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

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| In re | : | Chapter 9 |
| CITY OF DETROIT, MICHIGAN, | : | Case No. 13-53846 |
| Debtor. | : | Hon. Steven W. Rhodes |
| CITY OF DETROIT, MICHIGAN, | : | Chapter 9 |
| Plaintiff, | : | Adv. Pro. No. 14-04112 |
| vs. | : | Hon. Steven W. Rhodes |
| DETROIT GENERAL RETIREMENT SYSTEM SERVICE CORPORATION, DETROIT POLICE AND FIRE RETIREMENT SYSTEM SERVICE CORPORATION, DETROIT RETIREMENT SYSTEMS FUNDING TRUST 2005, and DETROIT RETIREMENT SYSTEMS FUNDING TRUST 2006 | : | |
| Defendants. | : | |

**MEMORANDUM OF DETROIT RETIREMENT SYSTEMS FUNDING TRUST 2005 AND DETROIT RETIREMENT SYSTEMS FUNDING TRUST 2006 IN OPPOSITION TO CITY OF DETROIT'S MOTION TO DISMISS IN PART THE FUNDING TRUSTS' COUNTERCLAIMS**

## TABLE OF CONTENTS

**TABLE OF CONTENTS**
(continued)

## TABLE OF AUTHORITIES

**Page(s)**

**CASES**

**STATUTES, RULES & REGULATIONS**

**OTHER AUTHORITIES**

Wilmington Trust, National Association ("WTNA"), successor trustee for the above-captioned defendants (a) Detroit Retirement Systems Funding Trust 2005 (the "2005 Funding Trust") and (b) Detroit Retirement Systems Funding Trust 2006 (the "2006 Funding Trust" and, together with the 2005 Funding Trust, the "Trust Defendants"), hereby submits, on behalf of the Trust Defendants, by and through its undersigned counsel, this Memorandum in Opposition to *City of Detroit's Motion to Dismiss in Part the Funding Trusts' Counterclaims* (the "Motion") (Adv. Pro. Doc. 23).[1]

## I. PRELIMINARY STATEMENT

The City's Emergency Manager has instructed the City's counsel to challenge the validity of a $1.44 billion financial transaction that benefited the City for over eight years and that, at the time it was sold to institutional investors, was approved by the Detroit City Council and authorized by more than one City ordinance. In the Complaint[2] (Adv. Pro. Doc. 1) filed this past January, the City has tried to contort the law and re-write the facts with respect to that transaction.

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[1] As pled in the *Answer with Affirmative Defenses and Counterclaims of Defendants Detroit Retirement Systems Funding Trust 2005 and Detroit Retirement Systems Funding Trust 2006 to Complaint for Declaratory and Injunctive Relief* (Adv. Pro. Doc. 10) (the "Trust Defendants' Answer"), the Trust Defendants maintain that this is a non-core proceeding and do not consent to the entry of final orders or judgment by this Bankruptcy Court.

[2] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Trust Defendants' Answer.

Now, in moving to dismiss all but one of the Trust Defendants' counterclaims (the "Counterclaims"), the City has turned federal civil procedure, including Rules 12(b)(6) and 12(c) of the Federal Rules of Civil Procedure (the "Rules"), made applicable in this Adversary Proceeding pursuant to Rule 7012 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), on their head, by relying on the alleged (and disputed) facts in its own Complaint, rather than accepting as true – as the City must – the allegations set forth in the Counterclaims.[3]

In ruling on the Motion, this Court must accept as true that the City in 2005, after receiving authority from the Detroit City Council, entered into valid and enforceable contracts with two (2) service corporations (the Detroit General

[3] Inappropriately, in the context of a Rule 12(b)(6) motion to dismiss, the City refers this Bankruptcy Court to "the detailed facts set forth in the City's Complaint and the transactional documents attached to the Complaint and to the Trusts' Counterclaims." *See Memorandum in Support of Motion* at 1 n.1 (the "Memorandum"). It then cites *Field Day, LLC v. County of Suffolk*, 463 F.3d 167, 192 (2d Cir. 2006), as authority for the Bankruptcy Court to consider facts stated in the Complaint and documents attached to the Complaint. *Field* concerned a motion to dismiss a complaint. When a motion is directed at a defendant's counterclaims, as is the case with the Motion, it is, of course, the factual allegations of the Counterclaims, not the Complaint, that must be accepted as true. *See Static Control Components, Inc. v. Lexmark Int'l, Inc.*, 697 F.3d 387, 401 (6th Cir. 2012) (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), *aff'd*, *Lexmark, Int'l Inc. v. Static Control Components, Inc.*, 572 U.S. __, 134 S. Ct. 1377 (2014); *Ford Motor Co. v. Mich. Consol. Gas Co.*, No. 08-13503, 2011 U.S. Dist. LEXIS 48313, at *16-17 (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).

Retirement System Service Corporation and the Detroit Police and Fire Retirement System Corporation (collectively, the "Service Corporations")). Further, as alleged in the Counterclaims, the Service Corporations (a) met all of their contractual obligations to the City, including raising the "Initial Funding" used to reduce the City's financial burden on account of the existing unfunded accrued actuarial liabilities ("UAALs"), and (b) assigned their rights to receive Service Payments to the Trust Defendants.

The City does not dispute in the Motion – nor could it – the financial predicament it was in by 2005. At that time, the Detroit Police and Fire Retirement System ("PFRS") and the Detroit General Retirement System ("GRS" and, together with PFRS, the "Retirement Systems") collectively had UAALs totaling no less than approximately $1.7 billion, which were accruing interest at an annual rate of 7.8% or 7.9%. *See* Mich. Comp. Laws § 38.1140m; 2005 Offering Circular (Exhibit A to Complaint) at 6; 2006 Offering Circular (Exhibit J to Complaint) at 8. The City was constitutionally and statutorily obligated to fund both the current service costs *and* the UAALs of the Retirement Systems, while leaving to the municipalities the issue of how the necessary funds would be raised. *Shelby Twp. Police & Fire Ret. Bd. v. Charter Twp. of Shelby*, 475 N.W.2d 249, 255 (Mich. 1991). Also undisputed by the City is the amount of money – $1.44 billion – raised by the City in mid-2005 through the issuance of Certificates of Participation

("COPs") that was then transferred (at the City's direction) to the Retirement Systems to be held in a segregated and identifiable fund within each of the Retirement Systems.

Nevertheless, with the Motion, the City attempts to re-write its own financial history, along with a good deal of Michigan law, and deny the Trust Defendants *any* recovery on the $1.44 billion raised by the City – funding that was desperately needed in 2005 to meet its constitutional and statutory obligations, as well as court mandate.[4]

At a minimum, there are a number of disputed issues of fact material to the Counterclaims that are not appropriately resolved now on a motion to dismiss or for judgment on the pleadings.[5] The disputed issues, among others, include:

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[4] On June 2, 2005, the Michigan Court of Appeals affirmed orders issued on December 5, 2003 and December 17, 2004 by the Wayne County Circuit Court granting motions for summary disposition mandating the City to comply with its UAAL obligations. *See Bd. of Trs. of Policemen/Firemen Ret. Sys. of City of Detroit v. City of Detroit*, Nos. 253343 & 260069, 2005 Mich. App. LEXIS 1387 (June 2, 2005) (per curiam).

[5] The City's Motion and Memorandum make reference to Rule 12(c), but both documents and the City's proposed form of order request dismissal; they do not request judgment on the pleadings. Indeed, the City's own counsel acknowledged, in open court, that the Motion seeks dismissal of the Counterclaims, not a judgment on its own pleadings. The City's counsel further indicated that the merits of the claims in the Complaint would be addressed, in the first instance, at the summary judgment stage. *See* July 14, 2014 Status Conference Tr. at 15:18-16:13. Implicit in the City's plan to address its own claims no sooner than summary judgment is a recognition that resolution of the City's claims requires a more developed record, not simply a pleading. Similarly, this Bankruptcy Court questioned the City's counsel about the likely

- the role of the Service Corporations, which the City utilized and treated (and still recognized)[6] as *bona fide* corporate entities until well after the commencement of the City's Chapter 9 proceeding, *compare, e.g.*, Complaint at ¶¶ 13-15, 23, *with* Trust Defendants' Answer at ¶¶ 13-15, 23, *and* Counterclaims at ¶¶ 11-13, 18-19, 22, 25;

- representations made by the City in connection with the 2005 COPs Transaction and the 2006 COPs Transaction (collectively, the "COPs Transactions"), *compare, e.g.*, Complaint at ¶¶ 11, 17, 23-25, *with* Trust Defendants' Answer at ¶¶ 11, 17, 23-25, *and* Counterclaims at ¶¶ 9, 21, 34-41, 55, 73-75, 78-86, 90, 100, 109;

- the City's authority to make those representations, *compare, e.g.*, Complaint at ¶¶ 11, 17, *with* Trust Defendants' Answer at ¶¶ 11, 17, *and* Counterclaims at ¶¶ 9, 21, 45-48, 50, 55, 73, 79-86, 90, 100, 109;

- how the City determines what obligations fall within the Home Rule Cities Act's ("HRCA") debt limitations, *compare, e.g.*, Complaint at ¶¶ 9, 16, 25, 29, 31, *with* Trust Defendants' Answer at ¶¶ 9, 16, 25, 29, 31, *and* Counterclaims at ¶¶ 52-54, 90, 100, 109;

- the services provided by the Service Corporations in connection with the COPs Transactions and thereafter, *compare, e.g.*, Complaint at ¶¶ 12-15, 23, *with* Trust Defendants' Answer at ¶¶ 12-15, 23, *and* Counterclaims at ¶¶ 11-13, 18-19, 22, 25;

- whether the City was duly authorized to enter into the transactions at issue and, if not, what steps were not taken that were necessary for proper authorization, *compare, e.g.*, Complaint at ¶¶ 17, 18, 29, *with* Trust Defendants' Answer at ¶¶ 17, 18, 29, *and* Counterclaims at ¶¶ 48, 50, 52-56, 90, 100, 109;

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prospect that genuine issues of material fact would exist based on the Complaint and the several defenses thereto. *Id.* at 16:14-25. The same logic, of course, holds true with respect to the Counterclaims, which raise similar factual issues that are improper for resolution on either a motion to dismiss pursuant to Rule 12(b)(6) or a motion for judgment on the pleadings pursuant to Rule 12(c).

[6] *See* May 15, 2014 Hr'g Tr. at 82:24-83:14.

- whether the transactions were an essential means for the City to satisfy its legal mandates or – as the City contends – the product of a corrupt mayor, *compare, e.g.*, Complaint at ¶ 24, *and* Memorandum at 21, *with* Complaint at ¶ 7, Trust Defendants' Answer at ¶ 24, *and* Counterclaims at ¶¶ 45-47, 78, 118-19; and

- whether the transactions had a positive *net* effect on the City's finances or (as the City also contends) precipitated its eventual Chapter 9 filing, *compare, e.g.*, Complaint at ¶¶ 30-35, *with* Trust Defendants' Answer at ¶¶ 30-35, *and* Counterclaims at ¶¶ 49, 51, 79-80, 118-19.

This Court cannot address on the merits the claims at issue until these disputed issues of fact, among others, are resolved. Accordingly, as discussed more fully below, the Motion is both procedurally and substantively defective, and it should be denied. There is simply too much factually in dispute with respect to the origins and nature of the COPs Transactions. And there is just too much at stake for parties and non-parties alike, both in terms of money and precedent, for this Bankruptcy Court to adopt the City's novel interpretation of Rules 12(b)(6) and 12(c) – an interpretation that lacks any case law support – and dismiss any of the Counterclaims, let alone without an adequate record before it.

## II. STANDARD OF REVIEW

In reviewing the Counterclaims, this Bankruptcy Court must accept as true all factual allegations asserted in the Counterclaims and must draw all reasonable inferences in the Trust Defendants' favor. *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); *Ford Motor Co.*, 2011 U.S. Dist. LEXIS 48313, at *16-17; *see also* Fed. R. Bankr. P. 7008, 7012. The Counterclaims survive the Motion so long as the Counterclaims plausibly show legal entitlement to relief. *See Static Control Components*, 697 F.3d at 401; *Ouwinga*, 694 F.3d at 790. Claims are plausible when a claimant pleads "factual content that allows the court to draw the reasonable inference that the [opposing party] is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009).

The Motion also references Rule 12(c), but the City makes no effort to explain how or why it is entitled to judgment on the pleadings, and the City does not actually request judgment on the pleadings in the Motion or in its proposed form of order with respect to the City's claims in the Complaint. Furthermore, as a procedural matter, moving for judgment on the pleadings would be premature in this Adversary Proceeding because the City has not filed a reply to the Counterclaims. Thus, the pleadings are not closed and the City cannot seek relief under Rule 12(c). *See Med-Systems v. Masterson Mkt'g*, No. 11CV695, 2011 U.S. Dist. LEXIS 115920, at *4-5 (S.D. Cal. Oct. 7, 2011) (noting that if a defendant interposes counterclaims, the pleadings are not closed until the plaintiff files its reply to the counterclaims); *Edelman v. Locker*, 6 F.R.D. 272, 274 (E.D. Pa. 1946)

("Until the reply is filed, the pleadings are not closed and plaintiff cannot invoke the provisions of Rule 12(c)."). In any event, the same standard of review applies as to the City's request for dismissal. *EEOC v. J.H. Routh Packing Co.*, 246 F.3d 850, 851 (6th Cir. 2001).

## III. ARGUMENT

### A. The Trust Defendants Alleged Valid Contract Claims in Counterclaim Counts I, II, and V.

The Motion, like a house of cards, falls apart because the Service Contracts, as alleged in the Counterclaims, are valid and enforceable agreements that enabled the City to meet its paramount constitutional obligation to maintain the actuarial integrity of the Retirement Systems. If the facts asserted in the Counterclaims are accepted as true, as they must be for purposes of Rules 12(b)(6) and 12(c), the existence and validity of the Service Contracts must also be accepted as true. Indeed, the City *itself* has repeatedly acknowledged that until a decision has been rendered on the Complaint, the Service Contracts are presumptively valid. *See Memorandum of Law in Response to Service Corporations' Motion to Dismiss* (the "Response to Service Corporations") (Adv. Pro. Doc. 46) at 7 ("[T]he Service Corporations are the counterparties to Service Contracts that are, until demonstrated otherwise, *presumptively valid*." (emphasis added)); *see also* May 15, 2014 Hr'g Tr. at 38:13-15 ("[T]his is not a case in which the city is attempting to invalidate the service contracts at large. Indeed, the city couldn't do that."). Despite this clear acknowledgment by the City, the Motion is premised on the City's contradictory and baseless assumption that the Service Contracts are *presumptively invalid*. Further, no party – including the City – contests the fact that the City has treated the Service Contracts as valid and binding contracts, and

the City's obligations thereunder as valid and binding obligations, for nearly nine years.

In the Motion, the City asks this Bankruptcy Court to accept its novel legal argument as fact. The essence of the City's argument is that the Service Contracts are invalid because the Service Payments constitute debt and, that when aggregated, the Service Payments exceed the statutory debt limit imposed on home rule cities like the City under the HRCA. *See* Memorandum at 4-5. As discussed below, this argument for contract invalidity fails because (a) the Service Contracts "do[] not constitute or create any indebtedness of the City within the meaning of the limitation of the [HRCA] or any Michigan constitutional or other non-tax statutory or City charter limitation," and (b) the City has not pledged its faith and credit as security for the service payments. *See* Section III.A.1, *infra*; *see also, e.g.*, 2005 GRS Service Contract (Exhibit C to Complaint), General Terms and Conditions at § 3.02(c). At a minimum, there are disputed factual issues precluding the relief the City seeks in the Motion, which, as noted above, requests

dismissal of all but one of the Trust Defendants' Counterclaims. *See supra* at 4 n.5; Sections III.A.1-4, *infra*.[7]

1. The Service Contracts are Valid and Enforceable Agreements for Service Payments That are Not, for Multiple Reasons, Subject to the City's Debt Limit.

The Michigan Constitution directs the Michigan Legislature to "restrict the powers of cities and villages to borrow money and contract debts." Mich. Const. (1963), art. VII, § 21. The Legislature, in turn, empowered cities to borrow money, but provided that "the net indebtedness incurred for all public purposes shall not exceed" certain amounts. *See* Mich. Comp. Laws § 117.4a(2).

[7] The City does not dispute that the Service Payments accelerated when the City filed its petition for bankruptcy under Chapter 9 of Title 11 of the United States Code (the "Bankruptcy Code") and are now due in full under the terms of the Service Contracts. *See* Counterclaims, Count V; *see also* Complaint at ¶ 47 (conceding that WTNA can seek "the whole amount" of the Service Payments owed pursuant to the various transaction documents). The City contends only that the acceleration provision cannot be enforced pursuant to 11 U.S.C. § 365(e) because it is an *ipso facto* clause. Memorandum at 16 n.6. To the contrary, there is no categorical prohibition against *ipso facto* clauses. *See U.S. Bank Trust Nat'l Ass'n v. AMR Corp. (In re AMR Corp.)*, 730 F.3d 88, 106 (2d Cir. 2013) (finding no merit to argument that the Bankruptcy Code categorically prohibits enforcement of *ipso facto* clauses); *In re Reed*, No. 10-67727, 2011 Bankr. LEXIS 4855, at *14 (Bankr. E.D. Mich. Dec. 14, 2011) (holding that, following 2005 amendments to Bankruptcy Code, *ipso facto* clauses "are now categorically enforceable"). The City also recognizes that the Service Contracts are executory contracts; thus, the City is necessarily conceding that the Service Contracts are valid and that future services remain due. *See U.S. Bank*, 730 F.3d at 106 (defining executory contract as a contract "on which performance remains due to some extent *on both sides*" (emphasis added)).

Section 117.4a goes on to exclude certain categories of obligations from calculating a Michigan city's net indebtedness. *Id.* § 117.4(a)(4).

For more than a century, however, Michigan case law has recognized that municipalities do not incur "indebtedness" when they enter into service contracts. *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 (Mich. 1899)); *see also Walinske v. Detroit-Wayne Joint Bldg. Auth.*, 39 N.W.2d 73, 81 (Mich. 1949). The Service Corporations, as alleged in the Counterclaims, assisted the City in 2005 in servicing its outstanding UAALs and were entitled to payments in return. Moreover, the Service Corporations remained in existence thereafter to provide services as the need arises, which happened when the City in 2006 refinanced its obligations incurred as part of the initial funding arrangement. *See, e.g.*, 2005 GRS Service Contract (Exhibit C to Complaint), General Terms and Conditions at §§ 2.01(c), 4.01, 7.04 (contemplating Service Corporation's availability for future transactions); 2005 PFRS Service Contract (Exhibit 2 to Trust Defendants' Answer), General Terms and Conditions at §§ 2.01(c), 4.01, 7.04 (same); 2006 GRS Service Contract (Exhibit H to Complaint), General Terms and Conditions at §§ 2.01(c), 4.01, 7.04 (same); 2006 PFRS Service Contract (Exhibit 3 to Trust Defendants' Answer), General Terms and Conditions at §§ 2.01(c), 4.01, 7.04 (same); 2005 Offering Circular (Exhibit A

to Complaint) at 5, 18; 2006 Offering Circular (Exhibit J to Complaint) at 5. In fact, the City continued to enlist the Service Corporations' services for the interest swap transactions; the resolution of the termination issues in 2009; the 2013 forbearance agreement among the City, the Service Corporations, and the swap counter-parties; and, more recently, the City's initial attempt to settle with the swap counterparties in the pending chapter 9 bankruptcy. Tellingly, it was not until the commencement of this Adversary Proceeding in 2014 that the City claimed the Service Corporations provided no services.[8] The aggregate amount the City is obligated to pay pursuant to the Service Contracts does not, accordingly, constitute indebtedness and does not count toward the City's debt limit.

The City's present attempt to distinguish *Walinske*, *Royal Oak*, and *Ludington* is misguided because it improperly presumes there is only a single form of service contract. Yet, Michigan courts have never established an exhaustive list

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[8] The Motion suggests that the 2005 Offering Circular "openly admitted" that the Service Corporations would not have a significant active role and, therefore, they would not provide services. *See* Memorandum at 9. The city omits a critical qualification to the statement in the Offering Circular:

> The Service Corporations are not expected to have a significant active role *with regard to any outstanding Certificates after the Closing Date*.

2005 Offering Circular (Exhibit A to Complaint) at 5 (emphasis added). Thus, while the Service Corporations were not expected to have an active role with the COPs, they were expected to provide services to the City as discussed above. Further, the fact that the Service Corporations lacked staff, *see* Memorandum at 9, did not prevent them from providing services in 2005, 2006, 2009, 2013, and as recently as 2014, as also discussed above.

of what constitute "services" in the context of service contract obligations not subject to any debt limit. Moreover, at the motion to dismiss stage, the Trust Defendants are entitled to reasonable inferences in their favor with respect to the nature of the Service Corporations and the services they provided. *Compare* Complaint at ¶¶ 12-15, 23, *with* Trust Defendants' Answer at ¶¶ 12-15, 23, Counterclaims at ¶¶ 11-13, 18-19, 22, 25, *Defendants Detroit General Retirement System Service Corporation and Detroit Police and Fire Retirement System Service Corporation's Answer and Affirmative and Other Defenses* (the "Service Corporations' Answer") (Adv. Pro. Doc. 82) at ¶¶ 12-15, 23, *Answer and Affirmative Defenses of Defendant Financial Guaranty Insurance Company* ("FGIC's Answer") (Adv. Pro. Doc. 88) at ¶¶ 12-14, *and Answer and Affirmative Defenses of Certificate Holders* (the "COPs Holders' Answer") (Adv. Pro. Doc. 89) at ¶¶ 12-14. Dismissal of the Counterclaims would be premature before any of these factual disputes are resolved and an adequate record has been established.[9]

[9] This would be consistent with the procedural posture of the City's own authority. *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), *Ludington*, 78 N.W. at 560 (factual findings by trial judge); *see also McCurdy v. Cnty. of Shiawassee*, 118 N.W. 625, 625 (Mich. 1908) (trial); Response to Service Corporations at 7 (conceding that the Service Contracts "are, until demonstrated otherwise, *presumptively valid*" (emphasis added)).

Furthermore, to the extent the City presumes that if the Service Contracts are not for future services then they necessarily must constitute indebtedness within the meaning of Section 117.4a, that is a false presumption.[10] In Michigan, constitutional and statutory debt limits are intended to limit the amount of *general* obligations and *full faith and credit* obligations incurred by a municipality. *See City of Gaylord v. Gaylord City Clerk*, 144 N.W.2d 460, 474 (Mich. 1966); *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*." (emphasis added)). A limitation on full faith and credit borrowing is consistent with the purpose behind debt limits to avoid imposing additional burdens on taxpayers. *See*, *e.g.*, *Att'y Gen. ex rel. Eaves v. State Bridge Comm'n*, 269 N.W. 388, 391 (Mich. 1936) ("[D]ebt or borrowing restrictions of the statute or Constitution . . . are to be regarded as intended for the purpose of forbidding imposition of additional burdens on the taxpayer . . . ." (quotation marks omitted)); *see also Dieck v. Unified Sch. Dist. of Antigo*, 477 N.W.2d 613, 618-19 (Wis. 1991) ("For it must be kept in mind that the purpose of a debt limitation is not to prevent the municipality from acquiring buildings or

[10] Because service contracts are not considered "indebtedness," the definition of that term in *Young v. City of Ann Arbor* is necessarily overbroad and cannot control in this Adversary Proceeding. *See* 255 N.W. 579, 582 (Mich. 1934).

public works, but to place a limitation on the extent to which it may pledge its credit and hence burden the taxpayers." (citation omitted)). When, as here, a municipality does *not* pledge its full faith and credit and does *not* issue a general obligation, the municipality is not incurring "indebtedness."

By the express terms of the various documents constituting the COPs Transactions, the Service Payments "***are not general obligations of the City***" and the City's "***faith and credit [is not] pledged to the COP Service Payments coming due under the Service Contracts***." *See* 2005 Offering Circular (Exhibit A to Complaint) at 7 (emphasis added); 2006 Offering Circular (Exhibit J to Complaint) at 9 (emphasis added); 2005 GRS Service Contract (Exhibit C to Complaint), General Terms and Conditions at § 4.02 (confirming that the Service Payments are *not* general obligations of the City to which the City has pledged its full faith and credit); 2005 PFRS Service Contract (Exhibit 2 to Trust Defendants' Answer), General Terms and Conditions at § 4.02 (same); 2006 GRS Service Contract (Exhibit H to Complaint), General Terms and Conditions at § 4.02 (same); 2006 PFRS Service Contract (Exhibit 3 to Trust Defendants' Answer), General Terms and Conditions at § 4.02 (same).

It is also immaterial to the validity of the Service Contracts if the COPs Transactions were structured in a way to avoid any applicable debt ceiling. *See Bacon v. City of Detroit*, 275 N.W. 800, 803 (Mich. 1937) ("There is no fraud in

reaching a desired end by legal means even though other means to the end would be illegal."); *see also 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." (quoting *Tranter v. Allegheny Cnty. Auth.*, 173 A. 289 (Pa. 1934)). Facing approximately $1.7 billion in UAALs due and owing to the Retirement Systems and possible constraints on its capacity under its debt limit to borrow sufficient funds, the City, through a resolution of the Detroit City Council, provided an alternative funding mechanism through which the City did not incur indebtedness but restored the actuarial integrity of the Retirement Systems.

2. The COPs Transactions Enabled the City to Meet Its Constitutional and Statutory Obligations.

The City's effort to invalidate the COPs Transactions also fails because any statutory constraint on its general fundraising authority must yield to the City's specific constitutional and statutory obligations to maintain the actuarial integrity of the Retirement Systems. 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. The City's debt limit is established by statute, and not by the state Constitution. *Compare id.* art. VII, § 11 ("No *county* shall incur any indebtedness which shall increase its total debt beyond 10 percent of its assessed valuation." (emphasis added)), *with id.* art. VII, § 21 ("*The legislature* shall provide by general laws for the incorporation of cities and villages. Such

laws shall . . . restrict the powers of *cities and villages* to borrow money and contract debts." (emphases added)). The City's obligation to fund the Retirement Systems, on the other hand, is constitutionally mandated. *Id.* art. IX, § 24. To the extent that a constitutional provision and a statutory provision conflict, the Constitution must prevail. *See Young*, 255 N.W. at 580-81. When 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, is not intended to cover that obligation. *Cf. 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).

Further, courts in other jurisdictions have 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*, 172 Cal. App. 4th 749, 764 (Cal. 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 applicable law it cannot be considered indebtedness); *Los Angeles Cnty. v. Byram*, 36 Cal. 2d 694, 696, 698-99 (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).

Moreover, public pensions are of paramount importance in Michigan and the City's challenge to the COPs Transactions must be considered in the historical context of Michigan's public pensions. Before 1963, public pensions were gratuitous; since 1963, they are contractual obligations of the state and its political subdivisions. *See Shelby Twp. Police & Fire Ret. Bd. v. Charter Twp. of Shelby*, 475 N.W.2d 249, 251 (Mich. 1991); *see also* Fred I. Chase, Constitutional Convention 1961, Official Record, at 770-71 (Austin C. Knapp, ed., 1964). The 1961 Constitutional Convention was also concerned with "back door" spending to fund pensions, *i.e.*, failing to meet current pension fund needs and deferring responsibility to future generations. Chase, *supra*, at 771, 772. To meet both ends, the Constitutional Convention proposed and the state adopted the following:

> The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby.
>
> Financial benefits arising on account of service rendered in each fiscal year *shall be funded during that year* and such funding shall not be used for financing unfunded accrued liabilities.

Mich. Const. (1963), art. IX, § 24 (emphasis added).

Municipalities are also required by statute to appropriate an amount sufficient to maintain the actuarial integrity of their retirement systems, including an annual accrued amortized interest on any UAALs. *See* Mich. Comp. Laws §§ 38.559(2), 38.1140m; *Shelby Twp.*, 475 N.W.2d at 256. Michigan courts recognize the "paramount" importance of the constitutional obligation to fund public pensions. *See Shelby Twp.*, 475 N.W.2d at 251 ("The paramount concern of the 1961 Constitutional Convention . . . was to ensure the proper maintenance and the actuarial integrity of the state pension system."); *Detroit Police Officers Ass'n v. City of Detroit*, 214 N.W.2d 803, 816 (Mich. 1974) ("With this paramount law of the state as a protection, those already covered by a pension plan are assured that their benefits will not be diminished by future collective bargaining agreements."); *see also Studier v. Mich. Pub. Sch. Emps. Ret. Bd.*, 698 N.W.2d 350, 358 (Mich. 2005) ("[T]he second clause seeks to ensure that the state and its political subdivisions will be able to fulfill this contractual obligation by requiring them to set aside funding each year . . . .").

The City's Charter authorizes the establishment and maintenance of retirement plan coverage for City employees. Detroit, Mich. Charter § 11-101. The authority and obligation to *maintain* current funding necessarily implies that the City has discretion in determining *how* to fund such obligation. *See Houlihan Bros. Builders, Inc. v. Carrollton Twp.*, 222 N.W.2d 170, 172 (Mich. Ct. App. 1975) (concluding that township's authority to engage in project implied authority to pay for the project); *see also Shelby Twp.*, 475 N.W.2d at 254 ("Township protection of pension system actuarial integrity is a proper municipal purpose."). A municipality's exercise of its discretion is not subject to judicial review, except in one circumstance not relevant here.[11] *Shelby Twp.*, 475 N.W.2d at 255 ("How the township creates the revenues necessary to restore the 'actuarial integrity' of the pension system is not an issue for the board or this Court.").

Not only does the City's *constitutional* obligation trump the statutory debt limit, the City's specific *statutory* obligation also trumps the generalized statutory debt limit. When two (2) statutes are in conflict, courts give effect to the more specific provision as an exception to the general provision. *See Bullinger*, 72 N.W.2d at 788-89; *Staiger v. Madill*, 43 N.W.2d 77, 83 (Mich. 1950). The debt

[11] There is only one limitation on funding UAALs, and it appears in the Michigan Constitution: a municipality cannot borrow from current funding to finance UAALs. Mich. Const. (1963), art IX, § 24; *Kosa v. State Treasurer*, 292 N.W.2d 452, 458-59 (Mich. 1980). There is no suggestion in this Adversary Proceeding that the City has engaged in such a "borrowing" scheme.

limit in section 117.4a is a general law of Michigan and addresses a city's debt limit in general terms. *Cf. Brimmer v. Vill. of Elk Rapids*, 112 N.W.2d 222, 226 (Mich. 1961) (recognizing that provisions governing local government taxing and borrowing authority are general laws of the state).[12] Section 38.559, on the other hand, considers a particular form of municipal liability, and expressly requires the municipality to properly fund its obligation without reference to a debt limitation. *See* Mich. Comp. Laws § 38.559. Thus, because Michigan statutory law requires the City to preserve the actuarial integrity of the Retirement Systems (a specific obligation of the City), the City cannot be limited in meeting this obligation by the City's general borrowing authority (a generalized law purporting to limit borrowing). *See Am. Axle & Mfg., Inc. v. City of Hamtramck*, 604 N.W.2d 330, 336-37 (Mich. 2000) (per curiam) (concluding that HRCA enacted general laws that must yield to more specific statutory requirements, including a statutory requirement to levy taxes that may exceed general limit on taxation); *Simonton v. City of Pontiac*, 255 N.W. 608, 610, 613 (Mich. 1934) (finding in favor of claimant who had argued that city's statutory tax limit must yield to express statutory

[12] The Legislature has authority to enact a debt limit pursuant to article VII, section 21 of the Michigan Constitution, but the Legislature cannot limit a municipality's debt in a way that conflicts with another constitutional provision. *See Mich. United Light & Power Co. v. Vill. of Hart*, 209 N.W. 937, 938 (Mich. 1926) (recognizing that statutory debt limits cannot trump the Michigan Constitution).

obligation to pay debts, and directing city to appropriate funds and levy taxes if necessary).

3. The Service Contracts and Obligations Thereunder, as Alleged in the Counterclaims, were Authorized Transactions and Not *Ultra Vires*.

The City's *ultra vires* arguments are premised on disputed factual issues and are, at best, premature. The City attempts with the Motion to sweep aside the presumption that the Service Contracts are valid and enforceable, as well as its constitutional and statutory obligations to fund the UAALs, with a misapplication under Michigan law of the *ultra vires* doctrine. *See* Memorandum at 11-16. The City's *ultra vires* arguments are not only premature – before the Service Contracts and obligations thereunder can be found *ultra vires*, this Court must resolve numerous factual issues raised by the Counterclaims – but also ignore the particulars of Michigan case law. The City overlooks that "Michigan falls within the general rule that while the doctrine of estoppel is inapplicable to [*u*]*ltra vires* acts, it will be applied to bind the municipality if the act is within the municipality's general powers, but is performed in an irregular fashion or in an unauthorized manner." *Parker v. Twp. of W. Bloomfield*, 231 N.W.2d 424, 429 (Mich. Ct. App. 1995). The City also overlooks the findings in the *ultra vires* authorities that the municipalities involved or their officials acted without *any*

authority of law. *See, e.g.*, *McCurdy v. Cnty. of Shiawassee*, 118 N.W. 625, 628 (Mich. 1908).

The City characterizes *McCurdy v. County of Shiawassee* as the "leading Michigan case" on the issue, Memorandum at 12, but fails to mention the circumstances of that case that make it readily distinguishable from this Adversary Proceeding. First, the restriction at issue was a prohibition on borrowing money for current and ordinary expenses, subject to elector approval, and the "intimation [was] strong from the pleadings that these loans were not made for the purposes set forth in the resolutions." *McCurdy*, 118 N.W. at 628, 629. Second, the pertinent electors – on *three* occasions – rejected the particular transaction in question. *Id.* at 625-26. It was in those factual circumstances that the Michigan Supreme Court stated that the only way to protect against fraud and collusion (among public officials and their friends) was to invalidate the promissory notes. *Id.* at 629; *see also Newberry v. Nine Mile-Halfway Drain District*, 30 N.W.2d 430, 432 (Mich. 1948) (relying on the sentiment that the project resulted from corruption and waste and represented the "grossest squandering of public funds").

In contrast, other than the City's disputed allegations, there is no suggestion that the COPs Transactions were motivated by fraud against the City or collusion

or waste of public funds.[13] Indeed, the absence of any such malfeasance directed at the City is among the distinguishing features of the cases relied upon by the City and the transactions at issue in this Adversary Proceeding. In many of the *ultra vires* cases, an individual or small group of public officials acted outside his or its municipal authority, often to the detriment of the municipality as a whole. *See*, *e.g.*, *Bloomfield Vill. Drain Dist. v. Keefe*, 119 F.2d 157, 164-65 (6th Cir. 1941) (noting drain commissioners had no authority to enter into transactions); *Hanslovsky v. Twp. of Leland*, 275 N.W. 720, 721 (Mich. 1937) (finding township officers lacked authority to execute promissory notes); *Stratton v. City of Detroit*, 224 N.W. 649, 652 (Mich. 1929) (finding board of health lacked authority to modify contract); *Wolverine Eng'rs & Surveyors v. City of Leslie*, No. 299988, 2011 Mich. App. LEXIS 2048, at *5-6 (Nov. 17, 2011) (concluding city was not bound by act of official who "acted beyond the limits of his authority"); *see also Hatch v. Maple Valley Twp. Unit Sch.*, 17 N.W.2d 735, 740 (Mich. 1945) (recognizing that the *ultra vires* case law turns on whether public official was acting within scope of authority).[14]

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[13] The City references the conviction of the City's former mayor, Kwame Kilpatrick. *See* Memorandum at 21. Yet, the City makes no effort to draw any connection between Mr. Kilpatrick's conviction and the transactions at issue in this Adversary Proceeding.

[14] Further, other than *Wolverine Engineers*, all of the City's authority precedes the liberalization of the Michigan Constitution in 1963, which granted to municipalities broader implied authority and adopted a rule of construction in

Here, the City had constitutional authority to fund the UAALs in the manner it chose. As discussed above, the Michigan Constitution grants municipalities the right to form pensions for their employees, and it obligates the municipalities to preserve the actuarial integrity of the pensions. *See* Mich. Const. (1963), art. IX, § 24; *see also Houlihan Bros.*, 222 N.W.2d at 172 (authority implies power to fund). Express authority also came from the Detroit City Council. *See, e.g.*, Detroit, Mich. Code § 47-1-2; *see also* Detroit, Mich. Charter § 11-101(1) ("The City shall provide, by ordinance, for the establishment and maintenance of retirement plan coverage for city employees.").

More generally, the City had authority to borrow money. Mich. Comp. Laws § 117.4a(1) ("Each city in its charter may provide for the borrowing of money on the credit of the city and issuing bonds for the borrowing of money, for any purpose within the scope of the powers of the city."); Detroit, Mich. Charter § 8-501 ("The City may borrow money for any purpose within the scope of its powers . . . ."); *see also* Mich. Const. (1963), art. IX, § 13 (granting public bodies corporate power to borrow money and issue securities evidencing debt); Mich. Comp. Laws § 117.2 (cities shall be bodies corporate). Notably, there is no express limitation on the *purpose* for borrowing money, *see In re Advisory Op. on Constitutionality of PA 1966*, 158 N.W.2d 416, 420 (Mich. 1967), and

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favor of municipal authority. *See* Mich. Const. (1963), art. VII, § 34; *see also City of Gaylord*, 144 N.W.2d at 471.

constitutional and statutory provisions regarding home rule entities are to be construed favorably and in the entities' favor, Mich. Const. (1963), art. VII, § 34; *Conroy v. City of Battle Creek*, 22 N.W.2d 275, 278 (Mich. 1946).[15]

Likewise, the cases cited by the City that involved statutory proscriptions of either the nature of the contract at issue or certain provisions are inapposite. Memorandum at 11-12. For instance, in *American Trust Co. v. Michigan Trust Co.*, a statute prohibited any party from claiming rents, issues, income, and profits while foreclosure of the first mortgage was pending. 248 N.W. 829, 830 (Mich. 1933). A contract that attempted to assign those interests to the second mortgagor was in violation of the statute and, therefore, would not be enforced. *Id.* at 829-30. In addition, in *Mino v. Clio School District*, a state statute prohibited a school from agreeing not to disclose certain information regarding current or former employees; therefore, a non-disparagement provision in a severance agreement was illegal and unenforceable. 661 N.W.2d 586, 590 (Mich. Ct. App. 2003). In contrast, the City does not identify a single statute prohibiting either the nature of or any provisions in the Service Contracts.

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[15] These provisions and principles of Michigan law demonstrate the irrelevance of the City's reliance on *City of Litchfield v. Ballou*, 114 U.S. 190 (1885). In *Litchfield*, the U.S. Supreme Court interpreted an *Illinois* constitutional provision that unambiguously prohibited a city from becoming "indebted in any manner, or for any purpose." 114 U.S. at 192. In contrast, Michigan law permits the City to borrow money *for any purpose*, without any restriction on the nature of the debt and with a limit only on *net* indebtedness.

In sum, there was no "total lack of authority" and no "statutory proscription" that should, as matter of law, relieve the City of making the Service Payments in consideration of the $1.44 billion fiscal benefit it received. *Cf. DiPonio v. City of Garden City*, 30 N.W.2d 849, 852 (Mich. 1948) (concluding city's argument was flawed because home-rule tax limit is not dispositive of *ultra vires* question where city had authority to enter into contract in the first instance).[16] Accordingly, the doctrine of *ultra vires* does not, as a matter of law, invalidate the contract claims in Counts I, II, and V.

4. The Net Financial Impact of the COPs Transactions is an Additional Source of Disputed Issues of Fact.

Even if, assuming *arguendo*, section 117.4a *could* limit the City's authority in the particular circumstance of funding pensions, the statutory debt limit applies to "*net* indebtedness," not "*any* indebtedness." *Compare* Mich. Comp. Laws § 117.4a (limiting City's "net indebtedness") (emphasis added), *with* Mich. Const. (1963), art. VII, § 11 (limiting "any indebtedness" of counties) (emphasis added). The variation in the language – "net" versus "any" – must be given effect to

[16] In addition, the City's factual allegation (which the Trust Defendants dispute) that the parties failed to comply with the Revised Municipal Finance Act ("RMFA") in completing the COPs Transactions is insufficient to invalidate the Service Contracts. Even if true, the City's alleged failure to comply with the RMFA constituted a procedural defect. *See 1st Source Bank v. Vill. of Stevensville*, 947 F. Supp. 2d 934, 947-48 (N.D. Ind. 2013) (applying Michigan law and concluding that failure to obtain state approval constituted procedural defect, but did not invalidate loan agreements).

preserve the Legislature's intent. *See, e.g.*, *Toy ex rel. Elliott v. Voelker*, 262 N.W. 881, 887 (Mich. 1935) (finding that legislature's use of different term "necessarily carries the inference that the Legislature intentionally used different language to produce a different effect").

This distinction is significant because the City's liability for the UAALs is, in substance, comparable to its liability for the Service Payments pursuant to the COPs Transactions documents. The City's failure to meet its obligations year after year gave rise to significant liabilities to the Retirement Systems, which, like the Service Payments, constitute a binding obligation of the City. *See* Mich. Const. (1963), art. IX, § 24. Accordingly, and again assuming *arguendo*, that the Service Payments under a broad reading of the HRCA constitute indebtedness, the City's UAAL obligations are necessarily indebtedness, as well.

Thus, by entering into the COPs Transactions, the City effectively substituted a cheaper alternative liability for another or – adopting the language of section 117.4a – reduced the "net indebtedness" of the City.[17] *See Kosa*, 292 N.W.2d at 462 (considering proposed revision to pension funding program and concluding that the proposal's practical impact, rather than its literal impact, is

[17] The net effect of the COPs Transactions is also significant because it promotes the general policy behind the current funding obligation, which is to prevent current generations from burdening future generations through "back door" spending or "borrowing" against future budgets. *See Shelby Twp.*, 475 N.W.2d at 252; *Musselman v. Engler*, 533 N.W.2d 237, 241-42 (Mich. 1995); Chase, *supra*, at 771, 772.

dispositive); *see also* 2005 Offering Circular (Exhibit A to Complaint) at 7 (stating that Service Payments are intended to replace payments that the City would otherwise be obligated to make for the UAALs); *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 in 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). As such, the subsequent obligations incurred by the City in connection with the COPs Transactions – including the Service Payments – could not exceed any debt limit because the COPs Transactions simply replaced (on terms more favorable to the City) binding obligations that the City incurred prior to June 2, 2005. *Cf. Wilcox*, 247 N.W. at 925; *Banta v. Clarke Cnty.*, 260 N.W. 329, 332-33, 337 (Iowa 1935) (holding that refinancing of a pre-existing obligation at lower interest rate in a new transaction does not increase county's indebtedness, particularly where proceeds from new transaction are segregated and dedicated to satisfying pre-existing obligation). In essence, the COPs holders purchased the valid and enforceable claims that the Retirement Systems held against the City by court mandate; the City has never contended that the Retirement Systems held invalid claims against the City.

Finally, dismissal of Counterclaims I, II, and V is improper because both the City's and the Trust Defendants' claims are premised on disputed factual issues

regarding the financial aspects of the City's debt limit. The City bears the burden of demonstrating factually that the transactions increased the net indebtedness of the City. *See City of Litchfield*, 114 U.S. at 192 (noting that city demonstrated by factual showing that the transaction at issue exceeded debt limit); *Am. LaFrance & Foamite Indus., Inc. v. Vill. of Clifford*, 255 N.W. 596, 597 (Mich. 1934) (finding village failed to introduce sufficient evidence to demonstrate *ultra vires* defense based on fund-raising limit); *Arbuckle-Ryan Co. v. City of Grand Ledge*, 81 N.W. 358, 360 (Mich. 1899) (concluding city failed to introduce evidence that transaction in question violated debt limit because City did not introduce any data about its debt).[18] Moreover, the City acknowledged in the Complaint, at ¶ 16, that at least a portion of the 2005 COPs Transaction did not cause the City to exceed its debt limit; that acknowledgment entails a further factual issue (assuming the debt

[18] The City's contention that the City's remaining debt limit was undisputed is false. *See* Memorandum at 5. The City alleged its debt status at the time of the Service Contracts, which the Trust Defendants denied in the Trust Defendants' Answer, as did the other Defendants and the Intervenors. *Compare* Complaint at ¶¶ 9-10, *with* Trust Defendants' Answer at ¶¶ 9-10, Counterclaims at ¶¶ 11-13, 18-19, 22, 25, Service Corporations' Answer at ¶¶ 9-10, FGIC's Answer at ¶¶ 9-10, *and* COPs Holders' Answer at ¶¶ 9-10. The City made no effort to explain how it calculated its debt level; nor did the City explain how or if it "netted" out its debt. For example, the City has not explained whether it excluded from its indebtedness calculations the amount of any bonds issued or contract or assessment obligations incurred to comply with an order of a court of competent jurisdiction. *See* Mich. Comp. Laws § 117.4a(4)(f). Any amount incurred for this purpose, even if deemed to have been raised by debt issuance, would be excluded when computing "net indebtedness" under the HRCA. *See also supra* at 4 n.4 (noting that the City was subject to circuit court orders mandating its compliance with its UAAL obligations).

ceiling statute applies, which, as set forth herein, it does not) as to the amount, if at all, the Service Payment obligations exceeded any applicable limit. Under the circumstances, when there is a dispute over the amount owed, it is improper to dismiss at the pleading stage a claim for breach of contract. *See, e.g.*, *Three Rivers Landing of Gulfport, LP v. Three Rivers Landing, LLC*, No. 11-00025, 2012 U.S. Dist. LEXIS 62581, at *12-13 (W.D. Va. May 4, 2012) ("As the Plaintiffs correctly note, a motion to dismiss is not the proper vehicle to dispute Plaintiffs' alleged damages."); *United States ex. rel. Advance Concrete, LLC v. THR Enters., Inc.*, No. 12-198, 2012 U.S. Dist. LEXIS 120709, at *7 (E.D. Va. July 18, 2012) ("A dispute over the amount owed on a contract claim is ordinarily an issue for trial or possibly summary judgment.").

### B. The City's Arguments as to the Remaining Counterclaims are also Meritless.

The City also seeks to dismiss the Trust Defendants' alternative (non-contractual) theories of recovery in Counterclaim Counts VI-XIV.[19]

As a general matter, the City's efforts to dismiss the Trust Defendants' alternative theories of recovery are inconsistent with the very law on which the City purports to rely. For instance, in *City of Litchfield*, the U.S. Supreme Court

[19] Counterclaim Counts VI-XI assert claims for promissory estoppel, equitable estoppel, fraudulent inducement, fraudulent misrepresentation, negligent misrepresentation, and unjust enrichment and restitution. Counterclaim Counts XII-XIV assert claims based on procedural and substantive due process, unlawful taking, and unlawful conversion.

noted that money could be reclaimed if the complainant can clearly identify the money or funds. *See* 114 U.S. at 195. That is the case here, because the funding proceeds are segregated within the Retirement Systems' funds, separately accounted for, and readily identifiable, as discussed further below. *City of Litchfield* and other authorities stand as a reminder that "[t]he good faith of government should never be less sacred than that of individuals." *DiPonio*, 30 N.W.2d at 852 (quoting *Am. LaFrance*, 255 N.W. 596).

As more fully addressed below, the specific arguments the City makes against the remaining Counterclaims are legally and factually defective.

1. The Counterclaims are within the Scope of the Proofs of Claims.

The City has made a brief argument, unsupported by applicable case law authority,[20] that certain Counterclaims (Counts II, IV, and VI-XIV) are barred by the bar date. In doing so, the City has ignored both the language of the Bankruptcy Court's order (the "Bar Date Order"), dated November 21, 2013, establishing the bar date, and claim no. 1197, the Trust Defendants' timely-filed proof of claim

[20] The only case cited by the City, *Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380 (1993), is inapplicable. *Pioneer* addresses the standard of "excusable neglect" governing a bankruptcy court's allowance of an untimely proof of claim. 507 U.S. at 397-98 (affirming the allowance of an untimely claim as excusable neglect, particularly given the lack of any prejudice to the debtor or to the interests of efficient judicial administration). The case does not, however, support the City's position that the Trust Defendants' *timely* proofs of claim are not sufficient to preserve all of their Counterclaims in this Adversary Proceeding.

("Proof of Claim No. 1197"), a claim filed solely as a result of the Complaint.[21] As discussed below, even if the Counterclaims were subject to the bar date, the Trust Defendants have preserved them.

The Bar Date Order provides, in pertinent part, 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").

*See* Bar Date Order at ¶ 4. WTNA timely filed four (4) proofs of claim. Collectively, they provided the City with detailed information on the amounts owed as of the petition date (July 18, 2013), with a description of the basis of the claims in the COPs Transactions, and with copies of each of the Service Contracts, as well as other relevant transactional documents. The proofs of claim filed by

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[21] The City's description of Proof of Claim No. 1197 is incomplete, since it cites only a portion of the language describing the claims filed by WTNA. In fact, Proof of Claim No. 1197

> asserts claims and contingent claims (the "Claims") against the Debtor arising from or relating to that certain *Complaint for Declaratory and Injunctive Relief* filed January 31, 2014 (the "Complaint"), whereby the Debtor commenced Adversary Proceeding No. 14-04112-swr, *City of Detroit Michigan v. Detroit General Retirement System Service Corporation, et al.*, seeking, among other things, a declaratory judgment invalidating the Service Contracts and determining that the Debtor's contractual and other obligations under the Service Contracts and any of the COPs Transactions Documents (as defined below) are unenforceable. The amount of the Claim arising from or relating to the Complaint is unliquidated . . . .

Proof of Claim No. 1197 at ¶ 6.

WTNA satisfied their procedural purpose of providing "sufficient information so that a Debtor may identify the creditor and match the creditor and the amount of the claim with the claims scheduled by the Debtor." *In re Hughes*, 313 B.R. 205, 212 (Bankr. E.D. Mich. 2004); *see also* 5-88 Collier Bankruptcy Practice Guide ¶ 88.03 (citations omitted).

Proof of Claim No. 1197 was filed in direct response to the Complaint in this Adversary Proceeding, which sought, *inter alia*, a sweeping declaration that: "any claims based on the City's obligations to make the City Payments under the service contracts on account of the COPs should be disallowed pursuant to 11 U.S.C. § 502(b)(1) because the agreements creating those obligations are unenforceable, void, and of no effect whatsoever, or other such relief as the Court deems just and appropriate." Complaint at ¶ 49. By its express terms, Proof of Claim No. 1197 asserts claims as broadly as the City's Complaint seeks to disallow them. It states: "This Supplement and the Proof of Claim assert claims and contingent claims [] against the debtor arising from or relating to that certain *Complaint for Declaratory and Injunctive Relief* filed on January 31, 2014 . . . ." Proof of Claim No. 1197 at ¶ 6; *see also Bassett v. NCAA*, 528 F.3d 426, 430 (6th Cir. 2008) (stating court may consider public documents when considering motion to dismiss). Moreover, in asserting claims that mirrored the broad relief sought by the Complaint, the Trust Defendants expressly did not elect their remedies and,

instead, preserved all their rights, claims, and actions, in law or in equity. Proof of Claim No. 1197 at ¶ 12.

The City's bar date argument is also flawed because the Counterclaims it seeks to preclude, Counterclaim Counts II, IV, and VI-XIV, are not prepetition claims within the meaning of the Bar Date Order. Prior to the filing of the petition for chapter 9, the Trust Defendants had contractual claims against the City, based on its unilateral decision to cease making Service Payments in June 2013, prior to its July 18, 2013 chapter 9 filing.[22] If the City obtains the declaratory relief it seeks via its post-petition filing, only then will the Trust Defendants' claims for alternative (non-contractual) relief accrue. The City's observation that the Complaint was filed three (3) weeks before the February 21, 2014 bar date is immaterial, because it does not transform the Counterclaims into Prepetition Claims (as defined in the Bar Date Order). The Trust Defendants timely filed a broad proof of claim to match the sweeping declaratory relief requested in the Complaint, and the City has no grounds to argue that the Counterclaims were untimely.[23]

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[22] The City does not argue that the Trust Defendants' Counterclaims regarding prepetition contract claims (Counts I, III, and V) are not preserved.

[23] The Trust Defendants' Answer was timely filed based on the Bankruptcy Court's order (Adv. Pro. Doc. 7), dated February 27, 2014, which set March 17, 2014 as the deadline for responding to the Complaint.

2. The Trust Defendants are Allowed, Under Michigan Law, to Plead Alternative Theories of Recovery Against the City.

The City seeks to dismiss Counterclaim Counts VI-XI[24] by contending that, if the Service Contracts are declared void, there is no alternative theory for the Trust Defendants and COPs holders to reclaim any part of the approximate $1.44 billion used to purchase the COPs and pay down the City's outstanding and unfunded UAAL obligations. The Motion in this regard is premature because it attempts to dismiss Counterclaims that are, by their nature, contingent on the outcome of the Complaint and Counterclaim Count III. The Trust Defendants' non-contractual theories of recovery need be addressed only if the City successfully invalidates the Trust Defendants' and COPs holders' contractual rights to the Service Payments, and only if the City is not otherwise estopped from arguing that the COPs Transactions were *ultra vires*.

As with the rest of the Motion, the City's arguments rely on the unfounded assumption that it has already proven its disputed factual allegations and, therefore, fail as a matter of law because they are premised on an incorrect application of Rule 12(b)(6). Further, the law in this context is not nearly as draconian as the

[24] Counterclaim Counts VI-XI assert claims for promissory estoppel, equitable estoppel, fraudulent inducement, fraudulent misrepresentation, negligent misrepresentation, and unjust enrichment and restitution. *See* Counterclaims at ¶¶ 71-121. Other than discussed in Section III.B.3, *infra*, the City does not allege that the Trust Defendants have not pled sufficient facts to plausibly allege entitlement to relief on these Counterclaims.

City would have the Court believe. Simply stated, the City is not permitted to retain in excess of one *billion* dollars just because it now claims to have lacked authority to enter into the Service Contracts and the COPs Transactions. In fact, even if the City were able to prevail at trial on its argument that the Service Contracts are legally unenforceable (which we believe they will be unable to do) the City and/or the Retirement Systems would be required to return the billion dollars it received from the COPs Transactions. *See* 1 Steingold & Etter, Michigan Municipal Law § 4.26, at 4-23 to 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, emphasis added)); *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*.").

Courts will often impose equitable remedies to avoid the unjust outcome that the City seeks, even when the outcome arises out of an *ultra vires* contract (which is not the case here because the Service Contracts were *intra vires*). Indeed, the City's own authority notes that the other party to a contract found void *ab initio* may be entitled to relief and contemplates that the municipality may have to return the benefit it has received if the contract is invalidated. For instance, in *McCurdy*, which was cited by the City, it was recognized that

> The case at bar does not present the question whether a municipal corporation may not be required to restore to the owner specific property which it has attempted without authority to buy or take, or whether an action lies for money paid by mistake, or upon a consideration which fails, or which was obtained through imposition. It 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.

118 N.W. at 633 (Ostrander, J., concurring). And, as the Michigan Supreme Court aptly stated in *Highway Commissioners of Sault Ste. Marie v. Van Dusan*,

> This rule that a corporation cannot vitalize and substantiate something it has no original power to do, and which if done as matter of fact is absolutely void in point of law, *has no bearing on those cases where property or money obtained beyond power is required to be disgorged*, or to cases where the fault in question is the want of formalities or the neglect of methods, and the irregularity is not such as to render the proceeding positively void. The *recovery of money or property* obtained and held through transgression of power does not affirm the power. It denies it.

40 Mich. 429, 431 (1879) (emphases added); *cf. Cent. Transp. Co. v. Pullman's Palace Car Co.*, 139 U.S. 24, 59-61 (1891) (asserting that proper recourse for *ultra vires* contract is to disaffirm the contract, but a party retains the right to seek compensation, property, or money that the other party has no right to possess); *AFSCME Int'l Union v. Bank One NA*, 705 N.W.2d 355, 362 (Mich. Ct. App. 2005) (finding that union was entitled to recover monies withdrawn from bank account where conduct of those withdrawing the money was *ultra vires*).

In addition, in *Newberry*, also cited by the City, the court held that a constructive trust could be impressed on certain property in favor of bondholders where the "moneys of the bondholders obtained for an illegal project can be traced directly into the acquisition [of certain real property], which became completely separated" from the sewer system after the system was disconnected from the plant on the disputed property. 30 N.W.2d at 437; *see also id.* at 432-33. Rather than completely reject any form of relief, the court remanded the constructive trust question for a hearing in the trial court. *Id.* at 437; *see also, e.g.*, *City of Detroit v. Mich. Paving Co.*, 36 Mich. 335, 341 (1877) ("The material not incorporated in the pavement, stands on a different footing. It did not belong to the city, and its proceeds, therefore, were not properly receivable or retainable. *For these there is a liability arising out of a wrong*, and not out of contract; and the form of the remedy in assumpsit, waiving the tort, does not prevent the maintenance of the action based on the facts." (emphasis added)).

The proposed relief in *Newberry* is consistent with *City of Litchfield*, another case cited by the City in the Memorandum, which recognized that a party can reclaim property if it is segregated and traceable:

> 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.

114 U.S. at 195. This remedial option presents factual issues that preclude dismissal of the Counterclaims, particularly because the Trust Defendants and COPs holders can clearly identify the money that they may seek to reclaim – if the Service Contracts are invalidated – without taking other property or interfering with the property rights of others not contemplated by the COPs Transactions.

Here, equitable arguments are particularly strong because the proceeds from the COPs Transactions are easily identifiable. Upon information and belief, the Retirement Systems currently account for the proceeds of the COPs Transactions separately and have not commingled those funds with other assets. *See, e.g.*, PFRS Annual Report, Statement of Changes in Plan Net Assets at 12 (2013), *available at* http://www.pfrsdetroit.org/images/pdf/financial%20PFRS%202012%20annual%20rpt.pdf; GRS Annual Report, Statement of Revenues, Expenses & Changes in Fund Balance at 12 (2013), *available at* http://www.rscd.org/financial_2012%20GRS%20Annual%20Report.pdf.[25] Indeed, they are required to do so by

[25] "When a court is presented with a Rule 12(b)(6) motion, it may consider the Complaint and any exhibits attached thereto, public records, items appearing in the record of the case and exhibits attached to defendant's motion to dismiss so long as they are referred to in the Complaint and are central to the claims contained therein." *Bassett*, 528 F.3d at 430. The PFRS and GRS Annual Reports are independently audited records available to the public and, therefore, are appropriate material for the Court to consider in denying the Motion. *See, e.g.*, *Total Benefits Planning Agency, Inc. v. Anthem Blue Cross & Blue Shield*, 552 F.3d 430, 435 (6th Cir. 2008) (finding that district court properly relied on public annual reports and corporate disclosure statements in ruling on Rule 12(b)(6) motion).

City code. *See* Detroit, Mich. Code § 47-2-18(d)(4); Detroit, Michigan Ordinance No. 04-05, § 54-43-4(e) (amending Chapter 54 of the 1964 City Code, which was saved from repeal by the section 11-102 of the 1974, 1977, and 2012 City Charters and incorporated by reference into, but not codified in, Chapter 47 of the City Code).

*Doyle & Associates*, another case that the City cites, reached a similar resolution. Doyle constructed and equipped a hospital on land owned by the county and leased to Doyle, in exchange for ten years of lease payments, after which the county would own the hospital and equipment. 132 N.W.2d 99, 100-01 (Mich. 1965). The Supreme Court concluded that lease payments in exchange for the building and equipment constituted "indebtedness," in excess of the county's constitutional debt limit. *Id.* at 102. Although Doyle could not assert a claim under the lease or quantum meruit, the Court acknowledged that Doyle retained its lease interest in the land and the hospital Doyle had constructed on that land. *See id.* at 103. Moreover, the Supreme Court recognized that, since the original transaction, the Michigan Constitution had been liberalized in a manner that would now allow the transaction between the county and Doyle. *Id.* The Court permitted the parties to attempt to renegotiate the terms of the voided transaction. *See id.* Accordingly, *Doyle & Associates* does not justify the City's request to dismiss the Trust Defendants' claims for alternative relief.

Permitting relief to the Trust Defendants and the COPs holders here is particularly appropriate considering the equities involved. The COPs holders, through the Trust Defendants, provided the City with more than $1.4 billion to address the City's UAAL shortfall of $1.7 billion. The City benefited by complying with its constitutional and statutory obligations (and court mandate) to maintain the actuarial integrity of the Retirement Systems and reduced its net indebtedness by finding a cheaper alternative to fund its pension obligations. *Compare, e.g.*, Trust Defendants' Answer at Eighth Affirmative Defense, *and* Trust Defendants' Counterclaims at ¶¶ 49, 79, 120, *with* Memorandum at 21. The relief provided by the COPs Transactions helped the City maintain solvency for several more years and provided the City's retired employees with the security that the City could not. As a result, "[t]he defense of *ultra vires* in this case is most inequitable and unjust. It should not be sustained unless the rigid rules of law require it. The good faith of government should never be held less sacred than that of individuals." *Coit v. City of Grand Rapids*, 73 N.W. 811, 813 (Mich. 1898) (quotations omitted); *see also Am. LaFrance*, 255 N.W. at 597 ("[T]he defense of *ultra vires* urged in the instant case is wholly technical and utterly void of merit when tested by everyday principles of right and wrong."). More to the point,

> A city cannot be permitted to take advantage of its own wrong. A municipality must be held to the same standard of right and justice which applies to an individual, and such defense now comes too late

> because the city is estopped by its actions to deny the validity of [city] ordinances.

*Brown-Crummer Inv. Co. of Wichita, Kan. v. City of Florala, Ala.*, 55 F.2d 238, 243 (M.D. Ala. 1931).

Thus, under the factual circumstances pled in the Counterclaims, the law in Michigan and elsewhere does not, as the City contends, support a wholesale rejection of alternative (non-contractual) remedies. This Bankruptcy Court, therefore, should deny the Motion as to Counterclaim Counts VI-XI.[26]

3. The Trust Defendants have Pled Actionable Claims for Fraudulent Inducement, Fraudulent Misrepresentation, and Negligent Misrepresentation.

Fraudulent inducement, fraudulent misrepresentation, and negligent misrepresentation require a claimant to plead justifiable reliance. *See Rooyakker & Sitz, PLLC v. Plante & Moran, PLLC*, 742 N.W.2d 409, 420 (Mich. Ct. App. 2007) (fraudulent inducement); *Bergen v. Baker*, 691 N.W.2d 770, 774 (Mich. Ct. App. 2004) (fraudulent misrepresentation); *Law Offices of Lawrence J. Stockler, P.C. v.*

[26] The City moved to dismiss Counterclaim Count VII on the separate ground that equitable estoppel is not an independent cause of action. Memorandum at 21 n.7. Equitable estoppel is a valid theory under Michigan law and is properly applied in this Adversary Proceeding because – as the Trust Defendants allege in Counterclaim Count VII – they justifiably relied on the City's representations and warranties, among other misrepresented facts, as true. *See Conagra, Inc. v. Farmers State Bank*, 602 N.W.2d 390, 405 (Mich. Ct. App. 1999); *see also, e.g.*, 2005 GRS Service Contract (Exhibit C to Complaint), General Terms and Conditions at § 9.13(b). Therefore, this Bankruptcy Court should deny the Motion on this basis.

*Rose*, 436 N.W.2d 70, 81 (Mich. Ct. App. 1989) (negligent misrepresentation). Counterclaim Counts VIII-X each sufficiently allege this element, notwithstanding the City's factual contention, which the Trust Defendants deny, that the Trust Defendants and the COPs holders "knew what the City knew." Memorandum at 13 n.5. Notably, the City does not assert that this element was inadequately pled and does not argue that the Trust Defendants lack standing to bring these claims.[27]

Instead, the City appears to make a *caveat emptor* argument of sorts and, with it, a presumption that a party contracting with a municipality has the same scope and degree of knowledge as the most informed and knowledgeable of hypothetical municipal officials. Any such legal presumption is untenable here for several reasons. First, the City waived the presumption by the terms of the Service Contracts. Section 9.13(b) of each of the four (4) Service Contracts states that third-party beneficiaries (including WTNA as successor trustee and successor contract administrator) "shall be *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 (Exhibit C to Complaint), General Terms and Conditions at § 9.13(b) (emphases added). Thus, the City expressly disavowed the presumption that it now attempts to invoke to defeat the Counterclaims.

[27] The City has also not challenged the sufficiency of Trust Defendants' pleading as to remaining elements of Counterclaim Counts VIII-X.

Second, the factual and legal issues relevant to municipal financing are sufficiently complicated that everything known to the City's officials should not be automatically imputed to the investment community. The City is in a unique position to make certain determinations, including those regarding which obligations are subject to the HRCA's debt limit. Further, because Michigan courts have recognized exceptions to "indebtedness," particularly in the context of service contracts and lease-back transactions, the City and its officials are in a significantly better position than private parties to know the scope of its own authority. *See, e.g.*, *Walinske*, 39 N.W.2d at 81; *Royal Oak*, 10 N.W.2d at 446. Despite recognizing the complexity of the issues at hand in other City submissions – for example, stating that "even the best intentions and investigation would not answer the legal question before this Court" (*City of Detroit's Opposition to Motions to Intervene* (Adv. Pro. Doc. 19) at 20) – the City now creates and employs a higher (double) standard for the Trust Defendants and COPs holders. This Bankruptcy Court should not support this proposition and should not impute knowledge to the Trust Defendants in light of such a complicated legal landscape.[28]

[28] The City also makes the frivolous argument that it was an "agent" for the Trust Defendants and, therefore, its knowledge should be imputed to the Trust Defendants on that basis. *See* Memorandum at 13. Nothing in the Complaint nor in the Trust Defendants' Answer or the Counterclaims supports the faulty legal conclusion that the City acted as an "agent" of the Trust Defendants.

Third, not all of the City's representations and warranties were *legal* issues; many were based on facts – or a combination of facts and law – solely within the City's specialized knowledge. *See, e.g.*, *Chem. Bank & Trust Co. v. Cnty. of Oakland*, 251 N.W. 395, 399 (Mich. 1933). For instance, the City represented that the COPs Transactions "require no action by or in respect of, or filing with, any governmental body, agency or official[,] do not contravene, or constitute a default under, any provision of applicable law," and that "[a]ll acts, conditions and things required by the Constitution and laws of the State of Michigan of the Funding Ordinances to exist, have happened and to have been performed precedent to or in the execution and delivery of the Service Contract by the City . . . exist, have happened and been performed in due time, form and manner required . . . in order to make the Service Contract a binding obligation of the City." *See, e.g.*, 2005 GRS Service Contract (Exhibit C to Complaint), General Terms and Conditions at § 3.02. There are factual components to each of these representations, including the City's *net* indebtedness at the time and the City's compliance with procedural requirements (including compliance with the RMFA), which simply cannot be automatically imputed to the investment community. There is, furthermore, no suggestion that the City and its officials did not have authority to make these additional representations.

Fourth, and finally, the Trust Defendants have alleged that the City made a variety of representations and warranties, among others, beyond the scope-of-authority issue, on which the Trust Defendants presumptively relied. *See* Counterclaims at ¶¶ 34-39, 90, 100, 109; *see also, e.g.*, 2005 GRS Service Contract (Exhibit C to Complaint), General Terms and Conditions at § 9.13(b) (Third Party Beneficiaries conclusively presumed to have relied on the City's representations and warranties). For instance, the City made express representations and warranties, *inter alia*, regarding (a) the Service Contracts required no further action by or in respect of, or filing with any governmental body, agency or official; (b) the satisfaction of all conditions precedent to its payment and other contractual obligations under the Service Contracts; (c) the valid and binding nature of the City's contractual commitment; and (d) the amount of the UAAL as within the authority of the City's funding ordinance. *See* 2005 Offering Circular (Exhibit A to Complaint) at G-2 to G-3; 2005 GRS Service Contract (Exhibit C to Complaint), General Terms and Conditions §§ 3.02, 4.02(b); 2005 PFRS Service Contract (Exhibit 2 to Trust Defendants' Answer), General Terms and Conditions §§ 3.02, 4.02(b); 2006 GRS Service Contract (Exhibit H to Complaint), General Terms and Conditions §§ 3.02, 4.02(b); 2006 PFRS Service Contract (Exhibit 3 to Trust Defendants' Answer), General Terms and Conditions §§ 3.02, 4.02(b).

The City's instant argument does not address any of those other actionable representations and warranties. *See Schmid v. Vill. of Frankfort*, 91 N.W. 131, 132 (Mich. 1902) ("We have held in several cases that one relying upon the recitals in a bond that it was lawfully issued may be a purchaser in good faith."); *Thompson v. Vill. of Mecosta*, 86 N.W. 1044, 1046 (Mich. 1901) ("This bond purports to have been issued under authority of a law which it mentions, and for the purpose prescribed by the act, – a thing that the village might lawfully do. As a matter of fact, it was not issued for such a purpose, but for a private improvement, and upon its face it unquestionably carried a false pretense; *but 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*; *i.e.*, public improvements." (emphasis added)). For the foregoing reasons, the Motion should be denied as to Counterclaim Counts VIII-X.

4. The Property Interests in Both the Investment Assets and the Service Payments are Sufficient to Support Counterclaim Counts XII-XIV.

The City also moves to dismiss Counterclaim Count XII (Due Process), Counterclaim Count XIII (Unlawful Takings), and Counterclaim Count XIV (Conversion), on the basis that the Trust Defendants have not alleged a "property interest" sufficient to support those three (3) Counterclaims. This argument for dismissal fails for three basic reasons. First, as the City's own authority makes

clear, "[n]o doubt exists that contractual rights are a species of property within the meaning of the Due Process Clause." *Charles v. Baesler*, 910 F.2d 1349, 1352 (6th Cir. 1990). Second, the City ignores the property interest of the Trust Defendants, in their role as trustee on behalf of the COPs holders, in the $1.44 billion worth of investment assets that were transferred, at the City's direction, to the Retirement Systems to be held in a segregated and identifiable fund within each of the Retirement Systems. Third, the City also ignores the Trust Defendants' secured property interest in the Service Payments, as evidenced by a publicly-recorded UCC financing statement filed on June 12, 2006, as contemplated by the 2006 Trust Agreement. *See* 2006 Trust Agreement (Exhibit I to Complaint) at § 201.[29]

*a. Procedural and Substantive Due Process*

Counterclaim Count XII asserts that the Trust Defendants' procedural and substantive due process rights were violated by the City. To state a procedural due process claim, a claimant must allege (1) that it has a life, liberty, or property interest protected by the Due Process Clause; (2) that it was deprived of this

[29] The City's arguments as to Counterclaim Counts XII and XIII are flawed whether directed at the Trust Defendants' federal or state constitutional claims. *See City of Kentwood v. Sommerdyke Estate*, 458 Mich. 642, 656 (1998) (noting that federal and Michigan Takings Clauses are "substantially similar"); *Lucas v. Monroe Cnty.*, 203 F.3d 964, 972 n.4 (6th Cir. 2000) (noting that because due process rights under Michigan Constitution "essentially track those guaranteed by the United States Constitution, the same analysis that governs the[] federal constitutional claims applies to the[] corresponding state claims").

protected interest; and (3) that the state actor in question did not afford adequate procedural rights prior to depriving plaintiff of its protected interest. *See, e.g.*, *Gunasekera v. Irwin*, 551 F.3d 461, 467 (6th Cir. 2009). To state a claim for a substantive due process violation, a plaintiff must allege that the state actor proceeded in an arbitrary and capricious manner, or that its actions "shock the conscience" in a constitutional sense. *See, e.g.*, Cnty. *of Sacramento v. Lewis*, 523 U.S. 833, 847 (1998). The City seeks to dismiss both aspects of the Trust Defendants' due process claim on the flawed theory that the Trust Defendants have no protected property interest at stake.[30]

In *Board of Regents of State Colleges v. Roth*, the U.S. Supreme Court observed that its decisions have "made clear that the property interests protected by procedural due process extend well beyond actual ownership of real estate, chattels, or money." 408 U.S. 564, 571-72 (1972). This broadly-defined concept of what constitutes protected property rights is sufficiently elastic to encompass

[30] The additional elements of the Trust Defendants' procedural due process claims are satisfied by the City's unilateral decision, in June 2013, to discontinue permanently making the required Service Payments, without affording the Trust Defendants adequate prior notice or an opportunity to be heard. *See* Counterclaims at ¶ 129; *see also, e.g.*, *Cleveland Bd. of Educ. v. Loudermill*, 470 U.S. 532, 542 (1985) (due process entitled tenured employee to pre-termination hearing). Thus, the City overstates its position that this Adversary Proceeding renders the Trust Defendants' procedural due process claim moot. As also alleged, the City's actions with respect to the COPs Transactions were arbitrary and capricious, and they shock the conscience, particularly given the steps it took to proactively seek the financial assistance prior to its unilateral default in 2013. *See* Counterclaims at ¶¶ 129-30.

both the Trust Defendants' interest in the initial $1.4 billion in investment assets transferred to the Retirement Systems, at the City's direction, and the secured contractual rights to receive the Service Payments.

Indeed, contrary to the central premise of the City's argument, it is generally recognized that such a constitutionally protected property interest can be created by a state statute, a formal contract, or a contract implied from the circumstances. *See, e.g.*, *Singfield v. Akron Metro. Hous. Auth.,* 389 F.3d 555, 565 (6th Cir. 2004). The case law that the City itself cites in support of the Motion acknowledges this general relationship between contract rights and protected property interests. *See*, *e.g.*, *Blazy v. Jefferson Cnty. Regional Planning Comm'n*, 438 F. App'x 408, 412 (6th Cir. 2011) (property interests can be created by a formal contract or a contract implied from the circumstances); *Charles*, 910 F.2d at 1352 (same).

The key inquiry to be made is whether the contractual benefit is more than "an abstract need or desire" and "more than a unilateral expectation" of receiving the benefit. *Roth*, 408 U.S. at 577. In *Singfield*, the plaintiff was terminated from his tenured position with the Akron Metropolitan Housing Authority, without advance notice or a pre-termination hearing. The Sixth Circuit reversed summary judgment against the plaintiff's due process claim, finding that he had a protected property right pursuant to the terms of the collective bargaining agreement. 389 F.3d at 565. In reaching this result, the Sixth Circuit found that the collective

bargaining agreement gave the plaintiff a reasonable expectation of receiving the benefits of continued employment and, accordingly, a constitutionally protected property interest.

As alleged, the Trust Defendants had more than a "unilateral expectation" with regard to the receipt of the Service Payments. The transaction pursuant to which the $1.44 billion was transferred to the Retirement Systems, and pursuant to which the Trust Defendants were entitled to receive the Service Payments, was supported by, among other things, written agreements and representations signed by the City, financing statements securing the Trust Defendants' interest in the Service Payments, opinions of outside counsel on contract validity,[31] and funding ordinances passed by the Detroit City Council. *See* Counterclaims at ¶¶ 6-27; *see also* 2005 Trust Agreement (Exhibit D to Complaint), General Terms and Conditions § 201; 2006 Trust Agreement (Exhibit I to Complaint), General Terms and Conditions § 201. The Trust Defendants' reasonable expectation of continued receipt of the Service Payments was reinforced by the understanding of the parties, including the City, that the payments were not subject to appropriation. *See* 2005 Offering Circular (Exhibit A to Complaint) at 8 ("The City's unconditional contractual obligation to pay all COP Service Payments is not 'subject to

[31] A legal opinion provided by the municipality that the transaction is legal estops the municipality from contesting the validity of the transaction in subsequent litigation. *See Brown-Crummer Inv. Co.*, 55 F.2d at 242.

appropriation,' as is customary with many certificate of participation transactions entered into by municipalities in the United States.").

The two cases that the City relies on to support its proposition that courts "generally" distinguish between contractual rights and property interests are inapposite. First, the Supreme Court's decision in *Texaco, Inc. v. Short* involved an abandonment of mineral rights. 454 U.S. 516 (1982). The Court held that, since the appellant mineral owners did not execute any coal or oil leases until *after* the statutory lapse of their mineral rights, there was no impairment of contracts. *Id.* at 531. Second, in *In re Riso*, the dispute did not involve a contractual claim within the scope of the Due Process Clause; instead, the issue on appeal was whether a right of first refusal was "property" under section 523(a)(6) of the Bankruptcy Code. 978 F.2d 1152 (9th Cir. 1992). The Ninth Circuit affirmed on summary judgment that the breach of the right of first refusal was not the sort of willful property damage that was excepted from discharge under section 523(a)(6) of the Bankruptcy Code.

Neither of these two cases is precedent for a categorical rule that contractual rights are mutually exclusive of property rights protected by the Due Process Clause. At minimum, there are disputed issues of material fact as to whether the Trust Defendants' provision of the investment assets and their expected benefits from the COPs Transactions gave rise to property interests that the City infringed

by its unilateral decision to discontinue permanently the Service Payments. It would be inappropriate, given the applicable Rule 12(b)(6) standard of review, to resolve those disputed issues now at the motion to dismiss stage. *See, e.g.*, *Loudermill*, 470 U.S. at 547-48 (reversing order granting motion to dismiss due process claim pursuant to Rule 12(b)(6)).[32]

*b. Unlawful Takings*

The City's argument for dismissal of the Trust Defendants' unlawful takings claim (Counterclaim Count XIII) fails for similar reasons. The City cites *S&D Maintenance Co. v. Goldin*, 844 F.2d 962 (2d Cir. 1988), for the proposition that contractual rights to payment do not constitute "property" that can be taken within the meaning of the Taking Clause. The Second Circuit opinion does not support such a blanket rule. At issue in *S&D* was a demand for prompt payment for parking meter services by an at-will municipal contractor that was under criminal investigation. Rather than apply a broad legal principle that municipal contracts can never constitute protected property, the Second Circuit began its analysis by recognizing that the Supreme Court had expanded the scope of interests protected by the procedural guarantees of the Due Process Clause. *Id.* at 965 (citing *Roth*, 408 U.S. 564). Then, it reviewed the summary judgment record at length to

[32] With the exception of *Loudermill*, which reversed the grant of a Rule 12(b)(6) motion, all the appellate decisions the City cites in support of its due process argument involved, at a minimum, a full summary judgment record.

determine whether, on the facts of that case, the municipal contract provided the plaintiff with a protected property interest within the framework set forth by the Supreme Court in *Roth*. It found no clear entitlement to prompt payments and no guarantee of future business, based in part on the city's unconditional termination rights under the contract. *Id.* at 968. Here, in contrast, the City has unilaterally discontinued payments in contravention of the various transaction documents, seeks to completely void such transactions, and attempts to dismiss the Trust Defendants' constitutional claims without even the benefit of a developed record. There is no valid basis to dismiss these claims at this time.

The City's reliance on cases involving secured and unsecured claims in bankruptcy is also misplaced. *See, e.g.*, *In re Treco*, 240 F.3d 148 (2nd Cir. 2001); *In re Varanasi*, 394 B.R. 430 (S.D. Ohio 2008). In *Treco*, the appellant bank and leasing company challenged on multiple grounds a decision by the bankruptcy court to require the turnover of certain allegedly secured funds pursuant to section 304(a) of the Bankruptcy Code. The Second Circuit vacated the turnover order and remanded for a determination of whether the appellants' claim was secured; the Court of Appeals was not asked to decide – and did not hold – that unsecured contract claims can never constitute protected property interests. 240 F.3d at 151.

Similarly, the City's reliance on *Varanasi* reflects a basic misunderstanding of the Trust Defendants' property interests. Their protected interest in the

$1.44 billion raised from the COPs holders and their entitlement to receive, and secured interest in, the Service Payments arose from the COPs Transactions. The unsecured claim at issue in *Varanasi* concerned the creditors' general interest in the debtor's property arising *after* it filed for bankruptcy. 394 B.R. at 438. Under these circumstances, the bankruptcy court held that allowing the debtor to claim an exception in certain residential real estate, pursuant to section 522(b)(3) of the Bankruptcy Code, was not an unconstitutional taking. *Id.* at 438-39. That is fundamentally different from the City's unilateral decision to deny payments owed in consideration of a $1.44 billion private bailout for the benefit of the City's retirees. *See AFT Mich. v. Michigan*, 825 N.W.2d 595, 604 (Mich. Ct. App. 2012) (recognizing that the government's assertion of ownership of a specific and identifiable parcel of money implicates the Takings Clause).

*c. Conversion*

Neither of the two cases that the City relies on supports dismissal of the Trust Defendants' conversion claims (Counterclaim Count XIV). *See Haviland v. Metro. Life Ins. Co.*, 876 F. Supp. 2d 946 (E.D. Mich. 2012); *Live Nation Worldwide, Inc. v. Hillside Prods., Inc.*, No. 10-11395, 2011 U.S. Dist. LEXIS 34405 (E.D. Mich. March 30, 2011). In making its argument, the City has, again, ignored the $1.4 billion in investment assets that were raised from the COPs holders and transferred, at the City's direction, to the Retirement Systems to be

held in a segregated and identifiable fund within each of the Retirement Systems. In *Live Nation*, the plaintiff sought to recover net revenues generated from live entertainment events. The court dismissed the conversion claim because the plaintiff did not allege that it entrusted "specific" money in the care of the defendant. 2011 U.S. Dist. LEXIS 34405, at *8. Here, in contrast, the Trust Defendants have made the allegation that a specific sum of money was raised and then transferred at the City's direction. *See* Counterclaims at ¶¶ 140-45.

Similarly, the conversion claim in *Haviland* failed because the plaintiff policyholders did not allege any "specifically identifiable" funds entrusted in the care of the defendant insurance company. 876 F. Supp. 2d at 956-57. Also, in contrast to the Trust Defendants, the plaintiffs did not have any current claims for payment. *Id.* Instead, the plaintiffs were challenging a reduction in potential *future* benefits under term life insurance policies, as part of General Motors' 2009 reorganization plan. *Id.* at 956. Nor is it material that the $1.44 billion in investment assets were transferred directly to the Retirement Systems, since the law of conversions encompasses unlawful transfers involving third parties. *See* Mich. Comp. Laws § 600.2919a(1)(b); *see also, e.g.*, *In re Magna Corp.*, Adv. No. 03-9032, 2005 Bankr. LEXIS 1114, at *9 (Bankr. M.D.N.C. Mar. 14, 2005) ("The essence of a conversion is not the acquisition of property, but the wrongful

deprivation of that property from its true owner."). For the same reasons, the Trust Defendants have also sufficiently pled a common-law claim for conversion.

For the foregoing reasons, the Motion should be denied with respect to Counterclaim Counts XII-XIV.

### C. The City's Statute of Limitations Argument is Both Premature and Misplaced.

With respect to Counterclaim Count IV, the City first argues that no statute of limitations should apply because the contracts at issue are void *ab initio*.[33] Memorandum at 27. Such an argument is, at best, premature because it is intertwined with the substantive issue regarding the nature of the Service Contracts that, as discussed above, is inappropriate for resolution on a Rule 12(b)(6) motion. Indeed, *Riverside Syndicate, Inc. v. Munroe*, the case the City primarily relies on for its argument, decided the statute of limitations issue at summary judgment, and only after holding that the contract at issue was invalid because it violated New York City's Rent Stabilization Code. *See* 882 N.E.2d 875, 877 (N.Y. 2008).

Like *Riverside*, neither of the two remaining cases cited by the City was decided at the motion to dismiss stage – *Bertelsen v. Harris*, 537 F.3d 1047

[33] The City also contends that Counterclaim Count IV, which seeks a declaratory judgment that the City's claims are barred by the statute of limitations, should be dismissed because "it makes no sense and wastes the time of the Court and the City." Memorandum at 3-4. Notably, the City offers no explanation for why the claim is a waste of judicial resources, nor does it cite any authority for dismissing a request for a declaration that the City's claims are time-barred.

(9th Cir. 2008), was reviewed on appeal following a bench trial, and *Farrell v. Wurm* (*In re Donnay*), 184 B.R. 767 (Bankr. D. Minn. 1995), was decided on summary judgment. The City's reliance on *Bertelsen* is even more tenuous, given the context of the citation. The language that the City cherry-picks from *Bertelsen* is in a footnote in the dissenting opinion, addressing an issue that was not before the court. *See Bertelsen*, 537 F.3d at 1061 n.1 (Smith, J., dissenting) (explaining inapplicability of statute of limitations to agreements made in violation of Washington Rules of Professional Conduct).[34]

The City argues in the alternative that if a statute of limitations does apply, section 600.5807(7) of Michigan's Compiled Laws, which provides for a ten-year limitations period for actions to "recover damages or sums due for breach of contract, or to enforce the specific performance of any contract . . . on bonds, notes, or other like instruments which are the direct or indirect obligation of . . . the

[34] The remaining out-of-state cases that the City cites are distinguishable or no longer good law. For instance, the City relies on *Smith v. JPMorgan Chase Bank, N.A.*, 825 F. Supp. 2d 859, 861 (S.D. Tex. 2011), for its argument, but the Fifth Circuit rejected the reasoning in *Smith*. *See Priester v. JPMorgan Chase Bank, N.A.*, 708 F.3d 667, 674 & n.4 (5th Cir. 2013) (rejecting *Smith* as contrary to the relevant constitutional scheme). The City, however, fails to advise this Bankruptcy Court that the Fifth Circuit rejected the precise conclusion from *Smith* on which the City now purports to rely. According to *Priester*, the limitations period does in fact apply, contrary to the holding in *Smith*. 708 F.3d at 674; *see also Prutzman v. Wells Fargo Bank, N.A.*, No. H-12-3565, 2013 U.S. Dist. LEXIS 113106, at *5-9 (S.D. Tex. Aug. 12, 2013) (discussing application of statute of limitations period to voidable liens).

. . . city," supplies the appropriate limitations period. Memorandum at 28. That argument, which is unsupported by case law authority, is no more persuasive.

As a preliminary matter, section 600.5807 only applies to specific types of actions, namely actions to recover damages or sums due for breach of contract or actions to enforce the specific performance of a contract. The City's Complaint, which seeks to invalidate contractual obligations and *not* to enforce such obligations, falls outside the scope of section 600.5807. *Cf. Mazur v. Empire Funding Home Loan Owner Trust 1997-3*, No. 03-74103, 2004 U.S. Dist. LEXIS 30225, at *24 n.4 (E.D. Mich. Jan. 9, 2004) ("[I]nasmuch as the Michigan courts and legislature have failed to specify a limitations period for actions based on the illegality of a contract, the court finds that a six-year, catch-all period is appropriate."). Accordingly, section 600.5807(7)'s ten-year limitations period simply does not apply here. *See Auto Club Ins. Ass'n v. Hill*, 430 N.W.2d 636, 638 (Mich. 1988) (noting that, when construing statutes, courts look first to the statutory language).

In any event, section 600.5807 would not apply to the City's Complaint. Under Michigan law, "[t]he type of interest allegedly harmed is the focal point in determining which limitation period controls." *Barnard v. Dilley*, 350 N.W.2d 887, 888 (Mich. Ct. App. 1984); *see also Mazur*, 2004 U.S. Dist. LEXIS 30225, at *24 n.4 (stating that a request for declaratory relief does not avoid the statute of

limitations applicable to the substantive basis for the claim). Although the City argues that the ten-year limitations period for "public obligations" should apply, the Complaint asks for declaratory and injunctive relief excusing the City from its duties to make payments under the Service Contracts. Complaint at ¶¶ 36-51. Such a request constitutes a personal action governed by the six-year statute of limitations set forth in section 600.5813 of Michigan's Compiled Laws. *See* Mich. Comp. Laws § 600.5813 ("All other personal actions shall be commenced within the period of 6 years . . . ."); *see also Nikiforuk v. CitiMortgage, Inc.*, No. 11-10815, 2011 U.S. Dist. LEXIS 152552, at *10 (E.D. Mich. Dec. 27, 2011) (concluding that claim seeking to invalidate contract based on fraudulent misrepresentation was subject to section 600.5813), *accepted and adopted by* 2012 U.S. Dist. LEXIS 10775 (E.D. Mich. Jan. 30, 2012).

Application of section 600.5813 is supported by *Smith v. Department of Treasury*, the *only* case that even cites the ten-year period the City advocates. 414 N.W.2d 374 (Mich. Ct. App. 1987). In *Smith*, the plaintiff sought to collect payment on a certificate of indebtedness that had been issued by Michigan in 1839. *See id.* at 375. The principal sum of $1,000 was due to be collected on July 15, 1842. *See id*. The plaintiff sought that amount, plus 7% interest compounded annually, which would have yielded a payment of over $20 million at the time of the lawsuit. *See id*. The court held that the plaintiff's complaint was barred by the

statute of limitations. *See id*. at 376. In determining that the complaint was time-barred, the court applied a twenty-year limitations period for personal actions on contracts not otherwise limited, pursuant to RS 1838, part 3d, title VI, chapter 2, section 7 ("RS 1838"). Significantly, the court in *Smith* did not apply 600.5807(7) – the statute of limitations proposed by the City – even though it was raised by the State. *See id*. at 378.

The statute of limitations applied in *Smith*, RS 1838, was subsequently amended by RS 1846, part 3d, title XXVI, chapter 140, section 7 ("RS 1846"). *See id*. at 376 n.1. RS 1846 limited the time for bringing "personal actions on any contract, not limited by the foregoing sections, or by any law of [the] state," to a period of ten years. *See* Rev. Stat. 1846, part 3d, tit. XXVI, ch. 140, § 7. RS 1846 was later amended in 1915 by section 12323 of Michigan's Compiled Laws, which set a six-year limitations period for all personal actions not otherwise specified. *See* Mich. Comp. Laws § 12323 (1915).

Today, this six-year limitations period is codified in section 600.5813 of Michigan's current compilation of laws. *See* Mich. Comp. Laws § 600.5813. Therefore, similar to the plaintiff's action on the note of indebtedness in *Smith*, because the City brings a personal action not limited by statute with respect to the Service Contracts, a six-year limitations period applies. The Motion as to Counterclaim Count IV should, therefore, also be denied.

## IV. CONCLUSION

For the reasons set forth above, the Trust Defendants respectfully request that the Court deny the Motion in full.

August 14, 2014

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## CERTIFICATE OF SERVICE

I, Heath D. Rosenblat, hereby certify that on this day I caused a true and correct copy of the foregoing **Memorandum of Defendants Detroit Retirement Systems Funding Trust 2005 and Detroit Retirement Systems Funding Trust 2006 in Opposition to the City of Detroit's Motion to Dismiss in Part the Funding Trusts' Counterclaims** to be filed electronically, and to be thereby served upon the following:

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