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Volume 7

Issue 4 Summer 2009: Symposium - Into the  
Sunset: Bankruptcy as Scriptwriter of the  
Denouement of Financial Distress

Article 5

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## A Fistful of Dollars: Hedge Funds, Private Equity and Bankruptcy

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### Recommended Citation

Marti Kopacz, Jeff Marwil, Sandra Mayerson & Bradley Sharp, *A Fistful of Dollars: Hedge Funds, Private Equity and Bankruptcy*, 7 DePaul Bus. & Com. L.J. 597 (2009)

Available at: <https://via.library.depaul.edu/bclj/vol7/iss4/5>

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## **A Fistful of Dollars: Hedge Funds, Private Equity and Bankruptcy<sup>1</sup>**

*Marti Kopacz, Jeff Marwil, Sandra Mayerson, and Bradley Sharp*

MS. MAYERSON: Hi. We're going to be talking this afternoon about hedge funds and private equity in bankruptcy, and we're going to cover what hedge funds and private equity investors are: historically, how far they've invested in bankruptcy, and how this has impacted reorganization.

Then, we're going to take our crystal balls and try to talk about how that might change, given the current economic climate, and how that will impact on the ability to reorganize.

The term "hedge fund", which is used in the materials, is a term that people throw around pretty loosely, and I thought maybe we would start by talking a little bit about what is a hedge fund. So Marti, can you tell us what a hedge fund is, and what makes it different from private equity?

MS. KOPACZ: I'll give it a shot, and we'll get the mic up here and we'll do that. Hedge funds have been around since the '40's, much like private equity has been around since the '40's. We think there are about 9,000 hedge funds today with — and how many have closed and how many are going out of business, we'll know in another year when we take a look at it. But those 9,000 hedge funds that we can identify had \$1.7 trillion invested when they were formed. So again, it's a conjecture as to what still sits in a hedge fund today, significantly less than \$1.7 trillion. But regardless, it's still a lot of money.

Hedge funds are a vehicle for investments by institutions and wealthy individuals. You really can't invest in a hedge fund in increments less than, you know, very high six figures or seven figures. They are limited; each fund is limited to one hundred different individuals, and they're very lightly regulated. We think that may change under the current administration and the current sorts of circumstances, but they still are very lightly regulated. Hedge funds came about to allow for aggressive investment strategies, and I think when you think about

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1. This is an edited version of the transcript from the second panel at the DEPAUL BUSINESS AND COMMERCIAL LAW JOURNAL SYMPOSIUM, *Into the Sunset: Bankruptcy as Scriptwriter of the Dénouement of Financial Distress*, held on April 16, 2009.

the term “hedge,” hedge means safe, or at least balanced, you know, on both sides. That’s the whole point of a hedge. Well, hedge funds today, and for most of their existence, have oftentimes not been particularly safe and, in fact, have been highly risky sorts of investment strategies. Hedge funds have characteristics as to what it is in which they are investing. Most hedge funds invest in public types of securities, bank debts, bonds, those sorts of things, things that could be easily traded in and out. Some of them may have a profile around where they invest. They may invest in some sort of a global strategy or a country or region strategy, or they may invest in a specific industry or they may avoid a specific industry. They may have a certain time horizon. So there’s not a — there’s no set definition, there’s no single view that I can give you of what a hedge fund is. It is a — it’s a loosely regulated pool of money from wealthy individuals and institutions to which management of those funds can apply very aggressive strategies. You’ll often hear in the context of hedge funds something called the two and twenty formula. That’s how hedge fund managers get paid. The two percent is the fee that they get paid as a part of the committed capital. So again, that can be a lot of money on \$1.7 trillion. And the twenty percent is twenty percent of the profits of the fund. You can begin to get an appreciation why, you know, young, smart fresh-faced M.B.A.s wanted to go into the hedge fund business over the last number of years. There was a lot of money to be made and a lot of personal income that they can garner in their role as masters of the universe.

AUDIENCE: And taxed at the capital gains rate.

MS. KOPACZ: And taxed at the capital gains rate. Compare and contrast that with private equity. Private equity came to be after World War II and, you know, contrast that a little bit with hedge funds. Private equity is a lot more about what its name is, in the sense that the investments are in private companies and the investments are intended to be more permanent capital. So they’re intended to be at the equity level, or definitely at a subordinated level, to the bank debtor, more secured debt in an organization. The time frame is very, very long in some of these — in some these funds. It can be, you know, seven, eight, ten, twelve years. It’s very illiquid as compared to a hedge fund investment. We think there are about 2,700 private equity firms today with about \$1.3 trillion invested, at least at the outset. Again, what that’s worth today, don’t really know, but it’s — it’s clearly a lot of money that has gone into private equity.

Private equity funds tend to have a personality to them in the sense of the way they like to invest. Maybe they’re an LBO shop, and they

like to do leverage buyouts and that's what they did, or they were venture capital or they were growth capital oriented, but they tended to have a profile around what they wanted to invest in and really stay more tightly focused than what you would see in a hedge fund. Their fees again are a percentage of the capital that is committed. So when you hear somebody say, "Oh, I've just raised a \$500 million fund," well, what that means is, for the most part, they've got promises from investors to give them \$500 million if they come to them with investments that they want to make. So, private equity doesn't get paid until they actually commit the capital and put it to work, whereas hedge funds will raise the pot of money, take their fees and then deploy it.

The similarities are that they're both lightly regulated. They're both private pools of capital. And their compensation ultimately depends on the profitability. The biggest difference, and this will be more relevant when we talk about how they behave in a restructuring context, is that hedge funds are willing to accept limited knowledge in return for favorable pricing, whereas a private equity firm will seek deeper knowledge and will be willing to pay more for more certainty in their investment decisions. So in your materials, pages 16 and 17 have comparison charts between them on a whole variety of components, some of which I've mentioned, but there's a lot more in your materials on the compare and contrast.

MS. MAYERSON: If you're an investor, how do you get out of a hedge funds or a private equity fund? Is it the same for both?

MS. KOPACZ: A private equity fund will have a stated term when you go into it. You used to be able to get out of a hedge fund. I don't know that you can get out now.

MR. SHARP: You can get out, but they have a catch.

MR. MARWIL: The documents provide for redemptions on a quarterly basis. But hedge fund managers reserve the right in their documents to suspend redemptions, and many of the hedge funds now, given the current market climate, have, in fact, suspended the redemptions, and it's typically a permanent suspension until the hedge fund managers prepare to start making distributions from the fund, presumably as the fund is liquidating. So, at least in the setup, the difference was that hedge fund investors could get out on a moment's notice quarterly. Private equity investors, on the other hand, were stuck for the entire term of the partnership, typically five to seven years.

And that, the psychology of managing those two funds, is very different as a result of the demands that investors place on hedge fund

managers for constant high returns, whereas the private equity manager has the entire term of the partnership in order to accomplish the return goals. So the behavior of the two funds in investments differs at least in part because of how the investors are entitled to be paid.

MS. MAYERSON: I think with the recent rash of redemptions, the run of everyone to redeem, a lot of the hedge funds are very illiquid right now, whereas the private equity still has the commitments for capital and has a lot of money to spend. So, I think you're going to be seeing hedge funds investing less in the distressed space and private equity investing more in the distressed space.

But speaking of that, Brad, obviously both hedge funds and private equity have a lot of different investment options, not just distress. What factors have made them such dominant players in the distressed marketplace historically?

MR. SHARP: Well, as we kind of discussed earlier, we'll focus first on a hedge fund and then we'll talk about private equity and the distressed investing. Hedge funds pursue a more aggressive strategy, and in a distress situation, it is a terrific opportunity to be very aggressive. By definition it's a period of high uncertainty. As Marti said, they're willing to trade knowledge for price. If they get a cheaper price, they're willing to go in and take a flier, and a distressed situation is perfectly engineered for that kind of structure.

Private equity is slightly different because they're looking more for a buy and hold. So they're looking more for the true turnaround to come in, buy a company in a distressed environment or buy a piece of some of the debt structure in a distressed environment, expecting that it will turn around over some period of time. The advantage of buying into distressed businesses is if the plan works, you're going to get your return. If the plan doesn't work, then you will end up essentially owning the asset, and if you like the asset, particularly when you're investing in a distressed business, if you like the underlying concept of the business, you end up owning it and can take control of it and can turn it around yourself.

Both entities, probably more the hedge funds than the private equity, are very flexible in what they're looking for. They're not like a National Bank, you know, that has to look for particular collateral advances and rates and fees. Your hedge funds and private equity can be much more flexible since they're lightly regulated as far as what they're looking for. Because of the risk/reward scenario in the distressed environment, they can really buy low because, at least historically, hedge funds had a lot of cash. They could step into a cash stressed environment, be the white knight, buy very cheap, turn the

thing around and then make a lot of money, and that worked very well for them for a long period of time.

Now, the issue is not the “why’s,” it’s the “how’s.” And I’ve seen hedge funds and private equity in a distressed environment do everything from making a direct loan to the entity, buying a piece of a secured debt, make a direct mezzanine loan to the company or buying a piece of a mezzanine or making equity investments or buying equity. So they can be pretty much in any piece of the capital structure, and here’s the scary part, they could be in all of the pieces of the capital structure. They could have a piece of the secured debt. They could have a piece of the mezzanine debt. They could have a piece of the equity. And how that particular deal works out depends upon which one of their pieces they’re going to make their money on.

As we will talk about a little later, that can kind of have an impact on their behavior, depending upon which piece of the capital structure they see is currently in the money, and if they take a different action, whether that is going to bring one piece into the money or the other piece out of the money and which way to work that. It’s kind of a Rubik’s Cube of return, whichever way they can get the colors to all line up. The big difference that I’ve seen when looking between hedge funds and the private equity scenarios is exactly what Jeff was talking about, and that’s their timeline. When you’re looking at a hedge fund, they’re looking to show their increase in assets every quarter. They want to be able to show a growth in profits. They want to show their assets continuing to increase every single quarter because that’s how they’re going to be judged, that’s how their investors are going to make a decision: do I get out or stay in? That’s going to lead to certain types of investments and a certain type of management of that investment in the process.

The private equity, once they’re in, they’re probably going to stay until that particular asset either gets sold or moves on. They’re not as concerned with showing the quarterly numbers. So they’re a little less concerned about how it shows on their balance sheet, whereas a hedge funds is very concerned with what values show on the hedge fund’s reporting to the investors. That’s pretty much the how’s and the why’s on investing in distressed markets.

MR. MARWIL: You know, I think the hedge fund investor, at least in the corporate space – I mean, hedge funds invest in all kinds of liquid securities and now the illiquid securities, the derivatives and the mortgages and CLOs and such. But the hedge funds that are investing in the middle market corporate America private companies - and there are a host of funds that make those investments in both the eq-

uity side as well as the debt side, they are of a different mindset, typically in the lending groups that they buy into, and they typically are not going to hold an entire position within a company that—an entire debt position. They're only going to be one of the many lenders at a particular level. And they do get fairly active with those groups. And they have a different mindset and a different agenda than the typical lender or a CLO lender, for instance, in a particular tranche of debt.

You know, from the company's perspective, it's really important to know who your lenders are. It then becomes important to know what kind of hedge fund and what condition the hedge fund is in, in order to judge how that hedge fund is going to react to the restructuring initiatives of the company.

MS. MAYERSON: Picking up on what Jeff said about the different agenda of hedge funds, I think it's very important to recognize that their investment goals are different from traditional lenders, and that this has caused some issues for bankruptcy professionals who were used to dealing with institutional lenders. Brad, how do you think that the investment goals of hedge funds have affected reorganization in general, talking about historically?

MR. SHARP: Well, you know, historically, when you were working for a debtor in a restructuring environment, you were dealing with your secured lenders, who used to be all banks, and you knew how the banks were going to react as you dealt with the situation. If you showed them that you had good numbers, you could turn it around, the collateral position wouldn't deteriorate, you could pretty much count on what direction they were going to head because they didn't want to take a loan loss, they didn't want to increase their exposure, but they also weren't all that interested in foreclosing and shooting you in the head if they didn't have to.

Hedge funds are very different because it depends on what their strategy is and what their view is of the company. They may want to foreclose. This may be a loan to own where they made the loan as a secured creditor hoping and expecting that the company would default, that they'd be able to foreclose and take the assets of the company, and instead of having a debt return, they now have an equity return. So their motivation and your negotiations with them as a lender are going to be very different because they want you to default. They want you to blow covenants, and they want to foreclose as quickly as possible once you do so. And that is entirely different than how you'll deal with a major bank, or how you used to deal with a major bank.

The complexity in this is you could start your conversation with a bank, at least historically, and the bank was working how normal banks would. And then partway through the process, some hedge fund offered them a serious chunk of change for their secured loan, and now the bank is gone, and now you're dealing with a hedge fund. That changes the dynamics significantly. And, as Jeff said, the hedge fund is not necessarily the entire tranche of the debt structure. They're not all of your secured debt. Maybe they bought a piece of participation of one of the lenders. So now you have a fifteen member bank group that consists of fourteen banks and one hedge fund, and that hedge fund is going to make as much noise and as much difficulty as possible until somebody pays them out or they get what they want. So that's going to very much drive their strategy, and you can take that same analysis and put it into a mezzanine debt or put it into an equity position. You know, they're looking at, every quarter, what is their return, and given their position, what is the best way for them to maximize that return. And they're going to be taking — making decisions based on their own internal analysis. They're not going to be looking at it like other credit providers who will say, "Where is this company going to be in six months, twelve months, two years from now?" They're going to be looking at what they can report for earnings next quarter.

MR. MARWIL: There's another dynamic that also plays itself out and has for a while. Hedge funds trade in and out of positions in securities all the time. And they may not be a long-term player. And if their strategy is to be a long-term player, sometimes they'll buy in and they'll buy debt at a discount, and if the debt is performing, meaning that interest and principal are being paid, if it buys in at a discount, it's buying at a much higher interest rate performance-wise than that at which the debt was originally issued. And sometimes the hedge funds are looking for that kind of return. And although they'll take the position Brad's talking about in terms of really pushing either to get control of the company through a debt for equity swap or maybe buying up other positions in the debt structure to have that increased return on interest, they'll be okay hanging out for a little while, and sometimes their agenda isn't exactly what it seems.

Sometimes they'll play out the agenda that Brad is talking about, but what they're really looking to do is to create fatigue with some of the bank lenders, get the bank lenders to sell at an even deeper discount and have an even bigger slice of the performing debt for a period of time, and then ultimately exact the strategy to which Brad is referring.



MR. SHARP: To that point, I mean you are kind of in an awkward position as the debtor because your hedge fund may own some of the junior debt. They want this thing to go as poorly as possible because then the senior lenders are going to set out as cheaply as possible, and they can pick up that position, and now suddenly everything is much better than it used to be. You know, when you have a player that's playing it at each different strata of the debt structure, their strategy will change or they'll show one strategy and it means something entirely different.

MS. KOPACZ: Only to Jeff, who is their attorney, will they tell you what they intend to do.

MR. MARWIL: They won't even tell me.

MS. KOPACZ: So when you're advising the company — and understand, you know, Brad and I are on the financial side and Sandy and Jeff are on the legal side, and they've got some privilege, so you can keep secrets, right?

MS. MAYERSON: Have to.

MS. KOPACZ: The truth is when you're the company and you're the "debtor in waiting," as we like to say sometimes, this is not always evident and it's like peeling an onion and it changes. And one of the other things we're beginning to see, particularly as we follow investors who have had concentrations in certain industries, is that they have, they're basically going through their portfolio and deciding who they're going to support and who they're not, what they want to do here and what they don't. And it also has to do with who they've co-invested with. So talk about a Rubik's Cube. It's at least a three-dimensional view of how they make their decisions and it's not just economic, which is very hard for those of us on the financial advisory side, even the legal side; we think people should be economically motivated.

MS. MAYERSON: You know, is there a question, Allen?

AUDIENCE: I have a question. In the current environment, in the Madoff environment that exists versus what you described as the overall strategy, how do you think this has affected and how do you think it's changed from a, on the legal side.

MS. MAYERSON: You mean how are hedge funds going to behave differently in this environment?

AUDIENCE: How are they going to?

MS. MAYERSON: We're going to get into that after we lay a little more foundation. So let us get a little further and then if you don't feel that the question has been answered, we'll come back to you. Is

that okay? You know, one of the challenges, of course, for bankruptcy professionals given what all the panelists have been saying is, you know, the debtor's professionals used to have to know their debtor. Now that almost isn't enough. You have to know your investor too because unless you can try to parse through some of these issues that the hedge fund is facing, you're not going to be able to propose something that's appealing to them. So how do the panelists feel we should go about — if you're the debtor's professional, how do you go about figuring out what you need to do to do something appealing to your investors?

MR. SHARP: Well, let me start and then, you know, I know we'll segue into this and different pieces of it. Part of it, I think Jeff said earlier, is know who your hedge fund is and try to find out what you can about what that hedge fund's strategy is.

MS. MAYERSON: And how do you go about that?

MR. SHARP: Well, the sad part is hedge funds are not a very open organization. You know, you can try to find out, do as much public searching as you can about what they're into. You'll talk to a lot of colleagues in the industry and ask, "Well, this particular hedge fund, what are they into, what type of investments do they do?" And the advantage with all of us is we've been doing this long enough that we see the same hedge funds in different deals, so you can sometimes intuit what they're looking for in investments. The problem is, especially now, that's changing, because before, as Jeff said, they'd be perfectly happy to get their yield on the debt because they bought at a discount, it's a current paid, everything's good and then they're happy to carry that in the future. Now they're getting hit with a whole bunch of redemptions. Now they're tight for cash. The yield on their interest debt is no longer what they need. They now need cash and need it fast. So what was a historical strategy is going to change. I think right now the only way you can intuit where they're headed is what they're doing. But I wouldn't count on that staying to be what they're doing for the next sixty days. I think it's very short run. Jeff, do you have different views of how to predict what they're going to do?

MR. MARWIL: I think the only thing you can really do is look at their behavior when you're interacting with them, try and talk to them, and listen through word of mouth. I mean, if there is a hedge fund out there where its investors are clamoring for redemptions and not getting them, clamoring for the fund to liquidate, clamoring for a change in management, if you get out there and network enough either in the professional network or just with people who are in the hedge fund industry, you'll hear about it.

So I mean it's a little bit of luck and it's a little bit of the needle in a haystack in terms of finding out exactly what the agenda of the hedge fund is. And if you can't figure it out, then I think you have to test it a little bit. There are two ends of the spectrum. First, the healthy end, which is that the fund is going to pursue its stated goals and it wants to be in the investment, and it's either a loan-to-loan kind of fund where you know that by reputation or it wants to hang out and take the increased yield based on buying at a discount. The opposite side of that spectrum is when all bets are off in funding cash, and it's going to do anything and everything it possibly can to agitate for the debtor to either sell itself, to file bankruptcy and get refinancing or some other liquidity event to the extent there's something available in the marketplace, and that's uncertain at this point, as well.

MS. MAYERSON: Isn't it also a problem that these strategies, which, as you're saying, are very short-term right now, can change in the middle of a case? And the debtor may have been working with the hedge fund, and the hedge fund either changes its strategy or has decided it's gotten the return it's looking for and sells its claim, and you're starting all over again. How is that affecting reorganization?

MR. SHARP: It's obviously making them much more difficult. And previously, reorganizations were a negotiation: you reach a conclusion, the maximized value, you implement it, you move on. Now the debtor really has to drive the bus and try to make the hedge funds or other creditors react to what he is doing and try to push it as hard and as fast as he can, not necessarily depending upon creating a deal with the other side. That used to be, in the last two years, much easier than it is now because to have that kind of strategy you need capital. Unfortunately, there's not a lot of capital out there right now.

MS. KOPACZ: I'll give you a perfect example. I don't know if anybody here is really involved in the Chrysler situation, but our firm does a lot of work in the auto space, and I can comment on this because we're not in the Chrysler situation.

Up until December 31st of last year, the word on the street was that Servers was pulling all the levers. They were making all the decisions. They had a flock of people in Chrysler's offices. They were making decisions on bankruptcy counsel and financial advisors and negotiating with the banks and they were in — they were driving the bus. They were completely driving the bus.

December 31st, they left. They haven't been back. They don't answer phone calls. Okay. So right, who is driving the bus?

MR. SHARP: The bus driver took a coffee break.

MS. KOPACZ: The bus driver took a coffee break, and I don't think the bus driver's coming back. So that is — that's a very dramatic example, but the truth of the matter is, it happens a lot with our middle-market companies, and that goes to the private equity side as well where it's a private company, the private equity firm has been incredibly involved, and all of a sudden, they make a decision and they're out of the picture. And the management team there is left with, "My God, I've got to run this company."

MR. MARWIL: It used to be, before the current market conditions, that hedge funds could trade out of anything on a moment's notice. There was always a market. You could always sell something. It was just a question of price. And there would be a lot of positioning in order to attract the best price, but you could get out.

Now they're very illiquid markets. Corporate debt is not really trading, and if it is, it's trading at fairly significant discounts that may not even reflect reality. Some of the other positions that are out there aren't trading either, and part of the reason for lack of trading and the decreased prices and discounts is that there isn't very much capital out there chasing deals right now in space.

On the private equity side, however, there's a lot of capital, as Sandy pointed out, and the private equity players are entering the marketplace now, not as equity owners and not trying to buy companies through equity purchases or through LBOs<sup>2</sup>, but they're getting into the market by buying debt positions. And what I think we're going to see going forward is, I think we're going to see some exodus by the hedge funds that need the liquidity in favor of the private equity firms that are going to be buying into debt positions with the expectation that they're going to be able to convert that debt into equity, and maybe even controlling equity through some additional capital investment. So I think, and maybe this is a little cynical, but it's definitely ironic where you're going to have the private equity players that are going to become the "loan to own" in the marketplace.

MR. SHARP: Do you think, Jeff, that will stabilize the situation or make it worse?

MR. MARWIL: I don't know that it will make it worse, but I don't think it's going to stabilize anything. I think it's going to create volatility and uncertainty, and I think the corporate managers and advisors to these companies need to move quickly, and the decisions about restructuring for everybody in the capital structure, people need to

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2. Leveraged Buyouts.

make the decisions. Delay is not anybody's friend, I don't think, right now.

MS. MAYERSON: Do we have a question? Can you come to the microphone, please?

AUDIENCE: Good presentation. The question had to do with short squeezes and driving the market, the zero — you're kind of getting there. You know, where does the runaway stop?

MS. MAYERSON: It hasn't stopped yet.

MR. SHARP: We'll let you know — it's kind of like how the government predicts when we're in a recession, and they wait about a year and say, we're in a recession. In about a year or two, we'll all tell you, all right, here is where it stopped.

AUDIENCE: Are you selling futures on that?

MR. SHARP: Before we go on to that, I want to make sure that we're clear. This is not just in a large corporate environment. This impacts middle-market companies down to, literally, \$25 million in revenues. This is not just the multi-billion dollar companies, this is not just Chrysler. Hedge funds are involved in small "mom and pop" \$25 million deals. So this is across the board.

MS. MAYERSON: Kathy, did you have a question, and you need to use the microphone.

AUDIENCE: This is a really basic question, but what did private equity do over the last few or several years that they have capital to use in a time when the hedge funds, and so many players in our national economy, don't seem to have capital? What do they do differently?

MS. MAYERSON: There are a couple of things. First of all, it has to do with the structure that Marti talked about of the private equity funds as opposed to the hedge funds. The hedge funds get all their money up front. Private equity gets a commitment, so that you commit that you're going to give the money over time, so they haven't called in all of their commitments, so they still have cash available in the pipeline.

Second of all, a lot of the — you may want to comment too, but a lot of the private equity funds that I work with have been sitting back. They have not even begun to use up their commitments because they haven't found attractive things to buy into that are going to give them the return that they want. Or they're finding companies that were so distressed they didn't really feel there was a good chance to turn them around, so now they're finding other points in the capital structure that give them the returns that they're looking for and, you know, the

companies that are still surviving may be more attractive to them. So now I think they're thinking about coming in with this committed capital that they have on hand.

MR. MARWIL: There was also, in the prior business cycle, so much competition for deals, and there was so much money that was being made ironically through, investors were taking the money they were making in the hedge funds and committing it to private equity funds. The private equity funds were competing with each other, driving prices up on these companies, and they weren't able to deploy all of the money, given the kind of competition that was there.

So I think probably less intentional than anything else, there's money that's still available from the equity raises that went out before the market downturn.

MR. SHARP: And I think what we're seeing now is that money is looking — still looking for a place to go. I'm running a home builder right now, and I get calls everyday from somebody who wants to give me money. Now there's — the real drawback is they want to give me very little, and they want a whole lot for it. They want to buy the assets at \$0.10 on the dollar. So if you want to sell assets at \$0.10 on the dollar, there's money out there, a lot of it.

MS. KOPACZ: In your materials — and I remember Fred and I did this, we looked at private equity funds created specifically for distressed investing and the billions of dollars that were raised in 2008, we think something like \$30 billion were raised by private equity just for distressed investing. So again now that \$30 billion isn't sitting in a private equity bank account, but it's committed by somebody who has, you know, a few hundred million sitting in their bank account. There's money out there.

MS. MAYERSON: One of the things we haven't touched on yet is, traditionally, if you were dealing with a bank, a bank would pretty often give you DIP financing to protect the loan that it has. What is the difference in the appetite for DIP financing with hedge funds, private equity from financial institutions?

MR. MARWIL: I think, first of all, you have to understand that there has been significant value deterioration across the board for any of these companies that are going to require DIP financing. And not only has there been value deterioration, there's also been balance sheet deterioration. And by that, I mean the following: when the senior loans and the junior capital or the mezzanine loans were made for these companies, it was during the prior business cycle, which I call the "free money" cycle. Banks were lending at very reasonable lending rates, virtually no or no covenants at all, and it literally was free

money. If you had a problem with your bank, you'd go refinance it somewhere else, and if you had a problem with them, you'd refinance it somewhere else. You might even get a cheaper rate and fewer restrictions on what you're doing in your business.

All of that has flipped, and not only that, but the productivity of the business, the profitability of the business, is reduced, as well. So now you have lenders who are saying, "I'm not going to take as much risk and I'm not going to lend at eight times EBITDA.<sup>3</sup> I'm going to lend at four or six times EBITDA." And you've got a company whose EBITDA has been reduced by — pick a percentage, twenty percent, thirty percent, fifty percent, so what you have is a complete and utter inability to refinance all of the debt that was made during the free money period, and you've got a company now that doesn't have any value beyond its debt in its assets or in its business so it's got no collateral, no additional collateral to pledge, no additional value to pledge, no additional value to even predict because it's so far behind where it was when it got that last loan that DIP<sup>4</sup> money is not going to be available from any outside lender.

So the DIP money is going to be available either from the private equity player or the equity owner that wants to re-up in effect and try to get rid of all of this excess debt and take the DIP money that it's putting in and convert that into some kind of equity position coming out of bankruptcy. Or it's going to have to come from the existing debt players themselves, and the senior lenders are — were at least in the last downturn, the typical source to find DIP money. Now I'm not so sure that's going to be the case given the different kinds of participants that play in the senior debt tranche. You've got the traditional banks who theoretically have money but may not have the ability to commit additional capital to any particular credit. You've got the CLOs that are playing that have contractual inability to advance any additional money and have no ability to consent to being primed by other lenders. Finally, you've got the hedge funds who are playing who may want to lend or who may not want to lend but are going to be fairly predatory, as Brad was talking about, in establishing pricing and establishing terms.

MR. SHARP: And, something new in this particular cycle, what I'm seeing is you have lenders out there that have the willingness to lend, but they don't have the financial ability to lend. And I haven't seen that since, you know, the S&Ls went bust where you have —

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3. Earnings before interest, taxes, depreciation and amortization.

4. Debtor in possession.

you're dealing with a lender that says, "Quick, cut a deal with me because tomorrow I'm going to be controlled by the Feds." And that creates for an interesting dynamic.

MS. MAYERSON: I've heard a lot of bankruptcy judges complain that they have not had any real Chapter 11s in front of them because the hedge funds and private equity either shut the company down or insist on an immediate 363 sale.<sup>5</sup> And that, while hedge funds and private equity being in the space, may be good for liquidity, but it has not really been good at all for reorganization. Do you think that's a fair criticism?

MS. KOPACZ: Absolutely. I do. And that's the — and you have to remember all of us up here are pretty experienced. I'm not going to say old. Pretty experienced. Okay, this is my fourth restructuring wave, and I think my colleagues are probably only on their third. But the truth of the matter is every one of these is different. Every one of these has been different. And this is the first time we've dealt with hedge funds and private equity funds in a real bankruptcy setting. I mean, there were a few guys out there in the last wave, but they were much more predictable and they stayed inside a sandbox, which they created for themselves. And the truth of the matter is that private equity — and I'm doing a lot more with private equity funds than I am hedge funds right now, private equity guys do not understand bankruptcy. They do not understand reorganization, and all they can think of is if I'm at the bottom of the barrel now, right, I'm not moving up.

And, as recently as a couple of weeks ago, I had a client tell me, and this was a middle-market company, it should survive long term, it's got real issues right now because of the business it's in and the locations it's in, but the truth of the matter, he says, "If we had put this company into bankruptcy in February like you told us, we'd be on our way out now." And we may not make it through this out-of-court restructuring phase.

MS. MAYERSON: We've talked historically about what it's been like having hedge funds and private equity come into the bankruptcy space. So now moving more along to what Allen wanted to hear, the financial world around hedge funds is changing, and Jeff, do you think that's going to cause hedge fund strategy to change as to how the funds invest and how they treat bankruptcy?

MR. MARWIL: Yeah, I think so. And to understand it, you have to understand a little bit about the dynamics within a hedge fund and what they're facing themselves. The first dynamic is that they've got

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5. 11 USC §363.



illiquid markets for their investments. And hedge funds like to trade and rely on liquidity at the end of a quarter in order to pay off investors that want to get out of their fund, and that requires trading, and with the illiquid markets, the trading is difficult, if not impossible.

In addition, hedge funds typically lever their investments, meaning they go into the marketplace and they borrow and they borrow from lenders or counterparties or both in order to increase their returns based on what they think will be a profitable trade. The lenders require collateral or margin to be posted, and when the redemptions start coming in and the managers are not able to fulfill the redemption requests, they have the opportunity to drop a gate, if you will, and that's the terminology that the industry uses, and they'll drop a gate to prevent any further redemptions. They'll suspend redemptions and when they suspend redemptions, word gets out to counterparties and lenders, and the first thing those lenders and counterparties do, which is their right in a lot of these trades, is to say, "I need additional collateral, I need more margin." That puts a further squeeze on the cash and on the need to create cash for the managers, so it becomes a little bit of a self-fulfilling prophecy in that once you drop the gates to suspend redemptions, it's pretty rare that a hedge fund is going to be able to right itself, lift the gate, give the redemptions out that investors have asked for, and resume its normal operation.

So I think if you see a fund that has suspended redemptions, you can expect that it's probably in the process of winding itself down and it needs to liquidate itself, typically over a fairly long period of time given the illiquidity in the market and the types of investments that the fund is making, and that long period of time may be years, not even months. So you've got that pressure and that spiral, if you will. And then what you have is, as you are trading out of a certain position, and this really pertains more to the hedge funds that trade in securities and with derivatives than it does the single debt issuance of a corporation, but if you're trading out of a position and you've got a decent sized position, as you start trading down, if your counterparty knows that your margin requirements went up and you suspended redemptions, they're going to bid to lower the price. They're not going to give you necessarily a higher price. They're going to hold out and give you a lower price. Then you have to sell more of it, and as you're selling more, the price is dropping. So you have these spirals that are happening all around these hedge fund managers, and it is killing value for the investor. The hedge fund managers are reporting net asset values to their investors every month and as the spiral is down, each of these different spirals go down, then that asset value of the

fund is dropping, investors get agitated; the investors are clamoring for liquidity, clamoring for the fund manager to commence a liquidation of the fund at all costs, no matter what, give us our cash. And there are other investors who will say, "That's okay, don't kill us on value, leave the value, maximize the value, but we want transparency. We want an independent director that we choose and their communicating with us as investors on a regular basis. We want a monitor." And sometimes the investors will say, "We want you, the management company, to replace yourself with somebody that we choose who will manage the liquidation."

So that is kind of the dynamic that is occurring in many of the hedge funds that are out there. Certainly not in all of them, but in a lot of them. As these hedge funds get closer and closer to actually liquidating healthy positions, which most are not there yet, it's going to take a lot longer for them to get there, but then there will be a whole host of problems associated with actually closing the funds. So I think that's the dynamic that you have there, and when you're dealing with an entity like that in a bankruptcy case, you have no idea how to predict what they're going to do and what their position is. And in all likelihood, in my view, their position and their attitude will change on a daily basis.

MR. SHARP: Some of the things I've seen are companies that are owned by a hedge fund that had counted on and depended upon that hedge fund for a continuing source of either growth or working capital; suddenly, that source of growth and working capital is gone. You now have a lender who is now incapable of lending you more money and in fact, they're now in a push to say, "All right, we want you to start paying something back," and that makes it a distressed situation, that makes it ten times worse. And they have something of a strong position: "Look, if you can't pay us back our loan, we're going to liquidate because we need the cash. It's only \$0.50, but it's better than what we have right now."

MS. MAYERSON: So would you predict that even healthy companies might be affected by the problems of the hedge funds because if they have — the hedge fund has a significant investment, how is that going to affect a healthy company?

MR. SHARP: I will take a drastic position and I'll let Jeff disagree with me. I don't think there is a healthy company that has a hedge fund as a component of its financial structure.

MR. MARWIL: I have no idea.

MR. SHARP: So I think it's going to —

MS. MAYERSON: A better off company.

MR. SHARP: However distressed or not distressed it is, it's going to make it worse, because any time your capital structure is stressed, all things will flow downhill, and you will be stressed. As Jeff and I were talking about earlier, this is the first time in my career that the lender sitting across the table is as scared as the debtor. And while I enjoy a good economic downturn as much as the next guy, this one makes my palms sweat because I don't like it when the bank sitting across the table from me is more scared than my client. That makes me nervous.

MR. MARWIL: And some of the dynamics in dealing with the traditional lenders—they don't necessarily want to write down their loan. In fact, they don't want to write down the loan at all if they don't have to. They certainly don't want to get collateral back. They don't want to be an owner of a business, and they don't want to suffer the adverse consequences of liquidation on their balance sheet.

And so a lot of these banks are saying, "Listen, I'm going to let you live, and I'm not going to play hardball like I might have in the last downturn or during the last business cycle. I'm going to let you live because the alternative for me is much worse. I might die as a result, in particular, if I do this across the board in my portfolio." So the borrowers may have some advantage right now depending on who their lenders are in going to the lenders and saying, "We're not going to make any more payments, no interest, we're not going to live up to the covenants. We just need to go into survival mode, and we're going to operate with our cash, and we're going to hope we make it, and when we make it out at the end of the downturn or when our industry turns around, we'll try and sell the company, and hopefully we'll get you paid as much as possible." Nobody else is in the money, and it's not predictable that anybody else will be. And they go to their constituents and say, "We're better off alive than dead. If you push too hard, we're going to kill ourselves." And I think you're going to see companies out there just operating.

MR. SHARP: I think that's right.

MS. KOPACZ: That's what we do on Monday, Wednesday and Friday.

MR. SHARP: This is the Cleavon Little, "Don't make me shoot."

MS. MAYERSON: You know, we've talked about hedge funds having been opportunistic investors in the distressed space. Now they're forced to be in the distressed space. Do they have the professionals to handle that and to make rationale decisions?

MR. MARWIL: We're right here.

MR. SHARP: Let me hand out my cards.

MS. KOPACZ: The challenge really is that so many people that are on the inside of hedge funds — and I'm not talking about the named people that you do see, but the people that actually run the investments, run the complicated models that match the portfolios and look at them everyday — have never been in a downturn. They've never been in a business cycle where credit wasn't available. So the challenge is that yeah, obviously they need some professional advice, and we're not saying we've got the answers. As I said before, every restructuring that all of us have been in has always been different and that's why it's so exciting to be in our business because you get to learn all the time and you just kind of rely on what you know. But the people inside of hedge funds, they don't know what they don't know right now. And that's the challenge.

MR. SHARP: We're seeing the same situation with lenders. You have lenders out there who have never been through the cycle who don't know — I'm saying they don't know what they're doing is maybe strong, but they really don't know what they're doing.

So these are the bright, young people, and they are very smart, and the MBAs that went to the hedge funds because they were making a ton of money at the two and twenty, and they were making a ton of money based on their certain business model and decisions they made, which created a lot of money for them. Those same decisions, that same matrix doesn't work anymore, and they've never been in a situation where that doesn't work anymore, and it will be fun.

MS. MAYERSON: Let's talk a little bit more about the portfolio companies. We've talked a lot about the hedge fund, but how do you think the companies should react now that their source of capital has dried up? We've talked about how little capital there is out there. What are some strategies for the company, the portfolio company, and how is that changing?

MR. SHARP: Dial a prayer.

MR. MARWIL: Communication is one of the keys. Communication and planning. Given our prior comments about the lack of accessibility to Debtor In Possession financing in the event a bankruptcy is needed, management really needs to focus on future cash flows and making predictions that are maybe not necessarily so rosy about those future cash flows to see if there's a possibility that it's going to wake up one day and it won't be able to make payroll, if it's going to hit the wall, a cash flow wall. And management really needs the crystal ball in certain respects, but it needs a pessimistic view in order to avoid what would then be probably certain liquidation. If a company gets so close that it needs additional liquidity in order to keep its doors open, and

there is no additional liquidity and the lenders and others in the capital structure don't have the ability to provide that liquidity, not that they don't want to or that they're being levered into it and don't like it, but they literally can't provide it, it's incumbent on management and the Board of Directors and their advisors to try to prevent that day from happening. And the only way to do that is you need the luxury of time, and you need to be looking into the future, and you need to be making decisions and entrenchments in order to make sure you avoid that.

And I know to some of you that probably sounds like, "Well, how is this country ever going to get out of the decline that we're in? How are we going to get back to growth if companies are constantly cutting expenses, if they're pulling back, if they're not making investments, if they're not spending money?" I don't know the answer to that, but I do know that, for companies that are on the edge or close to the edge and even for companies that aren't that close to the edge, you've got to have that kind of contingency plan. The other thing is there are a lot of managers out there who have never been through a situation where their balance sheet or their industry is distressed, and they don't know how to manage in a time of, where they need the discipline. And there are bank groups out there and lenders out there and investors out there who will exact that discipline on management, and management should welcome it.

And like Brad said when I had lunch with him, he said, "Sometimes you've got to whack the management with a two-by-four and if you hit them enough times, they'll ultimately get the fact that they need to be reporting, they need to be planning and need to be moving forward, and they need to be thinking about the future without the rose-colored glasses."

So that kind of planning and communicating with your lenders and your investors and your constituents, your employees, your customers, your vendors, talking to people about the business and setting expectations, I think, are all part of the formula, and that includes, you know, talking to your hedge fund investors and maybe even still being out there looking to see if you can find some new money or find more friendly investors who may be willing to come in and buy out the investors who really need to be bought out.

**MR. SHARP:** All of the management practices that companies used to thrive during this last business cycle, those no longer work. And hopefully the management team has seen that whatever they've learned to do to thrive, they have to change because before, if you needed more capital, you went out and got it. You didn't really have

to focus on the checkbook accounting, bringing in more cash than you're spending. Now you do. And those that will survive are those that can make that adjustment.

**MS. KOPACZ:** The point Brad makes is really important; it is that an awful lot of people that sit inside corporate controller or treasury functions inside of businesses do not know how to manage for cash. And that is—it's a skill that— you know, what we try to do in restructuring is give people some optionality, and when you're walking down a road and you think that you're going to hit something, what we try to do is stretch that road out so that you could figure out how to turn.

And the only way you do that is through liquidity and cash management, and that's a skill set that many, many, most managers today, even you know, sophisticated finance departments don't have and it is and it was, what we're seeing is that you have to, they never had to solve a problem. In the last ten years, for the most part, businesses didn't have to actually solve a problem. They simply raised more money. And that's now what we're seeing, it's not, I heard the CEO or COO of General Growth today basically say he's just got a balance sheet problem. Just a balance sheet problem.

**AUDIENCE:** I have a question. You've been talking about recognizing a problem, and we do a lot of debtor work too, and my problem is getting the CEOs and the CFOs to recognize the problem and accept the problem, and they're always fighting with you. "Well, you can't tell this group. I've got to make a special deal with this group." How do you solve that problem, which is a basic problem you have in representing a debtor?

**MR. MARWIL:** That's the age-old question. It's "denial is not a river in Egypt." It is a problem, and sometimes it takes a discussion with the Board of Directors and convincing the Board that they've got an obligation to consider alternatives and to weigh the risks and benefits and the likelihood of success and the various alternatives and to tell them that they need to plan for the contingencies. And it's access to the Board sometimes that's hard to get, and sometimes your Board is your management.

**MR. SHARP:** I had a conversation with a CEO, and I said at the end of the day, "I have an office to go back to. You won't." And thirty days later, he was gone, and I was still there. You try, somebody asked me what's the hardest part of my job and the hardest part of my job is convincing them they have a problem. Once you get there, you're eighty percent there. But you have to hit them with a two-by-four sometimes, and sometimes they don't get it, and our saying in the

firm is “If you’re dumped, you suffer.” And that’s what’s going to happen to them.

MS. MAYERSON: I have found that sometimes the problem is even convincing my partners. Something will show up on my radar screen, I’ll go to my partner whose corporate client it is and say, “I’d like to make a presentation to your client.” “I’m not mentioning insolvency to my client. I can’t introduce you.”

So it really sometimes takes creativity. But I find that usually if you convince them that there will be no equity left in a middle market or a small company if they continue on the road they’re on, somehow equity perks up their ears and you can get them to at least start listening, but it is really hitting them over the head.

MS. KOPACZ: It is, and one of the things this is — again we use the word creativity, but it’s also just, you know, sometimes a little underhanded, if you’ve got a poster child that is in deep, deep do-do that’s in their industry that’s a competitor, sometimes we can get them to move in the right direction just so they don’t end up like X.

I do a lot of work in retail and, you know, I love the Steve & Barry story. Let’s not go down that path. And again, whatever you can do, whatever you can do, form some, it’s the solvency speech, scare them, hit them over the head, lie to them.

MS. MAYERSON: Don’t go that far.

MS. KOPACZ: But try to — try any method you can because, quite frankly, what does happen is you wake up and you put off the decision, you put off the decision, and all of a sudden a week from Thursday, you’re out of cash, and then you have no options.

MS. MAYERSON: I know that Jeff has predicted that this is going to be an utterly chaotic period, but I want to put forth a different scenario and get your reactions based on some of the things that have been said. As Marti said, private equity doesn’t really get bankruptcy, but they’re going to have to because they’re going to be investing more and more in it, so we have to think that maybe they’ll start getting people on board who have these skills. We’ve talked about the fact that every fund has a different strategy. So you normally don’t know what that strategy is, which makes it kind of hard to appeal to them. And this unpredictability, of how they’ll react, has made it hard to reorganize.

But the fact of the matter is, if all these funds are struggling the way Jeff has described, then it becomes pretty predictable again because they’re all facing the same kind of liquidity issues and trying to get out of it. Then we’ve also talked about the fact that they may let companies live because they have no choice. So my question is, with all

these factors coming together, could it lead at the end of this cycle to more predictability when we have funds having more experience in bankruptcy, we have more of a sameness of goals, might we get to more predictability that would facilitate reorganization instead of situation we're emerging from where funds being involved has not helped reorganization?

MR. SHARP: I do think we will get to more stability, but the question is, you know, after the last shoe has dropped, and I think we're still — the closet is still falling. The auto industry hasn't even started yet.

MS. KOPACZ: You're looking at us crazy. The restructuring in the auto industry hasn't started. Go ahead.

MR. SHARP: We've seen drips out of the pipe, but the pipe has not burst. It's going to. And so until the shoes stop dropping, we're not going to see stability. The bright light I see out there, and there is one, is that look at the business leaders that are getting trained right now. These young people that we talked about that don't have any experience are getting a hell of a lot right now. And twenty years from now, these are going to be the people who are going to be sitting up at the panel talking to young people and saying, "Let me tell you about what happened in 2009."

MS. KOPACZ: We're going to have to hit bottom.

AUDIENCE: We are a capitalist society.

MS. KOPACZ: When you start, I read Business Week only for chuckles and laughs in that commentary thing in the front end. The idea that we're turning around in the second half of this year, go figure. Not happening. And I think until the greater populous — and I don't want to be a Chicken Little here, but until the greater populous, until the pundits, until the economists and the politicians accept that we still have either a ways to drop or a period of time in which we're going to sit at this level until we can get all of these massive, massive problems sorted out, we're going to continue to deal with the denial and the fact that the sun's coming up tomorrow.

AUDIENCE: Increasing taxes isn't going to help the situation.

AUDIENCE: We've been discussing the legal issues, but what about accounting issues? The Chairman of FASB<sup>6</sup>, of course, has been grilled in Congress, and I was wondering if you have some issues that you can raise with what accounting changes should be made or have been made in the past and what should be made in the future.

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6. Financial accounting standards board.



MS. KOPACZ: I was thrilled with the relaxation of mark to market. The question was, what about changes in accounting, and how can that, I think, help or not help the situation. And I personally was really happy with the relaxation on the mark to market rules and regulations. I'm not sure what the right answer is, but I know and we're going to — Sandy has a question a little bit later about some of the proposed solutions that are coming out of Washington, and right now you can't value anything. You cannot value anything right now.

MR. SHARP: Jeff and I were talking earlier. It used to be that values were based on, "What's the cash flow generated by that asset, what is the underpinning value of that company?" We got past that, and we got to the value, which is what somebody's going to pay for it in the market, and somebody's going to pay for it in the market because there's a lot of money chasing it. So the value got disconnected from the underlying cash flow generation of the asset. And people started making bets on where the price was going to go, and it was price and not value. And with the mark to market that goes the same way, it goes up and then it goes down. When there's no market, there's no price. So I think the accounting rules need to get back to, "what is the underlying cash flow generated by the asset," and that's what the value needs to be.

I share the view that this mark to market was silly. Just the same as when you have a corporation that is focused on its quarterly dividend. What's the quarterly dividend going to be, what's the quarterly stock price? We must show a consistent growth, regardless of what it does to overall long-term decisions for the business. It's the same bad result. And when you have a hedge fund that is focused on showing quarterly increase in asset value, they start making bad decisions. Yes, we should write this asset down, but that will show us a reduction in the net asset value, so let's forget about that; let's show it at a higher value even though it's not a reflection of reality. Accounting rules need to get back to reality. And we haven't been there for ten years.

MS. MAYERSON: One of the changes that I think is very beneficial is in the economic stimulus package<sup>7</sup>; they provided that cancellation of indebtedness income can be spread out — the recognition of it can be spread out over four or five years, but they only gave a very small window where that benefit is going to exist, and consistent with what Marti said, I think the legislators have to start realizing we're in this for the long haul and things like that are helpful and need to be extended for a longer period of time. Also piggybacking on your ques-

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7. Pub. L. No 111-5 (Feb. 17, 2009).

tion, in our materials, you'll see towards the end of the materials that we talk about some legislation that has been proposed to make hedge funds more transparent and more accountable. As Marti said, one of the benefits — one of the things that have allowed hedge funds and private equity to operate as they have is that they're very lightly regulated. So do you think these proposals to make hedge funds and private equity more transparent is going to be a good thing or bad thing as far as reorganization is concerned?

MR. SHARP: One of my colleagues is a dyed in the wool, buyer beware; investors know what they're buying into when they're buying into a hedge fund, and if they're dumb enough to not ask for the things they want, they're dumb enough to live with the consequences. I'm not quite that far. I think transparency is important because if you have multiple investors that don't like the way things are going, they can contact each other and drive change. So I think — I'm in favor of transparency. I'm in favor of consistent accounting policy and reporting. And then after that, with full and adequate information, the investor gets what they get.

MR. MARWIL: We used to have a seller's market. The management companies and the geniuses that formed these hedge funds, they could put out any terms that they wanted and basically put together what their strategy was and contract capital and make a fortune, and the investors, if they wanted to invest. And I think this even goes to Allen's questions about Madoff; he created a mystique. And a lot of these managers create mystiques about themselves and about their funds and about the returns they've been able to generate such that, you know, they don't need your money and if you want to invest, you've got to invest on their terms, and you'll get whatever information the manager wants to give you regardless of what the documents say, and those are the rules. That's all changed, and I think now people are going to be very careful about what they invest in, and they're going to be careful about making sure that they have real rights, real rights to transparency and rights to some level of control or taking control at least away from a fund manager who may be on the line or across the line in terms of fiduciary duties.

So I think there is going to be a change. There are plenty of healthy hedge funds that are still out there, probably more that are healthy than that are not, but there are so many. I think there are something like, Marti said, 9,000 hedge funds. Thousands of them are in the process of failing and winding up. And no matter what, that's a lot of — there's a lot of capital that's associated with that, and that, I think, is

going to change the dynamic of the investor and the agenda of the investor going forward.

MR. SHARP: But the one thing I think — and Jeff, you can correct me if I'm wrong — the investors in these hedge funds are not necessarily widows and orphans.

MR. MARWIL: A lot of them are fund to fund. A lot of these funds invest in other funds, and if you boiled it all down, you don't know —

MR. SHARP: You have three people in New Jersey who are actually investing in this.

MS. KOPACZ: Understand a lot of what went on during — in the last few years was funds making money off of other funds. It's that — kind of that musical chairs game that children play in terms of by the way people made money was through the increase in the velocity of the money, not in making profits out of the business. So you necessarily, when the music stops or when that chair gets pulled out, you're necessarily going to have a contraction in capital, and I think that's going to be permanent.

AUDIENCE: You haven't talked about, or you have indirectly, the government involvement, and I wrote myself about re-establishing the market equilibrium, because that's what we're talking about, the peaks and valleys of the business cycles and the other vagaries transposed and then trying to make money during those periods. So a good question is whether we should let the market work and not impose more regulation and more, more regulation I guess.

MR. SHARP: I'll start. I think we as a society have two choices. Try to shallow out the drop and run the risk of making the pain last longer or let the drop just fall and make it last less time. This is: do you yank the Band-Aid off fast or slow? My response is yes, you need to do a little bit of both. I think you do need to try to address some of the systemic issues, but I think they resolve around what some of the questions said: what are the accounting rules? Make sure that the information is out there for the investors to make an informed decision, and let the market happen the way the market should happen. That's my view.

MS. MAYERSON: We're getting close to the end, and before we do, I think we should talk about the fact that we are all aware that the Obama administration is floating various proposals to have hedge funds and private equity buy up the bad assets of financial institutions as part of their, they will give incentives to hedge funds and private equity to buy the bad assets so that the financial institutions can clean up their balance sheets. Marti, do you think that hedge funds and

private equity will have an appetite for that in this current environment?

MS. KOPACZ: I don't know whether or not they're going to have an appetite, but I think if they buy the bad assets, it's a really scary proposition. Let's think about it first in the context of a hedge fund. Hedge funds are traders.

MR. SHARP: Traitors.

MS. KOPACZ: That's right. They're traders, okay. These toxic assets, think about it, it's consumer debt. It's household mortgages. It's corporate loans to businesses that as we said don't have any more capacity to do anything. Hedge funds don't manage businesses, not very well. They also aren't set up. Where do you get the systems to manage these assets? They don't have that. Now think about private equity. Private equity, again private equity may be a little better situated in terms of managing a loan, if you will, to a corporation in the sense that there's a fundamental understanding of that business. But at the end of the day, what — I don't know what we're thinking. None of these organizations — I mean even the biggest hedge funds in the world don't have 200 employees. How are they going to manage billions and billions of dollars?

AUDIENCE: It's a Ponzi scheme again.

MS. KOPACZ: So I think, you know, the rate of return, think back. Those of us who were around with the RTC<sup>8</sup> and the FDIC<sup>9</sup> and all those assets, okay, I mean there are people who made a lot of money on those assets. So history will tell us that the rate of return is there, which should be appealing to people who want to make the investment and want to make that return. But to put it into the hands of the hedge fund guys or the private equity guys, I think, is really quite foolhardy.

MR. MARWIL: A couple of other things. The offer by the administration to the hedge funds is limited. I think there's a requirement of size and there are only a couple of hedge funds in the country that are big enough and that will qualify. Secondly, why would any smart individual at this point, seeing how the government has flip flopped and imposed itself on the organizations in which it's made its investments and provided the relief, why would they invite the government if they don't need it? If they make the investment, is the government going to come in and limit how much an investment manager or portfolio manager or the hedge fund manager can make? I don't think any of

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8. Resolution trust corporation.

9. Federal deposit insurance corporation.

those guys are going to take that risk. So I personally just don't think that this proposal is going to be successful.

MR. SHARP: And my view is that I don't think this proposal is necessary. I think, as Marti said, the yield is out there. We played this game before in the RTC days, and a lot of people made a lot of money. I think I've already seen in cases I'm dealing with that there's money out there that's chasing these assets. It's going to continue to chase these assets. If it's the right deal at the right price, people are going to buy it without government assistance because, I agree with Jeff, they don't want the government mucking around in their business, and I think that's going to be out there. This is the classic greed and fear. Greed was so strong for so long that people forgot the fear. They forgot that risk goes with reward. Well, now the fear is outlasting greed, and that will continue for a while until people get greedy again, which we all know they will because we all depend upon that. And at some point, the greed will overwhelm the fear, and people start buying the stuff at a discount and make a lot of money, and that's the way it should work.

MS. MAYERSON: Someone asked me why I became a bankruptcy lawyer, and I said, "Well, because as long as there's greed, I'll always have business." So I understand what you're saying. I think we're getting to the close of our time, and before we end, I would like each panelist to take a couple minutes and tell you one point they want you to leave with today. So if you can only go away with one thing on your mind, Jeff, what do you think it should be?

MR. MARWIL: No two hedge funds are the same, and no two hedge funds are going to have the exact same objectives and agenda. And in dealing with them and dealing with your clients and the situations that you face, getting information and trying to understand what's driving the hedge fund and what's driving its business agenda, I think, is important, but more important than that is dealing with all of the constituents that you have in your capital structure and keeping your eye on the ball down the road so that you don't end up in that situation where you've hit the wall and you've got no liquidity and you're forced to liquidate.

MS. MAYERSON: Marti?

MS. KOPACZ: I think whether you're involved representing the investors, lenders, equity holders or whether you're representing the companies or the individuals, I think, right now, time is not your friend. The best decisions should be made sooner rather than later, and there will be more options available for success today than I think there will be six months or nine months down the road.

MR. SHARP: I guess I'll say focus on value. Focus on the value of the enterprise you're dealing with and drive the bus. And there is so much uncertainty right now that if you focus on the values that are there and push hard and make everybody try to react to you, you will stand a much better chance of getting through alive because a lot of them have so much else on their plate that it's easier for them to react than for them to make their own decisions.

MS. MAYERSON: For myself, I would just say I'm a true believer in the reorganization process, and at the start of my career, we did reorganizations routinely and saved jobs and saved businesses and that felt really good. But it's been a long time since we've been able to do much beyond a 363 sale.<sup>10</sup> And I do think that the only good news today is that as these hedge funds and private equity get more experience in bankruptcy and reorganizations, because they're going to have to get more experience in bankruptcy and reorganization, I think over time we will be able to start doing reorganizations again, and I think in the long term, that will be good for the economy.

AUDIENCE: I think I can speak loud enough. How long do you think it will be before a state has to reorganize?

MR. SHARP: I'm from California. What time is it?

AUDIENCE: There are lots of them on the line right now and the first one's that's going to cross I would say –

MS. KOPACZ: Michigan.

AUDIENCE: I think, in two to five years, you'll have a state that will be forced to reorganize, and that's even optimistic.

MR. SHARP: If it's going to happen, it will happen in less than two years.

MS. KOPACZ: I agree with that.

MS. MAYERSON: Any more questions? I want to thank you all for your attention. You're a fabulous audience. Thank you so much.

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10. 11 USC §363.

