Emergency manager acknowledges bank deals pushed on Detroit were likely illegal

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6 January 2014

During testimony last Friday in US bankruptcy court in Detroit, the city's emergency manager acknowledged that financial schemes Wall Street banks foisted on the city in the mid-2000s were probably illegal. The swaps deals with Bank of America-Merrill Lynch and Swiss-based UBS cost the city hundreds of millions of dollars and have been cited as a major cause of the city's financial crisis.

Orr's statements in court underscore the criminal nature of the entire bankruptcy operation, which is being used to cover up illegal actions by Wall Street banks and extort the money the city owes as a result of predatory financial schemes from the working class. The hearing Friday also highlighted the complicity of the federal government and the bankruptcy court in this conspiracy.

Emergency Manager Kevyn Orr was questioned by attorneys for city employee pension funds and other creditors, which are challenging Orr's plan to pay Bank of America and UBS $165 million to end the swaps deals with the city. Testifying under oath, Orr said the city had determined there were "serious questions" about whether it should pay the banks at all, and he noted the possibility of a successful fraud claim against UBS and Bank of America.

He added that last year, prior to taking Detroit into bankruptcy court in July, he had asked the federal Securities and Exchange Commission (SEC) about the possibility of criminal prosecution of UBS and Bank of America over the deal. Orr did not say how the SEC responded to his request.

Orr gave the following list of reasons the swaps deals may have been illegal:

The banks may have presented false or misleading information about future interest rates.

The Michigan Gaming Act may render illegal the city's 2009 pledge of casino revenue as collateral.

The 2005 debt deal may have overstepped the city's legal debt limit.

UBS has since been named as one of the banks involved in the rigging of Libor, the main international benchmark interest rate.

In 2012, UBS paid $1.5 billion to the SEC and European regulators as part of a settlement of charges that it worked to rig Libor, which determines the interest rate of many financial products, including interest rate swaps.

These illegal activities only scratch the surface of the manipulation and deception carried out by the banks during the subprime mortgage bubble that burst in 2008. Complex financial arrangements were used by major financial institutions to fleece cities across America.

Orr and attorneys from his former law firm Jones Day originally sought approval to pay UBS and Bank of America-Merrill Lynch some $230 million, a sum equivalent to 75 cents on the dollar, but were ordered to renegotiate the terms by Bankruptcy Judge Steven Rhodes in mid-December. Orr and the city negotiated the agreement to pay $165 million to end the swaps deal last week, and obtained the approval of Chief US District Judge Gerald Rosen, who mediated the talks between the city and the banks.

Orr has told city pensioners they may be paid as little as 10 cents on the dollar for the city's outstanding pension obligations under his "adjustment plan," which is slated to be released in coming weeks.

But he recommended that the city pay the banks, claiming this would prevent a drawn-out legal case and allow the city to gain access to casino revenues currently tied up in the swaps deal. He testified Friday that city officials estimated the chances of winning a suit against the banks were "more or less 50/50," and then decided to negotiate a termination payment to the banks instead. Orr claimed that he never drew up an "actual draft order" for suing Bank of America and UBS.

Thus, the banks will be paid—rather than the pensioners—even though the banks were likely engaged in illegal activity. Orr acknowledged that there were "strong legal arguments" to be made against the banks in relation to the original 2005-2006 deal as well as the 2009 renegotiation of the agreement, under which the banks were given claims on city casino revenues as collateral.

UBS and Bank of America have already collected hundreds of millions from the city, which saw its monthly payments shoot up after the financial collapse of 2008. When the city failed to keep up with the rising payments, UBS and Bank of America threatened to invoke their contractual right to a $400 million termination fee. Then-City Council President Ken Cockrel Jr. cut the deal with the banks giving them access to city casino revenues as collateral.

The swaps deal, supposedly designed to offset risks to Detroit's pensions, has served as the mechanism for a massive transfer of wealth from the city to the banks, and led directly to the cash-flow problem used by Governor Rick Snyder and Orr to justify the Chapter 9 filing.

Under a deal negotiated by Orr, the money to pay off UBS and Bank of America will be loaned to the city by the London bank Barclays.

At last Friday's hearing, the attorney for Ambac Assurance disputed the legality of the Barclays deal during cross-examination of Orr, and demanded that Jones Day release documents detailing its internal assessment of the legality of the 2005/2009 swaps deal with Bank of America-Merrill Lynch and UBS. The bond insurance firm's attorney said: "They're playing games with the privilege that should not be permissible." Orr had invoked attorney-client privilege to keep this information secret last month.

In response to the Ambac attorney's request, Judge Rhodes called a recess and returned after an extended deliberation, only to deny the motion.

Minutes later, an individual interrupted the court proceedings with demands that the banks be prosecuted, shouting, "Jones Day is not the city of Detroit." He was forced out of the courtroom by security. Judge Rhodes fled to his chambers and later, upon returning to court, assured Orr that he could do likewise in the event of a similar incident.

There is little doubt the documents would expose the fact that Jones Day knew the deals were criminal. Jones Day counts among its clients Bank of America and UBS.

The latest stage in the bankruptcy hearings has highlighted the role of the banks in wrecking municipal and family finances across the country. Detroit had one of the highest percentages of subprime loans—many from Countrywide, which was taken over by Bank of America in 2007—and an estimated 69,000 home foreclosures that have left entire neighborhoods abandoned and boarded up. This disaster was the outcome of predatory lending schemes—using variable interest rates—similar to those entered into by the city in 2005.

Absolute priority over Detroit's wealth is being given to financial firms, as preparations are made to gut city worker pensions. While the banks have swallowed hundreds of millions in city revenues, the city has cut the number of public employees and basic services have been slashed. The banks, the courts, the city government and elite firms like Jones Day are determined to make the workers of Detroit pay off the same banks that organized the illegal swaps deal.

This has been carried out with the intimate involvement of the Obama administration, as was indicated when an SEC representative refused to confirm or deny Orr's claim that he consulted with the agency about making a case against UBS and Bank of America.