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Testimony of
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Ramifications of Auto Industry Bankruptcies, Part III

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My name is Michael J. Robinson, and I am Vice President and General Counsel of North America for General Motors Company. Prior to July 10, I was employed by General Motors Corporation, then a debtor-in-possession in a bankruptcy case pending in the United States Bankruptcy Court for the Southern District of New York, in essentially the same capacity. Thank you for the opportunity to address your Subcommittee on the topic of the Ramifications of Auto Industry Bankruptcies.

General Motors Corporation filed its bankruptcy petition on June 1, 2009. The circumstances facing the company at that time are common knowledge, and I will not elaborate upon them at length. In brief, following the collapse of Lehman Brothers in September of 2008 and consistent with the substantial dislocation in the credit, housing and other markets at that time, the demand for vehicles in this country fell to levels not seen since World War II. Virtually the entire global automotive industry suffered substantial operating losses. In that environment, General Motors, which was burdened with substantial legacy costs, was unable to implement its existing business plan that provided for funding its transformation through asset sales and access to the credit markets. But for loans extended by the United States Treasury on December 31, 2008 and afterwards, General Motors Corporation would have had no option but to liquidate the company, with catastrophic impact upon its employees, dealers, suppliers and the national economy as a whole.

On February 17, 2009, General Motors Corporation submitted its then current viability plan to the Automotive Task Force of the U.S. Treasury as required by the outstanding Loan Agreement. On March 30, President Obama addressed the nation and announced that the Task Force had determined that the plan was not adequate to assure a viable enterprise that would be able to pay back the outstanding government loans. The administration allowed the company sixty days to develop an appropriate plan. Although the President did not at that time rule out the possibility that the company might restructure outside the bankruptcy process, he clearly communicated that a bankruptcy might be necessary and that, in that eventuality, the government would pursue an accelerated approach. That determination was consistent with the company's view, as expressed in the February 17 Viability Plan and elsewhere, that bankruptcy posed profound risks for any auto manufacturer.

On April 27, 2009, General Motors Corporation launched a bond exchange offer in an effort to address it's approximately $27 billion of outstanding public debt. When that exchange offer expired on May 26 without receipt of sufficient tenders to implement the exchange, the company was left with no alternative to a bankruptcy filing. Moreover, given the large sums required to finance the transformation of General Motors' business, as well as the current state of the capital markets and the outstanding debt to the United States Treasury, the implementation of any transaction other than liquidation of the business clearly required an approach fully supported by the government.

After extensive discussions and negotiations with the Automotive Task Force and its advisors spanning the entire period between March 30 and the end of May, the Board of Directors of General Motors Corporation approved the commencement of a Chapter 11 bankruptcy case to implement the sale of substantially all of the assets of the company pursuant to Section 363 of the United States Bankruptcy Code 11 U.S.C. § 363 to a purchaser created and funded by the United States Treasury on terms set forth in a Master Sale and Purchase Agreement negotiated with the Automotive Task Force. The

Board concluded that the Section 363 transaction offered the only alternative to liquidation of General Motors Corporation and was therefore in the best interests of the company and all of its economic stakeholders.

On June 1, General Motors Corporation filed for bankruptcy in the United States Bankruptcy Court for the Southern District of New York, and the case was assigned to Judge Robert E. Gerber.

Fundamentally, the purpose of Chapter 11 of the Bankruptcy Code is to preserve and protect, to the extent possible consistent with applicable legal provisions, the value of an enterprise as a going concern. There is no doubt the bankruptcy of a major corporation almost inevitably imposes severe hardship on employees, creditors, suppliers, customers and other interested stakeholders. However, by preserving the value of the enterprise, Chapter 11 maximizes the value for each constituency.

The bankruptcy of General Motors Corporation amply illustrates these principles. As of March 31, 2009, as reflected in its last published financial statements, the company had liabilities exceeding $172 billion. In contrast, the liquidation value of its assets, as reflected in an affidavit and analysis filed in connection with the Section 363 transaction, was $6 billion to $10 billion. Furthermore, as of June 1, the company had outstanding more than $25 billion of secured debt with its assets. As a consequence, in the event of liquidation unsecured creditors, including dealers, suppliers, employees and customers would have received no recovery.

The Section 363 sales transaction negotiated with the United States Treasury was the only viable alternative available to General Motors Corporation to avoid the liquidation scenario. The terms of its approval by the Bankruptcy Court were the subject of extensive negotiations with numerous parties, including the National Association of Attorneys General. As confirmed by Judge Gerber's finding in his written decision, the government was the <u>only</u> source of financing for any alternative as well as the only party that expressed any interest in any acquisition. The basic decision to pursue a sale transaction reflected a determination by the Automotive Task Force that alternative approaches, including in particular a traditional Chapter 11 Reorganization Process, would be unduly risky and expensive for taxpayers. As Judge Gerber stated in his opinion approving the sale, "[a]s nobody can seriously dispute, the only alternative to an immediate sale [was] liquidation—a disastrous result for GM's creditors, its employees, the suppliers who depend upon on GM for their own existence, and the communities in which GM operates. In the event of liquidation, creditors now trying to increase their incremental recoveries would get nothing."

In exchange for the operating assets of General Motors Corporation, the purchaser assumed many of the liabilities of the seller necessary to continue the business and provided 10% of its equity (plus warrants for 15% more) to the seller for ultimate distribution to creditors. Thus, the 363 transaction was highly favorable to the stakeholders of General Motors Corporation. As a result of the 363 transaction, hundreds of thousands of jobs at GM and its suppliers and dealers were preserved. The GM dealer and supplier network was largely preserved. The fundamental viability of the US automotive industry was preserved. Even creditor and other constituencies that will not have a relationship with the purchaser going forward can expect to receive a substantial recovery through the equity to be distributed through the bankruptcy process, depending on the success of General Motors Company. In liquidation, which was the only available alternative, various creditor constituencies would have received nothing. Although bankruptcy is necessarily a painful process, GM's bankruptcy accomplished the statutory purpose of preserving the value of the assets to the benefit of <u>all</u> constituencies.

Inevitably, given the size and scope of economic interests at stake, not all parties have been fully satisfied with the outcome of the bankruptcy process. As an initial matter, some have criticized the decision to sell assets instead of pursuing a traditional Chapter 11 reorganization process for General Motors Corporation. However, as Judge Gerber found, the use of Section 363 to sell assets in circumstances like those that faced the company is well established. The company lacked financing for an extended bankruptcy case, which presented numerous significant risks. It broke no new ground to pursue a sale of the business on an expedited basis. Again, the Court said it best:

> Neither the Code, nor the caselaw. . . requires waiting for the plan confirmation to take its course when the inevitable consequence would be liquidation. Bankruptcy courts have the power to authorize sales of assets at a time when there still is value to preserve—to prevent the death of the patient on the operating table"

Nor is it in any sense unusual that the purchaser chose to assume certain obligations of General Motors Corporation but not others. The government sponsored purchaser, like any purchaser, had an interest in maintaining the business relationships with employees, suppliers, dealers and customers necessary to continue the business as a viable enterprise moving forward. In the negotiations leading up to the transaction, it pursued an express philosophy emphasizing a willingness to assume obligations necessary to the successful operation of the purchasing entity, but not other obligations. In Judge Gerber's words, "[a]rrangements that will be made by the Purchaser do not affect the distribution of the Debtor's property, and will address wholly different needs and concerns—arrangements that the Purchaser needs to create a new GM that will be lean and healthy enough to survive."

Nevertheless, I take this opportunity to briefly address some of the specific concerns expressed regarding the 363 sale.

The impact of the bankruptcy on dealers has received considerable attention. Dealer restructuring was an essential aspect of GM's viability plan. A strong dealer body is vital to the enterprise. Nevertheless, dealer restructuring is quite painful – for the company, for our customers, and especially for our dealers. GM's current dealer network was largely established in the late 1940s and '50s, before the U.S. Interstate Highway system was built. Because of our long operating history and existing dealer locations, many dealerships now operate in outdated facilities that are no longer located where they can best serve our customers. Many of our dealers operate businesses that have been in their families for generations.

Unfortunately, times have changed. In particular, virtually every knowledgeable observer of the automotive industry has long expressed the view that General Motors had too many dealers. With the current economic crisis, GM no longer had the luxury of relying on the evolutionary approach to address the dealer network pursued in recent years. Indeed, the direction we received from Congress, the current and previous Administrations, the Automotive Task Force, and countless industry analysts and pundits, was clear and to the point: to remain viable, GM needed to enact a dramatic restructuring, with speed, across all parts of our business. Prior to the bankruptcy filing, GM had roughly 6,000 dealerships in the U.S., compared to 1,240 for Toyota and 3,358 for Ford. Going forward, General Motors Company will still have more dealerships than any of our competitors, including Toyota, Honda, Nissan, Ford or Chrysler.

In recent years, many GM dealers could not earn enough profit to renovate their facilities and retain top-tier sales and service staffs. At the same time, the company sustained very substantial costs to support an uncompetitive network. A right-sized dealer network built around strong dealers will allow us to drastically reduce, and in some case eliminate, many direct dealer support programs – programs such as the incentives paid to the dealer, factory wholesale floorplan support, and the one percent market support for each vehicle. In the long run, the reductions in direct dealer support will result in annual savings of over $2 billion. Dealer network reductions will also save an estimated $415 million per year in structural cost savings – items like local advertising assistance, service and training, and information technology systems. In total, the dealer restructuring should result in approximate savings of over $2.5 billion per year. At the same time, a strong and profitable dealer network can provide the industry's best customer service and enhance the image of our four remaining brands: Chevrolet, Cadillac, Buick and GMC. GM's remaining dealerships will be better positioned to serve their current GM customers, while aggressively marketing to take sales from competitors.

It is well established that debtors in bankruptcy are entitled to reject unfavorable contracts that are a burden on their business. Nevertheless, the company did not pursue this approach as its preferred option. Instead, GM developed a unique wind-down process that we believe is considerably more favorable to dealers. It started with a thorough analysis of every GM dealer in every market throughout the U.S. to assess individual market requirements and dealer performance, which focused on critical objective criteria. The company carefully considered our dealer network coverage in rural areas and small towns versus urban/suburban markets, taking great pains to ensure that minority dealers were considered equitably and proportionally in our process. In fact, the percentage of minority dealers overall may actually increase slightly after the consolidation is completed.

After identifying dealers that would not be retained in the GM dealer network, GM offered such dealers wind-down agreements which, when accepted, permits them to remain in business until October 2010 – the expiration date of their current dealer agreement – to facilitate the disposition of vehicle inventories and provision of warranty service to customers. This allows dealers to exit their businesses in an orderly fashion – for the benefit of GM, our dealers and our customers. The wind-down agreements also offered some financial assistance to smooth that process. In the aggregate, this will be about $600 million. GM notified dealers about our planning as soon as possible – on May 15, in most cases. While this process is far from painless, we think it is far preferable to an abrupt termination. GM also implemented an appeals process, reviewing approximately 900 appeal requests to date, and acted favorably on 70 to date.

By reducing the number of GM dealers, our remaining dealers will see increased sales throughput at more competitive levels. This will provide a greater return on their investment, especially in metropolitan markets. They will be able to retain top sales and service talent, invest in their facilities and focus more resources on selling vehicles to people who don't currently own a GM car or truck. Most importantly, they will be able to improve the overall customer experience and retain current customers.

Another aspect of the bankruptcy that has been the subject of comment is its effect on personal injury claims. Like all motor vehicle manufacturers, General Motors Corporation was subject to product liability claims by individuals injured in accidents involving GM products.

As a threshold matter, like every other creditor constituency, product liability claimants benefit substantially from the Section 363 transaction. In a liquidation of General Motors Corporation, they would likely have received no recovery. Moreover, subsequent to the commencement of GM's bankruptcy filing, the government sponsored purchaser agreed to also assume responsibility for claims that may arise by reason of future accidents involving vehicles manufactured and sold earlier. This was consistent with the Automotive Tasks Force's basic philosophy of accepting responsibility for obligations tied to and supportive of the future operation of the acquired business.

The purchaser did not assume responsibility for existing claims or categories of claims that do not arise from the performance of vehicles. These would include claims alleged to arise from asbestos exposure and other miscellaneous claims. Obviously, the company is sympathetic to injured persons, regardless of the merit of their individual claims. However, to the extent claims have merit, they give rise to general unsecured claims against the bankrupt entity, to be satisfied on a *pro rata* basis with other claims out of available proceeds of the sale. This represents the straightforward application of basic bankruptcy law to the prevailing circumstances.

A number of concerns have been expressed about the use of Section 363 of the Bankruptcy Code to protect the purchaser from successor liability under state law. Ultimately this presents a question of law, which we believe was correctly decided by Judge Gerber in the GM bankruptcy case, following decisions rendered by both the Bankruptcy Court and United States Court of Appeals for the Second Circuit in the *Chrysler* Chapter 11 case and other consistent opinions. However, there is also a strong level of common sense underlying this outcome. In the Section 363 transaction, the government funded purchaser provided financial support and consideration that substantially exceeded the objective value of the assets acquired, to the benefit of <u>all</u> creditors. Tort claimants, like all other creditors, will receive substantial benefit from that consideration under a Chapter 11 liquidating plan that will need to be approved as appropriate by the Bankruptcy Court. To permit such claimants to also pursue the purchasing entity would, in effect, require the purchaser to pay twice, to the benefit of a single class of creditors and to the detriment of all others.

Finally, I would like to comment briefly on environmental issues related to the Section 363 transaction. Under the relevant agreements and the terms of the Sale Approval Order, new General Motors Company has assumed the legal obligations that flow with properties it has acquired. With respect to properties that remain with the Chapter 11 debtor, the government has provided substantial funding, with a budget of $1,175,000 to support administrative and wind down costs including environmental remediation. Accordingly, the debtor's remedial obligations should be appropriately discharged.

In conclusion, bankruptcy is always an unfortunate event and we recognize and regret the hardships it has imposed upon many. However, with the support of the United

States government, General Motors Corporation was able to implement a speedy process which preserved and enhanced the value of its assets to the substantial benefit of the national economy and all of the economic stakeholders. In short, the system worked. We are grateful to the government for its assistance and I appreciate the opportunity to address you today.

I look forward to your questions.