

Bond Case Briefs

Municipal Finance Law Since 1971

Philadelphia Sues Seven Banks Over ‘Collusion’ in Muni Deals.

- **Suit follows others making similar claims in state courts**
- **City alleges that banks fixed prices on variable-rate debt**

Philadelphia sued seven banks including JPMorgan Chase & Co. and Bank of America Corp., accusing them of costing local governments billions of dollars by colluding to fix the prices on floating-rate bonds issued to finance public works.

The city alleges the banks conspired to inflate the interest rates on the bonds from as early as 2008, according to a class-action filed in federal court in Manhattan on Wednesday. According to the complaint, the Justice Department opened a preliminary criminal investigation into the banks’ practices after meetings with a whistle-blower in 2015 and 2016. The Securities and Exchange Commission has contacted at least four banks “regarding their conduct in the VRDO market,” according to the complaint.

Citigroup Inc., Goldman Sachs Group Inc., Wells Fargo & Co., RBC Capital Markets LLC and Barclays Plc were the other banks named in the suit. Scott Helfman, a spokesman at Citigroup, declined to comment, while representatives at the other banks were not available for comment.

The lawsuit appears similar to several filed by Edelweiss Fund LLC on behalf of California, Illinois, Massachusetts and New York that center around the pricing of variable-rate demand obligations, a type of long-dated bond that carries low interest rates because buyers have the option to sell them back to banks periodically. Edelweiss, which is backed by an anonymous principal with experience in the municipal-bond industry, is seeking at least \$3.6 billion in damages and penalties as part of three of the suits.

The Philadelphia suit seeks to represent a group including municipalities, hospitals and universities, according to the complaint, and a judge must agree to certify the suit as a class action. The city is being represented by Quinn Emanuel Urquhart & Sullivan LLP, a firm that says it has won \$30 billion in settlements over the past five years.

Representatives of JPMorgan didn’t immediately respond to emailed requests for comment on the suit sent outside regular business hours. Bill Halldin, a spokesman for Bank of America, declined to comment.

Philadelphia and the purported class of issuers paid “billions of dollars” in inflated interest rates, according to the lawsuit.

“By artificially increasing the rates paid by plaintiff and the class, defendants’ conduct necessarily decreased the amount of funding available for critical public projects and services, as well as the operations of 501(c)(3) organizations,” the city said in the complaint.

Banks that are hired as remarketing agents on the bonds set the rates and often take securities that

have been put back into inventory for resale, giving them an incentive to set the rates higher if they want to avoid holding them.

According to the Edelweiss suits, instead of “actively and individually” marketing and pricing bonds at the lowest possible interest rates, the banks “engaged in a coordinated ‘Robo-Resetting’ scheme where they mechanically set the rates en masse without any consideration of the individual characteristics of the bonds, the associated market conditions or investor demand.”

“Defendants ‘Robo-Reset’ these rates in order to keep the bonds in the hands of their holders, and thus alleviate the need for defendants to remarket the bonds,” Edelweiss claimed.

In the early 2000s, issuers sold between \$30 billion and \$60 billion of such debt annually, often in conjunction with interest-rate swaps, according to Thomson Reuters Deals Intelligence.

In 2008, they sold more than \$115 billion in such paper as they refinanced both auction-rate and insured floating-rate debt, as the auction market froze and insurance companies were downgraded. Since then issuance has dwindled, totaling \$7 billion in 2018. The total size of the outstanding VRDO market has been estimated at \$150 billion.

The case is *City of Philadelphia v. Bank of America Corp.*, 1:19-cv-01608, U.S. District Court, Southern District of New York (Manhattan).

Bloomberg Markets

By Joe Mysak and Amanda Albright

February 21, 2019

— *With assistance by Chris Dolmetsch*