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BY EMMANUEL U. OBI AND CAMISHA L. SIMMONS¹



Emmanuel U. Obi
Norton Rose Fulbright
Dallas



Camisha L. Simmons
Norton Rose Fulbright
Dallas

Emmanuel Obi and Camisha Simmons are associates in the Dallas office of Fulbright & Jaworski LLP (Norton Rose Fulbright). Mr. Obi serves as bond counsel, underwriter's counsel and disclosure counsel in public finance matters. Ms. Simmons represents debtors and creditors in complex bankruptcy and restructuring matters and serves as a coordinating editor for the ABI Journal.

Detroit's Art: Priceless Public Treasure or the City's Disposable Assets?

Since the City of Detroit's chapter 9 filing on July 18, 2013, it has been in the process of marshaling its property in hopes of monetizing some assets to create liquidity to satisfy claims of creditors. Some of these creditors are pushing for the sale of the art collection that is held by the Detroit Institute of Arts (DIA). This collection, possibly worth billions of dollars, is owned by Detroit and operated by a nonprofit organization, the DIA Founders Society. The city recently retained Christie's International Plc to appraise the collection.

The potential sale of the art collection has raised general moral and legal questions. Morally, some have asserted that a collection of art is a priceless community treasure and should not be subject to a bankruptcy fire sale. In fact, in an opinion, Michigan Attorney General Bill Schuette takes this exact position, which he predicated on a charitable-trust argument. The pertinent question in the Detroit case is whether the city *owns* the art collection without restriction, or whether Detroit is merely a trustee required to hold the art collection in trust for the benefit of the city's citizens. This article examines the charitable-trust argument, and provides suggested solutions and best practices that may provide guidance to municipalities and other related parties faced with issues similar to those presented in the Detroit case.

Chapter 9: Deferential Municipal Treatment

A key aspect of the chapter 9 process is that the bankruptcy court must afford any participating municipality a great deal of deference and control over its property and affairs on account of such enti-

ty's sovereign and perpetual nature. For example, pursuant to § 904 of the Bankruptcy Code, unless a city (like Detroit) consents or submits a plan providing otherwise, the bankruptcy court cannot interfere with such city's (1) political or governmental powers, (2) property or revenues, or (3) use or enjoyment of its income-producing property.² Detroit thus has full control over the property of its estate, and creditors and the bankruptcy court cannot force the city to sell any property that it owns.

Brief History of the Museum

To properly analyze the question of whether a charitable trust exists, a clear understanding of Detroit's current and historical relationship with the DIA is required. Originally known as the Detroit Museum of Art, the DIA was incorporated in 1885 by 40 Detroit residents as a private nonprofit corporation for the purpose of establishing a public art institute.³ The DIA was organized under Michigan's Act No. 3 of the Public Acts of 1885 (the "Act").⁴ Pursuant to the Act, a corporation organized under the Act could not sell, encumber or otherwise dispose of its general art collection absent authorization by the state legislature.⁵

Beginning in 1899, the Michigan legislature, through an amendment of the city's charter and other acts, authorized Detroit to annually appropriate public funds to support the DIA.⁶ The Michigan legislature also authorized the city to issue bonds pledging the city's full faith and credit to raise the necessary funds to erect additional buildings for the DIA.⁷ Prior to the first of these bond issuances, Detroit and the DIA entered into an agreement

² 11 U.S.C. § 904.

³ See Articles of Incorporation, available at www.dleg.state.mi.us/bcs_corp/sr_corp.asp.

⁴ See *Detroit Museum of Art v. Engel*, 153 N.W. 700 (Mich. 1915) (citing 1885 Mich. Pub. Acts No. 3).

⁵ See *id.*

⁶ See *id.* at 700-01.

⁷ See *id.*

¹ This article represents the views of the authors, and such views should not necessarily be imputed to Norton Rose Fulbright, Fulbright & Jaworski LLP or their respective affiliates and clients.

whereby the museum's primary building and other real estate were conveyed to the city.⁸ The DIA's board of trustees, however, maintained control of the museum.⁹

At one point, Detroit's ability to use funds to support the private museum was challenged.¹⁰ Subsequent to this challenge, the DIA transferred the art collection and its remaining property to the city in 1919.¹¹ In 1997, the DIA and Detroit entered into an operating agreement,¹² pursuant to which the city maintained legal title to the art collection, but transferred the day-to-day operations and the costs associated with such operations back to the DIA Founders Society.

The Art: Unrestricted City Property or Assets of Public Trust?

Today, Detroit holds legal title to the art collection and other property of the DIA, and the DIA Founders Society manages and operates the museum pursuant to the operating agreement.¹³ The DIA Founders Society is authorized to acquire new art and dispose of individual pieces of the art collection in accordance with the DIA's collections-management policy.¹⁴ This policy provides that "[i]n considering objects or groups of objects, the Museum must be ever aware of its role as trustee of the collection for the benefit of the public. Objects are acquired for permanent retention in the collections and not with the thought of disposal."¹⁵ In the event that permanent retention is not best and a sale of the art is required, funds from any such sale must be used to purchase other works for the DIA.¹⁶ Further, any restrictions placed on the sale or transfer of artwork by any donor must be honored.¹⁷

The Attorney General's Position

The crux of the attorney general's recent opinion is that as a legal entity holding assets for a charitable purpose, the DIA is a charitable trust, and its charitable purpose is the exhibition of art for the public.¹⁸ Accordingly, the art collection, acquired by the DIA since its inception, became the *res* or assets of the trust.¹⁹ As such, when the city of Detroit accepted the transfer of the art collection in 1919, it was bound by applicable statutory provisions to perpetuate and "maintain a public art institute" that exhibits art to the general public, and to "faithfully use" the art conveyed for that purpose.²⁰ Therefore, Detroit and the DIA are enjoined from freely selling, conveying or transferring the art collection to satisfy Detroit's debts.²¹ Similarly, it is the DIA's position that the museum and the city hold the art collection in trust for the public.²² Therefore, the DIA asserts that "the City

cannot sell art to generate funds for any purpose other than to enhance the collection."²³

Michigan Charitable Trust Law

Michigan courts liberally construe instruments creating charitable trusts with the aim of giving effect to such trusts whenever possible.²⁴ The trustee of the trust holds legal title to the trust property for the beneficial enjoyment of others.²⁵ Express trusts are created through "an explicit declaration of trust, or circumstances [that] show beyond reasonable doubt that a trust was intended to be created."²⁶ Otherwise, a charitable trust may be created either "by (a) declaration by the owner of property that he holds it upon a charitable trust; or (b) a transfer *inter vivos* by the owner of property to another person to hold it upon a charitable trust."²⁷

Charitable purposes for which such trusts may be established include (1) "the advancement of education" and (2) "other purposes the accomplishment of which is beneficial to the community."²⁸ Even if an instrument conveying property does not contain the words "trust" or "trustee," a court might still find that a charitable trust exists if the surrounding circumstances indicate that the conveying party intended that the conveyed property be held for charitable purposes.²⁹

Charitable Trust Law Analysis

There are some considerations that may call into question the ultimate charitable trust conclusion reached by the attorney general. First, there is no evidence revealing that the instruments of conveyance related to the transfer of the DIA property to the city expressly provide that the property should be held as restricted charitable-trust property.³⁰ Therefore, if a charitable trust was created in 1885, creditors may argue that the charitable trust was converted or dissolved by the nonprofit's act of conveying title of the art collection and other property of the DIA to Detroit without specifying that a restricted trust was being created. Of course, the bankruptcy or other reviewing court may find that the surrounding circumstances suggest that the transfer was a transfer of the DIA Founders Society's legal interest, as trustee, in charitable assets (*i.e.*, the art collection) to a new charitable trustee, the city.

Second, most charitable trusts are created through a private individual's outright testamentary or *inter vivos* gift to a municipality or other entity. In the case of Detroit, the art collection and other DIA assets that might be sold were originally acquired through acquisitions made by a private nonprofit corporation or by the city using public funds. This factual distinction may prove relevant in the court's analysis of whether a charitable trust actually exists with respect to the art collection.

8 See *id.*

9 *Id.*

10 *Id.*

11 See AG Opinion No. 7272, at 6, available at http://media.mlive.com/news/detroit_impact/other/AG0%207272.pdf (last visited Sept. 18, 2013).

12 See Operating Agreement, Contract No. 77009, available at www.scribd.com/doc/144896834/Detroit-Institute-s-Operating-Agreement-with-City (last visited Sept. 21, 2013). The 1997 operating agreement expires in 2018 and is currently the primary agreement governing the relationship between the DIA Founders Society and the city.

13 See *id.*

14 See *id.* at 10.

15 See also DIA Collections Management Policy, available at <http://usmuseumsurvey.claimscon.org/PDF/1326-58.pdf> (last visited Sept. 22, 2013).

16 See Operating Agreement at 10.

17 See DIA Collections Management Policy.

18 See generally AG Opinion.

19 *Id.*

20 *Id.*

21 See *Lord v. City of Wilmington*, 332 A.2d 414 (1975) (concluding that "a threatened diversion of [donated public] park property to an inconsistent use is an imminent breach of trust subject to being enjoined").

22 See Official Statement, available at www.facebook.com/DetroitInstituteofArts/posts/10151518872640983 (last visited Sept. 18, 2013).

23 See *id.*

24 See, e.g., *In re Estes Estate*, 523 N.W.2d 863, 870 (Mich. Ct. App. 1994) (citations omitted).

25 *Attorney Gen. of Mich. v. Livy (In re Americana Found.)*, 378 N.W.2d 586, 588 (Mich. Ct. App. 1985) (citations omitted).

26 *Scarney v. Clarke*, 275 N.W. 765, 767 (Mich. 1937) (citation omitted).

27 See, e.g., *id.*

28 See, e.g., *Cleveland v. Second Nat'l Bank & Trust Co.*, 92 N.W.2d 449, 454 (Mich. 1958).

29 See *Knights of Equity Mem'l Scholarships Comm'n v. Univ. of Detroit*, 102 N.W.2d 463, 467 (Mich. 1960).

30 *Cf. Hardman v. Feinstein*, 240 Cal. Rptr. 483, 484-85 (Cal. Ct. App. 1987) (concluding that museums donated in trust to City of San Francisco and restricted to public use as museums were charitable trusts). Interestingly, the AG has not articulated an alternative constructive-trust argument, which does not require an agreement or intention to create a trust. This may be so due to the fact that in the Sixth Circuit, bankruptcy courts may not impose constructive trusts on property of the estate unless a constructive trust was deemed to be impressed upon the property before the bankruptcy petition was filed. See *XL/Datacomp, Inc. v. Wilson (In re Omegas Group Inc.)*, 16 F.3d 1443 (6th Cir. 1994). See also *Poss v. Morris (In re Morris)*, 260 F.3d 654 (6th Cir. 2001); *Bank Midwest NA v. CyberCo Holdings Inc. (In re CyberCo Holdings Inc.)*, No. 04-14905, 05-80020-RJH, 1:05-CV-566, 2005 WL 2704508, at *1 (W.D. Mich. Oct. 20, 2005).

In the event that it is found that Detroit does not hold the art collection in a charitable trust, then in order to address liquidity problems, the city is free to sell the art collection and may even consider partially or fully privatizing ownership of the art and other DIA property.

Best Practices

There are a number of ways in which municipalities and other public entities may prevent similar disputes relating to public/private partnerships, specifically ones related to museum assets. In light of the fact that many other municipalities are fiscally strained and face many of the same challenges as those faced by Detroit, these municipalities may also consider a public/private partnership as a solution to address liquidity issues. In pursuing a public/private partnership, such parties should proactively employ the following best practices, as applicable, to increase the probability of success and avoid costly and protracted litigation.

Pre-Planning and Diligence

Prior to entering into any public/private partnership, all parties must independently understand each other and any historical facts that might serve to impact the structure of the partnership or its future operation. Early in the process of analyzing a proposed “partnership” transaction, the parties should also assess the nature and extent of any outside consulting or analytical services that the public entity may require for proper analysis and negotiation of the transaction. During this due-diligence phase, the public entity should diligently and comprehensively take steps to (1) research prospective partners, their business and market; (2) research the type of transactions being considered; (3) consult with the appropriate professionals about federal and state tax laws applicable to the transaction; (4) vet the financial and non-financial impacts of the various proposals presented; and (5) explore alternative structures including, but not limited to, the use of a separate and distinct entity to ensure that museum art will not be confused or commingled with other municipal assets.

Scope of Partnership

Parties should work collaboratively to delineate a scope that facilitates the accomplishment of stated goals and objectives while complying with applicable legal and financial requirements.

Compliance

All partnerships should be based on a firm statutory compliance foundation for the effective implementation of the partnership’s goals. Some states have recently established statutory frameworks to foster and guide public/private partnerships. Parties should be aware of and comply with all such applicable state statutory requirements.

Partnership Oversight

For public/private partnerships to succeed, the public- and private-sector parties must agree on key management oversight processes in the initial stages of the relationship. The oversight structure is necessary in the event that key adjustments must be made or other critical bottleneck issues must be addressed and resolved.

Effective Contract Drafting

The agreement memorializing the partnership must be clear and unambiguous. Additionally, the agreement should contain all aspects of the deal and any impor-

tant limitations. This is a key issue in the current *Detroit* case because the city did not affirmatively negotiate for express provisions disclaiming any type of trust argument and the perfection of its unencumbered right to the art collection.

Conclusion

While there is ongoing debate about Detroit, chapter 9 and related issues, these filings are not common and will hopefully not become a mainstay of the bankruptcy landscape. Chapter 9 provides a framework for eligible municipalities and other stakeholders to restructure debt pursuant to an orderly process administered by an impartial judge. Whether the judge will (or even should) find in Detroit’s favor in the battle over the art collection remains to be seen. In any event, one thing is clear: Public players must employ the best practices summarized above, among other prudent steps, to avoid disputes and potential litigation of similar issues. As Michigan Gov. Rick Snyder recently stated, Detroit’s filing “gives the city a chance for a fresh start, without burdens of debt it cannot hope to fully pay.”³¹ Whether Detroit’s legendary art collection will be sold as part of this effort to achieve a fresh start is now in the hands of the bankruptcy process. **abi**

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31 Letter from Rick Snyder, Michigan Governor (July 18, 2013) (approving emergency city manager’s recommendation and authorizing Detroit’s chapter 9 filing), available at www.michigan.gov/documents/snyder/Governor_Snyder_Chapter_9_Authorization_427830_7.pdf (last visited Sept. 25, 2013).