Bond Case Briefs

Municipal Finance Law Since 1971

NYT: Painful Progress in Detroit.

If the measure of a good compromise is that everyone is left unhappy, the Detroit bankruptcy plan certainly qualifies.

Detroit's municipal retirees have approved a restructuring blueprint that will cut their promised pension payouts significantly as part of a larger effort to reduce the city's $18 billion debt. Other creditors rejected the blueprint, including hedge funds and bond insurers that hold or back billions of dollars in municipal debt. One of their complaints is that the blueprint unfairly discriminates against them in favor of pensioners. Another complaint, advanced by a group of bondholders who would receive 100 percent of their principal under the plan, is that their losses are too great compared with what they would have made under the bonds' original terms.

The next step is for Judge Steven Rhodes of federal bankruptcy court to hold a trial, scheduled to begin on Aug. 14, at which the City of Detroit will have to make the case for the blueprint, while objectors argue against it. If the judge finds the plan legal, equitable, fair and feasible, he would confirm it, in effect, forcing the blueprint's terms on the "no" voters.

Whatever the result, there will be no victories. Pensioners voted yes not because they were getting a sweet deal, but because they faced even deeper cuts — potentially as high as 27 percent of monthly benefits for some retirees — if they voted no. To avert such a crippling blow, the State of Michigan, nonprofit foundations and donors to the Detroit Institute of the Arts pledged $816 million to reduce the planned pension cutback and to protect the city's art collection from being sold to pay off bondholders — but only if the pensioners approved the blueprint and if the judge confirms the plan. Nonuniformed city retirees now face cuts to their monthly pension payments of 4.5 percent, the elimination of annual cost-of-living adjustments and, for some, claw backs of annuity payments deemed excessive. Police and fire retirees, who are not covered by Social Security, face deep cuts to annual cost-of-living adjustments.

The no votes, in contrast, basically reflect the hopes of bondholders for a better deal, which they have the right to fight for. Some of their grievances involve complex legal issues that clearly need to be resolved in court. But there is no doubt that municipal pensioners who voted yes on the blueprint are a more vulnerable constituency than the financial institutions that voted no.

The pensioners also have negotiated in good faith on a plan that is now Detroit's best hope for making a fresh start. By comparison, most of the other creditors are professional investors who knew or should have known the risks of lending money to Detroit yet now find themselves calling for deeper pension cuts or auctioning off masterpieces in order to minimize their losses. Their no votes on the blueprint — and their probable appeal if Judge Rhodes confirms the blueprint — will only further delay Detroit's restructuring and deepen its misery.

For now, the painful bankruptcy process is moving forward as it should. The outcome is uncertain, but one thing is sure: The people of Detroit have suffered enough.

By THE EDITORIAL BOARD

JULY 22, 2014