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A Detroit bankruptcy could be long, costly

Municipal experts fear that a Chapter 9 filing would prove complex, difficult

BY LEONARD N. FLEMING The Detroit News

Detroit — The deepening financial crisis in Detroit has intensified hints that the city could opt for bankruptcy, but financial experts warn the move could cost taxpayers millions, stall economic development and take years to be resolved in the courts.

Bankruptcy is an option if the city can't win major concessions from its unions and if the state's tough new emergency manager law is suspended or repealed.

Under the law passed in March, an emergency manager appointed by the governor would have the power to throw out union contracts, sell off assets such as the Detroit Water & Sewerage Department and other powers to fix the city's fiscal crisis.

Attorney General Bill Schuette said he is undecided whether Michigan would revert to its old emergency manager law if opponents get enough signatures to put the repeal question on the ballot next year.

But bankruptcy would be a worst-case scenario, warned Brad Coulter, who specializes in municipal turnaround and bankruptcy services.

"That's where the opponents of an EM maybe don't quite understand the consequences if (the law is) repealed, and Detroit has no choice but to file for bankruptcy; I think it's going to be an expensive, time-consuming potential disaster," said Coulter, director of O'Keefe & Associates Consulting in Bloomfield Hills. "It's uncharted territory as to how long a city the size of Detroit will take to wind its way through bankruptcy.

"I'll guarantee you this: It's not going to be a quick in-and-out of bankruptcy that we saw with GM and Chrysler. That's not going to happen."

Others contend a Detroit bankruptcy could be an advantage because city officials would have more control over the outcome than if it were under the thumb of a state-appointed emergency manager.

A city Detroit's size has never filed for bankruptcy. In the late 1970s, Cleveland defaulted on its bank loans, but never filed for Chapter 9. There were bankruptcy filings in Orange County in 1994 and Vallejo, Calif., in 2008, and both emerged from it after their finances were restructured.

In what was at the time the largest municipal bankruptcy filing in history, Orange County filed for Chapter 9 with almost \$2 billion in liabilities. Afterward, county officials sued their financial advisers to collect millions in settlements.

Last month, Jefferson County, Ala., filed for bankruptcy protection, owing more than \$4 billion in obligations including \$3 billion in sewer debt.

In Vallejo, officials cut costs by canceling union contracts and selling off assets. The city spent three years under Chapter 9.

Including Jefferson County, which is home to Alabama's largest city, Birmingham, there have been four municipal bankruptcies filed this year. Others include Harrisburg, Pa.; Central Falls,

R.I.; and Boise County, Idaho. Judges in the Harrisburg and Boise County cases have rejected those filings.

Detroit Mayor Dave Bing, who is negotiating with the city's 48 unions for major concessions and the state officials who recently finished a preliminary review of Detroit's finances, won't even comment on the possibility of filing for bankruptcy. State Treasurer Andy Dillon and Gov. Rick Snyder have declined to discuss it as well.

Under current state law and Public Act 4, an emergency manager would be the only one who could file for bankruptcy on behalf of the city.

Terry Stanton, the spokesman for Dillon, said the EM would have to get the governor to sign off "after reaching the determination that no other workable solution exists for a local unit of government under a financial emergency."

Although bankruptcy would allow for judicial oversight of debt restructuring and be a surefire way to cancel union contracts, it could take from two to five years and cost taxpayers tens of millions of dollars in legal fees to get a city the size of Detroit through a successful bankruptcy filing, experts contend. That's because every party involved — the state, city, unions — has attorneys and would rack up legal fees and court costs.

Accord a better bet

A state-appointed emergency manager does not have the authority — unlike a bankruptcy judge — to restructure bonds or what's owed to vendors, which also makes bankruptcy more relevant in Detroit's case as a way to address those issues Public Act 4 doesn't cover, some say. The bankruptcy judge who would oversee Detroit's case would come from the U.S. Sixth Circuit Court of Appeals, which encompasses Tennessee, Michigan, Ohio and Kentucky.

Ray Graves, a retired U.S. bankruptcy judge based in Detroit, said the city could be "drifting toward bankruptcy" if a state-appointed EM can't get a deal done that would help right-size the city.

"If people don't come to the table and make a deal, the EM could propose a Chapter 9, and if the governor thinks that is the way to go, you're going to wind up in a Chapter 9 with a judge you don't know and a long, extensive formal court process," Graves said.

"So, for people who are concerned about who the decision-maker is going to be, that's not a very good scenario."

Coulter said that in bankruptcy, every group that's owed money — the retirees, unions and bondholders — gets attorneys, "so you're talking tens of millions of dollars in legal fees."

"This emergency manager law is really set up to accomplish what you can do in bankruptcy without having to file for bankruptcy," Coulter said. "That's how you would do it the proper way, versus fighting until the end until you have no choice but to do an EM or file (Chapter 9)."

James T. McTevia, a nationally recognized financial turnaround expert who has served as a receiver and a bankruptcy trustee, said the best way to resolve Detroit's financial problems is to get all the parties together before it goes to Chapter 9.

"Bankruptcy is a very expensive way to solve financial problems," said McTevia, whose company is based in Bingham Farms. "I can tell you there are certain advantages in a bankruptcy, but the disadvantages far outweigh the advantages."

City 'incapable or unwilling'

What put Detroit on this floundering fiscal course is mentioned in the Department of Treasury's preliminary report on Detroit's finances. The document states "city officials are either incapable or unwilling to manage its own finances."

It went on to detail how the city has long-term liabilities of \$12 billion, could be at risk of losing hundreds of millions if its credit rating is downgraded and how officials have failed to file an "adequate or approved" deficit-elimination plan that would reduce the general fund deficit.

Kirk Lewis, Bing's chief of staff, said in a statement he doesn't want to speculate on bankruptcy while the city is negotiating for concessions with its 48 unions.

“As Mayor Bing has repeatedly said, the remedy for the city’s financial crisis is his plan that seeks \$102 million in savings for this fiscal year, including structural reforms in health care and pensions, layoffs and other cuts,” Lewis said. “Speculating on worst-case scenarios — like the extreme prospect of bankruptcy — is not productive nor is it something we’re focused on.”

Michael E. Baum, an attorney specializing in bankruptcy and restructuring for Schafer & Weiner, said bankruptcy is not a silver bullet, nor will it “be a move to avoid the tough decisions” because of a shrinking tax base.

“It offers some very unique ways to restructure debt,” he said. “Bankruptcy does not produce money. It’s not a panacea in terms being able to provide funds. There’s no opportunity absent some creativity to create more money. But what bankruptcy offers to Detroit and the taxpayers are the opportunity to be in control of whatever restructuring needs to take place.”

Suburbs put at risk, too

A bankruptcy in Detroit could have consequences for its suburban neighbors, too.

L. Brooks Patterson, the Oakland County executive, has been warning for years about Detroit’s precarious financial situation harming the suburbs. He has been told his county’s rating could be in jeopardy if Detroit falls under receivership and later seeks bankruptcy.

Patterson sees an emergency manager coming into Detroit “as a positive development” because that person can help whittle down the size of government to fit a reduced city that has lost hundreds of thousands of its residents.

But if the city opts for bankruptcy, “we’ve already been warned by Moody’s and Standard & Poor’s that we will lose our Triple A bond rating, and that will cost my taxpayers over time millions of dollars,” Patterson said, adding Oakland County might have higher interest rates when it floats bonds, for example.

If Detroit continues to lose a large percentage of its tax base, Patterson added, “I don’t see how the city survives without cleansing itself with a quick bankruptcy much like Chrysler and GM did.” lfleming@detnews.com (313) 222-2072

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