indeed, FGIC's assertions of justifiable reliance put its arguments for equitable relief in stark perspective. In the COPs transaction, city officials, investment banks, and monoline insurers colluded to evade the debt limit so as to provide funding for the City's pension systems and to generate significant fees for the banks and insurers. If the mere existence of a conclusory legal opinion from the City is enough to trigger the possibility of equitable relief to investors, there would be nothing left of the municipal debt limit or any other restriction on borrowing. Under such a regime, any municipality seeking to exceed its debt limit

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indebtedness. The key representation was that the COPs did not created indebtedness within the meaning of the HRCA – a legal issue that the City was not authorized to determine.

[4] The City accepts, as it must for purposes of these motions to dismiss, the Defendants' allegations that they relied on the City's representations of the law. It does not follow, however, that such reliance was in any way reasonable or justifiable.

could readily obtain financing by providing a bald legal opinion that the deal is valid. In that scenario, investors would enjoy the potential windfall of complete restitution so long as they took pains to keep themselves in the dark about the deal's true nature.

2. All Facts Necessary To Evaluate The Legality Of The COPs Transaction Were Revealed In The COPs Transaction Documents

In assessing justifiable reliance, courts have dismissed claims "as a matter of law in light of a plaintiff's failure to take steps to ascertain the truth of representations under certain circumstances, including: (1) where the evidence has established that a sophisticated plaintiff had indisputable access to truth-revealing information . . . or (2) where evidence demonstrated that the plaintiff was on notice that the representations may have been false." *Doehla v. Wathne Ltd*., 1999 U.S. Dist. LEXIS 11787, *32-33 (S.D.N.Y. Aug. 2, 1999); *see also Hunt v. Alliance North Am. Gov't Income Trust, Inc*., 159 F.3d 723, 730 (2d Cir. 1998) ("An investor may not justifiably rely on a misrepresentation if, through minimal diligence, the investor should have discovered the truth.") (internal quotation marks and citation omitted).

Both of these circumstances were present here. It is undisputed that the structure of the COPs transactions was fully disclosed in the transaction documents. Among other things, those documents revealed that the Service

Corporations were to have no ongoing role with respect to the COPs after the closing date, notwithstanding the fact that the City was obligated to pay them several hundred-million dollars in "service payments" in the following years. Even a cursory reading of the Service Contracts reveals that the City would receive no future services under the contracts, but instead would simply pay down the debt incurred when the COPs were issued. *See, e.g.,* GRS Service Contract 2005 (Complaint Ex. C), §§ 4.01 ("Provision of Services"); 4.02 ("Payment Obligations"); 4.03 ("Funding Obligation").

Everything the Defendants needed to know about the structure and nature of the COPs transactions was readily apparent and available in the Service Contracts, the Offering Circulars and publicly available documents that disclosed the City's debt limit and net indebtedness.[5] *See* pp. 1-2, *supra*. Those documents made it possible for any party interested in doing so to reach a conclusion about the legal validity of the transaction. *See Haralson v. E.F. Hutton Group, Inc*., 919 F.2d 1014, 1026 (5th Cir. 1990) (a "plaintiff may not justifiably rely on 'representations . . . which are shown by facts within his observation to be so patently and obviously false that he must have closed his eyes to avoid discovery of the truth'") (quoting Prosser on Torts, § 103, at 731 (3d ed.); additional citations omitted).

[5] *See* City of Detroit's 2005 Comprehensive Annual Financial Report at 144; 2006 Comprehensive Annual Financial Report at 175.

Similarly, "willful blindness" to red flags – such as the fact that the Service Contracts required no actual future services of the Service Corporations – is "manifestly unreasonable" and precludes a finding of justifiable reliance. *Edgewater Place, Inc. v. Real Estate Collateral Mgmt. Co. (In re Edgewater Place, Inc.)*, 1999 U.S. Dist. LEXIS 23692, *21-22 (C.D. Cal. May 18, 1999); *see also GAMCO Investors, Inc. v. Vivendi*, 917 F. Supp. 2d 246, 254 (S.D.N.Y. 2013) ("In essence, then, the 'reasonableness' prong of reliance merely recognizes that a plaintiff cannot willfully blind herself to a known risk."). Thus, if FGIC did not do its own diligence, and willfully ignored the problematic structure of the deal, it entered into the transaction at its own peril.

F. The Trusts' Additional Claims Likewise Fail

In addition to asserting claims that require the demonstration of justifiable reliance, the Trusts also assert claims for statutory conversion, substantive and procedural due process, and unlawful taking. As already noted, each of these claims should be dismissed because they would come into play only upon a determination that the Service Contracts are illegal and void, and the Defendants cannot recover under alternative theories what they are barred from recovering under the illegal contracts. In addition, each of these claims fails on its own terms.

1. The Trusts Have Failed to State a Claim for Statutory Conversion

The Trusts' claim for statutory conversion seeks to recover treble the amount of the $1.44 billion received by the Retirement Systems,[6] on the theory that the funds were wrongfully taken from the COPs investors and transferred to the Retirement Systems. The Trusts repeatedly refer to the funds being "raised and then transferred at the City's direction." *See, e.g.,* Trusts Br. at 58. This attempt at obfuscation ignores the fact that nothing was done "at the City's direction" but rather as a result of a heavily negotiated agreement.

However, even if every action undertaken with respect to the COPs transaction had been done "at the City's direction," the Trusts' claim for statutory conversion fails. Under Michigan law, a statutory claim of conversion – which is what the Trusts pled in their Counterclaim – "consists of knowingly buying, receiving, or aiding in the concealment of stolen, embezzled, or converted property. M.C.L. § 600.2919a. The Michigan courts have held that simply retaining a particular item or sum does not amount to 'buying, receiving or aiding in the concealment of stolen, embezzled or converted property.'" *Olympic Forest Prods. v. Cooper*, 148 Fed. Appx. 260, 265 (6th Cir. 2005). Here, the Trusts have

[6] It should be noted that the transactional documents show that the Retirement Systems did not receive the entire $1.44 billion, but rather received the proceeds of the 2005 COPs transaction net of fees.

alleged no more than that the Retirement Systems received and have retained the proceeds of the COPs transaction in accordance with the negotiated agreement of the parties to that transaction. The City neither bought, received nor aided in the concealment of the COPs proceeds. In fact, far from the funds being concealed, the Defendants have argued that they know exactly where the proceeds of the COPs transaction are.

2. The Trusts Have Failed to State a Claim for Violation of Due Process

The Sixth Circuit has explained that "[t]he substantive Due Process Clause is not concerned with the garden variety issues of common law contract. Its concerns are far narrower, but at the same time, far more important. Substantive due process 'affords only those protections so rooted in the traditions and conscience of our people as to be ranked as fundamental'. . . . Routine state-created contractual rights are not 'deeply rooted in this Nation's history and tradition,' and, although important, are not so vital that 'neither liberty nor justice would exist if [they] were sacrificed.'" *Charles v. Baesler*, 910 F.2d 1349, 1352 (6th Cir. 1990) (citations omitted). An ordinary right to repayment of debt clearly falls within the "garden variety issues of common contract law" that are entitled to substantive due process. *Cf. Samson v. City of Bainbridge Island*, 683 F.3d 1051 (9th Cir. 2012) (explaining that government action that affects only economic interests does not implicate fundamental rights for purposes of substantive due process).

With respect to procedural due process, the City has not attempted to interfere unilaterally with the Trusts' contractual rights. It is not "state action" but rather the federal bankruptcy law – specifically, the automatic stay and the Plan – that are responsible for the suspension in payments and reduction in potential claim amount.[7] The only affirmative act that the City has taken to affect the Trusts' underlying contract rights is the institution of this adversary proceeding, which plainly provides the Trusts all the process they are due.

Since the Trusts are not entitled to substantive due process, and any procedural due process to which they are entitled is provided by this Court through the adversary proceeding, the Trusts' claim for violation of due process fails and should be dismissed.

3. The Trusts Have Failed to State a Takings Claim

In asserting their Takings claim, the Trusts mischaracterize the interests they hold, asserting that they have a property interest in funds held by the Retirement Systems and a security interest in the moneys to be used by the City to make the Service Payments. As to the former, there is nothing in the transactional

[7] To the extent that the Trusts' procedural due process claim is based on the payment that the City missed shortly before filing for bankruptcy, it would be a very strained interpretation of the procedural due process clause to find that an insolvent municipality is required to provide notice and a hearing before defaulting on its financial obligations. The Trusts have certainly not identified any case law to that effect.

documents that grants the Trusts a reversionary or other interest in the proceeds of the COPs, and – as discussed above – the law will not impress those funds with a trust. As to the latter, the supposed "security interest" is not in the City's cash flow but rather in the Service Corporations' contractual interest in receiving the Service Payments. *See* 2006 Trust Agreement (Complaint Ex. I) at § 201. In other words, the Service Corporations assigned their rights to payment to the Trusts, and in the event that such assignment was deemed a pledge, also granted the Trusts a security interest in the Service Corporations' rights. But the Service Corporations (if they are creditors at all) are *unsecured* creditors of the City, and it is black letter law that an assignor cannot grant to its assignee more than it holds itself. *See, e.g., Pinto v. Allstate Ins. Co*., 221 F.3d 394, 409 (2d Cir. 2000) (stating that "the assignor can give no more than the assignor has"); *State Bank & Trust Co. v. Insurance Co*., 132 F.3d 203, 207 n.12 (5th Cir. 1997) ("The general rule is that an assignee … acquires no greater right than was possessed by his assignor, and simply stands in the shoes of the latter.") (citation omitted). Thus, the Trusts have no cognizable property right subject to the Takings clause.

More to the point, the City is not trying to "take" anything from the Trusts. To the extent that the Trusts' claims are reduced or even eliminated in the City's bankruptcy case, that is the result of bankruptcy law and not the City's own actions. *See, e.g., Kuehner v. Irving Trust Co.*, 299 U.S. 445, 451-52 (1937). To the

extent that this Court determines that the Service Contracts are void, the Trusts have nothing to "take"; it is beyond cavil that a party can have no protectable property interest in a contract that is illegal, null and void. *See, e.g., Telford v. Roberts*, 2013 U.S. Dist. LEXIS 110271, *5 (E.D. Mich. Aug. 6, 2013) ("Defendants argue that the amended contract was invalid because it fails to satisfy the elements of a contract and is contrary to public policy. This would render plaintiff's claim to a property interest in the contract void."). And if the Court were to determine that the Service Contracts were valid and enforceable, the City would of course abide by that decision and treat the Trusts' claims accordingly under its Plan. Thus, regardless of whether the Service Contracts are found to be void or valid, the Trusts' Takings claim fails.

G. The City's Claims Are Not Barred By The Statute Of Limitations

As set forth in the City's motion to dismiss, the City's claims are not barred by the statute of limitations because such statute is either ten years (in which case the City's claims were brought well within the limitations period) or inapplicable because a contract that is void *ab initio* cannot be made valid by the passage of time.

The statute of limitations is inapplicable for another reason as well. This adversary proceeding is, in effect, the objection and reconciliation process for the COPs claims. *See* 11 U.S.C. § 502(b)(1). The Defendants' counterclaims –

including claims regarding the validity of the COPs transactions – are the equivalent of proofs of claim. *See, e.g., Schwinn Plan Comm. v. AFS Cycle & Co. (In re Schwinn Bicycle Co.)*, 184 B.R. 945 (Bankr. N.D. Ill. 1995) ("the act of filing a counterclaim in an adversary proceeding instituted by a debtor-in-possession . . . qualifies as filing a 'claim'"). The City's claim that the Service Contracts are void is a defense to those claims. A claim used purely defensively is not subject to the statute of limitations. *See, e.g. Wells v. Rockefeller*, 728 F.2d 209, 213-214 (3d Cir. 1984) (citing 3 J. Moore, MOORE'S FEDERAL PRACTICE para. 13.11 (1983)). Here, the City is not seeking an affirmative recovery from any of the Defendants, but rather disallowance of their claims. Thus, the City's claims are not subject to the statute of limitations.

III. CONCLUSION

For the foregoing reasons, the City respectfully requests that the Court grant its motions to dismiss.

Dated: September 18, 2014 Respectfully submitted,

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