

pension liabilities (the “2005 Pension Funding Transaction and the “2006 Pension Funding Transaction,” respectively, and, collectively, the “Pension Funding Transactions”). The City’s attempt to now avoid its obligations has forced FGIC to seek declaratory relief to establish the enforceability of these contractual promises and the claims that FGIC has against the City in its bankruptcy case. In the event the City’s allegations are true and it did, in fact, induce FGIC to insure transactions that the City misrepresented as clearly binding obligations of the City, then FGIC seeks declaratory relief to establish FGIC’s recovery from the parties that have unjustly profited from such misdeeds—the City, or the GRS and the PFRS (the “Retirement Systems”).

2. In 2005, the City was in the midst of a financial crisis. The City acknowledged this. The City’s budget was imbalanced, it had unexpected liabilities—in part as a result of judgments issued in favor of the PFRS—and decreased revenues, and, to stay afloat, it had already made substantial reductions in its workforce. On top of all this, the City was facing increased pressure from the Retirement Systems to fund each System’s unfunded accrued actuarial liabilities (“UAAL”)—obligations that the City was *constitutionally and statutorily* required to satisfy but could not service fully from its available resources. Confronted with this dilemma, the City and its advisors developed a structure that would enable the City to fund these obligations on a timely basis and in a much more cost efficient manner. This structure, described more fully in FGIC’s factual allegations, was ultimately documented and executed pursuant to the Pension Funding Transactions, which resulted in the issuance to investors of instruments known as certificates of participation. The Pension Funding Transactions, which were lauded by the City and experts at the time, are expressly authorized by City ordinances still in effect, and assisted the City in meeting its otherwise insurmountable constitutional obligations.

3. The 2005 Pension Funding Transaction was the first iteration of this structure. The 2006 Pension Funding Transaction, which allowed the City to amortize its payments under the Service Contracts (defined below) over a longer period of time, provided additional relief to the City's stressed finances. At a high level, the Pension Funding Transactions were carefully structured to create contractual obligations pursuant to which the City employed the services of two single purpose corporations tasked with assisting the City with funding its pension liabilities. This relationship was documented in the Service Contracts, pursuant to which the City became contractually obligated to compensate the Service Corporations (defined below) for their services. Importantly, the City did *not* pledge its full faith and credit in support of the Service Contracts. The nature of the City's contractual obligations under the Service Contracts was a critical component of the Pension Funding Transactions, which all interested parties were made aware of and relied upon. Indeed, contrary to what the City now expresses in its Complaint, at the time of the deals the City expressly represented—in City ordinances, in multiple presentations to and discussions with FGIC, and in the Pension Funding Transaction documents themselves—that its obligations under the Service Contracts are not indebtedness “within the meaning of the limitation of The Home Rule City Act or any Michigan constitutional or other non-tax statutory or City charter limitation.”

4. The Pension Funding Transactions allowed the City to replace sizeable annual pension payment obligations that are set by the Retirement Systems themselves using amortization periods and interest rates (nearly eight percent in 2005) chosen by the Retirement Systems with much smaller contractual payment obligations under the Service Contracts. These payment reductions resulted principally from the much lower interest rates associated with the Pension Funding Transactions due to the insurance provided by insurers, including FGIC. In

connection with the 2005 Pension Funding Transaction, for example, the City was charged a service charge nearly three percentage points per annum less than the rates used by the Retirement Systems. The Pension Funding Transactions provided the City with a much-needed reprieve from the Retirement Systems' payment demands. The Pension Funding Transactions also provided an immediate benefit to the Retirement Systems, and the people they serve—in the form of an immediate reduction of UAAL, which otherwise would have taken the City approximately 30 years to reduce or eliminate and would have been subject to the risk of payment shortfalls in each of those years, and the opportunity to benefit from significant investment earnings on the amounts funded by such transactions.

5. The City could not have achieved such cost-savings on its own, which the City has acknowledged. The City retained significant benefits from the insurance provided by FGIC in connection with the Pension Funding Transactions, which the City has acknowledged. Because the insurance provided by FGIC in connection with the Pension Funding Transactions made the financing more marketable and higher rated, the City's financing costs were much lower than what they otherwise would have been.

6. Recognizing that insurance was necessary for the City to obtain the substantial benefit it sought from the Pension Funding Transactions, the City approached FGIC early about participating in the Pension Funding Transactions. The City, through its representatives and advisors, met with FGIC in connection with both the 2005 and the 2006 Pension Funding Transactions to pitch the deals. Part of the City's pitch was to reassure FGIC that the securities FGIC was being asked to insure were backed by a reliable payment stream. In this regard, the City warranted that it would live up to and abide by its promises and had taken all necessary steps to confirm that the Pension Funding Transactions and the City's obligations under the

Service Contracts were valid and lawful, including steps to confirm that the City's obligations would not constitute indebtedness for the purpose of any statutory or constitutional debt limit. For example, in a hard-copy presentation to FGIC dated April 26, 2005, the City represented and asserted that its obligations under the Service Contracts would be valid and binding and described the nature of its obligations under the Service Contracts as contractual. The City represented and asserted that such obligations "will not constitute 'indebtedness' under the Home Rule City Act." To secure FGIC's participation, the City also provided FGIC with memoranda prepared by reputable Michigan law firms advising the City in structuring the 2005 Pension Funding Transaction, which concluded that the proposed structure for funding the City's pension obligations was valid, that any obligations incurred by the City in connection therewith would be contractual obligations not subject to the debt limit imposed by the Home Rule City Act (the "HRCA"), and that no action was required with respect to any governmental body, agency, or official. In reliance on the City's representations, FGIC agreed to assist the ailing City and provide insurance in connection with the Pension Funding Transactions.

7. For almost nine years, the City and the Retirement Systems, and the retirees they serve, have benefitted from the Pension Funding Transactions. Counsel for the City acknowledged as much in a January 3, 2014 hearing in this Court by stating that "there's no debate that the City at the time thought it had saved the City's pensions and restored their financial viability, so clearly there were benefits." Now, facing billions in liabilities, the City launched a smear campaign against the entities that funded the Pension Funding Transactions and seeks to portray the Pension Funding Transactions in a very negative light. Opportunistically, the City has engaged in "revisionist history" and now wants to characterize its obligations under the Service Contracts as full faith and credit debt obligations that run afoul of

the City's debt limit and should be declared illegal and unenforceable. In doing so, the City and the Retirement Systems seek to foist the burden of funding the City's constitutional and statutory pension obligations on the same entities that have already funded the Pension Funding Transactions.

8. The City's Complaint is baseless, particularly in light of the contractual obligations the City has acknowledged and complied with over the last nine years.

9. To the extent the Service Contracts are deemed to be invalid, the holders of certificates issued in connection with the Pension Funding Transactions (the "COPs") and the insurers who were induced to insure the Pension Funding Transactions based on fraud and misrepresentations must be made whole, and each have direct claims against the City.

JURISDICTION AND VENUE

10. This Court has jurisdiction over FGIC's Counterclaims against the City pursuant to 28 U.S.C. §§ 157(c)(1), 1334, and 2201.

11. This is a non-core proceeding. FGIC does not consent to entry of final orders or judgment by the bankruptcy court.

12. Venue is proper in this district under 28 U.S.C. § 1409.

THE PARTIES

13. FGIC is a New York stock insurance corporation licensed under Article 69 of the New York Insurance Law, with its principal place of business at 125 Park Avenue, New York, New York 10017. FGIC emerged from its rehabilitation proceeding on August 19, 2013, and is required to conduct its business in accordance with the First Amended Plan of Rehabilitation for FGIC dated June 4, 2013.

14. Counterclaim-Defendant the City is a municipal corporation located in Wayne County, Michigan.

FACTUAL ALLEGATIONS

I. Background

A. The City's Pension Obligations

15. The City has two retirement systems, the GRS and the PFRS, for the purpose of providing retirement allowances as well as death and survivor benefits for eligible City employees. The Retirement Systems are governed by independent boards.

16. Under the Michigan Constitution, the City is contractually obligated to satisfy the accrued financial benefits of the Retirement Systems, which obligations cannot be diminished or impaired by the action of the City's officials or governing body. The Michigan Supreme Court has reinforced that the Michigan Constitution expressly mandates that townships and municipalities fund all public employee pension systems to a level that includes UAAL.

17. Michigan's Public Employees Retirement System Investment Act requires that the City's annual contribution to employee retirement systems must include (1) the current service cost payment, (2) payment of at least the annual accrued amortized interest on any UAAL, and (3) payment of the annual accrued amortized portion of the unfunded principal liability.

18. Pensions are municipal obligations but they are not "debt obligations," within the common understanding of that term; rather, the expense of funding a pension is an accrued liability or general operating expense.

19. Prior to 2005, City ordinances specified detailed means for the City to meet its pension obligations through annual payments made directly by the City to the Retirement Systems (the "Traditional Funding Mechanism").

20. Annually, each Retirement System, after consulting with an actuary, determines the amount of pension contributions, including UAAL, owed by the City to the particular Retirement System for that year. The Retirement Systems and their actuaries are responsible for determining the amortization period and interest rate associated with the City's amortized payments of UAAL.

21. As of June 30, 2004, the GRS and the PFRS had an estimated total UAAL of \$913,683,202 and \$782,976,693, respectively, with interest accruing on the GRS UAAL at 7.9% per annum and the PFRS UAAL at 7.8% per annum. The amortization period for the GRS UAAL was set at 20 years while the amortization period for the PFRS UAAL was set at 13 years.

22. By 2004, annual contributions to the Retirement Systems were an increasingly large component of the City's payroll obligations. In 2004, approximately 23% of the City's payroll consisted of payment of the annual contribution to the GRS, including the service cost, UAAL and accrued interest on the UAAL, and for the PFRS, the percentage of payroll was even greater at approximately 54%.

B. The City's Deteriorating Financial Situation

23. In the years and months leading up to the 2005 Pension Funding Transaction, the City faced a number of fiscal challenges. From 2002-2005, the City's major sources of revenue decreased by nearly seven percent while, during the same time period, the City's major expenditures, including its pension obligations, increased over eight percent. The City finished fiscal year 2004 with an unexpected general fund deficit of nearly \$100 million.

24. To address its cash flow issues, the City, which at one point employed over 21,000 individuals, had already reduced its workforce by nearly 20 percent by April 2005, and

more reductions were in process. The City also sought to increase taxes and reduce certain subsidy programs to fix its imbalanced budget.

25. In March 2005, Standard & Poor's Rating Services ("S&P") downgraded its rating of the City's unlimited tax and limited tax general obligation bonds to BBB+ and BBB, respectively, based on the continued deterioration of the City's financial conditions.

C. The Retirement Systems and the City Dispute the Pension Obligations

26. During this time period, the Retirement Systems began mounting pressure against the City. The trustees of the PFRS sued the City a number of times in the years leading up to the 2005 Pension Funding Transaction, seeking judgments on account of alleged underpayments by the City of its required contributions and a declaratory judgment that the PFRS could impose a shorter amortization period for the PFRS UAAL than the period set forth in the applicable City ordinance, thus forcing the City to make ever larger annual payments to fund the PFRS UAAL.

27. In May 2005, at the time the 2005 COPs (defined below) were marketed to investors, the City had already lost two of these lawsuits and paid \$35 million to the PFRS as a result. The \$35 million payment contributed to the City's substantial unexpected general fund deficit for fiscal year 2004. The City owed, but had not yet paid, an additional \$10 million to the PFRS.

D. The Ordinances

28. As early as May 2004, the Detroit City Council (the "City Council") was considering an alternative financing mechanism for the City to fund the Retirement Systems' UAAL (the "Alternative Funding Mechanism") and the legal implications of the transactions authorized by the mechanism. In a detailed nineteen page letter from the City's certificate counsel, Lewis & Munday P.C., to the City Council, dated November 10, 2004, in response to inquiries from the City Council, the City's certificate counsel explained why the City had the

power to enter into the transactions contemplated by the Alternative Funding Mechanism and why obligations incurred by the City in connection with such transactions would be valid and binding obligations of the City and would not constitute indebtedness for purposes of the HRCA.

29. In February 2005, after consultation with the City Council and the two Retirement Systems, the City enacted three ordinances that, collectively, amended the City's Traditional Funding Mechanism and authorized the Alternative Funding Mechanism.

30. By its terms, Detroit City Ordinance No. 05-05 (the "Funding Ordinance") authorized the City to create two non-profit corporations (the "GRS Service Corporation" and the "PFRS Service Corporation," and, together, the "Service Corporations"), for the charitable purpose of assisting the City in maintaining the actuarial integrity of the Retirement Systems by funding each Retirement System's UAAL and thereby providing financial benefits to the City. The Funding Ordinance further authorized the City's Finance Director, in the name of and on behalf of the City, to enter into contracts with the Service Corporations to compensate them for these services, a form of which was approved by the City Council, and authorized the City to make payments under such contracts. The Funding Ordinance anticipated that the financing would take the form of certificates issued by a third-party funding trust evidencing an interest in the City's payments under the service contracts and, because such certificates would be issued for the benefit of the City, authorized the City to enter into certain ancillary agreements in connection with the certificates, including underwriting and disclosure agreements.

31. By their terms, Detroit City Ordinance No. 03-05 and Detroit City Ordinance No. 04-05 (the "Pension Ordinances") detail how funds realized through the Alternative Funding Mechanism and payable to the Retirement Systems (the "Funding Proceeds") would be applied within the Retirement Systems. The Pension Ordinances required that the Funding Proceeds be

deposited into a separate fund within each Retirement System, each an “Accrued Liability Fund,” which may only contain that Retirement System’s Funding Proceeds and earnings thereon. The Retirement Systems are authorized to invest the Funding Proceeds as part of each Retirement System’s overall assets; however, the Funding Proceeds must be separately accounted for and, pursuant to the Pension Ordinances, money from each Accrued Liability Fund may only be transferred into another fund within each Retirement System, the “Pension Accumulation Fund,” when, among other things, the City has certified to each Retirement System’s board that it is current on its obligations under the Service Contracts (as defined below).

32. The Funding Ordinance and Pension Ordinances are in full force and effect.

E. The Service Corporations

33. Pursuant to the Funding Ordinance, and in connection with the Alternative Funding Mechanism, the City formed the Service Corporations, which were each formally incorporated on May 2, 2005 for the purpose of “reducing the burden of government by assisting the City . . . in meeting and managing its obligations under the Michigan Constitution” to maintain the actuarial integrity of the Retirement Systems.

34. Each of the Service Corporations’ articles of incorporation, by their terms, state that they are legal entities that are “separate and distinct from the City” and that “the City shall not be responsible for any debts or other obligations” of the Service Corporations.

35. Further, the Funding Ordinance, by its terms, explicitly states that “the City shall not be responsible for any debts or other obligations” of the Service Corporations and that no such debt or obligation shall “constitute ‘indebtedness’ within the meaning of *The Home Rule City Act*.”

36. Both Service Corporations held the first meetings of their boards of directors on May 13, 2005. At the first meetings, the respective boards approved, by resolution, a number of documents related to the 2005 Pension Funding Transaction, including transactional documents and a preliminary offering circular.

37. At the first meetings, each of the boards also passed resolutions regarding the purpose of the Service Corporations, the authority of individual board members to take actions on behalf of the Service Corporations, and the legal separateness of the Service Corporations from the City.

38. On May 30, 2006, the Michigan Bureau of Commercial Services certified that both the GRS Service Corporation and the PFRS Service Corporation were validly incorporated, still validly in existence, and in good standing in Michigan. Both Service Corporations observed corporate formalities in connection with the 2006 Pension Funding Transaction, including by providing notices to the City such as a notice regarding the appointment of the Contract Administrator and a notice regarding the assignment of certain of the Service Corporations' rights under their respective 2006 Service Contracts.

39. On June 23, 2009, the Michigan Bureau of Commercial Services once again certified that both the GRS Service Corporation and the PFRS Service Corporation were validly incorporated, still validly in existence, and in good standing in Michigan. The boards of directors of both Service Corporations met on June 24, 2009 at the Coleman A. Young Municipal Center in Detroit and approved various resolutions.

40. From 2006 through and including 2012, the Service Corporations filed annual reports with the Michigan Department of Licensing and Regulatory Affairs that listed the elected

directors and officers for each Service Corporation and paid the required annual fee. The 2012 annual reports were filed in April 2013.

II. The Pension Funding Transactions

A. The 2005 Pension Funding Transaction

41. On May 25, 2005, pursuant to the Funding Ordinance, the City entered into two service contracts, one with each Service Corporation (the “2005 Service Contracts”), pursuant to which the Service Corporations agreed to reduce the “financial burden of [each Retirement System’s] Subject UAAL to the City in the current and in future years” in exchange for periodic contract payments made by the City to the Service Corporations (the “Contract Payments”). The Contract Payments include amounts sufficient to meet the Service Corporations’ funding costs (the “Service Payments”) and additional amounts to fund the Service Corporations’ general operating expenses. The Contract Payments replaced, with more favorable terms and better interest rates, the payments the City was then making to the Retirement Systems to pay the Subject UAAL.

42. On June 2, 2005, the closing date of the 2005 Pension Funding Transaction, the Service Corporations entered into a trust agreement (the “2005 Trust Agreement”) through which they formed a trust (the “2005 Funding Trust”) for the purpose of funding certain amounts of each Retirement System’s UAAL, as required by the 2005 Service Contracts. The 2005 Funding Trust agreed to provide the funding to the Service Corporations in exchange for an assignment of and security interest in certain of the City’s Service Payments.

43. In order to raise the necessary funds to pay the Service Corporations, the 2005 Funding Trust issued two series of taxable certificates of participation in an aggregate principal amount equal to the “Total Stated Funding Amounts” provided in the 2005 Service Contracts: the Series 2005-A COPs (the “Series 2005-A COPs”), with a fixed interest rate and in the

original aggregate principal amount of \$640,000,000 and the Series 2005-B COPs, with a floating interest rate and in the original aggregate principal amount of \$800,000,000 (the “Series 2005-B COPs” and together, with the series 2005-A COPs, the “2005 COPs”). The fixed interest rate on the Series 2005-A COPs ranged from 4.004% to 4.948%.

44. On June 2, 2005, contemporaneous with entering into the 2005 Trust Agreement, the Service Corporations and the 2005 Funding Trust entered into a contract administration agreement (the “2005 Contract Administration Agreement”), appointing a contract administrator (the “Contract Administrator”) to manage the relationship between the parties and facilitate the 2005 Pension Funding Transaction. The Trustee of the 2005 Funding Trust and the Contract Administrator are the same entity—initially U.S. Bank National Association and currently Wilmington Trust, National Association.

45. In connection with the 2005 Pension Funding Transaction, Lewis & Munday P.C. provided an approving opinion dated June 2, 2005 (the “2005 Approving Opinion”) concluding, among other things, that each 2005 Service Contract was validly authorized, executed and delivered by the respective Service Corporation and the City and is a valid and binding agreement of such Service Corporation and the City and is enforceable in accordance with its terms. The 2005 Approving Opinion also concluded that the City’s obligation to pay the Service Payments under the 2005 Service Contracts did not constitute indebtedness within the meaning of any Michigan law applicable to the City.

46. Lewis & Munday P.C. also issued supplemental opinions dated June 2, 2005 addressed to FGIC and other parties concluding, among other things, that no enactment of state legislation was necessary for the valid adoption by the City Council of the Funding Ordinance, no approval or other action was required to be obtained by the Service Corporations or the City

in connection with, among other things, the execution of the 2005 Service Contracts, and the obligations of the City to pay Contract Payments under the 2005 Service Contracts do not constitute indebtedness within the meaning of any limitation of Michigan law applicable to the City.

47. The City, through its Corporation Counsel, represented to FGIC that it had performed the requisite due diligence in connection with the 2005 Pension Funding Transaction to conclude that the 2005 Pension Funding Transaction was lawful. Specifically, in a June 2, 2005 letter from the City of Detroit's Corporation Counsel, Ruth C. Carter, addressed to FGIC and other participants in the 2005 Pension Funding Transaction, based on Corporation Counsel's own personal knowledge of the legal affairs of the City, as well as her review of the Funding Ordinance and Pension Ordinances, the 2005 Service Contracts, the preliminary and final offering circulars, the City Charter, applicable Michigan statutes, the Michigan Constitution, and other transaction documents and necessary documents, Corporation Counsel rendered a legal opinion to FGIC concluding, among other things, that:

- a) the 2005 Service Contracts were "duly authorized, executed and delivered by the City," and created "valid and binding obligations of the City;"
- b) the adoption of the Funding and Pension Ordinances and the execution and delivery of various transaction documents, including the 2005 Service Contracts, "do not and will not conflict with or constitute on the part of the City a breach or default under any existing law, regulation, court order, or consent decree" to which the City is subject; and
- c) *all* actions on the part of the City necessary for the making and performance of, among other things, the Service Contracts, including the creation of the Service

Corporations, have been “duly and effectively taken” and no consent, authorization, filing or registration with a governmental or regulatory officer is required for the City to enter into, and perform under, among other things, the Service Contracts.

48. The 2005 Pension Funding Transaction was lauded by municipal experts. The Bond Buyer, a leading industry publication, awarded the 2005 Pension Funding Transaction “Midwest Regional Deal of the Year” because the transaction utilized a creative structure to service Detroit’s pension liabilities at a significant cost savings to the City.

B. The 2006 Pension Funding Transaction

49. In June 2006, in order to take advantage of recent extensions of the required amortization period for funding the UAAL of the GRS and PFRS, the City entered into a new service contract with each Service Corporation (the “2006 Service Contracts” and, together with the 2005 Service Contracts, the “Service Contracts”). Through these contracts, the City replaced certain scheduled obligations under the 2005 Service Contracts with new payment obligations extended over the newly authorized 30-year period. As under the 2005 Service Contracts, the City’s payment obligations under the 2006 Service Contracts include Service Payments in amounts sufficient to meet the Service Corporations’ funding costs and additional amounts to fund the Service Corporations’ general operating expenses. This type of refunding transaction was specifically contemplated, and authorized, by the Funding Ordinance and an April 26, 2006 resolution of the City Council.

50. In connection with the 2006 Pension Funding Transaction, the Service Corporations established an additional funding trust (the “2006 Funding Trust” and, together with the 2005 Funding Trust, the “Funding Trusts”), which agreed to provide the funds necessary to satisfy the Service Corporations’ obligations under the 2006 Service Contracts in exchange for

an assignment of and security interest in certain of the City's payment obligations thereunder. To raise the necessary funds to pay the Service Corporations, the 2006 Funding Trust issued two series of COPs in an aggregate principal amount equal to the "Stated Funding Amounts" provided in the 2006 Service Contracts: the Series 2006-A COPs (the "Series 2006-A COPs"), with a fixed interest rate and in the original aggregate principal amount of \$148,540,000, and the Series 2006-B Cops (the "Series 2006-B COPs" and, together with the Series 2006-A COPs, the "2006 COPs"), with a floating interest rate and in the original aggregate principal amount of \$800,000,000.

51. The 2006 Funding Trust and the Service Corporations also entered into a contract administration agreement (the "2006 Contract Administration Agreement") appointing the Contract Administrator to facilitate the 2006 Pension Funding Transaction, including the redemption of certain 2005 COPs, and take certain actions on behalf of the parties.

52. In connection with the 2006 Pension Funding Transaction, Lewis & Munday P.C. provided an approving opinion dated June 12, 2006 (the "2006 Approving Opinion") concluding, among other things, that the City has the power to enter into the 2006 Service Contracts, each 2006 Service Contract was validly authorized, executed and delivered by the respective Service Corporation and the City and is a valid and binding agreement of such Service Corporation and the City and is enforceable in accordance with its terms. The 2006 Approving Opinion also concluded that the City's obligation to pay the Service Payments under the 2006 Service Contracts did not constitute indebtedness within the meaning of any Michigan law applicable to the City.

53. Lewis & Munday P.C. also issued a supplemental opinion dated June 12, 2006 addressed to FGIC and other parties concluding, among other things, that no approval or other

action was required to be obtained by the Service Corporations or the City in connection with, among other things, the execution of the 2006 Service Contracts, and that the obligations of the City to pay Contract Payments under the 2006 Service Contracts do not constitute indebtedness within the meaning of any limitation of Michigan law applicable to the City.

54. Lewis & Munday P.C. also informed the insurers, including FGIC, on the City's behalf that, under Michigan law, the City could not avoid a contract, such as the Service Contracts, under which it has accepted the benefits, including the benefits of FGIC's insurance, and retain those benefits, including such insurance benefits.

55. The City, through its Corporation Counsel, represented to FGIC that it had performed the requisite due diligence and legal analysis in connection with the 2006 Pension Funding Transaction to conclude that the 2006 Pension Funding Transaction was lawful. In a June 12, 2006 letter from the City of Detroit's Corporation Counsel, John E. Johnson Jr., addressed to FGIC and other parties to the 2006 Pension Funding Transaction, Corporation Counsel rendered a legal opinion to FGIC concluding, among other things, that:

- a) the 2006 Service Contracts were "duly authorized, executed and delivered by the City," and created "valid and binding obligations of the City;"
- b) the resolution passed in connection with the 2006 Pension Funding Transaction and the execution and delivery of various transaction documents, including the 2006 Service Contracts, "do not and will not conflict with or constitute on the part of the City a breach or default under any existing law, regulation, court order, or consent decree" to which the City is subject; and
- c) *all* actions on the part of the City necessary for the making and performance of, among other things, the Service Contracts, including the creation of the Service

Corporations, have been “duly and effectively taken” and no consent, authorization, filing or registration with a governmental or regulatory officer is required for the City to enter into, and perform under, among other things, the Service Contracts.

56. Corporation Counsel reached the conclusions in his June 12, 2006 opinion after reviewing numerous documents, including the 2006 Service Contracts, the preliminary and final offering circulars related to the 2006 Pension Funding Transaction, the Funding Ordinance and Pension Ordinances, the City Charter, applicable Michigan statutes, the Michigan Constitution, and based on his own familiarity with the legal affairs of the City.

C. The City’s Obligations and Representations Under the Service Contracts

57. As discussed below, in all four of the Service Contracts, the City expressly represented and warranted, among other things, that the City was authorized to enter into the Pension Funding Transactions and that the City’s obligations under the Service Contracts do not constitute indebtedness within the meaning of the HRCA or any Michigan constitutional or other non-tax statutory or City charter limitation. These representations were made on May 25, 2005 and June 7, 2006 by the City, through its Finance Director (as authorized by the Funding Ordinance), for the benefit of the Service Corporations, the Funding Trusts, COPs holders, and third-party beneficiaries which, in the Service Contracts, explicitly includes insurers such as FGIC.

58. Under the terms of the Service Contracts, FGIC has the benefit of the representations and warranties made by the City therein and is “conclusively presumed” to have relied upon such representations and warranties.

59. Under the terms of the Service Contracts, FGIC has the right to enforce the promises made in the Service Contracts as if such promises were made directly to it.

60. Under the terms of the Service Contracts, FGIC has the same rights as a COPs holder because FGIC has received assignment of certain COPs in exchange for FGIC's payment of claims under its insurance policies and has become subrogated to such COPs holders' rights (as discussed below).

61. In each of the Service Contracts, the City expressly waived any right "conferred by statute or otherwise to quit, terminate, cancel or surrender" any obligation of the City under the Service Contracts.

62. The offering circulars used to market the COPs, as well as the Service Contracts themselves, explicitly state that the City's obligations under the Service Contracts are "absolute and unconditional" continuing contract obligations of the City that are binding upon, and enforceable against, the City but are *not* obligations to which the City has pledged its full faith and credit.

63. As required under the Trust Agreements, each COP includes a statement, in capital letters, indicating that it does *not* create any "indebtedness" of the City within the meaning of any applicable law.

64. As recently as 2009, the City ratified and confirmed the 2006 Service Contracts in amendments to the 2006 Service Contracts.

III. FGIC's Participation in the Pension Funding Transactions

A. FGIC is Induced to Insure the COPs

65. From 2004 to 2006, the City solicited FGIC to issue insurance policies (collectively, the "Policies") to guarantee payment of interest and principal on the COPs. The City sought insurance from FGIC in order to improve the ratings on the COPs issuances, which, in turn, made the COPs more marketable to investors and allowed the COPs to be marketed at

lower interest rates, thus saving the City a considerable amount of money in corresponding reduced Service Payments.

66. In connection with the underwriting process, the City and the underwriters provided FGIC with memoranda prepared by two law firms: (i) a memorandum dated May 12, 2004 from Honigman Miller Schwartz and Cohn LLP addressed to Jeffrey Scruggs, Robert Doherty and Freda Wang, UBS Financial Services Inc., and Sean Werdlow, the City's Chief Financial Officer, and (ii) a memorandum dated August 18, 2004 from Lewis & Munday P.C. addressed to Sean Werdlow, the City's Chief Financial Officer (together, the "2004 Memos"). In the 2004 Memos, both firms opine that the City's contractual obligations under the proposed Alternative Funding Mechanism could not constitute indebtedness under Michigan law or be subject to any limitations on the City's net indebtedness capacity and the COPs could not constitute municipal securities as defined in Michigan's Revised Municipal Finance Act (the "RMFA") and, thus, could be issued without approval from the Michigan Department of Treasury or any other Michigan department or agency. The 2004 Memos cite as support the following facts:

- a) the City's contractual obligations under the proposed Alternative Funding Mechanism are not limited or unlimited tax obligations;
- b) there is no direct or indirect pledge of the City's full faith and credit;
- c) several Michigan Supreme Court decisions in a variety of circumstances have found that municipal obligations that meet a public necessity and are paid from current revenues year to year cannot be "indebtedness" in the sense of a statutory indebtedness limitation, even if the aggregate sum of all payments would exceed the statutory limitation;

- d) the City's contractual obligations under the proposed Alternative Funding Mechanism merely replaced the City's payments under the Traditional Funding Mechanism, which did not constitute indebtedness; and
- e) the City's contractual obligations under the proposed Alternative Funding Mechanism permit the City to improve its financial condition, which presents a compelling factual predicate for concluding that the City's contractual obligations are not indebtedness.

67. The City also made representations to FGIC in numerous presentations regarding the Alternative Funding Mechanism and proposed 2005 Pension Funding Transaction. In a presentation dated July 2004 by the City of Detroit and UBS, and titled "Pension Obligation Certificates Update" (the "July 2004 Detroit Presentation") the City represented, among other things, that:

- a) the COPs "do not create any additional liability, but rather provide an alternate method for funding the City's constitutional and statutory obligations to fund existing liabilities for the [Retirement] Systems' UAALs";
- b) the City's contractual obligations "will not be a general obligation to which the City has pledged its full faith and credit or its taxing powers"; and
- c) the City's contractual obligations "will not constitute 'indebtedness' under the [HRCA] and, thus, will not count against the City's debt limit."

68. Similarly, an October 2004 presentation sent to FGIC by UBS titled "Updated Information on Pension Obligation Certificate Transaction for Insurers" (the "October 2004 Presentation"), makes representations regarding the 2005 Pension Funding Transaction structure, including the following:

- a) the “Service Contracts will be valid and enforceable as any other City contract”;
- b) the “transaction structure, including the COPs, does not create any additional liability for the City, but rather provides an alternative method to fund the City’s statutory obligation for its existing UAAL”; and
- c) “[a]ccording to Certificate Counsel, the Service Contract and the Service Payment obligation will not constitute ‘indebtedness’ under the [HRCA] and, thus, will not count against the City’s debt limit.”

69. The City also made representations to FGIC in a hard-copy and in-person presentation on April 26, 2005 (the “2005 Detroit Presentation” and together with the July 2004 Detroit Presentation and the October 2004 Detroit Presentation, the “Detroit Presentations”). The participants in the presentation include: Sean Werdlow, Finance Director, City of Detroit; Thomas Gavin, Managing Director, Robert W. Baird & Co.; G. Allen Bass, Lewis & Munday, P.C.; John Kamins, Honigman Miller Schwarz and Cohn LLP; and several employees from UBS Financial Services, Inc.

70. The 2005 Detroit Presentation set forth key points of the proposed 2005 Pension Funding Transaction, including:

- a) the City’s obligation to fund the GRS and PFRS is not discretionary and is constitutionally-mandated;
- b) the combined UAAL of the Retirement Systems as of fiscal year 2004 was estimated at approximately \$1.7 billion and would accrue interest at 7.8%-7.9%;
- c) the proposed 2005 Pension Funding Transaction would allow the City to manage this obligation at much lower rates and would save the City approximately \$460 million (\$390 million present value in 2005);

- d) the proposed 2005 Pension Funding Transaction would allow the City to realize both cash flow relief in the near term and long-term savings; and
- e) from “a legal perspective,” the City’s obligations under the proposed Service Contracts were identical to the City’s pension funding obligations at the time (*i.e.*, “converting a hard obligation into another hard obligation”).

71. As part of the 2005 Detroit Presentation, the City represented to FGIC that the proposed 2005 Pension Funding Transaction would reduce the expected UAAL funding rate the City was obligated to pay from 7.8% and 7.9% to approximately 5.8% and thus result in substantial cost savings to the City.

72. In addition, the City represented to FGIC in the 2005 Detroit Presentation that the legal structure of the proposed 2005 Pension Funding Transaction would accomplish certain objectives, including:

- a) creating “a valid and binding funding structure within constitutional, statutory and charter provisions;”
- b) using none of the City’s debt capacity; and
- c) making the statutory rights and remedies already available to the Retirement Systems also available to the COPs holders.

73. The City also represented to FGIC in the 2005 Detroit Presentation that the proposed 2005 Transaction was supported by legal authority, including (i) the Michigan Constitution, (ii) the Michigan Public Employees Retirement System Investment Act, and (iii) three City Council ordinances, each adopted in February 2005.

74. In connection with the underwriting process, prior to April 28, 2005, the City provided FGIC with drafts of the transaction documents, including draft 2005 Service Contracts,

to review and comment on as well as financial information regarding the City, such as the City's five-year projected budget.

75. The City made a number of representations in the 2005 Service Contracts, dated May 25, 2005, including representations that:

- a) the City's obligations under the 2005 Service Contracts are unconditional contractual obligations of the City;
- b) the City's payment obligations under the 2005 Service Contracts do not constitute or create any "indebtedness" of the City within the meaning of the HRCA or any constitutional, statutory, or charter limitation;
- c) the 2005 Service Contracts constitute valid and binding agreements of the City enforceable in accordance with their terms; and
- d) all acts, conditions and things required by the constitution and laws of the State of Michigan or City ordinance to exist, to have happened and to have been performed as a condition precedent to the City's execution and delivery of the 2005 Service Contracts existed, had happened and had been performed in due time, form and manner required by Michigan constitution or law in order to make the 2005 Service Contracts valid and binding obligations of the City.

76. In reliance on numerous representations, including those referenced above, FGIC issued certain of the Policies, as discussed below.

77. At the time the 2005 Pension Funding Transaction was negotiated and entered into, it was contemplated that the City might enter into a refunding transaction amortizing the City's payment obligations under the 2005 Service Contracts over a longer period of time. In

May 2005, the City was involved in litigation and negotiations with the PFRS about this amortization period.

78. Prior to May 12, 2006, the City approached FGIC about participating in such a refunding and FGIC met with senior staff from the City's finance and economic development departments. To that end, the City provided FGIC with a five-year projection of the City's finance operations, information about the City's payroll reduction efforts, and tables detailing how the 2006 Pension Funding Transaction would provide significant cost savings to the City. City officials assured FGIC that the City had a workable plan to address the City's financial challenges in light of recent rating agency downgrades.

79. In connection with FGIC's underwriting process, prior to the 2006 Pension Funding Transactions, the City provided FGIC with drafts of the transaction documents, including draft 2006 Service Contracts, to review and comment on.

80. The City made a number of representations in the 2006 Service Contracts, including representations that:

- a) the City's obligations under the 2006 Service Contracts are unconditional contractual obligations of the City;
- b) the City's payment obligations under the 2006 Service Contracts do not constitute or create any "indebtedness" of the City within the meaning of the HRCA or any constitutional, statutory, or charter limitation;
- c) the 2006 Service Contracts constitute valid and binding agreements of the City enforceable in accordance with their terms; and
- d) all acts, conditions and things required by the constitution and laws of the State of Michigan or City ordinance to exist, to have happened and to have been

performed as a condition precedent to the City's execution and delivery of the 2006 Service Contracts existed, had happened and had been performed in due time, form and manner required by Michigan constitution or law in order to make the 2006 Service Contracts valid and binding obligations of the City.

81. In reliance on these numerous representations, FGIC issued certain of the Policies, as discussed below.

B. The Policies

82. FGIC issued the Policies guaranteeing the scheduled payment of principal and interest on (i) \$1,000,000,000 in original aggregate principal amount of 2005 COPs,² (ii) \$148,540,000 in aggregate principal amount of Series 2006-A COPs, and (iii) \$500,845,000 in aggregate principal amount of Series 2006-B COPs (the "FGIC-Insured COPs").

83. As discussed above, the City sought out FGIC's participation in each of the Pension Funding Transactions prior to marketing the applicable COPs to investors or entering into the related Service Contracts.

84. FGIC's insurance was vital to the success of the Pension Funding Transactions; because of the Policies, the FGIC-Insured COPs received significantly higher ratings and were more marketable to investors. Specifically, as a direct result of the insurance policies issued in connection with the 2005 COPs, including the Policy issued by FGIC, the 2005 COPs received ratings from S&P, Moody's Investors Service, Inc. ("Moody's") and Fitch Ratings ("Fitch") of "AAA," "Aaa," and "AAA," respectively, at the time of issuance. If insurance policies were *not* issued, the 2005 COPs would have been rated "BBB," "Baa1," and "BBB+," respectively, at the time of issuance. With the insurance policies, including those issued by FGIC, the 2006 COPs

² The total aggregate principal amount of outstanding 2005 COPs insured by FGIC as of February 14, 2014 was \$450,615,000.

were rated “AAA” by S&P and Fitch and “Aaa” by Moody’s.; without insurance, the 2006 COPs would have been rated “BBB-” by S&P, “Baa2” by Moody’s, and “BBB” by Fitch, in each case at the time of issuance.

85. Further, pursuant to the City’s underwriting agreement, the underwriters’ participation in the Pension Funding Transactions was conditioned upon receipt of certain documents, many of which related to, or could only be delivered in connection with, insurance.

86. Finally, the City itself acknowledged, in two letter agreements dated June 2, 2005 and June 12, 2006 addressed to FGIC and XL Capital Assurance Inc. (the “Insurer Letter Agreements”), that it received “significant benefits” from the insurance, “including reducing the amounts of Service Charges payable by the City under the Service Contracts.” The City projected in 2005 that this reduction in service charges would generate overall savings to the City of over \$460 million over the life of the transaction (\$390 million on a net present value basis). Accordingly, the City’s payment obligations under the Service Contracts were significantly lower than its payment obligations under the Service Contracts would have been had FGIC not issued the Policies. In addition, by extending the City’s payment obligations under the Service Contracts over a 30-year period, the 2006 Pension Funding Transaction provided the City with essential cash flow relief.

C. FGIC’s Payments Under the Policies and Proofs of Claim

87. To date, FGIC has made payments on claims for amounts that are due and owing, but unpaid, in connection with the FGIC-Insured COPs. To the extent of such payments and pursuant to the terms of the Policies and the Service Contracts, FGIC has been subrogated to the rights of the owners of the FGIC-Insured COPs and has been assigned their certificates of participation (or coupons thereof or rights to payment therein, as the case may be). Pursuant to

the terms of the Policies, FGIC will be subrogated to and assigned FGIC-Insured COPs to the extent of any future payments that it makes pursuant to the Policies.

88. The filing for chapter 9 relief by the City triggered an acceleration clause in the Service Contracts. Pursuant to that clause, all remaining payments due under the Service Contracts are due and payable.

89. On February 18, 2014, pursuant to that certain Order entered November 21, 2013 (Docket No. 1782), FGIC filed two proofs of claim (the “Proofs of Claim”) asserting claims against the City in connection with:

- a) FGIC’s rights as an express third-party beneficiary under the Service Contracts, pursuant to which FGIC has the right to enforce the City’s obligations under the Service Contracts as if the City had directly promised to pay those amounts to FGIC, which obligations include all amounts due and owing, but unpaid, or outstanding under the Service Contracts in connection with the FGIC-Insured COPs and payment of certain of FGIC’s fees and expenses; and
- b) FGIC’s interest as subrogee to and assignee of FGIC-Insured COPs, pursuant to which FGIC has claims for all amounts due and owing, but unpaid, or outstanding under the Service Contracts in connection with the FGIC-Insured COPs.

IV. The City Withholds Information on the Legality of the Alternative Funding Mechanism from FGIC

90. Upon information and belief, prior to the closing of the 2005 Pension Funding Transaction, the City sought and received legal advice from a Detroit-area law firm regarding the legality of the Alternative Funding Mechanism, and such law firm questioned the legality of the Alternative Funding Mechanism and refused to participate in the 2005 Pension Funding Transaction. The City did not share this legal advice with FGIC or inform FGIC that the law

firm had refused to participate in the 2005 Pension Funding Transaction. Instead, the City provided FGIC with the 2004 Memos and related correspondence, through which the City represented that it took all necessary steps to assess the legality of the Alternative Funding Mechanism and Pension Funding Transactions and had conclusively determined that the City's contractual obligations under the Pension Funding Transactions at issue could not constitute indebtedness under Michigan law or be subject to any limitations on the City's net indebtedness capacity.

V. The Retirement Systems Participated in, and Benefited from, the Pension Funding Transactions

A. The Retirement Systems Participated in Structuring the Pension Funding Transactions

91. The Retirement Systems participated in both the 2005 and 2006 Pension Funding Transactions.

92. In connection with the 2005 Pension Funding Transaction, the Retirement Systems provided the City with an opinion letter from their auditor, Plante & Moran, PLLC, discussing the Pension Ordinances and treatment of the Funding Proceeds within each System.

93. In connection with the 2005 Pension Funding Transaction, each Retirement System provided the City with certifications detailing the amount of the respective System's UAAL and, upon receipt of the applicable Funding Proceeds, certificates acknowledging receipt of such funds and "payment in full and discharge of a corresponding amount of" UAAL.

94. In 2004 and 2005, Sean Werdlow, the Chief Financial Officer and Finance Director of the City, was *ex officio* Secretary to the board of trustees of both the PFRS and GRS.

95. The 2006 Pension Funding Transaction resulted from resolutions passed by the boards of directors of the GRS and the PFRS providing for amortization periods of 30 years. These extended periods were adopted for the City's benefit. The resolutions of the GRS board of

directors explicitly state that the City requested that the board adopt this extended 30 year amortization period.

B. The Retirement Systems Have Benefitted From the Funding Proceeds

96. As required under the 2005 Service Contracts, the Funding Trust, as assignee of those contracts, paid the COPs proceeds to the Contract Administrator to be administered as outlined in the Service Contracts. On June 2, 2005, the Funding Proceeds were paid to each Retirement System as provided in the 2005 Service Contracts. Per the 2005 Service Contracts, \$739,793,898 was paid to and received by the GRS, and \$630,839,189 was paid to and received by the PFRS. The Funding Proceeds were deposited into the applicable Accrued Liability Fund within each Retirement System.

97. The independent auditors of the Retirement Systems verified that the Funding Proceeds from the 2005 Pension Funding Transaction once deposited in the respective Accrued Liability Funds within each Retirement System, would, from an actuarial and accounting perspective, be deemed to have funded the respective UAAL of each Retirement System to the extent of the deposited Funding Proceeds.

98. As mandated by the Pension Ordinances, each Accrued Liability Fund contains the relevant Funding Proceeds and any interest, dividends, income or other earnings derived from investment of the Funding Proceeds, which earnings are credited annually to the Accrued Liability Fund based on the total rate of investment return of each Retirement System's overall assets. Further, each Accrued Liability Fund is accounted for separately in the Systems' annual audit reports.

99. Until June 2013, the City regularly made its Contract Payments to the Service Corporations, as provided in the Service Contracts, and allocated the liability associated with the

Service Contracts among a number of governmental funds and organizations whose retirees benefited from the Pension Funding Transactions.

100. If the City has no available funds to make the Service Payments, under the terms of the Pension Ordinances, the City may certify this fact to the Retirement Systems; upon receipt of such certification by the Retirement Systems, each respective Board is authorized to make the transfer of funds from the Accrued Liability Fund to the Pension Accumulation Fund for that year.

101. Pursuant to the Insurer Letter Agreements, the City is contractually obligated to “promptly” notify FGIC of any such certification to the Retirement Systems.

102. The City missed a required payment under the Service Contracts in June 2013 and has not made any subsequent payments under those contracts.

103. Upon information and belief, contrary to the terms of the Pension Ordinances, the City has not provided any certification to the Retirement Systems and has failed to notify FGIC of any such certification.

104. On February 14, 2014, counsel for the Retirement Systems was asked to confirm in writing that the Retirement Systems were complying with the Pension Ordinances. To date, no such confirmation has been made.

105. According to the 2012 Financial Report of the PFRS, the most recent PFRS financial report available, as of June 30, 2012, the PFRS Accrued Liability Fund contained \$695,971,515. According to the 2013 Financial Report of the GRS, the most recent GRS financial report available, as of June 30, 2013, the GRS Accrued Liability Fund contained \$816,985,139. The 2013 Financial Report of the GRS reflects that, in the fiscal year ending June 30, 2013, the GRS transferred \$57,461,792 from its Accrued Liability Fund to its Pension

Accumulation Fund. As financial data for the fiscal year ending June 30, 2013 is not yet available for the PFRS, FGIC is unable to confirm whether a comparable transfer was made within the PFRS.

VI. The City Has Repeatedly Affirmed the Validity of the Pension Funding Transactions

106. Since 2005, the City has consistently affirmed the validity of the Pension Funding Transactions and the nature of its obligations thereunder in, among other things, its financial reports and offering circulars. In the City's annual financial reports, its payment obligations under the Service Contracts are described as "current" liabilities and are distinguished from liabilities that constitute "debt" subject to the City's debt limit. The liabilities included in the City's debt limit analysis generally appear to include obligations to which the City pledged its full faith and credit and thus is obligated to raise taxes to repay, but do not include contract obligations like the Service Contracts.

107. Further, in offering circulars issued by the City in 2008 and 2011, the City explicitly states that the "payments made by the City under the [S]ervice [C]ontracts are not debt of the City but are contractual obligations and are payable in addition to the debt" discussed elsewhere in the circulars. In a number of other offering circulars issued between 2005 and 2011, the City lauded the benefits of the Pension Funding Transactions, noting that they would reduce the City's costs and "better ensure the timely and full payment of retirement benefits." In those circulars, the City also notes that it is "contractually obligated" to make payments under the Service Contracts and that those payments are "intended to replace payments the City would otherwise make to meet its constitutional obligation" to fund the Retirement Systems' UAAL.

108. The City provides no indication as to when or why the City changed its mind about the nature of its payment obligations under the Service Contracts. For years, it has

provided the same message regarding the validity of these obligations that it provided to FGIC in 2004, 2005, and 2006 to induce FGIC to issue the Policies.

FIRST COUNTERCLAIM
(Declaratory Judgment Against the City for Contract Interpretation)

109. FGIC re-alleges and incorporates by reference paragraphs 1 through 108 of these Counterclaims.

110. The City has a constitutionally and statutorily mandated, non-discretionary obligation to fund the Retirement Systems' UAAL.

111. The Service Contracts and the City's payment obligations thereunder do not constitute "indebtedness" subject to the net indebtedness limitation in the HRCA and are not subject to the requirements of the RMFA.

112. The City made numerous representations to FGIC in connection with the Pension Funding Transactions, including that it took all necessary steps and conclusively determined that the City's obligations under the Service Contracts did not create "indebtedness" subject to the net indebtedness limitation in the HRCA, that the Service Contracts constitute valid and binding agreements of the City enforceable in accordance with their terms, and that all conditions precedent to the City's execution and delivery of the Service Contracts were met in order to make the Service Contracts valid and binding obligations of the City.

113. The City also represented to FGIC that the City could not avoid a contract, such as the Service Contracts, under which it has accepted the benefits, including the benefits of FGIC's insurance, and retain those benefits, including such insurance benefits.

114. The Service Contracts and the City's payment obligations thereunder constitute a lawful means of fulfilling the City's constitutional and statutory obligation to fund the Retirement Systems' UAAL. The Contract Payments the City owes under the Service Contracts

merely replace, at a lower cost, the payments the City would have made under the Traditional Funding Mechanism to satisfy its constitutional and statutory obligations.

115. FGIC has paid policy claims arising in connection with the City's failure to make certain Service Payments under the Service Contracts and is subrogated to and has been assigned the rights of the owners of the related COPs with respect to such payments. If the Court determines that the City has no obligations under the Service Contracts, the Funding Trusts will not have funds to make payments owed to, among others, the owners of FGIC-Insured COPs and, as a result, claims will likely continue to be asserted against FGIC under the Policies.

116. FGIC also has a contractual right to payment of certain of its fees and expenses, which right will be impaired if the Court determines that the City has no obligations under the Service Contracts.

117. FGIC has filed proofs of claim to preserve and enforce its rights under the Service Contracts, including with respect to policy claims on FGIC-Insured COPs that have been paid to date and may be paid in the future as a result of the City's failure to meet its obligations under the Service Contracts.

118. An actual controversy has arisen and now exists between the parties that is ripe for adjudication because the City has initiated the Adversary Proceeding and asked this Court to find the Service Contracts and the City's contractual obligations thereunder invalid, void *ab initio*, or otherwise unenforceable, and as such, there is substantial controversy of sufficient immediacy and reality to warrant issuance of a declaratory judgment. The declaratory relief FGIC seeks will resolve the dispute among the parties completely and will avoid inconsistent adjudications.

119. Accordingly, pursuant to 28 U.S.C. § 2201 and Federal Bankruptcy Rule 7001, FGIC is entitled to a declaration that:

- a) the Service Contracts and the City's obligations thereunder are valid, legal, and enforceable contractual obligations under applicable Michigan law;
- b) 11 U.S.C. § 502(b)(1) is not a basis to disallow claims asserted in connection with the City's payment obligations under the Service Contracts; and
- c) FGIC should have an allowed claim against the City for any and all amounts paid in respect of claims that have arisen to date and may arise in the future under the Policies and any other amounts payable to FGIC under the Service Contracts.

120. In the alternative, pursuant to 28 U.S.C. § 2201 and Federal Bankruptcy Rule 7001, FGIC is entitled to a declaration that:

- a) the City is estopped from denying the validity, legality or enforceability of the Service Contracts or the City's obligations thereunder; and
- b) FGIC should have an allowed claim against the City for any and all amounts paid in respect of claims that have arisen to date and may arise in the future under the Policies and any other amounts payable to FGIC under the Service Contracts.

**SECOND COUNTERCLAIM
(Against the City for Fraudulent Inducement)**

121. FGIC re-alleges and incorporates by reference paragraphs 1 through 120 of these Counterclaims.

122. The City in its Complaint alleges that the Service Contracts and all other contractual or other obligations incurred by the City in connection with the Pension Funding Transactions are unenforceable and void *ab initio*, and that the purpose, design, and effect was to violate state laws.

123. Assuming, *arguendo*, that the City's claims are meritorious, which FGIC denies, then the City induced FGIC to issue the Policies through material and fraudulent misrepresentations and omissions. As described in more detail above, the City made numerous representations in connection with the Pension Funding Transactions, including that it took all necessary steps and conclusively determined that the City's obligations under the Service Contracts did not create "indebtedness" subject to the net indebtedness limitation in the HRCA, that the Service Contracts constitute valid and binding agreements of the City enforceable in accordance with their terms, that all conditions precedent to the City's execution and delivery of the Service Contracts were met in order to make the Service Contracts valid and binding obligations of the City, and that the City could not avoid the Service Contracts, under which it has accepted benefits, including the benefits of FGIC's insurance, and retain those benefits, including such insurance benefits. The City also chose to share only select legal opinions with FGIC; the City kept from FGIC legal advice questioning the legality of the Alternative Funding Mechanism while, concurrently, providing FGIC with the 2004 Memos.

124. The City represented, through the 2004 Memos it provided to FGIC and through the opinions of its outside counsel and Corporation Counsel, that the City took all necessary steps and had conclusively determined that the City's contractual obligations under the Pension Funding Transactions at issue could not constitute indebtedness under Michigan law or be subject to any limitations on the City's net indebtedness capacity.

125. The misrepresentations were also made in the Detroit Presentations provided to FGIC, including the 2005 Detroit Presentation in which the City, represented by its Finance Director Sean Werdlow, participated in person. The Detroit Presentations included, without limitation, representations that:

- a) the City's obligation to fund the GRS and PFRS is not discretionary and is constitutionally mandated;
- b) from a "legal perspective," the City's obligations under the Service Contracts were identical to the City's pension funding obligations at the time because they "convert[ed] a hard obligation into another hard obligation" and did not create additional liability;
- c) the proposed 2005 Pension Funding Transaction would create "a valid and binding funding structure within constitutional, statutory and charter provisions";
- d) the Alternative Funding Mechanism and the proposed 2005 Pension Funding Transaction were supported by legal authority including the Michigan Constitution, the Michigan Public Employees Retirement System Investment Act, and three City Council ordinances adopted in February 2005;
- e) the proposed 2005 Pension Funding Transaction would use none of the City's debt capacity; and
- f) the COPs holders had the same statutory rights and remedies already available to the Retirement Systems to enforce the City's obligations.

126. These misrepresentations were also made in the Service Contracts and related transaction documents for both Pension Funding Transactions that senior staff from the finance and economic development departments of the City provided to FGIC, in both draft and final form, for the purpose of inducing FGIC to issue the Policies in 2005 and 2006. As set forth above, these statements included, without limitation, representations that:

- a) the City's obligations under the Service Contracts are unconditional contractual obligations of the City;

- b) the City's payment obligations under the Service Contracts do not constitute or create any "indebtedness" of the City within the meaning of the HRCA or any constitutional, statutory, or charter limitation;
- c) the Service Contracts constitute valid and binding agreements of the City enforceable in accordance with their terms; and
- d) all acts, conditions and things required by the constitution and laws of the State of Michigan or City ordinance to exist, to have happened and to have been performed as a condition precedent to the City's execution and delivery of the Service Contracts existed, had happened and had been performed in due time, form and manner required by Michigan constitution or law in order to make the Service Contracts valid and binding obligations of the City.

127. The City intentionally omitted material information regarding the legality of the Alternative Funding Mechanism from FGIC. Prior to the closing of the 2005 Pension Funding Transaction, a Detroit-area law firm refused to participate in the transaction because the law firm questioned the legality of the Alternative Funding Mechanism. The City did not inform FGIC that it had sought legal advice related to the Alternative Funding Mechanism from the law firm, that the law firm had questioned the legality of the Alternative Funding Mechanism, or that the law firm had refused to participate in the 2005 Pension Funding Transaction.

128. The City now alleges in its Complaint that the many representations and statements it made in connection with the Pension Funding Transactions were false.

129. The City intended for its fraudulent statements to induce FGIC's issuance of the Policies.

130. The City's misrepresentations and omissions were material to FGIC's decision to issue the Policies effective June 2, 2005 and June 12, 2006. FGIC reasonably relied upon the City's fraudulent statements when it agreed to issue the Policies. Had FGIC been aware of the true facts, it would not have issued the Policies.

131. By issuing the fraudulently induced Policies, FGIC insured payments of principal and interest on the COPs, which represent interests in the right to receive certain Service Payments that the City now alleges it was never authorized to pay.

132. The City has directly benefited from its misrepresentations and omissions because FGIC's issuance of the Policies increased the ratings on the COPs and made the COPs more marketable to investors. This permitted the Service Corporations, on behalf of the City, to obtain the necessary funds from the sale of COPs to substantially reduce the UAAL of the Retirement Systems. FGIC's insurance also reduced the amount the Service Corporations charged the City for their services in funding the UAAL of the Retirement Systems, which resulted in significant cash flow relief for the City and generated hundreds of millions of dollars of savings over the costs the City would have incurred had it funded such obligations directly pursuant to the Traditional Funding Mechanism.

133. An actual controversy has arisen and now exists between the parties that is ripe for adjudication because the City has initiated the Adversary Proceeding and asked this Court to find the Service Contracts and the City's contractual obligations thereunder invalid, void *ab initio*, or otherwise unenforceable, and as such, there is substantial controversy of sufficient immediacy and reality to warrant issuance of a declaratory judgment. The declaratory relief FGIC seeks will resolve the dispute among the parties completely and will avoid inconsistent adjudications.

134. Accordingly, if the Court finds the Service Contracts and all other contractual or other obligations incurred by the City in connection with the Pension Funding Transactions are unenforceable and void *ab initio*, FGIC is entitled to a declaration that FGIC was fraudulently induced to issue the Policies and has incurred and will incur damages in an amount to be determined at trial.

THIRD COUNTERCLAIM
(Against the City for Misrepresentation)

135. FGIC re-alleges and incorporates by reference paragraphs 1 through 134 of these Counterclaims.

136. The City in its Complaint alleges that the Service Contracts and all other contractual or other obligations incurred by the City in connection with the Pension Funding Transactions are unenforceable and void *ab initio*, and that the purpose, design, and effect was to violate state laws.

137. Assuming, *arguendo*, that the City's claims are meritorious, which FGIC denies, then the City made statements that were (i) false representations of material fact to FGIC; (ii) made in connection with negotiations between the City and FGIC over FGIC's participation as insurer of the Pension Funding Transactions; (iii) intended for FGIC to rely upon; and (iv) reasonably relied upon by FGIC to its detriment and the City's benefit.

138. As described in more detail above, the City made numerous representations in connection with the Pension Funding Transactions, including that it took all necessary steps and conclusively determined that the City's obligations under the Service Contracts did not create "indebtedness" subject to the net indebtedness limitation in the HRCA, that the Service Contracts constitute valid and binding agreements of the City enforceable in accordance with their terms, that all conditions precedent to the City's execution and delivery of the Service Contracts were

met in order to make the Service Contracts valid and binding obligations of the City, and that the City could not avoid the Service Contracts, under which it has accepted benefits, including the benefits of FGIC's insurance, and retain those benefits, including such insurance benefits.

139. The City represented, through the 2004 Memos it provided to FGIC and through the opinions of its outside legal counsel and Corporation Counsel, that the City took all necessary steps and had conclusively determined that the City's contractual obligations under the Pension Funding Transactions at issue could not constitute indebtedness under Michigan law or be subject to any limitations on the City's net indebtedness capacity

140. The misrepresentations were also made in the Detroit Presentations provided to FGIC, including the 2005 Detroit Presentation in which the City, represented by its Finance Director Sean Werdlow, participated in person. The Detroit Presentations included, without limitation, representations that:

- a) the City's obligation to fund the GRS and PFRS is not discretionary and is constitutionally mandated;
- b) from a "legal perspective," the City's obligations under the Service Contracts were identical to the City's pension funding obligations at the time because they "convert[ed] a hard obligation into another hard obligation" and did not create additional liability;
- c) the proposed 2005 Pension Funding Transaction would create "a valid and binding funding structure within constitutional, statutory and charter provisions";
- d) the Alternative Funding Mechanism and the proposed 2005 Pension Funding Transaction were supported by legal authority including the Michigan

Constitution, the Michigan Public Employees Retirement System Investment Act, and three City Council ordinances adopted in February 2005;

- e) the proposed 2005 Pension Funding Transaction would use none of the City's debt capacity; and
- f) the COPs holders had the same statutory rights and remedies already available to the Retirement Systems to enforce the City's obligations.

141. The misrepresentations were also made in the Service Contracts and related transaction documents for both Pension Funding Transactions that senior staff from the finance and economic development departments of the City provided to FGIC, in both draft and final form, for the purpose of inducing FGIC to issue the Policies in 2005 and 2006. As set forth above, these statements included representations that:

- a) the City's obligations under the Service Contracts are unconditional contractual obligations of the City;
- b) the City's payment obligations under the Service Contracts do not constitute or create any "indebtedness" of the City within the meaning of the HRCA or any constitutional, statutory, or charter limitation;
- c) the Service Contracts constitute valid and binding agreements of the City enforceable in accordance with their terms; and
- d) all acts, conditions and things required by the constitution and laws of the State of Michigan or City ordinance to exist, to have happened and to have been performed as a condition precedent to the City's execution and delivery of the Service Contracts existed, had happened and had been performed in due time,

form and manner required by Michigan constitution or law in order to make the Service Contracts valid and binding obligations of the City.

142. FGIC, as an express third-party beneficiary of the Service Contracts, is in contractual privity with the City.

143. The City's misrepresentations were material to FGIC's decision to issue the Policies effective June 2, 2005 and June 12, 2006. FGIC reasonably relied upon the City's misrepresentations when it agreed to issue the Policies.

144. FGIC was deceived by the City's misrepresentations, and its reliance on the City's misrepresentations has caused FGIC to issue Policies insuring, to its detriment, payments of principal and interest on the COPs, which represent interests in the right to receive certain Service Payments that the City now alleges it was never authorized to pay.

145. The City has directly benefited from its misrepresentations because FGIC's issuance of the Policies increased the ratings on the COPs and made the COPs more marketable to investors. This permitted the Service Corporations, on behalf of the City, to obtain the necessary funds from the sale of COPs to substantially reduce the UAAL of the Retirement Systems. FGIC's insurance also reduced the amount the Service Corporations charged the City for their services in funding the UAAL of the Retirement Systems, which resulted in significant cash flow relief for the City and generated hundreds of millions of dollars of savings over the costs the City would have incurred had it funded such obligations directly pursuant to the Traditional Funding Mechanism.

146. An actual controversy has arisen and now exists between the parties that is ripe for adjudication because the City has initiated the Adversary Proceeding and asked this Court to find the Service Contracts and the City's contractual obligations thereunder invalid, void *ab*

initio, or otherwise unenforceable, and as such, there is substantial controversy of sufficient immediacy and reality to warrant issuance of a declaratory judgment. The declaratory relief FGIC seeks will resolve the dispute among the parties completely and will avoid inconsistent adjudications.

147. Accordingly, if the Court finds that the Service Contracts and all other contractual or other obligations incurred by the City in connection with the Pension Funding Transactions are unenforceable and void *ab initio*, FGIC is entitled to a declaration that the City's misrepresentations have and will cause damages to FGIC in an amount to be determined at trial.

**FOURTH COUNTERCLAIM
(Against the City for Unjust Enrichment)**

148. FGIC re-alleges and incorporates by reference paragraphs 1 through 147 of these Counterclaims.

149. FGIC conferred benefits on the City by issuing the Policies, which benefits included permitting the Service Corporations, on behalf of the City, to obtain the necessary funds from the sale of COPs to substantially reduce the UAAL of its Retirement Systems and at a reduced cost, and providing essential cash flow relief for the City thus improving the quality of life for residents, with the expectation that the City would fulfill its obligations under the Service Contracts, which would result in funds available to repay the FGIC-Insured COPs.

150. The City accepted and has retained the benefits conferred by FGIC through the date of these Counterclaims.

151. The City knew or should have known that FGIC issued the Policies with the expectation that the City would fulfill its obligations under the Service Contracts, which would result in funds available to repay the FGIC-Insured COPs, and if the City could not fulfill its obligations, then the City could not retain the benefits of FGIC's insurance.

152. An actual controversy has arisen and now exists between the parties that is ripe for adjudication because the City has initiated the Adversary Proceeding and asked this Court to find the Service Contracts and the City's contractual obligations thereunder invalid, void *ab initio*, or otherwise unenforceable, and as such, there is substantial controversy of sufficient immediacy and reality to warrant issuance of a declaratory judgment. The declaratory relief FGIC seeks will resolve the dispute among the parties completely and will avoid inconsistent adjudications.

153. In the event the City prevails in the Adversary Proceeding, the City has accepted and retained the benefits provided by FGIC under circumstances that, in good conscience, and as described more fully above, would be inequitable for the City to retain the benefits it received.

154. Accordingly, pursuant to 28 U.S.C. § 2201 and Federal Bankruptcy Rule 7001, FGIC is entitled to a declaration that, if the Court finds the Service Contracts and the City's contractual obligations thereunder are invalid, void *ab initio*, or otherwise unenforceable, the City will have been unjustly enriched at FGIC's expense and equity dictates that the City should make restitution to FGIC in an amount to be determined at trial.

FIFTH COUNTERCLAIM
(Against the City for Promissory Estoppel)

155. FGIC re-alleges and incorporates by reference paragraphs 1 through 154 of these Counterclaims.

156. During its discussions with the City to insure the Pension Funding Transactions and in the Service Contracts, the City made clear and unambiguous promises to FGIC that the FGIC- Insured COPs were backed by a reliable payment stream and FGIC would have subrogation rights with respect to any claims FGIC paid under the Policies and direct claims against the City for certain fees and expenses. The City also promised FGIC that it could not

avoid the Service Contracts and, at the same time, retain the benefits of FGIC's insurance. If the City's allegations in the Adversary Proceeding are true, then, in fact, the City never intended to honor its obligations under the Service Contracts to pay any party, let alone FGIC, the amounts promised under the Service Contracts, and such statements were misrepresentations.

157. FGIC reasonably and foreseeably relied on the City's misrepresentations when it issued the Policies.

158. An actual controversy has arisen and now exists between the parties that is ripe for adjudication because the City has initiated the Adversary Proceeding and asked this Court to find the Service Contracts and the City's contractual obligations thereunder invalid, void *ab initio*, or otherwise unenforceable, and as such, there is substantial controversy of sufficient immediacy and reality to warrant issuance of a declaratory judgment. The declaratory relief FGIC seeks will resolve the dispute among the parties completely and will avoid inconsistent adjudications.

159. In the event the City prevails in the Adversary Proceeding, FGIC is entitled to a declaration that its reliance on the City's misrepresentations directly caused damages in an amount to be proven at trial.

SIXTH COUNTERCLAIM
(Against the City for Mutual Mistake)

160. FGIC re-alleges and incorporates by reference paragraphs 1 through 159 of these Counterclaims.

161. The City knew it was of material importance to FGIC that the City's obligations under the Service Contracts and other documents related to the Pension Funding Transactions were valid, legal, and enforceable contractual obligations.

162. As described above, the City made numerous representations and warranties to FGIC that the City took all necessary steps and conclusively determined that the City's obligations under the Service Contracts did not create "indebtedness" subject to the net indebtedness limitation in the HRCA, that the Service Contracts constitute valid and binding agreements of the City enforceable in accordance with their terms, that all conditions precedent to the City's execution and delivery of the Service Contracts were met in order to make the Service Contracts valid and binding obligations of the City, and that the City could not avoid the Service Contracts, under which it has accepted benefits, including the benefits of FGIC's insurance, and retain those benefits, including such insurance benefits. The City now alleges these representations and warranties were false.

163. FGIC insured the FGIC-Insured COPs based on its reasonable belief that the City had, in fact, taken all necessary steps and conclusively determined that the City's obligations under the Service Contracts did not create "indebtedness" subject to the net indebtedness limitation in the HRCA, that the Service Contracts constitute valid and binding agreements of the City enforceable in accordance with their terms, that all conditions precedent to the City's execution and delivery of the Service Contracts were met in order to make the Service Contracts valid and binding obligations of the City, and that the City could not avoid the Service Contracts, under which it has accepted benefits, including the benefits of FGIC's insurance, and retain those benefits, including such insurance benefits.

164. If the City prevails in the Adversary Proceeding, then both FGIC and the City were mistaken as to a basic assumption.

165. FGIC did not assume the risk of the mistake. It was reasonable for FGIC to believe that the City had taken all such steps and made such conclusive determinations because,

among other reasons, FGIC received express representations to that effect in the Service Contracts and other documents related to the Pension Funding Transactions as well as opinions from the City's outside legal counsel and Corporation Counsel.

166. This mistake was substantial and goes to the underlying purpose of the Service Contracts, existed at the time the Service Contracts were made, and prevented a meeting of the minds.

167. As a direct and proximate result of the mistake regarding the underlying purpose of the Service Contracts and the related contracts executed in connection therewith, the City has been unjustly enriched at FGIC's expense.

168. An actual controversy has arisen and now exists between the parties that is ripe for adjudication because the City has initiated the Adversary Proceeding and asserted that the Service Contracts and the City's contractual obligations thereunder invalid, void *ab initio*, or otherwise unenforceable, and as such, there is substantial controversy of sufficient immediacy and reality to warrant issuance of a declaratory judgment. The declaratory relief FGIC seeks will resolve the dispute among the parties completely and will avoid inconsistent adjudications.

169. As such, if the Court finds the Service Contracts and all other contractual or other obligations incurred by the City in connection with the Pension Funding Transactions are unenforceable and void *ab initio*, FGIC is entitled to a declaration that the Service Contracts and the related contracts executed in connection therewith should be rescinded with each party returned to its relative position *ex ante*.

PRAYER FOR RELIEF

WHEREFORE, FGIC prays for the following:

1. Dismissal of the City's claims with prejudice;

2. A finding that the City's claims are barred, in whole or in part, based on one or more of the affirmative defenses asserted herein;

3. A judgment declaring that: (i) the Service Contracts and the City's obligations thereunder are valid, legal, and enforceable contractual obligations or, in the alternative, that the City is estopped from denying the validity, legality or enforceability of the Service Contracts or the City's obligations thereunder, (ii) 11 U.S.C. § 502(b)(1) is not a basis to disallow claims asserted in connection with the City's payment obligations under the Service Contracts, and (iii) FGIC has an allowed claim against the City for any and all amounts paid in respect of claims that have arisen to date and may arise in the future under the Policies and any other amounts payable to FGIC under the Service Contracts;

4. A judgment declaring that, if the Service Contracts or the City's contractual obligations thereunder are invalid, void *ab initio*, or otherwise unenforceable, FGIC was fraudulently induced to issue the Policies and has incurred and will incur damages in an amount to be determined at trial;

5. A judgment declaring that, if the Service Contracts or the City's contractual obligations thereunder are invalid, void *ab initio*, or otherwise unenforceable, the City's misrepresentations have and will cause damages to FGIC in an amount to be determined at trial;

6. A judgment declaring that, if the Court finds the Service Contracts and the City's contractual obligations thereunder invalid, void *ab initio*, or otherwise unenforceable, then there was a mutual mistake as to the underlying purpose of the Service Contracts warranting rescission of the Service Contracts and the related documents executed in connection therewith and return of each party to its relative position *ex ante*;

7. A judgment declaring that, if the Court finds the Service Contracts and the City's contractual obligations thereunder invalid, void *ab initio*, or otherwise unenforceable, the City will have been unjustly enriched at FGIC's expense and equity dictates that the City should make restitution to FGIC for damages it has incurred and will incur in connection with the Policies; and

8. Such other and further relief as the Court deems just.

Dated: August 13, 2014
Birmingham, Michigan

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*Attorneys for Defendant and Counterclaim-Plaintiff
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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

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In re	:	
	:	Chapter 9
	:	
CITY OF DETROIT, MICHIGAN,	:	Case No. 13-53846
	:	
Debtor.	:	Hon. Steven W. Rhodes
	:	
-----X	:	
CITY OF DETROIT, MICHIGAN,	:	Chapter 9
	:	
Plaintiff,	:	Adversary No. 14-04112
	:	
vs.	:	Hon. Steven W. Rhodes
	:	
DETROIT GENERAL RETIREMENT	:	
SYSTEM SERVICE CORPORATION,	:	
<i>et al.,</i>	:	
	:	
Defendants.	:	
-----X		

CERTIFICATE OF SERVICE

I hereby certify that on August 13, 2014 the *Counterclaims of Defendant Financial Guaranty Insurance Company* was filed and served via the Court’s electronic case filing and noticing system to all registered users that have appeared in this Adversary Proceeding.

Dated: August 13, 2014

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