The drama and discord over U.S. bank bailout

By Mark Landler and Eric Dash

WASHINGTON: The chief executives of the nine largest banks in the United States trooped into a gilded conference room at the Treasury Department at 3 p.m. Monday. To their astonishment, each was handed a one-page document that said they agreed to sell shares to the government. Then Treasury Secretary Henry Paulson Jr. said they had to sign it before leaving.

The chairman of JPMorgan Chase, James Dimon, was receptive, saying he thought the deal looked good, once he had run the numbers through his head. The chairman of Wells Fargo, Richard Kovacevich, protested strongly that, unlike his New York rivals, his bank was not in trouble because of investments in exotic mortgages and did not need a bailout, according to people briefed on the meeting.

But by 6:30, all nine chief executives had signed, setting in motion the largest government intervention in the American banking system since the Great Depression of the 1930s and retreating from the rescue plan that Paulson had fought so hard to get through the U.S. Congress only two weeks earlier.

What happened during those three and a half hours is a story of high drama and brief conflict, followed by acquiescence by the bankers, who felt they had little choice but to go along with the Treasury plan to inject $250 billion of capital into thousands of banks, starting with theirs.

Paulson announced the plan Tuesday, saying "we regret having to take these actions." Pouring billions in public money into the banks, he said, was "objectionable," but unavoidable to restore confidence in the markets and persuade the banks to start lending again.

In addition to the capital infusions, which will be made this week, the government said it would temporarily guarantee $1.5 trillion worth of new senior debt issued by banks, as well as insuring $500 billion in deposits in non-interest-bearing accounts, mainly used by businesses.

All told, the potential cost to the government of the latest bailout package comes to $2.25 trillion, triple the size of the original $700 billion rescue package, which centered on buying distressed assets from banks. The latest massive show of government firepower is an abrupt about-face for Paulson, who just

BAILOUT, Continued on Page 12

Drama and discord over U.S. bank deal

BAILOUT, From Page 1

days earlier was discouraging the idea of capital injections for banks. Analysts say the United States was forced to shift policy in part because Britain and other European countries had announced plans to recapitalize their banks and backstop bank lending. But unlike the British authorities, the Treasury secretary presented his plan as an offer the banks could not refuse.

"It was a take it or take it offer," said a person who was briefed on the meeting, speaking on condition of anonymity because the discussions had been private. "Everyone knew there was only one answer."

Getting to that point, however, necessitated sometimes tense exchanges between Paulson, a former chairman of Goldman Sachs, and his former colleagues and competitors, who sat across a dark-wood table from him, sipping coffee and cola under a soaring rose and sage-colored ceiling. This account is based on interviews with government officials and bank executives who attended the meeting or were briefed on it.

Paulson began calling the bankers personally on Sunday afternoon.

Some were already in Washington for a meeting of the International Monetary Fund. The executives did not have an inkling of Paulson's plans. Some speculated he would brief them about the government's latest bailout program, or perhaps sound them out about a voluntary initiative. No one expected him to present his plan as an ultimatum.

Paulson, according to his own account, presented his case in blunt terms. The largest U.S. banks needed to begin lending to each other for the good of the financial system, he said during an interview by telephone, recalling his remarks. To do that, they needed to be better capitalized.

"I don't think there was any banker in that room who was going to look us in the eye and say they had too much capital," Paulson said. "In a relatively short period of time, people came on board."

Indeed, several of the banks represented in the room are in need of capital. And analysts said the terms of the government's investment were attractive for the banks, certainly compared with the terms that Warren Buffett extracted from Goldman Sachs for his $5 billion investment.

The Treasury will receive preferred shares that pay a 5 percent dividend, rising to 9 percent after five years. It will get warrants to purchase common shares, equivalent to 15 percent of its initial investment. But the Treasury said it would not exercise its right to vote those common shares.

The terms, officials said, were designed not to be punitive. The rising dividend and the warrants are meant to give banks an incentive to raise private capital and buy out the government after a few years.

Still, it took some cajoling. Kovacevich of Wells Fargo objected that his bank, based in San Francisco, had avoided the mortgage-related woes of its Wall Street rivals. He said the investment could come at the expense of his other shareholders.

Kovacevich is also said to have expressed concern about restrictions on executive compensation at banks that receive capital injections. If he steps down from Wells Fargo after completing the Wachovia takeover, he will be entitled to retirement benefits worth about $43 million and $140 million in accumulated stock and options, according to James Reda & Associates, a firm that consults on executive pay. Pay experts say the new Treasury limits would probably not affect Kovacevich's exit package. Kovacevich declined to be interviewed about the meeting.

Kenneth Lewis, the chairman of Bank of America, also pushed back, saying that his bank had just raised $10 billion on its own. Later, Lewis urged his colleagues not to quibble with the plan's restrictions on executive compensation for the top executives. These include a ban on the payment of golden parachutes, repayment of any bonus based on earnings that prove to be inaccurate, and a limit of $500,000 on the tax deductibility of salaries.

If the bankers let executive compensation block this, "we are out of our minds," he said, according to a person briefed on the meeting.

In an interview Monday, before the meeting, John Mack said that his bank, Morgan Stanley, did not need capital from the Treasury. It had just sealed a $9 billion deal with a large Japanese bank. During the meeting, however, Mack said little, according to participants.

Paulson, however, was peppered with questions about the terms of the investment by other chief executives with experience in deal-making: Lloyd Blankfein of Goldman Sachs, Vikram Pandit of Citigroup, John Thain of Merrill Lynch and Dimon. Among their concerns: How would the government's stake affect other preferred shareholders? Would the Treasury demand control over management in return for the capital? How would the warrants work?

With the discussion becoming heated, the chairman of the Federal Reserve, Ben Bernanke, who was seated next to Paulson, interceded.

He told the bankers that the session need not be combative, because both the banks and the broader economy stood to benefit from the program.

Without such measures, he added, even the situation of healthy banks could deteriorate.

The president of the Federal Reserve Bank of New York, Timothy Geithner, then proceeded to outline the details of the investment program. When the bankers heard the amount of money the government planned to invest, they were stunned by the size, according to several people.

As they heard more of the details, some of the bankers began to realize how attractive it was for them.

Even as they insisted they did not need the money, bankers recognized the extra capital could be helpful if the economy got shakier. Many of these banks' biggest businesses are tied to the stock and credit markets; the quicker they improve, the better their results.

Later, Pandit told colleagues that the investment would give Citigroup more flexibility to borrow and lend. Dimon told colleagues he believed the relatively cheap capital was a fair deal for his bank. Lewis said he recognized the prospects of his bank are closely aligned with the American economy.

Thain was intrigued by the terms of the guarantee by the Federal Deposit Insurance Corp. on new senior debt issued by banks, participants said. He mentally calculated the maturities on debt issued by Merrill Lynch, to determine how the program could benefit his bank.

For Paulson, selling the bankers on capital injections may not have been as difficult as overhauling a rescue program that had originally focused on asset purchases from banks. Paulson said the worsening conditions made a change in focus imperative.

"I've always said to everyone that ever worked for me, if you get too dug in on a position, the facts change, and you don't change to adapt to the facts, you will never be successful," he said.

Paulson insisted that purchases of distressed assets would remain a big part of the program. But having allocated $250 billion to direct investments, the Treasury has only $100 billion left from its initial allotment of $350 billion from Congress to spend on those purchases.

Eric Dash, Louise Story and Ben White reported from New York.

iht.com/biz

A report from The Time's Jeff Sommer and Floyd Norris on government bailouts.

Daniel Acker/Bloomberg News

Richard Kovacevich of Wells Fargo reportedly questioned executive pay restrictions.

A hard sell for fliers in an airborne mall

AIRLINES, From Page 1

proached $150 a barrel during the summer. Now that the oil price has receded, few airlines are revoking those charges. United doubled the fee, to $50, for a second bag last month.

Willie Walsh, the chief executive of British Airways, said there were some things his flag carrier would never charge for.

"We won't unbundle seat assignment," he said during an interview last month. "We won't unbundle the checked-in bag allowance. We won't unbundle check-in at airports and we won't charge you for a glass of water on the aircraft."

But he did not rule out introducing fees for checking in golf bags and skis. "That debate is still going on," Walsh said.

Passengers' comfort is not expected to be the top priority for flight attendants in the midair shopping malls of the future.

"You need them to break away from Salvation Army service," said Joao Monteiro, an executive at LSG Sky Chefs, a Lufthansa-owned airline caterer and service provider. "You want retailers on board."

Sales commissions of 10 percent to 12 percent would work as powerful incentives for cabin crews to sell extra products, said Laura Duran, ancillary revenue manager at Vueling, a low-cost airline based in Barcelona that is merging with a rival, Clickair.

"From Vueling's perspective it's a very good idea," Duran said. Making cabin crew salaries entirely commission-based would, however, be a step too far, she said. "It's just a topper."

Passengers could be encouraged to spend with offers of discounts on attractions like Disneyland if they paid more than $50 on board, Nuwar said, while sales targets would drive cabin crews to ring up more in-flight sales. Train tickets, hotel rooms and rental-car reservations could all be offered.

Duty-free perfumes and alcohol, which are too heavy to stock aboard weight-sensitive aircraft like Vueling's, could be picked up at destinations or even delivered. "You scan and pay with your credit card and have them delivered to your home," Nuwar said.

No midair snack is too small to generate a profit, provided it can last through several flights before being sold.

"The basic needs are hunger and thirst — not the lifestyle of gourmet food," said Monteiro of Sky Chefs, whose experience in supplying gourmet sandwiches to one airline was not a happy one. "We had wastage of more than 30 percent — we had to throw them all out after the first flight."

Airlines, he said, should think like flying supermarkets instead.

"You have to think like a retailer who has space on board to get higher margins," Monteiro said. "When you are struggling to make a profit on a ticket, then selling for $3 to $5 that item of water on board that cost you 20 cents can make you a profit."

Meanwhile low-cost airlines, early adopters of all new methods to make the passenger spend, are impatient for new technology that will let them charge for access to live and satellite TV. But the prohibitive cost of retrofitting existing aircraft for broadband, Rutter said, means that cash source will be realized only when airlines renew their fleets.

At a time when planes are jettisoning ballast to reduce their fuel bills, the equipment alone will add 70 kilograms, or 154 pounds, to a plane's load.

But Asbjorn Christoffersen, chief regulatory officer at OnAir, an information technology company, said the system would allow airlines to offer passengers services like in-flight gambling.

"If you can make one passenger sign up for a gambling application on your aircraft, you will be paid $100 by the gambling application provider," he said.

Ryanair, the biggest low-cost operator in Europe, will roll out the mobile phone and Internet system on its whole fleet "in the next few weeks," Christoffersen said. Two other low-cost airlines — Air Asia and Shenzhen Airline of China — are set to follow, while Kingfisher of India and TAM of Brazil are interested.

"Low cost airlines are aggressively driving this," Christoffersen said. Mainstream carriers like Air France-KLM, TAP of Portugal and BMI of Britain are also starting to explore the service. "It's becoming something you have to have," he said.

Laws about gambling do not apply over water, and they apply only during descent into the national airspace of certain countries, said Rutter of Flybe. Like Ryanair, Flybe has long been interested in gambling as a form of entertainment on flights too short for watching films.

Vueling, meanwhile, hopes advertising will bolster its revenues. Duran sees tray tables as untapped ad space.