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PILLS AND PICASSO: EVALUATING THE PROPOSED LIQUIDATION OF THE DETROIT INSTITUTE OF ARTS DURING THE DETROIT BANKRUPTCY

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INTRODUCTION

The Detroit Institute of Arts (DIA) is among the world's most renowned museums. Famous for its works by Diego Rivera, Vincent van Gogh, and Henri Matisse, the museum has been Detroit's flagship cultural institution since the nineteenth century.[1] But not long ago, the DIA's continued existence was uncertain. During Detroit's Chapter 9 bankruptcy, the City's creditors sought a sale of the museum's art to limit the losses that they would suffer upon discharge of their claims.[2] Creditors included not only bond insurers who stood to lose billions, but also tens of thousands of retirees who depended on the City for their healthcare and pension benefits.[3] Detroit stood to lose its prized cultural institution, which the DIA's supporters claimed would severely damage the

* J.D. Candidate, May 2020, University of Michigan Law School. Thank you Professor Carl Schneider, Nicholas Cagle, Jacob Muller, Abby Jacobs, and the staff of the *Michigan Business & Entrepreneurial Law Review* for your support and guidance.

1. NATHAN BOMEY, DETROIT RESURRECTED: TO BANKRUPTCY AND BACK 5 (2016).
2. *Id.* at 112, 116-17.
3. Mike Wilkinson, *Here's a Short List of the 8 Detroit Creditors Who Will Win and Lose the Most* MICH. RADIO (Mar. 27, 2014), https://www.michiganradio.org/post/heres-short-list-8-detroit-creditors-who-will-win-and-lose-most.

City's economy, reputation, and recovery.[4] Michigan's Attorney General was prepared to fight any sale of the artwork in court.[5]

Despite how fiercely this issue was debated in public, the bankruptcy court never reached this issue. Fearing that the sale would damage Detroit's prospects, Detroit's bankruptcy mediator, Judge Gerald Rosen, raised $816 million from corporate and non-profit donors to pay Detroit's creditors.[6] Had the bankruptcy court decided whether to approve a liquidation of the DIA collection, the court would have shed light on the possibilities and limits of liquidation in Chapter 9 bankruptcy. This Note assumes the $816 million rescue package never came, and uses the potential sale as a vehicle for exploring liquidation in Chapter 9 bankruptcy. This Note concludes that a court should have ordered a partial sale of the DIA's collection. There is scant evidence that the museum was essential for Detroit's future, and the collection was far too valuable to keep completely out of creditors' hands—particularly given the fact that retiree creditors would have faced severe financial harm without a sale. This Note does not evaluate the commonly floated legal and equitable arguments postulating that the art was held in some kind of trust, as there already exists plenty of literature dissecting that issue.

Part I of this Note provides background information that is helpful for understanding the Detroit bankruptcy, the role of the DIA in the bankruptcy, and municipal bankruptcies in general. Part II evaluates equitable arguments against a sale of the DIA's collection. Part III provides a rationale for a partial sale of the DIA's collection.

PART I: BACKGROUND

A. HISTORICAL BACKGROUND

For decades, the City of Detroit owned the DIA, an unusual relationship between a city and a major museum.[7] The Detroit Museum of Art (DMA) opened as a private institution in 1888, but quickly ran into financial trouble.[8] In 1894, the City of Detroit agreed to subsidize the museum until a 1915 court decision

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4. *See* Mallika Rao, *Detroit's Art Sale Scare Reveals Better Options for Bankrupt City* HUFFINGTON POST (July 24, 2013, 10:11 AM), https://www.huffpost.com/entry/detroit-art-sale-bankruptcy_n_3643597.

5. Conveyance or Transfer of Detroit Institute of Arts Collection, Mich. Dept. of Att'y Gen., Op. 7272 (June 13, 2013), http://media.mlive.com/news/detroit_impact/other/AGO%207272.pdf [hereinafter A.G. Schuette opinion].

6. Monica Davey, *Finding $816 Million, and Fast, to Save Detroit* N.Y. TIMES (Nov. 7, 2014), https://www.nytimes.com/2014/11/08/us/finding-816-million-and-fast-to-save-detroit.html.

7. *See* Philip Kennicott, *Detroit Institute of Arts Fire Sale: The Worst Idea Out of Motor City Since the Edsel*, WASH. POST (Oct. 4, 2013), https://www.washingtonpost.com/entertainment/museums/detroit-institute-of-arts-fire-sale-the-worst-idea-out-of-motor-city-since-the-edsel/2013/10/03/e95e842a-217b-11e3-b73c-aab60bf735d0_story.html.

8. BOMEY, *supra* note 1, at 113.

declared this arrangement illegal under Michigan law.[9] Hoping to protect the Detroit Museum of Art's collection, the museum's board of trustees arranged to transfer ownership of the collection to the City without conditions in 1919, and the Detroit-owned DMA became the DIA.[10] As the center of the American auto industry, Detroit thrived during this period. World War II brought Detroit more prosperity as the city became the center of wartime production.[11] By the end of the war, Detroit had the highest paid blue-collar workers of any American city.[12]

This prosperity gradually evaporated over the second half of the twentieth century. Beckoned by the prospect of larger properties, paranoid about a growing African-American population, and shepherded by an expanding highway system that facilitated longer commutes to work, Detroit's white middle class began moving to the suburbs in the 1950s.[13] Automobile production and related manufacturing also shifted out of labor-friendly Detroit to rural areas without organized labor and to the suburban areas where middle-class workers were relocating.[14] Making matters worse, slum clearance and the construction of interstate highways destroyed cohesive communities, removing the social support networks that many residents relied on.[15] Racial tensions in the city boiled over in the summer of 1967 when African-American residents, infuriated by police abuses, rioted when police attempted to arrest, *en masse*, the patrons of an unlicensed bar, there celebrating the return of two G.I.'s from the Vietnam War. The riots, including the heavy-handed response by police, only exacerbated white flight.[16] As Detroit's economy shrank and as its population became poorer, crime rose and drove even more people out.[17] Between 1950 and 2010, Detroit lost 1.1 million residents, roughly two-thirds of its population.[18] Meanwhile, the DIA remained housed in its grandiose Beaux-Arts walls as a draw for suburban visitors.

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9. Detroit Museum of Art v. Engel, 187 Mich. 432, 439 (1915).

10. BOMEY, *supra* note 1, at 115.

11. Gerald Scott, *Detroit's war effort went well beyond the vehicles* CHICAGO TRIBUNE (Dec. 9, 2001), https://www.chicagotribune.com/news/ct-xpm-2001-12-09-0112090415-story.html.

12. THOMAS J. SUGRUE, ORIGINS OF THE URBAN CRISIS 3 (1996).

13. *Id.* at 245.

14. *Id.* at 127-28.

15. *Id.* at 48-49.

16. *See id.* at 265-66.

17. *See* BOMEY, *supra* note 1, at 3.

18. *See* U.S. CENSUS BUREAU, UNITED STATES CENSUS OF POPULATION: 1950, CENSUS TRACT STATISTICS: DETROIT MICHIGAN AND ADJACENT AREA 7 (1952), https://www2.census.gov/library/publications/decennial/1950/population-volume-3/41557421v3p2ch02.pdf; U.S. CENSUS BUREAU, QUICKFACTS: DETROIT CITY, MICHIGAN, https://www.census.gov/quickfacts/fact/table/detroitcitymichigan/PST120218 (last visited May 9, 2019).

The City's finances suffered but remained well managed during the second half of the twentieth century.[19] Property values "plummeted from $45.2 billion in 1958 to $9.6 billion in 2012,"[20] which sharply reduced tax revenues. During his twenty-year mayoralty from 1974 to 1994, Coleman Young responded to falling revenue by deeply cutting the City's budget. These cuts allowed Mayor Young to keep Detroit's budget mostly balanced.[21] His successor, Mayor Dennis Archer also maintained a balanced budget and a solvent pension system.[22] The City's budget cuts included its support of the DIA. Detroit ceased contributing to the museum's coffers in 1955.[23] Still, the City of Detroit owned the museum, making the art collection an asset of the City.

Detroit's finances became dangerously strained during the mid-2000s under Mayor Kwame Kilpatrick. In 2004, bad investments led to a $1.7 billion shortfall in pension funding.[24] In response, the City issued $1.44 billion in bonds through a convoluted scheme designed to skirt legal limits on the City's obligations.[25] When the Great Recession caused Detroit's property tax revenues to further decline, the City defaulted on the loans.[26] This default triggered a $400 million "termination payment," which could have forced Detroit into bankruptcy but for Detroit's pledge to compensate creditors with tax revenue from its casinos.[27]

In the years after the recession, dwindling tax revenue and growing financial obligations racked the City's ability to provide basic services. Quality-of-life services were completely neglected: large swaths of Detroit were without working streetlights, abandoned buildings were allowed to remain standing, and parks went without maintenance.[28] Emergency services were dangerously strained, with police response times reaching up to half an hour.[29] This crisis brought Detroit to a breaking point. On July 18, 2013, the City of Detroit filed for Chapter 9 bankruptcy protection.[30] Naturally, Detroit's creditors demanded repayment and turned to one of the City's most valuable unencumbered assets, the DIA.

19. *See id.* at 18-19; *Archer, Dennis*, DET. HIST. SOC'Y, https://detroithistorical.org/learn/encyclopedia-of-detroit/archer-dennis (last visited May 6, 2019).

20. BOMEY, *supra* note 1, at 18-19.

21. *Id.* at 2.

22. DET. HIST. SOC'Y, *supra* note 19.

23. Liam Sweeney & Katherine Daniel, *Becoming a Public Square: Detroit Institute of Arts* 4 (2018), https://sr.ithaka.org/publications/becoming-a-public-square-detroit-institute-of-arts/.

24. BOMEY, *supra* note 1, at 22.

25. *Id.* at 23-24.

26. *Id.* at 27.

27. *Id.* at 27-28.

28. *Id.* at 3.

29. *Id.*

30. Monica Davey & Mary Williams Walsh, *Billions in Debt, Detroit Tumbles into Insolvency*, N.Y. TIMES (July 18, 2013), https://www.nytimes.com/2013/07/19/us/detroit-files-for-bankruptcy.html.

B. CHAPTER 9 BANKRUPTCY

i. *History & Mechanisms*

Cities seeking bankruptcy protection are forced to file under Chapter 9 of the bankruptcy code,[31] which Congress created in 1934.[32] Before Congress added Chapter 9, creditors of municipal governments sought writs of mandamus forcing municipal governments to raise taxes in order to service debt.[33] During the Great Depression, this proved impractical because the country's economic malaise made raising tax revenue "useless," as the Supreme Court stated.[34] Since 1937, 680 municipalities have gone bankrupt, and over 40 of these bankruptcies have been filed since the Great Recession.[35]

Today, Chapter 9's protections are modeled after the provisions of Chapter 11, which governs the restructuring of business debts[36] and allows business debtors to continue operating.[37] This is material to understanding the function of Chapter 9; fundamentally, municipal bankruptcy is about keeping the municipality "alive."[38] Unlike Chapter 7, which liquidates consumer and business debtors, Chapter 11 bankruptcy allows a debtor to restructure its debt so the debtor will be financially solvent post-bankruptcy.[39] Furthermore, Chapter 11 often functions as a negotiation between a debtor and its creditors over the specific provisions of the restructuring, known as the "bankruptcy plan."[40] While the Code's stay on debt collection and a bankruptcy court's "cram down" provision provide the debtors with leverage,[41] creditors also have leverage because their approval of a plan is necessary.[42] This balance of power is a key component of the negotiation and collaboration that Congress intended to be part of a Chapter 9 bankruptcy. "[C]hapter 9 provides essentially for federal court protec-

31. *See* 11 U.S.C. §109(c) (2018).

32. *See* Bankruptcy Act of 1898, Pub. L. No. 251, 48 Stat. 798 (1934) (current version at 11 U.S.C. §§ 901-946 (2018)).

33. Ashton v. Cameron Cty. Water Improvement Dist., 298 U.S. 513, 534 (1936) (Cardozo, J., dissenting).

34. United States v. Bekins, 304 U.S. 27, 53-54 (1938).

35. James Spiotto with Jeff Garceau, *Chapter 9 Municipal Bankruptcy Statistics: Use by Number, Type and Year,* MUNINET GUIDE (June 14, 2018), https://muninetguide.com/municipal-bankruptcy-statistics/.

36. Sometimes consumers file under Chapter 11. *See* Toibb v. Radloff, 501 U.S. 157, 163 (1991).

37. *See* 11 U.S.C. 901.

38. *See* Nathalie Martin, *The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation*, 28 B.C. INT'L & COMP. L. REV. 1, 3 (2005).

39. *Id.* at 359.

40. *Id.* at 365.

41. "Cram down" refers to the ability of a bankruptcy court to force recalcitrant creditors to accept a restructuring plan. *See* 11 U.S.C. 1129(b).

42. *See* 11 U.S.C. 1126.

tion, and supervision of a settlement between the debtor municipality and a majority of its creditors."[43]

ii. *Liquidation of Assets in Chapter 9*

A sale of the DIA collection would have liquidated a portion of Detroit's assets. Although Chapter 9 is intended to restructure the debt of a municipality rather than liquidate its assets, the Code permits limited liquidation of municipal debtors, as Chapter 9 incorporates 11 U.S.C. 1123(b)(4), which allows for the liquidation of assets in a restructuring plan. A municipality can volunteer to liquidate its possessions in a Chapter 9 bankruptcy.[44] The only limit on liquidation in Chapter 9, it seems, is that the local government must retain enough assets to continue functioning.[45]

A key difference between Chapters 9 and 11 is that "[i]n chapter 9, no liquidation alternative exists. . . . the only alternative to a debtor's plan is dismissal and resort to largely ineffective state remedies."[46] Chapter 11 bankruptcies can be converted to a Chapter 7 liquidation case if a court determines that a debtor is unlikely to successfully reorganize under Chapter 11.[47] In contrast, Congress denied the possibility of a liquidation bankruptcy for municipalities. As the House of Representatives' report on amendments to the Code noted, "A municipal unit cannot liquidate its assets to satisfy its creditors totally and finally. Therefore, the primary purpose of Chapter 9 is to allow the municipal unit to continue operating while it adjusts or refinances creditor claims with minimum (and in many cases, no) loss to its creditors."[48] In other words, Congress would prioritize preserving the vitality of a municipality, sufficient for its continued operation as a government entity.

Underscoring Congress' intent to prohibit large-scale liquidation of municipal assets, section 904(3) of the Code provides substantial protection to property owned by municipalities. As one bankruptcy court wrote:

> In the overall construct, § 904 . . . is so comprehensive that it can only mean that a federal court can use no tool in its toolkit — no inherent authority power, no implied equitable power, no Bankruptcy Code § 105 power, no writ, no stay, no order — to interfere with a municipality regarding political or governmental powers, property or revenues, or use or enjoyment of income-producing property. As a practical matter, the § 904 restriction functions as an anti-injunction statute — and more.[49]

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43. H.R. REP. No. 95-595, at 263 (1977).

44. 11 U.S.C. 901 (2012); *see also* 11 U.S.C. 1123(a)(5) (2012).

45. *See* H.R. REP 95-595, at 263 (1978).

46. Laura N. Coordes, *Formalizing Chapter 9's Experts*, 116 MICH. L. REV. 1249, 1257 (2018).

47. *See* 11 U.S.C. 1112(b) (2012).

48. H.R. REP 95-595, at 263.

49. *In re* City of Stockton, 478 B.R. 8, 20 (E.D. Cal. Bankr. 2012) (citations omitted).

In other words, a court cannot order a liquidation. Instead, liquidation is only possible if a debtor municipality consents to selling its assets.

Of course, the protection of 904(3) is limited by the pressure that a unified coalition of creditors can place on a municipality and the Court.[50] Namely, creditors may withhold their votes to approve a Chapter 9 plan,[51] which is how creditors convinced Kevyn Orr to consent to a liquidation of the DIA's artwork.[52]

PART II: ECONOMIC EQUITABLE CONSIDERATIONS

A readjustment plan must meet the "fair and equitable" requirement of the Code in order to be confirmed by a bankruptcy court.[53] "In a Chapter 9 case, the fair and equitable requirement has been interpreted to mean that Holders of Claims must receive all they can reasonably expect under the circumstances of the Case."[54] The "fair and equitable" standard differs between Chapters 11 and 9:

> Under Chapter 11, a plan of reorganization is "fair and equitable" with respect to secured creditors if such creditors (1) retain their liens on their prepetition collateral and receive deferred payments on account of their claims; (2) are given the right to credit bid their claims if their collateral is sold free and clean of their liens and have those liens attach to the proceeds of such sale; or (3) receive the indubitable equivalent of their claims.[55]

In contrast, "the plan is 'fair and equitable' in Chapter 9 if the amount to be received by the bondholders is all that they can reasonably expect in the circumstances."[56] In Chapter 9, the "fair and equitable" requirement is better described as a "reasonable expectations" requirement, a more liberal standard than Chapter 11's requirement.[57] The ability of a municipality to continue providing services to its residents and to emerge solvent from its bankruptcy limits creditors' reasonable expectations. Essentially, for a Chapter 9 plan to be "fair and equitable," the plan must be fair and equitable to both the creditors and the debtor.

Opponents of the sale frequently argued that the DIA was of substantial economic value to Detroit, and that this economic value outweighed the liquida-

50. BOMEY, *supra* note 1, at 134.

51. *See* 11 U.S.C. §§ 901, 943, 1126, 1129.

52. *See* BOMEY, *supra* note 1, at 117-18.

53. 11 U.S.C. 901(a); 11 U.S.C. 1129(b)(1).

54. *In re* Hardeman Cnty. Hosp. Dist., 540 B.R. 229, 239 (2015).

55. JOHN J. RAPISARDI ET AL., CHAPTER 9 BANKRUPTCY STRATEGIES: A BIG STICK RARELY USED 6 (2011), https://www.cadwalader.com/uploads/books/93f1695e93f36727586428ff06bf27ba.pdf; *see also* 11 U.S.C. 1129(b)(2)(A), (B).

56. RAPISARDI ET AL., *supra* note 55, at 8 (quotations omitted) (citation omitted).

57. Oral Opinion on the Record of Judge Rhodes at 31, *In re* City of Detroit Bankr., No. 13-53846 (Bankr. E.D. Mich. Nov. 7, 2014), https://www.scribd.com/doc/245864897/Oral-Opinion-on-Detroit-Plan-Confirmation-Judge-Rhodes-FINAL-for-Release.

tion value of the artwork.[58] The DIA, opponents claimed, was necessary to keeping Detroit alive. This argument was unsupported by economic data and also ignored possible compromises. Overall, the different measures of the DIA's value supported a sale of the artwork, although as this Note will later argue, other considerations justified limiting the sale.

A. Valuing the Artwork

Valuing the DIA's collection is essential to an analysis of the economic arguments for saving the DIA, because it is necessary to understand what the City of Detroit had to lose and what its creditors had to gain. Practical considerations rather than established legal principles determine valuations.[59] There are some established methods for valuing property, but these vary among different bankruptcy courts.[60] In practice, valuation in bankruptcy is a "quagmire."[61]

Many different measures can represent monetary value. This section explores three measures—going concern value, liquidation value, and economic value—and assesses the value of the DIA's collection under each measurement. Each measure provides a different angle to analyze the impact of a sale of the collection upon Detroit. I also explore the "immeasurable" value of the museum for Detroit.

i. *Going Concern Value*

Going concern value is the value of a business as an income producing entity.[62] Generally speaking, "[g]oing concern values generally exceed liquidation values. There are, however, exceptions," such as a business with a net operating loss.[63] When a business depends on its property, like the DIA on its collection, an approach called "income capitalization" can represent the business's going concern value. The income capitalization approach "determines market value by examining the actual income versus the operating expenses of the

58. *See, e.g.*, Nora Caplan-Bricker, *Detroit's Art Is Worth More in the Museum than Out,* NEW REPUBLIC (July 22, 2013), https://newrepublic.com/article/113979/detroits-art-worth-more-museum-out.

59. *See* Kenneth Ayotte & Edward R. Morrison, *Valuation Disputes in Corporate Bankruptcy*, 166 U. PA. L. REV. 1819, 1824-25 (2018).

60. *See id.*

61. Anthony J. Casey & Julia Simon-Kerr, *A Simple Theory of Complex Valuation*, 113 MICH. L. REV. 1175, 1177 (2015).

62. Chaim J. Fortgang & Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061, 1063 (1985).

63. *Id.* at 1064.

property."[64] The net operating income is then divided by a capitalization rate, which then results in the income capitalization.[65]

Courts typically consider a property's income capitalization when calculating the value of collateral for secured creditors. For example, if a hotel property is mortgaged, the value of the hotel property may be best determined not by the value of the land, but rather, by how much income the hotel can generate.[66] Of course, the DIA's collection was not real property. However, like real property, the collection had a rental value. Visitors paid to see the collection similar to how tenants pay to reside on a rental property. In the case of the DIA, income capitalization could theoretically provide a justification for blocking the liquidation of the museum's collection. Alternatively, it could have been sold by the City to a private operator for a price based on income capitalization.

Unfortunately, the DIA only brought in about $10 million per year in revenue at the time of Detroit's bankruptcy.[67] This was far from covering its $25 million budget,[68] most of which was covered by the millage paid by residents of Oakland, Macomb, and Wayne counties.[69] This means that the DIA had a negative net operating income and in turn no income capitalization leading up to the Detroit bankruptcy. Because the museum had no income capitalization, it would have been worth little if it were marketed as an attraction to private operators.

ii. *Liquidation Value*

Were the DIA collection auctioned off, the proceeds derived from the auction would represent the collection's "liquidation value." The liquidation value of the collection was estimated to be between $1.1 billion and $8.1 billion by three different appraisals.[70] Christie's auction house, which Kevyn Orr commissioned to value works purchased by the City, valued the DIA's city-purchased artwork between $454 million and $867 million; this represented the liquidation value of only about 5% of the artwork.[71] A handful of pieces, how-

64. Whitehouse Condo. Group, LLC v. Cincinnati Ins. Co., 959 F. Supp. 2d 1024, n. 1 (E.D. Mich., 2013).

65. *Id.*

66. *See, e.g.*, *In re* Buena Vista Oceanside, 479 B.R. 342 (Bankr. W.D. Pa. 2012).

67. Caplan-Bricker, *supra* note 58.

68. Jennifer Guerra, *Detroit Institute of Arts Uses Restricted Funds to Cover Operating Costs*, MICHIGAN RADIO (Aug. 21, 2011), http://www.michiganradio.org/post/detroit-institute-arts-uses-restricted-funds-cover-operating-costs.

69. *See Millage Details*, DETROIT INSTITUTE OF ART, https://www.dia.org/visit/millage-details (last visited Oct. 27, 2019).

70. *See generally* Expert Witness Report of Michael Plummer, *In re* City of Detroit, 524 B.R. 147 (Bankr. E.D. Mich. 2014) [hereinafter Artvest Report] (No. 13-53846), https://app.box.com/s/6wmjw6qve42c99tta48c (last visited May 9, 2019) (for two appraisals); Expert Witness Report of Victor Wiener, *In re* City of Detroit, 542 B.R. 147 (Bankr. E.D. Mich. 2014) (No. 13-53846) [hereinafter Wiener Report].

71. *See* BOMEY, *supra* note 1, at 127-28.

ever, represented seventy-five percent of the value of the DIA's collection.[72] Pieter Bruegel's *The Wedding Dance*, for instance, was valued between $100 million and $200 million.[73] Van Gogh's *Self-Portrait with Straw Hat* was worth between $80 million and $150 million.[74]

Lower estimates assumed that any of the liquidated artwork would be considered tainted by the art world and that the risk purchasing DIA artwork posed to purchasers' reputations would lower the price.[75] Indeed, "a prized painting is not worth anything until you convince someone to buy it."[76] Another issue that impacted some estimates was that the open market would be flooded with so much art at one time.[77]

Artvest, a financial advisory firm specializing in the art market, noted in an expert witness report that a then-recent auction of Impressionist and Modern paintings similar to the DIA's most valuable pieces sold for less than expected.[78] Around the time of the Detroit bankruptcy, the art market's prices had "plateaued," according to Artvest, and "[i]n such a market where prices and sales volumes are not appreciating quickly, selling at or below the low estimate is more the norm, and selling at the higher end of the estimate range becomes an anomaly."[79] Artvest was retained by the DIA[80] and surmised that the DIA's collection could fetch as little as $1.1 billion to $1.8 billion in a fire sale.[81] In a less hurried sale, Artvest estimated the collection could yield $2.8 billion to $4.6 billion.[82]

Victor Wiener Associates (VWA), which was contracted by one of Detroit's largest creditors to appraise the DIA's collection, valued the artwork at $8.1 billion.[83] This report, valuing the DIA's tens of thousands of pieces, was completed in fourteen days.[84] VWA admitted this time span amounted to "highly limiting conditions."[85] In reaching its valuation, VWA assumed that the auction of

72. *Id.* at 127.

73. *Id.*

74. *Id.*

75. *See* Artvest Report at 29.

76. BOMEY, *supra* note 1, at 127.

77. *See id.* at 171.

78. Artvest Report at 8-9.

79. *Id.* at 9.

80. *Id.* at 4.

81. *Id.* at 37.

82. BOMEY, *supra* note 1, at 171.

83. Weiner Report at 3.

84. City of Detroit's Motion to Exclude Testimony of Victor Wiener at 1, *In re* City of Detroit, 542 B.R. 147 (Bankr. E.D. Mich. 2014) (No. 13-53846), http://www.mieb.uscourts.gov/sites/default/files/detroit/docket7000.pdf.

85. Wiener Report, *supra* note 70, at 18.

the artwork would not be tainted, and would instead be akin to a "celebrity sale."[86]

The VWA could not have been thorough in assessing each piece of the DIA's collection, and its assumption that the artwork would fetch a higher value by virtue of having been part of the DIA collection runs counter to almost universally followed rules against museum deaccessioning.[87] Because deaccessioning is so controversial,[88] it is extremely unlikely that an auction of the DIA collection would have taken on the aura of a celebrity sale. Instead, it would have been more likely that the art would sell for prices that reflected the tainted nature of the sale. "[M]ajor U.S. museums almost certainly would have refused to bid to avoid upsetting industry standards, risking their accreditation status, and triggering a publicity crisis."[89] And while private buyers would not have been constrained by similar ethical considerations, the demand of private buyers, who often have an interest in eventually donating their collectables, could still have been curbed by anti-deaccessioning rules because museums would not accept donations of pieces that were once part of the DIA collection.

In addition to anti-deaccessioning rules depressing the prices of the DIA collection, in general, bankruptcy sales tend to destroy value, while reorganizations retain more value. As one study found in the context of selling businesses that filed for Chapter 11:

> [We] compared the prices for which thirty large public companies were sold with the values of thirty similar companies that were reorganized in the period 2000 through 2004. We found that companies sold for an average of 35% of book value but reorganized for an average market capitalization value—based on post-reorganization stock trading—of 91% of book value. Even controlling for the differences in the prefiling earnings of the two sets of companies, sale yielded less than half as much value as reorganization.
>
> In nearly every instance, the sales we examined were "market-tested" by public auction. . . . We interpret the data as showing that the high costs of evaluating companies, combined with the low probability of success for competing bidders, discourages competitive bids . . . .[90]

Artwork auctions suffer from similar informational issues and disincentives. Appraising artwork is expensive and bidders at public art auctions have a low probability of placing a successful bid. Thus, the liquidation value of the DIA's

86. Typically, this refers to the sale of a famous person's art collection. *Id.* at 27.

87. *See generally* ASS'N OF ART MUSEUM DIRS, AAMD POLICY ON DEACCESSIONING (2010), https://aamd.org/sites/default/files/document/AAMD%20Policy%20on%20Deaccessioning%20website_0.pdf (amended Oct. 2015). "Deaccessioning" refers to "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." *Id* at 2.

88. *See, e.g.*, David R. Gabor, *Deaccessioning Fine Art Works: A Proposal for Heightened Scrutiny*, 36 UCLA L. REV. 1005, 1005-06 (1989).

89. BOMEY, *supra* note 1, at 127.

90. Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 3-5 (2007) (footnote omitted).

art is likely on the lower end of the appraisals. But creditors would not necessarily be in a rush to sell the artwork and could put pieces on the auction block over a longer period of time than they would in a fire sale. Given these considerations, a valuation similar to Artvest's higher appraisal was probably most accurate.

Overall, a lower valuation would have been good news for the DIA because the less the collection was worth, the more likely the collection's economic value to Detroit would outweigh the collection's liquidation value. In turn, a sale would not be as justified.

iii. *The Collection's Economic Value*

Judge Steven Rhodes, Detroit's bankruptcy judge, indicated a willingness not to permit a sale of the DIA collection because of the collection's impact on Detroit's economy. In his opinion approving Detroit's actual bankruptcy plan, Rhodes stated that "[t]o 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."[91]

Unfortunately, there is no report or study describing the DIA's economic impact on Detroit, but there are data points that one can use to draw inferences about the DIA's economic impact. Specifically:

- The DIA had a budget of $25.4 million.[92]
- In 2014, while the Detroit bankruptcy was still ongoing, cultural-heritage-related activity, including art museums, generated over $59 million in wages in the Detroit region.[93]
- The DIA was one of sixty-four cultural heritage institutions in Detroit, which employed a total of 2,026 people in Detroit.[94]
- The DIA had about 600,000 visitors annually.[95]

There is data on the multiplier effect, or the total economic output resulting from economic activity, for arts spending nationally.[96] Yet this would be un-

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91. BOMEY, *supra* note 1, at 238.

92. Patricia Cohen, *Suburban Taxpayers Vote to Support Detroit Museum* N.Y. TIMES (Aug. 8, 2012), https://www.nytimes.com/2012/08/09/arts/design/detroit-institute-of-arts-county-millage-tax-approved.html.

93. CREATIVE STATE MICHIGAN, REGIONAL PROFILE: DET. 3 (Mar. 11, 2016), http://www.creativemany.org/wp-content/uploads/2016/03/2016CreativeIndustriesReport_regional-Detroit.pdf.

94. *Id.*

95. Randy Kennedy & Monica Davey, *Detroit's Creditors Eye Its Art Collection*, N.Y. TIMES (July 19, 2013), https://www.nytimes.com/2013/07/20/arts/design/detroits-creditors-eye-its-art-collection.html.

96. *E.g.*, Josh Bivens, *Updated employment multipliers for the U.S. economy*, ECON. POLICY INST. (Jan. 23, 2019), https://www.epi.org/publication/updated-employment-multipliers-for-the-u-s-economy/.

helpful for analyzing the economic value of the DIA, as the multiplier effect for spending on the arts in Detroit is likely smaller compared to other American cities. In contrast to cities like New York or Boston, Detroit has fewer restaurants and retail stores that museum visitors could patronize after visiting the DIA. The smaller multiplier effect in Detroit limits the economic impact of the DIA. A precise figure representing the DIA's economic value to Detroit cannot be calculated absent more information, although the impact is likely insignificant given the small budget and diminished multiplier effect.

iv. *Immeasurable Economic Value*

DIA supporters also often cited the immeasurable value of the DIA to Detroit as a reason to prevent a sale of the museum's collection.[97] The two concerns detailed below both could have harmed Detroit's economy, making its recovery from bankruptcy more challenging. In turn, a court should have given meaningful weight to these concern in evaluating whether to allow a sale or to allow a limited sale of the DIA's artwork.

The museum's impact on the prestige of the city is one important immeasurable economic consideration. Prestige is important to a municipality because "[m]any cities consciously engage in what has become known as place marketing, which involves striving to sell the image of a place so as to make it more attractive to businesses, tourists, and inhabitants."[98] A city's reputation can attract or repel business.[99] Were Detroit to lose the DIA, the City's reputation could be damaged, which in turn could have a repulsive influence on firms from all sectors of the economy. Around the time of its bankruptcy, Detroit's reputation could hardly have gotten worse. Nevertheless, like Chapter 11, underlying Chapter 9 bankruptcy is the idea that a municipal debtor should be positioned by a court to succeed after bankruptcy. Therefore, a court should have considered how preserving the DIA could provide Detroit a better opportunity to improve its reputation post-bankruptcy.

Additionally, "clustering" is an important component of the "creative economy." Creative firms and institutions attract other creative firms and institutions by allowing collaboration between firms and by reducing costs.[100] Further, investments in the creative sector tend to be relatively high-risk ventures. Diversification and collaboration are necessary in this field:

> [I]n the last several decades, we have witnessed an increasing "commodification" of cultural goods, which allows culture from punk to hip-hop to be sold in a global

97. *E.g.*, *In re* City of Detroit, 524 B.R. at 167.

98. John Crompton, *Beyond Economic Impact: An Alternate Rationale for the Public Subsidy of Major League Sports Facilities*, 18 J. SPORT MGMT. 40, 44 (2004).

99. Peter Jakub & Eva Happ, *Impact Assessment between the City and the Company Reputation*, 10 ECONOMICS AND SOCIOLOGY 279, 279 (2017).

100. Allen J. Scott, *Cultural Economy and the Creative Field of the City*, 92 GEOGRAFISKA ANNALER 115, 117 (2010).

> marketplace. But in this commodification process, creative industries and creative producers must engage each other and generate new products together on some part for survival, because creative goods are risky and inherently attract fickle consumer tastes . . . [T]he more people, firms, and industries able to participate in producing a particular good, the more diffused the risk. These dynamics emerge as a result of the taste-driven, uncertain nature of the cultural economy.[101]

Without the DIA, collaboration could become more challenging in Detroit's creative sector as there would be fewer creative individuals in the area to consult about proposed creative ventures. The demise of the DIA could weaken the creative sector activity around Detroit, which in turn could discourage other firms in the creative sector from clustering into Detroit.

B. What to Make of the Collection's Value

While liquidation sales generally destroy the value of a debtor's property, the DIA artwork also had relatively little demonstrable economic value to Detroit. As an asset of the City, the DIA was a money-loser and had an income capitalization of zero. While determining the museum's economic impact on Detroit with certainty is a task beyond the scope of this Note, the data available suggest that the DIA was likely worth more on the auction block than it was as an asset to the City and as part of Detroit's economy.

Not liquidating the art, in fact, could have had a negative impact on Detroit's economy and government—and perhaps a more severe impact than the DIA's demise. Detroit's creditors were not only bond insurers and contractors, but also retired public employees. One attorney involved in the bankruptcy described the tension as "Pills over Picasso."[102] Denying retirees the opportunity to extract any value from the DIA would have resulted in slashed pension payouts and healthcare benefits for retirees. This would force retirees, many of whom still lived in Detroit and southeast Michigan, to reduce their spending. For some retirees, "quality of care in assisted living centers and nursing homes was directly correlated with their monthly income."[103] Ultimately, cuts to retirees' pension and healthcare benefits would have adversely impacted businesses that relied on retirees' spending, and as a result the City of Detroit would see reduced tax revenue.

i. *The Possibility of a Partial Liquidation*

Liquidating the DIA's artwork might not have meant the demise of the museum. As one staffer to Kevyn Orr wrote, "[I]f [the DIA's benefactors] don't like it . . . [t]hey can buy the art and gift it back to the DIA."[104] Given the pub-

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101. Elizabeth Currid, The Warhol Economy: How Fashion, Art, and Music Drive New York City 115 (2007).

102. Bomey, *supra* note 1, at 123.

103. *Id.* at 155.

104. *Id.* at 123.

lic outcry in reaction to the possible sale of the DIA's artwork, purchasing and regifting auctioned DIA pieces could have become a *cause célèbre* for philanthropists. This task would have been more feasible if only the most valuable paintings were auctioned, as there would have been fewer opportunities for the DIA's benefactors to be outbid by buyers uninterested saving the DIA. In this ideal scenario, proceeds from the sale would go to retirees' pensions and healthcare benefits, while the economic benefit of the museum to the City would have been preserved.

ii. *The Possibility of Sharing Liquidation Proceeds to Replace the DIA's Economic Impact*

A sale of the DIA's artwork could have generated enough revenue both to repay creditors a significant sum and to theoretically provide principal for the City to invest and generate returns equal to the museum's economic impact. For example, if the artwork were worth $2.8 billion at auction, as Artvest conservatively appraised, and if the museum had a $20 million annual economic impact on Detroit, Detroit would then keep $500 million of the proceeds of the sale. The $500 million sum would produce $20 million per year in investment returns, assuming a four percent rate of return.

In Chapter 7 liquidations, debtors are always able to keep some of their assets up to a certain value. What a Chapter 7 debtor keeps is called an "exemption," which is related to the "fresh start" principle. "To help the debtor obtain a fresh start, [the Code] permits him to withdraw from the estate certain interests in property, such as his car or home, up to certain values."[105] If the value of an asset exceeds an exemption limit, the asset is considered "partially exempt."[106] The concept of Detroit "exempting" a portion of the liquidation revenue is a similar concept, although seemingly unprecedented in Chapter 9 bankruptcy. Formally speaking, the Code's provisions governing exemptions are not incorporated into Chapter 9 bankruptcy.[107] But because Chapter 9 readjustment plans are negotiated, Detroit's plan still could have split the proceeds of liquidating the DIA's collection. Treating the proceeds of the DIA's liquidation as property subject to an "exemption" by sharing auction proceeds would have balanced the need to repay creditors with the "fresh start" principle by allocating a nine or ten-figure sum toward creditor repayment while enabling Detroit to replace the economic output that the museum generated with investment income.

105. Rousey v. Jacoway, 544 U.S. 320, 325 (2005).

106. Hearings before the Subcommittee on Civil and Constitutional Issues of the Committee on the Judiciary of the House of Representatives, 94 Cong. 27 (1976) (Statement of William T. Plumb, Jr.).

107. *See* 11 U.S.C. §901 (2012).

PART III: HOW A COURT SHOULD HAVE DECIDED THE ISSUE

Ultimately, a court should have decided to allow a partial sale of the collection—to allow some, but not all of the DIA's most valuable pieces and artwork held in storage to be sold. This could have raised hundreds of millions, if not billions, to repay creditors, while leaving enough of the DIA intact to continue as a cultural beacon for Detroit.

A. THE NEED TO LIQUIDATE

The liquidation value of the DIA's collection was simply too valuable to leave the collection untouched, and the going concern value of the collection was too small to justify saving the museum. Although the liquidation value of the museum is unknowable, the museum made only a modest amount of money in ticket sales and the liquidation value was very likely far greater than the value of the collection as an income-producing asset. The museum, in fact, was a money-loser that relied on taxpayer dollars and donations to survive.

While defenders of the museum cited the immeasurable economic and cultural impact of the DIA on Detroit, the economic and human impact of failing to repay the City's retirees would also have been severe—and measurable. Nearly 32,000 former city employees, including disabled former policemen and firemen would have been affected.[108] The quality of life that these retirees could afford was at stake. Even following the actual plan, under which $816 million was raised to save the museum and compensate creditors, retirees have had their benefits reduced and some struggle to make ends meet as a result.[109]

B. THE FRESH START IN BANKRUPTCY

Chapter 9 emphasizes the "fresh start" principle undergirding legal thought surrounding bankruptcy. Although usually discussed in the context of consumer bankruptcy, the concept can be applied to other forms of bankruptcy.[110] "The fresh start philosophy places the cost of a borrower's failure on his lenders . . ."[111] By punishing creditors, bankruptcy:

> . . . not only provides lenders with incentives to charge borrowers for the cost of failure (in the form of higher interest rates), but also provides incentives for lenders

108. *See* Susan Tompor, *Even 5 Years Later, Retirees Feel the Effects of Detroit's Bankruptcy*, DETROIT FREE PRESS (July 18, 2018), https://www.freep.com/story/money/personal-finance/susan-tompor/2018/07/18/detroit-bankruptcy-retirees-pension/759446002/.

109. *Id.*

110. *See* Jonathan S. Hermann, *Restoring Bankruptcy's Fresh Start*, 86 FORDHAM L. REV. 189, 194 (2017).

111. Nicholas L. Georgakopoulos, *New Value, Fresh Start*, 3 STAN. J.L. BUS. & FIN. 125, 160 (1997).

> to counteract adverse selection and moral hazard problems by filtering out uncreditworthy borrowers and by monitoring the performance of existing borrowers.[112]

While some may balk at the idea of a government entity skirting its financial obligations, forcing borrowers to bear the risk of a municipal bankruptcy in theory discourages predatory lending to mismanaged municipalities. Likewise, forcing Detroit's lenders to bear the burden of its financial failure discourages the granting of high-risk, high-interest loans to struggling cities moving forward.

One key difference between Chapters 9 and 11 that Congress has recognized is that "a municipality is generally not a business enterprise operating for profit, and there are no stockholders."[113] As Justice Sonia Sotomayor recently noted, "[w]hile a business corporation can use bankruptcy to reorganize, and, if that fails, fold up shop and liquidate all of its assets, governments cannot shut down power plants, water, hospitals, sewers, and trains and leave citizens to fend for themselves."[114] This suggests Congress recognizes that Chapter 9 may weigh more on the side of providing a debtor municipality with relief as compared to a business debtor in a Chapter 11 bankruptcy. "[U]nlike the other Chapters, Chapter 9 does not attempt to balance the rights of the debtor and its creditors, but rather, to meet the special needs of a municipal debtor."[115]

C. The Possibility of Compromise

Lost in the public debate over the potential sale of the DIA art was the possibility of a compromise over the fate of the museum. Neither did a sale need to involve all of the art, nor did all of the proceeds of such a sale need to go entirely to creditors. "Chapter 11 is sometimes described as an *invitation to a negotiation*."[116] As the municipal form of Chapter 11, Chapter 9 can be characterized the same way, and the $816 million fundraising plan that saved the DIA from the auction block was the result of a negotiation. A compromise could have balanced the need to compensate creditors with the need to give Detroit a shot at a "fresh start" by minimizing whatever harm could befall Detroit as a result of auctioning all or part of the DIA's collection.

Although the City of Detroit could have received part of the proceeds of an auction of the entire collection, liquidating the entire museum was likely unnecessary and risked harming Detroit's economy in the long run; a complete liquidation of the DIA would have been antithetical to the "fresh start" principle. The complete loss of the DIA would have risked damaging Detroit's creative

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112. *Id.*

113. H.R. REP. No. 95-595, at 263 (1977).

114. Puerto Rico v. Franklin Cal. Tax-Free Tr., 136 S. Ct. 1938, 1950 (2016) (Sotomayor, J., dissenting).

115. *In re* Richmond Unified School Dist., 133 B.R. 221, 225 (1991).

116. *In re* Indianapolis Downs, LLC, 486 B.R. 286, 297 (Bankr. D. Del. 2013) (emphasis added).

sector, hurt the City's reputation, and left the City deeply humiliated. While the risk of harm would have been difficult, if not impossible, to demonstrate, the spirit of Chapter 9 would have afforded that risk great weight. Additionally, the portion of auction proceeds that would be allocated to the City of Detroit in order to produce dividends equivalent to the museum's economic value[117] would likely have deprived creditors of a sum of money unacceptable to creditors. And seventy-five percent of the value of the DIA's collection was concentrated in a handful of pieces, meaning that creditors would derive the bulk of their compensation from a small portion of the collection. Therefore, the vast majority of the collection could have remained with the museum while generously compensating creditors relative to the value of the entire DIA collection.

The best compromise would have involved selling only part of the collection. The DIA could have survived as a cultural institution without some of its most valuable paintings and without many of the paintings that were kept in storage. Moreover, benefactors committed to the museum's vitality could have purchased whatever was auctioned from the DIA's collection and gifted the works back to the museum. Finally, the $816 million bailout plan that ultimately saved the DIA functioned much as a partial sale or an auction of the full collection would have. In other words, money raised to save the museum in effect gave creditors value from the collection, the same result if the museum had been liquidated.

117. *Supra* Part II.