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YRC and the Street's Appetite for Destruction

- By DENNIS K. BERMAN

In the battle between the truckers and the hedge funds, the truckers won. The fact that YRC Worldwide almost went bust because of credit-default swaps shows how little has changed on Wall Street.

The struggle for survival at YRC, trucking company best known for its Yellow and Roadway-branded big rigs, attracted scant media attention in the waning days of 2009.

YRC did survive, but only after the last-minute intervention of the Teamsters union, which threatened to protest at the office of one Park Avenue hedge fund.

The fight revolved around credit-default swaps, the Wall Street invention that allows investors to profit when a company goes bust. Made famous for bringing down American International Group, credit-default swaps act like insurance policies on debt, and may make a company worth more dead than alive, at least to some investors.

Fifteen months since Wall Street's brush with Armageddon, the tale of YRC is a reminder of the perils still embedded in our financial system. There are plenty of legitimate uses for CDS. But with little transparency or oversight over credit-default swaps, traders can exploit a kink in the system, holding insurance on a company that's more valuable than underlying bonds or bank debt.

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Certain fund managers "were trying to destroy YRC on purpose," says Mike Green, CEO of Tenex Capital, which advised YRC on its restructuring. "It's fundamentally improper that people can force an insurer to pay a policy when the person insured has the right to destroy his property."

YRC got into trouble after overpriced acquisitions were laid bare by the recession of 2008. Negotiations with Teamsters and banks culminated in December, when the company launched a plan to exchange about 90% of its equity in exchange for bondholder's forgiving about $536.8 million of debt.

Like most debt-for-equity swaps, the deal went through arduous negotiations, with both sides jockeying for better terms. As December dragged on, the company was receiving substantial support for the tender—but still not enough to complete the tender offer.

It's here where YRC began to suspect that certain funds were holding out their consent, largely because they had CDS positions that were more valuable, says Mr. Green. In all, YRC and its advisers couldn't convince—or even locate—owners of about $40 million to $50 million in notes to tender their holdings.

Their resistance was especially perplexing, said Mr. Green, because the company reckoned that bondholders would likely receive nothing in a bankruptcy filing.

As YRC saw it, a tiny group of holders held the fate of a company with 55,000 employees and annual revenues of about $9 billion in its hands.

One problem was the opacity of the holders' positions, said William D. Zollars, YRC's chief executive. "It's really difficult to tell who has CDS and how much they have. You can never be certain."

Conditions grew so desperate for YRC that it enlisted the Teamsters in its effort to complete the bond tender. The Teamsters targeted a handful of bondholders, singling out the likes of New York hedge fund Brigade Capital. It planned a protest for Dec. 30 on Park Avenue. Brigade declined to comment.

At the same time, the union secured the help of Pennsylvania state Treasurer Rob McCord, whose pension fund is an investor in Brigade. It's unclear what effect Mr. McCord's intervention had on the matter, but Brigade executive Don Morgan told Bloomberg on Dec. 29 he held no YRC bonds. In a statement, Mr. McCord said "it was a great to have a chance to help."

The pressure paid off. By Dec. 31, YRC had enough bondholder support to complete its restructuring.

Still, the taint of the CDS issue remains hanging over future reorganizations. Leave it to Teamsters president James Hoffa to remind what's at stake as Congress reshapes financial regulation in 2010: "There's still a divide between Wall Street and Main Street. We're out there fighting for our lives and Wall Street is doing very, very well."

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