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Chrysler's Bankruptcy: Money Laundering on a Grand Scale

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Editor's Note: "President Obama forced Chrysler into federal bankruptcy protection on Thursday so it could pursue a lifesaving alliance with the Italian automaker Fiat, in yet another extraordinary intervention into private industry by the federal government." That was the assessment by The New York Times *when the news broke in April.*

We knew some of our faculty would have strong opinions about the way the bankruptcy was handled. We weren't disappointed. In the next two articles, read J.J. White's opinion about the Obama administration's "clever but legal manipulation of the bankruptcy system." Then read John Pottow's ruminations, see where he parts from his colleague, and learn his answer to what he calls the "big picture question." 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?

By James J. White, '62

The bankruptcy of two of America's prominent industrial companies, Chrysler and General Motors, will be remembered as a curious footnote in the financial crisis of 2008 and 2009.

Both companies left bankruptcy through the side door via a "Section 363" sale, not through a plan of reorganization confirmed by the vote of the creditors. Section 363 of the Bankruptcy Code was designed to allow a company in Chapter 11 to sell off unneeded assets such as outmoded factories, unused real estate, or other assets that would not contribute to the business that was to emerge from Chapter 11 by the adoption of a Chapter 11 plan.

Since the 1980s, debtors have used Section 363 to turn the Chapter 11 process on its head. In many Chapter 11 cases of public companies, the debtor in possession has sold the live part of the business through 363 and has left the dead assets for later liquidation. In these transactions, the debtor in possession typically sells to a buyer who purchases the live business out of the estate for cash. Despite controversy over its wisdom and legality, the 363 sale of the living part of a business in Chapter 11 has now become a well-recognized and widely practiced method of conducting the reorganization of a failing company.

Both academics and practicing lawyers have questioned this use of Section 363. The principal criticism is that this use deprives the creditors of the protection that is built into the process of proposing and approving a plan of reorganization. It is possible but difficult to gain a court's approval of a plan over the negative vote of a class of creditors. In a 363 sale there is no vote, and creditors fear that the debtor in possession will team up with a subset of the creditor group and propose a sale that disadvantages the other creditors.

Indeed the principal limitations on such "cramdowns" over creditors' negative votes arose out of just such practices by coalitions of shareholders and subsets of creditors in 19th century reorganization practice. Set against these complaints is the argument that the speed of 363 sales saves money and by the claim that a properly conducted 363 sale will bring as much as, or more than, the value that would have been realized in a fully negotiated and confirmed plan. UCLA Professor Lynn LoPucki, '67, and I have debated the latter point in the *Michigan Law Review.*

But I bore you. Chrysler presents political issues far more interesting and relevant than any claim about the proper reading of the bankruptcy code. Even under the new thinking on Section 363 sales, the Chrysler sale was deviant. In Chrysler, the nominal buyer, Fiat, put up no money. Rather the federal government put the $2 billion into Chrysler so that it could pay off the secured creditors at 28 cents on the dollar. By removing $7 billion of secured debt from Chrysler's balance sheet, the administration greatly increased the value of the New Chrysler's unsecured promise to pay $4 billion to the UAW Voluntary Employee Beneficiary Association, or VEBA. In effect, the payment of $2 billion to liquidate the superior secured debt made it possible to move $4 billion from New Chrysler to the UAW for its unsecured claim.

Had the President simply announced that the federal government would give $4 billion to the UAW, the public, even the public in the UAW's home state of Michigan, would have been up in arms.

The interesting issue in Chrysler is not the lawyers' manipulation of the law; it is the politicians' use of the bankruptcy to launder money. Had the President simply announced that the federal government would give $4 billion to the UAW, the public, even the public in the UAW's home state of Michigan, would have been up in arms. By laundering the money through the Chapter 11 process, the administration disguised the payment and avoided the outrage.

Where is the evidence to support my hypothesis? Some comes from the deviance of the process; most can be inferred from Steven Rattner's description of the political negotiation in the administration and of the acts and thinking of the White House automobile task force that Mr. Rattner directed. In an article published in *Fortune* in October, Mr. Rattner (not to be confused with Michigan Law's own Steven Ratner) describes some of the political considerations. He notes that a proposal by Austan Goolsbee, a member of President Obama's Council of Economic Advisers, to let Chrysler die (and so to let GM prosper) was rejected when the participants realized that as many as 300,000 persons could be thrown out of work by Chrysler's liquidation. Mr. Rattner has the audacity to claim that the politicians did not interfere in the task force's work, only a few pages after he describes how White House Chief of Staff Rahm Emanuel was able to recite from memory the names of the members of Congress who represented the districts where Chrysler had manufacturing plants.

The surprising capitulation of the secured creditors is also suspicious. There is a strong argument that a Section 363 sale cannot be made over the objection of a secured creditor, unless the creditor is paid not merely the value of the collateral that secures its debt (here no more than a few billions and quite possibly less than that) but the face amount of its debt (here $6.9 billion). Because the secured creditors agreed to the government's offer of $2 billion—or, more accurately, because JPMorgan Chase & Co., the agent for the secured creditors, was found to have bound all of the secured creditors by its agreement—no court ever had to consider the argument that Section 363 required payment of the face amount of the secured debt. Mr. Rattner proudly claims to have moved Jimmy Lee, the Morgan banker who spoke for the secured creditors, from a claim for "not one penny less than $6.9 billion" to a $2 billion settlement by adroit negotiation.

There is another possibility. Mr. Lee's employer and several of the other secured creditors were TARP (Troubled Asset Relief Program) recipients. It is plausible that Mr. Lee accepted the $2 billion and chose not to argue for more in court because word was passed to his boss, Jamie Dimon, that the administration wanted it that way.

Understand what I am not claiming; I do not claim that the lawyers or the judges in Chrysler did anything wrong. If they are aggrieved it is only because they were the puppets attached to the administration's strings. By its clever but legal manipulation of the bankruptcy system, the administration was able to move $4 billion of value to its friend the UAW while being much less generous to Chrysler's secured creditors who, in another setting, could have received a much larger payoff.