Detroit bankruptcy judge considers $85 million payment to global banks

Thomas Gaist at the Federal Court
4 April 2014

US Bankruptcy Judge Steven Rhodes heard arguments Thursday over a proposed payment by the city Detroit of $85 million to UBS and Bank of America. The money would go to terminate an interest rate swap deal entered by the city in 2005-06, which has already cost Detroit hundreds of millions.

Emergency Manager Kevyn Orr had previously agreed to give the banks $285 million, but was sent back to negotiations by Judge Rhodes. The judge was clearly concerned that the massive payout, taking place while retired city workers are being robbed of their pensions, would be seen as a provocation. Rhodes also rejected a second proposal, which would have paid the banks $160 million.

Both Rhodes and Orr have acknowledged that the two banks likely broke the law when they inveigled the city into the swap deal, which was sold to Detroit officials as a protection against rising interests rates. When rates fell sharply after the 2008 crash, the city was saddled with massive costs to terminate the deals.

Effectively admitting that the deal they are seeking to pay off was illegal from the beginning, the city attorneys argued that the settlement was preferable because failure in litigation would mean the banks could grab $170 million in casino revenues being held in liens (as collateral).

Attorney for the city Robert Hertzberg argued that despite Rhodes' previous acknowledgment that various aspects of the swaps deal may be illegal, he should still approve the $85 million termination fee. "Questionable liens are settled every single day in every single bankruptcy court across the nation," Hertzberg argued, referring to the claims on casino revenue granted to the banks as collateral.

The collateral arrangement, which Rhodes previously suggested was in violation of the Michigan Gaming Act, was concluded in 2008-09 in order to extend the swap deal, after the city defaulted on its payments. Since this extension, the city has paid $4-5 million monthly on average to the banks, which maintain a stranglehold over one of the city's main sources of revenue.

Under the Gaming Act, the casino revenues are to be used exclusively for "socially beneficial" purposes.

Orr told the court during testimony Thursday that he was on the verge of suing UBS and Bank of America for fraud, misrepresentation, and a number of other violations in January, but pulled back once the bank agreed to a termination figure of less than $100 million. Orr said he reasoned that such a figure would be better for the city's interest than attempting litigation, which could be too expensive.

Orr testified that his team is planning to wrap up the bankruptcy by October 15, and that retirees must agree the "global" plan, dropping all rights to appeal or challenge the plan, in order to receive a small reduction in the sweeping cuts to their benefits.

Syncora Insurance, which will have to pay out to cover potential losses of big municipal bondholders, argued that the banks will receive a "windfall" under the deal, including a $55 million payment right after the bankruptcy ends.

The swaps deal was the primary factor leading to the short-term cash-flow crisis seized upon by Governor Rick Snyder, Orr, and their co-conspirators to justify the Chapter 9 filing. Detroit residents are now asked to believe that the best possible outcome is tossing another big bag of cash to the same financial institutions.

The atmosphere of the proceeding was marked by chumminess and joviality. Jokes were exchanged repeatedly between the parties. The highly paid attorneys doing the dirty work of the city and the banks will continuing to live very comfortably, whatever happens to the workers of Detroit. Their laughter gave a reminder of the enormous disconnect between this privileged social layer and the deadly reality facing Detroit workers.

Jerome Goldberg, member of the pro-Stalinist Workers World Party (WWP), and a lawyer who sued the banks on behalf of retirees over the swaps deal, also testified Thursday, arguing that the banks could be made to pay restitution to the city, rather than the city paying the banks. Goldberg said that by challenging the swaps deal, the city could seek the return of some $300 million in payments made to UBS and Bank of American as result of the deal. The city has paid nearly $50 million a year to the two global banks.

"It's not a whole lot better than the previous settlements, which have been taken to this court, which essentially award the banks with millions of dollars for claims that are questionable…How can this be palatable to a retiree," Goldberg said.

In fact, the lawsuit initiated by the WWP is not aimed at protecting pensions but the trade union bureaucracy, which is engaged in feverish behind-the-scenes negotiations for a more favorable re-distribution of public assets in the bankruptcy court. AFSCME, the UAW and the other unions function not as defenders of retirees or current workers but as another business entity chiefly concerned with protecting their control over multi-billion dollar retiree benefit investment funds.

The unions and the pseudo-left supporters in the WWP accept the demand that workers must pay for the financial crisis they did not create. The appeal to Judge Rhodes is also aimed at blocking workers from drawing the necessary political conclusions about the courts and the Democratic and Republican parties and developing an independent strategy to fight.

The swaps deal hearings and the bankruptcy process as whole have shown that the financial elite can override the law with impunity. Payment of any amount to UBS and Bank of America will be made in violation of law, just as workers' pensions are being stolen in violation of the state constitution. Ever more money is to be shoveled into the troughs of the bankers, even as Detroit retirees are denied the means of survival.

Workers must reject the entire framework of the bankruptcy. The social wealth monopolized by the banks must be used to fund the rebuilding of Detroit and the full funding of pensions and health benefits. Such an outcome is only possible, however, through the political mobilization of the working class in Detroit, the US and internationally to break the grip of the corporate and financial elite and put the banks and other financial entities under the democratic control of the working class.