

Emergency manager and Michigan governor follow Jones Day blueprint to gut pensions

By Shannon Jones
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An article published by the Jones Day law firm in 2011 sheds light on the process through which Michigan Governor Rick Snyder and Detroit Emergency Manager Kevyn Orr forced the city into bankruptcy.

The article titled, “Pensions and Chapter 9: Can municipalities use bankruptcy to solve their pension woes?” and published in *Emory Bankruptcy Journal* in March 2011, was written by two Atlanta-based Jones Day attorneys, more than two years before Detroit’s bankruptcy filing. It was submitted as evidence by attorneys for the United Auto Workers in the ongoing bankruptcy case in Detroit.

The international bankruptcy firm—where Orr served as a law partner between 2001 and 2013—was hired by the state of Michigan shortly after newly Republican Governor Rick Snyder pushed through the first version of the emergency manager law in early 2011.

The document is part of the mounting evidence that Snyder, Jones Day and top Democratic officials, including former State Treasurer Andy Dillon, Detroit Mayor David Bing and current mayoral candidate Mike Duggan, plotted to throw the city into bankruptcy and strip workers of pensions and other benefits long before the formal filing by Orr in July 2013.

The contents of this article further rebuts the claim that Orr and Snyder were striving to reach a settlement with the unions, pensioners and creditors, eyeing bankruptcy only as a last resort. Such “good faith” negotiations are legal requirement for the city to be eligible for Chapter 9 municipal bankruptcy.

Snyder chose Orr for emergency manager specifically for his bankruptcy experience. Indeed, he was hand-picked by Snyder and Dillon because of his work for Jones Day. While at Jones Day Orr was one of the attorneys working on the Chrysler bankruptcy, where he oversaw the use of bankruptcy laws in 2009 to cancel contracts with hundreds of dealers whose contracts would

have been protected by state law outside of bankruptcy.

As its title makes clear, the Jones Day article establishes a blueprint for the use of bankruptcy law to gut pensions. It begins by noting the increasing financial pressures facing local governments in the wake of the 2008 financial crash and it singles out the unfunded liabilities of state and municipal pension funds as a particular concern, claiming the deficit is by some accounts \$3 trillion nationwide.

It then states that one of the alternatives being discussed to address these liabilities is the use of chapter 9 of the Bankruptcy Code. While noting that not all the provisions available in corporate bankruptcies apply in chapter 9 and that chapter 9 is not available in all states, the article goes on to assert, “Despite these limitations, chapter 9 offers a potentially powerful mechanism to assist municipalities in obtaining relief from creditors and adjusting their debts. As a result, from coast to coast, municipalities are examining the pros and cons of chapter 9 as an alternative of last resort.”

They go on to write, “The purpose of this Article is to identify certain tools and strategies offered by chapter 9 and to consider whether, individually or in unison they may offer a real, workable solution to the overwhelming and seemingly unassailable pension obligations of many municipal debtors.”

It then explains the difficulties states and municipalities face in altering pension agreements outside of bankruptcy. In addition to the likelihood that cuts in pensions will arouse mass public opposition, in many states pensions are constitutionally protected under the so-called vested rights doctrine.

The “vested rights” doctrine came about in the wake of a reactionary 1889 Supreme Court ruling in the case of *Pennie v. Reis* that established the precedent that, as the authors write, “the modification of a public employee’s entitlement to pension benefits is permissible because,

until actual retirement, the employee possesses no contractual or absolute property interest in receiving pension benefits.” This “gratuity theory” holds that a state or municipality is free to alter pensions at will during employment.

However, the authors complain, in many states *Pennie* has been found to be “outmoded.” As one court held in 1977, “The medieval or even colonial concepts of a compassionate and generous sovereign rewarding his humble, devoted subjects is completely alien to our modern views of a democratic government’s obligations to its citizens.” Thus the constitutions of at least nine states, including Michigan, bar the arbitrary revocation of retirement benefits during employment and any reduction in benefits for retired workers. Further, the courts in eight states have ruled that the beginning of the employment relationship creates a constitutionally protected contractual right to receive benefits.

The authors argue in favor of using bankruptcy to re-establish the “medieval” concept of the “gratuity theory.” While not a “silver bullet,” the authors write, “Chapter 9, however, does provide a debtor with a toolbox” to attack pensions that would otherwise be protected. “By using the available tools of chapter 9 in a coordinated manner, the bankruptcy process may provide a means of reducing the unfunded liability portion of a municipality’s pension obligation or otherwise compromising a municipality’s pension debt. In this way, chapter 9 also may generate leverage for the municipality and pave the way for consensual modifications to its pension obligations.”

The authors cite four specific provisions of the Bankruptcy Code that provide a municipal debtor with leverage to seek a reduction of pensions. This includes the “automatic stay” of payment to all creditors, including payments to retiree pension funds. It also includes the “rejection of executory contracts,” e.g. the voiding of labor agreements. Other “tools” include the “claims allowance process,” which determines the validity and priority of claims by creditors, and “the plan of adjustment process.”

The authors stress that the plan of adjustment process provides perhaps the strongest leverage for municipalities to slash their pension obligations, allowing bankruptcy judges the power to override state constitutions that protect pensions. The authors write, “There is limited case law on this topic in the chapter 9 context; however, several important lessons can be learned. For example, if the municipality has been authorized by the state to avail

itself of chapter 9, state laws, ordinances, and other rules should not be available to impede the municipal debtor’s efforts to use chapter 9 to impair and restructure its obligations.

Accordingly, even where state law establishes rules of priority or otherwise prefers one unsecured creditor over another, chapter 9 (and the state’s voluntary agreement to permit chapter 9 filings) allows the debtor to disregard such state law preferences and impair the rights of such unsecured creditors.” Significantly, one of the cases the authors cite is Chrysler’s move to liquidate 789 car dealerships as part of its 2009 bankruptcy and restructuring. They write, “Outside of bankruptcy, each of the dealership agreements was protected by applicable state laws imposing conditions and financial burdens on the termination of the agreements. The dealers argued, in part, that the debtors should be prohibited from rejecting the dealership agreements unless they also complied with the state dealer laws.”

The court, however, held for Chrysler, ruling that provisions of the Bankruptcy Code trumped state law. Kevyn Orr was one of Chrysler’s lead attorneys in that case.

The authors note that the use of the bankruptcy courts to gut pensions is largely untested. However, they cite at least one case, that of the city of Prichard, Alabama, where a bankruptcy court agreed to an adjustment plan that included an 8.5 percent reduction in all existing and future pension payments and other changes.

This only underscores the significance of the Detroit bankruptcy filing. It is being used by the financial elite, with the full backing of both big business parties, as a model for a nationwide assault on public employee wages, healthcare and pensions. It is an anti-democratic conspiracy against the population that has far-reaching implications for workers across the United States and internationally.

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