UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re **CITY OF DETROIT, MICHIGAN,** **Debtor.**	**Chapter 9** **Case No. 13-53846** **Hon. Steven W. Rhodes**
CITY OF DETROIT, MICHIGAN, **Plaintiff,** **v.** **DETROIT GENERAL RETIREMENT SYSTEM SERVICE CORPORATION, *et al.*,** **Defendants.**	**Chapter 9** **Adversary No. 14-04112** **Hon. Steven W. Rhodes**

FINANCIAL GUARANTY INSURANCE COMPANY'S OPPOSITION TO CITY OF DETROIT'S MOTION TO DISMISS IN PART FGIC'S COUNTERCLAIMS

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Financial Guaranty Insurance Company ("FGIC") respectfully submits this Brief in Opposition (the "Opposition") to the City of Detroit's (the "City") Motion to Dismiss in Part FGIC's Counterclaims (the "Motion" or "Mot.") [Adv. Pro. Docket No. 152] and respectfully states as follows:

PRELIMINARY STATEMENT

The City's Motion is premised on a misapplication of the law, that asks this Court to dismiss FGIC's Counterclaims[1] on the basis of the facts as alleged in the City's own Complaint. In the context of the City's Motion to Dismiss, it is the facts alleged by FGIC, not the City, that must be taken as true, and FGIC's Counterclaims must be construed in the most favorable light. Assuming the City could skirt this elementary rule, which it cannot, the Motion fails because the material issues of fact set forth in FGIC's Counterclaims make it clear that this case is anything but simple and undisputed, as the City suggests. Finding that the City has the right to receive and retain the benefit of upwards of *one billion dollars*, without paying for it, is not an exercise of connecting the dots between a few agreed-upon facts. The Pension Funding Transactions were complex arrangements struck through scores of communications, negotiations, authorizations, and representations by the City, its agents, and its advisors. The facts and issues arising from this complex web, which the City has yet to dispute, provide the basis for FGIC's Counterclaims – not the facts alleged by the City in support of its own claims.

The City's theory of strict liability is just one example of its mischaracterizations of the law in an effort to sweep complex factual issues under the rug. The City suggests that in all instances the law forbids any counterparty from ever relying on any municipality's

[1] Capitalized terms not otherwise defined herein shall have the meaning ascribed to them in the Counterclaims of Defendant Financial Guaranty Insurance Company [Adv. Pro. Docket No. 129] (the "Counterclaims" or "Countercl.").

representations about its ability or authority to enter into a contract. The City is wrong. The law does not protect municipalities in a way that allows them to deceive counterparties into investing over a billion dollars, and it certainly does not protect a municipality that discloses its own fraud in an attempt to shield itself from liability at the expense of the very counterparties it deceived.

Tellingly, the City has not denied the misrepresentations it made to FGIC, as alleged in FGIC's Counterclaims. Yet, even if the City did attempt to retract its past statements, promises, and representations about the Pension Funding Transactions and about the actions it took to confirm the nature and validity thereof (which views and actions were confirmed by the official actions and authorizations of the City at that time), the Motion fails. FGIC's entitlement to relief, as alleged in the Counterclaims, is straightforward and must be taken as true for the purposes of the Motion: in 2005 and 2006, by developing and implementing innovative contractual obligations as a substitute for its traditional mechanism for funding its pension liabilities, the City asked for and obtained nearly one billion dollars in investments from the defendants, and, under the terms of the transactions, the City applied these investments to finance its otherwise underfunded pensions. Now, a decade later and in the form of a lawsuit aimed at the very counterparties that invested in the City's pensions, 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 in order to induce the COPs Holders to invest in the City and in order to induce FGIC to issue the Policies. Nowhere does the City explain how it was able to conceal these lies from sophisticated counterparties for the last decade, until the wake of the City's bankruptcy filing. Based on the facts asserted in FGIC's Counterclaims, which the Court must accept as true for the purposes of the Motion, the Motion should be denied. The City has not established that FGIC's Counterclaims do not contain factual content sufficient to plausibly

show legal entitlement to relief, as it must to succeed on a motion to dismiss in this Circuit. *Static Control Components, Inc. v. Lexmark Int'l, Inc.*, 697 F.3d 387, 401 (6th Cir. 2012), *aff'd, Lexmark, Int'l Inc. v. Static Control Components, Inc.*, 134 S. Ct. 1377 (2014).

STANDARD OF REVIEW

In reviewing a motion to dismiss counterclaims pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure (the "Rules"), made applicable to this Adversary Proceeding by Rule 7012 of the Federal Rules of Bankruptcy Procedure, a court must accept all factual allegations as true and construe the counterclaims in the light most favorable to the counterclaim plaintiff. *See Static Control Components*, 697 F.3d at 401 (reversing in part an order dismissing counterclaim and confirming that factual allegations in counterclaims are assumed true for purposes of a motion to dismiss under Rule 12(b)(6)); *Ouwinga v. Benistar 419 Plan Servs.*, 694 F.3d 783, 790 (6th Cir. 2012) ("In assessing a complaint for failure to state a claim, we must construe the complaint in the light most favorable to the plaintiff, accept all well-pled factual allegations as true, and determine whether the complaint contain[s] sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." (citation and internal quotation marks omitted)). "Factual allegations must be enough to raise a right to relief above the speculative level . . . on the assumption that all the allegations in the complaint are true (even if doubtful in fact)." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). Here, where the Counterclaims set forth "a short and plain statement of the claim showing that the pleader is entitled to relief," the City's motion to dismiss should be denied.[2] Fed. R. Civ. P. 8(a)(2); Fed. R. Bankr. P. 7008(a).

[2] In ruling on the Motion, the Court may also consider public records and items appearing in the record of the case. *Bassett v. NCAA*, 528 F.3d 426, 430 (6th Cir. 2008) (*citing Amini v. Oberlin Coll.*, 259 F.3d 493, 502 (6th Cir. 2001)).

The City refers the Court to the "detailed facts set forth in the City's Complaint." (Br. in Supp. of Mot. 1 n. 1.) However, as the Motion is directed at FGIC's Counterclaims, the Court must accept as true the factual allegations in FGIC's Counterclaims rather than the City's Complaint. *See Static Control Components*, 697 F.3d at 401 (confirming that factual allegations in counterclaims are assumed true for purposes of a motion to dismiss counterclaims under Rule 12(b)(6), and reversing in part district court order granting motion to dismiss); *Ford Motor Co. v. Mich. Consol. Gas Co.*, No. 08-CV-13503, 2011 WL 1743735, at *2 (E.D. Mich. May 5, 2011) (assuming, for purposes of Rule 12(b)(6) motion to dismiss, that the factual allegations in the defendants' counterclaims are true).

Despite the fact that the pleadings are not closed, as the City has not yet filed an answer to FGIC's Counterclaims, the Motion also improperly seeks relief under Rule 12(c). The City's request for judgment on the pleadings is premature and should not be considered at this time. *See Med-Systems, Inc. v. Masterson Mktg.*, No. 11CV695, 2011 WL 4715170, at *2 (S.D. Cal. Oct. 7, 2011) (noting that if a defendant imposes counterclaims, the pleadings are not closed until the plaintiff files a reply to those counterclaims); *Geir ex rel. Geir v. Educ. Serv. Unit No. 16*, 144 F.R.D. 680, 686 (D. Neb. 1992) (finding motion for judgment on the pleadings premature where defendants had not yet answered and construing the motion as one to dismiss claims under Rule 12(b)(6) (citing *Geltman v. Verity*, 716 F. Supp. 491 (D. Colo. 1989) (same)); *Edelman v. Locker*, 6 F.R.D. 272, 274 (E.D. Pa. 1946) (holding that when the defendant filed an answer with a counterclaim and no reply was filed, the pleadings were not closed and thus the plaintiff's motion for judgment on the pleadings was premature).[3]

[3] In addition, the Case Management Order entered on August 14, 2014 [Adv. Pro. Docket No. 131] discourages a request for summary judgment of the "intensely fact-specific" and "broadly controverted" allegations in this case. The merits of this action should be resolved on a more developed record, and not at the outset of this case on a motion for judgment on the pleadings or a motion to dismiss. In any event,

SUMMARY OF FACTS

The facts set forth below, all of which were specifically alleged in FGIC's Counterclaims, must be deemed to be true for purposes of the Court's consideration of the City's Motion.

I. The Counterclaims Detail the Nature of the Pension Funding Transactions

In the midst of a financial crisis in 2005, and facing increased pressure from the Retirement Systems to live up to the City's constitutional and statutory mandate to fund each System's UAAL (Countercl. ¶¶ 16, 23-26), the City developed a structure to enable the City to fund such obligations on a timely basis and in a much more cost efficient manner. (*Id.* ¶¶ 29, 41.) The City did this by first enacting several ordinances that remain in full force and effect. (*Id.* ¶¶ 29-32.) One of these ordinances, the Funding Ordinance, authorized: (i) the creation of two single-purpose Service Corporations, which are legally separate from the City, to assist the City with funding its pension liabilities, (ii) the City's entry into contracts with the Service Corporations to compensate them for their services, (iii) the issuance of COPs by a third-party funding trust that would evidence an interest in the City's payments under the Service Contracts, and (iv) the City's entry into ancillary agreements in connection with the COPs, such as underwriting and disclosure agreements. (*Id.* ¶ 30.) The other ordinances, the Pension Ordinances, required that the Funding Proceeds from the issuance of the COPs be deposited into the Accrued Liability Fund within each Retirement System and that the assets be separately accounted for, even if they were invested as part of each System's overall assets. (*Id.* at ¶ 31.)

The City subsequently entered into the 2005 Service Contracts and obligated itself to make Service Payments under the Service Contracts that had more favorable terms and better

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the standard for a Rule 12(c) motion for judgment on the pleadings is the same as a Rule 12(b)(6) motion to dismiss for failure to state a claim. *Lindsay v. Yates*, 498 F.3d 434, 438 (6th Cir. 2007).

interest rates than the payments the City was then making to the Retirement Systems to pay the Subject UAAL. (*Id.* ¶ 41.) The Service Corporations, in turn, established the 2005 Funding Trust for the purpose of funding certain amounts of each Retirement System's UAAL, and the 2005 Funding Trust agreed to provide such funding to the Service Corporations in exchange for an assignment of and security interest in certain of the City's Service Payments. (*Id.* ¶ 42.) The 2005 Pension Funding Transaction resulted in the issuance of the 2005 COPs to investors, which funded over one billion dollars of the Retirement Systems' UAAL. (*Id.* ¶¶ 43.) This structure was repeated in 2006 after the Retirement Systems extended the required amortization periods for funding those Systems' respective UAAL; the City entered into the 2006 Service Contracts, through which the City replaced certain scheduled obligations under the 2005 Service Contracts with new payment obligations extended over the newly extended amortization period, and the Service Corporations established the 2006 Funding Trust to issue the 2006 COPs. (*Id.* ¶¶ 49-50.) The 2006 Pension Funding Transaction thus allowed the City to amortize its payments under the Service Contracts over a longer period of time, providing additional relief to the City's stressed finances. (*Id.* ¶ 49-50.)

II. The Counterclaims Specifically Identify the City's Misrepresentations and Omissions

FGIC relied on the City's numerous representations about the nature of its contractual obligations under the Service Contracts. In the Service Contracts, the City expressly represented and warranted, among other things, that the City was authorized to enter into the Pension Funding Transactions, all conditions precedent to the City's execution and delivery of the Service Contracts had been met in order to make the Service Contracts valid and binding obligations of the City, and that the City's obligations under the Service Contracts do not constitute indebtedness. (*Id.* ¶¶ 57, 75.) 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. (*Id.* ¶ 58.) In addition, the Service Contracts and the offering circulars used to market the COPs 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. (*Id.* ¶ 62.) Each COP also includes a statement that it does not create any "indebtedness" of the City within the meaning of any applicable law. (*Id.* ¶ 63.)

The City, through its representatives, agents, and advisors, made representations in-person and in writing to FGIC on numerous occasions in the time leading up to the Pension Funding Transactions about the nature of the deal and about the steps it took to confirm the City's authority to enter into the Service Contracts, the valid and binding nature of those agreements, and the fact that the transactions would use none of the City's debt capacity. (*Id.* ¶¶ 66-72.) This included sharing with FGIC the 2004 Memos in an effort to assure FGIC 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. (*Id.* ¶¶ 47, 125.)

Unknown to FGIC at the time, the City 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 and other documents analyzing the transaction structure and obligations. (*Id.* ¶¶ 90, 123.) The City's conduct and communications indicated to FGIC that the City had undertaken the necessary due diligence to

represent to FGIC that the Pension Funding Transactions and the City's obligations under the Service Contracts were valid and lawful. (*Id.* ¶¶ 65-76, 90.)

Furthermore, at the closing of each of the Pension Funding Transactions, various legal opinions were issued stating, among other things, that no enactment of state legislation was necessary and no approval or other action was required to be obtained in connection with, among other things, the execution of the Service Contracts, and the Service Payments under the Service Contracts do not constitute indebtedness within the meaning of any limitation of Michigan law applicable to the City. (*Id.* ¶ 46.) In connection with the 2006 Pension Funding Transaction, the City's counsel also informed the insurers, including 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. (*Id.* ¶ 54.)

III. The Counterclaims Specifically Identify the Benefits the City Received Through the Policies

FGIC issued the Policies guaranteeing the scheduled payment of principal and interest on the FGIC-Insured COPs. (*Id.* ¶ 82.) The insurance that FGIC (and other insurers) provided improved the ratings on the COPs issuances, which, in turn, made the COPs more marketable to investors and allowed the COPs to be issued at lower interest rates, thus saving the City a considerable amount of money in corresponding reduced Service Payments. (*Id.* ¶ 65.) The City acknowledged the significant benefits that it received on account of FGIC's insurance in letter agreements for each of the Pension Funding Transactions. (*Id.* ¶ 86.)

ARGUMENT

I. FGIC Adequately Alleges a Counterclaim of Estoppel

The City, in a conclusory two-sentence footnote, moves to dismiss FGIC's First Counterclaim to the extent FGIC seeks a declaration that the City should be estopped from denying the validity, legality, or enforceability of the Service Contracts or the City's obligations thereunder because "FGIC identifies no basis for this claim of estoppel." (Br. in Supp. of Mot. 28 n.5.) Yet FGIC specifically pleads, in great detail, that, based on the recitals on the face of the certificates and the City's representations and conduct, the City is estopped from denying the validity of the transaction.

As a matter of black letter Michigan law, a municipality is estopped from denying the validity of an act or representation if the non-municipal party demonstrates: (a) a good faith reliance upon the City's conduct, (b) lack of actual knowledge or means of obtaining actual knowledge of the fact in question, and (c) a change in position significant enough that, should the transaction be invalidated, the non-municipal party would incur a substantial loss. *Parker v. W. Bloomfield Twp.*, 231 N.W.2d 424, 428 (Mich. Ct. App. 1975). Applying this standard, courts regularly estop municipalities from asserting a claim or defense of ultra vires, even in cases where the contract would otherwise be void. *See, e.g., id.* at 429; *1st Source Bank v. Vill. of Stevensville*, 947 F. Supp. 2d 934, 950 (N.D. Ind. 2013) (noting that, under Michigan law, "a municipal corporation is estopped from denying the validity of a contract where the contract has been executed and the municipal corporation retains the benefit of that contract, even if the contract was entered into in an irregular fashion"); *see also Dixon Cnty. v. Field*, 111 U.S. 83, 92 (1884).

Estoppel is particularly appropriate where, as specifically alleged here, the City retained a significant benefit from the contract that it now asserts is ultra vires. *See, e.g., Highland Park*

Policemen & Firemen Ret. Sys. v. City of Highland Park, No. 252424, 2006 WL 1709335, at *3 (Mich. Ct. App. June 22, 2006); *1st Source Bank*, 947 F. Supp. 2d at 950. In *Highland Park*, an instructive case, defendants, including the City's Emergency Financial Manager, argued that the promissory note at issue was "illegal and unenforceable" because it had not been executed by certain municipal officials, as required by the City Charter. 2006 WL 1709335, at *3. The Michigan Court of Appeals noted that it was "telling that defendants [sought] to render the agreement illegal, and consequently void, after the City [ ] already received the benefit of the bargain," and, accordingly, estopped defendants from asserting that the promissory note was illegal. *Id.* ("We conclude that having received the benefit of the bargain, defendants are estopped from asserting that the promissory note is illegal when, given the circumstances of the case, their acts have created a situation where it would be inequitable and unjust to permit them to deny what they have done or permitted to be done." (internal citation omitted)).

Courts have also held that estoppel is warranted where representations about the validity of a municipal obligation are recited on the face of the instrument representing such obligation, as the Counterclaims specifically identify is the case with the COPs.[4] Unless it is clear from the face of the bond that the representations about validity are untrue, courts have found that it is reasonable for bona fide purchasers to rely on these representations and thus estop the municipal issuer from arguing that the representations are untrue. *See, e.g.*, *Chem. Bank & Trust Co.*, 251

[4] *Chem. Bank & Trust Co. v. Oakland Cnty.*, 251 N.W. 395, 399 (Mich. 1933) ("[A]lthough 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 had been taken, then the municipality is estopped from denying that they were taken."); *Gibbs v. Sch.-Dist. No. 10*, 50 N.W. 294, 295-96 (Mich. 1891) (same); *see also Thompson v. Vill. of Mecosta*, 86 N.W. 1044, 1046 (Mich. 1901) ("[A] bona fide purchaser for value had a right to rely upon the statement of the board, appearing in the bond, - that it was issued to borrow money under this act, for lawful purposes.").

N.W. at 399. (*See also* Countercl. ¶¶ 62-63 (alleging recitals in offering circulars and face of each COP include statement regarding validity of City's obligations).)

A. The Facts Asserted in FGIC's Counterclaims, Taken as True, Adequately Allege That Estoppel Applies to the City's Claim

The Counterclaims allege: (a) that FGIC relied, in good faith, on the City's many representations and conduct regarding the nature of the Pension Funding Transactions and the steps the City took to verify that those transactions would create valid, binding obligations of the City (Countercl. ¶¶ 76, 81, 130, 143-44, 157, 163, 165); (b) that FGIC was unable to independently determine whether the City took all necessary internal steps to ensure that the Pension Funding Transactions created such valid, binding obligations (Countercl. ¶¶ 45-47, 52-56, 57-58, 61, 65-75, 78-80, 165), and (c) that, should the Service Contracts be invalidated, FGIC will likely see an increase in asserted claims under the Policies (Countercl. ¶¶ 82, 87-89, 115). Further, it is undisputed that the result of the Pension Funding Transactions, the funding of $1.4 billion of the UAAL, was well within the City's powers because, as all parties acknowledge, the City is constitutionally obligated to fund the UAAL. (Countercl. ¶ 16; Complaint ¶ 7.) *See Shelby Twp. Police & Fire Ret. Bd. v. Charter Twp. of Shelby*, 475 N.W.2d 249, 252 (Mich. 1991) (holding that the Michigan Constitution "expressly mandates townships and municipalities to fund all public employee pension systems to a level which includes unfunded accrued liabilities"). Finally, FGIC adequately alleges that the City benefited significantly from the Pension Funding Transactions, which paid approximately $1.4 billion of UAAL that the City was obligated to fund. (Countercl. ¶¶ 84-86, 93, 150, 153.) Therefore, the City's contention that FGIC identifies no basis for the application of estoppel to the City's invalidity claim is baseless.

B. FGIC's Counterclaims Allege Facts Demonstrating That the City Should Be Estopped From Denying the Validity of Its Obligations Without Reaching the Merits of the Claim

The Michigan Supreme Court has estopped municipalities from denying the validity of its acts or representations without reaching the merits of the case when, as alleged here, the municipality made specific representations upon which the non-municipal counterparty relied. In *Chemical Bank & Trust Co. v. Oakland County*, the owner of certain County bonds sued to compel the County to levy a tax to repay its bonds. 251 N.W. at 399. The County, in response, asserted, among other things, that the bonds had been issued "entirely without authority of law" and "in violation of the constitutional limitation on the bonded indebtedness of the county." *Id.* at 397. In *Chemical Bank*, unlike here, the bonds at issue were undoubtedly "debt" of the municipality, subject to the applicable debt limit — the bonds explicitly pledged the County's full faith and credit and taxing power. *Id.* at 398-99. Nonetheless, the court estopped the County from maintaining its ultra vires defense and compelled the County to levy a tax to repay the bonds because the face of the bond included a number of recitals — including that "all acts, conditions and things" required to exist or be done precedent to issuing the bonds exist and have been done, that the bonds were issued "pursuant to and in strict compliance with the Constitution and Statutes of the State of Michigan," and that the indebtedness therein incurred "does not exceed the statutory or constitutional limit" — and nothing on the face of the bonds themselves showed those recitals to be untrue. *Id.* at 398-99 ("The recital in the bond to the effect that such determination has been made, and that the constitutional limitation had not been exceeded in the issue of the bonds, taken in connection with the fact that the bonds themselves did not show such recital to be untrue, under the law, estops the county from saying that it is untrue."). The *Chemical Bank* court came to this conclusion based on its finding that these recitals were factual determinations that had been made by the county commissioners (who were charged with

making such determinations) and bondholders could rely on these recitals, without making an explicit finding regarding whether the debt limit had been violated or whether, absent estoppel, the bonds would be invalidated. *Id.* at 398-99.[5]

The Counterclaims allege facts demonstrating that the City made representations nearly identical to those at issue in *Chemical Bank* in connection with the Pension Funding Transactions, including on the face of the COPs and in City ordinances. (*See* Counterclaims ¶¶ 45, 47, 52, 53, 55, 57, 63.) *See* Detroit, Mich. Ord. No. 05-05 § 18-5-120(j). These facts must be taken as true for purposes of the Motion, and when representations such as these are present, the contracting municipality is estopped from asserting they are untrue unless the falsity of these representations is apparent on the face of the relevant note or instrument. *See Bd. of Comm'rs of Chaffee Cnty. v. Potter*, 142 U.S. 355, 364 (1892) ("The recital in the bond . . . that the constitutional limitation had not been exceeded in the issue of the bonds, taken in connection with the fact that the bonds themselves did not show such recital to be untrue, under the law, estops the county from saying that it is untrue."); *see also Thompson*, 86 N.W. at 1046-47. Therefore, FGIC has adequately pled facts to support a request for a declaratory judgment that the City is estopped, based on recitals on the face of the certificates and the City's representations and conduct, from denying the validity of the Service Contracts and the City's obligations thereunder.

[5] *See also Dixon*, 111 U.S. at 94 ("Where it may be gathered from the legislative enactment that the officers of the municipality were invested with the power to decide whether the condition precedent has been complied with, that their recital that it has been made in the bonds issued by them and held by a bona fide purchaser, is conclusive of the fact, and binding upon the municipality, for the recital is itself a decision of the fact by the appointed tribunal." (quoting *Town of Coloma v. Eaves*, 92 U.S. 484, 491 (1875) (internal quotation marks omitted))); *Spitzer v. Vill. of Blanchard*, 46 N.W. 400, 403 (Mich. 1890) ("Where there is a total want of power, under the law, in the officers or board who issue the bonds, then the bonds will *not* be void in the hands of innocent holders, the distinction being between questions of fact and questions of law. 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] the municipality is estopped." (emphasis added)).

II. The Counterclaims Specifically Allege that the Service Contracts Are Not Illegal, Ultra Vires, or Invalid

Attempting to side-step any discovery into the claims or defenses (including the fact-intensive allegations of estoppel, fraud, and mischaracterization) and contrary to the applicable rules of procedure and relevant laws, the City once again asks this Court to "simply" adjudicate the supposed central issue — whether the Service Contracts and obligations thereunder are valid, binding obligations of the City, as they have been treated for almost nine years.[6] The City is wrong on procedure and it is wrong on the law. On procedure, there is no support for the City's request to flip this adversary proceeding on its head and adjudicate the validity of the Service Contracts prior to the allegation that the City is estopped from questioning their validity. On the law, taking the facts asserted in the Counterclaims as true, the validity of the Service Contracts and the City's obligations thereunder are not in question. The Motion therefore fails, and no further analysis is needed.

A. The City In its Motion Erroneously Assumes That the Service Contracts are Invalid

Even assuming the Court takes up the City's request to review validity at this early (and inappropriate) stage of the litigation, the transaction is valid. The City itself has acknowledged, in filings in this Adversary Proceeding, that the Service Contracts are presumptively valid. (*See* Mem. of Law in Resp. to Service Corps.' Mot. to Dismiss [Adv. Pro. Docket No. 46] at 7 ("[T]he Service Corporations are the counterparties to Service Contracts that are, until demonstrated otherwise, presumptively valid.").) Despite this acknowledgement, the City bases its Motion on the contradictory and baseless assumption that the Service Contracts and the

[6] The City's Motion is inconsistent in this respect, as elsewhere the City states that it is not seeking to dismiss FGIC's First Counterclaim for a declaratory judgment, except insofar as it seeks a declaration that the City is estopped from asserting the invalidity of the Service Contracts. (Br. in Supp. of Mot. 1 & n.1.)

obligations thereunder are not only invalid but are wholly illegal and ultra vires. Such assumption over-simplifies complex legal issues and fails for the reasons discussed below.

B. The Counterclaims Assert Facts Specifically Alleging that the Service Contracts Are Valid Contracts that Create Binding Obligations of the City

FGIC's Counterclaims specifically allege facts that, accepted as true, establish that the Service Contracts are valid contracts that created valid and binding obligations of the City.[7] FGIC's Counterclaims specifically allege that the City did "*not* pledge its full faith and credit in support of the Service Contracts" (Countercl. ¶ 3), and that the express terms of the documents related to the Pension Funding Transactions — and statements in memoranda provided in connection with those transactions — clearly state that the Service Payments are not general obligations of the City and that the City's faith and credit was not pledged in connection with those payments. (Countercl. ¶ 62, 66, 67.) Under Michigan law, when, as specifically alleged here, a municipality does not issue a general obligation to which it has pledged its full faith and credit, the HRCA, and related policy considerations, are not implicated.

The HRCA empowers Michigan cities to borrow money but provides that "the net indebtedness incurred for all public purposes shall not exceed" certain amounts. Mich. Comp. Laws § 117.4a(2); *see also* Mich. Const. (1963) art. VII, § 21 (directing the Michigan Legislature to "restrict the powers of cities and villages to borrow money and contract debts"). The "debt limit" imposed by the HRCA is subject to a number of statutory and non-statutory exceptions.

[7] *See, e.g.*, Countercl. ¶¶ 16, 19-20, 29-31, 33, 41, 70 (alleging that the City substituted one obligation (the Service Payments) for another constitutionally mandated obligation (the Traditional Funding Mechanism for servicing the Retirement Systems' UAAL); *id.* ¶¶ 47, 55, 57, 65, 73, 75, 80 (alleging that the City made numerous binding representations about its actions and regarding the nature of the Pension Funding Transactions); *id.* ¶¶ 58, 76, 81 (alleging that FGIC reasonably relied on these representations, many of which FGIC was unable to fully assess on its own because of the City's superior access to information about the City); *id.* ¶¶ 31, 96-98 (alleging that the proceeds of the Pension Funding Transactions are in segregated, easily-identifiable accounts within the Retirement Systems).

Mich. Comp. Laws. § 117.4(a)(4). Indeed, the HRCA's limitation is only consistently applied in specific borrowing situations; namely, when cities incur general obligations to which they pledge their full faith and credit. *See, e.g.*, *Bullinger v. Gremore*, 72 N.W.2d 777, 795 (Mich. 1955) ("Inasmuch as the bonds proposed to be issued . . . are not faith and credit obligations of its incorporators, they need not be voted on by the electorate, nor are they subject to the debt limitations of the municipalities."). The allegations in FGIC's Counterclaims, taken as true, state a plausible claim that such a situation is not present here. (*See* Countercl. ¶¶ 3, 62, 66, 67.)

FGIC's Counterclaims also specifically allege that the City entered into Service Contracts with the Service Corporations in 2005 and 2006 (Countercl. ¶¶ 41, 49), that the Service Corporations, in turn, has provided services to the City since they were formed, including in 2005, 2006 and 2009 (Countercl. ¶¶ 30, 36-44, 49-51),[8] and that obligations created under the Service Contracts are contractual in nature (Coutercl. ¶¶ 3, 4, 6, 8, 75, 107). Michigan courts have recognized for over a century that municipalities do not incur "indebtedness" when they enter into service contracts, like the Service Contracts at issue here. *See, e.g.*, *Drain Comm'r of Oakland Cnty. v. City of Royal Oak*, 10 N.W.2d 435, 446 (Mich. 1943) (citing *Ludington Water-Supply Co. v. City of Ludington*, 78 N.W. 558, 562 (Mich. 1899)); *see also Walinske v. Detroit-Wayne Joint Bldg. Auth.*, 39 N.W.2d 73, 81 (Mich. 1949). The Counterclaims have, at a

[8] The Service Corporations, as alleged in the Counterclaims, assisted the City in 2005 in satisfying certain of the Retirement Systems' UAAL, assisted the City in 2006 in refinancing its initial funding obligations to take advantage of a more favorable amortization period, and, through the Contract Administrator, facilitated payments of those obligations for the past eight years. (*See* Countercl. ¶¶ 41-44, 49-51). The City's argument that the Service Corporations admitted in their amended answer that the Service Corporations had no ongoing function after they were created, (Br. in Supp. of Mot. 8) cannot support the City's Motion because "the answer of one defendant cannot be used as evidence against his co-defendant[.]" *Leeds v. Marine Ins. Co.*, 15 U.S. 380, 383 (1817); *see also McMurtry v. Wiseman*, No. 04-cv-00081, 2006 WL 5186509, at *3 (W.D. Ky. Aug. 4, 2006) (the answer of one defendant had "no binding effect on other defendants").

minimum, established that there is a dispute as to the nature of the Service Contracts. Such dispute cannot be resolved at the motion to dismiss stage.[9]

FGIC also adequately alleges that the Service Contracts are valid because these contracts enabled the City to satisfy a preexisting constitutional obligation. (Countercl. ¶¶ 16-18, 30, 41.) The fact that the City had an obligation to fund its pensions' UAAL that is imposed by the state constitution is undisputed. (*Compare* Countercl. ¶ 16 *with* Compl. ¶ 7.) *See also* Mich Const. (1963), art. IX, § 24; Mich. Comp. Laws §§ 38.599(2), 38.1140m (requiring that municipalities appropriate an amount sufficient to maintain the actuarial integrity of their retirement systems, including an annual accrued amortized interest on any UAAL). And the Counterclaims include the allegation that the City's payments under the Service Contracts "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" (Countercl. ¶ 41), to satisfy its constitutionally and statutorily mandated funding obligations.[10]

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[9] In this respect, the procedural postures of the cases that the City cites in support of its Motion are different from the procedural posture of this Adversary Proceeding and make the City's cases readily distinguishable. *See Walinske*, 39 N.W.2d at 77 (findings of fact and conclusions of law issued by the trial judge); *Royal Oak*, 10 N.W.2d at 440 (noting that the dispute proceeded to trial), and *Ludington*, 78 N.W. at 560 (factual findings by trial judge); *see also McCurdy v. Shiawassee Cnty.*, 118 N.W. 625, 625 (Mich. 1908) (trial); *see also* Mem. of Law in Resp. to Service Corps.' Mot. to Dismiss [Adv. Pro. Docket No. 46] at 7 (conceding that the Service Contracts "are, until demonstrated otherwise, *presumptively valid*" (emphasis added)).

[10] The City's direct contributions to the Retirement Systems, including with respect to the UAAL, are contractual obligations that are not considered "debt" subject to the HRCA's limitations on indebtedness and, to FGIC's knowledge, have not historically been applied to that limitation by the City. Mich. Comp. Laws Ann. Const. Art. 9 § 24 (West 2012) ("The accrued financial benefits of each pensions plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof."); *Kinder Morgan Michigan, L.L.C. v. City of Jackson*, 744 N.W.2d 184, 192 (Mich Ct. App. 2007) ("[Pensions] are quite simply not debt obligations. We agree with petitioners that the expense of funding a [ ] pension is an accrued liability or general operating expense of the local unit of government, and is not a debt within the common understanding of that term."). The Service Payments simply replace those preexisting obligations. They do not increase the City's indebtedness and should be afforded the same treatment as the City's payments under the Traditional Funding Mechanism. *See, e.g.*, *Banta v. Clarke Cnty*., 260 N.W. 329, 332-33 (Iowa 1935) (holding that new bonds issued to refund valid outstanding

The limitation on the City's indebtedness is established by statute (the HRCA), and not by the state constitution. *See* Mich. Comp. Laws § 117.4a. Moreover, the powers reserved in the Michigan constitution to a city governed by the HRCA are expressly "subject to the constitution and law." Mich. Const. (1963), art. VII, § 22. To the extent that a constitutional provision and a statutory provision conflict, the constitution must prevail. *See Young v. City of Ann Arbor*, 255 N.W. 579, 580-81 (Mich. 1934). Thus, any statutory constraint on the City's general fundraising authority must yield to the City's specific constitutional obligations to maintain the actuarial integrity of the Retirement Systems. Furthermore, when, as here, the HRCA, or a comparable statute, is silent on a local government obligation that the Michigan constitution expressly addresses, the Michigan Supreme Court has inferred that the statute in question, and any debt limits imposed by the statute, do not cover that constitutional obligation. *See Kuhn ex rel. McRae v. Thompson*, 134 N.W. 722, 726-28 (Mich. 1912) (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).

Courts in other jurisdictions have also recognized an exception to constitutional or statutory debt limitations for "obligations imposed by law," such as a city's obligation to fund its pension UAAL. *See, e.g.*, *Taxpayers for Improving Pub. Safety v. Schwarzenegger*, 91 Cal.Rptr.3d 370, 379 (Ct. App. 2009) (noting that an "exception to the constitutional debt limits has been recognized for obligations imposed by law" and that indebtedness only exists when the municipality *itself* has chosen to incur the obligation – if it must incur the obligation under

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bonds "are not issued for the purpose of increasing the indebtedness of the county" and do not violate the debt limit); *cf. Wilcox v. Bd. of Comm'rs of Sinking Fund of City of Detroit*, 247 N.W. 923, 925 (Mich. 1933) (refunding bonds issued in lieu of and exchange for bonds subject to an exception to a limit on property taxes are a continuation of the prior obligation and, accordingly, also fall within the exception).

applicable law it cannot be considered indebtedness); *Cnty. of Los Angeles v. Byram*, 227 P.2d 4, 7-8 (Cal. 1951) (finding that a county's obligations under a lease did not violate the applicable debt limitation because the county had an explicit duty, imposed by law, to provide for adequate quarters for courts); *see also Lonegan v. New Jersey*, 809 A.2d 91, 105-07 (N.J. 2002) (blessing a flexible financing arrangement, in part, because the proceeds were being used to fund the building of a constitutionally required facility).[11]

C. The City's Motion Disregards the Distinctions Between Illegal, Ultra Vires, and Invalid Contracts

FGIC's Counterclaims, which must be taken as true for purposes of the Motion, adequately allege that the Service Contracts and the City's obligations thereunder are valid and binding obligations of the City. *See supra* § II.B. However, even ignoring these allegations and, instead, accepting as true the City's argument that the Service Contracts are invalid, the City's Motion must fail. The City's argument that the Service Contracts are "illegal contracts" that "are void" and, as such "cannot be enforced" or give rise to equitable relief, not only assumes that this Court has already decided the merits of this case in its favor but also disregards the distinction between contracts that are wholly illegal or ultra vires and contracts that are simply invalid but not wholly illegal. (Br. in Supp. of Mot. to Dismiss 10-17.) In attempting, once again, to

[11] Finally, the Service Contracts and obligations imposed thereunder are lawful and valid even if the Pension Funding Transactions were, as the City alleges, structured to fall outside of the statutory debt limit (a fact not alleged in the Counterclaims and, for purposes of the Motion, not relevant). "There is no fraud in reaching a desired end by legal means even though other means to the end would be illegal." *Bacon v. City of Detroit*, 275 N.W. 800, 803 (Mich. 1937) (rejecting challenge to transaction where county applied for a grant and a loan on behalf of the city, whose prior loan application was rejected in light of the debt limit, on the condition that the City was to enter into a ten-year service contract with the county); *accord Walinske.*, 39 N.W.2d at 80 ("It is never an illegal evasion to accomplish a desired result, lawful in itself, by discovering a legal way to do it."). The Pension Funding Transactions merely refunded in a lawful and more cost efficient manner the constitutional and statutory obligations that the City already had to service its mounting pension UAAL. Thus, even if the City sought to do indirectly what it could not do directly this would not in and of itself render the transactions invalid, and certainly does not provide a sufficient basis to grant the Motion.

oversimplify the issues in this Adversary Proceeding, the City mischaracterizes the law on the validity or invalidity of municipal obligations.

The City erroneously asserts that there are "only two" issues relevant to determine whether the COPs transaction was "illegal": (1) how much debt the City had, relative to the limit imposed by the HRCA[12] and (2) what was the structure of the Pension Funding Transactions. (Br. in Supp. of Mot. to Dismiss 2.) However, when determining whether a municipal obligation complies with the applicable debt limit, Michigan courts look at a number of issues that the City does not address in its Motion. Even if a municipal obligation does not comply with the applicable debt limit (a situation not present here), those obligations are simply not *presumptively* "illegal."

Under Michigan law, a contract will only be found ultra vires or illegal if the party entering into the transaction was not authorized to enter into such a transaction or incur such an obligation. *See, e.g.*, *Parker*, 231 N.W. 2d at 430 ("The doctrine of [u]ltra vires will be applied to preclude a city from engaging in a course of conduct where it specifically lacks the authority to do so."). In such cases — and only in such cases — a municipality may argue that it is not liable under the contract because the transaction was illegal. This, in turn, requires that the municipality establish that it was wholly lacking in authority to incur the obligation at issue. For example, in *City of Highland Park v. Clark*, no recovery could be had on bonds purportedly issued by a drain commissioner to build a sewer drain because he was "wholly without jurisdiction" to issue such bonds. 2 N.W.2d 479, 482 (Mich. 1942) (distinguishing the case at hand, in which the drain commissioner who signed the bonds had "no legal authority whatever"

[12] The City's allegation that this first question is "undisputed" is simply false. (*See* Br. in Supp. of Mot. to Dismiss 4.) FGIC did not admit facts related to the City's debt limit in 2005 and 2006 in its Answer, nor could it as this information is uniquely available to the City, not FGIC. (*See* FGIC's Answer ¶¶ 9, 16, 25, 29, 31.)

to speak for the county from a case in which it was not apparent from the face of the bonds that they were issued for an illegal purpose or by an entity wholly lacking in authority).[13]

In other instances, if the transaction is void as a matter of fact because authorized representatives of the municipal body entered into a transaction based on faulty findings of fact or procedure or because the subject of the transaction is within the municipality's power and not "illegal," the transaction will be deemed invalid but not ultra vires or illegal. *See, e.g., Wolverine Eng'rs & Surveyors, Inc. v. City of Leslie*, No. 299988, 2011 WL 5609822, at *3 (Mich. Ct. App. Nov. 17, 2011) (noting that "an implied contract may be found when the municipal corporation possessed the authority to enter the contract and retained its benefit, but a defect or irregularity prevented the formation of a valid contract"); *Parker*, 231 N.W.2d at 428 (holding that where "the subject matter of the disputed contract is within the municipality's power and is not illegal" the municipality is "bound by its dealings even if that power had been exercised in an irregular fashion or in disregard of directory provisions in its charter regarding the exercise of that power"). In such cases, as long as the municipality retained some benefit from the invalid contract (as the City did here), a bona fide contract counterparty is entitled to recover on the contract, either in equity or through estoppel, because the counterparty could have reasonably relied on the representations made by the authorized person. *Wolverine Eng'rs*, 2011 WL 5609822, at *3; *see infra* § III.

[13] *See also Bloomfield Vill. Drain Dist. v. Keefe*, 119 F.2d 157, 163 (6th Cir. 1941) (holding that estoppel by recitals does not apply where the person certifying the bonds had "no authority to pledge the faith and credit of the county nor to certify on behalf of the county to facts stated in the bonds"); *McCurdy*, 118 N.W. at 629-30 (finding that there could be no recovery on a "floating indebtedness" of the County where the electorate had, on three prior occasions, specifically voted *against* permitting the County to incur such indebtedness); *but see Thompson*, 86 N.W. at 1046-47 (holding that bonds would not be void in the hands of a bona fide holder even though the bonds were issued to fund a private improvement, an unlawful purpose).

Nowhere in the Counterclaims does FGIC allege that the City was wholly unauthorized to enter into the Service Contracts. To the contrary, FGIC alleges that the City *was* authorized to enter into those contracts) and, as the City has readily acknowledged, that the Pension Funding Transactions assisted the City in satisfying a constitutionally mandated obligation, something the City was clearly authorized to do. (Countercl. ¶¶ 16, 30, 67; Compl. ¶¶ 7, 13.) Accordingly, any assertion by the City that the Service Contracts are "illegal" must fail as it is not supported by the facts alleged in the Counterclaims.

III. FGIC Alleges Adequate Facts to Support its Counterclaims Relating to Alternative Theories of Recovery

The City cites several cases for the proposition that alternative theories of recovery are not available to parties to "illegal" contracts. (Br. in Supp. of Mot. 12-18.) This proposition should not be addressed at this time, on a motion to dismiss, because FGIC's Counterclaims assert facts alleging that the Service Contracts are valid, *not* invalid. Nonetheless, the cases the City cites are readily distinguishable from the instant facts. Further, even in cases where municipal obligations are found invalid, Michigan courts have allowed contract counterparties to recover in equity. This is most often true in cases, as FGIC has alleged in this one, where the municipality benefited from the transaction and/or the proceeds of the transaction are segregated and readily identifiable.

A. FGIC Specifically Alleged That the City Benefitted From the Pension Funding Transactions and the Policies

FGIC has alleged in its Counterclaims that the City received a benefit from the Pension Funding Transactions, including the Policies for the FGIC-Insured COPs. (Countercl. ¶¶ 82, 86, 107.) Such benefit is undeniable – as a result of these transactions, the Retirement Systems hold over one billion dollars of Funding Proceeds that have earned investment returns over time, and the City faces a lower claim from the Retirement Systems in this bankruptcy as a result of having

funded over one billion dollars of the Retirement Systems' UAAL. In a situation where, as alleged here, a municipality has received a benefit from a transaction that it claims is unenforceable, it cannot retain such benefit and deny the other parties a remedy for their loss. *See 1st Source Bank*, 947 F. Supp. 2d at 946-47 ("Beginning in the nineteenth century, Michigan courts recognized that municipalities were obligated to repay contracts where: (1) the municipality had the general power to enter into the contract; (2) the parties carried out the contract; and (3) the municipality received the full benefit of the contract.").[14]

Specifically, FGIC alleged that, as a result of the Pension Funding Transactions, "$739,793,898 was paid to and received by the GRS, and $630,839,180 was paid to and received by the PFRS" and that, upon receipt of such funds, each Retirement System certified to the City that such funds constituted "payment in full an discharge of a corresponding amount of UAAL." (Countercl. ¶¶ 96, 93.) FGIC further alleged that as a result of FGIC's insurance, the COPs received higher credit ratings than they would have without insurance and were more "marketable to investors" (Countercl. ¶ 84), and that — as the City itself acknowledged — the City's payment obligations were "significantly lower" as a result of FGIC's insurance. When a municipality has received and retained benefits such as these, courts *will* impose equitable

[14] *See also Waters, Cook, Oslund & Waugh, PC v. City of Benton Harbor*, No. 213687, 2000 WL 33409143, at *1-2 (Mich. App. Ct. Aug. 11, 2000) (holding that the city could be liable for payment on defendant's legal services under a theory of quantum meruit, notwithstanding that provision of such services was not authorized); *Big Prairie Twp. v. Big Prairie Twp. Grange*, 282 N.W. 143, 145 (Mich. 1938) (holding township could not retain the fruits of a contract that benefited the public and at the same time deny the validity of the contract); *Coit v. City of Grand Rapids*, 73 N.W. 811, 813 (Mich. 1898); 1 Steingold & Etter, Michigan Municipal Law § 4.26 at 4-24 ("An *ultra vires* contract that does not benefit the municipality is void. If the municipality benefits, the contract is at most voidable, and the city must pay for the benefit it receives." (citations omitted)); *see also id.* § 4.24 at 4-20 ("A municipality may not retain the fruits of a contract but deny its validity on the grounds that it is an agreement for the city to act *ultra vires*." (citations omitted)).

remedies to avoid the unjust outcome of the municipality retaining such benefits without paying for them.[15]

For example, *McCurdy v. Shiawassee County*, which the City relies on extensively, notes that the counterparty to a contract found void *ab initio* may be entitled to relief in the form of the return of the benefit that it conferred on the municipality. 118 N.W. at 633 (noting that the Court was not presented with the question of whether a municipal entity might be required to restore the property it attempted without authority to buy or take but that "[i]t is apparent, however, that in such cases a remedy might be afforded without in any way affirming the exercise by the municipality of a power it did not possess, and without rendering nugatory the express provisions of a statute"). In *1st Source Bank v. Village of Stevensville*, the municipality was obligated to repay certain loan agreements, notwithstanding the fact that they were improperly made and purportedly did not comply with applicable statutes (including the Revised Municipal Finance Act). 947 F. Supp. 2d at 948-51. Where the municipality has benefited from the transaction, invalid contracts are also regularly enforced through estoppel. *See supra* § I; *Webb v. Wakefield Twp*., 215 N.W. 43, 45 (Mich. 1927) (noting that where an unauthorized municipal contract "has been executed and the corporation has received the benefit of it, the law imposes an estoppel in the nature of an implied contract and will not allow the validity of the claimed void contract to be

[15] *See Big Prairie Twp.*, 282 N.W. at 145; *McGaughan v. W. Bloomfield Twp.*, 256 N.W. 545, 546-47 (Mich. 1934) ("Plaintiffs having been permitted and induced to perform the services and the township having accepted the benefits thereof, it cannot, under the circumstances, escape its obligation to pay."); *Coit*, 73 N.W. at 813; *Highway Comm'rs of Sault Ste. Marie v. Van Dusan*, 40 Mich. 429, 431 (1879); *see also Normandy Estates Metro. Rec. Dist. v. Normandy Estates Ltd.*, 553 P.2d 386 (Colo. 1976) (en banc) (permitting contract counterparty to recover on equitable grounds where metropolitan recreational district sought to invalidate as void a purchase contract on the grounds that it failed to obtain voter approval); *Lodi Twp. v. Little Ferry Nat'l Bank*, 189 A. 58 (N.J. Chanc. 1937) (holding, in suit by a New Jersey municipality for cancellation of municipal securities, that the municipality could not keep the consideration for the securities and at the same time be relieved of payment for the securities); *City of Henderson v. Winstead*, 215 S.W. 527 (Ky. Ct. App. 1919) (permitting recovery by holder of municipal bond issued in pursuance of a statute and ordinance that were subsequently declared unconstitutional).

questioned" and that a municipal corporation "cannot take greater advantage of its own errors than can a private person" (internal citation omitted)).

B. FGIC's Counterclaims Specifically Allege That the Funding Proceeds Are in Existence and Readily Identifiable

In its Counterclaims, FGIC has alleged that the Funding Proceeds are in existence and readily identifiable. Specifically, FGIC has alleged that the Funding Proceeds are segregated within the Accrued Liability Fund of each Retirement System and are separately accounted for in each Retirement System's annual statements. (*See* Counterclaims ¶¶ 31, 96-98.) *See also* Detroit, Mich. Ord. Nos. 03-05 § 47-2-18(a)(3)(d), 04-05 §54-43-4(e) (mandating segregation of and separate accounting for Funding Proceeds). Courts are especially likely to allow recovery in equity on an invalid contract or transaction where, as here, a party seeks to reclaim money or property that is segregated and readily identifiable. *See, e.g.*, *City of Litchfield v. Ballou*, 114 U.S. 190, 195 (1885) ("If the complainants are after the money they let the city have, they must clearly identify the money or the fund, or other property which represents that money, in such a manner that it can be reclaimed and delivered without taking other property with it, or injuring other persons or interfering with others' rights."). In fact, the City in its Motion mischaracterizes *Litchfield*, which involved an Illinois constitutional provision that specifically prohibited a city from becoming "indebted in any manner, or for any purpose." *Id.* at 192. The Supreme Court, in interpreting that Illinois statute, noted that the money borrowed *could* be recovered from the city if the money or funds were clearly identifiable. *Id.* at 195. Thus, the Court did in fact find there was a remedial option, even where the transaction at issue exceeded the debt limit. *Id.*

Similarly, in *Newberry v. Nine Mile Halfway Drain Dist.*, 30 N.W.2d 430 (Mich. 1948), the Michigan Supreme Court held that a constructive trust could be impressed on certain property in favor of the bondholders where the "moneys of the bondholders obtained for an

illegal [sewer] project can be traced directly into the acquisition [of certain real property], which became completely separated" from the sewer system. *Id.* at 437. Rather than completely reject any form of relief, the court remanded the constructive trust question for a hearing in the trial court. *Id.* Equitable relief is more readily granted in cases where money, instead of goods or services, was exchanged because the contract counterparty can be made whole without imposing on taxpayers. *See City of Henderson*, 215 S.W. at 527 (distinguishing cases in which funds are exchanged from cases in which services are performed and noting that the "difference between the two classes of cases affords ample room for the application of [ ] different legal principle[s]" (internal citation omitted)).

The City cannot establish, as it must to meet its burden in connection with the Motion, that FGIC cannot assert sufficient facts in support of its Counterclaims to plausibly show legal entitlement to relief under alternative theories of recovery. *See, e.g.*, *Static Control Components*, 697 F.3d at 401. Indeed, FGIC has asserted numerous facts demonstrating that, even if the City were able to prevail at trial on its argument that the Service Contracts are legally unenforceable, alternative theories of recovery are particularly appropriate here because the City benefited substantially from the Service Contracts it now seeks to disavow and because the Funding Proceeds are segregated and readily identifiable.

C. The City's Draconian "Strict Liability" Rule is Without Support

There is also no basis for the City's articulation of its "strict liability" situation (*see* Br. in Supp. of Mot. 12, 14); the City cites no case that articulates such a draconian rule. The City simply seeks to prop up its argument that a determination of FGIC's fact-intensive Counterclaims is appropriate on a motion to dismiss.

It is readily apparent from the above discussion of estoppel that the City's theory of "strict liability" does not exist under Michigan law. As discussed *supra*, when it would be

inequitable to find a contract unenforceable, Michigan courts have enforced otherwise invalid contracts, for example, through estoppel. *See Parker*, 231 N.W.2d at 428; *United Sav. Bank of Detroit v. Sch. Dist. No. 5, Fractional, Redford & Livonia Tps., Wayne Cnty., & Farmington Twp., Oakland Cnty*., 273 N.W. 753, 755 (Mich. 1937) ("The good faith of government should never be held less sacred than that of individuals. Where the executed contract is neither malum in se nor malum prohibitum, but can only be avoided because of defects in the manner of its execution, the corporation cannot retain the benefits and deny its authority." (quoting *Am. La France & Foamite Indus. v. Clifford*, 275 N.W. 596, 597 (Mich. 1934) (internal quotation marks omitted))); *see also Webb*, 215 N.W. at 45 (noting that the defense of ultra vires should not be "sustained unless the rigid rules of law require it" (internal citation omitted)); *Coit*, 73 N.W. at 813 ("The doctrine of ultra vires, when invoked for or against a corporation, should not be allowed to prevail where it would defeat the ends of justice." (internal citation omitted)); *Spier v. City of Kalamazoo*, 101 N.W. 846, 847 (Mich. 1904) (citing *Coit*).

Moreover, the factual circumstances of the cases supposedly announcing the per se rule the City would have the Court blindly follow in this case have no bearing on the factual circumstances pled in FGIC's Counterclaims.[16] (*See* Br. in Supp. of Mot. 14-17.) For example, in *Stratton v. City of Detroit*, the plaintiffs blatantly disregarded a contract limiting the budget for the building related to plaintiffs' work to an amount appropriated by the City, and, instead, performed work based on a building budget of over $1 million more than the appropriated amount. 224 N.W. 649 (Mich. 1929). Similarly, in *Hanslovsky v. Leland Twp.*, the township

[16] Two of the cases cited by the City – *Newberry* and *People v. Doyle & Assocs., Inc.*, are wholly inapposite because in those cases the courts *did* provide some form of relief to the private parties. *People v. Doyle & Associates, Inc.*, 132 N.W.2d 99, 103 (Mich. 1965) (permitting parties to renegotiate terms of voided transaction); *Newberry*, 30 N.W.2d at 437 (remanding for consideration of whether constructive trust should be imposed on certain property in favor of bondholders).

records clearly indicated that the township had *not* satisfied the procedural prerequisites needed to borrow money, and the notes in question were not executed by the township's authorized agents. 275 N.W. 720 (Mich. 1937). In *McCurdy*, the particular transaction in question was subject to elector approval and the pertinent electors had already rejected it *three times*. 118 N.W. at 625. In addition, there was no evidence that the money from the transaction had even been used by the county; indeed, the "intimation [was] strong" that the transaction was not made for the purposes set forth in the county board of supervisors' resolutions. *Id.* at 629.

In contrast, this case does not present a situation where a private party disregarded obvious limitations on public officials' authority or failed to do its proper due diligence to ensure that the public officials with whom they were dealing had the requisite authority they claimed to possess. In its Counterclaims, FGIC has alleged its reliance on the City's ability to engage in the Pension Funding Transactions was justified based on the factual representations that were made to FGIC by the City and its authorized agents prior to and at the time of the Pension Funding Transactions, the various opinions that were provided to FGIC by or on behalf of the City indicating that the City's obligations under the Service Contracts were valid, binding and enforceable, and the ordinances the City passed authorizing the Pension Funding Transactions (which ordinances are still in effect and which the City has not challenged or sought to repeal).

Based on the City's representations, it was reasonable for FGIC to conclude that the City was acting with proper authority. And, in fact, the City *was*. Its belated attempt to suggest otherwise is inconsistent with the fact that, at the time of the Pension Funding Transactions, FGIC (and others) reasonably believed that whatever procedures were necessary to render those transactions legal and binding had been followed. Accordingly, the factual circumstances pled in

FGIC's Counterclaims support denial of any wholesale rejection of FGIC's Second through Sixth Counterclaims.

IV. FGIC's Second, Third, and Fifth Counterclaims Are Adequately Pled and Withstand Scrutiny on a Motion to Dismiss

The City's contention that the Second, Third, and Fifth Counterclaims are not adequately pled also fails, as FGIC has indicated with ample specificity those of the City's representations of past or existing facts that the City believed were false when made and that FGIC justifiably relied upon to its detriment.

A. FGIC Adequately Alleges Misrepresentations of Fact

In its Second and Third Counterclaims, FGIC has alleged that the City made numerous material representations of past or existing facts, including that (a) the City took all necessary steps to assess the legality of the Alternative Funding Mechanism and the Pension Funding Transactions and had conclusively determined that the contractual obligations under the Pension Funding Transactions could not constitute indebtedness under Michigan law or be subject to any limitations on the City's net indebtedness capacity, (b) all necessary acts, conditions and things required to exist had happened and were performed precedent to the City's entry into the Service Contracts to make the obligations binding, and (c) the Pension Funding Transactions would use none of the City's debt capacity. (Countercl. ¶¶ 45, 55, 67-76, 80, 123-27, 138-41, 156.) FGIC relied on these and other representations in agreeing to issue the Policies. In addition, FGIC alleges, upon information and belief, that the City concealed from FGIC that one law firm the City had sought legal advice from questioned the legality of the Alternative Funding Mechanism and refused to participate in the 2005 Pension Funding Transaction. (*Id.* ¶ 90.)

Contrary to the City's characterizations in the Motion, these representations are factual in nature; at most, they involve issues of *both* law and fact. *See, e.g.*, *Chem. Bank*, 251 N.W. at

399. The City also overlooks that "even though the language of a representation concerns only legal consequences and is in the form of an expression of opinion, it may, as in the case of any other statement of opinion, carry with it by implication the assertion that the facts known to the maker are not incompatible with his opinion." *Wal-Mart Stores, Inc. v. AIG Life Ins. Co.*, 901 A.2d 106, 115 (Del. 2006) (citing Restatement (Second) Torts § 545 (1977)); *S.E.C. v. Conaway*, 698 F. Supp. 2d 771, 830 (E.D. Mich. 2010) ("[T]he concept of implied representation is well established [] in common law fraud . . . ."); *State Coll. Area Sch. Dist. v. Royal Bank of Can.*, 825 F. Supp. 2d 573, 587 n.2 (M.D. Pa. 2011) (stating an opinion, "if not explicitly, at least *implicitly*, states certain facts").

Moreover, in *Wal-Mart*, the plaintiff adequately pled a common law fraud claim where it alleged that an issuer had knowingly chosen an investment structure that might prompt regulators to disapprove the tax-exempt status of the offered investments, but furnished legal opinions and conclusions concerning their tax-exempt status. *Wal-Mart*, 901 A.2d at 116. Here, FGIC has similarly alleged that the City was at least aware of, but did not disclose, that a retained professional had cast doubts on the transaction's viability, despite the fact that the City was aware that the nature of its contractual obligations was material information that FGIC would rely on.

FGIC has adequately pled its misrepresentation claims even in the unlikely event that the City's representations solely constituted opinions of law (which FGIC disputes).[17] "[A] statement of opinion made in bad faith by one who is possessed of superior knowledge respecting such matters, with a design to deceive and mislead, may constitute an actionable

[17] Despite the City's assertion that one of the 2004 Memos, the Honigman Miller memo, "was not even legal opinion[] of the City's counsel" (Br. in Supp. of Mot. 19.), the memo was, in fact, addressed to employees of UBS *and* Sean Werdlow, the City's Chief Financial Officer at the time. (Countercl. ¶ 66.)

misrepresentation." *Sheridan v. New Vista, L.L.C.*, 406 F. Supp. 2d 789, 794 n.1 (W.D. Mich. 2005) (citation and internal quotation marks omitted); *French v. Ryan*, 62 N.W. 1016 (Mich. 1895) (same).[18] "[W]hether a specific representation is classified as an expression of opinion or an actionable statement of fact is contingent upon the circumstances of each case." *Foreman v. Foreman*, 701 N.W.2d 167, 175 (Mich. Ct. App. 2005) (citing *McDonald v. Smith*, 102 N.W. 668 (Mich. 1905)). Here, FGIC alleges that the City was in a position of superior knowledge and was uniquely situated to make certain determinations, such as those regarding the nature and extent of its diligence, the scope of its authority, the procedural requirements that had to be met, and the HRCA debt limit and relevant exceptions. *See Eisenberg v. Gagnon*, 766 F.2d 770, 776 (3d Cir. 1985) ("When a representation is made by professionals or those with greater access to information or having a special relationship to investors making use of the information, there is an obligation to disclose data indicating that the opinion or forecast may be doubtful." (citation and internal quotation marks omitted)). As such, in the context of such complex determinations and given the City's greater access to information, the City had the obligation to disclose all material information to FGIC, even where those representations may have included opinions of law, and it did not.

Brazenly, the City now contends in its Complaint that the 2005 and 2006 Pension Funding Transactions were in flagrant violation of existing law. Whatever its intended purpose in doing so, the City cannot have it both ways – either the transactions were lawful and City's representations concerning the material facts relating to the transactions were true, in which case the City cannot disavow its binding obligations at its convenience, or the transactions were

[18] *See also Rosenberg v. Cyrowski*, 198 N.W. 905, 906 (Mich. 1924) (recognizing that the requirement for a misrepresentation of fact rather than law is premised on the maxim that all parties are presumed to know the law, but noting that: "[T]his maxim finds but little support in fact. It may be doubted if it was ever intended to excuse fraud.").

fraudulent and the City made actionable misrepresentations, in which case FGIC is entitled to prosecute its fraudulent inducement and misrepresentation claims.[19]

Accordingly, by delineating the specific material representations of past or existing fact by the City, FGIC has more than adequately pled that element of its Second and Third Counterclaims at the motion to dismiss stage.

B. FGIC Adequately Alleges Justifiable Reliance

Notwithstanding the City's assertions in the Motion, FGIC did not simply take on faith the City's pre-contractual and contractual representations. (*See* Br. in Supp. of Mot. 25.) Rather, as detailed in the Counterclaims, FGIC required enforceable contractual representations and warranties that the Service Contracts and the City's obligations thereunder complied with the represented attributes and relevant conditions precedent. In addition, as an express third-party beneficiary of the Service Contracts, FGIC is "conclusively presumed to have relied upon [the City's] representations and warranties, and such reliance shall survive any investigation made." (*See, e.g.*, 2005 GRS Service Contract (Compl. Ex. C).)

Further, FGIC's reliance on the City's numerous material misrepresentations was reasonable. The written misrepresentations were presented to FGIC *time and time again* in an effort to induce FGIC to issue the Policies and were expressly included in the Service Contracts and even on the face of the COPs. Courts have clarified that "*unreasonable* reliance includes relying on an alleged misrepresentation that is expressly contradicted in a written contract that

[19] If the City developed such knowledge at any point during the over two-year negotiation of the transactions, then it is equally culpable by virtue of a "silent fraud," as the City had a duty to disclose such information to FGIC upon learning that its previous representations were untrue, but instead remained silent. *See U.S. Fid. & Guar. Co. v. Black*, 313 N.W.2d 77, 89 (Mich. 1981) (noting that a "party to a business transaction is under an obligation to exercise reasonable care to disclose to the other party, before the transaction is consummated, any subsequently acquired information which he recognizes as rendering untrue, or misleading, previous representations which, when made, were true or believed to be true").

the plaintiff reviewed and signed." *Versatrans, Inc. v. Hirsch Int'l Corp.*, No. 12-13913, 2013 WL 943519, at *7 (E.D. Mich. Mar. 11, 2013) (citing *Aron Alan, LLC v. Tanfran, Inc.*, 240 Fed. Appx. 678, 682 (6th Cir. 2007)) (emphasis added); *see also MacDonald v. Thomas M. Cooley Law School*, 724 F.3d 654, 665 (6th Cir. 2013). In like manner, "Michigan courts have long recognized that a plaintiff cannot establish a reasonable reliance by relying 'on oral representations that are contradicted by a written contract … that is readily available to the plaintiff.'" *Tocco v. Richman Greer P.A.*, 912 F. Supp. 2d 494, 521 (E.D. Mich. 2012) (citing *Chimko v. Shermeta*, No. 264845, 2006 WL 2060417, at *3 (Mich. Ct. App. July 25, 2006)); *Miller v. CVS Pharmacy, Inc.*, 779 F. Supp. 2d 683, 689 (E.D. Mich. 2011).[20] FGIC's reliance, it follows, was the exact opposite of unreasonable, as FGIC relied on misrepresentations that were expressly reaffirmed in the legal opinions, 2004 Memos, and Detroit Presentations, and included in the Service Contracts and related closing documents.

The City argues that FGIC could not reasonably rely on the misrepresentations of the City because it had an obligation to investigate and uncover that the representations continuously affirmed by the City – 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

[20] *See also Cook v. Little Caesar Enters., Inc.*, 210 F.3d 653, 658 (6th Cir. 2000) (finding "[r]eliance upon oral representations or prior documents, even if false, is unreasonable if the party enters into a subsequent agreement"); *Oliverio v. Nextel West Corp.*, No. 13-10296, 2013 WL 2338706, at *5 (E.D. Mich. May 29, 2013) (finding "any reliance on the alleged [prior oral] statements would be unreasonable as a matter of law" where "such statements are expressly contradicted by the terms of the written contract"); *3 P.M., Inc. v. Basic Four Corp.*, 591 F. Supp. 1350, 1366 (E.D. Mich. 1984) (holding that a plaintiff may not reasonably rely on prior oral statements that directly contradict the terms of a written contract).

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 – were false. The law does not require any such obligation or duty. *See Titan Ins. Co. v. Hyten*, 817 N.W.2d 562, 555 n.4 (Mich. 2012) ("[T]here is no common-law duty to attempt to acquire such knowledge [to the contrary of a representation]"). While it is true that "fraud is not perpetuated upon one who has full knowledge to the contrary of a representation," FGIC was no such party. *Id.* (internal citations omitted). Here, as alleged, the truthfulness of the representations was not available to FGIC. To the contrary, the City intentionally failed to fully disclose all material information concerning the Pension Funding Transactions. Similarly, courts have held that there is no duty to independently investigate the truthfulness of a representation "where, by reason of the defendant's acts, the plaintiff had no reason to believe that further inquiry was necessary." *Ypsilanti Cmty. Utils. Auth. v. Meadwestvaco Air Sys., LLC*, 678 F. Supp. 2d 553, 568 (E.D. Mich. 2009) (citation omitted); *see also Titan Ins. Co.*, 817 N.W.2d at 568; *Mable Cleary Trust v. Edward-Marlah Muzyl Trust*, 686 N.W.2d 770, 782 (Mich. Ct. App. 2004). In this case, the City's misrepresentations for a period of over two years in meetings, discussions, presentations, opinions, and transaction documents (and its omission of material information about its diligence of the transaction) gave FGIC no reason to believe that the City's representations were anything but true and could be reasonably relied upon.

Ultimately, whether FGIC justifiably relied on the City's representations, including whether FGIC conducted appropriate due diligence for the risk it undertook, involves a fact-dependent inquiry that cannot be resolved on the pleadings. Courts recognize that justifiable reliance on a defendant's misrepresentations "is to be evaluated in light of all the elements of a

transaction . . . these characteristics involve questions of material fact best left for a [trier of fact]." *Arioli v. Prudential-Bache Secs., Inc.*, 792 F. Supp. 1050, 1060 (E.D. Mich. 1992); *see also Fed. Hous. Fin. Agency v. JPMorgan Chase & Co.*, 902 F. Supp. 2d 476, 496 (S.D.N.Y. 2012) (stating reliance analysis "involves many factors to consider and balance, no single one of which is dispositive" and that therefore it is "often a question of fact for the jury rather than a question of law for the court" (internal citation omitted)). FGIC's status as a sophisticated party does not *per se* alter this approach, especially considering that FGIC did not have access to certain information possessed by the City, including the contrary legal opinion the City failed to disclose. As discussed above, FGIC also expressly bargained for third-party beneficiary status in the Service Agreements and is presumed to have relied on the City's representations. Indeed, in *Wal-Mart*, a sophisticated investor could prosecute its fraud claim even though it signed a letter stating that it had not relied upon any of the issuer's representations because the letter "does not, by its terms, state that Wal-Mart was absolving AIG Life of liability for material misrepresentations as to the structural flaws in its product." *Wal-Mart*, 901 A.2d, at 116; *see also JPMorgan Chase*, 902 F. Supp. 2d at 496–98 ("[E]ven sophisticated plaintiffs are not required as a matter of law to conduct their own audit . . . where they have bargained for representations of truthfulness . . . . A jury may ultimately conclude that [plaintiffs] should have known better than to rely on the defendants' representations . . . [b]ut this motion to dismiss does not permit such a finding as a matter of law." (citation and internal quotation marks omitted)). Similarly, even if FGIC consulted its own attorneys, this fact would not absolve the City from liability for any fraudulent conduct.

In sum, FGIC has adequately raised multiple issues of fact that are not appropriate for determination as a matter of law at this time. As such, its Counterclaims based on the City's numerous misrepresentations must proceed.

C. FGIC Adequately Alleges Promissory Estoppel

In Michigan, the elements of promissory estoppel are (1) a promise (2) that the promisor reasonably should have expected to induce action of a definite and substantial character on the part of the promisee (3) which in fact produced reliance or forbearance of that nature and (4) in circumstances such that the promise must be enforced if injustice is to be avoided. *Ypsilanti Cmty. Utils. Auth.*, 678 F. Supp. 2d at 574 (quoting *Novak v. Nationwide Mut. Ins.*, 599 N.W.2d 546 (Mich. Ct. App. 1999)). In the promissory estoppel context, a "promise" is defined as a "manifestation of intention to act or refrain from acting in a specified way, so made as to justify a promisee in understanding that a commitment has been made." *Schippers Excavating, Inc. v. Crystal Creek Enters., L.L.C.*, No. 295754, 2011 WL 2518934, at *3 (Mich. Ct. App. June 23, 2011) (citing *State Bank of Standish v. Curry*, 500 N.W.2d 104, 107-09 (1993)). A promise may be stated in words, either orally or in writing, or may be inferred entirely or partly from a party's conduct. *See State Bank,* 500 N.W.2d at 108. Whether a promise is clear and unambiguous requires consideration of the specific factual circumstances. *See Pinto v. Gen. Motors Corp.*, No. 208392, 1999 WL 33327151, at *6 (Mich. Ct. App. Dec. 10, 1999) (finding that promises made by defendant were made on several occasions and attended by circumstances under which it was entirely reasonable for plaintiff to rely on the promises); *see also Ypsilanti Cmty. Utils. Auth.*, 678 F. Supp. 2d at 575 (considering nature, number and quality of representations alleged by plaintiff).

FGIC has pled adequately that it relied on the City's promises and conduct in issuing the Policies, FGIC's reliance was reasonable under the circumstances, and FGIC has or will likely

incur damages as a result. Among the City's promises were that, in the event the Service Contracts were voidable, the City could not seek to void the contract while at the same time retaining the benefits it received. (Countercl. ¶ 54.) This statement is definite and unconditional. *See Metro. Alloys Corp. v. Considar Metal Mktg., Inc.*, 615 F.Supp.2d 589, 598 (E.D. Mich. 2009) (finding verbal sales commitment that was unconditional and without prerequisites to be a definite promise); *Ypsilanti Cmty. Utils. Auth.*, 678 F. Supp. 2d at 575 (finding promise "to stand behind [a] performance guarantee" was "clear and definite enough to sustain" promissory estoppel claim). In addition, the City's numerous statements and conduct indicating to FGIC that the COPs were backed by a reliable payment stream that, if interrupted, would give rise to subrogation rights or direct claims against the City are likewise clear and unconditional promises. (Countercl. ¶¶ 58-61.) *Cf. Ypsilanti Cmty. Utils. Auth.*, 678 F. Supp. 2d at 574 ("This Court previously held that YCUA alleged a valid claim of promissory estoppel by its allegations that MWV: (1) expressed its intent, plan and commitment to the YCUA project's completion; (2) represented that its significant financial resources and strength were behind the project and would remain; and (3) intentionally accentuated to YCUA its financial resources and strength as a reason for YCUA to select MWVAS as the supplier of air ionization equipment to YCUA."). Absent these promises, FGIC would not have issued the Policies.

Moreover, because FGIC's claim for promissory estoppel only arises if the Court finds that the Service Contracts and the City's contractual obligations thereunder are invalid, void *ab initio*, or otherwise unenforceable, the City's use of *Willis v. New World Van Lines, Inc.*, 123 F. Supp. 2d 380 (E.D. Mich. 2000), is misguided. The Sixth Circuit holding in *General Aviation, Inc. v. Cessna Aircraft Co.*, 915 F.2d 1038, 1042 (6th Cir. 1990) that is cited in *Willis* – that the doctrine of promissory estoppel is not applicable where the performance which is said to satisfy

the detrimental reliance requirement is the same performance which represents consideration for the written contract – requires exactly that, a *written contract*. In fact, in *Willis*, the court found the *General Aviation* holding inapplicable because the plaintiff conceded that there was no written contract. *See Willis*, 123 F. Supp. 2d at 395. For the same reason, the *General Aviation* holding is inapplicable in this case. If the Service Contracts and related documents are found to be invalid, void *ab initio*, or otherwise unenforceable, there is no written contract under which to analyze FGIC's performance. This is the exact circumstance where a claim for promissory estoppel arises.[21]

Justice requires enforcement of the City's promises. The law does not support the City's attempt to receive an over one billion dollar reduction in its obligations to fund its pension liabilities and then refuse to make the promised payments that induced FGIC to insure. The equities require that promissory estoppel be applied to enforce the City's promised obligations.[22] Thus, the City's motion to dismiss the Fifth Counterclaim should be denied.

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[21] *See Lotsadough, Inc. v. Comerica Bank*, No. 12-10121, 2012 WL 5258300, at *9 (E.D. Mich. Oct. 23, 2012) ("Michigan courts only apply promissory estoppel when 'an implied agreement exists between the parties, in the absence of an express contract.'" (citing *APJ Assocs., Inc. v. North Am. Philips Corp.*, 317 F.3d 610, 617 (6th Cir. 2003))); *see also Diamond Computer Sys., Inc. v. SBC Commc'ns, Inc.*, 424 F. Supp. 2d 970, 986 (E.D. Mich. 2006) (same); *McClarty v. Detroit Edison Co. (In re DCT, Inc.)*, 261 F. Supp. 2d 864, 868 (E.D. Mich. 2003) (same); *Ayoub v. Unum Life Ins. Co. of Am.*, No. 06-CV-15768, 2007 WL 1059177, at *5 (E.D. Mich. Apr. 6, 2007) ("[A] promissory estoppel theory allows for recovery only when no contract exists or 'where a party doubts the existence of a contract.'" (internal citation omitted)); *LaSalle Group, Inc. v. Crowell*, No. 04-71563, 2006 WL 3446215, at *6 (E.D. Mich. Nov. 27, 2006) ("[A] claim for promissory estoppel may only lie in the absence of an express contract.").

[22] The City's argument that the City's performance under the Service Contracts for almost nine years somehow precludes a promissory estoppel claim is misguided. (Br. in Supp. of Mot. 27.) The City's own admissions in its Complaint indicate that the City never intended to honor its promises to FGIC. (Compl. ¶¶ 10-11, 13, 16, 23-24, 31.)

V. FGIC'S Counterclaims Are Within the Scope of Its Timely-Filed Proofs of Claim

The City argues, without citing applicable authority,[23] that the Court's order, dated November 21, 2013, establishing the bar date (the "Bar Date Order")[24] bars FGIC's Second through Sixth Counterclaims. (Br. in Supp. of Mot. 28-31.) The City's conclusory assertion that the Second through Sixth Counterclaims are barred by the Bar Date Order is a woefully insufficient basis to seek dismissal of those counterclaims.[25]

Even if FGIC's Counterclaims were subject to the bar date specified in the Bar Date Order, which they are not, FGIC timely filed, among others, proofs of claim numbers 1190 and 1195 that the City's claims agent received on February 19, 2014 (the "COPs Proofs of Claim"), and which preserved claims arising from or relating to the Adversary Proceeding.[26] Specifically, the COPs Proofs of Claim state:

> [B]y this Proof of Claim, and to the extent the City's obligations under the Service Contracts in connection with Series 2005 COPs are subordinated and/or such obligations or the Service Contracts are declared invalid or void *ab initio*, as a result of the Adversary Proceeding or otherwise, FGIC asserts a contingent

[23] The only case that the City draws upon is *Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380 (1993), which articulates the standard of "excusable neglect" for a bankruptcy court's allowance of an untimely proof of claim. As discussed *infra*, *Pioneer* is inapplicable and does not support the City's argument that FGIC's timely filed proofs of claim do not preserve FGIC's Counterclaims.

[24] The Bar Date Order states, in paragraph 4, that "all entities . . . that assert claims against the City that arose (or are deemed to have arisen) prior to July 18, 2013 (any such claim, a 'Prepetition Claim') must file a proof of claim in writing in accordance with the procedures described herein by 4:00 p.m., Eastern Time, on February 21, 2014 (the 'General Bar Date')."

[25] The City does not argue that FGIC's First Counterclaim is not adequately preserved. In addition, the City fails to allege that FGIC has not pled sufficient facts to plausibly allege entitlement to relief on its Fourth Counterclaim for unjust enrichment and its Sixth Counterclaim for mistake.

[26] The City also mischaracterizes the procedural posture of FGIC's Counterclaims in its Motion. When the City filed its Complaint, it did not name FGIC as a defendant; FGIC, thus, moved to intervene in the Adversary Proceeding. Subsequently, by order entered on June 30, 2014 [Adv. Pro. Docket No. 73], the Court permitted FGIC to intervene, with limitations, as a defendant in the Adversary Proceeding. FGIC then sought leave on July 17, 2014 to file its Counterclaims [Adv. Pro. Docket No. 83], which leave was granted on August 6, 2014 [Adv. Pro. Docket No. 114]. FGIC filed its Counterclaims on August 13, 2014 [Adv. Pro. Docket No. 139].

> and/or unliquidated Claim for any and all damages arising therefrom or related thereto. Furthermore, as discussed above, FGIC asserts a contingent and/or unliquidated Claim for any and all FGIC Fees and Expenses incurred in connection with the Adversary Proceeding and as otherwise permitted under the Documents.
>
> COPS Proofs of Claim ¶ 23.

As described above, the COPs Proofs of Claim provide the City with "sufficient information so that [the City] may identify the creditor and match the creditor and the amount of the claim with the claims scheduled by the [City]." *In re Hughes*, 313 B.R. 205, 212 (Bankr. E.D. Mich. 2004). In any event, since the Counterclaims relate to the COPs Proofs of Claim, FGIC could amend those proofs of claim (should any such amendments be appropriate) to plead its claims based on the Adversary Proceeding with greater particularity or to plead more specific theories of recovery. *See, e.g.*, *In re Bondi's Valu-King, Inc.*, 126 B.R. 47, 49-50 (N.D. Ohio 1991); *In re Lee Way Holding Co.*, 178 B.R. 976, 979-80 (Bankr. S.D. Ohio 1995). FGIC has explicitly retained the right to amend the COPs Proofs of Claim with additional facts and claims. (*See* COPs Proofs of Claim ¶ 26.)

Furthermore, FGIC's Counterclaims are not prepetition claims that were required to be filed prior to the date specified in the Bar Date Order. FGIC's Counterclaims accrue if the City obtains the declaratory relief it seeks via its post-petition commencement of the Adversary Proceeding. The City's observation that the Complaint was filed three (3) weeks before the February 21, 2014 bar date is of no importance, because it does not transform the Counterclaims into prepetition claims within the meaning of the Bar Date Order.[27]

[27] The City has indicated that it intends to reject the Service Contracts (which the City recognizes are executory contracts) as of the later of (i) the Effective Date (as defined in the Sixth Amended Plan for the Adjustment of Debts of the City of Detroit [Docket No. 6910] (the "Plan")) or (ii) the resolution of any objection to the proposed rejection of the Service Contracts. (*See* Plan § II.D.6 & Ex. II.D.6.) Any claims arising from the rejection of the Service Contracts pursuant to the Plan will be treated as Class 14 Claims (Other Unsecured Claims). (*Id.* § II.D.6.) If the Service Contracts are rejected, FGIC would have

VI. If the Court Determines Additional Facts are Necessary, FGIC Should be Given Leave to Amend its Counterclaims

Insofar as this court believes additional facts are necessary, FGIC respectfully requests leave to amend its Counterclaims. Courts in the Sixth Circuit agree that leave to amend should be freely given unless a court determines that the pleadings could not possibly be cured by the allegation of other facts, there was undue delay or bad faith in seeking to amend, there was lack of notice to the opposing party, or the amendment would cause prejudice to the opposing party. *Cendrowski Selecky Prof'l Corp. v. Nat'l Ass'n of Certified Valuation Analysts, Inc.*, 10-CV-14432, 2012 WL 1554209, at *3 (E.D. Mich. Apr. 30, 2012) ("The court is to consider several factors when deciding when to allow a motion to amend: Undue delay in filing, lack of notice to the opposing party, bad faith by the moving party, repeated failure to cure deficiencies by previous amendments, undue prejudice to the opposing party, and futility of amendment are all factors which may affect the decision.") (citing *Commercial Money Ctr., Inc. v. Ill. Union Ins., Co.*, 508 F.3d 327, 346 (6th Cir. 2007)). Because none of these factors is present here, and based on the allegations already set forth in the Counterclaims, leave to amend is warranted. *See, e.g.*, *Choon's Design Inc. v. Tristar Prods., Inc.*, No. 14-10848, 2014 WL 4064254, at *4 (E.D. Mich. Aug. 18, 2014) (granting leave to amend a complaint because there was no allegation of bad faith or prejudice and the complaint could be cured).

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an opportunity to assert rejection damages on or before the later of (i) 45 days after the Effective Date or (ii) 45 days after rejection pursuant to a Final Order (as defined in the Plan). (*Id.* § II.D.7.) Thus, any attempt to bar FGIC's Counterclaims, which arise out of the Service Contracts, is premature.

WHEREFORE, FGIC respectfully requests that the Court deny the motion to dismiss in its entirety.

DATED: September 11, 2014

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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re **CITY OF DETROIT, MICHIGAN,** **Debtor.**	**Chapter 9** **Case No. 13-53846** **Hon. Steven W. Rhodes**
CITY OF DETROIT, MICHIGAN, **Plaintiff,** **v.** **DETROIT GENERAL RETIREMENT SYSTEM SERVICE CORPORATION, *et al.*,** **Defendants.**	**Chapter 9** **Adversary No. 14-04112** **Hon. Steven W. Rhodes**

CERTIFICATE OF SERVICE FOR FINANCIAL GUARANTY INSURANCE COMPANY'S OPPOSITION TO CITY OF DETROIT'S MOTION TO DISMISS IN PART FGIC'S COUNTERCLAIMS

I hereby certify that on September 11, 2014 the *Financial Guaranty Insurance Company's Opposition to City of Detroit's Motion to Dismiss in Part FGIC's Counterclaims* 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.

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Dated: September 11, 2014

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