RAMIFICATIONS OF AUTO INDUSTRY BANKRUPTCIES (PART I)

HEARING

BEFORE THE

COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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RAMIFICATIONS OF AUTO INDUSTRY BANKRUPTCIES (PART I)

THURSDAY, MAY 21, 2009

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Committee met, pursuant to notice, at 1:07 p.m., in room 2141, Rayburn House Office Building, the Honorable John Conyers, Jr. (Chairman of the Committee) presiding.

Present: Representatives Conyers, Watt, Jackson Lee, Waters, Delahunt, Cohen, Johnson, Sherman, Maffei, Smith, Coble, Goodlatte, Issa, King, Gohmert, and Jordan.

Staff Present: Danielle Brown, Majority Counsel; Susan Jensen, Majority Counsel; Daniel Flores, Minority Counsel; and Zachary Somers, Minority Counsel.

Mr. CONYERS. Good afternoon. The Committee will come to order.

This oversight hearing is one of a series that the Judiciary Committee has held on business bankruptcy reorganization in this Congress and in prior Congresses. Today's hearing will consider a wide-ranging ripple effect and possibly unintended consequences presented by automobile industry bankruptcies. In particular, I want to focus on how various constituencies are being affected—the workers, the retirees, the auto dealers, the automobile owners and consumers in general.

We have thousands of dealers, many of whom are small, family-run businesses, but have been passed sometimes from one generation to the next, being summarily terminated by Chrysler and General Motors. Some say it makes no economic sense to terminate these dealerships, and that doing so could actually undermine the ability of our Nation's auto industry to regain its financial stability.

Customers are already anxious about whether their repair warranties will be honored. Now they will also have to worry about whether their local dealer will even be in business long enough to service their car, or whether they will have to drive a long distance to some other dealer—or whether they should just purchase their next auto from a foreign car dealer to have some assurance of continued service.

The lack of consumer confidence in American cars is largely what drove this industry into bankruptcy. But what the industry now proposes to do to its dealerships may actually exacerbate the industry's financial difficulties by further undermining consumer confidence.

So we need to consider the consequences of these bankruptcies on American workers and their families. Right now thousands of Americans are either losing their jobs or at risk of losing their jobs. And not just at GM and Chrysler, but also at the thousands of suppliers and other businesses directly or indirectly connected to the automobile industry in some way.

In Detroit, the official unemployment rate is at an amazing 22 percent, three times the national average; and the unofficial rate is assuredly even higher than that. In addition, many of the retirees may lose or have already lost their hard-won health and medical benefits as a result of these bankruptcies.

Some of these costs will be shifted to budget-strained State and local governments. Witness California. Others will fall onto the already overburdened shoulders of the retirees and their families.

Just the other day we learned that General Motors may close more than a dozen as yet undetermined plants, and shift production to Mexico, Korea, China and other foreign locations. This latest development is particularly egregious in light of the fact that American workers, as taxpayers, as loyal citizens, are being asked to bear the burden of funding General Motors financial reorganization, a process that now appears to be designed to either intentionally or unintentionally eliminate American jobs by shipping them overseas.

We should consider how safety and legal accountability concerns will be affected by these bankruptcies. And so I am happy and proud that this Committee and those witnesses that we were able to assemble are here.

I will insert the rest of my statement in the record and turn to our friend from Texas, the Ranking Minority Member Lamar Smith for his comments.

Mr. SMITH. Thank you, Mr. Chairman.

The events the Nation has witnessed with Chrysler and General Motors are very troubling. An attorney for senior secured creditors of Chrysler has said, quote, “One of my clients 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,” end quote. For a brief moment, these creditors held firm refusing to hand over their property to the Administration and the United Auto Workers union. They stood their ground until the President himself demonized them on April 30th before the White House press corps. Seeing a threatened plan unfold before their eyes, they backed down. In short order, other dissonantcreditors went with them.

Let’s be clear about what is happening to America’s automakers. Union labor costs priced these companies out of the market and drove them to the brink of bankruptcy. What is the President’s proposed solution? Deliver the companies over a union ownership through bankruptcy.

Poor management is said to have hastened the demise of these companies. So what was President Obama’s solution? To sack the senior management and appoint himself CEO. Thanks to the Administration, GM now stands for Government Motors. That is my own line.

While the UAW is cashing in, it is the dealers, creditors and the American taxpayers who are being forced to cash out. Secured creditors, pension funds for teachers, fire fighters and State workers, like the dealers, are being sacrificed to appease the demands of the UAW.

And what has happened to the taxpayers' money? The Administration is now using taxpayer dollars to rescue UAW. What is worse, the money will be written off as a forgiven debt. The UAW gets the piggy bank and the American people won't see a dime.

The Administration's handling of Chrysler and General Motors should give all Americans great concern. In Chrysler and GM the Administration is replacing CEOs and strong-arming senior secured creditors. Corporate bondholders are being asked to sacrifice their property rights to deliver companies into union hands.

In the TARP program the Administration is giving billions to banks and refusing to let the banks pay them back. That is hijacking the banks. In the GM negotiations, billions of dollars in TARP aid appeared slated to be completely forgiven. Call it a gift on the taxpayers to the UAW, courtesy of President Obama.

Mr. Chairman, today we have an opportunity to scrutinize the unprecedented actions that have brought us to this point with these two auto dealers, and I thank you for having this hearing.

Mr. CONYERS. Lamar, you always manage to get a zinger in there in the opening statements. Thank you.

I would like to recognize Subcommittee Chair Steve Cohen of Memphis, Tennessee, for any comment that he would like to make.

Mr. COHEN. Thank you, Mr. Chairman.

There are few things as firmly woven into our fabric as a Nation and our customs as the automobile. Everybody wants to get a car when they turn 16, or soon thereafter, and learn how to drive. There are cars that inspire songs: Beach Boys' GTO and Little Deuce Coupe; the first rock and roll song ever, Jackie Brenston's Rocket 88; unfortunately, another company that didn't do good, My Little Nash Rambler, BP; Mustang Sally, Warren Zevon's Studebaker.

You will notice, none of those songs are about Toyotas or Hondas or Isuzus. It is American cars. And American cars are a lot about what our country has been about and what we have defined ourselves as with our cars—which cars we drive and what we do.

General Motors, Ford and Chrysler produced those cars and employed millions of Americans and been a great part of our engine. At one time it was said what is good for General Motors is good for the Nation. I am not sure we can say that today.

They have employed many people, and they still do, and they continue to employ hundreds of thousands of people who work in the industry and for suppliers and at dealerships.

U.S. Automakers support thousands of retirees who are concerned about losing their pensions and their health care, and we need to be concerned about how these people come out in this bankruptcy of Chrysler and possible bankruptcy of General Motors, for these people gave their lives and expected payments. There are literally tens, probably hundreds of thousands of individuals in this class.

The automobile industry is important for many areas in our country's economy and historically in east Tennessee, far away from my home, but in my State, people went from east Tennessee to Anderson, Indiana, and places in Michigan to gain employment and have since returned to retire. But their retirements are in jeopardy.

The American automakers have stumbled badly. Some blame President Obama for the situation. I had a lady call me last week who said, "President Obama has closed the Chrysler dealership in South Haven; he doesn't know anything about how to run a car company."

Well, apparently the people that were running the car companies didn't know much either. They failed initially to respond seriously to the challenge from foreign competitors until after those competitors had established strong footholds in our country and taken over the marketplace with cars that had better fuel efficiency and better records as long-lasting and safe vehicles. They resisted fuel efficiency standards and resisted making fuel-efficient vehicles. Even last year there were folks coming to my district and opposing better fuel standards for our cars.

While American automakers have made great strides in addressing some of these problems, they are suffering because of their past missteps. Now one American icon, Chrysler, is in already in bankruptcy. Another, GM, faces an imminent bankruptcy filing. And while I hope to learn more about the details of both companies' restructuring proposals, I am particularly interested in a few points based on my understanding of their proposals.

I am concerned about reports indicating GM intends to shift a significant amount of its production out of the country while depending on American moneys to keep it going. I hope we don't end up subsidizing the shipping of American jobs to other countries.

Additionally, I wonder about the fate of GM stockholders, particularly the retirees, who will end up with very little in their investments. And I wonder how Chapter 11 is going to affect these people, and if these experts could tell us what they think the old Chapter 11 would have been at addressing the concerns of the American automobile companies, the workers, the retirees that might be different from this new Chapter 11, because Chapter 11 is the bailiwick upon which my Committee is looking.

So I thank Chairman Conyers for holding this important hearing on the actual and potential bankruptcies of these automobile giants. I thank our witnesses for making themselves available to testify on short notice. And I am eager to learn about their thoughts on Chapter 11 and the possible consequences to the American public of the bankruptcy of these two most heralded and traditional American companies.

Thank you, Mr. Chairman.

Mr. CONYERS. You are welcome.

Steve King, Iowa, is recognized for any comments he may choose to make.

Mr. KING. Thank you, Mr. Chairman. I very much appreciate being recognized. And I appreciate this hearing today. This is a subject matter the American people need to know about, and I am going to be very interested in the perspective that each of the witnesses brings before this Committee.

What is on my mind is, how do we preserve free enterprise, how do we preserve the rights of property, the rights of contract, the rights of franchise? What is happening to the capital investment in America if it fears that it will be taken over by the Federal Government or some machinery that results in the same?

As I look at the sequence of events, we passed, over my objection, the TARP funding last fall, the $780 billion. Some of that went to bail out investment companies; some of the investment companies were secured holders of collateral in Chrysler and in General Motors. Some of those investment companies were leveraged out of their position to force a Chapter 11 result, which would have been a better result for the secured creditors if that had been the case. But they were leveraged out of their position because they received TARP money. One after another they dropped out until only about 5 percent of the secured creditors were left when they gave up their position and the shares that get proposed to be handed over to the unions rather than the secured creditors, which turns this collateral and property right upside down.

While that is going on we have franchise holders across this country that are told you are out of business and we handed your neighbor your assets of maybe $1 million or multiple millions of dollars in values of these franchises.

Now, the rights of property are essential to the vigor in the free enterprise system. And how this could unfold and we end up with companies that are run for the benefit of the people working for them rather than for the profit of the investors, it is anathema to me and my entire philosophy about how the economy in the United States of America should work.

If you want somebody's business, go buy it. If you don't like that, then start your own business and compete. That is what has made America great. And those are some of the things that I hope come out in the hearing today. And I know there will be differing viewpoints on the panel.

Mr. Chairman, I ask unanimous consent to enter into the record an objection filed in bankruptcy court in the Chrysler bankruptcy case. It is a group of Indiana State pension funds, and the objection is to the Obama administration's Chrysler bankruptcy plan. This brief I would ask unanimous consent to enter into the record.

And, without objection, I would also be willing to yield back the balance of my time.

Mr. CONYERS. Without objection, so ordered.

Mr. KING. I would yield back and I thank the Chairman.

Mr. CONYERS. Let me yield for an introduction: Mr. Daniel Maffei, our distinguished colleague from New York.

Mr. MAFFEI. Thank you, Mr. Chairman. I will not take more than a couple of minutes, but I do want to welcome a constituent of mine. He is one of the members of the panel, Randolph B. Henderson.

Mr. Chairman, Mr. Henderson is one of the many dealers in my district that had stories that concerned me and prompted me to get together with a number of my colleagues and write a letter to the White House Auto Task Force. I would ask unanimous consent that

that letter, along with my full opening statement, be submitted into the record.

Mr. CONYERS. Without objection, so ordered.

Mr. MAFFEI. Thank you very much.

Mr. Randolph Henderson, Randy Henderson, is the owner of Webster Chrysler Jeep in Webster, NY, which is just east of the city of Rochester. He has been selling Chryslers for 15 years, and in fact, in 1998, was named a five-star dealer.

Before opening up the dealership in Rochester, he worked his way up in retail business. He is also very active in the community with his charitable work supporting many nonprofit organizations such as Action for a Better Community.

Late last year Chrysler Financial froze Randy's floor line plan threatening his dealership. And now he is one of the 789 affected dealers who were given just 3 weeks in the middle of this recession to close their doors after being notified that Chrysler was terminating his franchise agreement.

So, Mr. Chairman, I do want to welcome particularly Mr. Henderson here to the Committee on the Judiciary.

Very, very grateful that you would take the time to come, along with the rest of the panel. And I appreciate your story since it is so important to what we are doing.

I yield back.

Mr. CONYERS. I thank the gentleman. We have a large panel, but it is a distinguished panel.

We welcome Professor David Skeel from the University of Pennsylvania Law School; the redoubtable Ms. Joan Claybrook, President Emeritus of Public Citizen; consumer advocate, author, activist Ralph Nader; Clarence Ditlow, Treasurer, Executive Director of the Center For Auto Safety; the Honorable Bruce Fein, a principal in the Lichfield Group; Mr. Andrew Grossman, Senior Legal Policy Analyst of the Heritage Foundation—welcome; Mr. Randy Henderson, President of Henderson Automotive Family of the National Automobile Dealers Association; President Damon Lester of the National Association of Minority Auto Dealers; and Professor Lynn LoPucki, the Security Pacific Bank Professor of Law, UCLA Law School.

Mr. CONYERS. We will stand in recess until Sheila Jackson Lee of Houston, Texas, returns. And she will then commence the hearing while the rest of us finish voting.

And so the Committee stands in recess.

[Recess.]

Ms. JACKSON LEE [presiding]. Thank you for your patience. We are going to reconvene the hearing on the ramifications of auto industry bankruptcies. We have just completed our opening statements because we are very interested in the very important testimony that is coming forward. Would you allow me to yield to Mr. Watt, if he wanted to have 1 minute.

Mr. WATT. I came to the hearing to hear the witnesses.

Ms. JACKSON LEE. Thank you.

He yields back.

Mr. Sherman.

Mr. SHERMAN. Obviously, saving the auto industry is very important. At the same time, we have to make sure that all creditors are treated according to the law.

I look forward to hearing how we can accomplish that and how we are not straining too far to help those creditors that these auto companies are going to need to do business with in the future, as opposed to those creditors who are not part of their future, but are part of their past.

I yield back.

Ms. JACKSON LEE. I thank the Chairman very much.

Mr. ISSA. Madam Chairman.

Ms. JACKSON LEE. I thank Mr. Sherman very much. And I hear another voice seeking to be recognized. We are now 1 minute because of the witnesses and because we want to proceed.

Mr. Issa of California.

Mr. ISSA. Madam Chair, I appreciate this opportunity to hear from such a panel of witnesses and to begin the process of reminding the entire world that we are a country of laws and that our bankruptcy laws and our contract sanctity matter. And I hope by the time we leave today that people far and wide will begin to realize that regardless of the actions of the executive branch, ultimately rule of law is paramount and must be obeyed.

And certainly Chrysler seeking bankruptcy and the protection has never been more protection than it is now.

I yield back.

Ms. JACKSON LEE. The gentleman has yielded back.

I understand Mr. Coble would like to be recognized for 1 minute.

Mr. COBLE. One minute. Thank you, Madam Chairman.

I am just concerned about what cost benefit is realized by the factories in reducing the number of franchise dealers, number one. And what savings were realized by eliminating Chrysler dealers with a 30-day notice, as opposed to a 1-year notice.

Those are two questions I would like to hear from.

I yield back, Madam Chairman.

Ms. JACKSON LEE. I thank the Chairman, former Chairman very much. And let me take my 1 minute very briefly.

I think the questions that have been raised by my colleagues are crucial; but I am here for one reason, and that is the lack of appreciation and understanding of the utilization of Chapter 11 and the negative impact and the seemingly pointed impact on automobile dealers and, in particular, minority automobile dealers. My concern is, how do you go into Chapter 11 and harm those who have been part of the infrastructure of your business? How do you go into Chapter 11, and before you even go in, you rid yourself of dealerships who have proven themselves to be financially worthy?

I find it to be unacceptable, and I believe that even in this late time, as these companies are in bankruptcy, there should be an immediate legislative fix that we hope can be signed by the President that specifically designates and points out the automobile dealers who were, in essence, creditworthy doing their work, and with a particular focus on the minority automobile dealers that I believe have been both offended and certainly not defended.

So I hope that there can be some guide even beyond the instructions that have been given by this government for Chrysler and

GM to fix itself. Why then is the burden falling heavy on the heads of those in our community that are doing business and doing it right every single day?

And I yield back.

We will now start with Mr. LoPucki and we would appreciate the presenting of your testimony for 5 minutes. And we would ask that you revise your statement, or summarize your statement and we would be willing to submit the statement into the record in its full completion. Thank you.

TESTIMONY OF LYNN M. LoPUCKI, PROFESSOR, SECURITY PACIFIC BANK PROFESSOR LAW, UCLA LAW SCHOOL

Mr. LoPUCKI. Thank you for the opportunity to be here.

The United States bankruptcy courts have a progressive disease. That disease is forum shopping and competition for big cases.

Chrysler is a Detroit company. So is General Motors. Chrysler has filed in New York, in the New York bankruptcy court, and GM will probably do the same.

In the 1980's, this phenomenon, forum—this is called forum shopping, filing away from where the company is located—in the 1980's, about 30 percent of large public companies forum shopped. The last time I addressed this subcommittee, in 2004, the number was 65 percent forum shopping, and today it is 75 percent. Seventy percent of all the larger public bankruptcies in the United States are filed now in just two courts—Delaware and New York.

The cases don't just come to those courts; the courts have to do something to attract the cases. The result is that Chapter 11 is evolving a bias, and it is a bias in favor of the people who control the choice of a court: the managers of the company, the professionals who represent the company, and whoever finances the bankruptcy. And here that is the United States.

So the United States is, in the Chrysler case, the beneficiary of this bias.

But every bias in favor of someone is a bias against someone else. And the people on the other side of this bias are the creditors, the suppliers, the employees, the landlords, the tax authorities, the dealers, the communities, literally hundreds of thousands of people. It is not a level playing field for the rest.

I want to just give you two examples of this evolution. Chapter 11 takes about a year to 2 years if you go through the ordinary procedure. Managers want to get out more quickly, though. They would like to be out in 30 to 60 days, and there is a procedure whereby someone can do that. It is a 363 sale, a sale of the company. It is an exception for unusual cases, the unusual case being where there is a buyer for this company, where the company is actually being sold.

Now, GM and Chrysler are presented in the form of a sale, but they are really reorganization plans. They shouldn't be approved by the court, but everybody knows that they will be approved. If the New York court did not approve the Chrysler case, the New York court would not get the GM case, it would go to Delaware instead. And once those two sales are approved, then a lot of future debtors are going to want to do the same thing—30 to 60-day bankruptcies, not the year to 2 years. And the courts will be unable to deny them because if one court says "no" to them, they will simply go to a different court.

Now, the second example is professional fees. They have been increasing at the rate of 10 percent per year over a period of 10 years. I think that is higher than the rate of increase in health care costs. The effect is to drain funds that could have been used in the reorganization, could have made the company stronger. If a court tries, though, to control the fees, again it has no effect, because the cases will simply go to a different court that doesn't control the fees.

So the system that has been set up by Congress for reviewing the fees has atrophied. The courts are simply ignoring the statutes and rules.

We have documented this in a report. It was released a few weeks ago, and it contains—it is linked to all of the evidence out of the court files that these laws are being broken.

The United States Trustee is the agency that monitors compliance with the fee control system. To date, they have had no comment on our report; and it is one of my hopes in coming here today that this Committee or some Member of this Committee will ask them for a comment.

Thank you very much.

Ms. JACKSON LEE. Thank you very much for your testimony.

[The prepared statement of Mr. LoPucki follows:]

PREPARED STATEMENT OF LYNN M. LOPUCKI

U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

Hearing on
Ramifications of Auto Industry Bankruptcies

Prepared testimony of Lynn M. LoPucki
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Thursday, May 21, 2009
12:00 pm
Room 2141 Rayburn Office Building

Chrysler Corporation has already filed under Chapter 11 of the bankruptcy code and General Motors is widely expected to do so prior to June 1. The immediate purpose of Chapter 11 is to save financially troubled companies and by doing so to save jobs. The larger purpose is to assist in deleveraging companies in a fair and orderly manner in times of financial crisis. A financial crisis of the nature the country now faces is what Chapter 11 was designed to address. Yet the prevailing belief, both inside and outside government, seems to be that Chapter 11 cannot be relied upon. It is too complex, too slow, too expensive, and sends too negative a message about the filing company. As a result, both Chrysler and GM are attempting to use Chapter 11 in a manner for which it was not designed.

Chapter 11 Procedure

The ordinary course of a Chapter 11 case is for the company to file a petition with the appropriate bankruptcy court, propose a comprehensive plan of reorganizations, make extensive disclosure to creditors and other stakeholders regarding the company's financial condition, allow the creditors to vote on the plan, and then seek confirmation of the plan by the court. If management seeks to modify or reject a collective bargaining agreement, the bankruptcy code requires management to bargain in good faith – after filing the case. If no agreement is reached, the company is entitled to reject agreement if rejection is necessary to complete the reorganization. The Chapter 11 plan process ordinarily takes from one to two years, and in some cases can take longer. In a traditional Chapter 11, the company remains "in bankruptcy" during that entire time.

Much of the effort and the controversy surrounding the GM and Chrysler bankruptcies result from the efforts of GM and the United States Treasury to shorten the time that the companies would be under the jurisdiction of the bankruptcy court. GM and Chrysler have strategies that will enable both to emerge within thirty to sixty days of the day each entered bankruptcy. In both cases, the strategy is to sell the company – essentially to the government – pursuant to section 363 of the bankruptcy code.

The intended consequences of the bankruptcies are (1) to keep both companies operating, at least temporarily, (2) to keep a substantial portion of the companies' workforces employed, (3) to avoid a domino effect in which the collapse of GM and Chrysler might take down those companies suppliers and dealers, (4) to minimize the costs to the government of achieving these goals. I believe that the GM-Chrysler-government bankruptcy strategy will succeed in achieving these goals.

There are, nevertheless, problems with the manner in which the bankruptcy system is functioning in these cases.

1. Participation in the proceedings. Chrysler and GM are Detroit companies. Their suppliers and employees are concentrated in the Detroit area. Yet the Chrysler case was, and the GM case is expected to be, filed in New York. As a result, the opportunity for many suppliers, employees and members of affected communities to participate in the cases is sharply limited.

The bankruptcy venue statute, 11 U.S.C. §1408 allows large, public companies to choose the courts in which they file. Forum shopping – choosing a court for one's own advantage – is rampant in large bankruptcy cases. At minimum, it creates the appearance of impropriety. About seventy-five percent of all large, public companies filing bankruptcy in the United States since 2006 have filed in a bankruptcy court other than the one with jurisdiction at the company's headquarters. About seventy percent of all large, public company filings are made in just two bankruptcy courts: Delaware and New York.

The drafters of the current rules intended that if a company filed in a legally permissible, but less than ideal venue, the court should transfer it to the ideal venue. 11 U.S.C. § 1412. That remedy has not be effective. No bankruptcy court has ever transferred a billion-dollar-or-more case, except at the request of the company that initially filed it. Instead, some bankruptcy courts are competing to attract cases.

2. Bias in favor of managers, professionals, and DIP lenders. The managers control the choice of a bankruptcy court. The company's bankruptcy professionals influence that choice, as do the lenders who finance the bankruptcies (the "DIP lenders"). In the Chrysler case, the government is the DIP lender and it, rather than Chrysler, was the first to announce the choice of the New York court. Courts attract cases because they appeal to these three parties (the "case placers"). One result is the widespread perception that the courts most successful in attracting cases are biased in favor of the case placers.

3. The truncation of the Chrysler and GM bankruptcies. The use GM and Chrysler are making of bankruptcy code section 363 is legally questionable. A company that has a good business justification for selling all of its assets without going through the plan process outlined above is permitted by law to do so. But if the transaction is not really a sale or effects a "sub rosa plan" the transaction is improper and should not be approved. Chrysler and GM are in form selling their companies, but in economic reality are not. Fiat is not buying Chrysler (it pays nothing at all in the transaction) and the government is not buying GM (it is reorganizing GM by turning creditors into shareholders). These are sales with no real, arms-length buyers to negotiate terms and fix prices, and the transactions are occurring in economic conditions unlikely to produce competing bids.

4. Future reorganizations. Most reorganizing companies suffer from lengthy stays in Chapter 11. They would prefer to have what Chrysler and GM are having – buyer-less 363 sales that will permit them to exit bankruptcy in 30-60 days. Once the Chrysler and GM sales have been approved, other bankrupt companies will strategize to achieve the same result. For example, a bankrupt company with no buyer may propose to sell to a newly created entity in return for all of the stock of that entity. A bankruptcy court that approved such a sale, would immediately attract large numbers of large cases.

Such sales are sufficiently common in United Kingdom bankruptcies to have a name – "phoenix sales." They may, if properly regulated, represent a better way to reorganize companies. The danger, however, is that they will be implemented by clever lawyers and competing bankruptcy courts without regulation or even appropriate examination. In the current forum-shopping environment, any importantly pro-management practice that is accepted in even a single bankruptcy court, can quickly become the norm.

5. The termination of auto dealerships. Both Chrysler and GM intend to terminate substantial numbers of their dealers. The effect of terminating a dealership while in bankruptcy is the same as the effect of terminating it immediately prior to bankruptcy: the company becomes liable to the dealership for money damages. But if the company has filed a bankruptcy case, the dealers claims for those damages share pro-rata with other general creditors. In Chrysler, general creditors will receive no payout at all. In GM, general creditors will probably receive only a few cents on the dollar. Thus, the effect of bankruptcy is to pretty much nullify the dealers' contract rights.

The bankruptcy court is likely to allow Chrysler to terminate whatever dealers it may choose. Terminated dealerships are likely to close, thus eliminating the jobs of their employees. The Chrysler National Dealer Council, a trade organization representing Chrysler dealers, has filed a statement with the bankruptcy court in opposition to that grant of authority. Their argument is essentially that even weak dealers are not a burden on Chrysler because they pay their own way. The issue they raise, like so many others, is within the discretion of the bankruptcy court, and so possibly compromised by competition-induced, pro-management bias. I have not conducted the study necessary to know whether the Council is correct, but it is certainly something that the bankruptcy court, Chrysler, and the government should consider if they have not done so already.

6. Effect on future lending. Some have expressed concern that the harsh treatment of the secured lenders in Chrysler and the unsecured bondholders in GM will affect willingness to extend credit to large, public companies in the future. At least in the case of the secured lenders, I agree that the treatment was harsh, but I am skeptical that the Chrysler and GM cases alone will have much effect on future willingness to lend. These are extraordinary times. The government is rescuing GM and Chrysler because they are "too big to fail." Whether the harsh treatment has or will result in an actual, substantial reduction in the creditors' recoveries is not clear. I think these events should, and will, be regarded as unique. If, however, future cases follow the phoenix model without effective regulation, I believe that creditors will have cause to, and will, react by constricting their lending.

7. Asbestos and products liability litigation. Those with products liability claims against GM and Chrysler are general, unsecured creditors. If they win judgments, they, like other unsecured creditors, will be paid only a few cents on the dollar (GM) or nothing at all (Chrysler) in the bankruptcy cases. If GM or Chrysler have liability insurance, they may be able to achieve recoveries from that source.

8. Professional fees. Bankruptcy professional fees are a continuing problem. The cost of reorganizing a large public company rose by 10% per year from 1998 through 2007. Because those who employ the professionals are spending other peoples' money, bankruptcy law requires that the professionals keep time records, apply for their fees, and receive only the amounts awarded by the courts. My colleague, Joseph Doherty, and I recently released a study, *Routine Illegality in Bankruptcy Court Fee Practices*, showing that in large, public company cases, the bankruptcy courts have adopted numerous practices that are in clear violation of the bankruptcy code and/or rules. These practices allow some fees to be paid without application or award, allow most fees to be paid prior to application, and allow applications that do not make statutorily required disclosures. The study and supporting evidence is available from this UCLA website. http://www.law.ucla.edu/erg/pubs The study will be published in the American Bankruptcy Law Journal in August.

The United States Trustee, a division of the Department of Justice, is the government agency is charged with monitoring and commenting on fee applications. It has, to date, had no comment on the study. I hope that this subcommittee, or a member, will request comment from the United States Trustee.

Ms. JACKSON LEE. We will now hear from Mr. Lester. Mr. Lester, I believe in your representation of the National Association of Minority Automobile Dealers you are joined by a number of members, which include Carl Barnett of Houston, Sam Wright, Alfred Glover, Warren Allen, Alan Moore, officers or principals in the organization, and many others. So we thank you for your presence. You, too, may submit your statement for the record and summarize your statement.

TESTIMONY OF DAMON LESTER, PRESIDENT, NATIONAL ASSOCIATION OF MINORITY AUTO DEALERS

Mr. LESTER. Thank you, Madam Chairwoman.

Again, my name is Damon Lester. I am the President of NAMAD, the National Association of Minority Automobile Dealers. NAMAD represents ethnic minority automobile dealers in the United States which—currently there are a total of 19,000 new automobile dealers of which less than 1,200 or 5 percent are owned by ethnic minority dealers in the United States.

Since the auto bailout hearing last year and with the submission of both Chrysler and General Motors viability plans, it has been well documented by these manufacturers to either rationalize or reduce their dealer body by consolidation and brand elimination.

In fact, dealerships are independently owned and independently financed franchises. They are the middleman between the manufacturer and the consumer, they represent the only distribution channel for manufacturer products, and they generate revenue for the manufacturers and are not an expense line item to the manufacturers. So using the excuse for consolidating and eliminating brands as a reason to save a manufacturer money is simply not true.

Today's small dealerships throughout the U.S. are in a crisis and we need help now. The help needed is largely due to the lack of consumer confidence, the lack of confidence for retail credit, the lack of lender confidence to provide loans to automobile dealers for both working capital and floor plan loans even with government-backed loan guarantees. In fact, since our government provided working capital loans to automobile manufacturers, fair consideration should have also been given and needs to be given now to automobile dealerships via directly from the SBA, similar to what was done during the Carter administration in 1980.

As the Chrysler bankruptcy filing and its announcement to terminate 789 dealerships in which these stores must close their doors by June 9, 2009, will result in over 40,000 direct dealership job losses, a projected loss of over $10 billion in local and State economic dealership contributions and employees, taxes, customer services, suppliers and charities, the bankruptcy filings will save Wall Street, but will tear down Main Street as many of these displaced employees do not have another option to seek employment quickly.

For minority dealers, our representation has always been disproportionate compared to the entire dealer network. At our peak we have reached a maximum of over 2,000 dealerships in the United States, and today we are less than 1,200 with another reduction due to the Chrysler and General Motors terminations. This reduction in our dealer body will and has begun the elimination of wealth in the minority communities.

The bankruptcy filing will allow Chrysler to evade the dealer franchise laws in various States. More importantly, the Federal statute intended to protect dealers in the Automobile Dealers Day in Court Act is negatively implicated by the recent filings. It is because of the filing that allows Chrysler and any other manufacturer that may file for bankruptcy to hide behind the Bankruptcy Code and the bankruptcy filing in order to terminate the dealer's franchise agreement and reduce its dealer body without providing reasonable and just compensation.

Therefore, we request that Congress consider relieving the individual small dealers from personal liability as guarantors on floor plan and term loans. In addition, we believe that the small dealers should be allowed to keep the sales proceeds from the parts inventory, special tools and fixed assets to provide these dealers with a fresh start. Any financial institution that received TARP money, as well as captive finance companies such as Chrysler Financial, should take back their inventory and sell it themselves.

Thank you.

Ms. JACKSON LEE. Let me thank you very much Mr. Lester for your testimony.

[The prepared statement of Mr. Lester follows:]

PREPARED STATEMENT OF DAMON LESTER

Testimony of Damon Lester, President

National Association of Minority Automobile Dealers (NAMAD)

Before the House Judiciary Committee

Hearing on

May 21, 2009

Thank you Chairman Conyers and members of the Committee

I want to thank you for inviting me to speak on behalf of the small new automobile dealers in the United States.

My name is Damon Lester, and I am the President of the National Association of Minority Automobile Dealers (NAMAD). NAMAD represents ethnic minority automobile dealers in the United States. Currently, there a total of 19,000 new automobile dealerships of which less than 1,200 or 5% are owned by ethnic minorities.

I am here today to not simply to talk about ethnic minority automobile dealers but the owners of all small dealerships in the country. Since the Auto Bailout hearings last year and with the submission of both Chrysler and General Motors viability plans, it has been well documented by these manufacturers to either rationalize or reduce its dealer body by consolidation and brand elimination. For the dealer body that I represent and my counterparts at NADA and AIADA we have long fought the need that rationalizing and reducing the dealer body has absolutely nothing to do with the viability of the manufacturer. In fact, dealerships:

- are independently owned and independently financed franchises
- are the middle man between the manufacturer and the consumer
- represent the only distribution channel for manufacturer products
- generate income to manufacturers, not expense line items to manufacturers

So using the excuse for consolidating and eliminating brands, as a reason to save a manufacturer money is not true.

Today, small dealerships throughout the United States are in a crisis and need help now. The help needed is largely due to the lack of consumer confidence, lack of confidence for retail credit, lack of lender confidence to provide loans to automobile dealers for both working capital and floor plan loans even with government backed guarantees. Small dealerships are not in a crisis because they are an expenditure to the manufacturer. In fact, since our government provided working capital loans to automobile manufacturers, fair consideration should have also be given and needs to be given now to automobile dealerships to receive working capital loans directly from our government via the SBA. As the Chrysler bankruptcy filing and its announcement to terminate 789 dealerships in which these stores must close their doors by June 9, 2009; will result in over

40,000 direct dealership job losses; a projected loss of over $10 billion in local and state economic dealership contributions in employees, taxes, customer services, suppliers, and charities. The bankruptcy filings will save Wall Street but tear down Main Street, as most of the displaced employees will not be able to find other employment quickly

For minority dealers our representation has always been disproportionate compared to the entire dealer network, at our peak we've reached a maximum of over 2,000 dealerships in the U.S. and today we are less than 1,200 with another reduction due to the Chrysler and General Motors terminations. This reduction in our dealer body will and has began the elimination of wealth in minority communities.

The Bankruptcy filing will allow Chrysler to evade the dealer franchise laws in the various states. More importantly, the federal statute intended to protect dealers, in the Automobile Dealers Day in Court Act (ADDCA) is negatively implicated by the recent filing. It is because of the filing allows Chrysler and any other manufacturer that may file for bankruptcy to hide behind the bankruptcy code and the bankruptcy filing in order to terminate the dealers franchise agreements and reduce its dealer body without providing reasonable and just compensation.

Therefore, we request that Congress consider relieving the individual small dealers from personal liability as guarantors on floor plan and term loans in addition we believe that the small dealers should be allowed to keep the sales proceeds from the parts inventory, special tools, and fixed assets to provide these dealers with a fresh start. Any financial institution that received TARP money as well as Captive Finance companies such as Chrysler Financial take back the inventory and sell it themselves.

Ms. JACKSON LEE. And, Mr. Henderson, as you address the Committee, allow me to acknowledge that I believe accompanying you today is Mr. Henry Ware, owner of the South Haven Pontiac-Buick-GMC in South Haven, Mississippi, and the President of the General Motors Minority Dealers Association. We welcome him to the hearing. Would he raise his hand?

Thank you very much. I just greeted you. Thank you very much.

Mr. Henderson.

TESTIMONY OF RANDOLPH B. HENDERSON, JR., PRESIDENT, HENDERSON AUTOMOTIVE FAMILY, NATIONAL AUTOMOBILE DEALERS ASSOCIATION

Mr. HENDERSON. Thank you Madam Chair. I am here today as a member of the National Automobile Dealers Association, the Chrysler Minority Dealers Association, the National Association of Minority Automobile Dealers, as well as——

Ms. JACKSON LEE. Mr. Henderson, would you please pull the mic closer and make sure your green light is on.

Mr. HENDERSON. I am here today as a member of the National Automobile Dealers Association, the National Association of Minority Automobile Dealers, the Chrysler Minority Dealers Association; and as you indicated, I am accompanied by Mr. Ware, who is President of the General Motors Minority Dealers Association.

I am also here to present the perspective of many of my fellow Chrysler and General Motors dealers across the Nation.

We want to inform you of, one, the devastating impact of the Chrysler Corporation's bankruptcy and possible GM bankruptcy on the dealership body; two, the lack of transparency and the accountability in the taking of our properties and livelihood; and three, the disparate impact of the proposed dealership reductions on the minority dealer community and the communities in which they serve.

I have been in the automotive retail area for 15 years—for 27 years, the last 15 of which as a Chrysler corporation dealer, working my way up through the ranks and at one time employing over 130 people between three dealerships and generating annual revenues up to $85 million.

My wife and I have donated hundreds of thousands of dollars over the years to our churches and community and have been an asset to Chrysler Corporation. However, the events that have developed around us recently have created an economic environment that is causing us financial ruin. Chrysler has slated my dealership franchise agreement and hundreds of others for termination through the rejection mechanism of the bankruptcy process.

Over the last year, natural disasters, high gas prices and a drop in consumer spending made selling Chrysler vehicles very difficult. In spite of these factors, Chrysler told us we needed to order unneeded and unwanted vehicles to help to keep the plants going if we wanted to see the company survive. These very vehicles on June 9th could become a personal liability to many dealers.

As you know, Chrysler filed for bankruptcy protection on August 30, 2009. There was a great deal of uncertainty among the dealer body because of no clear criteria regarding who would remain and who would not. On May 14th, Chrysler announced a list of 789 dealerships slated for termination. These businesses are slated for rejection and closure as Chrysler, Jeep or Dodge dealers on June

9th, and it creates challenges to some dealers as it relates to the Warren Act.

Once our names were announced, we were inundated by the media, our employees went into shock and dealers saw 10, 30, 50 years of hard work go down the drain; and the hardworking men and women that we employ, through no fault of their own, face the prospect of joblessness and inability to support their families.

There has still been no clarity or clear criteria presented to us. There are dealers with identical profiles on both lists. There is no accountability, transparency or equity in the process by which the termination decisions are being made. Chrysler is not buying back vehicles, parts or special tools, and there is no right to appeal this decision within the company, yet the company has received billions of dollars in Federal loans and is currently receiving Federal taxpayer dollars.

Because of Chrysler's action, Chrysler Financial has frozen many of our accounts. I am sad to say that many dealers are unable to even afford to retain individual legal representation to defend ourselves in this very expensive bankruptcy procedure. Deadlines to file individual objections to being rejected are approaching next week.

For the 2,300 dealers on the assumed list, their survival is no less certain. They also could be moved to the rejection list.

For minority dealers, the prospect of Chrysler's bankruptcy are tragic. Less than 5 percent of Chrysler's dealerships are minority owned, yet the Census Bureau reported last week that minorities make up 34 percent of the U.S. population. Out of Chrysler's 3,181 dealerships, minority business people own only 158, yet Chrysler, in the first phase of its eliminations, plans to reject and thereby eliminate 24 percent of those minority dealers. By ethnicity, that is a 15 percent reduction for Hispanic dealers, 22 percent for Native American, 27 percent for African American and 32 percent for Asian American dealers. The statistical evidence of disparate impact is hard to ignore.

Similarly, the projected impact on the GM minority dealers is catastrophic as well. Out of General Motors' 6,000 dealerships only 298 are owned by minority business dealers, representing less than 5 percent of the entire GM dealer network. It is estimated that 57 percent of the GM minority dealer body will be impacted by the Pontiac brand eliminations and the potential sale and spin-off of Saturn, Saab and Hummer franchises.

The statistical evidence of disparate impact is hard to ignore. Moreover, given that Chrysler and General Motors are utilizing Federal funds, we believe there should be reasonable representation of minorities in this dealer body.

In conclusion, I regret that I am here today on behalf of thousands of majority and minority business owners who face the prospect of financial ruin and the taking of their property without due process and fair compensation. This bankruptcy should not isolate Chrysler from accountability to this Judiciary Committee, dealers or consumers.

I am proud to live in a country where I can call these hardworking small and large business people my friends and colleagues.

We appeal to the leaders of this great Nation for direct intervention and assistance.

Thank you, Ms. Chairman.

Ms. JACKSON LEE. Thank you very much, Mr. Henderson, for, as has been by the previous witnesses, very astute testimony.

[The prepared statement of Mr. Henderson follows:]

PREPARED STATEMENT OF RANDOLPH B. HENDERSON, JR.

Good morning Mr. Chairman, Congressman Smith, and members of the committee.

I am here today at your invitation with Mr. Henry Ware, President of the General Motors Minority Dealers Association, and on behalf of the National Automobile Dealers Association, the Chrysler Minority Dealers Association and the National Association of Minority Automobile Dealers to present the perspective of many of our fellow Chrysler and General Motors Dealers across this nation. We want to inform you of 1) the devastating impact of the Chrysler Corporation's bankruptcy and possible GM bankruptcy on the dealership body; 2) the lack of transparency and accountability in the taking of our properties and livelihood; and 3) the disparate impact of the proposed dealership reductions on the minority dealer community.

I am a Chrysler Jeep dealer in Webster, NY. Like many dealers, I grew up in the automobile business, started at the bottom by washing, gassing, and repairing cars, and then moved into the retail area for 27 years, the last 15 of which as a Chrysler Corporation dealer. I have enjoyed the opportunity to strive for the American dream. Like many dealers, I have worked my way up through the ranks of the dealership world, competing on a national level, winning numerous awards, and employing over 130 people at one time between three dealerships and generating annual revenues of up to 85 million dollars. My wife and I have donated hundreds of thousands over the years to our churches and community and have been an asset to the Chrysler Corporation. However, the events that have developed around us recently, have created an economic environment where preventable circumstances are causing financial ruin. Chrysler has slated my dealership franchise agreement and hundreds of others for termination through the rejection mechanism of the bankruptcy process.

This situation was not created overnight. It started with Chrysler strongly encouraging it's dealers to sell or purchase additional franchises as part of its consolidation plan—"the Genesis Plan" and in many cases to also build new upgraded and expensive facilities. At a time when many challenges were arising in the market, lenders refused to assist many of us with our working capital needs. The financial sector froze and access to capital evaporated. In addition, Chrysler pressured dealers repeatedly during 2007 and 2008 to order additional new vehicles for our inventory to help the company even though we were unable to move the vehicles currently on our lots. Natural disasters, high gas prices and a drop in consumer spending because they were facing their own economic challenges, made selling Chrysler vehicles very difficult.

Nonetheless, Chrysler told us we needed to help keep the plants going if we wanted to see the company survive. They sought federal financial assistance but did not provide any of those assistance funds to dealers despite the fact that at their request, we assisted them side by side in visits to capital hill to discuss the need for auto industry funding. Towards the end of the year, Chrysler Financial froze my floor plan lines in spite of the fact that we were and always had been current on our capital line, floor line, and mortgage payments to them and also denied us access to our working capital account deposits. Mine is not an isolated story, it has been repeated many times in the last several months all over the country. Chrysler has systematically used low working capital or low profits as the reason to shut down many dealers.

CHRYSLER BANKRUPTCY

Then came the Bankruptcy—Chrysler filed bankruptcy on April 30, 2009. There was a great deal of uncertainty among the dealer body because of no clear criteria regarding who would remain and who would not. On May 14, 2009, Chrysler announced the list of 789 dealerships slated for termination. These businesses are slated for rejection and closure as Chrysler, Jeep, or Dodge franchises on June 9th.

Once our names were announced, we were inundated by the media, our employees went into shock, and dealers saw 10, 20, 40, 50 years of work go down the drain, the value of our assets disappeared and the hardworking men and women we employ, who through no fault of their own, faced the prospect of joblessness and the inability to support their families. Our sales have dropped or in some cases completely stopped. Customers are staying away because of the uncertainty regarding both the future of Chrysler and their local dealer.

Why were we on the list? There has still been no clarity or clear criteria presented to us. There are dealers with identical profiles on both lists. There is no accountability, transparency or equity in the process by which the termination decisions are being made. Chrysler is not buying back vehicles, parts, or special tools and there is no right to appeal this decision with the company. Yet the company has received billions of dollars in federal loans and is currently receiving federal taxpayer dollars. What do the dealers receive? A few cents on the dollar, maybe. We have put our life savings into our businesses. Because of Chrysler's actions and the economy, we are cash poor and Chrysler Financial has frozen many of our accounts. I am sad to say that many dealers are unable to even afford to retain individual legal representation to defend ourselves in this very expensive bankruptcy proceeding. Deadlines to file individual objections to being rejected are approaching next week, but what can we do?

For the 2300 dealers on the Assumed list, their survival is no less certain. They could be moved to the rejection list at Chrysler's whim. Even if they stay on the assumed list, many cannot afford the extensive facility upgrades and the working capital that Chrysler requires. Chrysler knows that with no access to capital in the private sector or direct aid from the federal government, these dealers will not be able to continue to operate in the current environment. As a dealer in Texas who is on the assumed list says, "whether you will go away by rejection or attrition, you still go away."

MINORITY DEALERS

For minority dealers, the prospects of Chrysler's bankruptcy are tragic. Less than 5% of Chrysler's dealerships are minority owned. Yet the Census Bureau reported last week that minorities make up 34% of the U.S. Population. We drive cars, we help build the cars and we service the cars. We contribute to our communities and minority dealerships employ 50 people on average, both skilled and unskilled workers.

Out of Chrysler's 3,181 dealerships, minority business people own only 158. Yet Chrysler, in the first phase of eliminations, plans to reject and thereby eliminate 24% of those minority dealers. By ethnicity, that is a 15% reduction for Hispanic dealers, 22% reduction for Native American dealers, 27% reduction for African American and 32% reduction for Asian American dealers. The statistical evidence of disparate impact is hard to ignore.

Similarly, the projected impact on the GM minority dealers is catastrophic as well. Out of General Motors' 6,000 dealerships, only 298 are owned by minority business people, representing a little less than 5% of the entire GM dealer network. While the actual number of ethnic minority dealers who received a franchise termination letter from General Motors last Friday is not yet confirmed, it is believed that a disproportionate number of those 1,124 dealers were ethnic minorities. Furthermore, it is estimated that 57% of the minority dealer body will be impacted by the Pontiac brand eliminations and potential sale or spin-off of the Saturn, Saab and Hummer franchises.

The statistical evidence of disparate impact is hard to ignore. Moreover, given that Chrysler and General Motors are utilizing federal funds, there should be reasonable representation of minorities in its dealer body.

CONCLUSION

In Conclusion, I regret that I am here today on behalf of thousands of majority and minority business owners who face the prospect of financial ruin and the taking of their property without due process and fair compensation. This bankruptcy should not isolate Chrysler from accountability to this Judiciary Committee, dealers or consumers. I am proud to live in a country where I can call these hardworking, small and large business people my friends and colleagues. We appeal to the leaders of this great nation for direct intervention and assistance. Thank you, Mr. Chairman and God Bless.

Ms. JACKSON LEE. Mr. Andrew Grossman, you are recognized for 5 minutes. And you may summarize your statement and submit your entire statement into the record.

Mr. Grossman.

TESTIMONY OF ANDREW M. GROSSMAN, SENIOR LEGAL POLICY ANALYST, THE HERITAGE FOUNDATION

Mr. GROSSMAN. Good afternoon, and thank you for the opportunity to testify today.

My name is Andrew Grossman, and I am Senior Legal Policy Analyst for The Heritage Foundation. My research there focuses on law and finance, economic regulation and the proper role of the government in structuring markets, and I will begin this hearing with the use of bankruptcy in the automotive sector, a subject on which I have published and spoken extensively.

The testimony this afternoon concerns the very serious and negative consequences of the Obama administration scheme to evade the requirements of the bankruptcy system and reward a labor union at the expense of senior creditors.

I have three points:

First, this approach sacrifices the pragmatic discipline of a standard Chapter 11 reorganization, leaving both Chrysler and General Motors at a disadvantage;

Second, the President besets risk-gutting bankruptcy law and facilitating corporate looting and freeze-outs; and

Third, trampling senior lenders' contractual and property rights undermines the rule of law and threatens to do great damage to our economy.

Contrary to the Administration's claims, these cases are not real bankruptcies. Instead, the Administration is abusing the Bankruptcy Code to grease the wheels of a massive automaker bailout. When this sort of sham transaction has been attempted by the private sector, the results have been close scrutiny by regulators and even prosecutions. Think Enron.

My first point is that the scheming is counterproductive. Chapter 11, with its strict focus on maximizing the value of a business' assets, is designed to address the kind of deep-seated, long-term problems that have plagued the automakers. Replacing Chapter 11 with a political process will impede the reforms that these companies need to be competitive. There is already evidence of this.

For example, both Chrysler and General Motors have announced cuts to their dealer networks, an essential step. But the cuts are nowhere near as deep as industry veterans say are necessary, and this is probably due to politics. The result is that neither automaker will come close to achieving the efficiencies of Toyota's world-class distribution network.

Another example is work rules. These Byzantine arrangements govern nearly every facet of automobile production at a major cost in terms of flexibility and efficiency. In its deal with Chrysler, the UAW did agree to simplify them a bit, a step in the right direction, but again, the gains are nowhere near what might have been had in a regular Chapter 11 case.

This leaves Chrysler at a severe competitive disadvantage, and General Motors will probably suffer the same fate. The bottom line is that a regular Chapter 11 reorganization would have had better results than the Administration's bailout scheme.

My second point is that the precedent set by the scheme puts our bankruptcy system at risk. Chapter 11, as crafted by Congress, works well to turn around troubled businesses. Research by Elizabeth Warren and others shows success rates of up to 72 percent for companies that were once on the verge of failure.

The system is threatened when it is abused to steal from one party to give to another. That is exactly what happened in the case of Chrysler. Secured creditors holding super-safe debt were told to take a hike so that their assets, with some additional from the government added in, could be handed over to union control.

This precedent will facilitate the looting of companies by insiders and the freezing out of investors. It is that dangerous.

My third point is that trampling senior lenders' contractual and property rights undermines the rule of law and threatens grave damage to our economy. The rule of law means clear, generally applicable laws applied consistently by which individuals can organize their affairs. As James Madison explained in The Federalist, "The rule of law is a prerequisite to due process and a protection against the arbitrary exercise of power," in other words, tyranny. Tossing aside well-established rights merely because they are inconvenient or expensive to the government strikes directly at the rule of law, and it will have consequences.

Several are obvious. The automakers, of course, will have limited access to financial markets for years to come. When they are able to borrow, it will be expensive and on unfavorable terms. This will impede their recovery.

More generally, unionizing industries will suffer a major blow. As one hedge fund manager explained this week, the obvious lesson of this episode is, don't lend money to a company with big legacy liabilities. That means unions. The automaker bailout will cost jobs in unionized industries.

Finally, lending across the entire economy could be affected. Investor Warren Buffett has expressed this fear. Tinkering with the rule of law does not come cheap.

I conclude with a recommendation. This episode of lawlessness began in Congress with the legislation that established the Troubled Asset Relief Program, or TARP, which has become the Administration's slush fund. Congress also has the power to put an end to these abuses by blocking future bailouts and beginning the slow process of unwinding those already made.

Thank you for the opportunity to appear before you today. I stand ready to answer your questions.

Ms. JACKSON LEE. Thank you very much, Mr. Grossman.

[The prepared statement of Mr. Grossman follows:]

PREPARED STATEMENT OF ANDREW M. GROSSMAN

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CONGRESSIONAL TESTIMONY

Bailouts, Abusive Bankruptcies, And the Rule of Law

Testimony before
Judiciary Committee
United States House

May 21, 2009

Andrew M. Grossman
Senior Legal Policy Analyst
The Heritage Foundation

Testimony of Andrew M. Grossman, Senior Legal Policy Analyst, The Heritage Foundation

The Obama Administration is abusing bankruptcy law to benefit a favored constituency, the United Auto Workers union. This threatens serious consequences:

- Without the discipline of a real bankruptcy reorganization, General Motors and Chrysler may not be able to achieve the reforms that they need to survive and prosper.
- The restructuring plans announced by both automakers are not bold enough. To gain a competitive edge, they will have to cut more dealers loose, put an end to the Byzantine system of work rules that stifles flexibility, and in general, make deeper cuts.
- Selling Chrysler to a shell corporation for the purpose of divesting lenders of their rights is a stunning abuse of U.S. bankruptcy laws that threatens to upend this important resource for troubled companies.
- The "rule of law" means clear, generally applicable laws by which individuals can organize their affairs and which are applied consistently, without respect to status. By favoring a political constituency over individuals with actual legal rights, the Obama Administration has violated a fundamental principle of our constitutional government.
- Striking down contractual rights arbitrarily, merely because they are inconvenient or expensive to the government, raises the costs of making and enforcing agreements across the economy.
- Certain industries and businesses will suffer disproportionately: the automobile industry, heavily unionized industries, corporations that are faltering or undergoing reorganization, and already weakened financial institutions.
- This episode of lawlessness began with legislation, the Emergency Economic Stabilization Act, that many at the time recognized as an illegally unbounded delegation of power from the legislative to the executive branch. It was that act which created the TARP that is now the Administration's slush fund for bailing out its allies and otherwise upsetting economic expectations. That outcome should be no surprise; unbridled discretion breeds unchecked power.
- The bankruptcies of Chrysler and soon General Motors are a microcosm of the lawlessness that threatens our freedom and our prosperity. With its legislative power, Congress can put an end to the bailouts and begin the slow process of unwinding those that entangle us today.

My name is Andrew Grossman. I am Senior Legal Policy Analyst at The Heritage Foundation. The views I express in this testimony are my own, and should not be construed as representing any official position of The Heritage Foundation.

My testimony this afternoon concerns the impact that the abuse of the bankruptcy system to bail out Chrysler and soon General Motors will have on the automobile industry, the rule of law, and the economy. This is an important issue, and I applaud the Committee for taking the time to address it and consider my comments.

Members of this Committee should focus on three points. First, that the U.S. auto industry itself has been harmed by the initiatives of the Bush and Obama Administrations that were meant to save it. Second, that the Obama Administration's abuse of bankruptcy to carry out its initiatives will serve as a precedent for others to sidestep the requirements of America's Chapter 11 reorganization process. The third point is that in rescuing Chrysler and General Motors, the federal government has trampled the rule of law in ways that will prolong our current recession unless Congress acts to rein in the excesses of the Administration's interventionist policies.

The auto industry, like AIG and like many of the banks now scrambling to extract themselves from the government's Troubled Asset Relief Program (TARP), may have been better off had the federal government followed the will of Congress and declined to intervene in their troubles. Though this counterfactual is difficult to prove—we will, of course, never know what would have happened in some alternative scenario—the major issues left unaddressed, or only partially addressed, in the government's reorganization strategy point to this conclusion. So, too, do a surprising number of indicators.

The Detroit-centered auto industry's collapse was the result of deep-seated structural problems that have been decades in the making—not just the recent drop-off in sales. To understand the extent of these problems, some history is required.

The combined market share of the Big Three U.S. automakers has been in decline for more than 35 years, since the oil crisis provided an opening for more fuel-efficient Japanese cars. In the 1980s, with the price of oil down, foreign carmakers gained market share on the strength of their quality, reliability, and prices, and quickly muscled in to the profitable luxury segment of the market. More recently, foreign automakers simply out-innovated their American competitors, investing heavily in smart, fuel-efficient vehicles that Detroit is now struggling to duplicate.

Those failures in management and leadership have been compounded by bad operational and governmental policy. Years of protectionism, such as import restrictions, complex fleet requirements, and regulations that raise costs for foreign producers, shielded the Big Three from competition in vital markets but allowed their creative juices to evaporate. Meanwhile, fat years and government interference allowed the automakers and their workers to put off restructuring their labor agreements, even as foreign competitors opened U.S. plants producing cars with fewer workers working at less cost and achieving greater quality. By 2008, these "legacy costs" dominated the U.S. automakers' balance sheets, and they spent $20 to $30 more per hour on labor than their competitors, even following minor concessions by the unions, and, due to inflexible work rules, continued to require more hours to produce a vehicle. Well aware of the writing on the wall, the Big Three and the United Auto Workers union demonstrated their cynicism in signing on to untenable labor agreements, under which the companies lose money on most small car sales, under the assumption that the taxpayers will eventually shoulder much of the burden.

The Big Three are also burdened with obsolete and expensive business structures. All are top-heavy with management and bureaucracy, compared to other manufacturing industries. They are also bogged down by too many nameplates that, due to state franchising laws, cannot easily be folded into other brands. As of December, General Motors manufactured and marketed automobiles under eight brands in the United States, including Chevrolet, Saturn, Pontiac, and Buick, in a market where few customers perceive any significant difference among them. Their antiquated and bloated dealership structures also prevent the Big Three from instituting modern and more flexible inventory-management practices and selling cars over the Internet.

In late 2006, shortly before the current economic slowdown, Ford separated itself from its two domestic rivals. Its new management team, led by former Boeing executive Alan Mulally, recognized both that the company needed a top-to-bottom revamp and that, without extraordinary commitment, this restructuring would probably fare no better than the many others Ford had undertaken over the decades. To commit itself to a major, years-long overhaul, Ford mortgaged its assets to the hilt, raising $23.6 billion to reorganize, develop new cars and technologies, and free itself of many of the legacy costs that sapped its competitiveness.

Already weakened by years of bad business decisions, the Big Three were hit hard by high fuel prices and then the economic slowdown. Though sales are down across the industry, buyers' interest in the Big Three's fleets has plummeted. For the first time in history, Detroit's share of the U.S. market dipped below 50 percent in 2008 and has fallen further since.

Ford, to date, has had the wherewithal and the resources to ride out the recession and weak auto market. General Motors and Chrysler, however, have not, and so late last year asked the federal government to give them the money needed to undertake the sort of reorganization already well underway at Ford.

The usual process for accomplishing this type of restructuring is bankruptcy—specifically a Chapter 11 filing. Under Chapter 11, bankruptcy affords companies that have hit hard times a fresh start and a chance to reorganize to take better advantage of their assets. Dire claims that bankruptcy is somehow equivalent to the end of a business—for example, some claimed that bankruptcy would imperil the employment of all of an automaker's workers—are simply incorrect. Instead, the reorganization process provides unique flexibility to unlock the fundamentally sound productive capabilities of a faltering business by freeing it of many obstacles to success, such as unviable contracts, crushing debt, and poor management. Reorganization is the usual tonic for businesses, like the Big Three, that need to adjust quickly to new economic realities but are, at their cores, sound, productive, and potentially profitable.

Yet after Congress declined to bail out General Motors and Chrysler, the Bush Administration and then the Obama Administration acted to accomplish the same end, drawing on funds that had been appropriated to shore up financial institutions under the TARP.

Bankruptcy has been, with Chrysler, and probably will be, with General Motors, a part of this process. As explained further below, the Obama Administration's Automotive Task Force (ATF) developed a plan to use several provisions of the bankruptcy code while evading most of its requirements. In this way, it could bail out Chrysler and General Motors for far less money than would otherwise be required—essentially by forcing others to pay for much of it—without relinquishing its effective control of either company or forcing favored constituencies, unions chief among them, to accept serious concessions.

The result is that neither company will go through the full Chapter 11 restructuring process but only, in the words of various Administration officials, a "quick dip" or "surgical bankruptcy." Thus, both will forgo the essential discipline of the Chapter 11 process, its narrow focus on finances and sustainability, that has made it so successful. Altering or evading this essential focus reduces the likelihood of achieving the goal: rehabilitating a business that has suffered financial failure and restoring it to profitability and, over the longer term, success.

Given the deep-seated nature of these companies' problems—how long they have persisted, how much they cut to the core of their businesses—it is obvious that meek efforts will not suffice. Yet, aside from the billions of taxpayer dollars being committed to them, meekness, rather than discipline, buttressed by tough talk characterizes the Obama Administration's approach. The result is that heavily touted reforms are less aggressive than could be expected in an ordinary bankruptcy reorganization. This imperils both companies.

One example is the rationalization of dealer networks. Both General Motors and Chrysler recently announced plans to sever their ties with some of their dealerships. Chrysler, relying on a provision of bankruptcy law that allows the setting aside of contracts, will drop 800 of its dealers, about a quarter of its total network, leaving about 2500. General Motors, meanwhile, notified 1,100 of is 6,000 dealers that their contracts will not be renewed next year; it hopes to cut another 900 to 1,300 dealers over the next few years, reducing its total to 3,600 to 4,000. Further reductions could come from attrition and consolidation.

These are, unambiguously, steps necessary to the survival of both automakers, but there is a real question as to whether they are enough. Even with the cuts, neither company will come close to matching Toyota's much-envied statistic of 1,100 car sales per dealer, per year, on average. If it meets its most aggressive goals, General Motors will still have, relative to that standard, an excess of 1,800 dealers. The result is that overhead and marketing expenses will remain too high, that dealers in some markets may face cannibalizing competition from cross-town rivals, and that many dealers will not be able to invest the money necessary to improve customer experience.

If the economy, and car sales, recover, both companies will find it tough to make further cuts. Outside of bankruptcy, both will be, once again, subject to restrictive state franchising laws that heavily penalize closures. For example, when General Motors shut down one underperforming and duplicative brand, Oldsmobile, in 2004, it had to pay dealerships over $1 billion in "financial assistance" to avoid lawsuits and is still, 4 years later, embroiled in litigation from former Oldsmobile dealers who declined to accept assistance or settle their claims. The costs could be even greater for cutting loose multiple-brand dealers.

There is also concern about which dealers are being cut and whether they are the right ones to go. As wards of the state, both automakers face intense pressure to make decisions that reduce political friction, rather than those that maximize economic gain. It would be difficult to believe, considering the ATF's deep involvement in both companies' plans, as well as the power of certain Members of Congress, that no political pressure was brought to bear and that all decisions were made entirely on the merits.

Unfortunately, such pressure, and such doubt, will accompany every decision made by General Motors and Chrysler in the months ahead. Some, for example, speculate that General Motors and Chrysler threw their support behind President Obama's new emissions and fuel efficiency standards at the behest of his Administration.[1] No doubt politics played some role in transforming the automakers' former intransigence on the issue.

As with dealers, both companies have begun the process of culling underperforming brands from their stables to reduce expenses and improve focus. Again, this is a necessary step, but questions remain as to whether it is enough. Does Chrysler need both the Chrysler brand and Dodge? And while General Motors was right to retire Pontiac, and Cadillac maintains its allure, does it need Chevrolet, Buick, and GMC, or do further opportunities to cut brands, and costs, exist? These questions could be answered in a regular Chapter 11 case, but outside of that context, there's little to guide the inquiry. Some industry analysts, however, have maintained for years that these extra brands only add costs and distraction, not value.

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[1] *See* Jake Tapper, Arnold Hypothesizes POTUS Told U.S. Automakers to Go Along with New Enviro Regs for Federal $, May 19, 2009, http://blogs.abcnews.com/politicalpunch/2009/05/arnold-hypothes.html.

And once again, trimming brands in future years will be a difficult, expensive effort, due to the same state laws that make it hard to cut loose dealers. Efficiencies forgone now, during restructuring, may not be available in the future.

Labor is another area where the concessions made, though a big step in the right direction, may be insufficient to put General Motors and Chrysler on a level playing field with their competitors. At this moment, General Motors is locked in negotiations with the United Auto Workers, but Chrysler completed a deal with the union shortly before it entered bankruptcy. The new agreement will, in theory, eventually put hourly costs in line with those of the foreign automakers, known as "transplants," who build cars in the United States. It also trims benefits a bit (e.g., vision, dental, prescriptions for Viagra), reforms overtime calculations, and consolidates some skilled trades to reduce the complexity of work rules.

Some issues, however, were not fully addressed by the new agreement. Current employees, for example, will not be asked to take cuts in their base wage rates until at least 2011, if at all. At that point, the company and the union will enter into binding arbitration with the stated goal of equalizing "all-in" hourly wages with those of the transplant automakers. That agreement could potentially push equalization even further into the future; if auto sales have recovered by then, Chrysler may not be in a position to demand that its workers accept more cuts. The agreement also requires the automaker to continue making payments to the union-run Voluntary Employee Beneficiary Association (VEBA) that provides health benefits to retirees and their families. Those payments will total $9.2 billion. Benefits for laid-off workers will also remain unusually generous. Some workers will be eligible to receive payments covering 50 percent or more of their gross pay for up to 2 years after being laid off. Given the need to shrink operations, this stands to be a significant expense.

Work rules also remain a barrier to competitiveness. The agreement does make some significant improvements to these Byzantine arrangements that govern nearly every facet of automobile production, but they will still reduce flexibility and efficiency, while imposing a bureaucratic, union-mediated process on all employer-employee relations that is expensive, time-consuming, and morale-sapping—for both sides. A better, though perhaps unlikely, outcome would have been scrapping plant-level work rules in favor of the more flexible approach taken at New United Motor Manufacturing (NUMMI), a Toyota and General Motors joint venture in California that regularly wins awards for its innovation and productivity. That approach is based on the one used at all of Toyota's facilities and is similar to those employed by other transplant automakers. This shortcoming alone leaves Chrysler, and almost certainly General Motors under its forthcoming agreement, at a major competitive disadvantage.

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.[2] 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.

Impaired access to debt and capital will stymie future restructuring, investment, and growth, reducing the likelihood that either company will fully rebound and, beyond that, prosper. There is the risk that this will lead to further government intervention, using taxpayer funds; rather than the lender of last resort, the federal government could become the first, and only, option.

Finally, there is the stigma of having accepted government funds. For months, auto executives asserted that consumers would not purchase cars manufactured by a company in bankruptcy. Poll after poll, however, showed that fear to be overblown, especially as consumers came to know more about the restructuring process. Meanwhile, as auto sales plummeted, General Motors and Chrysler lost the most, as Ford, the holdout, snatched their market share. There is a stigma to taking taxpayer dollars that, according to polls, is far worse than any attached to filing for bankruptcy. Fully 72 percent of those surveyed nationwide say they are more likely to purchase a Ford product because the company has not taken government money.[3] A Rasmussen poll found that 88 percent of Americans would prefer to buy a car from an automaker not receiving government aid.[4] And many articles published in newspapers and online have quoted individuals once devoted to GM brands or Chrysler (known as "Mopar" fans, after the company's auto-parts division) whose loyalty is now defunct—or shifted to Ford.

These downsides prove—as much as is possible at this time—that aggressive government intervention has had a negative effect on both Chrysler and General Motors, relative to the usual alternative, a regular bankruptcy, even one with some degree of debtor-in-possession financing provided by or (even better) merely guaranteed by the federal government. There is every reason to believe that unexceptional bankruptcies, though taking longer and demanding greater sacrifice, would have left both companies on firmer competitive footing. But for mostly political reasons, that is not what the Obama

[2] There is some evidence that this is already happening. See, e.g., Eric Berman, *State to No Longer Invest in Federal Bailout Recipients*, WIBC News, May 20, 2009, http://www.wibc.com/news/Story.aspx?ID=1094872 (describing how Indiana's State Treasurer ordered the managers of the state's investment funds, such as pensions, "not to buy any more bonds from Chrysler, GM, or banks covered by the bailout").
[3] Bill Vlasic, *Choosing Its Own Path, Ford Stayed Independent*, N.Y. TIMES, April 8, 2009, at B1.
[4] Ken Bensinger, *GM, Chrysler sales hurt by mixed messages*, L.A. TIMES, March 29, 2009.

Administration chose to do. That it chose, however, to rely on portions of the bankruptcy code to implement its bailout plan raises concerns that it may have, in the process, altered that body of law.

Specifically, the Obama Administration's abuse of bankruptcy to carry out its initiatives could serve as a precedent for others to sidestep the requirements of the Chapter 11 reorganization process, thereby undermining what has been an extraordinarily successful tool to turn around troubled enterprises.

America's Chapter 11 process has been a model for the rest of the world. As one recent article describes, China's new bankruptcy law, its first, allows for reorganization of insolvent businesses and the "cramdown" of their debts, very closely tracking the U.S. model.[5]

Its success can also be judged in statistical terms. A recent article from Elizabeth Warren and Jay Lawrence Westbrook analyzes data from thousands of bankruptcy cases involving both small and large businesses.[6] They found that, among companies that, entering bankruptcy, had a plausible chance of reorganizing, between 65 percent and 72 percent were able to confirm a reorganization plan to exit bankruptcy.[7] And the rate is likely higher for larger firms.[8] This is an encouraging statistic, considering that all of these businesses had reached the point of insolvency or illiquidity at the time that they entered bankruptcy.

Warren and Westbrook also found that bankruptcy proceeds at a quick pace in most cases; the typical case is resolved in about 9 months.[9] While firm size is a factor, larger businesses only took an average of 4 months longer than smaller businesses.[10] And by 24 months, they report, nearly all cases were resolved.[11]

They summarize their findings thusly:

> These data expose the heart of the efficiency question: is successful reorganization a rarity, available in a relatively small number of cases? Are the benefits of Chapter 11 achieved only at the expense of long delays? Our data...show that confirmation rates jumped to two-thirds or more among larger debtors, debtors that were able to survive the first nine months in bankruptcy, and debtors who at least proposed a plan to reorganize. The data reveal that the

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[5] Michael Burke, Wei Cui, & Paul Jones, *International Legal Developments in Review: 2006: Regional & Comparative Law*, 41 INT'L L. 777, 784-787 (2007)
[6] Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH L. REV. 603, 607 (2009).
[7] *Id.* at 617-18.
[8] *Id.* at 635-37.
[9] *Id.* at 629.
[10] *Id.* at 637.
[11] *Id.* at 629.

cases—both those that exit the system and those that confirm plans of reorganization—moved at a lively pace.

Those conclusions, however, describe a system that is premised on maximizing the value of an enterprise for (in the case of insolvency) the benefit of its creditors, who wield great control over the process. That is the system that the Obama Administration opted to circumvent.

In a normal case, a business files for bankruptcy and then has an "exclusivity period" of up to 18 months during which it can prepare a reorganization plan to present to its creditors. That plan, under Section 1129 of the Bankruptcy Code, must adhere to the "absolute priority rule," which simply mandates that senior creditors, such as those with security interests, are paid off before junior creditors. Further, creditors who, under the plan, are not paid in full and are slated to receive less than they would in a Chapter 7 liquidation—that is, when the assets of the business are sold off—have a chance to vote, as a class, on whether to accept or reject it.

Taken together, these rules protect creditors' contractual rights and ensure that bankruptcy law is used to promote economic efficiency, rather than for more nefarious purposes, such as enriching favored creditors at the expense of others. This is important because, within bankruptcy, a business has extraordinary power to accept or reject contracts, alter the terms of its debt, and even dismiss debt altogether. Without these rules, bankruptcy could easily be misused to defraud lenders and other creditors.

But Chrysler, which filed for bankruptcy on April 30, will never file a plan subject to the approval of impaired creditors. Though it is taking advantage of bankruptcy to exit contracts, such as with some dealers, and cram down its debt, it gets to skip the requirements of Chapter 11 reorganization thanks to a combination of aggressive lawyering, coercion, and intimidation, all courtesy of the Obama Administration.

The means to evading the law is a provision of the Bankruptcy Code, Section 363(b), which allows the sale of assets of the bankruptcy estate. Relying on that provision, the government arranged a sham sale of nearly the entire company to a newly created "Chrysler" capitalized by the government. The price? $2 billion, all of which would go to secured creditors for senior debt worth $6.9 billion, for a recovery of just 29 cents on the dollar. Meanwhile, one junior debtor, the UAW-administered VEBA, was slated to receive 43 cents on the dollar for its unsecured $11 billion claim, as well as 55 percent of the new Chrysler. In a typical case where senior debt-holders were not paid in full, the UAW, along with other junior creditors, would receive nothing.

In effect, the Administration used Section 363(b) to accomplish a *sub rosa* reorganization of Chrysler, financed in part by Chrysler's former senior debtors. It then transferred a large portion of that value, along with added value from additional bailout funds, to the UAW and Fiat, which is investing some technology, but no money, in its new joint venture with Chrysler.

This is exactly the kind of abuse—stealing from one party to give to another—that the bankruptcy code was designed to prevent.

This is not the first time that Section 363(b) has been used to sell essentially an entire company or its "crown jewel" assets, though it is certainly the most prominent. Courts have been justifiably wary of the practice and carefully scrutinized transactions to ensure that the law was not being abused. In an early case employing this legal "innovation," the Fifth Circuit rejected it outright, writing:

> [T]he district court was not authorized by Sec. 363(b) to approve the [transaction]. In any future attempts to specify the terms whereby a reorganization plan is to be adopted, the parties and the district court must scale the hurdles erected in Chapter 11. See e.g. 11 U.S.C. Sec. 1125 (disclosure requirements); id. Sec. 1126 (voting); id. Sec. 1129(a)(7) (best interest of creditors test); id. Sec. 1129(b)(2)(B) (absolute priority rule). Were this transaction approved, and considering the properties proposed to be transferred, little would remain save fixed based equipment and little prospect or occasion for further reorganization. These considerations reinforce our view that this is in fact a reorganization.[12]

A more recent case stated the concern with Section 363(b) sales even more plainly: "The reason sub rosa plans are prohibited is based on a fear that a debtor-in-possession will enter into transactions that will, in effect, short circuit the requirements of Chapter 11 for confirmation of a reorganization plan."[13] That court went on to state:

> [W]hether a particular settlement's distribution scheme complies with the Code's priority scheme must be the most important factor for the bankruptcy court to consider when determining whether a settlement is "fair and equitable" under Rule 9019 [concerning the settlement of controversies within classes]. The court must be certain that parties to a settlement have not employed a settlement as a means to avoid the priority strictures of the Bankruptcy Code.

Any court examining the Chrysler transaction would be compelled to reach the opposite conclusion. It is difficult to argue that what Chrysler is undergoing at present is not a reorganization. The Treasury, in fact, refers to the transaction as a "restructuring initiative" and to the new shell company as "the reorganized Chrysler."[14] Further, it

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[12] In Re Braniff Airways, Inc., 700 F.2d 935, 940 (5th Cir. 1983).
[13] In re Iridium Operating LLC, 478 F.3d 452, 466 (2nd Cir. 2007) (internal quotations omitted). The court approved the sale in this case only after it found that the transaction "had a proper business justification and was a step towards possible confirmation of a plan of reorganization and not an evasion of the plan confirmation process." *Id.*
[14] Press Release, Department of the Treasury, Obama Administration Auto Restructuring Initiative
Chrysler-Fiat Alliance, April 30, 2009, *available at*
http://www.ustreas.gov/press/releases/tg115.htm.

describes the time period after the transaction as part of a "restructuring period."[15] Even more clearly, the transaction, unlike a sale to an established entity such as another company, had no economic substance. Finally, the distribution is hardly "fair and equitable;" it upends the Code's priority scheme, with junior creditors faring better than those holding senior claims.

In short, the entire point of using Section 363(b) was to force a very unfavorable plan on (understandably) recalcitrant secured creditors in violation of their contractual and property rights.

Lawyers justified the sale using much the same language as was employed in support of the Section 363(b) sale of Lehman Brother's brokerage unit, just after its parent had filed for bankruptcy, to Barclays Capital. They argued that Chrysler would precipitously decline in value, wreaking havoc throughout the supplier base, and that only a quick sale could prevent that end. Unlike in the case of Lehman, however, there was little evidence to support this claim, just hand-waving.

Under the Bankruptcy Code, creditors can object to a proposed sale. But reminiscent of the Sherlock Holmes tale about "the dog that didn't bark," banks that held the bulk of Chrysler's senior debt, and that were also TARP recipients and so subject to close scrutiny and regulation by the Treasury, declined to do so. Though an anonymous Administration aide told reporters that the White House forbade the use of TARP as leverage over these banks, other creditors saw early on in negotiations that TARP recipients were more willing than non-TARP parties to cut a deal on unfavorable terms.[16] The implication is that, whether they were explicitly ordered to or not, these banks were coerced into supporting the government-backed proposal.

And there were threats, too, after about 20 creditors banded together to form the "Chrysler Non-TARP Lenders Group" and challenge the Section 363(b) sale. This was just days after President Obama had put pressure on those who had rejected the Administration's previous offer, publicly blaming "investment firms and hedge funds" for Chrysler's bankruptcy, claiming that by rejecting the government's deal, they had "decided to hold out for…a taxpayer-funded bailout" and were "hoping that everybody else would make sacrifices, and they would have to make none."[17] (In reality, the hold-outs had offered a compromise plan under which they would receive 60 cents on the dollar, about the same as the UAW.) The group, representing teachers unions, pension funds, and school endowments, among others, moved to delay the sale, and the judge agreed to hold a hearing. But the effort would quickly fizzle, as members deserted the group in the face of death threats, criticism from lawmakers, and according to one prominent attorney, threats from the administration:

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[15] *Id.*

[16] Neil King, Jr., & Jeffrey McCracken, *U.S. Forced Chrysler Creditors to Blink*, WASH. POST, May 11, 2009, at A1.

[17] Remarks of President Barack Obama, April 30, 2009.

> One of my clients," [attorney Tom]Lauria told [radio] host Frank Beckmann, "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."[18]

After suffering days of abuse, the group folded, ending the leading objection to the sale.[19]

According to news reports, General Motors will follow a similar course at the end of this month, with an anticipated Section 363(b) sale to a new entity that would initially be owned by the federal government.[20] Secured lenders would be paid 28 cents on the dollar, while holders of the company's $27 billion in unsecured bonds would receive a 10 percent stake in the new company. The UAW, meanwhile, would receive $10 billion in cash and up to a 39 percent stake in the "new" General Motors in exchange for its $20 billion in unsecured debt—a far better payout than those to secured lenders and similarly situated bond holders. The government is also expected to take a big ownership stake.

These high-profile precedents threaten to change the nature of bankruptcy for businesses carrying heavy debt loads. Professor Mark Roe, of Harvard Law School, described this risk in a recent column:

> [I]f the current deal becomes a strong bankruptcy court precedent, it'd throw priorities into question generally, because the tactics are easily imitated even without the government as the major player. In Chapter 11 reorganizations going forward, if a coalition of creditors and insiders can convince a judge to use the same structure as the Chrysler judge has provisionally approved, they can freeze out a creditor group who then couldn't call on any of bankruptcy law's normal protections.[21]

Insiders alone, as well, might wish to take advantage of this technique to keep their hold on the business, while dropping debt. Rather than persevere the rigor and

[18] Michael Barone, *White House puts UAW ahead of property rights*, WASH. EXAMINER, May 6, 2009.
[19] One challenge, though, is still pending. The Indiana State Teachers Retirement Fund, Indiana State Police Pension Trust, and Indiana Major Movers Construction Fund have asked the bankruptcy judge to block the sale, arguing that it is "illegal and tramples their rights," nothing more than a scheme to reward creditors the "government deems politically important." Objection of Indiana Pensioners, In Re Chrysler, No. 09-50002 (Br. S.D. N.Y. May 19, 2009), available at http://chapter11.epiqsystems.com/viewdocument.aspx?DocumentPk=8b2f9a28-04cd-4161-b3b6-50fc8e37ef9c.
[20] Chelsea Emery & Tom Hals, *GM bankruptcy plan eyes quick sale to government*, Reuters, May 19, 2009.
[21] Mark Roe, *Stress-Testing Washington's Chrysler Bankruptcy Plan*, FORBES, May 13, 2009.

discipline of the current bankruptcy system, and its inconvenient insistence on fair treatment of creditors, businesses will have another option: arrange a sham sale to a shell company, wiping out debts and other obligations in the process.

If this practice becomes more prevalent, it threatens to disrupt both lending and capital investment across the economy. This consequence is discussed further below.

Just as bad, it promises poor results. Businesses will be washed of their debt, but without realizing the efficiency gains of a real, profits-focused reorganization. Managers regularly overestimate their ability to turn around a failing business, and creditor control in bankruptcy provides an important check on this tendency. Cutting creditors out of the picture will only lead to more business failures, as firms opt to take the easy way out.

Congress should, the next time it takes up bankruptcy reform, study the use, or misuse, of Section 363(b) sales to evade the requirements of the bankruptcy code and frustrate the principles of fairness and rule of law on which it is premised.

It is appropriate here to discuss the rule of law, because in rescuing Chrysler and General Motors, the federal government has trampled it in ways that will hurt our economy.

The "rule of law" means clear, generally applicable laws by which individuals can organize their affairs and which are applied consistently, without respect to status. This was something that the Framers of the U.S. Constitution took very seriously. In three separate clauses of the Constitution—the Contracts Clause, the prohibition on bills of attainder (i.e., legislation that punishes particular individuals, as if they had been convicted of a crime), and the prohibition on *ex post facto* laws (i.e., criminal laws that apply retroactively)—they sought to limit the power of the government they were creating and of the states to intervene in lawful conduct.

James Madison, for one, understood that the temptation to do so would be irresistible otherwise. His explanation in Federalist No. 44 is worth repeating:

> Our own experience has taught us, nevertheless, that additional fences against these dangers ought not to be omitted. Very properly, therefore, have the convention added this constitutional bulwark in favor of personal security and private rights; and I am much deceived if they have not, in so doing, as faithfully consulted the genuine sentiments as the undoubted interests of their constituents. The sober people of America are weary of the fluctuating policy which has directed the public councils. They have seen with regret and indignation that sudden changes and legislative interferences, in cases affecting personal rights, become jobs in the hands of enterprising and influential speculators, and snares to the more-industrious and less informed part of the community. They have seen, too, that one legislative interference is but the first link of a long chain of repetitions, every subsequent interference being naturally produced by the effects of the preceding. They very rightly infer, therefore, that some thorough reform is

> wanting, which will banish speculations on public measures, inspire a general prudence and industry, and give a regular course to the business of society.

In this view, the consistent application of law is the assumption behind every other clause of the Constitution, the principle, without which, none life, liberty, and the pursuit of happiness could be secure. It is, thus, a prerequisite to due process and protection against the arbitrary exercise of power—that is, tyranny.

When the rule of law is cast aside, for whatever seemingly pragmatic reason, it impairs the machinery of private ordering, such as contractual rights, that are at the core of our economic freedom and prosperity. The broad enforceability of contracts, tempered by several narrow doctrines of abrogation, makes it possible to conduct economic affairs with strong assurance that other parties will keep their promises or be held liable for failing to do so. In this way, people are able to order their affairs, in employment contracts, insurance contracts, service agreements, and the myriad of other contractual agreements that make modern life possible.

Striking down contractual rights arbitrarily, merely because they are inconvenient or expensive to the government, raises the costs of making and enforcing agreements across the economy by reducing the certainty of all agreements. Madison himself described the slippery slope that would result: The more the legislative branch interferes in private affairs, the more who will demand that it interfere in their affairs, to their advantage, and the less the role private agreements will play in economic life. It is, in effect, a tax on contracting, for more contracts will require a lawyer's hand in drafting to avoid government abrogation. And where that is unavoidable, parties may decline to contract at all, costing the U.S. economy the surplus of their avoided transaction, while others may alter the terms of their agreements to reduce risk but also reward. Still others may shift their business to foreign shores that show greater respect for the rule of law.

We can predict who will suffer these consequences. The automakers, surely, will have only limited access to financial markets for years to come and pay usurious rates when they are able to borrow. Sadly, Ford will probably suffer the same fate, if to a slightly lesser degree, because the mere fact of its present solvency is not enough to guarantee that lenders' rights will not be gutted at some point in the future.

Quite perversely—or quite appropriately, depending on one's point of view—unionized industries may also see their cost of capital rise, hampering growth and hiring. The Obama Administration's transparent favoritism toward its political supporters in the United Auto Workers Union may lead other unions to demand the same: 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."[22]

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. As Warren Buffet opined, "[I] priorities don't mean anything that's going to disrupt lending practices in the future."[23]

Professor Todd Zywicki offers an observation on this point: "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?"[24]

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.

The effects of abrogating the rule of law are broad and deep. They can be witnessed first-hand in any nation where contracts are unenforceable and the government's rule is arbitrary and absolute. They are also evident in the prosperity of nations:

> [Economists Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny (LLSV)] documented empirically that legal rules protecting investors vary systematically among legal traditions or origins, with the laws of common law countries (originating in English law) being more protective of

[22] Caroline Salas, *Fund Managers Burned by Obama Now Say They Are Wary*, Bloomberg.com, May 20, 2009.
[23] Interview with Warren Buffet, CNBC, May 9, 2009, http://www.moneycontrol.com/india/news/fii-view/best-dow-sp-returns-were-during-recession-warren-buffet/396389/2.
[24] Todd Zywicki, *Chrysler and the Rule of Law*, WALL ST. J., May 13, 2008, at A19.

outside investors than the laws of civil law (originating in Roman law) and particularly French civil law countries. LLSV then used legal origins of commercial laws as an instrument for legal rules in a two stage procedure, where the second stage explained financial development. The evidence showed that legal investor protection is a strong predictor of financial development.[25]

Empirical studies also show that the rule of law has an impact on civil society, affecting such disparate variables as entrepreneurship, military conscription, and government control of the media.[26]

In sum, continued disregard of this fundamental principle threatens severe consequences.

This episode of lawlessness began with legislation, the Emergency Economic Stabilization Act, that many at the time recognized as an illegally unbounded delegation of power from the legislative to the executive branch.[27] It was that act which created the TARP that is now the Administration's slush fund for bailing out its allies and otherwise upsetting economic expectations.[28] That outcome should be no surprise; unbridled discretion breeds unchecked power.

What began with Congress can end with it, too. It is time to stop the economic adventurism that marked the last months of George W. Bush's Administration and the first of President Obama's. The bankruptcies of Chrysler and soon General Motors are a microcosm of the lawlessness that threatens our freedom and our prosperity. With its legislative power, Congress can put an end to the bailouts and begin the slow process of unwinding those that entangle us today.

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[25] Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, *The Economic Consequences of Legal Origins*, NBER Working Paper No. W13608, November 2007.
[26] *Id.*
[27] *See, e.g.*, Todd Gaziano & Andrew Grossman, *All Deliberate Speed: Constitutional Fidelity and Prudent Policy Go Hand in Hand in Fixing the Credit Crisis*, Heritage Foundation WebMemo No. 2079, http://www.heritage.org/Research/Economy/wm2079.cfm.
[28] See Andrew Grossman & James Gattuso, *TARP: Now a slush fund for Detroit?*, Heritage Foundation WebMemo No. 2170, December 12, 2008, http://www.heritage.org/Research/Economy/wm2170.cfm.

Ms. JACKSON LEE. And now we recognize Mr. Fein, who is well familiar with this Committee. We thank you for coming again, and we ask you if you might summarize your statement and submit your entire statement into the record. You are recognized for 5 minutes.

TESTIMONY OF BRUCE FEIN, PRINCIPAL, THE LICHFIELD GROUP

Mr. FEIN. Thank you, Madam Chairman and Members of the Committee.

I am here representing the Constitution of the United States. It is a document that you, of course, are all sworn to uphold and defend under Article VI, that has been viewed as quaint in recent years, I think much to the disadvantage of the rule of law and otherwise.

And I am compelled to make this analogy, I think, hearing, I think, the consensus of the enormous impact the reorganizations of General Motors and Chrysler will have across the spectrum of the American economy, and the complaints about what the bankruptcy judges might be doing, what the executive branch is doing.

And I recall a statement from Pogo in the 1970's, "We have met the enemy and we are they," because the only reason why we are here complaining and worrying about bankruptcy judges and the executive branch is because this branch has given away all of the power without any guidelines whatsoever.

Let's review exactly how we got to where we were through the delegation of power. It was this branch, through the TARP funds, that enabled the executives to utilize virtually unchanneled discretion to decide which businesses, which companies, would get money; which would not; what limitations would be placed on the money. There were no guidelines.

And compared to the Supreme Court's invalidation of the National Recovery Act in Schechter Poultry, that statute was micromanagement compared to the TARP. And from there we go to bankruptcy.

Well, bankruptcy judges serve for 14 years. They are appointed by courts of appeals, who also are appointed and serve life tenure. Where is the accountability to the bankruptcy judge, despite the fact that their decisions will have the enormous impact that you have described in your opening statements and the witnesses have described?

The reason why the Founding Fathers entrusted legislative power to this branch was because you are politically accountable. Constituents have the ability to communicate directly, and you have to pay a price if you do something that turns out to be untoward.

The Founding Fathers did not want platonic guardians sitting as bankruptcy judges, standing at the commanding heights of the economy, doing whatever they wanted and if it turned out wrong, that is too bad. Who is going to go pick at a bankruptcy judge? You can't have the response that the democratic process anticipates.

And this is not an impractical suggestion that this branch should be deciding the fate of Chrysler and General Motors or other big companies. When the railroad industry was in peril, and I remember—I am sure Chairman Conyers remembers—that in the 1970's, Amtrak was established to take over the passenger service, out of bankruptcy, and it was a statute that enacted Amtrak.

Conrail ended up taking over the freight rail service, and it was this branch that enacted the Conrail statute. It was called the Regional Railroad Reorganization Act of 1973, and it was this branch that privatized Conrail. They said, well, it is just too complex, it will be too lengthy a bill.

Well I remember testifying and you voting on the World Trade Organization, over 1,000 pages long. I think ERISA was the one statute that no one had read completely, it was so long. So there are clear precedents for this branch enacting very complicated statutes and taking the accountability that the Constitution anticipates.

Moreover, there are serious other constitutional questions than the unconstitutional delegation at issue here, and they have been raised with regard to the contracts clause. The bankruptcy laws basically endow unelected officials the authority to void executory contracts involving hundreds of thousands of persons, whether retirees, employees, dealers or otherwise. That is a very, very alarming power to delegate to someone who sits for 14 years because the court of appeals appointed him there. More reason than otherwise why it should be this branch should be taking that review process. That doesn't mean that ultimately this legislation that you would enact would be subject to judicial review, but every branch of government has the obligation to uphold and defend the Constitution of the United States, not just the bankruptcy courts.

And I am worried seeing a broad spectrum of problems this country confronts of the repeated effort by this branch to yield to the executive branch all the important decision-making power, whether it is war and peace, whether it is the TARP funds or otherwise.

You are elected here to make decisions, not to duck them; and that is what your obligation requires you to do. And I think this demonstration and hearing today shows what enormous ramifications will flow from the Chrysler and General Motors reorganizations that you should decide and let the politics work as they will.

That is how democracy works. It doesn't mean you will be infallible, but at least we will have the dignity to know we will charting our own economic destiny, not a bankruptcy judge.

Thank you, Madam Chairman.

Ms. JACKSON LEE. Let me thank the witness for his testimony.

[The prepared statement of Mr. Fein follows:]

PREPARED STATEMENT OF BRUCE FEIN

Dear Mr. Chairman and Members of the Committee:

I am pleased to share views on the impending bankruptcy reorganizations of Chrysler and General Motors. I strongly believe the Congress of the United States should enact laws to stipulate the terms of any reorganization of these twin motor companies because of their an enormous affect on interstate commerce. If Congress fails to act, the reorganization decision will fall to politically unaccountable bankruptcy judges appointed to serve a 14 year terms by federal appellate courts. The Constitution does not contemplate the regulation of interstate commerce by Platonic Guardians standing over the commanding heights of the economy. The legislative power was assigned to Congress for a reason: self-government is a farce unless major decisions are made by political actors representing the collective voice of the people.

General Motors and Chrysler employ tens of thousands. Even a greater number of retirees depend on the companies for various benefits. They also support dealer networks. Vehicle sales are in the millions. The Constitution entrusts the legislative power to regulate interstate commerce to Congress. When the railroad industry was reorganized in the 1970s, Congress played a pivotal role. It enacted the National Railroad Passenger Corporation Act of 1970 to form Amtrak to operate a passenger railroad system. Congress later enacted the Regional Rail Reorganization Act of 1973 to authorize the creation of Conrail to operate a railroad freight system. Conrail was later privatized at the direction of Congress with the Conrail Privatization Act of 1986.

There is no sound reason based on precepts of democracy and the Constitution for Congress to play a lesser instrumental role in reorganizing major auto companies. Their impact on the economy is comparable. Bankruptcies entail the revision or voiding of executory contracts, which is in tension with the Contracts Clause and the due process clause of the Fifth Amendment. Further, the vast discretionary authority enjoyed by bankruptcy judges to readjust economic relations and contracts with toothless legislative guidance is in tension with the non-delegation doctrine of separation of powers.

Members of Congress are elected to make significant economic decisions because they are closest to the people whose lives and livelihoods will be significantly affected. Members should decide on the economic destinies of General Motors and Chrysler. They would be neglecting their constitutional obligations by shuffling off the decisions to appointed bankruptcy judges shielded from the American people.

Ms. JACKSON LEE. Let me now recognize Mr. Clarence Ditlow for 5 minutes.

And, likewise, you can summarize your statement and submit your entire statement into the record. Mr. Ditlow, you are recognized for 5 minutes.

TESTIMONY OF CLARENCE M. DITLOW, EXECUTIVE DIRECTOR, CENTER FOR AUTO SAFETY

Mr. DITLOW. Thank you, Madam Chairman and Members of the Committee.

Before I begin my testimony, I would like to introduce two people who have come from California and from Indiana. Fargood Norian, who was injured when a Jeep failed to hold it in park; and Jeremy Warriner, who was burned tragically in another Jeep in a fire impact.

Mr. WARRINER. Thank you very much for having this hearing.

Mr. DITLOW. At this point——

Ms. JACKSON LEE. Before you continue, let me—with the difficulty of standing, let me again welcome Mr. Fargood Norian and Jeremy Warriner to this hearing. We understand that they are plaintiffs in a personal injury and product liability suit with Chrysler.

Your presence here today is recognized and it is acknowledged as very important. We thank you for your presence here today.

Mr. WARRINER. Thank you.

Ms. JACKSON LEE. The witness may continue.

Mr. DITLOW. Thank you, Madam Chairman.

I want to go from the lofty ideals of the Constitution, just expounded, to the world of the consumer who is dramatically affected by this Chrysler bankruptcy. And what we are looking at are consumers who purchased lemon automobiles today, who will lose their lemon rights under the bankruptcy proceeding and consumers who buy an automobile who have the misfortune of being in a crash in the future. Because under the bankruptcy, the Chrysler, the new Chrysler will purchase the assets free and clear of interest in property. And basically what that means is that the new Chrysler will not assume litigation costs for an accident, no matter how significant that accident is; and for the consumer who gets a lemon, they won't assume the lemon rights under the litigation.

So now what we are really looking at is that seldom have consumers needed a voice more today, when fundamental rights are jeopardized by this proceeding; and, in fact, the rights are being taken away with the assistance of payment of billions of taxpayer dollars.

Now, what are we talking about: What we are talking about are defects such as the lack of a brake shift interlock in a car that allows Mr. Norian to be run over and injured, fire systems in vehicles that caused the burn injuries of Jeremy Warriner and others.

We are talking about seat backs that are so weak that when you are hit from behind in a minor collision, they collapse and cause injuries. What we are talking about are roofs that are weak and, in a rollover crash, the roof doesn't hold.

Now, not all Chrysler vehicles are this way, but some are. We have a recall system in place in this country. Recall rights are preserved. But recalls come about because consumers are injured, come to the attention of the National Highway Traffic Safety Administration, and we get the recall.

But the very consumers who are injured, that generated the recall, have no rights under this new proceeding because their liability litigation rights are taken away. They won't receive compensation for those injuries that led to a recall. And even when we do have a recall, ones like the Chrysler tailgate latch, there were—almost half of those vehicles were never fixed in the recall, so they are still out there on the roads. So we have a tremendous gap that is not covered.

And when we look at this, the consumers in the future—I mean, we are not talking about an enormous amount of money, but we are putting tens of billions of dollars into this reorganization of Chrysler and GM, but we are not taking care of the consumer. Their rights are being wiped out. And to the consumer, it is their entire life.

The automobile—as the dealers have indicated, it is the primary means of transportation in this country. If you have a lemon and you lose your vehicle, it is not reliable, you are not going get to work; you may lose your job, that causes family problems. But yet every single State has a lemon law, but the rights under that lemon law are now being jeopardized by this bankruptcy.

In addition, when you look at a consumer who is injured, often a consumer in a rollover crash becomes paralyzed. If there is no coverage through a liability claim, their insurance will often run out; they become wards of the State.

So sooner or later the taxpayers are going to pick it up. The system is not designed to work that way. And what we would recommend is that the new Chrysler recognize those liabilities and assume them from the old Chrysler in the future, that they take out an insurance policy to cover it.

And if all else fails, and we can't get this bankruptcy court to listen to reason and take care of the consumer, then we should create a fund from the government to take care of the consumer, just like we are taking care of the corporation.

So I want to thank you for that, and I want to assure you that there are just tremendous impacts on the consumers that have been overlooked in this entire proceeding.

Thank you.

Ms. JACKSON LEE. Mr. Ditlow, we thank you again for that instructive testimony.

[The prepared statement of Mr. Ditlow follows:]

PREPARED STATEMENT OF CLARENCE M. DITLOW

Statement of Clarence M. Ditlow
Executive Director, Center for Auto Safety
On Auto Industry Bankruptcies
Before the
House Judiciary Committee
May 21, 2009

Mr. Chairman and members of the Committee thank you for the opportunity to testify on Ramifications of Auto Industry Bankruptcies. The Center for Auto Safety (CAS) is a consumer group which was founded by Consumers Union and Ralph Nader in 1970 to be a voice for consumers on auto issues affecting their lives and pocketbooks. Seldom have consumers needed a voice more than today when fundamental rights such as the right to return a lemon or get compensation for deaths and injuries caused by defects may be swept away in auto industry bankruptcies aided by billions of tax payer dollars.

When the sale of Chrysler LLC's assets using $2.2 billion taxpayer funds to pay off secured creditors to "New Chrysler" (New CarCo Acquisition LLC) was negotiated, New Chrysler would have retained all its obligations to consumers under state law including responsibility for mechanical and design defects in vehicles that caused economic or personal injury. BUT when Chrysler entered bankruptcy, it left consumers behind and proposed to sell all its valuable assets "free and clear" to "New Chrysler" leaving both consumers and personal injury victims without recourse against "New Chrysler" which assumed only the following consumer liabilities:

- *Liabilities for product warranties, product returns and rebates on vehicles sold pre-closing;*
- *Warranty obligations and product recall liabilities related to vehicles sold pre-closing;*
- *Product liability claims arising out of vehicles manufactured pre-closing and sold post-closing;*

All other Chrysler LLC has issued notices of bankruptcy in all pending lawsuits against it whether they are class actions, lemon lawsuits, or personal injury lawsuits against citing the automatic stay provision of § 362 of the Bankruptcy Code. If the bankruptcy proceeds as Chrysler seeks, consumer litigation claims whether they are personal injury or economic claims will be virtually worthless.

CAS and other consumer groups including Consumer Action, Consumers for Auto Reliability and Safety, Public Citizen and the National Association of Consumer Advocates have filed an objection to the sale of Chrysler LLC assets to "New Chrysler" free and clear of claims of consumer and personal injury victims on the basis that § 363 of the Bankruptcy Code permits free and clear sale of only "interests in property" such as liens, mortgages, encumbrances and security interests. Claims of consumer and personal injury victims are not "interests in property.' Even if they were, other provisions in § 363 of the Bankruptcy Code bar free and clear sale from applying to claims of consumer and personal injury victims. See attached copy of Objection of Tort Claimants and Consumer Groups.

Let's put a face on some of the claims Chrysler LLC wants to wipe out. The following examples of known safety defects in Chrysler vehicles that have killed and injured consumers in the past and will continue to do so in the future.

Lack of Brake-Shift Interlock

An industry standard since 1990, BSI prevents the INADVERTENT and unintentional movement of an automatic transmission from "Park" to non-park. Chrysler management refused

to install BSI in it cars, trucks and minivans on the basis that the US Government did not require. All Chrysler vehicles dating from model years 1990 through 2000, involving approximately **15 million** vehicles, continue to pose the threat of injury or death to unsuspecting owners and bystanders because Chrysler has refused to retrofit the defective vehicles or notify the owners of the lack of BSI.
Pending BSI Cases/Filings:
McIntosh v Chrysler LLC, 4 deaths, 2007, Connecticut
Callara v Chrysler LLC, severe injury, 2008, New York
Shew v. Chrysler LLC, severe brain damage, 2007, Illinois

Jeep Grand Cherokee Fuel Tank
Fuel tank mounted to the rear of axle causes tank rupture and explosion during real world collisions. No other SUV on the highway continues to utilize this defective fuel tank system design EXCEPT Chrysler Jeep SUVs. Jeep vehicles dating from model years 1993 through 2004, involving approximately **3 million** vehicles, continue to pose the threat of horrible fire death to unsuspecting owners. Chrysler identified a safety fix called a "Fuel Tank blocker" in 2003 but has refused to issue a safety recall notice.
Pending Jeep Grand Cherokee Fuel System Defect Cases:
Kline v Chrysler LLC, 1 fire death, wife and mother of 4, 2007, New Jersey

Other Chrysler models have defects that have lead to burn deaths and injuries including the Dodge Neon which is significantly over-represented in fatal fire crashes in NHTSA's FARS system. Even defects in brake and power steering fluid systems cause fires. A successful hotel manager, Jeremy Warriner from Indianapolis, Indiana, was heading home after a long day at work. Another motorist sped through a stop sign, smashing into Jeremy's 2005 Jeep Wrangler. The poor design of the brake fluid reservoir ignited a fire that trapped Jeremy in the driver's seat for five minutes, severely burning his legs. Ultimately, Jeremy's legs had to be amputated.

Seat Back Collapse
NHTSA Safety Standard 207 is woefully inadequate and out of date. Internal standard used by Chrysler continues to rely on NHTSA standard as basis for manufacture. Rear collision to Chrysler vehicles results in seat back collapse and instant injury to children behind the collapsing seat or subsequent injury due to loss of vehicle control. Chrysler vehicles dating from model years 1990 through 2009, involving over **10 million** vehicles, continue to pose the threat of seat back collapse.
Chrysler has admitted to over one hundred instances of serious injury in its vehicles due to seat back collapse.

Julio and Lilian Melgar's case pending in District Court in Clark County, Nevada against Chrysler represents the devastation the current Chrysler bankruptcy restructuring plan will create for Chrysler customers and their families. Mr. Melgar's 1997 Dodge Caravan was rear ended while stopped at a traffic light. Although the collision was moderate and the person driving the Ford Taurus that struck Mr. Melgar's minivan suffered no serious injuries, Mr. Melgar's front seat collapsed rearward in the impact, throwing him to the rear of the vehicle and causing a catastrophic spinal cord injury. Mr. Mr. Melgar was not at fault and was wearing his seat belt. The Melgar family faces enormous future medical bills, and Mr. Melgar has lost his ability to work as well as to independently care for himself.

As early as 1980, Chrysler meeting minutes revealed that seat backs had collapsed rearward in every rear impact crash test but that any improvements were resisted because they would entail additional development costs. In fact, Chrysler's internal memoranda showed that the seats were so weak that, in rear crash tests, the front seats were braced to prevent the seatbacks from impacting testing equipment occupying the back seat. Chrysler has also received hundreds of reports of minivan seats collapsing rearward in rear impacts. Of these incidents, many involve deaths and serious injuries.

In the early 1990s, Chrysler formed the Minivan Safety Leadership Team ("MSLT"). The MSLT sought to address safety concerns in Chrysler minivans, including specifically the issue of seat back strength. The MSLT studied complaints regarding injuries caused by yielding seat backs. At its March 16, 1993, meeting, the MSLT reached a consensus that it was unacceptable for seats to yield rearward into the passenger space behind them and that the seats were *inadequate to protect customers*. After the meeting, the minutes of the meeting were distributed to various Chrysler executives. Later, a Chrysler executive in charge of engineering ordered the meeting minutes retrieved and destroyed.

Chrysler never issued any warning to customers and continued to advertise the Caravan as a vehicle specifically designed as a family vehicle. Seat backs in minivans sold before the bankruptcy will continue to collapse after the bankruptcy. The only difference will be consumers will have no recourse for their catastrophic losses against Chrysler.

Roof Crush in Chrysler SUV's

CAS dynamic roof crush tests have shown that Chrysler SUVs such as the Jeep Grand Cherokee have weak roofs that have substantial buckling of the roof header over the driver. Over 2 million Grand Cherokee with weak roofs have been produced since 1994.

Pending Jeep Grand Cherokee Roof Crush Case:

Schute v Chrysler LLC, New York State Court

Some defect claims which Chrysler LLC seeks to wipe out impose significant economic loss on consumers who receives no bailout from the government. Chrysler used to buy back over 5,000 lemons each year. At an average price of $25,000, that's $125 million of lemons every year. While Chrysler LLC says it will continue to buy back some lemons before lawsuits are filed, the $125 million is significant economic incentive for Chrysler to force consumers into filing lawsuits which are automatically stayed by the bankruptcy and which could be wiped out if the free and clear sale goes through.

Some economic defects are so widespread they have formed the basis for class actions which would also be wiped out by the bankruptcy. For example, 1998-2005 Chrysler cars with 2.7L engines are prone to oil sludge which causes catastrophic engine failure typically at 50-90,000 miles which is well within the normal vehicle life. Repair costs run from $5-9,000. A class action on 2.7L engine oil sludge which would be wiped out by this bankruptcy is pending in a MDL proceeding in Federal District Court in New Jersey (*In re Chrysler LLC 2.7 Liter V-6 Engine Oil Sludge Products Liability Litigation*), Master Case No. 07-1740.

The free and clear sale would preserve the right to a safety recall but this creates a huge and ironic safety gap. Recalls are often based on deaths and injuries yet the victims of the crashes that led to the recall would not be entitled to any compensation for their injuries if the vehicles were sold prior to the bankruptcy even if the crash occurred after the bankruptcy. In large recalls, only 50-60% of the defective vehicles are remedied leaving millions on the road to result in future deaths and injuries which will go uncompensated if the bankruptcy goes through. In the Chrysler tailgate latch failure that resulted in 40 deaths, only 2.4 out of 4.1 million minivans were ever repaired leaving 1.7 million with a defective tailgate latch that could pop open with the occupant flying out. If the Chrysler bankruptcy goes through with free and clear of injury claims, owners of unrepaired vehicles, yet recalled, vehicles will have no recourse against Chrysler for admitted defects.

According to the National Highway Traffic Safety Administration (NHTSA), the cost of motor vehicle crashes is $366 billion annually based on the most recent data. Chrysler and GM crashes account for almost half of the total. With Chrysler already in bankruptcy and GM soon to be in bankruptcy, a significant portion of the economic costs of vehicle deaths and injuries for vehicles on the road today will fall on the consumer and government programs like Medicare if crash victims have no insurance or when their insurance runs out.

One of the early warnings of the impact of the Chrysler bankruptcy was Chrysler's failure to pay lemon law claims. Just this week, GM told lemon lawyers it would no longer pay its lemon claims even if an agreement to buyback a lemon had been reached. Another early warning was auto dealers going out of business. In all too many cases, consumers who traded in cars with liens which were supposed to be paid off by dealers in the trade-ins were never paid off, leaving consumers victimized by yet another consequence of auto bankruptcies. With Chrysler terminating nearly a 1,000 dealers and GM 2,000 more, we can expect another major economic hit on consumers who are the forgotten victims of auto company bankruptcies.

Conclusion: What needs to be done is not to stop the restructuring of GM and Chrysler but to stop treating consumers as if they were collateral damage. Catastrophic injury in crashes and loss of income can destroy a family. Even a lemon vehicle in a country where the private passenger automobile is the primary means of transportation can cause loss of jobs and strains on family ties. To ask consumers to bear the cost of design and manufacturing defects in Chrysler and GM vehicles at the same time tens of billions of their tax dollars are bailing out these companies is too much.

We recommend:
(1) the "New Chrysler" assume the liability for all personal injury and consumer liability claims of Chrysler LLC, the "Old Chrysler."
(2) the "New Chrysler" take out an insurance policy to pay such claims.
(3) the government create a fund sufficient to make consumers whole should the "New Chrysler"fail to pay personal injury and consumer liability claims. Such fund should also cover consumer losses associated with bankrupt dealers failing to pay off liens on purchase of new vehicles.
(4) when GM goes bankrupt, take the same steps outlined above for Chrysler to insure that consumers are protected, and

(5) as recommended by the International Association of Lemon Law Administrators in the attached statement which I have asked to deliver, honor all lemon law claims regardless of when a vehicle is purchased.

Message on Behalf of Philip Nowicki, Ph.d., President
International Association of Lemon Law Administrators (IALLA)

IALLA, established in 1997, is comprised of government officials who administer and enforce our states' new motor vehicle lemon laws. The laws, enacted in all 50 states, afford minimum protections for consumers who acquire chronically defective new motor vehicles. IALLA's mission on behalf of its member agencies is, in part, to:

Ensure an honest, safe, and informed marketplace.

Protect the rights of consumers who buy motor vehicles, including the right to receive a refund or replacement vehicle if a manufacturer cannot conform a new motor vehicle to the warranty within a reasonable number of attempts.

Since Chrysler went into bankruptcy, there has been a stay on all lemon law claims with the disposition of those claims uncertain. Neither Chrysler, nor the Presidential Task Force on the Automobile Industry, has indicated whether lemon law claims, including those brought by consumers who bought unbranded or undisclosed repurchased "lemon' vehicles, will be covered during the bankruptcy period or after the new company emerges. With a similar situation looming for General Motors consumers, IALLA believes that Chrysler and GM consumers currently experiencing a hardship as a result of a chronically defective vehicle as well as prospective Chrysler and GM customers need to know whether their lemon law rights are safe and whether their lemon law claims will be honored, regardless of when they acquired their new motor vehicles.

IALLA would greatly appreciate the help of this Committee to have this question answered.

UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK

In re:	Chapter 11
CHRYSLER LLC, *et al.*,	Case No. 09-50002 (AJG)
Debtors. /	(Jointly Administered)

OBJECTION OF TORT CLAIMANTS AND CONSUMER ORGANIZATIONS TO NOTICE OF PROPOSED SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' ASSETS FREE AND CLEAR OF LIENS, CLAIMS, INTERESTS AND ENCUMBRANCES AND FINAL SALE HEARING RELATED THERETO

I. INTRODUCTION AND SUMMARY OF ARGUMENT

Prior to the Debtors' bankruptcy filing, the United States Treasury and the Debtors negotiated a sale that would have paid the secured creditors $0.31 on the dollar (using $2.2 billion in Treasury funding to retire the secured debt) and sold all of the Debtors' assets to New CarCo Acquisition, LLC ("**New Chrysler**"). New Chrysler would have retained all of the current obligations of the Debtors. These included obligations under State law to consumers ("**Consumers**") who purchased the Debtors' vehicles who have reliability or mechanical issues with their vehicles and those individuals—both the Debtors' customers and bystanders—who are unfortunately injured by what are alleged to be defects in the Debtors' products ("**Personal Injury Victims**").

Despite New Chrysler's earlier willingness to take over the Debtors' obligations to millions of individuals to whom Debtors have sold vehicles, the Debtors now propose that their

only valuable assets be sold, "free and clear," to New Chrysler,[1] leaving both Consumers and Personal Injury Victims without recourse against New Chrysler. Such a sale is not only inequitable, but in the unusual circumstances of a mass market manufacturer of automobiles, it would have unfortunate consequences for the public, the economy, the Debtors' employees and business partners, and New Chrysler's ability to survive as a going concern:

- It would leave both Consumers and Personal Injury Victims without recourse against the products' manufacturer, the entity which is best situated to address their complaints in a fair and reasonable manner;
- Many of these Consumers and Personal Injury Victims, in turn, will sue others in the chain of production and sale, including dealers and suppliers—the very entities that New Chrysler will rely upon for its survival. Transferring consumer and personal injury liability (where dealers and others can be reached) to third parties who are less able to address that litigation, will in the longer term endanger the survival of New Chrysler;

• For those individuals who are unable to reach dealers or suppliers, the cost of their injuries, and Consumers losses, will be borne by them, the government, or insurers in the form of uncompensated care;

• The current owners of Chrysler vehicles (New Chrysler's future customers) will be left with vehicles devalued by the lack of anyone standing behind them, devastating resale and trade-in values further; and

• New Chrysler will then be confronted by a slew of articles in the press and complaints on the Web about how those who bought Chrysler vehicles, *or might buy them in the future*, are left out in the cold. This will cause Consumers to think long and hard about ever

[1] The current $2 Billion offer is 28% of the $6.9 Billion in Secured Debt.

buying a vehicle from New Chrysler, damaging the brand and making the survival of New Chrysler difficult, if not impossible.

These results are not appropriate as to current claimants (both Consumers and Personal Injury Victims), let alone those individuals who are certain to suffer injury and losses in the future as a result of defects in the Debtors' vehicles, and who, as discussed below, obviously cannot come forward in this Court and file claims. As such, the sale of the Debtors' assets to New Chrysler should be subject to the retention of liability to Consumers and Personal Injury Victims that arise out of alleged defects in the vehicles sold by Debtors, and this Court should not find the sale "free and clear" under Section 363(f) of the Bankruptcy Code. Given the widespread sale and presence of Debtors' vehicles in the United States, as well as the Debtors' superior knowledge regarding any issues with these vehicles, it would be inequitable and unwise to attempt to transfer the liability for defects in these consumer products to third parties and the public at large.

II. <u>INDIVIDUALS AND ORGANIZATIONS MAKING OBJECTIONS</u>

The personal injury victim objectors include William Lovitz, who is the plaintiff in *Lovitz v. Daimler North America Corp., et al.*, Case No. 1:08cv0629 (N.D. Ohio, O'Malley, J.) for the death of his mother due to a defect in a Dodge Neon; Farbod Nourian, who is the plaintiff in *Nourian v. Chrysler, LLC; Chrysler Motors, LLC; Daimler A.G.; and Walker Motor Co. d/b/a Buerge Chrysler-Jeep*, Case No. SC098902 (Los Angeles Sup. Ct.) for personal injuries he suffered as result of a defect in a 1998 Jeep Cherokee; and Brian Catalano, who is the plaintiff in *Catalano v. Chrysler, LLC, et al.*, Case No. 08-32664-NP (Sanilac County, Mich. Cir. Ct.) for the death of his mother due to a defect in a 1997 Chrysler Town and Country Mini Van. Each of these plaintiffs has a direct interest in whether Chrysler, LLC is able to sell its assets "free and clear" to New CarCo Acquisition, LLC.

The consumer organization objectors all work to protect Consumers who will be affected by the outcome of the bankruptcy proceedings. These objectors include the following.

1. The Center for Auto Safety (the "**Center**") is a non-profit consumer advocacy organization that, among other things, works for strong federal safety standards to protect drivers and passengers. The Center was founded in 1970 to provide Consumers a voice for auto safety and quality in Washington, DC, and to help "lemon" owners fight back across the country. The Center advocates for auto safety before the Department of Transportation and in the courts.

2. Consumer Action is a national nonprofit education and advocacy organization serving more than 9,000 community based organizations with training, educational modules, and multi-lingual consumer publications since 1971. Consumer Action serves Consumers nationwide by advancing consumer rights in the fields of credit, banking, housing, privacy, insurance and utilities.

3. Consumers for Auto Reliability and Safety ("**CARS**") is a national, award-winning non-profit auto safety and consumer advocacy organization dedicated to preventing motor vehicle-related fatalities, injuries, and economic losses. CARS has worked to enact legislation to protect the public and successfully petitioned the National Highway Traffic Safety Administration for promulgation of regulations to improve protections for Consumers. The United States Congress has repeatedly invited the President of CARS to testify on behalf of American Consumers regarding auto safety practices and policies.

4. National Association of Consumer Advocates ("**NACA**") is a non-profit association of attorneys and advocates whose primary focus is the protection and representation

of Consumers. NACA's mission is to promote justice for all Consumers by maintaining a forum for communication, networking, and information sharing among consumer advocates across the country, particularly regarding legal issues, and by serving as a voice for its members and Consumers in the ongoing struggle to curb unfair or abusive business practices that affect Consumers.

5. Public Citizen, a consumer advocacy organization, is a nonpartisan, non-profit group founded in 1971 with members nationwide. Public Citizen advocates before Congress, administrative agencies, and the courts for strong and effective health and safety regulation, and has a long history of advocacy on matters related to auto safety. In addition, through litigation and lobbying, Public Citizen works to preserve Consumers' access to state-law remedies for injuries caused by consumer products, such as state product liability laws.

III. ARGUMENT

A. The claims of the Consumers and Personal Injury Victims are not "interests in property" under 11 U.S.C. § 363 (f).

Although the memorandum of law in support of the sale motion does not directly address successor liability issues, and the notice provided by Debtors is less than clear on the point, the accompanying motion and sale order do appear to provide for the sale to be free and clear of all successor liability claims. Section 363(f) of the Bankruptcy Code narrowly permits the sale of property of the estate free and clear of any "interest in such property" if one of five conditions are met. While the Bankruptcy Code does not define "interest in property," manifestly the claims of Personal Injury Victims and Consumers do not qualify. Accordingly, New Chrysler cannot purchase Chrysler's assets free and clear of successor liability for such claims.

Successor liability analysis involves consideration of "three principal factors": (1)

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continuity in operations and work force; (2) notice to the successor of its predecessor's legal obligation; and (3) inability of the predecessor to provide adequate relief directly. *Criswell v. Delta Air Lines, Inc.*, 868 F.2d 1093, 1094 (9th Cir.), cert. denied, 489 U.S. 1066 (1989); *see also EEOC v. G-K-G, Inc.,* 39 F.3d 740, 747-48 (7th Cir. 1994). These factors are all present in the case at bar, suggesting that successor liability will exist for New Chrysler. As such the issue is if that liability can be cut off under Section 363(f).[2]

Where the language of a statute is plain, and the context supports giving effect to that plain language, the statue must be applied. See *Holloway v. United States*, 526 U.S. 1, 7 (1999) ("the meaning of statutory language, plain or not, depends on context") (internal quotation marks omitted); accord, *Raygor v. Regents of Univ. of Minn.*, 122 S.Ct. 999, 1007 (2002) (reiterating that statutory language must be analyzed in context); *Owasso Indep. Sch. Dist. v. Falvo,* 122 S.Ct. 934, 939-40 (2002), vacated in part on other grounds, 288 F.3d 1236 (10th Cir. 2002) (same); *Food and Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132-33 (2000) (same).

Here, the language of Section 363(f), read in conjunction with other provisions of the Bankruptcy Code, is clear. It establishes that "interests in property" which can be foreclosed under Section 363(f) are liens, mortgages, money judgments, writs of garnishment and

[2] Preliminarily, it is worth noting that the availability of successor liability will likely be decided outside the bankruptcy proceeding and on the basis of state law. And, courts have held that successor liability may obtain even despite a § 363(f) sale. *See Lefever v. Hovnanian Enterprises, Inc.*, 734 A.2d 290, 298-301 (N.J. 1999); *Chicago Truck Drivers, Helpers and Warehouse Workers Union (Independent) Pension Fund v. Tasemkin, Inc.*, 59 F.3d 48 (7th Cir. 1995). Because many states recognize the "product line" theory, see *Lefever*, 734 A.2d at 293-95 (citing *Ray v. Alad Corp.*, 19 Cal. 3d 22, 136 Cal. Rptr. 574 (Cal. 1977)), and because of the evident continuity of the former and proposed new Chrysler entities, there is good reason to believe successor liability will be available to consumers and personal injury claimants. At any rate, the fact that this issue will be decided by the state courts responsible for interpreting their respective laws, irrespective of a purported "free and clear" sale under § 363(f), counsels against issuing such an order at this time.

attachment, and the like, and cannot encompass unliquidated successor liability claims. *See Folger Adam Sec., Inc. v. DeMatteis/MacGregor, JV*, 209 F.3d 252, 258, 259-60 (3d Cir. 2000) (stating that "[u]nder the rule of ejusdem generis, the term 'other interest' would ordinarily be limited to interests of the same kind as those enumerated, i.e., 'liens, mortgages, security interests, encumbrances, liabilities, [and] claims"'; that "[m]ortgages, security interests, encumbrances and liabilities possess characteristics similar to a lien"; and that "[a] lien is distinct from the obligation it secures ...").

Supporting this conclusion, the Code's definitions suggest that "liens" and "interests in property" are interchangeable, as a "lien" is defined to mean a "charge against or interest in property to secure payment of a debt or performance of an obligation." 11 U.S.C. § 101(37) (emphasis added). *See also*, *In re Schwinn Bicycle Co.*, 210 B.R. 747, 761 (Bankr. N.D. Ill. 1997), *aff'd*, 217 B.R. 790 (N.D. Ill. 1997); *In re Fairchild Aircraft Corp.,* 184 B.R. 910, 917-19 (Bankr. W.D. Tex. 1995), vacated on other grounds, 220 B.R. 909 (Bankr. W.D. Tex. 1998).

Moreover, the language of Section 1141 of the Bankruptcy Code confirms the propriety of a narrow reading of Section 363(f). Section 1141, which governs the disposition of estate property in a plan of reorganization, broadly states that property dealt with in a plan is free and clear of all "claims and interests of creditors." 11 U.S.C. § 1141(c). This language is much broader than that of Section 363(f) by including "claims", not just "interests in property," i.e. liens. Accordingly, the drafters of the Code did not intend to include "claims and interests" within the reach of Section 363(f) because that statute addresses only "interest[s] in property" i.e. liens. Section 363(f) therefore must be limited by its terms to "interest[s] in property" and can not be expanded by construction to attempt to capture the claims of Personal Injury Victims and Consumers that a debtor might *try* to foreclose under the broader Section 1141(c)

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Yet, courts have even permitted successor liability claims under sales pursuant to the broader protections afforded a purchaser under Section 1141(c), a section which, as the Court is well aware, is much broader than Section 363(f). *See Zerand-Bernal Group. Inc. v. Cox*, 23 F.3d 159, 163 (7th Cir. 1994); *R.C.M. Executive Gallery Corp. v. Rols Capital Co.*, 901 F. Supp. 630, 636-37 (S.D.N.Y. 1995). Because successor liability claims have survived plans in the face of the more inclusive reach of Section 1141 (c), *a fortiori* such claims should survive the more limited scope of Section 363(f) which only reaches "interest[s] in property" not "claims and interests" as with Section 1141(c).

As such, several courts have held that unsecured claims are not within the reach of Section 363(f). *See, e.g., Zerand-Bernal Group, Inc. v. Cox*, 23 F.3d 159, 163 (7th Cir. 1994); *In re Wolverine Radio Co.,* 930 F.2d 1132, 1147 n.23 (6th Cir. 1991), cert. dismissed 503 U.S. 978 (1992). *See In re White Motor Credit Corp.*, 75 B.R. 944, 948 (Bankr. N.D. Ohio 1987) (holders of tort claims "have no specific interest in a debtor's property"; therefore, "section 363 is inapplicable"); *In re New England Fish Co.,* 19 B.R. 323, 326 (Bankr. W.D. Wash. 1982) (unsecured claimants "do not have an interest in the specific property of the estate being sold ... which is contemplated by 11 U.S.C. § 363(f)").

This conclusion makes eminently good sense. A general unsecured claim is not an interest (like a lien) against property that the Code transfers to the proceeds of a sale under Section 363(f). Instead, it is a charge against the general assets of the estate. Accordingly, a general unsecured claim such as a common law successor liability claim cannot be readily transferred to the proceeds of an asset sale as it is not an "interest in property" within the meaning of Section 363(f). This Court should therefore not allow the sale free and clear of any successor liability claims that Consumers and personal injury claimants might possess under

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state law.

B. <u>Even if the claims at issue do qualify as "interests in property, " the conditions under Section 363(f) have not been satisfied.</u>

Even if this Court were to conclude that the consumer and personal injury claims at issue are "interests in property" within the meaning of Section 363, none of the requisite conditions found in the subsections of Section 363(f) has been met. The primary exceptions that might conceivably apply to the claims at issue are Sections 363(f)(1) and (5), but neither is applicable here. Without limitation, as further discussed above, "applicable nonbankruptcy law" prohibits the sale of the assets free and clear of the claims at issue, without consideration of successor liability principles. Accordingly, Section 363(f)(1) is not satisfied. Further, Section 363(f)(5) presupposes that a creditor's claim will be fully satisfied. *See Collier on Bankruptcy*, II 363.06[6c] ("Applicable nonbankruptcy law may recognize a monetary satisfaction when the lienholder is to be paid in full out of the proceeds of the sale or otherwise."). That is not the case here.

Simply put, this "quick sale" under Section 363(f) is not the appropriate mechanism to attempt to make the type of carefully reasoned decisions about questions of state law successor liability and whether to foreclose tort claimants. This Court should not expand the meaning of Section 363(f) beyond the clear statutory text which only allows "interests in property", i.e. liens, to be foreclosed.

C. <u>Any Sale Of The Property "Free And Clear" Would Be Inequitable, And Would Undermine The Ability Of Chrysler To Survive As A Going Entity By Undercutting Consumers' Willingness To Purchase New Vehicles From New Chrysler</u>

Missing from the Debtors' memorandum is any discussion of the effect of its plan (never clearly stated in the notice) to tell millions upon millions of its past customers that New Chrysler

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will not stand behind their vehicles beyond the limited warranty protection it says it will "assume" in the Section 363(f) sale. Chrysler certainly cites no case studies, let alone legal authority, for a consumer business continuing to exist and prosper after leaving its entire prior customer base out in the cold.

Chrysler's proposed "free and clear" sale begs the question of why anyone would buy a used car which lacked anyone standing behind it, for either durability or safety issues. This is not merely an academic question–a 6% drop in the resale value of Chrysler vehicles less than 3 years old was observed after Chrysler's bankruptcy announcement. See *Resale values fall 6% for Chrysler vehicles*, Detroit Free Press May 11, 2009 (available at http://www.freep.com/article/20090511/BUSINESS01/905110423/, last visited May 18, 2009). Given that this fall occurred in the face of statements of President Obama himself that the United States itself would stand behind Chrysler vehicles, one can only assume that the fall in resale values will be yet greater once Chrysler owners realize that no one is standing behind their vehicles, and that if they are injured or their vehicle has a defect, they are on their own as Chrysler has sought to leave them without any realistic remedy.

Yet, those who currently own Chrysler vehicles (who would all suffer if resale and trade in values fall), not to mention their social networks which form an important referral base, are precisely the future customers Chrysler most needs to survive. Customer retention is key in the automobile industry, and as JD Powers noted in reporting a horrible 32.8% retention rate for Chrysler in 2008 (compared to over 50% for Ford and Chevrolet), "Customer retention will become even more critical to automakers in the coming year, as new light-vehicle sales in 2009 are projected to decline to below 12 million units." J.D. Power and Associates: Honda Ranks Highest in New-Vehicle Buyer Retention, *As New-Vehicle Sales Continue to Fall, Customer*

Retention Becomes Critically Important (available at http://www.jdpower.com/corporate/news/releases/pressrelease.aspx?ID=2008265, last visited May 18, 2009).

The factors J.D. Powers noted were most important to customer retention were "creating safe vehicles with high resale value." Id. It is hard to see how the Debtors' plan to turn itself into a new company which destroys its prior customers' vehicle values and at the same time refuses to compensate its customers if they are injured by its defective vehicles is likely to be successful.

Of course, if Chrysler is willing to abandon customers with defective or lemon vehicles, including customers who have been physically injured, one would question why anyone in the market for a new vehicle would buy a car from Chrysler's successor company, which now aims to leave its prior customers holding the empty bag. Simply put, Chrysler's proposed "free and clear" sale adversely affects its prior customers, and all but guarantees in this day of web and media savvy buyers that New Chrysler will not survive long.

The damage done to New Chrysler's ability to survive would be further magnified by the ability of some injured Consumers and Personal Injury Victims to reach Chrysler's dealers and suppliers for compensation under the laws of the several States. Yet, if Chrysler is to have any chance of surviving, and not simply to be liquidated at enormous costs to taxpayers a few months hence, it must have a healthy dealer and supplier base. Shifting tort liability to these third parties, as Chrysler proposes to do, does not help achieve this goal. Moreover, these dealers and suppliers are likely far less able to address the underlying issues with Chrysler's vehicles than is Chrysler with its greater technical and managerial resources.

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D. New Chrysler Should Not Be Released from Liability for Future Consumer and Personal Injury Claims

The organizational objectors further object to the "free and clear" clause insofar as it purports to release future claims of people who have not yet been injured because, although they have purchased a Chrysler vehicle that has a defect or is a lemon, that defect or other problems have not yet become manifest. As the Third Circuit stated in *Schweitzer v. Consolidated Rail Corp.*, 758 F.2d 936, 943 (3d Cir. 1985), cert. denied 474 U.S. 864 (1985), it would be "absurd" to expect a "person who had no inkling" that he would be injured by the debtor's product years in the future to file a claim in the debtor's bankruptcy proceedings to preserve his rights. Because their claims have not yet arisen, and thus they cannot know of them, future consumer and personal injury claimants have not and cannot receive meaningful notice that their rights in a future suit are being lost, and thus they have no opportunity to seek to preserve those rights.

As discussed above, *supra* page 7, Section 363(f) narrowly allows the sale of property free and clear of any "interest in such property," rather than free and clear of all "claims and interests," as does Section 1141(c). But even under the broader language, the future causes of actions of people who have not yet suffered a loss or injury due to the defect in their vehicles would not be covered. "The term 'claim' means . . . right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101. A person who has not yet suffered a loss or injury has no right to payment from the debtor. *Cf. Schweitzer*, 785 F.2d at 944 (holding that claims for personal injuries that developed after a bankruptcy were not dischargeable "claims" under prior version of the Bankruptcy Act); *Mooney Aircraft Corp. v. Foster*, 730 F.2d 367 (5th Cir.1984) (holding that a bankruptcy court's order of a sale of a debtor's assets free and clear of all claims and liabilities did not disallow future wrongful death actions against the purchaser of the assets based on an accident that occurred after the assets were sold because the actions were not claims that existed at the time of the sale and thus were not claims under prior version of the Bankruptcy Act); *see also In re Chateaugay Corp.*, 944 F.2d 997, 1003-04 (2d Cir. 1991) ("Accepting as claimants those future tort victims whose injuries are caused by pre-petition conduct but do not become manifest until after confirmation, arguably puts considerable strain not only on the Code's definition of 'claim,' but also on the definition of 'creditor.'").

Although *Schweitzer* and *Mooney* relied on language of Section 101 of the Bankruptcy Act that has since been amended, they also discussed the due process issues that would arise from considering future claims to be dischargeable. Recognizing "that a sale free and clear is ineffective to divest the claim of a creditor who did not receive notice," the Fifth Circuit noted that, "were it necessary to reach this question, this lack of notice might well require [the court] to find that the bankruptcy court's prior judgment was ineffective as to" the later arising wrongful death claims. *Mooney*, 730 F.3d at 375. And explaining the "the general rule is that all known creditors must receive personal notice," the Third Circuit in *Schweitzer* stated that considering future tort claimants to be creditors whose claims could be discharged would raise "thorny constitutional issues." *Schweitzer*, 758 F.2d at 944 (citing *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 318-20 (1950)). Here, too, the Court should avoid the difficult constitutional questions that would arise from clearing New Chrysler of liability for claims that do not yet exist, and make clear that the sale does not release the claims of Consumers who will be injured or suffer losses in the future as a result of defects in Chrysler vehicles sold by Chrysler before the bankruptcy proceeding.

IV. CONCLUSION

For the foregoing reasons, the Objectors hereby request that the Court decline to approve

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any sale "free and clear" under Section 363(f) of product liability claims by either Consumers or Personal Injury Victims, and leave the issue of successor liability to state law.

Dated this 19th day of May, 2009.

Respectfully submitted,
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Ms. JACKSON LEE. And we recognize a gentleman that needs no further introduction, but we acknowledge his long years of service and commitment to the consumer.

Mr. Ralph Nader is recognized for 5 minutes.

TESTIMONY OF RALPH NADER, CONSUMER ADVOCATE

Mr. NADER. Thank you, Madam Chair and Members of the House Judiciary Committee for this hearing.

The government-led restructuring of Chrysler and General Motors has been twice delegated, first by Congress to the executive branch and then by the President to a task force.

The task force is made of up cabinet official an high level political appointees, but the predominant ones have from Wall Street. They have a financial approach to this problem, they are not reflecting manufacturing knowledge at all. And I mention Secretary Geithner, economic director Larry Summers and Steve Rattner. In law school we used to study cases involving excess delegation of congressional authority to agencies and departments in the government. Those problems are really quaint compared to the wholesale delegation these days. I think Congress feels it is so overwhelmed that it is exhibiting evidence of cognitive dissidents.

And it is important historically to know that Congress has conducted hearings and pronounced policies into law that are very complex, the tax laws for example, the pension laws, the Trade laws. As Bruce Fein pointed out a very detailed analysis of that led to the Conrail legislation, Amtrak legislation. And in 1979, the House and Senate had extensive hearings on the Chrysler bailout. What is the difference it now except that the ramifications are horrifically greater. Whatever the difference now except the damage to checks and balances constitutionally are greater than ever.

I think it is important to note that if the GM is going to go into bankruptcy without any shareholder approval, notice that, the business judgment rule now extends that a few bosses under prodding from Washington can throw a company into bankruptcy without a shareholders vote of either approval or denial. The shareholders, common shareholders, preferred shareholder shunt to the side.

Today we had a press conference where small bond holders were making their plea. If GM goes into bankruptcy, what will emerge, what will be launched would be a conclusive death star to tens of thousands of jobs, thousands of smaller businesses and adverse effects it to hundreds of communities around the country. And Congress is entitled to ask does this have to happen. When a company in 2008 can sell 8.1 million cars, 3 million in this country, over 1 million in China, the rest around the world and be considered a basket case unworthy of detailed congressional examination and policy making, along with the rest of the industry, we are entitled to ask a lot of questions. Workers are entitled to ask questions, the dealers are entitled to ask questions, rural dealers, minority dealers are entitled to ask questions, auto suppliers.

Toyota has been conducting people here saying if GM goes bankrupt, its suppliers, a lot of its suppliers will go bankrupt because they sell the GM and Toyota. There are a lot of issues in your opening statements, Members of the Committee and in the prior statements here that argue overwhelmingly for this task force to be considered in its final report in a few days as an advisory committee to the Congress. And it comes back here to the Congress for thorough areas, policy resolution and legislation. This is, if anything is, a responsibility of the Congress.

When an unelected little task force, operating in secret a few days ago can tell Chrysler to terminate 780 dealers, averaging 60 jobs per dealer, that is 45,000 jobs, against Chrysler's will, because it doesn't cost anything for Chrysler to have dealers and they sell more cars, and it is more convenient to motorists, especially in poorer areas an rural areas. When that can happen, that is just a harbinger of congressional delegation run riot.

I would like to note, in conclusion, that the fly in the ointment here is the China strategy of General Motors, years ago General Motors realized that the U.S. market was a stagnant, declining market for itself, it couldn't compete with Toyota and others, and that China was the future. And now China is being used as the platform to reexport to the United States to further hollow out communities and jobs on behalf of General Motors.

I don't think you can ever have free trade with a country that is a dictatorship, because a dictatorship dictates costs, it dictates wage levels and no unions and dictates pollution at will, it dictates bribery. And those are serious unfair methods of competition. Whatever you can say about China violating repeatedly for visions of the World Trade Organization, you can also add that if Congress does not examine the China policy and examine all these other issues that have been raised here, it will go down as one of the greatest abdications of congressional responsibility in the economic realm. And that death star will turn into a fire ball of political protests that will come back to Washington, and it will not be directed at the Republican party, it will be directed at the party in power.

And I will conclude with a short comment by a worker in the Kenosha Chrysler plant in Wisconsin, an award winning modern engine plant when he said—this is Rudy Kuzel, K-U-Z-E-L, he said, "the government's coming in saying we have to shape these communities up and providing the money to do it. That's good, that's what we want. But if the companies use the government's support, the tax money to shut factories and move the jobs out of the country, what are we saving, the company name?"

In short, what is at stake here is a huge demand for congressional policy making, bringing together all the various variables, all the value systems that only Congress can bring together. And the other day, I was astonished by a legislative agent to a senator who told me, we don't want this to come back from a task force to a congressional fish bowl, Congress cannot make tough decisions. Well, if Congress cannot make tough decision, I think it better have a major hearing on itself.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Nader follows:]

PREPARED STATEMENT OF RALPH NADER

Dear Senator Dodd and Congressman Frank:

The government-led restructuring of Chrysler and General Motors has been twice delegated—first by Congress to the Executive, and then by the President to a task force. Formally made up of cabinet officials and high-level political appointees, control over the process has in fact been delegated, without adequate standards, to a handful of special advisers. Thus has the future of a centerpiece of American manufacturing capacity been delegated to a small unelected and largely unaccountable group arranged to avoid the Federal Advisory Committee Act. The Congress must, at the least, reclaim its oversight role in this process, and subject the Auto Task

Force's proposals and plans to careful scrutiny before irreversible measures—such as a GM bankruptcy filing—are undertaken.

The President has stated that "I am absolutely committed to working with Congress and the auto companies to meet one goal: The United States of America will lead the world in building the next generation of clean cars." That is a laudable sentiment, and it is imperative that this goal be achieved.

But it is not befitting our system of checks and balances for Congress to rely on a presidential statement of good intentions—particularly when it is a small, informal group of appointed non-experts who are charged with rescuing the auto industry.

The Auto Task Force has guided Chrysler into bankruptcy, and appears on course to do the same with GM. The government overseers are hoping for a quick bankruptcy reorganization, resolution of creditor claims that were not resolving themselves through private negotiation, and emergence of a debt-free company, shorn of encumbering assets, post-bankruptcy.

However, there is enormous risk in such a move. The bankruptcy process may not move as quickly as imagined; it is after all, independent judges who control the process, not the executive branch. Especially if the bankruptcy process lingers—but even if it does not—there is a serious risk of impairing consumer purchasing confidence in a once-bankrupt auto company. This was conventional wisdom just six months ago. It is not clear why this conventional wisdom has been abandoned, notwithstanding the government guarantee of GM and Chrysler warrantees.

The matter of impaired consumer confidence deserves much more attention than it has received, at least in any public fashion. Already, reports are emerging of further declines in Chrysler sales after its bankruptcy filing, and of widespread belief among consumers that the company is liquidating.

Lost consumer confidence in GM could quite conceivably overwhelm the "benefits" to the company of eliminating outstanding liabilities. Thus the plans of the task force may prove to be a house of cards.

The bankruptcy route for GM is also likely to have important ripple effects especially on suppliers, with a ripple of supplier bankruptcies likely to follow such a move by GM. Even Toyota has commented to Members of Congress on its concern that a GM bankruptcy will pull down suppliers that sell to both companies. Such a ripple will mean more lost jobs, more pain for communities across the country, and a loss of some the most dynamic and innovative parts of the industry.

It is obvious that GM needs a new direction, and the removal of its CEO was a welcome step. The rest of the incumbent management though, remains in place, raising concerns about the ability of the company to remake itself.

While the company needs a new direction, and probably a contraction, it is not obvious that it needs to contract as much as the secretive task force envisions, and in the ways apparently planned. Before the task force's plans with GM are enacted—and certainly before the company declares bankruptcy—Congress should hold deliberative hearings to protect taxpayers' investments and seek answers to these questions, among many others:

- Is the task force right in pushing for elimination of as many brands as it has demanded?
- Is the task force asking for too many plants to close?
- Do GM and Chrysler really need to close as many dealerships as have been announced? Is the logic of closing dealers to enable the remaining dealers to charge higher prices (See, for example, Peter Whoriskey and Kendra Marr, "Chrysler Pulls Out of Hundreds of Franchises," Washington Post, May 15, 2009); and if so, why is the government facilitating such a move? Is it reasonable and fair for GM to impose liability for disposing of unsold cars on dealers with which it severs relations, as Chrysler has apparently done?
- Has the task force evaluated the social ripple effects on suppliers, innovation, dealers, newspapers, banks and others that hold company stock and/or are company creditors, and other unique harms that might stem from bankruptcy?
- Would a government-driven bankruptcy process comport with the rights of owner-shareholders?
- Why has the task force maintained the Bush administration-negotiated obligation for unionized auto workers at GM and Chrysler to accept wages comparable to those in non-unionized Japanese company plants in the United States? This requirement is especially troubling given the low contribution of wages to the cost of a car (10 percent), and that it may set off a downward

spiral of wages, with the non-union plants no longer needing to compete with union wages, and union wages following those in non-union plants.

- Is the task force obtaining guarantees that, after restructuring with U.S. taxpayer financing, GM cars sold in the United States be made in the United States? If not, why not?
- How will bankruptcy affect GM's overseas operations, with special reference to China and GM corporate entanglements with Chinese partners? Are they and their profits being exempted from the restrictions and cutbacks imposed on domestic operations? If there is such a disparity, is it reasonable and unavoidable?
- How will bankruptcy affect GM's obligations to parties engaged in pending litigation in the courts with GM regarding serious injuries suffered because of design or product defects?
- What guarantees is the task force obtaining to ensure that the GM of the future invests in safer and more fuel efficient vehicles, and what investments will the new company make in ecologically sustainable technologies? How will a potential bankruptcy filing affect, ignore or preclude any such future investments and commitments?

Among the most worrisome components in the restructuring plan is the willingness to sacrifice U.S. manufacturing, and permit GM to increase manufacturing overseas for export back into the United States. Recent news reports indicate that the company will rely increasingly on overseas plants to make cars for sale in the United States, with cars made in low-wage countries like Mexico rising from 15 to 23 percent of GM sales in the United States. For the first time, GM plans emerged to export cars from China to the United States, in what may be a harbinger of the company's future business model; although the company has stated after negative publicity that it will not export from China, there is no evidence that it is abandoning the business model of outsourcing production for the U.S. market, and questions remain about how binding is the recent commitment not to export to the United States from China.

Not surprisingly, industry analysts have quickly weighed in to emphasize that "political considerations" should not interfere with obtaining purported "efficiencies." But such talk is gibberish in the context of a government bailout. What is the point of the U.S. government bailing out GM if not to respond to the political considerations of preserving jobs, communities, manufacturing capacity and directing the mismanaged company to an ecologically sustainable future?

Will the U.S. Congress abdicate its responsibilities while such plans are finalized by the delegated task force? Such a willful abdication would contrast starkly with the dutiful legislative hearings and legislation regarding the Chrysler bailout in 1979.

At the very least, the Congress must exercise its oversight powers. It should, at the very least, urge the Obama administration to defer any plans for bankruptcy or other irreversible moves until after the task force plan has been subjected to close and careful review via thorough Congressional hearings. If delay requires some additional bridge funding for GM, surely such funding with suitable equity positions is appropriate, in light of the potential risks of bankruptcy to millions of families and further governmental relief programs, and the vastly greater sums that have been so recklessly expended on the virtually condition-free Wall Street bailout.

Ms. JACKSON LEE. I thank the gentleman for his testimony.

Mr. LoPucki, you have a schedule departure time, what time is that?

Mr. LOPUCKI. I will need to leave shortly after 3.

Ms. JACKSON LEE. All right. I think we might be able to get in the last 2 witnesses and then the questioning will begin with you.

Again Ms. Claybrook needing no extensive introduction, but we thank you for your long-standing service to the consumer, Ms. Claybrook is recognized for 5 minutes.

TESTIMONY OF JOAN CLAYBROOK, PRESIDENT EMERITUS, PUBLIC CITIZEN

Ms. CLAYBROOK. I thank you, Madam Chairman, and I will try and take less than that so that your other witnesses can be questioned. The major point that I want to make is that the United States taxpayers are shelling out about $35 billion to Chrysler and General Motors and GMC, another 5 to suppliers and as much as 60 billion more to come. And yet there is, in both the bankruptcy decisions and in the bailout decisions, that has already been explained are being made by a small group of individuals. There is no give-back by the companies in terms of safety. Now, I would have said that about fuel economy until the President's announcement on Monday or Tuesday, which I was extremely pleased about, so I can't go into that detail. But what the President has pushed for and is going to implement is vastly improve fuel efficiency and a national standard for emissions and fuel economy.

But the issue that is on the table as well for this Nation is health care and in the President's meeting with industry leaders and others last week, he talked about the importance of prevention. While there are 40,000 people killed every year, and 2½ million people injured on our highways. There is a lot that can be done about it. And the automotive industry has spent decades trying to prevent safety standards from being adopted. And yet there is a very important unrealized agenda for safety improvements. I would like to briefly mention them for the record, and that is stronger rules inside window glazing, and important safety belt protection for occupants in rollover crashes. They kill 10,500 people a year, so much more than almost any other issue that we are so concerned about obviously in wars and other things.

Stronger seats and seat backs which fail, causing terrible injury, not only to people in those seats but to children who we now insist be put in the back seat. And protection for rear seat occupants as well with side impact air bags and belt use warning signals, improved latching for child seats, testing them in real crashes. And pedestrians protection, most people don't realize it, but a car can be designed so that pedestrians are far less likely to be seriously injured and also bicycle riders. And Honda is leading the way on this, but the U.S. Government has no standard on pedestrian protection.

And then compatibility and safety requirements between vehicles of different size, which is very important, given the different size vehicles on our highway and event data recorders in all vehicles, some have them, some don't. It is not a systematic requirement so that we know what happens on the highway.

My view, Madam Chairman, and Mr. Chairman, is that if we are going to give all this money to the auto industry, we ought to at least get improved safety on the highway and not just give it to them and let them to continue to oppose safety improvements for our people. I, of course, endorse all the other statements, particularly about the automobile dealers and closing the plants. I would like to submit for the record an excellent article called The Case for Kenosha in the Nation Magazine this week that talks about this great plant that is being closed arbitrarily. Thank you so much.

Ms. JACKSON LEE. With unanimous consent and without objection it will be submitted into the record. Hearing no objection.

[The prepared statement of Ms. Claybrook follows:]

PREPARED STATEMENT OF JOAN CLAYBROOK

Statement by Joan Claybrook
President Emeritus of Public Citizen
Concerning Auto Company Bankruptcies and Bailouts

Before the Committee on the Judiciary
House of Representatives
Washington, D. C. 20591

May 21, 2009

Mr. Chairman and Members of the Committee

Thank you for the invitation to testify today on the implications of the current automotive industry bankruptcies and bailouts. I am Joan Claybrook, President Emeritus of Public Citizen and a former Administrator of the Nation Highway Traffic Administration in the U. S. Department of Transportation. I will focus my comments on the unfinished safety agenda and the capacity of the auto companies to meet critical new and upgraded safety standards.

American taxpayers to date are shelling out over $35 billion to Chrysler and General Motors and GMAC, another $5 billion to automotive suppliers with as much as $60 billion more to come in the future to save near bankrupt U.S. automotive companies. These manufacturers for the last 40 years have bobbed and weaved to oppose any serious improvements in motor vehicle safety, fuel economy and emissions. The public will no longer put up with this double standard.

This week President Obama announced tough new federal emission and mileage standards requiring the fleet to meet 35.5 mpg by 2016, four years earlier than the 2007 law. This matches the California program that had been stalled by the refusal of the Bush Administration to grant the state a waiver to issue its rules. The Obama program for the first time requires a national standard to limit motor vehicle climate-altering gases. The new national standard is about 40 percent higher by 2016 than current fuel economy rules.

For years the auto industry has opposed higher fuel economy and emission standards. In fact, at the industry's request, the Gingrich Congress in 1995 and for seven years thereafter, deleted all funding for the fuel economy program in the U.S. Department of Transportation, stalling any action on issuance of standards. In 2007 the auto industry successfully pushed hard to seriously weaken the legislation updating the fuel economy law, in order to continue manufacturing large fuel using vehicles they expected to continue selling as cash cows.

The Detroit manufacturers' refusal to embrace high fuel economy and limits on green house gases while continuing to produce mammoth gas guzzling vehicles is a major factor in their current financial difficulties. But with the Obama announcement this week, the automotive companies did an about face. Under the threats of bankruptcy and the need for bailout money, their rationale now is that the new program is acceptable because it would provide a single national standard they want, the timetable is reasonable, and the new program gives them certainly for their product development plans. They could have decided this ten years ago and saved the nation, their workers, their retirees, and the state of Michigan endless grief.

But, no initiative or agreements have been made to improve motor vehicle safety. Yet motor vehicle crashes kill over 40,000 Americans every year on our nation's highways, injure more than 2.5 million more, and are the leading cause of fatalities for all persons in the United States, ages four to 34. Motor vehicle crashes exact a huge personal toll in terms of deaths, injuries and disruption to family life, as well as imposing a heavy financial burden on society, estimated at $230.6 billion (in 2000 dollars) annually, or a "crash tax" of about $800 for every man, woman and child.[1]

Motor vehicle crashes are the leading cause of occupational fatalities in the U.S. The most dangerous part of the work day for any employee is the time they spend in their vehicle, with a crash occurring every 5 seconds, property damage occurring every 7 seconds, an injury occurring every 10 seconds and a motor vehicle fatality occurring every 12 minutes. In 2000, the economic cost of crashes to employers was $60 billion resulting in three million lost workdays. Although the federal motor vehicle safety standards issued by the NHTSA have historically been responsible for saving hundreds of thousands of lives,[2] there has been little progress in recent years in reducing the annual number of highway trafficfatalities.[3]

Advancing a strong national highway traffic safety agenda is critical for many reasons. First, prevention is the key to saving lives and reducing injuries. General fleet-wide improvements in vehicle safety through design, technology and behavioral responses reap benefits in reducing fatalities and serious, traumatic physical injuries. Second, progress toward crash prevention and vehicle crashworthiness provides economic benefits by reducing public health care costs for medical response to crash scenes, emergency room visits, hospital and rehabilitation stays, long-term care, physical and occupational therapy, reduced time away from work, and other medical treatments. Since motor vehicle crash injuries and costs are a major contributing factor to health care and employment costs, crash avoidance and injury prevention should be part of any well-developed policy initiative to bring national health care costs under control.

[1] *The Economic Impact of Motor Vehicle Crashes 2000*, NHTSA Technical Report, DOT HS 809 446, NHTSA (May 2002).

[2] NHTSA study estimated cumulative number of lives saved from 1960 through 2002 at 328,551, *Lives Saved*
by the Federal Motor Vehicle Safety Standards and other Vehicle Safety technologies, 1960-2002, NHTSA Technical Report, DOT HS 809 833, NHTSA (Oct. 2004).

[3] Decline in motor vehicle traffic fatalities to an estimated 37,313, reported for 2008, *Early Estimate of Motor Vehicle Traffic Fatalities in 2008*, Traffic Safety Facts Research Note, DOT HS 811 124 , NHTSA (Mar.2009), reflects not only efforts to improve safety but also the effects of an estimated decline in vehicle miles of travel (VMT) and likely changes in discretionary driving patterns resulting from the steep increase in oil and gasoline prices during much of the year, as well as the precipitous economic decline in the last third of the year.

In fact, just this week, President Obama met at the White House with corporate executives, labor leaders and government officials to discuss innovative and effective strategies that employers are using to hold down the cost of health care for workers and their families. The foundation of all of the successful strategies, programs and cost-saving measures was repeatedly framed as "prevention". The highway and auto safety programs of the U.S. Department of Transportation (DOT) will be an essential element of the Obama Administration's health care and economic stimulus proposals to assist families and employers. Preventing motor vehicle crashes, deaths and injuries is a cost-effective, prudent, and successful investment of government resources.

This year, Congress will draft a new surface transportation reauthorization bill that will, in all likelihood, advance a balanced transportation system and expand consumer choices for transportation alternatives. This is a positive approach that will result not just in expanded public transportation options, but will encourage more pedestrian and bicycle traffic as well as a greater variety of different types of fuel efficient vehicles. While these changes provide opportunities to alter energy-use patterns, they also could lead to more interactions and safety conflicts between vehicles and non-occupants and between large and small vehicles. In drafting the reauthorization bill, we urge the Committee and the Administration to consider the safety needs that all of these future transportation choices will require in order to improve the level of safety provided to the public in a highly mobile society.

The unfinished motor vehicle safety agenda is long and deep. It reflects a failure to advance safety requirements over the last three decades except to minimally comply with congressional legislative requirements. Thousands of lives and many of thousands of debilitating injuries could be saved if new safety standards were adopted. These include:

- Strong roofs, side window glazing with pretensioning and load-limiting safety belts to protect occupants from injury and ejection in rollover crashes tested with dynamic tests as are used for years for frontal and side impact standards
- Stronger seats and seat backs which too often fail causing severe injury to back seat occupants such as children and quadriplegia and paraplegia for front seat occupants
- Protection for rear seat occupants (often children as DOT advises parents to place children in rear seats) with improved side impact air bags, belt use warning signals, improved latching of child seats that are tested in real vehicle crash tests
- Pedestrian protection in vehicle design to lessen the harm when pedestrians and bikers are hit by removing exterior sharp objects, making the front ends more rounded, designing the windshield area to be smooth and possibly contain an exterior airbag (Honda is leading the way with improved vehicle pedestrian protection.

- Compatibility crash safety requirements that lessen the adverse impact on smaller vehicles of crashes with larger vehicles.
- Event data recorders in all vehicles to monitor the causes of a crash and gather data to improve vehicle and driver performance. Some vehicle now contain different systems but they should be consistent across the fleet.

It is clear Mr. Chairman that if the Congress does not get more deeply involved on behalf of the people, the decisions being made on the vehicle manufacturers bailouts and potential bankruptcies will not reflect their concerns that are being expressed today at this hearing. We appreciate the opportunity to testify on these issues today.

Ms. JACKSON LEE. Mr. Skeel, you are Professor Skeel, you are recognized for 5 minutes and you might summarize your statement and submit the entire statement into the record.

TESTIMONY OF DAVID A. SKEEL, PROFESSOR, S. SAMUEL ARSHT PROFESSOR OF CORPORATE LAW, UNIVERSITY OF PENNSYLVANIA LAW SCHOOL

Mr. SKEEL. Thank you, Madam Chairman and Members. Of the Committee, it is a great honor to appear before you this afternoon. I would like it make two basic points in my opening remarks. First, our bankruptcy laws are well designed to handle the financial distress of Chrysler and General Motors and to facilitate their restructuring.

Second, the Administration's handling of the Chrysler bankruptcy and its apparent plans for GM have violated the basic rules of bankruptcies in ways that could have and I think may well have dangerous consequences. Let me briefly expand on each of these points. First our bankruptcy laws, in particular Chapter 11, are well designed to successfully restructure the automakers. There is a widespread misconception in this country that bankruptcy means the death of a business. In many countries, this would be accurate, but the American bankruptcy laws are uniquely designed, as they have been, since corporate organization was first devised over a century ago to preserve and restructure viable enterprises like the car makers.

The first major mistake with the car makers, in my view, was waiting so long to consider the bankruptcy option. General Motors lost $20 billion last year. The company surely would have lost less and would be much further along in its efforts to restructure if it's former management had not refused to plan for or even consider the possibility of a bankruptcy until late last year. The arguments GM's management made for avoiding bankruptcy, such as the claim that customers would refuse to buy the cars of a company in bankruptcy were never plausible. In my view, the decision finally to use Chapter 11 has thus been a good and overdue decision. But the Administration's handling of the bankruptcy process has been deeply problematic. This is the second of my two points.

In a case like Chrysler, the parties ordinarily would negotiate over the terms of the reorganization plan and then each class of creditors or shareholders would vote whether to approve the plan. Rather than use the traditional process, the Administration has structured Chrysler's bankruptcy as a shame sale of most of Chrysler's assets to a new entity to called new Chrysler for roughly $2 billion. The goal of this strategy seems to circumvent the voting process and to alter the ordinary rules of priority. Under the usual priority rule known as absolute priority, senior lenders are entitled to be paid in full before lower priority creditors, including employees receive anything. The sale in Chrysler undermines the rights of senior lender by setting an artificially low sales price that will give them less than 30 percent of what they are owed, while promising a substantial recovery to lower priority creditors.

I believe that the Auto Task Force and the Administration generally believe that their plan is the best strategy for restructuring the you a tore industry and making it profitable again. But they have distorted the bankruptcy rules to achieve this result. The Chrysler strategy could have at least two very dangerous consequences. First, the subversion of basic priority rules could interfere with lenders willingness to extend credit to troubled corporation. Senior lenders have been burned in Chrysler, they will take steps not to be burned again. Lenders will be especially reluctant to make loans to any company that might be the subject of government intervention, such as the suppliers to the auto industry. More generally, the unsettling of the priority rules could appreciably increase the cost of borrowing for any company that is in financial distress in the coming years.

Second, the Chrysler sale sets a dangerous precedent. In future cases the insiders of a company that files for bankruptcy will be able to propose a similar sham sale that benefits favored creditors, perhaps the managers of the company at the expense of disfavored creditors. Interest already are reasons to worry about bankruptcy sales that are proposed by insiders. But the Chrysler precedent goes well beyond anything that previously would have been thought possible. I don't believe that the sham sale in Chrysler will be treated as an extraordinary one time event. Much like the Supreme Court decision in Bush versus Gore, it will influence future cases on these issues in the years to come.

In sum, I believe that our bankruptcy laws are well designed for restructuring of the troubled car makers, but it is very dangerous for the Administration to distort the bankruptcy laws to achieve its preferred outcome. Thank you.

[The prepared statement of Mr. Skeel follows:]

PREPARED STATEMENT OF DAVID A. SKEEL, JR.

TESTIMONY OF DAVID A. SKEEL, JR.

Judiciary Committee
U.S. House of Representatives
May 21, 2009

Good afternoon, Chairman Conyers, Ranking Member Smith and members of the committee. I am David Skeel, Professor at the University of Pennsylvania Law School. It is a great honor to appear before you.

I'd like to make two basic points in my opening remarks. First, our bankruptcy laws are well designed to handle the financial distress of Chrysler and General Motors, and to facilitate their restructuring. Second, the administration's handling of the Chrysler bankruptcy and its apparent plans for GM have violated the basic rules of bankruptcy in ways that could have dangerous consequences. Let me briefly expand on each of these points.

First, our bankruptcy laws—in particular, Chapter 11—are well designed to successfully restructure the automakers. There is a widespread misconception that bankruptcy means the death of a business. In many countries this would accurate, but the American bankruptcy laws are uniquely designed-- as they have been since corporate reorganization was first devised over a century ago-- to preserve and restructure viable enterprises like the carmakers. (The history is described in detail in David

A. Skeel, Jr., *Debt's Dominion: A History of Bankruptcy Law in* America (2001)).

The first major mistake with the carmakers was waiting so long to consider the bankruptcy option. General Motors lost $20 billion last year. The company surely would have lost less, and would be much further along in its efforts to restructure, if its former management had not refused to plan for or even consider the possibility of bankruptcy until late last year. The arguments GM's management made for avoiding bankruptcy—such as the claim that customers would refuse to buy the cars of a company in bankruptcy-- were never plausible.

In my view, the decision finally to use Chapter 11 has thus been a good and overdue decision.

But <u>the administration's handling of the bankruptcy process has been deeply problematic.</u> This is the <u>second of my two points</u>.

In a case like Chrysler, the parties ordinarily would negotiate over the term of a proposed reorganization plan, and then each class of creditors or shareholders would vote whether to approve the plan. Rather than use the traditional process, the administration has structured Chrysler's bankruptcy as a sham sale of most of Chrysler's assets to a new entity called New

Chrysler for $2 billion. The goal of this strategy seems to be to circumvent the voting process and to alter the ordinary rules of priority.

Under the usual priority rule—known as absolute priority—senior lenders are entitled to be paid in full before lower priority creditors (including employees) receive anything. The sale in Chrysler undermines the rights of the senior lenders by setting an artificially low sales price that will give them less than 30% of what they are owed, while promising a substantial recovery to lower priority creditors.

I believe the auto task force and the administration genuinely believe that their plan is the best strategy for restructuring the American auto industry and making it profitable again. But they have distorted the bankruptcy rules to achieve this result. Ironically, they have done so by resurrecting a strategy—the sham sale—whose potential abuses the reformers of the New Deal era—your predecessors—thought they had stamped out more than seventy years ago. (This point is discussed more fully in David Skeel, "Why the Chrysler Deal would horrify a New Dealer, available at http://www.american.com/archive/2009/may-2009/why-the-chrysler-deal-would-horrify-a-new-dealer).

The Chrysler strategy could have at least two very dangerous consequences.

First, the subversion of the basic priority rules could seriously interfere with lenders' willingness to extend credit to troubled corporations. Senior lenders have been burned in Chrysler; they will take steps not to be burned again. Lenders will be especially reluctant to make loans to any company that might be the subject of government intervention, such as the suppliers to the auto industry. The administration's misuse of the bankruptcy process in Chrysler may make it more difficult for these other companies to survive on their own, and could make government help more necessary than it otherwise would be. More generally, the unsettling of the priority rules could appreciably increase the cost of borrowing for any company that is in financial distress in the coming years.

Second, the Chrysler sale sets a dangerous precedent. In future cases, the insiders of a company that files for bankruptcy will be able to propose a similar sham sale that benefits favored creditors at the expense of disfavored creditors. There already are reasons to worry about bankruptcy sales that are proposed by insiders. But the Chrysler precedent goes well beyond anything that previously would have been thought possible.

I don't believe that the sham sale in Chrysler will be treated as an extraordinary, one time event. Much like the Bush v. Gore decision by the Supreme Court, it will influence cases in the future.

In sum, I believe that our bankruptcy laws are well designed for a restructuring of the troubled carmakers. But it is very dangerous for the administration to distort the bankruptcy laws to achieve its preferred outcome.

THANK YOU.

Mr. CONYERS. [Presiding.] Thank you so much, I want to begin by thanking our colleague, Sheila Jackson Lee, for Chairing the Committee through this very important and serious testimony that has been rendered 2, 4, 6, 8, 9 panelists; and we are grateful to them. And I would like to ask any of my colleagues if anyone has any burning questions they would like to put to Mr. LoPucki before he may have to depart at whatever time is required of him to leave?

I would like now to yield to Lamar Smith, who has been extremely cooperative with the Committee in terms of us coming together as quickly as we were able to.

Mr. SMITH. Thank you, Mr. Chairman.

Mr. Grossman, let me direct my first question to you. There have been serious allegations that is Chrysler senior secured creditors were strong armed into agreeing to the auto task force Chrysler deal. What are the ramifications of that for creditors, the bankruptcy system and our overall financial institutions.

Mr. GROSSMAN. Thank you, Mr. Smith for that question. As you noted, there have been ample news reports that multiple of holdout creditors were holding senior debts of Chrysler were approached by officials of the Administration and were in various terms threatened that their reputation would be tarnished and that is the Administration would use various means at its disposal to impact their businesses. The effect of these almost thuggish techniques on lending and on really the availability of credit to corporate entities I think will be very severe. Politically connected companies, companies that have large union work forces, and other companies that may be subject to government intervention will find it tougher to access capital markets.

When they are able to arrange loans, those loans will be more expensive. The results will be that those companies and those industries will suffer competitive disadvantage and that will cost job and economic growth.

Mr. SMITH. Thank you. Mr. Nader, individuals in the room who are under 40 or 50 may not know that back in the 1960's and 1970's, you were a campus hero. And I had several classmates, in fact, who worked for you after graduation.

My quick question for you has a couple of words that will be familiar only to those of us over 50 or thereabouts. And my question is this, do you believe that the Auto Task Force is unsafe at any speed?

Mr. NADER. Yes. Worse than that.

I just want to add I disagree with my colleague here, Professor Skeel, when he said that consumers be less willing to buy cars from companies in bankruptcy. He called it implausible. I don't think it is implausible, do you, Clarence?

Mr. DITLOW. Absolutely not.

Mr. NADER. The whole structure is built on a house of cards. If there is another strong dip in sales for GM. As Chrysler has been down from last year big time, but it is down even more if I am not mistaken since the bankruptcy. You know there is resale value and all these things. And the fact that the government is guaranteeing warranty, I don't think that solves the problem and it hasn't sunk in. This is a task force that looks at these companies in very financial terms and doesn't take into account enough variables around the country. It is ideological, empirically starved and this is what happens when you put Wall Street people in charge of heartland manufacturing companies fate and the future. I am not saying we have the answers, I am saying Congress has got to get this back before it is too late in the next 10 days because they will go into bankruptcy court within hours after this task force reports.

Mr. SMITH. Thank you, Mr. Nader. I liked your one-word initial response, yes.

You said that the Chrysler bankruptcy deal is a sham, what does it mean to the rule of law under our bankruptcy system?

Mr. SKEEL. I think it is very dangerous, as I said in my opening statement, what this is, it is not a real sale. If there had been a real urgency about selling the assets right away or this had been a sale we are there were real buyers out there, it would be one thing, but this is a completely artificial sale devised by the government to achieve the results it wants to achieve, which is turning the ordinary priorities on their head. My fear is not only is that going to have significant negative consequences for Chrysler itself in the Chrysler restructuring itself, but in the future, it is going to tempt other people to do the same sort of thing. Once the government does it, other companies that are in trouble are going to do this as well. They are going to get into bankruptcy, instead of going through the ordinary restructuring process with the voting rules, what they will do is propose a sale to the company that they will—a shell company that they will set up and ask the court to bless it and I fear that some courts will.

Mr. SMITH. Thank you, Professor. Thank you, Mr. Chairman.

Mr. CONYERS. The Chair is pleased to recognize the gentleman from North Carolina, Mel Watts.

Mr. WATTS. Thank you, Mr. Chairman. And I thank the Chair for convening this hearing, a somewhat distressing hearing, but unfortunately that is not unique over the last several months as a Member of the Judiciary Committee and the Financial Services Committee. We have had a number of very, very difficult choices to make and it is always difficult to hear some of the projected consequences of those choices, but let me confine myself to this aspect of what we are talking about rather than the overall financial malaise that we have been trying to deal with in my other Committee, Financial Services.

We obviously have been working very closely with the minority automobile dealers, trying to save them. We tried to get them included in the original bailout with the manufactures that did not succeed. We have worked with them to try to get them included under TARP in some various ways to increase the size limits of the SBA. So we have a very strong interest in trying to assist minority automobile dealers who have been underrepresented in the industry for years. And now that they—the one who were represented in the industry are finding themselves at a very, very difficult crossroads.

I am interested in knowing, and I will address this question to Professor Skeel. What different outcome there would be in a regular bankruptcy proceeding that proceeded in the way you perceive Chapter 11 should proceed, what would be the consequence for the dealers, let's just deal with the dealers, then if we have time maybe you can address the suppliers and the other creditors. What would be the different consequences as you perceive it had there been a regular Chapter 11 bankruptcy.

Mr. SKEEL. I think in my respects the consequences would have been similar. I think there would have been a restructuring of the dealerships, but I think it would have been more planned out and it would have been developed earlier and perhaps there would have been more discussion about which dealerships will be cut and which ones not.

Mr. WATTS. When would have had those discussions.

Mr. SKEEL. Presumably Chrysler and its dealerships. Chrysler or GM as well should have been talking to them before bankruptcy.

Mr. WATTS. I am not sure what process there would be in a regular Chapter 11 bankruptcy process. We make it sound like the regular bankruptcy process is when we have a choice we have to figure out what the choice is between. And I understand the potential consequences of gaming the system by setting up sham sales going forward for future bankruptcies. And that is something I guess we will have to deal with as a legislative body going forward, but I am not sure that your implication that somehow the dealers, the creditors, the other creditors who got this Hobson's choice presented to them as Mr. Grossman has testified about. I don't see a pleasant end game for any of them in a regular Chapter 11 bankruptcy.

Mr. SKEEL. Well, the first thing I would want to say in response is that with respect to the dealerships, this is a regular bankruptcy. I mean, one way to look at this is the government is picking and choosing who it wants to favor. And it is——

Mr. WATTS. That is the answer to a question, I am just not sure it is the answer to the question I am posing.

Mr. SKEEL. I think it is. I think the answer in terms of what the rights of the dealerships are and how they are treated is the same under this bankruptcy——

Mr. WATTS. Basically the answer then is the dealers were going to get really taken advantage of regardless of whether this played itself out the way this is playing itself out now or whether there wasn't this honeymoon deal that is in the process of being made.

Mr. SKEEL. The rules would have been the same. I think if the restructuring had begun earlier, it is quite possible fewer dealerships would have been cut. If Chrysler were in healthier shape when the restructuring took place, they wouldn't be thinking about cutting lots of dealerships.

The rest of what I would say is I think the most effective way to protect dealerships, particularly minority dealerships going forward is to put pressure on Chrysler and to say this restructuring is not the end of the came. They are going to be a car company afterwards, they better have an equitable distribution of their dealerships.

Mr. WATTS. I think my time has expired. I am glad we got to an opportunity to hear some affirmative suggestions other than just take back your authority. When we take back our authority, then we have to have some responsibility to deal with it. We delegate to governmental agencies in virtually every aspect of government.

And I guess I get a little impatient with the people who say we ought to take back all the authority that we have given to the Federal Reserve. I don't know that I would want these decisions made in a political context by the 435 Members of this body or the 100 Members of the other body other than in the framework of giving them general guidance that we hope will lead to some kind of thoughtful results.

Mr. FEIN. May I respond to that?

Mr. WATTS. I am sure Mr. Lichfield has a response to it. He thinks we ought to abolish the Federal Reserve too.

Mr. FEIN. I'm Mr. Fein, that is all right.

It is matters of degree and what is the extent of the delegation. It is one thing to delegate with——

Mr. WATTS. I appreciate it. My time has expired, Mr. Chairman. I am going to yield back and I have heard your speech before Mr. Fein and I am not arguing with you, I just—everything in life is a matter of degree. I guess I agree with you on that.

I think I am finished.

Mr. CONYERS. Well, if Mr. Fein insists on a response, I think the least we can do is hear what he has got to say.

Mr. FEIN. Thank you, Mr. Chairman.

I want to say that it may seem like a platitude but matter of degree count in term of how much the responsibility for making these decision is given to those who are not politically accountable and can do whatever they want with that discretion. That is not the exercise of judgment by this body as to what the policy ought to be. It is something akin to saying let the IRS write the Internal Revenue Code and let it be fair. That is different than saying you have a 4,000 page bill and then the Internal Revenue Service can add additional regulations or gloss on it. And with regard to accountability and process, that is what democracy is about. The Federal Reserve Board is not only relatively secret, but these are members who are independent. You would want to say Mr. Watt, that we don't want political accountability for an institution that affects the jobs of tens of millions of people? That seems to me silly. That is what self-government means. That is critical to their entire lives. We want it to be political. You may make errors, but that means you get to decide your own fate. These people on the Federal Reserve Board, they sit there 14 years, they are independent, they can't be removed by this body whatsoever. I think that is a real concern. Thank you.

Mr. CONYERS. The Chair is pleased to recognize yet another Member from North Carolina. This time it is Howard Coble, senior Member of this Committee.

Mr. COBLE. Thank you, Mr. Chairman. Thank you for calling the hearing. Thank you all for being with us. I addressed these two questions earlier but I don't think either of you responded. Mr. Grossman, let me ask you this, what is the cost benefit realized by the factories of reducing the number of franchise dealers, A.

And what savings is produced in eliminating Chrysler dealers with a 30-day notice as opposed to a 1-year notice?

Mr. GROSSMAN. Mr. Coble, according to independent automotive analysts, the automotive companies actually do spend a fair amount of money to service their various dealers. There are certain fixed costs that they face for every single dealer no matter the number of cars that that dealer sells.

In addition, there is a question of focus, the amount of attention that an automaker can devote to any particular franchisee. An that attention is diffused when it has too many franchisees. There is also the issue of canalized sales when you have franchisees that are located in areas that are too near one another, there is the risk that those franchisees will compete against themselves in a way that is bad for the automaker, and that may be bad for the stability of that company and that brand.

So I think the key answer to your question is a question of focus, it is a question of resources and it is a question of making sure that customers have the best experience that they can when they visit dealers.

Mr. COBLE. Thank you, sir.

Mr. Henderson, what criteria was used to determine what dealers were sent termination notices, A and B what is the practical outcome are to those dealers who wish to appeal a termination letter.

Mr. HENDERSON. Thank you, Mr. Coble, we have not gotten any clarity on what criteria was used. We have been raving those questions and Chrysler is giving indications that there have been a combination of factors that have to do with market share, location, facility and so forth. But as we look at the dealers on the assumed list and the dealers on the list that would not have their agreements assumed, there are very similar profiles with dealers on both lists. There is no clarify on that question.

Mr. COBLE. Now, I have been told that there was a disproportionate number of semi rural or small town dealers that were terminated; is that, in fact, accurate or do you know?

Mr. HENDERSON. That appears to be the case that there is some disproportionate termination. What happens is that it makes it a lack of convenience for customers to be able to have dealers in their locality to be able to service their vehicles. And also it takes away some level of competition.

If I may respond to Mr. Grossman, while there is some potential savings according to the manufacturer for eliminating dealers, dealers are the customers of the manufacturers, we buy cars. Less dealers typically is going to mean will mean less vehicles, it will mean less competition for consumers and the pricing will be less convenient for consumers in getting that car serviced.

Mr. COBLE. How about the rights of a terminated dealer if he wanted to appeal that, any thoughts on that?

Mr. HENDERSON. According to Chrysler, there are no internal deal process. The process at this point is going to be objection that would be filed in the bankruptcy court, which is very expensive process and very difficult for dealers to embark upon.

Mr. COBLE. Thank you, Mr. Henderson.

Mr. Nader, you responded very promptly to Mr. Smith's question regarding the unsafe at any speed, and I don't mean to speak for you but I suspect you would probably go an additional step and say to us that the deals that the auto task force have negotiated are equally unsafe at any speed, would you not.

Mr. NADER. Well if you want to extend that metaphor. You can see the testimony here, there are safety consequences. There are health consequences. There are burdens on the taxpayer because more unemployed people will have to go on social welfare so it is a very sad situation. I have always been excessively sensitive to excessive congressional delegation, knowing full well you have got huge burdens on you, you can't micromanage. But what I think Bruce has been saying and others is that you are delegating basic policy decisions, basic policy decisions. I am old enough to remember the Dealer Day in Court Act that others did for the dealers to develop a better balance between dealers and auto companies. Those hearings were incredibly thorough, documented, detailed before the Congress then went to the Floor with the legislation.

Mr. COBLE. My red light has illuminated, so I yield back, Mr. Chairman. Thank you ladies and gentlemen.

Mr. CONYERS. Distinguished gentlelady from Houston, Texas, Sheila Jackson Lee.

Ms. JACKSON LEE. Thank you very much, Mr. Chairman. I want to thank the witness again and I thank the Chairman for yielding to me and sharing the Chairman's chair because the testimony from the position of that Chair seems to be intense. And you really do get it or you attempt to get it.

Let me try to just recite some of the points that both Mr. Lester and Mr. Henderson made and it is startling and striking. I do want to acknowledge the work of many Members of this panel, meaning Members of the Judiciary Committee that have worked intently over the years. I would like to acknowledge the lessons that I received in meeting with the National Association Minority Automobile Dealers just recently or a couple of months ago in Houston and the strong arguments that were made and arguments that we tried to take to the table.

And so here we are and I would just offer words such as brand elimination. The only distribution system that is in place to get from the manufacturer, the owner to the ultimate consumer, which is true, we need help now and the reduction of dealers certainly is reduction of wealth in the minority community. And one that I would add is that the dealerships, minority and otherwise are anchors in our community, they are the grounding of civicness, they are the Little League supporters and school supporters, the PTO supporters, the civic club supporters. And so I think this is more than a crisis.

Mr. Henderson, you mentioned something I thought it as startling, that you tried to help, in this instance, Chrysler, by agreeing to buy vehicles that you may not have needed in your inventory. But as good citizens and good laborers, if you will, on behalf of your brand company, you stretched and stuck your neck out on the line. And this may have happened across America and this is tragic and disgraceful.

It is disgraceful that you get this kind of thanks. Not that you extended yourself, but you get this kind of thanks. And certainly as the burden has been put at our feet, I don't believe and I know that Members of Congress did not intend to give unfettered control, but we wanted to be partners and get the team rolling, to get us back on our feet.

Interestingly enough there is a little light at the end of the tunnel and the economy is turning at least as we look at the Dow. But what we have here I think warrants some kind of legislative fix. And so I want to pose my questions along those lines and ask quickly, though Mr. Fein has suggested that we have unburdened ourselves from our responsibility. I want to know besides the Constitution, do you think we need to rush in with a legislative fix? And I use as an example this issue of individual liability for the dealerships as they close and are left holding the bag on probably purchases that they made. Do we now come in and step along side of the bankruptcy proceeding and ask to protect certain creditors?

Mr. FEIN. It is certainly true that this body has authority by statute to override anything that a bankruptcy judge night be considering. Bankruptcy judge is acting under the delegation of the standards that this body enacted. So that makes quite sensible thing to do.

In the railroad case, the Congress was acting, in some sense, in collaboration with the bankruptcy courts that were unable to fashion something that was viable and that seems to me quite appropriate decision for this body to make.

Ms. JACKSON LEE. I think it is more than appropriate. Mr. Grossman, what about a legislative fix, particularly in the issues of unwanted inventory so that the dealer may be now liable for a number of issues. The keeping of the fixed assets so that dealers that want to come back, so we would do a parallel action along side of the bankruptcy proceeding, meaning legislatively. Do we have to put all of our eggs in that basket? If, and I guess the question, the question of overriding the franchise laws which are allowed, or at least happening through the bankruptcy proceeding.

Mr. GROSSMAN. You are correct that State franchise laws are not applicable in a bankruptcy proceeding. I think the legislative fix you describe would have I think there are at least two concerns that it raises. One is that it will delay and impede the reforms necessary for General Motors and Chrysler to regain their competitive footing. We may wind up in a scenario where the two companies again are on the verge of insolvency or bankruptcy, despite the taxpayer that have been invested in them.

Ms. JACKSON LEE. So you are not looking for a fix.

So Mr. Nader, these are consumers of sorts that you are talking about, even though an ultimate consumer may be the gentleman injured, plaintiffs now in proceedings, but also purchasers, but these dealerships. Is it just, say, from the moral representation of consumers, should we put our heads together on a legislative fix, if we are leaving dealerships holding the bag.

Mr. NADER. I think Congress's role is to rearrange the equities, there are a lot of equities and inequities and that is way beyond bankruptcy court. I am not entirely unaware of the possibilities of remedies by the dealers if they are not faced with the bankruptcy of their parent, of their parent company, so to speak. Maybe that is what one answer you might be looking for. Do the existing contracts allow for a remedy absent any bankruptcy by Chrysler or GM, existing franchise?—on the way you have been treated—it is pretty shabby treatment, wouldn't you say?

Ms. JACKSON LEE. They are left holding the bag.

I will conclude by saying I think the issue of a non existing health policy, Mr. Chairman, for America is more at fault than to suggest that we are scapegoating labor unions who are trying to provide health care for their members. So I think, Mr. Nader, you have given us a sidebar opportunity of possibly looking at this fix based upon either contractual relationships or the moral compass that we all need to use. I yield back and I thank you for this. Certainly I believe the points that you have given are worthy of study and worthy of a legislative fix, and I look forward to hearing from you and working with you in the future. I yield back.

Mr. CONYERS. Thank you very much. I am always pleased to recognize the gentleman from Texas, Judge Louie Gohmert.

Mr. GOHMERT. And I am also pleased to be recognized by our honorable Chairman. Thank you, Chairman Conyers. Appreciate you all being here today.

Mr. Nader you and I met about 36 years ago, you came to Texas A&M when I was there and I got to escortyou a little bit. Are you still getting 4 hours of sleep at night?

Mr. NADER. I keep meeting people who have picked me up at airports. We should have an alumni club. It turns out, the present Secretary of Agriculture picked me up when he was a student at Hamilton College.

Mr. GOHMERT. It was a pleasure then and now. You are probably the most recognized consumer advocate in the world. And I am sorry I was late, we had another hearing that goes on at the same time, but what does this mean, this deal with Chrysler for consumer prices, safety, choices and that the UAW will now be an owner of both Chrysler and GM the way it is looking now?

Mr. NADER. Well, as the testimony around me asserted, there are serious questions about people who have product liability suits what have been seriously injured, two of whom are in this room pursuant to a Chrysler bankruptcy. There are serious questions about whether the government's investment in Chrysler is going to lead to elevation of long delayed safety standards that the auto companies have been fighting. And there are really serious questions about the intermediate consumers which obviously are the dealers. I think you have got about 8 or 9 days before you can turn this around and bring it back to Congress. Your tens of billions of dollars that you have already loaned out or are about to loan out, there is a reciprocity involved there.

Mr. GOHMERT. Well, you have been innovative in some of your approaches to try to advocate on behalf of consumers. Do you see a suit by you through the Federal Advisory Committee Act to try to prevent some of these sacrifices that appear to be in the making?

Mr. NADER. You mean, the way the task force is structured?

Mr. GOHMERT. Yes.

Mr. NADER. It is very cleverly structured to avoid coming under the Federal Advisory Committee Act. It is basically run by existing high officials in the Administration and they have basically provided assistance in the form of the few people who are actually doing the operating work, and it is not called an advisory committee. Therefore, we can't demand representation in terms of the people on the advisory committee to represent the various stakeholders or a certain open records. All the other things that Ms.

Claybrook, a public citizen, has worked very long and hard on, the Federal Advisory Committee Act.

Mr. GOHMERT. You had to be shocked that you weren't invited to be part of the Auto Task Force, I take it?

Mr. NADER. I think it is very, very Wall Street-oriented. I don't want to stereotype Wall Street because it stereotyped itself in recent months, more than I could ever expect to.

Mr. GOHMERT. Now they are partners with the government, though, so it is a good thing, because the government and Wall Street have partnered, and now the government and the auto industry are partnering, and of course, insurance industry, we are partnering with them. It seems to have a theme I have heard of before in history that listed about 70 years before it was brought down. But let me ask——

Mr. NADER. You mean in the corporate state, right?

Mr. GOHMERT. Yes.

Mr. NADER. That is a very serious issue for Congress to have hearings on, because you just pinpointed a very serious giant step into the moral of the corporate state, that Franklin Delano Roosevelt warned us about in 1938 when he said, when government is controlled by private economic power that is fascism. Those are his very words.

Mr. GOHMERT. It seems like maybe Orwell had it wrong by about 25 years is the way it is appearing.

Mr. Grossman, how can we possibly hope that giving the UAW major ownership in these companies could produce a successful bankruptcy or long-term lease structuring of these entities?

Mr. GROSSMAN. I think the answer is that we can't. The history of sorts of transactions is one that is filled with failures, that is filled with companies bouncing in and out of bankruptcy. I think the risk at that point is that taxpayer enormous investment in these companies. It will be entirely unrecoupable.

Mr. GOHMERT. Thank you, Mr. Chairman.

Mr. CONYERS. Please note I recognize the gentlelady from Los Angeles, Maxine Waters.

Ms. WATERS. I thank you very much, Mr. Chairman. I have to apologize for being in and out of the Committee. We have Secretary Donovan over in the Financial Services Committee on my section 8 legislation that is dealing with housing for all of these poor people in the country. But this is very important and I wanted to be back here.

I have been working with Mr. Damon Lester for months now as he has walked these halls trying to get some attention to what has been happening with the minority auto dealers when we were spending the other $350 billion of the TARP money and trying to determine how they could be heard and what we could do to be of assistance, this is kind of disastrous here. I think everything has been said about the importance of dealerships to towns and communities and the economic value that they have.

And I want to speak particularly to the minority auto dealers and the fact that we have been very proud that as African Americans have tried to build wealth in this country, that the minority auto dealers was at the top of the list of those who worked very hard and who brought jobs and opportunities into our community and helped us to build wealth and to stabilize our communities. Unfortunately all of that seems to be at risk at this point as we look at what is happening with the major manufacturers and the deals that are being cut in order to reshape them, reform them, or realign them or whatever is being done.

There are two aspects of this that I would like to speak to and I hope that I can center in on what I consider two major problems. Number 1, there are those who would like to stay in business and would like to have some assistance, and would who would like to find a way to do that needing very badly to have some financial assistance. And then there are those who are ready to get out of the business, but they don't want to be left stuck with all of this liability, whether it is the inventory forced upon them by the manufacturers or related liabilities, all having to do with the management of those dealerships.

I suppose the questions I have in mind are those, number 1, as they make decisions about what dealerships will be cut and those that will stay, what is the formula? How are the determinations made? Does anyone have that information?

Mr. LESTER. For Chrysler, as Randy Henderson already mentioned, there was no criteria has been made publicly. We reached out to the head of Chrysler, Jim Press, on several occasions already. I am now being directed to the public relations department, inquiring as to why and what was the rationale for the 789 termination dealer lists.

For General Motors they have made it public that their criteria was based on sales, expectancy, customer service, profitability, and capitalization, as well as the number of vehicles that were sold per year, but for Chrysler there has not been any transparency at all yet. It has just been very quiet as far as how they should be accountable to these dealers now.

Ms. WATERS. Professor David Skeel, can't this information be compelled?

Mr. SKEEL. I would think so. Certainly in the bankruptcy court, there is a very, very high premium on disclosure and transparency. The dealers as creditors in the bankruptcy have the right to question the debtor, and I think they should be able to compel.

Ms. WATERS. And should do that. And additionally, if inventory was forced upon dealers that is creating a liability for them, should not that information be made available and documented for the bankruptcy court?

Mr. SKEEL. I would think so. That would be part of the claim that the dealerships in the bankruptcy case.

Ms. WATERS. And could not the bankruptcy judge make a determination that that is unfair liability and they should not have to assume it and that the manufacturers would have to pick up those costs to absorb those costs, whatever they are, could that not be a determination?

Mr. SKEEL. That is harder. The normal rule would not be that that is part of your claim in the bankruptcy case and it would be treated like the rest of your claim in the bankruptcy case. So getting the court to actually force Chrysler to pay the expense, it may be there is some argument that you could make along those lines, but that is a little bit harder. The information part is easier.

Ms. WATERS. And maybe I should not be asking you this, maybe I should be asking myself and my colleagues this. As the government considers the assistance that they are going to give to the manufacturers, could not a case be made that the liability costs be assumed in whatever TARP funding may be forthcoming.

Mr. SKEEL. Certainly something that could be considered.

And one point that I would like to make for you all that has been made indirectly is the most important thing, in my view, is to separate what goes on in the bankruptcy court from what is done outside of bankruptcy. And things like guaranteeing the warranties, which I think was a very good idea, helping particular constituencies, those can be done outside of bankruptcy. Where it becomes pernicious is when those two things are put and the bankruptcy process is distorted. I think it is very important to keep those two functions separate.

Ms. WATERS. And let me just ask, as decisions are made about what dealerships should be cut and if part of those decisions are a consideration such as you have dealerships that are in close proximity to each other and that that is not viable, that they will not be able to support, could one raise questions about who determined where dealerships would be in the first place?

Mr. SKEEL. Yes, you absolutely can raise those questions. In the bankruptcy process, it is very hard to win that kind of an argument. There is a lot of deference to the company itself, to Chrysler in making that decision. But certainly the dealerships are entitled to know exactly why they made those decisions and what the basis for them is. And all of that can be raised in the bankruptcy court.

Ms. WATERS. Thank you.

I guess what I am getting out of this, Mr. Chairman, if I may, is that we may still have a role to play in all of this; and that role has to do with negotiating with this Administration about what they are going to do to help ease the pain on these dealers.

We have the TARP money. That money is going to be used in some shape, form, or fashion. And if the dealers could put together a wish list of how they can be assisted in this terrible time that we are in, whether that is to maintain or to exit, and that was presented by way of negotiation or legislation with this Administration, we may be able to be of some real help. Could you conclude that?

Mr. SKEEL. I think so. TARP is extraordinarily broadly worded; and so the companies that are funded through TARP, there is a lot of flexibility there.

Ms. WATERS. We can do whatever. We lost the battle to have control of the second $350 billion, as you know. It is all over in the Administration with a lot of flexibility, and that may give us an open window here by which to try and impact the way that that is appropriated.

Mr. SKEEL. It is certainly an option.

Ms. WATERS. Thank you, Mr. Chairman. I think that shines a little bit of light on what is possible.

Mr. CONYERS. Thank you so much, Maxine Waters.

Before I recognize Bob Goodlatte, I want to point out that there is a chronological warp we are in. The 8 or 9 days will have run out by the time we come out of the week's recess. And so assuming that we were going to have the staff working on a legislative redirection of some of these issues, unless we got an extension of this expiration date, we would be doing some noble things, but it would be after the fact. And I would like to just open up to the eight of you if anybody sees a way that, if we chose to do this, we would have to get some permission to extend the time line and then begin to work on the legislation.

I just wonder what you eight and Mel Watt and Maxine Waters respond, how would you all respond to this chronological fix that I think we are in.

Mr. FEIN. I think, Mr. Chairman, you can maybe get unanimous consent by legislation. Just freeze or hold in abeyance the situation so you have more than 8 or 9 days. Because that is not complex legislation.

And another method of at least temporarily providing some protection would be to just pass simple legislation saying that the bankruptcy court cannot preempt certain State protection, consumer protection, dealer protection laws. It is very simple legislation, and then it automatically would kick in to provide some to the dealer and consumer protections that have been mentioned here.

Mr. NADER. Mr. Chairman, I just might add that the obstacle is a June 1st guideline for $1 billion payment on GM bonds by the company. If the Chrysler precedent is teachable, the task force will make its report before the end of May, and they can be in bankruptcy court in 48 hours. So the $1 billion payment is going to be put before you as an obstacle, and I think the Administration can handle that with its TARP money. So that is an insuperable obstacle on June 1, and you can ask for more time. And short of a resolution, I think just a political communication to the White House by leaders of the House and Senate saying, wait, don't rush to the bankruptcy court; we have to look at this.

Ms. CLAYBROOK. I would also suggest, Mr. Chairman, if you can't get it done through the leadership, you may just want to send out a, hey, dear colleague, and see how many Members sign on. And if you get more than 218 Members in the House or 50 Members in the Senate, you have got a majority that spells problems for the Administration if they don't listen to you.

Mr. LESTER. I think our President is the only one that can really do this thing immediately for us. At this point in time, as you already mentioned, the time, the clock is ticking. And these gentlemen back behind me, we don't have time to wait for any legislative action, particularly since you guys are in recess. At this point, our President is the only one who can mandate this and get this thing done immediately.

Mr. CONYERS. Let's turn now to Bob Goodlatte, who, in addition to being a senior Member of the Committee, was the past Chairman of the Agriculture Committee.

Mr. GOODLATTE. Mr. Chairman, thank you very much for holding this hearing. I hope that it has been timely, given the rush of events that we have here. And, quite frankly, I view this as an oversight hearing of the actions taken by both the Bush administration and the Obama administration that raise considerable questions regarding what is the appropriate role of bankruptcy in this process.

Quite frankly, I did not support the bailouts last year. I felt that there was an appropriate role to be played. I find Professor Skeel's and the comments of others, including the President, that the Congress could play a role in guaranteeing the warranties so that companies going into bankruptcy could still sell cars to people and hopefully come out of a bankruptcy on the other side—but I am very, very concerned about the role that is being played behind closed doors in the dark of night to decide the fate of this bankruptcy before it ever gets to the fair judicial process that it is supposed to undergo. And if there are some alternations that need to be made because of the magnitude of these bankruptcies or because of the impact on consumers, then the Congress should be playing an aboveboard and clear role, and it should not be occurring out of the sight of the public and the people who are funding these bailouts and are going to suffer the consequence of this action.

So with that having been said, Mr. Grossman, let me ask you, are you concerned that the Chrysler bankruptcy plan is an illegal sub rosa plan cooked up in the dark of night by the Auto Task Force of the Administration without any meaningful input from Chrysler's senior secured lenders?

Mr. GROSSMAN. There is a strong argument to be made that the sale, the sham sale, that has been put together by the Obama administration does indeed violate the Bankruptcy Code. That said, the way that the appeals process works within the bankruptcy courts it seems very unlikely that the sale would be overturned or in any way annulled. It does, of course, as I think many people on this panel have discussed, create a very serious precedent that could allow more and more of these types of sales to go forward, whether aided and abetted by the government or by managers of a corporation that are seeking to freeze out outside investors or indeed to loot the company.

Mr. GOODLATTE. People playing outside the scope of the law as it has been structured by this Congress over centuries.

Let me ask you, Professor Skeel, can you briefly explain what a sub rosa plan is, why it is illegal, and whether you believe the Chrysler plan is a sub rosa plan?

Mr. SKEEL. To answer your last question first, I do believe it is a sub rosa plan. What a sub rosa plan is, what it means is a disguised plan, where this is, in form, a sale of assets. In theory, we are just selling Chrysler's assets to this new company. But really what we are using this sale to do is to decide who gets what. We are not just raising money for the assets. We are deciding who gets that—that Fiat gets some stock in Chrysler, that the employees get some stock in Chrysler, that the dealerships are not protected by this sale, that other people are not protected by this sale.

So, in effect, what we have is a reorganization plan without going through any of the reorganization process, the right to negotiate the plan, the right to vote on it. So, yes, I do believe it is a sub rosa plan; and I do believe it is illegal.

Mr. GOODLATTE. We have been sitting here concerned about the speed with which events are unfolding with the inability of the Congress to act. But let me ask you also, and others may want to answer this as well, the sale procedures for Chrysler's assets provided for just over 1 week for potential bidders to put in a final offer for substantially all of Chrysler's assets with no due diligence or financial contingency. Does anyone believe that this is an absurdly short time period for a multi-billion dollar transaction that was designed to do anything other than to preordain a bankruptcy plan that is being structured out of the sight of the public and before we are ever in the bankruptcy court somewhere in the corridors of the Administration?

Mr. SKEEL. I will start by saying, yes, I do think it is an absurdly short period of time. Short time period sales are sometimes appropriate if the assets are going to disappear suddenly or there are other extraordinary circumstances. A short time for a sale is not necessary here. We could have allowed much more time.

Ms. CLAYBROOK. I would like to say that when you have a very short period of time it means that the people who are less powerful don't have a voice because they don't have the time to get organized. If you have lawyers on your payroll, if you are normally involved in litigation, then you do have time.

Mr. GOODLATTE. And that is what a Chapter 11 reorganization is supposed to do. It freezes the situation as best you can and puts it in the court for a deliberative process to evaluate the assets, evaluate the rights of all of the parties involved and then come forward with the best plan in the judgment of the court, hopefully with the agreement of the parties, to be able to move forward and move this out of bankruptcy again and have the company survive and the employees survive and the consumers rights be protected and the cars that they purchased and want to have their warranties honored. Or, as Mr. Nader points out, the right to be protected if the car has been defective and want to have their rights protected in that process.

All of that has to be carefully considered, and it ought to be done in a formal process under the rule of law, rather than have that all happen ahead of time and then drop down on the court and say this is what we expect to happen.

Mr. Chairman, if I might be allowed one more question. Mr. Grossman, did the Troubled Asset Relief Program funds essentially to bail out Chrysler and General Motors violate the terms of the Emergency Economic Stimulus Act which only gives the Secretary of the Treasury the power to purchase troubled assets from financial institutions which are defined as, quote, any bank, savings association, credit union, security broker or dealer or insurance company, end quote.

Mr. GROSSMAN. I think the answer is that it does violate the terms of that Act. I think an automaker by anyone's estimation is not a financial institution. Under the Administration's logic, any corner restaurant that offers a tab to its customers would be a financial institution. I think that is ridiculous.

Mr. GOODLATTE. Well, Mr. Chairman, I have heard from many who were—I don't have any auto plants in my district, but I have a lot of auto parts manufacturing plants. I have many, obviously, auto dealers who I have heard from about this process. They believe that this is something that is not being decided by Chrysler; it is being decided by somebody somewhere in the Administration. And if there is anything that Congress can do to bring this to the light of day and restore an orderly process to it I certainly would be anxious to work with you, and I will bet many on my side of the aisle would be willing to work with you and others on your side of the aisle who have expressed concerns about where we have been brought to to this point.

Mr. CONYERS. Thank you, Mr. Goodlatte. Thank you very much.

The Chair recognizes Bill Delahunt of Massachusetts, a Member of the Foreign Affairs Committee and himself a former prosecutor from Massachusetts.

Mr. DELAHUNT. Thank you, Mr. Chairman.

I would like to associate myself with the ending of the concluding remarks of the gentleman from Virginia. I think we have an obligation along the lines articulated by Mr. Goodlatte.

But I think some of us are having difficulty understanding the basics. So I just want to have one of you walk me through the process. I have real process issues here, procedures. Now, I don't know who I could pick on. Mr. Fein I rely on on a regular basis. But in a typical Chapter 11 reorganization there is a plan, and the plan is either approved by the bankruptcy court or amended by the bankruptcy court after objections are filed and there are hearings. Am I correct?

Mr. SKEEL. Yes, that is mostly correct. The only distinction I would make is the bankruptcy court doesn't amend the plan. The bankruptcy court is meant to be a referee. So the bankruptcy court can hear objections on a plan, agree with the objections if they are correct, and then say to the parties, you need to go back and do this over; this does not square with the bankruptcy laws.

Mr. DELAHUNT. Okay. So we are talking about a referee here.

Now, we have this situation where one of the stakeholders, obviously a significant stakeholder, is the American public, the taxpayers. Government funds are here. Now, I have heard Mr. Nader and other panelists talk about accountability and delegation. Tell me if I am wrong. Is this particular process, since the government is, let's say, the centerpiece or the major stakeholder in this, given the bailout money, this Committee specifically, because we have jurisdiction of bankruptcy, has oversight. And I think that is what we are doing today. Mr. Nader, I hear you reference 8 or 9 days to go. That doesn't give us very much time.

Mr. NADER. On your first point, which is the responsibility of the government, it is essentially—the moment a major company comes to Washington and asks Washington to save it, as General Motors did, it is a political process and a congressional responsibility. So anybody who says, well, we don't want to politicize this, you have crossed that Rubicon. It is a political responsibility with radiating concerns way beyond the General Motors headquarters in Detroit and communities all over the country.

Mr. DELAHUNT. I guess what I am saying, Mr. Nader, is that we do that—we might have—you or others would argue or suggest that the delegation—I think this is Bruce Fein's point, too—is we have delegated too much.

I guess what I am saying is when we passed a Bankruptcy Act, I guess one could say that was delegation and conferred upon the bankruptcy court certain powers. But I guess what I am saying, because of the unique nature or the unusual nature of this particular reorganization, the government has a different role. And what we do here is to exercise—Congress exercises its oversight responsibility to ensure—I think you used the term, Mr. Nader—that the equities are there. I don't think it really requires us to pass new legislation. Help me.

Mr. NADER. I think it does. Let me tell you. I will give you an example.

The task force has a very narrow focus, and it is secret, and it is not representative, but it has a full authority of the President to, right now, as we speak, dictate to Chrysler and General Motors certain things like closing down dealers.

Mr. DELAHUNT. Let me just ask you about the task force. That is an executive branch——

Mr. NADER. But there are no standards. You set no standards for it. Even for the independent—yeah, that is the point. There are no congressional standards. It is a two-tier delegation ending up in a secret negotiation.

Mr. DELAHUNT. But I guess what——

Mr. NADER. Just to go to your point. For example, the task force has not informed us how it is handling General Motors' assets and unrepatriated profits in China. Now, for example, if General Motors says, well, we don't have money to pay the $1 billion on June 1st and the task force says, yeah, are we entitled to accept that on trust? What is the asset base and the unrepatriated profits, which are enormous in China?

Mr. DELAHUNT. I guess what I am saying—I am not necessarily disagreeing with you. What I am saying is our next step in the process would be to call, to summons in or invite in the task force to this Committee to explain the process and how they concluded what decisions they made.

Mr. NADER. Exactly. Before they rush to bankruptcy court.

Mr. CONYERS. Will the gentleman yield briefly?

Why don't we rush into 1600 Pennsylvania Avenue and get this thing worked out and bring a bipartisan delegation?

Mr. DELAHUNT. Well, Mr. Chairman, whatever you say. I know Mr. Gohmert would go. I know Mr. Goodlatte would be there. Darrell Issa, you know he would be there.

Mr. CONYERS. Well, what about Bill Delahunt?

Mr. DELAHUNT. You know, I am just a lieutenant in the Conyer's army. Between trips overseas, I would be happy to accompany you.

But I just kind of wanted to understand this conceptually. Mr. Fein.

Mr. FEIN. Mr. Delahunt, I think what could be done is, instead of having the bankruptcy judge be the referee, as we discussed who is ordering the priorities, the equities, you could require that the plan be presented to the Congress which has 60 or 90 days to vote on it. So it is not oversight. You are deciding whether the priorities are correct or not, which—and it doesn't have to be in every single bankruptcy. It could be where the government also has invested its own funds. It is not just a bystander. Or the size of the particular level that makes the equities far more significant than in a tiny case so you are not bombarded with these countless occasions. We are always told, well, these companies are too big to fail. Well, maybe they are too big to get bankruptcy judges to get them out and you have to decide that as well.

Mr. DELAHUNT. Could I have an additional 30 seconds, Mr. Chairman?

I am beginning to think that we should have a new standard in terms of our antitrust, our marketplace, and that is if it is too big to fail it never should have got there in the first place. Because I think we really do put at risk our economy. And who ends up getting tagged with the bill? It is the American taxpayer. And it diverts us away from a free market.

If it is too big to fail, then you no longer have a—in my judgment, or at least in my limited economic perspective, that is not a free marketplace. That is not a marketplace that is working.

I yield back.

Mr. CONYERS. Thank you very much, Mr. Delahunt.

The Chair is pleased to recognize the gentleman from Ohio, Jim Jordan.

Mr. JORDAN. Thank you, Mr. Chairman. I thought Darrell was next, but I appreciate it.

Mr. CONYERS. Wait a minute.

Mr. JORDAN. I spoke too soon.

Mr. CONYERS. Now that I am looking at the gentleman from California——

Mr. ISSA. Thank you both.

Mr. CONYERS. Darrell Issa.

Mr. ISSA. Thank you, Mr. Chairman.

When I was born in Cleveland, Ohio, I never knew how important my Ohio roots would be to me.

Mr. Chairman, I would ask unanimous consent to include in the record articles from *The New York Times, The Wall Street Journal,* and *The Financial Times.*

Mr. CONYERS. Without objection, so ordered.*

Mr. ISSA. Thank you.

I would like to go down a fairly narrow track, but I think one that may not have been covered here. Professor Skeel—and I think the minority auto dealers may very well find this unexpectedly pleasant. From a bankruptcy standpoint, the monies that the American people put in to—let's just take Chrysler for a moment—those monies are, in a sense, monies that were outside a bankruptcy. In other words, they were put in under terms that, if not for those monies, these companies would, both GM and Chrysler, would have already been bankrupt. In other words, these are like debtor-in-possession funds, even though they weren't put in under those terms. Don't they have that sort of color to them, in anticipation of insolvency we rushed in?

Mr. SKEEL. Absolutely. In fact, I would go a step further and say they are debtor-in-possession funds. The government is a debtor-in-possession financier even in a formal sense.

Mr. ISSA. So I am going take the next step for a moment. Because I think the auto dealers, both GM and Chrysler, are getting a raw deal. And as a person that grew up in the industry I have got a concept I want to run by you as a professor knowledgeable with what we could do in bankruptcy. If in fact there but for the

*Note: The information referred to was not submitted for inclusion in the record.

dollars all the dealers would have closed, then no dealer has any right to its franchise, is that correct, in abstract terms?

Mr. SKEEL. In a sense, yes.

Mr. ISSA. And in a bankruptcy all the franchises could be voided on day one, right?

Mr. SKEEL. That's right. The way it would work is Chrysler would terminate the agreements. It is known as rejecting an executory contract.

Mr. ISSA. So if we do A and B, then C would seem to be that all the dealers on some proportional basis have an equal right in new contracts, new franchises, assuming for a moment, as is planned, they are going to be issued for no dollars.

Now, if Chrysler said, we are going to void all these things and we are going to go out and look for dealers and raise money, that would be a different story. But since they have nothing in their plan that is going to bring in new dollars, wouldn't it be fair for all of the dealers, including the many dealers being closed, some of them minority dealers, to say that they have an equal right to the common new dealerships, even though some are being given and some are not?

Mr. SKEEL. As a matter of equity, you can make that argument. As a matter of bankruptcy law, that is not going to work. The bankruptcy law rule is that Chrysler gets to decide which dealerships to keep and which not to keep. So to the extent you are making an equitable argument, it may be a powerful argument. It is not a bankruptcy argument.

Mr. ISSA. But back to the bankruptcy point, you said none of the dealers have a claim.

Mr. SKEEL. Well, they do have a claim.

Mr. ISSA. Well, okay. Let me rephrase that. None of the dealers have a right to keep their dealerships.

Mr. SKEEL. Right.

Mr. ISSA. And they can all be voided, and they would just be unsecured creditors. Given that situation, I am going hypothecate something. Chrysler and GM should in fact in bankruptcy in their plan void all the contracts and require people to bid value to be franchise dealers again.

In other words, there is a pot of money, of value that GM and Chrysler are not looking to which the corpus has an obligation to seek. To the extent that they waive that for some legacy reason, fairness, whatever, or to the extent that the DIP financier is waiving his own funds—which we are doing, we are going to forego our own funds—we in a sense buy that deal. We say, you can't go out and charge more.

If you make those logical arguments, that in fact nobody has a right, you absolutely could and should try to seek new monies for whoever wants those valuable franchises, whatever the amount are, because there is certainly going to be a lot of people with empty dealerships looking for a business opportunity and willing to pay new money to not have an empty building. To the extent that they forego that, they have to forego it for a reason; and to the extent that we, the taxpayers, are giving—literally giving money into this deal, is it not reasonable for those of us here that represent the taxpayers to ask for that equity?

And is there anything in bankruptcy law that would prevent essentially—and I will just throw out an abstract. For each car you sell, you get a share. The sustaining dealers, the ones that are chosen to continue, have X amount of shares, but in order to buy their dealership they essentially have to find the rest of the shares, which means they have to make whole these other shareholders who do not get their dealers open.

From a bankruptcy standpoint, there is nothing prohibiting it. From a standpoint of the people who are literally giving money into a deal, there is no problem.

And, back to my original question, which is the only one I am going ask here, if they do not do something like this, if something is not done to equalize this, then why in the world shouldn't we, the taxpayers, expect in order to have the maximum wholeness they void all the contracts and resell their franchises if there is a net value that would go to the creditors?

Mr. SKEEL. Again, you can make this argument. It is Chrysler's decision whether to do that or not. You can make an argument they——

Mr. ISSA. But Chrysler has a fiduciary obligation to its creditors to maximize that value.

Mr. SKEEL. That's right.

Mr. ISSA. And is there any way that anyone can say that if you voided all the contracts you couldn't go out and sell new dealerships for more than $1?

Mr. GROSSMAN. Mr. Issa, if I may, in a traditional bankruptcy, where a plan is proposed and creditors rights are taken seriously——

Mr. ISSA. Not this one, but in a traditional one.

Mr. GROSSMAN. That is the sort of proposal that would be on the table and that the company would have a possibility of executing. Because they would be taking their creditors' rights seriously. That is not this bankruptcy.

Mr. ISSA. Not yet.

Mr. GROSSMAN. The Obama administration has done something very different.

Mr. LESTER. For our standpoint, the issue still remains of access to capital. We can do a fire sale today, and the dealer still needs to get adequate working capital to survive. We can do a dollar buy-out, we can do a penny stock buy-out, but the issue is the credit markets as it relates to dealerships across this country today are not lending to automobile dealers.

So we are still—no matter what value you want to place on this scenario, having access to capital is the problem. And then we are going to create a scenario where those that have is going to be versus those that have not that don't have, and the deep pockets will always win. So that balance is still going to be off scale because of the fact——

Mr. ISSA. I understand that the companies who do not have access to capital and are small dealers and are scheduled to not be renewed, they presently are getting zero. And even if we said you could stay in business, you would have to go find money, and it is not likely to be easy to find.

What I am saying is, in an ordinary bankruptcy where this kind of money has come in and we are looking at the equities, is there any basis for the current deal that is on the table, which is we pick winners and losers, we tell the losers tough luck, and we don't actually exercise any recognition of the value given for those who get to keep their franchises for free versus those who lose them regardless?

More than anything else, Chairman, that seems to be one of— we have lot of anomalies that may or may not be fixed in bankruptcy. I have taken my time to ask of this one because I am confounded to believe that people are simply told, you lose and you get no credit, but the people who get to continue being dealers, multimillion dollar, actually enhance the value, pay nothing for the enhanced value they are getting of their competitor down the street being closed out.

I cannot—even though I am as conservative as the day is long, I cannot understand how that equity of closing your competitor and giving you the business doesn't have a value that needs to be equalized, particularly since we, the taxpayers, are giving billions of dollars in this transaction.

Mr. CONYERS. Would you be willing to present this argument on Pennsylvania Avenue?

Mr. ISSA. Absolutely. As long as we have got an American car to ride down the street to, I will go with you, Chairman. And it can be one of those made in America by any tag name.

Mr. CONYERS. Oh, gosh.

Jim Jordan, Ohio.

Oh, I am sorry, Brad Sherman, California.

Mr. SHERMAN. Thank you, Mr. Chairman.

I want to start off by mentioning the comments of two people who are no longer here. First, Mr. Goodlatte mentioned that there is a real question whether TARP money can be used to bail out auto dealers. I point out that this House passed a law that was thought to be necessary to give the Secretary of the Treasury the right to do that with the TARP money.

I voted for that, because when I looked at all the ways they could use the TARP money, bailing out the auto dealers seemed to be among the better. And the law didn't pass the Senate. And the Treasury acted as if the law had passed the Senate, thus disempowering and making useless the Senate, which seemed to be a wonderful idea. But at least when we all voted for that law it was with the assumption that it was necessary.

I should point out that there was discussion of evading the law— not evading, structuring around the law by having TARP give the money to GMAC or some other financial institution in return for— well, you basically have the bank buy stock from General Motors and then sell it to TARP or to the Treasury; and then we would have been buying a troubled asset, a/k/a stock in General Motors, from a financial institution.

Also, Professor Lynn LoPucki—I believe is the correct pronunciation—made the point, Mr. Chairman, about how forum shopping in bankruptcy undermines not only the bankruptcy system but the financial services system. Because whenever you make a loan you have to ask what happens if the company goes bankrupt or at least has trouble. And I think he did an excellent job of outlining why we should be getting rid of forum shopping.

Professor Skeel—and I don't know if your background encompasses bankruptcy law.

Mr. SKEEL. It does.

Mr. SHERMAN. I could see why a judge in Delaware would really want the business because he could help support his whole community. It would be significant to the local economy. But why would a judge in New York City whose economy is not supported by the bankruptcy law business do violence to the law just to land some more cases? Most of the district judges I know don't want more cases. Why does the bankruptcy court in New York want to do everything possible to bring in more cases?

Mr. SKEEL. Well, it is dangerous to have me channeling Lynn LoPucki, because I don't agree with Lynn about many of his arguments in this area. Although I think we do agree on this as to— I don't think that forum shopping is worrisome, as Lynn LoPucki does.

But I do agree with him on why judges might be interested in having the cases. Having one of these cases—I am not sure Chrysler is a good example—but having WorldCom or Enron, it is very exciting if you are a bankruptcy judge, and it is sort of in all of your career you might get two or three cases like this. So if you have an opportunity to have Enron or WorldCom or some other big case, it is exciting for you as a judge.

Mr. SHERMAN. Got you.

Mr. Henderson, I am trying to figure out why every article I read about GM and Chrysler says they would be much better off if they got rid of half their dealers or a third of their dealers. This strikes me as odd.

I mean, Sony could have worked things out so that I could only buy a Sony TV in 5,000 places around the country. They are happy to have 50,000 places sell me a television. And that creates competition, which means there is less markup, which means either Sony can charge more and I pay less and the middleman—you being the middleman—in the automobile industry gets less.

So why is it thought—I mean, I can see why if I was an auto dealer I would want the three auto dealers closest to me all shut down. But why would General Motors or Chrysler feel that they would benefit? How do they save money if they have only six dealers in L.A. County instead of nine dealers in L.A. County?

Mr. HENDERSON. Mr. Sherman, I think that their argument is around a term called throughput. They believe that the more units solid per facility, the stronger those dealers will be. The more those dealers will be able to invest in their businesses, the more they will be able to compete against other franchises. That is their argument.

Mr. SHERMAN. So their theory is that if you could make another hundred bucks a car for every car you sold you would make your showroom nicer. There would be the gourmet teas, not just the Lipton available for those of us who don't drink coffee.

Mr. HENDERSON. That is part of their argument, yes, sir.

Mr. SHERMAN. On the other hand, if you have got dealers three miles in each direction, you are going to have to cut the price of that car by another hundred bucks.

Mr. HENDERSON. That is correct. It would present a more——

Mr. SHERMAN. Don't give me the fancy tea. I want the hundred bucks.

Is there somebody selling cars in the United States that has as their model, let's try to have lots of dealers and each one will sell only 500 cars or 1,000 cars? Or is it generally accepted in the business it is somehow great to have dealers that do 5,000 cars a year? I am making those numbers up. I could be off as to what is the difference between a small dealer and a big dealer.

Mr. HENDERSON. There are arguments on both sides of that issue, and they have been ongoing for some time. And there are markets that dealers will be the first to agree that could stand to have less dealers.

Mr. SHERMAN. Well, the dealers would, because you can jack up the price. And you may or may not then invest more money in the dealership. You may just invest more money in your vacation home.

Mr. HENDERSON. Absolutely. The question becomes——

Mr. SHERMAN. Back when this was a profitable business and you all had vacation homes.

Mr. HENDERSON [continuing]. As it relates to a bankruptcy how that process is accomplished. Is it accomplished through market attrition or a dealer buying out and paying fair compensation or is it accomplished by just the stroke of a pen that allows people's wealth to dissipate?

Mr. SHERMAN. Is there anyone else with expertise in the auto industry that can opine as to whether GM or Chrysler is actually making itself healthier by getting rid of dealers?

Ms. CLAYBROOK. I would like to comment on that, Mr. Chairman.

I have dealt with many auto dealers over the years, and there are favored auto dealers and there are unfavored auto dealers by the factory, as they call it. And if there is an auto dealer who is a bit of a troublemaker, who complains a lot, who doesn't do their warranty work as well, who claims too many warranty claims, those dealers they would just as soon get rid of.

This is an opportunity, particularly in the Chrysler case, where there is no standards, it is highly discretionary among Chrysler, to make their choices. And I don't know how much of a role that is playing in this, but I will tell you that it is a subject of conversation all the time at the factory level.

Mr. SHERMAN. I mean, I can see them wanting to get rid of 5 or 10 percent of their dealers who do bad warranty work or whatever. But I can't imagine you would want to get rid of a third of your dealers for that. Are there that many doing bad warranty work?

Ms. CLAYBROOK. No, no, no. As long as they have this wide discretion. So they are going do get rid of the ones they don't want, and then they are having to deal with the government saying they want to get rid of more of them so that they are slimmed down.

But I am just saying that one of the factors probably is the factory wants have the discretion to make the choice about who to keep and who not to keep.

Mr. SHERMAN. I would say it benefits consumers to have as many competitors as possible not only to compete to sell me the car but then when I want to get the car serviced I would like to take it someplace pretty close.

Mr. Nader, do you have any comment on this? Are consumers benefited? No one has focused on consumers more than you have. Do consumers benefit by——

Mr. NADER. Of course. If you are in the position of someone who wants to have a car serviced or buy a car, do you want to travel 10 miles, 15 miles? Do you want to travel 7 miles through a congested city or do you want one in your neighborhood? Already there are far less dealers than there were 20, 30 years ago. Take a look at Washington, DC.

Mr. SHERMAN. Are there far less total dealers or just fewer domestic and more foreign auto dealers?

Mr. NADER. No, no. Overall, overall. Your neighborhood dealer is almost extinct in terms of traveling three or four blocks for a dealer.

The other thing is you are less likely to repair your car if you have to take more time out and go to the dealer. That is why there is legislation here in Congress to allow equal access by independent repair shops, because there aren't that many dealers. In the rural areas, they are being shut down; minority areas, they are being shut down. So for safety, convenience, and competition, the fewer dealers, the price is going to be going up. The Washington Post had an article on that very recently. So all to more dealers.

Mr. SHERMAN. So it is bad for the consumers, I have got all the dealers complaining about it, and I can't get anybody on this august panel to tell me how it makes more money for the manufacturers.

Mr. Grossman, you are raising your hand. How is putting the folks to your right out of business going to help these companies survive? Or just some of them, not all of them.

Mr. GROSSMAN. Well, I don't presume to know which dealers should be in business and which ones should not in particular. But I would note that the most powerful automotive retailer chain in the United States, the most powerful sales force, is widely considered in the industry to be Toyota's. Toyota's dealers have a throughput, on average, of about 1,100 vehicles per year. Many General Motors and Chrysler dealers sell as few as 50 or 70 cars per year. There are fixed costs that are associated with addressing every single dealer, and for many of those dealers——

Mr. SHERMAN. What are these enormous fixed costs of dealing with a smaller dealer?

Mr. GROSSMAN. There are marketing costs.

Mr. SHERMAN. There are marketing costs. What does that mean?

Mr. GROSSMAN. It means that they do joint marketing. For example, they may place ads in newspapers, on television, in the radio.

Mr. SHERMAN. But a small dealer gets very little of that money, I mean, proportionately. If you only sell 50 cars——

Mr. GROSSMAN. Right. Proportionately, a small dealer will get less of that money. But, at the same time, the expense of creating those advertisements, creating those radio spots is, to some extent, a fixed cost.

Mr. SHERMAN. Or it could be borne by the dealer. I can't imagine that there is a dealer about to be put out of business that wouldn't say, fine, leave me in business and I will design my own ads, or, hell, I will even just do my own advertising. This is not a situation where they are turning to some dealers and saying we are going to reduce your cooperative marketing budget. We would get a lot less angst from auto dealers if they said, well, we have got to do advertising on our own than what we hear from the dealer.

Mr. Lester.

Mr. LESTER. There is absolutely no validity to a shrinkage of a dealer body that will show the viability of a manufacturer. As Mr. Nader pointed out, historically, there are less dealers than there were maybe 50 years ago; and that has been based on natural attrition. A dealer who just makes his own decision on when he or she decides to go out of business, that should not be dictated or demanded from our government or via the Auto Task Force.

The Auto Task Force and I have had an opportunity to sit before them on several occasions, took a clean-sheet-of-paper approach and decided to use the model of Toyota that had very few dealerships across the country with the thought that their model of a successful dealer should also fit within the model of GM and Chrysler. That in and of itself is a model that may work for Toyota.

It may not work for GM and Chrysler, who have historically been in those neighborhoods who get their car vehicles serviced, and to now have these consumers with these terminations with these dealerships closing to now be inconvenienced, to have to travel 10, 15, 20 miles to be able to sit 2 hours to get an oil change where they are accustomed to getting oil changes in 30 minutes. So it is not a valid point on a fixed cost——

Mr. SHERMAN. I will agree with you. If you are starting to market cars for the first time in the United States you might very well say, oh, copy Toyota, that seems to be working for them. But if you already have dealers with goodwill all over the country, it should take more than Toyota envy to get you to close them all down.

With that, I will yield back.

Mr. CONYERS. Thank you, Brad Sherman.

Jim Jordan, Ohio, you are the last Member to question the panel.

And then any member of the panel that wishes to make a closing comment, we would welcome it before we adjourn the hearing today.

Mr. JORDAN. Thank you. Thank you, Mr. Chairman.

Last fall, when we were in the midst of this bailout fever that got ahold of Congress, whether you are talking the financial industries or the auto industry, I remember in the midst of the debate about the car czar and everything else, the headline in *The Wall Street Journal,* "Do You Want a Car Built by Congress?"

And it is actually worse, as Mr. Nader has pointed out. The headline should read now: Do You Want a Car Built by Bureaucrats? Because it seems to me that is where we are at.

And I want to ask the gentleman here in the dealership business. This is from the press, at least what our office got from the Department of Treasury. Do we know if any of these individuals have, as Mr. Sherman just said, any expertise in the auto industry? Treasury.

Secretary Geithner; Diana Farrell, Deputy Director of National Economic Council; Gene Sperling, Counsel to the Secretary of Treasury; Jared Bernstein, Chief Economist to the Vice President; Andrew Montgomery, Senior Advisor Department of Labor; Lisa Heinzerling, Senior Climate Policy Counsel to the EPA; Austan Goolsbee, Staff Director/Chief Economist to the Economic Recovery Advisory Board; Dan Utech, Senior Advisor to Secretary of Energy; Heather Zichal, Deputy Director, White House Office of Energy and Climate Change; Joan DeBoer, Chief of Staff, Department of Transportation; and Rick Wade, Senior Advisor, Department of Commerce. Do these individuals have any expertise on the manufacturing side or on the dealer side?

Mr. LESTER. None.

Mr. JORDAN. Does anyone else know if they have any expertise in how car manufacturing or car dealership businesses operate?

Mr. GROSSMAN. *The Wall Street Journal* actually did a survey of the members of the Automotive Task Force and discovered that a substantial portion of them don't even own cars.

Mr. JORDAN. Mr. Chairman, I think Mr. Delahunt's suggestion earlier—which I know Congressman Gohmert, as well as others—to have the task force come here would be great. I would love to ask them some questions.

Just for the record, Mr. Lester or Mr. Henderson, is it your testimony—and I have heard conflicting testimony on this from various sources over the last week. Is it your belief that it is the task force making the decision about which dealerships stay in business and which don't, or is it Chrysler and GM making the decision and then getting the thumbs up from the task force?

And, frankly, it may be the same difference. But just for the record, which is it? A or B?

Mr. LESTER. What we have been told by the task force is that they have no decision-making process between General Motors and Chrysler in the decisions that they have been making. It is our assumption that we think that they actually are pulling the strings of General Motors and Chrysler and directing them in the way that they want to be directed to see this outcome.

Mr. JORDAN. Mr. Henderson.

Mr. HENDERSON. What we have been told by Chrysler is that the task force has been directing their large, drastic, quick reduction of the dealer body as part of the bankruptcy.

Mr. JORDAN. Well, that is sort of contradictory. Are you saying that it is starting with the task force and then going to the manufacturer?

Mr. HENDERSON. It starts with the task force. The task force is not making the decisions on the specific dealers but the process of doing a large dealer reduction.

Mr. JORDAN. Is the task force saying, we want X number, this number, now GM and Chrysler get to that number. Is that going on? Are they making the determination on the——

Mr. LESTER. On the number? No, I think that number was coming from the manufacturers. I think the task force did not make an individual selection based on who stays and who goes, but I think the task force demanded that the manufacturers adhere to what they put in their viability plans last December 19th.

Mr. HENDERSON. Again, it is an acceleration, Mr. Jordan. The plan of reducing and consolidating dealers has been on the table at Chrysler for a number of years, but it has been dictated by the market, and people were being compensated fairly for their franchises.

Mr. JORDAN. Mr. Gross, if I can just sort of change—just a general question. And this is a guy who thought we never should travel down this road, this bailout road, voted against every single one of them, and thought it was the wrong approach because of the very mess we are in right now and the fact that we put this kind of taxpayer dollars at risk and what we are doing to the debt and everything else.

But to use again the words that Mr. Nader used, when do you believe we crossed the line? Crossed the Rubicon, I believe is the word used earlier. Was it when we started the bailout with the auto industry last fall? Was it when the President of the United States told Rick Wagner to take a hike, he now decides who runs companies in this country, not the stakeholders, not the board? Was it when we did the first TARP bailout?

I mean, in your judgment—or, frankly, anyone can jump in there, I guess, if they want. But, Mr. Grossman, in your judgment, when did we cross this what I believe is a very dangerous line in this country?

Mr. GROSSMAN. I think that line was crossed about 3 to 4 days after the passage of the TARP legislation. That was the point when Secretary Paulson acknowledged that the original plan for the TARP to purchase troubled assets would not be followed and that the government would do something completely different. And I think that was an indication—and it should have been a clear notice to Congress—that the legislation that had been passed was something that gave pretty much unprecedented discretion to the Treasury and to the executive branch.

Mr. JORDAN. All right. Thank you, Mr. Chairman.

Mr. CONYERS. Any closing observations?

Judge Gohmert.

Mr. GOHMERT. I have just appreciated the comments—Mr. Jordan, Mr. Sherman, panel members, Mr. Lester—your comments about the dealers and how that really helps the manufacturers to put people out of business. But I have been hearing specifically of one dealership where $2 million was paid to the former dealer to buy the dealership, been paying down on it, owe a million and a half still, and all of a sudden they are told by some group that met behind closed doors they are going to take that and give it to somebody down the street.

I mean, what happened to contract law, what happened to bankruptcy law, what happened to secured creditors, all these things? If we continue down this course without getting back on track to the rule of law and the law of contracts and the bankruptcy law, then I am concerned that we degenerate to a third-world nation where some king says, oh, you are more favored as a duke today, so I am taking this one's land and giving it to you. It seems where we have gone, and I think it is up to this Committee to see that we don't stay there, we get back on track.

So I very much appreciate the hearing, and I very much appreciate your input, and any in the future in writing is certainly welcome. Thank you very much.

Mr. NADER. If I may say, Mr. Chairman, the contemplation that most delighted me, and I think some people here, was your statement that there might be a bipartisan journey to 1600 Pennsylvania Avenue very quickly before it is too late.

Mr. CONYERS. Like tomorrow.

Mr. NADER. Yes. And I think the bipartisan aspect is very important. I think some of the things that Congressman Delahunt was talking about would be supported by a lot of conservatives and vice versa.

Mr. CONYERS. Could Judge Gohmert help make it more bipartisan?

Mr. GOHMERT. Yes, absolutely.

Mr. CONYERS. Thank you.

Mr. LESTER. I want to definitely echo what Mr. Nader said. We have no time to waste.

As dealers, just the amount of stress and the amount of stress on these dealers' employees from the Chrysler side that know they are on that termination list with no place to go, with no health care is just tragic. And to give these dealers an opportunity to survive and a chance to survive because they were surviving already even with the low economy is very well within this merit. And I think you guys going to the White House and demanding that the President act now because we don't have time to wait.

Mr. FEIN. Mr. Chairman, I would like to add a couple of examples which amplifies on the lawlessness of the attitude that is so alarming.

It was Secretary Paulson—and this is even before the TARP funds were authorized—was bailing out Bear Stearns and he was asked, well, what authority did you have? And he said, none whatsoever, but I learned in this town if you lead everyone will follow. And it was Mr. Paulson who got these bankers around a table and said, even if you don't want the funds, you develop preferred stock so we can buy them. A coercion of the type that I think Mr. Grossman referred to with regard to getting the senior creditors to take a subordinate role.

That is dangerous, that mentality. I mean, what do you mean to be so cavalier? We didn't have any authority. Then you should go to Congress and ask for it.

Mr. CONYERS. What about Paulson calling in the leaders of the Congress and laying down those three sheets of paper: one, I want more power than any Treasurer has ever had; two, I want $700 billion, and I want it fast; and, three, I don't want it reviewable by the Congress or the courts.

Ms. CLAYBROOK. Mr. Chairman, I would just like to say that the auto dealers are a tragic case, and I completely agree with everything that has been said here. But I don't want the record to close without saying that the individual consumer, the individual consumer that has been harmed by a defective product, the individual consumer who is likely to be killed or injured because there are not safety standards in these vehicles, they are the ones whose voices are rarely heard. And I hope that when you do go to the White

House—and I urge you to do that as well—that you will be sure to bring those cases to their attention.

Because the liability that these consumers have the potential to secure, to protect themselves in the future is all they have; and many of them are so badly injured they can't do anything else except to survive on those funds.

Thank you.

Mr. CONYERS. We might want to make an expedited transcript of this record available to the White House.

Mr. DITLOW. Mr. Chairman, if I may, I am very much concerned that at the end of the day this task force and the bankruptcy will create what looks like a financially viable corporation by getting rid of liabilities, focusing and cherry-picking the best assets, but will it sell cars? I don't think it is going to do that.

Because you have to have a consumer who has confidence that if I buy a lemon, if I am in a crash, I have a right that I can exercise. No one wants to be in a crash. No one wants to buy a lemon. But consumers want to know that they have a right. And this reorganization doesn't do that.

And, furthermore, from a dealer viewpoint, the consumer wants to buy a car from a dealer that they know and trust, someone in their neighborhood; and it doesn't even give them that. So it may have a good economic tune, but it is not going to be an organization that is going to sell cars.

Mr. GROSSMAN. Mr. Chairman, this issue is important because the fake bankruptcies of Chrysler and soon, apparently, General Motors are a microcosm of the abrogation of the rule of law that I think threatens our freedom and prosperity. I commend you for holding this hearing and thank you for having me testify.

Mr. CONYERS. The Chair notices the presence of other dealers and nonprofit organizations that have been working along with us, and we particularly appreciate the stamina of the eight of you to be here as long as we have been here.

So we thank you all and adjourn this hearing.

[Whereupon, at 4:40 p.m., the Committee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE DANIEL MAFFEI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK, AND MEMBER, COMMITTEE ON THE JUDICIARY

Thank you, Mr. Chairman for holding this hearing, and I thank our witnesses for being here, especially on such short notice. While I am glad that we are holding this hearing today, I hope that we can explore this issue further in future hearings as well. This is obviously an important issue, and we need more time to fully understand the matter at hand.

As I'm sure we are all aware, Chrysler and GM have begun to restructure their business model by drastically reducing their dealer networks. The closing of these dealerships will have a significant impact on local communities and will have a ripple effect on all the related businesses that depend on them. If these closings go into effect, we could possibly see 150,000 more people out of work. This is unacceptable in good economic conditions, and it is completely intolerable during a time of financial crisis. This goes beyond CEOs to hard working Americans across the country fighting to survive this recession.

I think it is important to ask how the closing of hundreds of dealerships will be financially beneficial to these two auto companies. This is a question that I just cannot seem to answer. I have recently requested that the President's Auto Task Force help Congress get answers on why this is happening.

Both GM and Chrysler accepted TARP money, so their restructuring plans should come under congressional oversight. There has been an utter lack of transparency in the means by which Chrysler and GM have chosen to reject dealers' franchise agreements. If there are too many auto dealers in the market, then maybe some do need to close, but the closings need to be justified. Trimming the dealer network is a situation that either needs to be done using very specific, very transparent criteria, or it needs to be done by the market through attrition and consolidation. At the very least, I think the Task Force should step in and slow the reduction, so communities can gradually absorb the jobs being cut.

I would hope that the automakers reconsider their decision and really think about the damaging effects that this will have on local communities. I look forward to the testimony from our panel. Thank you, Mr. Chairman, I yield back.

PREPARED STATEMENT OF THE HONORABLE TRENT FRANKS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARIZONA, AND MEMBER, COMMITTEE ON THE JUDICIARY

Opening Statement of Subcommittee on Commercial and Administrative Law Ranking Member Trent Franks at Full Committee Hearing on "Ramifications of Auto Industry Bankruptcies,"
Thursday, May 21, 2009
1:00 p.m., 2141 RHOB

I associate myself with the comments of the distinguished Ranking Member. I, too, find what has happened with Chrysler and GM to be deeply disturbing on many levels.

From my perspective as Ranking Member on the Commercial and Administrative Law Subcommittee, I would like to highlight today the troubling implications of these matters for investment, the bankruptcy system, and the taxpayers.

For investment and the bankruptcy system, the world has been turned upside down by the actions of the President's Auto Task Force. Conservative investors who bought secured Chrysler bonds did so assured in the knowledge that the bonds would be paid off. If Chrysler continued to be a going concern, they would be paid off in the ordinary course of business. If Chrysler went bankrupt, they would be paid 100-cents on the dollar before any other creditor received a single dime.

The ability of corporations to offer and sell safe and sound secured corporate bonds is critical to our system of corporate finance. And the unshakable priority of secured creditors in bankruptcy is critical to our bankruptcy system.

Thanks to the Auto Task Force and its shakedown operations, investors' ability to rely on the soundness of secured corporate debt has gone up in smoke. Investors are on notice that, if government bailout money gives the government leverage over a struggling corporation, the government may shake them down and convert their security – and their priority in bankruptcy – into an empty promise. All to serve political ends.

Investors in Chrysler know that to a mortal certainty. Investors in GM surely know it. And investors in any TARP recipient know it as well.

To achieve what great end did the Auto Task Force inflict this damage on our investment and bankruptcy systems?

It appears primarily to pay back the Obama Administration's power base, by converting Chrysler and GM into the crown jewels of the United Auto Workers.

And it is not only investors in secured credit who may now be leery of making future U.S. investments. On the contrary, the Obama Administration's haste to tear up the rule of law and the sanctity of contracts to serve political ends unsettles investor confidence in all areas of our economy.

This is no laughing matter as we try to stimulate private sector lending and investment to turn around our deeply troubled economy. And it is a matter of deadly seriousness when we are simultaneously relying on foreign investment to finance crushing national debt, but showing foreign investors that we are fully capable of behaving like a banana republic.

Is there any way in which the Obama Administration could more greatly have betrayed the taxpayers?

When the taxpayers learned that their money would be used under the TARP legislation to help GM and Chrysler, surely this is not what they expected to happen. They expected the money to fund straightforward bridge loans that would help GM and Chrysler sort out restructuring plans, preserve American companies, and preserve American jobs. If no such plans were attainable, they expected the money to be paid back, and the companies to go into the ordinary processes of bankruptcy.

In their wildest and darkest dreams, they could not have imagined that these loans would instead be converted into bridges to ownership of Chrysler by the UAW and Fiat; GM loans being potentially forgiven by the billions and the UAW receiving a huge ownership share, while GM jobs are shipped overseas; and the set up of the entire apparatus to serve the Obama Administration's plans to limit greenhouse gases and automotive fuel consumption.

They could not possibly have envisioned Administration shakedown artists converting the Chrysler and GM loans into the levers by which to overturn the basic rules of investment and bankruptcy.

But this is what they have seen, and I fear they will see more.

I am shocked. I am stunned. And I believe the American people are as well.

PREPARED STATEMENT OF THE HONORABLE NICK J. RAHALL, II, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WEST VIRGINIA

Mister Chairman, first, please let me thank you for holding this important hearing. As you know, the state of the American auto industry is of crucial concern to all of us. Second, I want to express my sincere appreciation for allowing me to offer my opinion on this issue.

I want to express my grave reservations with the recent announcement by Chrysler and General Motors to cut nearly 1,800 dealerships nationwide. I am very concerned about the harmful impact it will have on local communities, as well as the future market-share of American car manufacturers.

Such a drastic reduction of dealerships will be devastating to communities. Car dealerships are an important economic engine. As you know, they provide high paying jobs and significant tax revenue for local governments. In my home state of West Virginia, franchised dealers account for over $3 billion in sales, $165 million in sales taxes, and approximately $75 million in titling fees for the highway fund.

It is not clear how each dealership was chosen for closing or if cutting such a number of dealerships will even have a significant impact on improving the manufacturers' viability. Dealers generate more than 90 percent of manufacturer revenue. A rapid reduction of dealerships undercuts that revenue while doing nothing to address concerns about production and innovation.

In closing, I urge transparency and openness regarding the manner in which these dealerships have been chosen, and I ask that you pass along my opinion that the Presidential Auto Task Force revisit the current strategy as it relates to such a large number of dealership closures.

I believe that dealerships, especially in West Virginia, can be part of the solution to improving the long term solvency of our nation's auto industry.

Thank you for your consideration and, again, thank you for allowing me to comment on this important topic here today.

MATERIAL SUBMITTED BY THE HONORABLE STEVE KING, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA, AND MEMBER, COMMITTEE ON THE JUDICIARY

Hearing Date: May 27, 2009 at 10:00 a.m.
Objection Deadline: May 19, 2009 at 4:00 p.m.

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ATTORNEYS FOR THE
INDIANA STATE TEACHERS RETIREMENT FUND,
INDIANA STATE POLICE PENSION TRUST, AND
INDIANA MAJOR MOVES CONSTRUCTION FUND

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

In re	)	Chapter 11
CHRYSLER, LLC, et al.,	)	Case No. 09-50002 (AJG)
	)	Jointly Administered
Debtors.	)	

CORRECTED OBJECTION OF INDIANA PENSIONERS TO DEBTORS' MOTION FOR AN ORDER (A) AUTHORIZING THE SALE OF SUBSTANTIALLY ALL OF THE DEBTORS' OPERATING ASSETS, FREE AND CLEAR OF LIENS, CLAIMS, INTERESTS AND ENCUMBRANCES, (B) AUTHORIZING THE ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND UNEXPIRED LEASES IN CONNECTION THEREWITH AND RELATED PROCEDURES AND (C) GRANTING CERTAIN RELATED RELIEF

TO THE HONORABLE ARTHUR J. GONZALEZ,
UNITED STATES BANKRUPTCY JUDGE:

The Indiana State Teachers Retirement Fund and the Indiana State Police Pension Trust, which are fiduciaries for the investment of retirement assets for approximately 100,000 civil servants, including policeman, school teachers and their families, and the Indiana Major Moves Construction Fund, an infrastructure construction fund (collectively, the "Indiana Pensioners"), by and through their undersigned counsel, hereby file this objection (the "Objection") to the Motion of Chrysler, LLC ("Chrysler") and the above-captioned debtors and debtors in possession (collectively, the "Debtors"), for an order (A) authorizing the sale of substantially all of the Debtors' operating assets, free and clear of liens, claims, interests and encumbrances, (B) authorizing the assumption and assignment of certain executory contracts and unexpired leases in connection therewith and related procedures, and (C) granting certain related relief [Docket No. 190] (the "Sale Motion"). In support of their Objection, the Indiana Pensioners respectfully state and represent as follows:

PRELIMINARY STATEMENT

The Indiana Pensioners are holders of first lien debt, secured by substantially all of the Debtors' assets. In their Sale Motion, the Debtors seek authority to sell substantially all such collateral, and to distribute the proceeds of such collateral to unsecured creditors, primarily trade creditors and the UAW. Following such proposed sale and distribution, there will be nothing substantive left in this case. Indeed, the government has repeatedly stated its objective of reorganizing Chrysler within a 30-day time period. To do so, the government needed to avoid the requirements of Chapter 11. The government has done exactly that, by seeking approval of a *sub rosa* plan without following any of the required procedures for confirmation. The Debtors' position that its business is effectively a "melting ice cube" provides no grounds of approval of an illegal *sub rosa* plan. The courts can approve the sale of "melting" assets, but there is no authority for approving a distribution scheme in a Section 363 sale. Indeed, not a single court has ever approved a sale and distribution of proceeds as proposed here.

In addition to being an illegal *sub rosa* plan, the Debtors' Sale Motion seeks to extinguish the property rights of the secured lenders, trampling the most fundamental tenets of creditor rights in disregard of over 100 years of bankruptcy jurisprudence. The Debtors' proposed restructuring of stakeholders' rights seeks to make payments of billions of dollars to unsecured creditors, while paying the secured creditors only 29 cents on the dollar.

In addition, the financing proposed by the section 363 sale is illegal. The United States Treasury Department (the "Treasury Department") is accessing funds under the Troubled Asset Relief Program ("TARP"). TARP, however, provides funds only for the purchase of trouble assets from financial institutions. Chrysler is an automotive company, not a financial institution. The Treasury Department is also improperly controlling Chrysler, without authority, before it even purports to purchase any assets. The Debtors' motion must be denied.

BACKGROUND[1]

1. On April 30, 2009 (the "Petition Date"), the Debtors filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code, thereby commencing their respective chapter 11 cases (collectively, the "Chapter 11 Cases"). The Debtors purport to be operating their businesses as debtors and debtors in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. The Chapter 11 Cases are being jointly administered for procedural purposes.

2. Chrysler and certain of its affiliates are parties to that certain Amended and Restated First Lien Credit Agreement, dated as of August 3, 2007 (as may have been amended or supplemented, the "Senior Credit Agreement") with JPMorgan Chase Bank N.A., as administrative agent (the "Administrative Agent"), and certain lenders party thereto from time to time (the "Senior Secured Lenders"), under which the Senior Secured Lenders are owed $6.9 billion (the "Senior Secured Debt") secured by a first lien on substantially all of the Debtors' assets, including their plants, equipment, inventory, bank accounts, and almost every other U.S.

[1] Certain of the facts set forth herein are based upon the representations of the Debtors in the Sale Motion. The Indiana Pensioners reserve the right to challenge such representations, and nothing herein shall constitute a waiver of such right.

asset owned by the Debtors (the "Collateral"). (Senior Credit Agreement; Affidavit of Ronald E. Kolka ("Kolka Aff.") ¶ 28 [Docket No. 23].)

3. On May 3, 2009, the Debtors filed the Sale Motion. On May 5, 2009, the Court held a hearing to consider proposed bidding procedures. On May 7, 2009, the Court approved the bidding procedures and set the hearing to consider the Sale for Motion for May 27, 2009.

I. The Secured Lenders Loan Billions Of Dollars To Chrysler

4. The Indiana Pensioners are holders of first priority secured claims. Their claims arise out of nearly $10 billion of loans taken in 2007. (Senior Credit Agreement § 2.1; Kolka Aff. ¶ 26.) These loans financed the purchase of the company, and were hailed at the time for returning Chrysler to U.S. control.

5. The Senior Secured Lenders made the loans because the Senior Secured Debt was secured by first priority liens on the Collateral. (Senior Credit Agreement § 3.14; Kolka Aff. ¶ 28.) These liens, and the security they afforded, are crucial to the Indiana Pensioners because they are responsible for investing billions of dollars on behalf of approximately 100,000 of ordinary Americans, including teachers and police officers. This responsibility caused the Indiana Pensioners to seek the safety of secured loans, and they paid for this security by accepting a comparatively low interest rate.

II. The Global Financial Crisis And TARP

6. In December of 2007, less than a month after the Senior Secured Lenders' loan to Chrysler, the United States economy entered into the worst recession since the Great Depression, which resulted in an unprecedented response from the United States government (the "Government"). Perhaps the most widely reported element of that response was the Emergency Economic Stimulus Act ("EESA"), which was passed by Congress and signed by President George W. Bush on October 3, 2008. 12 U.S.C. § 5202. One critical component of the EESA

was the TARP, which gives the Secretary of the Treasury the power to purchase "troubled assets" from "financial institutions." 15 U.S.C. § 211. TARP authorized the Government to inject hundreds of billions of dollars into the national banking system in order to restore confidence in the economy and reestablish the flow of credit.

7. Chrysler (along with the rest of the automotive industry) suffered tremendous losses in 2008, following drastic reductions in automobile sales. (See Chrysler Plan for Long-Term Viability, Feb. 17, 2009 at U32-37 (the "Feb. 17, 2009 Viability Report"); Kolka Aff. ¶¶ 55-58.) By the end of 2008, it was very clear that Chrysler was running out of money, as it had only $1.898 billion of cash left. (Kolka Aff. Schedule 3.)

III. Chrysler Seeks Government Assistance

8. By the fourth quarter of 2008, Chrysler's deteriorating cash position caused it to seek financial assistance from the Government. (See Dec. 2, 2008 Viability Report; Kolka Aff. ¶ 59.) Shortly before that request, then-Treasury Secretary Henry Paulson testified that TARP authorized investment in financial institutions, and "auto companies fall outside of that purpose." (See Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and of Government Lending and Insurance Facilities; Impact on Economy and Credit Availability: Hearing Before the H. Comm. on Fin. Servs., 110th Cong. 19 (Nov. 18, 2008) (statements of Henry M. Paulson, Jr.).) Subsequently, Chrysler was instructed to seek Congressional authorization if it wanted Government assistance.

9. Chrysler then lobbied for such authorization and, although on December 10, 2008, the House of Representatives passed the Auto Industry Financing Restructuring Act (H.R. 7321, 110th Cong. § 10 (2008)), the Senate did not and the bill was not enacted into law.

10. Less than a week after having failed to obtain congressional authority to provide financing to Chrysler, the Treasury Department remarkably declared Chrysler, an automobile

company, a "financial institution," so that the Treasury Department could access TARP funds. That complete reversal of its prior admission is plainly without merit.

11. On December 31, 2008, Chrysler and the Treasury Department entered into a Loan and Security Agreement ("Treasury Loan and Security Agreement"), pursuant to which the Government loaned Chrysler $4 billion on a third-priority secured basis at approximately 5% interest. (Appendix A, Supplement to Treasury Loan and Security Agreement § 2.01; Treasury Loan and Security Agreement §§ 2.05, 4.01.) Thus, the Government took a security interest in Chrysler's assets that was junior in priority to the existing liens of the Indiana Pensioners. Although the maturity date of the loan was December 30, 2011, the Government had the right to accelerate the entire amount due if Chrysler failed to submit a restructuring plan, or "viability plan," acceptable to the Government by February 17, 2009 (after the inauguration of a new president). (Treasury Loan and Security Agreement § 7.20(a); Kolka Aff. ¶ 68.)

12. This loan agreement left Chrysler at the mercy of the Treasury Department in a number of ways. First, the amount of the loan was not nearly enough to fund a meaningful restructuring. The $4 billion was simply an interim lifeline that would postpone Chrysler's collapse until after the new administration took office in January, 2009. Second, the Treasury Department would have complete discretion to determine whether Chrysler's viability plan was satisfactory. If the Government chose to reject the plan, it would have the right to call the full amount of the loan. Third, even if Chrysler put forth a reasonable viability plan, the Government made no commitment to provide the additional funds necessary to allow Chrysler to implement its plan.

IV. The Government Rejects Chrysler's Plan And Chrysler Cedes Control

13. Chrysler submitted its plan to the President's Task Force on the Auto Industry on February 17, 2009. (Kolka Aff. ¶ 68.) The viability plan submitted by Chrysler called for a

reorganization of Chrysler on a stand-alone basis. Feb. 17, 2009 Viability Report at 13. In the viability plan, Chrysler admitted that it could not survive absent relief from the Senior Secured Lenders' debt, the debt owed under the Treasury Loan and Security Agreement, and the obligations owed to the United Auto Workers' Voluntary Employment Benefit Association ("VEBA"). (Kolka Aff. ¶¶ 79, 80.) In that regard, Chrysler stated its intention of obtaining $50 billion of aggregate relief from those three lender groups, and speculated that the debt would be exchanged for some combination of common stock, preferred stock, new debt, and cash. (Feb. 17, 2009 Viability Report at 13.) Chrysler also stated that during the course of this reorganization and following it, Chrysler would seek to finalize an alliance with Fiat S.p.A ("Fiat"). (Feb. 17, 2009 Viability Report at 13, 81-97).

14. On March 30, 2009, newly-elected President Barack Obama announced the rejection of Chrysler's viability plan. The President sought to override the determination by Chrysler's management that Chrysler was viable as a stand-alone going concern. (See Remarks by the President on the American Automotive Industry (March 30, 2009), http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-on-the-American-Automotive-Industry-3/30/09, (the "Remarks by the President")) The President informed the country that the Government would give Chrysler thirty days to reach an agreement with Fiat, its unions, and its creditors (including the Senior Secured Lenders) under which Chrysler and Fiat would combine to form a new entity. (Id.) Also, the President required Chrysler to restructure itself in a way that enabled it to (a) gain access to Fiat's technology, thus enabling Chrysler to produce the type of smaller cars the Government wants manufactured, (b) satisfy the demands of unsecured creditors such as the VEBA trust and union laborers, and (c) provide some of Chrysler's equity to the Government—all components of a political agenda imposed on

Chrysler's management. (Id.) In doing so, the President reversed the business judgment of Chrysler's management, which had determined a stand-alone reorganization was in the best interests of Chrysler's stakeholders. (Transcript of Hearing on First-Day Relief ("Hr'g Tr.") 122:13-124:21 (May 4, 2009).)

15. Following the President's announcement, Chrysler began working at the behest of the U.S. Government to make the President's strategic vision a reality. (Kolka Aff. ¶¶ 84-85.) Chrysler's agreement to this political agenda marked the end of independent management. In clear violation of its fiduciary duties, Chrysler stopped functioning as a private company and became an instrument of a third-lien lender, the U.S. Government.

V. Chrysler Files For Bankruptcy To Force Fiat Sale And Wipe Out Secured Debt

16. On April 30, 2009, the Debtors commenced these Chapter 11 cases. As with its other major business decisions, the timing of the filing and the venue were made by the Government. (See Press Background Briefing on Auto Industry (April 30, 2009), www.whitehouse.gov/the_press_office/Background-Briefing-on-Auto-Industry-4/30/2009 (emphasis supplied).) Even though the cases were filed under chapter 11 of the Bankruptcy Code, it is very clear that the Debtors have no intention (or even possibility) of reorganizing these estates. Instead, the Debtors have filed the Sale Motion seeking to sell substantially all of their assets, free and clear of liens, to a newly formed company created for the purpose of this transaction ("New Chrysler"). (Sale Motion at 57; Kolka Aff. ¶ 88).

17. The purpose of this transaction is to transfer value from the Senior Secured Lenders' collateral to junior Chrysler stakeholders without regard to the well established legal priority of creditor claims. For example, though the Senior Secured Lenders will recover only 29% of their secured claims, Chrysler's unsecured creditors will receive over $20 billion over time. Robert Manzo, the Debtors' financial advisor, testified that over $20 billion in liabilities

would be assumed and paid out by New Chrysler with respect to worker and retiree healthcare and other benefits, prepetition auto parts and service supplier invoices, warranty and parts obligations, and pension obligations. (Hr'g Tr. 236:7-238:25; 242:16-244:20.) In particular, the VEBA trust (which has an unsecured claim of approximately $10 billion), will receive a new note with a value of $4.5 billion as well as 55% of the equity interest in New Chrysler. (Hr'g Tr. 234:3-235:6.) Fiat, one of the Debtors' foreign competitors, is slated to receive 20% of New Chrysler (with the right to acquire a total of 51%) in exchange for granting access to its "small car" technology. (Id.) Fiat is not paying any cash for its stake in New Chrysler. (Id.) The Treasury Department, a creditor with liens on the Collateral that are still junior to those of the Senior Secured Lenders, is slated to receive an 8% equity interest in New Chrysler. (Id.)

18. Following the sale the Debtors will cease to function as a going concern and will be left with only those assets New Chrysler deems essentially worthless. The Debtors describe the sale as of "substantially all" of their assets. (Id.)

19. Even though this transaction will reorder the economic interests of every Chrysler stakeholder, the Debtors have ignored fundamental issues related to this transaction. The Debtors made no effort to determine whether selling its assets to New Chrysler as a going concern would bring creditors a better recovery than a liquidation of Chrysler's component parts. (Hr'g Tr. 252:3-253:18.) Indeed, the Debtors cannot make this judgment, as they claim not to know either the liquidation value or the going concern value of the company. (Hr'g Tr. 251:7-252:18) Given this, it is not surprising that the Debtors admit to not having considered its fiduciary duty to work for the benefit of all stakeholders or how to protect against conflicts of interest among various stakeholders. (H'rg Tr. 256:23-258:1.)

20. The Debtors have likewise ignored the structure of the sale transaction. The Debtors' chief financial officer does not know the value of New Chrysler, the amount of debt it can support, or the value of the New Chrysler stock being distributed under the sale transaction or why it was allocated as proposed in the Sale Motion. (Hr'g Tr. 235:9-236:6.) The Debtors did not play any role in negotiating the capital structure of New Chrysler and did not decide what any of its stakeholders would receive as part of the transaction. (Hr'g Tr. 235:9-236:6; 246:10-19; 130:16-23.)

21. The Debtors abdicated each of these critical management decisions to the Treasury Department, whose only legally cognizable interest in these cases is that of a third-lien lender.

VI. The Government Strong Arms Lenders To Consent To Its Plan

22. Unlike any other bankruptcy in history, Chrysler's bankruptcy was announced by the President of the United States. President Obama's announcement made clear that he had made the decision to put Chrysler into bankruptcy. He blamed this decision on certain Senior Secured Lenders that had not received TARP funds and, therefore, had not bowed to the Government's pressure to accept an unfair 29 cents recovery where unsecured creditors were receiving all recoveries. The President branded those Senior Secured Lenders with fiduciary duties to their own investors as "speculators" who were unwilling to make "sacrifices." (www.whitehouse.gov/the_press_office/remarks-by-the-president-on-the-Auto-Industry 4/30/2009.) He accused these lenders of refusing to compromise and instead seeking "an unjustified taxpayer-funded bailout." Id. This was not true.

23. First, the Senior Secured Lenders not accepting the unfair deal—including the Indiana Pensioners—are not "speculators." They invested in first-lien secured debt, which is (or at least should be) a conservative investment. Second, certain of the Senior Secured Lenders did

offer to compromise. They offered to accept a 50% reduction of their debt, even though they might receive a better recovery in chapter 7 liquidation. Their offer was in stark contrast to other Chrysler stakeholders, whose "compromise" will enable them to receive a much larger recovery then they are entitled to receive under the Bankruptcy Code. Finally, the Indiana Pensioners have never sought a Government bailout. Indeed, they are among the few Chrysler stakeholders that can make that statement. Unlike Chrysler and the TARP banks, who accepted billions of taxpayer dollars, the Indiana Pensioners have not received a dime of bailout money from the Government. To the contrary, it was the Government that was taking from them. Under the Government's plan, billions of dollars of collateral belonging to the Senior Secured Lenders will be taken away and given to unsecured and junior lien creditors and (ironically) Fiat, a foreign automaker. Because certain of the Senior Secured Lenders asked to be paid for their interests in that collateral, they were vilified.

OBJECTION

I. The Proposed Sale Constitutes An Illegal *Sub Rosa* Plan That Distributes The Value Of The Collateral Among Creditor Classes

24. An expedited sale of substantially all of a debtor's assets, coupled with a distribution to the debtor's creditors of the value derived from the sale, which effectively terminates the debtor's business, is universally recognized as an impermissible *sub rosa* plan of reorganization. Here, the proposed sale goes far beyond what courts permit for an expedited sale. And it is far more than a sale of assets to preserve the value of a wasting asset, which is the conventional rationale for expedited sales under section 363. Instead, the proposed sale transaction is part of a multi-faceted plan that would allocate the value of the on-going enterprise and virtually all of its assets among creditor classes without the protections of the plan process.

A. The Debtors Attempt To Short Circuit The Plan Process

25. As shown below, courts have refused to approve section 363 sales that "short circuit" the requirements of chapter 11. The sale proposed by the Debtors is designed primarily to benefit certain junior unsecured creditors, without affording the Senior Secured Lenders the protections and requirements of a plan, disclosure statement and confirmation procedures as contemplated in sections 1122 to 1129 of the Bankruptcy Code.

26. The seminal case prohibiting sales as *sub rosa* plans is Braniff: "The debtor and the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets." PBGC v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 700 F.2d 935, 940 (5th Cir. 1983). In Braniff, the terms of the proposed sale included (a) the issuance of scrip that would only be used in a plan and only to fund obligations to former employees and shareholders, (b) that debt would be required to vote a portion of its deficiency claims in favor of any future plan approved by a majority of the Official Committee of Unsecured Creditors, and (c) releases in favor of Braniff and its directors and officers. Id. at 939-40. The court recognized the potential for mischief if a section 363 sale of substantially all of a debtor's assets is not closely scrutinized. The court held that where a proposed sale:

> attempts to specify the terms whereby a reorganization plan is to be adopted, the parties and the district court must scale the hurdles erected in Chapter 11 . . . . Were this transaction approved, and considering the properties proposed to be transferred, little would remain save fixed based equipment and little prospect or occasion for further reorganization.

Id. at 940; see also In re Abbotts Dairies of Pa., 788 F.2d 143, 150 (3d Cir. 1986) (holding that the "good faith" requirement of a section 363 sale is to be used to assure that by means of an asset sale a debtor does not abrogate the protections afforded to creditors by section 1129 of the Bankruptcy Code and the plan confirmation process).

27. The court's analysis in In re Westpoint Stevens Inc., 333 B.R. 30 (S.D.N.Y. 2005), is particularly instructive with respect to the increased scrutiny that must be applied to the sale of substantially all of a company's assets outside the context of a chapter 11 plan. In Westpoint, the bankruptcy court approved a sale of substantially all of the debtors' assets in exchange for cash and a transfer of certain unregistered securities and subscription rights to acquire securities of the corporate parent of the purchaser. Id. at 33-34. The sale order (i) provided that certain secured creditors would receive replacement liens in the securities, (ii) placed a value on the securities, (iii) directed a distribution of a portion of the securities to the senior secured creditors in full and complete satisfaction of their claims, and (iv) a partial distribution of the securities to junior lienholders, free and clear of the senior secured creditors' liens. Id.

28. The senior secured creditors appealed, arguing that the sale order converted more than $240 million of secured monetary claims against the debtors into an illiquid minority equity interest in the parent of successor entities of the debtor. Id. at 34. The district court for the Southern District of New York reversed, holding that the rights of the senior secured creditors could not be abrogated and that the bankruptcy court lacked authority to approve such a transaction under section 363 of the Bankruptcy Code. The court then warned of the dangers of a "powerful creditor" and debtor creating a proposed sale to create value for "favored constituencies"—the very situation the instant case presents:

> The Bankruptcy Court pointed to no authority, nor has this court despite the extensive research efforts of counsel and the undersigned's own chambers found any, standing for the proposition that an action in permanent derogation of a senior creditor's contractual rights can be forced upon that creditor for the purpose of providing 'adequate protection' to a junior creditor . . . . Taken to its logical extreme, the Bankruptcy Court's notion of adequate protection would allow a powerful creditor and a debtor anxious to achieve some value for its favored constituencies to run roughshod over disfavored creditors' rights, so long

> as a section 363(b) asset sale transaction could be defended as an exercise of reasonable business judgment in the context of dire economic circumstances.

Id. at 49-50.

29. The district court also reversed the provisions of the sale order relating to imposition of the distribution, claim satisfaction and lien-elimination provisions, holding that nothing in sections 363 or 105 of the Bankruptcy Code provides authority to impair the claim satisfaction rights of objecting creditors or to eliminate the replacement liens granted by the court. Id. at 55. Specifically, "section 363(h) is not to be utilized as a means of avoiding Chapter 11's plan confirmation procedures." Id. at 52. As the Westpoint court explained, "[w]here it is clear that the terms of a section 363(b) sale would preempt or dictate the terms of a Chapter 11 plan, the proposed sale is beyond the scope of section 363(b) and should not be approved under that section." Id.; see also Clyde Bergemann, Inc. v. The Babcock & Wilcox Co. (In re The Babcock & Wilcox Co.), 250 F.3d 955, 960 (5th Cir. 2001) ("[T]he provisions of § 363 . . . do not allow a debtor to gut the bankruptcy estate before reorganization or to change the fundamental nature of the estate's assets in such a way that limits a future reorganization plan."); Institutional Creditors of Continental Air Lines, Inc. v. Continental Air Lines, Inc. (In re Continental Air Lines, Inc.), 780 F.2d 1223, 1226-28 (5th Cir. 1986) ("When a proposed transaction specifies terms for adopting a reorganization plan, 'the parties and the district court must scale the hurdles erected in Chapter 11.' " (citations omitted) "[A] debtor in Chapter 11 cannot use § 363(b) to sidestep the protection creditors have when it comes time to confirm a plan of reorganization . . . .").

30. As the court further explained, section 363 cannot be used to abrogate Chapter 11 plan protections: "If a debtor were allowed to reorganize the estate in some fundamental fashion pursuant to § 363(b), creditor's [sic] rights under, for example 11 U.S.C. §§ 1125, 1126,

1129(a)(7), and 1129(b)(2) might become meaningless. Undertaking reorganization piecemeal pursuant to § 363(b) should not deny creditors the protection they would receive if the proposals were first raised in the reorganization plan." Id.

31. The Westpoint court's analysis is on point here. Under the transaction proposed by the Debtors, the Debtors would sell substantially all of their assets—including the Collateral—to New Chrysler. The Debtors then propose that New Chrysler would provide the Senior Secured Lenders with $2 billion—far less then the current amount of $6.9 billion due and owing—while satisfying favored unsecured creditors in the amount of over $20 billion. (See Sale Motion, at ¶¶ 41 & 58.) Just as in Westpoint, the Debtors cannot use Section 363 to force the Senior Secured Lenders to take a distribution of other property in satisfaction of their liens. Such a transaction is an impermissible *sub rosa* plan that, if approved, would abrogate the Chapter 11 plan protections of section 1129 of the Bankruptcy Code.

B. The Proposed Allocations Among Creditor Classes Violate The Priority Scheme Established By The Bankruptcy Code

32. The Sale Motion dedicates the first five pages of the argument section to the proposition that reorganization is an important object of bankruptcy. Yet the Debtors conveniently ignore that the equitable remedies that may be available in a chapter 11 case to achieve the goal of reorganization are circumscribed by the Bankruptcy Code. Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 202 (1988). The U.S. Supreme Court in Ahlers rejected a plan which sought to favor certain equity holders over certain creditors based on the purported contribution of future "labor, experience, and expertise." Id. at 199, 204-05. The Court held that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code" and that a "fair and equitable" reorganization is one which complies with the Bankruptcy Code. Id. at 206-207.

33. Here, the Debtors specifically seek to obtain the benefits of the section 1129 confirmation process, through an accelerated section 363 transaction, while flatly ignoring the requirements and creditor protection of section 1129 of the Bankruptcy Code.[2] Among other things, allowing the Debtors to ignore the priority scheme established by the Bankruptcy Code while selling substantially all of their assets, in permanent derogation of the Indiana Pensioners' property rights, would turn the law on its head.[3] Accordingly, the sale should not be approved except through the plan process, which assures creditors and other parties in interest full disclosure, the opportunity to vote on their fates and the protections of a fully noticed confirmation process. Indeed, as an initial matter, the Administrative Agent has taken the position that the objecting Senior Secured Lenders do not even have the right to object because the Senior Credit Agreement permits the sale to be approved by Required Lenders (51%) and such approval has already been obtained. Clearly, such an argument would be irrelevant if the transaction were properly put forth as a plan, and the very fact that the argument is being made is evidence of the fact that the transaction has at least in part been structured so as to eliminate (or clearly has the effect of eliminating) voting and objection rights that would otherwise exist. Moreover, if a majority in number rejected the plan, then the plan could only be confirmed if the Senior Secured Lenders got the indubitable equivalent for their secured claims, and to the extent that did not reflect their full claim amount, their deficiency claim could not be unfairly

[2] Section 1129(b)(1) of the Bankruptcy Code requires, among other things, that a plan does not discriminate unfairly among similarly situated creditors and is fair and equitable. Here, the proposed transaction violates both principles. Not only does the transaction improperly provide value to unsecured creditors at the expense of the Senior Secured Lenders, such as the Indiana Pensioners, but it also favors certain unsecured creditors over others, including any potential deficiency claims.

[3] The absolute priority rule is a fundamental tenet of bankruptcy law. The absolute priority rule provides that "the holder of any claim or interest that is junior to the claims of [a] class will not receive or retain under the plan on account of such junior claim or interest any property." In re Adelphia Communications Corp., 544 F.3d 420, 427 n. 5 (2d Cir. 2008) (citing 11 U.S.C. § 1129(b)(2)(B)(ii)) (internal quotations omitted). "A court may approve such a compromise or settlement only when it is fair and equitable." Id. (internal citations omitted). "The words 'fair and equitable' are terms of art-they mean that 'senior interests are entitled to full priority over junior ones.'" Id. (citing SEC v. Am. Trailer Rentals Co., 379 U.S. 594 (1965); Protective Committee v. Anderson, 390 U.S. 414 (1968)).

discriminated against vis-a-vis other *pari passu* unsecured claims (such as trade claims and the VEBA claim). The proposed sale provides no such protection before substantially all the value of the Debtors' estates is distributed out to other stakeholders in satisfaction of their claims.

34. The flaw in the Debtors' logic in support of the sale is further exposed by the fact that the Senior Secured Lenders' claims are supposedly getting full satisfaction (based on a disputed liquidation value). First of all, in a contested plan confirmation process, the Senior Secured Lenders would be able to fully test and challenge the Debtors' view of liquidation value; an opportunity the present process deprives them of. More importantly, however, assuming the validity of the Debtors' view, there is no provision for the treatment of the Senior Secured Lenders' approximately $5 billion deficiency claim even though other substantial unsecured claims are going to receive significant consideration. Results so patently offensive to the fundamental principles of the chapter 11 process should not be permitted—at least not without all the protections of the chapter 11 plan process.

II. The Government's Actions Exceed Its Statutory Authority and Are Improper

35. It is axiomatic that the Executive Branch's authority must derive either from an act of Congress or from the Constitution itself. Youngstown Sheet & Tube Co., 343 U.S. 579, 585 (1952). As cautioned by Justice Jackson in Youngstown, in language that is equally applicable here:

> That comprehensive and undefined presidential powers hold both practical advantages and grave dangers for the country will impress anyone who has served as legal adviser to a President in time of transition and public anxiety.
>
> * * *
>
> The opinions of judges, no less than executives and publicists, often suffer the infirmity of confusing the issue of a power's validity with the cause it is invoked to promote, of confounding the permanent executive office with its temporary occupant. The tendency is strong enough to emphasize

> transient results upon policies—such as wages or stabilization—and lose sight of enduring consequences upon the balanced structure of our Republic.

36. It is this very infirmity that the Government apparently seeks to exploit in this case. The assault on the contract rights of the Senior Secured Lenders here is of particular concern. As James Madison wrote in the Federalist Papers in 1788, "laws impairing the obligation of contracts are contrary to the first principles of the social compact, and to every principle of sound legislation." THE FEDERALIST No. 44 (James Madison).

37. Here, the Executive Branch relies on TARP. TARP, however, limits the spending to purchases of "troubled assets" of "financial institution[s]" only. 12 U.S.C. § 5211(a). Here, the EESA was explicit that troubled assets only were to be purchased from "financial institution[s]." 12 U.S.C. § 5211(a)(1).

38. And the EESA expressly lists the types of entities that are financial institutions as "any bank, savings association, credit union, security broker or dealer, or insurance company" clearly not encompassing automakers. Another federal statute the Bank Holding Company Act ("BHCA"), further illustrates the definition of financial institution, defining the activities that are "financial in nature" as including:

> (A) Lending, exchanging, transferring, investing for others, or safeguarding money or securities.
>
> (B) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any State.
>
> (C) Providing financial, investment, or economic advisory services, including advising an investment company (as defined in section 3 of the Investment Company Act of 1940 [15 U.S.C.A. § 80a-3]).
>
> (D) Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly.
>
> (E) Underwriting, dealing in, or making a market in securities.

(F) Engaging in any activity that the Board has determined, by order or regulation that is in effect on November 12, 1999, to be so closely related to banking or managing or controlling banks as to be a proper incident thereto (subject to the same terms and conditions contained in such order or regulation, unless modified by the Board).

(G) Engaging, in the United States, in any activity that—

(i) a bank holding company may engage in outside of the United States; and

(ii) the Board has determined, under regulations prescribed or interpretations issued pursuant to subsection (c)(13) of this section (as in effect on the day before November 12, 1999) to be usual in connection with the transaction of banking or other financial operations abroad.

12 U.S.C. § 1843(k)(4).[4] Again, making and selling cars obviously does not qualify.

39. That TARP was aimed at financial institutions—that is the types of already regulated institutions listed in the TARP definition of "financial institution"—and not auto manufacturers, is also confirmed by the other sections of EESA which expand previously authorized statutory mandates for the Federal Reserve, FDIC and Treasury Department. See 12 U.S.C. §§ 5233 (EESA § 126 regarding FDIC authority), 5235 (EESA § 129 regarding the Federal Reserve's loan authority), 5236 (EESA § 131 regarding the Treasury's authority as to the Exchange Stabilization Fund), and 5241 (regarding an increase in FDIC deposit and share insurance).

40. In his testimony before Congress on November 18, 2008, Treasury Secretary Paulson unequivocally stated "that the auto companies fall outside that purpose [of TARP]." (See Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and off

[4] The BHCA also includes certain other categories of activity that are considered "financial in nature," which relate to certain types of potential acquisitions by bank holding companies, and do not affect the analysis here. See 12 U.S.C. § 1843(k)(4)(H)-(I).

Government Lending and Insurance Facilities; Impact on Economy and Credit Availability: Hearing Before the H. Comm. on Fin. Servs., 110th Cong. 19 (Nov. 18, 2008)).

41. The House of Representatives further reiterated this inescapable conclusion when it attempted to authorize the Executive Branch to bailout the automotive manufacturing industry after enacting TARP, an act that would have been unnecessary if TARP was available for such purpose. The Auto Industry Financing and Restructuring Act, H.R. 7321, 110th Cong. § 10 (2008), passed by the House of Representatives attempted, and failed, to authorize the Executive Branch to do what the Treasury Department is attempting to do here. That legislation failed in the Senate. As a result, the Executive Branch (including the Treasury Department) never received Congressional authorization to bail out auto manufacturers, as it is attempting to do here.

42. Even the Treasury Department has recognized that TARP funds are available only to financial institutions. In its December 18, 2008 determination, Secretary Paulson concluded that TARP funds would be made available to Chrysler because "such thrift and other holding companies engaged in the manufacturing of automotive vehicles and the provision of credit and financing in connection with the manufacturing and purchase of such vehicles are 'financial institutions' . . . ." (Treasury Department Determination dated Dec. 19, 2009 (Docket No. 69, Ex. 1)). The Chrysler entity that extends credit is Chrysler Financial, which is not one of the Debtors in this case, and is not the recipient of any of the TARP funds. Consequently, under the Treasury Department's own determination, TARP funds are not available to fund the Debtors' reorganization.

43. The Treasury Department now ignores the statutory language, intent, purpose and its own prior determinations and the failed auto bailout bill, proceeding on the remarkable

position that TARP funds can be used to purchase assets of "any institution" that is "established and regulated under the laws of the United States and have significant operations in the United States." (Statement of the United States Department of the Treasury in Support of the Commencement of Chrysler LLC's Chapter 11 Case, Exhibit B [Docket No. 69].). The Treasury Department has simply, and improperly, read out of the definition of "financial institution" the word "financial" as well as the list of representative financial institutions that confirms the limits on the scope of TARP. 12 U.S.C. § 5202(5). The Treasury Department's "interpretation" eviscerates the clear Congressional intent of TARP and is squarely at odds with well-settled principles of statutory construction concerning the definition of "financial institution" as set forth in the EESA. If the phrase "any institution" were to be interpreted to mean literally any institution of any nature, regardless of whether it was financial in nature, the qualifier "financial" and the listing of types of financial institutions that follows would be utterly meaningless and effectively written out of the statute. See Leocal v. Ashcroft, 543 U.S. 1, 12 (2004) ("we must give effect to every word of a statute wherever possible").[5]

[5] 1. In Hibbs v. Winn, 542 U.S. 88, 101 (2004), the Supreme Court examined whether the term "assessment" in the phrase "enjoin, suspend or restrain the assessment, levy or collection of any tax under State law" was so broad as to signify the entire taxing plan. In rejecting that view, the Court explained:

> We do not focus on the word "assessment" in isolation, however. Instead, we follow "the cardinal rule that statutory language must be read in context [since] a phrase gathers meaning from the words around it." General Dynamics Land Systems, Inc. v. Cline, 540 U.S. 581, 596, 124 S.Ct. 1236, 1246, 157 L.Ed.2d 1094 (2004) (internal quotation marks omitted). In § 1341 and tax law generally, an assessment is closely tied to the collection of a tax, i.e., the assessment is the official recording of liability that triggers levy and collection efforts.
>
> The rule against superfluities complements the principle that courts are to interpret the words of a statute in context. See 2A N. Singer, Statutes and Statutory Construction § 46.06, pp. 181-186 (rev. 6th ed. 2000) ("A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant . . ." (footnotes omitted)). If, as the Director asserts, the term "assessment," by itself, signified "[t]he entire plan or scheme fixed upon for charging or taxing," Brief for Petitioner 12 (quoting Webster's New International Dictionary of the English Language 166 (2d ed. 1934)), the TIA would not need the words "levy" or "collection"; the term "assessment," along, would do all the necessary work.

See also Rapanos v. United States, 547 U.S. 715, 731-32 (2006) (noting that the qualifier "navigable" in the term "navigable waters" is not devoid of significance).

A. The Sale Motion Violates The Plain Language Of The EESA And Is An Unconstitutional Taking

44. TARP also contains express language prohibiting the impairment of the Senior Secured Lenders' rights, which is being attempted through the guise of the section 363 sale. Section 119(b)(2) of the EESA provides that "[a]ny exercise of the authority of the Secretary pursuant to this chapter shall not impair the claims or defenses that would otherwise apply with respect to persons other than the Secretary." 12 U.S.C. § 5229(b)(2).

45. As discussed above, if the Debtors are successful in obtaining approval of the section 363 sale, $2 billion would be distributed to the Senior Secured Lenders, representing approximately 29% on their Senior Secured Debt. Meanwhile, New Chrysler would receive billions of dollars in new loans based on the very same Collateral, which would allow New Chrysler to repay many of the Debtors' former unsecured creditors at or close to par—and at a higher recovery rate than paid to the Senior Secured Lenders *or* than those creditors would have received under a chapter 11 plan. As such, the Debtors' plan is to use section 363 to strip itself of the assets pledged to the Senior Secured Lenders and put those assets to the benefit of unsecured creditors *instead of* the Senior Secured Lenders *even though* the Senior Secured Lenders will not have been paid in full (including on any unsecured deficiency claims).

46. By mandating a treatment of the Debtors' assets that precludes any unsecured deficiency claims of the Senior Secured Lenders from being paid while allowing inferior creditors to receive substantial value from the estate, the Treasury Department also is causing the Debtors to ignore the priority rules embodied in the Bankruptcy Code as applied by the Supreme Court in Bank of America Nat'l Trust & Sav. Ass'n v. 203 North LaSalle Street Partnership, 526 U.S. 434 (1999). There, the court held that a debtor could not refuse to consider alternative plan structures where the proposed plan permitted the debtor's pre-bankruptcy equity holders, over

the objection of a senior secured class of creditors, to contribute new capital and receive ownership interests in the reorganized entity while the senior creditor's unsecured deficiency claims went unpaid. As noted above, that is exactly what is being mandated here by the proposed 363 sale transaction being scripted by the Treasury Department.

47. Not only do the Government's actions far exceed its statutory authority, they also subject the Government to potential lender liability and equitable subordination actions. "[A] creditor will be held to an insider standard where it is found that it dominated and controlled the debtor." Official Comm. Of Unsecured Creditors of the Debtors v. Austin Fin. Servs. (in re KDI Holdings, Inc.), 277 B.R. 493, 511 (Bankr. S.D.N.Y. 1990). When such a creditor overwhelmingly dominates the debtor, there is a merger of identity and the creditor will be held to a fiduciary standard. Id. at 512; see also Schubert v. Lucent Techs., Inc. (In re Winstar Commc'ns, Inc.), 554 F.3rd 382, 411-12 (3d Cir. 2009) (finding "egregious" conduct where the creditor had exerted such influence and control as to qualify as an "insider" acting to the detriment of other creditors); In re Process-Manz Press Inc., 236 F. Supp. 333 (N.D. Ill. 1964) (upholding the Referee's ruling that the claimant was "in substance the owner" of the bankrupt and therefore a fiduciary), rev'd on jurisdictional grounds, 369 F.2d 513 (7th Cir. 1966).

48. Here, the Government has taken control over Chrysler's business, and has used that control to impose its own plan of reorganization at the expense of other creditors. This would normally subject a party to liability. See, e.g., Melamed v. Lake County Nat'l Bank, 727 F.2d 1399 (6th Cir. 1984) (finding that lender's actions to "salvage" the corporate borrower were sufficient to state a claim of tortious interference with the debtor's business relationsbips).

49. The Supreme Court long ago recognized tbat a secured creditor's interest in specific property is protected in bankruptcy under the Fifth Amendment. Louisville Joint Stock

Land Bank v. Radford, 295 U.S. 555, 589, 594 (1935). That case involved a Depression-era statute that was intended to help bankrupt farmers avoid losing their land in mortgage foreclosure. But rather than mandate some form of moratorium, which had been upheld, see Home Building & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934), the statute in Radford took a unique approach to the bankruptcy process. The bankrupt debtor could achieve a release of the security interests either (i) with the lender's consent, purchasing the property at its then appraised value by making deferred payments for two to six years at statutorily-set interest rates; or (ii) if the lender refused the purchase option, by having the bankruptcy court stay the proceedings for up to five years during which time the debtor could use the property by paying a rent set by the court, which payments would be for the benefit of all creditors, with a purchase option at the end of that period. Id. at 575-76.

50. Justice Brandeis noted that the "essence of a mortgage" is the right of the secured party "to insist upon full payment before giving up his security [i.e., the property pledged]." Id. at 580. In invalidating the statute, the Court noted that no bankruptcy law had ever "sought to compel the holder of a mortgage to surrender to the bankrupt either the possession of the mortgaged property or the title, so long as any part of the debt thereby secured remained unpaid." Id. at 581-82. Commenting on the law allowing the debtor to repay less than the full amount owing and keep the property, the Court also noted that no prior law had "attempted to enlarge the rights or privileges of the mortgagor as against the mortgagee" including by going beyond reducing the debtor's liabilities to "supply [the debtor] with capital with which to engage in business in the future." Id. at 582.

51. Holding that secured creditors could not be treated this way, the Court stated that "[t]he bankruptcy power . . . is subject to the Fifth Amendment," and that the pernicious aspect

of this law was its "taking of substantive rights in specific property acquired by the bank prior to the act." Id. at 589-90.[6] Thus, Congress could not pass a law that could be used to deny to secured creditors their rights to realize upon the specific property pledged to them or "the right to control meanwhile the property during the period of default." Id. at 595.[7] That is precisely what the Treasury Department would have Chrysler do here.

52. The Treasury Department is demanding that the Collateral be stripped away from the Senior Secured Lenders' liens—thereby impairing the rights of the Senior Secured Lenders to realize upon those assets—so that it may be put in New Chrysler. The plan is then to use those assets to benefit unsecured creditors in this proceeding, who will then recover substantially more than the Senior Secured Lenders, who also will realize nothing on their unsecured deficiency claims. Radford specifically disallowed this type of procedure as antithetical to the idea of a lien on property. That the Treasury Department would do this to help the United States address difficult economic times is not an answer. Indeed, the same justification was expressly rejected in Radford, where Justice Brandeis noted that a statute which violated secured creditors' rights, but which was passed for sound public purposes relating to the Great Depression, could not be saved because "the Fifth Amendment commands that, however great the nation's need, private property shall not be thus taken even for a wholly public use without just compensation." Id. at 602.

[6] The legislative history relating to adequate protection under section 363 echoes this commitment under the Fifth Amendment to protecting the value of property pledged to secured creditors. See S. Rep. No. 95-989, at 49, 53, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5835, 5839 (citing Radford and finding that "the purpose of the section is to insure that the secured creditor receives the value for which he bargained"); H.R. Rep. No. 95-595, at 339, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6295 (to similar effect).

[7] Tellingly, in Wright v. Union Central Life Ins. Co., 311 U.S. 273, 278 (1940), the Court upheld the revised version of the statute at issue in Radford based on safeguards "to protect the rights of secured creditors, throughout the proceedings, to the extent of the value of the [pledged] property."

B. The EESA And TARP Do Not Authorize The Government to Control Chrysler Or Its Bankruptcy

53. In addition to the fact that TARP funds cannot be used to purchase troubled assets of car manufacturers, rather than financial institutions, and that use here improperly impairs the Senior Secured Lenders' rights, the statute also does not permit the Treasury Department to take effective possession of Chrysler, impose new management and dictate the terms of its continued operations and ultimate survival. See Youngstown, 343 U.S. at 588-89. There is no statutory authority for the Treasury Department's actions in effectively causing the marshaling and sale of the Debtors' assets by way of a particular sale process so as to ensure that the Senior Secured Lenders' rights as first lien secured lenders are paid only 29 cents on the dollar and their unsecured deficiency claims left unpaid while also ensuring that unsecured creditors who have no secured status are paid in full or receive equity in New Chrysler. This may be the type of authority that the Treasury Department or its sub-agencies may exercise with respect to financial institutions, but those powers come with specific Congressional authorization and are expressly limited by the scope of the enabling statutes in question. The very specificity of those statutes shows that Congress knows how to cloak an agency with such powers—something Congress never did in the EESA or TARP. See, e.g., 12 U.S.C. § 1821(d)(2) (powers of FDIC with respect to failed depositary institutions); 45 U.S.C. 701, et seq. ("Railroad Reorganization Act") (establishing detailed procedures for railroad reorganizations under the bankruptcy laws); 11 U.S.C. § 1163 (detailing authority of Transportation Secretary in railroad bankruptcy proceeding).

54. Absent such express statutory authority, even the federal banking regulators do not have unlimited power in marshaling assets and classifying creditors. See, e.g., Wheeler v. Greene, 280 U.S. 49 (1929) (Federal Farm Loan Bank as receiver had no authority under statute

to maintain suit to enforce stockholders' liability); Sharpe v. F.D.I.C., 126 F.3d 1147, 1155 (9th Cir. 1997) (FDIC exceeded statutorily granted powers in attempting to record a reconveyance of the debtor's deed of trust for which it did not pay full consideration); Adagio Inv. Holding Ltd. v. F.D.I.C., 338 F. Supp.2d 71, 73 (D.D.C. 2004) (noting broad FDIC powers under section 1821, but finding that "none of these broad powers encompasses the right to reclassify deposits without authorization..."). TARP contains no reference—or even hint—of Treasury Department authority to direct the course of a Chapter 11 proceeding as to a private company like Chrysler.

C. This Proceeding Also Violates The EESA's Conflict Of Interest Rules

55. The EESA also provides that in acting, the Treasury Department must avoid conflicts of interest and must issue regulations designed to manage or prohibit conflicts. 12 U.S.C. § 5218. The relevant regulations relating to the EESA and TARP are found in 31 C.F.R. Part 31. There, the Treasury Department defined a conflict of interest, *inter alia*, as "a situation in which [a] retained entity has an interest or relationship that could cause a reasonable person with knowledge of the relevant facts to question the retained entity's objectivity or judgment to perform under the arrangement." 31 C.F.R. § 31.201. It also prohibited concurrent conflicts of interest: "[i]f [a] retained entity advises Treasury Department with respect to a program for the purchase of troubled assets, the retained entity, management officials performing work under the arrangement, and key individuals shall not, during the term of the arrangement, sell or offer to sell, or act on behalf of anyone with respect to a sale or offer to sell, any assets to Treasury under the terms of that program." 31 C.F.R. § 31.214.

56. Here, one of the Government's key legal advisors is Simpson, Thacher & Bartlett LLP ("STB"). Starting in October 2008, and continuing through the present, STB entered into two contracts with the Treasury Department to provide it with a broad range of legal advice with regard to the implementation of the TARP program, including "guidance in the development of

equity and debt investments and co-investment programs instituted pursuant to the Emergency Economic Stabilization Act of 2008." See Contract Numbers T0S09007 (Dec. 10, 2008) and TOFS-09-D-001 (Feb. 20, 2009). In this proceeding, however, STB is now representing the Administrative Agent for all the Senior Secured Debt that has acted to solicit consents for the very actions being pursued by the Treasury Department which violate EESA. See (Comments of Peter V. Pantaleo, Esq., Hr'g Tr. at 28) ("JPMorgan is the first lien administrative agent. . . . [A]t the company's request in concluding negotiations over the amount by which the required lenders would agree to liquidate the collateral in this case in the context of a sale to Fiat, the agent solicited written consents from each of the holders of the first lien debt"). Neither the Government nor the Debtors have provided any explanation as to why this overlapping representation does not create an improper conflict of interest that also infects these proceedings.

III. A Sale Of Substantially All Of A Debtor's Assets Is Subject To Close Scrutiny And A Heightened Burden, That Debtors Fail To Satisfy

57. Section 363(b)(1) of the Bankruptcy Code provides the general authority for a debtor to sell assets outside the ordinary course of business. However, when a debtor proposes to sell substantially all of its assets and without the structure of a chapter 11 disclosure statement and plan, courts impose higher scrutiny, recognizing that such a sale constitutes an essential termination of the debtor's on-going business, leaving only the orderly distribution of the sale proceeds to be performed under the law governing the priority of creditors.

A. Close Scrutiny And A Heightened Burden Apply

58. Courts are required to ensure that a debtor does not use the cover of a section 363 sale to effect a plan of reorganization without compliance with the rigors mandated in a judicial confirmation of a plan. In re Channel One Communications, Inc., 117 B.R. 493, 496 (Bankr. E.D. Mo. 1990) (citing In re Industrial Valley Refrigeration & Air Conditioning Supplies, Inc.,

77 B.R. 15, 17 (Bankr. E.D. Pa. 1987) (the transaction "must be closely scrutinized and the proponent bears a heightened burden of proving the elements necessary for authorization.")); In re Wilde Horse Enterprises, Inc., 136 B.R. 830, 841 (Bankr. C.D. Cal. 1991); Western Auto Supply Co. v. Savage Arms, Inc., 43 F.3d 714, 720 n.9 (1st Cir. 1994) (order confirming a chapter 11 liquidation sale warrants special "bankruptcy court scrutiny"); 3 COLLIER ON BANKRUPTCY, ¶ 363.02[3]; see, e.g., Stephens Indus., Inc. v. McClung, 789 F.2d 386 (6th Cir. 1986) (due to the fact that "there is some danger that a section 363 sale might deprive parties of substantial rights inherent in the plan confirmation process, sales of substantial portions of a debtor's assets under section 363 must be scrutinized closely by the court")); In re CGE Shattuck, LLC, 254 B.R. 5, 12 (Bankr. D. N.H. 2000) (looking through form to substance and rejecting creditor disclosure that would circumvent the requirements of chapter 11 of the Bankruptcy Code).

59. The Debtors must prove the following elements to gain approval of the Sale Motion: (i) the existence of a sound business purpose for conducting the sale without a disclosure statement and plan; (ii) there has been accurate and reasonable notice of the sale; (iii) the price to be paid is fair and reasonable; and (iv) the sale will not unfairly benefit insiders or the prospective purchasers, or **unfairly favor a creditor or class of creditors**. Channel One, 117 B.R. at 496 (emphasis added); see also In re Engman, 395 B.R. 610, 620 (Bankr. W.D. Mich. 2008) (sales must be "fair and reasonable in price and made in 'good faith'" and must be "in the best interests of the estate and creditors") (internal quotations and citations omitted). As demonstrated below, the Debtors cannot satisfy the required elements of a section 363 sale.

60. The proposed sale fails to satisfy the heightened standards applicable to sales in substantially all a debtor's assets. As addressed below, (i) the proposed sale violates absolutely

priority, (ii) was not negotiated in good, (iii) does not serve the best interest of the estate and creditors (other than certain unsecured creditors), (iv) is an illegal *sub rosa* plan, and (v) eliminates all of the protections of a Chapter 11 reorganization.

1. No Sound Business Purpose Exists For Approval Of The Sale Motion And Redistribution Of Value

61. To determine if an asset sale under section 363(b) is permissible, the "judge determining [the] § 363(b) application [must] expressly find from the evidence presented before him [or her] at the hearing [that there is] a good business reason to grant such an application." Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1070-1 (2d Cir. 1983) (a debtor should not sell substantially all of its assets outside the ordinary course of business under section 363(b) absent an "articulated business justification"); see also Stephens Indus., Inc., v. McClung, 789 F.2d 386, 390 (6th Cir. 1986); In re Montgomery Ward Holding Corp., 242 B.R. 147, 153 (D. Del. 1999); In re Exaeris, Inc., 380 B.R. 741, 744 (Bankr. D. Del. 2008). Here, no legitimate reason exists to take value properly belonging to the Indiana Pensioners and distribute it to unsecured and junior creditors. Although the Debtors claim that they are preserving "going concern" value, they have no intention of remaining a going concern. Instead, they plan to sell everything to New Chrysler, which entity ultimately will benefit from any "going concern" value purchased by paying junior claims. Preservation of value for a non-Debtor to the detriment of Senior Secured Lenders hardly can be considered a good business reason for the estates.

62. Indeed, the Dehtors have produced no evidence indicating why the proposed transaction could not be accomplished in a plan process other than that such sale likely would not satisfy the Chapter 11 confirmation standards. Courts should not approve proposed sales under section 363, however, when the proposed transaction would not be approved if proposed in a

plan. See Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 450 (1968) (finding that expedition does not justify abandoning proper standards); In re Continental Airlines, Inc., 780 F.2d 1223, 1226 (5th Cir. 1986) ("When a proposed transaction specifies the terms for adopting a reorganization plan, the parties and the district court must scale the hurdles erected in Chapter 11.") (internal citation omitted); In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983) (rejecting proposed sale because it "ignores the equity interests required to be weighed and considered under Chapter 11" and holding that "[t]he need for expedition . . . is not justification for abandoning proper standards") (internal citation omitted).

2. The Debtors Did Not Provide Accurate And Reasonable Notice

63. The Debtors acted as if they were selling a Chrysler LeBaron and not a multinational corporation with billions of dollars in assets. Indeed, the sales procedures proposed by the Debtors were designed to do nothing more than give the appearance of legitimacy to the proposed sale that is nothing more than an illegal *sub rosa* plan. The sales procedures effectively precluded anyone but the Government from bidding on the Debtors' assets, and thus, were inherently unfair and did not comply with the fundamental purpose for bidding procedures—to maximize the sale price for the Debtors' assets.

64. The sale procedures provided just over one week for potential bidders to put in a final offer for substantially all of the Debtors' assets with no due diligence or financial contingency. The Debtors themselves recognize this to be absurd. For example, Scott R. Garberding, Senior Vice President and Chief Procurement Officer, testified that it took four months and over 200 people to put the Fiat deal together, and acknowledged that a one-week time period is an enormously shortened time period for a multibillion dollar transaction. (Hr'g

Tr. at 89-92) Mr. Garberding also agreed that one week to conduct due diligence and come forward with a bid would eliminate bidders. (Hr'g Tr. at 97)

65. To compound the absurdity of seeking bids within a week, the Debtors mandated virtually every term of a potential bid, with each restriction designed not to generate bids but rather to discourage them. For example, the Debtors required that the purchase price and terms as well as the conditions of bids be substantially the same as those set forth in the proposed Purchase Agreement (even requiring a "redline" of any proposed agreement reflecting changes against the Purchase Agreement). The Debtors required bids to be made without the protection of any due diligence, financing contingencies, or other bid protections, another absurdity for bids amounting to billions of dollars. Finally, the Debtors required a bidder to assume billions in liabilities held by certain favored unsecured creditors, and assume certain collective bargaining agreements, whether or not doing so maximizes value for the estates. The Debtors cannot establish a business reason for requiring competing bids that includes terms that provide no benefit to the estate, and such requirement simply demonstrates that the Debtors are not exercising any business judgment, but are merely implementing the direction of the Treasury Department.

66. Also telling is that the sale procedures provided broad rights to reject bids upon consultation with, among others, the Treasury Department—one of the sponsors of the Debtors' proposed sale transaction. The sale procedures simply further evidence the Debtors' and the Government's attempt to push through this Court the prearranged Government-Chrysler-UAW-Fiat *sub rosa* plan, without concern for the law.

3. <u>The Sale Price Is Not Fair And Reasonable</u>

67. No evidence exists regarding what value the Debtors could receive, outside of the proposed sale the Debtors and the Government are bulldozing through this Court. Indeed, the

Debtors' own analysis indicates that a liquidation of the Debtors (who, according to the Sale Motion at ¶11, had assets of over $39 billion as of December 31, 2008) could achieve more value for the Senior Secured Lenders. Hr'g Tr. 235:9—236:6. Even more importantly, though, aside from the sale price itself, it is the allocation of proceeds that is grossly unfair to the Indiana Pensioners, as discussed in section 5 below.

4. The Sale And Redistribution Of Value Unfairly Benefits Insiders Or The Prospective Purchaser

68. Importantly, the sale of assets by the Debtors to New Chrysler is not a sale that was negotiated by independent parties at arms' length. Rather, it is a sale that was orchestrated entirely by the Treasury Department and foisted upon the Debtors without regard to corporate formalities, the fiduciary duties of the Debtors' officers and directors or the other important checks and balances typically found in good faith sales. Indeed, well before the filing, the Debtors had ceased to function as an independent company and had become an instrumentality of the Government. President Obama, in his public statements made it clear that the Debtors would be required to pursue the sale transaction with Fiat and ordered the Debtors to cease all efforts to pursue any other transaction. Both actions are clearly inconsistent with the requirements of a good faith sale. And the Government exerted extreme pressure to coerce all of the Debtors' constituencies into accepting a deal which is being done largely for the benefit of unsecured creditors at the expense of senior creditors. Under the circumstances, New Chrysler simply cannot establish that it is a good faith purchaser in connection with the proposed sale.

5. The Sale And Redistribution Of Value Favors Certain Creditors And/Or Classes Of Creditors And Is Unfair

69. A fundamental tenet of bankruptcy law is that unfair treatment of creditors is prohibited, and that the debtors bear the burden to prove that creditors are being treated fairly. Channel One, 117 B.R. at 496; see also In re Engman, 395 B.R. at 620 (sale must be made in

"good faith" and must be "in the best interests of the estate and creditors"); In re Dow Corning Corp., 198 B.R. 214, 222 (Bankr. E.D. Mich. 1996) (sale must be "fair and equitable," "in good faith" and "in the best interests of the estate"). The Debtors cannot show that the proposed sale treats the Senior Secured Lenders fairly.

IV. The Debtors Have Failed To Satisfy The Requirements Of 11 U.S.C. § 363(f)

70. A sale free and clear of third party interests must comply with one of the provisions of section 363(f)(1) though (5). Here, the Debtors rely on subsections (2) and (3)[8] that provide as follows:

> (2) such entity consents;
>
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property.

11 U.S.C. §§ 363(f)(2)-(3). The Debtors' proposed sale does not comply with any of these requirements.[9]

A. The Debtors Have Failed To Satisfy 11 U.S.C. § 363(f)(2)

71. Section 363(f)(2) authorizes a sale free and clear of the Senior Secured Lenders' liens only if "such entity consents." 11 U.S.C. § 363(f)(2). "There is no indication within Section 363 itself or its underlying legislative history that Congress intended 'consents' to have any meaning other than that which it is commonly understood to have. 'Consent,' when used as a verb, means 'to give assent or approval.'" In re Roberts, 249 B.R. 152, 155 (Bankr. W.D.

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[8] To the extent that the Debtors seek to argue for approval under section 363(f)(5) in footnote 10 of the Sale Motion, that argument fails. Section 363(f)(5) applies only where the secured party can be compelled to have its lien replaced by a payment or some other interest that provides adequate protection. 11 U.S.C. § 363(f)(5); 3 Collier on Bankruptcy, ¶ 363.06[6]; see also Clear Channel Outdoor 391 B.R. at 39-40, 44-45 (363(f)(5) applies only when a proceeding exists to force a creditor's interest to be completely satisfied without full payment of the amount owed such as a liquidated damages clause or a buy-out arrangement among partners); see also, Richardson v. Pitt County (In re Stroud Wholesale, Inc.), 47 B.R. 999, 1003 (E.D.N.C. 1985), aff'd without opinion, 983 F.2d 1057 (4th Cir. 1986) ("money satisfaction" as used in section 363(f)(5) means full satisfaction of an interest).

[9] The Sale Motion does not seek relief under 11 U.S.C. § 363(f)(1) or (4).

Mich. 2000) (citing Webster's Third New International Dictionary (unabridged) (1986)) "[C]onsent' [as used in § 363(f)(2)] obligates the trustee to approach the lienholder and secure the lienholder's assent if the trustee wishes to sell the property free and clear of the lien." Id. When a debtor attempts to sell estate property free and clear of the liens of multiple lienholders pursuant to section 363(f)(2), the debtor must obtain unanimous consent from all lienholders. See In re Mulberry Corp., 265 B.R. 468, 469 (Bankr. M.D. Fla. 2001) (denying a motion to sell estate property free and clear of multiple liens pursuant to section 363(f)(2) on grounds that the debtor failed to obtain unanimous consent of all lienholders to the proposed sale); see also In re Bobroff, 40 B.R. 526, 528 n.3 (Bankr. E.D. Pa. 1984).

72. Here, the Indiana Pensioners oppose the sale. Thus, the Debtors fail to satisfy the standard required by section 363(f)(2). To the extent the Debtors contend that consent has somehow been conferred through the Administrative Agent, that contention is misplaced. The Indiana Pensioners are parties in interest and have not consented. Yet, the loan agreement between the Debtors and the Senior Lienholders unambiguously requires, among other things, that each of the Senior Lienholders must provide "written consent" before the Collateral can be released.

73. Section 9.1(a) of the Senior Credit Agreement expressly identifies certain instances where the Administrative Agent may **not** act on behalf of the Indiana Pensioners. In pertinent part, section 9.1 provides:

> (a) Neither this Agreement, any other Loan Document, nor any terms hereof or thereof may be amended, supplemented or modified except in accordance with the provisions of this Section 9.1 or as otherwise expressly provided herein. The Required Lenders and the Company (on its own behalf and as agent on behalf of any other Loan Party party to the relevant Loan Document) may, or, with the written consent of the Required Lenders, the Administrative Agent and the Company (on its own behalf and as agent on behalf of any Loan Party party to the relevant Loan Document) may, from time to time, (i) enter into written

> amendments, supplements or modifications hereto and to the other Loan Documents for the purpose of adding any provisions to this Agreement or the other Loan Documents or changing in any manner the rights or obligations of the Lenders or of the Loan Parties hereunder or thereunder or (ii) waive, on such terms and conditions as the Required Lenders or the Administrative Agent, as the case may be, may specify in such instrument, any of the requirements in this Agreement or other Loan Documents or any Default or Event of Default and its consequences; **provided, however, that no waiver and no such amendment, supplement or modification shall:**
>
> . . .
>
> > (iii) reduce any percentage specified in the definition of Required Lenders, consent to the assignment or transfer by or release of the Company of any of its rights and obligations under this Agreement and the other Loan Documents, **release all or substantially all of the Collateral** or release all or substantially all of the Subsidiary Guarantors or Holdings from their obligations under the Guarantee or the Security Agreement (except as otherwise provided in the Loan Documents), in each case **without the writteu consent of all Lenders.**

Senior Credit Agreement, § 9.1(a)(iii) (emphasis added). The plain language of section 9.1(a)(iii) unequivocally provides that the Administrative Agent does not have the authority to release all or substantially all of the Collateral on behalf of any other lender party to the Senior Credit Agreement without the written consent of **all** the Senior Secured Lenders. Without that consent, section 9.1(a)(iii) expressly prohibits the Administrative Agent from engaging in any acts that would release all or substantially all of the Collateral.

74. Moreover, the Administrative Agent may not consent on behalf of the Indiana Pensioners to satisfy section 9.1(a)(iii) because such consent is outside the scope of its delegated powers under the Senior Credit Agreement. Under New York law,[10] an agent's authority to bind a principal is limited by what powers the principal grants to the agent. In re Parmalat Securities Litig., 594 F. Supp. 2d 444, 451-52 (S.D.N.Y. 2009) (quoting Merrill Lynch Interfunding, Inc. v. Argentis, 155 F.3d 113, 122 (2d Cir. 1998) (applying New York law)).

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[10] New York law applies pursuant to section 9.11 of the First Lien Credit Agreement.

75. No provision in the Senior Credit Agreement or the accompanying loan documents expressly delegates to the Administrative Agent the power to release all or substantially all of the Collateral on behalf of Senior Secured Lenders without each such lender's written consent. In fact, as discussed above, section 9(a)(iii) expressly prohibits the Administrative Agent from taking such action. Based on the clear and unambiguous language of section 9(a)(iii), the Indiana Pensioners never granted to the Administrative Agent the authority to release all or substantially all of the Collateral on behalf the Senior Secured Lenders without all of their written consent. Accordingly, the Administrative Agent cannot consent to the proposed sale on behalf of the Indiana Pensioners.

76. Indeed, according to the Debtor and the Treasury Department, and reflecting their knowledge that the credit documents do not permit the Administrative Agent to approve the proposed sale on behalf of the Indiana Pensioners, the bankruptcy was filed because they did not get 100% consent from the secured lenders.

B. The Debtors Have Failed To Satisfy 11 U.S.C. § 363(f)(3)

77. Section 363(f)(3) authorizes a sale free and clear of the Senior Secured Lenders liens only if "the price at which such property is to be sold is greater than the aggregate value of all liens on such property." 11 U.S.C. § 363(f)(3). The Debtors selectively identify a handful of decisions and suggest that the weight of authority supports their argument that section 363(f)(3) authorizes a sale if the sale price exceeds the economic value of the liens against the assets sold. It does not. In fact, the Debtors ignore the true state of the law.[11]

78. The language of section 363(f)(3) is clear (as is the statutory scheme). Most courts now recognize this clarity and hold that "greater than the aggregate value of all liens"

[11] The Debtors abjectly fail to cite any of the decisions that are directly contrary to the proposition of the few cases supporting the Debtors' position. This omission of relevant authority is notable and telling.

means the sale must be for more than the entire debt asserted against the property. See Clear Channel Outdoor, Inc. v. Nancy Knupfer, Chapter 11 Trustee, et al. (In re PW, LLC), 391 B.R. 25, 40-1 (9th Cir. B.A.P. 2008) (holding that section 363(f)(3) of the Bankruptcy Code does not authorize the sale free and clear of a lienholder's interest if the price of the estate property is equal to or less than the aggregate amount of all claims held by creditors who hold a lien or security interest in the property being sold); see also Matter of Riverside Investment P'ship, 674 F.2d 634, 640-1 (7th Cir. 1982); Richardson v. Pitt County (In re Stroud Wholesale, Inc.), 47 B.R. 999, 1002 (E.D. N.C. 1985), aff'd mem., 983 F.2d 1057 (4th Cir. 1986) (free and clear sale not allowed unless the sale proceeds will fully compensate all secured lienholders); Scherer v. Fed. Nat'l Mortgage Ass'n (In re Terrace Chalet Apartments, Ltd.), 159 B.R. 821, 828 (N.D. Ill. 1993) (same); In re Perroncello, 170 B.R. 189, 190-2 (Bankr. D. Mass. 1994) (same); In re Feinstein Family P'ship, 247 B.R. 502, 508 (Bankr. M.D. Fla. 2000) (same); In re Canonigo, 276 B.R. 257, 262-3 (Bankr. N.D. Cal. 2002) (same); Criimi Mae Servs. Ltd. P'ship v. WDH Howell, LLC (In re WDH Howell, LLC), 298 B.R. 527, 531 (D. N.J. 2003) (same); In re Healthco Int'l, Inc., 174 B.R. 174, 176 (Bankr. D. Mass. 1994) (same); In re Heine, 141 B.R. 185, 189 (Bankr. D. S.D. 1992) ("'value' as used in 11 U.S.C. § 363(f)(3) is synonymous with amount"); In re Julien Co., 117 B.R. 910, 919 (Bankr. W.D. Tenn. 1990) (sale not allowed under section 363(f)(3) because the total liens and interests claimed against the asset exceed the value of the asset); Matter of Rouse, 54 B.R. 31, 33 (Bankr. W.D. Mo. 1985) ("[I]n order for a sale free and clear of the liens to be authorized, it must be demonstrated that such a sale has a reasonable promise of realizing excess value over the balances due on the existing liens which can go into the bankruptcy estate. When the plaintiffs, according to their own contentions, request to sell the property for less than the liens, it appears that the prerequisites for a sale free and clear of liens cannot be met."); In re Red Oak Farms, Inc., 36 B.R. 856, 857-58 (Bankr. W.D. Mo. 1984) (the debtors could not sell property of the estate free and clear of all liens because the debtors contended that the value of the asset did not exceed the amount owed to the lienholder). Although a select few courts have held that the aggregate value of all liens refers only to the economic value of such liens, see, e.g., In re Terrace Gardens Park P'ship, 96 B.R. 707(Bankr. W.D. Tex. 1989), these decisions are not well reasoned or consistent with the plain meaning and structure of the Bankruptcy Code. The reasoning in the recent decisions (now, the majority of published decisions) is compelling and should be followed.

79. First, as explained by the court in Clear Channel, "[t]he [Bankruptcy] Code . . . tends to refer not to the economic value of the property secured by liens but to the value of claims secured by those liens." 391 B.R. at 38. The interpretation proffered by Debtors "would essentially mean that an estate representative could sell estate property free and clear of any lien, regardless of whether the lienholder held an allowed secured claim," which is "inconsistent with" "the context of paragraph (3)." Id. at 40. As held by the court in Clear Channel, if "Congress had intended such a broad construction, it would have worded the paragraph very differently," such as how it worded section 1206 of the Bankruptcy Code (discussed below). Id. at 40, n. 15.

80. Moreover, the language of section 363(f) simply does not justify the sale of collateral over the objection of an undersecured creditor because the statute expressly requires that the sale price be greater than, not just equal to, the value of the liens upon the property.[12] This condition cannot be met unless the price is greater than the nominal amount of a secured creditor's claim because, if a creditor is undersecured, the price can only equal (or be less than) a secured creditor's claim. Clear Channel, 391 B.R. at 40-41; WDH Howell, 298 B.R. at 532-33

[12] This power to reduce a secured claim to its value is reserved in section 1129(b) of the Bankruptcy Code. It would be anomalous to permit section 363(f)(3) to be utilized with the same effect as section 1129(b) - - without the due process requirements of voting and substantive requirements of a plan of reorganization.

(value cannot mean economic value when read in context of preceding term "greater than" because then the sale price for overencumbered property could never exceed the aggregate value of the liens on the property). As noted by the court in WDH Howell, "[c]ourts following the economic value approach have either overlooked or dodged this dilemma . . . ." WDH Howell, 298 B.R. at 533. Just as the courts in the more recent and well reasoned decisions have done, this Court should "refuse to evade the plain meaning of § 363(f)(3)" in the way the Debtors suggest. See, e.g., Id.

81. Further, the "face amount" approach is consistent with the language of the statute, and a contrary interpretation would make section 363(f)(3) a "loophole" permitting a trustee or debtor to avoid the requirements of section 363(f)(5) through the use of section 363(f)(3). Perroncello, 170 B.R. at 192.

82. There are other holistic approaches that require an interpretation consistent with the proposition that section 363(f)(3) requires a sales price in excess of the aggregate amount of the liens. Specifically, Congress specifically recognized that a sale under 363(f)(3) must exceed the aggregate amount of the liens by creating an explicit exception to the rule for chapter 12 debtors. 11 U.S.C. § 1206; United States v. Ron Pair Enters., Inc., 489 U.S. 235, 242 n. 5 (1989) (Congress knows distinction between types of liens, and the language of the Bankruptcy Code should be interpreted in a way that recognizes that knowledge). Any other approach to the interpretation of section 363(f) would eviscerate the procedural and substantive protections of section 1111(b) and 1129.

83. Finally, the reasoning asserted by the court in Terrace Gardens to justify invocation of the lesser standard assumed that a creditor who disagreed with the proposed sale had the right to credit bid through section 363(k), which permits the creditor to bid its lien to

head off the sale. 96 B.R. at 713. Should that recourse be disallowed, the conclusion in Terrace Gardens is even more unjustifiable. Here, the Debtors' proposed sale, free and clear of liens, plainly does not exceed the $6.9 billion of Senior Secured Debt, let alone the aggregate value of all liens on such property to be sold. Thus, the Debtors fail to satisfy the standard required by section 363(f)(3).

84. Even if the Court follows the approach proffered by the Debtors, the proposed sale does not qualify under section 363(f)(3). The Debtors propose to sell substantially all of their assets—including the Collateral—to New Chrysler, which would then provide the Senior Secured Lenders with $2 billion. See Sale Motion, at 41 & 58. But the value of the Collateral has not been adequately established, and even according to the Debtors' own liquidation analysis, the liquidation value of their assets could exceed $3.2 billion. See Viability Report, at 167. The Senior Secured Lenders could be better off in a straight liquidation of the Debtors' assets.

V. The Proposed Sale Eliminates The Senior Secured Lenders' Right To Credit Bid Granted By Section 363(k)

85. Under a sale pursuant to section 363 of the Bankruptcy Code, a holder of a secured claim, such as the Senior Secured Lenders, has the right to credit bid for the purchase of the asset that is the subject of the sale. The secured party's right to credit bid is expressly granted by statute:

> At a sale under subsection (b) of this section of property that is subject to a lien that secured an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. § 363(k). Credit bidding permits a secured creditor to bid its debt and take title to the property in order to, among other things, protect against a debtor's sale of its

collateral for less than its debt. The Debtors here propose to abrogate the Indiana Pensioners' right to credit bid granted by section 363(k), without compensation or cause.

86. Courts have consistently held that if the creditor has a valid lien on the property, the secured creditor can credit bid the face amount of its claim, even if the claim is potentially undersecured. See In re SubMicron Sys. Corp., 432 F.3d 448, 459 (3d Cir. 2006) ("It is well settled among district and bankruptcy courts that creditors can bid the full face value of their secured claims under § 363(k)."); In re SunCruz Casinos, LLC, 298 B.R. 833, 839 (Bankr. S.D. Fla. 2003) ("[A] secured creditor may credit bid the entire amount of its claim, including the unsecured portion thereof."); In re Realty Inv., Ltd. V, 72 B.R. 143, 146 (Bankr. C.D. Cal. 1987) (finding that the "allowed claim" for purposes of credit bidding is the creditor's total claim without reference to the "value" of the property); 3 COLLIER ON BANKRUPTCY ¶ 363.09 (15th ed. rev. 2008). A secured creditor's claims are treated as equal to cash for the purposes of credit bidding. See In re HNRC Dissolution Co., 340 B.R. 818 (E.D. Ky. 2006) ("Clearly 11 U.S.C. § 363(k) treats credit bids as a method of payment—the same as if the secured creditor has paid cash and then immediately reclaimed the cash in payment of the secured debt.").[13]

87. The Indiana Pensioners' right to credit bid cannot be abrogated without same compensation or adequate protection, yet that is just what the Debtors seek to do through the proposed sale.

[13] The court has discretion to deny the right to credit bid for "cause," but no cause exists here. 11 U.S.C. § 363(k). Courts have found that cause may exist when: (1) the secured creditor's liens are in dispute, and in such circumstances, a court may place conditions on the creditor's ability to credit bid; (2) the credit bid prejudices other secured parties with equal priority to the credit bidder; or (3) the creditor has failed to comply with court-approved bidding procedures. See In re Diebart Bancroft, 1993 WL 21423, *4-5 (E.D. La. Jan. 26, 1993); In re Taxi Takeout Holdings, 307 B.R. 525, 536 (Bankr. E.D. Va. 2004); Antaues Tech. Servs., 345 B.R. 556 (Bankr. W.D. Va. 2005); Greenblatt v. Steinberg, 339 B.R. 458 (N.D. Ill. 2006).

VI. Any Finding Of "Good Faith" Under Section 363(m) Is Inappropriate

88. The facts stated in the Sale Motion (and the supporting declarations) do not support any finding that (i) the New Chrysler is a purchaser in "good faith" under section 363(m) of the Bankruptcy Code, or (ii) would vitiate the relief provided by section 363(n) of the Bankruptcy Code. The Debtors have the burden to establish the "good faith" of New Chrysler. Indeed, the court is "required to make a finding with respect to the 'good faith' of the purchaser." Ginther v. Ginther Trusts (In re Ginther Trusts), 238 F.3d 686, 689 (5th Cir.), cert. denied, 534 U.S. 814 (2001). Based on the facts adduced, the burden on the Debtors is unsustainable and no finding of good faith is appropriate.

89. To facilitate bankruptcy sales, Congress provided that the validity of a sale to a good faith purchaser will not be affected by a reversal or modification of the order approving the sale unless the order is stayed pending appeal. 11 U.S.C. § 363(m). Collusion, coercion, and any other attempt to take unfair advantage destroys good faith. Here, there is no good faith purchaser. The Treasury Department is on both sides of the transaction, controlling both the Debtors and New Chrysler, and is forcing the sale to promulgate the Executive Branch's political agenda to the detriment of the Indiana Pensioners.

VII. Even The Executive Branch Must Comply With The Bankruptcy Code

90. In this case, the Court is being asked to determine whether the proposed sale is appropriate. The fate of the U.S. automotive industry is high on the national agenda and is being closely monitored by the public. In recent months, high ranking members of the Executive Branch have dedicated substantial time and resources in an effort to rescue this troubled industry. Although the level of public interest and the federal Government's involvement make this case unusual, these circumstances do not change the absolute rights of the Senior Secured Lenders to the protections provided by the Bankruptcy Code.

91. Nevertheless, apparently ignoring the plain letter of the law, the Debtors and the Government have asked the Court to approve the Sale Motion, which seeks to alter the very priority established by the Bankruptcy Code. The transaction that the Debtors and the Government seek to implement is designed primarily to benefit junior creditors whose claims the Executive Branch seeks to elevate in contradiction of the law. The system of checks and balances put in place by the United States Constitution should not be influenced or disturbed by the Executive Branch's priorities.

92. Given the current political environment, the significance of an independent judiciary cannot be overstated. "The Federal Judiciary was [] designed by the Framers to stand independent of the Executive and Legislature—to maintain the checks and balances of the constitutional structure, and also to guarantee that the process of adjudication itself remained impartial." N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 58 (1982). Indeed, the Supreme Court has warned that permitting "the political branches [] the power to switch the Constitution on or off at will . . . would permit a striking anomaly in our tripartite system of government, leading to a regime in which Congress and the President, not [the judiciary], say 'what the law is.'" Boumediene v. Bush, 128 S. Ct. 2229, 2259 (2008) (citing Marbury v. Madison, 1 Cranch 137, 177 (1803)). Here, the Executive Branch has effectively "turned off" the constitutional property rights of the Indiana Pensioners. This "denial of constitutionally protected rights demands judicial protection," notwithstanding the fact such protection necessitates this Court "entering into [a] political thicket[]." Reynolds v. Sims, 377 U.S. 533, 566 (1964).

93. Despite the pressures of other Government and societal forces, the creditor protections inherent in the chapter 11 process must be upheld.

WHEREFORE, the Indiana Pensioners respectfully request entry of an order denying the Debtors' Sale Motion and granting such other and further relief as the Bankruptcy Court deems just and proper.

Dated: May 19, 2009
New York, New York

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By: /s/ Glenn Kurtz

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Glenn M. Kurtz

ATTORNEYS FOR THE
INDIANA STATE TEACHERS
RETIREMENT FUND, INDIANA STATE
POLICE PENSION TRUST, AND INDIANA
MAJOR MOVES CONSTRUCTION FUND

LETTER TO THE HONORABLE STEVEN RATTNER, COUNSELOR TO THE SECRETARY OF THE TREASURY, SUBMITTED BY THE HONORABLE DANIEL MAFFEI, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK, AND MEMBER, COMMITTEE ON THE JUDICIARY

Congress of the United States
House of Representatives
Washington, D.C. 20515

May 15, 2009

The Honorable Steven Rattner
Counselor to the Secretary of the Treasury
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Mr. Rattner:

We are writing to express our serious concerns regarding the decision by the Auto Industry for the rapid and potentially disorderly elimination of thousands of Chrysler and General Motors dealerships. This action, if implemented, could put approximately 150,000 people out of work. Since these dealer reductions and its ripple effects would have a serious and adverse impact on the United States, we would like to ask you to inquire with the companies about their rationale for revoking franchise agreements with thousands of dealerships.

To justify these job losses, GM and Chrysler are apparently relying on a misperception that new car dealers create a cost burden to auto manufacturers. This is not true, on average reportedly almost all of an automaker's revenue comes from dealers purchasing the automakers' vehicles. Far from saving money, a rapid reduction in dealerships could very likely reduce GM's and Chrysler's revenue and market share.

Automobile dealers are one of the largest private sector employers in the United States, providing tens of thousands of local jobs and contributing millions of dollars in tax revenues to states. Auto dealers are anchors in communities throughout the country and many times ownership is passed down from generation to generation. In addition many auto dealerships are minority owned and have traditionally provided strong local community support. Each dealership creates an average of 52 neighborhood jobs and these positions typically pay twice the national average as other retail-sector jobs. Dealers have invested about $233 billion to create an auto sales network that provides a vast distribution and service channel for consumers. In fact, automakers created the franchise dealer network specifically to lower their costs, as they outsource virtually all costs associated with selling and servicing cars.

Last year, over a thousand auto dealers closed their doors for good. Further thinning of the dealer ranks through normal market, dealer-driven consolidation, and other forces is inevitable. The action being proposed has not taken into effect the impact on communities and workers, and without any evidence that massive and immediate dealer reductions are necessary to restore the financial health of GM and Chrysler.

We appreciate the enormity of the mission your Task Force has undertaken to help the auto industry. However, we are concerned the reduction of dealerships, at a time when the national unemployment rate is rising, is counterproductive policy. We respectfully request that the Auto Task Force urge the companies to provide more transparency and justification on forced dealership closures, revisit their decision and consider the damaging effects on local communities.

Sincerely,

Daniel B. Maffei
Member of Congress

Christopher Lee
Member of Congress

Chris Van Hollen
Member of Congress

Betty McCollum
Member of Congress

Alan Grayson
Member of Congress

Michael E. McMahon
Member of Congress

Sue Wilkins Myrick
Member of Congress

Mark H. Schauer
Member of Congress

Leonard Lance
Member of Congress

Dan Burton
Member of Congress

Suzanne M. Kosmas
Member of Congress

Marcia L. Fudge
Member of Congress

Joe Courtney
Member of Congress

Peter Welch
Member of Congress

Eric J.J. Massa
Member of Congress

Gene Green
Member of Congress

Michael H. Michaud
Member of Congress

David Scott
Member of Congress

Member of Congress

Mary Jo Kilroy
Member of Congress

Chet Edwards
Member of Congress

Carolyn B. Maloney
Member of Congress

Joseph Crowley
Member of Congress

Bill Posey
Member of Congress

Neil Abercrombie
Member of Congress

John Hall
Member of Congress

Earl Pomeroy
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Artur Davis
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Mike D. Rogers
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Ron Klein
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Jo Ann Emerson
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Erik Paulson
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Paul C. Broun
Member of Congress

Bill Pascrell, Jr.
Member of Congress

John M. McHugh
Member of Congress

Ben Ray Lujan
Member of Congress

Michael K. Simpson
Member of Congress

Brian Higgins
Member of Congress

Charles A. Wilson
Member of Congress

Loretta Sanchez
Member of Congress

Joe Baca
Member of Congress

Michael A. Arcuri
Member of Congress

Bobby Bright
Member of Congress

Steve Kagen
Member of Congress

Stephen Lynch
Member of Congress

Timothy J. Walz
Member of Congress

Parker Griffith
Member of Congress

Andre Carson
Member of Congress

Paul Hodes
Member of Congress

Ron Kind
Member of Congress

Frank Pallone, Jr.
Member of Congress

Aaron Schock
Member of Congress

David Wu
Member of Congress

Robert B. Aderholt
Member of Congress

Todd W. Akin
Member of Congress

Jim Gerlach
Member of Congress

Blaine Luetkemeyer
Member of Congress

Adam Schiff
Member of Congress

Peter Hockstra
Member of Congress

Dina Titus
Member of Congress

David Loebsack
Member of Congress

Corrine Brown
Member of Congress

Bill Foster
Member of Congress

Doc Hastings
Member of Congress

Jo Bonner
Member of Congress

Member of Congress

IL-19

Member of Congress

Member of Congress

MATERIAL SUBMITTED BY RALPH NADER, CONSUMER ADVOCATE

GM Bondholders Try to Salvage Investment

By PETER WHORISKEY
Washington Post Staff Writer 5/21/09

Retirees Moe and Joan Pryor bought $25,000 of General Motors bonds five years ago at a time when they figured the investment would be as sturdy as the Rock of Gibraltar.

Today, the former American corporate icon stands at the threshold of bankruptcy, and the Pryors' investment is on the verge of being wiped out.

"Never in our worst dreams did we think this would happen," said Joan, 77, a retired antiques dealer from Essex, Conn.

The Pryors and other small investors in GM have come to Washington this week to lobby for a better deal from the Obama administration's autos task force, which they say has run roughshod over their financial claims.

Under the restructuring deal being shaped by the task force, GM's bondholders are asked to trade their bonds for a small equity stake.

Many of the bondholders, which include large institutions and small investors, believe that their compensation in the deal is far too meager, particularly compared with the stake being given to the United Auto Workers' health plan.

"It's totally inequitable," Joan Pryor said.

Others believe that the government never should have rescued GM because they think the bondholders would have recovered more of their investments in a bankruptcy without government intervention.

"The government should get their hands out of it," said Chris Crowe, a retired electrician from Colorado who accumulated $115,000 in GM bonds over the years. "It's unconstitutional. The government is just coming in to take over the company."

The group meeting in Washington is being organized by the 60 Plus Association, a conservative seniors advocacy group.

Administration officials said they were seeking to restructure the company fairly and were meeting with bondholders last night.

"Absent government intervention, GM would have run out of money and shut down altogether," said an administration official who spoke on the condition of anonymity because of the sensitivity of the negotiations. "In making the decision to be the lender of last resort, the government took on the obligation to ensure that all parties are treated fairly."

Under the terms of the restructuring proposal, the government will get an equity stake in the company of 50 percent or more, the union's health fund will receive a stake of as much as 39 percent, and bondholders will receive 10 percent.

The bondholders' primary complaint is that they have been asked to swap $27 billion in debt for a 10 percent stake, while the union health plan would get a much larger equity stake in exchange for giving up $10 billion in debt claims.

Administration officials have argued that the union needs to be accommodated because it is making labor concessions and because its cooperation is required to revive the company.

Moreover they note, some of GM's bonds were purchased on the cheap after the value had plummeted, and their owners are now demanding unreasonable returns.

For example, Crowe said he had purchased a small portion of his bonds in February and paid only 12 cents on the dollar for them.

About 75 percent of GM's bonds are held by financial institutions, and about 25 percent are held by retail investors.

During a Senate hearing yesterday on the Troubled Assets Relief Program, Sen. Bob Corker (R-Tenn.) questioned how bondholders are being treated.

"The bondholders basically becoming toast to me is something that's very politically, philosophically motivated in a way that shows no balance," Corker said.

Staff writer Kendra Marr contributed to this report.

Mr. President, you said you would stand with America's auto dealers.

So why is your automotive task force demanding drastic cuts in the number of dealers in this country?

- Fewer dealers would mean another 150,000 Main Street Americans will lose their jobs.
- Fewer dealers would mean less convenience for consumers and less competition.
- Fewer dealers would mean less revenue for the auto makers; dealers are the manufacturers' customers, buying the vehicles and the parts and even the signs in front of their dealerships.
- Fewer dealers would mean state and local governments will lose millions of dollars in auto sales tax revenue.

Cutting dealers at this time would do absolutely nothing to make either GM or Chrysler more viable. The idea that dealer numbers should be rapidly and drastically reduced apparently comes from Wall Street.

Mr. President, we urge you to choose Main Street over Wall Street.

John P. McEleney

John McEleney
Chairman, National Automobile Dealers Association
and
President, McEleney Autocenter, Clinton, Iowa

NADA

NADA, founded in 1917 and based in McLean, Virginia, represents the nation's new-car and -truck dealers, domestic and international.

The Nation.

THE BEAT

Congress Needs to Intervene on Auto Bailout

posted by **JOHN NICHOLS** on 05/20/2009 @ 09:24am

The Chrysler and General Motors restructuring processes, which will result in an unprecedented number of auto plant closings in the United States, the layoffs of tens of thousands of auto workers and of an estimated 100,000 employees of auto dealerships has the potential to deliver a devastating blow to local economies in communities across the Great Lakes states and the Upper Midwest.

The process is being driven by the Obama administration's auto-industry task force, which is made up of investment bankers and proponents of off-shoring who have little or no experience with manufacturing. The task force, which is coordinating the investment of tens of billions in U.S. tax dollars in an effort to "save" the domestic anto industry is overseeing a process that will result in a dramatic shift of manufacturing from the hard-hit factory towns of the United States to foreign countries.

So where is Congress, which unlike the auto task force includes a number of representatives of manufacturing communities and working families?

That's exactly what Ralph Nader and Multinational Monitor editor Rob Weissman are asking.

"The government-led restructuring of Chrysler and General Motors has been twice delegated -- first by Congress to the Executive, and then by the President to a task force. Formally made up of cabinet officials and high-level political appointees, control over the process has in fact been delegated, without adequate standards, to a handful of special advisers," argue Nader and Weissman, who have long histories of challenging misguided auto-industry policies. "Thus has the future of a centerpiece of American manufacturing capacity been delegated to a small unelected and largely unaccountable group arranged to avoid the Federal Advisory Committee Act."

In an urgent letter dispatched to Senate Committee on Banking, Housing and Urban Affairs chair Chris Dodd, D-Connecticut, and House Committee on Financial Services chair Barney Frank, D-Massachusetts, Nader and Weissman write, "At the very least, the Congress must exercise its oversight powers. It should, at the very least, urge the Obama administration to defer any plans for bankruptcy or other irreversible moves until after the task force plan has been subjected to close and careful review via thorough Congressional hearings. If delay requires some additional bridge funding for GM, surely such funding with suitable equity positions is appropriate, in light of the potential risks of bankruptcy to millions of families and further governmental relief programs, and the vastly greater sums that have been so recklessly expended on the virtually condition-free Wall

Street bailout."

Nader and Weissman explain that, "Among the most worrisome components in the restructuring plan is the willingness to sacrifice U.S. manufacturing, and permit GM to increase manufacturing overseas for export back into the United States. Recent news reports indicate that the company will rely increasingly on overseas plants to make cars for sale in the United States, with cars made in low-wage countries like Mexico rising from 15 to 23 percent of GM sales in the United States. For the first time, GM plans emerged to export cars from China to the United States, in what may ~~be a harbinger of the company's future business model; although the company has stated after~~ negative publicity that it will not export from China, there is no evidence that it is abandoning the business model of outsourcing production for the U.S. market, and questions remain about how binding is the recent commitment not to export to the United States from China."

The pair pose a number of questions that the House and Senate should get answered before the the branch of government that holds the power of the purse -- and thus the authority to authorize bailouts of American industries -- authorizes the administration to pour billions into the accounts of corporations that are closing modernized factories, laying off skilled workers and shuttering car dealerships.

They write:

"Congress should hold deliberative hearings to protect taxpayers' investments and seek answers to these questions, among many others:

* Is the task force right in pushing for elimination of as many brands as it has demanded?

* Is the task force asking for too many plants to close?

* Do GM and Chrysler really need to close as many dealerships as have been announced? Is the logic of closing dealers to enable the remaining dealers to charge higher prices (See, for example, Peter Whoriskey and Kendra Marr, "Chrysler Pulls Out of Hundreds of Franchises," Washington Post, May 15, 2009); and if so, why is the government facilitating such a move? Is it reasonable and fair for GM to impose liability for disposing of unsold cars on dealers with which it severs relations, as Chrysler has apparently done?

* Has the task force evaluated the social ripple effects on suppliers, innovation, dealers, newspapers, banks and others that hold company stock and/or are company creditors, and other unique harms that might stem from bankruptcy?

* Would a governmeut-driven bankruptcy process comport with the rights of owner-shareholders?

* Why has the task force maintained the Bush administration-negotiated obligation for unionized auto workers at GM and Chrysler to accept wages comparable to those in non-unionized Japanese company plants in the United States? This requirement is especially troubling given the low contribution of wages to the cost of a car (10 percent), and that it may set off a downward spiral of wages, with the non-union plants no longer needing to compete with union wages, and union wages following those in non-union plants.

* Is the task force obtaining guarantees that, after restructuring with U.S. taxpayer financing, GM cars sold in the United States be made in the United States? If not, why not?

* How will bankruptcy affect GM's overseas operations, with special reference to China and GM corporate entanglements with Chinese partners? Are they and their profits being exempted from the restrictions and cutbacks imposed on domestic operations? If there is such a disparity, is it reasonable and unavoidable?

* How will bankruptcy affect GM's obligations to parties engaged in pending litigation in the courts with GM regarding serious injuries suffered because of design or product defects?

* What guarantees is the task force obtaining to ensure that the GM of the future invests in safer and more fuel efficient vehicles, and what investments will the new company make in ecologically sustainable technologies? How will a potential bankruptcy filing affect, ignore or preclude any such future investments and commitments?"

Nader and Weissman are right.

It makes sense for the federal government to follow the lead of other industrialized nations and assure that vital manufacturing sectors -- and the communities that rely on them -- survive a global economic downturn.

As such, it is not the federal intervention but the quality of that intervention that is in question.

The Obama administration's approach is wrongheaded and destructive to the future prospects for job retention and creation in the auto sector, and for the communities that rely on this industry as an essential underpinning of their local economies. If implemented, it will lead to spikes in unemployment, dislocation and a weakening of domestic manufacturing and the broader *real economy* -- as opposed to Wall Street's paper economy, with its enthusiasm for downsizing, layoffs and off-shoriug.

Congress has the authority, and the responsibility, to make sure that an unelected, unaccountable and profoundly misguided auto task force does not steer the nation's manufacturing sector into oblivion.

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PREPARED STATEMENT OF JEREMY WARRINER, SUBMITTED BY JOAN CLAYBROOK, PRESIDENT EMERITUS, PUBLIC CITIZEN

Testimony of Jeremy Warriner
Indianapolis, Indiana

I lost my legs as a direct result of a design flaw in a Jeep Wrangler, which is a Chrysler product. Yes, I have a pending personal injury/product liability lawsuit against Chrysler that, due to the way this bankruptcy plan has been written, will be eliminated before I have an opportunity to face Chrysler in court. There are approximately 300 other American Citizens whose tort claims will be similarly affected by this bankruptcy. However, this is only a small part of a much larger issue.

The current plan will free Chrysler of any liability for injuries caused by any Chrysler product that was purchased before the bankruptcy. This means all of the Chrysler products currently on the road! The new Chrysler will honor all warranties for Chrysler products sold before the bankruptcy, which means that they know there are defective products out there. The new Chrysler will be responsible for repairing defective products, but they will have no responsibility for the people who are injured by these products. This has the potential to harm millions of American's, whether they own a Chrysler product or not.

No matter how much Chrysler denies it, we all know that there are vehicles on the road today with defective parts or flawed (unsafe) designs. If there weren't, we wouldn't need warranties and vehicle manufacturers wouldn't issue recall notices. These defective products and design flaws can cause severe permanent injuries like traumatic brain injuries, paralysis, death, etc. I lost my legs because Chrysler used a plastic reservoir to hold a highly flammable liquid (brake fluid) that was not protected from impact. A few years before my vehicle was built, Chrysler switched from a metal brake fluid reservoir to a plastic one, presumably to cut cost. When another driver struck my vehicle the plastic reservoir broke and allowed the brake fluid to leak into the hot engine, which ignited the fire that burned my legs to the point that amputation was the only option to save my life.

We all say "it won't happen to me", but the fact is that it can. This didn't only happen to me, it also happened to my family. For five and a half weeks they waited while I lingered in a medically-induced coma. My parents stood by my bedside and watched helpless as my lungs and kidneys failed, wondering if they would outlive their son. My four year old niece became selectively mute because of the extreme sadness that she felt all around her. My burn injuries and the complications from those burns have had a dramatic effect on more people than I am even aware of.

Something like this could happen to any member of the House Judiciary Committee either directly or indirectly through someone they love. This could happen to any of your constituents. This is a simple issue that must not become complicated by political affiliation. Regardless of Democrat or Republican alliance the members of this committee owe it to themselves, their families, and their constituents to ensure that Chrysler is not allowed to use American tax money to escape their liabilities to the American people. Our President has said that we must all make sacrifices. However, the safety of millions of Americans, even from as domestic a threat as a defective or poorly designed automobile, and our right to hold those who injure us accountable in court, are sacrifices that cannot be made.

I can spend time talking about the fact that I have had approximately 38 surgeries over the course of the last three years and my insurance is almost used up. I can spend time talking about the fact that I have lost my career as a direct result of the loss of my legs. I can spend time talking about the fact that people who have acquired disabilities as a direct result of defective, or poorly designed, Chrysler products place additional burden on Social Security and other government assistance programs. I can spend time talking about the fact that financial restitution will allow people who have been injured by Chrysler products to get off of government assistance with a fair shake and a fresh start. I can spend time talking about the fact that consumers will have no incentive to go to the dealerships and buy Chrysler vehicles if they treat their past and current customers this way. But we don't have any more time to spend talking. It is now time for action!

There are solutions that will allow the "new Chrysler" to honor their responsibilities to people who have been injured by their products, but Chrysler does not want to consider those options. The "new Chrysler" should assume the liability for all personal injury and consumer liability claims of Chrysler LLC, the "old Chrysler". The "new Chrysler" can take out an insurance policy to pay such claims. The government can create a fund sufficient to make consumers whole should the "new Chrysler" fail to pay personal injury and consumer liability claims. When GM goes bankrupt the same steps can be taken. The treasury department and the administration will be owners of the new Chrysler and control the new Chrysler by version of the 6 Billion dollars we are loaning them. The administration can do and will do whatever Congress tells it to do because Congress controls the purse strings.

Our government has a responsibility to use our tax dollars in a manner that will not harm the American citizens who have provided that tax money. Freeing Chrysler of their liability for injuries caused by their products does not protect the people who are paying for this bankruptcy. It will also set a precedent for how the GM bankruptcy will be handled, which will cause further harm to even more Americans.

If Chrysler is allowed to use a government financed bankruptcy to sweep their liabilities under the rug, then GM will be allowed to do the same. If that happens, then the American people will have paid to absolve both Chrysler and GM of their present and future liability for injuries caused by their products, which make up the majority of American made vehicles on the road today. This is an irresponsible, unethical, and immoral use of tax money. The members of the House Judiciary Committee must take immediate action to ensure that the "new Chrysler" takes responsibility for its products and those people who are, or have been, injured by those products.

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