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Art & the "Public Trust" in Municipal Bankruptcy

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ABSTRACT

In 2013, the City of Detroit filed the largest municipal bankruptcy action in United States history, affecting about $20 billion in municipal debt. Unusually, Detroit owned its municipal art museum, the Detroit Institute of Arts ("DIA") and all of the works of art in the DIA collection, which were potentially worth billions of dollars. Detroit's creditors wanted Detroit to sell the DIA art in order to satisfy its debts. Key to the confirmation of Detroit's plan of adjustment was the DIA settlement, under which Detroit agreed to sell the DIA art to the DIA corporation in exchange for $816 million over 20 years.

The bankruptcy court approved the DIA settlement as fair and in the best interests of the creditors because it found that Detroit could not, would not, and should not sell the DIA art. The bankruptcy court's conclusion that Detroit could not sell the DIA art was wrong. It could and did sell the DIA art. But the bankruptcy court's effective conclusion that Detroit was free to sell the DIA art on its own terms was correct.

The Detroit bankruptcy and DIA settlement suggest that art museums should be permitted and even encouraged to sell works of art in order to preserve the rest of their collections and continue operations. Professional standards that prohibit art museums from selling works of art for any purpose other than purchasing works of art are unjustified and should be abandoned.

INTRODUCTION

On July 18, 2013, the City of Detroit, Michigan filed for municipal bankruptcy under Chapter 9 of the Bankruptcy Code. It was the largest municipal bankruptcy filing in United States history, affecting about $20 billion in municipal debt to pensioners and bondholders.

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During the bankruptcy proceedings, Detroit proposed several draft plans of adjustment, which increasing numbers of its creditors accepted. Ultimately, the bankruptcy court had to decide whether to approve Detroit's final plan of adjustment, which the overwhelming majority of its creditors had accepted. Among other things, the bankruptcy court considered whether Detroit could and should sell certain works of art that it owned in order to satisfy its creditors.

Unlike most cities, Detroit owned its municipal art museum, the Detroit Institute of Arts ("DIA"), and all of the works of art in the DIA collection, which were potentially worth billions of dollars. Detroit's creditors argued that that the DIA art was a non-core asset that could and should be liquidated in bankruptcy. The DIA corporation and the Michigan Attorney General argued that Detroit could not sell the DIA art, because it owned the art subject to the public trust, a charitable trust, and gift restrictions specific to particular works of art.

While Detroit initially considered selling the DIA art, ultimately it argued that it could not, and should not, sell the DIA art. Detroit's final plan of adjustment included the "DIA Settlement" or "Grand Bargain," under which Detroit would transfer the DIA art to the DIA corporation, in exchange for contributions of $816 million over twenty years from the DIA corporation and other charities, which would be used to partially satisfy Detroit's debt to its pensioners.

The bankruptcy court confirmed Detroit's final plan of adjustment, including the DIA settlement. It concluded that the DIA settlement was fair and in the best interest of the creditors, because Detroit could not, would not, and should not sell the DIA. First, the court found that Detroit could not sell the DIA art, listing the arguments advanced by the DIA corporation and the Michigan Attorney General, but not identifying a specific basis for its finding. Second, the court found that Detroit would not sell the DIA art, and that it lacked the authority to force Detroit to sell the DIA art. Third, the court found that Detroit should not sell the DIA art, because the DIA was necessary to Detroit's economic recovery.

The court's finding that Detroit could not sell the DIA art was incorrect on the facts and the law. Detroit owned most or all of the DIA art outright, not subject to the public trust, a charitable trust, or gift restrictions. Nothing prevented Detroit from selling some or all of the DIA art. Indeed, not only did the court implicitly acknowledge that Detroit could sell works of art from the DIA collection in order to purchase other works of art, but also the DIA settlement literally amounted to the sale of the DIA art to the DIA corporation.

However, the court correctly found that the DIA settlement was fair and in the best interests of the creditors. Because creditors had not relied on the DIA art as collateral, the court could not force Detroit to sell the DIA art, and Detroit reasonably believed that preserving the DIA collection was necessary to its economic recovery. Accordingly, the DIA settlement

and Detroit's final plan of adjustment provided the largest recovery that the creditors could reasonably expect under the circumstances, and was better than the only alternative, which was rejection of the plan of adjustment.

Detroit correctly decided to sell the DIA art to the DIA corporation in order to ensure that it could satisfy its obligations to its pensioners. But professional standards prevent most art museums from making the same decision. That is wrong. The Detroit bankruptcy and the DIA settlement support the conclusion that art museums should be permitted, and even required, to sell works of art when necessary to continue operations.

I. MUNICIPAL BANKRUPTCY UNDER CHAPTER 9 OF THE BANKRUPTCY CODE

Chapter 9 of the Bankruptcy Code allows "municipalities" to file for bankruptcy under certain circumstances.[1] Congress first enacted municipal bankruptcy legislation in 1934, but the Supreme Court held that the 1934 Act was unconstitutional because it exceeded the authority granted to Congress by the Bankruptcy Clause by violating state sovereignty as guaranteed by the Tenth Amendment.[2] Congress enacted revised municipal bankruptcy legislation in 1937, and the Supreme Court held that the 1937 Act was constitutional because it required the consent of the state and the majority of the creditors.[3] And in 1942, the Supreme Court held that states could compel unwilling creditors to join a plan of adjustment of municipal debts.[4]

While Chapter 9 has existed for quite some time, municipal bankruptcies are relatively rare. Fewer than 700 municipalities have filed bankruptcy petitions under Chapter 9 since it was enacted in 1937. By comparison, in 2016 alone there were 523,394 bankruptcy petitions filed under Chapter 7, 7,380 bankruptcy petitions filed under Chapter 11, and 302,193 bankruptcy petitions filed under Chapter 13.[5] Moreover, the overwhelming majority of municipalities that have filed for bankruptcy under Chapter 9 are special tax districts, municipal utilities, and small towns that have not issued public debt. As a consequence, much of the law governing municipal bankruptcy is sparse and undeveloped.[6]

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* 11 U.S.C. §§ 901-46 (2012).

2. Pub. L. No. 251, 48 Stat. 798 (1934); *See* Ashton v. Cameron Cty. Water Improvement Dist., 298 U.S. 513 (1936).

3. Pub. L. No. 302, 50 Stat. 653 (1937); United States v. Bekins, 304 U.S. 27 (1938). *Bekins* is generally understood to have overruled *Ashton* sub rosa, insofar as *Ashton* held that a state could not consent to federal infringement of its sovereignty under the Bankruptcy Clause, and *Bekins* held that it could. *Id.* at 41-43.

4. *See* Faitoute Iron & Steel Co. v. Asbury Park, 316 U.S. 502 (1942).

5. *See* Report F-5A, U.S. Bankruptcy Court (Mar. 31, 2016), http://www.uscourts.gov/statistics/table/f-5a/bankruptcy-filings/2016/03/31.

6. *See generally* Clayton P. Gillette, *Fiscal Federalism, Political Will, and Strategic Use of Municipal Bankruptcy*, 79 U. CHI. L. REV. 281 (2012).

A. Eligibility for Bankruptcy Protection Under Chapter 9

Under the Bankruptcy Code, only a "municipality" can file for bankruptcy under Chapter 9.[7] The Bankruptcy Act defines a "municipality" quite broadly as a "political subdivision or public agency or instrumentality of a State."[8] As a result, the entities eligible to file for bankruptcy under Chapter 9 include cities, counties, townships, school districts, and public improvement districts, as well as fee-based public entities like bridge authorities, highway authorities, and gas authorities. While only municipalities can file for bankruptcies under Chapter 9, municipalities cannot file for bankruptcy under any other chapter of the Bankruptcy Code.[9]

A municipality is eligible to file a bankruptcy petition under Chapter 9 only if: (1) it is authorized by the state to file for bankruptcy; (2) it is insolvent; (3) it wants to adjust its debts; and (4) it has either negotiated a plan to adjust its debts or cannot negotiate such a plan.[10] These eligibility requirements can complicate municipal bankruptcy filings, and can prevent some municipalities from filing for bankruptcy.

First, a municipality is eligible to file for bankruptcy only if it "is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a

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7. *See* 11 U.S.C. § 109(c)(1) (2012) ("An entity may be a debtor under chapter 9 of this title if and only if such entity . . . is a municipality").

8. 11 U.S.C. § 101(40) (2012).

9. 11 U.S.C. § 101(41) (2012) ("The term 'person' includes individual, partnership, and corporation, but does not include governmental unit.").

10. 11 U.S.C. § 109(c) (2012) provides:

> An entity may be a debtor under chapter 9 of this title if and only if such entity—
>
> (1) is a municipality;
>
> (2) is specifically authorized, in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter;
>
> (3) is insolvent;
>
> (4) desires to effect a plan to adjust such debts; and
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> (5) (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;
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> (B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter;
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> (C) is unable to negotiate with creditors because such negotiation is impracticable; or
>
> (D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title.

debtor under such chapter."[11] Fifteen states have authorized municipalities to file for bankruptcy on their own initiative.[12] Most states, including Michigan, require municipalities to obtain explicit authorization to file for bankruptcy.[13] Only Georgia prohibits municipalities from filing for bankruptcy.[14]

Second, a municipality is eligible to file for bankruptcy only if it is "insolvent."[15] Under the Bankruptcy Act, a private debtor is "insolvent" and eligible to file for bankruptcy if its debts exceed its assets.[16] By contrast, a municipal debtor is "insolvent" only if it is: (1) "generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute" or (2) "unable to pay its debts as they become due."[17] Effectively, a municipality is "insolvent" and eligible to file for bankruptcy under Chapter 9 only if it cannot raise taxes or borrow in order to pay its debts.[18] As a consequence, only the most financially distressed municipalities are eligible to file for bankruptcy.

Third, a municipality is eligible for bankruptcy only if it "desires to effect a plan to adjust such debts."[19] In other words, unlike private debtors, municipalities must choose to file for bankruptcy, and cannot be forced into bankruptcy.

And finally, a municipality is eligible for bankruptcy only if it:

> (A) has obtained the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter . . . ;
>
> (B) has negotiated in good faith with creditors and has failed to obtain the agreement of creditors holding at least a majority in amount of the claims of each class that such entity intends to impair under a plan in a case under such chapter . . . ;

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11. 11 U.S.C. § 109(c)(2) (2012).

12. Those states are Alabama, Arizona, Arkansas, California, Idaho, Kentucky, Minnesota, Missouri, Montana, Nebraska, New York, Oklahoma, South Carolina, Texas and Washington. John Gramlich, *Municipal Bankruptcy Explained: What it Means to File for Chapter 9*, The Pew Charitable Trusts, November 22, 2011, http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2011/11/22/municipal-bankruptcy-explained-what-it-means-to-file-for-chapter-9.

13. *See* Mich. Comp. Laws § 141.1558 (2012).

14. *See* Ga. Code Ann. § 36-80-5 (2010).

15. 11 U.S.C. § 109(c)(3) (2016).

16. 11 U.S.C. § 101(32)(A) and (B) (2016).

17. 11 U.S.C. § 101(32)(C) (2016).

18. *Se,e e.g.*, *In re* City of Bridgeport, 129 B.R. 332 (Bankr. D. Conn. 1991).

19. *See* 11 U.S.C. § 109(c)(4) (2016) and 11 U.S.C. § 303(a) (2016) ("An involuntary case may be commenced only under chapter 7 or 11 of this title, and only against a person, except a farmer, family farmer, or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which such case is commenced.").

> (C) is unable to negotiate with creditors because such negotiation is impracticable; or
>
> (D) reasonably believes that a creditor may attempt to obtain a transfer that is avoidable under section 547 of this title. . . .[20]

Essentially, in order to file for bankruptcy, a municipality must show that it has negotiated a plan of adjustment with the majority of its creditors, has tried and failed to negotiate a plan of adjustment, effectively cannot negotiate a plan of adjustment, or reasonably believes that a plan of adjustment will prevent inequitable treatment of its creditors.

B. The Authority of the Bankruptcy Court Under Chapter 9

The authority of a bankruptcy court hearing a municipal bankruptcy action under Chapter 9 is considerably more limited than under other chapters of the Bankruptcy Act. Under other chapters of the Bankruptcy Act, the bankruptcy court can make certain financial decisions on behalf of the debtor during bankruptcy proceedings and can force the debtor to liquidate or accept a plan of reorganization.[21] By contrast, under Chapter 9, the bankruptcy court cannot make financial decisions on behalf of the municipal debtor and cannot force a municipal debtor to accept a plan of adjustment.[22]

As a consequence, the formal powers of a bankruptcy court hearing a municipal bankruptcy action under Chapter 9 are essentially limited to: (1) determining whether the municipality is eligible to file for bankruptcy; (2) overseeing the handling of executory contracts, including collective bargaining agreements; and (3) approving or denying the municipality's proposed plan of adjustment.[23] But the court's formal powers enable it to exert considerable informal power over the bankruptcy action. The primary source of the court's informal power derives from its formal power to approve or deny the municipality's proposed plan of adjustment. As a consequence, the court can exert informal power over the municipality by threatening to deny the plan of adjustment, and can exert informal power over the creditors by threatening to approve the plan of adjustment. In practice, this informal power ideally enables the court to mediate disputes among the municipality and its creditors and to help them reach a settlement.

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20. *See* 11 U.S.C. § 109(c)(5) (2016).

21. *See* 11 U.S.C. § 303 (2016) (Involuntary cases); 11 U.S.C. §§ 361-66 (Administrative Powers).

22. 11 U.S.C. § 303 (2016) (Involuntary cases); 11 U.S.C. § 904 (Limitation on jurisdiction and powers of court).

23. 11 U.S.C. §§ 901-46 (2012).

C. The Rights of the Creditors Under Chapter 9

The rights of the creditors in a municipal bankruptcy action under Chapter 9 are also considerably more limited than under other chapters of the Bankruptcy Act. Under other chapters of the Bankruptcy Act, creditors may commence an involuntary bankruptcy action and may file a plan of reorganization.[24] By contrast, under Chapter 9, creditors of a municipal debtor cannot commence an involuntary bankruptcy action and cannot file a plan of reorganization.[25]

Chapter 9 protects creditors in several different ways. First, it adopts the Chapter 11 requirement that at least one class of impaired creditors must accept the plan.[26] And second, it adopts the Chapter 11 treatment of secured creditors, providing that they are entitled to receive at least the value of the property securing their claims.[27] Under Chapter 9, this ensures that creditors with claims secured by particular revenue streams are entitled to the value of those revenue streams. These provisions are intended to ensure that at least some impaired creditors have received fair treatment under the plan of adjustment, and that the municipality cannot collude with junior creditors to the detriment of senior creditors.[28]

But Chapter 9 protects creditors primarily by requiring that the court determine that "the plan is in the best interests of creditors and is feasible."[29] Courts have typically held that a plan of adjustment is "in the best interest of creditors" if it provides creditors with the best recovery that they can reasonably expect under the circumstances, and that it is "feasible" if the municipal debtor can actually execute the plan.[30] As a consequence, the court should approve a proposed plan of adjustment only if it provides a reasonable recovery to all of the creditors, depending on their respective circumstances, and the municipality can actually provide the recovery that it promises in the plan.

This provision enables a bankruptcy court to exert pressure on both the municipality and the creditors to reach a settlement. The court can

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24. See 11 U.S.C. § 303 (2016) (Involuntary cases); 11 U.S.C. §§ 361-66 (Administrative Powers); 11 U.S.C. § 1121 (2000) (Who may file a plan).

25. 11 U.S.C. § 303 (2016) (Involuntary cases); 11 U.S.C. § 904 (Limitation on jurisdiction and powers of court); 11 U.S.C. § 941 (2012) (Filing of plan).

26. 11 U.S.C. § 901(a) (incorporating 11 U.S.C. § 1129(a)(10) (2000)).

27. 11 U.S.C. § 901(a) (incorporating 11 U.S.C. § 506 (2012)).

28. *But see* Stephen J. Lubben, The Overstated Absolute Priority Rule (Mar. 20, 2015) (unpublished manuscript) (on file with author) (arguing that there is not, cannot, and should not be an "absolute priority rule" in bankruptcy).

29. 11 U.S.C. § 943(b)(7) (2012). *See also* Matthew Bruckner, *The Virtue in Bankruptcy*, 45 LOY. U. CHI. L.J. 233, 236 & nn.10-12 (2013).

30. *See, e.g.*, *In re* Corcoran Hosp. Dist., 233 B.R. 449, 454 (Bankr. E.D. Cal. 1999) (finding plan of adjustment "in the best interests of creditors" because obtaining additional tax revenue to support a hospital district was not possible) and Kane v. Johns-Manville Corp., 843 F.2d 636, 649 (2d Cir. 1988).

exert pressure on the municipality by threatening not to confirm its proposed plan of adjustment, and can exert pressure on the creditors by threatening to confirm the municipality's proposed plan of adjustment. But in practice, the court has more leverage over the creditors than the municipality, because it can force the creditors to accept a plan, but cannot force the municipality to adopt a plan. And the social benefits of approving a plan that provides a suboptimal recovery to the creditors typically exceed the social costs. As a consequence, while a bankruptcy court could theoretically refuse to approve a plan of adjustment that provided a suboptimal recovery to the creditors, in practice it provides an incentive for the court to approve a reasonable plan of adjustment, and enables municipal debtors to obtain bankruptcy protection on more favorable terms than non-municipal debtors.[31] Moreover, the court must consider whether a plan that provides a suboptimal return to the creditors still provides a better return than the creditors could expect in case the plan was rejected.

II. THE DETROIT BANKRUPTCY

In April 2012, after decades of gradual economic decline, the City of Detroit faced an acute financial crisis, precipitated by former Mayor Kwame Kilpatrick's decision to issue $1.4 billion in risky and possibly illegal pension obligation certificates-of-participation and corresponding interest rate swaps, which were secured by Detroit's casino tax revenue. Mayor David Bing and the City Council entered a consent agreement with the State of Michigan to implement certain reforms in exchange for financial assistance. When Detroit missed several deadlines and failed to meet certain benchmarks, the State of Michigan appointed an independent financial review team. On February 19, 2013, the financial review team released its report, which found that Detroit faced a financial emergency it had "no satisfactory plan" to address.[32]

Based on the report, Michigan took control of Detroit's finances. On March 14, 2013, Michigan Governor Rick Snyder declared a financial emergency. On March 15, 2013, the Local Emergency Financial Assistance Loan Board appointed Kevyn Orr the Emergency Financial Manager of the City of Detroit, pursuant to Public Act 72 of 1990 of the State of Michigan, also known as the Local Government Fiscal Responsibility Act, and Orr took office on March 25, 2013.[33] On March 28, 2013, Public Act 72 was repealed by referendum, but it was quickly replaced by Public Act 436, which restored Orr's authority.[34]

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31. In theory, this benefit is offset by the burden of obtaining permission to file for bankruptcy and the more stringent standard for showing insolvency under Chapter 9.

32. DETROIT FINANCIAL REVIEW TEAM, REPORT OF THE DETROIT FINANCIAL REVIEW TEAM (Feb. 19, 2013).

33. MICH. COMP. LAWS §§ 141.1201-141.1291 (repealed 2013).

34. MICH. COMP. LAWS §§ 141.1542(e), 141.1571 (2013).

A. The Bankruptcy Court's Initial Decisions

On July 16, 2013, Orr recommended that Detroit file for municipal bankruptcy under Chapter 9 of the Bankruptcy Code. And on July 18, 2013, Governor Snyder authorized Detroit to file for bankruptcy, satisfying the first condition for a municipal bankruptcy action under Chapter 9, that a municipality be "specifically authorized" by the state to file for bankruptcy.[35] Detroit immediately filed a Voluntary Petition for the City of Detroit, Michigan, commencing a municipal bankruptcy action. At that point, Detroit had about $20 billion in outstanding debt, making its bankruptcy filing the largest municipal bankruptcy filing to date.

Unsurprisingly, the bankruptcy court found that Detroit was "insolvent" and therefore qualified to be a debtor under Chapter 9 of the Bankruptcy Code, as its debts far exceeded its revenue and raising additional revenue was impossible.[36] On August 2, 2013, the bankruptcy court required Detroit to file a plan of adjustment on or before March 1, 2014.[37] Between February 21, 2014 and August 20, 2014, Detroit filed seven proposed plans of adjustment.[38] And on May 12, 2014, Detroit began soliciting formal acceptance of its final plan of adjustment by its various classes of creditors. Ultimately, the overwhelming majority of Detroit's creditors accepted the plan, including most of its impaired creditors.

Detroit's most substantial creditors were:

- UBS and Bank of America Merrill Lynch, which owned the secured interest rate swaps;
- The City's pensioners, who were entitled to pension and medical benefits; and
- Syncora and Financial Guaranty Insurance Company ("FGIC"), which owned hundreds of millions of dollars of unsecured debt.

First, UBS and Bank of America Merrill Lynch settled with the Detroit for a fraction of the value of their secured claims, after the

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35. 11 U.S.C. § 109(c)(2) (2016).

36. *See In re* City of Detroit, 504 B.R. 97, 190-91 (Bankr. E.D. Mich. 2013).

37. First Order Establishing Dates and Deadlines, In re City of Detroit (Bankr. E.D. Mich. Aug. 2, 2013) (No. 13-53846), ECF No. 700.

38. Plan for the Adjustment of Debts of the City of Detroit, *In re* City of Detroit, 504 B.R. 97 (Feb. 21, 2014); Amended Plan for the Adjustment of Debts of the City of Detroit, *In re* City of Detroit, 504 B.R. 97 (Mar. 31, 2014); Second Amended Plan for the Adjustment of Debts of the City of Detroit, *In re* City of Detroit, 504 B.R. 97, (Apr.16, 2014); Third Amended Plan for the Adjustment of Debts of the City of Detroit, *In re* City of Detroit, 504 B.R. 97 (Apr. 25, 2014); Fourth Amended Plan for the Adjustment of Debts of the City of Detroit, *In re* City of Detroit, 504 B.R. 97 (May 5, 2014;) Corrected Fifth Amended Plan for the Adjustment of Debts of the City of Detroit, *In re* City of Detroit, 504 B.R. 97 (July 29, 2014); and Sixth Amended Plan for the Adjustment of Debts of the City of Detroit, *In re* City of Detroit, 504 B.R. 97 (Aug. 20, 2014).

bankruptcy court repeatedly rejected Detroit's proposed settlements on the ground that claims were based on debt that may have been illegally issued. Then, the pensioners settled with Detroit, after the DIA settlement enabled Detroit to offer them almost all of their pension benefits, and a small percentage of their medical benefits. And finally, Syncora and FGIC settled with Detroit when they realized that the bankruptcy court would approve the final plan of adjustment with or without their consent. Ultimately, only a few creditors objected to Detroit's final plan of adjustment.[39]

B. The DIA Settlement

The key to the resolution of the Detroit bankruptcy was the DIA settlement, which enabled Detroit to obtain the consent of its pensioners. Initially, when Detroit realized that it owned the DIA art and that the DIA art was worth billions of dollars, it considered selling the DIA art, in order to satisfy its creditors. The DIA corporation vigorously opposed any sales, arguing that Detroit could not sell the DIA art, because it owned the DIA art subject to the public trust, a charitable trust, and various gift restrictions specific to particular works of art. And on June 13, 2013, the Attorney General of Michigan issued an opinion stating that Detroit could not sell the DIA art, because it owned the DIA art subject to a charitable trust.[40] Essentially, the Attorney General opined that the Detroit Museum of Art ("DMA") was formed as a charitable trust, that it conveyed its collection to Detroit subject to a charitable trust, and that Detroit therefore owned the DIA art subject to a charitable trust.[41]

But Detroit's principal creditors disagreed. Detroit's pensioners wanted to recover the full value of their pensions, even if it meant selling the DIA art. And Syncora and FGIC made common cause with the pensioners, realizing that the DIA art was the most valuable asset owned by Detroit. The DIA corporation was appalled by the prospect of Detroit selling any of the DIA art in order to pay its creditors, as were other art museums, professional organizations of art museums and museum directors, and charitable foundations affiliated with art museums. But Detroit's pensioners and creditors did not care, and considered the DIA art an asset like any other.

In order to resolve the dispute, Detroit and the DIA corporation entered into mediation, supervised by Judge Gerald Rosen. The primary purpose of the mediation was to reach an agreement between Detroit and the DIA corporation that would enable Detroit to form a settlement

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39. *See generally* NATHAN BOMEY, DETROIT RESURRECTED: TO BANKRUPTCY AND BACK (2016).

40. Conveyance or Transfer of Detroit Institute of Arts Collection, Op. Att'y Gen. No. 7272, *available at* http://www.ag.state.mi.us/opinion/datafiles/2010s/op10351.htm.

41. *Id.*

agreement with its pensioners. Judge Rosen observed that while Detroit's aggregate obligation to its pensioners was enormous, the individual claims were relatively modest. As a result, any reduction of the pension claims would impose serious hardships on individual pensioners.

Judge Rosen's solution was to ask the DIA corporation and a congeries of charitable foundations to effectively purchase the DIA art from Detroit for a fraction of its market value, but a sum sufficient to satisfy Detroit's pensioners. The settlement negotiated by Judge Rosen provided that the City would transfer the DIA art to the DIA corporation, in exchange for contributions of $816 million over twenty years from the DIA corporation and other charities and the State of Michigan. Specifically, it provided that:

- The DIA would secure and guarantee commitments for contributions to the General Retirement System and the Police and Fire Retirement System of $100 million over 20 years.
- Various local and national charitable foundations, including the Ford, Kresge, and Knight foundations would contribute $366 million to the General Retirement System and Police and Fire Retirement System over 20 years.
- The State of Michigan would contribute $350 million to the General Retirement System and Police and Fire Retirement System over 20 years.
- The City would transfer the art to the DIA Corp., which will hold the art in a perpetual charitable trust for the benefit of the people of the City and the State.[42]

The DIA settlement negotiated by Judge Rosen became known as the "Grand Bargain" because it enabled Detroit to satisfy both the DIA corporation and its pensioners. Under the DIA settlement, the DIA corporation acquired all of the DIA art, in exchange for enough money to enable Detroit to pay its pensioners almost the full value of their claims. As a result, the DIA settlement enabled Detroit to both preserve the DIA collection in Detroit and settle with its pensioners, who might have been able to present confirmation of Detroit's plan of adjustment if they were sufficiently dissatisfied with Detroit's offer. However, Detroit was not obligated to agree to the DIA settlement, and could have refused to sell the DIA art or sold the DIA art on the open market.

III. A BRIEF HISTORY OF THE DETROIT INSTITUTE OF ART

The historical record shows that the city owned most or all of the DIA art outright, not subject to the public trust, a private charitable trust, or gift restrictions. The public trust doctrine is irrelevant, as it does not and

42. Oral Opinion on the Record, *In re* City of Detroit (Bankr. E.D. Mich. Nov. 7, 2014) (No. 13-53846).

should not apply to works of art. Detroit did not own the DIA art subject to a charitable trust, as it purchased some of the DIA art from a charitable corporation via an unconditional bill of sale, purchased some of the DIA art with its own funds, and received some of the DIA art via unconditional gifts. While Detroit received a few of the works of art in the DIA collection subject to limited gift restrictions, it owned the overwhelming majority of the DIA art outright. Moreover, Detroit repeatedly and explicitly rejected efforts to impose trust and gift restrictions on its ownership of the DIA art.

A. The Creation of the Detroit Museum of Art

In 1881, James E. Scripps, the publisher of *The Detroit News*, embarked on a five-month European tour. When he returned, *The Detroit News* published a series of columns in which Scripps described the art and culture of Italy, France, Germany, and the Netherlands. The columns were popular, so Scripps revised and republished them as a book in 1882.[43] In 1883, William H. Brearley, the manager of *The Detroit News* advertising department, organized an art exhibit inspired by Scripps's book, which was also popular.

Based on the success of the book and exhibit, Scripps and Brearley decided to establish an art museum. Scripps pledged to contribute $50,000 to the museum, and asked forty prominent Detroit businessmen to contribute at least $1,000 each.

On February 16, 1885, the Michigan Legislature passed "An act for the formation of corporations for the cultivation of art."[44] The 1885 Act authorized the formation of private, nonprofit corporations for the purpose of collecting and exhibiting works of art, with certain conditions:

> Such corporations shall have power to acquire and hold such real estate as is suitable for the site of such art buildings as it may erect or maintain thereon, to receive and use such gifts, contributions, devises, and bequests as may be made to it for art purposes; to receive, acquire, collect, and own paintings, sculpture, engravings, drawings, pictures, coins, and other works of art and to institute, maintain, or assist schools for the teaching of art.
>
> The public exhibition of its collection of works of art shall be the duty of every such corporation, and, as soon as it shall be prepared to do so, it shall, under reasonable regulations, and without any improper discriminations, open its building and art collections to the general public.
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43. JAMES E. SCRIPPS, FIVE MONTHS ABROAD, OR, THE OBSERVATIONS AND EXPERIENCES OF AN EDITOR IN EUROPE (1882).

44. 1885 Mich. Pub. Acts 3.

> All gifts, devises, or bequests made to any such corporation, and all its income, shall be faithfully used for the purposes for which the corporation was organized; and no dividend in money or property shall ever be made by such corporation among its members.
>
> The character and purposes of such corporation shall not be changed, nor its general art collection be sold, incumbered, or disposed of, unless authorized by the legislature of this state upon the concurrent request of said corporation, and of the mayor and board of aldermen of the city in which it is situated. But if any such corporation should ever cease, be diverted from the lawful purposes of its organization, or become unable usefully to serve such purposes, the legislature may by law provide for the winding up of its affairs and for the conservation and disposition of the property in such way as may best promote and perpetuate, in the city where it is situated, the purposes for which such corporation was originally organized.[45]

On April 16, 1885, the DMA was incorporated under the 1885 Act by 40 members, each of whom contributed at least $1000. Among other things, its articles of incorporation provided:

> Said corporation is formed for the objects and purposes contemplated by the act above mentioned, to wit, for the founding of a public art institute in the City of Detroit, which may acquire and hold such real estate as may be suitable for the site of such art buildings as it may erect or maintain thereon; receive and use such gifts, contributions, devises and bequests, as may be made it for art purposes; receive, acquire, collect and own paintings, sculpture, engravings, drawings, pictures, coins and other works of art, and may institute, maintain or assist schools for the teaching of art, and may do all other things authorized by said act, and have and enjoy all the privileges and franchises given thereby.[46]
>
> . . .
>
> The affairs of said corporation shall be managed by a board of trustees, the number of which shall be regulated by by-law, but in no case shall the number be less than four, nor more than sixteen. Three-fourths of said trustees shall be elected by the members of the corporation, from their own number. The other one-fourth of such trustees shall be appointed from resident free-holders, by the board of aldermen of the city where such corporation is situated, upon the nomination of the mayor.[47]

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45. 1885 Mich. Pub. Acts 3, §§ 3-4, 15-16.
46. Articles of Incorporation of the Detroit Museum of Art (1885).
47. *Id.*

The DMA purchased a plot of land at 704 E. Jefferson Avenue, and built an art museum in the Richardsonian style, which opened to the public on September 1, 1888. The founding collection of the DMA consisted of more than 70 works of art donated by Scripps.

Initially, the DMA was privately funded.[48] In 1893, the City of Detroit began providing funds from its contingent account to the DMA, in exchange for the museum not charging an admission fee. In 1899, the Michigan Legislature amended the charter of the City of Detroit, empowering the Detroit Common Council to appropriate up to $20,000 per year for the DMA, and the Common Council exercised that power.[49] In 1903, the Michigan Legislature again amended the charter of the City of Detroit, empowering the Common Council to issue bonds to finance the construction of a new building for the DMA.[50] In 1904, the Common Council authorized a $50,000 bond issue to help finance the construction of a new building for the DMA, which was approved by the Board of Estimates, and sustained by the Wayne County Circuit Court.[51] The DMA used the money to build a lecture hall and classrooms.

In November 1914, the DMA considered embarking on a significant construction project, but was concerned that it might not be eligible to receive public funding. On November 27, 1914, the DMA Board of Directors decided to determine whether the DMA was legally eligible to receive public funding. In 1915, the Board of Directors asked the Controller of the City of Detroit to withhold funds payable to the DMA, and filed an action to compel payment. Ultimately, the Supreme Court of Michigan held that the act authorizing the Common Council to issue bonds to finance the construction of a building for the DMA violated the Michigan Constitution, which provided that "The credit of the state shall not be granted to, nor in aid of any person, association or corporation, public or private."[52]

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48. REPORT OF THE PRESIDENT, DETROIT MUSEUM OF ART REPORT FOR THE FISCAL YEAR JULY 1ST, 1917 TO JUNE 30, 1918 (1918).

49. Loc. Acts 1899, No. 429.

50. Loc. Acts 1903, No. 489, § 66 ("The common council shall also have power to appropriate from time to time such sums as is necessary for the purpose of erecting an additional building or buildings for the Detroit Museum of Art, which sums shall be paid from the general fund. The common council shall also have power, with the approval of the board of estimates, for the purpose of erecting such additional building or buildings for said museum of art to borrow upon the best terms it can make and for such time as it shall deem expedient, such sums of money as it shall deem necessary, not exceeding the sum of fifty thousand dollars, and shall have authority to issue bonds pledging the faith and credit of said city for the payment of the principal and interest of said bonds, which bonds shall be denominated 'Detroit Museum of Art Bonds,' of the city of Detroit and shall bear interest not exceeding four per cent. per annum.").

51. *See* Detroit Museum of Art v. Engel, 153 N.W. 700, 701 (Mich. 1915).

52. MICH. CONST. art. 10, § 12.

In 1916, the City devised a method of providing public funds to the DMA that did not violate the constitutional prohibition on direct appropriations. The City of Detroit Recreation Commission hired the DMA to operate the museum without charging admission, in exchange for $40,000 per year.[53] However, the DMA soon found itself in financial distress. On January 11, 1918, the DMA resolved to close its art school for lack of funds.[54]

B. The Creation of the Detroit Institute of Art

On June 25, 1918, the City of Detroit created an Arts Commission, consisting of four members, which was empowered to, *inter alia*, "build, operate and maintain suitable buildings to be used for the exhibition of paintings and works of art and auditorium purposes, to be known as the Detroit Institute of Arts, and to which, under proper rules and regulations, the public may have access free of charge"; "acquire, collect, own and exhibit, in the name of the city, works of art, books, and other objects such as are usually incorporated in Museums of Art"; "with the approval of the common council, in the name of the city, take and hold, by purchase, gift, devise, bequest or otherwise, such real and personal property as may be proper for carrying out the intents and purposes for which it is established"; and "with the approval of the council, sell and convey or lease any of the buildings or land under its control, whenever required by the interests of the city."[55]

In January 1919, the City appointed the initial members of the Arts Commission.[56] On January 27, 1919, the Arts Commission submitted its first proposed budget to the Detroit Common Council.[57] In March 1919, the Common Council approved an initial appropriation of $85,000, and in May 1919, it approved a final appropriation of $79,000, with $20,000 earmarked for the purchase of artwork.[58] The Arts Commission began to consider purchasing artwork in April 1919, and made its first recorded purchase on June 2, 1919, when it approved the purchase of two bronze sculptures for $1,800.[59] Later that year, the Arts Commission also

53. ANNUAL REPORT, DMA BULLETIN, at 9 (1916); DMA Minutes, Apr. 29, 1916.

54. DMA Minutes, Jan. 11, 1918.

55. CITY CHARTER, title IV, ch. XIX, §§ 1, 7 (June 25, 1918).

56. REPORT OF THE ARTS COMM'N (1919); DIA BULLETIN, (Jan. 1920).

57. Minutes of the Arts Comm'n of the City of Detroit, Mich., Jan. 27, 1919.

58. Minutes of the Arts Comm'n of the City of Detroit, Mich., Mar. 3, 1919; Minutes of the Arts Comm'n of the City of Detroit, Mich., May 12, 1919.

59. Minutes of the Arts Comm'n of the City of Detroit, Mich., Apr. 29, 1919 (considering the purchase of a rug collection); Minutes of the Arts Comm'n of the City of Detroit, Mich., June 2, 1919.

purchased six oil paintings, four etchings, three carved wood panels, and 44 textiles for the DIA collection.[60]

On December 6, 1918, the members of the DMA authorized the trustees to convey its property, including its building and art collection, to the City.[61] And on February 18, 1919, the trustees authorized the President and Treasurer "to execute and deliver to the City of Detroit a Deed of Conveyance of said real estate, the deed to be in such form and with such conditions as should to them appear sufficient to insure the use of said property for the purpose for which the Detroit Museum of Art was incorporated, or for some purpose kindred to such purpose."[62]

The President and Treasurer prepared a draft deed "which contained a provision for the reversion of the title to the Detroit Museum of Art upon the happening of either of the following conditions: (a) If the city should at any time use or permit the use of said premises, or any part thereof, for any other purpose than the one contemplated by Charter 19, Title 4, (IV), relating to an Arts Commission of the present charter of the City of Detroit; (b) If the city should fail within a given number of years to erect and complete on said premises a building costing a lot less than an agreed sum, suitable for the housing and exhibition of art, or (c) If the city should at any time fail to provide for and continue the proper care, maintenance and exhibition of the art collection then or thereafter belonging to the City of Detroit."[63]

The President and Treasurer presented the draft deed to a committee of the Detroit Common Council, which was "of the opinion that no Deed would be accepted except one without conditions."[64]

On June 28, 1918, the President of the DMA observed in his report to the members that the City of Detroit had appropriated $40,000 for the DMA for 1918, with the expectation that the DMA would convey its building and artwork to the City. "Consistent with this financial encouragement, the city in its new charter has provided for an arts commission, contemplating that you will convey the property and trusts you hold to the city, as the basis for the Detroit Institute of Arts, as the new institution is to be named. At a date to be set for the early fall you will probably be called together for the special purpose of acting upon the question of conveyance to the city, at which time your trustees will make such recommendations as may appear to them best."[65]

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60. REPORT OF THE ARTS COMM'N (1919); DIA BULLETIN, (Jan. 1920).

61. DMA Minutes, Jan. 27, 1920.

62. *Id.*

63. *Id.*

64. *Id.*

65. REPORT OF THE PRESIDENT (June 28, 1918); DETROIT MUSEUM OF ART, ANNUAL REPORT FOR THE YEAR 1918.

On April 15, 1919, the State of Michigan enacted Public Act 67, which amended the 1885 Act to provide:

> Any of the real estate of a corporation organized under this act may be used for any purpose which the circuit court in chancery, of the county in which said corporation is situated determines to be a purpose kindred to that for which the corporation is organized.
>
> Any corporation organized under this act situated in a city empowered to maintain a public art institute like or similar to that described in this act, may convey all or any of its property to said city upon such terms, in such manner and at such time or times as may be agreed upon by its trustees and the legislative body of said city; and said property so conveyed shall in the hands of said city be faithfully used for the purposes for which such corporation was organized: *Provided, however,* That any real estate so conveyed may be used for a kindred purpose as provided in section nineteen of this act. Said trustees are hereby empowered, in the event of their conveying to the city all of the property of said corporation, to wind up its affairs by taking appropriate proceedings in the circuit court in chancery, above mentioned.[66]

On June 27, 1919, the President of the DMA informed the members of developments in the plan to transfer the DMA's building and collection to the City of Detroit, noting that the City had rejected the DMA's proposed conditions on the transfer:

> Beginning with the first of July, the Arts Commission of the City of Detroit takes in charge the city funds for the carrying out of its purposes and the building we now occupy has been placed in the hands of the Arts Commission by the city for its uses. Carrying out your intention, as expressed at our last meeting called for the purpose, steps have been taken looking to the conveyance of our property and collections to the City of Detroit with due regard for the trust we hold and of the obligations attached thereto. The state legislature has amended the act under which we incorporated which will become part of the law within the next 60 days, under which it becomes proper for us to much such conveyance to the municipality. Under such conveyance the property can only be used for such purposes as we have received it or for some kindred purpose so indicated by the Circuit Court. Final action on this matter cannot be taken at this meeting, but inasmuch as we shall be without funds for maintenance otherwise, your President suggests that if it appears to you to be in order, that a resolution be passed indicating the intention to make conveyance when the law permits and in the meantime to ask the Arts Commission to accept the responsibility of the operation and maintenance of the museum for us at the expense of the city. In considering the all-important move of conveyance to the city,

66. 1919 Mich. Pub. Acts 67, §§ 19-20 (1919).

> permit me to mention at this time that during the past year your officers have given particular attention to the value that might be set upon our collections, real estate and other property, with the result that we believe that the collections may be conservatively valued at a million dollars and the new museum site on Woodward Avenue at over one million dollars. Our invested endowments amount to $20,000. Cash on hand available for purchases is $9,460.95. You have authorized your Board of Trustees to act upon this matter in accordance with their judgment, but opportunity for discussion will be given at this meeting. It was expected to make conveyance of the real estate at once as the required change in the law covered only the transfer of our collections. It was thought reasonable and in conformity with our obligation to ask the city to accept a deed to the real estate with a clause therein providing that the property should revert to this corporation if the city did not with a reasonable number of years erect thereon a suitable Museum building and properly maintain the collections later to be conveyed to it. This received the concurrence of Mr. Wm. C. Weber, in whose name some of our property stands. The form of deed was presented for consideration by the city council but the council expressed a unanimous opinion that it would be inexpedient to accept such a transfer with any reversionary clause or any other definitely expressed obligation. If you should convey the real estate and the collections to the city in conformity with the amended legislation it should be noted that the property can be used only for such purposes as this permits, and further the conveyance would be made to the Arts Commission, who would hold the property in behalf of the city for its uses in accord with the provision of the city charter and the immediate intention of the city is definitely expressed in the appropriation for the ensuing year of $79,000.00 to cover maintenance and upkeep of the Detroit Institute of Arts, purchases for art collections and the sum of $3,000.00 to assist in the development of plans for a new museum building, which may clearly be taken as an earnest of intention.[67]

The members of the DMA adopted a resolution authorizing the trustees "to execute and deliver a Deed of the real and personal property of the Association," without conditions.[68] On June 30, 1919, the DMA informed the City that it could no longer operate the museum, and offered to transfer its collection to the City.[69] On July 1, 1919, the City accepted the collection and assumed the maintenance and operation costs of the museum pending formal conveyance.[70]

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67. REPORT OF THE PRESIDENT (June 27, 1919); DETROIT MUSEUM OF ART ANNUAL REPORT FOR THE YEAR 1919, at 11-12.

68. DMA Minutes, Jan. 27, 1920.

69. *See* Letter from DMA to Arts Comm'n, June 30, 1919.

70. *See* Letter from Arts Comm'n to DMA, July 1, 1919.

On September 12, 1919, the trustees authorized the President and Treasurer to make the conveyance to the City.[71] And in November 1919, the President and Treasurer "executed and delivered a Warranty Deed of the real estate and a Bill of Sale of the collection of Art, both running to the city of Detroit."[72] They delivered the deed and bill of sale to the Arts Commission, which presented them to the Common Council for approval. The Common Council accepted both and approved them by resolution over the Mayor's veto.[73] On December 16, 1919, the Common Council authorized the Controller to pay $35,863.22 for the DMA's property.[74] And on December 29, the transaction was completed.[75]

In 1920, the officers of the DMA made the following observation:

> You will recall that Act #67 of the Public Acts of the State of Michigan, approved April 15, 1919, under which authority was granted for the conveyance by Art Associations to the municipality of their property, contained a provision that the property so conveyed should in the hands of the city be faithfully used for the purpose for which the particular corporation was organized. In the Deed to the City of Detroit it was expressly recited that the conveyance was executed and delivered under and in pursuance of said act. This fact, together with the fact that the Deed was delivered to the Arts Commission, seemed to us sufficiently to give assurance that the property cannot be used excepting for the same purposes as were provided for in the incorporation of the Detroit Museum of Art, or some kindred purpose, as provided in the Act of the Legislature referred to.[76]

Notably, the DMA did not dissolve, but rather adopted the following resolution:

> WHEREAS all of the property and collections of the Detroit Museum of Art, with the exceptions of its invested trust funds, have been conveyed and transferred to the City of Detroit to be administered by the newly created Arts Commission of the City of Detroit, and
>
> WHEREAS it is believed that the following enumerated objects can be obtained by the continuance of present corporation, i.e.
>
> a - To promote public interest in and appreciation of art in Detroit
>
> b - To co-operate in every way with the Detroit Institute of Arts, and to augment its collections from membership funds and contributions

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71. DMA Minutes, Jan. 27, 1920.

72. *Id.*

73. DMA Minutes, Jan. 27, 1920 (It is unclear why the Mayor vetoed the decision of the Common Council).

74. REPORT OF CONTROLLER (Dec. 16, 1919).

75. Arts Comm'n Minutes, Dec. 29, 1919.

76. DMA Minutes, Jan. 27, 1920.

> c - To administer the funds and endowments now in the hands of the corporation and to encourage and receive in trust and to administer future gifts and legacies
>
> Now, therefore be it
>
> RESOLVED, that this corporation with its membership and funds be continued and also be it
>
> RESOLVED, that a committee of two be appointed by the President (himself acting as ex-officio member) for recommending of such changes and revisions as will best carry out the intentions herewith expressed.[77]

On February 20, 1920, the DMA informed its members that the corporation would continue to exist under a new name, the "Detroit Museum of Arts Founders' Society."[78] The purpose of the Founders' Society was to assist the DIA "in every way," and to use its endowment fund and other contributions in order to add to the DIA's collection.[79]

In January 1920, the Arts Commission requested an additional appropriation of funds from the City to purchase artwork, on the ground that it was a capital investment, not an expense.

> Because of their precious quality, art objects of suitable character for a public collection require a large capital outlay. This appropriation, however, is not an expense. The accessions purchased with it are a continuing asset which constantly fulfills a sphere of usefulness in the lives of the people, and at the same time these objects increase in intrinsic worth each year.[80]

The City agreed and provided an additional appropriation of $50,000, which the Arts Commission used to purchase 27 paintings, 15 sculptures, 50 etchings, 15 woodcuts, and 36 other works.[81] Throughout the 1920s, the Arts Commission added many works to the DIA collection, including purchases, gifts, and bequests. The City also began construction of a new DIA building on Woodward Avenue. And, in 1927, the DIA moved from its original building on Jefferson Avenue to its current home on Woodward Avenue.

In the 1930s, the Common Council reduced the Arts Commission's appropriation, forcing it to lay off the DIA's curatorial staff and consider closing the DIA.[82] However, the Mayor vetoed the Common Council's

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77. DMA Minutes, Jan. 27, 1920.
78. DMA Minutes, Feb. 20, 1920.
79. 1920 DMA REPORT.
80. REPORT OF THE ARTS COMM'N, 1919; DIA Bulletin, Jan., 1920.
81. REPORT OF THE ARTS COMM'N (1920).
82. Letter from the Arts Comm'n to the Common Council, Jan. 1, 1932.

action and increased the Arts Commission's appropriation, enabling it to keep the DIA open.[83]

On January 29, 1962, the Detroit Museum of Arts Founders' Society changed its name to "Founders Society Detroit Institute of Arts."[84] In 1962, the trustees of the DIA hired a new director, Willis Woods, who secured public and private funding to expand the building. In 1966, the DIA opened its South Wing, and in 1971, it opened its North Wing. Woods also expanded the DIA's collection, primarily through large bequests. City funding for the DIA also increased between 1964 and 1974, from $630,000 to $2,240,000.

However, in 1974, the City drastically reduced the DIA's appropriation, cutting $786,000 to $1,792,000. The DIA Director chose to terminate the museum guards, forcing the DIA to temporarily close to the public.[85] While the DIA attempted to pursue state funding, city funding continued to decrease. In 1976, the City decreased the DIA appropriation from $1,792,000 to $47,000. Luckily, state funding offset the decrease in City funding, and the DIA's budget remained stable. In 1977, the DIA's budget increased to $1,800,000, in addition to a $1,000,000 art acquisition budget.

On September 30, 1992, the Founders Society Detroit Institute of Arts changed its name to "The Detroit Institute of Arts Founders Society."[86] And on October 11, 2000, it changed its name to "The Detroit Institute of Arts."[87]

In the 1990s and 2000s state appropriations for the DIA gradually began to decrease. And in 2010, the State reduced its DIA appropriation to a token $20,000. In response to this financial crisis, the DIA laid off 20% of its employees, and began a lobbying campaign to secure a tax millage to fund the DIA. On August 7, 2010, Oakland County, Macomb County, and Wayne County voted to approve the tax millage, which provides about $23 million in annual funding for the DIA, in exchange for the DIA providing free admission to the residents of those counties.

IV. THE BANKRUPTCY COURT'S OPINIONS

On November 7, 2014, the bankruptcy court issued an oral opinion confirming the City of Detroit's plan of adjustment, and approving the settlements incorporated into that plan of adjustment, including the DIA

83. Arts Comm'n Public Statement, 1932.
84. *See* Certificate of Amendment to the Articles of Incorporation, filed Jan. 29, 1962.
85. Arts Comm'n Minutes, Jun. 6, 1975.
86. Certificate of Assumed Name, filed Sept. 30, 1992.
87. Certificate of Amendment to the Articles of Incorporation, Oct. 11, 2000.

settlement.[88] And on December 31, 2014, the bankruptcy court issued a written opinion expanding on its written opinion.[89]

A. The Bankruptcy Court's Oral Opinion

On November 7, 2014, the bankruptcy court issued an oral opinion confirming the City of Detroit's plan of adjustment, and approving the settlements incorporated into that plan of adjustment, concluding that they were "reasonable, fair and equitable."[90] Specifically, the bankruptcy court found that the DIA settlement was both fair and in the best interest of the creditors.

1. Fairness to the Creditors

In its oral opinion, the bankruptcy court concluded that the DIA settlement was fair to the creditors because the City held the DIA art subject to both a trust and specific transfer restrictions that prohibited its sale. The court also observed that litigation would be lengthy and costly, and that any attempt to sell the DIA might result in a cancellation of the millage taxes that provided the majority of the DIA budget:

> Addressing the fairness of the settlement, the Court will first examine the relative strengths of the parties' positions. Both the Michigan Attorney General and the DIA itself take the position that the DIA art is subject to a trust that prohibits the City from selling it to pay debts and places it beyond the creditors' reach. The DIA also asserts that the donors of many of the pieces of art had imposed specific transfer restrictions on them.
>
> The evidence supports these assertions. The Court was especially impressed with the testimony of Ms. Erickson on these points, and with the historical documentary evidence that the DIA cited in its brief and that was admitted in evidence.
>
> The evidence further establishes that nationally accepted standards for museums prohibit the de-acquisition of art to pay debt. The creditors also admitted, perhaps grudgingly, that no creditor had ever considered the value of the art as a possible source of repayment when it decided to lend money to the City or to acquire City debt.
>
> On the other hand, the creditors did submit substantial evidence and legal grounds supporting the contrary view that the City can legally sell or monetize the DIA art.

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88. Oral Opinion on the Record, *In re* City of Detroit (Bankr. E.D. Mich. 2014) (No. 13-53846).

89. *In re* City of Detroit, 524 B.R. 147 (Bankr. E.D. Mich. 2014).

90. Oral Opinion on the Record, *In re* City of Detroit (Bankr. E.D. Mich. 2014) (No. 13-53846).

> On balance, the Court concludes that in any potential litigation concerning the City's right to sell the DIA art, or concerning the creditors' right to access the art to satisfy its claims, the position of the Attorney General and the DIA almost certainly would prevail.
>
> However, evidence also established that any such result in litigation might well have taken years to achieve and would have been costly to pursue. It also would have been difficult for the City to endure the delay and expense while at the same time attempting to revitalize itself. The DIA and the attorney general state with credibility that they would vigorously contest any attempt to sell any art. Credible evidence also establishes that an attempt by the City to sell its art might result in a cancellation of the county millage taxes that support the DIA's operations and constitute almost 70% of the DIA's budget.
>
> The Court concludes that the DIA settlement was a most reasonable and favorable settlement for the City and its pension creditors. The Court readily approves it. Accordingly, the Court approves all aspects of the grand bargain.[91]

Essentially, the bankruptcy court held that the DIA settlement was fair because Detroit could not sell the DIA art, which it owned subject to an unspecified "trust," as well as gift restrictions specific to particular works of art. The court also recognized that "nationally accepted standards for museums prohibit the de-acquisition of art to pay debt," but did not explicitly rely on those rules in reaching its conclusion. And the court noted that the creditors had not relied on the DIA as collateral. Finally the court observed that litigating Detroit's right to sell the DIA art would be costly and potentially harmful to the DIA.

2. The Best Interests of the Creditors

The bankruptcy court also held that the DIA settlement was in the best interests of the creditors, primarily because Detroit refused to sell the DIA art:

> Section 943(b)(7) requires that the plan be in the best interests of creditors. The cases generally hold that in chapter 9, this means that the creditors will receive all that they can reasonably expect under the circumstances. The only legal alternative to plan confirmation is dismissal, because no other party can file a plan of adjustment and the liquidation of a municipality's assets is not permitted in chapter 9. Accordingly, the Court will also consider whether the plan is a better alternative for creditors than dismissal.

91. *Id.* at 12-13.

> Under the plain language of section 943(b)(7), the issue is the best interests of creditors as a whole, not any particular creditor or class of creditors.
>
> The Court finds that the plan is in the best interests of creditors.
>
> Some creditors have argued that the City could pay more to creditors by raising taxes and by monetizing assets, specifically the art at the DIA.
>
> No provision of law allows the creditors to access the DIA art to satisfy their claims, whether in bankruptcy or outside of bankruptcy. The market value of the art, therefore, is irrelevant in this case. A judgment creditor's sole remedy is a court-ordered property tax assessment process under Michigan's Revised Judicature Act. Michigan law prohibits execution on municipal property.
>
> Some creditors argue that the best interest test in chapter 9 requires this Court's full consideration of all of the City's assets, including the art, even if the assets would not be accessible to unsecured creditors outside of bankruptcy.
>
> The Court also rejects the argument. The legal limitations on the collection of judgments that apply outside of bankruptcy also constrain the best interests of creditors test in bankruptcy. Neither the bankruptcy code nor the case law suggests otherwise.
>
> As noted, the City determined not to sell or monetize the DIA art in the art market. Under section 904, that decision is off-limits to this Court.[92]

Essentially, the court found that confirmation of the plan was in the best interests of the creditors, because the only alternative was dismissal of the plan, which would be worse for the creditors than confirmation. The creditors asked the court to refuse to confirm the plan unless Detroit agreed to sell some or all of the DIA art. The court effectively responded that Detroit had refused to sell any of the DIA art, that the court could not force Detroit to sell the DIA art, and that the DIA art was therefore not available to the creditors as a remedy for their claims. In other words, the court found that the DIA settlement was in the best interests of the creditors because it was the best deal they could get.

But the court also observed that the continued existence of the DIA was important to the future and economic recovery of Detroit:

> However, even if the law did give the Court some authority here, the Court would not have interfered with the City's decision. The City made the only appropriate decision. Maintaining the art at the DIA is critical to the feasibility of the City's plan of adjustment and to the City's future. The Court toured parts of the DIA and saw the art there, as well as how its many visitors were experiencing the art. It also

92. *Id.* at 22-23

> accepts the testimony of Ms. Erickson on the priceless value that the DIA and the art creates for the City, the region and the state.
>
> The evidence unequivocally establishes that the DIA stands at the center of the City as an invaluable beacon of culture, education for both children and adults, personal journey, creative outlet, family experience, worldwide visitor attraction, civic pride and energy, neighborhood and community cohesion, regional cooperation, social service, and economic development. Every great City in the world actively pursues these values. They are the values that Detroit must pursue to uplift, inspire and enrich its residents and its visitors. They are also the values that Detroit must pursue to compete in the national and global economy to attract new residents, visitors and businesses. To sell the DIA art would only deepen Detroit's fiscal, economic and social problems. To sell the DIA art would be to forfeit Detroit's future. The City made the right decision.
>
> The City also rejected the concept of using the art as a collateral for a loan to pay creditors, for two reasons. First, that proposal would just substitute debt for debt and would not help the City. Second, if the City defaulted, it might lose the art. The City made the right decision here too.
>
> Beyond that, the record reflects that the City has made reasonable efforts to monetize other assets, including the Detroit Windsor Tunnel, certain real estate properties, certain parking properties, the Joe Louis arena property and certain other property that it no longer needs. It also entered into the Great Lakes Water Authority memorandum of understanding with Wayne, Oakland and Macomb Counties, which benefits all creditors. The Court finds that the City has made reasonable efforts to monetize its assets to satisfy the best interests of creditors test.
>
> The evidence also establishes that raising taxes is not a viable option for the City. In the eligibility opinion, the Court found that the City cannot legally increase its tax rates. Mayor Duggan testified that the likelihood of the people of Detroit or the state legislature voting to raise taxes is remote.
>
> Further, a property tax increase would produce very little additional revenue. The Mayor testified that taxes in Detroit are among the highest relative to surrounding communities and the city services are comparatively low. Kevyn Orr credibly testified that the City is at tax saturation and raising taxes would likely add to the population decline.
>
> The evidence also establishes that the plan is a better, indeed much better, alternative for creditors than dismissal. Significant City obligations would become immediately due. As mentioned earlier, in that scenario, the creditors' only remedy is the property tax assessment remedy under the Revised Judicature Act. It is easy to foresee that a great number of creditors would race for that relief and the result would

> be chaos and an administrative nightmare for all involved. The City's reinvestment and revitalization initiatives would stall. The pension UAAL and OPEB claims in the billions of dollars would go unresolved.
>
> There is no more money available for creditors in the City's already tight budget projections. The Court's feasibility expert so testified, as the Court will review here shortly. Every dollar is accounted for in providing necessary services, in implementing the City's necessary RRIs, and in repaying plan obligations. All of those cash uses are essential to the City's future.
>
> Accordingly, the Court finds that the plan will provide creditors all that they can reasonably expect under the circumstances and that it is in their best interests.[93]

In other words, the court recognized that the purpose of municipal bankruptcy is not liquidation but reorganization. Municipal bankruptcy is intended to enable a distressed municipal debtor to discharge its debts and resume operations, while providing a reasonable and fairly distributed recovery to its creditors. As a consequence, municipal bankruptcy does not require a city to liquidate municipal assets that are necessary to the future viability of the municipality, and the court took an expansive view of such assets to include the DIA.

B. The Bankruptcy Court's Written Opinion

On December 31, 2014, the bankruptcy court issued a written opinion confirming the City of Detroit's plan of adjustment.[94] In its written opinion, the court affirmed its holding that the DIA settlement was fair and in the best interests of the creditors. The written opinion also expanded on the oral opinion, primarily by providing additional reasoning.

1. Fairness to the Creditors

In its written opinion, the bankruptcy court reiterated and expanded upon its holding that the DIA settlement was fair because Detroit could not and should not sell the DIA art. The court recognized the Michigan Attorney General's and the DIA corporation's claims that "all of the art at the DIA is held in charitable trust for the benefit of the people of the State and so it cannot be sold to pay the City's debts."[95] The court also recognized the DIA corporation's claim that "the donors of many of the pieces of art imposed specific transfer restrictions on them."[96] The court recognized that "the Attorney General, the DIA itself and even many of its individual donors would vigorously challenge any attempt by the City to

93. *Id.* at 23-25.
94. *In re* City of Detroit, 524 B.R. 147 (Bankr. E.D. Mich. 2014).
95. *Id.* at 177.
96. *Id.*

sell any of the art."[97] And the court observed that "[a]ny sale could result in the cancellation of the tri-county millage taxes that support almost 70% of the DIA's operating budget."[98]

The court found that the DIA "presented credible historical documentary evidence in support of its position that the City holds the art in trust."[99] The court identified three bases for the DIA's argument that Detroit held the DIA art in trust.

First, the court observed that "Public Act 67 of 1919, which provided for the transfer of the DIA real property and its art from the Detroit Museum of Art (the predecessor to the DIA) to the City, required that the 'property so conveyed shall in the hands of said city be faithfully used for the purposes for which the [Detroit Museum of Art] was organized.'"[100] And the court recognized that the trustees of the DMA "believed the restrictions in PA 67 of 1919 'give assurance that the property cannot be used excepting for the same purposes as were provided for in the incorporation of the Detroit Museum of Art.'"[101]

Second, the court observed that the May 15, 1984 Operating Agreement between Detroit and the Founders Society "state that the City 'has maintained and operated the DIA for over 60 years for the benefit of the citizens of the City and the State of Michigan'" and that "the City would use state-allocated funds solely for the DIA, which was consistent with 'the goal of continuing to benefit the citizens of the City and the State by preserving for their enjoyment the treasures of the DIA[.]'"[102]

Third, the court observed that "the DIA's current Collection Management Policy states that 'the [DIA] must be ever aware of its role as trustee of the collection for the benefit of the public'" and that "the façade of the DIA itself, built by the City in 1927, states that it is 'Dedicated by the People of Detroit to the Knowledge and Enjoyment of Art.'"[103]

The court concluded that these historical facts provided "strong evidence that the DIA was founded for the benefit of the residents of the City and the State, that the City believed that this was the case when the City received title to the art in 1919, and that the City has treated the DIA as a public trust for over one hundred years."[104]

The court also observed that "nationally accepted standards for museums prohibit the de-acquisition of art to pay debt."[105] Specifically, the

97. *Id.*
98. *Id.*
99. *Id.*
100. *In re City of Detroit*, 524 B.R. at 177.
101. *Id.*
102. *Id.* at 178.
103. *Id.*
104. *Id.*
105. *Id.*

court recognized that the standards of the Association of Art Museum Directors (the "AAMD") only permit museums to sell works of art in order to purchase new works of art, and prohibit museums from selling works of art for any other purpose, including to pay operating expenses, which would include city debt. As a consequence, the court recognized that "if the City sold any of its art to pay its debts, the national and international art community would refuse to do business with the DIA."[106]

Finally, the court observed that selling some or all of the DIA art could "flood the art market" and lower prices. "Consequently, there is no guaranty that the City would achieve the high returns that many creditors asserted."[107]

The court acknowledged that "the creditors did submit substantial evidence and legal grounds to support the contrary view that the City can legally sell or monetize the DIA art."[108] Specifically, the court observed that "the current DIA Operating Agreement states that '[t]he City shall retain title to and ownership of the (a) City art collection and (b) the DIA properties.'"[109]

But the court concluded that "in any potential litigation concerning the City's right to sell the DIA art, or concerning the creditors' right to access the art to satisfy their claims, the position of the Attorney General and the DIA would almost certainly prevail."[110] Notably, the court did not explain why it reached that conclusion. But it also observed that "any such litigation would take years to conclude and would be costly to pursue" and that "[i]t . . . would be difficult for the City to endure that delay and expense while at the same time attempting to revitalize itself."[111]

2. The Best Interests of the Creditors

The court also concluded that the DIA settlement was in the best interests of the creditors under Section 943(b)(7) of the Bankruptcy Act, because it provided "'a better alternative for creditors than what they already have.'"[112] The court observed that under Chapter 9, the only options are confirmation or dismissal of the municipality's plan of adjustment, so the question is "whether the available state law remedies could result in a greater recovery for the City's creditors than confirmation of the plan."[113] The court concluded that they could not, and "that losing

106. *In re City of Detroit*, 524 B.R. at 178.
107. *Id.*
108. *Id.*
109. *Id.* (emphasis omitted).
110. *Id.* at 179.
111. *Id.*
112. *In re City of Detroit*, 524 B.R. at 213 (quoting *In re* Pierce Cty. Hous. Auth., 414 B.R. 702, 718 (Bankr. W.D. Wash. 2009)).
113. *Id.*

the benefits of the plan will actually impair creditors' recoveries under these state law remedies."[114]

Specifically, the court held that the DIA settlement was in the best interests of the creditors because "no provision of law allows the creditors to access City assets, most importantly including the DIA art, to satisfy their claims. The market value of the City's assets, including its art is, therefore, irrelevant in this case."[115] Certain creditors argued that the court should consider the market value of Detroit's assets in determining whether the plan was in the best interests of the creditors. But the court disagreed, concluding that "[t]he legal limitations on the collection of judgments that apply outside of bankruptcy also constrain the best interests of creditors test in bankruptcy."[116] As the court explained, "the City determined not to sell or monetize the DIA art in the art market. Under § 904, that decision is off-limits to the Court."[117]

The court further observed that even if Detroit could sell the DIA art, it should not do so.

> However, even if the law did give the Court some authority here, the Court would not have interfered with the City's decision. The City made the only appropriate decision. Maintaining the art at the DIA is critical to the feasibility of the City's plan and to the City's future. . . . To sell the DIA art would only deepen Detroit's fiscal, economic and social problems. To sell the DIA art would be to forfeit Detroit's future. The City made the right decision.[118]

Ultimately, the court concluded that the DIA settlement and the plan of adjustment as a whole were in the best interests of the creditors because they provided the creditors with as much as they could reasonably expect to receive. "The Court finds that the City has made reasonable efforts to monetize its assets to satisfy the best interests of creditors test."[119]

V. ANALYSIS OF THE BANKRUPTCY COURT'S OPINIONS

The bankruptcy court's oral and written opinions with respect to the DIA settlement were broadly similar. In both, the bankruptcy court found that the DIA settlement was fair to the creditors because Detroit could not sell the DIA art, and found that the DIA settlement was in the best interests of the creditors because Detroit would not and should not sell the DIA art. The primary difference between the two is that the written opinion elaborated on the court's reasons for concluding that Detroit could not sell

114. *Id.*
115. *Id.* at 218.
116. *Id.*
117. *Id.*
118. *In re City of Detroit*, 524 B.R. at 218.
119. *Id.* at 219.

the DIA art, and that Detroit's unwillingness to sell the DIA art was both dispositive and correct.

However, the court's conclusions as to why the DIA settlement was both fair to the creditors and in the best interests of the creditors are mutually contradictory. If Detroit could not sell the DIA art, its refusal to sell the DIA art was irrelevant to the best interests of the creditors. So why did the court rely on Detroit's refusal to sell the DIA art to conclude that the DIA settlement was in the best interests of the creditors?

The inescapable answer is that the court's stated conclusion that Detroit could not sell the DIA art was incorrect, and the court surely knew that it was incorrect. Detroit owned the DIA art outright, not subject to the "public trust" or a charitable trust, and few if any of the works of art in the DIA collection were affected by private gift restrictions. Moreover, not only could Detroit sell the DIA art, it did in fact sell the DIA art. The DIA settlement itself specifically provided that Detroit would sell the DIA art to the DIA corporation, in exchange for contributions of $816 million over twenty years from the DIA corporation and other charitable foundations and the State of Michigan.

However, the court's conclusion that the DIA settlement was fair to the creditors was still correct, even though Detroit could sell the DIA art, because the court could not force the City to sell the DIA art, and the creditors were not entitled to collect on the DIA art. Accordingly, the DIA settlement was fair, not only because the plan of adjustment fairly distributed Detroit's available assets among its different classes of creditors, but also because the DIA settlement actually resulted in Detroit selling the DIA art and distributing the assets generated by the sale to the creditors. While Detroit was not obligated to sell the DIA art, it chose to do so anyway, resulting in a plan of confirmation that was arguably more generous to the creditors than they were entitled. As a consequence, the DIA settlement was clearly in the best interests of the creditors, as it increased the amount of their recovery. Moreover, the DIA settlement was instrumental in convincing Detroit's pensioners, its most politically potent and vulnerable class of creditors, to consent to the final plan of adjustment.

A. Fairness to the Creditors

In both its oral opinion and its written opinion, the bankruptcy court concluded that the DIA settlement was fair to the creditors because the City could not sell the DIA art. While the court did not specify why it concluded that the City could not sell the DIA art, it recognized three possible reasons: 1) the City owned the DIA subject to the "public trust" or a charitable trust; 2) professional rules governing museums prohibit them from deaccessioning works in order to pay debt; and 3) the sale of the DIA art would not generate as much revenue as projected. On examination, none of these are convincing.

1. The City Did Not Own the DIA Art Subject to the "Public Trust" or a Charitable Trust

First, the bankruptcy court observed that the Michigan Attorney General and the DIA argued that the City owned the DIA art subject to the "public trust" or a charitable. The law supports neither of these claims. The City did not and could not own the DIA subject to the "public trust" because the "public trust" doctrine only applies to natural resources like navigable waters and parks, and does not apply to chattel property like works of art.

a. The "Public Trust" Doctrine

The "public trust" doctrine grew out of Roman and English law, both of which provided that certain rights to use navigable waters were irrevocably dedicated to the public, and could not be alienated by the sovereign, with certain qualifications.[120] United States law incorporated the public trust doctrine, providing that the federal and state governments held the navigable waters of the United States "in trusteeship" for the public.[121] As Joseph Sax explained in his history of the "public trust" doctrine, "American law courts held it 'inconceivable' that any person should claim a private property interest in the navigable waters of the United States."[122]

However, under United States law, the public trust doctrine does not prohibit all conveyances of navigable waters, only those which are inconsistent with the government's obligation to exercise its police powers.[123] Accordingly, under the "public trust" doctrine, a person can claim a private property interest in a section of the shoreline, but cannot claim a private property interest in the majority of the waterfront of the City of Chicago.[124] The former may be consistent with the public interest, but the latter cannot.

Eventually, United States courts arguably extended the public trust doctrine to include certain lands dedicated to public use as parks, in a limited fashion.[125] While some scholars have argued that the public trust doctrine should be interpreted expansively to include any property owned by a public or charitable entity, it currently applies only to real property dedicated to a public use. No state has applied the public trust doctrine to

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120. *See generally* Joseph L. Sax, *The Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention*, 68 MICH. L. REV. 471 (1970); *see also* Carol M. Rose, *Joseph Sax and the Idea of the Public Trust*, 25 ECOL. L.Q. 351 (1998).

121. *See* Shively v. Bowlby, 152 U.S. 1 (1894).

122. Sax, *supra* note 121, at 484.

123. *See* Illinois Central R.R. Co. v. Illinois, 146 U.S. 387 (1892).

124. *See id.*

125. *See* Sax, *supra* note 121, at 556.

chattel property, and more specifically, no state has applied the public trust doctrine to works of art.

And quite rightly. The purpose of the public trust doctrine is to protect the sovereign authority of government bodies by prohibiting them from conveying private property rights that would prevent them from exercising their sovereign authority.[126] The sale of chattel property does not and cannot prevent a government body from exercising its sovereign authority. While it is perfectly reasonable to argue that a government body should not sell works of art, it is nonsensical to argue that selling works of art would prevent a government body from exercising its sovereign authority. In fact, the opposite could easily be the case. For example, under the DIA settlement, Detroit sold the DIA art in order to enable itself to exercise its sovereign authority and satisfy the legitimate demands of its pensioners.

b. The DIA Art & the "Public Trust"

While the DIA corporation argued that the City owned the DIA art subject to the "public trust," its argument on that point was desultory at best. The DIA correctly observed that the "public trust" doctrine provides that "governmental entities have a duty to preserve and protect resources held in trust for the public" and that Michigan recognizes the doctrine.[127] But it conceded that no Michigan court has ever found that the "public trust" doctrine applies to "cultural property" like a museum collection, and merely argued that the court should extend the doctrine and apply it to museums.[128]

The Michigan Attorney General also grudgingly conceded that the "public trust" doctrine only applies to natural resources, and does not apply to museum collections. "The term 'public trust' as used by museums and their associations should not be equated with the 'public trust doctrine' that Michigan and other courts have applied to navigable waterways."[129]

In sum, the claim that the City owned the DIA art subject to the "public trust" was entirely unfounded and not taken seriously by the parties or the court. Moreover, it makes no sense to apply the "public trust"

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126. *But see, e.g.*, Jennifer Anglim Kreder, *The "Public Trust"*, 18 U. PA. J. CON. L. (forthcoming 2016) (arguing that the "public trust" doctrine should be construed in light of the term "public Trust" in the No Religious Test clause of Art. VI of the Constitution, and may prevent museums from selling art works under certain circumstances).

127. *See Illinois Central R.R. Co.*, 146 U.S. at 452; *see also* Glass v. Goeckel, 703 N.W.2d 58, 65 (Mich. 2005).

128. Response of the Detroit Institute of Arts to Objections to the City's Amended Plan of Confirmation at 19, *In re* City of Detroit, Mich., 524 B.R. 147 (Bankr. E.D. Mich. 2014).

129. Conveyance or Transfer of DIA Collection, Mich. Op. Att'y Gen. No. 7272, at 10 n.8 (2013) (citing Glass v. Goeckel, 703 N.W.2d 58 (Mich. 2005); Netweg v. Wallace, 208 N.W. 51 (Mich. 1926); State v. Venice of America Land Co., 125 N.W. 770 (Mich. 1910)), *available at* http://media.mlive.com/news/detroit_impact/other/AGO%207272.pdf.

doctrine to chattel property like works of art. As Donn Zaretsky has trenchantly observed, "it is not at all inconceivable that any person should claim a private property in [works of art]. It is in fact quite conceivable: *most* works of art are privately owned."[130] Indeed, most art museums are nonprofit corporations that privately own works of art which they may freely sell. If anything, the DIA art was the exception to the rule, given that it actually was owned by a public entity, the City of Detroit. But it was owned by the City like any other chattel property, which the City could and did freely sell.

c. The DIA Art & Charitable Trust Law

The Attorney General and the DIA also argued that Detroit could not sell the DIA art because it owned the DIA art subject to a charitable trust. And the bankruptcy court apparently agreed, finding that the DIA "presented credible historical documentary evidence in support of its position that the City holds the art in trust."[131] But it was incorrect. The evidence presented by the Attorney General and the DIA corporation did not support a finding that Detroit owned the DIA art subject to a charitable trust.

First, the Attorney General and the DIA claimed that the 1885 Articles of Incorporation of the DMA established a charitable trust.[132] That is plainly incorrect. The DMA was formed as a charitable corporation, not a charitable trust.[133] Moreover, in 1885, Michigan law did not even recognize charitable trusts.[134] So if the DMA had been formed as a charitable trust, the trust would have been invalid. Notably, the bankruptcy court simply ignored this argument.

Second, the Attorney General and the DIA claimed that Public Act 67 of 1919, which authorized the DMA to transfer its assets to a "city empowered to maintain a public arts institute," either perpetuated or created a charitable trust obligating Detroit to "perpetuate and 'maintain a public art institute' that would exhibit art to the general public, and to

130. DONN ZARETSKY, *There's No Such Thing as the Public Trust, and It's a Good Thing, Too*, THE LEGAL GUIDE FOR MUSEUM PROFESSIONALS 151, 153 (Julia Courtney, ed. 2015).

131. *In re* City of Detroit, 524 B.R. 147, 177 (2014).

132. Conveyance or Transfer of DIA Collection, Mich. Op. Att'y Gen. No. 7272 at 18; Response of the Detroit Institute of Arts to Objections to the City's Amended Plan of Confirmation, May 27, 2014, at 13.

133. *See generally* Articles of Incorporation of the Detroit Museum of Art (1885).

134. *See, e.g.*, Chicago Bank of Commerce v. McPherson, 62 F.2d 393, 395 (6th Cir. 1932) ("For nearly a hundred years prior to 1907 charitable trusts were not recognized by the laws of Michigan."); *see also* Hopkins v. Crossley, 96 N.W. 499, 499–501 (Mich. 1903) (invalidating a nonprofit corporation's attempt to create a charitable trust).

'faithfully [. . .] use [. . .]' the art conveyed for that purpose.[135] The bankruptcy court apparently credited this claim, finding that Public Act 67 "required that the 'property so conveyed shall in the hands of said city be faithfully used for the purposes for which the [Detroit Museum of Art] was organized,'" and that the trustees of the DMA "believed the restrictions in PA 67 of 1919 'give assurance that the property cannot be used excepting for the same purposes as were provided for in the incorporation of the Detroit Museum of Art.'"[136]

These arguments are also incorrect. The terms under which the DMA transferred its assets to Detroit unequivocally show that no charitable trust was created, and that Detroit expressly rejected the DMA's efforts to create a charitable trust. The City created the Arts Commission and established the DIA before the DMA transferred its assets to the City.[137] The DMA initially offered to sell its assets to the City subject to the condition that title would revert to the DMA if, among other things, the City "did not suitably provide for the care and maintenance of the collections of the Detroit Museum of Art."[138] The City rejected the DMA's offer on the ground that it would only accept an unconditional transfer.[139] And on December 29, 1919, the City purchased the DMA's assets for $35,863.22, pursuant to a bill of sale and two deeds that included no conditions.

In other words, not only did the bill of sale and deeds not explicitly create a charitable trust, but also the City expressly refused to accept terms that might have created a charitable trust. While the City may have had a statutory obligation to use the assets transferred to it by the DMA for the purpose of operating an art museum, it did not own those assets subject to a charitable trust. And any wishful thinking to the contrary on the part of the trustees of the DMA is simply irrelevant.

Third, the Attorney General and the DIA claimed that the City recognized or created a charitable trust by representing that it held the DIA art in charitable trust for the people of Michigan.[140] The bankruptcy court also apparently credited this claim, observing that the May 15, 1984 Operating Agreement between the City and the Founders Society "states that the City 'has maintained and operated the DIA for over 60 years for the benefit of the citizens of the City and the State of Michigan'" and that

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135. Conveyance or Transfer of DIA Collection, Mich. Op. Att'y Gen. No. 7272, at 19; *See also* Response of the Detroit Institute of Arts to Objections to the City's Amended Plan of Confirmation, May 27, 2014, at 14.

136. *In re City of Detroit*, 524 B.R. at 177.

137. *See* Detroit City Charter (1918), Tit. III, Ch. XIX.

138. *See* DMA Minutes, Feb. 18, 1919.

139. *See* Arts Comm'n Minutes, June 2, 1919.

140. State of Michigan, Mich. Op. Att'y Gen. No. 7272, at 20-21, *available at* http://www.ag.state.mi.us/opinion/datafiles/2010s/op10351.htm; *see also* Response of the Detroit Institute of Arts to Objections to the City's Amended Plan of Confirmation, May 27, 2014, at 15-16.

"the City would use state-allocated funds solely for the DIA, which was consistent with 'the goal of continuing to benefit the citizens of the City and the State by preserving for their enjoyment the treasures of the DIA.'"[141] Further, the court observed that "the DIA's current Collection Management Policy states that 'the [DIA] must be ever aware of its role as trustee of the collection for the benefit of the public'" and that "the façade of the DIA itself, built by the City in 1927, states that it is 'Dedicated by the People of Detroit to the Knowledge and Enjoyment of Art.'"[142]

These arguments are even more clearly incorrect. None of these statements made by Detroit even colorably recognize or create a charitable trust. They are mere hortatory language, reflecting the City's commitment to benefit the people of Detroit and the State of Michigan. Notably, with a few rare exceptions, the City refused to accept donations to the DIA subject to any conditions. Not only did the City not recognize or create any charitable trusts, it affirmatively refused to accept donations that could be construed as creating charitable trusts. In fact, many of the works in the DIA collection were simply purchased by the City with City funds.

Notably, the bankruptcy court acknowledged that "the creditors did submit substantial evidence and legal grounds to support the contrary view that the City can legally sell or monetize the DIA art," and observed that "the current DIA Operating Agreement states that '[t]he City shall retain title to and ownership of the (a) City art collection and (b) the DIA properties.'"[143]

In sum, the bankruptcy court's suggestion that the City could not sell the DIA art because it owned the DIA subject to a charitable trust is clearly incorrect. The City owned the DIA art, and owned almost all of the DIA art subject to no restrictions. Accordingly, it could have sold most of the DIA art at its discretion.

Moreover, as a group of creditors observed, the DIA settlement itself expressly provided for the sale of the DIA to the DIA corporation.

> DIA Corp. and the Attorney General allege that the City is the trustee of a charitable trust encompassing the DIA Collection, held for the purposes set forth in the DMA's 1885 Articles of Incorporation, namely "the public exhibition of its collection of works of art." By their logic, if the DIA Collection is held in charitable trust for the benefit of the people of the State of Michigan, and the terms of such trust provide that artwork may only be sold or encumbered to buy additional pieces of artwork, then the City has no right to monetize the artwork to satisfy its

141. *In re City of Detroit*, 524 B.R. at 178.
142. *Id.*
143. *Id.*

> general municipal obligations (such as the repayment of its debts). This is precisely what the City is doing pursuant to the Grand Bargain.[144]

Likewise, Professor David Skeel recognized that the DIA settlement amounted to a sale of the DIA art to the private DIA corporation:

> The deal calls for Detroit to "sell" its art to a newly created trust that is required to keep the art in the city, using roughly $370 million raised from the Ford, Kresge, Knight and other foundations, $350 million from the state of Michigan (if the Republican legislature agrees) and the institute's own funds. Not only would the new entity keep the art in Detroit but also the entire $816 million would be used to pay Detroit's pensioners. The art world and Detroit's pensioners both win. It's almost like the deus ex machina solution to a Greek play.[145]

If the City owned the DIA art subject to a charitable trust, then the DIA settlement violated that charitable trust in precisely the same way that the sale of the DIA art on the open market would have violated that charitable trust. The bankruptcy court's conclusion that the City could not sell the DIA art because the City owned the DIA art subject to a charitable trust is unconvincing not only because the bankruptcy court failed to identify any plausible reason to believe that a charitable trust existed, but also because the bankruptcy court approved the DIA settlement, under which the City sold the DIA art to the DIA corporation. In other words, while the bankruptcy court found that the City could not sell the DIA art, by approving the DIA settlement, it actually held that the City could sell the DIA art.

In a recent article largely tracking and elaborating on the arguments made by the Michigan Attorney General and the DIA corporation, Steven W. Golden argues that Detroit owned the DIA art subject to a charitable trust and therefore could not sell the DIA art.[146] While Golden correctly argues that Detroit could have owned the DIA art subject to a charitable trust, and that Detroit could not sell the DIA art if it owned the DIA art subject to a charitable trust, he fails to show that Detroit actually owned the DIA art subject to a charitable trust. Indeed, he relies on precisely the same unconvincing claims made by the Michigan Attorney General and the DIA corporation. Not only did Detroit not expressly intend to create a charitable trust, it expressly rejected the DMA's efforts to create a charitable trust.

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144. Joint Pretrial Brief in Support of Objection to the DIA Settlement, *In re* City of Detroit, 504 B.R. 97 (Feb. 21, 2014).

145. David Skeel, *Detroit's clever and likely illegal art-for-pensions deal*, WASHINGTON POST, May 9, 2014, https://www.washingtonpost.com/opinions/detroits-clever-and-likely-illegal-art-for-pensions-deal/2014/05/09/e3f93e84-cf1e-11e3-a6b1-45c4dffb85a6_story.html?utm_term=.ad19647722f0.

146. *See generally*, Steven W. Golden, *In Art We Trust: The Intersection of Trust and Bankruptcy Law in Detroit*, 48 TEX. TECH L. REV. 313 (2016).

Moreover, Golden fails to address the fact that the under the DIA settlement, Detroit actually did sell the DIA art to the DIA corporation. Of course, Detroit sold the DIA art to the DIA corporation on the understanding that the DIA corporation would manage the DIA collection subject to the relevant professional standards (i.e. that it would sell works of art only in order to purchase works of art) and that the DIA corporation would remain in Detroit. But the DIA settlement still amounted to the sale of a public asset to a private entity, the DIA corporation.

2. Deaccessioning Standards Were Irrelevant and Indefensible

The bankruptcy court also observed that "nationally accepted standards for museums prohibit the de-acquisition of art to pay debt," and that "if the City sold any of its art to pay its debts, the national and international art community would refuse to do business with the DIA."[147] And the bankruptcy court was correct, as far as it goes.

The most important professional associations governing art museums are the American Alliance of Museums ("AAM") and the Association of Art Museum Directors ("AAMD"). Both the AAM and the AAMD have adopted policies governing "deaccessioning" or the de-acquisition of artworks. "Deaccessioning is defined as the process by which a work of art or other object (collectively, a 'work'), wholly or in part, is permanently removed from a museum's collection."[148] The AAM and AAMD deaccessioning policies both permit museums to sell artworks in their collections only to purchase additional artworks, prohibit museums from selling works of art in their collections for any other purpose, including to pay operating expenses.

The AAM Code of Ethics for Museums explicitly provides that the proceeds from deaccessioned works may only be used for acquisition or the care of the collection:

> The distinctive character of museum ethics derives from the ownership, care and use of objects, specimens, and living collections representing the world's natural and cultural common wealth. This stewardship of collections entails the highest public trust and carries with it the presumption of rightful ownership, permanence, care, documentation, accessibility and responsible disposal.
>
> Thus, the museum ensures that:
>
> . . .

147. *In re City of Detroit*, 524 B.R. at 178.

148. Association of Art Museum Directors Policy on Deaccessioning 2, June 9, 2010, *available at* https://aamd.org/sites/default/files/document/AAMD%20Policy%20on%20Deaccessioning%20website.pdf.

- disposal of collections through sale, trade or research activities is solely for the advancement of the museum's mission. Proceeds from the sale of nonliving collections are to be used consistent with the established standards of the museum's discipline, but in no event shall they be used for anything other than acquisition or direct care of collections."[149]

The AAMD Policy on Deaccessioning provides more specifically that proceeds from the sale of a deaccessioned artwork may only be used for acquisition, and explicitly provides that they may not be used for operations or capital expenses:

> I. Purpose of Deaccessioning and Disposal
>
> A. Deaccessioning is a legitimate part of the formation and care of collections and, if
>
> practiced, should be done in order to refine and improve the quality and
>
> appropriateness of the collections, the better to serve the museum's mission.
>
> B. Funds received from the disposal of a deaccessioned work shall not be used for
>
> operations or capital expenses. Such funds, including any earnings and
>
> appreciation thereon, may be used only for the acquisition of works in a manner
>
> consistent with the museum's policy on the use of restricted acquisition funds. In
>
> order to account properly for their use, AAMD recommends that such funds,
>
> including any earnings and appreciation, be tracked separate from other
>
> acquisition funds.[150]

The AAMD Policy on Deaccessioning also provides for imposing sanctions on member and nonmember museums that violate the policy:

> VIII. Sanctions
>
> In the event a member or museum violates one or more of the provisions of this Policy, the member may be subject to censure, suspension, and/or expulsion, and the museummay be subject to censure and/or sanctions in accordance with the relevant provisions of the Code of Ethics of the AAMD, which have been amended consistent with the
>
> following:

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149. American Alliance of Museums, Code of Ethics for Museums (2000), *available at* http://www.aam-us.org/resources/ethics-standards-and-best-practices/code-of-ethics.

150. Association of Art Museum Directors Policy on Deaccessioning, *supra* note 149, at 4-5.

> A museum director shall only dispose of accessioned works of art in accordance with the Professional Practices and the Task Force Report adopted by the members on June 9, 2010, as the same may be amended.
>
> The Code of Ethics provides that AAMD members who violate the Code may be subject to discipline by censure as determined by the Board of Trustees of the AAMD and/or, suspension and/or expulsion from the Association in accordance with the By-Laws of the AAMD.
>
> Infractions by any art museum may expose that institution to censure and/or sanctions, as determined by the Board of Trustees of the AAMD, that may, in the case of sanctions, include, without limitation, suspension of loans and shared exhibitions between the sanctioned museum and museums of which AAMD members are directors.[151]

The AAM and AAMD claim that museums may not deaccession works of art for any purpose other than the purchase of works of art because they own their collections subject to the "public trust."[152] For example, the The AAM Code of Ethics for Museums repeatedly invokes the "public trust":

> Thus, the museum ensures that:
>
> - collections in its custody support its mission and public trust responsibilities
>
> . . .
>
> - acquisition, disposal, and loan activities conform to its mission and public trust responsibilities
>
> . . .
>
> - collections-related activities promote the public good rather than individual financial gain[153]

Likewise, the AAMD Policy on Deaccessioning invokes the "interests of the public":

> Deaccession decisions must be made with great thoughtfulness, care, and prudence. Expressions of donor intent should always be respected in deaccession decisions and the interests of the public, for whose benefit collections are maintained, must always be foremost in making deaccession decisions.[154]

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151. *Id.* at 9-10.
152. ZARETSKY, *supra* note 131, at 151.
153. American Alliance of Museums Code of Ethics for Museums, *supra* note 150.
154. Association of Art Museum Directors Policy on Deaccessioning, *supra* note 149, at 3.

And opponents of deaccessioning for any purpose other than purchasing artwork have eagerly adopted this argument.[155] For example, the Michigan Attorney General and the DIA both argued, *inter alia*, that the City could not sell the DIA art because it owned the DIA art subject to the "public trust."[156]

However, the argument that art museums own the artworks in their collections subject to the "public trust" is obviously false and borders on ridiculous. As observed above, the "public trust" doctrine only applies to natural resources like navigable waters and parks, not chattel property like artworks.[157] But more damningly, if art museums owned works of art subject to the "public trust" then they could not sell them for any purpose, including the purchase of artwork. And that is simply not the case. In fact, charitable art museums can legally sell works of art from their collection for any purpose that is consistent with their charitable mission.[158] And non-charitable art museums can legally sell works of art from their collection for any reason or no reason, at their discretion.

Indeed, the AAM and AAMD positions on deaccessioning are simply incoherent. If art museums own the artworks in their collections subject to the "public trust," then they cannot sell those works for any reason, including the purchase of artworks. As Donn Zaretsky has repeatedly and amusingly observed, either art museums own the artworks in their collections subject to the "public trust," or they do not. The AAM and AAMD wish to have their cake and eat it too.

Of course, the AAM and AAMD, as well as other opponents of deaccessioning artwork for any purpose other than purchasing artwork, actually rely on "ethical" rather than legal arguments. In other words, while art museums can legally sell artworks from their collections for any reason, including operations and capital costs, they should not do so.

And yet, it is unclear why it is "ethical" to sell artworks in order to buy artworks, but "unethical" to sell artworks for other purposes. For example, under the AAM and AAMD guidelines, it is "unethical" for an art museum to sell a work of art in order to avoid bankruptcy. As a consequence, art museums facing financial crises have been forced to close, when the sale of a single artwork could have covered their expenses. Most recently, the Corcoran Museum of American Art found itself in precisely this situation, and we lost an American institution. Would it really have been "unethical" for the Corcoran to have sold an artwork in order to maintain its existence? Would it really be "unethical" for a

155. ZARETSKY, *supra* note 131, at 151.

156. *See supra* notes 132-48 and accompanying text.

157. *See supra* note 133 and accompanying text.

158. *See generally* Mark S. Gold, *Monetizing the Collection: The Intersection of Law, Ethics, and Trustee Prerogative*, *in* THE LEGAL GUIDE FOR MUSEUM PROFESSIONALS 127 (Julia Courtney, ed. 2015).

museum to sell an artwork from its collection in order to provide free admission? Would it really be "unethical" for a university art museum to sell an artwork in order to provide scholarships?

Indeed, a modicum of cynicism suggests an alternative reason that the AAM and AAMD rules might prohibit museums from selling artworks from their collections for any purpose other than purchasing artworks: supply and demand. Artwork is an asset, and the people who own artworks want to internalize the value of their assets. Art museums obtain artworks primarily by way of donations, for which the donor is entitled to a tax deduction based on the value of the work. And the value of artwork depends primarily on scarcity. If museums sold artworks from their collections for the purpose of raising cash, they would be competing with their benefactors. The AAM and AAMD prohibitions on museums selling artwork for any purpose other than purchasing artwork means that donating an artwork to a museum effectively preserves scarcity. And museums selling artwork in order to buy artwork is tolerated by donors because it is effectively a wash. While it reduces scarcity of one artist's work, it increases scarcity of another.

Of course, this interpretation of the AAM and AAMD rules on deaccessioning calls into question their foundation in "ethical" principles. Not only do they impose restrictions that needlessly prevent museums from selling artworks for socially beneficial purposes, but also there is good reason to believe that they effectively serve to further cartelize the art market.

In sum, the AAM and AAMD deaccessioning rules do not, cannot, and should not prevent art museums from selling artworks from their collection for socially beneficial purposes, including to cover operations and capital expenses. They are not legally binding and are based on "ethical" principles of dubious legitimacy. And in any case, they were entirely irrelevant to the City's ability to sell the DIA art.

B. The Best Interests of the Creditors

In both its oral and written opinions the bankruptcy court concluded that the DIA settlement was in the best interests of the creditors, because the City would not and should not sell the DIA art. The court observed that the City refused to sell the DIA art at auction and make the proceeds available to its creditors. And the court agreed with the City's decision, finding that the DIA was essential to the future of Detroit. The court was correct on both counts.

Under Chapter 9 of the Bankruptcy Act, a bankruptcy court hearing a municipal bankruptcy action can only confirm or dismiss the municipality's plan of adjustment.[159] It cannot modify the plan of adjustment or force the

159. 11 U.S.C. § 943 (2012).

municipality to sell any municipal assets. As a consequence, a municipality's plan of adjustment is in the best interest of the creditors and should be affirmed by the bankruptcy court so long as it provides "a better alternative for creditors than what they already have."[160]

The bankruptcy court correctly concluded that the City's plan of adjustment was in the best interests of the creditors, because it provided the largest recovery the creditors could expect to receive. The court correctly refused to consider the value of the DIA art in determining whether the City's plan of adjustment was in the best interest of the creditors, because neither the creditors nor the court could force the City to sell the DIA art. The value of the DIA art was irrelevant because the creditors were not entitled to collect it.

Moreover, the City's plan of adjustment was manifestly in the best interests of the creditors, because it effectively gave them part of the value of the DIA art, to which they were otherwise not entitled. As explained above, while the court held that the City could not sell the DIA art, under the DIA settlement, the City effectively sold the DIA art to the DIA corporation, and used the proceeds to compensate its creditors. The court correctly concluded that the DIA settlement and the plan of adjustment as a whole were in the best interests of the creditors because they provided the creditors with as much as they could reasonably expect to receive. "The Court finds that the City has made reasonable efforts to monetize its assets to satisfy the best interests of creditors test."[161]

Finally, the court correctly concluded that the DIA settlement was in the best interests of the City as a whole. As the court observed, even if the City could sell the DIA art, it should not do so.

> However, even if the law did give the Court some authority here, the Court would not have interfered with the City's decision. The City made the only appropriate decision. Maintaining the art at the DIA is critical to the feasibility of the City's plan and to the City's future. . . . To sell the DIA art would only deepen Detroit's fiscal, economic and social problems. To sell the DIA art would be to forfeit Detroit's future. The City made the right decision.[162]

The DIA is one of the most important art museums in the United States, if not the world. The bankruptcy court correctly concluded that the City's refusal to liquidate the DIA art was in the best interests of the City of Detroit, and that the DIA settlement was in the best interests of the creditors, given that it provided them with the largest recovery they could

160. *In re* City of Detroit, 524 B.R. 147, 213 (2014) (citing *In re* Pierce Cnty. Hous. Auth., 414 B.R. 702, 718 (2009)).

161. *Id.* at 219.

162. *Id.* at 218.

expect, and arguably a larger recovery than that to which they were entitled by law.

CONCLUSION

The bankruptcy court confirmed the City of Detroit's plan of adjustment and the DIA settlement because it found that the City could not, would not, and should not sell the DIA. Its finding that the City could not sell the DIA art was incorrect, but its recognition that the City would not and should not sell the DIA art were correct and entirely adequate on their own. Or rather, the bankruptcy court correctly recognized that the City was entitled to monetize the DIA art on its own terms and consistent with the best interests of the city, rather than simply liquidating the collection.

But the DIA settlement does not support the claim that museums cannot deaccession artworks for the purpose of paying operating or capital costs. In fact, it stands for the opposite. The City of Detroit did sell the DIA art, and it sold the DIA art for the purpose of satisfying its debts. Independent art museums ought to be able to do the same.