



Birmingham, Alabama's Bankruptcy: the Fraud That Will Not Go Away

Mike Shedlock, who has been watching the Jefferson County, Alabama, municipal bond bankruptcy and default closely, has turned up some more fraud. It appears that the original bonds issued to pay for the county's new sewage treatment plant weren't bonds after all, but warrants. But they were sold as the same thing, backed by the "full faith and credit" of the county. In the event of bankruptcy investors holding the warrants were to be first in line to receive their interest payments, ahead of any other creditors. And if there isn't enough money even for that, the investors were assured that the county would do whatever is necessary to redeem them, even if it meant raising taxes or fees on the citizens.



But a warrant isn't a bond; instead, it is [merely a right](#) granted to its holder to purchase a bond in the future. The county board of commissioners decided against issuing bonds as that would have required a referendum by the taxpayers who, at the time, were already suffering from increased sewage rates — four increases over the past 10 years. The likelihood of approval was between slim and none.

The story of corruption, bad faith, and "paying to play" schemes involving major banks and brokers has been covered in detail [here](#), [here](#), and [here](#), but the sordid story began when the Environmental Protection Agency forced the county to build a new sewage plant in the mid-1990s. It was supposed to cost \$300 million, relatively affordable to the residents of Birmingham, with its population of 650,000. But by the time the bankers and the brokers and the county commissioners got through with them, the taxpayers now face a bill approaching \$4 billion. The current commissioners, after struggling for years to find a way out, finally threw in the towel last month and declared a Chapter 9 bankruptcy.

Under normal conditions that would mean that the county would continue to service the debt until a bankruptcy judge sorted things out and determined just what the county could afford to pay. In the meantime, however, the county has simply stopped paying anything altogether, putting, for the first time, the true real-world meaning of "full faith and credit" to the test.

Because Jefferson County issued the warrants, they did an end run around the requirement for a referendum. But they were sold as bonds, with investors counting on the "full faith and credit" clause to protect them in the event of bankruptcy. However, in Alabama counties have no authority to raise taxes; only the state can do that. And so, now that the county has stopped paying the \$4.5 million monthly interest payments, the bondholders are [headed to court](#).

A Birmingham bankruptcy judge has yet to make a decision on the matter, but community activists are threatening violence. Sheila Tyson, who lives in the low-income West End was blunt: "These people are



Written by [Bob Adelman](#) on December 27, 2011

going to end up rioting about this. If [the commissioners] let this stuff happen they are going to get the biggest riot the South has ever seen ... over this sewer business. I can see it coming." Tony Petelos, the county manager appointed by the new commissioners to help sort things out, agrees: "The public has lost confidence in Jefferson County over the past decade and a half, because of the mismanagement, because of the corruption. We have got to rebuild that confidence."

The best way to rebuild that confidence, according to Shedlock, is to cancel the debt, let the bondholders take the loss, and put some more people in jail:

I have had it with the notion that bondholders can never take a loss. The best court ruling would be [that] those are indeed general obligation bonds, but bankruptcy changes the game. My guess is the courts will duck the issue based on the fact Jefferson County never issued a referendum.

If the court ruling is favorable to the taxpayers, who are the silent invisible parties to the ongoing and unrolling fraud, then investors will be forced to take a "haircut." It will also be a warning to the 40 percent of America's counties which have also issued "full faith and credit" bonds (or warrants) but which also don't have the legal authority to raise taxes to pay them off.

Photos: Main courthouse (top) and Bessemer courthouse in Jefferson County



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