The cure for automakers’ crisis? File Chapter 14

Editor’s Note: Academy President Rinaldo S. Brutoco wrote the following proposal which presents a politically acceptable way to use taxpayer funds to help preserve the United States’ industrial base and autoworkers’ jobs.

In all the analyses of The Big Three automakers’ looming insolvency, no one has suggested the best solution. GM, Ford and Chrysler need to file for Chapter 14 bankruptcy protection and the National Corporations Recovery Administration (NCRA) needs to classify them as “companies of national interest.” The reason this hasn’t happened, of course, is because neither Chapter 14 nor the NCRA exist. But they should.

Congress is in the sticky position of trying to protect the jobs and suppliers that Detroit supports while dealing with a major American industry whose business model is broken. On top of that, the public’s bailout fatigue after AIG, Fanny and Freddy, and now Citigroup, is pressuring lawmakers to demand detailed restructuring plans before writing any more checks.

Solutions mostly revolve around GM reorganizing into profitable pieces, each capable of making and selling fuel-efficient vehicles while preserving jobs for the manufacturers and parts suppliers. But filing Chapter 11 would keep in place GM’s incompetent management along with their bloated compensation packages. That won’t make GM competitive globally. To do that, GM must fundamentally change its business model, something it won’t do on its own.

The new bankruptcy provisions would create a mechanism to sweep aside bad management and speed reorganization or the sale of assets. Congress should pass a major amendment to the Bankruptcy Reform Act that would establish Chapter 14 for companies that have previously received federal bailouts or are widely regarded as “too big to fail.” (This provision alone would slash the number of companies asking for federal handouts.)

Under Chapter 14, the NCRA-appointed trustee would be charged with running the troubled entity. The trustee would wield immediate power to terminate management and their stock option packages and golden parachutes, sever other agreements, and sell assets. To protect taxpayers and guarantee transparency, a Chapter 14 trustee would create a public record with written explanations of all material decisions.

With Chapter 14, sophisticated financing or joint ventures could speed corporate turnarounds. An idle GM factory in Fremont, Calif., could join a transaction with a company like Tesla, the electric car manufacturer, which would otherwise have to build a new plant in San Jose. The government could supply Tesla with a GM factory in return for Tesla’s agreement to rapidly increase production.

Did you know?
Amount of bonuses Wall St. paid out last year ................................................................. $33.2 billion
Percentage of 1.9 million job losses in past year that occurred in the last 3 months .............. 66%
Percentage of 300-year-old Barclays now owned by Mideast investors ................................ 30%
Percentage of China’s small toy exporters that closed in the first 9 months of 2008 ................ 66%
U.S. world rank in countries’ access to high-speed internet connections. .............................. 15th
Markets and The Economy

The job picture
As too many people know all too well, the job picture is tanking fast.

Job losses, Nov. 2008 ........................................... 533,000
Job losses, Oct. 2008 ........................................... 320,000
Average monthly job losses, Sept.-Nov. 2008 .......... 419,000
Average monthly job losses, first 9 months of 2008 ... 82,000

The U.S. Labor Department’s reported unemployment rate of 6.7% for November 2008 vastly understates the true rate, as we’ve reported in EconForecast, because the Department’s standard rate doesn’t count people as unemployed whose unemployment benefits have expired. But even the Department’s report showed that the November unemployment rate was 12.5% when the count included the “total employed part time for economic reasons... plus all marginally attached workers.” The NY Times reported that “the number of people working part-time because they couldn’t find a full-time job rose by 621,000 last month.”

Meanwhile, major companies’ job cuts in Q4 just keep coming.

Fed ups the ante, rolls the dice
During the last year, the Fed’s balance sheet has tripled to $2.2 trillion. This week, it effectively cut the fed funds rate to zero, taking yet another action unprecedented in its 95-year history. The discount rate is down to 0.5%, the lowest since the 1940s.

If the saga and numbers of the Fed’s journey ever deeper into uncharted territory are becoming too much to hold in your head, read the UPI’s handy summary. Just don’t try to recount it in your mind to fall asleep because warm, fuzzy sheep will work much better.

A few easy-to-remember tidbits from the UPI’s assembled numbers: The federal government and its various agencies have already committed over $7 trillion to the financial crisis, “about the wealth that the entire U.S. economy produces in six months.... But we are only in the initial stages of this recession, and already the federal debt is heading toward 80 percent of GDP. Back in 1980, it was just over 30 percent of GDP. The last time it was as high as this was the aftermath of World War II, when the debt peaked at 120 percent of GDP.”

The Fed has injected over $1 trillion in new money since September, when its balance sheet was only about $900 billion. Because the Fed can’t lower its benchmark rate below zero, it is now switching its approach to “quantitative easing,” injecting money into the economy rather than focusing on interest rates. Moran Stanley’s chief economist, Richard Berner, said, “This is a whole new world.”

1 in 10 homeowners in trouble
At the end of September, about 1 in 10 Americans with a mortgage were at least a month behind on payments or in foreclosure. In Florida, over 7% of loans were in foreclosure, compared with about 3% nationally.

Latin American economies feel the pain
Since 2002, Latin America has enjoyed a period of unusual social gains and economic growth. According to a UN study released last week, the percentage of Latin Americans living in poverty has fallen to 33% this year, down from 44% in 2002. That may change. Now countries throughout the region, including powerhouse Brazil, are launching stimulus plans to fight the impact of the global downturn.
Tribune Company debacle

Governor Blagojevich schemed to oust journalists at *The Chicago Tribune* who criticized him, but the real damage to the paper’s employees was done by Sam Zell’s $8.2 billion take-over of the Tribune Company, which owns *The Chicago Tribune* and the *LA Times*.

When the 161-year-old *Tribune* filed bankruptcy last week, the spotlight on the company gave new meaning to Zell’s moniker, “The Grave Dancer.” (He earned the name by buying when everyone else was selling).

Zell took control less than a year ago, using the employees’ pension fund to help finance the deal. In return, employees got equity. Zell reportedly put up just $315 million of the purchase price himself in the course of tripling the company’s debt. Employees who took buy-outs or were recently laid off stand in the long line of unsecured creditors, well behind Zell.

The employees’ big financial hit is in stark contrast to the fees paid the bankers and analysts who put together and blessed the deal, walking away with tens of millions of dollars. Andrew Ross Sorkin’s *New York Times* piece exposes the “year-long debacle” and the Wall Street fees that drove the deal:

Tribune’s board was advised by a group of bankers from Citigroup and Merrill Lynch, which walked off with $35.8 million and $37 million, respectively. But those banks played both sides of the deal: they also lent Mr. Zell the money to buy the company. For that, they shared an additional $47 million pot of fees with several other banks… And then there was Morgan Stanley, which wrote a “fairness opinion” blessing the deal for which it was paid a $7.5 million fee (plus an additional $2.5 million advisory fee). On top of that… the Valuation Research Corp. wrote a “solvency opinion” suggesting that Tribune could meet its debt covenants. Thomson Reuters…estimates V.R.C. was paid $1 million for that opinion.

This just in: the Street can’t assess risk

Just when you thought the evidence couldn’t get stronger that Wall Street can’t assess risk, the news breaks about the Marc Dreier and Bernard Madoff frauds. Con artists are nothing new but there’s quite a roster of supposedly sophisticated individual investors, institutions, and funds managers who hadn’t heard the adage about eggs and a basket, and who didn’t question oddly consistent investment returns, the tiny shop that did Madoff’s accounting, or the lack of an independent outfit to hold assets.

Funds of hedge funds and investment subsidiaries of some of the biggest European banks are among those whose reputations will suffer. A fund of funds operation of the Spanish bank Santander had $8 billion under management and had parked $3.1 billion of it with Madoff.

With about $50 billion of estimated losses from Madoff’s Ponzi scheme, those who funneled him their clients’ money have not yet begun to feel the pinch.

CEO bonuses: end of an era

For now, year-end bonuses are being slashed. After UBS executives waived bonuses, others including Credit Suisse, Deutsche, and Goldman followed suit.

Even Merrill Lynch’s CEO John Thain has decided to do without a bonus. Until this month, he insisted on a bonus of at least $10 million despite the fact that Merrill lost about $11.7 billion this year and is being acquired by Bank of America. Thain argued that since taking over a year ago (with a $15 million signing bonus), he had salvaged value from his predecessor’s mistakes. Morgan Stanley and UBS AG have instituted mechanisms for bonus clawbacks if gains prove illusory.
Energy and Sustainability

The nuclear nemesis redux

The Academy’s most recent article on nuclear power was published this month in the second issue of a new European magazine, FORUM CSR International, which reports on the latest developments and best practices in sustainability and corporate responsibility in business, politics, and society.

The article, "The Nuclear Nemesis Redux," by Academy President Rinaldo Brutoco and Vice President Madeleine Austin, is a sequel to their article, "The Nuclear Nemesis," published in the American Bar Association’s Trends in May 2008.

The articles explain how nuclear power creates unacceptable risks to the planet, undercuts our ability to solve the intertwined energy and climate change crises, and increases the risk of cancer, contamination from nuclear waste, nuclear proliferation and terrorism.

The first issue of FORUM CSR International was devoted to the theme, "Responsibility for one world," and included prefaxes by EU Environment Commissioner Stavros Dimas and EU Commission Vice-President Günther Verheugen.

U.S. food aid fans starvation

For blunt reporting about how “U.S. farm and shipping lobbyists have stifled efforts to simplify aid deliveries, leaving Africans to starve when they might have been saved,” read the Bloomberg News article, “Dead Children Linked to Aid Policy in Africa Favoring Americans.”

Canada and the EU provide food aid by buying food near where it is needed. Because of legal mandates to buy U.S. produce and transport it on U.S. ships, Oxfam America says that U.S. food aid “serves domestic interests more than the world’s needy.” Shipping, logistical, and administrative costs can consume 2/3 of the budget for Food for Peace, the GAO reported last year.

The U.S. program steers the bulk of its food purchases to its largest three agribusinesses, Archer Daniels Midland Co., Cargill Inc., and Bunge Ltd., which together received 47% of all 2007 U.S. commodities spending for food aid. Their lobbying expenditures in the first 11 months of 2008 came to $1.78 million, $669,000, and $395,000, respectively.

Last year, Congress rejected President Bush’s proposal for locally-purchased food aid. Congress eventually approved such a pilot project involving 1% of 2008 U.S. food aid, and approved a one-time $50 million expenditure in 2009 for locally-purchased food aid.

We can do better.

Nuclear illusions

In October 2008, Mohamed ElBaradei, the head of the UN International Atomic Energy Agency (IAEA), reported that there had been 250 reports of theft of nuclear or radioactive material in the year ending in June. Without question, there is an urgent need to devise a better global regime to make it harder for terrorists to get such material, and we applaud the President-elect’s determination to make this a priority. It is long overdue.

But it is a dangerous illusion to think that such a system could ever be foolproof in light of the rampant corruption in countries that have nuclear materials. The only solution is to stop the spread of nuclear power technology.

Graham Allison’s article, “Nuclear Deterrence in the Age of Nuclear
continued from page 4: Nuclear illusions

Terrorism,” in the December issue of MIT’s Technology Review, is too optimis-
tic about the global capacity for good governance.

To give just two examples, Bulgaria and Romania, which both plan to expand
their use of nuclear power, are notoriously corrupt and already have plenty of
nuclear material to go around. Bulgaria is so corrupt that the EU recently cut off
its EU funds. We recommend comparing the list of countries that have nuclear power plants or
are planning to build them with those countries’ rankings on Transparency International’s Corrup-
tion Perception Index.

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lower the sale price, and hire more GM workers.

Or, investor T. Boone Pickens, a big natural gas
speculator, could play a valuable role in a new
joint venture combining an idle GM plant with
Mazda technology to mass-produce natural gas
vehicles. The Mazda Rx-8 Rotary Hydrogen car is
the only mass-production vehicle whose engine
can go from running on gasoline to natural gas
or hydrogen with the flip of a dashboard switch.
A third option would be to use an idle GM factory
as part of a deal with Nissan or another partner
of Better Place, which has an innovative busi-
ness model to speed the introduction of electric
vehicles by creating vast networks of charging
stations and battery-exchange depots.

GM’s creditors may not like the structure of trans-
actions like these in the short term. But Chapter
14 would make it possible to use GM’s existing
assets for the greater good — and would event-
ually make those assets viable again. Without
Chapter 14’s swift options and protections, GM
won’t be able to retool its factories fast enough.

Everyone wants to know when the cascading
demands for bailouts and federal largesse will
end. It’s time for a solution worthy of what Frank-
lin Delano Roosevelt would have proposed had
he been faced with this degree of widespread
financial destruction. We need a way to provide
troubled companies with government loans con-
tingent on smart restructuring plans with durable
controls. The expanded powers of a Chapter 14
trustee are designed to limit the rights of credi-
tors and shareholders to object to operational
decisions, reducing the time and money required
to successfully restructure a company.

A mechanism like Chapter 14 is the only possible
way to both assist truly troubled companies and
discourage bailout requests from companies
who should rely on their own innovation and
resources for financial solutions. Corporate brass
would do everything to avoid running into trou-
ble in the first place if they understood that bail-
out funds came with strings pulled by a trustee
with almost total power over the disposition of
assets and contracts. And for those companies
that we must bail out, Chapter 14 provides all
stakeholders with a solution that’s efficient and
just while protecting the public’s money.