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### **Ron Bloom, Senior Advisor at the U.S. Treasury Department Written Testimony House Judiciary Commercial and Administrative Law Subcommittee “Ramifications of Auto Industry Bankruptcies, Part II”**

Ron Bloom

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## U.S. DEPARTMENT OF THE TREASURY

### Press Center

# Ron Bloom, Senior Advisor at the U.S. Treasury Department Written Testimony House Judiciary Commercial and Administrative Law Subcommittee “Ramifications of Auto Industry Bankruptcies, Part II”

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Good morning.

Chairman Cohen, Ranking Member Franks, and members of the House Judiciary Commercial and Administrative Law Subcommittee, thank you for the opportunity to testify before you today.

#### Introduction

On behalf of the Obama Administration and the Auto Task Force, I am here to report on the restructurings of General Motors and Chrysler and the broader state of the American automobile industry.

As you know, the New GM and the New Chrysler have recently completed the purchase of assets through bankruptcy processes and are now operating as independent companies. While this has been exceedingly difficult and painful, it has resulted in two great American companies being given a new lease on life and has kept literally hundreds of thousands of Americans working. During the bankruptcy proceedings, every affected stakeholder had a full opportunity to have his or her claim heard and every creditor will almost certainly receive more than they would have had the government not stepped in.

The President did not invite the government's involvement in these proceedings. Just a few months ago, both of these companies were on the brink of complete failure and requested substantial financial assistance that only government could provide. Without such assistance, both companies would almost certainly have been liquidated, with a devastating impact on communities throughout the country.

Despite that very real prospect, President Obama was unwilling to provide additional tax dollars to these companies unless they and their stakeholders were willing to fundamentally restructure, address prior bad business decisions, and chart a path toward a sustainable future that would not require ongoing government assistance.

Therefore, the President made two decisions. First, he gave both GM and Chrysler a limited window to work with their stakeholders to secure the sacrifices necessary to make them stronger, leaner, and more competitive so that an investment of additional taxpayer dollars could be justified. Second, he directed his Auto Task Force to take a commercial approach to these restructurings and refrain from intervening in the day-to-day decisions of these companies. He did this precisely because the companies' long-term viability and ability to

repay the taxpayer dollars they were receiving would be seriously undermined if the government became involved in day-to-day business decisions.

In only a few months, both General Motors and Chrysler – working with their stakeholders and the President's Auto Task Force – have achieved things that many thought impossible. After proceeding through fair and open bankruptcy processes, both the New Chrysler and the New GM have emerged as stronger global companies.

This process required deep and painful sacrifices from all stakeholders – including workers, retirees, suppliers, dealers, creditors, and the countless communities that rely on a vibrant American auto industry. Anytime a company as large and interconnected as GM or Chrysler becomes fundamentally insolvent, the collateral damage is enormous. However, the steps that the President took not only avoided a potentially catastrophic collapse and brought needed stability to the entire auto industry, but kept hundreds of thousands of Americans working and for the first time in decades, gave the New GM and New Chrysler a chance to become viable, competitive American businesses with bright futures.

### **President Obama's Auto Task Force**

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On February 15, 2009 the President appointed an Auto Task Force to oversee his Administration's efforts regarding the industry. The Task Force is co-chaired by Treasury Secretary Timothy Geithner and National Economic Council Director Lawrence Summers, includes representatives from across the executive branch <sup>[1]</sup>, and is staffed by a joint Treasury-NEC team, of which I am now the senior member. This team reports to the Task Force and its co-chairs, who report up to the President.

From the beginning of this process, the President gave the Auto Task Force two clear directions regarding its approach to the auto restructurings. The first was to behave in a commercial manner by ensuring that all stakeholders were treated fairly and received neither more nor less than they would have simply because the government was involved. The second was to refrain from intervening in the day-to-day management of these companies. Our role was to act as a potential investor of taxpayer resources, and not become involved in specific business decisions, which are the job of management. The President was clear in his view that it would be both politically improper and economically unwise to view our reluctant interventions in these private companies as opportunities to achieve broader policy objectives.

Because the investments made by both the prior and current Administrations to support the auto companies have come from the TARP, the Task Force and its staff's activities have been subject to the full range of disclosure and reporting requirements under the EESA statute. This includes oversight by the GAO, EESA's Financial Stability Oversight Board, the Special Inspector General for TARP or "SIGTARP," the Congressional Oversight Panel established under EESA, and the OMB as well as required reporting to multiple House and Senate committees.

Given the emergence of the New GM and the New Chrysler from bankruptcy, the involvement of the Auto Task Force with the companies will now change. The companies are being run as commercial enterprises by their management teams, and they will report to new, independent Boards of Directors. In acting as a lender and investor in New Chrysler and New GM, the Auto Task Force will closely monitor the loans and investments made in both companies going forward.

### **Chrysler**

The New Chrysler completed its purchase of assets through the bankruptcy process on June 10, 2009. The Company is now run by its new Board of Directors, under the leadership of its new Chairman C. Robert Kidder and a new management team.

This achievement was the culmination of a series of steps that began with the company submitting a detailed business plan to the U.S. Treasury on February 17, 2009, which on March 30<sup>th</sup> the President announced was not viable. However, the President also determined

that Chrysler could achieve viability through a partnership, likely with the international automobile manufacturer Fiat.

On April 30<sup>th</sup>, after Chrysler and its stakeholders made important and meaningful sacrifices, the President determined that Chrysler had made sufficient progress to justify an additional investment of U.S. taxpayer resources. In order to effectuate these agreements, on April 30<sup>th</sup> Chrysler filed for bankruptcy. Just over one month later, after a court process that gave all creditors a chance to raise their concerns, the bankruptcy court approved the sale of substantially all of Chrysler's assets to the new Chrysler-Fiat Alliance.

In approving the sale motion, Judge Gonzalez held that the bankruptcy proceedings had been fair and open, and "that all relevant standards [had] been established to grant the relief requested" and that "the assets in the Sale Transaction [were] sold free and clear of liens, claims, interests, and encumbrances pursuant to section 363(f)" of the Bankruptcy Code. *In re Chrysler LLC*, 405 B.R. 84, 113 (Bankr. S.D.N.Y. 2009).

While this proceeding received an understandably large amount of public scrutiny, neither the speed nor the substance of the court process was exceptional. As Judge Gonzalez explained, "[t]he sale transaction...is similar to that presented in other cases in which exigent circumstances warrant an expeditious sale of assets prior to confirmation of a plan. The fact that the U.S. government is the primary source of funding does not alter the analysis under bankruptcy law." *In re Chrysler LLC*, 405 B.R. 84, 87 (Bankr. S.D.N.Y. 2009).

On June 5<sup>th</sup>, this judgment was affirmed unanimously by a three-judge panel of the Second Circuit Court of Appeals. On Tuesday, June 9<sup>th</sup> the U.S. Supreme Court denied an application to stay the closing of the sales transaction leading to the successful emergence of New Chrysler. The President's commitment to completing this alliance helped ensure that tens of thousands of jobs have been saved. [2]

Reaching this historic alliance was only possible because of unprecedented sacrifices from Chrysler and all of its key stakeholders:

*The UAW made important concessions on wages, benefits, and retiree health care.* These concessions brought New Chrysler's compensation in line with Toyota and other transplants. In addition, the UAW retirees exchanged an almost \$8 billion fixed obligation to the Voluntary Employees' Beneficiary Association (VEBA) retiree health trust for a \$4.6 billion unsecured note and stock in New Chrysler. This arrangement shifts substantial risk onto the retiree health care trust and will likely result in meaningful reductions in health care benefits for New Chrysler's 150,000 retirees. The Trust, beyond a single seat on the Company's Board of Directors, will have no role in the governance of the Company. However, the ability of the Trust to provide decent benefits over the long-term will require that the Company's stock become valuable, thus significantly aligning the interests of the Company and a key stakeholder. *Chrysler's largest secured creditors agreed to an exchange of \$2 billion in cash for their \$6.9 billion in outstanding secured debt.* The Court determined that the \$2 billion was well in excess of the liquidation value of Chrysler [3] and thus found the treatment of secured creditors in the bankruptcy process to be very normal and conventional. In addition, it was always made clear to the secured lenders that no one contested their right and they were therefore free to take their collateral and do with it as they pleased, including either liquidating the company or operating it. Instead, they made a commercial choice to take their recovery in cash. *New Chrysler determined that meaningful actions were required to reduce the overcapacity in both the Company's plant footprint and dealer network. Therefore New Chrysler's business plan included reductions in plants and dealers across the United States.* These decisions, while difficult, are absolutely critical to making New Chrysler competitive

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ensuring the success of the Company in the future. Importantly, the New Chrysler retained the *overwhelming majority* of dealers from the old company – 87 percent of dealers by volume. *Product liability and some workers compensation claimants will not be permitted to carry their claims forward to New Chrysler.* This was a difficult decision, which New Chrysler made on a commercial basis. While everyone involved is certainly sympathetic to the hardships faced by these claimants, the company made a commercial decision quite similar to that of hundreds of other companies going through bankruptcies.

The Company's successful emergence, in conjunction with financial support from the U.S. and Canada, has put New Chrysler on a solid footing to succeed and generate jobs well into the 21st century.

## General Motors

The New General Motors completed its purchase of assets through the bankruptcy process on July 10, 2009. This process also included President Obama's rejection of GM's February 17<sup>th</sup> business plan. As part of that rejection, on March 30<sup>th</sup> the President outlined a framework for General Motors to achieve financial viability. After two months of significant work by the company's management and engagement with its stakeholders, GM developed a more robust operating plan. As a result, the President deemed GM's plan viable and on June 1, 2009 committed approximately \$30.1 billion of additional federal assistance from the TARP to support the company's

restructuring. <sup>[4]</sup> To effectuate its plan, General Motors filed for bankruptcy protection and, like Chrysler, utilized Section 363 of the bankruptcy code to conduct a sale of certain of its assets to New GM.

As with Chrysler, every one of the company's stakeholders made substantial sacrifices. These include:

*The UAW made significant concessions on compensation that will result in New GM also having wage rates comparable to foreign competitors. In addition, the GM VEBA retiree health trust exchanged a \$20 billion fixed obligation for a \$2.5 billion note and stock in New GM (in the form of \$6.5 billion in preferred stock, 17.5% in common equity of New GM and warrants to purchase an additional 2.5% in common equity at a \$75 billion strike price). Unsecured creditors will receive 10% of the equity of New GM, plus warrants for an additional 15% of the new company. This settlement makes it highly likely that unsecured creditors will recover far more than they would have if GM had liquidated. As Judge Gerber explained, "the only alternative to an immediate sale [was] liquidation—a disastrous result for GM's creditors, its employees, the suppliers who depend on GM for their own existence, and the communities in which GM operates." In re General Motors Corp., 2009 WL 1959233, at 2 (Bankr. S.D.N.Y. July 5, 2009). And "[i]n the event of a liquidation, creditors now trying to increase their incremental recoveries would get nothing." Id. (emphasis added). This includes pre-petition product liability claim holders, who will receive their pro-rata share of the disposition of the unsecured creditors' consideration. New GM's plan includes reductions in its workforce – both hourly and salaried – and in its plant footprint. These steps are part of the company's broad effort to right-size the business to reflect current and expected levels of demand. The resulting New GM is now operating with a dramatically improved cost structure. Its breakeven point has been lowered to a 10 million annual unit environment compared to a prior breakeven point of more than 16 million. Because of its reduced debt-load and the elimination of other post-retirement benefit obligations, New GM has credit statistics consistent with its well capitalized peers. New GM is maintaining franchise agreements with the substantial majority of the old company's dealers, and providing a wind-down process for dealers not moving forward.*

## **Automotive Dealers**

The Administration understands the importance of supporting America's auto dealers during this period of crisis in the auto industry. We also understand the importance of this issue for many members of Congress, and have had occasion to speak directly with several of you and your colleagues about this issue over the past several weeks.

While many issues in this process have been very painful – for dealers, retirees, laid off workers and product liability victims to name only some of the stakeholders who have sacrificed – it is important to recognize what would have happened if the President had not stepped forward. These companies would have been liquidated and all of their dealer franchise agreements would have been terminated.

Instead, as a result of the restructurings, both new companies are in a position to move forward with new networks that maintain franchise agreements with the substantial majority of the dealers. For example, the New Chrysler's network maintains 87% of the old Chrysler's dealers by volume. Even after these restructurings, New GM and New Chrysler will have the most extensive dealer networks in the country, with more rural representation than any other companies. New GM, for instance, will have more rural and small town dealers than Toyota, who sells almost as many cars, has total dealers in the country.

Consistent with the Task Force's role, we were not involved in the design or implementation of New GM or New Chrysler's dealer rationalization plans. We were not involved in any individual decisions about dealers, and we do not intend to be going forward.

I understand that several members have raised concerns about the processes the Companies have taken with respect to the dealers. Specific questions about the criteria used in the process or individual dealer determinations are best posed to the Companies themselves. However, throughout this process we have played an oversight role and sought to help ensure transparency in the process. Over the past several weeks, New GM and New Chrysler have worked to explain their processes, and have made several accommodations and clarifications in response to important issues raised by members of this committee and others. We have been assured that any dealer which seeks detailed information about the decision criteria and its specific case will receive this information promptly from the companies.

In addition, the companies have engaged recently with several members of Congress – including members of this subcommittee – about potential additional modifications of their review and reconsideration processes that would further increase transparency and objectivity for everyone involved. We have been supportive of this process, in our role as a facilitator, to ensure this process is transparent, fair and objective.

However, the Administration strongly opposes the amendment to the Financial Services appropriations bill that attempts to restore prior Chrysler and GM franchise agreements. The decision to invest taxpayer dollars into these companies required all stakeholders to make difficult sacrifices, and at this point it would set a dangerous precedent, potentially raising enormous legal concerns, to say nothing of the

substantial financial burden it would place on the companies, to intervene into a completed portion of a judicial bankruptcy proceeding on behalf of one particular group. Political intervention of this nature could also jeopardize taxpayer returns by making it far more difficult for the companies to access private capital markets if there is ongoing uncertainty about whether Congress will intervene to overturn judicially approved business decisions anytime that it disagrees with the judgments of the companies

### **Steps to Stabilize Auto Finance Market**

A viable auto industry requires automotive financing for dealers and consumers. The vast majority of automobile purchases in the U.S. are financed, including an estimated 80%-90% of consumer purchases and substantially all dealer inventory purchases. Given the importance of the availability of financing, a total of \$13.4 billion of TARP funding has been committed to GMAC, \$7.5 billion of which has been funded under the oversight of the Auto Task Force. Also, \$4 billion of this funding is being used by GMAC to support New Chrysler dealers and New Chrysler customers as Chrysler Financial will no longer fulfill that role. Together, these fundings will allow GMAC to meet the needs of a substantial number of dealers and customers for both Chrysler and GM.

Also, the Treasury Department, in conjunction with the Federal Reserve, has continued to expand the TALF program to support lending broadly and auto lending in particular. This program has helped automotive finance companies raise over \$26.5 billion through July 2009 to support consumer purchases of vehicles <sup>[5]</sup>. And, in a positive note for the taxpayer, Chrysler Financial recently successfully completed a TALF offering allowing it to repay the \$1.5 billion loan that it previously borrowed from the Treasury Department. With the resolution of the fate of Chrysler and GM and the improvement in the capital markets, the availability of credit to dealers and customers across the automotive industry should continue to improve. Also, as of July 1st, auto, RV and other dealerships can apply for SBA-guaranteed floor plan financing, which will make it easier for these small businesses to borrow against their inventory and increase their cash flow

### **Stabilizing the Auto Supply Base**

Because of the credit crisis and the rapid decline in auto sales, many of the nation's auto parts suppliers have struggled to access credit and have faced uncertainty about the prospects for their businesses and for the auto companies that rely on them. Suppliers that ship parts to auto companies generally receive payment about 45-60 days after shipment. In a normal credit environment, suppliers can either sell or borrow against those commitments--so-called "receivables"--in the interim period to pay their workers and fund their ongoing operations. However, due to the uncertainty about the ability of the auto companies to honor their obligations, banks have been unwilling to extend credit against these receivables.

On March 19, 2009 the U.S. Treasury announced a \$5 billion Automotive Supplier Support Program to help address this problem. <sup>[6]</sup> Any eligible domestic auto company may participate. This program has contributed to the stability of the supplier base and the OEMs at a critical time. In addition, based on commercial decisions by GM and Chrysler to pay their suppliers through their filings, the supplier industry was provided financial support beyond what typically occurs in most bankruptcies. This action was taken based on the commercial necessity of ensuring continuity of supply for the manufacturers.

Now with the emergence of New GM and New Chrysler and with the threat of liquidation greatly reduced, there has been some modest opening in credit market access for suppliers. Nonetheless, the Task Force is mindful of the continuing challenges facing auto suppliers and is continuing to actively monitor the health and state of the supply base during this period of industry restructuring.

### **Auto Warranty Commitment Program**

Toward the beginning of the restructuring process, the Auto Task Force implemented a Warranty Program to give confidence to GM's and Chrysler's customers during a period of substantial uncertainty regarding the outlook for the companies. With the successful emergence of the new companies, consumers can now feel assured that the companies have the financial wherewithal to meet their warranty commitments on a continuing basis. As such, the Auto Task Force determined that it was appropriate to end the Warranty Program. I am happy to report that \$641 million invested in the program has been returned to United States Government along with interest payments on the program. This achievement represented a prudent short-term use of taxpayer funds.

### **Conclusion**

In a better world, the choice to intervene would not have had to be made. But amid the worst economic crisis in three-quarters of a century, the Administration's decisions avoided a devastating liquidation and put a stop to the long practice in the auto industry of kicking hard problems down the road. The Auto Task Force worked quickly to assist GM and Chrysler and did so in a fair and open way. While difficult for all stakeholders involved, these transactions provide New GM and New Chrysler with a new lease on life and a chance to succeed.

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[1] The other members of the Task Force are the secretaries of Transportation, Commerce, Labor, and Energy, along with the Chair of the President's Council of Economic Advisers, the Director of the Office of Management and Budget, the EPA Administrator, the Director of the White House Office of Energy and Climate Change and the Chief Economist for the President's Economic Recovery Advisory Board.

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[2] To effectuate this transaction, substantial taxpayer dollars were utilized. When the President announced the future direction for Chrysler on April 30<sup>th</sup>, he committed to funding over \$8 billion by providing both debtor-in-possession financing during the bankruptcy period and exit financing. Because of the accelerated time frame of the bankruptcy, the proportion of the funding through the exit financing was greater than initially expected. Ultimately, \$1.9 billion of funding was provided in debtor-in-possession loans and \$6.3 billion was provided in exit financing. Added to the exit financing was a \$350 million commitment related to a loss sharing agreement with GMAC that is not expected to be utilized. Also, the governments of Canada and Ontario funded more than \$2.0 billion in debtor-in-possession and exit financing.

[3] \$800 million is on the high end of the range. See *In re Chrysler LLC*, 405 B.R. 84, 97-98 (Bankr. S.D.N.Y. 2009).

[4] In exchange for the total \$49.5 billion of funding (\$30.1 billion to effectuate the bankruptcy process and \$19.4 billion that was provided before the bankruptcy filing), the U.S. Treasury received \$8.8 billion in debt and preferred securities as well as a 60.8% equity stake in New GM (The U.S. Treasury's equity stake is about 50% on a fully diluted basis). The Governments of Canada and Ontario invested \$9.5 billion and received a proportional share of each of these securities.

[5] Figure includes Auto Loan, Auto Lease, and Motorcycle ABS issuance as noted in a report produced by the Markets Group at the Federal Reserve Bank of New York on July 8, 2009.

[6] The Program is implemented through a special purpose vehicle ("SPV") and functions as follows: The OEMs initially identify critical suppliers to participate in the Program. Once included, the OEM submits receivables of the Suppliers eligible for the Program. For those receivables, a participating supplier is entitled to be paid directly from the SPV. Suppliers have the option of receiving payment immediately, in which case they pay a 3% discount, or receiving payment under the supply contract's normal payment terms (usually 45-60 days), in which case the supplier pays a 2% discount. In either scenario, since the supplier receives payment from the SPV, the payment is certain. When the OEM's payment is due to the supplier under the terms of their contract, the OEM makes the payment to the SPV. The SPV thus bears the risk of the OEM's non-payment, and the supplier is secure. Also, New GM and New Chrysler made determinations as of July 1<sup>st</sup> to reduce their allocated commitments thereby shrinking the size of the program to \$3.5 billion, which they are confident is sufficient to address the needs of the supply base.

