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.
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> 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.
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> 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:
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> 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.
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> GM response:
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> 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

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[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."
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> 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.
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> 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:

[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

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[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."

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]

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[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

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[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

(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.

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[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.