

OBAMA AND O'BANKRUPTCY...HE'S TANGLED UP IN HIS EMPATHY

Stephen L. Bakke – May 2009

This caught me by surprise! I was naïve enough to believe that contract law had some continuing value to all in our society – particularly as it relates to security interests, commercial lending, and bankruptcy. As a former Chairman of the Commercial Finance Association, I would be remiss if I didn't have something to say about President Obama's recent comments and actions regarding a significant and important group of Chrysler's creditors. The process can be compared to a professional wrestling match.

Circling Each Other in the Ring

Our President "guided" Chrysler into an internal shakeup, negotiations for a sale, and as we all know, Chrysler found it necessary to file for Chapter 11 bankruptcy. As a career secured lender, I have dealt with this many times – not always with pleasant results but at least the ground rules were reasonably well defined. Under Chapter 11, everybody who is a stakeholder or creditor lines up to see what kind of settlement they can negotiate based on the facts and contracts in place. There are secured creditors, and unsecured creditors. Their status is determined by an examination of the facts and contracts. The secured creditors have contractual claims against specific assets if their loans are unpaid. The President didn't think the secured lenders should push to retain their priority and thereby maximize recovery. But some of the secured creditors pushed back because they didn't approve of the government's plan of reorganization.

I heard someone say that this is extreme and unusual – it's a Chapter 11, and therefore "all bets are off." Absolutely not! It is for just such an event that security interests are obtained. If not for a bankruptcy filing, or some other type of reorganization or unusual event, there would seldom be any need to have collateral for a loan. This process is intended to follow consistent guidelines and procedures. There are rules (or I thought so). President Obama either didn't understand this, or he was on a quest to "transform" this critical part of our economy.

Growling and Intimidation

Among the secured creditors there are TARP organizations (those having received bailout dollars) whom the President "prevailed upon" to step aside in spite of their secured interests. They had to agree – they received big government bailout dollars, and Barack Obama is now the CEO (he's their boss!). Recall the assurances given by Treasury Secretary Paulson that the government would not interfere with their operations or dictate their decisions – except, apparently, for dictating how much they lend, who they lend to, how much they pay their executives, how much they accept as a settlement in major bankruptcy cases, and so on.

A very important group of secured creditors didn't agree to "roll over" – at least initially – because they didn't have to! They were not TARP recipients, were contractually secured by their lending agreements, and have a responsibility to their funding sources and investors to do the best they can to recover the dollars they loaned. If they "played dead" they just might have separate legal problems. They were protecting the pension funds, endowments, and insurance

companies that invested in them – putting their clients’ fiduciary interests first. Is that bad? To show you the magnitude of what President/CEO Obama asked them to do, it has been reported that if their claim remained intact, they expected to recover up to 80 cents on the dollar – considerably more than the 29 cents proposed by the President. The potential amounts involved aren’t as important as the fact that President/CEO Obama clearly tried to intimidate them into settling for a fraction of the amount they were entitled to attempt to recover. It really was their right and obligation to do so!

Cliff Asness, Managing Partner at AQR Capital Management stated the case very well: “Let’s be clear, it is the job and obligation of all investment managers, including hedge fund managers, to get their clients the most return they can. They are allowed to be charitable with their own money, and many are spectacularly so, but if they give away their clients’ money to share in the ‘sacrifice’, they are stealing.”

Bankruptcy attorney Tom Lauria has publicly reported that “One of my clients (a secured creditor) was directly threatened by the White House and in essence compelled to withdraw its opposition to the deal under threat that the full force of the White House press corps would destroy its reputation if it continued to fight.” He also said in front of the bankruptcy judge: “I’ve never represented a group of creditors who were called out by the President of the United States just for standing up for their rights.”

Head-butt and Stranglehold

Our President stood at the familiar place in front of his teleprompter, severely criticizing organizations which are important to our economy – secured lenders. He referred to them as “greedy speculators”. Speculators? What is any major business transaction if not a form of speculation? This was not the foolish speculation of making mortgage loans to consumers who really can’t afford it. No! These loans were between an informed borrower and experienced lenders. The purpose of the loans was to provide working capital and other loans to a struggling manufacturer so that jobs would be retained and an important entity was given a chance to survive. Not foolish speculation, but legitimate secured loans with Chrysler assets backing them.

The President acknowledged the resistance of these few secured lenders and decided to put them into a “stranglehold” he hoped they couldn’t overpower.

Takedown and Pin

Bottom line – the secured creditors were offered very little by President/CEO Obama because he considers them just “greedy speculators”. B.S. (pronounced “poppy-cock”) – in my opinion, the real speculator here was the government that went head-long, without in-depth research, into a bailout relationship with a large American company. And if the UAW wasn’t such a strong supporter of President Obama and others of the uninformed multitude in Washington, maybe this wouldn’t have happened.

First, one of the secured creditors withdrew its opposition – the threat started to work! Then, it was reported that “Chrysler holdout creditors give up court challenge”. These dissident creditors

decided to give up their battle as announced in a written statement from their attorney: “After great soul-searching and quite frankly agony, Chryslers’s non-TARP lenders concluded they just don’t have the critical mass to withstand the enormous pressure and machinery of the U.S. government.” The statement said the lenders would drop the fight against the plan, but they are not agreeing to the proposal to settle for 29 cents on the dollar – that may be a distinction without a difference – we will see.

Was the First Match “Winner Take All”?

It looks like it! What’s the UAW getting? 55% of a potentially viable U.S. manufacturer. And their pension funds are being “shored up” by the President/CEO’s “generosity”. What are the secured creditors getting? If President Obama gets his way, they’ll get a “crap sandwich!” And how about the “invisible” pension funds that are a large part of the investors in these secured lenders? The non-UAW pensions have effectively been “subordinated” to the pensions of the UAW. Political commentator Michael Barone had this to say: “The White House is seeking to transfer the property of one group of people to another group that is politically favored. In the process it is setting aside basic property rights in favor of rewarding the United Auto Workers for the support the union has given the President and his political party.”

What Might the Referee Rule in the Next Match?

Just like a wrestling match, every bankruptcy case has a “referee” to assure procedural order and integrity. That person is the bankruptcy judge. Are the secured creditors assured of good things happening in the final settlement? Absolutely not. Are there challenges to the secured creditors’ positions which could ultimately prevail? Of course. But a courageous judge would make sure there was proper conduct by all concerned – including President/CEO Obama. But, unfortunately (I think), the dissenting secured creditors’ initial objections will not be judged on their merits – they “caved” under the pressure.

There will be more opportunities for arguments. Examine the technical legal writings on this case to get more detail – “sub rosa” or “de facto” plan objections, “363 sales”, “absolute priority rule”, and others. I’m certainly not the one to address these, but in the final analysis, the integrity of this process relies upon it being conducted according to traditional procedures and precedents. It must NOT be influenced by the misguided transformational philosophies of the current administration.

Aftermath and Analysis

Why the concern? Why, as a businessman myself, don’t I stand with the businesses such as Chrysler and GM, by encouraging the government to bail them out? Because that’s not what should be done! I believe we would all be better off in the long term if these corporations actually were permitted to fail, or succeed, WITHOUT government interference. I don’t wish for them to fail, but that’s the way the system should work. Failed business structures generally need to change dramatically or disappear – let Chrysler or GM simply file Chapter 11, or otherwise reorganize if they must – but it should be done on their own without installing a totally inexperienced political “machine” to run them. It’s painful, but a better way in the long run.

What's the big deal? Can you imagine the consequences if the President gets his way and the bankruptcy judge gives consideration to creditors not according to contracts, rules, and established legal precedents, but according to which group is most politically favored? As of now, we have an active secured lending industry. Our commercial finance industry is one of the only reasons stressed and troubled companies have any ability at all to raise money. As Bill Frezza of Adams Capital Management recently said, "Credit flows because everyone knows the rules of the game, even in bankruptcy".

Mr. Frezza offers these questions: Why would anyone lend money to unionized companies knowing that if things went wrong, the President and his men could trash their security interests by executive decree, hold them up to public vilification, and subject them to future retribution by regulators? Why would anyone buy the shares of TARP-backed banks or invest alongside them knowing that their executives have proven their willingness to sacrifice shareholders' interests and throw co-investors under the bus any time the president snaps his fingers? Why would anyone buy the debt of stressed U.S. companies knowing that this debt cannot be secured by law but only by political clout?

Cliff Asness of AQR Capital Management made these comments: "(Consider) the irony of this same President begging hedge funds to borrow more to purchase other troubled securities. That he expects them to do so when he has already shown what happens if they ask for their money to be repaid fairly would be amusing if not so dangerous the President screaming that the hedge funds are looking for an unjustified taxpayer-funded bailout is the big lie Find me a hedge fund that has been bailed out. Find me a hedge fund, even a failed one, that has asked for one The President's comments here are backwards and libelous The President's attempted diktat takes money from bondholders and gives it to a labor union that delivers money and votes for him."

Empathy?

President Obama says he's not standing with the greedy speculators. That means he must be constantly distancing himself from hedge funds and other greedy speculators. Right? Wrong! Hedge fund manager Larry Summers heads the National Economic Council. The White House Chief of Staff Rahm Emanuel is reported to have made millions as an investment banker. And Vice President Biden's son was in the hedge fund business. While the President is not standing with greedy speculators, he is standing with the workers (UAW). He said it! Is that a play for/reward for votes or what?! But be careful what you wish for, Mr. President, you might get it.

Bad things will happen if President Obama prevails and changes, by fiat or influence, decades of legitimate precedent and rule of law. Does he really want to make secured lending vanish? Maybe I'm foolish, but if he takes time to analyze the reality of the situation, I really don't think so! It's the life blood of liquidity in our economy.

So far he's acting like a community organizer! Maybe he just needs time to get his empathy untangled.