

The Honorable Richard E. Mourdock

Indiana State Treasurer

July 21, 2009

Ramifications of Auto Industry Bankruptcies, Part III

Mr. Chairman and distinguished Members of the Subcommittee, I would first of all like to thank you for allowing me the opportunity to participate in today's hearing. I am Richard Mourdock, Treasurer of the State of Indiana.

In providing testimony to you, please note that I am not an attorney though it is clearly the issues of law that cause me to be before you today. I come today as the elected official with strict fiduciary duties on behalf of all Hoosiers. More specifically, I come as the fiduciary of two specific funds in Indiana, the Major Moves Construction Fund and the Indiana State Police Pension Trust, and as a representative of the Teachers' Retirement Fund of Indiana.

As a result of the recent Chrysler filing, I was placed in the difficult position of asking the Southern Bankruptcy Court of New York to stop the proceedings on behalf of the funds that I represent. Simultaneously, Chrysler and the Obama administration were arguing that if the bankruptcy did not occur in a prompt manner all of the Chrysler jobs would be lost. Specifically, it was said that Fiat SpA, the company interested in "purchasing" twenty percent of the assets, would walk away from the deal causing the company to collapse if all aspects of the bankruptcy were not completed by June 15th, 2009.

Please note, Chrysler is a major employer in Indiana with some 6,000 jobs in the Kokomo area. Chrysler had recently contracted with a German firm, Getrag, to expand its operations in nearby Tipton County. In short, taking a position that was perceived to be against the company and its workers was not convenient, but it was the right thing to do.

I'm frequently asked why I decided to take on the administration and risk possibly losing thousands of Hoosier jobs. The answer to that is as simple as my oath of office. Like each of you, I pledged to "uphold the Constitution of the United States." As a fiduciary of public funds AND as an official who has taken a solemn oath to serve, I could not NOT act in a circumstance when I saw our beneficiaries losing value as a result of the law being violated.

I'm also often asked if I sought to stop the bankruptcy: 1) as a result of the monetary loss to the Hoosier funds or, 2) as a result of the violation of the law or, 3) as a protest in general principle of what was occurring. My answer is simply "yes". When viewed in the context of American law, fairness and propriety, these three issues are indivisible in the Chrysler case.

The legal points of contention will be discussed subsequently in my testimony. The fundamental chronology of events that causes me to be before the subcommittee today is as follows:

- In July of 2008, acting on behalf of the three Indiana funds, Reams Asset Management, (a private sector money-manager working for the state), purchased 'secured' debt of Chrysler with a face value of \$42 million dollars for approximately \$17 million dollars, \$0.43 on the dollar. The essence of their valuation is based on collateral claimed by Chrysler to be in excess of \$29 billion in the prior year. Also, as a most conservative approach, they valued Jeep's brand and revenues ALONE to be worth more than \$3 billion dollars. Indiana was pleased to make the investment as Chrysler's footprint in Indiana is a large one. We hoped to be a party to their success and certainly never imagined at the time we would have long-held, established investor rights ripped away from us.
- In September, 2008, the collapse of Lehman Brothers began a steep slide in the stock market and sent a serious shock wave through the economy. As a result, for the first time in fifty-six years of record keeping, the Federal Reserve noted a decrease in average American household indebtedness and the purchasing of "big ticket" items decreased dramatically. Heavily leveraged automakers, (Chrysler and General Motors), were devastated.
- In October, 2008, the Congress debated and subsequently passed the Troubled Asset Relief Program (TARP) to "aid the ailing financial industry."

- In December, 2008, Congress debated the “Automobile Bailout Bill” that failed to pass. Failing to find funding from Congress to assist the automakers, an executive order was signed by President George W. Bush to allow the auto companies, (Chrysler and General Motors), access to billions of dollars of bailout funds from the TARP.
- In early 2009, it had become apparent that funds from TARP would not be enough to save Chrysler and discussions between company executives and officials of the U.S. Treasury Department began to place Chrysler, LLC into a Chapter 11, Section 363 bankruptcy procedure, which would ultimately result in an auction of the assets.
- Details of the bankruptcy were unprecedented. For the first time in American history and totally counter to all established laws of bankruptcy, secured creditors would receive less than non-secured creditors. A majority of the secured debt was held by JP Morgan, Citigroup, Goldman Sachs Group, Inc. and Morgan Stanley which, in the prior six months, had received a total of \$90 billion in TARP proceeds. They were owed *in total* some \$6.3 billion.
- Officials of the U.S. Treasury convinced secured creditors of JP Morgan, Citigroup, Goldman Sachs Group, Inc., and Morgan Stanley to accept \$0.29 on the dollar for their investments instead of seeking just compensation through traditional bankruptcy proceedings despite the fact that they had previously all made loans to Chrysler based on claims of as much as \$29 billion in collateral the prior year.
- Private equity funds and pension funds held approximately \$300 million of secured Chrysler debt. Upon hearing of the unprecedented nature of the “settlement,” several private equity funds filed objections in the bankruptcy proceeding arguing the assets were being undervalued and that secured creditors rights were being grossly violated.

- President Obama in a press conference said those who would file objections to stop the sale were “unpatriotic,” “hedge funds,” “greedy speculators,” and “unwilling to sacrifice.” The case was stated to be, “One of the most complex bankruptcies in American history.”
- As widely reported, executives from the funds that filed the court cases began to receive threats and within three days withdrew their lawsuits and petitioned the court that the records be sealed to protect their identities.
- Bankruptcy documents identified that a number of states and localities had pension fund investments in Chrysler secured debt including funds representing public employees in California, Michigan and Indiana.
- At 10:00 am, on Monday, May 18, 2009, the United States Bankruptcy Court for the Southern District of New York notified the Indiana Treasurer of States’ Office by first class mail that in this, “..one of the most complex bankruptcies in American history” Indiana’s funds had thirty hours or until Tuesday, May 19, 2009, at 4:00 p.m. to file objections or claims.
- On Tuesday, May 19, 2009, an objection was filed on behalf of Indiana’s Major Moves Construction Fund, The Indiana State Police Pension Fund and the Indiana State Teachers’ Retirement Fund.

Indiana’s legal filings in the Chrysler, LLC bankruptcy sale made three essential points: First, the bankruptcy laws which have been in place protecting the rights of secured creditors cannot be arbitrarily overturned by an act of the Executive. This is a violation of Article I, Section 8 of the U.S. Constitution in that Congress is solely assigned the role to determine uniform bankruptcy law. Neither the Courts nor the Executive can do this arbitrarily. Our funds suffered a “taking” in violation of the Fifth Amendment in that there was no “due process of law”. There was, and is in all financial arrangements between debtor and

creditor, a contractual relationship, which is here being rendered null and void. If allowed to stand, this violation of two party contracts undermines a basic and essential tenet of debt financing in the capital markets.

Second, money provided by the federal government to Chrysler is being provided illegally and clearly counter to the intent of Congress. When TARP was being debated then Secretary of the Treasury Henry Paulson testified the money was NOT for the auto companies. It was targeted to aid the ailing financial industry, i.e, those with “Troubled Assets” that needed a “Recovery Program.” Evidence that the money was NOT intended to be an automotive bailout bill could not be more clearly illustrated than to review the failure of the separate automobile bailout bill presented in Congress in December 2008. If Congress had intended the TARP bill to cover the auto companies when it passed in October 2008, why were they even attempting to pass a separate automobile bailout bill just two months later? We believe both the Bush and Obama administration have acted illegally in this use of TARP funds.

Third, we argue that a *sub rosa* or “under-the-table-arrangement” between the Treasury and Chrysler prevented a fair valuation of the assets. In a legitimate auction sale, no potential bidder would be allowed to set the value of the assets being auctioned. But that is precisely what happened in this case as the Treasury was assigning values to creditors, determining which assets would be liquidated, what new parties, (i.e., Fiat SpA), would be brought into the deal, and how a new dealership network would be defined, etc. It was known from the outset that when the Chapter 11, Section 363 sale of the assets would occur, there would be only one bidder: the U.S. Treasury. Secured creditors could not have their rights protected or fairly valued in such an arrangement. Such an “insider-deal” reeks of impropriety.

Indiana’s legal case began at the Southern Bankruptcy Court of New York where we participated vigorously in the hearing in order to raise our objections in the hopes that the plan might be rejected and a structured bankruptcy sale might occur pursuant to precedent. The bankruptcy court judge seemed interested only in ratifying the government’s preferred plan as quickly as possible and failed to even address the merits of many of the legal issues we raised. Following his ruling, Judge Gonzales shortened the usual 10 day stay

period typically granted in bankruptcy cases. The District Court for the Southern District of New York has previously declined to take up the case but noted from the bench that the points of law raised in our petition had merit.

Officials of the U.S. Treasury then asked that the case be certified for immediate appeal to the United States Court of Appeals for the Second Circuit. We were pleased with this potential opportunity to have the merits of our case heard. During the hearing before the three judge panel, one of the judges commented from the bench to our attorney, “Don’t you think the United States Supreme Court should be taking a swing at this?” Perhaps reflecting that sentiment, on Friday, June 12th, 2009, the Second District Court of Appeals issued a perfunctory order ratifying the bankruptcy court’s decision and issuing a stay until 4:00 pm the following Monday to allow for United States Supreme Court review.

Indiana requested that the United States Supreme Court issue a stay to prevent the sale so that the points of law that we raised be reviewed in full context. Justice Ginsburg granted the stay on Monday, June 15th.

At approximately 7:00pm on Tuesday June 16th, 2009, The Supreme Court issued an order *per curiam* removing the stay and allowing the sale to proceed. The order stated that Indiana had failed to meet all the conditions required to stop the sale but did add: **“A denial of stay is not a decision on the merits of the underlying legal issues.”**

The sale of Chrysler to the U.S. government occurred within forty-eight hours and the assets were promptly divided among the selected field of creditors and newly chosen stakeholders. Indiana is currently weighing its options for further legal action to establish the wrongfulness of the precedent set in the Chrysler case.

My purpose in providing testimony is not to re-state all of the intricacies of the case. I have included as an addendum to my testimony the filing of our legal brief for that purpose. I believe my presence before you

today is best served to ask the questions that Congress, and only Congress, can address in light of all that has happened in the Chrysler case. Indeed, while I am available to answer any of your questions to the best of my ability, the most significant questions that linger I cannot answer.

Questions and issues regarding the Chrysler bankruptcy are specific:

- Were the assets of Chrysler, LLC valued correctly for the purposes of the bankruptcy? Some questions had been raised by various groups that certain assets or automobile lines of Chrysler, LLC were intentionally undervalued. For example, the Jeep product accounts for more than \$500,000,000 in annual revenue from licensing arrangements for the use of its name. An appraisal not long before the auction had the value of Jeep at \$6 billion yet the total auction for all of the Chrysler assets resulted in a value of just over \$2 billion. Why should secured creditors feel they received anything close to fair value given these facts?
- Also, it has been reported that one existing, experienced, savvy, automotive investor group had negotiated with Chrysler in late February '09 for the purchase of the Dodge Viper brand for \$35 million. And yet, Chrysler executives told the bankruptcy court less than sixty days later the brand could only be assigned a value of \$5 million. How can a good-faith purchaser be told “no” when he offers \$35 million only to see the same product valued for \$5 million weeks later in a government auction?
- The crisis mentality that drove the process was totally undermined by the President of Fiat. Prior to the bankruptcy sale in each court, the federal government argued that if the sale didn't close by June 15th, the deal with Fiat would fall apart. I argued throughout the several weeks of Indiana's involvement that this made no sense whatsoever as Fiat was not required to expend a single penny to acquire the 20% stake in Chrysler. Said differently, if someone is offered a \$400,000,000 asset at no cost and told that it wouldn't be available until next week, I'm betting they'd return one week later. Or one month later. \$400,000,000 for zero expenditure is too good

a deal to walk away from. Sure enough, on the day of the sale Fiat's president said exactly this and indicated he was unsure where the June 15th date had originated. Clearly, it came from the Treasury in its rush to close the deal in haste which was again, greatly to the detriment of the investors.

For a detailed analysis of the legal consequences of this case see the attached article *Assessing the Chrysler Bankruptcy*.

Broader and greater questions related to the precedents set if the actions of the Congress continue to be ignored by the Executive and if the rules of law no longer have application:

- If the term “secured creditor” no longer have meaning, what other terms of art in the world of finance no longer have meaning? The long-standing rights of secured creditors have been so well understood that during the War of 1812 the U.S. government continued to pay principal and interest to British citizens even as we were at war with their nation! Our government realized then that if you default to “secured creditors” regardless of the circumstance, you have begun to destroy your own credit rating. Recent discussions by Russia and China to seek a new international reserve currency are not unrelated to the message of the Chrysler bankruptcy. Change the rules and the players will change. If foreign investors in U.S. Treasury debt sense that “good faith and credit of the United States government” can be swept away with an arbitrary act to deal with a momentary crisis, we will have a problem far, far greater than Chrysler in scope and impact.
- If investors no longer feel the law is uniform, predictable, and based on precedent, why would they continue to invest in American markets? I could not agree more with the Obama administration's belief that the American manufacturing sector must be revitalized if we are to again become globally competitive. But the Chrysler precedent of stripping value and rights from secured bond holders flies in the face of maintaining a sound investment environment. It is

easy to predict that hundreds of billions of dollars will begin to be invested in foreign markets as a result of this decision.

I realize that most who come to testify before committees of Congress typically come to demand some change or some new set of laws or regulations. They come to revise a set of laws that may no longer apply to modern circumstances but I do not.

I appreciate the opportunity to come before you to plead simply that Congress act pursuant to Article I, Section 8 that mandates that you, not the Executive, not the Judicial, make a uniform set of bankruptcy laws. It is your job but you have already done it. You need not do it again. You do not need to revise what you have already done. You need only stand to argue that what has been put in place has worked for almost two hundred years. And what is the evidence of that success? The strongest, most vibrant economy on the planet over that period. Investors seek stability in the market place and that's what our laws have provided. It is also why investment houses often use in their advertising words that paint mental images of stability. They include the image of rocks or bluffs, cliffs, or mountains. Never do they send a message of shifting sands. Yet that is what today's investors see when secured investors rights are thrown away in the name of momentary economic crisis or perceived threat. It is a dangerous message to send. The members of this Subcommittee need to stand firm on what the investing community has long held in violate: sound, consistent, and stable bankruptcy laws.

If you do that, investment will flow back into American corporations. If you fail to do so, it, like so many American jobs, more American capital will flow overseas as investors will want to put their money in more stable markets where the rules don't change with the moment.

Mr. Chairman and distinguished Members of the committee, I would like to thank you for allowing me to testify at this hearing today and to express my views and concerns about current bankruptcy laws and unintentional consequences that could affect the financial markets in the future.