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Bloomberg: New Detroit Bankruptcy Plan in the Hands of Creditors.

Disagreement from both bond insurers and unions signals a more contentious negotiation phase

Detroit's plan to end its $18 billion bankruptcy assumes bondholders offered 20 cents on the dollar will eventually swallow a deal that guarantees police and firefighters collect 90 percent of their pensions.

The city's debt-adjustment plan, filed on Friday in U.S. Bankruptcy Court in Detroit, is built on $820 million in contributions from private foundations and the state. Those groups say no money will flow without a settlement that protects the city's valuable art collection from liquidation by bondholders and other creditors.

Within hours of the plan being filed, the creditors that city officials must win over rejected the proposal, even as they continue talking behind closed doors. Unions and bond insurers both registered their displeasure.

"While we understand that favoring pensioners and discriminating against bondholders and other creditors might be politically popular, we believe this is contrary to bankruptcy law and will result in costly litigation that will hamper the city's emergence from bankruptcy," Steve Spencer, a financial adviser for bond insurer FGIC Corp., said in an e-mailed statement.

The filing opens a new, potentially more contentious phase of the biggest U.S. municipal bankruptcy. Unless confidential mediation sessions produce settlements, U.S. Bankruptcy Judge Steven Rhodes will be asked to approve the plan over objections from creditors, including unions.

'Gut Punch'

"The proposed plan of adjustment is a gut punch to Detroit city workers and retirees," the American Federation of State, County and Municipal Employees said in a statement. "Retirees cannot survive these huge cuts to the pensions they earned. The plan is unfair and unacceptable."

Under the plan, the city's retired general employees, represented by AFSCME, wouldn't get as much as police and firefighters. If Rhodes approves the plan as-is, the general workers would be forced to take 66 percent of their current pensions. If the workers voluntarily accept the proposal, they would get 74 percent, and police and firefighters 96 percent, according to the filing.

A committee approved by Rhodes to represent more than 23,500 retired city workers in the case also condemned the plan, claiming in a statement that the proposal would force 20 percent of current city retirees into poverty in the next 10 years.

Offers Less

The new plan offers less than what the city said last month it would pay investors who hold two types of general obligation bonds. The limited and unlimited versions of the bonds would be paid only 20 percent of about $539 million outstanding, down from a maximum of 31 percent and 48 percent respectively.

Bond insurers, who would be expected to pay any losses on the bonds they back, have sued the city, arguing that the debt is guaranteed by property taxes and should have a higher repayment priority than other creditors, such as retired city workers.

‘All In’

The city’s emergency financial manager, Kevyn Orr, told reporters yesterday that the $820 million contribution hinges on an “all in” deal.

“We need a settlement from everybody,” he said. The foundations supplying the money are trying to protect the artwork in the city-owned Detroit Institute of Arts.

The proposal filed yesterday doesn’t include any cash for creditors from a potential new source: a Great Lakes Water and Sewer Authority, which would take over responsibilities from the city. Detroit has said it wants to create the authority and then lease its water and sewer operations to it to boost creditor recoveries.

Under the plan, the city would fully repay water and sewer bonds, as well as other debt that’s backed by collateral.

Water Bonds

Detroit water bonds maturing in 2041 fell more than 1 percent on Friday to 87.6 cents on the dollar, according to data compiled by Bloomberg.

Detroit filed for bankruptcy on July 18 after decades of decline, saying it couldn’t pay creditors while also providing basic services. Orr set an aggressive timetable for the case, seeking to finish by September 2014, when he can be removed from his post by the City Council.

Once the center of the U.S. auto industry, Detroit has seen factory jobs dwindle in recent decades. During the financial crisis, General Motors Co. and Chrysler Group LLC went through bankruptcies of their own. Both companies have since reorganized and are thriving again, while the city continues to cope with broken streetlights, blighted neighborhoods and overstretched emergency services.

Reinvestment Plan

The plan is meant to both cut debt and reinvest in the city, Orr said in a statement. Under the proposal, Detroit would spend $1.5 billion over 10 years on capital improvements and equipment and technology upgrades. As much as $500 million of that would be spent in the next five years on blight removal in a city with tens of thousands of abandoned properties.

Rhodes initially must decide whether the proposal contains enough information for creditors to vote on it. He has said he expected the city to keep talking to creditors even after a plan was filed.

“Mediation won’t be over until every last single issue has been settled or decided by me,” Rhodes warned the parties this week during a court hearing. “Maybe even it will continue until the case is on appeal.”

Eligibility Appeal

In December, Rhodes found the city eligible for bankruptcy protection, overruling the unions that want the case dismissed. Yesterday, the unions and retired public workers won permission to take their challenge to the city's eligibility directly to a federal appeals court, bypassing the district court, possibly speeding up a resolution.

Orr's plan would reduce benefits for some retirees who may have benefited from an annuity savings plan operated by the pension system. The optional savings plan boosted payouts by hundreds of thousands of dollars for some retirees who contributed their own money and reaped a guaranteed investment return, even in years when the pension fund lost money in the market.

Money paid from the pension fund to the annuity savings program from 1999 through 2012 would be put back in the fund. Orr didn't divulge how much the restitution would cost the employees and retirees who may have received the payments, which totaled about $756 million from 1985 through 2007, according to city records.

Retirement Restrictions

The plan also places restrictions on the city's two retirement programs, and leaves open the door to changing their governing boards under a mediated settlement that includes Republican Governor Rick Snyder and the GOP-controlled legislature. The pension board would be required to limit to 6.25 percent their expected returns on investment.

After a vote, creditors can raise further objections at a confirmation hearing. Rhodes will take the votes and the objections into account before deciding whether to confirm the plan. Bankruptcy law permits him to override a "no" vote through a process known as a cram-down.

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