

2010

Government Involvement in Chrysler Bankruptcy: The Least-Worst Alternative?

John A. E. Pottow

University of Michigan Law School, pottow@umich.edu

Available at: <https://repository.law.umich.edu/articles/646>

Follow this and additional works at: <https://repository.law.umich.edu/articles>



Part of the [Bankruptcy Law Commons](#)

Recommended Citation

Pottow, John A. E. "Government Involvement in Chrysler Bankruptcy: The Least-Worst Alternative?" *Law Quad. Notes* 53, no. 1 (2010): 66-7.

This Article is brought to you for free and open access by the Faculty Scholarship at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Articles by an authorized administrator of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

An American flag is draped across the top of the page. Below it, the word "CHRYSLER" is written in large, light blue, serif capital letters on a dark background.

Government Involvement in Chrysler Bankruptcy: The Least-Worst Alternative?

By John A. E. Pottow

As usual, my colleague Jim White has hit many nails on many heads. Also as usual, however, I'm going to be a pain and part ways with him a bit.

First, was Chrysler's bankruptcy "suspicious" in its use of section 363 of the Bankruptcy Code? You bet. Leaving aside the proliferation of 363 sales to swallow Chapter 11 as we once knew it, Chrysler was out in left field. Not only was it a "sale" of everything meaningful in the company, it was to a seller—Fiat—that put in no money. (To be fair, Fiat agreed to contribute technological know-how on cars that Americans will now be much more interested in buying than they were in a pre-financial collapse environment.)

And GM was even weirder: Not only did the government put up all the purchase money, but the purchaser wasn't even a foreign car maker with a plausible contribution of sweat equity; it was "new GM," a legal creation. GM bought its economic self from its former self for no money down, all at the underwriting of the government. So yes, that's "deviant," even worse than Professor White lets on.

But *why* the deviance? Was it to mask a nefarious government plan of wealth redistribution? Before we analyze the propriety of the government's conduct, we must consider why it got involved in the first place. And to do that, we have to understand basic business reorganization financing. In a regular reorg, companies turn to a now thick and sophisticated market of so-called DIP lenders who provide funds to reorganizing "debtors-in-

possession," as the struggling companies are called in the Bankruptcy Code. In a regular Chapter 11, you'd call up commercial lender CIT Group and ask for a multimillion dollar DIP loan (which, rest assured, gets highly favorable treatment in bankruptcy law, so don't worry about the DIP lender's risk). Thus, free marketeers would say, "Fie on public intervention! Let the auto companies fend for themselves, get a DIP loan, if they can, and reorganize the same way anyone else would have to in Chapter 11."

In the abstract, not an unfair point. But there was a problem, and it was twofold. First, the car companies were huge and so needed DIP loans that would be amongst the largest ever in bankruptcy (orders of magnitude beyond the traditional case). Not unprecedented, to be sure, but the size of loans that would need at the very least a syndicate of banks to cobble together the funds. Second, and more importantly, they needed the money in the midst of a financial collapse of the lending markets. (By the way, anyone see how that great DIP lender CIT Group fared?) So even the starchiest libertarian would grudgingly concede that if there's a time for public intervention into the DIP loan market, this would probably be it. It was a bold decision, but one that I believe will be eventually vindicated economically. It's not surprising that Mr. Rattner's *Fortune* article (see Professor White's article) recounts a 4–4 deadlock of advisers confronting the President in deciding whether to intervene with a loan.

Now the tricky part: You decide as a policy matter the feds should step in and provide a DIP loan to the failing auto giants. How do

you do that without nationalizing them? You do what they did: Appoint an ad hoc task force with negotiating authority and headed up by real financiers, not government bureaucrats. They drove hard bargains. They took an equity stake, because there's only so much debt financing you can tolerate in a reorg with this capital structure. And they decided to do it through 363 presumably for the reasons most 363 sales occur: for speed. (And speedy these reorgs were—in and out in a month.) Viewed thus, the 363 sale structure had nothing to do with masking redistribution goals; it was driven by bankruptcy reorganization strategy.

Now we judge in hindsight. Did they drive too hard a deal with certain parties? Were they too soft with others? Maybe. Let's start with the secureds. Were the feds too hard on them, knocking \$6 billion down to 2? (Let me be clear, I am assuming a proactive role of the government as negotiator because, as with all DIP lenders, they set the terms of when they'll be willing to lend; so yes, they get to set financial conditions.) I could try to weasel on this and point to the consent of the trustee representing the consortium of secured lenders, which bound the others, but Professor White rightly raises the enthusiasm with which some of the TARP-recipient secured lenders might have wanted to help out the government by being especially conciliatory.

The real question is: Are the assets encumbered by those lenders' liens worth more than the \$2 billion? No, as far as I'm aware, and certainly no one tried to make a valuation argument—common in bankruptcy litigation—to the contrary. In fact, some pundits opined that \$2 billion was generous, especially in the liquidation scenario that would unfold absent government financing. (As a sidebar, I disagree with Professor White and some courts that suggest a secured creditor could insist on payment of the face amount of the liens—more than \$6 billion—to block a 363 sale. I'm in the camp that reads the Code to say if \$2 billion is all the encumbered assets are really worth, that's all a secured creditor can expect in a 363 sale.)

In all the gnashing of teeth that was the appellate litigation (including brief Supreme Court stays) trying to block the 363 sale, there was plenty of hand-waving to alleged bias, *sub rosa* end runs around Chapter 11 through 363, and statutory interpretations of section 363. But there was never a good, meaty argument that \$2 billion was not a fair valuation of the secured creditors' assets. As such, I weep nary a tear for the purportedly aggrieved dissenting secureds.

The better raising of eyebrows comes from the treatment of the UAW as an unsecured creditor. Here, it ended up with a relatively handsome stake in new Chrysler (and GM for that matter). I don't

agree that they got a \$4 billion gift; at best they received a disproportionately favorable stake in the new company. To this charge of favoritism there is a technical argument of exquisite legal positivism and there's a better answer. The technical answer is that "new" Chrysler can distribute its capital structure however it likes, and so, for example, the Bankruptcy Code's command of equal treatment of unsecured creditors is inapposite (in contrast to a proposed restructuring under a Chapter 11 plan). That explanation is not likely to satisfy skeptics of why this was a 363 sale in the first place; in fact, it will infuriate them and prove their underlying mistrust.

The better answer is that even the Bankruptcy Code allows departure from the injunction if the creditors are uniquely situated. Here, there is a plausible argument that the union-creditor is differently situated: One needs a happy union to continue making cars at maximal efficiency, and it is not a far stretch to imagine labor unrest scuttling any hopes for economic survival. Thus, even if they had to defend the capital structure—which the positivists would not concede—there's a decent argument to rest behind that this favoritism was perfectly appropriate (although Professor White might brand it a mere fig leaf).

The \$64,000 question is how much value added the union contributed vis-à-vis the other creditors, and how does one commensurate that into a premium in terms of the stake in the new company? I don't have an answer to that, nor do I have a strong feeling whether a Republican-led auto task force (assuming it embraced the policy threshold whether to lend DIP money in the first place) would have come to strikingly different amounts. I'm not so wet behind the ears that I envision no labor solicitude from a task force emanating from this administration, but I'm also not sure how much of an effect it actually had. I don't think it was tantamount to a \$4 billion giveaway. (More thought is devoted by Professors Roe and Skeel in an upcoming issue of the *Michigan Law Review*.)



The big picture question for me was on which side of the divide did this fall: a government nationalization of heavy-handed policy guiding, or a reluctant intervention of capital by the ultimate lender of last resort? Contrary to popular rumor, Representative Barney Frank did not get to dictate which plants shut down, and I don't think the President was very involved in picking Fritz Henderson's replacement at the helm of GM. The jury's still out, but history may well judge this as restrained government intervention in a time of financial crisis that enhanced, not undermined, capital markets. **Q**