



Cuomo Snubs Treasurers in Rescue of Auction-Rate Debt Holders

By Martin Z. Braun



[+ Enlarge/Details](#)

Aug. 21 (Bloomberg) -- New York Attorney General **Andrew Cuomo's auction-rate securities** settlements with Wall Street banks show that the man who bills himself as the "people's lawyer" favors savers over shareholders.

The almost \$35 billion of frozen debt that **Citigroup Inc., UBS AG, JPMorgan Chase & Co.**, Morgan Stanley and Wachovia Corp. agreed to repurchase covers less than 18 percent of the \$200 billion Cuomo last week estimated was outstanding, and is targeted at individuals, charities and small businesses.

Corporate finance officers, who also say they bought the securities after banks marketed them as safe alternatives to money-market investments, aren't being offered the same commitment. The best they got was a promise by **Wachovia** to buy securities, though maybe not until June 10, 2009.

"It's safe to say we're not pleased that what was marketed as highly rated investment grade securities in our portfolio are illiquid and have lost value," said **Michael Smith**, a spokesman for **ADC Telecommunications Inc.**

The Minneapolis-based maker of telephone-networking equipment, which owned \$170 million of auction-rate securities in May, has written down the value of the debt by almost \$100 million since Oct. 31, 2007.

Company Writedowns

Companies from Mountain View, California-based **Google Inc.** and **United Parcel Service Inc.** in Atlanta to **Texas Instruments Inc.** in Dallas have taken markdowns totaling \$2.1 billion on more than \$32 billion of auction-rate holdings, according to a July 31 **survey** from New York-based Pluris Valuation Advisors LLC.

The auction-rate market collapse may also lead corporate treasurers to abandon Wall Street, jeopardizing fees for bankers who arrange bond sales, mergers and public offerings.

Some finance managers are moving their cash to the trading desks of commercial banks as others shift to money-market funds or bank accounts, said **Anthony Carfang**, a partner at Treasury Strategies Inc., a Chicago-based treasury consulting firm.

"They're coming home to the trusted provider," he said.

Memphis, Tennessee-based **Pinnacle Airlines Corp.**, whose subsidiaries operate a fleet of regional jets, including Delta Connection and United Express, reported a second quarter loss of 64 cents per share on Aug. 11 in part because of an \$8.7 million charge on \$136 million of auction-rate securities backed by student loans.

In a conference call to discuss the results, Pinnacle Chief Financial Officer **Peter Hunt** said the settlements seem "to focus more on taking care of the small guys."

`` It does seem like there are also some promises of assistance to larger companies over time," he said.
`` That doesn't change the fact the asset is impaired."

Periodic Auctions

Auction-rate securities allowed municipalities, student loan agencies, and closed-end mutual funds to sell long-term debt with lower short-term interest rates set at periodic auctions, typically held every seven, 28 or 35 days.

Investors have been stuck in the securities since the one-time \$330 billion market collapsed in February. That's when dealers, who for two decades bought debt that went unsold at auctions, suddenly pulled back because of widening credit-market losses. Investors who were told the debt was as safe and liquid as money-market funds were left with depreciating securities they couldn't sell as auctions failed.

`` A lot of institutions were lied to by their brokers, and brokerage firms put their own interests ahead of their institutional customers," said **Jacob Zamansky**, a securities lawyer at Zamansky & Associates in New York who represents institutional investors in auction-rate cases. `` Cuomo was run over in his haste to get a settlement by these major firms."

'Less Sophisticated'

Cuomo, at an Aug. 14 New York press conference announcing settlements with JPMorgan and **Morgan Stanley** to buy back \$7.5 billion of the securities, said returning money to retail investors was his priority because they needed more protection. Both firms are based in New York.

`` They're less sophisticated," Cuomo said. `` They have fewer resources to begin with. The institutional investors we also believe need fairness and need equity, and to the extent they were victimized, they need to be compensated."

The **settlements** reached with the banks by Cuomo and state securities regulators call for the firms to use their ``best efforts" to help institutional investors turn the securities to cash. The settlements didn't provide specifics.

`` If we believe those best efforts are not achieving the fair and just goal, then we can take action," he said.

Timetable

A spokesman for Google didn't respond to a request for comment about the settlements. **Norman Black**, a spokesman for UPS, declined to comment. **Christine Rongone**, a Texas Instruments spokeswoman, said they are a ``positive, initial step."

`` We expect Wall Street banks to address this issue in a timely manner for all investors who purchased auction rate securities," Rongone said.

Zurich-based UBS is the only other bank besides Wachovia of Charlotte, North Carolina, to set a timetable to buy back the frozen securities from institutional investors, **agreeing** to purchase any of the remaining \$10.3 billion debt for face value beginning June 2010.

`` Right now they're doing the minimum possible to avoid full fledged war with the attorney general," **Brian Weber**, a senior analyst at Chicago-based Houlihan Smith & Co., which advises institutional investors, said of Cuomo's office.

New York-based Citigroup, which sold auction-rate securities to Pinnacle Airlines, has provided the airline with an \$80 million line of credit secured by the debt.

Seeking Damages

`` To date we haven't received any concrete information about how Citigroup might deal with its larger institutional holders," said **Ron Kay**, Pinnacle's treasurer.

Citigroup spokeswoman **Danielle Romero-Apsilos** said the bank ``will continue to marshal its

resources to work diligently with issuers and regulatory authorities to provide liquidity solutions for all holders of auction rates."

Securities lawyer Zamansky said many of the institutions he represents will go to arbitration to seek damages for "fraudulent" sales of auction-rate securities.

"I think it's outrageous that the firms are going to wait two years to deal with the liquidity for institutional investors," Zamansky said. "These are companies that have to make payroll, that have to make investments. Some of the companies can be out of business by then."

MetroPCS Communications Inc., the largest pay-as-you-go mobile-phone service provider in the U.S., sued New York-based Merrill Lynch & Co. in October 2007 in a Dallas court for fraud and misrepresentation.

Worse Off

The Dallas-based company alleged Merrill invested \$133.9 million of its cash in auction-rate securities issued by collateralized debt obligations, which were underwritten by Merrill. The third-biggest U.S. securities firm didn't disclose to MetroPCS that the securities were risky, the company said in its suit.

Mark Stachiw, general counsel of MetroPCS, declined to comment on the auction-rate settlements with regulators, citing the ongoing litigation.

In a statement, Merrill spokesman **Mark Herr** said the firm "acted appropriately in its dealing with MetroPCS."

The deals struck between Wall Street and state regulators may even make companies stuck with the debt worse off than they already are, said Pluris president **Espen Robak**.

Banks buying back auction-rate securities from individuals may resell it at a discount to get it off their balance sheets, leading companies to mark down their portfolios further, he said.

To contact the reporter on this story: **Martin Z. Braun** in New York at mbraun6@bloomberg.net.

Last Updated: August 21, 2008 00:13 EDT

