Congressional Oversight Panel

September 9, 2009

SEPTEMBER OVERSIGHT REPORT*

The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry

*Submitted under Section 125(b)(1) of Title 1 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343

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Executive Summary*

Even before last year's financial crisis, the American automotive industry was facing severe strains. Foreign competitors had steadily eroded its market share. Rising fuel prices had softened demand for its products. Legacy costs had constrained its flexibility. And a series of poor strategic decisions by its executives had compounded these problems. In 2008, U.S. automotive sales fell to a 26-year low.

The financial crisis weakened American automakers even further, constricting credit and reducing demand, turning their long-term slump into an acute crisis. By early December, Chrysler and General Motors (GM) could no longer secure the credit they needed to conduct their day-to-day operations. Unless they could raise billions of dollars in new financing, they faced collapse – a potentially crippling blow to the American economy that Treasury estimated would eliminate nearly 1.1 million jobs.

Facing this prospect, the administration of former President George W. Bush stepped in and provided short-term financing to the automotive companies, using funds from the Troubled Asset Relief Program (TARP). The policy was later continued by the Obama Administration, which supplied additional loans that were used to finance the bankruptcy reorganizations of Chrysler and GM.

Treasury's financial assistance to the automotive industry differed significantly from its assistance to the banking industry. Assistance given to the banks has carried less stringent conditions, and money was made readily available without a review of business plans or without any demands that shareholders forfeit their stake in the company or top management forfeit their jobs. By contrast, Treasury was a tough negotiator as it invested taxpayer funds in the automotive industry. The bulk of the funds were available only after the companies had filed for bankruptcy, wiping out their old shareholders, cutting their labor costs, reducing their debt obligations and replacing some top management. The decision to provide financing for the automotive industry raises a number of questions about TARP and its use, including the decision to fund the automotive industry, the government as tough negotiator, the conflicts of interest that arise when the government owns a substantial stake in a private company, and the exit strategy. This report addresses each of these issues.

The decision to intervene also raises critical questions about Treasury's objectives. Was the primary purpose of this intervention to provide bridge funding to the automakers, with the expectation that these were viable companies that could eventually repay taxpayers in full? Was it to prevent an uncontrolled liquidation because such a prospect posed a systemic risk to the financial markets and the overall economy? Was it to advance broader policy goals, such as

* The Panel adopted this report with a 2-1 vote on September 8, 2009. Rep. Jeb Hensarling voted against the report. Additional views are available in Section Two of this report.

improving fuel efficiency or sustaining American manufacturing and jobs? Or was it some combination of these? To date, Treasury's public statements provide little clarity, as each of these objectives has been cited at various times.

Whether Treasury had the legal authority to use TARP funds to bail out Chrysler and GM is the subject of considerable debate. There was, however, enough ambiguity in the TARP legislation, and there continues to be ambiguity about congressional intent, so that Treasury has faced no effective challenge to its decision to use TARP funds for this purpose.

Given the size of the automotive companies, the historical importance of the industry, and the government's extensive engagement in this process, the bankruptcy proceedings were highly visible and invited much public scrutiny. Those creditors who saw their investments in the company sharply reduced in bankruptcy raised vigorous objections to the role of the government as tough negotiator. The Panel asked two experts on bankruptcy law, Professor Barry Adler of New York University and Professor Stephen Lubben of Seton Hall University, to provide the Panel with an analysis of the bankruptcy process.

When all had settled, substantial changes had been made in the businesses, shareholders had been wiped out, many creditors had taken substantial losses, and the American taxpayers emerged as the owners of 10 percent and 61 percent of post-bankruptcy Chrysler and GM, respectively.

Although taxpayers may recover some portion of their investment in Chrysler and GM, it is unlikely they will recover the entire amount. The estimates of loss vary. Treasury estimates that approximately $23 billion of the initial loans made will be subject to "much lower recoveries." Approximately $5.4 billion of the loans extended to the old Chrysler company are highly unlikely to be recovered. The Congressional Budget Office earlier calculated a subsidy rate of 73 percent for all automotive industry support under TARP and recently raised its estimate of the cost of that assistance by approximately $40 billion over the previous estimate. Because Treasury has not clearly articulated its objectives, it is impossible to know if this prospect, indeed, represents a failure of Treasury's strategy.

The government's emergence as the part-owner of a large, private company raises critical oversight questions. At times, in the ordinary course of business, natural tensions arise between the interests of a corporation's management team, its shareholders and the directors who represent them, its creditors, its workers, its regulators, and, and its customers. The government's investment in the American automotive industry has added a new complication, as the American public now directly or indirectly participates in many of these roles. This report explores the conflict between possibly competing objectives, including preventing significant job losses across the nation in the midst of an economic crisis against maximizing shareholder profits; changing the culture of these automotive companies against not interfering with day-to-day management; and public accountability against normal commercial operations. The Panel assesses how effectively Treasury has navigated these and other concerns, including its role in the bankruptcy process.

The Panel recommends that, to mitigate the potential conflicts of interest inherent in owning Chrysler and GM shares, Treasury should take exceptional care to explain its decision-making and provide a full, transparent picture of its actions. The Panel recommends that Treasury use its role as a significant shareholder in Chrysler and GM to ensure that these companies fully disclose their financial status and that the compensation of their executives is aligned to clear measures of long-term success. To limit the impact of conflicts of interest and to facilitate an effective exit strategy, Treasury should also consider placing its Chrysler and GM shares in an independent trust that would be insulated from political pressure and government interference.

Finally, because of the unprecedented nature of the assistance provided to the automotive industry, the Panel also recommends that Treasury provide its legal analysis justifying the use of TARP funds for this purpose. This analysis will inform policymakers' and taxpayers' understanding of the potential for Treasury to use its authority to assist other struggling industries.

Treasury must be clearer, more transparent, and more accountable in its TARP dealings, providing the American public with the information needed to determine the effectiveness of Treasury's efforts.

Section One: The Use of TARP Funds in the Support and Reorganization of the Domestic Automotive Industry

A. Introduction

Beginning in December 2008, Treasury broadened its allocation of funding under the Troubled Asset Relief Program (TARP) by using $85 billion in TARP funds to support the domestic automotive industry.[1] In this report, the Panel examines several key considerations relating to these disbursements, including: Treasury's justification for extending TARP funds to the automotive sector, how exactly this money has been used, and whether Treasury has properly and publicly articulated its objectives and taken action in furtherance of those objectives. This report also examines Treasury's role in the bankruptcy of Chrysler Holding LLC (Chrysler) and General Motors Corporation (GM), how Treasury plans to protect taxpayers' interests while the government controls these companies, and how Treasury intends to maximize taxpayers' returns when the government divests itself of ownership.

The Emergency Economic Stabilization Act of 2008 (EESA),[2] which governs Treasury's administration of TARP, specifically authorizes the Secretary of the Treasury "to establish the Troubled Asset Relief Program…to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution."[3] EESA also established the Panel to oversee Treasury's administration of the program. According to its mandate, the Panel is obliged to review and oversee the Secretary of the Treasury's use of his authority under TARP, the impact of TARP on the financial markets and financial institutions, the extent to which information made available on TARP transactions has contributed to market transparency, and TARP's effectiveness in minimizing long-term costs and maximizing benefits to the taxpayers.

While these oversight objectives do not fit as neatly into an examination of Treasury's involvement in the automotive industry as they do with respect to its involvement in the financial industry, if Treasury is of the understanding that it has the authority to use TARP funds to assist the automotive industry, then the Panel has the obligation to "follow the money" and determine whether Treasury used that money in furtherance of the stated objectives of TARP.

[1] U.S. Department of Treasury, *TARP Transaction Report* (Aug. 18, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report_08182009.pdf) (hereinafter "August 18 Transactions Report").

[2] Emergency Economic Stablization Act of 2008 (EESA), Pub. L. No. 110-343 (hereinafter "EESA").

[3] EESA § 101(a)(1).

B. What Happened? The Sequence of Events

Despite increasing competition from abroad, the U.S. automotive industry continues to account for a significant portion of America's economic output. As recently as early 2004, the industry produced almost four percent of this nation's gross domestic product.[4] Even though the industry lost approximately 435,000 jobs between 2000 and 2008, approximately 880,000 people continued to be employed in the industry in 2008.[5] This represents more than 6.5 percent of the total manufacturing jobs in the United States.[6] Notably, the American steel industry shipped almost 13 percent of its output to automotive manufacturers in 2008.[7]

However, in the fall of 2008, the combination of rising gasoline prices, tightening credit markets, eroding consumer confidence, high unemployment, and discretionary spending concerns prompted a significant downturn in automobile sales in the United States and abroad, with 2008 sales 18 percent lower than the previous year's.[8] U.S. automobile sales fell to a 26-year low, from a high point of 17.3 million cars and light trucks in 2000 to 13.2 million in 2008. Sales fell much further in the first half of 2009 as a result of deteriorating economic conditions and are projected to be roughly 10.3 million units for 2009 and 11.1 million in 2010.[9] The tightened credit market was especially significant because 90 percent of consumers finance automobile purchases through loans, either directly from the manufacturers' financing arms or through third-party financial institutions, all of which experienced increased difficulty in raising capital to finance the loans.[10] The particularly weak condition of the financing arms of Chrysler and GM – Chrysler Financial and GMAC, respectively – exacerbated the manufacturers' plummeting sales as the credit markets seized up.[11]

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[4] Bureau of Economic Analysis, *National Income and Product Accounts Table: Table 1.5.5 – Gross Domestic Product, Expanded Detail* (Aug. 27, 2009) (online at www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=35&ViewSeries=NO&Java=no&Request3Place=N&3Place=N&FromView=YES&Freq=Year&FirstYear=1990&LastYear=2008&3Place=N&Update=Update&JavaBox=no) (hereinafter "National Income Table").

[5] Bureau of Labor Statistics, *Automotive Industry: Employment, Earnings, and Hours* (accessed on Aug. 21, 2009) (online at www.bls.gov/iag/tgs/iagauto.htm) (hereinafter "Employment, Earnings, and Hours Report").

[6] *Id.*

[7] Center for Automotive Research, Sean McAlinden, Kim Hill, and Bernard Swiecki, *Economic Contribution of the Automotive Industry to the U.S. Economy – An Update*, at 21-25 (Fall 2003) (online at www.cargroup.org/pdfs/Alliance-Final.pdf).

[8] IHS Global Insights, *U.S. Executive Summary* at 9 (Aug. 2009) (hereinafter "U.S. Executive Summary").

[9] *Id.* at 2.

[10] House Committee on the Judiciary, Administrative Law Subcommittee, Testimony of Ron Bloom, Senior Advisor at the U.S. Department of Treasury, *Ramifications of Automotive Industry Bankruptcies, Part II*, 111th Cong., at 1 (July 21, 2009) (online at judiciary.house.gov/hearings/pdf/Bloom090721.pdf) (hereinafter "Ramifications of Automotive Industry Bankruptcies Part II").

[11] *Id.* at 19. The decline arose in no small part due to a history of actual and consumer-perceived inferior product quality relative to foreign competitors. U.S. Department of Treasury, *Chrysler February 17 Plan:*

In December 2008, Chrysler and GM faced a crippling lack of access to credit due to the global financial crisis.[12] Their CEOs appeared before Congress and appealed for government assistance to help them stay afloat.[13] The House of Representatives responded on December 10 by passing legislation to provide a total of $14 billion in loans to the two companies, allocating the funds from a previously enacted Department of Energy program for advanced vehicle technology.[14] The bill was blocked in the Senate on December 11, which effectively prevented the legislation from being signed into law.[15] The Bush Administration then announced that it would consider making TARP funds available to the automotive industry – a reversal of its previous stance that automakers were ineligible to receive TARP assistance – and on December 19 announced that Chrysler and GM would both receive TARP funds.[16] The White House Fact Sheet accompanying the announcement estimated that "the direct costs of American automakers failing and laying off their workers in the near term would result in a more than one percent reduction in real GDP growth and about 1.1 million workers losing their jobs, including workers for automotive suppliers and dealers."[17]

Under the Automobile Industry Financing Program (AIFP) that was announced on December 19, Chrysler and GM received bridge loans of $4 billion and $13.4 billion, respectively, under separate loan and security agreements.[18] The GM loan and security

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Determination of Viability, at 3 (Mar. 30, 2009) (online at www.financialstability.gov/docs/AIFP/Chrysler-Viability-Assessment.pdf) (hereinafter "Chrysler February 17 Viability Plan").

[12] Senate Committee on Banking, Housing, and Urban Affairs, Testimony of Chrysler Chairman and CEO Richard Nardelli, *State of the Domestic Automobile Industry: Part II*, 110th Cong., at 2 (Dec. 4, 2008) (online at banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=299be20f-5e40-4c5f-89ee-2ade064d4226&Witness_ID=45d1bc44-ac76-4539-be69-32e09c50b3b8) (hereinafter "Nardelli Senate Testimony").

[13] *Id.* The President and Chief Executive Officer of Ford Motor Company also testified at this hearing.

[14] H.R. 7321, Auto Industry Financing and Restructuring Act, 110th Cong (hereinafter "H.R. 7321").

[15] The failure to invoke cloture on the proposed legislation by a vote of 52 to 35. U.S. Senate, *Roll Call Vote on the Motion to Invoke Cloture on the Motion to Proceed to Consider H.R. 7005* (online at www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=110&session=2&vote=00215).

[16] White House Office of the Press Secretary, *President Bush Discusses Administration's Plan to Assist Automakers* (Dec. 19, 2008) (online at georgewbushwhitehouse.archives.gov/news/releases/2008/12/20081219.html) (hereinafter "Bush Plan to Assist Automakers").

[17] White House Office of the Press Secretary, *Fact Sheet: Financing Assistance to Facilitate the Restructuring of Auto Manufacturers to Attain Financial Viability* (Dec. 19, 2008) (online at georgewbush-whitehouse.archives.gov/news/releases/2008/12/20081219-6.html) (hereinafter "Auto Viability Financing Fact-Sheet").

[18] The loans were documented in two separate documents released by Treasury, both entitled *Loan and Security Agreement*, on December 31, 2008. In total, up to $13.4 billion was made incrementally available to GM (with $4 billion available upon the effective date of December 31, 2008) in the first TARP financing. In total, $4 billion was made available to Chrysler on the same effective date. Each agreement was for a secured term loan facility with a first lien on all unencumbered assets of each company. Treasury accepted junior liens on encumbered assets. The loans expire December 30, 2011. U.S. Department of the Treasury, *Loan and Security Agreement [GM]* (Dec. 31, 2008) (online at www.financialstability.gov/docs/agreements/GM%20Agreement%20Dated%2031%20December%202008.pdf)

agreement was signed on December 31, 2008 and GM drew the first $4 billion total loan amount on that date. The Chrysler loan and security agreement was signed on January 2, 2009, and Chrysler drew the entire $4 billion loan amount on that date. On January 16, 2009, GM drew an additional $5.4 billion installment.[19] These three loan installments used the last of the $350 billion first "tranche" of TARP under EESA. Beyond that, the President had to transmit to Congress a written report of the plan to exercise the authority to use the remaining half of the funding, after which Congress had 15 calendar days to enact a joint resolution of disapproval. Congress failed to pass the disapproval resolution for the second tranche of TARP funds on January 15, and GM then drew a third installment of $4 billion on February 17, 2009.[20] The term sheets for both companies established a loan interest rate of LIBOR plus three percent, with an additional five percent penalty on any amount in default.[21]

The AIFP loans were extended to Chrysler and GM under terms and conditions specified in the loan agreements.[22] The most important condition required each company to demonstrate that the assistance would allow it to achieve "financial viability," which was defined as "positive net value, taking into account all current and future costs, and [the ability to] fully repay the government loan."[23] Both companies were required to submit viability plans designed "to achieve and sustain [their] long-term viability, international competitiveness and energy efficiency."[24] Key to such viability would be "meaningful concessions from all involved in the automotive industry."[25] The loans also imposed conditions and covenants related to their operations, expenditures, and reporting thereof to the President's designee, including divestiture

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(hereinafter "GM Loan and Security Agreement"); U.S. Department of the Treasury, *Loan and Security Agreement [Chrysler]* (Dec. 31, 2008) (online at www.financialstability.gov/docs/agreements/Chysler_12312008.pdf) (hereinafter "Chrysler Loan and Security Agreement").

[19] U.S. Department of Treasury, *Fourth Tranche Report to Congress* (Jan. 7, 2009) (online at www.financialstability.gov/docs/TrancheReports/Fourth-Tranche-Report.pdf).

[20] U.S. Department of Treasury, *Section 105(a) Troubled Asset Relief Program Report to Congress for the period February 1, 2009 to February 28, 2009* (Mar. 6, 2009) (online at www.financialstability.gov/docs/105CongressionalReports/105aReport_03062009.pdf) (hereinafter "Fourth Tranche Report").

[21] *GM Loan and Security Agreement*, *supra* note 18; *Chrylser Loan and Security Agreement*, *supra* note 18.

[22] *Auto Viability Financing Fact-Sheet*, *supra* note 17.

[23] *Auto Viability Financing Fact-Sheet*, *supra* note 17.

[24] U.S. Department of the Treasury, *Indicative Summary of Terms for Secured Term Loan Facility [GM]*, at 5 (Dec. 19, 2008) (online at www.ustreas.gov/press/releases/reports/gm%20final%20term%20&%20appendix.pdf) (hereinafter "GM Secured Term Loan Facility Summary"); U.S. Department of the Treasury, *Indicative Summary of Terms for Secured Term Loan Facility [Chrysler]*, at 5 (Dec. 19, 2008) (online at www.ustreas.gov/press/releases/reports/chrysler%20final%20term%20&%20appendix.pdf) (hereinafter "Chrysler Secured Term Loan Facility Summary").

[25] *Bush Plan to Assist Automakers*, *supra* note 16.

of interests in all private passenger aircraft and nonpayment of unapproved bonuses to certain executives.[26]

Both companies submitted plans demonstrating their financial viability in February 2009. GM's plan called for reductions in plants, dealers, employees, and nameplates (Saturn, Saab and Hummer would be eliminated).[27] Chrysler's plan presented three scenarios:

1. Chrysler could continue as a stand-alone company with the help of $11 billion in loans from the government;

2. Chrysler could pursue a non-binding agreement already signed with the Italian automaker Fiat S.p.A. (Fiat) and, with additional government assistance, aim to sell more fuel efficient cars to a wider range of markets; or

3. Chrysler could file for bankruptcy and embark on an orderly wind down of the company.[28]

On February 15, 2009, President Obama announced the creation of an interagency Presidential Task Force on the Auto Industry (Task Force), that would assume responsibility for reviewing the Chrysler and GM viability plans. The Task Force is co-chaired by Treasury Secretary Timothy Geithner and Director of the National Economic Council Lawrence Summers and includes a number of ex-officio designees[29] and government staffers.[30] In addition, the President named two advisors to lead the Treasury auto team,[31] which had responsibility for evaluating the companies' viability plans and negotiating the terms of any further assistance:

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[26] *GM Secured Term Loan Facility Summary*, *supra* note 24 at 3-4; *Chrysler Secured Term Loan Facility Summary*, *supra* note 24 at 3-4.

[27] General Motors Corporation, *2009-2014 Restructuring Plan* (Feb. 17, 2009) (online at media.gm.com/us/gm/en/news/govt/docs/plan.pdf) (hereinafter "GM Restructuring Plan).

[28] Chrysler Group LLC, *Chrysler Restructuring Plan for Long-Term Viability* (Feb. 17, 2009) (online at www.media.chrysler.com/dcxms/assets/attachments/Restructuring_Plan_for_LongTerm_Viability.pdf) (hereinafter "Chrysler Restructuring Plan").

[29] Secretary of Transportation, Secretary of Commerce, Secretary of Labor, Secretary of Energy, Chair of President's Council of Economic Advisors, Director of the Office of Management and Budget, Environmental Protection Agency Administrator, Director of the White House Office of Energy and Climate Change.

[30] Diana Farrell, Deputy Director, National Economic Council; Gene Sperling, Counselor to the Secretary of the Treasury; Jared Bernstein, Chief Economist to Vice President Biden; Edward Montgomery, then Senior Advisor, Department of Labor, Lisa Heinzerling, Senior Climate Counsel to the EPA Administrator; Austan Goolsbee, Staff Director and Chief Economist of the Economic Recovery Advisory Board; Dan Utech, Senior Advisor to the Secretary of Energy; Heather Zichal, Deputy Director, White House Office of Energy and Climate Change; Joan DeBoer, Chief of Staff, Department of Transportation; Rick Wade, Senior Advisor, Department of Commerce.

[31] The missions and personnel of the Task Force and Treasury auto team – a joint Treasury-National Economic Council team which staffs the Task Force – overlap considerably, therefore these entities are often cited interchangeably. The auto team's analysis of the viability plans is discussed in more detail in Sections D and G below.

Ron Bloom, a former investment banker and advisor to the president of the United Steelworkers union, and Steven Rattner, the co-founder of the Quadrangle Group, a private equity firm. (Mr. Rattner subsequently left the Treasury auto team on July 13, 2009, leaving Mr. Bloom as the auto team's head.) The auto team reports to the Task Force and its co-chairs, who then report up to the President.

President Obama announced the results of the Treasury auto team's review on March 30. According to the auto team, the most important indicator of the companies' viability was their ability to "generate positive cash flow and earn an adequate return on capital over the course of a normal business cycle."[32] In making the individual determinations, the auto team generally assumed no significant changes in the operations of the companies' competitors, although they ran various scenarios to take into account changes in the competitive environment.

The auto team found GM's plan "not viable as it's currently structured,"[33] chiefly because it relied on overly optimistic assumptions about the company and the economy's recovery. The auto team focused on:

- GM's consistently decreasing market share over the past 30 years, which the auto team calculated at a 0.7 percent annual decrease – much greater than GM's assumption of 0.3 percent annual decrease going forward to 2014;
- consumer perception of GM's poor product quality compared to competitors;
- GM's large network of underperforming dealers;
- GM's costly and unprofitable European operations;
- GM's vulnerability to higher energy costs due to its disproportionate profit share from SUVs; and
- increasing legacy liabilities that would require GM to sell almost a million more cars in both 2013 and 2014.

In short, GM had too much catching-up to do, even without accounting for the sunk costs of restructuring, to generate positive cash flow over the projection period. GM was therefore asked to submit a "substantially more aggressive plan" and was provided an additional 60 days

[32] *Chrysler February 17 Viability Plan*, *supra* note 11.

[33] *Chrysler February 17 Viability Plan*, *supra* note 11.

of working capital.[34] Between March 30 and May 30, GM received another $6.36 billion in loans (including $361 million for the warranty program).[35]

In its analysis, the auto team found that Chrysler had an even poorer outlook than GM because of problems with scale, quality, product mix, lack of manufacturing flexibility, and geographic over-concentration. The auto team concluded Chrysler could succeed only if it developed a partnership with another automotive company.[36] Chrysler was offered working capital for 30 more days while it sought an agreement with Fiat.[37] Between March 30 and April

[34] U.S. Department of Treasury, *GM February 17 Plan: Determination of Viability* (Mar. 30, 2009) (online at www.whitehouse.gov/assets/documents/GM_Viability_Assessment.pdf) (hereinafter "GM February 17 Viability Plan").

[35] Aug. 18 Transactions Report, *supra* note 1 at 16.

[36] In fact, both Chrysler and GM had been contemplating mergers with other automotive companies for over a year. The contraction in domestic auto manufacturing that foreshadowed the economic crisis led Chrysler and GM to pursue possible strategic changes including mergers, the creation of partnerships, and sales. Chrysler, concerned with its viability, reached out to Nissan-Renault in the spring of 2007 and continued discussion on a wide range of possible scenarios until term sheets were exchanged in July 2008. *Declaration of Thomas W. LaSorda*, 11-12 (Apr. 30, 2009), *In Re* Chrysler LLC, S.D.N.Y. (No.09 B 50002 (AJG)) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1) (hereinafter "Thomas LaSorda Declaration"). Ultimately, only joint production agreements were signed and negotiations for a union between Chrysler and Nissan collapsed. Davis Welch, *Behind the Chrysler-Nissan Deal,* Business Week (April 14, 2008) (online at www.businessweek.com/bwdaily/dnflash/content/apr2008/db20080414_164988.htm?campaign_id=rss_daily) (hereinafter "Behind the Chrysler-Nissan Deal"). Chrysler executives then approached General Motors in August 2008. Some industry insiders believed that by folding Chrysler into GM, the proposed company would have easier access to the capital markets and would benefit from the increased market share. *Declaration of J. Stephen Worth*, 85-86 (May 31, 2009), *In Re* General Motors Corp., S.D.N.Y. (No. 09-50026 (REG)) (online at docs.motorsliquidationdocket.com/pdflib/425_50026.pdf) (hereinafter "Stephen Worth Declaration"). GM suspended the negotiations in November 2008 due to the lack of funding for the proposed arrangement and the company's impending liquidity crisis. After accepting the initial assistance from the Treasury, Chrysler contacted Nissan and GM in hopes of reviving negotiations, but both carmakers refused. These unsuccessful attempts, coupled with the lack of adequate funding in the capital markets and the rapidly deteriorating condition of the domestic automotive industry, led Chrysler and GM to seek assistance from the United States government. After receiving the initial bridge loans from the Bush Administration, Chrysler again reached out to GM in early January, but GM remained uninterested in further merger discussions. *Thomas LaSorda Declaration* at 13-14. The auto team has told the Panel that it did not discourage a merger between GM and Chrysler, that "[e]ach company made its own determination to pursue a future independent of the other." Congressional Oversight Panel, *Questions for the Record from the Congressional Oversight Panel at the Congressional Oversight Panel Hearing on July 27, 2009, Questions for Ron Bloom, Senior Advisor, U.S. Department of the Treasury*, at 8 (July 27, 2009) and Congressional Oversight Panel, *Ron Bloom Responses, Congressional Oversight Panel Hearing Transcript on July 27, 2009* (collectively, hereinafter "Ron Bloom COP Testimony").

[37] Chrysler had begun discussions with Fiat a year earlier, in March 2008, as part of its talks with other car companies about a partnership. By January 2009, "no party except Fiat emerged as a viable and willing partner." *Declaration of Thomas LaSorda*, *supra* note 36. Chrysler and Fiat agreed to an initial term sheet that became one of the options in the restructuring plan that Chrysler submitted to Treasury in February 2009. Chrysler's plan also included an option in which, with concessions and additional government support, it could have been viable as a stand-alone company. Declaration of Robert Manzo, 30 (Apr. 30, 2009) *In Re* Chrysler LLC, S.D.N.Y. (No. 09 B 50002 (AJG)) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1) (hereinafter "Robert Manzo Declaration"); *Chrysler Restructring Plan, supra* note 28. The auto team disagreed with the latter option, and informed Chrysler that it would only provide financing if Chrysler formed an alliance with Fiat – the only potential partner willing to form an alliance. It stated that:

30, Treasury agreed to commit up to $280 million in loans to Chrysler for the warranty program (no working capital loans were advanced).[38]

The auto team emphasized that, while Chrysler and GM presented different issues and problems, in each case, "their best chance of success may well require utilizing the bankruptcy code in a quick and surgical way."[39] In the Administration's vision, this would not entail liquidation or a "traditional," long, drawn-out bankruptcy, but rather a "structured" bankruptcy as a tool to "make it easier for Chrysler and General Motors to clear away old liabilities."[40]

1. New Chrysler

Chrysler was unable to complete a restructuring deal by the April 30 deadline.[41] A group of investors holding 30 percent of Chrysler's $6.9 billion in secured debt would not accept Treasury's $2 billion offer in exchange for the debt.[42] Chrysler filed for bankruptcy on April 30 under Chapter 11 of the U.S. Bankruptcy Code (the Code).[43] Forty-two days later the sale of the majority of its assets to a newly formed entity, Chrysler Group LLC (New Chrysler), under Section 363 of Chapter 11 of the Code, closed.

The technical details of the bankruptcy process and the precise manner of disposition of assets of Chrysler (often referred to as Old Chrysler, for clarity) and ownership of New Chrysler are discussed in more detail below.[44] In essence, however, the arrangements, set out in a master transaction agreement,[45] were as follows. The secured creditors had to accept the original offer

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> [Treasury] will provide Chrysler with working capital for 30 days to conclude a definitive agreement with Fiat and secure the support of necessary stakeholders. If successful, the government will consider investing up to the additional $6 billion requested by Chrysler to help this partnership succeed. If an agreement is not reached, the government will not invest any additional taxpayer funds in Chrysler.

White House, *Obama Administration New Path to Viability for GM & Chrysler* (Mar. 30, 2009) (online at www.whitehouse.gov/assets/documents/Fact_Sheet_GM_Chrysler_FIN.pdf) (hereinafter "New Path to Viability for GM & Chrysler").

[38] Aug. 18 Transactions Report, *supra* note 1.

[39] *New Path to Viability for GM & Chrysler*, *supra* note 37.

[40] *New Path to Viability for GM & Chrysler*, *supra* note 37.

[41] White House Office of the Press Secretary, *Obama Administration Auto Restructuring Initiative* (April 30, 2009) (www.whitehouse.gov/the_press_office/Obama-Administration-Auto-Restructuring-Initiative) (hereinafter "Chrysler Release").

[42] *Id.*

[43] *Id.*

[44] See Section C for a discussion of the precise disposition of assets, and Section E for a discussion of the Section 363 sale process.

[45] Master Transaction Agreement among Fiat SpA, NewCarCo. Acquisition LLC, Chrysler LLC, and the Other Sellers identified therein, Dated April 30, 2009 (May 12, 2009), *In Re* Chrysler LLC, S.D.N.Y. (No. 09 B 50002 (AJG) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1) (hereinafter "Chrysler Master Transaction Agreement").

of $2 billion. At the time of filing, Chrysler was privately owned by the private equity firm Cerberus Capital Management L.P. (Cerberus) and the automobile company Daimler AG (Daimler). Daimler, the minority shareholder, agreed to waive its share of Chrysler's $2 billion second lien debt, give up its 19 percent equity interest in Chrysler, and settle its pension guaranty obligation by agreeing to pay $600 million to Chrysler's pension funds. Cerberus agreed to waive its share of second lien debt and forfeit its equity stake in Chrysler. Cerberus also agreed to transfer its ownership of the Chrysler headquarters in Auburn Hills, Michigan to New Chrysler. Finally, Cerberus pledged to contribute a claim it had against Daimler to assist in the Daimler pension guaranty settlement.

Treasury provided a total of $8.5 billion in working capital and exit financing to facilitate the deal.[46] The U.S. government received approximately an eight percent equity stake in New Chrysler and the right to select the initial group of four independent directors. The governments of Canada and Ontario[47] together received two percent of the equity of New Chrysler, and Canada received the right to select one independent director. Fiat received a 20 percent equity stake and the right to select three directors of New Chrysler. In addition, Fiat has the right to earn up to 15 percent in additional equity, in three tranches of five percent each, if it meets certain performance metrics.[48]

As part of New Chrysler's purchase of Old Chrysler's assets, New Chrysler entered into an agreement with the United Auto Workers (UAW) regarding the funding of the UAW Retiree Medical Benefit Trust (the UAW Trust).[49] New Chrysler agreed to fund the UAW Trust with a

[46] U.S. Treasury Department, *AIFP Outlays for COP* (Aug. 18, 2009) (hereinafter "AIFP Outlays").

[47] During a meeting with Panel staff on July 11, 2009, Ron Bloom explained that the Canadian governments approached the U.S. government with an offer to provide assistance to the American automotive industry. Mr. Bloom stated his belief that the Canadian governments were concerned about the impact of the troubled American auto makers on the Canadian economy and therefore had an interest in providing such support.

[48] Chrysler Release, *supra* note 41.

[49] By the end of the last century, Ford, Chrysler and GM found themselves faced with tens of billions of dollars in employee health obligations. In 2007 and 2008, after it became clear to both the companies and their unions that the state of the American automotive industry made these healthcare obligations unsustainable, the UAW and each of the three companies ultimately entered into an agreement whereby, in exchange for significant upfront payments principally in the form of cash and notes, healthcare obligations for retired union employees would be transferred off the books of the companies and into a trust (an independent entity totally separate from either the union or the automotive companies), the UAW Retiree Medical Benefits Trust, also known as a Voluntary Employees' Beneficiary Association (VEBA). VEBAs are tax free entities that pay health, life, or similar benefits. Although subject to the fiduciary requirements of the Employee Retirement Income Security Act of 1974 (ERISA), they are not subject to ERISA funding rules as are qualified retirement plans – a company's funding obligation is solely contractual. The threat of a Chapter 11 bankruptcy filing by Chrysler and GM made it clear that these companies would not be able to meet the cash commitments they had made to the UAW Trust. As part of a new agreement reached with representatives from both the old and new Chrysler and GM entities to enable them to emerge from bankruptcy, the UAW agreed to significant changes to the funding structure of the UAW Trust. While the UAW was able to get these companies to transfer cash amounts already set aside by the old Chrysler and GM entities (about $10 billion from GM and about $1.5 billion from Chrysler), the balance of the commitments these companies had made will no longer be paid up front in cash. Instead, New GM and New Chrysler have agreed to contribute large portions of equity, as well as notes that will allow cash commitments to be deferred and paid over

$4.6 billion unsecured note and a 55 percent ownership stake in New Chrysler.[50] The UAW Trust, subject to approval of the UAW, has the right to select one independent director and no other governance rights.[51]

During the bankruptcy proceedings, three Indiana state pension funds, which were secured first lien debt holders of Chrysler, objected to the Section 363 sale to New Chrysler. The funds argued that the sale would violate the Code by impermissibly subordinating their interests as secured lenders and allowing assets on which they had a lien to pass free of liens to other creditors and parties.[52] Moreover, they claimed that the sale would violate bankruptcy priority rules by paying unsecured creditors, even though secured creditors were receiving only 29 cents on the dollar. The funds stated that they believed that Chrysler could sell the assets for more money if they did not rush the sale, or that first lien debt holders could recover more in liquidation. The bankruptcy court denied the funds' motion.[53] Of the other first lien debt holders, 92 percent had not opposed the sale.

The funds immediately began the appellate process. The Second Circuit issued a short order ratifying the bankruptcy court's decision and issuing a stay to allow for the U.S. Supreme Court's review. The Supreme Court denied a request for a stay of the bankruptcy reorganization.[54] Upon remand, the Second Circuit affirmed[55] the bankruptcy court's decision.[56]

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time, into the UAW Trust. In order to help it remain competitive and avert bankruptcy, Ford negotiated similar alterations to its settlement with the UAW. Starting January 1, 2010, UAW retirees' healthcare benefits will be funded solely by the assets in the UAW Trust, and will receive no further commitments from Old Chrysler, Old GM or Ford. New GM and New Chrysler – as with Ford – will no longer have the healthcare obligations that have been weighing down their predecessor companies' books for decades, while the healthcare benefits of the UAW's retired members will still be linked to the fortunes of all three companies through the tens of billions in stock and notes.

[50] Chrysler Release, *supra* note 41.

[51] Form of Amended and Restated Operating Agreement of New Carco Acquisition LLC, 17 (May 12, 2009) *In re* Chrysler LLC, S.D.N.Y. (No. 09 B 50002 (AJG) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1) (hereinafter "New Carco Operating Agreement").

[52] Emergency Motion of the Indiana Pensioners For Stay of Proceedings Pending Determination of Motion to Withdraw the Reference, 2-3 (May 20, 2009) *In re* Chrysler LLC, S.D.N.Y. (No. 09 B 50002 (AJG) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1) (hereinafter "Indiana Pensioners' Emergency Stay Motion").

[53] Order Denying Emergency Motion of the Indiana Pensioners for Stay of Proceedings Pending Determination of Motion to Withdraw the Reference (May 20, 2009), *In Re* Chrysler LLC, S.D.N.Y. (No. 09 B 50002 (AJG)) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1) (hereinafter "Order Denying Indiana Pensioners' Emergency Stay Motion").

[54] 556 U.S. ___ (2009) (Per Curiam) (online at www.supremecourtus.gov/opinions/08pdf/08A1096.pdf).

[55] *In re Chrysler LLC*, 2009 WL 2382766 (2d Cir. 2009). The funds then filed a petition for writ of certiorari to the Supreme Court in which the sole question presented is "is whether Section 363 may freely be used as a 'side door' to reorganize a debtor's financial affairs without adherence to the creditor protections provided by the chapter 11 plan confirmation process." Petition for Writ of Certiorari for Petitioners Indiana State Police

Treasury appointed four directors to New Chrysler's nine-member board of directors: C. Robert Kidder, chairman and CEO of 3Stone Advisors LLC; Douglas Steenland, former CEO of Northwest Airlines; Scott Stuart, a partner at Sageview Capital LP, and Ronald L. Thompson, chairman of the board of trustees for the nonprofit Teachers Insurance and Annuity Association and College Retirement Equities Fund (TIAA/CREF).[57] Mr. Kidder is chairman of the new board.[58] The Trustees of the UAW Trust appointed James J. Blanchard, a former Michigan governor, to the board.[59] As New Chrysler began operations, it was announced that Robert Nardelli would be departing as CEO.[60] Fiat CEO Sergio Marchionne subsequently replaced him.[61] The Obama Administration announced that Fiat would shake up other management in an effort to reorganize the company.[62]

Chrysler announced that it would retain an "overwhelming majority" of its suppliers[63] and would close 789 of its nearly 3,200 U.S. dealerships.[64] These dealerships employed more than 40,000 people.[65] State governments heavily regulate the relationship between dealerships

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Pension Trust, et al., at 2 No. ___ (Sept. 3, 2009) (hereinafter "Indiana Pensioners' Appeal"). It did, however, allude to Treasury's broad definition of "financial institution." *Id*. at 29.

[56] *In re Chrysler LLC*, 405 B.R. 79, 83 (Bankr. S.D.N.Y. 2009).

[57] U.S. Department of the Treasury, *Treasury Department Statement on Chrysler's Board of Directors Appointments* (July 5, 2009) (online at www.financialstability.gov/latest/tg197.html) (hereinafter "Statements on Chrysler Directors Appointments").

[58] Chrysler Group LLC, *Formation of Chrysler Group LLC Board is Completed* (July 5, 2009) (online at www.chryslergroupllc.com/en/news/article/?lid=formation_board&year=2009&month=7) (hereinafter "Formation of New Chrysler Board Completed").

[59] United Auto Workers, *Chrysler Update: VEBA Trust Names James Blanchard to Board of Chrysler Holding, LLC* (June 10, 2009) (online at www.uaw.org/chrysler/chry12.cfm) ("VEBA Trust Director Announcement").

[60] Letter from Robert Nardelli to Chrysler employees (Apr. 30, 2009) (online at images.businessweek.com/extras/09/nardelli_email.pdf?chan=top+news_special+report+–+auto+bailout+2009_special+report+–+auto+bailout+2009) (hereinafter "Richard Nardelli Letter to Chrysler Employees").

[61] Chrysler Group LLC, *Chrysler Group LLC Announces Organizational Structure Focused on Chrysler, Jeep, Dodge and Mopar Brands* (Jun. 10, 2009) (online at www.chryslergroupllc.com/en/news/article/?lid=new_organizational_structure&year=2009&month=60) (hereinafter Chrysler Org Structure Announcement").

[62] *Chrysler and Fiat facing a long road*, Pittsburgh Post Gazette (June 11, 2009) (online at www.post-gazette.com/pg/09162/976675-185.stm) (hereinafter "Chrysler/Fiat Face Long Road").

[63] Chrysler Group LLC, *Chrysler LLC to Assume Supplier Agreements* (May 15, 2009) (online at www.chryslerrestructuring.com/chr/Press%20Release%20May%2015%202009.pdf) (hereinafter "Chrysler Assumes Supplier Agreements").

[64] Chrysler Vice President Peter Grady, *The Real Story on Chrysler's Dealer Network*, Chrysler Corporate Blog (July 16, 2009) (online at blog.chryslerllc.com/blog.do?id=717&p=entry) (hereinafter "Real Story on Chrysler's Dealer Network").

[65] National Automobile Dealers Association, *NADA Statement on Chrysler's Dealership Reduction Announcement* (May 14, 2009) (online at

and automotive companies, usually claiming that close oversight is necessary to equalize the bargaining power of dealerships and automakers.[66] Generally, states only allow an automotive manufacturer to terminate a dealer contract if it has good cause.[67] However, the bankruptcy process provided the automotive manufacturers with greater flexibility in terminating dealership contracts.[68] Congress is currently considering a number of bills to restore the terminated dealers' contracts.[69]

Both Chrysler and GM maintain that their dealer networks were oversized and that downsizing was necessary to regain viability.[70] Domestic brands in 2008 accounted for about two thirds of U.S. dealerships,[71] but only 48 percent of new vehicle sales.[72] Chrysler, for

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www.nada.org/MediaCenter/News+Releases/NADA+Statement+on+Chrysler%E2%80%99s+Dealership+Reduction+Announcement.htm) (hereinafter "NADA Chrysler Statement").

[66] New Motor Vehicle Board of Cal.v. Fox, 439 U.S. 96, 100-01 (1978).

[67] National Automobile Dealers Association, *The Benefits of the Franchised Dealer Network: The Economic and Statutory Framework*, at 5 (Nov. 24, 2008) (online at www.magnetmail.net/images/clients/NADA/attach/BenefitsDealerNetwork.doc) (hereinafter "Benefits of the Franchised Dealer Network").

[68] In light of the recent news that Chrysler plans to open new dealerships, often nearby the ones that were closed, some assert that Chrysler used the bankruptcy to get rid of dealerships that it had wanted to close otherwise. See Greg Gardner, *Chrysler Plans New Dealerships*, Detroit Free Press (Aug. 13, 2009) (online at freep.com/article/20090813/BUSINESS01/908130448/1333/Chrysler-plans-new-dealerships) (hereinafter "Chrysler Plans New Dealerships"); see also *Chrysler Green Lights New Dealerships*, American Public Media (accessed Aug. 31, 2009) (online at marketplace.publicradio.org/display/web/2009/08/14/am-chrysler/) (hereinafter "Chrysler Green Lights New Dealerships").

[69] The Financial Services and General Government Appropriations Act of 2010, passed by the House on July 16, 2009, includes an amendment that would require Chrysler and GM to reinstate contracts with dealers that had agreements prior to the Chapter 11 filings. H.R. 3170, Sec. 745(b), Financial Services and General Government Appropriations Act of 2010, 111th Cong. (hereinafter "H.R. 3170").

[70] House Committee on Energy and Commerce, Subcommittee for Investigations and Oversight, Testimony of General Motors President and Chief Executive Officer Frederick A. Henderson, *Auto Dealership Closures*, 111th Cong., at 2-3 (June 12, 2009) (online at energycommerce.house.gov/Press_111/20090612/testimony_henderson.pdf) (hereinafter "Fritz Henderson House Testimony"); House Committee on Energy and Commerce, Subcommittee for Investigations and Oversight, Testimony of Chrysler Vice Chairman and President James Press, *Auto Dealership Closures*, 111th, Cong., at 3-5 (June 12, 2009) (online at energycommerce.house.gov/Press_111/20090612/testimony_press.pdf) (hereinafter "James Press House Testimony").

[71] General Motors has stated that it had 6,450 U.S. dealerships in 2008. Ford has said that it had 4,106 U.S. dealerships the same year. And Chrysler has reported that it had more than 3,330 U.S. dealerships in 2008. Summing those numbers, the "Big Three" had roughly 13,856 U.S. dealerships out of a total of 20,700 U.S. auto dealerships in 2008, or about 67 percent. See General Motors Corp., *Restructuring Plan for Long-Term Viability*, at 19 (Dec. 2, 2008) (online at online.wsj.com/public/resources/documents/gm_restructuring_plan120208.pdf) (hereinafter "GM December 2008 Viability Plan"). See alsoFord Sustainability Report 2008/9 – Dealers (accessed Aug. 30, 2009) (online at www.ford.com/microsites/sustainability-report-2008-09/society-dealers) (hereinafter "Ford Sustainability Report"); Patti Georgevich, *Chrysler's Economic Impact*, Chrysler Corporate Blog (Dec. 5, 2008) (online at blog.chryslerllc.com/blog.do?id=552&p=entry) (hereinafter "Chrysler's Economic Impact"); Casesa Shapiro Group, *The Franchised Automobile Dealer: The Automaker's Lifeline*, report prepared for the National Automobile Dealers Association, at 2 (Nov. 26, 2008) (online at www.nada.org/nr/rdonlyres/5c36b316-e765-4876-8d69-3bf3a57e7789/0/benefitsoffranchisedealers.pdf).

example, has less domestic market share than Toyota,[73] but even after its intended closings will have many more dealers.[74] In 2008, Chrysler's dealers lost on average $3,431.[75] By consolidating dealerships, the companies argue, they can drive more sales through more profitable businesses that can afford to invest in their businesses.[76] The remaining dealers may also be able to negotiate more favorable terms with their floor-plan financers.[77] This may in turn help dealers acquire more stock and sell it to consumers at lower prices, thereby increasing sales and profits for the dealers and for Chrysler and GM.

UAW Chrysler workers agreed to make concessions on compensation and retiree health benefits. These changes include the adjustments to the funding of the UAW Trust (as discussed above), cancellation of cost-of-living adjustments for the current workforce, and a restructuring of skilled trade classifications, among other concessions.[78] As Mr. Bloom told the Panel at its

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[72] Autodata Corp.'s Motor Intelligence Web site (accessed Aug. 30, 2009) (online at www.motorintelligence.com/fileopen.asp?File=SR_Sales-4.xls).

[73] In 2008, Toyota had 1,649,045 light-vehicle retail sales, compared with 1,076,170 for Chrysler. *Id.*

[74] Toyota, *United States Operations 2009*, at 5 (accessed Aug. 30, 2009) (online at pressroom.toyota.com/pr/tms/document/TNA_OPS_MAP_2009.pdf) (hereinafter "Toyota US Operations 2009").

[75] Senate Commerce, Science, and Transportation Committee, Testimony of Vice Chairman and President Chrysler LLC James Press, *Chrysler's Dealership Network*, 111th Cong., at 3 (June 3, 2009) (online at commerce.senate.gov/public/_files/PressTestimonyDealerships.pdf) (hereinafter "James Press Senate Testimony").

[76] Senate Commerce, Science, and Transportation Committee, Testimony of General Motors President and CEO Fritz Henderson, *GM and Chrysler Dealership Closures: Protecting Dealers and Consumers*, 111th Cong., at 3, 5 (June 3, 2009) (online at commerce.senate.gov/public/_files/HendersonTestimonyDealerships.pdf) (hereinafter "Fritz Henderson Senate Testimony"); James Press Senate Testimony, *supra* note 75 at 5-6.

[77] Comptroller of the Currency, *Comptroller's Handbook on Floor Plan Loans*, at 3 (accessed Aug. 30, 2009) (online at www.occ.treas.gov/handbook/floorplan1.pdf) (hereinafter "Comptroller Floor Plan Handbook") ("Dealers selling in large volume are usually granted a three-day leeway before proceeds from inventory sold are required to be received by the bank."); Lynn M. LoPucki & Elizabeth Warren, *Secured Credit: A Systems Approach*, at 252-53, 263 (hereinafter "Secured Credit: A Systems Approach").

[78] UAW Chrysler, *Modifications to 2007 Agreement and Addendum to VEBA Agreement* (Apr. 2009) (online at download.gannett.edgesuite.net/detnews/2009/pdf/UAWChrysler.pdf); Congressional Oversight Panel, *Testimony of Ron Bloom before the Congressional Oversight Panel: Regarding the Treasury's Automotive Industry Financing Program* (July 27, 2009) (online at cop.senate.gov/documents/testimony-072709-bloom.pdf) (hereinafter "UAW Statements on VEBA Modifications") ("The UAW made important concessions on wages, benefits, and retiree health care. These concessions brought New Chrysler's compensation in line with that of Toyota and other foreign automotive manufacturers at their US operations. In addition, the UAW retirees exchanged an almost $8 billion fixed obligation to the Voluntary Employees' Beneficiary Association (VEBA) retiree health trust for a $4.6 billion unsecured note and stock in New Chrysler. This arrangement shifts substantial risk onto the retiree health care trust and will likely result in meaningful reductions in health care benefits for New Chrysler's 150,000 retirees. The Trust, which is managed by an independent committee of legally bound fiduciaries, will, other than a single seat on the Company's Board of directors, will [sic] have no role in the governance of the Company. However, the ability of the Trust to provide decent benefits over the long-term will require that the Company's stock become valuable, thus significantly aligning the interests of the Company and the VEBA as a key stakeholder.") (hereinafter "Ron Bloom Prepared COP Testimony").

hearing in Detroit on July 27, "these concessions brought New Chrysler's compensation in line with that of Toyota and other foreign automotive manufacturers at their U.S. operations."[79]

New Chrysler is not a public company and is not required to file reports with the Securities and Exchange Commission (SEC). However, Mr. Bloom has stated that both New Chrysler and the New GM will file quarterly reports with the SEC.[80]

2. New General Motors

A month after Chrysler entered bankruptcy, GM followed on June 1, 2009.[81] On July 5, GM sold its "good" assets under Section 363 of the Code to a new, government-owned entity, General Motors Company (New GM).[82] The new company purchased substantially all of the assets of Old GM needed to implement its new, leaner viability plan, which will focus on four core brands: Chevrolet, Cadillac, Buick, and GMC. New GM plans to close 11 facilities and idle another three facilities.

Again, the technical details of the disposition of assets are discussed in more detail below. Under the terms of a Master Purchase and Sale Agreement, Old GM unsecured creditors will receive a pro-rata share of 10 percent of the equity of New GM, plus warrants for an additional 15 percent of New GM.[83] At least 54 percent of Old GM bondholders voted to approve the transaction. [84] New GM issued 17.5 percent equity to the UAW Trust, as well as warrants to purchase an additional two and a half percent of the company. The UAW Trust will also be funded by a $2.5 billion note maturing in 2017, and $6.5 billion in nine percent perpetual

[79] *Id.*

[80] Nick Bunkley, *U.S. Likely to Sell G.M. Stake Before Chrysler*, New York Times (Aug. 5, 2009) (online at www.nytimes.com/2009/08/06/business/06auto.html).

[81] Voluntary Chapter 11 Petition, at 1 (June 1, 2009), *In Re* General Motors Corp., S.D.N.Y (No.09-50026 (REG)) (online at docs.motorsliquidationdocket.com/pdflib/01_50026.pdf) (hereinafter "GM Bankruptcy Petition").

[82] Order (I) Authorizing Sale of Assets Pursuant to Amended and Restated Master Sale and Purchase Agreement with NGMCO, Inc., a Treasury-Sponsored Purchaser; (II) Authorizing Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection with the Sale; and (III) Granting Related Relief, (July 5, 2009), *In Re* General Motors Corp., S.D.N.Y. (No. 09-50026 (REG)) (online at docs.motorsliquidationdocket.com/pdflib/2968_order.pdf) (hereinafter "Order Authorizing GM 363 Sale").

[83] *First Amendment to Amended and Restated Master Sale & Purchase Agreement* (June 26, 2009) *In Re* General Motors Corp., S.D.N.Y. (No. 09-50026 (REG)) (online at docs.motorsliquidationdocket.com/pdflib/amendment_630.pdf) (hereinafter "First Amendment to GM Master Sale Agreement").

[84] Rod Lache, *Industry Update: Implication of GM's Bankruptcy Filing Today*, Deutsche Bank (May 31, 2009) (hereinafter "Deutsche Bank Report on Implications of GM Bankruptcy").

preferred stock.[85] The UAW Trust has the right to select one independent director, but no right to vote its shares nor any other governance rights.

Treasury received 61 percent of the equity of New GM and $9.2 billion in debt and preferred stock.[86] It also received the right to select 10 initial members of the GM board of directors. The governments of Canada and Ontario received approximately 12 percent of the equity in New GM, approximately $1.7 billion in debt and preferred stock, and the right to select one director for as long as they hold their current share of New GM equity.[87]

Treasury provided approximately $30.1 billion of financing to support GM through an expedited Chapter 11 proceeding and restructuring.[88] Treasury has no plans to provide any additional assistance to GM beyond this commitment.[89]

By the end of July, New GM had filled all of the positions on its board of directors.[90] The 13 members bring experience from a wide range of industries and backgrounds. Ten of these directors were appointed or reinstated by Treasury: Daniel Akerson, managing director and head of global buyout at private equity firm The Carlyle Group; David Bonderman, co-founder of private equity firm Texas Pacific Group; Erroll B. Davis, Jr., chancellor of the University System of Georgia; E. Neville Isdell, retired chairman and CEO of Coca-Cola; Robert D. Krebs, retired chairman and CEO of Burlington Northern Santa Fe Corporation; Kent Kresa, chairman emeritus of Northrop Grumman Corporation; Philip A. Laskawy, retired chairman and CEO of Ernst & Young LLP; Kathryn V. Marinello, chairman and CEO of Ceridian Corporation; Patricia F. Russo former chief executive officer of Alcatel-Lucent; and Edward E. Whitacre, Jr. former chairman of the board of AT&T, who was chosen to be chairman of the board. Carol M. Stephenson, dean of the Richard Ivey School of Business at the University of Western Ontario, was appointed by the Canadian government.

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[85] White House, *Fact Sheet: Obama Administration Auto Restructuring Initiative General Motors Restructuring* (June 30, 2009) (online at financialstability.gov/latest/05312009_gm-factsheet.html) (hereinafter "White House GM Restructuring Fact Sheet").

[86] General Motors Corp., *Form 8-K* (July 16, 2009) (online at www.sec.gov/Archives/edgar/data/1467858/000119312509150199/0001193125-09-150199-index.htm) (hereinafter "GM July 16, 2009 8-K").

[87] Stockholder Agreement by and Among General Motors Company, United States Department of the Treasury, 7176384 Canada Inc., and UAW Retiree Medical Benefits Trust, 8 (July 10, 2009) (online at www.sec.gov/Archives/edgar/data/1467858/000119312509150199/dex101.htm) (hereinafter "New GM Stockholder Agreement").

[88] *Declaration of J. Stephen Worth*, supra note 36 at appx. 18.

[89] White House Office of the Press Secretary, *Remarks by the President on General Motors Restructuring* (June 1, 2009) (online at www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-General-Motors-Restructuring/) (hereinafter "White House June 1 Remarks on GM Restructuring").

[90] General Motors, *Board of Directors* (accessed on Aug. 11, 2009) (online at www.gm.com/corporate/about/board.jsp) (hereinafter "GM Description of Board of Directors").

In late March 2009, as Treasury sought to invest additional funds in GM, President Obama announced the departure of CEO Rick Wagoner, who was replaced by COO Fritz Henderson.[91] As part of the restructuring, the Motors Liquidation Company (MLC) board of directors and former CEO Wagoner reduced their 2009 compensation to one dollar, and several other executive officers took salary cuts between 10 and 30 percent.[92]

GM subsequently notified 1,300 of its approximate 6,000 U.S. dealers that they would be closing by year end 2010, aiming eventually to trim its total to about 4,000.[93] GM provided approximately $600 million in financial assistance in return for the dealers' selling down their existing inventory over the subsequent twelve months.[94] These payments could vary widely based on each dealer's situation.

GM's UAW workers agreed to make concessions on compensation and health benefits. These concessions were similar to those of Chrysler workers. GM workers gave up cost-of-living adjustments, performance bonuses, one paid holiday in each of 2010 and 2011, tuition assistance, and some health benefits.[95] The UAW estimated that these cuts would save GM between $1.2 and $1.3 billion per year.[96]

New GM is not a public company and is not required to file reports with the SEC, although as discussed above it is intended that GM will file financial statements with the SEC by 2010.

3. Warranties

The automotive companies' widely publicized vulnerability in late 2008 and early 2009 raised concerns that consumers might not purchase Chrysler and GM automobiles for fear that these companies could not back their warranties. When Treasury announced the results of the auto team's work on March 30, Treasury also created a new program to backstop the two companies' new vehicle warranties. This program applied to any new GM or Chrysler car

[91] White House, *Remarks by the President on the American Automotive Industry* (Mar. 30, 2009) (online at www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-American-Automotive-Industry-3/30/09/) (hereinafter "March 30 Presidential Remarks").

[92] General Motors Corp., *Form 8-K*, at 39 (Aug. 7, 2009) (online at www.sec.gov/Archives/edgar/data/1467858/000119312509169233/d8k.htm) (hereinafter "GM August 7 8-K").

[93] House Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, Testimony of Vice President and General Counsel of North America General Motors Company Michael J. Robinson, *Ramifications of Auto Industry Bankruptcies, Part III* 111th Cong., at 5 (July 22, 2009) (online at judiciary.house.gov/hearings/pdf/Robinson090722.pdf) (hereinafter "Michael Robinson House Testimony").

[94] *Id.*

[95] *Id.*

[96] Kimberly S. Johnson and Tim Trisher, *UAW Workers Approve General Motors Concessions*, USA Today (May 29, 2009) (online at www.usatoday.com/money/autos/2009-05-29-gm-uaw_N.htm) (hereinafter "Kim Johnson and Tim Trisher May 29 USA Today Report").

bought during the restructuring period.[97] The program was sized at 125 percent of the costs projected by the manufacturer to satisfy anticipated claims. Each of Chrysler and GM provided 15 percent of the projected funds necessary with Treasury providing the remaining 110 percent of the projected costs via loans.[98]

Prior to entering bankruptcy proceedings, Chrysler and GM created special purpose vehicles (SPVs) to hold those funds. Treasury lent Chrysler and GM $280 million[99] and $361 million,[100] respectively. Both Chrysler and GM have since repaid these loans.[101] To date, GM's repayment of its SPV facility has been its only repayment of TARP funds.[102]

4. Supplier Support Program

As a result of the downturn in the economy, automotive suppliers, upon whose functioning Chrysler and GM depend, had great difficulty accessing credit.[103] The viability plans of Chrysler and GM both pointed to the vulnerability of their suppliers.[104] Consequently, on March 19, Treasury announced the Auto Supplier Support Program (ASSP) to make available up to $5 billion in financing.[105] The government guaranteed the payment of products suppliers shipped, even if the automotive companies went under. In order to further unlock credit, participating suppliers could also sell their receivables into the program at a discount before maturity. The program would be run through American automotive companies that agreed to

[97] U.S. Department of Treasury, *Obama Administration's New Warranty Commitment Program* (Mar. 30, 2009) (online at www.financialstability.gov/docs/WarranteeCommitmentProgram.pdf) (hereinafter "White House Statement on New Warranty Commitment Program").

[98] *Id.*

[99] White House Office of the Press Secretary, *Obama Administration Auto Restructuring Initiative: Chrysler-Fiat Alliance* (hereinafter "Chrysler-Fiat Alliance") (Apr. 30, 2009) (online at www.whitehouse.gov/the_press_office/Obama-Administration-Auto-Restructuring-Initiative/) (hereinafter "Chrysler-Fiat Alliance").

[100] U.S. Department of Treasury, *Obama Administration Auto Restructuring Initiative: General Motors Restructuring* (Mar. 31, 2009) (online at www.financialstability.gov/latest/05312009_gm-factsheet.html) (hereinafter "White House March 31 Remarks on GM Restructuring").

[101] U.S. Department of Treasury, *TARP Transactions Report*, at 15 (Aug. 4, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report_08042009.pdf) (hereinafter "August 4 Transactions Report").

[102] U.S. Department of Treasury, *Transactions Report*, at 16 (Aug. 28, 2009) (online at financialstability.gov/docs/transaction-reports/transactions-report_08282009.pdf) (hereinafter "August 28 Transactions Report").

[103] U.S. Department of Treasury, *Auto Supplier Support Program: Stabilizing the Automotive Industry at a Time of Crisis* (Mar. 18, 2009) (online at www.treas.gov/press/releases/docs/supplier_support_program_3_18.pdf) (hereinafter "Stabilizing the Automotive Industry at a Time of Crisis").

[104] *Chrysler Restructuring Plan*, *supra* note 28; *GM Restructuring Plan*, *supra* note 27.

[105] U.S. Department of the Treasury, *Treasury Announces Auto Supplier Support Program* (Mar. 19, 2009) (online at www.financialstability.gov/latest/auto3_18.html) (hereinafter "Treasury Auto Supplier Support Program Announcement").

participate in the program. The supplier would pay a small fee for the right to participate in the program. Although all domestic automotive companies were eligible, only Chrysler and GM chose to participate. By April 9, $1.5 billion was made available to Chrysler and $3.5 billion to GM under the program.[106] The total commitment was reduced on July 8 to $1 billion for Chrysler and $2.5 billion for GM.[107]

5. White House Council on Automotive Communities and Workers

One aspect of TARP assistance to the automotive industry is the fallout created by the restructurings. In aiming to make Chrysler and GM more competitive and sustainable, President Obama has recognized the difficult sacrifices that many stakeholders and communities have made across the nation.[108] The government-backed restructurings have resulted in substantial sacrifices for many, including further job reductions and dealership and parts supplier closings that impact the welfare and livelihood of dealers, retirees, workers and the greater communities[109] surrounding automotive plants and dealerships. The Obama Administration has created a White House Council on Automotive Communities and Workers, co-chaired by Mr. Summers and Secretary of Labor Hilda L. Solis. Edward Montgomery, a former deputy secretary of labor, was appointed as the new director of recovery for auto communities and workers to work with autoworkers and auto communities to help offset the impact of these changes and assist communities as they reorient their local economies.[110] President Obama stated that the hardships currently being faced are necessary in order for the American automotive industry to reemerge as the "best automotive industry in the world"[111] and for the future of this nation to continue to be premised on the ingenuity and entrepreneurship of current generations and generations past.[112]

C. The Impact of the Reorganizations: Who Got What?

1. Chrysler

[106] August 18 Transactions Report, *supra* note 1.

[107] August 18 Transactions Report, *supra* note 1.

[108] *White House June 1 Remarks on GM Restructuring*, *supra* note 89.

[109] According to data from the Center for Automotive Research, more than 50 U.S. towns and cities have had a major automotive plant closure in the past five years.

[110] White House, *Executive Order Establishing a White House Council on Automotive Communities and Workers* (June 23, 2009) (online at www.whitehouse.gov/the_press_office/Establishing-a-White-House-Council-on-automotive-communities-and-workers/) (hereinafter "Executive Order Establishing White House Council on Automotive Communities and Workers").

[111] White House Office of Press Secretary, *Remarks by the President on the Auto Industry* (Apr. 30, 2009) (online at www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-Auto-Industry/) (hereinafter "White House April 30 Remarks on Auto Industry").

[112] *Id.*

At the time of the Chapter 11 filing, Chrysler was owned 80.1 percent by Cerberus and its affiliates and 19.9 percent by Daimler and its affiliates.[113] Chrysler owed money to several groups of creditors. Under a first lien credit agreement, Chrysler had borrowed $10 billion from a group of lenders[114] on a secured basis, meaning that if Chrysler defaulted, specific assets, known as collateral, could be seized by those lenders.[115] The collateral for this loan was nearly all Chrysler's assets.[116] At the time of filing, Chrysler owed $6.9 billion to the "first lien lenders" under this agreement.

Under a second lien credit agreement, Chrysler received a further loan from affiliates of its shareholders.[117] This loan was secured by a "second lien" over the assets that formed the collateral for the first lien credit agreement, meaning the second lien lenders had access to collateral securing their loan only after the first lien lenders were paid off. At the time of filing, Chrysler owed $2 billion to the second lien lenders. Under the TARP funding discussed above, Chrysler borrowed a total of $4 billion from Treasury.[118] As security for this loan, Treasury received a third lien over the assets securing the first and second lien credit agreements, and a first lien on all unencumbered assets. (The warranty advance discussed above was secured by the funds in the warranty SPV.) The amount owed to Treasury at the time of filing was $4.28 billion.

In 2008, Chrysler (like GM and Ford) had entered into a settlement agreement pursuant to litigation between the UAW, individual workers and the automotive companies.[119] Under this agreement, a trust was created to provide medical benefits to UAW retirees. Chrysler was

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[113] Affidavit of Ronald E. Kolka In Support of First Day Pleadings, at 5 (April 30, 2009), *In Re* Chrysler LLC, S.D.N.Y. (No. 09 B 50002 (AJG)) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1) (hereinafter "Ronald Kolka Declaration").

[114] About 70 percent of this debt is held by four banks that received TARP funding: JP Morgan Chase ($25 billion in TARP funding), Citigroup ($45 billion in TARP funding), Morgan Stanley ($10 billion in TARP funding), Goldman Sachs ($10 billion in TARP funding). *Ronald Kolka Declaration*, *supra* note 113 at 5. Some creditors have claimed that Treasury used its status as a creditor to these institutions as leverage in negotiating over this secured debt. See, for example, *Indiana State Police Pension Trust et al. v. Chrysler LLC*, No. 09-2311-bk, 2009 WL 2382766 (2d Cir. Aug. 5, 2009); Neil King Jr. and Jeffrey Mccracken, *U.S. Forced Chrysler's Creditors to Blink*, Wall Street Journal (May 11, 2009) (online at online.wsj.com/article/SB124199948894005017.html) (hereinafter "Neil King and Jeffery McCracken May 11 Wall Street Journal Report").

[115] When the value of the collateral is less than the amount of the secured claim, the secured creditors become unsecured creditors with respect to the shortfall.

[116] *Ronald Kolka Declaration*, *supra* note 113 at 5.

[117] The lenders included Daimler Financial, an affiliate of Daimler, with $1.5 billion in commitments and Madeleine LLC, an affiliate of Cerberus, with $500 million in committments. *Ronald Kolka Declaration*, *supra* note 113 at 5.

[118] The $4.8 billion total includes three separate loans to Chrysler Holding LLC. Treasury made a $4 billion loan on Jan. 2, 2009. It made additional loans of $500 million and $280,130,642 on April 29, 2009. August 28 TARP Transactions Report, *supra* note 102.

[119] See discussion of the UAW Trust, *supra* note 49.

supposed to fund this trust with cash. At the time of the filing, Chrysler owed the UAW Trust $10.6 billion.[120]

Chrysler also had significant unsecured debt owing to trade creditors such as suppliers. At the time of filing, this amounted to approximately $5.3 billion.[121]

When, as discussed above, the government indicated that it would support Chrysler's viability plan,[122] Fiat established New CarCo. Acquisition LLC (New Chrysler) under Delaware law. Chrysler, Fiat and New Chrysler tentatively entered into a master transaction agreement (MTA).[123] Under the MTA, with the approval of the bankruptcy court[124] and in accordance with Section 363, Old Chrysler sold substantially all its operating assets to New Chrysler, and in exchange for those assets New Chrysler assumed some of the liabilities of Old Chrysler[125] (most importantly the obligations to the UAW Trust) and paid Old Chrysler $2 billion in cash.[126]

That $2 billion in cash, together with any remaining assets of Old Chrysler not transferred to New Chrysler, becomes the "bankruptcy estate" of Old Chrysler and will be distributed to the first lien lenders in accordance with bankruptcy law.[127] As also discussed above, certain of those lenders objected to the Section 363 sale. Notwithstanding the objection of the dissenting creditors, they will receive the same payout – about 29 cents on the dollar – that

[120] *Chrysler Restructuring Plan*, *supra* note 28.

[121] *Ronald Kolka Declaration*, *supra* note 113 at 5.

[122] See *supra* Section B.

[123] Master Transaction Agreement, *supra* note 45. The agreement was conditioned on the approval of various other agreements or settlements with other parties, including Treasury and the UAW, as well as overall acceptance of the transaction by the bankruptcy court.

[124] Master Transaction Agreement, *supra* note 45.

[125] U.S. Treasury Office of Public Affairs, *Obama Administration Auto Restructuring Initiative* (April 30, 2009) (online at www.financialstability.gov/latest/tg_043009.html) (hereinafter "White House April 30 Remarks on Auto Restructuring Initiative").

[126] *Id.*

[127] The secured creditors committee sued J.P. Morgan, the administrative agent for the deal, demanding that $1.4 billion paid to Chrysler secured debt holders be returned because liens on the debt were not perfected. See generally, *In re* Chrysler LLC, 405 B.R. 84 (Bankr. S.D.N.Y. 2009); Alan Zimmerman, *GM Creditor Panel Seeks to Recoup $1.4 billion from Secured Lenders*, Standard & Poor's: Leveraged Commentary & Data (Aug. 3, 2009) (hereinafter "Alan Zimmerman S&P Commentary").

the assenting creditors do.[128] Since the first lien lenders were owed $6.9 billion, there was no money left over for secured lenders with second or lower liens, or for any unsecured creditors.[129]

New Chrysler's operations are not constrained by bankruptcy law, and it is able to make whatever commercial arrangements it chooses regarding (a) to whom it sells ownership interests in New Chrysler, (b) which assets and contracts of Old Chrysler it will acquire, and (c) ongoing commercial relationships with persons (such as dealers, suppliers and unions) who may have had relationships with Old Chrysler.[130]

Thus, in exchange for a new collective bargaining agreement with the UAW, New Chrysler will fund the UAW Trust with a combination of a $4.6 billion note and 67.7 percent of the equity in New Chrysler.[131] Fiat will contribute technology and other capabilities, and receive about 20 percent equity in New Chrysler.[132] Treasury received a 10 percent stake in the company, as well as notes that equal about $7.1 billion. If Fiat is able to achieve certain performance goals with New Chrysler, its stake will increase to a 35 percent equity share, while the UAW Trust's and Treasury's stakes will decrease to 55 percent and 8 percent, respectively.[133]

The status of the principal stakeholders in Chrysler and New Chrysler at the time of filing[134] and after reorganization is thus:

Figure 1: Status of the Principal Stakeholders in Chrysler and New Chrysler

[128] This outcome stands in contrast with press release issued by the White House on April 30, 2009. This release stated: "In order to effectuate this alliance without rewarding those who refused to sacrifice, the U.S. government will stand behind Chrysler's efforts to use our bankruptcy code to clear away remaining obligations and emerge stronger and more competitive." *White House April 30 Remarks on Auto Restructuring Initiative*, *supra* note 125.

[129] Some of these entities, such as the UAW Trust, did receive interests in New Chrysler, as discussed in more depth below. From a technical point of view, they received these interests in their capacity as independent contracting entities offering consideration (such as revised employment contracts with the UAW) to New Chrysler in exchange for New Chrysler equity. Section 363 sales are discussed in more depth in Section E of this report.

[130] The significant policy implications of this are discussed in Section G below.

[131] *White House April 30 Remarks on Auto Restructuring Initiative*, *supra* note 125.

[132] *White House April 30 Remarks on Auto Restructuring Initiative*, *supra* note 125.

[133] *White House April 30 Remarks on Auto Restructuring Initiative*, *supra* note 125.

[134] This report analyzes information at several different points in the restructuring process. Dollar amounts in this section are given as at the time of filing for bankruptcy. They may therefore differ from dollar amounts in Section F, which shows amounts initially expended and amounts outstanding at the time of this report.

Stakeholder	What Old Chrysler Owed Them	What They Get from Old Chrysler in Liquidation	What They Contributed to New Chrysler	What They Got from New Chrysler
First lien secured lenders[135]	$6.9 billion in secured claims[136]	$2 billion cash	N/A	N/A
Daimler	$2 billion in second lien debt; 19.9% equity for Daimler and 80.1% equity for Cerberus	Wiped out	$600 million to settle claim with PBGC[137]	–
Cerberus			Contribution of claim against Daimler to indirectly assist settlement with PBGC	

[135] These lenders include JP Morgan Chase & Co., Citigroup Inc., Goldman Sachs Group Inc., & Morgan Stanley & Co. Inc., all recipients of TARP money, as discussed in note 155. *infra*. *Ronald Kolka Declaration*, *supra* note 113 at 5. These lenders include the Indiana Pension Funds.

[136] Chrysler Restructuring Plan, *supra* note 28.

[137] When Chrysler filed for bankruptcy, its pension liabilities were significantly underfunded. As part of the bankruptcy process, Chrysler received court approval of a settlement among the company, the Pension Benefit Guaranty Corporation, Daimler and Cerberus. As noted in the PBGC's press release (online at www.pbgc.gov/media/news-archive/news-releases/2009/pr09-21.html), the settlement frees Daimler of its $1 billion guaranty of the Chrysler pension plans. In exchange, Daimler will pay $200 million into the pension plans immediately upon final execution of the agreement, and will also pay $200 million into the plans in 2010 and 2011. If the Chrysler pensions terminate before August 2012 and are trusteed by the PBGC, Daimler will pay $200 million to the PBGC insurance program. In addition, Cerberus and Daimler have agreed to waive various loans they made to Chrysler as part of the Cerberus' 2007 acquisition of the company. Order Authorizing Debtor Chrysler LLC to Enter Into a Settlement on the Terms Set Forth in the Binding Term Sheet Among Daimler, the DC Contributors, Cerberus, Chrysler Holding, Chrysler and PBGC Pursuant to Rule 9019 Federal Rules of Bankruptcy Procedure (June 5, 2009), *In Re* Chrysler LLC, S.D.N.Y. (No. 09 B 50002 (AJG)) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1) (hereinafter "Order Allowing Chrysler Pension Settlement").

Treasury	First TARP financing (1/2/09): $4 billion; first lien on all unencumbered property, third lien on previously encumbered assets Second TARP financing (4/29/09): $1.89 billion for DIP (debtor-in-possession) financing (of $3.8 billion commitment)	Bankruptcy estate will not cover TARP or DIP financing except the portion assumed by New Chrysler (Note: With respect to the first TARP financing, Treasury has a claim on the value of Chrysler Financial equity at the greater of $1.375 billion or 40% of total equity value)	TARP financing (6/10/09): up to $6.6 billion senior secured debt	8 % equity (9.85% currently),[138] as well as a $6.6 billion note and the assumption of $500 million of the first TARP financing
UAW Trust	$8 billion in unsecured claims	Nothing from Old Chrysler	UAW gave concessions on wages, benefits, retiree health care to New Chrysler	55% equity (67.69% currently); $4.6 billion note
Fiat	N/A	N/A	Technology, IP, access to distribution network[139]	20% equity with an additional 15% available if certain performance metrics are met
Governments of Ontario and Canada	$600 million loan $1.125 billion for DIP financing	Nothing from Old Chrysler	$600 million original loan assumed by New Chrysler $1.3 billion loan[140]	2% equity (2.46% currently) and a note for up to $1.9 billion

2. General Motors

At the time of the Chapter 11 filing, GM was a publicly owned company traded on the New York Stock Exchange.[141]

[138] The "current" figures, which are indicated for Treasury, UAW Trust, and the Governments of Canada and Ontario, represent the equity breakdown before Fiat increases its equity holding after meeting specified performance metrics. If Fiat secures its potential 35 percent equity holding, the other equity holdings will decrease as indicated.

[139] *Chrysler-Fiat Alliance*, *supra* note 99.

[140] $1.3 billion of financing commitments were provided by the Canadian and Ontario governments in the form of working capital and exit financing loans that will continue to be the obligations of New Chrysler.

[141] General Motors Corp., *Form 10-K* (March 5, 2009) (online at www.sec.gov/Archives/edgar/data/40730/000119312509045144/d10k.htm) (hereinafter "GM Fiscal Year 2008 10-K").

As with Chrysler, GM owed money to various groups of creditors.

At the time of the GM bankruptcy filing on June 1, 2009, GM's largest secured debt was to Treasury (in the amount of $19.4 billion) backed by collateral including, in part, intellectual property, real property, cash, and equity. After GM filed for bankruptcy, Treasury provided GM with $30.1 billion of debtor in possession (DIP) financing[142] that was used to facilitate GM's restructuring process. As will be discussed below, this DIP financing constituted an administrative priority claim and gave Treasury priority over the claims of unsecured creditors.

GM's largest secured claims outside the U.S. government were: bank lenders represented by Citicorp US, Inc. ($3.865 billion); bank lenders represented by JP Morgan Chase Bank ($1.488 billion); Export Development Canada ($400 million); and Gelco Corporation ($125 million).[143] These totaled approximately $6 billion and were backed by collateral that included, in part, inventory, equipment, and equity interest.

Old GM had unsecured claims that totaled $116.5 billion. Of those claims, $27.1 billion were attributable to unsecured bonds.[144]

At the time of filing, the largest unsecured claims were: Wilmington Trust Company ($22.760 billion, bond debt); UAW ($20.560 billion, owed to the UAW Trust); Deutsche Bank AG ($4.444 billion, bond debt); IUE-CWA ($3.669 billion, employee obligations); and Bank of New York Mellon ($176 million, bond debt). The remaining 45 unsecured claims were all trade debt, and totaled $894 million.[145]

On June 1, President Obama outlined the Treasury auto team's plan to restructure GM.[146] New GM was created. Pursuant to the Master Sale and Purchase Agreement (MPA),[147] New GM purchased most of Old GM's assets and assumed certain liabilities.[148] In exchange, New

[142] See Section G(4) of this report.

[143] *GM Bankruptcy Petition*, *supra* note 81 at 94.

[144] *GM Bankruptcy Petition*, *supra* note 81at 6.

[145] *GM Bankruptcy Petition*, *supra* note 81at 81.

[146] *White House June 1 Remarks on GM Restructuring*, *supra* note 85.

[147] Master Purchase and Sale Agreement by and Among General Motors Corporation, Saturn LLC, Saturn Distribution Corporation, and Vehicle Acquisition Holdings LLC (June 1, 2009), *In Re* General Motors Corp., S.D.N.Y. (No. 09-50026 (REG)) (online at docs.motorsliquidationdocket.com/pdflib/pleading_5.pdf) (hereinafter "GM Master Purchase Agreement").

[148] New GM did not assume the following liabilities: (i) products liability claims arising out of products delivered prior to the 363 sale transaction closing (to the extent they were not assumed by reason of the change in the MPA after the filing of objections); (ii) liabilities for claims arising out of exposure to asbestos; (iii) liabilities to third parties for claims based upon contract, tort or any other basis; (iv) liabilities related to any implied warranty or other implied obligation arising under statutory or common law; and (v) employment-related obligations not otherwise assumed, including, among other obligations, those arising out of the employment, potential employment, or termination of any individual (other than an employee covered by the UAW collective bargaining agreement) prior to or at the closing of the 363 sales transaction. *In re GMC*, 407 B.R. 463, 482 (Bankr. S.D.N.Y. 2009).

GM paid Old GM consideration of 10 percent of the equity in New GM and warrants for a further 15 percent of New GM's equity, totaling approximately $7.4 to $9.8 billion in value.[149] In addition, Treasury and the Canadian government credit bid their loans to Old GM, which totaled approximately $45 billion.[150] This amount included the $19.4 billion in pre-bankruptcy indebtedness and the portion of the $33.3 billion DIP facility that was not assumed by New GM or left behind for the wind-down of Old GM. That consideration became part of Old GM's bankruptcy estate. Where cash is bid in a Section 363 sale (as was the case in Chrysler), that cash becomes part of the bankruptcy estate to be distributed to the debtor's creditors. In a credit bid, the debt owed to the bidder by the bankruptcy estate is offset by the amount of the credit bid, reducing the amount of claims that will share in the distribution of the remaining assets, and thereby increasing the value of the bankruptcy estate that will be distributed to the non-bidding creditors.

Old GM's secured lenders were repaid, leaving the unsecured lenders with their pro rata share of the 10 percent equity in New GM.

As with New Chrysler, New GM was able to dispose of ownership interests in New GM as it saw fit. Treasury received $6.7 billion in New GM debt (of which $361 million related to the warranty program has been repaid) and $2.1 billion in New GM preferred stock[151] and approximately 61 percent of the equity in New GM. The governments of Canada and Ontario received $1.7 billion in debt and preferred stock and approximately 12 percent of the equity in New GM.[152]

Old GM owed a $20 billion obligation to the UAW Trust. Pursuant to the UAW Retiree Settlement Agreement,[153] New GM will transfer to the UAW Trust 17.5 percent of the equity in New GM, warrants to purchase an additional 2.5 percent, a $2.5 billion note, and $6.5 billion in preferred stock.

The status of the principal stakeholders in Old GM and New GM at the time of filing and after reorganization is thus as follows:

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[149] *Stephen Worth Declaration*, *supra* note 36 at appx. 18.

[150] Amended and Restated Master Sale and Purchase Agreement by and Among General Motors Corporation, Saturn LLC, Saturn Distribution Corporation, and Vehicle Acquisition Holdings LLC (June 26, 2009) (hereinafter "Amended and Restated GM Master Purchase Agreement").

[151] *White House March 31 Remarks on GM Restructuring*, *supra* note 100.

[152] Prime Minister of Canada, *PM and Premier Dalton McGuinty Announce Loans to Support the Restructuring of Chrysler* (June 1, 2009) (online at pm.gc.ca/eng/media.asp?id=2547) (hereinafter "Canadian Prime Minister's Chrysler Announcement").

[153] Form of UAW Retiree Settlement Agreement (June 1, 2009) *In Re* General Motors Corp., S.D.N.Y. (No. 09-50026 (REG)) (online at docs.motorsliquidationdocket.com/pdflib/uaw_7.pdf) (hereinafter "UAW Retiree Settlement Agreement").

Figure 2: Status of the Principal Stakeholders in GM and New GM

Stakeholder	What Old GM Owed Them	What they Get from Old GM in Liquidation	What They Contributed to New GM	What They Get from New GM
Old GM shareholders	Shareholders' equity	Wiped out	N/A	N/A
UAW Trust	$20.56 billion in unsecured obligations[154]	Nothing from Old GM	UAW gave concessions on wages, benefits, retiree health care to New GM	17.5% equity; warrants to buy an additional 2.5% in equity, $2.5 billion note, $6.5 billion in preferred stock
Secured lenders[155]	$6 billion	Paid in full	N/A	
Unsecured creditors	$27.1 billion in bonds and various other claims	10% of New GM and warrants equal to 15% of New GM	N/A	(Equity issued to Old GM in exchange for assets)
Treasury	First TARP financing (12/29/08): $13.4 billion Second TARP financing (4/22/09): $2 billion Third TARP financing (5/20/09): $4 billion DIP financing (6/3/09): $30.1 billion	$986 million of Treasury DIP financing remains with Old GM; other debts were credit bid and thus no longer outstanding	Used approximately $42 billion in debts to credit bid for Old GM assets	61% equity $7.1 billion in notes (including $361 million for warranty program already repaid) and $2.1 billion in preferred stock
Governments of Canada and Ontario	$9.5 billion loan including $3.2 billion in DIP financing	$189 million of Canadian DIP financing remains with Old GM; other amounts credit bid	Approximately $3 billion of DIP financing was credit bid	12% equity $1.3 billion in notes and $0.4 billion in preferred stock

[154] $10 billion in cash scheduled to be transferred to the UAW Trust on January 1, 2009 had already been set aside by Old GM in an internal account. This cash is still scheduled to be transferred to the UAW Trust on that date.

[155] As discussed above, these creditors include J.P. Morgan, Citigroup Inc., Goldman Sachs Group Inc., & Morgan Stanley, all recipients of TARP money. *GM Bankruptcy Petition*, *supra* note 81.

D. Treasury's Objectives: What was Treasury Trying to Achieve?

1. What Were Treasury's Stated Objectives?

In this section, the Panel examines the publicly articulated statements of the Bush and Obama Administrations at the various points their decisions were announced in order to determine under which circumstances and upon which conditions the government might intervene in failing industries. As discussed above, Detroit automotive executives warned Congress in late 2008 that the collapse of one or more of the Big Three automotive companies would have national consequences, putting as many as 1.1 million jobs at risk.[156] Allocating TARP assistance under EESA came to be perceived by many as the fastest means to provide funding to the sector, since it could be done without further action by Congress.

a. December 2008: Rescue Funding – The Bush Administration's Decision to Allocate TARP Funds

The Bush Administration's initial December 2008 determination to allocate TARP funds to stabilize the automotive industry through short-term loans was made with the primary goals of preventing a substantial disruption to the national economy and allowing Chrysler and General Motors to undergo significant restructuring in order to achieve future profitability and long-term viability.[157] In a press release, then-Treasury Secretary Henry Paulson noted that Treasury "acted to support Chrysler and General Motors, with the requirement that they move quickly to develop and adopt acceptable plans for long term viability."[158] The Bush Administration stated that short-term funding would allow the companies to work with their creditors, the unions, and Congress to formulate a plan to reduce their debt, some of the residual healthcare costs, and to achieve additional concessions, in order to attain financial viability.[159]

Furthermore, as part of the initial decision to allocate TARP funding to the automotive sector, the Bush Administration made clear the importance of several policy targets as a critical component of the taxpayers' investment.[160] These targets included the reduction of outstanding unsecured debt by two-thirds through a debt for equity exchange, certain labor modifications

[156] For further discussions of the economic ramifications of liquidations of Chrysler and General Motors, see Section B, *supra.*

[157] U.S. Department of the Treasury, *Secretary Paulson Statement on Stabilizing the Automotive Industry* (Dec. 19, 2008) (online at www.treas.gov/press/releases/hp1332.htm) ("Today we have acted to support Chrysler and General Motors, with the requirement that they move quickly to develop and adopt acceptable plans for long term viability. This step will prevent significant disruption to our economy, while putting the companies on a path to the significant restructuring necessary to achieve long term viability. At the same time, we are including loan provisions to protect the taxpayers to the maximum extent possible.").

[158] *Id.*

[159] *Bush Plan to Assist Automakers*, *supra* note 16.

[160] *Chrysler Secured Term Loan Facility Summary*, *supra* note 24; *GM Secured Term Loan Facility Summary*, *supra* note 24.

(such as cuts in compensation), and modifications to UAW Trust account contributions, among others.[161] The companies were also required to conclude new agreements with their other major stakeholders, including dealers and suppliers, by March 31, 2009.[162] Many of these targets were included as part of the proposals for bridge loans that the Bush Administration negotiated with congressional leadership towards the end of 2008, but which were eventually blocked in the Senate before the congressional recess.[163]

b. February – March 2009: Formation of the Task Force and Release of the Obama Administration's Viability Determinations

President Obama noted the gravity of the situation facing the American automotive industry and made the commitment to work with and support these companies as they underwent restructuring. Upon taking office, the President "inherited an automotive industry that had lost 50 percent of its sales volume and over 400,000 jobs in the year before he took office."[164] By early 2009, despite having already received substantial loans from the Bush Administration through TARP funding, Chrysler and GM were requesting additional assistance. President Obama stated that he considered "the hundreds of thousands of Americans whose livelihoods are still connected to the American automotive industry, and the impact on an already struggling economy" and determined that "if Chrysler and GM were willing to fundamentally restructure their businesses, and make the hard choices necessary to become competitive now and in the future, it was a process worth supporting."[165] In particular, President Obama noted that among those Americans who "have suffered most during this recession have been those in the auto industry and those working for companies that support it," and cited the historic rise in unemployment across the Midwest.[166] The current Administration has cited the "centrality of the

[161] Chrysler Secured Term Loan Facility Summary, *supra* note 24; *GM Secured Term Loan Facility Summary*, *supra* note 24.

[162] Chrysler Secured Term Loan Facility Summary, *supra* note 24; *GM Secured Term Loan Facility Summary*, *supra* note 24.

[163] Bush Plan to Assist Automakers, *supra* note 16. President Bush noted that his administration worked with Congress on legislation to provide automotive companies with bridge loans while they developed plans for viability. "Unfortunately, despite extensive debate and agreement that we should prevent disorderly bankruptcies in the American Automotive Industry, Congress was unable to get a bill to my desk before adjourning this year." Noting that "Congress failed to make funds available for these loans," President Bush highlighted that "the federal government will grant loans to automotive companies under conditions similar to those Congress considered" in late fall 2008.

[164] *Ron Bloom Prepared COP Testimony*, *supra* note 78 at 1.

[165] White House, *Remarks by the President on the American Graduation Initiative, Macomb Community College, Warren, MI* (July 14, 2009) (online at www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-American-Graduation-Initiative-in-Warren-MI/) (hereinafter "White House July 14 Remarks").

[166] During his June 1 remarks on the General Motors restructuring, President Obama again referenced the importance of a viable auto industry to the welfare of families and communities across the Midwest and throughout the United States. "In the midst of a deep recession and financial crisis, the collapse of these companies would have been devastating for countless Americans, and done enormous damage to our economy – beyond the auto industry." *March 30 Presidential Remarks*, *supra* note 91.

automobile industry to the broader economy"[167] as justification for this substantial intervention and stated that inaction would have caused a "spiraling liquidation of Chrysler and GM leading to massive job losses and long-term damage to the U.S. manufacturing base."[168]

From early on in his administration, President Obama gave the Task Force two directives regarding its approach to the automotive restructurings. First, the Task Force was to avoid intervening in day-to-day corporate management and refrain from becoming involved in specific business decisions, since its role was not to manage but, rather, serve as a "potential investor of taxpayer resources" with the goal of promoting "strong and viable companies."[169] Second, the Task Force was to "behave in a commercial manner."[170] These dual roles, and their continued impact throughout the varying stages of bankruptcy and restructuring, are discussed in detail later in this report.

In evaluating the viability plans submitted by Chrysler and GM on February 17, 2009, the Treasury auto team acted with the stated goals of achieving the efficient, fair and commercial restructuring of these two companies, along with helping them rethink their business models and restructure their balance sheets.[171] As required by the original loan agreements executed with the Bush Administration, the viability plans were evaluated to determine whether the companies and their subsidiaries "have taken all steps necessary to achieve and sustain the long-term viability, international competitiveness, and energy efficiency"[172] of these companies. As discussed above, both companies have steadily lost market share, primarily to foreign automotive companies, over the past thirty years. A major challenge both companies face is therefore addressing this slippage and designing products that meet consumer demands. As part of this review process, the Treasury auto team's financial advisors performed "sensitivity analyses by varying the assumptions underlying the [viability] plans."[173] Mr. Bloom stated that these

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[167] *Interview with National Economic Council Director Lawrence H. Summers*, Wall Street Journal (June 15, 2009) (online at online.wsj.com/article/SB124388671265573443.html) (hereinafter "Lawrence Summers' WSJ Interview").

[168] Questions for the Record for Ron Bloom, *supra* note 36 at 4-5. ("Outright failure of GM and Chrysler would likely have led to uncontrolled liquidations in the automotive industry, with widespread devastating effects. Importantly, the repercussions of such liquidations could have included immediate and long-term damage to the U.S. manufacturing/industrial base, a significant increase in unemployment with direct harm to those both directly and indirectly related to the automotive sector (e.g. dealerships being shuttered, plant closings, supplier failures, service centers closing, etc.), and further damaged our financial system, as automobile financing accounts for a material portion of our overall financial activity.").

[169] *Ron Bloom Prepared COP Testimony*, *supra* note 78 at 1.

[170] Senate Committee on Banking, Housing, and Urban Affairs, Testimony of Senior Advisor at the U.S. Department of Treasury Ron Bloom, *The State of the Domestic Automobile Industry: Impact of Federal Assistance*, 111th Cong., at 5-6 (June 10, 2009) (hereinafter "Ron Bloom Senate Testimony").

[171] *Ramifications of Automotive Industry Bankruptcies, Part II*, *supra* note 10 at 1.

[172] *Chrysler February 17 Viability Plan*, *supra* note 11; *GM February 17 Viability Plan, supra* note 34.

[173] *Ron Bloom COP Testimony*, *supra* note 36, at 2-3.

viability plans were "very rigorously reviewed and challenged."[174] The review and evaluation of these viability plans was conducted through the eyes of a "provider of capital"[175] and potential investor – meaning that the Treasury auto team "had an obligation to challenge [Chrysler and GM] to make sure they were acting in a thoughtful and commercial fashion."[176]

c. April – May 2009: Decisions to File for Bankruptcy

The decisions by both Chrysler and General Motors to file for bankruptcy were prompted by the Treasury auto team's viability determinations issued on March 30, 2009, as discussed above. President Obama noted that the word "bankruptcy" was being used loosely to refer to the use of the Code, with the backing of the federal government, to help Chrysler and GM restructure and continue operating in an ordinary course, not a liquidation (where a company is broken up, sold off, and disappears), or where a company is in litigation for years with no immediate headway.[177]

The Treasury auto team's articulated objectives with respect to the Chrysler and GM bankruptcies were to save hundreds of thousands of jobs and to place the companies on a solid footing to succeed in the future and generate jobs "well into the 21st century."[178] In his testimony before the Panel at the Detroit field hearing on July 27, 2009, Mr. Bloom stated that the government-backed bankruptcy reorganizations of Chrysler and GM gave "every affected stakeholder a full opportunity to have his or her claim heard," adding that "every creditor will almost certainly receive more than they would have had the government not stepped in."[179] In addition, he stated that the Treasury auto team interacted with the various creditors of Chrysler and GM as a commercial actor would, given the commercial approach it has taken to the restructuring of these two companies.[180]

d. June and July 2009 Through the Future: Post-Bankruptcy and Looking Forward

New Chrysler and New GM completed their Section 363 purchases of assets through the bankruptcy process in June and July, respectively. As the two companies commence operations as independent companies, Treasury has entered a new phase in the federal government's temporary involvement in the automotive industry. Since the companies are now being run as commercial enterprises by their management teams and report to new, independent boards of

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[174] *Ron Bloom Senate Testimony*, *supra* note 170, at 8.

[175] *Ron Bloom Senate Testimony*, *supra* note 170, at 21.

[176] *Ron Bloom Senate Testimony*, *supra* note 170, at 8.

[177] *March 30 Presidential Remarks*, *supra* note 91.

[178] *Ron Bloom Senate Testimony*, *supra* note 170, at 3-4.

[179] Ron Bloom Prepared COP Testimony, *supra* note 78, at 3.

[180] Ron Bloom COP Testimony, *supra* note 36 at 4.

directors,[181] the roles of the Task Force and the Treasury auto team from now on will be characterized by moving toward a more passive role with a focus on monitoring the automotive industry and safeguarding the taxpayers' substantial investments. The Task Force and Treasury auto team's goal "is to promote strong and viable companies, which can be profitable and contribute to economic growth and jobs without government support as quickly as possible."[182]

Mr. Bloom has stated that President Obama's articulated view of the government's limited role in these companies has two main elements.[183]

First, while the government has a partial ownership stake in these companies, Treasury only plans to hold these equity stakes for a limited period of time and plans to dispose of them "as soon as practicable."[184] Treasury's primary goal is to establish viable companies capable of achieving future profitability.[185]

Second, Treasury expects to manage its stake in a "hands-off" manner, voting only on core governance issues, including the selection of directors and other major corporate actions and

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[181] *Ron Bloom Prepared COP Testimony*, *supra* note 78 at 9.

[182] *Ron Bloom Prepared COP Testimony*, *supra* note 78 at 9.

[183] The Administration has articulated a set of four guidelines that will govern its approach to managing ownership interests in financial and automotive companies. These guidelines will determine the government's approach to New Chrysler and New GM and its actions as a shareholder. These guidelines are as follows:

1. The government has no desire to own equity stakes in companies any longer than necessary, and will seek to dispose of its ownership interests as soon as practicable. The goal is to establish strong and viable companies that can quickly be profitable and contribute to economic growth and jobs without government involvement.
2. In exceptional cases where the U.S. government feels it is necessary to respond to a company's request for substantial assistance, the government will reserve the right to set upfront conditions to protect taxpayers, promote financial stability and establish the foundation for future growth. When necessary, these conditions may include new viability plans similar to those now underway at New Chrysler and New GM as well as changes to ensure a strong board of directors that selects management with a sound long-term vision to restore their companies to profitability and to end the need for government support as quickly as possible.
3. After any upfront conditions are in place, the government will protect the taxpayers' investment by managing its ownership stake in a hands-off, commercial manner. The government will not interfere with or exert control over day-to-day company operations. No government employees will serve on the boards or be employed by these companies.
4. As a common shareholder, the government will only vote on core governance issues, including the selection of a company's board of directors and major corporate events or transactions. While protecting taxpayer resources, the government intends to be extremely disciplined as to how it intends to use even these limited rights.

Ron Bloom Prepared COP Testimony, *supra* note 78, at 9; *White House GM Restructuring Fact Sheet*, *supra* note 85.

[184] Ron Bloom Prepared COP Testimony, *supra* note 78 at 9.

[185] *Chrysler February 17 Viability Plan*, *supra* note 11; *GM February 17 Viability Plan*, *supra* note 34.

transactions.[186] Having appointed its directors, Treasury will now step back until the next time that the directors are up for election, at which time it will decide whether to retain or replace these directors.[187] In reference to its "hands off" stance, Mr. Bloom has acknowledged that using GM or Chrysler as an instrument of broader government policy (for example, mandating the production of certain vehicles, requiring that the automotive companies build more vehicles in the United States or purchase more parts from U.S. manufacturers) "is inconsistent with these goals."[188] This also signifies that no government employees will serve on the boards or be on the payroll of these automotive companies. The Treasury auto team has repeatedly reaffirmed President Obama's commitment to this policy approach,[189] and additionally noted the Administration's strong opposition to the amendment to the House Financial Services Committee appropriations bill that attempts to restore prior Chrysler and GM franchise agreements.[190]

The Task Force and Treasury auto team are currently focusing on achieving three objectives with respect to New Chrysler and New GM: (1) financial restructuring; (2) operational

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[186] *Chrysler February 17 Viability Plan*, *supra* note 11; *GM February 17 Viability Plan*, *supra* note 34.

[187] At the Panel's Detroit field hearing, Mr. Bloom agreed that this is an adequate description of the government's approach. *Ron Bloom COP Testimony*, *supra* note 36.

[188] Ron Bloom Prepared COP Testimony, *supra* note 78, at 9. Some environmental activists have raised the question of whether the automotive companies, having received TARP assistance, should be required to build "greener" automobiles, in keeping with President Obama's focus on climate change. Brian Deese, Special Assistant to the President for Economic Policy and a member of the Task Force staff, has said that these broader issues are not the Administration's objective. "The question we were focused on was not what larger policy objectives we should be trying to achieve, but what is a commercially viable restructuring that will allow them to succeed in a way that they have not in the past." Michelle Maynard and Michael J. de la Merced, *A Cliffhanger to See if a G.M. Turnaround Succeeds*, New York Times (July 26, 2009) (online at www.nytimes.com/2009/07/26/business/26gm.html).

[189] Treasury meeting with COP Staff, July 29, 2009; *White House June 1 Remarks on GM Restructuring*, *supra* note 89. "What we are not doing – what I have no interest in doing – is running GM. GM will be run by a private board of directors and management team with a track record in American manufacturing that reflects a commitment to innovation and quality. They – and not the government – will call the shots and make the decisions about how to turn this company around. The federal government will refrain from exercising its rights as a shareholder in all but the most fundamental corporate decisions. When a difficult decision has to be made on matters like where to open a new plant or what type of new car to make, the new GM, not the United States government, will make that decision.").

[190] Treasury meeting with COP Staff, July 29, 2009; Mr. Bloom also stated that:

> [t]he decision to invest taxpayer dollars into these companies required all stakeholders to make difficult sacrifices, and at this point, it would set a dangerous precedent, potentially raising enormous legal concerns, to say nothing of the substantial financial burden it would place on the companies, to intervene into a completed portion of a judicial bankruptcy proceeding on behalf of one particular group. Political intervention of this nature could also jeopardize taxpayer returns by making it far more difficult for the companies to access private capital markets if there is ongoing uncertainty about whether Congress will intervene to overturn judicially approved business decisions anytime that it disagrees with the judgments of the companies.

Ramifications of Automotive Industry Bankruptcies, Part II, *supra* note 10, at 6. H.R. 3170, *supra* note 10, at sec. 745.

restructuring; and (3) cultural changes (i.e., establishment of new boards of directors).[191] President Obama has stated that it is the responsibility of each company's board of directors and management team to deliver these results, but that the Treasury auto team, in its role as lender and investor, will closely monitor the loans and investments made in both companies on an ongoing basis and work to ensure that the companies are in compliance with commitments they have made.[192]

While President Obama's stated policy is for the government to dispose of its stakes in the automotive companies "as soon as practicable,"[193] as noted above, the Task Force and Treasury auto team have declined to provide a more specific timeframe, given their desires to avoid market disruptions and prevent the dilution or degradation of the value of Treasury's ownership stakes. Treasury "plans to be a responsible steward of taxpayer money," and will regularly assess both the public and private options to dispose of its investments.[194] The financial performances of the companies and their return to profitability will play a key role in Treasury's determination as to when to dispose of its ownership stakes. The Treasury auto team expects that the New GM will undertake an initial public offering (IPO) sometime in 2010 (within the next twelve months), and Treasury will then seek to gradually sell off its shares at an appropriate time thereafter.[195] On the other hand, the Treasury auto team's "most likely exit strategy" for New Chrysler involves either a private sale or a gradual sell-off of shares following an IPO.[196] Mr. Bloom has stated, however, that Treasury will likely begin disposing of its ownership stake in GM before it does so for its Chrysler stake, but the final decision to proceed with an IPO is left ultimately in the hands of each company's board of directors and will be heavily dependent on conditions in the general economy and public securities markets.[197]

When asked to identify the primary metric that the public and policymakers could use to assess the TARP investments in Chrysler and GM, Mr. Bloom noted that success is best measured by whether taxpayers see a return of their money.[198]

As discussed above, President Obama, the Task Force and the Treasury auto team have articulated at least several different objectives for the government's intervention in the automotive industry. These include preventing the liquidations of the automotive companies and

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[191] *Ron Bloom Prepared COP Testimony*, *supra* note 78.

[192] *Ramifications of Automotive Industry Bankruptcies Part II*, *supra* note 10, at 2.

[193] *White House GM Restructuring Fact Sheet*, *supra* note 85.

[194] *Ron Bloom COP Testimony*, *supra* note 36, at 3.

[195] *Ron Bloom COP Testimony*, *supra* note 36, at 3. For further discussion describing ways in which Treasury might divest its ownership stakes in New Chrysler and New GM, see Section G2, *infra*.

[196] *Ron Bloom COP Testimony*, *supra* note 36, at 3.

[197] *Ron Bloom COP Testimony*, *supra* note 36, at 3.

[198] *Ron Bloom COP Testimony*, *supra* note 36, at 56-57.

the impact these occurrences would likely have on the greater economy, achieving particular policy goals (such as preventing mass layoffs and fostering energy-efficient automobiles), and retaining the domestic automotive industry. Given that each of these objectives has been cited at various times, there is little clarity with respect to what has ultimately driven the decision-making behind these interventions.

2. The Intended Impact on the Industry and Economy

As discussed above, the Treasury auto team has focused on fulfilling President Obama's substantial commitment to stabilize the domestic automotive industry. This policy approach is intended to give Chrysler and General Motors a second chance, help these companies emerge stronger and more competitive in a changing automotive market, and end the practice of "kicking the can down the road"[199] by refusing to confront the tough problems and decisions facing the American automotive industry. As President Obama noted in his March 30, 2009 speech on the automotive industry, "we, as a nation, cannot afford to shirk responsibility any longer. Now is the time to confront our problems head-on and do what's necessary to solve them."[200] The Obama Administration has acted with the assumption that its actions would create a "new beginning for a great American industry" that would out-compete the world and be marked by important innovations in fuel efficiency and energy independence.[201] This commitment to assist the companies with the restructuring processes and procedures necessary to help them achieve long-term viability has been a central underlying component of every aspect of the Treasury auto team's decision-making.

With respect to the broader economy, the Treasury auto team has aimed to avoid the devastating impact that the collapse of these companies would have had on countless Americans and the greater economy beyond the automotive industry in times of severe recession and financial crisis. As part of this approach, the President and the Treasury auto team have acted to avoid the prospect of both Chrysler and General Motors entering liquidation, which, they argue, would have caused "substantial job loss with a ripple effect throughout our entire economy."[202] For example, as a result of both companies achieving a quick restructuring during recent months, Secretary Geithner has noted that the "economy avoided the devastation that would have accompanied their liquidation."[203] President Obama has essentially viewed the restructuring of

[199] *White House June 1 Remarks on GM Restructuring*, *supra* note 89.

[200] *March 30 Presidential Remarks*, *supra* note 91.

[201] *March 30 Presidential Remarks*, *supra* note 91.

[202] *Ron Bloom Senate Testimony*, *supra* note 170.

[203] U.S. Department of the Treasury, *Statement from Treasury Secretary Geithner on the Presidential Task Force on the Automotive Industry* (July 13, 2009) (online at www.treas.gov/press/releases/tg207.htm) (hereinafter "Treasury Statement on Automotive Task Force").

Chrysler and General Motors as key elements of the strengthening of American manufacturing and the stabilization of the national economy.[204]

Since both Chrysler and GM came to the federal government "in a state of complete insolvency, facing almost certain liquidation" without further government assistance,[205] the Treasury auto team's actions and decision-making need to be considered and evaluated in the context of existing bankruptcy precedent, process and procedures.

E. Bankruptcy Law Aspects of the Automotive Company Rescues

This section provides a brief introduction to business reorganization in bankruptcy and summarizes the Chrysler and GM bankruptcy proceedings.

These reorganizations have triggered substantial debate in academic circles. As with previous reports, the Panel has engaged the assistance of prominent professors to discuss the technical and legal aspects of this debate in more detail. Papers by Professor Stephen Lubben of Seton Hall University School of Law[206] and Professor Barry Adler of NYU School of Law[207] appear as Annexes A and B to this report, and the report has also benefitted from the scholarship of Professor Mark Roe[208] of Harvard Law School and Professor David Skeel[209] of the University of Pennsylvania Law School. Their positions are discussed in Section G of this report.

1. The Options Available to Insolvent Businesses

Until the 1930s, bankruptcy generally meant the liquidation of a firm's assets for the benefit of its creditors. The stock market crash of 1929 caused widespread liquidations and spurred efforts to reform the bankruptcy laws. Forced liquidations and foreclosures were harmful to both creditors and debtors. Debtors were not given an opportunity to pay their debts, the going-concern value of the business was destroyed, and employees lost their jobs. During this time, creditors recovered only a fraction of the amount they were owed. From 1933-1934, the laws were changed so that corporations could obtain bankruptcy court protection and modify

[204] *White House June 1 Remarks on GM Restructuring*, *supra* note 89.

[205] *Ron Bloom COP Testimony*, supra note 36 at 23-24.

[206] Professor Stephen Lubben is the Daniel J. Moore Professor of Law at Seton Hall. He specializes in corporate finance, particularly issues concerning corporate debt and financial distress.

[207] Professor Barry E. Adler is the Bernard Petrie Professor of Law and Business and Associate Dean for Information Systems and Technology at New York University School of Law. His areas of research include bankruptcy, contracts, corporate finance, and corporations.

[208] Professor Mark J. Roe is the David Berg Professor of Law at Harvard Law School. His scholarship includes issues in corporate law, corporate finance and corporate bankruptcy and reorganization.

[209] Professor David A. Skeel is the Samuel Arsht Professor of Corporate Law at the University of Pennsylvania Law School. His areas of expertise are bankruptcy and corporate labor law.

their debts.[210] Although the reform was designed to address the market crisis during the Great Depression, it remained in place after the Depression was over and became the precursor for business reorganization under Chapter 11 today.[211]

a. Liquidation

In some countries, the only option when a business is unable to meet its obligations is to dissolve the business, liquidate its assets and distribute the proceeds of that liquidation to the business's creditors. The Code attempts to preserve economic value by permitting a viable business to attempt to reorganize and operate as a going concern. If that is not possible, the Code allows the estate to sell the business as a going concern, to break it up into viable parts, or to create an orderly liquidation. Some businesses that attempt to reorganize under Chapter 11 ultimately fail. Some businesses that are in serious enough trouble do not even attempt Chapter 11 reorganization, and instead liquidate in Chapter 7 under the supervision of a court-appointed trustee.[212] Others will wind up their business operations without any bankruptcy proceeding, simply disappearing from the economy.

b. "Traditional" Chapter 11 Reorganization

Chapter 11 permits a troubled company to continue its business as a going concern while it restructures its debts. The purpose of Chapter 11 is to preserve economic value, minimizing the impact of a business's failure on both its creditors and those who depend on the business, such as the employees and suppliers. Considering the intangible value of the business, such as business relationships, name recognition, and synergy created by the productive use of resources, there may be more value in a business as a going concern than in liquidation. This value is destroyed in liquidation, and the price the business's assets would realize in liquidation is often very low compared to the value they would have as a part of a productive whole. Liquidation value for a troubled business is generally less than the total amount of the business's outstanding debt. Creditors may receive more value from reorganization than from liquidation. Additionally, parties other than creditors, such as employees, gain more from the business' continuance. Consequently, when a business has any chance of continuing as a going concern,

[210] For a discussion of the history of bankruptcy legislation in the United States, see David A. Skeel, *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton University Press 2003).

[211] 11 U.S.C. 101 et. seq. (2009). For an explanation of the basic bankruptcy concepts referenced in this report, please see David G. Epstein & Steve H. Nickles, *Principles of Bankruptcy Law* (Thomson/West 2007).

[212] Chapter 7 of the Code addresses the liquidation of a business. 11 U.S.C. §§ 701-784 (2009). In cases where efforts to reorganize under Chapter 11 fail, such cases may be converted into Chapter 7 liquidation cases. Although liquidation of the debtor is primarily the function of Chapter 7, liquidation may also occur under other chapters. For instance, a Chapter 11 plan could provide for the partial or complete liquidation of a business.

public policy[213] and the best interests of the creditors[214] dictate that it should be given a chance to recover while being protected from its creditors' actions to collect.

In Chapter 11 reorganization, the business's debts are restructured. Each creditor is entitled to receive the present value of the amount that creditor would have received in liquidation. The bankruptcy court is required to protect the best interest of each individual creditor during reorganization. This requirement is known as the "best interest" test. The consideration the creditors receive under this standard may be paid over time with interest from the time that the plan of reorganization is confirmed. Any debt that exceeds the amount the creditor is entitled to in liquidation may be discharged in bankruptcy. In fact, however, many Chapter 11 plans offer to pay the creditors more than they are specifically entitled to, in part to attract the support of the creditors as they vote, by class, for or against the plan of reorganization, as described in more detail below.

In addition to (or in substitution for) repayment of debt, creditors may also be issued shares of stock or other ownership interests in the reorganized debtor to satisfy their claims. As a consequence, the capital structure of the pre-bankruptcy business may look very different after undergoing restructuring under Chapter 11.

In a traditional corporate reorganization, the restructuring process begins when the debtor files a bankruptcy petition[215] with the bankruptcy court. The petition asks for bankruptcy relief, and includes detailed schedules of the business' income, assets, and liabilities. Upon filing the petition, all the business' legal and equitable interests in any property are transferred to a new entity, which is known as the bankruptcy estate.[216] All the assets of the newly created bankruptcy estate instantly come under the full protection of the Code.[217] Most importantly, the rights of creditors, and the order of priority by which they will be paid, are locked into place.

Also at the time of filing, bankruptcy law imposes an automatic stay against all attempts by creditors to collect from the debtor. This allows the debtor to continue its ordinary business operations and the Chapter 11 reorganization to proceed in an orderly manner. The Code sets out rules for a collective system to coordinate the actions of the various creditors. In doing so,

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[213] Considering that keeping a business in operation is often much more desirable than liquidating it, the fundamental premise of Chapter 11 of the Code is that reorganization is desirable. Mark S. Scarberry, Kenneth N. Klee, Grant W. Newton & Steve H. Nickles, *Business Reorganization in Bankruptcy* (2006).

[214] Upon filing the bankruptcy petition, the Code requires the business to be run for the benefit of the creditors. The shareholders will recover their investment only in the unlikely event that all the valid claims of all creditors are paid in full and value remains in the business.

[215] In theory, creditors could file an involuntary petition to force a business into bankruptcy, but this is extremely rare. 11 U.S.C. § 303.

[216] 11 U.S.C. § 541.

[217] 11 U.S.C. § 362(a).

the Code permits the overall value of the business to be maximized by lowering both the business's losses and the costs of addressing the creditors' collection actions.

At the moment of the bankruptcy filing, creditors' claims against the debtor become claims against the bankruptcy estate. Claims against the estate are entitled to different levels of statutory priority, with some claims having seniority over others.[218] The order of priority is significant because priority determines the order in which claims against the bankruptcy estate will be satisfied. Shareholder interests, following behind secured and unsecured claims, have the lowest level of priority in a bankruptcy estate. Under the absolute priority rule,[219] shareholders are often wiped out and receive nothing in a Chapter 11 reorganization or a Chapter 7 liquidation.

The Code treats secured and unsecured creditors very differently. Secured creditors – those whose debts are secured by collateral in advance of the bankruptcy – hold a secured claim. The value of the secured claim is limited by the value of the collateral. If the secured claim is less than or equal to the value of the collateral that relates to that debt, the claim is fully secured and the secured creditor will recover its money entirely. If, however, the debt is greater than the value of the collateral, the creditor will receive the value of the collateral, and the balance of the debt becomes a general unsecured claim to be paid pro rata way with the other general unsecured claims against the debtor.

Generally, the business does not have enough value to pay unsecured claims in full. Instead, unsecured creditors often receive a pro rata distribution on account of their claims. However, not all unsecured creditors are treated exactly the same. Some unsecured claims, such as certain taxes and unpaid employee wages,[220] will be paid ahead of the general class of unsecured creditors.

The general unsecured creditors form a creditors' committee. The creditors' committee monitors the activities of the individual or entity managing the debtor's business, which may be a trustee, but is more likely to be the debtor-in-possession (DIP). When a business files for bankruptcy, the management team automatically becomes the management of the DIP, and continues to run the business. Old management, however, may not remain in place for long. Studies show that management is frequently replaced just before or after filing.[221] A party that

[218] The seniority of claims may also be determined by contractual agreement between creditors, when, for example, two creditors agree that one will subordinate its claim to the other.

[219] The absolute priority rule, simply stated, refers to the requirement that unless a dissenting class of creditors receives or retains property of a value equal to the allowed amount of its claims, no creditor of lesser priority, or shareholder, may receive any distribution under the plan. 11 U.S.C. §1129(b)(1).

[220] 11 U.S.C. § 507.

[221] Elizabeth Warren, *Chapter 11: Reorganizing American Business*, 61 (Aspen Publishers 2008).

is willing to provide financing after the business files bankruptcy will often have a substantial say in many aspects of the business, including appointing new management.[222]

After the petition is filed, any new monies coming into the bankruptcy estate are not bound by the rules constraining the assets of the pre-bankruptcy debtor. There are two basic reasons for the disparate treatment of incoming funds of the pre-bankruptcy and the post-bankruptcy debtor: (1) to attract new investment into the business (investors are unlikely to invest if they believe their funds would only be used to pay off old debt); and (2) to permit the business to find funding for a new business plan.

While undergoing Chapter 11 reorganization, the DIP must continue to operate the business as a going concern and protect it from disruptive interference. To do so, the DIP may use cash generated by the business and it may also seek DIP financing, new financing that is generally secured by assets of the post-bankruptcy debtor. Considering the risk that a business already in bankruptcy may eventually fail, it is often difficult, if not impossible, to find a lender willing to provide substantial post-petition financing to a distressed company on an unsecured basis. To encourage lenders to provide DIP financing, the Code provides that post-petition loans will be given seniority and preferential treatment over other claims.[223]

Unlike the prepetition creditors who have already invested in the business, the post-petition lenders bring fresh capital to the struggling enterprise. Because no post-petition lender is required to lend to the business and because dealing with bankrupt businesses is often regarded as quite risky, the leverage of the DIP lender is extremely high.[224] Some refer to DIP lenders as following the Golden Rule: Those with the gold make the rules.[225] There are no statutory limits on the conditions that DIP lenders may impose on the business. Instead, DIP lending can be undertaken only if the other creditors are given an opportunity to object and the court, after hearing those objections, approves of the financing and the terms on which the financing is

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[222] *Id.*

[223] 11 U.S.C. § 364(a) - (b). For example, DIP financing is often considered an administrative expense, which is entitled to payment in full in cash under 11 U.S.C. § 1129(a)(9)(A) on the effective date of a Chapter 11 plan of reorganization unless agreed otherwise.

[224] Sarah Woo, an SJD candidate at Stanford Law School, writes, "A concern often raised in relation to the U.S. bankruptcy regime is the high level of control over proceedings enjoyed by secured lenders. In particular, through the use of the arsenal of provisions in debtor-in-possession (DIP) financing, secured lenders can quickly effectuate asset sales. While this strategy minimizes the time taken to realize cash recoveries for the secured lenders, it may not maximize the value of the estate for all creditors." Sarah P. Woo, *Debtor-in-Possession Financing: Looking Beyond the Debtor* (Aug. 1, 2009) (abstract available online at papers.ssrn.com/sol3/papers.cfm?abstract_id=1442854).

[225] A liquid market for DIP loans would temper the DIP lender's leverage in the reorganization process by providing the debtor with alternative offers for DIP financing. While this may be the case in more traditional reorganizations, at the time Chrysler and GM filed bankruptcy the capital markets were experiencing a credit freeze and the amount of money needed to reorganize the auto companies was very large. This allowed any DIP financer that stepped forward more leverage than it may have had under ordinary circumstances.

proposed. If the court approves the terms of a DIP loan, then the loan, with all its contractual conditions, binds the bankruptcy estate.

Because of its leverage, a DIP lender may have the power to decide which contracts – with suppliers, vendors, dealers, etc. – it wishes the estate to assume and which contracts it wishes the estate to reject.[226] This is particularly true where the DIP lender is also the expected buyer at the 363 sale. The DIP also has the power to shape the proposed plan of reorganization and to condition its funding on the court's approval of such plan or another plan the DIP endorses.

The Code sets out the process by which creditors vote on Chapter 11 plans, and it provides some protection to dissenting creditors. Plans deal with creditors by classes.[227] Each unsecured creditor is placed into a class with other creditors that have legally-similar claims. As discussed above, claims are treated differently depending on statutory and contractual priority. Within each class, all creditors must receive the same treatment. The creditors vote on the plan by class. A class is deemed to have accepted a plan if creditors constituting a majority of the claims in the class by number and representing at least two-thirds of the dollar amount of debt owed to that class vote in favor of the plan.[228] Because of the need to have each class vote in favor of a plan, the allocation of creditors into classes can become the subject of extensive debate.[229] Within a class, dissenting creditors are bound by the majority vote of their class. Under certain circumstances, a class of dissenting creditors may nonetheless be required to accept confirmation of the proposed plan.[230]

If all classes of creditors have consented to the plan, the bankruptcy court inquires into the feasibility of the plan and whether the plan is proposed in good faith, and then typically confirms the plan. Section 1129 of the Code provides that the court may confirm the plan only if it meets with the many procedural requirements and safeguards of the Code, including, among many other things, adherence to the priority of classes of creditors.[231]

The absolute priority rule, the best interests test and the opportunity to vote constitute the major protections for creditors in a Chapter 11. These protections, however, are tempered by the impact of majority vote that binds dissenters and the sharp distinction between prepetition creditors and post-petition DIP financers.

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[226] If repudiation or cancellation of the contract results in a breach of contract, claims for that breach become unsecured debt of the estate. 11 U.S.C. § 365(g)(1). Debts of the estate, as contrasted with debts of the prepetition debtor, must be paid in full ahead of other unsecured claims.

[227] 11 U.S.C. § 1122.

[228] 11 U.S.C. §1126(c).

[229] See *infra* Section (G)(4) of this report.

[230] 11 U.S.C. § 1129(b).

[231] 11 U.S.C. § 1129(a)(1).

c. Sales under Section 363

As part of the reorganization effort, a debtor may propose to sell some or all of its assets during the course of the Chapter 11. This sale, conducted under Section 363(b) of the Code and known as a "363 sale," authorizes a DIP to sell property of the estate[232] outside the ordinary course of business.[233] The proceeds from a 363 sale may be used to fund the continuing operation of the debtor or to raise capital to pay creditors as part of a plan of reorganization. The use of 363 sales has evolved in recent years. Today, 363 sales often dominate the resolution of a Chapter 11 case by selling all or substantially all of the assets of the business and leaving only the remainder of the assets for distribution in the Chapter 11 plan.

In bankruptcy, the sale of assets under Section 363 offers substantial advantages over the sale of assets under state law. Under Section 363, the assets are sold "free and clear" of all liens if the sale satisfies one of the section's enumerated conditions.[234] This means a buyer gets clear title to the assets, whereas under state law, creditors' claims may cloud the title of the sold assets. Creditors' claims to assets sold by failing businesses are particularly worrisome to buyers, thus making bankruptcy protection and 363 sales particularly valuable tools. 363 sales permit the estate to transfer assets for their best and maximizing use, for the ultimate benefit of the creditors.

A 363 sale can be held in a relatively short time. Because the sale separates any disputes over the distribution of assets (arguments among creditors) from the process of realizing the maximum value of the estate (sale of the assets), the 363 sale often maximizes the total value of the assets. Once a business has filed for bankruptcy protection, both debtors and creditors often prefer the speed of 363 sales to the potentially long and drawn out traditional Chapter 11 plan confirmation process. Thus, 363 sales have been frequently used to resolve large bankruptcies since the mid 1990s.[235]

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[232] 11 U.S.C. § 1107(a).

[233] 11 U.S.C. § 363.

[234] 11 U.S.C. § 363(f). ("The trustee may sell property… free and clear of any interest in such property of an entity other than the estate, only if (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest; (2) such entity consents; (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property; (4) such interest is in bona fide dispute; or (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.")

[235] Stephen J. Lubben, *No Big Deal: The Chrysler and GM Cases in Context,* (Sept. 1, 2009) (hereinafter "No Big Deal: The Chrysler and GM Cases in Context") ("[I]n the past ten to fifteen years, secured lenders have used [Section 363], plus the control inherent in being a secured lender – particularly control over the debtor's cash, to take charge of chapter 11 cases…The lenders are willing to fund a quick sale because Section 363 provides a better mechanism for selling assets than state foreclosure law...The basic structure used to reorganize both GM and Chrysler was not unprecedented. Indeed, it was entirely ordinary…The notion that the speed of the sale was unique, or that the use of Section 363 to effectuate a quick sale was novel, is therefore without merit.").

Section 363 does not limit the type or amount of the assets that may be sold. The courts, however, have developed rules against *sub rosa* plans, that is, reorganization plans disguised as sales. These courts reason that such uses of 363 would undermine the Chapter 11 rules.[236]

In 363 sales, designated assets of the debtor are sold to a purchaser. That sale is subject to approval by the bankruptcy court, which examines whether the sale is a *sub rosa* reorganization plan.[237] If the court grants approval, the sale will be executed and the purchaser will typically receive the assets free and clear of any liens.

Once the purchaser pays the purchase price, typically either in cash or in the form of a credit bid,[238] the purchase price becomes part of the bankruptcy estate to be distributed to creditors in accordance with the Code's priority rules. Thus, a 363 sale comprises two parts: (1) a sale of assets to a new company, and (2) a distribution of the purchase price to the creditors of the old debtor.

Some media reports have conflated these two stages, causing confusion regarding the distribution rights under Chapter 11 by referring to an "exchange" of assets. In the case of GM, as a matter of law, there was no "exchange" of equity in New GM for claims against Old GM. Rather, there was a 363 sale of the assets of Old GM (the bankruptcy automotive company) that were purchased by New GM (the company formed to buy the assets and financed by the Treasury). As a part of this transaction, New GM also assumed certain liabilities of Old GM. The assets purchased and liabilities assumed from Old GM were used to form New GM, an entirely new entity that is legally unrelated to Old GM.

In the case of Chrysler, the 363 sale was structured in a similar manner and had substantially similar effects. The bankruptcy court in its Chrysler opinion noted,

> [T]he UAW, VEBA, and Treasury are not receiving distributions on account of their prepetition claims [against Old Chrysler]. Rather, consideration to these

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[236] Section 363 has been used to accomplish a sale of all or a substantial part of the debtor's assets in a single transaction. Such sales can effectively reorganize the debtor without complying with the normal process of preparing a disclosure statement and giving creditors the opportunity to vote on the plan. However, the courts generally permit such sales if there is a sound business purpose for the transaction, unless aspects of the sale restructure the priority and other rights of creditors. *Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063 (2d Cir. 1983); *Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 700 F.2d 935 (5th Cir. 1983).

[237] A sale is considered a *sub rosa* plan if it is essentially a de facto plan that disposes of assets and pays creditors without a formal disclosure statement, written plan, or a meaningful opportunity for creditors to participate in the negotiation and voting processes. *See* Section (H)(4) of this report, discussing factors courts use to determine whether a 363 sale is in fact a *sub rosa* plan.

[238] Credit bidding is a mechanism used in bankruptcy by which a creditor with a valid security interest in the assets being sold may bid for such assets by proposing to offset its claim against the purchase price of the assets. The ability to credit bid gives the lien holder protection against an attempt to sell its collateral too cheaply. 11 U.S.C. § 363(k).

entities is being provided under separately-negotiated agreements with New Chrysler.[239]

The aggregate result of reorganizations involving 363 sales may well be that an unsecured creditor of the bankrupt debtor becomes a large shareholder of the entity purchasing the assets in the sale.[240] This undoubtedly has major policy implications, to be discussed in further detail below.[241] However, understanding that these transactions are two separate commercial transactions and that legally there is no exchange of old claims for interests in the purchasing company is crucial to understanding the policy debate that ensues.

Proceeds resulting from a 363 sale are distributed to creditors of the bankruptcy estate in strict accordance with the Code's priority laws. By contrast, the purchaser of the assets may deal with those assets in any way it chooses. Typically, the purchaser of a bankrupt business's assets – whether structured under Section 363 or under a confirmed plan of reorganization – allocates its resources in a manner it believes will make its business profitable. If, for example, the purchaser needs to continue ordering from the bankrupt business' trade creditors, then the prepetition trade creditors may be paid in full by the purchaser, even though the trade creditors' pro rata distribution in the debtor's Chapter 11 is very small. Similarly, if the purchaser needs to retain the debtor's employees, the purchaser may negotiate a deal that gives the employees substantial interests in the new businesses, in excess of what the employees may have recovered under the debtor's Chapter 11 distribution.

Neither bankruptcy laws nor the courts are empowered to control the manner in which assets purchased in a 363 sale are subsequently used by the purchaser in its business. To the extent employees, suppliers, and others with relationships that have carried over from the debtor to the purchaser received more favorable treatment than those whose relationships terminated with the bankruptcy estate, this perceived disparity has a clear business reason; i.e., the purchaser needs to maintain these relationships to make its business viable.[242]

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[239] *In re Chrysler LLC, et al.*, 405 B.R. 84, 99 (Bankr. S.D.N.Y. 2009).

[240] Professors Roe and Skeel question whether Chrysler was in fact sold or whether the transaction constituted sub rosa plans of reorganization. In particular, they argue that because many of Old Chrysler's creditors are now creditors of New Chrysler, Chrysler's 363 sale is more accurately portrayed as a reorganization. Mark J. Roe & David A. Skeel, *Assessing the Chrysler Bankruptcy*, 21-24 (Aug. 12, 2009) (online at ssrn.com/abstract=1426530) (hereinafter "Assessing the Chrysler Bankruptcy"). The bankruptcy court and Second Circuit Court of Appeals specifically found that the 363 sale was not a *sub rosa* plan. Discussed in more detail in Section (G)(4) of this report below.

[241] See Section (G)(4) of this report.

[242] With respect to the Chrysler bankrtupcy, Professors Roe and Skeel question whether the decision to pay Old Chrysler's debts with the assets of New Chrysler was made after the conclusion of the 363 sale or whether such payment was a de facto condtion to the conclusion of 363 sale. They argue that while the former situation is justifiable, the latter may violate the principles underlying the Code. *Assessing the Chrysler Bankrtupcy*, supra note 240 at 21-24. This argument is discussed in more detail in Section (G)(4) of this report below.

2. How the Chrysler and GM Reorganizations Compare With Other Large Reorganizations

The Chrysler and GM reorganizations involve huge companies.[243] When such massive entities are involved, there inevitably will be a number of issues that must be handled on a case-by-case basis. Because there is no one-size-fits-all bankruptcy for multi-billion dollar companies, it is difficult to categorize the Chrysler and GM bankruptcies as being either typical or atypical.

A few aspects of the Chrysler and GM bankruptcies distinguish them from comparable restructurings. First, the involvement of the U.S. government was unique. While legally irrelevant because the law is applied to the government in the same way it is applied to a private party, the government's involvement invites higher scrutiny and closer analysis to ensure that it is treated no better–and no worse–than an ordinary investor. As the automotive companies' condition deteriorated, the government provided both pre- and post-petition financing. On account of the government's prepetition claim, it had the rights of a prepetition creditor entitled only to distributions from the bankruptcy estate in accordance with priority rules under Chapter 11. On account of its post-petition claim, the government had the power and leverage as a DIP financer, as previously discussed, [244] and its claims were given such preferential treatment. [245] Because Treasury played an important role in negotiating the restructuring of the automotive companies,[246] it appears to have exercised some of its bargaining power as a DIP lender. Second, the automotive bankruptcies proceeded with greater speed than was expected. Creditors nearly always push for speed in Chapter 11 reorganization. In fact, debtors will often file pre-packaged bankruptcies[247] in order to shorten the traditional process of confirming a reorganization plan. The expediency of the Chrysler and GM 363 sales may be attributed to the

[243] GM was ranked ninth in Fortune Magazine's Global 500 in 2007, with annual revenues topping $182 billion and more than 250,000 employees. *Global 500: Nine – General Motors*, Fortune (accessed Sept. 2, 2009) (online at money.cnn.com/magazines/fortune/global500/2008/snapshots/175.html). At the end of 2007, Fortune magazine listed Chrysler as the fourth largest private company in the U.S. with $49 billion in annual revenue and 72,000 employees. *The 35 Largest U.S. Private Companies*, Fortune (accessed Sept. 2, 2009) (online at money.cnn.com/galleries/2008/fortune/0805/gallery.private_companies.fortune/4.html).

[244] See Section (E)(1)(b) of this report.

[245] *Id*.

[246] Documents that Treasury provided to the Panel showed that Task Force members were involved in a variety of decisions with respect to the planning of the bankruptcy process, the structure of the asset sales, and the formation of the New Chrysler and New GM entities.

[247] A pre-packaged bankruptcy (pre-pack) is a plan for reorganization prepared in advance in cooperation with creditors that will be filed soon after the petition for relief under Chapter 11. Debtors do this to shorten and simplify the bankruptcy process and save the company money for professional fees and other costs associated with bankruptcy. The sooner the restructuring under Chapter 11 is completed, the sooner the company can return focus to its core operations. Some of these pre-pack reorganizations are extremely large, but can nevertheless be accomplished in less than two months.

care with which the bankruptcy package was assembled, leaving little need for additional procedures and negotiation. Nevertheless, Professors Roe and Skeel comment:

> The Chrysler chapter 11 proceeding went blindingly fast. One of the larger American industrial companies entered chapter 11 and exited 42 days later. Clearly speed was achieved because of the governments' cash infusion of $15 billion on noncommercial terms into a company whose assets were valued at only $2 billion. As a matter of bankruptcy technique, the rapidity of the Chrysler chapter 11 was a tour de force.[248]

While the speed was noteworthy, it was not unprecedented. The use of prepacks grew with astonishing speed among large companies in the early 1990s, with bankruptcies wrapped up in a matter of weeks. In 1993 about 21 percent of the bankruptcies of publicly traded companies were prepacks, with 1994 not far behind at 17 percent.[249] The numbers have leveled off since then, now down to an estimated 4 percent of all filings.[250]

To date, however, neither the GM nor Chrysler bankruptcy cases have closed. Both debtors, Old GM and Old Chrysler, remain to be wound up, and the proceeds of the 363 sales and any remaining assets will be distributed to each company's remaining creditors. In any statistical analysis of Chapter 11 cases, both bankruptcies would be listed in the "pending" category, with the days in bankruptcy continuing to mount. Professors Roe and Skeel use the term "exit" to loosely refer to the 363 sale, which arguably constitutes the key transaction of the reorganization and the bulk of the restructuring process for these two businesses. Some have argued that the use of Section 363 of the Code makes these bankruptcies unusual. Nevertheless, as discussed above, sales for substantially all a debtor's assets are an increasingly popular use of this Section 363.[251] The significance of the use of Section 363 of the Code is a subject of debate, even among bankruptcy scholars, as discussed in greater detail below.[252]

3. The Choices Available to Creditors of an Insolvent Business

Creditors of a troubled business must make decisions at several points during the company's decline. When the business first runs into trouble, there are usually negotiations between the debtor and individual creditors. As conditions deteriorate, creditors may join forces or the debtor may bring them together. At some point, the focus of creditors shifts, from trying to make sure that their debt is repaid in full or in part, to calculating what they would get if the

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[248] *Assessing the Chrysler Bankruptcy*, *supra* note 240 at 1.

[249] 2004 Bankruptcy Yearbook 162.

[250] Elizabeth Warren & Jay Lawrence Westbrook, Law of Debtors and Creditors (2009).

[251] *Id.* at 8.

[252] See Section (G)(4) of this report.

debtor filed for bankruptcy, and then to establishing what particular type of bankruptcy arrangements would best suit the creditor.

Because the purpose of Chapter 11 protection is to try to preserve economic value, it seems logical that most creditors would prefer that the debtor try to reorganize and operate as a going concern, rather than proceeding to liquidation. Other factors may be at work. For example, some years ago Professor Henry Hu noted unusual behavior patterns on the part of some creditors in bankruptcy proceedings.[253] Those creditors seemed to favor liquidation, in which they would receive less money, over reorganization. Professor Hu and others have theorized that these creditors may have entered into credit default swaps, in essence buying insurance against the debtor's failure, and thus causing them to favor liquidation and distort more typical creditor expectations.[254] Credit default swaps do not appear to have played a significant role in the automotive company reorganizations, but they serve as a reminder that the interests of particular creditors can be far more complex than those assumed by any simple model.

As discussed above, in bankruptcy, secured creditors look to their collateral, and unsecured creditors are organized into groups of similarly situated creditors, who vote by class with respect to proposed plans of reorganization. When substantially all the debtor's assets are sold in a 363 sale, creditors may object to the sale and the court will hold a hearing before ruling on whether the sale may go through. There is no creditor vote in a 363 sale, although the courts carefully weigh the objections and the support of the creditors in deciding whether to approve a sale. Following the sale, the remainder of the Chapter 11 case involves the allocation of the proceeds of sale to the creditors.

Many creditors supported–or failed to object–to the proposed 363 sales in both Chrysler and GM. There has been some discussion as to whether certain creditors, especially the secured creditors in Chrysler who were recipients of TARP funds, may have felt obligated to acquiesce in the government's restructuring plans, either tacitly or owing to direct government pressure. Because creditors are not given the right to vote on sales,[255] any such acquiescence would be in the form of refraining from challenging the sales, and it is difficult to attribute motive to inaction. The Treasury auto team has denied applying any such pressure.[256] In other contexts, many

[253] Henry T. C. Hu, *Abolition of the Corporate Duty to Creditors*, 107 Colum. L. Rev. 1321, 1402 (2007). Hu's article introduces the concept of the "empty creditors," who reduce or eliminate their economic exposure through coupled assets such as credit derivatives and thus behave differently from more traditional creditors). See also Stephen J. Lubben, *Credit Derivatives & The Future of Chapter 11,* 81 Am. Bankr. L.J. 405 (2007) who notes "[t]he operation of chapter 11 is premised on a perception of ownership that may no longer exist or is at the very least threatened by the expansion of credit derivatives."

[254] *Special Comment: Analyzing the Potential Impact of Credit Default Swaps in Workout Situations*, Moody's Global Banking (June 2009) (online at www.moodys.com).

[255] There was, however, an informal vote of the unsecured creditors in GM. GM Press Release, *GM Announcement on Bondholder Support* (May 31, 2009) (online at media.gm.com/servlet/GatewayServlet?target=image.emerald.gm.com/gmnews/viewmonthlyreleasedetail.do?domain=74&docid=54613).

[256] *Ron Bloom COP Testimony*, *supra* note 36.

TARP recipients have been quite vocal in their criticism of government actions that they disapprove of, suggesting that if they objected to the 363 sales, they would have made their views known.[257] It is possible that the creditors did not object because they believed it was in their own economic best interests. They may have believed that the 363 sales would give them the best deal possible, and that the likely alternative would be a liquidation of the companies that would result in far smaller payouts.

Academics have argued that the bidding process in both the Chrysler and GM bankruptcies was flawed because the court approved of a bidding structure that required that any bidder must assume certain designated liabilities of the debtors.[258] They argue that this may have prevented a true valuation of both companies, thereby obscuring the amount of potential return for the creditors in the event of liquidation.[259] These arguments are more thoroughly discussed in Section E4 below.

4. The Impact of these Transactions on the Financial Markets

Some would view the Chrysler reorganization as a government intervention that resulted in the transfer of value from one group to another based on political considerations. Or, to borrow the description of one participant, the assets of retired Indiana policemen were given to retired Michigan autoworkers.[260] They argue that not only is Chrysler a bad result, but that the Code was undermined in terms of the treatment of secured creditors under bankruptcy, and, as a result, the case could have adverse effects on the capital markets.[261] Similarly, financial experts such as Warren Buffett have stated that the federal government's actions in the bankruptcies can have "a whole lot of consequences" for deal making.[262] According to Buffett, if priorities are tossed aside, "that's going to disrupt lending practices in the future. If we want to encourage

[257] For instance, New York Times notes Jamie Dimon is "quick to criticize the administration." *In Washington, One Bank's Chief Still Holds Sway*, New York Times (July 20, 2009) (online at dealbook.blogs.nytimes.com/2009/07/20/in-washington-one-bank-chief-still-holds-sway/#more-90287).

[258] See generally Barry E. Adler, *What's Good For General Motors* (Sept. 1, 2009) (hereinafter "What's Good for General Motors"); *Assessing the Chrysler Bankruptcy*, *supra* note 240.

[259] An illustration of how the bidding process may have obscured the underlying mechanics of the transaction is as follows. If a bidder determines that the gross assets of Company X have a fair market value of $100, the bidder may reasonably enter a bid of up to $100 for the assets, representing $100 fair market value of the assets, with no assumed liabilities. If the bidding process, however, requires the bidder to assume $20 of the liabilities of the seller, the bidder may reasonably enter a bid of up to $80 for the assets, that is, $100 fair market value of the assets, less $20 of assumed liabilities. In the latter case the seller has $80 to distribute to its creditors, while in the former it would have $100. If the $20 liability was owed to a junior creditor, it would be possible that a creditor of the seller may not recover its full claim, assuming the $80 would be insufficient, even though the $20 owed to the junior creditor was paid in full.

[260] Congressional Oversight Panel, Testimony of Indiana State Treasurer the Honorable Richard E. Mourdock, *Financial Assistance Given to the Domestic Automobile Industry Via Treasury's Automotive Industry Financing Program* (July 27, 2009) (online at cop.senate.gov/documents/testimony-072709-mourdock.pdf).

[261] *What's Good For General Motors*, *supra* note 258.

[262] *Assessing the Chrysler Bankruptcy, supra* note 240.

lending in this country, we don't want to say to somebody who lends and gets a secured position that the secured positioning doesn't mean anything."[263]

The Panel's mandate includes looking at the impact of Treasury decisions on the financial markets, and thus the staff of the Panel consulted with academics and market participants to determine whether predictions that the Chrysler decision would result in changes in market behavior or the cost of capital that were (1) accurate and (2) measurable. The worry is that if the markets perceive that government intervention might, in some cases, interfere with the absolute priority rule of bankruptcy, investors will demand a higher return on their capital to compensate for the added uncertainty. The consequence would be higher borrowing costs for business and a corresponding decline in capital investment for businesses facing a possible bankruptcy. On the other hand, the infusion of cash into a business that otherwise seemed destined for liquidation may make government involvement more attractive for investors and may reduce the capital in otherwise high-risk transactions. Unfortunately, apart from academic opinion, there is little evidence, empirical or anecdotal, to prove or disprove the claim that the Chrysler bankruptcy had any effect on the market.

Academics and practitioners with whom the Panel's staff have spoken seem to believe that it is both too early and, given the number of variables, perhaps not possible to conclude one way or another as to what effect the government's involvement in the Chrysler bankruptcy will have on credit markets going forward. Given the currently impaired state of the credit markets generally, they argue, it would be difficult to attribute any anomalies to the outcome of a specific bankruptcy transaction. On the other hand, Treasury's involvement in the Chrysler bankruptcy, as well as the General Motors bankruptcy, where the Chrysler approach was mirrored, is likely to cause investors to reevaluate their risk assessment regarding certain companies with similar characteristics. Large, industrial, heavily unionized companies, especially those with significant liabilities in the form of pension or healthcare obligations, might be considered to be of special interest to the government. The cost of capital going forward for companies with similar characteristics might go up or down depending on how future creditors view the outcome of the Chrysler bankruptcy – whether government intervention left creditors with more, the same, or less than they would have received without such intervention.[264]

F. Following the Money

1. What has TARP Spent so Far and What Can Taxpayers Expect to get Back?

Earlier in this report the Panel describes the financial transactions and the outcomes of the bankruptcy proceedings for Chrysler and GM including all "parties in interest" – the United

[263] *Assessing the Chrysler Bankruptcy*, *supra* note 240.

[264] Assessments of how government action will affect the outcome of a particular investment are often described as political risk assessments. Generally, political risk refers to the kinds of issues that political decisions in government create for business planners.

States and Canadian governments, the UAW, the UAW Trust, equity holders, and creditors. This section focuses solely on the financial stake of U.S. taxpayers. As shown in Figure 3 below, U.S. taxpayers have expended $49.9 billion of TARP funds in conjunction with GM's bankruptcy and the subsequent creation of New GM. The Chrysler transactions have expended $14.3 billion of TARP funding, of which $10.5 billion remains outstanding. These stakes were originally in the form of debt, although now Treasury holds both debt and equity in both companies. Assistance to automotive suppliers and investments in GMAC, a financial institution substantially dedicated to automotive lending, account for another $16.9 billion of TARP resources, bringing TARP net support for the U.S. domestic automotive industry to slightly over $81 billion as of September 9, 2009. Total TARP funding commitments to the automotive industry reached an estimated $85 billion at one point, but that figure has been reduced by decreased usage for the auto supplier program, repayments of warranty program loans and the full repayment of the $1.5 billion loan to Chrysler Financial. As shown in the following table, of the federal government's $81 billion exposure to the automotive industry, $76.9 billion had actually been disbursed as of Aug. 5, 2008.

Figure 3: TARP Automotive Program Current Funds Outstanding (as of August 5, 2009)

	Cumulative Obligations[265]	**Amounts Advanced**
Chrysler	$14,312,130,642	$10,470,000,000
General Motors	$49,860,624,198	$49,500,000,000[266]
GMAC	$12,500,000,000	$12,500,000,000
Loan for GMAC rights offering[267]	$884,024,131	$884,024,131

[265] Cumulative obligation amount represents Treasury's total obligation to the automotive industry under the AIFP. The figure does not reflect repayments, de-obligations or committed funds that are unused. For example, Treasury originally allocated $3.8 billion for Chrysler's DIP financing. However, only $1.89 billion of this portion was used. Since Treasury has indicated in discussions with the Panel that the remaining $1.91 billion was de-obligated, it is not reflected in this metric. The Amounts Advanced are decreased by commitments that were not funded but includes amounts that are no longer owing such as the amounts credit bid in the GM bankruptcy.

[266] This number reflects the $8.8 billion in loans and preferreds outstanding as well as the original loan amounts that are now in the form of equity.

[267] Loans to GM that have been converted to shares of GMAC and are currently not obligations of GM or GMAC. The GM loan was terminated.

Auto Supplier Supports	$3,500,000,000	$3,500,000,000[268]
Total	**$81,056,778,971**	**$76,854,024,131**

In Section 123 of EESA, Congress required that both the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) calculate the budget costs of the TARP transactions under the procedures of the Federal Credit Reform Act of 1990,[269] while using discount rates reflecting market risk rather than simply the government's cost of funds. In publishing their calculations of TARP budget outlays for 2009 using this "credit reform" methodology, the OMB and CBO offered their estimates of the subsidy rate which taxpayers are providing.[270] OMB calculates separate subsidy rates for TARP automotive investment debt and equity transactions at 49 percent and 65 percent, respectively, while CBO estimates an aggregate credit subsidy rate for all TARP automotive industry support programs of 73 percent. These subsidy rates, which represent an estimate of the investment that will not be recouped by the federal government, incorporate assumptions concerning the timing of cash flows (mainly principal and interest or dividend payments) as well as defaults on, or (partial) losses of, the amounts invested. However, both sets of estimates that were completed after the initial Chrysler and GM viability plans were rejected by the Obama Administration but before the companies' respective bankruptcy proceedings had been completed. Nevertheless, these credit subsidy estimates reflect analysis by the two budget agencies that imply – at least as of the time they performed their analyses – there was a high likelihood that a substantial portion of the initial TARP financing provided to Chrysler and GM in December and January would not be recovered.[271] Similarly, the latest SIGTARP report notes that with respect to DIP financing

[268] This figure does not reflect the amount outstanding under the program, but instead is the total amount available under the cap.

[269] EESA § 123(a).

[270] Office of Management and Budget, *The President's Budget for Fiscal Year 2010*, 983 (May 2009) (online at www.whitehouse.gov/omb/budget/fy2010/assets/tre.pdf) (hereinafter "President's Fiscal Year 2010 Budget"); See generally Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009* (June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf) (hereinafter "CBO June TARP Transactions Report").

[271] The CBO analysis (see *CBO June TARP Transactions Report*, *supra* note 270) is based primarily on the yield of GM-issued preferred stock as observed in financial markets over the months prior to the GM bankruptcy filing. OMB's analysis (see *President's Fiscal Year 2010 Budget*, *supra* note 270 at 982-985) was developed by separating the AIFP into categories for debt and equity, encompassing working capital financing for Chrysler and GM, GMAC debt and equity, Chrysler Financial debt and the two companies' respective supplier programs. Subsidy estimates were calculated for each category using comparable data from both the industry and other government programs, where available; otherwise the category was assigned a 100 percent subsidy rate as a placeholder until refined estimates are prepared later this year, representing a worst case scenario that assumes no projected recovery of TARP funds. These individual calculations were then aggregated with weights reflecting relative funding levels.

provided to Chrysler, "Treasury does not expect to receive repayment."[272] As more federal dollars have been devoted to the automotive investment in Chrysler and GM, including funds committed to aid both companies throughout their bankruptcy proceedings, CBO has increased its estimates as to the dollar amount of the automotive assistance subsidy. In its August report, "CBO raised its estimate of the costs of that assistance by nearly $40 billion relative to the March baseline."[273]

Treasury officials have acknowledged to Panel staff that at least some portion of the initial TARP funds disbursed in conjunction with the Chrysler and GM bankruptcies may not be recouped.[274] They stress, however, that recovery of TARP investments in the automotive industry will be highly dependent upon the value of the stock that Treasury holds (or subsequently receives) in the two companies when they are able to go public. Hence, the prospects for recovery of the TARP investments depend on the forecast for Chrysler and GM stock appreciation, which is something they cannot predict. In discussions, Treasury agreed with the Panel's assessment that the new companies' stock prices will have to appreciate sharply in order for Treasury, i.e. taxpayers, to be fully repaid on all of the TARP funds that have been invested.[275]

With respect to Chrysler, Treasury has invested a combined $14.3 billion in the new and old entities, including $1.5 billion for Chrysler Financial and $280 million for the Chrysler warranty program. The bankrupt Chrysler estate (Old Chrysler) is liable for $3.5 billion of

[272] SIGTARP, Quarterly Report to Congress (July 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf).

[273] The Budget and Economic Outlook: An Update, *supra* note 271.

[274] During a meeting with Panel staff on August 11, 2009, Mr. Bloom explained that it was possible but unlikely that taxpayers would recover all of the money they had invested in Chrysler and General Motors. Mr. Bloom has acknowledged that "likely scenarios involve a reasonable probability of repayment of substantially all of the government funding for new GM and new Chrysler, and much lower recoveries for the initial loans." *Ron Bloom COP Testimony*, *supra* note 36. The Task Force has indicated to the Panel that the "initial loans" refer to the $4 billion lent to Old Chrysler ($500 million of which was assumed by New Chrysler) and the $19.4 billion lent to Old GM (which was part of the loans that were credit bid for the assets of New GM).

Over $7.3 billion was originally committed in TARP and DIP financing to Old Chrysler (only $1.9 billion of the original $3.8 billion DIP financing is outstanding); it is highly unlikely that these funds will be returned to Treasury by Old Chrysler and any recovery on these amounts will depend on New Chrysler's stock price. Deducting $3.5 billion in "initial loans" from the total amount expended, the 8 percent Treasury stake in New Chrysler stock would have to be worth $1.1 billion (a total capitalization of $13.75 billion) for the taxpayer to recover the amount that the auto team believes is reasonably likely to be recovered.

With respect to GM, there is $49.5 billion in government assistance that was initially extended to Old GM and then credit bid for the assets of New GM. Deducting $19.4 billion in "initial loans" from the total amount expended, the Treasury stake in New GM stock would have to be worth $21.29 billion (a total capitalization of $35.01 billion) for the taxpayer to recover the amount that the auto team believes is reasonably likely to be recovered.

[275] *Id.*

TARP financing, and given the competing claims on that estate, payment is unlikely.[276] Treasury's interest in the new Chrysler includes a note for $6.6 billion that includes up to $533 million of payment-in-kind interest and a issuance fee of $288 million, and a $500 million loan assumed from Old Chrysler and an equity ownership share. While the Panel did not have access to equity valuations for New Chrysler, it is clear that – with $12.5 billion invested ($14.3 billion less Chrysler Financial and the Chrysler warranty program, which have been repaid) and assuming repayment of both the $7.1 billion of this investment in the form of notes as well as the fees and payment-in-kind interest of $821 million – the Chrysler equity interest[277] would need to achieve the remaining investment value of approximately $4.6 billion[278] (implying total capitalization of New Chrysler of $57.5 billion) in order for taxpayers to recoup their investment.

With respect to New GM, the sizeable amount of debt for which the company is responsible means that repayment of the TARP financing will require New GM stock to appreciate to a level that is highly optimistic.

The valuation of New GM used by the bankruptcy court estimated that the market capitalization (the price of all outstanding shares) of the new entity would be worth between $59 and $77 billion in 2012.[279] Treasury has invested a combined $49.5 billion in the New and Old GM and approximately 61 percent of equity in New GM.[280] Assuming full repayment of the $8.8 billion note and preferred stock issued by New GM to Treasury, the shares in New GM will have to be worth $40.7 billion (the difference between $49.5 billion and $8.8 billion) for Treasury's investment to be repaid when Treasury sells its shares, meaning the market capitalization of the entire company needs to be worth $67.7 billion. In April 2000, when Old GM shares were at the height of their value (not adjusted for inflation), the company's total value was only $57.2 billion.[281] In other words, New GM will have to achieve a capitalization that is higher than was ever achieved by Old GM if taxpayers are to break even.[282]

Of course, preserving portions of Chrysler and GM might have resulted in savings for the government in other ways. As discussed in more detail below, Treasury has not clearly explained how the various competing policy and financial objectives involved in the rescue of the automotive companies influenced its decisions. Without Treasury clearly articulating these

[276] See *supra* Figure 1.

[277] Assuming that Fiat meets its performance targets and the Treasury interest is decreased to 8 percent.

[278] This does not account for the warrants Treasury owns in Chrysler Financial.

[279] Declaration of J. Stephen Worth, *supra* note 36.

[280] *White House March 31 Remarks on GM Restructuring*, *supra* note 100; *GM July 16, 2009 8-K*, *supra* note 86.

[281] *Id.*

[282] *Id.*

objectives and providing its analysis, the Panel is unable to discern whether other financial considerations should be taken into account when analyzing whether taxpayers will be repaid.

The following figures show TARP automotive program funding to Chrysler, Chrysler Financial, GM, and GMAC; and the funds committed to Chrysler and GM.

Figure 4: TARP Automotive Program Funding to Chrysler and Chrysler Financial (as of August 28, 2009)

Date	Assisted Entity	Initial Assistance Amount	Initial Security Type	Repayment/Exchange/ Note	Cumulative Assistance Amount	Current Security Type
1/2/2009	Chrysler Holding LLC	$4,000,000,000	Loan	$500,000,000 of 1/2/09 facility assumed by New Chrysler on 5/27/09	$3,500,000,000	Loan[283]
1/16/2009	Chrysler Financial Services Americas LLC	$1,500,000,000	Loan	Repaid ($1,500,000,000)	-	-

[283] Although the original assistance was in the form of the loan, the remaining $3.5 billion can no longer be classified as a loan since it was made to an entity that is now bankrupt. Treasury has indicated that the likelihood of recoupment of this amount is low, but possible if the equity value of Treasury's holding increases to a certain level. The $500 million assumed by New Chrysler remains a loan. Overall recovery may also be potentially increased by Treasury's interest in the equity of Chrysler Financial amounting to the greater of $1.375 billion or 40% of Chrysler Financial's equity.

4/29/2009	Chrysler Holding LLC	$500,000,000	Loan	Unused and de-obligated	-	Loan
4/29/2009	Chrysler Holding LLC	$280,130,642	Loan (Chrysler warranty)	Repaid Chrysler warranty loan ($280,130,642)	-	-
5/1/2009	Chrysler LLC	$3,043,143,000	Loan	Adjusted by Treasury[284]	$1,890,000,000	Loan
5/20/2009	Chrysler LLC	$756,857,000	Loan	Adjusted by Treasury[285]	$0	Loan
5/27/2009	New Chrysler	$6,642,000,000[286]	Loan	$500,000,000 of 1/2/09 facility assumed by New Chrysler on 5/27/09	$7,142,000,000	Loan
Total		**$16,722,130,642**			**$12,532,000,000**[287]	

[284] This information was provided to the Panel by Treasury staff. The amount committed was ultimately unnecessary and adjusted accordingly.

[285] *Id.*

[286] Treasury also received equity consideration in New Chrysler. An April 30, 2009 press release by the Administration states that upon the closing of the Chrysler-Fiat alliance, the U.S. government owned an 8 percent equity interest. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending August 5, 2009* (Aug. 5, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report_08052009.pdf); U.S. Department of the Treasury, *Obama Administration Auto Restructuring Initiative* (April 30, 2009) (online at www.financialstability.gov/latest/tg_043009.html). *See* Section (C) of this report for discussion of Treasury's equity ownership in New Chrysler. Only $4.58 billion of the committed $6.64 billion has been drawn as of August 18, 2009. Treasury provided de-obligation information in response to specific inquiries relating to the Panel's oversight of the AIFP. Treasury provided the Panel with information regarding specific investments made under the AIFP on August 18, 2009. Specifically, this information denoted allocated funds that had since been de-obligated (hereinafter "Treasury De-obligation Document").

[287] This figure reflects the de-obligation of $1.91 billion of the allocated $3.8 billion in DIP financing and the de-obligation of an unused $500 million loan facility.

Figure 5: TARP Funds Committed to Chrysler

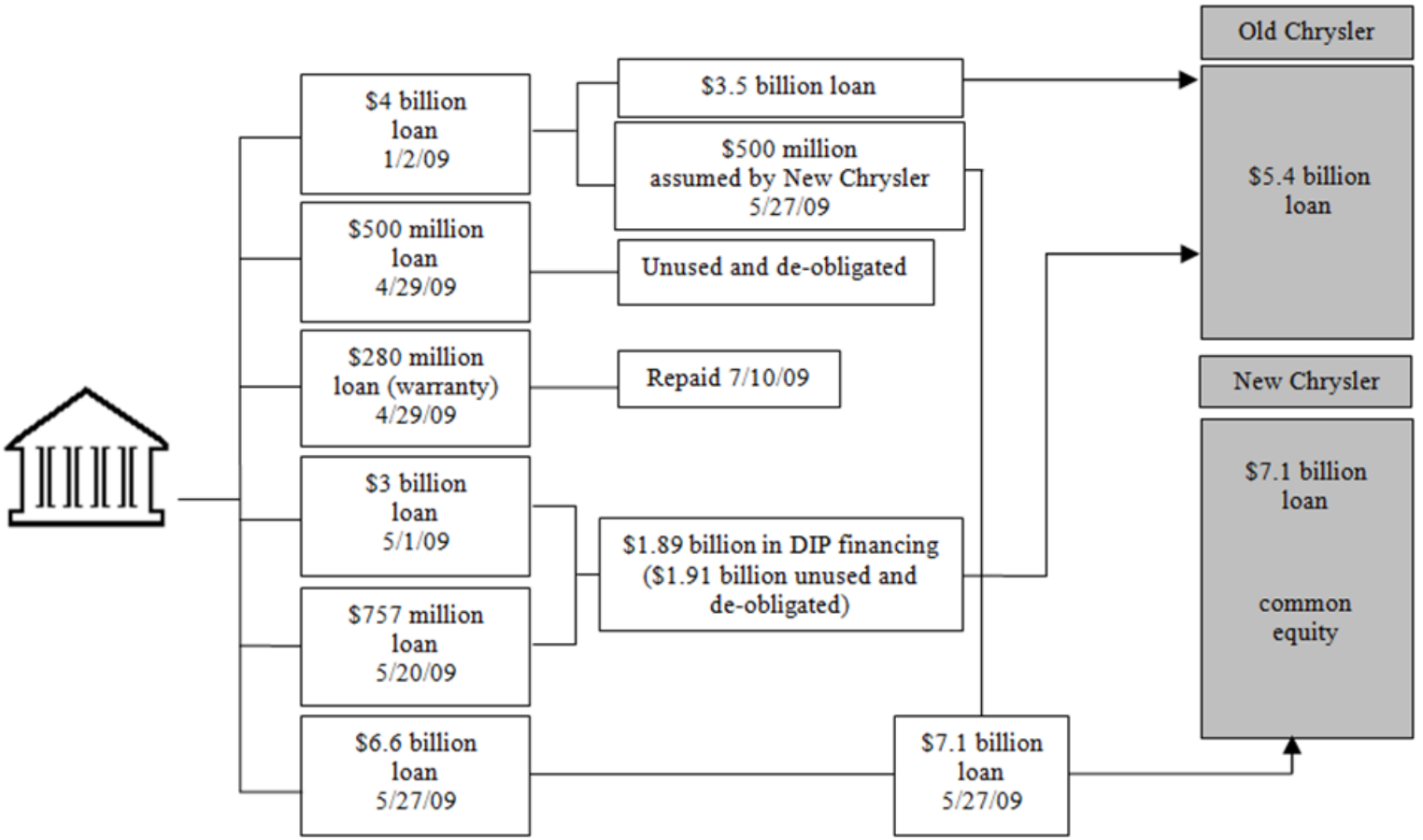


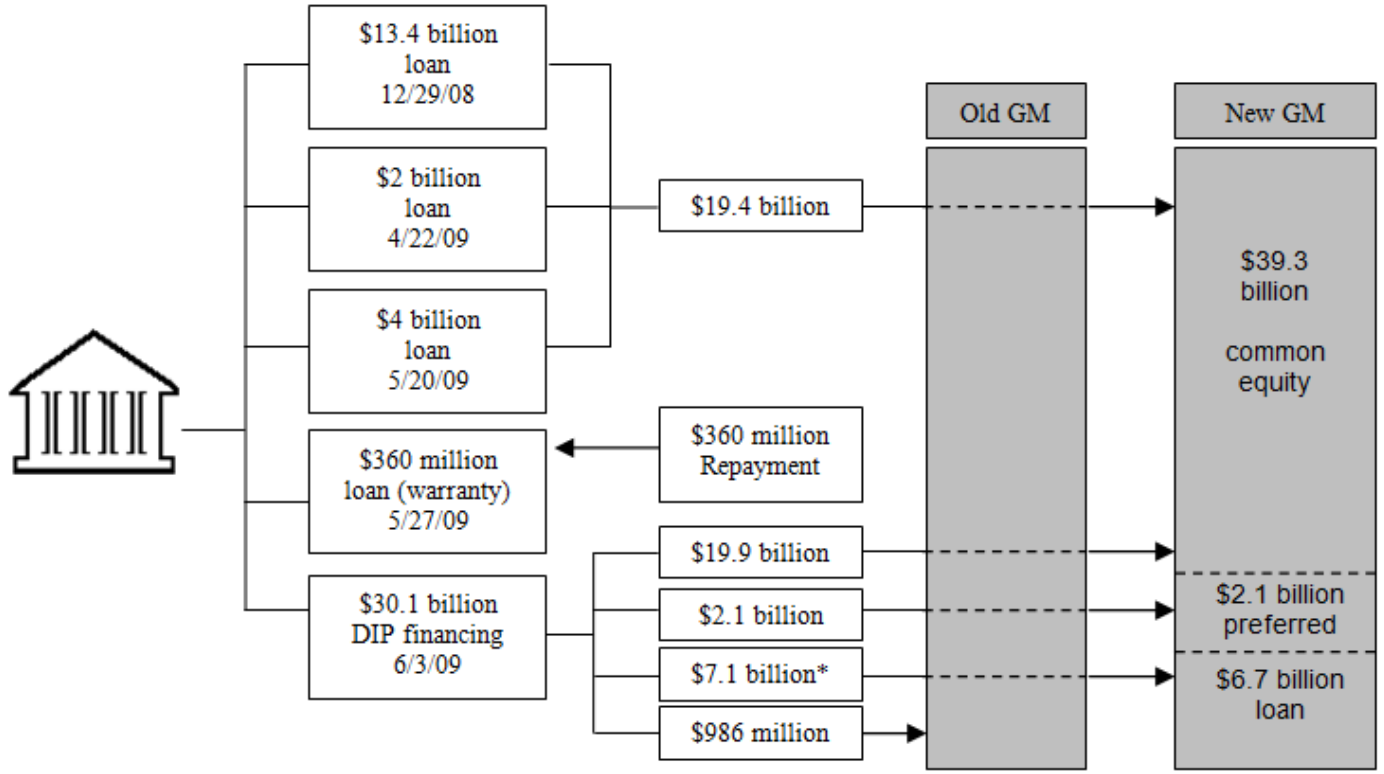
Figure 6: TARP Automotive Program Funding to General Motors and GMAC (as of August 28, 2009)

Date	Assisted Entity	Initial Assistance Amount	Initial Security Type	Repayment/Exchange/ Note	Cumulative Assistance Amount	Current Security Type
12/29/2008	General Motors Corporation	$884,024,131	Loan	Exchange for GMAC equity	-	GMAC, common equity
12/31/2008	General Motors Corporation	$13,400,000,000	Loan	Old GM debt credit bid; New GM equity received (**Original loan amount is thus now in the form of equity)*	$13,400,000,000*	New GM common equity, GM preferred
4/22/2009	General Motors Corporation	$2,000,000,000	Loan	Old GM debt credit bid; New GM equity received*	$2,000,000,000*	New GM common equity, GM preferred
5/20/2009	General Motors Corporation	$4,000,000,000	Loan	Old GM debt credit bid; New GM equity received*	$4,000,000,000*	New GM common equity, GM preferred
5/27/2009	General Motors Corporation	$360,624,198	Loan (GM warranty)	Old GM debt credit bid; New GM equity received*	$360,624,198*	New GM common equity, GM preferred

6/3/2009	General Motors Corporation	$30,100,000,000	Loan (DIP)	Old GM debt credit bid; New GM equity and preferreds received	$30,100,000,000	New GM common equity, GM preferred, GM loans
				Old GM debt credit bid; New GM equity*	$19,941,511,395*	New GM common equity
				Old GM debt credit bid; New GM preferreds received	$2,100,000,000	New GM preferred
				Became a New GM loan	$7,072,488,605[288]	New GM, loan
				Remained Old GM loan	$986,000,000	Old GM, loan
Total		**$50,744,648,329**			**$49,860,624,198**	

[288] $360,624,198 of this loan was repaid on June 10, 2009. August 28 TARP Transactions Report, *supra* note 102.

Figure 7: TARP Funds Committed to General Motors



*$360,624,198 of this loan was repaid on July 10, 2009

2. Performance and Financing Challenges for the Automotive Companies

In order for the taxpayers to recoup their investments in the automotive companies, the companies need to make enough money to cover their operating expenses and repay their debt, and then become profitable enough to be able to sell their shares in initial public offerings (IPOs). They face several challenges in achieving these objectives.

a. Cash flow challenges

At the time the automotive companies filed for bankruptcy, they were "burning" through a substantial amount of money. These are the amounts by which their operating expenditures (to pay workers and keep their factories running) exceeded the revenues they were generating from sales and other sources. More revealing is that this structural imbalance stemmed primarily from normal operations, and was not attributable to the type of major new capital spending that both companies will require to become competitive in the future. Admittedly, as discussed above, this burn rate reflected extraordinary market conditions.

The Panel reviewed elements of the viability plans approved by the Treasury auto team. The projected cashflow in those plans, which drove the determination of viability made by the Treasury auto team, assumes an increase in overall market size consistent with independent market analysts' projections and a market share that has a rational if optimistic basis.

Figure 8: Estimated New Chrysler Debt (U.S., Canada, and UAW)

Lender	Amount	Annual Interest Rate[289]	Maturity
U.S. government[290]	$2 billion $5.142 billion[291]	LIBOR + 5% LIBOR + 7.91%	Dec. 2011 June 2017
Canadian government[292]	$500 million $1.4 billion[293]	CDOR + 5% CDOR + 5%	Dec. 2011 June 2017
UAW Trust[294]	$4.587 billion	9%	July 2023

Figure 9: Estimated New GM Debt (U.S., Canada, and UAW)[295]

Lender	Amount	Interest Rate	Maturity
U.S. government	$7.1 billion[296]	LIBOR + 5%[297]	July 2015
Canadian government	$1.3 billion	CDOR + 5%[298]	July 2015
UAW Trust	$2.5 billion	9%[299]	July 2017

[289] For all of New Chrysler's loans with the U.S. and Canada, interest is accrued and paid on a quarterly basis. Interest accrued through the first two quarters is considered "paid in kind," and is added to the principal. Essentially, interest accrues, but is not paid in cash through the end of 2009. It is paid, however, at maturity.

[290] First Lien Credit Agreement between New Carco Acquisitions, LLC (to be named Chrysler Group LLC) and the U.S. Department of the Treasury (June 10, 2009).

[291] Of the $5.142 billion, all but $2.05 billion has been drawn by New Chrysler to date, according to information provided to the Panel by Treasury.

[292] First Lien Working Capital Credit Facility, Summary of Terms and Conditions, *In re Chrysler LLC*, 405 B.R. 79 (Bankr. S.D.N.Y. 2009) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1).

[293] The $500 million and $1.4 billion loan amounts presented here are in U.S. dollars based on the exchange rate at the time of issuance. Amounts owed to the Canadian government are paid in Canadian dollars.

[294] Draft Loan Agreement between New Carco Acquisition LLC (to be named Chrysler Holding LLC) and the bank of New York Trust Company (Trustee for VEBA, presented as UAW Trust Note) (Apr. 29, 2009).

[295] GM July 16, 2009 8-K, *supra* note 86.

[296] $361 million of this amount related to warranty loans repaid on July 10, 2009.

[297] According to GM's August 7, 2009 8-K filing, "each UST Loan accrues interest at a rate per annum equal to the 3 month LIBOR rate, which will be no less than 2.0%, plus 5.0% per annum, unless the UST determines that reasonable means do not exist to ascertain the LIBOR rate or that the LIBOR rate will not adequately reflect the UST's cost to maintain the loan. In such a circumstance, the interest rate to be applied shall be the greatest of (1) the prime rate plus 4%, (2) the federal funds rate plus 4.5% or (3) the 3 month LIBOR (which will not be less than 2%) plus 5%." *Supra* note 92.

[298] According to GM's August 7, 2009 8-K filing, loans outstanding to the Canadian government "accrue interest at a rate per annum equal to the greater of the three-month CDOR rate and 2.0%, plus 5.0%. Accrued interest is payable quarterly." *Supra* note 92.

The amount of money to service this debt, even before the companies start to pay for normal operations, such as steel and wages, is significant. The following tables set out the amounts necessary to service existing debt obligations:

Figure 10: Estimated Contractual Obligations of New Chrysler (in billions)[300]

	'09	'10	'11	'12	'13	'14	'15	'16	'17-'23	Total
U.S. government long-term debt maturities including interest payments[301]	$0	$.505	$2.56	$.373	$.379	$.386	$.393	$2.87	$1.6	$9.1
Canadian government long-term debt maturities including interest[302]	$.053	$.094	$.594	$.059	$.059	$.059	$.059	$.464	$.435	$1.877
UAW Trust note[303]	$0	$.315	$.3	$.4	$.6	$.65	$.65	$.65	$5.6	$9.16
Total	$.053	$.914	$3.45	$.832	$1.04	$1. 1	$1.1	$3.98	$7.64	$20.14

[299] According to GM's August 7, 2009 8-K filing, "the notes under the VEBA Note Agreement (VEBA Notes) are scheduled to be repaid in three equal installments of $1.4 billion on July 15 of 2013, 2015, and 2017." *Supra* note 92.

[300] The contractual obligations of New Chrysler presented in this table represent the Panel's best estimates based on information compiled from the available loan documents. With respect to New Chrysler's loan agreement with Canada, the interest rate of the loan is CDOR (or a minimum of 2 percent) plus 5 percent per annum. The Panel assumes a CDOR rate of 2 percent for the life of the loan.

[301] Estimates compiled from the First Lien Credit Agreement between New Carco Acquisitions, LLC (to be named Chrysler Group LLC) and the U.S. Department of the Treasury (June 10, 2009). Also reflected in these tables are two types of fees that New Chrysler owes the U.S. First, a "payment in kind" of $17 million every quarter in new notes is added to the principal of $5.142 billion until maturity in 2017. Second, a one-time payment of $288 million is added to the principle of $5.142 billion at issuance. Since both payments are added to the principal, they accrue interest over the length of the loan. New Chrysler pays these fees with interest at maturity in 2017.

[302] Estimates compiled from the Summary of Terms and Conditions of Canadian Loan Agreement with Chrysler Holding LLC (Apr. 29, 2009). Not reflected in these estimates is an additional fee that New Chrysler is expected to owe the Canadian government. According to Panel discussions with Treasury, terms of this fee are still being reviewed.

[303] Estimates compiled from Draft Loan Agreement between New Carco Acquisition LLC (to be named Chrysler Holding LLC) and the bank of New York Trust Company (Trustee for VEBA, presented in the table as UAW Trust note) (Apr. 29, 2009).

Figure 11: Estimated Contractual Obligations of New GM (in billions)[304]

	2010	'11	'12	'13	'14	'15	'16-'17	Total
U.S. government long-term debt maturities including interest payments	$.47	$.47	$.47	$.47	$.47	$7.18	$0	$9.53
Canadian government long-term debt maturities including interest	$.09	$.09	$.09	$.09	$.09	$1.38	$0	$1.83
UAW Trust note	$0	$0	$0	$1.4	$0	$1.4	$1.4	$4.2
Total	$.56	$.56	$.56	$1.96	$.56	$9.96	$1.4	$15.56

The viability plans assume positive cashflow in the relatively short term. To the extent cash from the sale of automobiles cannot cover the costs of production and other corporate costs, Chrysler and GM will have to borrow money from banks, or access the debt or equity capital markets.

b. Access to the Debt and Equity Markets; Initial Public Offerings

As discussed above, the Treasury auto team intends that both companies will eventually access the equity capital markets in the form of IPOs,[305] and as a result, successful IPOs form the basis for both repaying taxpayers and Treasury's exit strategy. This strategy hinges directly on the ability of the two companies to restructure and become profitable. At the moment, in a still-constrained credit market, and with the pressures associated with these two companies (not least the risk of political interference),[306] it is unclear whether either company in its current form could access the banks or the debt capital markets in the amounts and on the terms that they would require.

[304] The contractual obligations of New GM presented in this table represent the Panel's best estimates based on information compiled from GM's 8-K filed on August 7, 2009. *GM August 7 8-K*, *supra* note 92. With respect to New GM's loan with the U.S. government, the Panel assumes the U.S. will bear an interest of LIBOR plus five percent throughout the life of the loan. LIBOR is assumed to be two percent, therefore the total interest is assumed to be seven percent for the life of the loan. With respect to New GM's loan with the Canadian government, the interest rate of the loan is CDOR (or a minimum of two percent) plus five percent per annum. The Panel assumes a CDOR rate of two percent for the life of the loan, and therefore assumes a total interest rate of seven percent per annum. $361 million of the initial $7.1 billion loan amount was repaid on July 10, 2009.

[305] See *supra* section B.1 and *infra* section G.2.

[306] See *supra* section E.4.

Following the completion of a successful IPO, the Treasury auto team has made clear it intends to dispose of Treasury's ownership stakes in New Chrysler and New GM "as soon as is practicable," as discussed above. At least with respect to New GM, where Treasury holds 60.8 percent of the company, Treasury does not expect to sell its entire stake in the IPO.[307] The Stockholders Agreement[308] calls for Treasury to use "reasonable best efforts to exercise [its] demand registration rights under the Equity Registration Rights Agreement and cause an IPO to occur within one year of the date of this Agreement, unless the Corporation is already taking steps and proceeding with reasonable diligence to effect an IPO."[309] Thus, it is unclear when Treasury will completely exit its TARP investments in the automotive industry, but it is unlikely to be at any point in the near future.

The Treasury auto team has not ruled out other ways of exiting ownership of these companies and returning them to private hands, but options such as selling Treasury's stake to private equity investors seem unlikely at present.[310]

In making the decision – or decisions – to sell the equity stakes that it holds in the automotive companies, Treasury will have to balance the desire to exit as soon as practicable (as articulated by the President and the head of the Treasury auto team) with the need to maximize the return (or minimize the loss) to taxpayers. It is not easy to time the markets, and Treasury cannot force the companies' boards of directors to engage in an IPO. Until the companies go

[307] *Ron Bloom COP*, *supra* note 36. For further discussion of Task Force statements concerning its intent to eventually dispose of its ownership stakes, see Sections *supra* B.1 and *infra* G.2.

[308] *New GM Stockholder Agreement*, *supra* note 87.

[309] General Motors Company, *Form 8-K* (July 10, 2009) (online at www.sec.gov/Archives/edgar/data/1467858/000119312509150199/dex101.htm).

Under the terms of the New Chrysler Shareholders Agreement, Treasury can require New Chrysler to file a registration statement under the Securities Act of 1933 (a "demand registration"); in the case of an IPO, such demand notice can only be delivered by either (a) one or more holders holding 10 percent or more of the equity securities, or (b) both Treasury and Canada. Shareholders Agreement Among Fiat Newco, United States Department of the Treasury, UAW Retiree Medical Benefits Trust, Canada Development Invesment Corporation, and the other Members Party Hereto, section 3.2(a)(i) (filed May 12, 2009) *In Re* Chrysler LLC, S.D.N.Y. (No. 09 B 50002 (AJG)) (hereinafter "New Chrysler Shareholders Agreement"). Treasury cannot seek more than one demand registration in any 12-month period, and cannot request more than five. *Id.* at Section 3.2(a)(ii).

The New GM Stockholders Agreement directs Treasury to use its reasonable best efforts to exercise "[its] demand registration rights under the Equity Registration Rights Agreement and require an IPO to occur" by July 10, 2010 (one year from the date of the Stockholders Agreement). Additionally, pursuant to the terms of the New Chrysler Shareholders Agreement and the New GM Equity Registration Rights Agreement, each time New Chrysler or New GM proposes to offer any equity securities in a registered underwritten offering under the Securities Act, they must provide each holder (including Treasury) with the opportunity to include any or all of their registrable securities in such offering ("piggyback offering"). *Id.* at section 3.3(a); New GM Stockholder Agreement, *supra* note 87 at section 2.2.1.

[310] At a July 29, 2009 briefing with Panel staff, Treasury and Task Force staff indicated that, at least at that point, no private equity investor has come along with demonstrated interest in investing in these companies.

However, there are several pre-IPO contractual limitations on the public sale of Treasury's ownership stakes in New GM that are set out in the Stockholders Agreement.

public through the IPO process, Treasury's only option is to sell its stake privately (which, as discussed above, remains an unlikely event). Once the companies become public companies subject to SEC reporting requirements, Treasury's options would be somewhat broader. If the company concerned agreed, Treasury could sell large stakes in SEC-registered secondary offerings.[311] With or without the company's approval, Treasury could also sell smaller amounts of shares into the public markets.[312]

G. Issues Raised

1. Authority to Use TARP for Support of the Automotive Companies

The funds used by the Treasury auto team in the various transactions associated with the Chrysler and GM reorganizations were from the $700 billion appropriated for TARP. Treasury, as an executive agency, and the Task Force both acted under presidential direction. Their actions are therefore properly scrutinized as executive actions. Under this scrutiny, the use of TARP funds for the automotive industry raises questions regarding both presidents' authority to use these funds under EESA legislation and, more broadly, under the U.S. Constitution. The statutory language is ambiguous and, in light of the language and history of EESA, the question is a close one.

a. The Scope of Executive Authority

Unlike the first article of the Constitution, which clearly enumerates the powers vested in the legislative branch, the second article says only that "the executive power shall be vested in a President of the United States" and that it is the president's duty to "ensure that the laws be faithfully executed."[313] With a handful of exceptions, the president's authority to act will most often derive from a statute.[314] In this case, the relevant statute is EESA.

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[311] GM August 7 8-K, *supra* note 293.

[312] Shareholders that are "affiliates" of a company (in general, those with a significant stake in the voting equity of the company, or the right to a board seat) may sell their shares in the public markets without registration of the transaction with the SEC. SEC rules impose volume, timing and other restrictions on such sales. Commodity and Securities Exchanges, 17 C.F.R. § 230.144. Any such sales by the government are likely to have a significant impact on the securities market, which may suspect a signal to the market with respect to the specific companies, the auto industries, or the economy in general. For this reason (and the general difficulty in timing the market discussed above), holding these equity stakes in a trust, discussed in more detail below, might help to manage the taxpayers' stake more efficiently and maximize returns.

[313] U.S. Constitution, art. II, § 1 and 3.

[314] The leading authority on how the president's power should be interpreted is Justice Robert Jackson's concurring opinion in the 1952 U.S. Supreme Court case, *Youngstown Sheet & Tube v. Sawyer*. *Youngstown Sheet & Tube Co. et al. v. Sawyer*, 343 U.S. 579, 634 (1952) (Jackson, J., concurring). *Youngstown* presents three scenarios illustrating the varying scope of executive power. In the first scenario,when a president acts pursuant to Congressional mandate, the president's authority "is at its maximum, for it includes all that he possesses in his own right plus all that Congress can delegate." *Id.* at 635. At the other extreme is the scenario in which the president's power is "at its lowest ebb," that is, when the president takes action that has been specifically proscribed by

b. The Emergency Economic Stabilization Act

EESA does not explicitly state that the TARP is available to provide assistance to the automotive industry (or to any specific industry except arguably the financial and banking industry) but there may be an interpretation under which such assistance is nonetheless authorized.

EESA states that:

> The Secretary [of Treasury] is authorized to… purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and the policies and procedures developed and published by the Secretary.[315]

It defines a "troubled asset" as "residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages that in each case originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability"[316] and "any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress."[317] A "financial institution" is defined as:

> [a]ny institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State, territory, or possession of the United States…and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.[318]

Congress "for then he can rely only upon his own constitutional powers minus any constitutional powers of Congress over the matter." *Id.* at 637. In the middle is the case in which the president may act in certain situations when Congress has been silent on an issue – neither passing legislation to authorize presidential action nor passing legislation proscribing such action. *Id.* Despite its lack of one clear rule delineating the outer bounds of executive authority, *Youngstown* has remained the premier authority on the issue for the last 57 years. Lee Epstein & Tonja Jacobi, *Super Medians*, 61 Stan. L. Rev. 37, 60 n.85 (2008) (internal citations omitted). The *Youngstown* categories are not particularly relevant in this case, however, because there is no inherent executive authority on which the president could plausibly rely. The president's authority must therefore derive from statute.

[315] EESA § 101 (a)(1).

[316] EESA § 3 (9)(A).

[317] EESA § 3 (9)(B); see also Congressional Oversight Panel, *August Oversight Report: The Continued Risk of Troubled Assets*, at 10-22 (August 11, 2009) (discussion of what constitutes a "troubled asset") (online at cop.senate.gov/documents/cop-081109-report.pdf) (hereinafter "August COP Report").

[318] EESA § 3 (5).

The first question is therefore whether the transactions at issue constituted the purchase of "troubled assets" under EESA. While the majority of transactions associated with the Chrysler and GM deals did not involve residential or commercial mortgages or real estate-related securities, and therefore do not qualify under EESA § 3(9)(A), it appears that the assets purchased by Treasury do meet the qualifications under EESA § 3(9)(B). Before purchasing any assets from either GM or Chrysler, then-Secretary of the Treasury Henry Paulson submitted a determination to Congress stating that he had conferred with Chairman of the Federal Reserve Board Ben Bernanke and had determined that "the purchase of obligations of certain thrift and other holding companies which are engaged in the manufacturing of automotive vehicles and the provision of credit and financing in connection with the manufacturing and purchase of such vehicles is necessary to promote financial market stability."[319] To the extent that the transactions involved the purchase of assets, these assets appear to qualify as "troubled assets" under the definition provided in the statute.

The next question is whether GM or Chrysler can be called a "financial institution" under EESA. The language of the statute itself does not provide a clear answer. Although the statute provides a list of entities that may be considered "financial institutions," including such patently "financial" institutions as banks, savings associations, and credit unions, it states that the universe of what may be considered a "financial institution" includes but is "not limited to" those on the list. The ambiguity of this list presents a challenge in determining what types of institutions absent from the list may still be considered within the statute's purview.

c. The Executive's Interpretation

Both the executive branch and Treasury have spoken on this issue through various court documents, public statements, and congressional testimony. In the view of the executive branch, the use of TARP funds for the automotive industry is entirely appropriate. This was not President Bush's initial view, however.

At a press conference on November 7, 2008, Tony Fratto, Deputy White House Press Secretary in the Bush Administration, stated that:

> What we have to deal with here in the federal government, though, are the rules that – or the authorities that Congress gave us to deal with how we can assist the automakers and other automotive component makers. And that is the section 136 auto loan program that is being administered by the Department of Energy…If Congress has any interest in going beyond that, that's a decision that they're going to have to make.[320]

[319] Letter from Henry Paulson to Representative Charles Rangel (Dec. 23, 2008).

[320] White House Office of Press Secretary, *Press Briefing by Deputy Press Secretary Tony Fratto* (Nov. 7, 2008) (online at georgewbush-whitehouse.archives.gov/news/releases/2008/11/20081107-1.html).

On November 18, 2008, Secretary Paulson reiterated that position during his testimony before the House Financial Services Committee:

> [a]gain, you haven't seen any lack of consistency on my part with regard to the autos. The TARP was aimed at the financial system. That is what the purpose is. That is what we talked about with the TARP…I don't see [preventing the failure of one or more automotive companies] as the purpose of the TARP. Congress passed legislation that dealt with the financial system's stability.[321]

On December 19, President Bush announced that he would reverse his earlier position and use TARP funds for the automotive companies. During a press conference, President Bush explained that his administration had:

> [W]orked with Congress on a bill to provide automakers with loans to stave off bankruptcy while they develop plans for viability. This legislation earned bipartisan support from majorities in both houses of Congress. Unfortunately, despite extensive debate and agreement that we should prevent disorderly bankruptcies in the American automotive industry, Congress was unable to get a bill to my desk before adjourning this year. This means the only way to avoid a collapse of the U.S. automotive industry is for the executive branch to step in…So today, I'm announcing that the federal government will grant loans to automotive companies under conditions similar to those Congress considered last week.[322]

The Bush Administration reasoned that that EESA's definition of "financial institution" was broad enough to include the automotive companies, whose failures "would pose a systemic risk to financial market stability and have a negative effect on the economy of the United States."[323]

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[321] House Financial Services Committee, Statement of Secretary of the Treasury Henry Paulson, *Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and of Government Lending and Insurance Facilities: Impact on the Economy and Credit Availability*, 110th Congress , at 18 -19 (Nov. 18, 2008).

[322] President George W. Bush, Statement on Financial Assistance to Automakers, (Dec. 19, 2008) (online at www.washingtonpost.com/wp-dyn/content/article/2007/03/19/AR2007031900867_pf.html).

[323] U.S. Department of the Treasury, *Section 105(a) Troubled Asset Relief Program Report to Congress for the Period December 1, 2008 to December 31, 2008*, at 3 (Jan. 6, 2009) (online at www.financialstability.gov/docs/105CongressionalReports/105Report_010609.pdf). Critics argue that the executive's use of money authorized under EESA to assist the automotive industry is a violation of "the non-delegation doctrine," which stipulates that the separation of powers laid out in the Constitution implies limits on the size and kind of discretion that Congress may confer on the executive branch. They contend that Congress did not intend for EESA to cover automobile manufacturers, citing as evidence proposed legislation that would have explicitly provided rescue funds to the automakers. If Congress intended EESA to cover automotive companies, then the deliberation over additional legislation would have been unnecessary.

Treasury provided additional elaboration on its authority in Mr. Bloom's response to questions for the record posed during the Panel's hearing on the automotive industry in July 2009. In response to one question, Mr. Bloom wrote:

> Each program has guidelines that specify eligibility criteria. These criteria are posted on the financial stability website, www.financialstability.gov.
>
> For example, in determining whether an institution is eligible for funding under the Automotive Industry Financing Program, Treasury has identified the following factors for consideration, among other things:

1. The importance of the institution to production by, or financing of, the American automotive industry;
2. Whether a major disruption of the institution's operations would likely have a materially adverse effect on employment and thereby produce negative effects on overall economic performance;
3. Whether the institution is sufficiently important to the nation's financial and economic system that a major disruption of its operations would, with a high probability, cause major disruptions to credit markets and significantly increase uncertainty or losses of confidence, thereby materially weakening overall economic performance; and
4. The extent and probability of the institution's ability to access alternative sources of capital and liquidity, whether from the private sector or other sources of U.S. government funds.[324]

Presumably these criteria also informed the initial decision to provide support to the automotive industry.[325]

The Chrysler and GM bankruptcy cases have provided an additional forum for the executive branch to express its view with the added benefit of in-depth legal analysis. For

[324] *Ron Bloom COP Testimony*, *supra* note 36.

[325] Mr. Bloom also responded to a question regarding whether Treasury would provide a legal opinion stating its authority to use the TARP funds for the automotive industry. Mr. Bloom answered by referencing the bankruptcy filing described above, and noted that Judge Gerber's final sale order in the GM bankruptcy had stated:

> The U.S. Treasury's extension of credit to, and resulting security interest in, the Debtors, as set forth in the DIP Facility and the Existing UST Loan Agreement and as authorized in the interim and final orders approving the DIP Facility, is a valid use of funds pursuant to EESA.

This statement seems at odds with Judge Gerber's finding in the opinion issued the same day that found that the party raising the issue lacked standing, and because the question was moot and therefore not properly before the court. *In re General Motors*, 407 B.R. 463, 519 (Bankr. S.D.N.Y. 2009). Given the inconsistency between these two statements, the bankruptcy court's views on the issue are at best ambiguous.

example, a filing by the United States in the GM case stated that, according to the statute, a "financial institution" is "any institution…established and regulated under the laws of the United States or any State, territory, or possession of the United States…and having significant operations in the United States." [326] On this basis, the United States concluded that "GM plainly fits within the statutory language because it is an 'institution…established and regulated under the laws of the United States or any State, territory, or possession of the United States…and having significant operations in the United States."[327]

Based on this interpretation, the term "financial institution" means any institution organized under U.S. law with operations in the United States. This interpretation does not, however, seem to account for the phrase "including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company." It also would seem to lend little weight to Congress' selection of the term "*financial* institution." The canons of statutory construction, which traditionally provide guidance on how statutes should be interpreted, generally frown on interpretations that render any part of the statute superfluous.[328] The rule against superfluities assumes that legislatures, in general, mean what they say and that the inclusion of certain words or phrases is not accidental.[329] Using that assumption, Congress must be presumed to have had a purpose in listing institutions that might typically be considered "financial" institutions – banks, credit unions, broker dealers, and insurance companies.

It appears that the United States refined its position, perhaps to address this issue, during oral argument before the Second Circuit in the Chrysler case. The United States argued that there is a certain connection between the automotive companies' financing entities and the automotive companies themselves that permits the use of TARP funds to support the automotive companies, thereby supporting the companies' financial divisions. During argument, the United States asserted that:

> [T]he Secretary of the Treasury, in determining what is a financial institution, looks at the interrelatedness [of the company and its financing arm].
>
> Chrysler Financial can't survive without Chrysler….Without [Chrysler], the financial institution goes down…[Chrysler Financial] is the financial institution and the relationship [with Chrysler is the one] that the Secretary of the Treasury

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[326] Statement of the United States of America Upon the Commencement of General Motors Corporation's Chapter 11 Case, at 10 (Dec. 19, 2008). *In re* General Motors Corp., S.D.N.Y. (Dec. 19, 2009) (online at docs.motorsliquidationdocket.com/pdflib/37_50026.pdf) (hereinafter "U.S. December 2008 GM Bankruptcy Statement").

[327] *Id*.

[328] *Knight v. CIR*, 128 S. Ct. 782, 789 (2008) (quoting *Cooper Indus., Inc. v. Aviall Servs., Inc.*, 543 U.S. 157, 166 (2004)).

[329] *Id.*

> based his determination on, and that determination is entitled to deference by this court under administrative law principles.[330]

In neither the Chrysler nor the GM case was the question resolved because, in each case, the judge determined that the objectors did not have standing to raise the issue or that the issue was moot.[331] In the case of Chrysler, the lower court found that the Indiana pension funds could not raise the issue for two reasons: (1) they were bound by their Administrative Agent's acceptance of the sale; and (2) the value of the collateral at issue was no greater than the value of the amount that the first lien senior secured lenders were to receive and that therefore there was no injury that could be alleged.[332] The Second Circuit accepted the lower court's findings and confirmed its ruling.[333] In the GM case, the court simply noted the transaction at issue was the use of the bidding procedure and did not directly involve any TARP funds, and also that Judge Arthur Gonzales of the Bankruptcy Court for the Southern District of New York had found a lack of standing when the same issue was raised in the Chrysler case.[334]

However, if a court had reached the issue in either the GM or Chrysler case, it may have found guidance from the U.S. Supreme Court case *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[335] or from the earlier *Skidmore v. Swift*,[336] which together establish the framework for analyzing whether an agency has correctly interpreted a statute in the face of ambiguous language from Congress. According to *Chevron*:

> If…the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.[337]

In such circumstances, the court noted it had "long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer, and the principle of deference to administrative interpretations."[338] This deference,

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[330] *In re Chrysler LLC*, 2009 WL 2382766, * 10 n. 14, (2d Cir. Aug. 5, 2009) (quoting the transcript of the oral argument at 52).

[331] *Id.* at 11-12; *In re General Motors Corp.*, 407 B.R. 463, 518 (Bankr. S.D.N.Y. 2009).

[332] *In re Chrysler LLC*, 405 B.R. 79, 83 (Bankr. S.D.N.Y. 2009).

[333] *In re Chrysler LLC*, 2009 WL 2382766, *11-12 (2d Cir. 2009).

[334] *In re General Motors Corp.*, 407 B.R. 463, 518 (Bankr. S.D.N.Y. 2009).

[335] *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., et al.*, 467 U.S. 837 (1984).

[336] *Skidmore v. Swift*, 323 U.S. 134 (1944).

[337] *Id.* at 843.

[338] *Id.* at 844.

known now as "*Chevron* deference," reflects the judiciary's respect for the specialized and superior skill and knowledge that an executive agency brings to its area of expertise. A court will therefore honor an agency's interpretation of such a statute as long as the interpretation "represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute," and will not disturb such interpretation "unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned."[339]

Whether Treasury would be due such deference in this case is not clear. Later Supreme Court opinions have suggested that an agency must use some authority that has been, either explicitly or implicitly, delegated to that agency by Congress and that the authority has been used under "circumstances that Congress would expect the agency to be able to speak with the force of law when it addresses ambiguity in the statute or fills a space in the enacted law."[340] An agency speaks with the "force of law" when, for example, it engages in rule-making under the Administrative Procedure Act.[341] While Treasury (and President Bush) have made various statements regarding their interpretations of the statute and the authority to use the TARP in this way, it is not clear that any of these statements is sufficient to qualify as speaking with the force of law, especially since there has not been one coherent statement but a mix of court filings, oral argument, and statements by Treasury officials. On December 23, 2008, Secretary Paulson submitted to Chairman Rangel of the House Ways and Means Committee a determination under section 3(9)(B) of EESA that assets to be purchased from the automotive companies should be treated as "troubled assets" because their purchase was "necessary to promote financial market stability." The December 23 letter assumes, without any rationale, that the automotive companies may be treated as "financial institutions" under EESA, so the weight that letter would be accorded under *Chevron* is unclear.

In this situation, *Skidmore* may provide the more appropriate guidance. The *Skidmore* court, like the *Chevron* court, noted that an agency's "policies are made in pursuance of official duty, based upon more specialized experience and broader investigations and information than is likely to come to a judge in a particular case."[342] Furthermore, the court continued, "[t]his Court has long given considerable and in some cases decisive weight to Treasury Decisions and to interpretative regulations of the Treasury and of other bodies that were not of adversary origin" and that "rulings, interpretations and opinions" of an agency's administrator "do constitute a

[339] *Id.* at 845 (quoting *United States v. Shimer*, 367 U.S. 374 (1961)).

[340] *United States v. Mead Corp.*, 533 U.S. 218, 229 (2001).

[341] *Id.* See, by way of analogy, *Christensen v. Harris County*, 529 U.S. 576, 587 (2000) (interpretation contained in agency's opinion letter did not merit *Chevron* deference when the letter did not follow a formal adjudication or similar procedure).

[342] *Skidmore*, 323 U.S. at 139.

body of experience and informed judgment to which courts and litigants may properly resort for guidance."[343]

d. The Congressional Record

While not strictly authoritative, it is often useful also to consider the Congressional Record when interpreting a statute to determine whether a particular interpretation seems to forward the goals articulated by Members of Congress while debating the statute.[344] Of course, various Members of Congress may have widely divergent reasons for passing a piece of legislation and such divergence may result in purposely vague language in the final bill. Nonetheless, it is useful to consult the Congressional Record in such cases for any widespread views that might signal what the intent behind a statute was in the minds of its proponents.

In this case, the record shows that the Members of Congress who debated this legislation in late 2008 believed they were debating a bill aimed at banks and the financial sector. For example, multiple Senators remarked on the need to unfreeze the credit markets and their view that EESA was intended to address just those markets.[345] The understanding of EESA's purpose appears to have been the same in the House, as illustrated by the remarks of Representative Barney Frank, chairman of the House Financial Services Committee: "[i]n implementing the powers provided for in the Emergency Economic Stabilization Act of 2008, it is the intent of Congress that Treasury should use Troubled Asset Relief Program (TARP) resources to fund capital infusion and asset purchase approaches alone or in conjunction with each other to enable financial institutions to begin providing credit again[.]"[346]

On December 4, 2008, however, Senators Dodd and Reid and Representatives Pelosi and Frank wrote to President Bush, asking him to reconsider his position on the use of TARP funds

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[343] *Id.* at 140.

[344] *Wirtz v. Bottle Blowers Ass'n*, 389 U.S. 463, 468 (1968).

[345] Congressional Record, Statement of Senator Mitch McConnell, S10190-S10191 (Oct. 1, 2008) ("Right now…the credit markets are frozen, so the circulatory system is not working as it should. If the circulatory system doesn't work, it begins to choke off the body–the economy. With the step we take tonight, we are confident we will be able to restore the circulatory system, if you will, and regain health for the economy…."); Congressional Record, Statement of Senator Hillary Clinton, S10215 (Oct. 1, 2008) ("We are already seeing the consequences of a freezing credit market that will only worsen…Our economy runs on credit. Underlying that credit is trust. Both the credit and the trust is running out. Essentially, what we are doing in an intangible way is restoring trust and confidence, and in a very tangible way helping to restore credit. Banks will refuse to lend to businesses and even to one another; investors continue to withdraw to the safest investments…."); Congressional Record, Statement of Senator Judd Gregg, S10216 (Oct. 1, 2008) ("We also know, regrettably, that the credit markets are basically locked up and that credit on Main Street is disappearing, that people are not able to get financing for the payrolls, financing for inventory, financing to buy a car, send children to school, rebuild the local hospital, rebuild the local school system….").

[346] Congressional Record, Statement of Representative Barney Frank, H10763 (Oct. 3, 2008).

and allocate a portion of them to support the automotive industry,[347] suggesting that at least these four members of Congress believed that the TARP could be used for the automotive industry.

On December 10, 2008, a bill was passed by a 237 to 170 vote in the House to provide funds to the automotive industry by diverting $14 billion in loans to Chrysler and GM from a previously enacted program setup for the production of advanced vehicle technology.[348] Although a different version of the same bill was subsequently brought to the Senate floor, and debated long into the night on December 11, 2008, there was never a vote and Congress left for the December recess without passing any legislation aimed at the automotive industry.

Congress's explicit consideration of legislation that ultimately failed to pass creates a troubling question regarding the Bush Administration's decision to "step in" and rescue the automotive industry.[349] Recently, however, the Senate rejected an attempt by Senators Lamar Alexander and Bob Corker to use an amendment to a spending bill to limit the availability of TARP funds for automakers Chrysler and GM, suggesting that the Senate may not disagree with the way TARP funds have been used.[350] Given the various actions – and non-actions – by Congress, it is difficult to make any sweeping statement about "Congressional intent" with regard to the use of TARP funds to support the automotive industry.

f. Conclusion

At the end of this analysis, the question that remains is whether the executive should get the benefit of the doubt about a close question of statutory interpretation when the executive might have thought in good faith that interpreting the statute in a particular was crucial to the national interest. This question may never be answered with any finality as the Panel is not aware of any court before which the issue is currently pending and therefore it may never be resolved.[351]

2. Government as Owner of Commercial Enterprises: Management Issues

[347] Letter from Sens. Christopher Dodd and Harry Reid and Reps. Nancy Pelosi and Barney Frank to President George W. Bush, (Dec. 4, 2008) (online at www.democrats.senate.gov/newsroom/record.cfm?id=305476&).

[348] H.R. 7321, *supra* note 14.

[349] *Doe v. Chao*, 540 U.S. 614, 622 (2004) (declining to interpret Privacy Act of 1974 as not requiring showing by plaintiffs of actual damages where, *inter alia*, "drafting history show[s] that Congress cut the very language in the bill that would have authorized any presumed damages….").

[350] Congressional Record, Statements of Senators Alexander and Corker, S8217 – S8219 (July 29, 2009).

[351] As noted previously, *supra* note 55, the Indiana State Police Pension Trust filed a motion for writ of certiorari with the Supreme Court on September 3, 2009. There is no question raising the issue of Treasury's authority to use the TARP funds among the questions presented to the court in the motion.

When government intervenes in business, it creates uncomfortable tensions and the potential for conflicting policy priorities. Nowhere is this more apparent than when considering the government as the owner or significant shareholder of a corporation.

a. Issues Implicated in Government Involvement in Commercial Enterprises

Few would argue with the objective of achieving the long term viability of Chrysler and GM in order to protect the government's investment. The potential for conflict may, however, arise should the government decide to use its position in these companies to promote public policy initiatives. In the case of GM, in which the government is a controlling shareholder, promoting such initiatives could raise the issue of fiduciary duty. To whom does the government owe a fiduciary duty? Most courts have found that the controlling shareholder in a publicly held corporation owes a fiduciary duty to the corporation.[352] Others have found that a fiduciary duty is owed directly to the minority shareholders.[353] The pursuit of public policy objectives using an investee corporation could violate these duties.[354]

The prospect of a government using its position of ownership in companies to pursue public policy matters is not without historical precedent. During the 1980s, the United Kingdom and other European countries privatized many of their state-controlled industries. In some cases, they retained what are called "golden shares." Golden shares are an "interest retained by a government in a company that has been privatized after having been in public ownership state-owned companies."[355] While many of these shares have since expired, at the time, these shares provided European governments with a powerful voice in a company's decision-making.[356] It has been argued that some governments even used their shares to block potential acquisitions of these companies by outside investors out of interest "in maintaining inefficiently high levels of employment or reducing cross-border flows of capital and services."[357] In some countries where

[352] *Gatz v. Ponsoldt*, 925 A.2d 1265, 1281 (Del. 2007); *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del.1993).

[353] *Gentile v. Rossette*, 906 A.2d 91, 103 (Del. 2006); see also *Pfeffer v. Redstone*, 965 A.2d 676, 691 (Del. 2009).

[354] See, for comparison purposes, Dodge v. Ford Motor Co., 170 N.W. 668, 683-84 (Mich. 1919) (rejecting as violative of fiduciary duties Henry Ford's "humanitarian" ambition to "employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes" by reinvesting back into the company profits that otherwise would have been paid as dividends to other shareholders).

[355] BNET Business Dictionary (accessed Aug. 30, 2009) (online at dictionary.bnet.com/definition/golden+share.html).

[356] J J.W. Verret, *The U.S. Government as Control Shareholder of the Financial and Automotive Sector: Implications and Analysis*, Mercatus Center at George Mason University (accessed Aug. 30, 2009) (online at www.mercatus.org/uploadedFiles/Mercatus/Events/CHC_-_2009_FMWG_II_-_Verret_Handout.pdf) (hereinafter "U.S. Government as Control Shareholder").

[357] *Id.*

"mixed" public and private ownership of industry is common, the potential for conflicts between private and public policy objectives is openly acknowledged and accepted.[358]

Even under the best of intentions, the potential for conflict exists. Unlike other investors, the federal government has the ability to exert its influence in any number of ways. It has the authority to negotiate Free Trade Agreements (FTAs) with other countries, take trade cases before the World Trade Organization (WTO), and even impose safeguards on imports that it believes may threaten one of its domestic industries. It has the authority to enforce securities and trade laws, and can bring cases against individuals or companies found in violation of these laws, which could include the imposition of fines and imprisonment. In a speech before the Kennedy School of Government in October of 2007, then-SEC Chairman Christopher Cox stated: "if the powers of government are no longer used solely to police the securities markets at arm's length, but rather are used to ensure the success of the government's commercial or investment activities, not only retail customers but every institutional investor could be put at a serious disadvantage."[359] The longer that the government plays the role of regulator and regulated, the greater the opportunity a conflict has to occur.

There are certain things that the government can do that the private sector cannot. When credit is scarce, the government can act as a lender of last resort, providing a company with favorable financing through a troubled time. The housing Government Sponsored Enterprises (GSEs) – Fannie Mae and Freddie Mac – over the last two decades were able to use their implicit government guarantees to raise debt cheaply in the markets, and then use that debt to finance the purchasing of trillions of dollars of housing loans from originators. Whereas private companies may find it difficult to borrow under the current conditions of the market, the government, if it chooses, can indefinitely provide financing for its investment and act as the lender of last resort. The ability to borrow cheaply from the government, however, is not without risk, and over the long term can potentially undermine the private market by allowing firms to avoid the discipline of commercial failure – moral hazard.

In addition to acting as a lender of last resort, the government has the ability to assist Chrysler and GM indirectly. Unlike other investors, the government has the authority to enact legislation designed to incentivize certain types of consumer behavior. The passage of the "Cash

[358] See, for example, the following disclosure by the partly state-owned Brazilian company Eletrobras:

Centrais Elétricas Brasileiras S.A. – Eletrobrás, *Form 20-F*, at 15 (July 1, 2009) (online at www.sec.gov/Archives/edgar/data/1439124/000119312509142012/d20f.htm#toc51217_7) ("We are controlled by the Brazilian Government, the current policies and priorities of which directly affect our operations…The Brazilian Government, as our controlling shareholder, has pursued (and may continue to pursue) some of its macroeconomic and social objectives through us ...the Brazilian Government has in the past and may in the future require us to make investments, incur costs or engage in transactions (which may include, for example, requiring us to make acquisitions) that may not be consistent with our objective of maximizing our profits….").

[359] Chairman Christopher Cox, *Speech by SEC Chairman: 'The Role of Government in Markets' Keynote Address and Robert R. Glauber Lecture at the John F. Kennedy School of Government* (Oct. 24, 2007) (online at www.sec.gov/news/speech/2007/spch102407cc.htm).

for Clunkers" legislation, which was included in the Supplemental Appropriations Act of 2009,[360] provided rebates for consumers who traded in their old fuel inefficient cars to purchase new fuel efficient cars. The $1 billion appropriated for the program was largely used in the first week of its availability, and additional funds were appropriated shortly thereafter by passage of the Consumer Assistance to Recycle and Save Program (H.R.3435).[361] The objective of the program aimed, in part, to promote higher vehicle fuel efficiency; the program, however, also helped with declining automotive sales. On August 26, 2009, the Department of Transportation announced that the "Cash for Clunkers" program (which ended on August 25, 2009) generated the purchase of "nearly 700,000 vehicles."[362] While the program offered the rebate to purchases of new fuel efficient vehicles from all automotive companies, Chrysler and GM were certainly among the beneficiaries of the program.

A further complicating factor is the risk of political interference in government-owned entities. An example is the pressure the German government is putting onto the U.S. government with respect to the sale of Opel. Thus far, Congress has not directly become involved in the management of Chrysler and GM. The possibility, however, exists.[363] Management, executive compensation and bonus issues have become the subject of extensive public debate and have resulted in compensation restrictions for TARP recipients. Moreover, pressures could mount further given that federal assistance for the automotive companies is not politically popular.[364]

b. Tension Between Acting in a "Hands-Off Manner" and "Changing Culture"

At the Panel's Detroit field hearing, Mr. Bloom said the following:

> Our role has been to act as a potential investor of taxpayer resources, and as such we have not become involved in specific business decisions like where to open a new plant or which dealers to close. This is the job of management... Our goal is to promote strong and viable companies, which can be profitable and contribute to economic growth and jobs without government support as quickly as possible.

[360] Supplemental Appropriations Act, 2009, Pub. L. No. 111-32, 123 Stat. 1859 (hereinafter "Pub. L. 111-32").

[361] CAR Save Program Supplemental Appropriations Act, 2009, Pub. L. No. 111-47, 123 Stat. 1972.

[362] Department of Transportation, Office of Public Affairs, Press Statement for Transportation Secretary Ray LaHood: *Cash for Clunkers Wraps up with Nearly 700,000Car Sales and Increased Fuel Efficiency, U.S. Transportation Secretary LaHood declares program "wildly successful"* (August 26, 2009) (online at www.cars.gov/files/official-information/August26PR.pdf).

[363] Pub. L. No. 111-32, *supra* note 358.

[364] Rasmussen Survey, *Just 21% Favor GM Bailout Plan, 67% Oppose* (May 31, 2009) (online at www.rasmussenreports.com/public_content/business/auto_industry/may_2009/just_21_favor_gm_bailout_plan_67_oppose).

> Using GM or Chrysler as an instrument of broader government policy is inconsistent with these goals.[365]

On the other hand, the Treasury auto team has stated that in order to create the conditions most likely to lead to sustained viability for Chrysler and GM, it is necessary to change the culture within these automotive companies.[366]

While the Administration's stated purpose may not be to involve the federal government in the day-to-day business decisions of Chrysler or GM, the government will not be entirely absent from exerting any influence. Mr. Bloom further testified that as a shareholder, Treasury will vote on "core governance issues, including the selection of a company's board of directors and major corporate events or transactions." According to Mr. Bloom, the Treasury auto team was "involved in recruiting" many of the new directors who now sit on the new boards of Chrysler and GM.[367] As a shareholder, Treasury cannot escape these fundamental duties. Voting for directors is a basic right of shareholders, and it establishes the balance of power between shareholders and management of the company.[368] How Treasury manages these responsibilities without overstepping, however, is an area that needs careful and continued monitoring.

Moreover, the Treasury auto team's decision to dispose of its ownership stakes in Chrysler and GM "as soon as practicable" also raises important policy questions regarding the safeguarding of the taxpayers' investment, maximizing taxpayer return and the government's likelihood of achieving the operational, cultural and economic restructuring it seeks. The lingering issue is whether the government can really change the culture of these companies and help improve their profitability while it remains a (supposedly) disinterested shareholder with a "hands-off" approach to managing its investment. Merely exercising the right to vote on slates for boards of directors and other significant corporate governance issues may not provide the influence necessary to achieve the level of transformation sought. If the government intends to be a "silent partner of sorts," in the words of Senator Richard Shelby (R-AL),[369] then it also remains to be seen how it intends to protect the interests of the taxpayer as a shareholder.

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[365] *Ron Bloom Prepared COP Testimony*, *supra* note 79.

[366] In June 2009, Steven Rattner, then-head of the Task Force, stated: "[a]ddressing cultural issues is just as fundamental to our assignment as addressing the balance sheet or financing." Micheline Maynard, *U.S. Takes On the Insular Culture of G.M.*, New York Times (June 10, 2009) (online at www.nytimes.com/2009/06/11/business/11auto.html?dlbk).

[367] *Ron Bloom Prepared COP Testimony*, *supra* note 78.

[368] *U.S. Government as Control Shareholder*, *supra* note 356.

[369] Senate Committee on Banking, Housing and Urban Affairs, Statement of Ranking Member Shelby, *The State of the Domestic Automobile Industry: Impact of Federal Assistance*, 111th Cong. (June 10, 2009).

c. Models of Corporate Governance That Could Be Followed: Private Equity?

The private equity model could provide a useful template for the government in managing its investment in New Chrysler and New GM, and help address some of the tensions that exist when the government invests in commercial enterprises. A private equity firm will often invest in a company, put its people in place, set the operating rules and reporting practices that it believes will maximize its profits, and then let management run the company. A typical investment lasts between three to five years, but can vary anywhere from one to ten years depending on the investment.[370] A private equity investor tends to be more involved with management in the first months of the investment and more hands-off once a sense of stability at the investee company is achieved. During the first few months after an acquisition, the lead private equity partner generally spends at least half of its time working with management. The strategy, mission, and purpose of the company are set in the beginning. Changes in management help establish the new tone and culture. Together, the investor and management will "design and execute near-term improvements and develop a detailed multi-year business plan."[371] Once the plan is established and reporting procedures are put into place, the investor will let management run the day-to-day operations and manage the company.

Compensation is largely performance-based.[372] Private equity firms typically compensate their senior management with holdings in the company ranging anywhere from two to ten percent.[373] Management salaries tend to be much lower than at publicly traded companies. The private equity firm Texas Pacific Group, for example, brought in Millard Drexler in 2003 to be the CEO of J. Crew at an annual salary of $200,000 with no bonuses.[374] Instead, the bulk of his compensation was based on the increase in equity gains he brought to his equity holders. According to Scott Sperling, Co-President of Thomas H. Lee Partners, "around 90 percent of the

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[370] *Driving Growth: How Private Equity Investments Strengthen American Companies*, at 11 Private Equity Council (accessed Aug. 30, 2009) (online at: www.privateequitycouncil.org/wordpress/wp-content/uploads/driving-growth-final.pdf).

[371] *Id.*

[372] To the extent that there are any changes to compensation, the Panel recommends that those changes reflect the recommendations made in the its special report on regulatory reform. In that report, the Panel discussed the ways in which executive pay has actually become decoupled from performance and provided four recommendations for ensuring that compensation properly aligns executive and shareholder interests. These recommendations included: 1) creating of tax incentives to encourage long-term oriented pay packages; 2) encouraging financial regulators to guard against asymmetric pay packages in financial institutions; 3) recommending that regulators consider requiring executive pay contracts to provide for clawbacks of bonus compensation for executives of failing institutions, and 4) encouraging corporate governance structures with stronger board and long-term investor oversight of pay packages. Congressional Oversight Panel, *Special Report on Regulatory Reform: Modernizing the American Financial Regulatory System: Recommendations for Improving Oversight, Protecting Consumers, and Ensuring Stability*, at 37-40 (January 29, 2009) (online at cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf).

[373] *Id.*

[374] *Id.*

compensation the management teams get at our companies is driven by the performance of the equity value. The alignment of management's interests and our interests is absolute."[375]

Three aspects of the private equity model could be useful to Treasury going forward. First, Treasury should clearly articulate the duration of its investment. While the Treasury auto team has said that it plans to divest its holdings in New Chrysler and New GM "as soon as practicable," it should clearly articulate the conditions for divestment. Second, Treasury should consider structuring the compensation of management at New Chrysler and New GM to be more performance- based. The compensation of the new management is currently under review by Treasury's Special Master. The general public has directed outrage at the bonus packages of executives at various TARP recipient institutions. Tying management's compensation more closely to the performance of New Chrysler and New GM reflects current corporate governance best practices and may provide a more politically palatable alternative.

Finally, Treasury could articulate a mission and strategy for these companies that is transparent to management, the boards, and the taxpayers, set up a system for reporting and disclosures, and leave the business in the charge of management. The Treasury auto team has approved Chrysler and GM's viability plans. It has appointed or reinstated 10 of the 13 board members at New GM. It has appointed four of the nine board members at New Chrysler. New management is firmly in place. The longer that Treasury lingers in the decisions of management, the greater the opportunity that such decisions could become politicized.

Another approach that Treasury could employ to further separate management from politics is to hold Treasury's interest in a trust, not unlike the AIG trust, discussed in more detail below. While the government's influence would certainly still be evident, a trust would provide an additional barrier between the Administration and management that could serve to prevent any potential or actual politicization of management decisions.

d. Differences between Automotive Industry and Financial Institution Interventions

In some respects, Treasury's approach to its involvement with the domestic automotive industry is similar to its approach to bank intervention since the passage of EESA in October 2008. Facing a financial crisis, Treasury recognized the need to take a series of actions necessary to prevent a collapse of the financial system and its resultant impact on the greater American economy. As part of its response, Treasury decided to provide capital to viable financial institutions throughout the nation in order to strengthen their balance sheets, foster the provision of business and consumer credit within the economy, and help stabilize the financial

[375] *Id.*

system.[376] Its provision of TARP assistance to both banks and domestic automobile companies was, Treasury states, designed to prevent significant economic disruption.[377]

Treasury staff indicated to the Panel that they based their decisions to provide TARP assistance to institutions on an entity-by-entity basis, rather than by industry.[378] In other words, Treasury reviewed the particular circumstances of each institution before it decided to disburse TARP funding and was not seeking a uniform approach across the same industry. To support this assertion, Treasury pointed to the fact that Treasury is a significant shareholder of GM and Citigroup as well as a debt holder of Chrysler and the banks and other financial institutions participating in the Capital Purchase Program (CPP).

There remains a perception, however, that banks and other financial institutions have been treated rather differently from the automotive companies with respect to their TARP investments.[379] This perception remains despite both Treasury's assertions that it has based its decisions on a case-by-case basis, and the Administration's articulation of a set of uniform principles to govern its ownership interests in financial and automotive companies (one being that in "exceptional cases" where the government feels it is necessary to respond to a company's request for substantial assistance, Treasury will reserve the right to establish upfront conditions as necessary including requirements for new viability plans as well as changes to boards of directors and management.)[380] During Secretary Geithner's testimony before the Panel in April, he stated that the Obama Administration is prepared to oust top financial executives if their firms require more public aid. Secretary Geithner indicated that where Treasury provides capital in the future, it will be done so with conditions "not just to help protect the taxpayer, but to try to help ensure that the system emerges stronger, not weaker."[381] Where Treasury provides "exceptional

[376] U.S. Department of the Treasury, *Statement by Secretary Henry M. Paulson, Jr. on Actions to Protect the U.S. Economy* (Oct. 14, 2008) (online at www.treas.gov/press/releases/hp1205.htm).

[377] U.S. Department of the Treasury, *Secretary Paulson Statement on Stabilizing the Automotive Industry* (Dec. 19, 2008) (online at www.treas.gov/press/releases/hp1332.htm).

[378] Treasury staff discussed this issue, along with the overall status of the AIFP as well as the Administration's strategies and plans going forward as New Chrysler and New GM have completed their purchases of assets through the bankruptcy process, with Panel staff at a Treasury briefing held on July 29, 2009.

[379] Senate Finance Committee, Statement of Senator Stabenow, *TARP Oversight: Six Month Update*, 111th Cong. (Mar. 31, 2009) (online at www.cq.com/display.do?dockey=/cqonline/prod/data/docs/html/transcripts/congressional/111/congressionaltranscripts111-000003088824.html@committees&metapub=CQ-CONGTRANSCRIPTS). At the hearing, Senator Stabenow highlighted "the difference now that we're seeing between the approach with the auto industry, which is much more modeled on a reorganization approach, and the approach that is being used throughout the financial services industry. And that is a straightforward subsidization." She proceeded to ask Professor Elizabeth Warren: "And what lessons can we learn from the rigorous oversight of the – of the auto industry to learn from that and place it on the financial institutions that have been receiving TARP funds?" *Id*.

[380] For the set of principles articulated by the Administration, see *supra* note 183.

[381] Congressional Oversight Panel, Testimony of Treasury Secretary Timothy F. Geithner, at 40 (Apr. 21, 2009).

assistance," "it will come with conditions to make sure there is restructuring, accountability, to make sure these firms emerge stronger in the future."[382] Secretary Geithner also indicated that where Treasury has had to do exceptional things, it has replaced management and boards, and cited the government's interventions in AIG, Freddie Mac and Fannie Mae as examples.[383] An assessment of Treasury's actions, however, suggests that its commitment to this ideal is doubtful except in those rare circumstances involving government-mandated restructuring efforts.

For example, in order to achieve its goals for the automotive industry at the outset, Treasury determined that it was necessary for both recipients to formulate long-term viability plans, which required a credible demonstration of future profitability and alterations to business models. In addition to forcing Chrysler and GM to develop new viability plans in the restructuring process, the Treasury auto team negotiated a deal that wiped out shareholders, cut debt, influenced decisions regarding personnel,[384] and subjected creditors to losses. However, while the FDIC has placed some banks into receivership in the normal exercise of its powers, none have been forced to develop new viability plans, shareholders have not been wiped out, and debts have been guaranteed. In addition, Treasury has not forced TARP-recipient financial institutions to reorganize, nor has it completely changed their boards and managements.

While Treasury has not generally exercised a significant management role with respect to most of the financial institutions that have received TARP capital investments, it has done so with the largest and most distressed TARP recipients. For example, Treasury has exercised significant control over AIG, which received $70 billion in TARP funds under the Systemically Significant Failing Institutions program (SSFI) (in addition to other assistance provided by the Federal Reserve). As with the automotive companies, some of AIG's management has been replaced and the company has undergone a restructuring that has resulted in two of its profitable foreign insurance divisions being spun-off and its financial products division significantly cut back. However, Treasury has not required AIG to submit a forward-looking viability plan, nor has AIG been forced into reorganization. Additionally, those with equity stakes in AIG have seen their positions severely diluted by the government, but they have not been wiped out, in contrast to the treatment of automotive company shareholders. Companies with contractual ties to AIG, for instance those that owned AIG-originated credit default swap (CDS) contracts, have been made whole, unlike some creditors of the automotive companies.

Another significant difference between the various companies in which the government owns stakes is the manner of holding of equity. The shares that make up the government's 77.9

[382] *Id.*

[383] *Id.* at 40-41.

[384] In the case of New Chrysler, the entire management team is new, and in the case of New GM, some senior managers are no longer with the company and the management team is smaller than it was.

percent share in AIG are held in a trust for the benefit of the United States Treasury.[385] The Trust Agreement provides that the trustees must act "in or not opposed to the best interests of Treasury."[386]

There are a number of reasons why the Federal Reserve Bank of New York (FRBNY), and Treasury might have chosen a trust structure. The stated reason was to avoid conflicts of interest: the Trust Agreement provides that "to avoid any possible conflict with its supervisory and monetary policy functions, the FRBNY does not intend to exercise any discretion or control over the voting and consent rights associated with the Trust Stock."[387]

There is also the possibility that the shares were placed into a trust so as not to violate the Government Corporation Control Act (GCCA).[388] The GCCA prohibits the government from owning a corporation without specific Congressional authorization.[389] The trust structure also provides political insulation to shareholder-taxpayers who wear two hats – one as shareholders who want to maximize the return on their investments, and the second as taxpayers who want the financial system stabilized. The trustees are advised, however, in exercising their discretion under the Trust Agreement, that the FRBNY believes that AIG "being managed in a manner that will not disrupt financial market conditions, [is] consistent with maximizing the value of the Trust Stock."[390] Professor J.W. Verret testified before the House Oversight and Government

[385] *AIG Credit Facility Trust Agreement* (accessed Aug. 30, 200) (online at www.newyorkfed.org/newsevents/news/markets/2009/AIGCFTAgreement.pdf) (hereinafter "AIG Credit Facility Trust Agreement"). Note also that the trust is for the benefit of the United States Treasury, not the U.S. Department of Treasury. The AIG Trust Agreement explains that "any property distributable to Treasury as beneficiary hereunder shall be paid to Treasury for deposit into the General Fund as miscellaneous receipts." *Id.* at § 1.01.

[386] *Id.* at § 3.03(a). Professor J.W. Verret testified that usually, fiduciaries are tasked to "manage … wealth to maximize the value for their beneficiaries." House Oversight and Government Reform Committee, Testimony of Professor J.W. Verret, *Panel II, AIG: Where is the Taxpayer's Money Going?* (May 13, 2009) (hereinafter "Verret Testimony"). William Dudley, president and CEO of the FRBNY, testified in March that the "trustees have a legally binding obligation to exercise all of their rights as majority owner of AIG in the best interests of the U.S. taxpayer, with the proceeds of any ultimate sale of shares going directly to Treasury of the United States." House Committee on Financial Services, Tesimony of William Dudley (Mar. 24, 2009) (online at www.newyorkfed.org/newsevents/speeches/2009/dud090324.html). Representatives Issa and Bachus have sent letters to Treasury and SIGTARP calling for an audit of the AIG trust and setting out criticisms of the trust structure, including the "lack of standard fiduciary duties," the Trust's "broad indemnification of the actions of the trustees," and lack of accountability on the part of the trustees. Letter from Representatives Spencer Bachus and Darrell Issa to Neil Barofsky (Aug. 31, 2009); see also Letter from Representatives Spencer Bachus and Darrell Issa to Secretary Timothy Geithner (Aug. 31, 2009).

[387] *AIG Credit Facility Trust Agreement*, *supra* note 385.

[388] 59 Stat. 597, as amended, 31 U.S.C. § 9101 *et seq*.

[389] 31 U.S.C. § 9102. It could be argued that EESA, with its authorization to purchase securities in financial institutions, provides this authorization.

[390] *AIG Credit Facility Trust Agreement*, *supra* note 385 at § 2.04(d). Trustee Chester Feldberg testified that this clause "was put in by the Federal Reserve to express their [its] desire that that issue be considered in the course … of the trustee's deliberations. It was explicitly done in a way that it does not direct the trustees to do anything." House Committee on Oversight and Government Reform, Testimony of Chester Feldberg, *AIG: Where is the Taxpayer's Money Going?* (May 13, 2009).

Reform Committee in May 2009 that the trust is also intended to protect the shares from political influence, by creating "an independent buffer between the short-term political interests of an administration and the long-term health of the nation's financial system."[391]

There are a number of differences between the government's holdings in AIG and the automotive companies. Unlike the relationship between AIG and the FRBNY, Treasury holds no direct supervisory position over the automotive companies, nor does it hold the Federal Reserve Banks' and Board's monetary policy function.[392] AIG also has a more direct effect on U.S. financial markets than do the automotive companies.[393] This may require more of a buffer to protect against conflicts of interest, whether such conflicts are potential, actual, or simply based upon appearance. In addition, Mr. Bloom has announced that Treasury intends to start to sell its shares in GM by 2010.[394] Treasury, therefore, may not have the long-term ownership in Chrysler and GM that it will likely have in AIG.[395]

Treasury or Congress might choose to place the government's auto shares into a trust.[396] The Panel notes that the TARP Recipient Ownership Trust Act of 2009, currently under consideration in the Senate, would require Treasury to place into a trust the shares of any TARP recipient of which the government is more than a 20 percent owner.[397] This bill is designed to

[391] *Verret Testimony*, *supra* note 386. He opines that political considerations might create pressure for a nationally controlled bank to subsidize lending in battleground states. He points to Italy's government controlled banks as an example.

[392] Like any other automotive company or TARP recipient, GM is still subject to an array of government regulations.

[393] House Committee on Financial Services, Statement of the Chairman of the Board of Governors of the Federal Reserve System Ben S. Bernanke, *Oversight of the Federal Government's Intervention at American International Group*, 111th Cong., at 3 (Mar. 24, 2009) (online at www.house.gov/apps/list/hearing/financialsvcs_dem/statement_-_bernanke032409.pdf) ("At best, the consequences of AIG's failure would have been a significant intensification of an already severe financial crisis and a further worsening of global economic conditions. Conceivably, its failure could have resulted in a 1930s-style global financial and economic meltdown, with catastrophic implications for production, income, and jobs.").

[394] *Ron Bloom COP Testimony*, *supra* note 36 at 26.

[395] Edward Liddy has testified that he expects AIG to take three to five years to complete its restructuring and repay the Treasury and the FRBNY. House Committee on Oversight and Government Reform, Testimony of AIG Chief Executive Officer Edward Liddy (May 13, 2009) (online at www.cq.com/display.do?dockey=/cqonline/prod/data/docs/html/transcripts/congressional/111/congressionaltranscripts111-000003116243.html@committees&metapub=CQ-CONGTRANSCRIPTS&searchIndex=0&seqNum=17).

[396] Treasury already has plans to put its shares in Citigroup into a trust. U.S. Department of the Treasury, *Treasury Announces Participation in Citigroup's Exchange Offering* (Feb. 27, 2009) (online at www.treas.gov/press/releases/tg41.htm); see also U.S. Department of the Treasury, *Citigroup Exchange Offering Terms* (accessed Aug. 30, 2009) (online at www.treas.gov/press/releases/reports/transaction_outline.pdf).

[397] Senators Mark Warner (D-VA) and Bob Corker (R-TN) are the original lead sponsors of the TARP Recipient Ownership Trust Act of 2009. Under this legislative proposal, if the government owns more than 20 percent of a private company, that ownership stake would be placed in an independent trust supervised by three presidentially appointed trustees (uncompensated) with a with a fiduciary obligation to U.S. taxpayers. The trust would have a responsibility to sell these assets within 18 months, while trustees could ask for an extension if they collectively determine that additional time might provide a way to maximize the return on the taxpayers' investment.

remove any hint of politics from Treasury's temporary ownership stakes. Under this proposal, the trust would have a responsibility to sell these assets within 18 months, with limited exceptions.[398] The Panel takes no view on the specifics of this particular bill, or the details of establishing any such trust, but notes that problems identified with the AIG trust structure should be addressed in any future trust. In his testimony before the House Oversight and Government Reform Committee in May, Professor Verret advanced three criticisms of the AIG trust structure. First, he stated that the AIG trustees are required to "manage the trust in the best interests of Treasury, rather than the U.S. taxpayers specifically." Second, as discussed above, he believes that the trust should explicitly direct the trustees to act to maximize the value for the trust beneficiaries. Third, he stated that the Trust Agreement might allow trustees to benefit personally from investment opportunities that might belong to AIG.[399] All of these criticisms could be addressed in the drafting of a trust agreement for Chrysler and GM shares.

Fewer inherent conflicts and a shorter timeframe make the need for a trust for the Chrysler and GM shares less pressing than for the AIG shares, but it could still provide benefits. Placing the shares in a trust could also avoid the appearance of conflict. Even if no direct conflict exists, a trust could prevent the use or appearance of political influence in the government's ownership. Finally, placing the shares in a trust could also prevent any potential violation of the GCCA.[400]

The differences between the current treatment of the automotive companies and financial institutions might be due to several factors. First, Treasury potentially had greater leverage in its investment in Chrysler and General Motors than it did with the banking industry, since the automotive companies, being extremely close to bankruptcy, came to the federal government for assistance, while at least most of the banks receiving TARP assistance through the CPP have been perceived as solvent. Second, some of these alleged differences (i.e., management changes, creditor and shareholder treatment) were a direct result of Chrysler and GM's Section 363 sales, which TARP recipient banks have not faced. However, the state of many banks' balance sheets (and their potential need to undergo substantial balance sheet restructuring or face insolvency) was uncertain when EESA was passed in October 2008. Finally, these differences underscore

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Senator Warner believes that "this legislation will go a long way toward providing additional assurances that a political agenda is not being pursued through government ownership in any of these companies and that these companies also are being dealt with fairly." Mark R. Warner, *Exit Strategy Needed* (op-ed), Washington Times (July 27, 2009) (online at www.washingtontimes.com/news/2009/jul/26/exit-strategy-needed/).

[398] *Id*.

[399] *Verret Testimony*, *supra* note 386.

[400] The Panel takes no position as to whether the law is being violated if the shares are not placed in a trust.

the unique role that banks play in the larger economy. To fix the economy, Treasury recognized the need to repair the banking system and decided to recapitalize and shore up the banks.[401]

3. Government as Investor: Stewardship Issues

Section F above sets out the amounts of taxpayers' funds that are at risk. Section G6 below raises serious doubts that those funds will ever be recovered. While the ultimate goal, as the Administration recognizes, is to ensure that the companies are on a viable path to profitability such that they may begin the process for an IPO, the prudent course is obviously to hold the stock until an IPO presents an opportunity to at least recoup the government's investment, if not make some profit. There is no advantage, however, in rushing toward an IPO while the taxpayers' investment is still deeply underwater and all projections suggest that it will be a matter of years before the companies return to profitability.

In the meantime, the government must ensure that the investors – i.e., the U.S. taxpayers – are provided with adequate information to evaluate the companies' ongoing performance. During the Panel's Detroit field hearing, Mr. Bloom testified that both companies will file reports with the government, which will then be disclosed to the public on a quarterly basis.[402] He did not say how frequently these reports will be made to the government, except that they would be "periodic."[403] Mr. Bloom also testified that New Chrysler and New GM will become voluntary reporting companies and file reports with the SEC.[404] These filings, he said, would begin "shortly" although "not immediately."[405] Neither during public testimony nor during meetings with members of the Panel or Panel staff has Treasury stated a date on which such filings or reports will begin. It is understandable that assembling the data and analysis that such filings require is challenging given that both companies – in particular New GM – are large and complex and that their creation through bankruptcy has rendered each company's financial structure even more complex. Chrysler's recent history as a non-filing company must also be acknowledged. However, companies in the private sector are often required to assemble such data and analysis on a very tight timeline. The Panel expects that New Chrysler and New GM, which are answerable to a much wider segment of the public than any other public company, will endeavor to meet the same type of deadline.

It is also unclear what will be included in these reports. Mr. Bloom testified that the first reports from New Chrysler and New GM will not contain all of the information that an SEC

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[401] *Henry Paulson Congressional Testimony, supra* note 321. Senate Banking Committee, Testimony of Treasury Secretary Timothy Geithner, *TARP Oversight,* (May 20, 2009) (online at www.treas.gov/press/releases/tg139.htm).

[402] *Ron Bloom COP Testimony, supra* note 36.

[403] *Ron Bloom COP Testimony, supra* note 36.

[404] *Ron Bloom COP Testimony, supra* note 36.

[405] *Ron Bloom COP Testimony supra* note 36.

filing would typically include.[406] The reports will include "traditional measures of revenue and profitability that a normal investor would want to know about."[407] Mr. Bloom did not provide any additional information about what might be included in these reports, such as information about risks, management, major events, or any other data that is typically required to be included in SEC filings.

In addition to information about revenues and profitability, New Chrysler and New GM should provide the taxpayer investors with a set of metrics by which the companies' success can be measured, along with periodic updates regarding progress toward those goals.[408] The companies should also disclose to what extent internal controls, that is, clearly defined processes and procedures relating to the communication of information, accountability for individual employees, etc., have been established to ensure the companies' plans are being properly implemented and executed. To date, neither Treasury nor either company has disclosed such information.

Other corporate governance changes have begun with the appointment of well-qualified and independent[409] directors.[410] Given the large public investment in these companies, it may be appropriate to require even stricter guidelines than current law mandates. For example, the companies could require all of their directors to be independent, instead of only a portion of them. Board members could be restricted from serving on the boards of other companies, or could at least be restricted in the number or type of other board positions they could hold. The companies could impose term limits on board members, to ensure that no director becomes too entrenched in the company or too close to its management. As TARP recipients, the automotive companies are already subject to restrictions on executive compensation[411] and would be covered

[406] *Ron Bloom COP Testimony*, *supra* note 36.

[407] *Ron Bloom COP Testimony*, *supra* note 36.

[408] A forthcoming GAO report, due to be made public in mid-October, will recommend the provision of such metrics.

[409] See *supra* notes 71 and accompanying text. See also the recommendations regarding alignment of interests through compensation guidelines discussed in the Panel's special report on regulatory reform, discussed at note 372 *supra*.

[410] See *supra* note 71. See also discussion of this issue *supra* Section B.

[411] The Stimulus Bill imposed executive compensation restrictions on all TARP recipients. American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, § 7001. Treasury announced in February that companies receiving subsequent TARP assistance would be subject to certain limitations on executive compensation including, most notably, a $500,000 cap on executive annual salaries; any compensation above this amount would have to be made in the form of restricted stock. U.S. Department of the Treasury, *Treasury Announces New Restrictions on Executive Compensation* (Feb. 4, 2009) (online at www.financialstability.gov/latest/tg15.html) (hereinafter "Treasury Executive Compensation Statement"). If the new automobile companies are to provide SEC-style disclosures, these disclosures would presumably include Compensation Discussion and Analysis (CD&A), which provides information about and the rationale behind the process by which executive compensation is determined.

by the SEC's recent "say-on-pay" proposals.[412] The automotive companies could adopt their own more tailored compensation guidelines, however, and ensure that compensation for both executives and board members is based on clearly articulated performance criteria and aligned to long-term performance. Board members could, for example, be required to hold a certain amount and type of company stock to ensure the best alignment of director and shareholder (i.e., taxpayer) interests.

4. Government Involvement in Bankruptcy Proceedings

Bankruptcy law is intended to provide for an orderly reorganization or liquidation of failing businesses. While the various stakeholders in a failed business may generally be expected to feel strongly about the treatment of their claims, the intensity of public debate surrounding the Chrysler and GM reorganizations was high. Proponents of the plan denounced bondholders holding out for larger equity stakes in exchange for retiring their debt[413] and President Obama declared, "[the holdout bondholders] were hoping that everybody else would make sacrifices, and they would have to make none. Some demanded twice the return that other lenders were getting. I don't stand with them."[414] One disclosed e-mail allegedly reveals a Task Force member angrily asking, "You're telling me to bend over to a terrorist like Lauria [the lead attorney for Chrysler bondholders]?"[415] Representative John Carter (R-TX) noted on the House floor that according to Thomas Lauria, "Perella Weinberg Partners was directly threatened by the White House and, in essence, compelled to withdraw its opposition to the Obama Chrysler restructuring deal under the threat that the full force of the White House press corps would destroy its reputation if it continued to fight."[416] Recalcitrant bondholders and their supporters

[412] The proposed "say-on-pay" regulations would require public companies to subject decisions regarding executive compensation to a non-binding shareholder vote. Securities Exchange Commission, *Shareholder Approval of Executive Compensation of TARP Recipients*, Release No. 34-60218 (July 1, 2009) (online at www.sec.gov/rules/proposed/2009/34-60218.pdf) (hereinafter "SEC Release No. 34-60218").

[413] See, e.g., Felix Salmon, *Time for Chrysler's bondholders to man up and move on*, Reuters (May 4, 2009) (online at blogs.reuters.com/felix-salmon/2009/05/04/time-for-chryslers-bondholders-to-man-up-and-move-on/) (hereinafter "Felix Salmon May 4 Reuters Report); Executive Office of the President, *Remarks by Lawrence H. Summers at the 2009 National Conference of the Council on Foreign Relations*, at 4 (June 12, 2009) (online at www.cfr.org/publication/19618/prepared_remarks_by_lawrence_h_summers_director_of_the_national_economic_council.html?breadcrumb=%2Fbios%2F1001%2Flawrence_h_summers) (hereinafter "Lawrence Summers Council on Foreign Relations Remarks") ("There is nothing at all remarkable about the way in which finance was provided during the Chrysler or General Motors transactions."); Floyd Norris, *Why Chrysler's Bondholders Should Stop Whining*, New York Times (May 1, 2009) (online at www.nytimes.com/2009/05/02/business/02norris.html?dlbk) (hereinafter "Floyd Norris May 1 New York Times Report").

[414] *White House April 30 Remarks on Auto Industry*, *supra* note 111.

[415] Neil King Jr. and Jeffrey McCracken, *US Pushed Fiat Deal on Chrysler*, Wall Street Journal (June 6, 2009) (online at online.wsj.com/article/SB124424451815990495.html) (hereinafter "Neil King Jr. and Jeffrey McCracken June 6 Wall Street Journal Report"). See especially emails between Task Force officials and Chrysler legal counsel posted with article.

[416] Congressional Record, Statement of Representative John Carter (R-TX), H5086 (May 4, 2009) (hereinafter "Representative Carter May 4 Statement").

struck back, alleging that the "government is penalizing people…for having funded [their] retirement with…bonds" and that bondholders, especially small bondholders, were "being ignored in negotiations and singled out to bear the greatest share of the cost of restructuring."[417] Others noted how the "mauling of GM creditors tells investors not to invest in TARP banks because everything this Treasury touches turns to politics."[418]

The rhetoric in the legal debate is perhaps more tempered but positions are just as strongly held. The Panel does not second guess court decisions and this report is not a law review article, but the extensive involvement of Treasury in structuring[419] and defending the two transactions throughout the bankruptcy process, and the impact of the court decisions on the financial markets, requires that the Panel inquire into the legal issues involved.

There remains an ongoing challenge to the Chrysler bankruptcy. Both the Chrysler and GM 363 sales were approved by the respective courts,[420] and on appeal the Second Circuit affirmed the Chrysler opinion.[421] The Supreme Court did not[422] intervene in the Chrysler bankruptcy. However, on September 3, 2009, the Indiana Pension Funds filed a petition for *certiorari* to the Supreme Court to appeal the Second Circuit's decision. As of the date of this Report, it is unknown whether the Court will grant cert.[423]

The two cases have nonetheless attracted both both criticism and support among leading academics. The issues center on the use of the 363 sale in the auto bankruptcies.[424] It would be misleading to suggest that there are only two sides to the academic debate surrounding the

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[417] Dennis Buchholtz, *GM Bondholders Are People Like You and Me*, Wall Street Journal (op-ed), (May 27, 2009) (online at online.wsj.com/article/SB124338330278956585.html) (hereinafter "Buchholtz May 27 WSJ Op-Ed") ; see also *Statement from Non-TARP Lenders of Chrysler*, Wall Street Journal (Apr. 30, 2009) (online at blogs.wsj.com/deals/2009/04/30/statement-from-non-tarp-lenders-of-chrysler/) (hereinafter "Statement from Non-TARP Chrysler Lenders").

[418] *Gettelfinger Motors*, Wall Street Journal (May 4, 2009) (online at online.wsj.com/article/SB124105303238271343.html) (hereinafter "WSJ May 4 Report").

[419] See Sections B and D of this report.

[420] *In re Chrysler LLC, et al.*, 405 B.R. 84 (Bankr. S.D.N.Y. 2009) and *In re GMC*, 407 B.R. 463 (Bankr. S.D.N.Y. 2009).

[421] *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 2009 WL 2382766 (2d Cir. Aug. 5, 2009).

[422] The Supreme Court issued a temporary stay of the bankruptcy court's sale order pending appeal. Shortly thereafter, the Court removed the stay, noting that the appellants failed to meet their burden of showing that the delay was justified. However, the Court noted that the "denial of stay is not a decision on the merits of the underlying legal issues." *Indiana State Police Pension Trust, et al v. Chrysler LLC, et al*, 129 S. Ct. 2275 (2009).

[423] *See supra* note 55.

[424] In both the Chrysler and GM cases, parties argued that the Secretary of Treasury exceeded his statutory authority and violated the Constitution by using TARP money to finance the transactions. In each case, the presiding court held that the objectors lacked standing to raise this issue or that the issue was moot. For more in depth discussion, *see* Section G(1)(b) of this report.

Chrysler and GM bankruptcies, but academics generally agree on certain points. Scholars acknowledge that 363 sales had been used to resolve Chapter 11 cases long before the recent Chrysler and GM bankruptcies and that such sales have grown increasingly popular in the last few years.[425] Scholars also agree that the Code does not restrict the manner in which post-petition financing is used, including distributions made to certain creditors. Moreover, no academic disagrees that the government's additional loans of approximately $4.96 billion to Chrysler on April 29, 2009 and $30.1 billion to GM on June 3, 2009 constituted post-petition financing.

Instead, the debate among academics focuses more narrowly on the way in which the 363 sale was structured and the impact of the sale on GM's and Chrysler's prepetition creditors. In *Chrysler*,[426] the United States Bankruptcy Court for the Southern District of New York reviewed the 363 sale procedures. Relying on the *Lionel* case,[427] the bankruptcy court noted that the Second Circuit rejected a literal interpretation of Section 363, which would impose no limitations on the sale of estate assets, reasoning that such an interpretation would undermine "the congressional scheme" established for corporate reorganization.[428] The bankruptcy court also observed in *Lionel* the policy issues involved in balancing the debtor's ability to sell assets and a creditor's right to an informed vote on confirmation of a plan. Noting that the *Lionel* court held there must be some articulated business justification for a sale of property outside the normal course of business,[429] the bankruptcy court found that the proposed sale of assets to an entity

[425] See, generally, *What's Good For General Motors*, *supra* note 258 at 10, where, referring to the use of Section 363, Professor Adler writes, "bankruptcy courts have increasingly, and usefully conducted all asset sales." See also *Assessing the Chrysler Bankruptcy*, *supra* note 240, where Professors Roe and Skeel note that ("in time courts became more comfortable with [363 sales], partly because it makes sense for a failing business, partly because the general merger market deepened and thickened in the 1980s. Such sales became frequent in Chapter 11.").

[426] *In re Chrysler LLC, et al.*, 405 B.R. 84 (Bankr. S.D.N.Y. 2009).

[427] *In re Lionel Corp.*, 722 F.2d 1063 (2d Cir. 1983) (finding that a bankruptcy judge must have substantial freedom to tailor his orders to meet differing circumstances and concluding there has to be some articulated business justification for the use, sale or lease of property outside the ordinary course of business).

[428] *In re Chrysler LLC, et al.*, 405 B.R. 84, 94 (Bankr. S.D.N.Y. 2009).

[429] The *GM* court lists seven factors the *Lionel* court provided to determine whether a good business reason exists. The *GM* court adds four more factors in its opinion that are also to be taken into consideration. "In making the determination as to whether there is a good business reason to effect a 363 sale before confirmation, the *Lionel* court directed that a court should consider all of the 'salient factors pertaining to the proceeding' and 'act to further the diverse interests of the debtor, creditors and equity holders.' It then set forth a nonexclusive list to guide a court in its consideration of the issue: (1) the proportionate value of the asset to the estate as a whole; (2) the amount of elapsed time since the filing; (3) the likelihood that a plan of reorganization will be proposed and confirmed in the near future; (4) the effect of the proposed disposition on future plans of reorganization; (5) the proceeds to be obtained from the disposition vis-a-vis any appraisals of the property; (6) which of the alternatives of use, sale or lease the proposal envisions; and 'most importantly perhaps,' (7) whether the asset is increasing or decreasing in value. As the *Lionel* court expressly stated that the list of salient factors was not exclusive, this Court might suggest a few more factors that might be considered, along with the preceding factors, in appropriate cases: (8) Does the estate have the liquidity to survive until confirmation of a plan?; (9) Will the sale opportunity still exist as of the time of plan confirmation?; (10) If not, how likely is it that there will be a satisfactory alternative sale opportunity,

sponsored by Fiat was necessary to preserve the value of Chrysler's business and maximize the value of the bankruptcy estate.

In examining whether the Fiat sale was a *sub rosa* plan of reorganization, or a plan that violated bankruptcy's priority rules, the bankruptcy court focused on the fact that the bankruptcy estate received fair value for the assets being sold. The bankruptcy court also noted that the $2 billion paid by New Chrysler for the assets would be distributed entirely to the secured creditors, thus creating a bigger payout for these creditors than they would receive in liquidation. The bankruptcy court recognized that some creditors of the prepetition debtor (Old Chrysler), specifically the UAW Trust and the UAW, entered into agreements with the buyer of the assets (New Chrysler), and these creditors received ownership interests in the buyer (New Chrysler). Nonetheless, the bankruptcy court concluded that this fact did not "transform a sale of assets into a *sub rosa* plan"[430] because neither the UAW Trust nor the UAW received any distributions on account of their prepetition claims. Instead, these payments and ownership interests were the result of negotiations with the buyers (New Chrysler). The bankruptcy court observed:

> In negotiating with those groups essential to is viability, New Chrysler made certain agreements and provided ownership interests in the new entity, which was neither a diversion of value from the Debtors' assets nor an allocation of the proceeds from the sale of the Debtors' assets. The allocation of ownership interests in the new enterprise is irrelevant to the estates' economic interests.[431]

On appeal, the Second Circuit Court of Appeals adopted the bankruptcy court's reasoning and affirmed the lower court's ruling. The appellate court reiterated that *Lionel* does not require an "emergency" to justify a 363 sale, but merely requires that a court find there is a "good business reason." The appellate court agreed with the bankruptcy court that the 363 sale did not constitute a *sub rosa* plan. It also agreed that the transaction was consistent with creditor priority rules because all equity stakes in New Chrysler were entirely attributable to new value, including government loans, new technology contributed by Fiat, and new management – none of which were assets of the debtor's bankruptcy estate.[432]

The Second Circuit rejected appellants' argument that the 363 sale violates the Code by impermissibly subordinating appellants' interests as secured lenders on the ground that they lacked standing to make such objection. On this point, the Chrysler bankruptcy contains a twist

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or a stand-alone plan alternative that is equally desirable (or better) for creditors?; and (11) Is there a material risk that by deferring the sale, the patient will die on the operating table?" *In re GMC*, 407 B.R. 463, 490 (Bankr. S.D.N.Y. 2009).

[430] *In re Chrysler LLC, et al.*, 405 B.R. 84, 99 (Bankr. S.D.N.Y. 2009).

[431] *In re Chrysler LLC, et al.*, 405 B.R. 84, 99 (Bankr. S.D.N.Y. 2009).

[432] *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 2009 WL 2382766 (2d Cir. Aug. 5, 2009).

that makes the bankruptcy ruling more complicated to follow. The appellate court noted that long before the Chrysler bankruptcy, the appellants and the other first lien-holders had agreed by contract that, in the event of bankruptcy, an agent could be authorized to act on their behalf at the request of lenders holding a majority of Chrysler's debt. By the terms of the agreement, any action taken by the agent is binding on all lenders, including those in disagreement.[433] After Chrysler filed for bankruptcy, the majority of first lien-holders authorized the agent to act,[434] and the agent subsequently consented to the sale under Section 363(f)(2).[435] Because the consent was binding on appellants as per their credit agreement, the appellate court found that they lacked standing to make this objection. Appellants asserted that the majority of lenders were bullied into approving the sale, but they could produce no evidence to support the claim. As a result, the Second Circuit dismissed this allegation.

The General Motors bankruptcy court followed the Second Circuit appellate court in holding that a 363 sale was appropriate in that case.[436] The cases were similar in many respects, including the assertion that a quick sale would maximize the amount to be received by the bankruptcy estate. A major practical difference between the two cases, however, is that the assets of the debtor (Old GM) were sufficient that its secured creditors could be paid in full, which eliminated many of the objections that had been raised in Chrysler. Again, the court focused on the difference between the amount that creditors of Old GM would receive in liquidation and the higher amount that the bankruptcy estate would receive by reason of the sale. Evercore, GM's financial advisor, issued a fairness opinion that concluded that the purchase price was fair to GM from a financial point of view and the court stated that no contrary evidence was submitted. The court noted that Section 363 imposed no limits on the proportion of the debtor's estate that could be sold under that section. "If…the transaction has 'a proper business justification' which has the potential to lead toward confirmation of a plan and is not to evade the plan confirmation process, the transaction may be authorized."[437] The court specifically noted that all or substantially all the debtor's assets may be sold in a 363 sale. The court found that a proper business justification existed in the GM case. As in the Chrysler case, the court found that there was no *sub rosa* plan arising from the fact that contracts with certain creditors of the debtor (Old GM) were assumed by the buyer (New GM) or that some creditors received ownership interests in the buyer (New GM). Once again, the court found that the dealings with

[433] *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 2009 WL 2382766 (2d Cir. Aug. 5, 2009).

[434] *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 2009 WL 2382766 (2d Cir. Aug. 5, 2009).

[435] "The trustee may sell property… free and clear of any interest in such property of an entity other than the estate, only if – such entity consents." 11 U.S.C. § 363(f)(2).

[436] *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 2009 WL 2382766 (2d Cir. Aug. 5, 2009).

[437] *In re GMC*, 407 B.R. 463, 491 (Bankr. S.D.N.Y. 2009).

the buyer (New GM) were part of the post-bankruptcy negotiations that were designed to promote the survival of the business. The court observed:

> The Court senses a disappointment on the part of dissenting bondholders that the Purchaser did not choose to deliver consideration to them in any manner other than by the Purchaser's delivery of consideration to GM as a whole, pursuant to which bondholders would share like other unsecured creditors – while many supplier creditors would have their agreements assumed and assigned, and new GM would enter into new agreements with the UAW and the majority of dealers. But that does not rise to the level of establishing a *sub rosa* plan. The objectors' real problem is with the decisions of the Purchaser, not with the Debtor, nor with any violation of the Code or caselaw.[438]

Professor Adler contends that the sale in Chrysler was irregular and inconsistent with the principles that undergird the Code. He notes that assets can under appropriate circumstances be sold "free and clear" in a 363 sale, but that in Chrysler, the buyer ("New Chrysler") took the assets subject to specified obligations to the UAW Trust. He argues that if such obligations had not been a part of the sale, then the price for the assets might have been higher. Money that might otherwise have been available to repay secured creditors may thus have been withheld, in Professor Adler's view, by the purchaser in order to satisfy obligations to the UAW, with the result being that the purported sale was also a distribution of the sale proceeds seemingly inconsistent with contractual priority among the creditors. Professor Adler does not dispute that 363 sales are a common and effective means of resolving Chapter 11 reorganizations,[439] but he does argue that the Chrysler sale in particular was conducted in a manner inconsistent with the Code.

In response to the assertion that the bondholders received more than they would in liquidation, Professor Adler states that the nature of the process meant that the issue of whether the secured bondholders received the return that was due to them cannot be known: there was no market test because of the short amount of time permitted for the Section 363 bid and the unusual requirement in the bidding procedures that the purchaser assume the obligations to the UAW Trust.[440] The bankruptcy court's approval of the 363 sale meant that the rules governing

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[438] *In re GMC*, 407 B.R. 463, 496 (Bankr. S.D.N.Y. 2009).

[439] *What's Good For General Motors*, *supra* note 258 at 9-10 (Sept. 1, 2009) ("So long as a sale of a firm's assets is subject to a true market test, a sale may be the best and most efficient way to dispose of an insolvent debtor. Indeed, bankruptcy courts have increasingly and usefully conducted all-asset-sales. The key is to ensure a *true* market test….").

[440] Professors Roe and Skeel also adopt this opinion in their paper. *Assessing the Chrysler Bankruptcy*, *supra* note 240.

more traditional bankruptcies that involve the confirmation of a reorganization plan did not apply.[441]

Professor Adler argues that the bidding process in the GM bankruptcy, following the blueprint of the Chrysler bankruptcy, also did not allow for a true market valuation. As in the Chrysler case, the court required that any bidders, absent special exemption, must assume liabilities to the UAW as a condition of purchase. Professor Adler differentiates the two cases on the grounds that in GM there was no dissent by holders of the senior secured debt, much of which belonged to the U.S. and Canadian governments. He argues that even though this made approval easier, the decision still set a dangerous legal precedent.[442]

Professor Adler does not object to the eventual outcome of either transaction[443] as much as the fact that the process used does not make it clear whether the creditors were equitably treated.[444] He suggests a change to the Code to provide that Section 363 could not be used to sell all or substantially all of a debtor's assets on condition that the purchaser assume or pay some but not all of the claims of prepetition creditors; he would also have the bankruptcy law require that such a sale comply with applicable state law.[445]

Professors Roe and Skeel assert that the 363 sale in Chrysler amounted to a *sub rosa* plan, in that it allocated billions of dollars without the checks that a plan of reorganization requires.[446] They argue that the appellate courts have developed a strong set of standards for 363 sales, applying makeshift remedies to compensate for the fact that Section 363 does not provide for the procedural safeguards embodied in Section 1129.[447] They argue that the safeguards are particularly important if the transaction appears to be a *sub rosa* plan, determining critical Section 1129 features; and if the plan does determine critical Section 1129 features, such as judicial valuation, creditor consent, and an auction, it can only do so if the court fashions a

[441] See, generally, Section (C)(1)(b) of this report.

[442] *What's Good For General Motors*, *supra* note 258, at 7-8.

[443] Professor Adler stated, "[M]y criticism is not with the sale. It is with the restrictions on the sale." Congressional Oversight Panel, Testimony of Charles Seligson Professor at New York University School of Law Barry E. Adler, at 124 (July 27, 2009) (hereinafter "Barry Adler COP Testimony").

[444] Douglas Baird, the Harry A. Bigelow Distinguished Service Professor at the University of Chicago Law School, testified on Automotive Industry bankruptcies in front of the U.S. House of Representatives Subcommittee on Commercial and Administrative Law Committee on the Judiciary. Baird testified that he believed the bankruptcy process was flawed and that Chrysler and GM decisions set potentially dangerous precedents. However, he also stated that government intervention and an aggressive use of the bankruptcy code was necessary to minimize the cost to the taxpayer of keeping those companies alive. House Committee on the Judiciary, Subcommittee on Commercial and Administrative Law, Testimony of Harry A. Bigelow Distinguished Service Professor at University of Chicago Law School Douglas Baird, *Ramifications of Auto Industry Bankruptcies, Part III* (July 22, 2009) (judiciary.house.gov/hearings/pdf/Baird090722.pdf) (hereinafter "Douglas Baird Congressional Testimony").

[445] *What's Good For General Motors*, *supra* note 258 at 9-11.

[446] *Assessing the Chrysler Bankruptcy*, *supra* note 240.

[447] Section (C)(1)(b) of this report.

makeshift safeguard.[448] There was no such safeguard in the Chrysler case, they argue, and Section 1129 was hardly mentioned.[449] Similar to Professor Adler's views discussed above, Professors Roe and Skeel contend that the bidding process was flawed because it prevented a fair valuation of the company. They conclude that the Chrysler bankruptcy does not comply with good bankruptcy practice.

Professor Lubben, who furnished a paper titled *No Big Deal: The Chrysler and GM Cases in Context,* which appears at Annex B[450] of this report, and gave testimony at the Panel's Detroit field hearing,[451] takes a practical view of the reorganizations. Commenting on the arguments of academics speaking against the automotive bankruptcy cases, he asserts that their arguments "are not bankruptcy arguments but rather rhetorical arguments."[452] Professor Lubben points out that liquidation was the only practical alternative to the Section 363 sales in both cases because no financer other than the federal government would have stepped forward. Moreover, in the event of liquidation, the recovery received by creditors by reason of the sale would clearly be less than what they received as a result of the sale. Professor Lubben is of the opinion that neither the use of Section 363 to sell substantially all Chrysler and GM's assets nor the speed by which the 363 sales were executed was unusual. He details the many bankruptcy proceedings that have used this structure, which has been employed with increasing frequency since the mid 1990s.[453] Professor Lubben concludes, "Congress may well decide, as a matter of policy, that this should end, but until it does, there is little to the idea that these cases are 'unprecedented' in their structure. The identity of the DIP lender is novel, but what happened is routine. And the identity of the lender is not a bankruptcy issue."[454]

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[448] Professor Lubben notes that while all circuits developed safeguards to prevent *sub rosa* plans, the precise safeguards vary by circuit. For example, "in the second circuit the rule seems to be a subpart of that jurisdiction's larger requirement that a pre-plan sale be supported by a good business justification." While the Fifth Circuit requires "pre-plans to comply with the Bankruptcy Code's rules for plan confirmation." He notes that the Second Circuit has expressly rejected this approach. *No Big Deal: The Chrysler and GM Cases in Context*, *supra* note 235.

[449] The Second Circuit addresses some of these "safeguards" and finds them to be present in the Chrysler transaction. For instance, the court found that "to preserve resources" and because the "business was hemorrhaging cash," was a valid business reason justifying the expedient sale under 363. The court also found that the plan did not constitute a sub rosa plan because "all equity stakes in New Chrysler were entirely attributable to *new* value… " Moreover, in determining that secured creditor's rights were not infringed upon under section 1129, the court finds that the parties lack standing to raise such issue because the furnished consent under an agency theory. *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 2009 WL 2382766 (2d Cir. Aug. 5, 2009).

[450] *No Big Deal: The Chrysler and GM Cases in Context*, *supra* note 235.

[451] Congressional Oversight Panel, Testimony of Daniel J. Moore Professor of Law at Seton Hall University School of Law Stephen J. Lubben (July 27, 2009).

[452] *No Big Deal: The Chrysler and GM Cases in Context*, *supra* note 235.

[453] Stephen Lubben COP Testimony, *supra* note 451 at appendix A.

[454] *No Big Deal: The Chrysler and GM Cases in Context*, supra note 235 at 3.

Two courts have reviewed the 363 sale. Although the objections to the sale were vigorously argued by the creditors, the courts specifically determined that there was no factual basis for concluding either that the sales were defective or that they constituted a *sub rosa* plan of reorganization that deprived the creditors of their Chapter 11 protections. While a number of bankruptcy commentators agree with Professor Adler that the bankruptcy laws regarding 363 sales should be amended, few have criticized either the factual findings of the bankruptcy court or the application of current law to those facts.

The bankruptcy court addressed the bidding process issues raised by Professor Adler in its opinion. The court noted Chrysler's inability to find a company to merge with after an extensive two-year search and concluded that the Fiat transaction in addition to government protection was an "opportunity that the marketplace alone could not offer."[455] Capstone's Executive Director provided expert valuation testimony, which was not rebutted, and indicated the $2 billion Chrysler's first lien creditors would receive following the sale exceeded the value they would recover in immediate liquidation.[456] Moreover, the value of the company continued to decrease because it was burning through cash, thus further reducing the value creditors would collect as time went on.[457] Lastly, the court states that the first lien credit holders[458] could have refused to consent to the sale or could have credit bid instead of agreeing to take cash, without directly mentioning the objections of the minority first lien holders.[459]

There was a specific finding of fact in the bankruptcy court that, according to the court, permitted bids to be made without restrictions, which differs from the conclusion advanced by Professor Adler.[460] In the bankruptcy court's Bidding Procedures Order, "language was added to indicate that a 'Qualified Bid' included not only bids that met the previously set forth requirements but, in addition, any bid that 'after consultation with the Creditor's Committee, Treasury and the UAW, [was] determined by the Debtors in the exercise of their fiduciary duties to be a Qualified Bid.'" [461] According to the bankruptcy court, the procedures adopted were adequate to "encourage" any sophisticated party to bid on the Chrysler assets.[462] This means that the issue of bidding procedures was fully presented to the court and argued by the parties. The

[455] *In re Chrysler LLC, et al.*, 405 B.R. 84, 96 (Bankr. S.D.N.Y. 2009). No restrictions were placed on the sale of Chrysler's assets during the two year period it was marketed prior to filing for bankruptcy, whereas under the the 363 sale, New Chrylser assumed particular liaibities of Old Chrysler.

[456] *In re Chrysler LLC, et al.*, 405 B.R. 84, 97 (Bankr. S.D.N.Y. 2009).

[457] *In re Chrysler LLC, et al.*, 405 B.R. 84, 97 (Bankr. S.D.N.Y. 2009).

[458] These lenders included receipients of TARP money, as discussed in Section (C)(1) of this report.

[459] *In re Chrysler LLC, et al.*, 405 B.R. 84, 98 (Bankr. S.D.N.Y. 2009).

[460] *In re Chrysler LLC, et al.*, 405 B.R. 84, 108-09 (Bankr. S.D.N.Y. 2009).

[461] *In re Chrysler LLC, et al.*, 405 B.R. 84, 109 (Bankr. S.D.N.Y. 2009).

[462] *In re Chrysler LLC, et al.*, 405 B.R. 84, 109 (Bankr. S.D.N.Y. 2009).

Panel has no access to information that was not presented to the court and no basis for concluding that the courts' factual findings were wrong.

The Second Circuit did not discuss the bidding procedures in its opinion. In laying out the facts, the opinion briefly states that the bankruptcy court approved the bidding procedures and, apart from New Chrysler, no other bids were forthcoming.[463] The Indiana Pensioners appealed the bankruptcy courts' conclusion to the Second Circuit, but that court, with the full record before it, did not sustain any such objection.

Other commentators have moved past the legal analysis to the political and policy implications of the automobile bankruptcies, dubbing the auto bankruptcies as "Obama's Orwellian interventions."[464] They are particularly disturbed by what they see as the Administration's arm-twisting of Chrysler's TARP creditors and what they claim is a violation of the absolute priority rule to save the politically favorable union and its pension.[465] In their view, the "sham sale" of Chrysler, even if not per se unconstitutional, violates at least the spirit of the Takings[466] and Contracts[467] Clauses of the United States Constitution. As they see it, the Administration's interference may be ineffectual in the long-run; although "Obama may have helped save the jobs of thousands of union workers whose dues, in part, engineered his election," the Administration has instigated an "untold number of job losses in the future caused by trampling the sanctity of contracts today."[468] The current Administration, however, is not alone to blame in their opinion; rather, "long ago Chrysler and GM should have been allowed to bleed to death under ordinary bankruptcy rules, without government subsidy or penalty."[469]

The Panel agrees with commentators on all sides of the political spectrum that whether the government should have moved to rescue the automotive industry is a policy question with wide-reaching implications. However, the Second Circuit Court of Appeals held that the legal issues were correctly decided, and the Panel has no evidence to the contrary.

5. The Role Played by Treasury and Transparency with Respect to that Role

[463] *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 2009 WL 2382766 (2d Cir. Aug. 5, 2009).

[464] Richard A. Epstein, *The Deadly Sins of the Chrysler Bankruptcy*, Wall Street Journal (May 11, 2009) (online at www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html) ("Richard Epstein May 11 Wall Street Journal Op-Ed").

[465] *Id.*; see also Peter Morici, *Treasury Prepares for Chrysler Bankruptcy*, FinFacts (Apr. 24, 2009) (online at www.finfacts.com/irishfinancenews/article_1016519.shtml) (hereinafter "Treasury Prepares for Chrysler Bankruptcy").

[466] *Richard Epstein May 11 Wall Street Journal Op-Ed supra* note 464.

[467] Todd J. Zywicki, *Chrysler and the Rule of Law*, Wall Street Journal (May 13, 2009) (online at online.wsj.com/article/SB124217356836613091.html) (hereinafter "Chrysler and the Rule of Law").

[468] *Id.*

[469] *Richard Epstein May 11 Wall Street Journal Op-Ed supra* note 464.

This section assesses the transparency of Treasury's decision-making and evaluates its performance during its involvement with the automotive industry, keeping in mind its stated objectives with respect to these TARP investments, as discussed above in Section D.

In many respects, Treasury has presented its plans and decisions with respect to its TARP investments in Chrysler and General Motors on a prompt and regular basis. Mr. Bloom has recently testified before House and Senate congressional committees as well as the Panel, and various documents (e.g., loan agreements, program guidelines) were released concerning particular aspects of Treasury's investments. Given the gravity of the challenges and issues that Treasury has faced during the financial crisis, the Panel recognizes Treasury's attempts to keep the public informed as to the decisions it has made.

The Panel does question, however, some aspects of Treasury's transparency with respect to the process. Treasury has failed to follow a consistent and cohesive message with respect to its rationale for extending TARP to the automotive industry and its stated objectives in doing so. Treasury's intervention in the automotive industry could be attributed to one of (or a combination of) three broad policy objectives: (1) the prevention of a systemic threat to the U.S. financial markets and broader economy; (2) the advancement of social policy (such as tempering the impact of unemployment, environmental improvement, or provision of retirement benefits); or (3) the maintenance of a viable American automotive presence in the United States. At varying times, Treasury's public statements have addressed the merits of each of these objectives and their benefits to the overall economy; however, it is unclear which objective, or combination thereof, Treasury deems most important – or if all three carry equal weight.[470] As such, in the absence of a clearly articulated unifying strategy, it is difficult for outside observers to determine which metrics are the best indicators of Treasury's performance.

The Panel recognizes that thorough diligence was conducted by Treasury in evaluating each company's viability plan. In his speech on the automotive industry on March 30, President Obama noted that "after careful analysis [of the Chrysler and GM initial viability plans submitted on February 17], we've determined that neither [automotive company] goes far enough to warrant the substantial new investments that these companies are requesting."[471] The Panel

[470] See, for example, U.S. Department of Treasury, *Remarks by Interim Assistant U.S. Secretary for Financial Stability Neel Kashkari at the Brookings Institution* (Jan. 8, 2009) (online at www.financialstability.gov/latest/hp1347.html) (hereinafter "Neel Kashkari Brookings Institute Remarks") ("Treasury was forced to act to prevent a significant disruption of the automotive industry that would pose a systemic risk to financial markets and negatively affect the real economy."); Congressional Oversight Panel, Testimony of Assistant U.S. Secretary of the Treasury for Financial Stability Herbert Allison, at 53 (June 24, 2009) (online at cop.senate.gov/documents/testimony-062409-allison.pdf) (hereinafter "Herb Allison COP Testimony") ("What we're trying to do is to allow the automobile industry and encourage the automobile industry to restructure so that it is again a highly-competitive sector of our economy and can grow and create more jobs over time…"); *Ron Bloom COP Testimony*, *supra* note 36 at 34 ("[T]he administration and the prior administration believe that the centrality of the automobile industry to the broader economy justified this intervention.").

[471] *March 30 Presidential Remarks*, supra note 91.

requested access to certain documents from Treasury in order to determine the scope of the Treasury's due diligence and evaluations of Chrysler and GM's viability plans. The information shared with the Panel includes Treasury's assessment of the viability plans submitted by Chrysler and GM and the evaluation of the long-term economic viability of both companies as prepared by Treasury and its financial advisors. On the basis of the information that Treasury provided to the Panel, it appears they conducted extensive and thorough due diligence on the viability plans, asked the companies to consider other variables, criticized the companies' plans, and questioned their assumptions. The materials shared with the Panel also support Mr. Bloom's statements that Treasury used its own assumptions to conduct stress tests on these plans, looked at a variety of scenarios in order to formulate cash flow capability and the likely earnings capacity of the companies, challenged the companies to look forward, and created models of "potential enterprise value."[472] The scope and parameters of Treasury's review of these initial viability plans seem appropriate for the role Treasury found itself in – as a potential investor of taxpayers' money.

Nonetheless, while Treasury's diligence was detailed and thorough (and recognizing the difficulty posed by releasing sensitive corporate information), this does not mean that Treasury has been transparent and accountable during the process. Congress, and ultimately the American taxpayer, have been "left in the dark"[473] concerning the details of Treasury's review process and its methodology and metrics at a time when Treasury committed additional TARP funds to these companies. Treasury failed to disclose to the public both the factors and criteria it used in its viability assessments, the scope of outside involvement in its evaluations, and its basis and reasoning for selecting particular benchmarks. Simply, its disclosures did not go far enough. This is especially unfortunate given Treasury's apparent commitment to "ensure thorough

[472] *Ron Bloom Senate Testimony*, *supra* note 170 at 11-12.

[473] At the July 21, 2009 House Judiciary Subcommittee on Commercial and Administration *Hearing on the Ramifications of Automotive Industry Bankruptcies, Part II*, Representative Dan Maffei (D-NY) stated that "the Congress and the American public were left in the dark as to how the task force, then led by Steven Rattner, reached its conclusion and I think that is the underlying problem. There simply has not been very good communication between the president's Task Force and Congress. The decisions were implemented without the auto manufacturers or the task force presenting evidence publicly or even privately to Congress that some aspects of this reorganization would actually benefit the automotive companies financially." At the same hearing, Representative Bill Delahunt (D-MA) also noted that "[t]here have been significant complaints about transparency" and that "everyone is entitled to a full explanation of the rationale for decisions that are made." Furthermore, as Senator Mike Johanns (R-NE) noted at the June 10, 2009 Senate Banking Committee *Hearing on the State of the Domestic Automobile Industry*, "Hard decisions are best made in a transparent sort of way. For Congress to wake up like the rest of the American public on Monday and find that, over the weekend, we had bought General Motors, with all of the problems associated with it, is really outrageous, really outrageous." Such concerns led the House Financial Services Committee to approve a resolution on July 17, 2009 seeking information from the Task Force regarding major decisions made on the Chrysler and GM restructurings, including its decisions to extend bankruptcy financing to both companies, Treasury's assumption of equity stakes, and decisions on debt reduction. While the House Financial Services Committee voted unanimously to send its request to the full House of Representatives for consideration, the full House has not yet taken action on the measure. As Ranking Member Spencer Bachus (R-AL) stated, "It's not about taking sides. It's about acquiring information about the process. I think the American people and Congress have questions."

transparency and accountability for [its] actions."[474] Without an open process, attempts by policymakers and the general public to objectively assess AIFP as well as New Chrysler and New GM's performance and progress are substantially impeded. Even after the Panel's review of documents from Treasury, some questions remain, including:

- What happens if New Chrysler and New GM fail to live to up to the Treasury auto team's expectations? More specifically, if the companies do not begin to produce automobiles that will compete in the marketplace, what is Treasury's role at that point as the investor of taxpayers' money in these enterprises?

- What is the likelihood that the private sector will lend to, or do business with, these companies, particularly while Treasury retains an ownership interest in them? What were the predictions that the Treasury auto team relied on?

- What possible exit strategies did Treasury evaluate before making its investments?

Just as risk is an important variable to examine when making an investment, so too is the establishment of a feasible strategy for the disposition of an ownership position. While it is part of this Panel's responsibility to inquire as to how and when Treasury plans to unwind its ownership stakes in Chrysler and GM and return the money to the taxpayers where it properly belongs, Treasury has avoided sufficient public disclosure regarding its exit strategy for the investment in the automobile industry.[475] Officials have maintained the position that Treasury will dispose of its ownership stake in Chrysler and General Motors "as soon as is practicable." However, the meaning of "practicable" has yet to be defined, and it remains unclear whether Treasury is unwilling or simply unable to define specifically the timetable and method for ending its ownership position in the automobile industry. The elusive nature of this issue is typified in a recent statement by Mr. Bloom: "The definition of 'practicable' is a bit like 'pornography,' though; we'll know it when we see it."[476] While Treasury has stated its intent to sell its ownership stakes "as soon as practicable," Senator Lamar Alexander (R-TN), noted that Fritz Henderson, president and chief executive officer of New GM, told Senators and Congressmen in a telephone call on June 1, 2009 that while it is Treasury's decision, "this is a 'very large amount' of stock," and that "orderly offering of [Treasury's] shares to establish a market may have to be 'managed over a period of years."[477]

[474] *Ron Bloom Prepared COP Testimony*, *supra* note 78 at 3.

[475] See Part F of Section One of this report for further discussion of factors involved in Treasury's exit from its investment in the Automotive Industry, *infra*.

[476] *Nick Bunkley August 5 New York Times Report*, *supra* note 80.

[477] Congressional Record, Statement of Senator Lamar Alexander, S6152 (June 4, 2009) (hereinafter "Senator Alexander June 4 Statements").

Although the issue of Treasury's strategy, or lack thereof, for exiting its ownership positions is still a concern, comments by Mr. Bloom have shed some light on the future plans for those investments. In a remark during a question and answer segment of the Panel's recent Detroit field hearing, Mr. Bloom highlighted a series of practical issues for Treasury to consider regarding the disposition of its ownership stakes.[478] He maintained, however, that the disclosure of specific timetables and milestones regarding Treasury's exit strategy could ultimately negatively affect the taxpayers' interests.[479] First, the company's board determines the timing of an IPO, not the government. Moreover, to force a company to have an IPO would be inconsistent with Treasury's "hands off" approach. Second, in order to maximize the taxpayers' investments, Treasury expects to divest its ownership stakes at a future point when the companies become profitable and when Treasury can take advantage of a rise in markets.[480] For Treasury to do otherwise could have a negative effect on its ability to sell into the market and obtain maximum value – the so-called "overhang." Since Treasury's plans are hardly a secret, however, the market "overhang" concern might not appear to be so troubling, but the timing of sale certainly remains an issue so that the value of the taxpayers' investment is maximized. The Panel also recognizes, however, that there are other critical factors involved in the proper formulation and timing of an exit strategy. Private sector interest and involvement are essential elements of a successful Treasury exit strategy.[481] In order for this success to be achieved, the private sector must also be interested in doing business with these companies and demonstrate interest in owning these companies, even while Treasury retains an ownership interest. Although Mr. Bloom's points seem fundamentally reasonable and prudent, the Panel is concerned that the only viable metrics that Treasury will provide regarding its investments in Chrysler and GM will be provided in initial quarterly reports that will (at least until the companies become public) not be as comprehensive as filings required by the SEC. Without the release of additional specific milestones or markers on each company's path towards an IPO, the likelihood that taxpayers will be able to assess the chances of seeing the return of their money is slim, at best.

The Panel is also mindful of particular shortcomings in transparency with respect to the Administration's negotiations with the companies and various stakeholders in the bankruptcy process. Although such justification is legally irrelevant,[482] at least one of the companies – Chrysler – has defended its decision to enter into agreement with the UAW Trust on the grounds

[478] See Part F of Section One of this report for further discussion of factors involved in Treasury's exit from its investment in the automotive industry, *infra*.

[479] *Ron Bloom Prepared COP Testimony*, *supra* note 79 at 3, stating that "[t]he judgment was made that to put out a more specific timeline would create an overhang in the market that would be deleterious to receiving the best price."

[480] *Ron Bloom Prepared COP Testimony*, *supra* note 79 at 3.

[481] *Ron Bloom Senate Testimony*, *supra* note 170.

[482] See discussion of this issue *supra* Section E(1)(b).

that to continue as a going concern and return to profitability, it would need workers.[483] Without the UAW's support for the sales, the belief has been, there would be insufficient workers for the plants. The majority of the industries manufacturing operations are in Michigan,[484] a state whose unemployment rate stood at more than 15 percent as of June 2009, the highest of any state in the country.[485] The Treasury auto team has explained to the Panel that maintaining a stable pre-existing and experienced workforce was paramount in light of the difficulty of individually hiring and training many thousands of workers.

In its assessment of government actions to deal with the current financial crisis, the Panel has regularly called for transparency, accountability, and clarity of goals. Treasury must commit itself to those same principles when implementing TARP projects and administering the AIFP. Undoubtedly, the guidelines for the AIFP are expansive in order to maximize Treasury's potential options and facilitate rapid intervention in the midst of economic uncertainty. Treasury, therefore, maintains the authority to determine its involvement in stabilizing companies on a case-by-case basis and "may invest in any financial instrument, including debt, equity, or warrants, that the Secretary of the Treasury determines to be a troubled asset."[486] In both the AIFP and the Capital Purchase Program (CPP), Treasury has utilized all available financial instruments in order to stabilize the respective industries as it saw necessary. With such expansive discretion, the Panel believes it is imperative for Treasury to disclose its methodology and rationale since any use of taxpayer funds warrants comprehensive justification.

6. Has the Can Been Kicked Down the Road?

The day GM filed for bankruptcy protection, President Obama told the American people that he refused "to let these companies become permanent wards of the state, kept afloat on an endless supply of taxpayer money." "In other words," President Obama said, "I refuse to kick the can down the road."[487] The government-orchestrated bankruptcies of Chrysler and GM did not resolve the complex underlying problems facing the domestic automotive industry in the United States. It is therefore unclear whether the new entities will be able to overcome the historical shortcomings that led to their predecessors' failure. If they are unable to do so, either

[483] *In re Chrysler LLC*, 405 B.R. 84, 99 (Bankr. S.D.N.Y. 2009).

[484] GM U.S. Facilities (online at www.gmdynamic.com/company/gmability/environment/plants/facility_db/facilities/list); *Chrysler's U.S. Parts and Assembly Plants*, USA Today (Apr. 30, 2009) (online at www.usatoday.com/money/autos/2009-04-30-chrysler-plants-map_N.htm). At the Panel's Detroit field hearing held on July 27, 2009, Representative Carolyn C. Kilpatrick (D-MI) noted: "Here in Michigan, we are the epicenter of the manufacturing that is kind of eroding itself in America." Congressional Oversight Panel, Statement of Rep. Carolyn C. Kilpatrick, at 7 (July 27, 2009).

[485] Bureau of Labor Statistics, *Local Area Unemployment Statistics* (online at www.bls.gov/lau/home.htm).

[486] U.S. Department of the Treasury, *Guidelines for Automotive Industry Financing Program* (accessed Aug. 31, 2009) (online at www.financialstability.gov/docs/AIFP/AIFP_guidelines.pdf).

[487] *White House June 1 Remarks on GM Restructuring*, *supra* note 89.

the government will need to step in again, or the companies will need to liquidate, with much of the attendant misery that the government sought to avoid in 2008 and 2009.

The factors that led to the insolvency of Chrysler and GM were no secret.[488] The overcapacity of the global automotive manufacturing industry and the fierce competition it creates has plagued American automotive manufacturers for decades.[489] In addition, the healthcare and pension obligations of large corporations in the United States have created costs that put American automotive manufacturers at a disadvantage compared to foreign competitors.[490] These factors, coupled with the drastic decline in demand for new cars and trucks in the United States in 2008 and 2009, made the financial condition of Chrysler and GM untenable.[491]

In deciding to rescue these firms with taxpayer money, the Panel would expect the Treasury auto team to analyze several key considerations in the normal course of performing its due diligence as a prospective investor:

1. Revenue forecasts and market share. The viability of these companies is still dependent on sales volume, which, as a result of the global economic downturn, remains at historically low levels.[492] The projections provided by GM in SEC filings assumed New GM would maintain a market share ranging between 17.5 percent and 18.5 percent between 2009 and 2014, while the number of cars sold in the United States was projected to climb steadily from 10.5 million to 16.8 million during that period.[493] With these numbers, New GM projected that it could maintain a positive cash flow, the definition of viability used by the Treasury auto team.[494] But GM has been steadily losing market share for decades and it is unclear whether the projections provided adequately reflect this trend. Some analysts believe that New GM could see its market share decline to between 15 percent and 16 percent over the next several years.[495]

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[488] Fortune magazine ran a cover story predicting the General Motors bankruptcy in 2006. Carol Loomis, *The Tragedy of General Motors*, Fortune (February 6, 2006) (online at money.cnn.com/magazines/fortune/fortune_archive/2006/02/20/8369111/index.htm).

[489] The annual reports of the major public auto manufacturers repeatedly reference the overcapacity in the North American market as one of their most significant challenges. See, for example, General Motors, *Form 10-K*, I-17 (March 28, 2006) (hereinafter "GM Fiscal Year 2005 10-K"); Ford Motor Company, *Form 10-K, 3* (March 1, 2006) (hereinafter "Ford Fiscal Year 2005 10-K").

[490] Affidavit of Frederick A. Henderson Pursuant to Local Bankruptcy Rule 1007-2, 5-6 (June 1, 2009), *In Re General Motors Corp.*, (09-50026) (hereinafter "Frederick Henderson GM Bankruptcy Affidavit").

[491] *Id*; *Ronald Kolka Declaration*, *supra* note 113 at 4-5.

[492] *GM July 16, 2009 8-K*, at 20-21, *supra* note 86.

[493] *Stephen Worth Declaration*, *supra* note 36 at appendix. 18.

[494] New Path to Viability for GM & Chrysler, *supra* note 37.

[495] Merrill Lynch, *Car Wars 2010-2013* (July 15, 2009).

Moreover, declining confidence in Chrysler and GM vehicles, as a result of their financial difficulties, creates a challenge to new sales that must be overcome if either new company is to survive.[496] Market share in the North American market has historically been driven by the number of new products auto manufacturers bring to market.[497] While reducing capacity reduces fixed costs, it also reduces the number of new cars and trucks New Chrysler and New GM can bring to market in the short term, which is likely to have a negative effect on the market share of these companies. As market share declines, these companies will need to earn more profit per vehicle to maintain projected revenues.

2. Cost controls. There is no question that New Chrysler and New GM are better positioned companies than their pre-bankruptcy counterparts. Both have shed billions of dollars in debt and other liabilities, improving their ability to make profits and invest in new products and technology.[498] Both companies have renegotiated their agreements with the UAW, reducing labor costs dramatically. The closing of manufacturing plants and the shedding of unprofitable brands has somewhat reduced overcapacity. In addition, both companies are still hoping to achieve various post-bankruptcy cost reductions.[499] Achieving these reductions may prove to be critical to the ability of the new companies to fully realize their viability plans.[500] The cost reductions made to date were necessary for the viability of the new companies but it is unclear whether they will prove to be sufficient.

3. External shocks to revenue and cost projections. Viability plans for auto makers should be tested for the potential impact of sudden shocks to revenue and cost projections. The most obvious, but by no means only, sources of such shocks for the automotive industry are: (1) a sharp economic downturn – or, under current circumstances, another economic contraction before any recovery has a chance to take hold; (2) a surge in oil prices, most likely tied to a supply interruption; and (3) a sharp change in regulatory requirements, particularly environmental controls or fuel efficiency standards. Energy price trends would appear to be particularly critical for the prospects of the automotive industry; if they continue to fluctuate to the extent they have over the last five years, it may be difficult, if not impossible, for auto manufacturers to invest profitably in bringing energy efficient cars to market. In the case of New Chrysler, its alliance with Fiat was

[496] *Id.* at 21.

[497] *Id.*

[498] See *Moody's Auto Navigator* (July 15, 2009) (describing the reduction of General Motors debt from $43 billion to $26 billion).

[499] *Id.*

[500] *Id.*

predicated on Fiat's providing technology to produce fuel efficient vehicles in the American market.[501]

The Panel requested access to certain documents from Treasury in order to determine the extent to which the Treasury auto team conducted due diligence. The information shared with the Panel involves the auto team's assessment of the viability plans submitted by Chrysler and GM and the evaluation of the long term economic viability of both companies by the Treasury auto team and its advisors. On the basis of the information that Treasury has provided to the Panel, it appears that the auto team conducted due diligence as a private investor would and were fully informed when making its investment decisions. The auto team seems to have had a reasonable basis to believe in the long term viability of the two companies. This does not necessarily mean that the investment decision will prove to be a profitable one; the automotive sector in the United States is risky and these companies have a legacy of failure. Additionally, while Treasury followed the *process* that a private investor would follow, that does not mean its *objectives* were those of a private investor. A private investor seeks to establish it is receiving a reasonable rate of return on its investment through the due diligence process. As discussed above, there are significant obstacles to the two companies' ever achieving the level of profitability that would permit the return of all the taxpayer funds expended, and Treasury's best estimates are that some significant portion of those funds will never be recovered.[502] Treasury may not, however, have been seeking to maximize profits.[503]

A significant portion of the American automotive industry had failed by December 2008. Treasury, using TARP funds, effectively granted a reprieve to a large part of that sector. Treasury has taken significant and far-reaching actions that are intended to permit New Chrysler and New GM to function on their own without any further government assistance.[504] The specter of future government bailouts has gone. The possibility of failure (and the loss of taxpayer money), however, remains until these two companies can show that they are producing cars people want to buy.

H. Conclusion and Recommendations

The Panel will continue to monitor Treasury's use of TARP funds in its assistance to the automotive industry. In particular, the Panel will focus its attention on the issues described below.

1. Treasury's Role in Protecting Taxpayer Investment

[501] *Chrysler Release*, *supra* note 41.

[502] See discussion of this issue *supra* Section F(1).

[503] Ron Bloom's comments to Panel staff, *supra* note 274.

[504] *White House June 1 Remarks on GM Restructuring*, *supra* note 89.

Treasury's performance in protecting the interests of the taxpayers in the support of the auto companies is somewhat mixed. On one hand, Treasury negotiated aggressively in these transactions, demanding significant concessions from other stakeholders, and protecting taxpayer interests as if it were a private investor. On the other hand, the decisions to enter into the transactions in the first place suffer from a lack of transparency.

Treasury was instructed to act in a "commercial manner" by the White House,[505] and there can be no doubt that Treasury robustly defended its interests (and thus those of taxpayers) like any other stakeholder. There is also no doubt that the other parties involved were sophisticated and well-represented, and more than equal to intense negotiations. Some feel that the government was too tough,[506] or too tough with the wrong parties. Others wish the government had been equally tough in negotiating the investment of TARP funds in banks. The assertiveness displayed by the government in the reorganizations reduces the "moral hazard" implicit in using public money as a funding option for failing businesses.

It appears that Treasury to some degree acted as a private investor would in making the decision to support the automotive companies in the first place. However, the lack of transparency, as discussed in detail above,[507] also makes it difficult to determine the priorities of

[505] *Ron Bloom Prepared COP Testimony*, *supra* note 78; *Ramifications of Automotive Industry Bankruptcies, Part II*, *supra* note 10 at 1.

[506] The negotiations gave rise to allegations of threats and bullying. Some of the more extreme alleged threats have been impossible to prove, and have been vigorously denied by Treasury. Specifically, Thomas Lauria, a bankruptcy attorney with White & Case maintains Mr. Rattner threatened an official of Perella Weinberg Partners, an investment bank, that the White House press corps would smear Perella's reputation if they did not support the Administration's plan on the Chrysler bankruptcy. Joseph A. Giannone, *Perella Denies White House Threat Over Chrysler*, Reuters (May 4, 2009) (online at www.reuters.com/article/idUSN0441888520090504). Bloom, in his appearance before the Panel, denied this allegation. *Ron Bloom Prepared COP Testimony*, *supra* note 78. Because dealing with the U.S. government is not the same as dealing with other credit bidders or DIP finance providers, and when the government accuses a bondholder, who may be under a fiduciary obligation to get the best price for its bonds, and in any case has the right to protect its own interests the best way it can, of failing to assume some correct proportion of "shared sacrifice," some may feel that a line has been crossed. It would be hypocritical for Treasury to have its agents act in a commercial manner, protecting their own interests, without expecting its counterparties to do the same. However "commercial" Treasury's objectives, the U.S. government has a throw weight that its counterparties cannot match as there is little in the regular commercial arsenal that can counter a charge of "unpatriotic" behavior by the President of the United States. The Panel staff contacted many of the parties involved in these transactions to substantiate the allegations of threats and bullying, however none of the Panel's inquiries received a response. Zach Lowe, *White & Case's Tom Lauria Reflects on Non-TARP Lenders Crazy Chrysler Week*, The AmLaw Daily, (May 11, 2009) (online at amlawdaily.typepad.com/amlawdaily/2009/05/nontarp.html) (hereinafter "Thomas Lauria Statements"); Preliminary Objection of the Chrysler Non-Tarp Lenders to Motion of Debtors in Possession, Pursuant to Sections 105, 363 and 365 of the Bankruptcy Code and Bankruptcy Rules 2002, 6004 and 6006, For (I) An Order (A) Approving Bidding Procedures and Bidder Protections for the Sale of Substantially All of the Debtors' Operating Assets (B) Scheduling a Final Sale Hearing and (C) Approving the Form and Manner of Notice Thereof; and (II) An Order (A) Authorizing the Sale of Substantially All of the Debtors' Operating Assets, Free and Clear of Liens, Claims, Interests and Encumbrances, (B) Authorizing the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection Therewith and Related Procedures and (C) Granting Related Relief, *In Re* Chrysler LLC, S.D.N.Y. (No.09 B 50002 (AJG)) (online at chap11.epiqsystems.com/docket/docketlist.aspx?pk=1c8f7215-f675-41bf-a79b-e1b2cb9c18f0&l=1).

[507] See *supra* Section G5.

Treasury's primary objectives, including which competing policy considerations, if any, informed its actions. Based on Treasury's presentation to the Panel, the due diligence performed with respect to the ultimate viability of the automotive companies was extensive and thorough, and consistent with what a private investor would have done in the protection of its own interests. The ultimate decision to invest in the automotive companies, however, could have been made on policy grounds, regardless of their profitability, which would change the metrics for success. In the absence of a clear consensus of Treasury's objectives, it is difficult to assess their success.

2. Treasury's Role as Owner of Significant Stakes in Automotive companies

The tension between government intervention in the automotive companies and the hands-off approach that the government intends to take with respect to its ownership stake is examined above.[508] The Panel recommends that Treasury acknowledge the inherent conflicts that arise from its multiple roles and address the following issues:

- Treasury should clarify its policy objectives, reasonable expectations, and the implications of these policy decisions in the automotive bailouts. If Treasury's objectives include more than the rescue of Chrysler and GM but also other aims, such as environmental improvement, support for pension obligations, or continued employment, Treasury should make this clear, and also provide transparency on the costs of such objectives. Given the tension inherent in the government's overlapping roles and the fiduciary responsibility it has assumed in its disbursement of TARP funds, the Panel believes it is necessary for Treasury to provide more information regarding its decision-making and administration of the AIFP. The Panel is particularly concerned with the lack of publicly disclosed information regarding Treasury's evaluation of the viability of the automotive companies and its exit strategy with respect to the substantial investments it has made in those companies in order to ensure that "these companies – and this industry – must ultimately stand on their own, not as wards of the state."[509]

- Treasury must provide more detail about Treasury's corporate governance policies with respect to the automotive companies,[510] including how the government will deal with conflicts of interest between its role as an equity holder or creditor and as regulator. In addition, Treasury should establish policies prohibiting Treasury employees from accepting employment with either company for a period of at least one year following the termination of their employment at Treasury.

[508] See *supra* Section G.2.

[509] *March 30 Presidential Remarks*, *supra* note 91.

[510] See *supra* Section G.2.a.

- Treasury should consider the unparalleled opportunity it has been handed to set an example of corporate governance best practices in the companies in which it is now a major investor. Changes in corporate governance have begun with the appointment of well-qualified and independentdirectors.[511] Rules governing matters such as independence of directors, their service on other boards, term limits, stock ownership requirements and retirement should all reflect best efforts on corporate governance excellence. As TARP recipients, the automotive companies are already subject to restrictions on executive compensation, but they could adopt their own more tailored compensation guidelines, and ensure that compensation for both executives and board members are based on clearly articulated performance criteria and aligned to long-term performance. Because accurate financial reporting to the taxpayers is both essential and likely to be challenging in light of the reorganization of the two companies, special attention should be paid to the audit committees, possibly having all of their members being required to be "financial experts."[512] Equally important, internal controls that affect inputs into financial statements should conform to best practices. Particular attention should be paid to efforts to enhance shareholders' participation in corporate governance.[513] The Panel recommends that the automotive companies' bylaws and policies provide for full disclosure of all dealings with its significant shareholders (including, of course, the government).[514]

- With respect to disclosure of the performance of the automotive companies, Treasury has indicated that the two new companies will file periodic reports with the SEC.[515] These reports will, in essence, determine how the ultimate shareholders (the taxpayers) will share in the success of the auto bailout and the stewardship of their money. It is therefore essential that these reports be provided on a timely basis, and be as complete as possible. The Panel recommends that the companies produce reports to the standard and in compliance with the timing that applies to SEC reporting companies,[516] and that they do so as soon as possible. In particular, the Panel recommends that these reports include a "management's discussion and analysis," as SEC-reporting companies are required to do, which identifies known "trends and uncertainties" with respect to the company's

[511] *Supra* notes 181-183 and accompanying text. See discussion of this issue *supra* Section B.

[512] The Sarbanes-Oxley Law requires only one such expert. 15 U.S.C. § 7265(a).

[513] This would only be possible within the government's corporate governance guidelines if the shares were held in a trust, as suggested below.

[514] The Panel recommends that the CEO and chairman of each company certify each quarter as to the absence of government direction or intervention in their day-to-day business, or the nature of such direction or intervention.

[515] *Ron Bloom Prepared COP Testimony*, *supra* note 78 at 33.

[516] Exhibits required in such filings would include material contracts; the Panel assumes "material" would involve any transactions with the government.

financial performance and outlook. In the case of the automotive companies, in addition to discussing the issues outlined above,[517] these reports should include measurement of the companies' progress against the viability plans on the basis of which the government invested taxpayers' money. The discussion should also disclose any divergence of performance from the assumptions on which the viability plans were based.

- The Panel recommends that Treasury consider holding its interests in the automotive companies through a trust managed by an independent trustee.[518] This would have several advantages. First, it would send a clear message to the markets that the government was not interfering (and could not interfere) in private commerce. Second, decisions as to voting, holding, or the timing and volume of sales of government holdings could be made by an independent entity, in the best interests of the taxpayer, free of interference by any branch of government and not swayed by political expediency. Third, without a trust, the taxpayers' interest in the companies will be silenced, leaving disproportionate power in the hands of the minority shareholders.[519] Fourth, creating a trust with timeframes could provide taxpayers with confidence that they will not still retain large ownership stakes in these companies five, ten or twenty years down the road.

- As discussed above, there are serious policy implications in the government ownership of commercial entities. President Obama has stated that he doesn't think taxpayer subsidies to the automakers should continue indefinitely.[520] The Panel urges that divestment take place as soon as commercially reasonable. Divestment need not mean outright sale, however. The determination of what is "commercially reasonable" might be improved if the equity in the automotive companies were placed in a trust managed by an independent trustee, as discussed above, thus taking political considerations out of the equation, and permitting independent analysis of the timing of sale.

3. Compliance with Bankruptcy Code

Turning to Treasury's conduct in the bankruptcy proceedings, it appears that accusations of "illegal" behavior[521] are overblown and that allegations that statutory bankruptcy law priorities were overturned[522] are not accurate. The courts found that Section 363 sales occurred in accordance with the Code, and that no statutory priorities were overturned. Dissenting creditors may have been disappointed with what they received in the Chrysler bankruptcy, and

[517] See discussion of this issue *supra* section G.3.

[518] See discussion of this issue *supra* text accompanying note 212.

[519] This point is particularly applicable to GM because of the large proportion of shares held by taxpayers.

[520] White House Office of Press Secretary, *News Conference by the President* (Apr. 29, 2009) (online at www.whitehouse.gov/the_press_office/News-Conference-by-the-President-4/29/2009/).

[521] *Thomas Lauria Statements*, *supra* note 506.

[522] *Thomas Lauria Statements*, *supra* note 506.

they may feel that unsecured creditors, such as the UAW Trust, received more generous terms, but nothing in bankruptcy law takes away the leverage of those with whom the bankrupt company must do business going forward. The UAW agreed to substantial changes in its contracts that would improve the profitability of the automotive companies in return for the companies' continued support of the health benefit plans of their retirees and an ownership stake in New Chrysler. The secured creditors made no similar concessions. Thus, New Chrysler, a totally new entity that purchased the assets of Old Chrysler, was able to bargain directly with the UAW in the same way that any company can bargain, without any restraints imposed by bankruptcy laws. To mandate a different result would risk undermining the certainty of the bankruptcy and contract laws on which commerce in the United States relies.[523]

To the extent that Congress objects to the use of Section 363 in Chapter 11 reorganizations or the results that such use can produce, legislative fixes, including that suggested by Professor Adler, are available.[524]

4. Treasury's Authority

With respect to the question of authority, the authority of Treasury to use TARP for support of the automotive companies seems unclear. It is clear that at one point, neither President Bush nor Secretary Paulson believed TARP was available for this purpose and there is a strong suggestion in the Congressional Record that many in Congress also believed that EESA was a statute aimed specifically at the financial sector. Given the lack of serious opposition from Congress on the current approach or any party with standing to challenge it, however, it is unlikely that there will be any definitive finding on the constitutionality of this use. These issues are thus unlikely to affect future administration of the program. The Panel recommends that Treasury provide a legal opinion justifying the use of TARP funds for the automotive bailouts.

[523] The fact that a different result would likely undermine commercial markets is ironic in light of the criticisms that some have leveled that the failure to follow these well-established rules would upset commercial markets.

[524] *What's Good for General Motors*, *supra* note 258.

ANNEX A: “WHAT’S GOOD FOR GENERAL MOTORS”

What's Good for General Motors

Barry E. Adler*

The recent bankruptcy cases of Chrysler and General Motors were successful in that they quickly removed assets from the burden of unmanageable debt, but the price of this achievement was unnecessarily high because the cases established a precedent for the disregard of creditor rights. As a result, the automaker bankruptcies may usher in a period where the specter of insolvency will increase the cost of capital in an economy where affordable credit is sorely needed.

After brief analysis of the Chrysler and GM cases, below, and a brief description of potentially negative consequences, I describe how bankruptcy courts might disadvantageously extend these precedents and I offer a proposal for an amendment to the Bankruptcy Code to curb potential excesses. The proposal is designed to ensure that future bankruptcy courts honor the entitlement for which creditors contract and without which one cannot expect them to lend on favorable terms.

I. The Chrysler Bankruptcy

The rapid disposition of Chrysler in Chapter 11 was formally structured as a sale under §363 of the Bankruptcy Code.[1] While that provision does, under some conditions, permit the sale of a debtor's assets, free and clear of any interest in them, the sale in Chrysler was irregular and inconsistent with the principles that undergird the Code.

The most notable irregularity of the Chrysler sale was that the assets were *not* sold free and clear, but rather the purchaser, "New Chrysler"—an affiliation of Fiat, the U.S. and Canadian governments, and the United Auto Workers ("UAW")—took the assets subject to specified liabilities and interests. More specifically, New Chrysler assumed about $4.5 billion of Chrysler's obligations to, and distributed 55% of its equity to, the UAW's voluntary beneficiary employee association ("VEBA") in satisfaction, perhaps full satisfaction, of old Chrysler's approximately $10 billion unsecured obligation to the VEBA (which is a retired workers benefit fund).[2] So long as New Chrysler remains sol-

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* Petrie Professor of Law and Business, New York University. This article is based on testimony given before the Congressional Oversight Panel's July 27, 2009 hearing on assistance to the automobile industry under the Troubled Asset Relief Program. I thank Steve Choi, Marcel Kahan, Troy McKenzie, and Mark Roe for conversation that was valuable in the preparation of that testimony and this article. The article's title comes from a famous, or infamous, quote by Charles Erwin Wilson, General Motors president and later Secretary of Defense, who testified in 1953 before the Senate Armed Services Committee that "for years I thought that what was good for the country was good for General Motors and vice versa."

1 The Bankruptcy Code appears in Title 11 of the United States Code.

2 Although there is a distinction, legal as well as practical, between the UAW and its VEBA fund for retired union workers, for simplicity of exposition, such distinction is generally ignored in this article,

vent, this means that at least half of its obligation to the VEBA will be paid. This, while Chrysler's secured creditors are to receive only $2 billion in satisfaction of about $7 billion in claims, about 30 cents on the dollar. That is, money that might have been available to repay these secured creditors was withheld by the purchaser to satisfy unsecured obligations owed the UAW. Thus, the sale of Chrysler's assets was not *merely* a sale, but also a distribution—one might call it a diversion—of the sale proceeds seemingly inconsistent with contractual priority among the creditors.

To be sure, the situation is more complicated than may first appear. The purchaser in this case was funded primarily by the U.S. government, which had previously advanced $4 billion in funds from the Troubled Asset Relief Program ("TARP") and, along with the Canadian government, agreed to loan the new enterprise billions more. The government had political reasons to assure continuation of auto production and toward that end may have been willing to pay more for the assets than they were worth. For purposes of bankruptcy law, then, the question is not whether the government paid the UAW (or holders of other assumed obligations) too much, but whether the process deprived the secured creditors of a return to which the law entitles them. Some of these creditors, albeit a minority, objected to the sale because they believed they should have received more and would have but for the orchestration of the sale by the U.S. Treasury and automotive task force.

Proponents of the Chrysler sale argue that the sale was proper despite the protests. They contend that the secured creditors who objected to the sale were a minority of such creditors and as a minority lacked standing to complain, a point to which I return below. More fundamentally to the bankruptcy analysis, the proponents of the transaction insist that the company's assets would have been worth little in liquidation and so the secured creditors should have been satisfied with the return the bankruptcy sale provided them. But there was no market test of this proposition because Judge Gonzalez, who presided over the Chrysler case, permitted only days for a competitive bid to challenge the proposed sale and restricted bids to those that were willing to have the bidder assume specified liabilities, including Chrysler's obligation to the VEBA.[3] (There was an exception to this restriction for specially approved bids, but by the court's order, the UAW had to be consulted before a noncompliant bid would be approved.)

Given the constraint on bids, it is conceivable that the liquidation value of Chrysler's assets exceeded the company's going-concern value but that no liquidation bidder came forward because the assumed liabilities—combined with the government's determination to have the company stay in business—made a challenge to the favored sale unprofitable,

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which sometimes treats as interchangeable payments to the UAW on account of its claims in bankruptcy and transfers to the VEBA.

[3] The bankruptcy court opinion in Chrysler appears at 405 B.R. 84 (Bankr. S.D.N.Y. 2009). This opinion has now been affirmed, 2009 WL 2382766 (2nd Cir.).

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particularly in the short time frame afforded. It is also possible that, but for the restrictions, there might have been a higher bid for the company as a going concern, perhaps in anticipation of striking a better deal with workers.[4] Thus, the approved sale may not have fetched the best price for the Chrysler assets. That is, the diversion of sales proceeds to the assumed liabilities may have been greater than the government's subsidy of the transaction, if any, in which case the secured creditors would have suffered a loss of priority for their claims. There is nothing in the Bankruptcy Code that allows a sale for less than fair value simply because the circumstances benefit a favored group of creditors.

Against this criticism, the sale is defended on the ground that quick action was required to preserve the company's going concern value, but it is not certain that this was so or that the company's going concern value exceeded its liquidation value. Moreover, restrictions placed on the bidding process do not appear to be sensible even given a time constraint. The sale served the government's desire to assure continuation of the company and to protect the union's interest, but it is not apparent that the sale was designed to maximize the return to the bankruptcy estate and there seems no legitimate reason to have restricted bids based on the bidders' willingness to assume favored liabilities. The approved sale, therefore, ran afoul of the Supreme Court's admonition, in an analogous case, *North LaSalle Street*, that a court should not settle a valuation dispute among parties with a determination "untested by competitive choice."[5]

Viewed another way, the approved transaction was not a sale at all, but a disguised reorganization plan, complete with distribution to preferred creditors. In this light, the secured creditors who objected to the sale and distribution did not necessarily have a complaint with the amount paid (by the government) for the assets. Indeed the objecting creditors may well concede that the amount paid *to the UAW* was quite high; they objected to the distribution, which favored others at their expense. That is, the objection was to the fact that the approved transaction—a de facto reorganization plan—illegitimately distributed assets inconsistently with the priorities established under the Bankruptcy Code.[6]

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[4] Note that these restrictions would have prevented credit bidding even if the secured bondholders had collectively desired to make such a bid because the required assumption of liabilities effectively eliminated the secured lender priority that is necessary for a credit bid.

[5] Bank of America v. 203 North LaSalle Street Partnership, 526 US 434, 458 (1999). In *North LaSalle Street*, the prebankruptcy shareholders of an insolvent debtor in bankruptcy offered to pay for a continuing equity interest in the reorganized entity. When a creditor protested, the shareholders asked the bankruptcy court to affirm the exchange over the objection. The Supreme Court ruled that even if the bankruptcy judge believed the price offered to be a fair, the court lacked the authority to approve the transaction absent a market test of the price. The Bankruptcy Code provisions in the case were not entirely the same as those at issue in the Chrysler, or General Motors, case, but the principle applies equally well.

[6] As well summarized by Mark J. Roe and David Skeel, Assessing the Chrysler Bankruptcy (working paper, July 27, 2009), many bankruptcy courts have determined that a de facto reorganization plan is

Analysis turns next, then, to whether the objecting secured creditors could have blocked the transaction had the distributions in the case been subject to the rules prescribed by Chapter 11 rather than as part of a §363 sale.[7] One who would defend the approved transaction would say "no," relying again on the contention that the liquidation value of Chrysler was so small that the secured creditors received at least their due from the sale, an amount that the judge deemed satisfactory. What this argument overlooks, however, is that Chapter 11 contains rules designed precisely to protect creditors from a judicial determination with which the creditors disagree. When Judge Gonzalez approved the Chrysler sale, he stripped these protections from the secured creditors.

More specifically, the Chapter 11 rules that shield creditors from judicial error are called "fair and equitable" and "no unfair discrimination" provisions, which appear in §1129(b) of the Code and govern the confirmation of reorganization plans. The requirement that a reorganization plan be fair and equitable means that if a class of claims objects to the distribution under the plan, the plan may not be confirmed if the objecting class is not paid in full while a lower-priority class receives anything under the plan. The requirement that a plan not discriminate unfairly means that if a class of claims objects to the distribution under the plan, the plan may not be confirmed if a class of equal priority receives a higher rateable return under the plan. When applicable, these provisions prevent confirmation *even if* a judge is convinced that the claims in the dissenting class are receiving at least what they would receive in liquidation. Whether the dissenting class believes that the judge is mistaken as to the true liquidation value of the firm or merely demands its share of what it believes to be a firm's going concern surplus over liquidation value, the class can decide for itself whether to accept the plan.

In Chrysler, the dissenting secured creditors attempted to invoke the protection against unfair discrimination. Whatever the judge might deem to be the liquidation value of their collateral, §506 of the Bankruptcy Code bifurcates an undersecured claim—a claim that exceeds the value of its collateral—into a secured portion and an unsecured

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improper. See also, Scott D. Cousins, Chapter 11 Asset Sales, 27 Del. J. Corp. L. 835 (2002). For an example of a recent decision, see In re Iridium Operating LLC, 478 F.3d 452 (2d Cir. 2007).

Although the emphasis in this article is on the distribution of value among creditors rather on the propriety of a sale in the first instance, the case law does address the latter. Under the law, the proponents of an all or almost all asset sale must demonstrate a business reason to hold a sale rather than reorganize the debtor in the traditional way, with assets in place. This was true, for example, in the Chrysler case itself, where the bankruptcy court (as well as the court of appeals) was satisfied that there was a valid business reason for the §363 sale. In this article, which critiques the Chrysler and GM bankruptcy cases, I don't question whether the business justification requirement was satisfied in the cases I examine simply because I think that the requirement is ill-advised. In my view, an unconditional auction designed to achieve the highest return for the bankruptcy estate should always be permitted; I would not interpose the vague obstruction of business justification. My concern with the Chrysler case, and the GM case, described below, is that there was no such auction.

[7] For a similar analysis, which reaches many, though not all, of the same conclusions, see Roe & Skeel, *id.*

portion. The secured portion is equal to the judicially determined value of the collateral; the unsecured portion is equal to the deficiency claim. The secured creditor objectors to the Chrysler sale based a legal challenge on the treatment of their deficiency claims. A deficiency claim, like the UAW claims, is a general unsecured obligation and these claims have the same priority. Yet while the sale and distribution approved in Chrysler paid the deficiency claims nothing, it paid the UAW claims with billions of dollars. This, the objectors argued, is an unfair discrimination that would have rendered unconfirmable a formal reorganization plan and should have rendered illegitimate what they saw as a de facto reorganization embodied in the sale and distribution.

There is merit in the dissenters' argument. To be sure, proponents of the pro-UAW distribution can argue that the right to veto a plan on the basis of unfair discrimination is a class-based right—not available to individual dissenters within an accepting class of claims—and that a large majority of the secured creditors accepted the distribution.[8] But the accepting secured creditors were largely recipients of government TARP funds and thus arguably beholden to the government, which engineered the distribution to the UAW. Therefore, under §1122 of the Bankruptcy Code and relevant precedent, in a formal reorganization, the judge might have been obliged to classify the TARP lenders separately from the non-TARP creditors, thereby giving the dissenters control over their own class and, perhaps, the right to veto the UAW distribution as unfairly discriminatory. Against this unfair discrimination contention, plan proponents can argue further that the payment to the VEBA not as a distribution on account of an unsecured claim at all, but rather as prospective expense that assured the company a needed supply of UAW workers, with the union thus portrayed as a critical vendor of labor. However, even if one assumed that the automaker's value was greater as a going concern than in liquidation, one wonders whether so large a transfer to its labor force would have been necessary in this depressed economy. In any case, because the court characterized the transfer of assets from Chrysler to New Chrysler as a sale rather than as reorganization, it didn't need to reach the classification issue or the critical vendor issue. Consequently, this characterization improperly denied the dissenters the chance at the full protections of the Bankruptcy Code.

The foregoing assumes that the dissenting secured creditors had standing to object to the proposed, and ultimately approved, sale of Chrysler's assets. As noted above, proponents of the sale argued that the dissenters, as a minority of the secured creditors, lacked such standing. The proponents pointed to a provision of the secured creditors' loan agreement that arguably granted an agent of the creditors the right to sell their collateral on behalf of the group. According to this argument, because the creditors' agent was obliged to represent the secured creditor majority that favored the sale, the agent properly consented to the transaction on behalf of all secured creditors. Judge Gonzalez agreed and approved the sale, despite the lack of a true auction, in part because, in his opinion, given

[8] Section 1126 of the Bankruptcy Code provides that a class of claims accepts a plan if a majority of claim holders, holding at least two-thirds of claims by amount, accepts the plan.

the agent's consent, there was no objection. The judge rejected the dissenters' claim, among others, that the influence of the TARP lenders among the secured creditors tainted the agent's authority.

Whether Judge Gonzalez was correct to rule that the secured creditor dissenters should be deemed to have consented to the sale of their collateral is a matter of state contract law rather than bankruptcy law. But even if the judge correctly interpreted state law, Chrysler remains an unsettling bankruptcy precedent because approval of a sale of assets under §363 is not limited to a case where the affected parties consent. Some courts permit a sale free and clear of liens despite the objection of a secured creditor who will not be fully repaid by the proceeds.[9] Moreover, a §363 sale of a debtor's assets may occur over the objection of an unsecured class of claims, one that disputes the efficacy of a sale because the creditors believe they would, despite their lack of priority, receive a better distribution if the sale is disallowed. Thus, given the holding in Chrysler, if a sale of a firm's assets is to occur without a market test, there remains the opportunity for courts to approve a de facto reorganization plan that fails to protect creditor entitlements even over the objection of the disadvantaged creditors.

There are at least two negative consequences from the disregard of creditor rights. First, at the time of the deviation from contractual entitlement, there is an inequitable distribution of assets. Take the Chrysler case itself, where the approved transaction well-treated the retirement funds of the UAW. If such treatment deprived the secured creditors of their due, one might well wonder why the UAW funds should be favored over other retirement funds, those that invested in Chrysler secured debt. Second, and at least as importantly, when the bankruptcy process deprives a creditor of its promised return, the prospect of a debtor's failure looms larger in the eyes of future lenders to future firms. As a result, given the holding in Chrysler, and the essentially identical holding in the General Motors case, discussed next, one might expect future firms to face a higher cost of capital,[10] thus dampening economic development at a time when the country can least well afford impediments to growth.

II. General Motors

Chrysler was a blueprint for the General Motors bankruptcy, which, like that of Chrysler, included a sale of the debtor's valuable assets to an entity that assumed unse-

[9] Section 363(f) of the Bankruptcy Code, which provides the conditions for a sale of assets free and clear of interests in those assets, is poorly drafted and internally inconsistent. On one reading of the provision, property cannot be sold free of liens unless the sale proceeds are sufficient fully to satisfy those liens. On another reading, there is no such requirement. See In re PW, LLC, 391 B.R. 25 (9th Cir. BAP 2008), which describes the varying judicial interpretive approaches.

[10] Although I am unaware of empirical support for the claim that the Chrysler and General Motors cases will increase the cost of capital to corporate debtors, the cases are still new and it is not clear whether they will be extended, a topic to which I return in Part IV, below.

cured obligations owed its workers or former workers. In the case of GM, the purchaser, "New GM," owned largely by the United States Treasury, agreed to satisfy General Motors' approximately $20 billion pre-bankruptcy obligation to the VEBA with a new $2.5 billion note as well as $6.5 billion of the new entity's preferred stock, 17.5% of its common stock, and a warrant to purchase up to an additional 2.5% of the equity; depending on the success of New GM, the VEBA claim could be paid in full. As in the Chrysler case, the sale procedures required that, absent special exemption, any competing bidder was to assume liabilities to the UAW as a condition of the purchase. Therefore, once again, there was no true market test for the sale.

The primary difference between the cases, other than much larger size of General Motors, is that in GM there were no objections to the sale by holders of senior-secured claims, which were held by Unites States or Canadian governments or were to be assumed by the purchaser. Rather, in the case of General Motors, the United States and, to a lesser extent, Canadian governments were both the sponsors of the asset purchase that favored the UAW and the senior lenders from whose pockets any consequent diversion of value likely came. In particular, the United States Treasury, under TARP authority, lent GM about $50 billion in a combination of pre- and post-petition secured transactions; the governments assigned these obligations to New GM, which then credit bid for the assets. Some unsecured creditors objected to the transaction. But while the unsecured claims are substantial—including about $27 billion in unsecured bonds alone—the GM bankruptcy estate will receive between 10% and 12% of the shares of New GM plus warrants for additional shares. The value of these shares and warrants, plus that of other assets not tendered to New GM, may well exceed any plausible bid—net of the secured claims—that GM could have received from anyone else for the GM assets.

Still, just as in the case of Chrysler, the approval of a restricted bid process establishes a dangerous precedent, one that went unnoticed, or at least unnoted, by the court. In his opinion approving the GM sale, Judge Gerber addresses the objections of some unsecured creditors and makes the following observation:

> A 363 sale may … be objectionable as a [disguised reorganization] plan if the sale itself seeks to allocate or dictate the distribution of sale proceeds among different classes of creditors. But none of those factors is present here. The [sale and purchase agreement] does not dictate the terms of a plan of reorganization, as it does not attempt to dictate or restructure the rights of the creditors of this estate. It merely brings in value. Creditors will thereafter share in that value pursuant to a chapter 11 plan subject to confirmation by the Court.[11]

In this passage, however, Judge Gerber ignores the sales procedure, which, like that in Chrysler, strictly limited the time for competing bids and restricted bidders to those

[11] In re General Motors, Corp. 407 B.R. 463 (Bankr. S.D.N.Y. 2009)

willing to assume significant UAW liabilities. The process thus precluded a potentially higher bid by a prospective purchaser who was unwilling to make the same concessions to the UAW that the government-sponsored purchaser was willing to endure. Thus, there remained the theoretical possibility that the process impermissibly transferred asset value from the company's other creditors to the UAW. This is merely a theoretical possibility. As noted above, it may well be that no creditor other than the government secured lenders suffered a loss of priority from the transaction. But the case stands as precedent that might cause later lenders to doubt whether future debtors will be forced to live up to their obligations. And as also noted above, wary lenders are inhospitable to economic development.

III. Potential Extension

It is tempting to dismiss the Chrysler and General Motors bankruptcy cases as sui generis. The government insinuated itself into the process with cash in hand, and it may be that the cash was sufficient to pay everyone at least its due. The dissenters may have been greedy, not victims. And if the judges saw things this way, they may have been willing to approve a process that would not have survived their scrutiny under ordinary circumstances. But even if this is all true, the cases establish a precedent that could undermine the bankruptcy process in the future, even if the government recedes from the scene.

Consider the following illustration, where the government as lender or purchaser is nowhere to be found. Imagine a simple firm, Debtor, with only two creditors, each unsecured: Supplier, owed $60, and Bank, owed $20. After Debtor runs out of working funds and files a bankruptcy petition, Bank offers $40 for all of Debtor's assets (which Bank intends to resell). Bank contends that this is the best offer Debtor is going to get and that if Debtor does not accept the offer immediately it will be forced to liquidate piecemeal for $10. The court agrees and approves the sale over Supplier's objection even though there is no auction or other market test for the value of the assets. After the sale, Debtor moves through the ordinary bankruptcy process and distributes the $40 proceeds ratably between Supplier and Bank, with $30 to Supplier and $10 to Bank.

As long as the court is correct to accept Bank's valuation, the sale and the distribution are appropriate. But what if the court is wrong? Assume that Debtor's assets are worth $60. In this case, Supplier should receive $45 and Bank $15. But the sale and distribution approved by the court has different consequences. Instead, Bank pays $40 for assets worth $60 (i.e., gains $20) then receives a $10 distribution from Debtor's bankruptcy estate, for a total effective distribution of $30, half the true value of Debtor's assets, twice the amount to which it is entitled. All this while, as a formal matter, it is correct to say, as the courts did in Chrysler and GM, that the sale proceeds were distributed fairly among the creditors. The problem, of course, is not with the distribution of sale proceeds received; the problem is with the diversion of value to the purchaser, which paid the estate too little and thus, in its role as a creditor, received too much. This is Supplier's com-

plaint in this illustration and the dissenting creditors' complaint in the Chrysler and General Motors case.

In this illustration, an auction would solve the problem—because a bidder would offer $60 foiling Bank's scheme—as would granting Supplier a veto over the sale to reflect its dominant position in what would be the unsecured creditor (and only) class were the proposed distribution part of a reorganization plan. With neither protection in place, Supplier is left to suffer the consequences of judicial error, which can occur no matter how skilled or well meaning the judge; skilled and well meaning are not synonymous with omniscient.

As Mark Roe and David Skeel observe in their own criticism of the Chrysler bankruptcy, the ability of a court to approve an untested sale at the behest of some creditors over the objection of others without the safeguards prescribed by the Bankruptcy Code returns us to a past centuries' practice referred to as the equity receivership, where it was widely believed that powerful, favored creditors routinely victimized the weak and unconnected.[12] The Chrysler and General Motors cases are a step back and in the wrong direction.

IV. Proposed Reform

The Chrysler and General Motors bankruptcy cases are objectionable because they include a sale of virtually all of the debtors assets under §363 of the Bankruptcy Code without a market test for the value of those assets. In Chrysler and in GM, had the price paid for the assets been undeniably fair, dissenting creditors would have had no basis for complaint so long as they received a ratable share of the sale proceeds consistent with their levels of priority. In neither case, however, was the price undeniably fair. It is problematic that in each case the process favored some creditors over others through the assumption of some claims and the consequent relegation of others to receive perhaps inadequate sales proceeds.

A response to this problem could be a ban on the use of §363 to sell all or substantially all of the assets of a debtor in bankruptcy. Without a sale as a tool for de facto reorganization, a court would be forced to follow the Bankruptcy Code's procedural provisions in an actual reorganization of a debtor and could not easily deprive creditors of the Code's protections. This response would be excessive, however. As long as a sale of a firm's assets is subject to a true market test, a sale may be the best and most efficient way

[12] See Roe & Skeel, cited in note 7; see also David A. Skeel, Jr., Debt's Dominion: A History of Bankruptcy Law in America 48-70 (2001) (describing the equity receivership and its faults).

to dispose of an insolvent debtor. Indeed, bankruptcy courts have increasingly, and usefully, conducted all-asset sales.[13] The key is to ensure a *true* market test.

State courts have significant experience in deciding whether a proposed sale of a firm is likely to achieve the best price for investors. Under a line of cases that comprise what is referred to as the *Revlon* doctrine, the Delaware courts have imposed a standard that directors must meet when a corporation is up for sale. While this standard does not require any particular process in every case, the courts have suggested that there is a general obligation for the directors of the firm to hold an auction or conduct some other form of market test if there is a doubt about the true value of the firm.[14] Congress would do well to establish as a minimum procedural safeguard state law requirements for §363 sales of all or substantially all of a debtor's assets, at least where the debtor is large enough to justify the administrative expense of such a process.

In addition, as described above, the requirement that a bidder assume some of a debtor's liabilities dictates the distribution of sale proceeds, and cannot enhance the amount of those proceeds. Therefore, a condition of liability assumption is not a proper part of any sale, and should not be permitted, regardless of applicable state law.

To accomplish these ends, Congress could add to the Bankruptcy Code a new subsection of *§363*, one that would provide:

> *The trustee may sell property under subsection (b) or (c) of this section only if—*
>
> *(1)(A) where the debtor is not a small business debtor, the sale of all or substantially all of the debtor's assets complies with the requirements that would be imposed on the debtor by applicable nonbankruptcy law if the debtor were a corporation that was not a debtor and if such corporation's equity interest were publicly traded and subject to a bid for control; and (B) the process for the sale of such property imposes no condition, whether or not subject to exception, that an offeror agree to assume or pay some but not all claims; or*
>
> *(2) no holder of a claim, except a claim that will receive on account of such claim cash equal to the allowed amount of such claim upon distribu-*

[13] This trend is noted in the Second Circuit's affirmation of Chrysler, 2009 WL 2382766, which sites, e.g., Douglas G. Baird and Robert K. Rasmussen, The End of Bankruptcy, 55 Stan. L. Rev. 751 (2002).

[14] The recent Delaware Supreme Court case of Lyondell Chemical Co. v. Ryan, 970 A.2d 235 (Del. 2009) summarizes the current state of the *Revlon* doctrine (though the holding of *Lyondell* addresses only a narrow issue of director liability).

> *tion of the property of the estate or as of the effective date of the debtor's confirmed plan, objects to the sale.*

This provision, if adopted, would not apply to a small business debtor,[15] which cannot be expected to absorb the expense of auctioning its assets, and would have no effect on a debtor that, while too large to qualify as a small business debtor under the Bankruptcy Code, is still small enough that applicable state law would not impose a market test. For large debtors such as Chrysler or GM, however, whether or not publicly traded,[16] the provision would grant any creditor with a claim that will not be paid in full a right to insist on the sort of process that state law would provide shareholders of a solvent firm. This would include, where appropriate, the right to insist on an openly contested auction with ample time for potential bidders to assess the assets on which they may bid. Reliance on applicable state law—a common feature elsewhere in the Bankruptcy Code—would provide a debtor with the flexibility to opt out of an auction or other market test if exigent and unusual circumstances would allow a firm to opt out outside of bankruptcy. Yet, the provision would advantageously prevent a debtor from concluding a sale pursuant to a process that state law would disallow even if a bankruptcy judge believed, perhaps mistakenly, that the sale would be in the interest of the bankruptcy estate. That is, for a large firm, the bankruptcy sale process could not be more permissive than that required by applicable state law. And under no circumstance could the sale of a debtor's assets be conditioned on a bidder's willingness to assume some but not all of the debtor's liabilities, as this practice is illegitimate, and was the crux of the problem in the Chrysler and GM cases.

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15 This term is defined by §101(51D) of the Bankruptcy Code.

16 The proposed provision is designed to apply and to protect creditors in large, privately held firms just as it would apply to a publicly traded firm. The reference in the proposed provision to a "publicly traded" controlling interest is designed as a hypothetical test that would trigger the applicability of the provision; such tests are common in the Bankruptcy Code. A related provision might be desirable to define "publicly traded" for these purposes, though this term might be plain enough for courts to interpret in context.

ANNEX B: “NO BIG DEAL: THE GM AND CHRYSLER CASES IN CONTEXT”

NO BIG DEAL: THE GM AND CHYSLER CASES IN CONTEXT

Stephen J. Lubben[1]

INTRODUCTION

In the past summer, two historically important North American corporations – Chrysler and General Motors – entered reorganization proceedings to address their long-standing financial and operational difficulties. Both debtors were provided with substantial governmental financing from both Canada and the U.S.,[2] and both cases involved a quick sale of the "good" parts of the debtors' operating assets, while the remainder was left behind for liquidation.[3]

Almost every leading corporate bankruptcy academic has spoken against the automotive bankruptcy cases. And the Chrysler and GM chapter 11 cases have been vilified in every major finance-focused media outlet – by everyone from Ralph Nader[4] to Richard Epstein.[5] Why?

Many of the arguments against these cases, particularly those made in the press and by some of the participants in the cases, are hopelessly vague and amount, at heart, to a statement that the government should prefer investors over unions.[6] These are essentially political questions that do not support their related arguments, including that these cases somehow violated the "rule of law." The rule of law is not violated by a policy disagreement.

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[1] Daniel J. Moore Professor of Law, Seton Hall University School of Law. As always, Jennifer Ruth Hoyden made this article much better than it would have been.
[2] In the case of Canada, financial assistance came from both the federal and provincial (Ontario) governments.
[3] *E.g.,* In re General Motors Corp,, 2009 Bankr. LEXIS 1687 (Bankr. S.D.N.Y. July 5, 2009).
[4] http://online.wsj.com/article/SB124355327992064463.html
[5] http://www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html
[6] http://www.bloomberg.com/apps/news?pid=20601039&refer=columnist_woolner&sid=aN_5hvV_xqHM

The academic critics of these chapter 11 cases make arguments that appear more credible. But they are not any more convincing upon close examination. For example, in his testimony before Congress,[7] Professor Douglas Baird argued that the bidding procedures approved by the courts in connection with the sale of both companies amounted to an impermissible, stealth reorganization plan because bidders were required to treat the unions in the same manner as the initial, government-sponsored bidder.

This might be true if there had been alternative bidders, but in the absence of any evidence of such a bidder, the bidding procedures are irrelevant. The bidding procedures could require a competitive bidder to stand on its head, but if there is no such bidder the contents of the procedures are purely academic. In a period when the credit markets have been essentially "closed,"[8] those who take for granted the existence of unknown or theoretical bidders have some obligation to explain how such a bidder would have bought GM, a company with $27 billion of *secured* debt.[9]

I use this short paper to address the key arguments against the automotive cases and contextualize what happened in these two chapter 11 cases. Stripped of their speculation and "what ifs," I show that these arguments are no more persuasive than the loose, unsupported arguments thrown about in the popular press.[10] But first, I show how

[7] Because of the newness of this issue, few academics have published formal articles on these issues. Instead, they have engaged these issues in the form of testimony and editorial writings, which I respond to herein.
[8] http://www.ft.com/cms/s/0/8174765a-6058-11de-a09b-00144feabdc0.html
[9] *See* In re General Motors Corp,, 2009 Bankr. LEXIS 1687, *36-37 (Bankr. S.D.N.Y. July 5, 2009)("There are no merger partners, acquirers, or investors willing and able to acquire GM's business. Other than the U.S. Treasury and EDC, there are no lenders willing and able to finance GM's continued operations. Similarly, there are no lenders willing and able to finance GM in a prolonged chapter 11 case.").
[10] For an example of the latter, see David Brooks, *The Quagmire Ahead*, N.Y. Times, June 1, 2009 (arguing that "the Obama plan rides roughshod over the current private investors").

these cases, and particularly their structure – a quick lender-controlled §363 sale – are entirely within the mainstream of chapter 11 practice for the last decade.[11]

Congress may well decide, as a matter of policy, that this should end, but until it does there is little to the idea that these cases are "unprecedented" in their structure.[12] The identity of the DIP lender is novel,[13] but what happened is routine.[14] And the identity of the lender is not a bankruptcy issue.

I. MODERN CHAPTER 11 PRACTICE: ASSET SALES BEFORE PLANS

There are two sections of the Bankruptcy Code applicable in chapter 11 that explicitly authorize the sale of property. Section 363(b) authorizes a trustee, and thus the chapter 11 debtor in possession,[15] to sell property of the estate outside the ordinary course of business.[16] And section 1123 provides that a chapter 11 plan may include provisions for sale of all or any part of the property of the estate.[17] The latter course presupposes the drafting of a complete plan and disclosure statement, creditor voting, and a confirmation

[11] Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 Stan. L. Rev. 673, 674 (2003). *See also* Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc., 128 S. Ct. 2326, 2331 n.2 (2008).

[12] http://www.msnbc.msn.com/id/30507066/ (quoting Professor Skeel). In this article Skeel argues that government's role in the case is unprecedented in bankruptcy history, a contention which seems to neglect the Penn Central case in the 1970s. *See* In re Penn Central Transportation Co., 596 F.2d 1127, 1149 (3d Cir. 1979) ("The sheer size of the expenses of administration, the unprecedented scope and number of compromises preceding adoption of the Plan, and legislative intervention are all factors which require a unique approach . . . .").

[13] 11 U.S.C. §364 (authorizing post-petition or "DIP" lending). In chapter 11, the debtor retains possession or control of its bankruptcy estate, because no trustee is appointed, and is referred to as the "debtor in possession" or the "DIP." 11 U.S.C. §1107(a). *See* David A. Skeel, Jr., *The Past, Present and Future of Debtor-In-Possession Financing*, 25 Cardozo L. Rev. 1905, 1920-29 (2004).

[14] Rachael M. Jackson, Comment, *Responding to Threats of Bankruptcy Abuse in a Post-Enron World: Trusting the Bankruptcy Judge as the Guardian of Debtor Estates*, 2005 Colum. Bus. L. Rev. 451, 452 (2005).

[15] 11 U.S.C. §1107(a).

[16] John J. Hurley, *Chapter 11 Alternative: Section 363 Sale of all of the Debtor's Assets Outside a Plan of Reorganization*, 58 Am. Bankr. L.J. 233, 24-41 (1984) (Noting more than twenty years ago, that "it has become generally accepted that section 363(b) empowers a trustee or debtor in possession to sell all of the property of the debtor outside a plan of reorganization.").

[17] 11 U.S.C. §1123(b)(4).

hearing.[18] Section 363 sales are thus considered much faster alternatives, and the Bankruptcy Code provides no guidance on when either procedure should be used.[19]

To prevent abuse of the 363 process, courts have developed rules that prevent imposition of a reorganization plan through the sale process.[20] This is the so-called rule against "*sub rosa*" plans – that is, plans disguised as sales.[21] While all Circuits seem to follow the rule against covert plans, the precise content of the rule varies by Circuit.[22] For example, in the 2d Circuit the rule seems to be a subpart of that jurisdiction's larger requirement that a pre-plan sale be supported by a good business justification.[23] Shortcutting the Bankruptcy Code is not a business justification, good or otherwise.[24]

At the other end of the spectrum, the 5th Circuit seems to have adopted a sense of the rule against disguised plans as requiring pre-plan sales to comply with the Bankruptcy Code's rules for plan confirmation, particularly when all of the debtor's assets are being sold.[25] The 2d Circuit, on the other hand, has expressly rejected this equivalence, and has held that a pre-plan settlement can even violate the "absolute priority rule"[26] if the debtor

[18] *Cf.* Timothy D. Cedrone, *A Critical Analysis Of Sport Organization Bankruptcies In The United States And England: Does Bankruptcy Law Explain The Disparity In Number Of Cases?,* 18 SETON HALL J. SPORTS & ENT. L. 297, 310-12 (2008) (explaining the chapter 11 plan process).
[19] *See* J. Vincent Aug et al., *The Plan of Reorganization: A Thing of the Past?*, 13 J. Bankr. L. & Prac. 3, 4-5 (2004) ("A Section 363 sale is generally the preferred method for selling assets because it is quicker and less expensive, and provides a quick fix to address continuing losses, rapidly depleting assets, and loss of cash flow.").
[20] Jason Brege, *An Efficiency Model of Section 363(b) Sales*, 92 Va. L. Rev. 1639, 1650 (2006).
[21] The phrase was first used in In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983), but seems to add little to the discussion.
[22] James J. White, *Death and Resurrection of Secured Credit*, 12 Am. Bankr. Inst. L. Rev. 139, 161-63 (2004).
[23] Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983).
[24] In re Chrysler LLC, 2009 WL 2382766, *6 (2d Cir. Aug 05, 2009).
[25] *See, e.g.*, In re Babcock and Wilcox Company, 250 F.3d 955 (5th Cir. 2001); In re Continental Air Lines, Inc. 780 F.2d 1223 (5th Cir. 1986); *see also* In re Gulf Coast Oil Corp., 404 B.R. 407 (Bankr. S.D. Tex. 2009).
[26] The rule that each layer of debt be paid in full, starting with the most senior debt, before any junior claim receives any recovery. *See generally* Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. Chi. L. Rev. 738 (1988).

puts forth a sufficiently compelling business justification.[27] In short, until the Supreme Court or Congress weighs in on this matter, the location of the chapter 11 cases can have some bearing on the law applied in the case.[28]

Once a debtor in possession elects to sell its assets in a section 363 sale, the process typically involves indentifying an initial bidder, frequently called a "stalking horse," and approval of bidding procedures.[29] These bidding procedures provide structure for the solicitation of competing bids, followed by an auction if any competing bids materialize.[30] Throughout the process it is widely recognized that the bankruptcy courts have wide discretion in structuring sales of estate assets,[31] and prospective purchasers are often counseled to expect a "malleable" process.[32]

In particular, the ultimate goal is maximizing the value of the estate, to increase the return to creditors.[33] Thus, there is substantial caselaw to support the notion that "non-conforming" bids must be considered by bankruptcy courts if doing so will increase the return to creditors.[34]

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[27] Motorola, Inc. v. Official Comm. of Unsecured Creditors and J.P. Morgan Chase Bank, N.A. (In re Iridium Operating LLC), 478 F.3d 452, 466 (2d Cir. 2007).
[28] *Cf.* Stephen J. Lubben, *Delaware's Irrelevance*, 16 A.B.I. L. Rev. 267 (2008).
[29] *See* In re O'Brien Environmental Energy, Inc., 181 F.3d 527, 530 (3rd Cir. 1999).
[30] *See* C.R. Bowles & John Egan, *The Sale of the Century or a Fraud on Creditors?: The Fiduciary Duty of Trustees and Debtors in Possession Relating to the "Sale" of a Debtor's Assets in Bankruptcy*, 28 U. Mem. L. Rev. 781, 805-36 (1998).
[31] In re Financial News Network, Inc., 980 F.2d 165, 169 (2d Cir. 1992) (holding that the Bankruptcy Court may consider additional evidence pertaining to a bid after the official close of bidding, stating that "we have observed that '[f]irst and foremost is the notion that a bankruptcy judge must not be shackled with unnecessarily rigid rules when exercising the undoubtedly broad administrative power granted him under the [Bankruptcy] Code"') (quoting In re Lionel Corp., 722 F.2d 1063, 1069 (2d Cir. 1983)).
[32] In re Food Barn Stores, Inc., 107 F.3d 558, 565 (8th Cir. 1997).
[33] In re Chung King, Inc., 753 F.2d 547, 549 (7th Cir. 1985).
[34] *See, e.g.*, Corp. Assets, Inc. v. Paloian, 368 F.3d 761 (7th Cir. 2004); In re Financial News Network, Inc., 126 B.R. 152 (S.D.N.Y. 1991); In re Wintex, 158 B.R. 540 (D. Mass 1992); In re Edwards, 228 B.R. 552 (Bankr. E.D. Pa. 1998).

For much of the early years of the Bankruptcy Code and chapter 11, section 363 sales were of limited interest. Indeed, a review of the many cases in Lynn LoPucki's Bankruptcy Research Database[35] shows that only about a half-dozen cases before 1995 involved important 363 issues.[36] But in the past ten to fifteen years, secured lenders have used this provision, plus the control inherent in being a secured lender – particularly control over the debtor's cash,[37] to take charge of chapter 11 cases.[38] Among the well-known debtors that have used 363 sales in their cases are TWA, Vlasic Foods, Polaroid and Bethlehem Steel.[39]

In the new world of sale-driven chapter 11 cases, the secured lender drives the process by the simple fact that it has no obligation to fund the debtor's reorganization attempts, and thus funding will be provided only if it also benefits the controlling lender.[40] The lenders are willing to fund a quick sale because section 363 provides a better mechanism for selling assets than state foreclosure law.[41]

Other secured lenders are protected from "low ball" sales by their ability to credit bid their claim,[42] and take over control of the collateral.[43] Likewise, other creditors who

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[35] http://lopucki.law.ucla.edu/

[36] A complete list of cases is attached as Appendix A to my testimony before the TARP Congressional Oversight Panel, available at http://cop.senate.gov/hearings/library/hearing-072709-detroithearing.cfm.

[37] Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. Pa. L. Rev. 1209, 1229 (2006).

[38] Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 Tex. L. Rev. 795 (2005).

[39] *Cf.* Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 Mich. L. Rev. 1 (2007).

[40] Baird & Rasmussen, Missing Lever, *supra* note 37, at 1239-40. *See also* In re Decora Indus., 2002 WL 32332749, at *3 (D.Del. May 20, 2002).

[41] *See* In re Trans World Airlines, Inc., 322 F.3d 283, 288-90, 293 (3d Cir. 2003).

[42] In Chrysler, where the ability to credit bid was most relevant, the dissenting lenders had no independent right to credit bid, indeed they were arguably not even secured creditors when acting independently. Instead, all of the security interests in this loan were held by a collateral trustee, for the benefit of all lenders. Under the loan documents, the trustee was instructed to take orders from the agent bank upon default – Chase. At the Chrysler sale hearing, the government testified that Chase had been told it could credit bid if it did not like the deal. The dissenting lenders, representing less than 5% of the total loan, had no right under the load documents to override Chase's decision in this regard. The government certainly could have explained this before the sale hearing, as the apparent inability to credit bid appeared to

think the sale price is too low can orchestrate a competing bid. Once the sale is completed, the creditors are further protected during the distribution of the sale proceeds by the normal rules of chapter 11, including the absolute priority rule[44] and the rule against "unfair discrimination."[45]

The basic structure used to reorganize both GM and Chrysler was not unprecedented. Indeed, it was entirely ordinary.[46] In both cases the "good" assets were sold to new entities.[47] The consideration for that sale goes to the "old" debtor, and will be distributed according to the absolute priority rule. None of this constitutes a covert reorganization plan or a corruption of the bankruptcy process.[48]

The drawn-out, debtor-controlled chapter 11 process of Eastern Airlines and Pan Am is long gone.[49] Whether this is a good thing is open to debate, but it clearly reflects current reality[50] and creditor preference.[51] Moreover, the 2005 Amendments to the Bankruptcy Code, which increased the difficulty of pursuing a traditional chapter 11

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represent a problem with these cases. http://www.creditslips.org/creditslips/2009/05/chrysler-credit-bidding-again.html.

[43] *See* Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 121-22 (1991).

[44] 11 U.S.C. §1129. *Cf.* John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 Mich. L. Rev. 963, 969-70 (1989).

[45] Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 Am. Bankr. L.J. 227, 228 (1998).

[46] Douglas R. Baird, *The New Face of Chapter 11*, 12 Am. Bankr. Inst. L. Rev. 69, 80-82 (2004).

[47] *Cf.* In re Dial-A-Mattress Operating Corp., 2009 Bankr. LEXIS 1801 (Bankr. E.D.N.Y. June 24, 2009) (approving 363 sale to newly created corporation).

[48] *See* In re Trans World Airlines, Inc., 2001 Bankr. LEXIS 980, 2001 WL 1820326, *11 (Bankr. D. Del. Apr. 2, 2001).

[49] Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 Stan. L. Rev. 751, 751 (2002) ("Corporate reorganizations have all but disappeared. Giant corporations make headlines when they file for Chapter 11, but they are no longer using it to rescue a firm from imminent failure. Many use Chapter 11 merely to sell their assets and divide up the proceeds.").

[50] Stephen J. Lubben, *The "New and Improved" Chapter 11*, 93 Ky. L.J. 839, 841- 42 (2005) ("[I]t is not clear that this development promotes social welfare. Rather, lender control may only benefit lenders.").

[51] Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt*?, 47 B.C. L. Rev. 129, 156-57 (2005).

reorganization plan arguably suggest a Congressional "push" in favor of quicker, sale-driven chapter 11 cases.[52]

The notion that the speed of these cases was unique, or that the use of section 363 to effectuate a quick sale was novel, is therefore without merit.[53] As Judge Gonzalez noted in Chrysler, "[t]he sale transaction…is similar to that presented in other cases in which exigent circumstances warrant an expeditious sale of assets prior to confirmation of a plan. The fact that the U.S. government is the primary source of funding does not alter the analysis under bankruptcy law."[54]

Of course, the academic critics of theses cases have largely avoided this line of argument. Since many of the critics were among those to first discuss the new face of chapter 11 in an academic setting,[55] and were generally supportive of the new order,[56] or have otherwise long argued for chapter 11 to move away from traditional reorganizations in favor of market-based solutions, it could hardly be otherwise.[57] In the next part of this paper I address the more specific arguments that these leading scholars have made in the press and before Congress and the TARP Congressional Oversight Panel.

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[52] Lubben, Stephen J., Systematic Risk & Chapter 11(May 4, 2009). Temple Law Review, 2009; Seton Hall Public Law Research Paper No. 1399015. Available at SSRN: http://ssrn.com/abstract=1399015.
[53] Indeed, the Lehman Brothers sale was completed in even less time, with no government involvement. Stephen J. Lubben, *The Sale of the Century and Its Impact on Asset Securitization: Lehman Brothers*, 27 Am. Bankr. Inst. Journal No. 10, page 1 (2009).
[54] In re Chrysler LLC, 405 B.R. 84, 87 (Bankr. S.D.N.Y. 2009), *aff'd,* 2009 WL 2382766 (2nd Cir. Aug 05, 2009).
[55] *E.g.*, David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. Pa. L. Rev. 917, 935-38 (2003).
[56] Barry E. Adler, *Bankruptcy Primitive*s, 12 Am. Bankr. Inst. L. Rev. 219, 224-25 (2004).
[57] *See* Barry E. Adler & Ian Ayres, *A Dilution Mechanism for Valuing Corporations in Bankruptcy*, 111 Yale L.J. 83, 101-03 (2001); Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 Colum. L. Rev. 527, 559 (1983).

II. THE ACADEMIC ARGUMENTS

In this section I address the arguments that bankruptcy academics have made against the automotive bankruptcies. These arguments are generally more sophisticated than those presented in the cases themselves, yet I contend they still suffer from serious flaws. I make little effort to engage the criticisms mounted by non-bankruptcy legal academics, like Professor Richard Epstein, a well-known torts expert at the University of Chicago Law School.[58] As part of his critique of these bankruptcy cases, Professor Epstein notes that President Obama is "no bankruptcy lawyer."[59] The same, of course, can be said for Professor Epstein – and the suggestion that the President personally negotiated these cases is silly.[60] More generally, I have previously argued that many of these critiques of the chapter 11 cases show little understanding of how chapter 11 works.[61] The following arguments suffer from no such deficiencies.

A. *Bidding Procedures and "Sub Rosa" Plans (Douglas Baird)*

In his recent testimony before the House Subcommittee on Commercial and Administrative Law,[62] Professor Baird advanced a neat argument that the bidding procedures approved in the automotive cases so "locked in" a particular deal that they amounted to a plan of reorganization, in violation of the caselaw discussed in the prior section of this paper.

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[58] http://www.law.uchicago.edu/faculty/epstein
[59] http://www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html
[60] The full quote is "President Obama--no bankruptcy lawyer--twisted the arms of the banks that have received TARP money to waive their priority." *Id.* As I discuss *infra*, the "strong arming" argument is a contention without any supporting evidence.
[61] http://www.creditslips.org/creditslips/2009/06/the-absolute-priority-rule.html
[62] http://judiciary.house.gov/hearings/pdf/Baird090722.pdf

In both automotive cases, the approved bidding procedures provided that a bidder would only become a "Qualified Bidder" if they agreed to assume the same collective bargaining agreements that the initial bidder intended to assume. Because this requirement could have led a bidder to offer less cash for the debtors' assets – since they would have been forced to assume this additional liability – Baird argues that the process became "both a sale and a *sub rosa* plan."[63]

The requirement in the bidding procedures that any bidder assume the UAW agreements smacks of overreaching. But was another bidder willing to pay more than $2 billion for Chrysler's assets or otherwise top the proffered bids? I doubt it, and if not the bidding procedures are irrelevant.

A bidding procedure that only applies to competing bidders is a dead letter if there are no competing bidders – the terms of the bidding procedures are no more relevant than the instructions for inflating a life vest on a plane you will never fly on. The dissenting Chrysler lenders,[64] and some academic commentators,[65] have argued that the bidding procedures may have deterred an unknown bidder, thus undermining the process.

The deterrence argument presumes that the procedures have more "stickiness" than they actually do. As noted in Part I, the caselaw is abundant and clear that bankruptcy courts have an obligation to consider the highest bid presented, even if it does not conform with previously approved bidding procedures. Any investor who contemplates buying a multi-billion dollar distressed corporation will know this – the contrary presumption is not credible.

[63] Testimony at page 5.
[64] http://www.forbes.com/feeds/afx/2009/05/05/afx6380833.html
[65] For example, Mark Roe in the commentary I discuss, *infra*.

Irrespective of the potential effects of the bidding procedures, there are good independent reasons to think that there were no inhibited bidders who failed to appear. The automotive industry, both domestic and foreign, is presently heavily distressed. At the same time, the credit markets show no ability to provide the kind of financing that would be needed to purchase either GM or Chrysler.[66]

And why should we not trust the market information that is available to us? The senior lenders – who could have "credit bid" their claim[67] – showed no interest in taking on these assets. Chrysler had been trying to sell itself for months before the chapter 11 case, with no success at all.[68] And recall that in 2007, a time of easy credit and stable markets, Daimler essentially paid somebody to take Chrysler off its hands.[69] This does not suggest a group of assets with a lot of hidden value.

Professor Baird acknowledges the theoretical nature of his concern,[70] but still worries that the bankruptcy court could have done more. It is doubtful that such a move would have had any purpose, and thus seems to be an argument for more window dressing.

B. *Plan-Sale Equivalence (Barry Adler)*

In his remarks before the TARP Congressional Oversight Panel hearing in Detroit this past July,[71] Professor Adler argued

> that Chapter 11 contains rules designed precisely to protect creditors from a judicial determination with which the creditors disagree. When Judge Gonzalez

[66] http://www.ft.com/cms/s/0/33dbf8a6-82a3-11de-ab4a-00144feabdc0.html
[67] That is, forgiven their debt in exchange for the companies' assets. 11 U.S.C. §363(k).
[68] http://www.bloomberg.com/apps/news?pid=20601103&sid=aCWc52_2KMYs&refer=us
[69] http://business.timesonline.co.uk/tol/business/industry_sectors/engineering/article1786611.ece
[70] Testimony at pages 5-6.
[71] http://cop.senate.gov/documents/testimony-072709-adler.pdf

> approved the Chrysler sale, he stripped these protections from the secured creditors.[72]

Adler goes on to argue that the requirements of chapter 11 – particularly the "fair and equitable" and "no unfair discrimination" provisions of section 1129(b) – should have been applied to protect the interests of senior creditors.

There are two problems with this analysis. First, this is not the law in the 2d Circuit, where both GM and Chrysler's cases were filed. As previously discussed in Part I, the 2d Circuit has never held that 363 sales are subject to the full requirements of chapter 11, and has affirmatively held that one key part of section 1129(b), the absolute priority rule, can be ignored in situations where there is a suitable justification.[73] In short, Adler's position is a fair statement of the law of the 5th Circuit, and there could be good arguments for why this is what the law in the 2d Circuit *should* be, but it hardly seems fair to fault a bankruptcy court for following the (binding) opinions issued by its own Circuit Court.

More importantly, Adler has to rely on conjecture to even invoke the provisions of section 1129(b). As he notes, the tests he points to are class protections that are only applicable if the class in question rejects the debtor's plan.[74] Given that more than 90% of the Chrysler lenders supported the transaction, the reasons for imagining this class rejecting the plan are somewhat unclear.

Professor Adler argues "the accepting secured creditors were largely recipients of government TARP funds and thus *arguably* beholden to the government, which

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[72] Testimony at page 4 (discussing the Chryslers case).
[73] Motorola, Inc. v. Official Comm. of Unsecured Creditors and J.P. Morgan Chase Bank, N.A. (In re Iridium Operating LLC), 478 F.3d 452, 466 (2d Cir. 2007).
[74] 11 U.S.C. §1129(b)(1) ("if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if . . . "); *see also* 11 U.S.C. §1129(a)(8) (requiring all classes to accept the plan).

engineered the distribution to the UAW."[75] This, he argues, means that the lenders would have to be split into two classes, giving the non-TARP parties a means of rejecting the plan and invoking section 1129(b).[76]

The problem is that after extensive discovery and depositions, there is still no evidence to support the claim that the TARP lenders were bullied into accepting the proffered deal in Chrysler. In other contexts, like that of home mortgage modifications, it appears that some of the biggest recipients of TARP funds have been the ones least likely to bend to Administration policy.[77] And if these lenders were not "beholden" to the Treasury, the entire argument evaporates.

It has to be remembered that all of the key players in these cases were highly sophisticated. GM's board – represented by Cravath, Swaine & Moore – is hardly a group to be easily cowed by some hard bargaining. And Chrysler's senior lenders had agreed by contract to have JPMorgan Chase, the lead lender, negotiate on their behalf.[78] We would have heard if Jamie Dimon felt Chase was being strong-armed into supporting the sale – he's not known to be shy.[79]

Likewise, it was entirely rational for the bulk of Chrysler's secured lenders to believe that $2 billion in cash, on their $6.9 billion claim, was, by far, the highest possible recovery they could obtain. Indeed, a nearly 30% recovery is clearly better than

[75] Testimony at page 5 (emphasis added).
[76] *See* G. Eric Brunstad, Jr. & Mike Sigal, *Competitive Choice Theory and the Unresolved Doctrines of Classification and Unfair Discrimination in Business Reorganizations Under the Bankruptcy Code*, 55 Bus. Law. 1, 24-32 (1999).
[77] http://www.bloomberg.com/apps/news?pid=20601103&sid=a7kYntqozaKo
[78] Under section 6.12 of the Chrysler collateral agreement, Chase, as agent, has the power to release the liens granted under the loan agreements. Indeed, upon default the agent has full control over any "Collection Enforcement Action," defined to include "exercising any other right or remedy under the [UCC] . . . or under any Bankruptcy Law or other applicable law." This is not a problem created by TARP, the Bankruptcy Code, or the federal government, but by the loan agreement to which the lenders themselves voluntarily agreed to be bound.
[79] http://www.businessweek.com/careers/managementiq/archives/2008/10/ceos_on_the_cou.html

these lenders could have done if they had liquidated the debtor's assets. And liquidation was the lenders' only real alternative.

While commentators often imply that liquidation is a costless endeavor, liquidating a company the size of Chrysler would have cost millions of dollars. Liquidation would thus only make sense if the lenders could be sure to recover more than $2 billion *plus* the costs of liquidation. Given the distressed state of the automotive industry, and the attendant effects this reality had for the value of Chrysler's assets, the lenders no doubt saw the wisdom of a risk-free $2 billion.

C. *A Return to the (Bad) Old Days? (David Skeel)*

In testimony before Congress,[80] and as more fully explained in an article written for the American Enterprise Institute,[81] David Skeel has argued that the automotive cases represent a resurrection of the worst features of corporate reorganization from 100 years ago. In particular, Professor Skeel argues that the sale transaction in both automotive cases amounted to the kind of "sham" sale that was once a common feature of railroad receiverships, a type of corporate reorganization Congress ended in the New Deal by federalizing corporate bankruptcy.[82]

Skeel is undoubtedly correct that railroad receiverships involved stylized sales of the railroad's assets,[83] but he is wrong to identify that as the key problem with the

[80] http://judiciary.house.gov/hearings/pdf/Skeel090521.pdf
[81] http://www.american.com/archive/2009/may-2009/why-the-chrysler-deal-would-horrify-a-new-dealer
[82] DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 48-70 (2001).
[83] In particular, receiverships involved the initiation of a foreclosure action by a secured lender, the credit bid by that secured lender of its claim, and the transfer of the debtor's assets to a new shell corporation, capitalized as agreed by the prior holders of the debtor's securities. EDWARD SHERWOOD MEAD, CORPORATION FINANCE 406-12 (rev. ed. 1920) (describing the process used to commence a receivership).

receiverships.[84] Indeed, Professor Skeel himself previously explained that the problem with receiverships was that

> [t]he Wall Street professionals who organized protective committees in order to negotiate the reorganization seemed to focus more on obtaining generous fees for themselves than on striking a good bargain on behalf of the scattered investors whom they purported to represent. The big losers, of course, were small, individual investors.[85]

In addition, the process was generally designed to "squeeze out" small bondholders, benefiting the shareholders (who were typically large institutions) and management.[86] None of this really has much to do with the sale structure.

And it clearly is not Professor Skeel's primary concern either – instead the receivership analogy simply serves as a frame for his larger arguments that the automakers assets were undervalued and that the structure of the sale process unduly favored the unions over other creditors.[87]

But in neither case were the objecting creditors able to produce any credible evidence that the debtors were worth more than was being paid, and in fact the evidence presented suggested that strategy promoted by the Automotive Task Force was all that stood between these investors and a substantially lower recovery.[88] In addition, before presuming that these cases were some sort of intrigue to buy the automakers' assets on the cheap, it once again bears looking at the available market information. For example,

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[84] *See* Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 Cornell L. Rev. 1420, 1445-51 (2004).
[85] David A. Skeel, Jr., *Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship*, 113 Harv. L. Rev. 1075, 1089 (2000)(footnote omitted).
[86] Stephen J. Lubben, *Out of the Past: Railroads & Sovereign Debt Restructuring*, 35 Geo. J. Int'l L. 845, 850 (2004). *See also* In re Wabash Valley Power Ass'n, 72 F.3d 1305, 1314 (7th Cir. 1995) ("In its origins, the absolute priority rule was a judicial invention designed to preclude the practice in railroad reorganizations of "squeezing out' intermediate unsecured creditors through collusion between secured creditors and stockholders (who were often the same people).").
[87] This is particularly clear from the American Enterprise Institute paper, *supra* note 81.
[88] *See* In re Chrysler LLC, 405 B.R. 84, 105-06 (Bankr. S.D.N.Y. 2009), aff'd), *aff'd,* 2009 WL 2382766 (2nd Cir. Aug 05, 2009).

the dissenting Chrysler lenders – the Indiana Pension funds – paid $17 million for their stake in the senior debt that had a face value of $43 million. They received $15 million through the Chrysler bankruptcy process.[89] That is, their claim was paid at more than 88% of its market value, measured at the time the funds bought their claim. If the market price was roughly accurate, then the notion that the purchaser underpaid for Chrysler's assets falls apart.

And if the purchaser did not underpay for the assets, then the idea that the bankruptcy court should concern itself with the companies' post-sale transactions with the unions also becomes suspect. The UAW is getting better treatment than other unsecured creditors. But that better treatment is not coming from the debtor. It is coming from the government, passing through the purchaser of the "good" assets in each case. Asset buyers have no obligation to buy anything more than they want to buy, and no obligation to absorb any claims other than those the buyer feels it needs to operate the purchased assets.

We can debate whether it is wise for the government to bail out the UAW, but it does not implicate the bankruptcy process *unless* this bail out is being funded by value that should have gone into the debtors' estates. But if the assets were not undervalued, Skeel's argument that the funds going to the unions should have instead gone into the estates amounts to little more than a claim that the buyers (and thus the U.S. and Canadian governments) should have overpaid for the debtors' assets.[90]

[89] http://www.creditslips.org/creditslips/2009/06/what-did-the-indiana-funds-want.html

[90] Or, alternatively, that the creditors should have received a bailout too – a policy question, and not one that demonstrates a violation of the Bankruptcy Code or the "rule of law."

D. *Government Overinvestment and the Bidding Procedures, Again (Mark Roe).*

In a recent editorial in *Forbes*,[91] Mark Roe criticizes the government's decision to "flood[] Chrysler with money on non-commercial terms" and argues that the results in that case should not be taken at face value since "there was a market test here, but in form only, because the bidding was for the proposed plan." The first claim accuses the government of overinvestment in the automakers, the second reanimates the argument that the bidding procedures mattered in these cases.

It is not clear that the overinvestment argument is a bankruptcy issue; rather, it seems like another way of saying that Professor Roe does not agree with the Administration's policy choices. It is also not clear that it is an issue confined to government as DIP lender. Most DIP financing comes from the debtor's pre-petition lender,[92] and while these loans are often individually profitable, one might also wonder if there were not many cases of overinvestment by banks looking to postpone the consequences of an earlier lending mistake. Moreover, while Roe characterizes the automotive cases as an example of the government propping up defective companies, that alone does not tell us if the move was rational or socially efficient. For example, if the government faced an even greater cost upon liquidation of the debtors through unemployment payments, unpaid environmental cleanup costs, and other analogous expenses, providing bankruptcy financing to these debtors was the right move.[93] Indeed, unlike a private lender who can largely ignore these costs since they will be absorbed by the government, the government as lender has a better set of incentives in this instance.

[91] http://www.law.harvard.edu/news/2009/06/15_roe.html
[92] A. Mechele Dickerson, *Privatizing Ethics In Corporate Reorganizations*, 93 Minn. L. Rev. 875, 908-09 (2009).
[93] http://www.nytimes.com/2009/06/01/business/01deese.html

And as noted earlier, the idea that the bidding procedures prevented a "market test" of the value of the debtors' assets presupposes that there was a market for these assets.

CONCLUSION

The current reality of chapter 11 is undeniable – it is a sale-driven process, where courts seek to maximize the return to creditors. Chrysler and GM sit contentedly within this arrangement.

In analyzing these cases, it is helpful to consider if a proffered objection would be tenable if a private lender had structured the cases. If not, one has to consider if the special nature of the government, and the powers inherent therein, make a difference or if the critique in question is simply being advanced because of the proponent's discomfort with government involvement in corporate finance.

The objecting creditors in these cases had several options. They could have brought another buyer to the table, they could have credit bid, and they could have even sued the agent banks or indenture trustees that allegedly let them down. The fact that the objecting creditors did not pursue any of these more traditional options, and instead chose melodrama, is quite telling. Insisting that the buyer pay more than the debtor's assets are worth, or that the buyer pay specific creditors, or that the buyer not pay specific creditors, are not bankruptcy arguments but rather rhetorical arguments.

* * *

In short, by and large, I think that the criticism of the automotive bankruptcy cases does not stand up to careful scrutiny. In the future, Congress may choose to consider the policy implications of a chapter 11 process that has become heavily driven by quick asset sales and lender control.[94] But given the reality of current chapter 11 practice, both GM and Chrysler's chapter 11 cases were not all that exceptional.

[94] *See* George W. Kuney, *Let's Make it Official: Adding an Explicit Preplan Sale Process as an Alternative Exit from Bankruptcy*, 40 Hous. L. Rev. 1265, 1267-68 (2004).

Section Two: Additional Views

A. Representative Jeb Hensarling

Although I commend the Panel and its staff for their efforts in producing the September report, I do not concur with all of the analysis and conclusions presented and, thus, dissent. I would like, however, to thank the Panel for incorporating several of the suggestions I offered during the drafting process.

I offer the following summary of my Dissenting Views:

- Over the past several months the American taxpayers have involuntarily "invested" over $81 billion in Chrysler, General Motors (GM) and the other auto programs. According to the latest estimate from the Congressional Budget Office (CBO), the investment of TARP funds in the auto industry is expected to add $40 billion more to the deficit than CBO calculated just five months earlier in March 2009. This data supports Ron Bloom's – the head of Treasury's Auto Task Force recent comment that it is unlikely the taxpayers will recover all of their TARP funded investments in Chrysler and GM.

- By making such an unprecedented investment in Chrysler and GM, the Administration by definition chose not to assist other Americans who are in need. With the economic suffering the American taxpayers have endured during the past two years one wonders why Chrysler and GM merited such generosity to the exclusion of other taxpayers. The government clearly picked winners and losers.

- In my view, the Administration used taxpayer funds to orchestrate the bankruptcies of Chrysler and GM so as to promote its economic, social and political agenda.

- A number of bankruptcy law academics at top-tier law schools have questioned the Chrysler and GM bankruptcies. In the Chrysler and GM proceedings, Section 363 of the United States bankruptcy code was used by the Administration to upset well-established commercial law principles and the contractual expectations of the parties. A summary of the bankruptcy issues is provided in Annexes A and B.

- On a "before" v. "after" basis, the Chrysler and GM bankruptcy cases make little legal or economic sense. How is it possible that the Chrysler and GM pension funds (VEBAs) – unsecured creditors – received a greater allocation of proceeds than the Chrysler senior secured creditors or the GM bondholders? In other words, why did the United States government spend tens of billions of dollars of taxpayer money to bail out employees and retirees of the UAW to the detriment of other non-UAW employees and retirees – such as

retired schoolteachers and police officers from the State of Indiana – whose pension funds invested in Chrysler and GM indebtedness?

- A plain reading of the Emergency Economic Stabilization Act of 2008 (EESA) would necessarily preclude the employment of TARP funds for the benefit of the auto industry.

- The private sector must now consider incorporating the concept of "political risk" into its analysis before engaging in any direct or indirect transaction with the United States government. While private sector participants are accustomed to operating within a complex legal and regulatory environment, many are unfamiliar with the emerging trend of public sector participants to bend or restructure rules and regulations so as to promote their economic, social and political agenda as was clearly evident in the Chrysler and GM bankruptcies.

- I recommend that SIGTARP investigate: (i) whether it was appropriate for the Administration to use TARP funds in the Chrysler and GM transactions; (ii) Tom Lauria's claim that his client, Perella Weinberg, "was directly threatened by the White House and in essence compelled to withdraw its opposition to the deal under threat that the full force of the White House press corps would destroy its reputation if it continued to fight;" and (iii) the assertion that the Administration assisted with the negotiation of a "sweetheart deal" for the benefit of Platinum Equity in the Delphi transaction.

- Additional recommendations are provided in my Dissenting Views.

1. Policy Issues and Fundamental Questions Arising from the Use of TARP Proceeds in the Chrysler and GM Bankruptcies

Over the past several months the American taxpayers have involuntarily "invested" over $81 billion[525] in Chrysler, GM and the other auto programs. Recently, in a discussion with staff members of the Panel, Ron Bloom, the head of Treasury's Auto Task Force, stated that it is unlikely the taxpayers will recover all of their TARP-funded investments in Chrysler and GM.[526]

[525] According to the Panel's report, as of August 5, 2009, over $73 billion of TARP funds remain outstanding with respect to the auto programs.

[526] Following Mr. Bloom's statement, Treasury staff contacted COP staff and attempted to clarify Mr. Bloom's comments. The Treasury staff members stressed that the recovery of the TARP funds invested in Chrysler and GM will ultimately depend upon the financial success or failure of Chrysler and GM and whether a favorable market develops for the sale of the equity interests held by the United States government in the automakers. In addition, they stated that although Mr. Bloom may have appeared "personally pessimistic" during his meeting with COP staff, it is simply not possible for the Auto Task Force to predict the future value of Chrysler and GM stock. The Treasury staffers did acknowledge that the equity interests of Chrysler and GM will have to "appreciate sharply" for the American taxpayers to receive repayment in full. This attempt to explain Mr. Bloom's remarks is not particularly helpful because it is apparent that the TARP funds will not be repaid unless Chrysler and GM perform in an extraordinary manner – something they have not done in a long time. That Mr. Bloom – the head of the Auto Task Force – may be "personally pessimistic" regarding these prospects remains significant.

In addition, auto assistance provided by the Administration has added tens of billions of dollars to the budget deficit, and the losses are continuing to increase above and beyond initial expectations. According to the latest estimate from the Congressional Budget Office (CBO), the investment of TARP funds in the auto industry is expected to add $40 billion more to the deficit than CBO calculated just five months earlier in March 2009.[527] A reasonable interpretation of such estimate provides that the American taxpayers may suffer a loss of over 50 percent of the TARP funds invested in Chrysler, GM and the other auto programs. How is it possible that with the economic challenges facing our nation the Administration chose to allocate such a significant share of the TARP to such questionable investments? [528] How much additional funding will be provided by the Administration for Chrysler and GM? What is the strategy and timeline for recouping taxpayer dollars? What are the metrics for determining whether or not Chrysler and GM are "successful," and will the Administration continue to provide assistance until this is attained? If the Administration now equates TARP funds with Stimulus funds, why not direct the resources in the most efficient, equitable and transparent manner by granting tax relief to small businesses – the economic engine that creates approximately three out of every four jobs – and other American taxpayers?

By making such an unprecedented investment in Chrysler and GM[529] the Administration by definition chose not to assist other Americans who are in need. With the economic suffering the American taxpayers have endured during the past two years, one wonders why Chrysler and GM merited such generosity to the exclusion of other taxpayers.[530] Why, indeed, did the United

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[527] See "The Budget and Economic Outlook: An Update," *Congressional Budget Office*¸ August 2009, pages 55-56, at www.cbo.gov/ftpdocs/105xx/doc10521/08-25-BudgetUpdate.pdf. The report provides in part:

> *The improvement in market conditions results in a reduction in the subsidy rate associated with the Capital Purchase Program (CPP* – a major initiative through which the government purchases preferred stock and warrants (for the future purchase of common stock) from banks. CBO has dropped the projected subsidy for the remaining investments in that program from 35 percent in the March baseline to 13 percent. The decrease in the estimated CPP subsidy cost also reflects banks' repurchase of $70 billion of preferred stock through June. Similarly, the estimated subsidy cost for other investments in preferred stock (for example, that of American International Group) has also been reduced. *Partially offsetting those reductions in projected costs is the expansion of assistance to the automotive industry; CBO has raised its estimate of the costs of that assistance by nearly $40 billion relative to the March baseline.* [emphasis added.]

In addition, our country faces a staggering deficit of $1.6 trillion in 2009, and a debt that more-than *triples* in ten years.

[528] Section 113 of EESA discusses the "[m]inimization of long-term costs and maximization of benefits for taxpayers." It gives a clear mandate that the Treasury Secretary must consider the burdens and benefits to taxpayers in assessing initial outlays *as well as* potential long-term returns and economic benefits.

[529] In the bankruptcy proceedings for Chrysler and GM, (i) "Old Chrysler" sold substantially all of its assets to "New Chrysler" and (ii) "Old GM" sold substantially all of its assets to "New GM," each pursuant to Section 363 of the United States Bankruptcy Code. For purposes of simplicity, I generally refer to these entities as "Chrysler" or "GM," but occasionally employ other terms as appropriate.

[530] In a written response to the Panel the Administration stated:

States government choose to reward two companies that have been arguably mismanaged for many years at the expense of other hardworking taxpayers?[531] More poetically, *The New York Times* on July 25 asked: "Why, after all, should the automakers receive the equivalent of a Technicolor dreamcoat, giving them favorite-son status, when other industries, like airlines and retailers, also have suffered from the national recession?" More bluntly, the September 2009 issue of *The Atlantic* simply cut to the bottom line: "Essentially, the government was engineering a transfer of wealth from TARP bank shareholders to auto workers, and pressuring other creditors to go along."[532] The Chrysler and GM reorganizations represent a sad day for the rule

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> Outright failure of GM and Chrysler would likely have led to uncontrolled liquidations in the automotive industry, with widespread devastating effects. Importantly, the repercussions of such liquidations could have included immediate and long-term damage to the U.S. manufacturing/industrial base, a significant increase in unemployment with direct harm to those both directly and indirectly related to the auto sector (e.g., dealerships being shuttered, plant closings, supplier failures, service centers closing, etc.), and further damaged our financial system, as automobile financing accounts for a material portion of our overall financial activity.
>
> Under the direction of the President, the Administration sought to avoid such disruptions to the financial system and the economy as a whole by providing the minimum capital necessary to these companies to facilitate their restructurings. Prior to advancing new funds, the Administration has relied on commercial principles in determining the viability of these businesses and in structuring the terms of its investments.
>
> The President's March 30th, April 30th, and June 1st speeches detail the rationale for further investments in the companies.

Unfortunately, the Administration's response does not address how the $81 billion allocated to the auto programs could have been spent to assist other American taxpayers, including small businesses.

[531] In a written response to the Panel neither Chrysler nor GM acknowledged that by rescuing the two distressed and arguably mismanaged automakers the United States government chose not to assist other American taxpayers.

> Chrysler response:
>
> Please refer to (1) the materials submitted to the U.S. Congress by Chrysler LLC on December 2, 2008, (2) the Restructuring Plan for Long-Term Viability submitted by Chrysler LLC to the U.S. Treasury on February 17, 2009, and (3) the testimony and supporting materials from Chrysler LLC and its advisors that are part of the public record in the bankruptcy proceedings of Chrysler LLC pending in the U.S. Bankruptcy Court for the Southern District of New York. These public materials provide comprehensive information detailing the sudden and drastic effects of the global credit crisis on the U.S. auto industry, the potential disastrous effects on the U.S. economy of a liquidating bankruptcy of Chrysler, and the potential for the new Chrysler to preserve tens of thousands of jobs and generate billions of dollars of federal, state and local tax revenues in the U.S.
>
> GM response:
>
> The government's provision of debtor-in-possessing financing when none was available in the private market, along with its other support for General Motors, enabled the company to go through bankruptcy without liquidation. As Mr. McAlinden testified, the government's actions probably avoided millions of job losses and billions of dollars of lost income and lost tax revenue. These millions of taxpayers, along with the state and local governments which their taxes support, benefited substantially from the government's involvement. Beyond this, the soundness of the government's investment will only be proved out over time.

[532] See "The Final Days of Merrill Lunch," *The Atlantic*, September 2009, at www.theatlantic.com/doc/200909/bank-of-america.

of law, the sanctity of commercial law principles and contractual rights, long term economic growth, and the ideal that the United States government should not pick winners and losers.

Given the unorthodox reordering of the rights of the Chrysler and GM creditors, a fundamental question arises as to whether the Administration directed that TARP funds be used to advance its economic, social and political objectives rather than to stabilize the American economy as required by EESA. It has long been my view that the United States government should not engage in the business of picking winners and losers and certainly should not allocate its limited resources to favor one group of taxpayers over another. Following the Chrysler and GM bankruptcies one has to question what's next in the Administration's playbook – a bailout of the airline industry and its unionized workforce? What about Starbucks?

2. Transfer of TARP Proceeds and Retirement Saving of Indiana School Teachers and Police Officers to the UAW and the VEBAs

On a "before" v. "after" basis the Chrysler and GM bankruptcy cases make little legal or economic sense.[533] How is it possible that the Chrysler and GM VEBAs[534] – unsecured creditors

[533] The Chrysler and GM bankruptcy rearranged the rights of the creditors and equity holders as follows:

Chrysler. Pursuant to the Chrysler bankruptcy, the equity of New Chrysler was allocated as follows:

(i) United States government (9.846% initially, but may decrease to 8%),

(ii) Canadian government (2.462% initially, but may decrease to 2%),

(ii) Fiat (20% initially, but may increase to 35%), and

(iii) UAW (comprising current employee contracts and a VEBA for retired employees) (67.692%, but may decrease to 55%).

The adjustments noted above permit Fiat to increase its ownership interest from 20% to 35% by achieving specific performance goals relating to technology, ecology and distribution designed to promote improved fuel efficiency, revenue growth from foreign sales and US based production.

Some, but not all, of the claims of the senior secured creditors were of a higher bankruptcy priority than the claims of the UAW/VEBA.

The Chrysler senior secured creditors received 29 cents on the dollar ($2 billion cash for $6.9 billion of indebtedness).

The UAW/VEBA, an unsecured creditor, received (x) 43 cents on the dollar ($4.5 billion note from New Chrysler for $10.5 billion of claims) and (y) a 67.692% (which may decrease to 55%) equity ownership interest in New Chrysler.

GM. Pursuant to the GM bankruptcy, the equity of New GM was allocated as follows:

(i) United States government (60.8%),

(ii) Canadian government (11.7%),

(iii) UAW (comprising current employee contracts and a VEBA for retired employees) (17.5%), and

(iv) GM bondholders (10%).

The bankruptcy claims of the UAW/VEBA and the GM bondholders were of the same bankruptcy priority.

– received a greater allocation of proceeds than the Chrysler senior secured creditors or the GM bondholders? In other words, why did the United States government spend tens of billions of dollars of taxpayer money to bail out employees and retirees of the UAW to the detriment of other non-UAW employees and retirees – such as retired school teachers and police officers from the State of Indiana[535] – whose pension funds invested in Chrysler and GM indebtedness?[536]

The equity interest of the UAW/VEBA and the GM bondholders in New GM may increase (with an offsetting reduction in each government's equity share) to up to 20% and 25%, respectively, upon the satisfaction of specific conditions. It is important to note, however, the warrants received by the UAW/VEBA and the GM bondholders are out of the money and it's possible they will not be exercised. As such, it seems likely that the UAW/VEBA and the GM bondholders will hold 17.5% and 10%, respectively, of the equity of New GM.

> The GM bondholders exchanged $27 billion in unsecured indebtedness for a 10% (which may increase to 25%) common equity interest in New GM, while the UAW/VEBA exchanged $20 billion in claims for a 17.5% (which may increase to 20%) common equity interest in New GM and $9 billion in preferred stock and notes in New GM.

[534] The Chrysler and GM VEBAs (voluntary employee benefit associations) administer and fund the health and retirement plans of Chrysler and GM retirees.

[535] The Chrysler senior secured debt and the GM bonds were held by pension funds (for the benefit of retirees such as the Indiana school teachers and police officers), individuals (including the retirees who have contacted my office to ask why they lost their savings but UAW employees benefited) as well as different types of business entities.

Mr. Richard E. Mourdock, the Indiana State Treasurer tirelessly challenged the Administration's attempt to abrogate commercial and contractual law principles in the Chrysler Section 363 sale on behalf of, among others, pension funds for retired Indiana school teachers and police officers.

Mr. Mourdock has not conceded the match and on September 3, 2009 filed a Petition for Writ of Certiorari with the United States Supreme Court on behalf of the Indiana pension funds for retired school teachers and police officers. The Petition may be found at www.in.gov/tos/files/In_re_Chrysler_LLC_Cert__Petition.pdf.

> The Petition (at page i) asks the Court to consider the following question:
>
> Chrysler's first lien lenders received a liquidation based recovery while unsecured creditors received over $20 billion of going-concern value in cash, new notes and stock from the reorganized business. Affirming, the Second Circuit declared that "[t]he 'side door' of § 363(b) may well 'replace the main route of chapter 11 reorganization plans."
>
> The question presented is whether section 363 may freely be used as a "side door" to reorganize a debtor's financial affairs without adherence to the creditor protections provided by the chapter 11 plan confirmation process.
>
> The Petition (at pages 37-39) argues:
>
> Regardless of its outcome, the Chrysler bankruptcy carries profound implications for the Nation's economy. Going forward, nearly everyone will feel the impact, from auto workers and suppliers to pensioners and bondholders to unrelated companies who hope to raise money through the sale of secured debt in the future. This is all the more true because this case is but one of the most extreme manifestations of an increasingly common occurrence – the use of a section 363 sale to bypass the chapter 11 plan confirmation process.
>
> With these results, it is hard to imagine why other companies facing mounting debt and possible bankruptcy would not take this path, even without Government financing. See Roe & Skeel, supra, at 26 ("a coalition of creditors, managers, and (maybe) shareholders could present a § 363 'plan' to the court for approval, and the plan could squeeze out any creditor class."); see also Micheline Maynard, Automakers' Swift Cases in Bankruptcy Shock Experts, N.Y. Times, July 6,

Chrysler and GM were restructured with taxpayer money, that is, funds from the TARP. After New Chrysler and New GM purchased the assets of the old auto makers, it's relatively clear that the new entities had little choice but to enter into collective bargaining agreements with the UAW – the companies needed workers. But what's not clear is why the new entities transferred a substantial amount of equity to the VEBAs of New Chrysler and New GM.

Do the Administration and the UAW/VEBAs expect the American people to believe that the UAW employees would have refused to work for New Chrysler and New GM without receiving "the equivalent of a Technicolor dreamcoat"? I suspect the employees would have

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2009 ("For businesses that follow similar legal strategies, the G.M. and Chrysler cases could pave the way for a faster trip through court.").

Any struggling company could, after having made side deals with its favorite creditors or equity holders that the bankruptcy court imposes on other potential bidders, use section 363 to "sell" its valuable assets to a shell company at a deflated price, and in so doing eliminate all of its other debt obligations.

The high profile of this case and the extremes to which the courts below went to bless the Chrysler sale have shone a light on issues critical to many bankruptcy cases and the capital markets. There can be little doubt that these issues demand the Court's attention. There will be no better chance to address them than this, the case that most profoundly presents them; and there will be no better time to review them than now, when the urgency of an impending sale has passed and there is time for cool reflection about the implications of what has transpired.

The Petition (at pages 40-42) seeks the following relief:

The Indiana Pensioners, however, do not seek to unwind that sale by this appeal, and section 363(m), by its express terms, contemplates that a sale order can be reversed – even where a sale has been consummated – so long as "a remedy can be fashioned that will not affect the validity of the sale."

The Second Circuit itself has observed that it is not "clear why an appellate court, considering an appeal from an unstayed but unwarranted order of sale to a good faith purchaser, could not order some form of relief other than invalidation of the sale.

Such is the case here, where the Indiana Pensioners seek reversal of the Transaction Orders only to the extent that the distribution of proceeds was inequitable. The effect of those unwarranted orders could be remedied without disturbing the validity of the sale to New Chrysler, for example, by compelling the VEBA and the UAW to return to the bankruptcy estate the $4.6 billion note and common stock that they received under the transaction to be properly distributed pursuant to a chapter 11 plan of reorganization.

[536] In a written response to the Panel the Administration stated:

The President directed the auto team to take a commercial approach to the restructuring process of these companies. As a result, the Administration dealt with the various creditors to GM/Chrysler as a commercial actor would. The final division of debt, preferred, and equity securities between the various creditors was the result of arm's length negotiations.

The UAW/VEBA had many billions of dollars of claims and labor agreements governing the companies' active workforces. As part of this process the Union agreed to major modifications in their labor agreements. Under the new contracts, the VEBA received a stake in the reorganized companies without any immediate payment. The cooperation and support of the UAW is essential to the ability of the reorganized companies to succeed.

This response carefully avoids the fundamental issue – why were the UAW/VEBAs preferred to the Indiana school teachers and police officers, among other creditors?

been grateful for a job at a decent wage even if the VEBAs had "only" received proceeds in accordance with commercial law principles and the contractual expectations of the various bankruptcy claimants. Yes, I appreciate that Old Chrysler and Old GM owed substantial sums to their respective VEBAs and, yes, I agree that the claims should have been paid in full, but, no, I do not concur that the VEBAs should have received a windfall at the expense of Indiana school teachers and police officers and the other creditors of Old Chrysler and Old GM. The "company needs skilled workers" defense only goes so far given the adverse economic conditions affecting American manufacturing these days. Such an excuse cannot be used to obfuscate the transfer of taxpayer-sourced TARP funds to a favored political constituency.

If you trace the funds, TARP money was employed by New Chrysler and New GM to purchase assets of the old auto makers, *yet* a substantial portion of the equity in the new entities was transferred to the VEBAs and, thus, *not* retained for the benefit of the American taxpayers (who funded the TARP) or shared with other creditors of Old Chrysler and Old GM. Accordingly, it's hardly a stretch to conclude that TARP funds were transferred to the UAW and the VEBAs after being funneled through New Chrysler and New GM. In addition, New Chrysler and New GM entered into promissory notes and other contractual arrangements for the benefit of the VEBAs, but not for the benefit of the other creditors of Old Chrysler and Old GM. Why did the United States government – the controlling shareholder of New Chrysler and New GM – direct New Chrysler and New GM to make an exclusive gift of taxpayer funds to the VEBAs? Why didn't New Chrysler and New GM transfer more of their equity interests to the creditors of Old Chrysler and Old GM? Why were Indiana school teachers and police officers and other investors in the Chrysler senior secured indebtedness and the GM bonds in effect forced by the Administration to transfer a portion of their claims against Chrysler and GM, respectively, to the UAW and the VEBAs? That is, why did the Administration orchestrate two bankruptcy plans whereby one group of employees and retirees was preferred to another?

Over the past two weeks the Administration has undertaken to educate the Panel regarding the due diligence investigation undertaken by the Auto Task Force and its advisors with respect to the Chrysler and GM transactions. That Mr. Bloom and the CBO now believe the American taxpayers may lose part of their TARP investments in the auto industry seems to negate both the seriousness and the effectiveness of any due diligence undertakings. I have little doubt that many detailed memos were prepared and that a multitude of attorneys, CPAs and other advisors worked long hours producing prodigious due diligence files. But to what purpose were these efforts directed? How is it possible that the Administration – based upon its putative due diligence – invested $81 billion in the auto industry only to discover less than three months later that it overinvested and may suffer substantial losses? What intervening event occurred to cause such a loss in value? Absence total incompetence on behalf of Treasury and its advisors – a theory I do not accept – only one answer follows – the Administration was determined to bail out the auto industry and the UAW/VEBAs regardless of the cost to the American taxpayers and the due diligence undertakings served as nothing more than expensive window dressing.

3. Messages to Non-UAW Employees and the Financial Markets

What message does the Chrysler and GM holdings send to non-UAW employees whose pension funds invested in Chrysler and GM indebtedness – you lose part of your retirement savings because your pension fund does not have the special political relationships of the UAW? What message does the Chrysler and GM bankruptcies send to the financial markets – contractual rights of investors may be ignored when dealing with the United States government?

In written testimony submitted to the Panel, Barry E. Adler, Professor of Law and Business at New York University, noted:

> There are at least two negative consequences from the disregard of creditor rights. First, at the time of the deviation from contractual entitlement, there is an inequitable distribution of assets. Take the Chrysler case itself, where the approved transaction well-treated the retirement funds of the UAW. If such treatment deprived the secured creditors of their due, one might well wonder why the UAW funds should be favored over other retirement funds, those that invested in Chrysler secured bonds. Second, and at least as importantly, when the bankruptcy process deprives a creditor of its promised return, the prospect of a debtor's failure looms larger in the eyes of future lenders to future firms. As a result, given the holding in Chrysler, and the essentially identical holding in the General Motors case, discussed next, one might expect future firms to face a higher cost of capital, thus dampening economic development at a time when the country can least well afford impediments to growth.

In a recent article analyzing the Chrysler and GM bankruptcies, Mark J. Roe and David A. Skeel, Professors of Law at Harvard University and the University of Pennsylvania, respectively, noted:

> Warren Buffett worried in the midst of the reorganization that there would be "a whole lot of consequences" if the government's Chrysler plan emerged as planned, which it did. If priorities are tossed aside, as he implied they were, "that's going to disrupt lending practices in the future." "If we want to encourage lending in this country," Buffett added, "we don't want to say to somebody who lends and gets a secured position that the secured position doesn't mean anything."[537]

In a recent Op-Ed in *The Wall Street Journal*, Todd J. Zywicki, Professor of Law at George Mason University, noted:

[537] Roe, Mark J. and Skeel, David A., Assessing the Chrysler Bankruptcy (August 12, 2009). U of Penn Law School, Public Law Research Paper No. 09-17; U of Penn, Inst for Law & Econ Research Paper No. 09-22. Available at SSRN: ssrn.com/abstract=1426530.

> By stepping over the bright line between the rule of law and the arbitrary behavior of men, President Obama may have created a thousand new failing businesses. That is, businesses that might have received financing before but that now will not, since lenders face the potential of future government confiscation. In other words, Mr. Obama may have helped save the jobs of thousands of union workers whose dues, in part, engineered his election. But what about the untold number of job losses in the future caused by trampling the sanctity of contracts today?[538]

In the September 2009 issue of *The Atlantic*, William D. Cohan notes:

> The rules as to how the government will act are not what we learned," explained Gary Parr, the deputy chairman of Lazard and one of the leading mergers-and-acquisitions advisers to financial institutions. "In the last 12 months, new precedents have been set weekly. The old rules often don't apply as much anymore." He said the recent examples of the government's aggression are "a really big deal," but adds, "I am not sure it is going to last a long time. I sure hope not. I can't imagine the markets will function properly if you are always wondering if the government is going to step in and change the game.[539]

In his testimony before the Judiciary Committee of the United States House of Representatives on May 21, 2009, Andrew M. Grossman, Senior Legal Policy Analysts, The Heritage Foundation, stated:

> Also detrimental to General Motors and Chrysler is the difficulty that they will have accessing capital and debt markets. Lenders know how to deal with bankruptcy – it's a well understood risk of doing business. But the tough measures employed by the Obama Administration to cram down debt on behalf of the automakers were unprecedented and will naturally make lenders reluctant to do business with these companies, for fear they could suffer the same fate. Even secured and senior creditors, those who forgo higher interest rates to protect themselves against risks, suffered large, unexpected losses. So nothing that either company can offer, no special status or security measure, can fully assuage lenders' fears that, in an economic downturn, they could be forced to accept far less than the true value of their holdings. At best, if General Motors and Chrysler have access to debt markets at all, they will have to pay dearly for the privilege. At worst, even high rates and tough covenants will not be enough to attract interest.
>
> The Obama Administration's transparent favoritism toward its political supporters in the United Auto Workers Union may lead other unions to demand the same:

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[538] *The Wall Street Journal*, May 13, 2009, at online.wsj.com/article/SB124217356836613091.html.

[539] See "The Final Days of Merrill Lunch," *The Atlantic*, September 2009, at www.theatlantic.com/doc/200909/bank-of-america.

hefty payouts and ownership stakes in exchange for halfhearted concessions. Lenders know now that the Administration is unable to resist such entreaties. As one hedge fund manager observed, "The obvious [lesson] is: Don't lend to a company with big legacy liabilities, or demand a much higher rate of interest because you may be leapfrogged in bankruptcy."

Perhaps the most affected will be faltering corporations and those undergoing reorganization – that is, the enterprises with the greatest need for capital. Lending money to a nearly insolvent company is risky enough, but that risk is magnified when bankruptcy ceases to recognize priorities or recognize valid liens. With private capital unavailable, larger corporations in dire straits will turn to the government for aid – more bailouts – or collapse due to undercapitalization, at an enormous cost to the economy.

Financial institutions – enterprises that the federal government has already spent billions to strengthen – will also be affected. Many hold debt in domestic corporations that could be subject to government rescue, rendering their obligations uncertain. It is that uncertainty which transforms loans into impossible-to-value toxic assets and blows holes in balance sheets across the economy.

Finally, there are the investors, from pension funds and school endowments to families building nest eggs for their future. General Motors bonds, like the debt of other long-lived corporations, has been long regarded as a refuge from the turmoil of equity markets. The once-safe investment held directly by millions of individuals and indirectly, though funds and pensions, by far more, are now at risk, which will be reflected in those assets' values.[540]

4. The use of TARP Funds in the Chrysler and GM Bankruptcies

As part of its review of auto industry TARP financing, the Panel must investigate Treasury's rationale for using funding from a program intended to prevent systemic meltdown in the financial sector to support failing automakers. Section 101(a)(1) of the EESA states that:

> The Secretary [of the Treasury] is authorized to…purchase, and to make and fund commitments to purchase, troubled assets from any *financial institution*, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and the policies and procedures development and published by the Secretary. [emphasis added.]

[540] Andrew M. Grossman, Senior Legal Policy Analyst, The Heritage Foundation, "Bailouts, Abusive Bankruptcies, And the Rule of Law," Testimony before the Judiciary Committee of the United States House of Representatives, May 21, 2009, at www.heritage.org/Research/Economy/tst052209a.cfm..

A plain reading of the statute would necessarily preclude the employment of TARP funds for the benefit of the auto industry because, among other reasons, neither Chrysler nor GM qualifies as a "financial institution." If Chrysler and GM are somehow deemed to qualify as "financial institutions," then what business enterprise will fail to so qualify? If Congress had intended for TARP to cover all business enterprises it would not have incorporated such a restrictive term as "financial institution" into EESA.

Further, a funding bill specifically aimed at assisting the auto industry was not approved by Congress. Nevertheless, the Bush Administration extended credit to Chrysler and GM and the Obama Administration orchestrated the Chrysler and GM bankruptcies which resulted in an investment of over $81 billion in the auto industry.

Since the authority for such an investment remains unclear, I request that the Administration provide the Panel with a formal written legal opinion justifying:[541]

(i) the use of TARP funds to support Chrysler and GM prior to their bankruptcies;

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[541] In a written response to the Panel the Administration stated:

The Treasury described the authority to use TARP funds to finance the old Chrysler and GM in bankruptcy court filings made on its behalf by the Department of Justice, specifically in the Statement of the United States of America Upon The Commencement of General Motors Corporation's Chapter 11 Case filed June 10, 2009, a copy of which has been provided to the Panel. In Judge Gerber's final sale order in the GM bankruptcy case dated July 5, 2009, also provided to the Panel, he wrote:

> The U.S. Treasury and Export Development Canada ("EDC"), on behalf of the Governments of Canada and Ontario, have extended credit to, and acquired a security interest in, the assets of the Debtors as set forth in the DIP Facility and as authorized by the interim and final orders approving the DIP Facility (Docket Nos. 292 and 2529, respectively). Before entering into the DIP Facility and the Loan and Security Agreement, dated as of December 31, 2008 (the "Existing UST Loan Agreement"), the Secretary of the Treasury, in consultation with the Chairman of the Board of Governors of the Federal Reserve System and as communicated to the appropriate committees of Congress, found that the extension of credit to the Debtors is "necessary to promote financial market stability," and is a valid use of funds pursuant to the statutory authority granted to the Secretary of the Treasury under the Emergency Economic Stabilization Act of 2008, 12 U.S.C. §§ 5201 et seq. ("EESA"). The U.S. Treasury's extension of credit to, and resulting security interest in, the Debtors, as set forth in the DIP Facility and the Existing UST Loan Agreement and as authorized in the interim and final orders approving the DIP Facility, is a valid use of funds pursuant to EESA.
>
> The rationale and determination of the ability to use TARP funds applies equally to the financing provided to the new Chrysler. There was no new financing provided to New GM. Instead, cash flowed from old GM to new GM as part of the asset sale, and new GM assumed a portion of the loan that Treasury had made to old GM.
>
> The interests received by other stakeholders of Chrysler and GM including the UAW/VEBAs were a result of negotiations between all stakeholders as described in detail by myself and Harry Wilson in our depositions in the bankruptcy cases, transcripts of which have been provided to the Congressional Oversight Panel.

I find the response unhelpful and ask the Administration to provide a formal written legal opinion supporting its position. Since Congress specifically rejected the bailout of Chrysler and GM, under what theory and precedent did the Executive unilaterally invest $81 billion in these non-financial institutions?

(ii) the use of TARP funds in the Chrysler and GM bankruptcies;

(ii) the transfer of equity interests in New Chrysler and New GM to the UAW/VEBAs; and

(iii) the delivery of notes and other credit support by New Chrysler and New GM for the benefit of the UAW/VEBAs.[542]

5. How the Chrysler and GM Bankruptcies Have Been Received by Bankruptcy Scholars

A number of bankruptcy law academics at top-tier law schools have questioned the Chrysler and GM bankruptcies. In the Chrysler and GM proceedings, Section 363 of the United States bankruptcy code was used by the Administration to upset well established commercial law principles and the contractual expectations of the parties. As Professors Adler, Roe and Skeel note, the Chrysler and GM bankruptcy courts required each Section 363 bidder to assume certain obligations of the UAW/VEBAs as part of its bid. This means that potential purchasers could not simply acquire the assets free and clear of the liabilities of the seller, but, instead, were also required to assume certain of those liabilities. This requirement most likely chilled the bidding process and precluded the determination of the *true* fair market value of the assets held by Chrysler and GM. By disrupting the bidding process it's entirely possible that TARP proceeds were misallocated away from the Chrysler senior secured creditors and the GM bondholders to the UAW/VEBAs. Although I do not concur that EESA authorized the use of TARP proceeds in the Chrysler and GM bailouts, it's nevertheless important to follow the TARP funds once they were committed.

A summary of the analysis of Professors Adler, Roe, Skeel and Lubben as well as a set of examples are included in an Annex to these Dissenting Views. The examples illustrate how the Administration manipulated Section 363 of the bankruptcy code to achieve its economic, social and political objectives at the expense of the American taxpayers and the Chrysler senior secured creditors and GM bondholders.

6. Pressure on TARP Recipients and a Higher Standard of Conduct for the United States Government

The technical bankruptcy laws issues illustrated in the Annex are exacerbated because the winning purchaser in the Chrysler and GM cases – entities directly or indirectly controlled by the United States government – had virtually unlimited resources, which is certainly not the case in

[542] The promissory notes issued to the UAW/VEBAs are senior to the equity issued to the United States government. Since the government controlled New Chrysler and New GM at the time the notes were issued, it's apparent that the government agreed to subordinate the TARP claims held by the American taxpayers to the claims held by the UAW/VEBAs. What was the purpose of the subordination except perhaps to prefer the claims of a favored class over the claims of the taxpayers who funded the TARP program?

typical private equity transactions. The matter becomes particularly muddled when you consider that a majority in interest of the Chrysler senior secured debt was held by TARP recipients at a time when there was much talk in the press about "nationalizing" some or all of these institutions. It is not difficult to imagine that these recipients felt direct pressure to "get with the program" and support the Administration's proposal.[543]

In addition, the United States government should have held itself to a higher standard of conduct. This was not the time for brass-knuckles negotiating tactics where, yes, the rights of UAW employees and retirees were ultimately preferred to the rights of retired Indiana school teachers and police officers–notwithstanding the priority of their respective contractual claims under well accepted commercial law principles. That the United States government was part of the process–in fact, the driving force in the process–is distressing. Through the clever use of Section 363 of the bankruptcy code an ultra-wealthy and sophisticated party–the United States government–orchestrated and rammed-through a plan whereby a politically favored class of creditors–the UAW and the VEBAs–prevailed to the detriment and disenfranchisement of another class of creditors–retired Indiana school teachers and police officers, among others.

Based upon the analysis of Professors Adler, Roe and Skeel, the bankruptcy courts should have called a time-out and changed the bidding procedure (i.e., no assumption of liabilities required), extended the time to submit a bid[544] and applied the protections afforded

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[543] TARP recipients who were also Chrysler senior secured creditors included Citigroup, JP Morgan Chase, Morgan Stanley and Goldman Sachs.

See "Dissident Chrysler Group to Disband," The New York Times, May 8, 2009, at dealbook.blogs.nytimes.com/2009/05/08/oppenheimer-withdraws-from-dissident-chrysler-group/?scp=1&sq=TARP%20lender%20Chrysler%20pressure&st=cse. The article provides:

> After a great deal of soul-searching and quite frankly agony, Chrysler's non-TARP lenders concluded they just don't have the critical mass to withstand the enormous pressure and machinery of the US government," Thomas E. Lauria, a partner of Mr. Kurtz's and the lead lawyer for the group. "As a result, they have collectively withdrawn their participation in the court case."
>
> With the group's disbanding, a little over a week since it made itself public, a vocal obstacle to Chrysler's reorganization has subsided. The committee's membership has shrunken by the day as it faced public criticism from President Obama and others. That continued withdrawal of firms led Oppenheimer and Stairway to conclude that they could not succeed in opposing the Chrysler reorganization plan in court, the two firms said in separate statements.
>
> In its first public statement last week, the ad hoc committee said that it consisted of about 20 firms holding $1 billion in secured debt. But hours after Mr. Obama criticized the firms as "speculators," the group lost its first major member, Perella Weinberg Partners, which changed its mind and signed onto the Chrysler plan.

[544] Mr. Richard E. Mourdock, the Indiana State Treasurer, whose pension funds invested in Chrysler senior secured indebtedness, provided the following testimony to the Panel:

> The principal restriction was imposed by the time requirement that mandated the bankruptcy be completed by June 15, 2009. Throughout the bankruptcy process, the government maintained if the deal was not completed by that date that Fiat would walk away from its "purchase" of 20% of the Chrysler assets. From the beginning, the June 15 date was a myth generated by the federal government. Fiat was being given the assets at no cost at a minimum value of $400,000,000. Why

under the Chapter 11 reorganization rules. With those changes the judicial holdings would have most likely appeared fair and reasonable and could have served as a model for high-pressure bankruptcies that followed. Without such changes, however, the process was inherently flawed because we will never know if another bidder would have paid more for the gross assets (without the assumption of any liabilities) of Chrysler or GM.[545] As intentionally structured by the Administration, the bidding procedures ultimately adopted for the Section 363 sales necessarily precluded the determination of the *true* fair market value of the assets held by Chrysler and GM. Without such determination, the appropriateness of the price paid for the assets of Old Chrysler and Old GM as well as the appropriateness of the distribution made by Old Chrysler and Old GM to the Chrysler senior secured creditors and GM bondholders will remain in doubt.

7. "Political Risk" in American Business

I anticipate that the Chrysler and GM holdings will not age well as more corporate and commercial law attorneys, hedge and private equity fund managers and corporate finance officers learn of their intricacies. As previously noted, many bankruptcy scholars believe the cases were ill considered. This process will take some time to mature, but counsel will certainly add a "political risk" section to their diligence check-lists and businesspersons will price their deals accordingly.

I am troubled that the private sector must now consider incorporating the concept of "political risk" into its analysis before engaging in any direct or indirect transaction with the

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> would Fiat establish or negotiate such a date when they were to receive such a bonanza? On the very day that the Chrysler assets were transferred to Fiat, the company's chairman stated to the media that the June 15th date never originated from them. The artificial date drove the process in preventing creditors from having any opportunity to establish true values, prepare adequate cases, and therefore failed to protect their rights to the fullest provisions of the law. The artificial date also forced the courts to act with less than complete information.
>
> The U.S. [Second Circuit] Court of Appeals in its written opinion of August 9th, 2009, denied our pensioners standing pursuant to the argument that we could not prove, under any other bankruptcy plan, we could have received more than the $0.29 we were offered. We believe this was an error because the court used a liquidation value for the company rather than an 'on-going concern' basis. We received written notice from the U.S. Bankruptcy Court of New York by certified letter of our rights to file a claim on Monday, May 18, 2009, at 10:00 a.m. We were advised in the letter that any evidence we wished to submit to make a claim against the submitted plan, (in part, the $0.29), would have to include trade tickets, depositions, affidavits, documents of evidence to substantiate claims, and etc. and would have to be filed with the bankruptcy court on Tuesday, May 19, 2009, by 4:00p.m. The bankruptcy of Chrysler was frequently referred to as "the most complex bankruptcy in American history," and yet we were given thirty hours to respond. We feel this was clearly an error in the process that helped to reduce the wealth of our beneficiaries.

[545] It's also important to note that for these purposes it's irrelevant if certain Chrysler or GM creditors happened to have purchased their securities at a cheap price. Who cares? The substantive legal issue concerns whether their contractual rights were honored. Courts should not abrogate well established commercial law principles and contractual expectations simply because an investor has earned a "reasonable return" on its investment. That's not the rule of law, but the law of political expediency.

United States government. While private sector participants are accustomed to operating within a complex legal and regulatory environment, many are unfamiliar with the emerging trend of public sector participants to bend or restructure rules and regulations so as to promote their economic, social and political agenda as was clearly evident in the Chrysler and GM bankruptcies. The realm of political risk is generally reserved for business transactions undertaken in developing countries and not interactions between private sector participants and the United States government. Following the Chrysler and GM decisions it is possible that private sector participants may begin to view interactions with the United States government through the same jaundiced eye they are accustomed to directing toward third-world governments. It's disingenuous for the Administration to champion transparency and accountability for the private sector but neglect such standards when conducting its own affairs.[546] How is it possible for directors and managers of private sector enterprises to discharge their fiduciary duties and responsibilities when policy makers legislate and regulate without respect for precedent and without thoughtfully vetting the unintended consequences of their actions?

8. Management Decisions by the Federal Government

The President, in his June 1, 2009 remarks on the forthcoming bankruptcy of GM, called the government a "reluctant" shareholder that will "take a hands-off approach, and get out quickly."[547] Questions still remain on exactly the level of the Administration's involvement in operational decisions. If the Auto Task Force's conduct during the unique bankruptcies of Chrysler and GM is any indication of a heavier-handed approach to come, the Panel should carefully follow the taxpayer's TARP investment in the auto industry very closely.

For example, in an April 2009 interview with NPR, Environmental Protection Agency Administrator Lisa Jackson said the following:

> **Jackson**: "The President has said and I couldn't agree more that what this country needs is one single national road map that tells auto makers who are trying to become solvent again, what kind of car it is they need to be designing and building for the American people."
>
> **NPR reporter** (interrupting): "Is that the role of the government, though? I mean that doesn't sound like free enterprise."
>
> **Jackson**: "Well...it is free enterprise in a way...you know, first and foremost the free

[546] I have little doubt that the tepid response from the private sector regarding the Term Asset-Backed Securities Loan Facility (TALF) and the Public-Private Investment Partnership (PPIP) programs is attributable in significant part to the political risk issue.

[547] See the following speech: www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-General-Motors-Restructuring/.

enterprise system has us where we are right this second...and so some would argue that the government already has a much larger role than we might have when Henry Ford rolled the first cars off the assembly line."[548]

Lately, the Administration's policy goals have been explicit in its contractual dealings. At the government's discretion, Fiat may increase its ownership stake in Chrysler to 35 percent if, among other performance goals, it builds a car that gets 40 miles per gallon or more in the U.S.[549] What does this requirement have to do with stabilizing the American economy as required by EESA? Will the Administration demand any other specifications from Fiat or any other party, including Chrysler or GM? If so, how will these requirements correlate with the EESA mandate? It is also worth noting that in the latest United Kingdom JD Power survey, Fiat ranks last in overall satisfaction rankings (28th out of 28), which, according to one trade magazine, "is a roundabout way of saying Fiat's car's aren't exactly renowned for their reliability in Europe…"[550] Will the Auto Task Force require that Chrysler and GM produce and sell certain types of vehicles, even if demand for them is weak or reliability and performance are poor?

Below, I discuss several recommendations for the Panel to follow in discharging its duty to provide proper oversight for the Administration's financing of the auto industry. It is especially important that the Panel ensure that the Administration match its actions with its words and preclude its own day-to-day management decisions with respect to Chrysler and GM.

9. Recommendations for Investigations by SIGTARP

I request that SIGTARP promptly investigate the following three matters.

1. In the September 2009 issue, *The Atlantic*–hardly a bastion of the conservative establishment–reported:

   As the crisis has receded this year, the government has remained aggressive, seeking business outcomes it finds desirable with some apparent indifference to contractual rights. In Chrysler's bankruptcy negotiations in April, for example, Treasury's plan offered the automaker's senior-debt holders 29 cents on the dollar. Some debt holders, including the hedge fund Xerion Capital Partners, believed they were contractually entitled to a much better deal as senior creditors holding secured debt. But four TARP banks–JPMorgan Chase, Citigroup, Morgan Stanley, and Goldman Sachs–which owned about 70 percent of the Chrysler

[548] See the April 28, 2009 transcript of the interview between National Public Radio and Lisa Jackson at: www.npr.org/templates/story/story.php?storyId=103582546.

[549] See "Chrysler Said to Set Board Review of Models, Fiat Integration," *Bloomberg*, August 28, 2009, at: bloomberg.com/apps/news?pid=20601109&sid=ae_gNcQurQuA.

[550] See "Fiat ranks last in UK JD Power survey, bodes poorly for Chrysler," *MotorAuthority*, May 4, 2009, www.motorauthority.com/blog/1033084_fiat-ranks-last-in-uk-jd-power-survey-bodes-poorly-for-chrysler#comments.

senior debt at par (100 cents on the dollar), had agreed to the 29-cent deal. By getting these banks and the other senior-debt holders to accept the 29-cent deal and give up their rights to push for the higher potential payout they were entitled to, the government could give Chrysler's workers, whose contracts were general unsecured claims–and therefore junior to the banks'–a payout far more generous than would otherwise have been possible or likely. Essentially, the government was engineering a transfer of wealth from TARP bank shareholders to auto workers, and pressuring other creditors to go along.

A somewhat similar story played out during GM's bankruptcy – the government again put together a deal that looked to many like a gift to the United Auto Workers at the expense of bondholders, who were pressed hard to quickly take a deal that would leave them with 10 percent of the equity of the reorganized company (plus some out-of-the-money warrants) when they likely would have been able to negotiate for more in a less well-orchestrated bankruptcy proceeding.[551] [emphasis added.]

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[551] See "The Final Days of Merrill Lunch," *The Atlantic*, September 2009, at www.theatlantic.com/doc/200909/bank-of-america.

The Atlantic article also includes the following observations:

> On April 30, when President Obama announced the bankruptcy, he forcefully stated the White House position: "While many stakeholders made sacrifices and worked constructively," he said, "I have to tell you, some did not. In particular, a group of investment firms and hedge funds decided to hold out for the prospect of an unjustified taxpayer-funded bailout. They were hoping that everybody else would make sacrifices, and they would have to make none. Some demanded twice the return that other lenders were getting. I don't stand with them. I stand with Chrysler's employees and their families and communities."
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> In the face of this kind of political pressure, Perella Weinberg, the owner of Xerion, backed down. "In considering the President's words and exercising our best investment judgment," the firm said in a statement, "we concluded that the risks of potentially severe capital loss that could arise from fighting this in bankruptcy court far outweighed any realistic potential upside." Tom Lauria, an attorney who was representing the firm during the negotiations, said in a May 1 radio interview that his client had been told by the administration that the White House press corps would destroy Perella Weinberg's reputation if it continued to fight the deal. He later told ABC News that Treasury adviser Steven Rattner had made the threat. (The White House denied making any threats, and Perella Weinberg denied Lauria's account of events, without elaboration.) Lauria said, in his radio interview, "I think everybody in the country should be concerned about the fact that the president of the United States, the executive office, is using its power to try to abrogate that contractual right."
>
> The Obama administration also famously browbeat AIG employees, who had a contractual right to some $165 million in bonuses, to void that right. (In the face of the government's pressure and the public outcry, some 15 of the top 20 recipients of the retention bonuses agreed to give back a total of more than $30 million in payments.) Curiously, the government has put no pressure on Merrill executives to return their $3.6 billion in bonuses that were paid out in December 2008, even though the company had suffered those huge losses.
>
> The rules as to how the government will act are not what we learned," explained Gary Parr, the deputy chairman of Lazard and one of the leading mergers-and-acquisitions advisers to financial

If the Administration fails to submit a satisfactory formal written legal opinion justifying its investment of TARP funds in Chrysler, GM and the other auto programs, I recommend that SIGTARP undertake an investigation to determine:

(i) if the Administration inappropriately employed TARP funds in the Chrysler and GM bankruptcies;

(ii) if the Administration inappropriately influenced the actions of any TARP recipient in the Chrysler and GM bankruptcies;

(iii) if the Administration inappropriately engineered a "transfer of wealth from TARP bank shareholders" to the UAW/VEBAs in the Chrysler and GM bankruptcies; and

(iv) if the Administration otherwise inappropriately orchestrated the transfer of TARP funds to the UAW/VEBAs in the Chrysler and GM bankruptcies?

In conducting its investigation I recommend that SIGTARP subpoena the appropriate parties and ask them to respond under oath.

2. Thomas E. Lauria, the Global Practice Head of the Financial Restructuring and Insolvency Group at White & Case LLP, represented a group of senior secured creditors, including the Perella Weinberg Xerion Fund ("Perella Weinberg"), during the Chrysler bankruptcy proceedings.

   On May 3, *The New York Times* reported:

   > In an interview with a Detroit radio host, Frank Beckmann, Mr. Lauria said that Perella Weinberg *'was directly threatened by the White House and in essence compelled to withdraw its opposition to the deal under threat that the full force of the White House press corps would destroy its reputation if it continued to fight.*
   >
   > In a follow-up interview with ABC News's Jake Tapper, he identified Mr. [Steven] Rattner,[552] the head of the auto task force, as having told a Perella

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institutions. "In the last 12 months, new precedents have been set weekly. The old rules often don't apply as much anymore." He said the recent examples of the government's aggression are "a really big deal," but adds, "I am not sure it is going to last a long time. I sure hope not. I can't imagine the markets will function properly if you are always wondering if the government is going to step in and change the game." One former Treasury official in the Bush administration told me he believes that the Obama administration has been disturbingly heavy-handed with the automobile companies and those who have lent to them. "It's very easy, when you're holding all the cards, to impose your will," he said. "And when you are the only source of financing, forget it.

[552] For a further discussion of the interactions between Mr. Rattner and Perella Weinberg see:

"The Final Days of Merrill Lunch," *The Atlantic*, September 2009, at www.theatlantic.com/doc/200909/bank-of-america, and "Exit the Czar," *New York Magazine*, August 2, 2009, at nymag.com/news/features/58193/.

Weinberg official that the White House *'would embarrass the firm.'*" [emphasis added.]

I recommend that SIGTARP undertake an investigation to determine if Mr. Rattner made such statement to Mr. Lauria or Perella Weinberg.

In conducting its investigation I recommend that SIGTARP subpoena Mr. Rattner, Mr. Lauria and representatives of Perella Weinberg and ask them to respond under oath.[553]

Mr. Beckmann's interview with Mr. Lauria is available at www.760wjr.com/article.asp?id=1301727&spid=6525. It's definitely worth taking a few minutes to listen to Mr. Lauria.[554]

3. Regarding the reorganization of the auto parts manufacturer, Delphi, on July 17, *The New York Times* reported:

> Delphi's new proposal [reached with its lender group] is similar to its agreement with Platinum [Equity, a private equity firm], which was announced June 1, the day GM filed for bankruptcy. But hundreds of objectors, including the company's debtor-in-possession lenders, derided that proposal as a *"sweetheart deal"* that gave the private equity firm control of Delphi for $250 million and a $250 million credit line. [emphasis added.]

On June 24, *The New York Times* reported that "Delphi worked with GM and the Obama administration to negotiate with Platinum…"

I recommend that SIGTARP undertake an investigation to determine if the Administration assisted with the negotiation of a "sweetheart deal" for the benefit of Platinum Equity.

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[553] In a written response to the Panel the Administration stated:

> As [Mr. Bloom–the head of Treasury's Auto Task Force] testified during the July 27 Field Hearing of the Congressional Oversight Panel, [he has] spoken to Mr. Rattner about this matter, and he categorically denies Mr. Lauria's allegations. [Mr. Bloom has] no knowledge of any other contact with Mr. Lauria or with people at Perella Weinberg regarding the issues mentioned above. SIGTARP will determine the appropriate use of its subpoena power.

The response is not acceptable because the Administration has refused to conduct a proper due diligence investigation of this matter by contacting Mr. Lauria and representatives of Weinberg Perella. I recommend that SIGTARP promptly investigate this matter.

[554] I have read reports to the effect that Perella Weinberg denied the veracity of the statements made by Mr. Lauria. Perhaps that's true, but the press release issued by Perella Weinberg does no such thing. The press release merely states that Perella Weinberg did not change "its stance on the Chrysler restructuring due to pressure from White House officials," which is entirely different from simply denying Mr. Lauria's statements. See *The New York Times*, May 3, 2009, at dealbook.blogs.nytimes.com/2009/05/03/white-house-perella-weinberg-deny-claims-of-threat-to-firm/#statement.

In conducting its investigation I recommend that SIGTARP subpoena the appropriate parties and ask them to respond under oath.[555]

10. Additional Recommendations

I offer the following additional recommendations:

1. In order to end the abuses of EESA as evidenced by the Chrysler and GM bankruptcies the TARP program must end. These bankruptcies clearly show that the program is beyond capable oversight. Further, the TARP program should be terminated due to:

- the desire of the American taxpayers for the TARP recipients to repay all TARP related investments sooner rather than later;

- the troublesome corporate governance and regulatory conflict of interest issues raised by Treasury's ownership of equity and debt interests in the TARP recipients;

- the stigma associated with continued participation in the TARP program by the recipients; and

- the demonstrated ability of the Administration to use the program to promote its economic, social and political agenda with respect to, among others, the Chrysler and GM bankruptcies.[556]

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[555] In a written response to the Panel the Administration stated:

> The Delphi transactions were negotiated between GM and Delphi. GM determined a failure of Delphi would have led to high losses at GM. The auto team was involved in discussions to the extent necessary to avoid potential destruction of equity value of GM, which would have led to large losses to the Treasury investment and for the U.S. taxpayer.

Again, this response is particularly vague and inappropriate and avoids the key issue–did the Administration advocate a "sweetheart" deal for the benefit of Platinum Equity. I recommend that SIGTARP promptly investigate this matter.

[556] See "BofA Seeks to Repay a Portion of Bailout," *The Wall Street Journal*, September 1, 2009, at online.wsj.com/article/SB125176546582274505.html#mod=todays_us_money_and_investing

The article provides:

> The discussions between Bank of America and the government are the latest example of large corporations trying to wrestle themselves free of the government's grip after extraordinary federal assistance last year. Some other large firms, such as Goldman Sachs Group Inc., have already repaid the government's investment, but Bank of America's situation was seen as much more complex.
>
> In addition to giving Bank of America extra TARP money, the government agreed in January to absorb a chunk of losses on a $118 billion pool of assets owned by BofA and Merrill. The bank would be on the hook for the first $10 billion in losses, and the U.S. would cover 90% of the remainder.

Some of the adverse consequences that have arisen for TARP recipients include, without limitation:

- although necessary, uncertain executive compensation restrictions;
- corporate governance and conflict of interest issues;
- employee retention difficulties; and
- the distinct possibility that TARP recipients–including those who have repaid all Capital Purchase Program advances but have warrants outstanding to Treasury–may be subjected to future adverse rules and regulations.

I introduced legislation–H.R. 2745–to end the TARP program on December 31, 2009. In addition, the legislation:

- requires Treasury to accept TARP repayment requests from well capitalized banks;
- requires Treasury to divest its warrants in each TARP recipient following the redemption of all outstanding TARP-related preferred shares issued by such recipient and the payment of all accrued dividends on such preferred shares;
- provides incentives for private banks to repurchase their warrant preferred shares from Treasury; and
- reduces spending authority under the TARP program for each dollar repaid.

2. As previously noted, according to the latest estimate from the CBO, the investment of TARP funds in the auto industry is expected to add $40 billion more to the deficit than CBO calculated just five months earlier in March 2009.[557] A reasonable interpretation of

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In exchange for this protection, the bank would issue to the Treasury $4 billion in preferred stock carrying an 8% dividend, costing the bank about $320 million a year. BofA also would pay the Federal Reserve two-tenths of a percent on the $118 billion, or $236 million.

If the bank wanted to end the arrangement, an "appropriate fee" was required. The Treasury and the Federal Reserve are asking the bank to pay between $300 million and $500 million to end this plan and pushing executives to consider a number on the high end of that spectrum, said a person close to the situation. The bank is now considering the request.

The bank and the government never signed a final contract on the loss-sharing pact amid disagreement about what it would cover, and BofA said in May that it wanted out. Its view was that regulators "tried to change the game," said a person familiar with the bank's position.

The bank balked at the idea of an exit fee, saying that its positions had never actually been covered. Regulators argued that the bank benefited from the implied protection, and thus the bank should pay as if the agreement had been legally in place from January through May.

See "The Budget and Economic Outlook: An Update," *Congressional Budget Office*¸ August 2009, pages 55-56, at www.cbo.gov/ftpdocs/105xx/doc10521/08-25-BudgetUpdate.pdf. The report provides in part:

such estimate provides that the American taxpayers may suffer a loss of over 50 percent of the TARP funds invested in Chrysler, GM and the other auto programs. I request that the CBO release its latest estimates regarding the subsidy rate for the investment of TARP funds in the auto industry.

3. The Administration should provide the Panel with the criteria it uses to determine which entities or types of entities are allowed to receive assistance through TARP. The Administration should also provide the Panel with a formal written legal opinion justifying the use of TARP for any such entities.[558]

4. The Administration should inform the Panel whether it intends to recycle TARP funds that have been repaid by TARP recipients and, if so, provide the Panel with a formal written legal opinion justifying the treatment of TARP as a revolving credit and equity facility.

5. The Administration should inform the Panel whether it intends to extend the TARP program beyond December 31, 2009.

The improvement in market conditions results in a reduction in the subsidy rate associated with the Capital Purchase Program (CPP)–a major initiative through which the government purchases preferred stock and warrants (for the future purchase of common stock) from banks. CBO has dropped the projected subsidy for the remaining investments in that program from 35 percent in the March baseline to 13 percent. The decrease in the estimated CPP subsidy cost also reflects banks' repurchase of $70 billion of preferred stock through June. Similarly, the estimated subsidy cost for other investments in preferred stock (for example, that of American International Group) has also been reduced. *Partially offsetting those reductions in projected costs is the expansion of assistance to the automotive industry; CBO has raised its estimate of the costs of that assistance by nearly $40 billion relative to the March baseline*." [emphasis added.]

[558] In a written response to the Panel the Administration stated:

Each program has guidelines that specify eligibility criteria. These criteria are posted on the financial stability website, www.financialstability.gov.

For example, in determining whether an institution is eligible for funding under the Automotive Industry Financing Program, Treasury has identified the following factors for consideration, among other things:

1. The importance of the institution to production by, or financing of, the American automotive industry;

2. Whether a major disruption of the institution's operations would likely have a materially adverse effect on employment and thereby produce negative effects on overall economic performance;

3. Whether the institution is sufficiently important to the nation's financial and economic system that a major disruption of its operations would, with a high probability, cause major disruptions to credit markets and significantly increase uncertainty or losses of confidence, thereby materially weakening overall economic performance; and

4. The extent and probability of the institution's ability to access alternative sources of capital and liquidity, whether from the private sector or other sources of U.S. government funds.

I find the "anything goes," "we know it when we see it" response unhelpful and ask the Administration to provide a formal written legal opinion.

6. The Administration should continue to describe in detail what meaningful due diligence it conducted before investing $81 billion in Chrysler, GM, GMAC and the auto suppliers.

7. The Administration should disclose how much additional funding and credit support (and the source of such amounts) it expects to ask the American taxpayers to provide each of Chrysler, GM, GMAC and the auto suppliers (i) by the end of this year and (ii) during each following year until all investments have been repaid in full in cash and all credit support has been terminated. The Administration should clearly state that the U.S. government will not in any manner directly or indirectly guarantee the indebtedness, obligations or undertakings of Chrysler, GM, GMAC or any of the auto suppliers.[559]

8. The Administration should forthrightly answer the following question: If Chrysler and GM are unable to sell a substantial number of cars at an appropriate profit margin will they be permitted to fail and liquidate or will they remain wards of the state?

9. The Administration should provide the American taxpayers with monthly reports describing in sufficient detail the full extent of their investments in Chrysler, GM, GMAC and the auto suppliers. The reports should also address the following matters:

- when does the Administration anticipate that Chrysler, GM, GMAC and the auto suppliers will return to profitability;[560]

- what are the Administration's financial and business projections for Chrysler, GM, GMAC and the auto suppliers over the next five years;

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[559] In a written response to the Panel the Administration stated:

> The Administration does not plan to provide any additional funds to GM and Chrysler beyond those that have already been committed. GM and Chrysler may draw additional amounts under the loan agreements relating to the supplier support program. This amount is expected to be up to $500 million in total.

After allocating $81 billion of taxpayer funded TARP proceeds I sincerely doubt that the Administration will be able to resist "spending only a few more billion" if either Chrysler or GM hit a bump along the road.

[560] In a written response to the Panel the Administration stated:

> The Administration reviewed Chrysler's and GM's business plans, which were developed by the companies. As part of this review process, the Administration's financial advisors performed sensitivity analyses by varying the assumptions underlying the business plans. These scenarios helped the Administration with its decision making process.
>
> *The Administration has not projected dates by which the companies will return to profitability, which is dependent on the overall market conditions and economic recovery*
>
> GM, which will probably go public before Chrysler, is expected to go public over the next twelve months, but the final decision will be made in both cases by the companies' boards of directors and will be dependent, among other things, on the state of the public securities markets. [emphasis added.]

It is simply amazing to me that the Administration would invest over $81 billion of taxpayer sourced TARP funds without even projecting when Chrysler and GM may return to profitability.

- when does the Administration anticipate that Chrysler and GM will go public;
- what is the Administration's exit strategy regarding Chrysler, GM, GMAC and the auto suppliers;[561] and
- when does the Administration anticipate that Chrysler, GM, GMAC and the auto suppliers will repay in full in cash all TARP funds advanced by the American taxpayers?[562]

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[561] In a written response to the Panel the Administration stated:

> The Administration plans to be a responsible steward of taxpayer money, and will periodically evaluate both public and private options to exit these investments. For GM the most likely exit strategy is a gradual sell off of shares following a public offering. For Chrysler, the exit strategy may involve either a private sale or a gradual sell off of shares following a public offering.

The American taxpayers deserve a more thoughtful response for their $81 billion investment of TARP funds.

[562] In a response to the Panel the Administration stated:

> The Administration evaluated various scenarios and believes that, under certain assumptions, GM may be able to pay off a high percentage of the total funds advanced by the taxpayers. Less optimistic, and in Treasury's view more likely scenarios involve a reasonable probability of repayment of substantially all of the government funding for new GM and new Chrysler, and much lower recoveries for the initial loans. Such analyses are obviously sensitive to the overall market and the economy.

Based upon this vague response it appears that Chrysler and GM will most likely not repay all of the TARP funds advanced by the American taxpayers.

In a written response to the Panel representatives of GM stated:

> Question: When do you anticipate that your company will return to profitability?
>
> Response: On July 10, GM's CEO announced that our Viability Plan projections contemplate breakeven Adjusted Earnings Before Interest and Tax (EBIT) by 2010 and positive Adjusted Operating Cash Flow by 2011.
>
> Question: What are your projections for your company over the next five years?
>
> Response: Business plan projections for GM were included in the Stephen Worth Declaration filed in Bankruptcy court on June 4, 2009, in support of the proposed 363 sale. These projections contemplate adjusted Earnings Before Tax (EBT) of ($1.3)B, $3.0B, $5.3B, $6.9B and $7.8B for CY 2010 – 2014 and at the time were based on current assumptions including total U.S. industry sales projections of 12.5M units, 14.3M units, 16.0M units, 16.4M units and 16.8M units for CY 2010 – CY 2014.
>
> Question: When do you anticipate that your company will go public?
>
> Response: The timing of an initial public offering will be heavily influenced by conditions in the equity markets and continued recovery in the auto industry, but we'd like to see the company in a position to launch a public offering as soon as sometime next year if the market conditions are suitable. Ultimately, General Motor's Board of Directors will determine when an IPO would be in the best interest of the Company and its stockholders.
>
> Question: What is the Administration's exit strategy regarding the investment of TARP funds in your company?
>
> Response: We do not have any information to add to the testimony of Mr. Bloom at the hearing.

10. The Administration should treat the American taxpayers as bona fide investors in Chrysler and GM and provide them with at least the same level of disclosure they would receive under the securities laws and state corporate law if Chrysler and GM were public companies and each American taxpayer a common shareholder. Such materials should include, without limitation, Forms 10-K, 10-Q and 8-K, annual reports, management's discussion and analysis (MD&A), projections, proxy materials, offering documents, and the like.

11. Chrysler and GM should promptly disclose all contractual arrangements with the U.S. government, together with a detailed description of the contract, its purpose, the transparent and open competitive bidding process undertaken and the arm's length and market-directed nature of the contract.[563]

Question: When do you anticipate that your company will repay in full in cash all TARP funds advanced by the American taxpayers?

Response: The American taxpayer will be repaid as GM repays the United States Department of the Treasury loan and as the United States Department of the Treasury monetizes its equity in GM post our IPO. While we are required to repay the United States Department of the Treasury loan by 2015, our goal is to repay this loan much sooner. We expect the company will be taken public as soon as practical sometime next year. Ultimately, General Motor's Board of Directors will determine when an IPO would be in the best interest of the Company and its stockholders.

In a written response to the Panel representatives of Chrysler stated:

Question: When do you anticipate that your company will return to profitability? What are your projections for your company over the next five years? When do you anticipate that your company will go public?

Response: As part of the 363 sales process, Chrysler LLC submitted a business plan (the "363 plan"). Currently, Chrysler Group LLC is elaborating its 5-year business plan, the results of which are expected to represent an improvement on the 363 plan outcome.

Decisions with respect to an initial public offering are within the province of the Members (equity holders).

Question: What is the Administration's exit strategy regarding the investment of TARP funds in your company?

Response: The $7 billion secured loan to Chrysler Group LLC from the US Treasury requires repayment of all amounts borrowed by June 2017. Decisions with respect to an initial public offering are within the province of the Members (equity holders).

Funds advanced under the Warranty Support Program were repaid in July 2009, and funds advanced under the Supplier Support Program in May 2009 are scheduled to be repaid in 2010.

Question: When do you anticipate that your company will repay in full in cash all TARP funds advanced by the American taxpayers?

Response: The $7 billion secured loan to Chrysler Group LLC from the US Treasury requires repayment of all amounts borrowed by June 2017. Decisions with respect to an initial public offering are within the province of the Members (equity holders).

Funds advanced under the Warranty Support Program were repaid in July 2009, and funds advanced under the Supplier Support Program in May 2009 are scheduled to be repaid in 2010.

[563] In a written response to the Panel the Administration stated:

12. Chrysler and GM should not receive favorable government contracts or other direct or indirect subsidies the award of which is not based upon competitive, objective and transparent criteria.[564]

13. The U.S. government should establish transparent procedures to resolve any conflict of interest issues arising from its role as a creditor or equity holder in Chrysler and GM and as a supervising governmental authority for Chrysler and GM.[565]

14. The IRS, SEC and other governmental agencies should be permitted to discharge their regulatory and enforcement responsibilities with respect to Chrysler and GM without political influence.[566]

15. The Administration should disclose its corporate governance policies regarding Chrysler and GM as well as the vetting process for new directors of Chrysler and GM.[567]

Chrysler and GM will be subject to the same reporting requirements with respect to contractual arrangements as are any other similarly situated business entity. The companies are also subject to audit, including by SIGTARP and GAO.

[564] In a written response to the Panel the Administration stated:

Chrysler and GM will not receive any special treatment when competing for government contracts or any direct or indirect subsidies as a result of the government's investments in these companies. They will have to win contracts based on their commercial strengths like any other auto manufacturer. As a principle, the Administration does not plan to manage these businesses or get involved in day to day management.

It is critical that the Panel continue to monitor this issue.

[565] In a written response to the Panel the Administration stated:

The Administration has already separated its role as investor/lender from that of regulator. The Administration has completely different teams working in these capacities, and decision-making in these areas is very purposefully separated. For matters related to the financial interests of taxpayers, the team overseeing the investments and loans will continue to act like any commercial actor in terms of protecting taxpayer capital. For regulatory matters, those functions will continue as if the GM and Chrysler interventions had not taken place.

It is critical that the Panel continue to monitor this issue.

[566] In a written response to the Panel the Administration stated:

The companies will be subject to the same regulatory and enforcement requirements as are any other similarly situated business entity.

It is critical that the Panel continue to monitor this issue.

[567] In a written response to the Panel the Administration stated:

The Treasury auto team used a commercial process to vet directors as would be expected of any well-managed corporation. In the end, the auto team is comfortable that it has brought together world-class boards that are focused on being responsible stewards of taxpayer dollars and creating shareholder value.

In a written response to the Panel representatives of GM stated:

16. The Chair of the Board and CEO of Chrysler and GM should certify each quarter that the government has not in any manner directed or influenced the policies or day-to-day management and affairs of either company.

17. The management of Chrysler and GM should provide the American taxpayers with a quarterly business plan that addresses, without limitation, the following challenging issues:

Question: How frequently does communication occur between any member of the Administration and the directors and executives from your company?

Response: Communications between the Administration and General Motors Company has been reduced significantly since July 10, 2009. The number of members on the President's Automotive Task Force has been reduced significantly.

Question: What is the nature of such communication?

Response: The contact has focused on questions related to regular financial reporting requirements under the UST loan as well as the amendment of the UST loan document to further clarify certain reps and warranties related to GM and its covered group members.

Question: Is the Administration in any manner providing input regarding corporate policy and/or the day-to-day management of your company?

Response: There are some areas regarding corporate policy in which we communicate with the Administration such as executive compensation. The Administration does not provide input regarding day-to-day management of our company.

Question: If so, what input is being provided and under what authority?

Response: Generally, input has been provided by the United States Department of the Treasury and we expect input from the TARP Special Compensation Master.

Question: Does your company seek the approval of the Administration regarding any matter?

Response: Yes, under the terms of the United States Department of the Treasury loan we must seek approval on items such as withdraws from the escrow account as well as TARP Special Compensation Master approval of compensation plans and payments for our senior executive officers and the next 20 highest compensated employees.

In a written response to the Panel representatives of Chrysler stated:

Question: How frequently does communication occur between any member of the Administration and the directors and executives from your company? What is the nature of such communication?

Response: There is no established schedule for communications. Since June 10, 2009, interactions with the US Treasury have occurred a few times a week and have related to, among other things, the formation and composition of the Board, financial reporting requirements, efforts to finalize a long-term business plan and an executive compensation program, and the Warranty Commitment Program and Supplier Receivables Program sponsored by the US Treasury.

Question: Is the Administration in any manner providing input regarding corporate policy and/or the day-to-day management of your company? If so, what input is being provided and under what authority? Does your company seek the approval of the Administration regarding any matter?

Response: The US Treasury has no role in the company's day-to-day management or policy making, except that (1) the US Treasury included a requirement in its First Lien Credit Agreement with the company that requires the company to maintain an expense policy prohibiting or limiting certain expenditures, and (2) the company's executive compensation program is required to be approved by the US Treasury's Special Master for Executive Compensation, Mr. Kenneth Feinberg.

- Without a growing SUV market, how do Chrysler and GM plan to compete against the Asian and European manufacturers who have all but perfected the design and manufacture of well-built fuel efficient cars?[568]

[568] In a written response to the Panel representatives of GM stated:

GM continuously assesses the automotive market and consumer behavior from three viewpoints: historical lessons, current realities and future projections. History provides insight re: consumer behavior relative to actual market conditions - the end result of economic factors such as overall economic health, gas prices, regulatory impacts; new product entries; societal trends, etc. Current realities provide insight to real-time behaviors - for example, the dramatic shift to compact sized vehicles during the gas price spike of 2008 when consumers expected fuel prices to continue to climb to the $5/gal level. Future projections assess the expected impact of the economic and regulatory outlook, demographic and societal trends and expected supply side influences. This "scanning" process leverages consumer surveys, primary research and product clinics, internal models and external academic and industry experts from various fields.

As part of both the vehicle and marketing development processes, GM leverages extensive consumer and expert opinion research. The research may include full scale models of future entries in a competitive showroom environment with a representative sample of current new vehicle owners, "garage visits" (ethnography) in competitive owners' homes or focus groups in a neutral setting. All research is constructed to eliminate bias and GM's sponsorship of the research is masked.

In a written response to the Panel, representatives of Chrysler stated:

Analysis of industry trends indicate that over the past five years small and compact vehicles have captured a larger portion of the U.S. light vehicle industry (2004 14%; 2008 22%). Industry forecasts predict a continuation of this growth over the next five years.

Based on our propriety web-based survey about powertrains, Americans feel that fuel prices will be, on average, $2.89 per gallon in one year and $4.50 in five years. This supports the expectation that more fuel efficient vehicles will grow in demand as we have seen with recent fuel price spikes. With technology, consumers will also have a choice of getting large vehicles that are more fuel efficient but with the likely price premium of the technology, small car demand will rise.

Since 2004, there has been a gradual increase in purchase intentions for smaller vehicles and a gradual decrease for larger vehicles. The gas price spike in 2008 magnified (and possibly accelerated) this trend.

Based on our dedicated, proprietary i-community that monitors consumer perceptions of automotive propulsion and small cars, 41% of consumers would likely consider a small car in the future. Fifty percent indicated they were unlikely to consider a small car.

Chrysler does not currently offer A/B segment vehicles, however, we are successful in the segments in which we offer vehicles:

Chrysler Share of Segment (Chrysler Segmentation) Full Size Luxury 17.8 % (Chrysler 300/C)

Compact SUV 43.5% (Wrangler, Compass, Patriot)

MPV 40.1% (Town & Country, Grand Caravan)

Large Pick-Up 17.8% (Ram)

Research shows that for small car buyers the top five primary reasons for purchase are the following (2008 New Vehicle Experience Study, Strategic Vision Inc.):

Fuel Economy 42.7%

Value for the Money 17.6%

- How do Chrysler and GM plan to stop the deterioration of their market share?
- How do Chrysler and GM plan to decrease their time from design to market?
- How do the all-in wage costs of Chrysler and GM compare with those of Asian automakers both within and outside the United States?
- How do Chrysler and GM plan to develop the design and technical expertise necessary to build vehicles with the fit-and-finish and price-point of, for example, a Honda Accord or Civic or a Toyota Camry or Corolla, not to mention a Toyota Prius?[569]

Price/Monthly Payment 6.0%

Fun to Drive 4.2%

Reliability 3.7%

Having access to Fiat's technology will enable Chrysler to compete in the small vehicle segments with these needs.

Fiat's success in highly competitive small car segments in markets such as Europe and Brazil helped establish Fiat as a highly competitive global manufacturer. The small car technology that Fiat will transfer to Chrysler will lead to similar success in the growing U.S. small car segment.

In addition, Fiat will make available to Chrysler Group its C platform technology, which will be the basis for the renewal of the Chrysler product offerings in both the C and D market segments. These actions by Fiat will provide Chrysler with technologically updated and more competitive products in the most important segments in the US market.

[569] See "Fiat ranks last in UK JD Power survey, bodes poorly for Chrysler," *MotorAuthority*, May 4, 2009, at: www.motorauthority.com/blog/1033084_fiat-ranks-last-in-uk-jd-power-survey-bodes-poorly-for-chrysler#comments. The article provides:

Chrysler's vehicles, like all of America's cars, have improved greatly in recent years. But not-too-distant memory reminds us of the Le Baron and even of another ill-fated Italian tie-up and its Maserati-branded spawn. So Fiat's poor scores in the most recent JD Power survey in the United Kingdom gives cause to wonder if the Fiat-Chrysler union might ultimately be a tragic one.

Fiat's role in helping to save Chrysler post-bankruptcy was applauded by President Obama just days ago, but already the naysayers are building their case. And unfortunately, it's shaping up to be a decent one. The latest JD Power figures put Fiat at the bottom - 28th of 28 - in UK satisfaction rankings. Lexus, Skoda, Honda, Toyota and Jaguar filled out the top 5 spots, while Citroen, Kia, Chevrolet, Mitsubishi and Fiat rounded out the bottom five.

Which is a roundabout way of saying Fiat's car's aren't exactly renowned for their reliability in Europe, nor are those of sister brand Alfa Romeo though the brand wasn't separated in the results list. The last time either car was sold in the U.S. they had developed and suffered from a reputation for unreliability that ultimately contributed to their retreat from our shores.

Now the continued poor performance of Fiat in markets where it's already established calls into question whether the Italian company will be able to turn things around at Chrysler, or whether the partnership will just degenerate into a downward spiral of poor design feeding poor execution. On the other hand, Fiat also makes brilliant cars like the 500, which slots into a segment where Chrysler is completely absent.

- What progress have Chrysler and GM made with respect to the development of global car platforms?

- Will the Chevrolet Volt materially assist GM's turn-around efforts or is its anticipated price-point too high?[570]

- Will American consumers embrace very small Fiat-type cars?

- After the treatment of the Chrysler senior secured creditors and the GM bondholders in the bankruptcy proceedings, how do Chrysler and GM anticipate that they will raise private sector financing?

18. Why does it appear that Chrysler and GM failed to place any vehicle in the top-ten list of cars purchased under the "Cash for Clunkers Program"?[571] It has been reported that Asian manufacturers claimed eight spots and Ford took the remaining two. The program

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Will the synergies make both companies better than they are on their own? Or will the Fiat-Chrysler partnership make the DaimlerChrysler era seem like a golden age?"

See also "Chrysler Said to Set Board Review of Models, Fiat Integration," Bloomberg.com, August 28, 2009, at bloomberg.com/apps/news?pid=20601109&sid=ae_gNcQurQuA.

[570] See "GM's Long, Hard, Bumpy Road to the Chevrolet Volt," *The New York Times*, July 10, 2009, at www.nytimes.com/cwire/2009/07/10/10climatewire-gms-long-hard-bumpy-road-to-the-chevrolet-vo-40366.html?scp=3&sq=volt%20chevrolet%20july%20prius&st=cse. See also "Sticker Shock," *The Economist*, August 21, 2009, at www.economist.com/sciencetechnology/displaystory.cfm?story_id=14292008.

[571] GM, however, placed second overall with 17.6 percent of total sales under the program. Toyota was the lead manufacturer (19.4 percent) and Ford was third (14.4 percent) followed by Honda (13 percent) and Nissan (8.7 percent). See www.huffingtonpost.com/2009/08/26/cash-for-clunkers-topsell_n_269700.html.

See an AP article on the "Cash for Clunkers Program" at www.google.com/hostednews/ap/article/ALeqM5h4OJw5vl4nQapaKrl9XOdfTLhElwD9A5CE1O2.

See also, "Toyota Tops List of Cash-for-Clunkers Winners," *The New York Times*, August 26, 2009, at www.nytimes.com/2009/08/27/business/27clunkers.html?_r=1&emc=eta1.

See also, "Next for Auto Sector, Post-Clunker Hangover," *The Wall Street Journal*, September 1, 2009, at online.wsj.com/article/SB125175596718373969.html#mod=todays_us_money_and_investing.

The article provides:

> That could help send some car sales downward in coming months, offsetting somewhat the benefit to car makers and retailers of the governments' $2.9 billion of rebates given to customers who traded in 700,000 old, gas-guzzling cars, for new ones in the cash-for-clunkers program.
>
> "We expect sales for the remainder of the year to fall well below August results," wrote Brian Johnson, analyst at Barclays Capital.
>
> Mr. Johnson warned that investors may use Tuesdays sales figures to take profits in auto stocks. Already, auto stocks that appeared to get a boost from the program have begun to sell off.
>
> Now investors need signs of more solid repair to consumer confidence and growth in demand for cars absent government coupons.

See "GM, Chrysler to Advance Cash for Clunker Rebates," *The Wall Street Journal*, August 20, 2009, at online.wsj.com/article/SB125077503806246225.html.

served as a real-world market-check for the products offered by Chrysler and GM, and the news does not appear overly reassuring. Is it possible that in its haste to develop and expand the Cash for Clunkers Program the Administration actually harmed the prospects for Chrysler and GM? To the extent the program expedited the purchase of cars – primarily foreign cars – it's possible that future sales–including those by Chrysler and GM – will be unusually sluggish.[572] The management of Chrysler and GM should address their performance under the Cash for Clunkers Program and whether the program had the unintended consequence of depressing future demand for their products.

19. It has been reported that GM may be developing a plan to retain Opel and its British affiliate Vauxhall.[573] The Administration should disclose if TARP funds will be used in such endeavor or if the U.S. government will directly or indirectly guarantee any related financings or contractual undertakings. The Administration should also explain how the retention of Opel and Vauxhall will create or save any jobs in this country or facilitate the repayment of TARP funds previously invested in GM.

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[572] See "*Bangers and Cash*," *The Economist*, August 24, 2009, at www.economist.com/businessfinance/displaystory.cfm?story_id=14296297. The article provides:

> Rebate schemes like this tend to encourage buyers to advance purchases that they would have made anyway, thus cannibalising future sales. The termination of a car-scrappage scheme in France in the 1990s led to sales plunging by 20%. Nor is it certain that the scheme provides a more general boost to the economy, as buyers may have been put off other purchases in order to afford a new vehicle. That said, there is a case to be made that, given the depth of the crisis a few months ago, the boost to total demand prompted by the scrappage scheme did at least help to avert a Keynsian "liquidity trap", leading to a depression.
>
> The green benefits are also hotly contested. The scheme should help to make America's car fleet slightly less fuel inefficient, but there are significant environmental costs in scrapping perfectly good cars and building new ones.
>
> At least the scheme may have persuaded Americans to consider the whole cost of owning a vehicle, beyond the sticker price. Early figures showed that over 80% of the vehicles traded in were trucks and SUVs and that 59% of the vehicles bought were cars. That may be a sign of more trouble for American carmakers which are particularly reliant on sales of SUVs and trucks and which have been bailed out at huge cost to taxpayers. The top ten clunkers traded in are all products of Detroit's big three and the greater gains have come for foreign car companies (mainly American-built vehicles at non-unionised factories).
>
> Only Ford, which did not seek a government bail-out, partly because it was making and selling cars more in tune with America's new tastes, features in the top five of models bought under the programme. GM and Chrysler, hoping to reinvent themselves as greener car firms, may find that cash-for-clunkers, by turning more American heads towards Asia's carmakers, is a present they regret receiving.

[573] See "GM is Developing an Option to Keep Opel," *The Wall Street Journal*, August 24, 2009, at online.wsj.com/article/SB125114535906254779.html. See also "Looking for Reverse," *The Economist*, August 27, 2009, at www.economist.com/businessfinance/displaystory.cfm?story_id=14327351.

20. The Panel should address the following questions: (i) did the Administration force Chrysler to accept a deal with Fiat,[574] and (ii) did the Administration impede any potential merger or business combination or arrangement between Chrysler and GM?[575]

21. Representatives of the UAW were invited to testify at the auto bailout hearing held by the Panel at Wayne State University School of Law in Detroit on July 27. Even though the headquarters of the UAW – Solidarity House – is a mere fifteen minute drive from the location of the hearing,[576] no representative from the UAW agreed to testify. In addition, the CFOs of Chrysler and GM declined to appear and for some reason the Panel failed to invite the CEOs. Since the leadership of the UAW and senior management of Chrysler

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[574] In a written response to the Panel the Administration stated:

> The Administration made the determination that Chrysler's business plan submitted on February 17th was not viable and that, in order for Chrysler to receive taxpayer funds, it needed to find a partner with whom it could establish a successful alliance. Chrysler identified Fiat as a potential partner after conducting a lengthy search process that began before Treasury made its initial loan to Chrysler and in which Treasury had no involvement. Fiat was the only potential partner to offer to enter into such an alliance, and ultimately the Chrysler Board made the determination that forming an alliance with Fiat was the best course of action for its stakeholders.

In a written response to the Panel representatives of Chrysler stated:

> Chrysler pursued an alliance with Fiat because it viewed Fiat's products and distribution network as complementary to Chrysler's and capable of strengthening Chrysler for the long-term. The US Treasury indicated that it would provide financing in support of an alliance with Fiat – first in the context of an out-of-court restructuring that required significant concessions by key constituencies, and later in the context of a sale transaction under Section 363 of the U.S. Bankruptcy Code."

I would have expected a simple "no" or "yes" followed by an explanation.

[575] See "Unions Express Unease Over Potential G.M.-Chrysler Deal," *The New York Times*, October 14, 2008, at dealbook.blogs.nytimes.com/2008/10/14/unions-express-unease-over-potential-gm-chrysler-deal/?scp=24&sq=chrysler%20gm%20merger&st=cse. The article reports:

> According to Bloomberg News, United Auto Workers President Ron Gettelfinger, told a Detroit radio station on Tuesday, 'I personally would not want to see anything that would result in a consolidation that would mean the elimination of additional jobs.

In a written response to the Panel the Administration stated:

> The Administration allowed GM and Chrysler to work toward a commercial solution they thought made sense for their businesses. Each company made its own determination to pursue a future independent of the other.

In a written response to the Panel representatives of Chrysler stated:

> GM advised Chrysler it would discontinue merger discussions due to the need to address its own pressing liquidity issues.

In a written response to the Panel representatives of GM stated:

> No, the Obama Administration did not thwart or discourage any arrangements between GM and Chrysler.

[576] See MapQuest driving directions from Solidarity House to Wayne State University School of Law at www.mapquest.com/maps?1a=8000+Jefferson+Avenue%2C+Detroit%2C+Michigan+48214&2a=471+W.+Palmer+Avenue%2C+Detroit%2C+Michigan+48202+.

and GM have experienced little difficulty in arranging their schedules to travel to Washington, DC – hat-in-hand – in search of bailout funds, you would think they could find time to drive across town to testify before the Panel. You might also think they would welcome the opportunity to thank the American taxpayers for their profound generosity in rescuing two insolvent and grossly mismanaged companies from liquidation. With respect to all future hearings, the Panel should issue a press release noting the names and affiliations of all invitees who decline to testify.

ANNEX TO CONGRESSMAN JEB HENSARLING'S ADDITIONAL VIEWS

1. Analysis of Chrysler and GM Cases by Bankruptcy Scholars

The following analysis indicates that a number of well respected bankruptcy scholars believe the Chrysler and GM reorganizations were not legally well founded.[577] Instead of simply

[577] Other bankruptcy law scholars have commented on the Chrysler and GM cases, including:

(i) Richard A. Epstein, the James Parker Hall Distinguished Service Professor of Law, The University of Chicago, the Peter and Kirsten Bedford Senior Fellow, The Hoover Institution, and a visiting law professor at New York University Law School, offered the following analysis in the May 12, 2009 issue of *Forbes*, at www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html:

> The proposed bankruptcy of the now defunct Chrysler Corp. is the culmination of serious policy missteps by the Bush and Obama administrations. To be sure, the long overdue Chrysler bankruptcy is a welcomed turn of events. But the heavy-handed meddling of the Obama administration that forced secured creditors to the brink is not.
>
> A sound bankruptcy proceeding should do two things: productively redeploy the assets of the bankrupt firm and correctly prioritize various claims against the bankrupt entity. The Chrysler bankruptcy fails on both counts.
>
> In a just world, that ignominious fate would await the flawed Chrysler reorganization, which violates these well-established norms, given the nonstop political interference of the Obama administration, which put its muscle behind the beleaguered United Auto Workers. Its onerous collective bargaining agreements are off-limits to the reorganization provisions, thereby preserving the current labor rigidities in a down market.
>
> Equally bad, the established priorities of creditor claims outside bankruptcy have been cast aside in this bankruptcy case as the unsecured claims of the union health pension plan have received a better deal than the secured claims of various bond holders, some of which may represent pension plans of their own.
>
> President Obama–no bankruptcy lawyer–twisted the arms of the banks that have received TARP money to waive their priority, which is yet another reason why a government ownership position in banks is incompatible with its regulatory role. Yet the president brands the non-TARP lenders that have banded together to fight this bogus reorganization as "holdouts" and "speculators."
>
> Both charges are misinformed at best. A holdout situation arises when one party seeks to get a disproportionate return on the sale of an asset for which it has little value in use. Thus the owner of a small plot of land could hold out for a fortune if his land is the last piece needed to assemble a large parcel of land. But the entire structure of bankruptcy eliminates the holdout position of all creditors, secured and unsecured alike, by allowing the court to "cram" the reorganization down their throats so long as it preserves the appropriate priorities among creditors and offers the secured creditors a stake in the reorganized business equal to the value of their claims. Ironically, Obama's Orwellian interventions have allowed unsecured union creditors to hold out for more than they are entitled to.
>
> His charge of "speculation" is every bit as fatuous. Speculators (who often perform a useful economic function) buy high-risk assets at low prices in the hope that the market will turn in their favor. By injecting unneeded uncertainty into the picture, Obama has created the need for a secondary market in which nervous secured creditors, facing demotion, sell out to speculators who are better able to handle that newly created sovereign risk. He calls on citizens to buy Chrysler products, but patriotic Americans will choose to go to Ford, whose own self-help efforts have been hurt by the Chrysler and GM bailouts.
>
> Sadly, long ago Chrysler and GM should have been allowed to bleed to death under ordinary bankruptcy rules, without government subsidy or penalty. Libertarians have often remarked on these twin dangers in isolation. The Chrysler fiasco confirms their deadly synergistic effect.

paraphrasing the analysis of the bankruptcy scholars, I thought it best to let them describe the problems raised by the Chrysler[578] and GM decisions in their own words. The next section

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(ii) Professor Todd J. Zywicki, Professor of Law, George Mason University, offered the following analysis in the May 13, 2009 issue of *The Wall Street Journal*, at online.wsj.com/article/SB124217356836613091.html:

> The rule of law, not of men – an ideal tracing back to the ancient Greeks and well-known to our Founding Fathers – is the animating principle of the American experiment. While the rest of the world in 1787 was governed by the whims of kings and dukes, the U.S. Constitution was established to circumscribe arbitrary government power. It would do so by establishing clear rules, equally applied to the powerful and the weak.
>
> Fleecing lenders to pay off politically powerful interests, or governmental threats to reputation and business from a failure to toe a political line? We might expect this behavior from a Hugo Chávez. But it would never happen here, right?
>
> Until Chrysler.
>
> The close relationship between the rule of law and the enforceability of contracts, especially credit contracts, was well understood by the Framers of the U.S. Constitution. A primary reason they wanted it was the desire to escape the economic chaos spawned by debtor-friendly state laws during the period of the Articles of Confederation. Hence the Contracts Clause of Article V of the Constitution, which prohibited states from interfering with the obligation to pay debts. Hence also the Bankruptcy Clause of Article I, Section 8, which delegated to the federal government the sole authority to enact "uniform laws on the subject of bankruptcies."
>
> The Obama administration's behavior in the Chrysler bankruptcy is a profound challenge to the rule of law. Secured creditors – entitled to first priority payment under the "absolute priority rule" – have been browbeaten by an American president into accepting only 30 cents on the dollar of their claims. Meanwhile, the United Auto Workers union, holding junior creditor claims, will get about 50 cents on the dollar.
>
> The absolute priority rule is a linchpin of bankruptcy law. By preserving the substantive property and contract rights of creditors, it ensures that bankruptcy is used primarily as a procedural mechanism for the efficient resolution of financial distress. Chapter 11 promotes economic efficiency by reorganizing viable but financially distressed firms, i.e., firms that are worth more alive than dead.
>
> Violating absolute priority undermines this commitment by introducing questions of redistribution into the process. It enables the rights of senior creditors to be plundered in order to benefit the rights of junior creditors.
>
> The U.S. government also wants to rush through what amounts to a sham sale of all of Chrysler's assets to Fiat. While speedy bankruptcy sales are not unheard of, they are usually reserved for situations involving a wasting or perishable asset (think of a truck of oranges) where delay might be fatal to the asset's, or in this case the company's, value. That's hardly the case with Chrysler. But in a Chapter 11 reorganization, creditors have the right to vote to approve or reject the plan. The Obama administration's asset-sale plan implements a de facto reorganization but denies to creditors the opportunity to vote on it.
>
> By stepping over the bright line between the rule of law and the arbitrary behavior of men, President Obama may have created a thousand new failing businesses. That is, businesses that might have received financing before but that now will not, since lenders face the potential of future government confiscation. In other words, Mr. Obama may have helped save the jobs of thousands of union workers whose dues, in part, engineered his election. But what about the untold number of job losses in the future caused by trampling the sanctity of contracts today?

[578] The United States Court of Appeals for the Second Circuit recently affirmed the decision of the bankruptcy court in the *Chrysler* proceedings. *In re Chrysler LLC*, 2009 WL 2382766 (2d Cir. 2009). The court accepted the bankruptcy court's finding that the assets of Old Chrysler had a fair market value of approximately $2

contains a set of examples that illustrate certain of the fundamental objections raised by the bankruptcy law professors.

1. Barry E. Adler, the Petrie Professor of Law and Business, New York University, offered the following testimony to the Panel:

   > The rapid disposition of Chrysler in Chapter 11 was formally structured as a sale under §363 of the Bankruptcy Code.[579] While that provision does, under some conditions, permit the sale of a debtor's assets, free and clear of any interest in them, the sale in Chrysler was irregular and inconsistent with the principles that undergird the Code.
   >
   > The most notable irregularity of the Chrysler sale was that the assets were *not* sold free and clear...That is, money that might have been available to repay these secured creditors was withheld by the purchaser to satisfy unsecured obligations owed the UAW. Thus, the sale of Chrysler's assets was not *merely* a sale, but also a distribution–one might call it a diversion – of the sale proceeds seemingly inconsistent with contractual priority among the creditors.
   >
   > Given the constraint on bids, it is conceivable that the liquidation value of Chrysler's assets exceeded the company's going-concern value but that no liquidation bidder came forward because the assumed liabilities – combined with the government's determination to have the company stay in business – made a challenge to the favored sale unprofitable, particularly in the short time frame afforded. It is also possible that, but for the restrictions, there might have been a higher bid for the company as a going concern, perhaps in anticipation of striking a better deal with workers.[580] Thus, the approved sale may not have fetched the best price for the Chrysler assets. That is, the diversion of sales proceeds to the assumed liabilities may have been greater than the government's subsidy of the transaction, if any, in which case the secured creditors would have suffered a loss of priority for their claims. There is nothing in the Bankruptcy Code that allows a sale for less than fair value simply because the circumstances benefit a favored group of creditors.

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billion, but, unfortunately, did not address the "bidding procedure" irregularities raised by Professors Adler, Roe and Skeel which are discussed in the text below. The court also declined to address whether the Bush and Obama Administrations had the authority to use TARP funds with respect to Chrysler and GM.

[579] Professor Adler: The Bankruptcy Code appears in Title 11 of the United States Code.

[580] Professor Adler: Note that these restrictions would have prevented credit bidding even if the secured bondholders had collectively desired to make such a bid because the required assumption of liabilities effectively eliminated the secured lender priority that is necessary for a credit bid.

Viewed another way, the approved transaction was not a sale at all, but a disguised reorganization plan, complete with distribution to preferred creditors.

Chrysler was a blueprint for the General Motors bankruptcy, which, like that of Chrysler, included a sale of the debtor's valuable assets to an entity that assumed unsecured obligations owed its workers or former workers.

Still, just as in the case of Chrysler, the approval of a restricted bid process [in GM] establishes a dangerous precedent, one that went unnoticed, or at least unnoted, by the court.

Judge Gerber [in GM] ignores the sales procedure, which, like that in Chrysler, strictly limited the time for competing bids and restricted bidders to those willing to assume significant UAW liabilities. The process thus precluded a potentially higher bid by a prospective purchaser who was unwilling to make the same concessions to the UAW that the government-sponsored purchaser was willing to endure. Thus, there remained the theoretical possibility that the process impermissibly transferred asset value from the company's other creditors to the UAW. This is merely a theoretical possibility. As noted above, it may well be that no creditor other than the government secured lenders suffered a loss of priority from the transaction. But the case stands as precedent that might cause later lenders to doubt whether future debtors will be forced in bankruptcy to live up to their obligations. And as also noted above, wary lenders are inhospitable to economic development.

2. Mark J. Roe and David A. Skeel, Professors of Law, Harvard University and the University of Pennsylvania, respectively, offered the following analysis in their paper "Assessing the Chrysler Bankruptcy" (which also addresses the GM bankruptcy):

   Chrysler entered and exited bankruptcy in 42 days, making it one of the fastest major industrial bankruptcies in memory. It entered as a company widely thought to be ripe for liquidation if left on its own, obtained massive funding from the United States Treasury, and exited through a pseudo sale of the main assets to a new government funded entity. Most creditors were picked up by the purchasing entity, but some were not. The unevenness of the compensation to prior creditors raised considerable concerns in capital markets.

   Appellate courts had previously developed a strong set of standards for a § 363 sale: The sale must have a valid business justification, the sale cannot be a sub rosa plan of reorganization, and if the sale infringes on the protections afforded creditors under Chapter 11, the court can only approve it after fashioning appropriate protective measures.

The Chrysler reorganization failed to comply with these requirements. Although Chrysler needed to be repositioned, and needed to be repositioned quickly, it had a few weeks, maybe a month, to get the process done right in a way that would neither frighten credit markets nor violate priorities. Chrysler's facilities were already shut down and not scheduled to reopen immediately. Fiat, the nominal buyer, was providing no cash. The party with the money was the U.S. Treasury, and it wasn't walking away.

The plan surely was a sub rosa plan, in that it allocated billions of dollars – the core determination under § 1129 – without the checks that a plan of reorganization requires.

The informal, makeshift checks that courts had previously required when there were strong § 1129 implications were in *Chrysler* weak or nonexistent. The courts did not even see fit to discuss § 1129 in their opinions. There was de facto consent from a majority of the bank lenders (although not from products liability claimants), but that consent came from parties afflicted with serious conflicts of interest and who may well be viewed as controlled by the player controlling the reorganization – the United States Treasury. There was a pseudo-market test, not a real market test, because the plan only marketed the reorganization plan itself, when the issue at stake was whether the assets alone had a higher value.

Worse yet, it's quite plausible to view the Chrysler bankruptcy as not having been a sale at all, but a reorganization. The New Chrysler balance sheet looks remarkably like the old one, *sans* a couple of big creditors. Courts will need to develop rules of thumb to distinguish true § 363 sales from bogus ones that are really reorganizations. We suggest a rough rule of thumb to start with: if the new balance sheet has creditors and owners who constituted more than half of the selling company's balance sheet, but with some creditors left behind, the transaction should be presumed not to be a sale at all, but a reorganization. The Chrysler transaction would have failed that kind of a test.

One might be tempted to dismiss the inquiry as needless worry over a few creditors. But we should resist that easy way out. Much corporate and commercial law has to do with the proper treatment of minority creditors and minority shareholders. For minority stockholders, there's an elaborate corporate law machinery for freezeouts when a majority stockholder seeks to engineer a transaction that squeezes out minority stockholders. For minority creditors, there's a century of bankruptcy and equity receivership law designed to balance protection from the majority's potential to encroach on the minority and squeeze them out from their contractual priority against the minority's potential to hold out perniciously. These are neither small nor simply fairness-based

considerations: Capital markets depend on effective mechanisms that prevent financial majorities from ousting financial minorities from their ratable position in an enterprise. That's what's at stake.

It's in that light that the Chrysler bankruptcy was pernicious, in that it failed to comply with good bankruptcy practice, reviving practices that were soundly rejected nearly a century ago. Going forward, the extent of *Chrysler*'s damage to bankruptcy practice and financial markets will depend on how it is construed by other courts, and whether they will limit its application, as they should."

We can hope that bankruptcy judges will come to see *Chrysler* as flawed, but unique. They should require a better bidding process and attend better to priority. They can be more skeptical of the facts when parties say that the new entity is sua sponte recognizing the bulk of the old entity's debts; this is a strong signal that they are witnessing a sub rosa reorganization plan, designed to avoid § 1129. They could latch onto the fact that in *Chrysler* there was an unrebutted liquidation value study and, if they are faced with a contested valuation, require a more open auction and better makeshift substitutes for the § 1129 protections. Or they might simply say that the government's involvement made *Chrysler* sui generis. Better yet, the courts could develop rules of thumb, such as the 50% rule we suggested above to cull presumed pseudo sales from the real ones.

Whatever promising signs can be gleaned from *Delphi* and *Phoenix Coyotes*, are offset by the General Motors bankruptcy court's invocation of *Chrysler* as controlling law in the Second Circuit. The government used the same template for the § 363 sale in GM as it did in *Chrysler*. As in *Chrysler*, the buyer was not a true third party, the ostensible immediacy to the urgency of the sale was debatable, and the § 363 bidding procedures required that would-be bidders agree to the retiree settlement negotiated by the government and GM. But GM's secured creditors, unlike their counterparts in Chrysler, were paid in full. The GM sale was in this dimension thus easier to reconcile with ordinary priority rules than Chrysler. It's plausible that the Treasury adjusted to the pushback from capital markets and the media criticism that accompanied the Chrysler deal.[581]

3. Stephen J. Lubben, the Daniel J. Moore Professor of Law, Seton Hall University, offered the following testimony to the Panel:

   In short, by and large, I think that the criticism of the automotive bankruptcy cases does not stand up to careful scrutiny. In the future, Congress may choose to

[581] Roe, Mark J. and Skeel, David A., Assessing the Chrysler Bankruptcy (August 12, 2009). U of Penn Law School, Public Law Research Paper No. 09-17; U of Penn, Inst for Law & Econ Research Paper No. 09-22. Available at SSRN: ssrn.com/abstract=1426530.

consider the policy implications of a chapter 11 process that has become heavily driven by quick asset sales and lender control. But given the reality of current chapter 11 practice, both GM and Chrysler's chapter 11 cases were not all that exceptional.[582]

2. Examples that Illustrate the Issues Raised by Professors Adler, Roe and Skeel

The following examples[583] illustrate the issues noted above by Professors Adler, Roe and Skeel:

***Example 1*.** Professor Adler offered the following example in the paper he submitted to the Panel:

> Consider the following illustration, where the government as lender or purchaser is nowhere to be found. Imagine a simple firm, Debtor, with only two creditors, each unsecured: Supplier, owed $60, and Bank, owed $20. After Debtor runs out of working funds and files a bankruptcy petition, Bank offers $40 for all of Debtor's assets (which Bank intends to resell). Bank contends that this is the best offer Debtor is going to get and that if Debtor does not accept the offer immediately it will be forced to liquidate piecemeal for $10. The court agrees and approves the sale over Supplier's objection even though there is no auction or other market test for the value of the assets. After the sale, Debtor moves through the ordinary bankruptcy process and distributes the $40 proceeds ratably between Supplier and Bank, with $30 to Supplier and $10 to Bank.
>
> As long as the court is correct to accept Bank's valuation, the sale and the distribution are appropriate. But what if the court is wrong? Assume that Debtor's assets are worth $60. In this case, Supplier should receive $45 and Bank $15. But the sale and distribution approved by the court has different consequences. Instead, Bank pays $40 for assets worth $60 (i.e., gains $20) then

[582] I don't believe Professor Lubben's testimony is particularly instructive. I concur that Section 363 sales have become more commonplace, but I'm not sure the significance of that conclusion. He neglects the link between the procedural error in the bidding process and the sub rosa plan and concludes without support that the error was harmless.

[583] Another example: If a bidder determines that the gross assets of Company X have a fair market value of $100, the bidder may reasonably enter a bid of up to $100 for the assets ($100 FMV of the assets, less $0 of assumed liabilities). If the bidding process, however, requires the bidder to assume $20 of the liabilities of the seller, the bidder may reasonably enter a bid of up to $80 for the assets ($100 FMV of the assets, less $20 of assumed liabilities). In the latter case the seller only has $80 (not $100) to distribute to its creditors. So, it's possible that a senior creditor of the seller may not recover its full claim (because a distribution of $80 is insufficient) even though the claim of the $20 junior creditor that was assumed by the purchaser pursuant to the Section 363 bidding process may quite likely be paid in full. Due to the required assumption of the $20 claim, $20 of purchase consideration has been redirected and applied outside the provisions of the bankruptcy code that are charged with protecting commercial law priority rules and the contractual expectations of the parties.

receives a $10 distribution from Debtor's bankruptcy estate, for a total effective distribution of $30, half the true value of Debtor's assets, twice the amount to which it is entitled. All this while, as a formal matter, it is correct to say, as the courts did in Chrysler and GM, that the sale proceeds were distributed fairly among the creditors. The problem, of course, is not with the distribution of sale proceeds received; the problem is with the diversion of value to the purchaser, which paid the estate too little and thus, in its role as a creditor, received too much. This is Supplier's complaint in this illustration and the dissenting creditors' complaint in the Chrysler and General Motors case.

In this illustration, an auction would solve the problem – because a bidder would offer $60 foiling Bank's scheme – as would granting Supplier a veto over the sale to reflect its dominant position in what would be the unsecured creditor (and only) class were the proposed distribution part of a reorganization plan. With neither protection in place, Supplier is left to suffer the consequences of judicial error, which can occur no matter how skilled or well meaning the judge; skilled and well meaning are not synonymous with omniscient.

As Mark Roe and David Skeel observe in their own criticism of the Chrysler bankruptcy, the ability of a court to approve an untested sale at the behest of some creditors over the objection of others without the safeguards prescribed by the Bankruptcy Code returns us to a past centuries' practice referred to as the equity receivership, where it was widely believed that powerful, favored creditors routinely victimized the weak and unconnected.[584] The Chrysler and General Motors cases are a step back and in the wrong direction.

***Example 2*.** Assume Oldco (i.e., Old Chrysler or Old GM) has (i) assets with a fair market value (FMV) of $70, (ii) secured debt (with liens on $40 FMV of assets) in an outstanding principal amount of $90 held by Creditor 1, and (iii) unsecured debt in an outstanding principal amount of $50 held by Creditor 2. Creditor 1 in effect holds two claims, a $40 secured claim (equal to the FMV of the assets securing Creditor 1's claim) and a $50 unsecured claim (which together equal Creditor 1's total claim of $90); and Creditor 2 holds a $50 unsecured claim. Any distribution on the unsecured claims should be shared 50/50% (because each creditor holds a $50 unsecured claim) under the "no unfair discrimination" rule of Chapter 11.

If, in a Section 363 sale, Newco (i.e., New Chrysler or New GM) purchased the Oldco assets (with no assumption of Oldco liabilities) for $70 FMV, then the $70 cash proceeds would be distributed as follows: Creditor 1 would receive $55 ($40 secured position, plus $15 unsecured position), and Creditor 2 would receive $15.

[584] See Roe & Skeel, cited in note 7; see also David A. Skeel, Jr., Debt's Dominion: A History of Bankruptcy Law in America 48-70 (2001) (describing the equity receivership and its faults).

Conversely, if in the Section 363 sale the bankruptcy court required Newco to assume Creditor 2's debt of $50, then Newco would only pay $20 cash for the Oldco assets ($70 FMV of assets, less $50 required assumption of Creditor 2's debt). In such event, Creditor 1 would only receive $20 (representing 100% of the cash sales proceeds from the Section 363 sale, but leaving a shortfall of $70 ($90, less $20)). Creditor 2 would receive no proceeds from the Section 363 sale, but would quite possibly receive $50 in the future from Newco (the amount of Creditor 2's debt assumed by Newco).

Thus, without the required assumption of the $50 claim by Newco, Creditor 1 (the senior creditor) would receive $55 and Creditor 2 (the junior creditor) would receive $15. This result is consistent with commercial law principles and the contractual expectations of the parties. With the required assumption, however, Creditor 1 would only receive $20 and Creditor 2 would receive $50. The required assumption results in a *shift* of $35 from Creditor 1 to Creditor 2, a result that is not consistent with commercial law principles, the contractual expectations of the parties and the Chapter 11 reorganization rules.

***Example 3*.** If the FMV of the Oldco assets was only $30 (instead of $70), is it possible that Newco would pay $30 cash for the assets AND assume Creditor 2's debt of $50. Creditor 1 would, thus, receive $30 (representing 100% of the cash sales proceeds from the Section 363 sale, but leaving a shortfall of $60 ($90 outstanding principal balance, less $30)), and Creditor 2 would quite possibly receive $50 in the future from Newco (the amount of Creditor 2's debt assumed by Newco). No buyout group (other than one that legally controls the printing press– the United States government) would agree to pay full FMV for Oldco's assets AND assume Oldco's liabilities. A solvent buyout group might very well agree to pay FMV for the Oldco assets but would generally expect a dollar-for-dollar purchase price reduction for any liabilities assumed.

Newco may argue that since it paid $30 FMV for the Oldco assets it discharged its obligations under Section 363. Newco may further argue that it's of no concern to Creditor 1 that Newco also elected to assume Creditor 2's debt.

In response, Creditor 1 may argue that (i) another purchaser might have paid, for example, $35 or more for the Oldco assets (with no assumption of Creditor 2's debt), (ii) another purchaser (other than the United States government) would never have paid $30 FMV for the Oldco assets AND assumed Creditor 2's debt (and that any such requirement would have chilled the bidding process),[585] (iii) without a market auction or compliance with the applicable *Revlon/Lyondell* standards established by the Delaware courts, it's impossible to know if $30 or $35 or another amount represents the *true* FMV of the Oldco assets (with no assumption of

[585] A purchaser may conclude, however, that it's in its best interest to assume some of Creditor 2's debt.

Creditor 2's debt),[586] and (iv) to the extent the true FMV of the Oldco assets exceeds $30, Newco *redirected* its purchase price away from Creditor 1 to Creditor 2 by using funds to assume Creditor 2's debt that would have ordinarily been used to purchase the Oldco assets.

[586] As noted in Professor Adler's proposed legislative fix to the problems created by the *Chrysler* and *GM* cases (discussed below), it's important that the bidding procedures approved by the courts not require potential purchasers to assume some or all of Oldco's indebtedness to Creditor 2.

Section Three: Correspondence with Treasury Update

On behalf of the Panel, Chair Elizabeth Warren sent a letter on July 20, 2009,[587] to Secretary of the Treasury Timothy Geithner and Federal Reserve Board Chairman Ben Bernanke requesting copies of confidential memoranda of understanding involving informal supervisory actions entered into by the Federal Reserve Board and the Office of the Comptroller of the Currency with Bank of America and Citigroup. The letter further requests copies of any similar future memoranda of understanding executed with Bank of America, Citigroup, or any other bank holding companies that were subject to the Supervisory Capital Assessment Program (SCAP). Finally, the letter asks that the Panel be apprised of any other confidential agreements relating to risk and liquidity management that Treasury, or any of the bank supervisors, has or will enter into with any of the SCAP bank holding companies. Secretary Geithner responded on August 12, 2009.[588] The Panel has not received a response from Chairman Bernanke.

[587] See Appendix I of this report, infra.

[588] See Appendix II of this report, infra.

Section Four: TARP Updates since Last Report

A. TARP Repayment

Since the Panel's prior report, additional banks have repaid their TARP investment under the Capital Purchase Program (CPP). CVB Financial Corp. repaid $97,500,000 in TARP funds. Bank of Commerce repaid $12,500,000 in TARP funds. As of August 28, 2009, neither has repurchased their warrants. A total of 37 banks have repaid their preferred stock TARP investment provided under the CPP to date. Of these banks, 22 have repurchased the warrants as well.

B. CPP Monthly Lending Report

Treasury releases a monthly lending report showing loans outstanding at the top 20 CPP recipient banks. The most recent report, issued on August 17, 2009, includes data up through the end of June 2009 and shows that CPP recipients had $4.29 trillion in loans outstanding as of June 2009. This represents a 1.1 percent decline in loans outstanding between the end of May and the end of June.

C. Regulatory Reform Proposals

On August 11, 2009, the Obama Administration sent a legislative proposal to Congress which seeks to regulate over-the-counter (OTC) derivatives. The proposed legislation will require standardized OTC derivatives to be centrally cleared by a derivatives clearing organization regulated by the Commodities Futures Trading Commission (CFTC) or a securities clearing agency regulated by the Securities and Exchange Commission (SEC). The proposed legislation would also require standardized OTC derivatives to be traded on a CFTC- or SEC-regulated exchange or a CFTC- or SEC-regulated alternative swap execution facility, as well as higher capital and margin requirements for non-standardized derivatives. In addition, the proposal seeks to allow financial regulatory agencies access to confidential information on OTC derivative transactions and open market positions, require supervision and regulation of any firm that deals in OTC derivatives and any other firm that takes large positions in OTC derivatives. The proposal would require the SEC, CFTC, and federal banking regulators to supervise and regulate all OTC derivatives dealers and major market participants within their respective jurisdictions. The SEC, CFTC, and federal banking regulators would create and enforce margin and capital requirements for all OTC derivatives dealers and major market participants. The SEC and the CFTC would also issue and enforce strong business conduct, reporting, and recordkeeping (including audit trail) rules for all OTC derivative dealers and major market participants, as well as limit the number of investors eligible to engage in OTC derivative transactions. Finally, the proposal would grant the SEC and CFTC authority to set position

limits and large trader reporting requirements for OTC derivatives and to deter market manipulation, fraud, insider trading, and other abuses in the OTC derivative markets.

D. Term Asset-Backed Securities Loan Facility (TALF)

On August 17, 2009, the Federal Reserve Board and Treasury announced their approval of an extension to the Term Asset-Backed Securities Loan Facility (TALF). With the extension, the deadline for TALF lending against newly issued asset-backed securities (ABS) and legacy commercial mortgage-backed securities (CMBS) was extended from December 31, 2009 to March 31, 2010. Additionally, the deadline for TALF lending against newly issued CMBS was extended to June 30, 2010.

Also on August 17, 2009, the Federal Reserve Board and Treasury announced that they are holding in abeyance any further expansion in the types of collateral eligible for the TALF. The securities already eligible for collateralizing TALF loans include the major types of newly issued, triple-A-rated ABS backed by loans to consumers and businesses, and newly issued and legacy triple-A-rated CMBS. Nevertheless, the Federal Reserve and Treasury have indicated that they are prepared to reconsider their decision if financial or economic developments indicate that providing TALF financing for investors' acquisitions of additional types of securities is warranted.

At the August 20, 2009 facility, $2.15 billion in legacy CMBS were settled (though $2.3 billion in loans were requested). At the September 3, 2009 non-CMBS facility, $6.5 billion in loans were requested to support the issuance of ABS collateralized by loans in the auto, credit card, equipment, property and casualty, small business, and student loan sectors. There were no requests supported by floorplan or residential mortgage loans.

E. Making Home Affordable Program Monthly Servicer Performance Report

On August 4, 2009, the Treasury released its first monthly Servicer Performance Report detailing the progress to date of the Making Home Affordable (MHA) loan modification program. The report discloses that as of July 31, 2009, 85 percent of mortgages are covered by a Home Affordable Modification Program (HAMP) participating servicer. The report also indicates that as of July 31, 2009, 230,000 trial loan modifications have occurred out of 406,542 trial plan offers extended.

F. Metrics

The Panel continues to monitor a variety of financial market indicators that provide insight into the current economic conditions. In recent months, the Panel's oversight reports have highlighted a number of metrics that the Panel and others, including Treasury, Government Accountability Office (GAO), Special Inspector General for the Troubled Asset Relief Program (SIGTARP), and the Financial Stability Oversight Board consider useful in assessing the

effectiveness of the Administration's efforts to restore financial stability and accomplish the goals of the EESA. This section discusses changes that have occurred in several indicators since the release of the Panel's August report.

- **Interest Rate Spreads.** Key interest rate spreads have continued to flatten since the Panel's August report. Numerous officials have cited tightening credit spreads as a sign of the improving economy. [589] It is of particular note that the 3 Month LIBOR-OIS spread, an important measure of the cost of capital, has nearly rebounded to its pre-crisis level of .09 in January 2007.[590]

Figure 12: Interest Rate Spreads

Indicator	Current Spread (as of 8/31/09)	Percent Change Since Last Report (8/05/09)
3 Month LIBOR-OIS Spread[591]	0.17	-37.04%
1 Month LIBOR-OIS Spread[592]	0.09	0%
TED Spread[593] (in basis points)	20.75	-29.08%
Conventional Mortgage Rate Spread[594]	1.66	5.06%

[589] *Herbert Allison COP Testimony*, *supra* note 470. Allison noted that "[t]here are tentative signs that the financial system is beginning to stabilize and that our efforts have made an important contribution. Key indicators of credit market risk, while s till elevated, have dropped substantially."

[590] *3 Mo LIBOR-OIS Spread*, Bloomberg (online at www.bloomberg.com/apps/quote?ticker=.LOIS3:IND|) (accessed Aug. 31, 2009).

[591] *3 Mo LIBOR-OIS Spread*, Bloomberg (online at www.bloomberg.com/apps/quote?ticker=.LOIS3:IND|) (accessed Aug. 31, 2009).

[592] *1 Mo LIBOR-OIS Spread*, Bloomberg (online at www.bloomberg.com/apps/quote?ticker=.LOIS1:IND|) (accessed Aug. 31, 2009).

[593] *TED Spread*, Bloomberg (online at www.bloomberg.com/apps/quote?ticker=.TEDSP:IND) (accessed Aug. 31, 2009).

[594] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data (*Instrument: Conventional Mortgages, Frequency: Weekly) (accessed July 9, 2009) (online at www.federalreserve.gov/releases/h15/data/Weekly_Thursday_/H15_MORTG_NA.txt); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: U.S. Government Securities/Treasury Constant Maturities/Nominal 10-Year, Frequency: Weekly) (accessed July 9, 2009) (online at www.federalreserve.gov/releases/h15/data/Weekly_Friday_/H15_TCMNOM_Y10.txt) (hereinafter "Fed H.15 10-Year Treasuries").

Indicator	Current Spread (as of 8/31/09)	Percent Change Since Last Report (8/05/09)
Corporate AAA Bond Spread[595]	1.76	1.73%
Corporate BAA Bond Spread[596]	3.08	-4.94%
Overnight AA Asset-backed Commercial Paper Interest Rate Spread[597]	0.24	14.29%
Overnight A2/P2 Nonfinancial Commercial Paper Interest Rate Spread[598]	0.16	-11.11%

- **Commercial Paper Outstanding.** Commercial paper outstanding, a rough measure of short-term business debt, is an indicator of the availability of credit for enterprises. While asset-backed commercial paper outstanding had a modest increase since the last report, the total outstanding is still more than 55 percent below its level in January 2007.[599] Financial commercial paper outstanding increased in June, leaving the measure less than 20 percent below its January 2007 level.[600]

[595] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Corporate Bonds/Moody's Seasoned AAA, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly_Friday_/H15_AAA_NA.txt) (accessed Aug. 31, 2009); Fed H.15 10-Year Treasuries, *supra* note 594.

[596] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Corporate Bonds/Moody's Seasoned BAA, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly_Friday_/H15_BAA_NA.txt) (accessed Aug. 31, 2009); Fed H.15 10-Year Treasuries, *supra* note 594.

[597] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Asset-Backed Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed July 9, 2009); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Nonfinancial Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed Aug. 31, 2009) (hereinafter "Fed CP AA Nonfinancial Rate").

[598] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: A2/P2 Nonfinancial Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed Aug. 31, 2009); Fed CP AA Nonfinancial Rate, *supra* note 597.

[599] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Asset-Backed Commercial Paper Outstanding, Frequency: Weekly) (accessed Aug. 31, 2009) (online at

Figure 13: Commercial Paper Outstanding

Indicator	Current Level (as of 8/31/09) (dollars billions)	Percent Change Since Last Report (8/05/09)
Asset-Backed Commercial Paper Outstanding (seasonally adjusted)[601]	$457.8	4.56%
Financial Commercial Paper Outstanding (seasonally adjusted)[602]	$579.7	12.03%
Nonfinancial Commercial Paper Outstanding (seasonally adjusted)[603]	$116.7	-5.66%

- **Lending by the Largest TARP-recipient Banks.** Treasury's Monthly Lending and Intermediation Snapshot tracks loan originations and average loan balances for the 21 largest recipients of CPP funds across a variety of categories, ranging from mortgage loans to commercial and industrial loans to credit card lines. Originations increased across nearly all categories of bank lending in June when compared to May.[604] Lenders surveyed by Treasury attribute this increase to attractive rates that increased mortgage originations.[605] The return of mortgage originations to October 2008 levels is due in large measure to the increase in mortgage refinancings, which comprise over 63 percent

www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (hereinafter "Fed CP and Asset-Backed Commercial Paper Outstanding").

[600] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Financial Commercial Paper Outstanding, Frequency: Weekly) (accessed Aug. 31, 2009) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (hereinafter "Fed CP and Financial CP Outstanding").

[601] *Fed CP and Asset-Backed Commercial Paper Oustanding*, *supra* note 599.

[602] *Fed CP and Financial CP*, *supra* note 600.

[603] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Nonfinancial Commercial Paper Outstanding, Frequency: Weekly) (accessed Aug. 31, 2009) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP).

[604] U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot Data for October 2008 - April 2009* (Aug. 31, 2009) (online at http://www.financialstability.gov/docs/surveys/Snapshot_Data_June%202009.xls).

[605] U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot*: *Summary Analysis for June 2009* (Aug. 31, 2009) (online at http://www.financialstability.gov/docs/surveys/SnapshotAnalysisJune2009.pdf).

of mortgage originations since that date.[606] The noticeable increases in commercial, industrial, and commercial real estate originations are particularly noteworthy, with originations in both categories increasing by over 20 percent.[607] Average loan balances decreased by one percent from June to May, with banks reporting that borrowers are paying down existing debt.[608] The data below exclude lending by two large CPP-recipient banks, PNC Bank and Wells Fargo, because significant acquisitions by those banks since last October make comparisons difficult.

Figure 14: Lending by the Largest TARP-recipient Banks[609]

Indicator	Most Recent Data (June 2009) (in millions)	Percent Change Since May 2009	Percent Change Since October 2008
Total Loan Originations	$226,898	13.28%	4.00%
Mortgage Total Originations	$89,703	15.31%	102.53%
Commercial Real Estate New Commitments	$3,701	24.6%	-64.83%
Commercial & Industrial New Commitments	$40,978	22.4%	-30.5%
Total Average Loan Balances	$3,311,902	-0.76%	-3.24%

- **Loans and Leases Outstanding of Domestically-Chartered Banks.** Weekly data from the Federal Reserve Board track fluctuations among different categories of bank assets and liabilities. The Federal Reserve Board data are useful because they separate out large domestic banks and small domestic banks. Loans and leases outstanding for large and small domestic banks both fell last month.[610] However, total loans and leases outstanding

[606] *Id.*

[607] *Id*.

[608] *Id.*

[609] *Id.*

[610] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.8: Assets and Liabilities of Commercial Banks in the United States: Historical Data* (Instrument: Assets and Liabilities of Large Domestically Chartered Commercial Banks in the United States, Seasonally adjusted, adjusted for mergers, billions of dollars) (accessed Aug. 31, 2009) (online at www.federalreserve.gov/releases/h8/data.htm).

at small domestic banks remain near last October's level, while total loans and leases outstanding at large banks have dropped by over 6.7 percent since that time.[611]

Figure 15: Loans and Leases Outstanding[612]

Indicator	Current Level (as of 8/31/09) (in billions)	Percent Change Since Last Report (8/5/09)	Percent Change Since EESA Signed into Law (10/3/08)
Large Domestic Banks - Total Loans and Leases	$3,780	-1.13%	-6.73%
Small Domestic Banks - Total Loans and Leases	$2,496	-.86%	-.87%

- **Housing Indicators**. Foreclosure filings increased by roughly seven percent from May to June and are roughly 25 percent above the level of last October. Housing prices, as measured by the S&P/Case-Shiller Composite 20 Index, increased slightly in June. The index remains down over 10 percent percent since October 2008.

Figure 16: Housing Indicators

Indicator	Most Recent Monthly Data	Percent Change From Data Available at Time of Last Report (8/5/09)	Percent Change Since October 2008
Monthly Foreclosure Filings[613]	360,149	7.13%	28.8%
Housing Prices - S&P/Case-Shiller Composite 20 Index[614]	141.3	.86%	-10.05%

[611] *Id*.

[612] *Id.*

[613] RealtyTrac, *Foreclosure Activity Press Releases* (accessed Aug. 31, 2009) (online at www.realtytrac.com//ContentManagement/PressRelease.aspx). The most recent data available is for July 2009.

[614] Standard & Poor's, *S&P/Case-Shiller Home Price Indices* (Instrument: Seasonally Adjusted Composite 20 Index) (accessed Aug. 31, 2009) (online at www2.standardandpoors.com/spf/pdf/index/SA_CSHomePrice_History_082562.xls). The most recent data available is for June 2009.

G. Financial Update

Each month since its April oversight report, the Panel has summarized the resources that the federal government has committed to economic stabilization. The following financial update provides: (1) an updated accounting of the TARP, including a tally of dividend income and repayments the program has received as of July 31, 2009; and (2) an update of the full federal resource commitment as of August 28, 2009.

1. TARP

a. Costs: Expenditures and Commitments[615]

Treasury is currently committed to spend $531.2 billion of TARP funds through an array of programs used to purchase preferred shares in financial institutions, offer loans to small businesses and automotive companies, and leverage Federal Reserve loans for facilities designed to restart secondary securitization markets.[616] Of this total, $369.5 billion is currently outstanding under the $698.7 billion limit for TARP expenditures set by EESA, leaving $329.2 billion available for fulfillment of anticipated funding levels of existing programs and for funding new programs and initiatives. The $369.5 billion includes purchases of preferred and common shares, warrants and/or debt obligations under the CPP, TIP, SSFI Program, and AIFP; a $20 billion loan to TALF LLC, the special purpose vehicle (SPV) used to guarantee Federal Reserve TALF loans; and the $5 billion Citigroup asset guarantee, which was exchanged for a guarantee fee composed of additional preferred shares and warrants and has subsequently been exchanged for Trust Preferred shares.[617] Additionally, Treasury has allocated $21.5 billion to the Home Affordable Modification Program, out of a projected total program level of $50 billion.

b. Income: Dividends, Interest Payments, and CPP Repayments

A total of 32 institutions have completely repaid their CPP preferred shares, 22 of which have also repurchased warrants for common shares that Treasury received in conjunction with its preferred stock investments. The rapid pace of preferred shares and warrant repayments has slowed considerably since the issuance of the Panel's August report – out of a total preferred shares and warrant repayment of $70.3 billion, only $200 million has been repaid since July 29, 2009.[618] In addition, Treasury is entitled to dividend payments on preferred shares that it has

[615] Treasury will release its next tranche report when transactions under the TARP reach $450 billion.

[616] EESA, as amended by the Helping Families Save Their Homes Act of 2009, limits Treasury to $698.7 billion in purchasing authority outstanding at any one time as calculated by the sum of the purchases prices of all troubled assets held by Treasury. *EESA § 115(a)-(b)*, *supra* note 2; Helping Families Save Their Homes Act of 2009, Pub. L. 111-22, § 402(f) (reducing by $1.26 billion the authority for the TARP originally set under EESA at $700 billion).

[617] August 28 TARP Transactions Report, *supra* note 102.

[618] August 28 TARP Transactions Report, *supra* note 102.

purchased, usually five percent per annum for the first five years and nine percent per annum thereafter.[619] Treasury has begun to report dividend payments made by all TARP recipients. In addition to $7.3 billion in dividend payments, Treasury has received $206 million in interest from its assistance provided under the AIFP and over $2 million in interest stemming from the ASSP. In total, the Treasury has received approximately $85 billion in income from repayments, warrant repurchases, dividends, and interest payments deriving from TARP investments.[620]

c. Citigroup Exchange

Treasury has invested a total of $49 billion in Citigroup through three separate programs: the CPP, TIP, and AGP. As noted in the Panel's March report, Treasury announced on February 27, 2009 that it would convert up to $25 billion of its preferred stock holdings in Citigroup into common stock, which would provide additional tangible common equity for Citigroup. On June 9, 2009, Treasury agreed to terms to exchange its CPP preferred stock holdings for 7.7 billion shares of common stock priced at $3.25/share (for a total value of $25 billion) and also agreed to convert the form of its TIP and AGP holdings.

On July 23, 2009, Treasury, along with both public and private Citigroup debt holders, participated in a $58 billion exchange, which resulted in the conversion of Treasury's $25 billion CPP investment from preferred shares to interim securities to be converted to common shares upon shareholder approval of a new common stock issuance. The $25 billion exchange substantially dilutes the equity holdings of existing Citigroup shareholders and was subject to shareholder approval on September 2, 2009. Treasury's common stock investment in Citigroup, when finalized, will have a paper value of about $34.96 billion based on the company's September 1, 2009 $5.54 share price.[621] On July 30, Treasury exchanged its $20 billion of preferred stock holdings in Citigroup under the TIP and its $5 billion investment in the AGP[622] from preferred shares to Trust Preferred Securities (TruPS). The conversion allows Citigroup to improve its Tangible Common Equity ratio – a key measure of bank solvency and a component of the stress tests – 60 percent[623]

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[619] See, for example, U.S. Department of the Treasury, *Securities Purchase Agreement: Standard Terms* (online at www.financialstability.gov/docs/CPP/spa.pdf).

[620] U.S. Department of the Treasury, *Cumulative Dividends Report as of July 31, 2009* (Sep. 2, 2009) (online at www.financialstability.gov/docs/dividends-interest-reports/072009_report.pdf).

[621] The Panel continues to account for Treasury's original $25 billion CPP investment in Citigroup under the CPP until formal approval of the exchange by Citigroup's shareholders and until Treasury specifies under which TARP program the common equity investment will be classified.

[622] The AGP provides certain loss protections to select pools of mortgage or related assets held by financial institutions viewed as critical to the functioning of the financial system, and whose portfolios of distressed or illiquid assets pose a risk to market confidence. Similar to a typical insurance plan, Treasury insures these assets by providing guarantees or non-recourse loans with respect to the assets in exchange for a premium paid by the institution in preferred stock.

[623] The key components of the old and new TIP and AGP financial agreements between Citigroup and Treasury, including the amount outstanding and the coupon rate (8 percent), are essentially the same. U.S.

d. TARP Accounting

Figure 17: TARP Accounting (as of July 31, 2009)

TARP Initiative (in billions)	Anticipated Funding	Purchase Price	Repayments	Net Current Investments	Net Available
Total	$531.3	$444.1	$72.4	$369.5	$329.2[624]
CPP	**$218**	**$204.3**	**$70.3**	**$134.2**	**$13.7**[625]
TIP	**$40**	**$40**	**$0**	**$40**	**$0**
SSFI Program	**$69.8**	**$69.8**	**$0**	**$69.8**	**$0**
AIFP	**$80**	**$80**	**$2.1**	**$75.5**[626]	**$0**[627]
AGP	**$5**	**$5**	**$0**	**$5**	**$0**
CAP	**TBD**	**$0**	**N/A**	**$0**	**N/A**
TALF	**$20**	**$20**	**$0**	**$20**	**$0**
PPIP	**$30**	**$0**	**N/A**	**$0**	**$30**

Department of Treasury, *Transaction Outline* (Feb. 27, 2009) (online at www.treas.gov/press/releases/reports/transaction_outline.pdf).

[624] This figure is the summation of the uncommitted funds remaining under the $698.7 billion cap ($167.4 billion) and the difference between the total anticipated funding and the net current investment ($168.8 billion).

[625] This figure reflects the repayment of $70.3 billion in CPP funds. Secretary Geithner has suggested that funds from CPP repurchases will be treated as uncommitted funds upon return to the Treasury. This Week with George Stephanopoulos, *Interview with Secretary Geithner*, ABC (Aug. 2, 2009) (online at www.abcnews.go.com/print?id=8233298) ("[W]hen I was here four months ago, we had roughly $40 billion of authority left in the TARP. Today we have roughly $130 billion, in partly [sic] because we have been very successful in having private capital come back into this financial system. And we've had more than $70 billion ... come back into the government"). The Panel has therefore presented the repaid CPP funds as uncommitted (i.e., generally available for the entire spectrum of TARP initiatives). The difference between the $130 billion of funds available for future TARP initiatives cited by Secretary Geithner and the $239.8 billion calculated as available here is the Panel's decision to classify certain funds originally provisionally allocated to TALF and PPIP as uncommitted and available for TARP generally. See *infra* notes xiv and xvi.

[626] This figure reflects the amount invested in the AIFP as of August 18, 2009. This number consists of the original assistance amount of $80 billion subtracted by de-obligations ($2.4 billion) and repayments ($2.1 billion), $2.4 billion in apportioned funding has been de-obligated by Treasury ($1.91 billion of the available $3.8 billion of DIP financing to Chrysler and a $500 million loan facility dedicated to Chrysler that was unused). U.S. Department of Treasury, *TARP Transactions Report* (Aug. 26, 2009).

[627] Treasury has indicated that it will not provide additional assistance to GM and Chrysler through the AIFP. *Nick Bunkley August 5 New York Times Report, supra* note 80. The Panel therefore considers the repaid and de-obligated AIFP funds to be uncommitted TARP funds.

TARP Initiative (in billions)	Anticipated Funding	Purchase Price	Repayments	Net Current Investments	Net Available
Supplier Support Program	**$3.5**[628]	**$3.5**	**$0**	**$3.5**	**$0**[629]
Unlocking SBA Lending	**$15**	**$0**	**N/A**	**$0**	**$15**
HAMP	**$50**	**$21.5**[630]	**$0**	**$21.5**	**$28.5**
(Uncommitted)	***$167.4***	***N/A***	***N/A***	***N/A***	***$242.2***[631]

[628] On July 8, 2009, Treasury lowered the total commitment amount for the program from $5 billion to $3.5 billion, this reduced GM's portion from $3.5 billion to $2.5 billion and Chrysler's portion from $1.5 billion to $1 billion. *August 28 TARP Transactions Report, supra* note 102.

[629] Treasury has indicated that it will not provide additional funding to auto parts suppliers through the Supplier Support Program. *Nick Bunkley August 5 New York Times Report*, *supra* note 80.

[630] This figure reflects the total of all the caps set on payments to each mortgage servicer. *August 28 Transactions Report, supra* note 102.

[631] This figure is the summation of the uncommitted funds remaining under the $698.7 billion cap ($167.4 billion), the repayments ($72.4 billion), and the de-obligated portion of the AIFP ($2.4 billion). Treasury provided de-obligation information in response to specific inquiries relating to the Panel's oversight of the AIFP. Treasury provided the Panel with information regarding specific investments made under the AIFP on August 18, 2009. Specifically, this information denoted allocated funds that had since been do-obligated. (hereinafter "Treasury De-obligation Document").

Figure 18: TARP Repayments and Income (as of August 28, 2009)

TARP Initiative (in billions)	Repayments	Dividends[632]	Warrant Repurchases[633]	Total
Total	$72.4	$9.1	$2.9	$84.6[634]
CPP	**$70.3**	**$7.3**	**$2.9**	**$80.5**
TIP	**$0**	**$1.5**	**$0**	**$1.5**
AIFP	**$2.1**	**$.16**	**N/A**	**$2.46**
AGP	**$0**	**$.17**	**$0**	**$.17**

2. Other Financial Stability Efforts

Federal Reserve, FDIC, and Other Programs

In addition to the direct expenditures Treasury has undertaken through TARP, the federal government has engaged in a much broader program directed at stabilizing the U.S. financial system. Many of these initiatives explicitly augment funds allocated by Treasury under specific TARP initiatives, such as FDIC and Federal Reserve asset guarantees for Citigroup, or operate in tandem with Treasury programs, such as the interaction between PPIP and TALF. Other programs, like the Federal Reserve's extension of credit through its section 13(3) facilities and SPVs and the FDIC's Temporary Liquidity Guarantee Program, operate independent of TARP.

3. Total Financial Stability Resources (as of August 28, 2009)

Beginning in its April report, the Panel broadly classified the resources that the federal government has devoted to stabilizing the economy through a myriad of new programs and initiatives as outlays, loans, or guarantees. Although the Panel calculates the total value of these resources at over $3.1 trillion, this would translate into the ultimate "cost" of the stabilization effort only if: (1) assets do not appreciate; (2) no dividends are received, no warrants are

[632] U.S. Department of the Treasury, *Cumulative Dividends Report as of July 31, 2009* (Sep. 2, 2009) (online at www.financialstability.gov/docs/dividends-interest-reports/072009_report.pdf).

[633] This number includes $1.6 million in proceeds from the repurchase of preferred shares by privately-held financial institutions. For privately-held financial institutions that elect to participate in the CPP, Treasury receives and immediately exercises warrants to purchase additional shares of preferred stock. August 28 Transactions Report, *supra* note 102.

[634] This includes interest payments made by recipients under the ASSP ($2 million) and AIFP ($200 million).

exercised, and no TARP funds are repaid; (3) all loans default and are written off; and (4) all guarantees are exercised and subsequently written-off.

With respect to the FDIC and Federal Reserve programs, the risk of loss varies significantly across the programs considered here, as do the mechanisms providing protection for the taxpayer against such risk. The FDIC, for example, assesses a premium of up to 100 basis points on Temporary Liquidity Guarantee Program (TLGP) debt guarantees. The premiums are pooled and reserved to offset losses incurred by the exercise of the guarantees, and are calibrated to be sufficient to cover anticipated losses and thus remove any downside risk to the taxpayer. In contrast, the Federal Reserve's liquidity programs are generally available only to borrowers with good credit, and the loans are over-collateralized and with recourse to other assets of the borrower. If the assets securing a Federal Reserve loan realize a decline in value greater than the "haircut," the Federal Reserve is able to demand more collateral from the borrower. Similarly, should a borrower default on a recourse loan, the Federal Reserve can turn to the borrower's other assets to make the Federal Reserve whole. In this way, the risk to the taxpayer on recourse loans only materializes if the borrower enters bankruptcy. The only loans currently "underwater" – where the outstanding principal amount exceeds the current market value of the collateral – are the non-recourse loans to the Maiden Lane SPVs (used to purchase Bear Stearns and AIG assets).

Figure 19: Federal Government Financial Stability Effort (as of August 28, 2009)

Program (in billions)	**Treasury (TARP)**	**Federal Reserve**	**FDIC**	**Total**
Total	**$698.7**	**$1,630.8**	**$834.6**	**$3,164.1**[iii]
Outlays[i]	$388	$0	$35.6	$423.6
Loans	$40.5	$1401	$0	$1441.5
Guarantees[ii]	$25	$229.8	$799	$1053.8
Uncommitted TARP Funds	$245.2	$0	$0	$245.2
AIG	**$69.8**	**$98**	**$0**	**$167.8**
Outlays	$69.8[iv]	$0	$0	$69.8
Loans	$0	$98[v]	$0	$98
Guarantees	$0	$0	$0	$0
Bank of America	**$45**	**$0**	**$0**	**$45**
Outlays	$45[vii]	$0	$0	$45
Loans	$0	$0	$0	$0
Guarantees[vi]	$0	$0	$0	$0

Program (in billions)	**Treasury (TARP)**	**Federal Reserve**	**FDIC**	**Total**
Citigroup	**$50**	**$229.8**	**$10**	**$289.8**
Outlays	$45[viii]	$0	$0	$45
Loans	$0	$0	$0	$0
Guarantees	$5[ix]	$229.8[x]	$10[xi]	$244.8
Capital Purchase Program (Other)	**$97.7**	**$0**	**$0**	**$97.7**
Outlays	$97.7[xii]	$0	$0	$97.7
Loans	$0	$0	$0	$0
Guarantees	$0	$0	$0	$0
Capital Assistance Program	**TBD**	**$0**	**$0**	**TBD**[xiii]
TALF	**$20**	**$180**	$0	**$200**
Outlays	$0	$0	$0	$0
Loans	$0	$180[xv]	$0	$180
Guarantees	$20[xiv]	$0	$0	$20
PPIP (Loans)[xvi]	**$0**	**$0**	**$0**	**$0**
Outlays	$0	$0	$0	$0
Loans	$0	$0	$0	$0
Guarantees	$0	$0	$0	$0
PPIP (Securities)	**$30**[xvii]	**$0**	**$0**	**$30**
Outlays	$12.5	$0	$0	$12.5
Loans	$17.5	$0	$0	$17.5
Guarantees	$0	$0	$0	$0
Home Affordable Modification Program	**$50**	**$0**	**$0**	**$50**[xix]
Outlays	$50[xviii]	$0	$0	$50
Loans	$0	$0	$0	$0
Guarantees	$0	$0	$0	$0
Automotive Industry Financing Program	**$77.5**	**$0**	**$0**	**$77.5**
Outlays	$55.5[xx]	$0	$0	$55.5
Loans	$22	$0	$0	$22
Guarantees	$0	$0	$0	$0
Auto Supplier Support Program	**$3.5**	**$0**	**$0**	**$3.5**
Outlays	$0	$0	$0	$0
Loans	$3.5[xxi]	$0	$0	$3.5
Guarantees	$0	$0	$0	$0

Program (in billions)	**Treasury (TARP)**	**Federal Reserve**	**FDIC**	**Total**
Unlocking SBA Lending	**$15**	**$0**	**$0**	**$15**
Outlays	$15[xxii]	$0	$0	$15
Loans	$0	$0	$0	$0
Guarantees	$0	$0	$0	$0
Temporary Liquidity Guarantee Program	**$0**	**$0**	**$789**	**$789**
Outlays	$0	$0	$0	$0
Loans	$0	$0	$0	$0
Guarantees	$0	$0	$789[xxiii]	$789
Deposit Insurance Fund	**$0**	**$0**	**$35.6**	**$35.6**
Outlays	$0	$0	$35.6[xxiv]	$35.60
Loans	$0	$0	$0	$0
Guarantees	$0	$0	$0	$0
Other Federal Reserve Credit Expansion	**$0**	**$1,123**	**$0**	**$1,123**
Outlays	$0	$0	$0	$0
Loans	$0	$1,123[xxv]	$0	**$1,123**
Guarantees	$0	$0	$0	$0
Uncommitted TARP Funds	**$245.2**[xxvi]	**$0**	**$0**	**$245.2**

[i] The term "outlays" is used here to describe the use of Treasury funds under the TARP, which are broadly classifiable as purchases of debt or equity securities (e.g., debentures, preferred stock, exercised warrants, etc.). The outlays figures are based on: (1) Treasury's actual reported expenditures; and (2) Treasury's anticipated funding levels as estimated by a variety of sources, including Treasury pronouncements and GAO estimates. Anticipated funding levels are set at Treasury's discretion, have changed from initial announcements, and are subject to further change. Outlays as used here represent investments and assets purchases and commitments to make investments and asset purchases and are not the same as budget outlays, which under section 123 of EESA are recorded on a "credit reform" basis.

[ii] While many of the guarantees may never be exercised or exercised only partially, the guarantee figures included here represent the federal government's greatest possible financial exposure.

[iii] This figure is roughly comparable to the $3.0 trillion current balance of financial system support reported by SIGTARP in its July report. *SIGTARP Quarterly Report to Congress*, *supra* note 272, at 138. However, the Panel has sought to capture additional anticipated exposure and thus employs a different methodology than SIGTARP.

[iv] This number includes investments under the SSFI Program: a $40 billion investment made on November 25, 2008, and a $30 billion investment committed on April 17, 2009 (less a reduction of $165 million representing bonuses paid to AIG Financial Products employees). *August 28 Transactions Report*, *supra* note 102.

[v] This number represents the full $60 billion that is available to AIG through its revolving credit facility with the Federal Reserve ($37.8 billion had been drawn down as of August 28, 2009) and the outstanding principle of the loans extended to the Maiden Lane II and III SPVs to buy AIG assets (as of August 28, 2009, $16.9 billion

and $20.9 billion respectively). Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.4.1: Factors Affecting Reserve Balances* (Aug. 27, 2009) (accessed Sep. 2, 2009) (online at www.federalreserve.gov/releases/h41/Current/) (hereinafter "Fed Balance Sheet August 27"). Income from the purchased assets is used to pay down the loans to the SPVs, reducing the taxpayers' exposure to losses over time. Board of Governors of the Federal Reserve System, *Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet*, at 16-20 (Aug. 2009) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200908.pdf) (hereinafter "Fed August 2009 Credit and Liquidity Report").exposure to losses over time. *See* Board of Governors of the Federal Reserve System, Federal Reserve System *Monthly Report on Credit and Liquidity Programs and the Balance Sheet*, at 16-20 (Aug. 2009) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200908.pdf).

[vi] Beginning in our July report, the Panel excluded from its accounting the $118 billion asset guarantee agreement among Bank of America, the Federal Reserve, Treasury, and the FDIC based on testimony from Federal Reserve Chairman that the agreement was never signed and was never signed or consummated and the absence of [vi] Beginning in our July report, the Panel excluded from its accounting the $118 billion asset guarantee agreement among Bank of America, the Federal Reserve, Treasury, and the FDIC based on testimony from Federal Reserve Chairman that the agreement was never signed and was never signed or consummated and the absence of the guarantee from Treasury's TARP accounting. House Committee on Oversight and Government Reform, Testimony Federal Reserve Chairman Ben S. Bernanke, *Acquisition of Merrill Lynch by Bank of America*, 111th Cong., at 3 (June 25, 2009) (online at oversight.house.gov/documents/20090624185603.pdf) ("The ring-fence arrangement has not been consummated, and Bank of America now believes that, in light of the general improvement in the markets, this protection is no longer needed."); Congressional Oversight Panel, *July Oversight Report: TARP Repayments, Including the Repurchase of Stock Warrants*, at 85 (July 7, 2009) (online at .cop.senate.gov/documents/cop-071009-report.pdf). According to a recent news report, it now appears that the U.S. government is seeking at least $500 million from Bank of America to shelve the tentative agreement. Dan Fitzpatrick, *B of A Seeks to Repay a Portion of Bailout*, Wall Street Journal (Sept. 1, 2009) (online at online.wsj.com/article/SB125176546582274505.html). The account reports the government as taking the position that even though the guarantee deal was never signed, the government believes that because Bank of America benefited in the marketplace from its implied protection between from January to May 2009, Bank of AmericaBank of America benefited in the marketplace from its implied protection between from January to May 2009, Bank of America should be responsible for the payment of dividendsand other fees, including an program exit fee, associated with the program. *Id.* While the past and current status of the program is in some doubt, in the absence of official guidance, the Panel continues to follow Treasury and exclude it from our accounting, in part because the putative protection offered by the program is no longer in place. The Panel will include in its accounting premiums or fees, if any, that Bank of America ultimately agrees to pay the U.S. government in relation to the guarantee program.

[vii] *August 28 TARP Transactions Report*, *supra* note 102. This figure includes: (1) a $15 billion investment made by Treasury on October 28, 2008 under the CPP; (2) a $10 billion investment made by Treasury on January 9, 2009 also under the CPP; and (3) a $20 billion investment made by Treasury under the TIP on January 16, 2009.

[viii] *August 28 TARP Transactions Report*, *supra* note 102. This figure includes: (1) a $25 billion investment made by Treasury under the CPP on October 28, 2008; and (2) a $20 billion investment made by Treasury under TIP on December 31, 2008.

[ix] U.S. Department of the Treasury, *Summary of Terms: Eligible Asset Guarantee* (Nov. 23, 2008) (online at www.treasury.gov/press/releases/reports/cititermsheet_112308.pdf) (hereinafter "Citigroup Asset Guarantee") (granting a 90 percent federal guarantee on all losses over $29 billion of a $306 billion pool of Citigroup assets, with the first $5 billion of the cost of the guarantee borne by Treasury, the next $10 billion by FDIC, and the remainder by the Federal Reserve). See also U.S. Department of the Treasury, *U.S. Government Finalizes Terms of Citi Guarantee Announced in November* (Jan. 16, 2009) (online at www.treas.gov/press/releases/hp1358.htm) (reducing the size of the asset pool from $306 billion to $301 billion).

[x] *Citigroup Asset Guarantee*, *supra* note ix.

[xi] *Citigroup Asset Guarantee*, *supra* note ix.

[xii] This figure represents the $218 billion Treasury has anticipated spending under the CPP, minus the $50 billion investment in Citigroup ($25 billion) and Bank of America ($25 billion) identified above, and the $70.3 billion in repayments that will be reflected as uncommitted TARP funds. This figure does not account for future repayments of CPP investments, nor does it account for dividend payments from CPP investments.

[xiii] Funding levels for the CAP have not yet been announced but will likely constitute a significant portion of the remaining $245.2 billion of TARP funds.

[xiv] This figure represents a $20 billion allocation to the TALF SPV on March 3, 2009. *August 28 Transactions Report*, *supra* note 102. Consistent with the analysis in our August report, see *COP August Report*, *supra* note 317, and the fact that only $43 billion dollars has been lent through TALF as of September 2009, the Panel continues to predict that TALF subscriptions are unlikely to surpass the $200 billion currently available by year's end.

[xv] This number derives from the unofficial 1:10 ratio of the value of Treasury loan guarantees to the value of Federal Reserve loans under the TALF. U.S. Department of the Treasury, *Fact Sheet: Financial Stability Plan* (Feb.10, 2009) (online at www.financialstability.gov/docs/fact-sheet.pdf) (describing the initial $20 billion Treasury contribution tied to $200 billion in Federal Reserve loans and announcing potential expansion to a $100 billion Treasury contribution tied to $1 trillion in Federal Reserve loans). Because Treasury is responsible for reimbursing the Federal Reserve Board for $20 billion of losses on its $200 billion in loans, the Federal Reserve Board's maximum potential exposure under the TALF is $180 billion.

[xvi] It now appears unlikely that resources will be expended under the PPIP Legacy Loans Program in its original design as a joint Treasury-FDIC program to purchase troubled assets from solvent banks. In June, the FDIC cancelled a pilot sale of assets that would have been conducted under the program's original design. Federal Deposit Insurance Corporation, *FDIC Statement on the Status of the Legacy Loans Program* (June 3, 2009) (online at www.fdic.gov/news/news/press/2009/pr09084.html). In July, the FDIC announced that it would rebrand its established procedure for selling the assets of failed banks as the Legacy Loans Programs. Federal Deposit Insurance Corporation, *Legacy Loans Program – Test of Funding Mechanism* (July 31, 2009) (online at www.fdic.gov/news/news/press/2009/pr09131.html). These sales do not involve any Treasury participation, and FDIC activity is accounted for here as a component of the FDIC's Deposit Insurance Fund outlays.

[xvii] U.S. Department of the Treasury, *Joint Statement By Secretary of the Treasury Timothy F. Geithner, Chairman of the Board Of Governors Of The Federal Reserve System Ben S. Bernanke, and Chairman of the Federal Deposit Insurance Corporation Sheila Bair: Legacy Asset Program* (July 8, 2009) (online at www.financialstability.gov/latest/tg_07082009.html) ("Treasury will invest up to $30 billion of equity and debt in PPIFs established with private sector fund managers and private investors for the purpose of purchasing legacy securities."); U.S. Department of the Treasury, *Fact Sheet: Public-Private Investment Program*, at 4-5 (Mar. 23, 2009) (online at www.treas.gov/press/releases/reports/ppip_fact_sheet.pdf) (hereinafter "Treasury PPIP Fact Sheet") (outlining that, for each $1 of private investment into a fund created under the Legacy Securities Program, Treasury will provide a matching $1 in equity to the investment fund; a $1 loan to the fund; and, at Treasury's discretion, an additional loan up to $1). In the absence of further Treasury guidance, this analysis assumes that Treasury will allocate funds for equity co-investments and loans at a 1:1.5 ratio, a formula that estimates that Treasury will frequently exercise its discretion to provide additional financing.

[xviii] GAO, *Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues*, at 2 (June 17, 2009) (GAO09/658) (online at www.gao.gov/new.items/d09658.pdf) (hereinafter "GAO June 29 Status Report"). Of the $50 billion in announced TARP funding for this program, $21.5

billion has been allocated as of August 28, 2009, and no funds have yet been disbursed. *August 28 Transactions Report*, *supra* note 102.

[xix] Fannie Mae and Freddie Mac, government-sponsored entities (GSEs) that were placed in conservatorship of the Federal Housing Finance Housing Agency on September 7, 2009, will also contribute up to $25 billion to the Making Home Affordable Program, of which the HAMP is a key component. U.S. Department of the Treasury, *Making Home Affordable: Updated Detailed Program Description* (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/housing_fact_sheet.pdf).

[xx] *August 28 Transactions Report*, *supra* note 102. A substantial portion of the total $80 billion in loans extended under the AIFP has since been converted to common equity and preferred shares in restructured companies. $22 billion has been retained as first lien debt (with $7.7 billion committed to GM and $14.3 billion to Chrysler). This figure represents Treasury's cumulative obligation under the AIFP, the total does not reflect the aid provided under the Auto Supplier Support Program or any de-obligations or repayments**.** *Treasury De-obligation Document*, *supra* note 286. See also GAO June 29 Status Report, *supra* note xviii at 43.

[xxi] *August 28 Transactions Report*, *supra* note 102.

[xxii] *Treasury PPIP Fact Sheet*, *supra* note xvii.

[xxiii] This figure represents the current maximum aggregate debt guarantees that could be made under the program, which, in turn, is a function of the number and size of individual financial institutions participating. $320.1 billion of debt subject to the guarantee has been issued to date, which represents about 41 percent of the current cap. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program: Debt Issuance Under Guarantee Program* (July 31, 2009) (online at www.fdic.gov/regulations/resources/tlgp/total_issuance7-09.html) (updated Sep. 2, 2009).

[xxiv] This figure represents the FDIC's provision for losses to its deposit insurance fund attributable to bank failures in the third and fourth quarters of 2008 and the first quarter of 2009. Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Fourth Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_4qtr_08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Third Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_3rdqtr_08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (First Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_1stqtr_09/income.html). This figure includes the FDIC's estimates of its future losses under loss share agreements that it has entered into with banks acquiring assets of insolvent banks during these three quarters. Under a loss sharing agreement, as a condition of an acquiring bank's agreement to purchase the assets of an insolvent bank, the FDIC typically agrees to cover 80 percent of an acquiring bank's future losses on an initial portion of these assets and 95 percent of losses of another portion of assets. See, for example Federal Deposit Insurance Corporation, *Purchase and Assumption Agreement Among FDIC, Receiver of Guaranty Bank, Austin, Texas, FDIC and Compass Bank* at 65-66 (Aug. 21, 2009) (online at www.fdic.gov/bank/individual/failed/guaranty-tx_p_and_a_w_addendum.pdf). The FDIC does not publish aggregated data on the total amount of assets subject to these agreements and the amount that the FDIC has guaranteed, and it does not disaggregate anticipated losses from loss share agreement from total losses under the Deposit Insurance Fund. But, in contrast, see Damian Paletta, *Raft of Deals for Failed Banks Puts U.S. on Hook for Billions*, Wall Street Journal (Aug. 31, 2009) (online at http://online.wsj.com/article/SB125166830374670517.html) (calculating the total insolvent bank assets subject to loss sharing agreements at $80 billion and reporting an FDIC estimate of the FDIC's anticipated losses from its guarantees on these assets at $14 billion).

[xxv] This figure is derived from adding the total credit the Federal Reserve Board has extended as of August 27, 2009 through the Term Auction Facility (Term Auction Credit), Discount Window (Primary Credit), Primary

Dealer Credit Facility (Primary Dealer and Other Broker-Dealer Credit), Central Bank Liquidity Swaps, loans outstanding to Bear Stearns (Maiden Lane I LLC), GSE Debt Securities (Federal Agency Debt Securities), Mortgage Backed Securities Issued by GSEs, Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, and Commercial Paper Funding Facility LLC. *Fed Balance Sheet August 27*, *supra* note v. The level of Federal Reserve lending under these facilities will fluctuate in response to market conditions. The Federal Reserve has earned significant amounts of interest in these lending and purchase programs. *Fed August Report on Credit and Liquidity*, *supra* note v, at 23-24, Tables 30-32 (showing partial income statement for various Federal Reserve programs, including $1.88 billion interest earned from Jan. 1-June 30, 2009 on Central Bank Liquidity Swaps, $614 million interest earned from Jan. 1-June 30, 2009 on GSE Debt Securities, $4.97 billion interest earned from Jan. 1-June 30, 2009 on Mortgage Backed Securities, and $4.18 billion interest earned from Jan. 1-June 30, 2009 under the CPFF).

[xxvi] As discussed in the Panel's August report, we do not account for the Temporary Guarantee Program for Money Market Mutual Funds because it does not involve TARP funds and this program will expire September 18, 2009. *August COP Report*, *supra* note 317.

Section Five: Oversight Activities

The Congressional Oversight Panel was established as part of the Emergency Economic Stabilization Act (EESA) and formed on November 26, 2008. Since then, the Panel has produced nine oversight reports, as well as a special report on regulatory reform, issued on January 29, 2009, and a special report on farm credit, issued on July 21, 2009. Since the release of the Panel's August oversight report on the continued risk of troubled assets, the following developments pertaining to the Panel's oversight of the Troubled Asset Relief Program (TARP) took place:

- The Panel has received responses to its June 2009 letters to the largest mortgage servicing companies that had not signed a contract to formally participate in the Making Home Affordable foreclosure mitigation program. Fourteen of the fifteen servicing companies responded. These letters will assist the Panel in its evaluation of the foreclosure mitigation efforts.

- The Panel and Panel staff have held meetings with and requested documents from Treasury regarding the Automobile Industry Financing Program. The information obtained has assisted the Panel in its preparation of the September report, on the Automobile Industry Financing Program.

Upcoming Reports and Hearings

The Panel will release its next oversight report in October. The report will provide an updated review of TARP activities and continue to assess the program's overall effectiveness. The report will also examine the effectiveness of foreclosure mitigation efforts.

The Panel will hold its second hearing with Secretary Geithner on September 10, 2009. The Secretary has agreed to testify before the Panel once per quarter. His first hearing was on April 21, 2009.

Additionally, the Panel is planning a field hearing in Philadelphia on September 24, 2009 to hear testimony on foreclosure mitigation efforts.

Section Six: About the Congressional Oversight Panel

In response to the escalating crisis, on October 3, 2008, Congress provided Treasury with the authority to spend $700 billion to stabilize the U.S. economy, preserve home ownership, and promote economic growth. Congress created the Office of Financial Stabilization (OFS) within Treasury to implement a Troubled Asset Relief Program. At the same time, Congress created the Congressional Oversight Panel to "review the current state of financial markets and the regulatory system." The Panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, the Panel must oversee Treasury's actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury's actions are in the best interests of the American people. In addition, Congress instructed the Panel to produce a special report on regulatory reform that analyzes "the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers." The Panel issued this report in January 2009. Congress subsequently expanded the Panel's mandate by directing it to produce a special report on the availability of credit in the agricultural sector. The report was issued on July 21, 2009.

On November 14, 2008, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School to the Panel. With the appointment on November 19 of Congressman Jeb Hensarling to the Panel by House Minority Leader John Boehner, the Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair.

ACKNOWLEDGEMENTS

The Panel thanks Professor Steven Lubben, the Daniel J. Moore Professor of Law at Seton Hall School of Law; and, Professor Barry E. Adler, the Bernard Petrie Professor of Law and Business and Associate Dean for Information Systems and Technology at New York University School of Law for their papers discussing the Chrysler and GM bankruptcy cases. Special thanks also go to Professor Mark J. Roe, the David Berg Professor of Law at Harvard Law School; Professor David Arthur Skeel, the S. Samuel Arsht Professor of Corporate Law at University of Pennsylvania Law School; and, Professor Richard A. Fallon, the Ralph S. Tyler Professor of Constitutional Law at Harvard Law School for reviewing drafts of this report and providing invaluable comments. The Panel also wishes to express thanks to the following individuals for their thoughts and suggestions: Edward Altman, Max L. Heine Professor of

Finance at the Stern School of Business, New York University; Susan R. Helper, AT&T Professor of Economics at the Weatherhead School of Management, Case Western Reserve University; Mr. Howard Wial, Fellow for the Metropolitan Policy Program at the Brookings Institute; Dr. Sean McAlinden, Vice President for Research and Chief Economist at the Center for Automotive Research; Professor Clayton S. Rose, Senior Lecturer of Business Administration at the Harvard Business School; Jonathan Rosenthal, Partner at Saybrook Capital; Professor Malcolm Salter, James J. Hill Professor of Business Administration, Emeritus, Harvard Business School; Professor Michael A. Cusumano, Professor at the MIT Sloan School of Management and Co-director of the International Motor Vehicle Program; and, Mr. Dan Luria, Research Director at the Michigan Manufacturing and Technology Center.

APPENDIX I: LETTER FROM CHAIR ELIZABETH WARREN TO SECRETARY TIMOTHY GEITHNER AND CHAIRMAN BEN BERNANKE, RE: CONFIDENTIAL MEMORANDA, DATED JULY 20, 2009

732 NORTH CAPITOL STREET, NW
ROOM C–320
WASHINGTON, DC 20401

Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

July 20, 2009

The Honorable Timothy F. Geithner
Secretary of the Treasury
United States Department of the Treasury
Room 3330
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Messrs. Secretary and Chairman:

The Congressional Oversight Panel has learned that the Federal Reserve Board and the Office of the Comptroller of the Currency have entered into confidential memoranda of understanding involving informal supervisory actions affecting Bank of America and Citigroup.

I am writing to request that you furnish to the Panel copies of any such existing memoranda, as well as copies of any similar future memoranda of understanding executed with Bank of America, Citigroup, or any of the other bank holding companies that were subject to the Supervisory Capital Assessment Program. In addition, I ask you to apprise the Panel of any other confidential agreements relating to risk and liquidity management that Treasury or any of the bank supervisors has or will enter into with any of those bank holding companies.

If necessary, this information will be considered Protected Information, subject to the Panel's Protocols for the Protection of Potentially Protected Documents Produced, or Whose Contents are Disclosed, to the Congressional Oversight Panel.

The information sought by this letter is necessary for the Congressional Oversight Panel to carry out section 125 of EESA. This information request is made pursuant to section 125(e)(3) of that Act.

I would be happy to answer any questions about this letter that you may have. If you would prefer, a member of your staff can contact the Panel's Executive Director, Naomi Baum, to discuss any such questions. Ms. Baum's telephone number is [redacted].

Sincerely,

Elizabeth Warren
Chair
Congressional Oversight Panel

APPENDIX II: LETTER FROM SECRETARY TIMOTHY GEITHNER TO CHAIR ELIZABETH WARREN, RE: CONFIDENTIAL MEMORANDA, DATED AUGUST 12, 2009

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

August 12, 2009

Elizabeth Warren
Chair
Congressional Oversight Panel
732 North Capitol Street, NW
Rooms C-320 and C-617
Mailstop: COP
Washington, DC 20401

Dear Chair Warren:

Thank you for your letter of July 20 requesting copies of confidential memoranda of understanding involving informal supervisory actions affecting Bank of America and Citigroup.

If such confidential agreements exist, they would have been entered into between the banks and their regulators. Accordingly, your inquiry should directed to those institutions, and I am forwarding a copy of this letter to the Federal Reserve Board and the Comptroller of the Currency.

You also asked to be apprised of any other confidential supervisory agreements relating to risk or liquidity management with any of the bank holding companies that were subject to the Supervisory Capital Assessment Program (SCAP). Any such agreements would be be agreements between the banks and their regulators, and as such, this request should be addressed to the regulators as well.

Sincerely,

Timothy F. Geithner

cc: Ben S. Bernanke
John C. Dugan