

This Year's Model

Chrysler, GM and 'reorganization in disguise'

BY AMANDA BRONSTAD

When Chrysler LLC and General Motors Co. emerged from Chapter 11 on June 10 and July 10, respectively, President Obama cheered the speedy turnaround and clean bill of health of the new Chrysler and GM.

The accolades weren't to last. During the months that followed, several Indiana pension funds filed suit to block the sale of Chrysler's assets to Fiat SpA, alleging that the plan was illegal under bankruptcy law. The U.S. Court of Appeals for the 2d Circuit issued a ruling on June 5 upholding the deal.

Meanwhile, personal injury lawyers protested the limited liability of the "new" automakers, which effectively wiped out their pending claims. Members of Congress continue to question why thousands of dealerships had to be shut down during the restructuring. Creditors, dealers and bondholders that claim to be owed money, many of which are unsecured, are still in court waiting to get paid or fighting over what assets are left at the "old" Chrysler and "old" GM, which remain in bankruptcy.

The question remains whether the Chrysler and GM bankruptcies were anomalies or road maps for future cases. The cases also shine a light on the recession-era surge in so-called "363 sales," named for § 363 of the U.S. Bankruptcy Code, which allows bankrupt companies to sell assets free and clear of liability. [For more on 363 sales, see "Bigger, faster, cheaper," page, S6.]

Stephen Lerner, chairman of the global bankruptcy & restructuring practice at Squire, Sanders & Dempsey and a partner in the New York and Cincinnati offices, represented the Committee of Chrysler Affected Dealers in the Chrysler bankruptcy and significant suppliers in the GM case. Lerner

spoke with The National Law Journal about how failed negotiations with creditors before the automakers filed for bankruptcy necessitated the 363 sales and how both cases, which featured unprecedented federal intervention, could affect future bankruptcies.

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The interview has been edited for length clarity and to conform with NLJ style.

NLJ: GM and Chrysler emerged from bankruptcy in fewer than 45 days, yet many creditors felt left out of the process. In general, how successful do you think these bankruptcies were?

SL: From the perspective of Chrysler and GM and the U.S. government, and from the perspective of the United Auto Workers, it was a home run. You had two of the largest iconic companies in the United States go through a whirlwind of a process and come out the other end and operate free and clear of an enormous amount of debt and with financing from the federal government. From the perspective of a large number of dealers, suppliers, bondholders and lenders, that same process for them was frankly a disaster and one in which a lot



These... were actually plans of reorganization in disguise that didn't follow the rules.



of people suffered. There is lot of discussion as to whether these [automaker] cases are exceptions that ultimately will not mean anything for the future of bankruptcy, because they were so exceptional in their size and too big to fail, or whether these cases will be viewed as the model that will be followed in the future.

NLJ: How could these cases serve as models?

SL: The argument in Chrysler is it was the melting ice cube—if you did not act in 30 days, the ice cube would have to melt....They're putting a gun to the heads of judges and lenders and unsecured creditors and suppliers. The argument is that this may not be a good result, but it's better than the alternative.

NLJ: But the government doesn't generally intervene in businesses, and most companies aren't too big to fail.

SL: I've talked to a number of investors in distressed debt funds and hedge funds and banks whose perception it is that what happened was wrong. The treatment of secured creditors was inconsistent with the law, such that these important market participants are rethinking the ways in which they will or will not invest in companies going forward for fear of government intervention.

It's widely perceived, I think correctly, that the U.S. government played a very big role in trying to preserve as many jobs and do as little damage to the unionized labor at Chrysler and GM. Similarly, what about companies that have substantial underfunded pension obligations? Just as the

government intervened in Chrysler and GM to protect the unions, there's concern in the investor community about whether, in order to protect against PBGC [Pension Benefit Guarantee Corp.] liability, it might intervene [here] as well.

NLJ: Early on, there was talk that GM and Chrysler would emerge through prepackaged bankruptcies, or "pre-packs." What are those?

SL: Instead of filing for bankruptcy first and then developing the plan and voting on it, you do all of that in advance of the filing. So you negotiate with your major creditors and you go out and solicit votes. If you get all the votes, you can get the plan approved. If you don't get the votes, you don't file the bankruptcy and you save your-

self some trouble. It also saves a lot of time and money. A prenegotiated plan is one in which you do most of the negotiating with most of the parties before the bankruptcy, but you don't solicit votes. That's really what Chrysler and GM were thinking of doing. That didn't happen, and they went the sale route under 363.

NLJ: Why the change in plans?

SL: They just weren't able to reach all the agreements they wanted. To my knowledge, there was no negotiation in advance of the bankruptcy with the dealers. We had hoped to [make a deal]. My sense is that the government felt that time was running out and needed to act more quickly, and the only viable option at that point was to attempt to do a 363 sale.

NLJ: Historically, 363 sales have been used to purge a bankrupt business of assets. How common are 363 sales of entire companies, like in the case of GM and Chrysler?

SL: Section 363 sales of entire companies have been an important bankruptcy option for very long time. What is a more recent phenomenon is [that], certainly within the last couple of years, virtually every single Chapter 11 case has resulted in either a 363 sale or simply a liquidation, with the company going out of business. It's pretty hard to find companies that have emerged in reorganizations. Because of the collapse of the credit market, there is almost no lender out there who is prepared to finance companies through a Chapter 11 and through an exit outside of a sale. So all of these cases are ending up with sales because the lenders are willing to finance only through a sale process because then they know they'll get out [with some money]. They're going

to get paid. Once the capital markets recover, I do expect you'll see more traditional Chapter 11 reorganizations because the financing will enable an exit from bankruptcy.

NLJ: If 363 sales are so popular, why was there so much controversy in the case of GM and Chrysler?

SL: The view by many, not all, was that these were not simply asset sales, but they were actually plans of reorganization in disguise that didn't follow the rules for that type of transaction. It was a process that sold assets and treated prepetition claims in ways that, from a process perspective, should have been done with disclosure and voting. Instead, people's rights were not respected.

NLJ: The "old" GM and Chrysler are still in bankruptcy. Why?

SL: What happened in record fashion was the sale of the so-called "good" assets of both Chrysler and GM to "new" Chrysler and "new"

GM. And so, while it's true that there were expedited sales of assets, the older debtor entities are still in bankruptcy. The bankruptcy cases will go on for years to resolve claims because when you sell assets, you're monetizing the assets and reducing them to cash for consideration. While there are exceptions in GM and Chrysler, the vast majority of liabilities of the companies have yet to be resolved and may be the subject of claims in litigation for some period of time. The case was over quickly for the operating businesses that were sold, but the bankruptcy cases will go on for some time.

NLJ: What kind of precedent do these rulings set for other bankruptcies in the future?

SL: The Chrysler case was the very first case in which a court was asked to decide whether the supremacy clause of the [U.S.] Constitution means that the Bankruptcy Code's rights of debtors, with respect to franchise laws for dealers under state law, trumps state law. It doesn't have any direct legal precedent outside of the 2d Circuit. Having said that, for good reason the bankruptcy courts in New York are generally viewed as among the most significant bankruptcy courts.

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