

# Municipal Restructuring *News*

Detroit Docket Update

March 17, 2014

## Detroit Judge Vacates the Appointment of the Official Committee of Unsecured Creditors

*The Court in the City of Detroit (the “City”) municipal bankruptcy proceeding has issued a decision granting the City’s motion to disband the Official Committee of Unsecured Creditors (“Creditors’ Committee”) that had previously been appointed in the case by the U.S. Trustee. In so deciding, the Court concluded that the U.S. Trustee does not have automatic power to appoint an unsecured creditors committee in a municipal bankruptcy proceeding, and may do so only in instances where an interested party makes the request, and only upon a finding by the Court that it is necessary to assure adequate representation of unsecured creditors.*

*In addition to outlining when a creditors’ committee may be appointed, the decision provides greater insight into the role and duties of the U.S. Trustee in a Chapter 9 municipal bankruptcy proceeding.*

### Trustee’s Ability to Object

In its February 28, 2014 decision, the Court considered whether the U.S. Trustee had automatic standing to object to the City’s motion to disband the Creditors’ Committee. The Court determined that, unlike in a chapter 11 bankruptcy proceeding where the U.S. Trustee is granted broad authority to intervene in most aspects of a chapter 11 case, the Bankruptcy Code does not include an automatic right for the U.S. Trustee to intervene in a municipal bankruptcy proceeding, which arises under Chapter 9 of the Bankruptcy Code. While the Court found that the U.S. Trustee has no statutory standing in a municipal bankruptcy proceeding, the Court did, however, hold that the U.S. Trustee had a substantial interest in defending itself where its legal actions have been challenged, and therefore could object to the City’s motion.

### Trustee’s Authority Under Chapter 9

After finding that the U.S. Trustee could object to the City’s motion, the Court focused on whether the U.S. Trustee could appoint an unsecured creditors’ committee in a bankruptcy proceeding as of right. Specifically, the Court focused on § 1102 of the Bankruptcy Code, which Congress incorporated into the municipal bankruptcy provisions. The Court noted that § 1102(a)(1) provides that “following the order for relief under Chapter 11,” the U.S. Trustee “shall appoint” an unsecured creditors’ committee.

Previous to the Court’s decision, other bankruptcy courts have interpreted § 1102(a)(1) as an automatic grant of power for the U.S. Trustee to appoint an unsecured creditors committee as

soon as the court has granted a debtor’s Chapter 9 order for relief in a municipal bankruptcy proceeding. The Court, however, found that the phrase “after the order for relief under Chapter 11,” limits § 1102(a)(1) solely to Chapter 11 bankruptcies because in a municipal bankruptcy proceeding arising under Chapter 9 of the Bankruptcy Code, no “order for relief under Chapter 11” is ever entered. Rather, the order for relief is entered under Chapter 9; to interpret § 1102(a)(1) as applying to a Chapter 9 bankruptcy despite the existence of that limiting phrase would read the phrase out of the statute.

The Court did note, however, that under another subsection contained in § 1102, the U.S. Trustee may appoint a committee, subject to the approval of a bankruptcy court. Based on its review of the relevant statutory provisions, the Court held that the U.S. Trustee’s authority to appoint a committee in a municipal bankruptcy proceeding was limited solely to committees appointed by the U.S. Trustee and approved by the relevant bankruptcy court. In fact, the Court pointed out that the City’s Official Retirement Committee, which was appointed pursuant to § 1102(a)(2) and approved by the Court, was unaffected by its ruling.

Following the issuance of its decision, on March 11, 2014, the Court denied a motion by an undisclosed group of creditors who have asserted civil rights claims against the City under 42 U.S.C. § 1983 for an order directing the U.S. Trustee to appoint a committee to represent their interests. The undisclosed creditors’ motion had been made pursuant to § 1102(a)(2) of the Bankruptcy Code. The Court found that the mediation procedures in place in the bankruptcy proceeding would adequately protect the interests of these creditors.

## Court's Ability to Disband a Committee under § 105

The Court also concluded that it had the authority to vacate the U.S. Trustee's appointment of the Creditors' Committee pursuant to its equitable powers under the Bankruptcy Code.

The Court held that because the Bankruptcy Code does not explicitly prohibit the disbanding of an unsecured creditors committee, § 105 grants the Court the authority to do so, and that such authority should be, in the Court's discretion, exercised in this instance. The Court based its decision to invoke its equitable power and disband the Creditors' Committee on two key issues.

First, the Creditors' Committee specifically stated that it did not intend to join in mediation. The Court took this as a sign that the committee lacked respect for the importance of the mediation process and therefore would not be able to fulfill its role as a primary negotiating body for the formulation of the plan of reorganization. It also found that the four of the five committee members were already represented in the litigation, creating duplicative representation. Secondly, the Court found that the costs of the Creditors' Committee's professionals would be enormous and that any litigation undertaken by the Creditors Committee would likely be of little value.

Through this decision, the Court has added clarity to the role of the U.S. Trustee in Chapter 9 proceedings and determined the circumstances upon which an unsecured creditors' committee will be appointed in a Chapter 9 case.

## For More Information

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The information contained in this alert was derived solely from the Order Granting the City's Motion to Vacate the Appointment of the Official Committee of Unsecured Creditors [Docket No. 2784], entered by the Court in Case Number 13-53846 in the U.S. Bankruptcy Court for the Eastern District of Michigan, on February 28, 2014 and from Order Denying Motion to Appoint Committee of Creditors With Claims Under 42 U.S.C. § 1983 [Docket No. 2993], entered by the Court in Case Number 13-53846 in the U.S. Bankruptcy Court for the Eastern District of Michigan, on March 11, 2014.

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