

Chrysler: Fund Managers Burned by Obama Now Say They Are Wary

By Caroline Salas

May 20, 2009 (Bloomberg) -- Hedge fund manager George Schultze says he may avoid lending to any more unionized companies after being burned by President Barack Obama in Chrysler LLC's bankruptcy. Obama put Chrysler under court protection on April 30 after lenders balked at a proposal giving them about 29 cents on the dollar for their \$6.9 billion in debt. The investors said the president's plan favored a union retiree medical fund whose claims ranked behind them for repayment. It was offered a 55 percent equity stake in the automaker.

Pacific Investment Management Co., Barclays Capital and Fridson Investment Advisors have joined Schultze Asset Management LLC in saying lenders may be unwilling to back unionized companies with underfunded pension and medical obligations, such as airlines and auto-industry suppliers, because Chrysler's creditors failed to block Obama's move. The reluctance may put additional pressure on borrowers seeking capital in the worst financial crisis since the Great Depression. "Lenders will have to figure out how to price this risk," Schultze, 39, said in a telephone interview from his office in Purchase, New York. "The obvious one is: Don't lend to a company with big legacy liabilities or demand a much higher rate of interest because you may be leapfrogged in a bankruptcy."

Dissident Lenders

Schultze, whose firm had about \$247.7 million under management in February, according to a regulatory filing, declined to disclose which company debt he may avoid. He was among the last holdouts. The dissident lenders to the Auburn Hills, Michigan-based automaker -- including OppenheimerFunds Inc. and Perella Weinberg Capital Management LP, both in New York -- caved after Obama blamed hedge fund "speculators" for the bankruptcy of the 83-year-old car company and said he stood with its employees. At its peak, the group consisted of 30 funds holding more than \$1 billion, according to Tom Lauria of White & Case LLP, the investors' attorney, who is based in Miami and New York. "Anything that involves a large number of jobs or affects a large number of people, you can expect to see a Chrysler redux," Jerry del Missier, president of Barclays Capital, said in an interview from his New York office. "One of the consequences here is the so-called speculators, people who provide financing, will think twice about getting involved." Barclays Plc, based in London, is the third-biggest U.K. bank.

Hartmarx Rallies Support

The struggle between creditors and labor has also reached Hartmarx Corp., the 122-year-old clothing maker in Chicago that made the suit Obama wore to his inauguration. Unions are gaining government support in a fight against Wells Fargo & Co., the bankrupt company's lender. More than 30 members of Congress, including House Financial Services Committee Chairman Barney Frank are urging the San Francisco bank not to liquidate the clothier, according to Representative Phil Hare, an Illinois Democrat. The lawmakers are also seeking Treasury Secretary Tim Geithner's backing. Hare said last week that Wells Fargo, the fourth-largest U.S. lender, is responsible for Hartmarx's collapse because it refused to extend credit. Wells Fargo said in a statement the bank wants the suit maker, which defaulted on more than \$114 million in loans, to "stay in business."

Preferential Treatment

General Motors Corp., which accepted \$15.4 billion in U.S. taxpayer aid, is also giving unions preferential treatment over bondholders in its restructuring, even though their claims rank equally. The biggest owners of GM debt include San Mateo, California-based Franklin Resources Inc. and Capital Research & Management Co. of Los Angeles, regulatory filings show.

Detroit-based GM on April 27 asked the investors to swap \$27 billion in debt for a 10 percent stake in the reorganized automaker, while offering a retiree health-care fund \$10 billion in cash and as much as a 39 percent stake for \$20 billion in unsecured claims. "It's terrible precedent," said Schultze. "The sad thing is it impacts the manufacturing sector and the companies that have legacy liabilities directly. It will be nearly impossible, or much more expensive, to get secured financing for these type of companies." Unions spent \$52 million to help elect Obama, which includes \$5 million from the United Auto Workers, according to OpenSecrets.org, a Washington-based organization that tracks campaign spending. Roger Kerson, a spokesman for the UAW in Detroit, declined to comment.

Offer Rejected

A committee of GM bondholders rejected the offer and asked Obama's auto task force on April 30 for 58 percent of the company's equity. Their proposal hasn't been adopted and bankruptcy is "probable," Fritz Henderson, GM's chief executive officer, said in a Bloomberg Television interview last week. The U.S. bankruptcy code allows for workers to get preference over bondholders, said Richard Hahn, co-chairman of the bankruptcy practice at Debevoise & Plimpton LLP, a New York law firm, who isn't involved in the GM negotiations. Section 1114 of the

bankruptcy code requires that a debtor “timely pay” all “retiree benefits” unless the bankruptcy court orders otherwise or the authorized representative of the recipients of those benefits agrees to other treatment, he said.

Chrysler lenders might have recovered nothing if the government hadn’t poured billions of dollars into the carmaker, said Gary Hindes, managing director of distressed investments at Deltec Asset Management LLC in New York. The hedge fund firm didn’t buy the company’s debt or GM’s, in part because of the risk the government’s involvement would damp returns, Hindes said. “If you’re being paid more than what you would be paid in a liquidation, then the contractual obligation has been met,” said Hindes, whose firm oversees about \$526 million, according to a regulatory filing. “It’s still very disturbing to see the government basically strong-arm people into this.”

\$4.2 Billion

While debt prices haven’t yet reflected the shunning of unionized companies by investors, steel and automakers and airlines will face higher borrowing costs when they attempt to raise funds, Schultze said. Fort Worth, Texas-based AMR Corp. employs about 90,000 and 67 percent are represented by unions. AMR had about \$4.2 billion in underfunded pension obligations as of year-end, according to Fitch Ratings. AMR, the parent of American Airlines, is rated Caa2 by Moody’s Investors Service and B- by Standard & Poor’s, four and six levels above default. Andy Backover, an American spokesman, declined comment.

‘Justifiably Concerned’

Airline bonds haven’t fallen since Chrysler’s April 30 bankruptcy. High-yield air transportation debt is up 5.4 percent in May, outperforming the 3.8 percent climb in the average junk bond, according to Merrill Lynch & Co.’s U.S. High Yield Master II index. Speculative-grade bonds for auto and auto-part makers are up 3.9 percent.

“Creditors are justifiably concerned” about what precedent the auto bailouts are setting, said Mark Kiesel, global head of corporate bond portfolios at Pimco in Newport Beach, California. Pimco managed \$747 billion as of Dec. 31. “When you get these companies that have legacy costs, that’s something you have to factor in when evaluating credit risk,” Kiesel said. “Any investor is going to price in increasing political risk in considering where to put their money.” Pimco, manager of the world’s largest bond fund, didn’t have a stake in Chrysler and owns an “infinitesimally small” amount of GM debt, according to a report by co-chief investment officer Bill Gross on the firm’s Web site. The government’s “grassroots trend” signals “an increasing uncertainty of cash flows from financial assets” and risk premiums will increase as a result, Gross wrote.

Small-Car Technology

GM’s \$3 billion of 8.375 percent bonds due in 2033 have plummeted to 5.4 cents on the dollar from 21 cents at the beginning of the year, according to Trace, the price reporting system of the Financial Industry Regulatory Authority. The debt yields 149 percent. Chrysler began a bankruptcy process last month designed to revive the business. It will focus on small-car technology through a new partnership with Turin-based Fiat SpA, Italy’s biggest automaker. Obama says the plan will save more than 30,000 jobs.

‘Soul Searching’

A group of senior secured creditors, the Committee of Chrysler Non-Tarp Lenders, opposed Obama’s plan. Putting labor ahead of them in line for repayment violated “long-recognized legal and business principles,” the investors said in a statement the day Chrysler filed for protection. The committee gave up fighting on May 8 “after a great deal of soul-searching and, quite frankly, agony” and concluded that “they just don’t have critical mass to withstand the enormous machinery of the U.S. government,” said White & Case’s Lauria in an interview that day.

“People are starting to think ‘This is a very activist administration, even more than we counted on,’” said Martin Fridson, CEO of money manager Fridson Investment Advisors in New York. “If it comes down to the interest of creditors or labor unions, the administration is going to override what you thought you could do.”

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