This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior
Accounting: Quality of Earnings Issues
Governance: Corporate Governance Issues

Hidden Risks: Insider Shares Pledged as Collateral

3DAdvisors, LLC Special Report

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This *Special Report* covers situations where an insider or group of insiders have very large positions (sometimes more than 10% of the outstanding shares) and have pledged some or all of those shares as collateral for securities margin accounts or personal loans. During periods of increasing market volatility, such as we have been experiencing recently, these situations can add a hidden but sometimes very significant degree of risk for share prices that are already under pressure. In this report, we review not only some well known historical examples that manifested themselves as the tech bubble burst in 2001, but we also look at four current situations where this type of risk is clearly present. The Appendix lists other instances across a market cap and sector diverse group of companies where a significant percentage of shares outstanding are pledged as collateral.

Special Reports are published periodically on topics of general interest to 3DAdvisors, LLC subscribers.

Companies Highlighted in this Special Report

- Boston Scientific Corp. (NYSE: BSX)
- Chesapeake Energy Corp. (NYSE: CHK)
- Credit Acceptance Corp. (NASDAQ: CACC)
- Triarc Companies Inc. (NYSE: TRY)

Discussion of 3DAdvisors Findings

It was no insignificant amount of déjà vu that we felt upon seeing that the heads of both Tarragon Inc. (NASDAQ: TARR) and American Home Mortgage (OTC: AHMIQ) had pledged the majority of their holdings in their respective companies as collateral in margin accounts, forcing margin calls following the collapse of their share prices (see Research Notes 08/29/07), putting even more pressure on the stocks. These situations brought back old memories of similar events that occurred in the wake of the tech bubble in 2001, two of which remain etched in our memory.

Our clients, no doubt, recall the demise of internet service provider PSINet during that period and how Founder/Chairman **William Schrader**, who owned 11.3 million shares at the time (as of 03/31/00) had pledged 11 million as collateral to NationsBank to support four different lines of credit. Clearly, with PSI shares trading at about $60 at the time the shares were pledged, to say that his timing was opportune would be vastly understated as the shares would soon drop to around $1.50 by the time of the margin call, which claimed all of his shares. Of course the last thing PSI shareholders needed at the time was for 11 million shares to come on the market as NationsBank sold the shares. Schrader resigned in May of 2001 and the Company filed for bankruptcy the next month.

Then there was the move by WorldCom Founder/CEO **Bernie Ebbers**, who similarly had pledged 12.3 million of his shares (45% of his holdings) to collateralize $253 million in loans from Bank of America (Note: Ebbers had additional loans outstanding with other lenders that were not collateralized with WorldCom stock). The fascinating side to this one was that, as WorldCom shares tanked, the Company eventually stepped in to provide additional collateral so that Ebbers would not have to sell and put additional pressure on the already-sinking shares. The rest is history, as they say.

To us, there are two principal implications of this particular behavior. First of all, the behavior can be considered somewhat akin to a monetization event such as a forward sale. In this case, however, depending on the deal's structure, the institution to which the shares are pledged can be left holding the bag should the shares fall too far before action is taken. This behavior can also lead to outcomes that can be quite harmful to other shareholders if the stock experiences extreme volatility and begins to lose significant value. For this very reason, the SEC made an amendment to the beneficial ownership reporting rules which took effect this year, requiring all companies to footnote shares pledged as security by named executive officers, directors and director nominees in the Proxy Statement. Here is the SEC's rationale taken from the final rule [bolding is ours]:

> **To the extent that shares beneficially owned are used as collateral, these shares may be subject to material risk or contingencies that do not apply to other shares beneficially owned by these persons. These circumstances have the potential to influence management's performance and decisions. As a result, we believe that the existence of these securities pledges could be material to shareholders.**

Again, this practice seems an opportunity for an insider to monetize shares under the radar. Should the shares fall, it's easier to just let the counterparty sell, making such sales look as if they were out of the insider's control as opposed to "insider selling". But if such insiders were truly believers that their shares would not be heading lower, one would think those involved would put up more cash collateral, when required, instead of allowing the shares to be sold. Of course, the attendant effect of related margin calls, when pledged shares fall, only serves to put additional pressure on already-stressed share prices, usually at the most inopportune time.

We have constructed for our clients a list of companies where key insiders have pledged large stock positions as collateral for various loans. In some cases the disclosure is quite specific, in others quite vague. Although Proxy rules now require the pledged shares designation, the media is yet to take notice so our list should be considered one of the few out there on the subject. Since the collateralization of shares is uncommon to begin with (many companies explicitly prohibit it), there is only a handful of key inside shareholders who have pledged significant percentages of their company's stock.

The only criteria used to narrow down the list was that the shares pledged by the executive officers and directors as a group had to account for more than 5% of the company's outstanding shares. This did exclude some very interesting situations, such as General Growth Properties (NYSE: GGP), where three named officers, including CFO **Bernard Friebaum** (renowned for his insider buying) have 10 million shares pledged, or 80% of their combined ownership. Another good example is TCF Financial Corp. (NYSE: TCB), a regional bank whose consumer home equity loan portfolio accounts for roughly 40% of its total assets. Chairman **William Cooper**, the largest inside shareholder with a 3% stake, pledged 90% of his stock as collateral for loans while CEO **Lynn Nagorske** borrowed using 30% of her stock. By the way, TCB currently trades just off its 52-week low. We highlight below four names that stand out from the group in terms of the sheer extent of the activity or relevance to the current credit market climate. For the full list, see the Appendix.

Boston Scientific Corp. (NYSE: BSX)

Key Statistics

Sector:	Last Close:	Shares Outstanding:	# Insiders Pledged:
Healthcare	**$13.17**	**1.49B**	**3**
Industry:	**52 Week Range:**	**Average Volume (3m):**	**Shares Pledged:**
Med. Instr. & Supplies	**$12.11 - $18.69**	**11,922,400**	**131,405,250**
Market Cap:	**S&P Credit Rating:**	**Short % of Float:**	**% Out Pledged:**
$19.62B	**BB+**	**2.90%**	**8.8%**

With nearly $9 billion in debt on its books, Boston Scientific has been affected by the recent credit market conditions, evidenced by all three major credit agencies assigning a "junk" rating to BSX's debt. In fact, Boston Scientific was one of only 22 companies to have their credit rating lowered to junk bond territory this year. The current status will certainly increase the Company's incremental borrowing costs and could lead to problems meeting bank covenants if it doesn't reduce debt or increase EBITDA. With the current cash flow issues (cash from operations down more than 85% year-over-year in the past two quarters), defibrillator recall and safety warning setbacks and Taxus sales declines, it seems highly unlikely the Company will find any simple and quick solutions to its debt predicament.

Here is some equally troubling information you will not find receiving the same degree, or really, any media coverage: With BSX shares currently trading 30% off their 2007 high, two key inside shareholders might be facing their own credit challenges. Company co-founders, Chairman **Peter Nicholas** (65) and Director **John Abele** (70) collectively hold 131 million shares, or roughly 9% of the outstanding stock. Of this total, Nicholas has 67.6 million pledged as collateral for debit balances on margin securities accounts, while Abele collateralized 45.4 million shares for credit lines and margin accounts with multiple brokerage firms.

At first, it might seem irrational that Nicholas, ranked #189 on Forbes' most recent list of richest Americans with a net worth of $1.9 billion, could even be in jeopardy of receiving margin calls. But our calculations show that roughly 80% of his net worth at the time of the Forbes ranking (Q107) is comprised of shares pledged to his broker, and the decline in BSX stock this year has eaten away nearly one-third of his net worth. Keep in mind, WorldCom's former CEO **Bernie Ebbers** was ranked #210 on the list with a net worth of $1.4 billion in 1999 before his credit troubles (read: margin calls) eroded most of his personal worth.

Since Boston Scientific only began reporting pledged holdings in its most recent Proxy Statement (filed on 03/27/07), it is not known when Nicholas and Abele established their margin accounts. If it was done in 2004, when BSX traded as high as $45, it is possible their lenders might soon require additional collateral to secure their margin requirements. Accounts set up during other periods might not be at risk of receiving margin calls until BSX shares trade well below their current price, but given the amount of stock held by the top five institutional shareholders, along with the founders, there is good reason to believe the market could be flooded with these pledged shares should BSX, in fact, experience further weakness.

<u>Chesapeake Energy Corp. (NYSE: CHK)</u>

Key Statistics

Sector:	Last Close:	Shares Outstanding:	# Insiders Pledged:
Basic Materials	**$34.79**	**473.52M**	**4**
Industry:	**52 Week Range:**	**Average Volume (3m):**	**Shares Pledged:**
Independent Oil & Gas	**$27.27 - $37.75**	**8,425,670**	**49,410,944**
Market Cap:	**S&P Credit Rating:**	**Short % of Float:**	**% Out Pledged:**
$16.47B	**BB**	**11.600%**	**10.4%**

There has not been to this point, nor do we expect to see in the near future, a group of insiders who can match the magnitude of stock pledging and hedging as those at Chesapeake Energy. While the Company's co-founders, Chairman, Chief Executive

Aubrey McClendon (47) and **Tom Ward** (47), might best be known to insider trading followers for their aggressive open market buying over the years, a close examination of less-perused SEC documents reveals the chilling reality of their highly-leveraged ownership positions. (For a more descriptive explanation, see a full report on CHK dated 04/20/06 titled: *Once High-Profile Stock Buyers, Principals Quietly Exit*).

McClendon has laid out $261 million since September 2002 to acquire 14.6 million shares, either on the open market or through the exercise of vested stock options, increasing his ownership by 200%. But at what expense did he acquire these shares? A new disclosure in the Company's current Proxy reveals 25 million of McClendon's 26 million shares are "held in bank or brokerage margin accounts or escrow accounts securing brokerage accounts", but this brief description hardly spells out the complexity of his commitments. Please note: the information below comes from McClendon's most current 13D filed on 02/22/06. Some of the figures have increased based on information provided in the current Proxy [bolding is ours]:

> **Mr. McClendon maintains credit arrangements with RBC Dain Rauscher, Inc. ("RBC") pursuant to an agreement dated September 16, 2005 with Lehman Brothers pursuant to agreements dated September 13 and December 8, 2005, with Wachovia Securities pursuant to an agreement dated September 5, 1996, with Morgan Stanley pursuant to an agreement dated February 1, 2005 and with Goldman, Sachs & Co. ("Goldman") pursuant to an agreement dated July 11, 2002. As of February 10, 2006, Mr. McClendon and CI have pledged 4.51 million shares of Common Stock as collateral for the credit arrangement with RBC. Mr. McClendon has also pledged 1.06 million shares of Common Stock as collateral for the credit arrangement with Lehman Brothers, 2.13 million shares of Common Stock as collateral for the credit arrangement with Wachovia Securities, 826,282 shares of Common Stock as collateral for the credit arrangement with Morgan Stanley and 7.01 million shares of Common Stock as collateral for the credit arrangement with Goldman, as of February 10, 2006. The agreements contain standard default and remedial provisions.**
>
> **Mr. McClendon has pledged 2.01 million shares of Common Stock, 50,000 shares of the Company's 5.00% (2003) Preferred Stock (which is convertible at any time by Mr. McClendon into 304,810 shares of Common Stock), and 10,000 shares of 4.125% Preferred Stock (which is convertible under certain conditions by Mr. McClendon into 600,555 shares of Common Stock) as security for the performance of financial obligations Mr. McClendon may have from time to time pursuant to energy trading transactions with a large Oklahoma-based private oil company. As a result, the shares may be subject to transfer if there is a default in the obligations secured by the parties' oral pledge agreement.**

Tom Ward founded Chesapeake with McClendon and had also been an aggressive buyer of CHK shares ($84 million worth) until his resignation in February 2006. No longer an executive, he was released from Company rules prohibiting derivative transactions covering CHK securities and immediately took action, selling forward and collaring 14.3 million shares, the most aggressive position-hedging we have seen. There have actually been some very material Ward actions since our last Chesapeake coverage. He laid out $425 million in the first quarter to cancel all 2006 forward sale and collar contracts, only to sell forward his entire position (23.8 million shares) in March for an undisclosed price. What stands out to us is the fact that the eight contracts call for the shares to be delivered on the March 2008 to May 2008 expiration dates and do not include a provision for the contracts to be settled in cash (a common element of most forward sale agreements). **Barring any further contract cancellations, it would appear that 23 million shares will change hands in the next six to eight months**.

Credit Acceptance Corp. (NASDAQ: CACC)

Key Statistics

Sector:	Last Close:	Shares Outstanding:	# Insiders Pledged:
Financial	**$20.66**	**30.31M**	**1**
Industry:	**52 Week Range:**	**Average Volume (3m):**	**Shares Pledged:**
Credit Services	**$20.07 - $34.59**	**61,944**	**2,026,851**
Market Cap:	**S&P Credit Rating:**	**Short % of Float:**	**% Out Pledged:**
$626.29M	**N/A**	**12.60%**	**6.6%**

While the collateralization element of the Credit Acceptance Corp. story might not rival others highlighted in this report, it is certainly the most topical in the current credit environment. For those not familiar with the Company, Credit Acceptance provides automobile loans to individuals who are unable to secure financing elsewhere. CACC's high-risk loan portfolio would even make subprime mortgage lenders recoil. Just about everyone associated with Credit Acceptance is over-extended, from the clients, and the Company with its 1.84 debt-to-equity ratio, to the principal shareholder, Chairman **Donald Foss** (62), who founded the Company in 1972 and controls 65% of the outstanding stock. Thanks to the new Proxy disclosure requirements, the Company's current statement reveals 10.3% of Foss' ownership is "pledged pursuant to a margin account arrangement", which in turn, due to his sizeable stake, translates to 7% of the outstanding shares being held as collateral for his indebtedness.

The potential problems with Foss' pledge are clear to see. For one, Credit Acceptance shares have been decimated in recent weeks, falling 25% from the August peak, or 40% from the 52-week high. Since the Company has not disclosed any additional details on the shares held by Foss' broker, we do not know the stock's value at the time they were pledged or what his margin requirement might be. If he pledged the shares in the past five years, a margin call would not be out of the question, especially if CACC shares slide further into the mid teens. Secondly, the issue trades thinly, averaging only 62,000 per day, so a margin call of even 200,000 shares, or 10%

of Foss' total pledge, would clearly impact the market. Insiders sold just 85,000 shares in the aftermath of the Company's disappointing August 2^{nd} earnings release (Q2) and the current stock price is a reflection of shareholders' displeasure. Although some of the sales were motivated by options nearing expiration, this was not the case for President **Steven Jones** who cleared out more than half of his actionable holdings before they fell off the proverbial ledge.

Another potential concern is the Company's track record during periods of increased consumer debt and bankruptcies. Back in 1997, CACC shares fell from the upper $20s down to $2 when the Company had to take a $60 million charge to bolster loan-loss reserves, erasing almost the entire year's profits. The current credit environment already played a role in Credit Acceptance's second quarter earnings decline and any underestimation of new loan collection rates would extend the current freefall. Should this happen, there is the real possibility a significant number of shares could be sold by financial institutions under their pledge agreement with Foss.

Triarc Companies, Inc. (NYSE: TRY)

Key Statistics

Sector:	Last Close:	Shares Outstanding:	# Insiders Pledged:
Services	**$13.66**	**92.76M**	**2**
Industry:	**52 Week Range:**	**Average Volume (3m):**	**Shares Pledged:**
Restaurants	**$12.17 - $22.42**	**101,277**	**17,871,911**
Market Cap:	**S&P Credit Rating:**	**Short % of Float:**	**% Out Pledged:**
$1.27B	**B+**	**0.80%**	**19.2%**

Triarc Companies and its now non-executive chairman **Nelson Peltz** (64) have received a fair share of publicity lately as they, along with Peltz's Trian Fund Management firm, take additional steps towards adding Wendy's International (NYSE: WEN) to their restaurant portfolio. But just how likely is an acquisition by Triarc, especially with a reported offer around $3.5 billion, nearly three times TRY's own valuation? Triarc, the parent company of Arby's restaurants, is already one of the most leveraged chains in the restaurant industry, with a debt to equity ratio of 1.64, up from 1.48 at the beginning of 2007. The Company is finding out just how difficult it is to raise capital in the current environment as its proposed sale of asset management subsidiary Deerfield & Co. to Deerfield Triarc has stalled due to a lack of financing. We are also a little puzzled how Trian Fund Management is named as part of the Wendy's acquiring group. They reported a total of $1.3 billion in managed assets at the close of 2Q06 and showed assets of just $6.7 million on their 13F filed on 08/13/07.

This situation looks eerily similar to Boston Scientific's fall from grace, which first began when the Company overextended itself on the Guidant acquisition and now contends with slowing sales and quality control issues. Triarc currently faces its own operating difficulties, having recently reported declining same-store sales, royalties and franchise fees, and restaurant operating profits in Q2 (period ended 07/01/07) and the announcement of an overhauled management team. Wendy's is burdened with many of the same operational and execution challenges which prompted the board to acquiesce to activist investors and seek alternative strategies. Investors should be a little concerned that the company to emerge from this potential marriage will be over levered and, most likely, lacking managers with enough experience to right the ship.

Also highly leveraged is Peltz's personal fortune, along with the wealth of his longtime sidekick, Vice Chairman (former president and chief operating officer) **Peter May** (64). The two collectively hold 24.6 million shares, equal to 26%[1] of the outstanding Class A and Class B shares, and have pledged a total of 17.8 million to banks to secure loans. In effect, nearly 20% of Triarc's outstanding stock is being held as collateral by outside financiers. Peltz was ranked #297 out of 400 on this year's Forbes Wealthiest Americans list with a net worth of $1.3 billion, of which roughly 20% is collateralized TRY stock. But his net worth has declined along with Triarc shares this year. The stock is down nearly 40% from its January 2007 high of $22, and more importantly, down 25% from the January 31, 2006 date he put up additional shares to increase his available borrowings. Since the Company has always excluded their pledge schedules from SEC filings, it is difficult to gauge their margin requirements, but with the shares currently at the lower end of the 10-year trading range, we suspect Peltz or May could receive margin calls (or require additional collateral) should TRY shares fall below $10.

With the small amount of TRY shares trading daily (105,000), the news alone of a Peltz or May margin call would put significant downward pressure on the shares and the sales themselves would have a significant trading impact. It is possible the Company would contemplate intervening due to the amount of stock in question, by securing their bank indebtedness a la WorldCom and Bernie Ebbers, just to prevent the shares from hitting the market. This in itself could trigger an irreversible chain of events that would damage investor and Wall Street confidence. The potential detriment that can befall a company such as Triarc if a key shareholder receives margin calls is exactly why the SEC incorporated pledged stock in its new Proxy disclosure requirements that took effect in 2007. Interested parties have a right to know how insiders exploit their company stock, and frankly, should reflect on examples listed in this report.

[1] The Company reports Peltz and May collectively owned 34% of the outstanding shares on the 2006 Proxy filed on 04/30/07, but this includes duplicate stock the two share beneficial ownership. Our calculations include only shares they and their family's own solely.

3D ADVISORS

Appendix

Companies Where Insiders Have Pledged Large Stock Positions as Loan Collateral

Company	Ticker	Market Cap	Short Interest	Volume	Shares Outstanding (millions)	Insiders w/ Pledged Shares	Sole Ownership	Pledged Shares	% Ownership Pledged	Total % of Outstanding Pledged
Boston Scientific	BSX	$18.95B	2.9%	12,467,900	1,489.55	CB Pete Nicholas	72,653,015	67,666,167	93%	**9%**
						DIR J. Abele	58,600,886	45,471,288	78%	
						DIR J. Fleishman	151,349	105,317	70%	
Cheniere Energy	LNG	$1.66B	19.0%	551,610	47.28	CB, CEO Charif Souki	2,847,769	2,847,769	100%	**9%**
						VC Walter Williams	611,039	611,039	100%	
						CFO Don Turkleson	575,348	575,348	100%	
						DIR Keith Carney	249,172	249,172	100%	
						DIR Nuno Brandolini	169,200	169,200	100%	
Chesapeake Energy	CHK	$14.96B	11.6%	8,795,060	473.52	CB, CEO Aubrey McClendon	26,513,942	25,560,388	96%	**10%**
						B/O Tom Ward	23,816,390	23,816,050	100%	
						CFO M. Rowland	55,173	25,131	46%	
Constellation Brands	STZ	$5.17B	7.0%	2,160,810	215.58	Sands Family	27,623,460	14,259,475	52%	**7%**
Credit Acceptance	CACC	$692M	12.6%	59,055	30.31	CB Donald Foss	19,523,269	2,026,851	10%	**7%**
General Growth Properties	GGP	$11.85B	4.3%	3,352,940	245.58	CFO Bernard Friebaum	7,466,637	6,621,137	89%	**3%**
						P, COO Robert Michaels	2,032,294	1,093,784	54%	
						CCDO Jean Schlemmer	355,563	186,478	52%	
Iron Mountain	IRM	$5.51B	3.0%	660,365	200.09	DIR Kent Dauten	2,681,261	2,625,000	98%	**5%**
						CB, CEO C. Richard Reese	3,749,477	1,052,097	28%	
						DIR Vincent Ryan	15,516,057	6,805,622	44%	
Mannatech	MTEX	$229M	34.5%	389,953	26.46	CB Samuel Caster	5,463,116	5,300,000	97%	**27%**
						DIR Marlin Robbins	2,033,330	1,900,000	93%	
Papa John's Intl.	PZZA	$768M	10.2%	317,249	29.87	CB John Schnatter	6,814,747	1,644,196	24%	**7%**
Trailer Bridge	TRBR	$141M	0.3%	6,392	11.91	CB, CEO John McCown	1,587,800	359,000	23%	**28%**
						DIR Greggory Mendenhall	1,480,935	1,438,923	97%	
						DIR Malcolm McLean	1,457,594	1,443,922	99%	
						GC William Gotimer	181,097	49,838	28%	
Triarc	TRY	$1.34B	0.8%	104,952	92.76	CB Nelson Peltz	15,969,856	11,919,138	75%	**19%**
						VC Peter May	8,689,788	5,952,773	69%	
UBS Holdings	UBH	$515M	7.1%	95,704	21.95	P, COO Raymond Crotty	852,667	206,326	24%	**12%**
						DIR Michael Fury	570,140	229,997	40%	
						DIR Kenneth Torsoe	2,276,226	2,151,651	95%	

Appendix

Companies Where Insiders Have Pledged Large Stock Positions as Loan Collateral

Company	Ticker	Market Cap	Short Interest	Volume	Shares Outstanding (millions)	Insiders w/ Pledged Shares	Sole Ownership	Pledged Shares	% Ownership Pledged	Total % of Outstanding Pledged
Western Alliance Bancorp	WAL	$800M	18.8%	200,834	29.98	CFO Dale Gibbons	106,450	106,450	100%	**8%**
						P, CEO Robert Sarver	3,568,943	2,112,316	59%	
						DIR Donald Synder	212,221	96,082	45%	