Banks named as “co-conspirators” in municipal bid-rigging

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As states and cities throughout the United States slash social spending to pay their debts, major Wall Street firms have been accused of conspiring to drive up prices on loans to local governments.

Lehman Brothers, JPMorgan Chase & Co., and UBS, together with over a dozen other financial companies, colluded to drive up interest rates on bonds to states and cities, according to a class-action lawsuit filed by the State of Mississippi, together with other local governments.

The group alleges that these financial companies assigned negotiated bids amongst themselves to limit competition and ensure that cities, states, and small foundations paid them high interest rates on municipal bonds.

Last week, U.S. District Judge Victor Marrero refused a request to block the lawsuit, which was re-filed with more details and fewer defendants, after being tossed out last year. The case “is replete with detailed allegations regarding the acts in furtherance of the conspiracy,” the judge said in allowing the case to go forward.

The accusation by the State of Mississippi overlaps with a criminal investigation into CDR Financial Products Inc., a financial advisor for local governments. Charges were filed against the firm alleging that it took kickbacks from major banks in exchange for advising local governments to do business with them. The alleged payments, ranging from $4,500 to $475,000, were paid out between 2001 and 2005.

Bloomberg News said that the names of co-conspirators was submitted by defense lawyers for a former employee of CDR Financial Products Inc., which was indicted last year on charges of bid-rigging. The attorneys specified in their filing that the government had provided the document, which was titled “list of co-conspirators.”

In addition to JPMorgan Chase, Lehman and UBS, Bloomberg reported that the list contains the names of more than two dozen bankers at firms including Bank of America Corp., Bear Stearns Cos., Societe Generale, two of General Electric Co.’s financial businesses and Salomon Smith Barney, the former unit of Citigroup.

Defense attorneys for CDR filed a motion to withdraw the filing on March 25, however, saying the document had been filed “inadvertently.” The request was granted by Judge Victor Marrero, whose office declined to comment on Bloomberg’s report.

The class-action lawsuit and case against CDR correspond to an ongoing investigation by the SEC and Justice Department, which has thus far subpoenaed over a dozen banks in relation to price-fixing in the municipal bond market. The document submitted in the case against CDR represented the first time the largest banks were explicitly named as “co-conspirators” by the government, the *Wall Street Journal* wrote.

A representative from the Department of Justice said that its ongoing investigation into the municipal bond industry has resulted in three guilty pleas so far, all from former CDR employees relating to charges filed in October 2009. She declined to comment further on the list of co-conspirators.

JPMorgan admitted last year that it was under investigation for “possible antitrust and securities violations in connection with the bidding or sale of guaranteed investment contracts and derivatives to municipal issuers.” JPMorgan fired the managing director of its municipal derivatives service in March 2008 after learning he was the subject of an investigation.

Allegations of bid-rigging in the municipal market are emerging as states and municipalities slash

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spending to meet their debt payments. As tax revenues have plunged, states have faced extensive budget shortfalls. These have raised the perceived risk of their defaulting, and consequently the rates charged by banks for financing their debt.

Last week, New York City's Health and Hospitals Corporation said it would reduce its workforce by ten percent over the next two years, in an effort to address its budget deficit of over $1 billion. The job cuts, amounting to 2,600 positions, will come on top of reductions of 1,300 jobs this year.

The budget proposed by New York Governor David Paterson would cut over $1 billion from state assistance to health care, a quarter of which will come from hospitals.

Such cuts are emblematic of overall actions by states, which have frantically sought to cut costs in order to maintain their credit ratings. States, led by California and New York, have turned to furloughs, layoffs, and wage freezes in an effort to keep Wall Street from downgrading their credit ratings.

The *New York Times*, commenting on the danger of state government defaults, wrote that "states are showing many of the same signs of debt overload that recently took Greece to the brink—budgets that will not balance, accounting that masks debt, the use of derivatives to plug holes, and armies of retired public workers who are counting on benefits that are proving harder and harder to pay."

About $5 billion in municipal bonds are currently in default. A series of state failures would far eclipse that amount. "The fact that the states' debts aren't as big as Greece's doesn't mean [state defaults] can't happen," Kenneth S. Rogoff, an economics professor at Harvard and a former research director of the International Monetary Fund, told the *Times*.

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