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U.S. Motor Vehicle Industry: Federal Financial Assistance and Restructuring

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Summary

On December 19, 2008, President George W. Bush proposed financial assistance for General Motors (GM) and Chrysler. These two automakers had testified before Congress that if they did not receive federal financial assistance before the end of the year, they could be forced into bankruptcy. Congress considered, but did not provide, the assistance requested. The Treasury Department then loaned a total of $13.4 billion to GM and $4 billion to Chrysler from the Troubled Assets Relief Program (TARP), established by the Emergency Economic Stabilization Act (EESA, P.L. 110-343). The Bush Administration also loaned a further $6 billion under the TARP for General Motors Acceptance Corporation (GMAC), and $1.5 billion for Chrysler Financial, the two manufacturers' respective credit affiliates.

On March 30, 2009, President Barack Obama, acting on the advice of his Auto Industry Task Force, determined that viability plans put forward in February 2009 by GM and Chrysler were inadequate to warrant further federal support. He provided GM with 60 days to develop a more aggressive restructuring plan, after G. Richard Wagoner, its CEO, was asked to resign. For Chrysler, it was determined that it could not continue as a stand-alone company, but it was given 30 days to negotiate a partnership deal with the Italian company Fiat; if successful, up to $6 billion in federal assistance would be provided to the partnership.

The Detroit 3, which also includes Ford, have been affected by a long-term decline in their U.S. motor vehicle sales market share, plus the impact of a general decline in U.S. motor vehicle sales in 2008 resulting from a severe constriction of credit related to problems in U.S. and global financial markets. The rise in gasoline prices in mid-2008 caused a sales decline and a structural shift in motor vehicle consumption patterns. Motor vehicle purchases fell substantially in late 2008 despite a subsequent decline in gasoline prices.

A bill to provide up to $25 billion in direct loans from the TARP to auto companies (S. 3688) was introduced in November 2008 by Senate Majority Leader Harry Reid. The Bush Administration instead proposed to make general-purpose loans from a program for advanced technology vehicle production set up under Section 136 of the Energy Independence and Security Act (EISA, P.L. 110-140). This bill had become law in December 2007, and was funded under P.L. 110-329. In December 2008, Representative Barney Frank introduced H.R. 7321, which would have allowed most of the EISA loan funding to be used to support "bridge loans." This bill was supported by the Democratic leadership of both houses, and the Bush Administration. It passed the House on December 10 by 237-170. The bill was opposed by the Republican leadership in both bodies. Efforts to invoke cloture in the Senate in an attempt to pass the bill failed.

Loans for GM and Chrysler were then made from the TARP, subject to oversight conditions and presentation of viability plans. Completion of the loan package under TARP was allowed by the 111th Congress when S.J.Res. 5, a restrictive measure, was defeated 52-42 in the Senate on January 15, 2009. On February 20, 2009, President Obama established an interagency Task Force on the Auto Industry to review company viability plans and industry restructuring under the federal loan agreements.

Congress also included Section 1008 in the American Recovery and Reinvestment Act to stimulate auto sales. This temporarily allows purchasers to deduct state and local sales and excise taxes on qualified vehicle purchases from their federal taxable income. President Obama signed the measure into law on February 17, 2009, as part of P.L. 111-5.

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The Detroit 3 in Crisis [2]

A decline of sales in motor vehicles, which had been evident since 2004, accelerated sharply in late 2008, despite falling gasoline prices. For the year, sales were down to 13.2 million units, a decline of 18%, compared to more than 16 million units sold in 2007 (see section on domestic auto market later in this report for details). Consumer spending fell during the summer and fall, with purchases of motor vehicles and parts accounting for most of the decreases in durable goods in October and September.[3] Overall auto sales fell to a 26-year low, although automakers offered aggressive sales incentives.[4] Rapidly declining gas prices failed to boost automotive sales, but, together with incentives, may have caused the slight shift in consumer demand from cars back to light trucks starting in December 2008.

In the unfavorable economic circumstances of late 2008, the entire U.S. motor vehicle sector (passenger cars and light trucks, and both domestic and foreign-owned companies) faced difficult times. Almost every manufacturer reported declines for the year.[5] Moreover, the decline accelerated during the latter part of the year. Sales ran about 30-40% lower than in the same month in 2007. While year-over-year sales were 13.2 million units, the annual rate of monthly sales by late 2008 had declined to ten million units or less.

Within an overall down market, the U.S.-owned automakers have been especially hard hit. The "Detroit 3" consist of General Motors (GM), Ford Motor Company, and Chrysler LLC (owned by Cerberus Capital Management LP). For each, annual sales fell by more than 20%. The Japanese, Korean, and European producers, mostly reported lower rates of decline. Toyota, the largest foreign-owned producer, recorded the worst sales performance among them, down by 15.4%.[6] The U.S. market downturn has particularly affected Toyota's U.S. and global output, sales, and profitability.

Many argue that the current situation of the U.S. domestically owned auto industry primarily reflects a structural shift in the Detroit 3's competitive position, which has declined at an accelerating rate during this decade.[7] That decline has been compounded by the worst U.S. economic conditions in several decades. The credit crunch that has dampened general consumer demand for new vehicles has also reduced the ability of the Detroit 3's "captive" credit

[1] This section was written by Stephen Cooney, Specialist in Industrial Organization and Business.

[2] The "Detroit Three" comprise General Motors (GM), Ford Motor Company, and Chrysler LLC.

[3] U.S. Department of Commerce. Bureau of Economic Analysis. News release, "Personal Income and Outlays," October 2008.

[4] *Detroit News*, "Auto Sales Plummet to 26-Year Low" (December 3, 2008); *Financial Times*, "Incentives Rise as Carmakers Fight To Get Buyers Behind the Wheel," January 7, 2009.

[5] Subaru (owned by Fuji Heavy Industries of Japan) was the only brand to gain sales in the U.S. market in 2008, about 500 vehicles (+0.3%) ahead of the previous year.

[6] Sales data from *Automotive News* market data website.

[7] This is especially the theme of a critical book written about the U.S. auto industry, by Michelene Maynard, *The End of Detroit: How the Big Three Lost Their Grip on the American Car Market*, New York: Doubleday, 2003. The issue has been examined by in its historical context in CRS Report RL32883, *U.S. Automotive Industry: Recent History and Issues*, by Stephen Cooney and Brent D. Yacobucci.

companies to make loans to many consumers and to dealers for their inventories, an issue that the Treasury Department and the Federal Reserve Board have also begun to address. The Detroit 3 have much higher pension and retiree health care costs (frequently called "legacy costs") than foreign automakers, and also may be more adversely affected by stricter federal corporate average fuel economy (CAFE) standards than foreign-owned producers, because of their history of sales of less fuel-efficient product fleets.[8]

The cyclical decline in the market has also combined with a rapid shift in early 2008 by consumers from trucks and SUVs back to cars, declining overall sales, and accelerating losses of market shares for the "Detroit Three."[9] The combined shocks of these adverse factors have placed the Detroit 3 business model, which includes a collective bargaining relationship between management and labor, at risk. Congress is facing the possibility that one or more of the unionized, domestically owned motor vehicle companies could go out of business if its restructuring plans do not prove successful.

Legislation was introduced in the 110th Congress to implement a federal loan program to prevent one or more of the Detroit 3 from falling into bankruptcy, but no bills were approved. Congress in December 2008 left the decision whether and how to assist the Detroit 3 companies to the Bush Administration. On December 19, 2008, President George W. Bush announced a plan to loan $17.4 billion from the Troubled Assets Relief Program (TARP), established by the Emergency Economic Stabilization Act (P.L. 110-343),[10] to GM and Chrysler LLC to prevent any near-term bankruptcy and to help them to restructure as more viable and competitive companies over the longer term.

After accepting loans under the terms of these agreements, GM and Chrysler presented forward-looking business plans, as required in the agreements, on February 17, 2009. The plans indicated how they could become financially viable and pay back federal loans. Both companies indicated that they would require additional federal financial support to achieve long-term viability.

Organization of This Report

This report focuses on the current situation faced by the Detroit 3, key aspects of their current crisis, including possible consequences of a failure of one or more companies, and some aspects of legislative actions that have been considered to bridge their financial conditions to a more stable situation. The subjects covered are:

- The impact of the automotive industry on the broader U.S. economy and of potential failure of the Detroit 3 companies;
- Financial issues, including the present conditions affecting credit for automotive consumers and dealers, and legal and financial aspects of government-offered loans to the industry;

[8] On this point, see also CRS Report RL34743, *Federal Loans to the Auto Industry Under the Energy Independence and Security Act*, by Stephen Cooney and Brent D. Yacobucci.

[9] While cars may have outsold trucks over the course of 2008, it is not yet clear whether the decline in fuel prices at the end of the year will cause a longer term swing of consumer sentiment back from cars to SUVs and other truck-type vehicles; *Business Week*, "The SUV Is Rising from the Dead," December 8, 2008, p. 63.

[10] The basics of this legislation are discussed in CRS Report RS22963, *Financial Market Intervention*, by Edward V. Murphy and Baird Webel.

- The current situation in the U.S. automotive market, including efforts in 2007 and subsequently by the Detroit 3 and the United Auto Workers union (UAW) to address problems of long-term competitiveness;
- Issues related to government assistance, and various forms of bankruptcy, should this assistance fail to lead to longer term recovery;
- Legacy issues, specifically pension and health care responsibilities of the Detroit 3; and
- Stipulations that have been imposed on auto manufacturers as conditions of assisting in their restructuring.

Before reviewing these aspects of the situation and specific policy questions, the report will summarize the developments of December 2008 and early 2009. In late 2008, Congress considered aiding the Detroit 3, but was unable to agree on a plan to assist the companies. Deciding it was necessary to avoid a "disorderly collapse" of the Detroit 3, President Bush announced on December 18, 2008, a plan to aid the two companies closest to immediate bankruptcy, GM and Chrysler, using TARP funds already appropriated by Congress. At the end of 2008, GM and Chrysler reached agreements by which the latter company received a federal loan of $4 billion and GM received a total of $13.4 billion. On February 17, 2009, the two companies presented financial viability plans, as required in the initial loan agreements. Both said they would need further short-term financial assistance if they were to regain a positive net present value and be able to pay back the federal loans. The third company in the Detroit 3, Ford, has said that it does not yet need federal loans, but could require financial assistance in the near future, depending on market conditions.

Auto Industry Loan Developments: Late 2008-Early 2009[11]

Auto Industry Restructuring Plans in December 2008

Legislation to provide emergency "bridge loans" to the domestically owned Detroit 3 auto manufacturers ("original equipment manufacturers," OEMs) was introduced on November 17, 2008, by Senate Majority Leader Harry Reid (S. 3688). It would have provided loans to the Detroit 3 by using funds available in the TARP. The industry's need for these loans and their current situation was discussed in a hearing before the Senate Banking Committee on November 18, 2008, with the chief executive officers of the Detroit 3 and UAW president Ronald W. Gettelfinger. The next day, the same witnesses also appeared before the House Financial Services Committee.

Use of TARP funds by the Detroit 3 was opposed by the Bush Administration, as well as by many Members of Congress, including the Republican leadership.[12] The Administration suggested

[11] This section was written by Stephen Cooney, Specialist in Industrial Organization and Business.

[12] Opposition was expressed on and off the floor of Congress by, among others, John Kyl (Senate Minority Whip), Senate Banking Ranking Member Richard Shelby, Senator Lamar Alexander, House Majority Leader John Boehner, House Financial Services Ranking Member Spencer Bachus, and Representative Jim Cooper; all quoted variously in (continued...)

instead using funds already appropriated for the auto industry under a direct loan program operated by the Energy Department (DOE) under the Energy Independence and Security Act (EISA, P.L. 110-140, funded under P.L. 110-329, §129, as discussed in a previous CRS report[13]). A bipartisan group of senators, led by Senators George Voinovich of Ohio, Christopher Bond of Missouri, and Carl Levin and Debbie Stabenow, both of Michigan, subsequently drafted a compromise proposal, which would have shifted funding to EISA. But the House and Senate leadership on November 21, 2008, demurred on this approach, and suggested that the auto companies instead needed to provide more detailed plans, including how they would use bridge loan funding from the federal government and how they would restructure themselves to insure their long-term competitiveness and viability.

The companies presented their plans to Congress on December 2, 2008. Although each of the Detroit 3 faces serious economic difficulties, financial conditions among the three differ markedly. The following reviews the plans, as summarized in company documents and discussed in Senate Banking and House Financial Services Committee hearings that resumed on December 4-5, 2008.

GM December 2008 Restructuring Plan

GM's leadership took the position that the company is already on the right track to achieve long-term competitiveness and viability. This includes "a major transformation of its business model," while "accelerating its plans to produce more fuel-efficient vehicles." However, already that "transformation has consumed a substantial amount of resources and accounts for a major portion of GM's" debt – a total of $62 billion, according to data in the plan. Nevertheless, GM claimed, "the company would not require Government assistance were it not for the dramatic collapse of the U.S. economy, which has devastated the company's current revenues and liquidity."[14]

In its December 2008 congressional testimony GM stated that the company was so close to running low on operating capital that the company had to escalate its request for emergency "bridge loan" lending and credit. This included an immediate $4 billion loan from the government to ensure that the company would remain solvent through the end of 2008. It would need a further $6 billion for the same purpose for the first quarter in 2009. Furthermore, assuming a relatively pessimistic scenario of a U.S. light motor vehicle sales market of 12 million units for 2009, the company requested a total loan facility of $12 billion, plus a backup $6 billion line of government credit, in case things were worse than expected. This made a total government commitment of $18 billion through the end of 2009 requested at that time by GM.[15]

GM's December 2008 restructuring plan included a substantial future downsizing of the labor force, even in view of large numbers of buyouts that have already occurred. According to GM it

(...continued)

Detroit News, "Auto Aid Debate Heats Up," and "Congress Starts Talks on Auto Loans," November 17, 2008; "Blitz Starts for Big 3 Aid as Reid Introduces Bill to Tap $700B Bailout;" and, "Political Titans Clash in Auto Loan War," November 18, 2008.

[13] See CRS Report RL34743, *Federal Loans to the Auto Industry Under the Energy Independence and Security Act*, by Stephen Cooney and Brent D. Yacobucci, for the analysis, history, and funding of this legislation.

[14] General Motors Corporation. *Restructuring Plan for Long-Term Viability*, December 2, 2008, p. 2; debt level based on Table 4.

[15] *GM Restructuring Plan* (December 2008), p. 2.

has already reduced its total U.S. workforce from 191,000 in 2000 to 96,500 in 2008, a loss of 95,000 jobs. As part of its restructuring plans, it indicated a further elimination of 20,000 to 30,000 more positions by 2012, to include both hourly and salaried employees. A total of nine plants would be closed, from 47 down to 38 U.S. powertrain, stamping, and assembly plants by 2012 – most of these closures have already been announced.[16] GM's plans also included sale or downsizing of four out of their eight current brands, with Hummer, Saab, Saturn, and Pontiac not being considered as "core" future brands.

Chrysler December 2008 Restructuring Plan

In its December 2008 restructuring plan, Chrysler requested $7 billion in a "working capital bridge loan" by December 31, 2008. The Chrysler plan stated that its available cash had shrunk from $9.4 billion after the first half of 2008 to an estimated year-end level of $2.5 billion. The company would spend an estimated $11.6 billion in the first quarter of 2009, principally because of $8.0 billion in payments to suppliers and $1.2 billion to "other vendors." Yet, "the first three months of the year are the months with the lowest sales volumes and, hence, the lowest cash flows."[17] In testimony, CEO Robert Nardelli stated that Chrysler's private-equity majority holding company, Cerberus Capital Management LP, had contributed a fresh capital injection of $2 billion in mid-2008, but that it had rejected further capital assistance later in the year.[18]

Chrysler stressed that since acquisition of a majority share by Cerberus in mid-2007, it had taken major steps to reduce costs, streamline operations, and reduce its reliance on truck-based vehicles with low fuel economy ratings (Chrysler has been the most dependent of the Detroit 3 on light truck sales – see **Table 1** in a later section of this report). CEO Nardelli had been recruited from outside the auto industry to inject a fresh approach into corporate management. "Four unprofitable vehicle models were discontinued and over $1 billion in unprofitable assets were identified for sale, with more than 70% of those assets disposed of ... [the company] eliminated 1.2 million units of capacity ... [and] separated over 32,000 employees ..."[19] This, Chrysler said, left the company with 55,000 employees worldwide in 2008, almost all in North America. According to the company, virtually all of those jobs would be at risk if Chrysler were to go bankrupt, and could not obtain "debtor-in-possession" financing, which the company did not believe would be available.[20]

The Chrysler paper and CEO Nardelli both insisted that Chrysler has a long-term plan for viability as a stand-alone OEM. This included a proposal to bring out electric vehicles, supported by an $8.5 billion request for loans from the DOE loan program established under EISA. It also included some efforts to share manufacturing under joint ventures with such foreign-owned

[16] These data are from the December 2008 *GM Restructuring Plan*, Table 6, labeled "Manufacturing Improvements" – indicating that the proportional difference between number of plant closures versus personnel reductions is to be accounted for through technology and efficiency improvements.

[17] Chrysler LLC. *Chrysler's Plan for Short-Term and Long-Term Viability*, December 2, 2008, pp. 3-4.

[18] U.S. Senate. Committee on Banking, Housing, and Urban Affairs. Hearing, December 4, 2008, *The State of the Domestic Automobile Industry: Part II*. Testimony of Robert Nardelli. For press coverage, see *Detroit Free Press*, "Help from Cerberus Unlikely," December 6, 2008.

[19] *Chrysler's Plan* (December 2008), pp. 2-3.

[20] *Chrysler's Plan* (December 2008), pp. 11-12. On "debtor-in-possession" financing, see the section below that explains bankruptcy rules.

companies as Volkswagen and Nissan-Renault.[21] Many are skeptical of Chrysler's claim that it can continue to operate as an independent manufacturer, as exemplified by an exchange between Senator Robert Corker and Nardelli at the Senate hearing on December 4, 2008.[22] Subsequently, Chrysler and its parent, Cerberus Capital Management, signed a "non-binding" agreement with Italian auto manufacturer Fiat to establish a "global strategic alliance." In exchange, Chrysler gave Fiat "an initial 35% equity interest in Chrysler."[23]

Ford's Business Plan

Alone among the Detroit 3, Ford in late 2008 was not applying for immediate government assistance. In part, this was because Ford had already gone to "more receptive capital markets in December 2006 to raise $23.5 billion in liquidity ..." through borrowing secured by virtually all of the company's assets. The company, as part of its restructuring and market repositioning plan under new CEO Alan Mulally, had also sold its Aston Martin, Jaguar, and Land Rover brands and operations, all based in the United Kingdom. It had in late 2008 sold most of its controlling interest in Mazda, an OEM based in Japan, and was considering the "strategic" future of its Swedish subsidiary, Volvo. The focus of CEO Mulally's strategy has been to integrate disparate North American and overseas operations, enabling the company to more readily manufacture for the U.S. market the types of higher fuel economy vehicles that it already designs, produces, and sells overseas (called the "One Ford" strategy by the company).[24] Ford also is counting on $5 billion from the DOE loan program to support a $14 billion plan to reorient its lineup toward more fuel-efficient vehicles.[25]

Nevertheless, Ford was fully supportive of a program of federal assistance for the Detroit 3. Part of the reason that Ford had gone to credit markets earlier was that, "at the time, Ford was viewed as the Detroit automaker most likely to go under."[26] The company reports that it closed 17 plants and "downsized by 12,000 salaried employees and 45,000 hourly employees in North America" since 2005.[27] Ford's own plan stressed that its ability to survive a recession and return to profitability was not only contingent on how well the total market performs, but also on the short-term survival of its domestic competitors, because "Our industry is an interdependent one. We have 80% overlap in supplier networks," plus many dealers also have operations selling GM or Chrysler products. Accordingly, Ford requested a "stand-by" line of credit of up to $9 billion as "a back-stop to be used only if conditions worsen further and only to the extent needed."[28]

On January 29, 2009, Ford announced its 2008 annual and fourth quarter financial results. The company lost a total of $14.6 billion for the year. The net fourth quarter loss was $5.9 billion, with a pre-tax operating loss of $3.6 billion. Nevertheless, while the company announced that it

[21] *Chrysler's Plan* (December 2008), pp. 6-7. A planned joint venture with China's Chery auto manufacturing firm has been cancelled, however.

[22] Senate Banking Committee hearing, December 4, 2008.

[23] Chrysler LLC, "Fiat Group, Chrysler LLC, and Cerberus Capital Management LP Announce Plans for a Global Strategic Alliance," news release, January 20, 2009.

[24] This approach is summarized in its *Ford Motor Company Business Plan*, December 2, 2008, pp. 7-8.

[25] *Ford Business Plan*, p. 30.

[26] Sholnn Freeman, "A Temporary Reprieve: Ford, Others Must Still Negotiate Rough Road," *Washington Post*, December 20, 2008, p. D3.

[27] *Ford Business Plan*, p. 9.

[28] *Ford Business Plan*, p. 2.

would draw on an outstanding $10 billion line of credit to back up its cash holdings in the first quarter of 2009, Ford continued to state that, "it does not need a bridge loan from the U.S. government." It stated that it had achieved cost and inventory reduction targets, and had stopped the loss of market shares in the United States and Europe.[29]

Congressional Action in December 2008

Following the December appeals by the Detroit 3, Congress considered legislation to assist the industry. Initially plans to assist the industry were reportedly blocked by differences between the Bush Administration and many Members of Congress, including Speaker of the House Nancy Pelosi, over whether funding for short-term loans to the Detroit 3 should come from the TARP or from the EISA DOE loan program set up for production of advanced technology vehicles.[30] But this gridlock was soon broken in view of the automakers' urgent needs. The Speaker and Senate Democratic leaders agreed effectively to reprogram the DOE loan money for one or more short-term loans, with a plan to replenish the EISA loan funding after the 111th Congress convened in January 2009. With the likelihood of default by the companies continuing to rise, the amount of budget outlays for the EISA loans ($7.5 billion) was now estimated by the Congressional Budget Office to support $15 billion in direct loans, as opposed to $25 billion authorized under EISA, and $34 billion as requested in early December by the Detroit 3 (including the $9 billion in standby credit requested by Ford).[31]

Chairman Barney Frank of the House Financial Services Committee introduced a bill reflecting this compromise on December 10, 2008 (H.R. 7321). The bill was reportedly supported by the Bush Administration.[32] The legislation passed the House 237-170 on the same day. The legislation as approved authorized a total of $14 billion in direct loans, subject to a number of conditions, funded by $7 billion in budgetary support from the EISA program. The measure also set up a presidential designee (popularly known as a "car czar," although the bill allowed for multiple designees) to oversee compliance by borrowing companies with the terms of the program, including adequate compliance with requirements for meeting commitments to achieve long-term viability and competitiveness. The loans were limited to $14 billion, because $500 million of the original EISA budgetary support was reserved for the original purpose of that program, support for advanced vehicle technology production.

Despite the urging of the Bush Administration, H.R. 7321 faced further opposition in getting through the Senate.[33] On December 11, 2008, Minority Leader Mitch McConnell indicated to the Senate that the Republican caucus had studied the House-passed bill, and that they were unable to support it.[34] Efforts were made to craft a new compromise proposal, including conditions that would specify concessions by unions on behalf of the hourly workforce and by bondholders, but were unsuccessful. Majority Leader Reid moved to close debate, for the purpose of achieving a

[29] Ford Motor Co. News release," "Ford Reports 4th Quarter Net Loss of $5.9 Billion ...," January 29, 2009.

[30] *Bloomberg.com*, "Bush, Pelosi Deadlocked over Bailout for Automakers," December 4, 2008.

[31] *Detroit Free Press*, "Pelosi Drops Opposition to Tapping Plant Aid," (December 6, 2008).

[32] *Detroit News*, "Dems, White House Agree to $15B Auto Bailout, " December 10, 2008.

[33] See advocacy for the bill by Secretary of Commerce Carlos M. Gutierrez, "A Bridge Detroit Needs," *Washington Post*, December 11, 2008, p. A25; Republican opposition, particularly from Banking Committee Ranking Member Richard Shelby is noted in *ibid.*, "Auto Bailout Clears House, but Faces Hurdles in Senate," p. A1.

[34] *Congressional Record* (December 11, 2008), pp. S10895-96.

final vote on the House-passed bill. The vote in favor of cloture was 52-35, which was an insufficient majority, and the Senate abandoned further action on the issue.[35]

Federal Action to Aid the Auto Industry

Following the Senate cloture vote, the Bush Administration indicated that, after all, it would consider making loans from the TARP in support of the auto industry. White House Press Secretary Dana Perino stated:

> Under normal economic conditions, we would prefer that markets determine the ultimate fate of private firms. However, given the current weakened state of the U.S. economy, we will consider other options if necessary -- including use of the TARP program to prevent a collapse of troubled automakers. A precipitous collapse of this industry would have a severe impact on our economy, and it would be irresponsible to further weaken and destabilize our economy at this time.[36]

Over the course of the following week, the Administration determined how, and under what conditions, it would provide industry assistance. On December 19, 2008, speaking from the White House, President Bush announced his plan to assist the auto industry. He stated that, while "government has a responsibility not to undermine the private enterprise system ... If we were to allow the free market to take its course now, it would almost certainly lead to disorderly bankruptcy and liquidation for the automakers."[37]

The specific Administration plan was contained in two "term sheets," drawn up by the Treasury Department for GM and Chrysler, the companies in need of immediate assistance. The term sheets are identical, except for the appendices, which spell out the specific loans provided for each of the two companies.[38] The automakers were provided with $13.4 billion in loans in December 2008 and January 2009, divided as follows. GM and Chrysler received $4 billion each when the loans closed on December 29, 2008. On January 16, 2009, GM received an additional $5.4 billion. These three loan installments used what remained of the $350 billion first "tranche" of TARP under EESA. Beyond that, the Administration could make no more outlays without seeking approval from Congress to open the second tranche of TARP funds. Thus, a third projected loan of $4 billion to GM, planned by the Bush Administration for February 2009, was made "contingent on Congressional action."[39] This contingency was met on January 15, 2009, when the Senate voted 52-42 to release the second tranche without further conditions, and the

[35] Floor action on the measure was summarized by the Majority Leader in *Congressional Record*, December 11, 2008, pp. S10922-31. He credited Sens. Robert Corker and Christopher Dodd with leading the effort to produce a compromise. The move to close debate was made on an unrelated legislative item, H.R. 7005. The Chairman and Ranking Member of the Finance Committee, Sens. Max Baucus and Charles Grassley, respectively, announced their joint opposition to H.R. 7321 because of inclusion of a provision unrelated to the auto industry, which would have required the U.S. government to act as guarantor for "sale-in, lease-out" transactions engaged in by some public transportation authorities; see *ibid.*, pp. S10909-11.

[36] White House. Press Briefing, December 12, 2008, p. 1.

[37] White House. Office of the Press Secretary. "President Bush Discusses Administration's Plan to Assist Automakers," December 19, 2008.

[38] The term sheets are available on Treasury's website: http://www.treas.gov/press/releases/hp1333.htm. For a general discussion of TARP rules under EESA, see CRS Report RL34730, *The Emergency Economic Stabilization Act and Current Financial Turmoil: Issues and Analysis*, by Baird Webel and Edward V. Murphy.

[39] GM term sheet, Appendix A.

GM loan went forward as planned.[40] The Chrysler term sheet further specifies that Chrysler's parent holding company must guarantee the first $2 billion of the loan amount. The term sheets for both companies also establish a loan interest rate of 5%, with an additional 5% interest rate penalty on any amount in default.[41]

The Treasury Department made the loans available to Chrysler and GM only under certain "terms and conditions." The overriding condition is that each firm must become "financially viable"; that is, it must have a "*positive net value*, taking into account all current and future costs, and *can fully repay the government loan*." "Binding terms and conditions ... mirror those that were supported by a majority of both Houses of Congress ..." They establish oversight rules and security to be obtained by the government in exchange for providing loans. "Additional targets ... were the subject of Congressional negotiations," but were never voted on. These include a requirement to reduce corporate debt by two-thirds, transfer of half of cash contributions promised by companies for an independent hourly employee retiree health care fund to corporate equity, elimination of "jobs bank" rules that were the subject of much congressional discussion, and acceptance by unions of "competitive" wages and work rules.[42]

With respect to Chrysler's deal with Fiat, Chrysler CEO Robert Nardelli stated that, "The potential ... alliance is consistent both with our strategic plan and with the long-term viability plan required under the U.S. Treasury loan." The agreement would be designed to gain for Chrysler access to "all Fiat small-vehicle platforms," as well as to Fiat's international distribution network (Chrysler at present has only limited sales outside of North America). Nardelli further stated that, "It is important to note that no U.S. taxpayer funds would go to Fiat." He also said that Chrysler would continue to seek the remainder of the $7 billion in federal financial support that it had requested.[43]

The companies must submit to a "President's Designee" by March 31, 2009, a detailed restructuring plan indicating the extent to which they have met both financial and competitive labor restructuring targets. Subject to one 30-day extension allowed, the "Designee" must decide whether to certify that the plan meets all standards set in the term sheet, and, if not, may recall the outstanding loan balance.[44]

These terms and conditions will be discussed in more detail later in this report. Overall, they have been the focus of much discussion and debate since the presidential announcement. Some argue that requirements, though unilaterally set by the Bush Administration, are actually weaker than the legislation proposed by it and the Democratic majority, and approved in the House. Although H.R. 7321 did not mandate specific changes in labor contracts, it did provide (Section 8) that if the parties did not reach agreement on a restructuring plan by March 31, 2009, the presidential designee "shall call the loan ... within 30 days ..." In effect, unions, bondholders, and other interests had that window to negotiate a restructuring plan, or, in effect, by statutory law the

[40] Resolution of disapproval, S.J.Res. 5, introduced by Sen. David Vitter and nine cosponsors, defeated by 52-42 (January 15, 2009).

[41] U.S. Department of the Treasury. *Indicative Summary of Terms for Secured Term Loan Facility*, December 19, 2008, "Appendix A" in both GM and Chrysler term sheets.

[42] White House. Office of the Press Secretary. *Fact Sheet: Financing Assistance to Facilitate the Restructuring of Auto Manufacturers to Attain Financial Viability*, December 19, 2008. Emphases in original.

[43] Letter of Chrysler CEO Robert Nardelli "to all Chrysler employees, dealers, suppliers, and other stakeholders," January 23, 2009.

[44] Treasury, *Summary of Terms*, p. 7.

company would be forced into bankruptcy. Since the Bush plan is set by executive order, it can be subsequently modified by President Obama without further action by Congress.

The UAW believed that plan's conditions for labor contract changes are too prescriptive. President Ron Gettelfinger said that he was "pleased the Bush Administration acted to provide urgently needed bridge loans" to the auto companies, and "to pursue a process for restructuring outside of bankruptcy." But he was "disappointed that [President Bush] has added unfair conditions singling out workers ... We will work with the Obama Administration and the new Congress to ensure these unfair conditions are removed," he said.[45] Senator Debbie Stabenow in a press release said that

> [T]he White House has been characterizing the bridge-loan package as simply having goals for worker concessions ... [but] ... These provisions raise serious concerns regarding unfair, punitive conditions being placed on the backs of workers.[46]

On January 21, 2009, the House addressed the auto loans specifically, in Title III of H.R. 384, a bill to release the second tranche of TARP funds. This bill would have required that a restructuring plan must be agreed by all stakeholders, without reference to specific targets and requirements established in December 2008 term sheets for GM and Chrysler. The measure passed 260-166. However, as the Senate had already defeated a resolution to withhold TARP funds, the House action had no direct legal effect, without any further Senate action.[47]

As GM and Chrysler rolled out their viability plans on February 17, 2009, and the Obama Administration established a new interagency task force, negotiations continued under the same essential framework established by the Bush Administration. However, according to a report in the *Detroit Free Press*, the Obama Administration has "relaxed the rules" with respect to GM's turnaround plan, by not requiring deals with the UAW and bondholders to be finalized before submission of the viability plan.[48]

GM and Chrysler Viability Plans of February 2009

GM's Revised Restructuring Plan

On February 17, 2009, GM presented to the Treasury Department a revised restructuring plan. The new plan revised estimates from the plan presented to Congress just two months earlier: Forecasts of motor vehicle sales were revised downward, meaning that GM's loan requirements from Congress were revised upward.

Furthermore, GM on February 26, 2009, reported that it lost $30.9 billion in 2008. This followed an even higher reported loss for 2007, but that loss had been largely attributable to a one-time

[45] International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW). Press release, "UAW Applauds Auto Loans, But Says Workers Must Not Be Singled Out for Unfair Conditions," December 19, 2008.

[46] Office of Sen. Stabenow. Press release, "Stabenow Statement on Provisions in Auto Rescue Package," Dec. 19, 2008.

[47] See comments to the press by House Financial Services Committee Chairman Barney Frank, quoted in *Washington Post*, "House Urges Tighter Rules for Bailout Beneficiaries," January 22, 2009.

[48] *Detroit Free Press*, "GM Allowed to Forgo Some Loan Terms Set by Bush Administration," February 24, 2009.

write-down of future tax credits, a non-operating loss. While GM reported $3 billion in 2008 structural cost savings, revenue from worldwide automotive operations, responsible for almost all the company's total top-line revenue, fell by more than $30 billion, from $179 billion to $148 billion. At yearend 2008, GM cash and other liquid assets were reported as $14 billion, but this included $9.4 billion in loans already received from the TARP. With a weak auto market in the United States and worldwide, and given a further federal loan of $4 billion in February 2009, GM may have had no operating cash balance in the first quarter net of federal transfers, and continuing expenses would use up all the federal loans disbursed under the Bush Administration loan agreement.[49]

In filing its formal statement (10-K) on its annual results to the Securities and Exchange Commission, GM and its auditors agreed that "there is substantial doubt about GM's ability to continue as a going concern."[50] Commenting on the February 2009 viability plan, the company stated that, "GM requires [federal] funding in 2009 to continue operations until global automotive sales recover and its restructuring operations generate results ..."[51]

The revised GM plan of February 2009 was a detailed and thorough examination of the company's prospects, including a range of contingencies, depending on overall auto market and general economic developments:

- The December report projected a "baseline" scenario of 12 million total U.S. motor vehicle sales (cars and light trucks) in 2009, with a "downside" of 10.5 million units. By February, the old downside had become the new baseline, with a new downside of only 9.5 million. The company's forecast of U.S. 2009 gross domestic product (GDP) performance worsened from an annual 1.0% fall to a 2.0% decline.[52]
- With this decline of GDP and motor vehicle sales prospects, GM raised its estimates of required federal financial support from $18 billion in its December report to at least $22.5 billion. This could rise, the company said, to as much as $30 billion through2011, if market trends followed the downside scenario.[53]
- The February 2009 plan added information on foreign government assistance that was not disclosed in the December plan. GM has requested up to $6 billion in loans from Canada, Britain, Germany, Sweden, and Thailand, plus additional support to cover "legacy costs." GM projects that its global operating cash flow will stay negative through 2011.[54]

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[49] The calculation is as follows. GM reported a $14 billion cash balance as of December 31, 2008, presumably including $9.4 billion in low-interest loans from the TARP. That left $4.6 billion in GM's own internally generated cash reserves. A further TARP loan of $4.0 billion was disbursed on February 17,2009, but the Center for Automotive Research, an industry research group. estimated that GM's "cash burn" for the first quarter of 2009 would be $3 billion per month; see *American Metal Market*, "GM Struggling to Avoid Bankruptcy, $30.9B in Red" (February 27, 2009).

[50] Reported in *Detroit News*, "GM's Auditors Raise Doubts on Automaker's Viability; *Detroit Free Press*, "GM Auditors Raise the Specter of Chapter 11" (both March 5, 2009).

[51] GM, "GM Reports Preliminary Fourth Quarter and Calendar Year 2008 Financial Results," news release (February 26, 2009).

[52] General Motors Corporation. *2009-2014 Restructuring Plan* (February 17, 2009), Chart 2 on p. 8 and Table 1, p. 11.

[53] *GM 2009-14 Restructuring Plan* (February 2009), p. 10.

[54] *GM 2009-14 Restructuring Plan* (February 2009), pp. 10, 28 and Table 11. See also the summary reported in *Detroit Free Press*, "GM Survival Plan Seeks Up to $6 Billion from Other Governments" (February 20, 2009).

- GM provided further details and confirmation on its plans to reduce brands and models. As stated in its December plan, GM will reduce its U.S. vehicle offerings to four "core" nameplates: Chevrolet, Cadillac, Buick and GMC trucks. Pontiac will be downsized to a "niche" product, sold through a Buick-Pontiac-GMC dealer channel. GM will sell or otherwise dispose of the Saturn, Saab and Hummer brands. Whereas the December plan called for reducing 48 current model "nameplates" to 40 by 2012, with 12 new product "launches" in that year, the February 2009 viability plan called for a reduction to 36 nameplates with five 2012 launches.[55]
- In part as a consequence of this reduction in brands and nameplates, the GM restructuring plan anticipates a continued decline in domestic market share. From 23.8% of the North American motor vehicle market in 2006, GM estimates that its 2008 share fell to 21.5%, and will decline farther to 19.1% by 2014. However, its baseline market scenario is for a recovery in total vehicle sales to increase from 13.5 million units in the United States (16.6 million in North America) to about three million units more by 2014.[56]
- With a smaller market share in markets that will only recover to the levels of the early 2000s, GM will need fewer plants. From 47 U.S. manufacturing and assembly plants operating in 2008, GM planned in December 2008 to cut back to 38 plants in 2012, but already reduced that projection to 33 plants in the February 2009 plan. Its U.S. assembly plant production capacity, which in December it had planned to reduce from 2.8 million to 2.3 million units, would now be reduced to 2.0 million units in the United States. If the North American market reaches the GM baseline number of 18.9 million units in 2012, and GM's projected market share is just under 20%, this means only slightly more than half of the vehicles that it sells in North America will be assembled in the United States.[57]
- GM projects in its restructuring plan a worldwide reduction of 47,000 employees through the end of 2009, with the majority of those job cuts – 26,000 – taking place outside the United States.[58] The reduction in U.S. salaried employees will be from 30,000 in 2008 to 26,000, and in hourly production employees from 62,000 to 46,000. After 2009, GM projects that its U.S. salaried and hourly employment will roughly hold steady, or even increase slightly.[59]
- GM continues to project a significant decline in numbers of U.S. dealers. Already, between 2004 and 2008, GM reduced its total by more than 1,000 dealers, leaving 6,246 still operating in the United States. It projects a further 25% reduction, to about 4,700 dealers, by 2012, and a continued decline to 4,100 by 2014. Dealer totals in metropolitan market areas will be pruned even more severely, by almost half, while GM plans to reduce its number of rural market outlets by about 25% through 2014.[60]

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[55] *GM 2009-14 Restructuring Plan* (February 2009), pp. 15-16

[56] *GM 2009-14 Restructuring Plan* (February 2009), Table 9.

[57] These projections are from *GM 2009-14 Restructuring Plan* (February 2009), Table 9 and Appendix H.

[58] *GM 2009-14 Restructuring Plan* (February 2009), pp. 13-14.

[59] *GM 2009-14 Restructuring Plan* (February 2009), Appendix H.

[60] *GM 2009-14 Restructuring Plan* (February 2009), pp. 16-17 and Table 3.

- Under the GM viability plan, the possibilities for paying back its loans from TARP vary widely depending on projected market scenarios. GM's baseline scenario is 16.8 million units sold in 2014. If GM sees only a slight decline in market share, as projected, it anticipates that it would reduce its outstanding TARP loan balance to about $14 billion by that date. With an upside scenario of 18 million units, the TARP loans could be paid off by then. With a downside scenario of 15.3 million units sold, the balance owed by 2014 would be higher than in 2011, or close to $30 billion.[61]
- GM was required under the term sheet drawn up by the Bush Administration to project how the enterprise achieves a positive net present value (NPV). An independent analysis of GM's prospects was drawn up for this restructuring plan by Evercore LLC, an investment banking firm that specializes in providing advisory services to multinational corporations. Evercore's analysis indicated that GM could achieve a positive NPV of $5 billion-$14 billion by 2014, if the baseline scenario of a U.S. market of 16.8 million unit sales obtains. However, the NPV would be negative if the U.S. motor vehicle market only achieves the downside scenario of 15.3 million units. The estimate excludes estimated payments required by GM to the VEBA established to take over retiree health care expenses and a significant pension funding shortfall in 2008.[62]

In its February 2009 viability plan, GM revealed that its pension funds, which had been "consistently overfunded" in 2005-2007, recorded a substantial decline in the latter half of 2008. In its annual results, GM reported a pension fund deficit of $12.4 billion, or an underfunding of about 13%. In its viability plan, GM notes that it could be required to make additional contributions to the plan in 2013-2014.[63] Pension, VEBA, and labor concession issues will be discussed later in this report. Also to be discussed later in the report is GM's assessment of the cost of an alternative approach to continued federal assistance, reorganization under the protection of Chapter 11 of the federal bankruptcy code.

In calculating its future cash flow, GM also assumes a significant benefit in terms of low-interest loans from the DOE direct loan program from advanced technology vehicle manufacturing, described earlier. In 2008 it submitted two applications for a total of $8.4 billion from the program, and also anticipates a third request in 2009. GM's advanced technology vehicle planning, a major component of its strategic corporate plans, as well as its global cash flow analysis, assumes a net benefit through 2014 of $7.7 billion from the DOE program.[64]

The responses from other national governments to GM's requests for financial aid in early 2009 were mixed or indeterminate. This response may be critical, because 64% of GM's worldwide sales in 2008 were outside of the United States, up from 59% in just one year. GM's 2008 global sales were down 11%, compared to an overall global market drop of 5%.[65] In its viability plan, GM calls for holding its global market share roughly constant, at around 12.5% over six years,

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[61] *GM 2009-14 Restructuring Plan* (February 2009), pp. 26, 32 and Table 14.

[62] *GM 2009-14 Restructuring Plan* (February 2009), pp. 28-29 and Appendix J.

[63] *GM 2009-14 Restructuring Plan* (February 2009), p. 31 and Table 13; see also GM *CY2008 news release*.

[64] *GM 2009-14 Restructuring Plan* (February 2009), pp. 20-22, 30 and Table 12

[65] Data from GM *CY2008 news release.*

even while it accepts a possible loss of market share in the U.S. domestic market. And it is counting on a strong overall global market recovery in the out years, to reach 82.5 million units by 2014, from estimated sales of 67 million units in 2008, and not higher than 70 million annually through 2011.[66]

The Swedish government has so far refused to bail out GM's wholly owned subsidiary, Saab, forcing that company into bankruptcy reorganization, and possible liquidation.[67] In Germany, GM's subsidiary Opel has requested $4.2 billion to stay out of bankruptcy, but local labor leaders are calling for the company to be spun off from the U.S. parent. Senior GM officials have said that if GM, which directly employs 56,000 people in Germany and elsewhere in Europe, were to fail, it would put as many as 300,000 persons out of work. The German government is reportedly seeking talks with the U.S. Treasury, before making any financial commitments.[68] GM and Chrysler together have requested initially $3.2 billion ($C4 billion), from Canada, but there is a report that the requests could more than double, with the Canadian response contingent on further U.S. federal assistance.[69] Also, in a loan request not reported by GM, its Korean affiliate, Daewoo, has reportedly requested about $700 million in assistance from a Korean state-owned bank, which is also a large minority shareholder in the company.[70]

Chrysler's Revised Restructuring Plan

Chrysler introduces itself in its February 2009 viability plan as the "quintessential American auto company" – complete with a cover statement noting that (unlike GM) the vast majority of its sales (73%), production (61%), employees (74%), as well as dealers and suppliers, are in the United States. The cover also features the stars and stripes, soldiers driving a Jeep down Pennsylvania Avenue, the company's pentastar symbol, and photos of U.S. auto pioneers Walter P. Chrysler and the Dodge brothers.[71]

More substantively, the company reported for the first time that it lost $8 billion in 2008, and that at yearend it had a cash balance of $2.5 billion. As with GM, the company's report appears to confirm that it has a positive cash balance thanks only to federal loans already received.[72]

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[66] *GM 2009-14 Restructuring Plan* (February 2009), Table 11.

[67] Associated Press, "Saab Files for Bankruptcy Protection," reported in *Detroit News* (February 20, 2009); *Bloomberg.com*, "Saab Seeks Protection from Creditors as GM Pulls Out" (February 20, 2009); *Washington Post*, M's Saab Seeks Protection from Creditors in Sweden" (February 21, 2009).

[68] Deutsche Welle (German overseas broadcasting service), "German Unions Push to Split Opel from General Motors" (February 16, 2009); *Detroit News*, ""U.S.-German Working Group to Seek Help for GM's Opel" (February 22, 2009); *Financial Times*, "Opel's Dreams of GM Split May prove Elusive" (March 1, 2009); *Detroit Free Press*, "Germany: Opel Aid Request Will Take Time" (March 2, 2009). Estimates on employment impact of an Opel failure are in *Detroit Free Press*, "GM Appeals to Europe for Government Aid," and *Bloomberg.com*, "GM Says Opel Running Out of Cash ..." (both March 3, 2009).

[69] *Detroit News*, "Canada Will Get 2 Firms' Plans" (February 20, 2009). GM and its Canadian hourly workforce, organized in the Canadian Auto Workers Union, in March 2009 announced a tentative agreement on changes to their labor contract, including a pay freeze and acceptance of a worker co-payment on health care expenses; *Washington Post*, "GM Reaches Tentative Deal with Canadian Auto Union;" *Detroit Free Press*, "GM and CAW Strike a Deal on Concessions," (both March 9, 2009).

[70] *Detroit News*, "GM's South Korean Arm Holds talks with State-Run Bank" (February 19, 2009).

[71] *Chrysler Restructuring Plan for Long-Term Viability* (February 17, 2009).

[72] *Chrysler Viability Plan* (February 2009), pp U49-U51.

Chrysler crystallized its situation by analyzing viability under three scenarios:

- "Stand Alone." With specified concessions, Chrysler stated that it can survive on this basis, with $5 billion in short-term government assistance, beyond what it has already received, plus $6 billion as applied for under the DOE advanced vehicle technology loan program. This model assumes a minimum U.S. motor vehicle market of 10.1 million units in 2009, failing which the company would require additional assistance and concessions.
- Strategic Partnership/Consolidation. "In all industry scenarios ... Chrysler will be more viable, both operationally and financially, with a strategic partner." The plan noted the non-binding agreement signed with Fiat, and that this would enable Chrysler to produce more fuel-efficient vehicles in a broader range of markets. But it also noted that the Fiat deal was contingent on Chrysler receiving requested federal assistance. Nor would Chrysler be viable, even with the Fiat alliance, should U.S. sales fall as much as one million below the ten-million-unit level in 2009, unless Chrysler received additional government support.
- Orderly Wind Down. "If Chrysler is not able to restructure its balance sheet ... , negotiate targeted concessions from constituents, [and] receive an additional $5 billion capital infusion from the U.S. Government ... ," then the company's only option would be to file a Chapter 11 bankruptcy petition. This would be "a first step to achieving an orderly wind down."[73]

The balance of this subsection will consider Chrysler's description of its financing requirements and conditions under the first two alternatives. Its presentation of the bankruptcy option will be summarized, along with that of GM, in the subsequent section on reorganization and bankruptcy.

It should be noted that Chrysler bases its long-term viability on a market outlook that is much more conservative than the one presented by GM. Its December 2008 viability plan forecast an 11.1 million U.S. light motor vehicle sales market in 2009, rising to 13.7 million by the 2012-2014 out years. The February 2009 plan reduces forecast 2009 sales to 10.1 million (with a downside risk of 9.1 million), rising to 11.6 million in 2012, and 12.6 million in 2014 – about four million fewer than GM's baseline scenario, which GM says may be needed for it to reach a positive NPV.

In its current debt structure, Chrysler listed a total of $23.8 billion in outstanding indebtedness. Secured indebtedness to outside lenders stood at $6.9 billion. To that Chrysler added a total of $2 billion in secured debt received in 2008 from its parent, Cerberus, and the minority partner, Daimler AG.. It evaluated its government loan of December 2008 as $4.3 billion on its books. The remainder, almost half the total at $10.6 billion, is unsecured indebtedness owed to the UAW for retiree health care, including the VEBA scheduled to start in 2010.

Under the stand-alone plan, Chrysler states that it has an agreement with the UAW to cut its VEBA indebtedness in half, contingent on a satisfactory overall debt restructuring. Cerberus and Daimler have "expressed willingness" to relinquish existing equity in the company and to convert their $2 billion in secondary indebtedness into equity. However, Chrysler will need an additional $5 billion from the U.S. Treasury's TARP, plus it is counting on a $6 billion loan from the DOE

[73] These three alternatives are summarized in *Chrysler Viability Plan* (February 2009), p. U11. Chrysler emphasized that "Credit availability for customers/dealers is a prerequisite for [any] viability plan."

loan program. This would leave Chrysler, by its calculations, with $22.8 billion in indebtedness under the stand-alone model, of which $15.6 billion would be owed to the U.S. government.[74]

The Chrysler plan foresees significant advantages from the strategic partnership or consolidation model, as against a "stand-alone" future. However, the proposed deal with Fiat brings no cash into the equation, and the cash benefits are back loaded into the out years, from 2012 to 2016. Fiat has achieved a remarkable turnaround under Sergio Marchionne, its CEO since 2002, and has re-emerged as a profitable, though relatively small, major player in the global auto business (2.5 million annual sales versus about 2.0 million for Chrysler[75]). The advantages in such a deal, according to the Chrysler plan, are:

- "Among the top 10 selling brands in Europe, Fiat brand has the lowest level of CO_2 emissions," and also is the most fuel-efficient European OEM across the full range of its vehicles; 60% of its sales are "mini, small, and compact cars." By contrast "Chrysler's portfolio is dominated by minivans, mid and large sport utility vehicles, and trucks which represent over 50% of its sales." While new alliance platform and powertrain development costs would lead to a small net drain on Chrysler finances in 2009-11, the total benefit of development synergies would be $6.9 billion through 2016, with a potential positive bottom-line impact calculated at $7.4 billion.
- The Fiat alliance would benefit both companies' geographical presence. Chrysler sells more than 90% of its vehicles in North America, whereas Fiat sales are 65% in Europe and 33% in South America. Together, the plan states, the two companies would form the world's sixth-largest motor vehicle producer, and also establish a base to penetrate Asian markets, where their presence is currently negligible (Chrysler has discontinued plans for a joint venture with the Chinese auto OEM Chery).
- No federal loan money would be used to pay for the deal. Fiat would receive a 35% equity position in Chrysler in return for the alliance. Fiat would have the option to acquire an additional 20% of Chrysler's equity, "based on achieving performance metrics."[76]

Despite its emphasis on the benefits of the Fiat alliance, it was not Chrysler's first choice. Since 2007, it also explored partnerships with GM and Nissan-Renault. Chrysler management and an independent analysis by the Center for Automotive Research found that a deal with GM was the "best option for U.S. Auto Industry from financial and operational perspective but they [GM] 'took it off the table.'"[77]

Cerberus Capital Management, Chrysler's majority owner, and the *New York Times* engaged in a spirited debate over whether more federal funds should be committed to Chrysler, without any new cash infusion from Cerberus. In an editorial, the *Times* noted that, "Our argument for bailing out Detroit has been based on the notion that the collapse of the American carmakers would

[74] *Chrysler Viability Plan* (February 2009), p.p. U15-U17.

[75] See chart in *Chrysler Viability Plan* (February 2009), p. U93.

[76] The details and benefits of the Fiat alliance are presented in *Chrysler Viability Plan* (February 2009), pp. U81-U97.

[77] *Chrysler Viability Plan* (February 2009), p. U13. See also pp. U157-U159 for information on synergistic gains from a GM-Chrysler tie-up, as was considered.

devastate an economy already reeling from huge job losses." But, "The case for saving Chrysler is certainly the weakest." The newspaper stated that Chrysler's viability plan offered little or no additional capacity reductions "leaving it with capacity to make almost one million more vehicles than it will sell this year." So, the *Times* asked, "If Chrysler is really on track for a turnaround ... why doesn't Cerberus ... put up the money itself? Why should taxpayers have to take the risk?"[78]

Cerberus Chief Operating Officer and General Counsel Mark Neporent answered the editorial. He stated that:

> Cerberus' investors are pension and retirement plans, charitable and educational endowments and individual family savings. Our investment guidelines limit the amount of capital committed to any single investment.

Noting the *Times*' past criticism of "excessive risk-taking by money managers," he questioned why they should criticize the prudence of Cerberus and urge that it should be "'more pliant' and break rules intended specifically to control risk." He then defended the steps taken by Cerberus to turn Chrysler around, and emphasized other financial measures the company was willing to take, including subordination of $2 billion in "other interests" to government financing. He closed by adding that Cerberus remained committed "to help create a sustainable future for Chrysler."[79]

Requested Aid to Auto Industry Suppliers

Both GM and Chrysler in their viability plans highlighted the problem of the financial viability of their supplier base. OEM production cuts, uncertainty of payments of supplier receivables should an OEM enter bankruptcy, and the general freezing up of the credit system were all financially imperiling the Detroit 3 supplier base (and, by implication, the supplier base of other auto OEMs in the U.S. market, as well). GM listed the "supply chain" as the first "key risk" in its February 2009 viability plan. GM also noted its special commitment to Delphi, its former parts-making facility , which has been in bankruptcy for more than three years. Cash-strapped as it is, GM was required in March 2009 to agree to purchase Delphi's steering business, to insure its own continued supply of parts, after Delphi's plan to sell the unit fell through.[80] In its plan, Chrysler indicated that 22% of its supply base, by value, is "financially troubled," compared to just 10% in August 2008.[81] As will be illustrated in the subsequent section on the economic impact of an auto industry failure, suppliers directly employ about three times as many people in the United States as the OEMs.

The Motor & Equipment Manufacturers Association (MEMA), which represents suppliers to both the OEMs and the "aftermarket," has proposed to the Treasury Department and to Congress a three-part program, which would use the TARP to backstop the auto supplier industry. The total estimated cost of this program would be as much as $25.5 billion, distributed as follows:

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[78] *New York Times*, "Why Can't Cerberus Foot the Bill?" (February 23, 2009). Support for the position that Chrysler's February 2009 plan adds little to previously announced company plans is reported in *Detroit News*, "Chrysler Cuts Called Modest" (March 5, 2009).

[79] Mark A. Neporent, "Cerberus' Commitment to the Future of Chrysler," letter to *New York Times* (March 2, 2009).

[80] *GM 2009-14 Restructuring Plan* (February 2009), pp. 32-33; *Bloomberg.com*, "GM To Speed Payments to Delphi, Buy Parts Factory" (March 3, 2009); *Detroit News*, "GM Buys Back Delphi Steering" (March 4, 2009).

[81] *Chrysler Viability Plan* (February 2009), p. U153.

- Government guarantee of supplier receivables. A guarantee of receivables due to suppliers (to a value of 80%) from each of the Detroit 3 would enable suppliers to borrow against receivables in capital markets. Maximum cost to the Treasury, based on Detroit 3 production levels would be about $10.5 billion.
- "Quick pay" receivables program. This would provide additional liquidity to suppliers to TARP-supported OEMs by reducing the typical 45-55 day payback period for their suppliers to 10 days. Estimated cost of the program would be $7 billion, as a revolving credit fund would be set up to be used by GM and Chrysler.
- Government loan guarantees for suppliers. This would encourage commercial banks to increase lending to suppliers by guaranteeing commercial loans or lines of credit. Estimated guarantee level would be up to $8 billion.[82]

Both GM and Chrysler in their viability plans expressed support for federal support to suppliers. GM, however, called for a more limited program of credit insurance, to be established immediately, which would guarantee receivables of selected suppliers at a cost of about $4.5 billion. GM emphasized that such a program would be needed as GM seeks to reduce costs by establishing a more financially robust and smaller supplier base, within a more consolidated supplier industry.[83] Chrysler supported both the guarantee of accounts payable by the federal government and the "quick pay" proposal. It also called for direct loans to suppliers from the government, "to relieve Chrysler from the cash burden of funding [debtor-in-possession] loans for numerous suppliers."[84]

Presidential Task Force on the Auto Industry

The Bush Administration left office having devised a package of loans actually disbursed or to be disbursed to two of the Detroit 3, GM and Chrysler. Supervision of the companies' compliance with the terms of the loans and plans to achieve future viability was left to an undefined "President's designee" in the loan term sheets. In the presidential transition period and the initial weeks of the Obama Administration, there was speculation as to who might fill a role, popularly known as the "car czar," in managing the oversight of the loan program and the two companies' fulfillment of the terms of the loan agreements. On February 20, 2009, the White House announced that this role would not be filled by an individual but by a Presidential Task Force.

The Task Force will be led by the Secretary of the Treasury, Timothy Geithner, and the Director of the National Economic Council in the Office of the President, Larry Summers. Other ex officio designees named to the Task Force were the:

- Secretary of Transportation
- Secretary of Commerce
- Secretary of Labor

[82] Letter from Robert McKenna, president and CEO of MEMA to Secretary of the Treasury Timothy F. Geithner (February 13, 2009), including attached document *Motor Vehicle Supplier Sector Emergency Financial Assistance Request.* See especially pp. 5-10 of the attached document.

[83] *GM 2009-14 Restructuring Plan* (February 2009), pp. 32-33 and Appendix U.

[84] *Chrysler Viability Plan* (February 2009), p. U154.

- Secretary of Energy
- Chair of the President's Council of Economic Advisers
- Director of the Office of the Management and Budget
- Environmental Protection Agency Administrator
- Director of the White House Office of Energy and Climate Change

In addition to these ex officio appointments, the White House statement named specific individuals in current government positions who were designated as members of the Task Force:

- Diana Farrell, Deputy Director, National Economic Council
- Gene Sperling, Counselor to the Secretary of the Treasury
- Jared Bernstein, Chief Economist to Vice President Biden
- Edward Montgomery, Senior Advisor, Department of Labor
- Lisa Heinzerling, Senior Climate Counsel to the EPA Administrator
- Austan Goolsbee, Staff Director and Chief Economist of the Economic Recovery Advisory Board
- Dan Utech, Senior Advisor to the Secretary of Energy
- Heather Zichal, Deputy Director, White House Office of Energy and Climate Change
- Joan DeBoer, Chief of Staff, Department of Transportation
- Rick Wade, Senior Advisor, Department of Commerce[85]

In addition, the White House announcement also included as a member of the Task Force, Ron Bloom, formerly an investment banker and adviser to the head of the United Steelworkers union, who was newly appointed as Senior Advisor on the Auto Industry at the Department of the Treasury. On February 23, 2009, it was also announced that Steven Rattner, co-founder of the private equity firm, Quadrangle Group, would also join the Treasury as Counselor to the Secretary and would have a role as a leader of the Auto Industry Task Force.[86] A third person recruited from the private sector to assist the Task Force is Professor Alan B. Krueger, an economist from Princeton University.

After its initial formation, the Task Force spent late February and early March intensively interviewing auto industry leaders, including GM CEO Richard Wagoner, Chrysler CEO Robert Nardelli, and their senior executives. Interviewees also included top executives from Ford, Fiat, the UAW, bondholders, representatives of the supplier industry, and Governor Jennifer Granholm of Michigan.

[85] This list was taken from White House. Office of the Press Secretary, "Geithner, Summers Convene Official Designees to Presidential Task Force on the Auto Industry" (February 20, 2009).

[86] *Wall St. Journal*, "Rattner to Join Treasury as Auto-Industry Adviser";" and, *Detroit News*, "Treasury's Auto Efforts To Be Led by Private Equity Investor" (both February 23, 2009).

Task Force Acts to Aid Suppliers

In its first decision the Presidential Task Force on March 19, 2009, announced a limited auto supplier support program, with $5 billion of TARP funds. This program is similar to the model requested by GM. It is limited to suppliers of domestic OEMs and "will be run through American auto companies that agree to participate in the program:"

> The program will provide suppliers [for a small fee] with access to government-backed protection that money owed to them for the products that they ship will be paid no matter what happens to the recipient car company. Participating suppliers will also be able to sell their receivables into the program at a modest discount.[87]

Although the program was more modest than its request, MEMA supported it as an important step in stabilizing the supplier base.[88] A press article in the *Washington Post* stated that support would be limited to those suppliers designated by the OEMs receiving TARP funds, and that "suppliers ... besieged automakers with questions about who would receive support and who wouldn't." It quoted a Chrysler letter to suppliers saying that the "government loan associated with this program is not large enough to permit all of Chrysler's U.S.-based suppliers to participate." Ford would not participate, saying, "We remain viable and expect no issue with continued payments to our suppliers."[89]

Presidential Decision on Loan Requests – New Conditions for Support

On March 30, 2009, President Obama announced that the Auto Task Force had completed its evaluation of the GM and Chrysler viability plans in light of their requests for additional federal assistance. In the case of GM, he stated, "the plan they put forward is ... not strong enough." With respect to Chrysler, "with deep reluctance" the Administration concluded that it could not survive on a stand-alone basis and "needs a partner to remain viable."[90] The Administration therefore accorded the two companies a short period of time to revise their plans and undertake additional actions, before making a final decision on the amount and framework of longer-term support.

Administration Calls for "More Aggressive" GM Viability Plan

For GM, the Administration offered "adequate working capital over the next 60 days," while the company revised its viability plan. As an "initial step," the resignation of CEO Wagoner was requested and accepted, because, in the President's words, of a recognition of a need for "new vision and new direction to create the GM of the future."[91]

In its analysis, the Task Force found that not only had GM failed to complete the steps necessary to achieve agreement between the company, the bondholders, and the UAW on necessary concessions to succeed as a viable enterprise, but the plan itself was seriously flawed. It did not

[87] U.S. Department of the Treasury. "Treasury Announces Auto Supplier Support Program," press release, and fact sheet, "Auto Supplier Support Program: Stabilizing the Auto Industry at a Time of Crisis" (March 19, 2009).

[88] Motor & Equipment Manufacturers Association. "Parts Suppliers Praise Administration for Acting to Assist Industry," press release (March 19, 2009).

[89] *Washington Post*, "Auto Parts Makers Get $5 Billion Lifeline" (March 20, 2009), p. D1.

[90] White House. Briefing Room, "GM & Chrysler" (March 30, 2009).

[91] White House, "GM & Chrysler."

explain how GM was going to come close to maintaining its market share going forward while shedding half of its current product brands, and the plan assumed “improvement in net price realization despite a seriously distressed market, lingering consumer quality perceptions, and an increase in smaller vehicles (where the Company has previously struggled to maintain pricing power).” GM’s plan did not adequately deal with the issues of too many brands and dealers, nor did it significantly shift its product strategy away from a reliance for profits on high-margin trucks and SUVs. The plug-in hybrid Chevrolet Volt, currently in development, held “promise ... [but] will likely be too expensive to be commercially successful in the short term.” The Task Force found that cash needs associated with legacy liabilities would continue to grow through 2013-14, reaching a level of $6 billion per year. The Task Force analysis did conclude, however, that, given “improvements that have been made to date, ... there could be a viable business within GM if the Company and its stakeholders engage in a substantially more aggressive restructuring plan.”[92]

In support of this conclusion, the Administration announced that it would insure that GM had “working capital” for 60 more days “to develop a more aggressive restructuring plan and a credible strategy to implement such a plan.”[93] Leadership of the company as CEO during this period devolved to the president and chief operating officer under Wagoner, Frederick Henderson.

Administration: Chrysler Needs Deal with Fiat

> By contrast, the Task Force did not believe that Chrysler could continue as a stand-alone company. The company was considered to lack the scale necessary to transform its product mix toward smaller-size vehicles. It was not geographically diversified, with its sales concentration too heavily focused on North America. And, unlike GM, Chrysler had failed in recent years to make significant gains in quality improvements when measured against competitors. As a result, the [Task Force] found that Chrysler’s plan is not viable as currently structured. However, a partnership with another company, such as Fiat or another prospective partner ... could lead to a path for viability for Chrysler.[94]

Following up on this conclusion (and the Task Force had reportedly met with Fiat CEO Sergio Marchionne), the Obama Administration offered Chrysler support for 30 more days while it sought to reach a definitive partnership agreement with Fiat. If such a deal could be reached, the Administration would consider lending up to $6 billion more to the partnership, providing some additional conditions were met. These included “extinguishing the vast majority of Chrysler’s secured debt.” There would also have to be a labor agreement with the UAW “that entails greater concessions than those outlined in the existing loan agreements.” The new restructuring plan would have to assume no more than $6 billion in ongoing U.S. government support, provide for a positive company cash flow, and an “adequately capitalized mechanism” for financing vehicle purchases by both customers and dealers.[95]

[92] This analysis and criticisms are detailed in Department of the Treasury. *GM February 17 Plan: Viability Detrmination* (March 30, 2009).

[93] Department of the Treasury. “Obama Administration New Path to Viability for GM & Chrysler” (March 30, 2009).

[94] Details and conclusion in Department of the Treasury. *Chrysler February 17 Plan: Viability Determination* (March 30, 2009).

[95] Treasury, “Obama Administration New Path.”

Continued Administration Support for the Companies

In addition to the offer of "working capital" support as necessary during the one-to-two month period of further restructuring negotiations, the Obama Administration made two further offers of assistance.

- The Administration announced a new "warrantee commitment program," to assure potential vehicle purchasers that new car warranties would be backed by the federal government during the period in which the two companies were being restructured. Whatever the status of the companies, even if it included a period in bankruptcy, any vehicle warranty offered by the companies would be "back-stopped" with federal support.[96]
- The Administration also announced "a new initiative to support and help revitalize American auto communities." Edward Montgomery, a former Deputy Secretary of Labor and a dean at the University of Maryland, was announced as the Director of Recovery for Auto Communities and Workers. His job within the Task Force is to help coordinate federal, state, local, and private sector activities to assist communities impacted by industry downsizing, including provision of assistance through the Trade Adjustment Assistance program, and other federal measures.[97]

In a "key finding" on auto industry restructuring, the Administration emphasized that, while GM and Chrysler present different issues and problems, in both cases, "their best chance of success may well require utilizing the bankruptcy code in a quick and surgical way." This would not be a liquidation or a "traditional," long, drawn-out bankruptcy in the Administration's vision, but a "structured" bankruptcy as a tool to "make it easier for General Motors and Chrysler to clear away old liabilities ..."[98]

Impact on the National Economy[99]

The question of rescuing one or more of the Detroit 3 automakers comes up at a time of considerable weakness in the overall economy. In the third quarter of 2008, real gross domestic product (GDP) fell by 0.5%, and the Commerce Department advanced estimate for the fourth quarter was a decline of 3.8%.[100] Most economists are not very sanguine about short run prospects either. The *Blue Chip Economic Indicators* consensus forecast was for real GDP to decline by 1.6% for all of 2009 and for the unemployment rate to be above 8% by the end of 2009.[101] Many believe that the consequences of a Detroit 3 company's failure for the national economy would be serious.

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[96] The program is described in Department of the Treasury. "Obama Administration's New Warrantee Commitment Program" (March 30, 2009).

[97] Treasury, "Obama Administration New Path."

[98] Treasury, "Obama Administration New Path."

[99] This section was written by Stephen Cooney, Specialist in Industrial Organization and Business.

[100] U.S. Department of Commerce. Bureau of Economic Analysis. News release on "Gross Domestic product," January 30, 2009.

[101] *Blue Chip Economic Indicators,* Aspen Publishers, January 10, 2008. The Blue Chip forecast is an average of about 50 separate forecasts.

National Impact of Detroit 3 Failure

The White House *Fact Sheet* on the loan program for GM and Chrysler estimated that, "the direct costs of American automakers failing and laying off their workers in the near term would result in a more than 1% reduction in real GDP growth and about 1.1 million workers losing their jobs, including workers for auto suppliers and dealers." Economists generally assess that economic growth of at least 2% is required to accommodate a growing labor force and keep the rate of unemployment from rising.

In the third quarter of 2008, the annual-rate value of motor vehicle output was $331.3 billion out of a total annual-rate gross domestic product (GDP) of $14.4 trillion.[102] Motor vehicle production thus represents 2.3% of total output. The total number of workers employed in the manufacture of U.S. autos in 2007, measured on an annual basis, was 859,000. Of those, 186,000 worked in light vehicle assembly, and 673,000 were employed in the manufacture of parts.[103]

Estimates vary of job loss resulting from a failure of one or more Detroit 3 companies and their production. They depend on different models and assumptions. But in every case, the impact on employment is serious.

- The Inforum model at the University of Maryland produced estimates of "peak year" (2011) job loss ranging from 826,000 jobs in event of "retirement" of 20% of Detroit 3 production (a shutdown of Chrysler, for example) to more than 2.2 million peak-year job losses in the event of a 60% Detroit 3 shutdown. However, the study also notes that the higher shutdown level is unlikely over the long term and that the practical worst-case scenario would be a restructuring and downsizing, with a 40% production loss. This would be estimated to result in 1.5 million jobs lost in the peak year, and a net average loss of just under one million jobs per year through 2014, against what employment would otherwise be.[104]
- Anderson Economic Group/BBK, an international business advisory firm with customers in the automotive industry, produced a separate set of estimates with a different methodology. AEG/BBK's worst-case scenario was bankruptcy and eventual liquidation of two of the Detroit 3. In this case, they estimated that more than 1.2 million jobs would be lost in the first year, and nearly 600,000 in the second year. Netting out a small number of persons gaining alternative employment, the AEG/BBK estimate was 1.8 million jobs lost over two years among the OEMs, their suppliers and dealers, and others "indirectly" linked to the industry.[105]
- The Center for Automotive Research (CAR), a research organization with some support from industry, did an economic simulation of a failure of domestic

[102] Department of Commerce, Bureau of Economic Analysis.

[103] Thomas H. Klier and James M. Rubenstein, "Who Really Made Your Car?," *Chicago Fed Letter*, Federal Reserve Bank of Chicago, October 2008. See also **Table 2** below in this report.

[104] University of Maryland. Inforum Economic Summary, *Potential Job Losses from Restructuring the U.S. Auto Industry*, December 16, 2008.

[105] Anderson Economic Group/BBK. *Automaker Bankruptcy Would Cost Taxpayers Four Times More Than Amount of Federal Bridge Loans*, December 8, 2008.

automakers based on two separate sets of assumptions.[106] In the first case it was assumed that the problems of the Detroit 3 automakers led to a permanent 100% decline in the production of domestic automakers in the first year (2009). It was also assumed that the effect of that shock would result in such a large drop in the demand for parts that suppliers would be forced to either liquidate or restructure. It was assumed that the disruption to the parts suppliers would cause domestic production of foreign-owned auto manufacturers to also drop to zero in the first year. In this scenario, the total number of jobs lost in the United States in the first year was estimated to be 2.95 million.[107] That figure includes jobs lost at auto manufacturers, parts suppliers, as well as in the rest of the economy, because of the drop in consumer spending resulting from the direct job losses. In the second year (2010), production at the foreign-owned firms begins to pick up and employment recovers somewhat with the number of jobs lost falling to 2.46 million.

- The second CAR scenario assumes that although in the first year (2009) domestic production of the Detroit 3 automakers drops to zero, auto production recovers to 50% of its former output in the second year and continues at that level. In this scenario, the estimated U.S. job loss in the first year is 2.46 million, falling to 1.50 million in the second year.

Impact Focused on "Auto Alley"

Any loss of output due to the difficulties with U.S. automakers will likely be felt nationwide, but because of the geographic concentration of those firms it will be much greater in some regions than in others. According to Klier and Rubenstein, Michigan accounts for one-quarter of all auto parts.[108] They also point out that there is a corridor between the Great Lakes and the Gulf of Mexico that has become known as "auto alley." In 2008, 43 of 50 auto assembly plants were located in auto alley. Those geographic areas where automakers are concentrated would experience the greatest economic difficulties resulting from any loss of U.S. auto output. Klier and Rubenstein also estimate that three-quarters of all auto parts suppliers are located within a one day's drive (truck delivery) of Detroit, including those located within the Canadian province of Ontario.[109]

Howard Wial of the Brookings Institution, a Washington, DC-based think tank, has done an analysis of how different U.S. metropolitan areas would be affected if the Detroit 3 companies

[106] David Cole, *et al*., *CAR Research Memorandum: The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers*, Center for Automotive Research, November 4, 2008.

[107] Jeffrey Werling in the Maryland Inforum study (p. 3) stated, regarding the CAR top number, "It seems implausible that 100% of U.S. auto production would be idled. Yet the most widely cited total job loss figure, 'up to 3 million,' is based on such an unrealistic assumption." Toyota and Honda, for example, are already reportedly planning modifications to their "just-in-time" supply chain models in order to ameliorate the effects of supplier bankruptcies; see, *Detroit News*, "Toyota May Modify Supply Chain," December 30, 2008. The figure of 3 million could be taken, however, as an estimate of the total number of jobs that could be at risk.

[108] Klier and Rubenstein, "Who Really Made Your Car?," (October 2008 article). Also discussed more fully in their book, *Who Really Made Your Car? Restructuring and Geographic Change in the Auto Industry* (Kalamazoo, MI: Upjohn Institute, 2008).

[109] Klier and Rubenstein, *Who Really Made Your Car?*, chapters 5-6. For a state-by-state analysis of automotive manufacturing jobs, see CRS Report RL34297, *Motor Vehicle Manufacturing Employment: National and State Trends and Issues*, by Stephen Cooney, especially Figure 5 and Table 1.

were to go out of business.[110] Wial's analysis suggests that 50 metropolitan areas rely heavily on Detroit 3-related jobs, measured as the OEMs and suppliers accounting for 1% or more of the area workforce. Though this may seem a small share of total employment, he cites studies to claim that up to twice as many jobs in metro areas are supported by jobs directly in the auto and auto parts industry. These metro areas are almost all clustered in the "auto alley" region noted above, stretching as far south as Tuscaloosa, Alabama, and as far to the northeast as western New York. The only metro area west of St. Louis is Ogden, Utah, and no cities are included on either coast, or in the South, beyond Kentucky, Tennessee, and Alabama. Among the metro areas with the most Detroit 3-related jobs, only the Detroit area itself has more than 100,000 jobs in total that meet this description. The Chicago area is next with about 20,000 jobs. Some smaller cities figure among the top 20 metro areas in Detroit 3-related employment, such as Kokomo, Indiana, where 22% of all jobs are in autos and auto parts. But, Wial says

> There are also many auto and auto parts jobs in Los Angeles, Dallas, and Cincinnati, large metropolitan areas where these industries account for a smaller share of employment. Closures of Detroit 3- related plants in those areas would harm the workers who were laid off but would have less effect on metropolitan area economies.[111]

Conversely, he found that, "In addition, there are 21 metropolitan areas, mainly in the South where at least 1% of total employment is in autos and/or auto parts, but where little or none of that employment is attributable to the Detroit 3 or their suppliers." These metro areas are almost all in the southern states north of Florida and east of the Mississippi River. However, Wial concludes, "If the Detroit 3 disappear then some of [these] metropolitan areas may gain jobs, but they will not gain all of the jobs lost by the Detroit 3."[112]

In conclusion to this section, the consequences of a failure and liquidation of one or more Detroit 3 companies, would be large, and possibly far-reaching in extent.

The Domestic Motor Vehicle Market[113]

Loss of Detroit 3 Market Share

Foreign brands, both imported and produced at U.S. plants, have been gaining market share for decades. [114] As illustrated in **Figure 1**, the Detroit 3's decline relative to the total U.S. market has continued since 2000. From two-thirds of the total U.S. market for passenger cars and light trucks in 2000, the Detroit 3 share declined gradually to 58.2% in 2005. Some of this decline represented aggressive U.S. manufacturing and expansion plans by foreign-owned companies: Toyota, Honda, Nissan, and Hyundai have all opened new assembly plants in the United States since 2000, and more are on the way. While, as noted below in this report, some planned foreign-owned plants may be delayed, Toyota is still planning to open a new plant in Mississippi, Kia is

[110] Howard Wial, "How a Metro Nation Would Feel the Loss of the Detroit Three Automakers," *Metropolitan Policy Program at Brookings*, December 12, 2008.

[111] Wial, "Loss of Detroit Three," p. 3.

[112] Wial, "Loss of Detroit Three," p. 4.

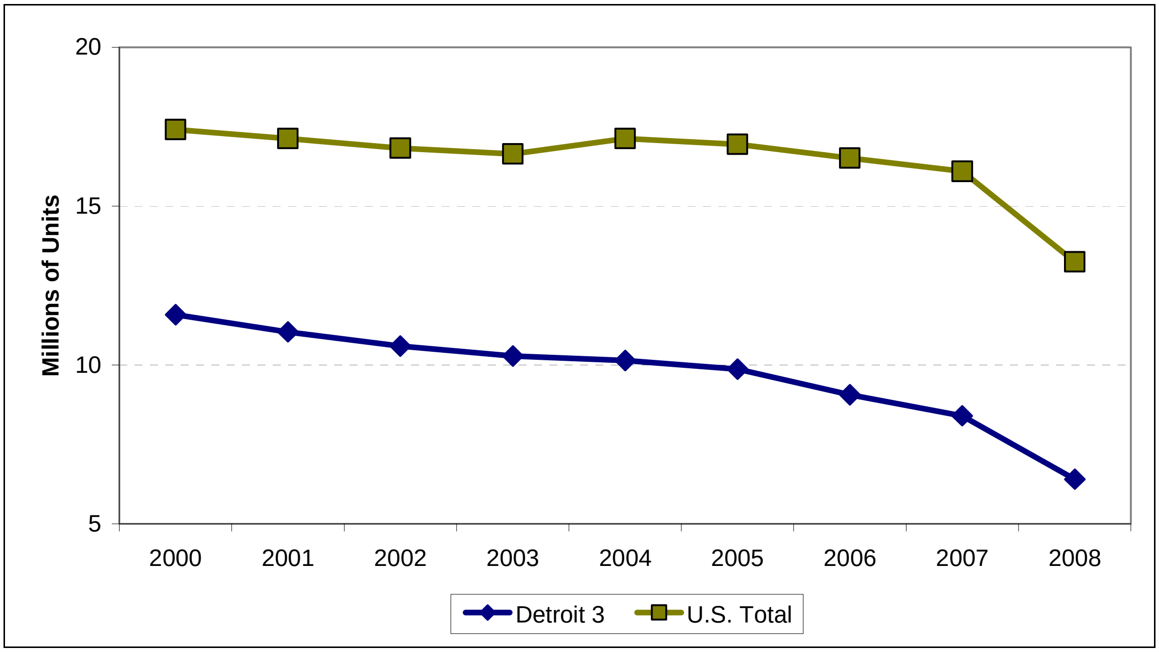
[113] This section was written by Stephen Cooney, Specialist in Industrial Organization and Business.

[114] CRS Report RL32883, *U.S. Automotive Industry: Recent History and Issues*, by Stephen Cooney and Brent D. Yacobucci, esp. Figure 9 and Table 3.

building its first plant in Georgia, and Volkswagen, which had closed a U.S. plant in the 1980s, has said that it will continue to build an announced plant in Tennessee. Additionally, a number of the foreign-owned plants have significantly expanded existing facilities.[115]

Figure 1. U.S. Motor Vehicle Sales

Passenger Cars and Light Trucks



Source: Automotive News Market Data Center (2008 data); *Ward's Automotive Yearbook* (2001-2008).

However, after losing eight points of market share in 2000-2005, the Detroit 3 saw their losses accelerate by an additional 10 points between then and the first three quarters of 2008, to a 48% market share. This loss of market share occurred at the same time as the total market was in decline. Although the U.S. automotive market is cyclical, the decline in sales starting in mid-2008 appears to have been especially abrupt because of the crisis in global credit markets.[116] **Figure 1** indicates that the total domestic light motor vehicle market stabilized at around 17 million sales per year through 2005 (passenger cars and light trucks, which include sport utility vehicles, minivans, and pickup trucks). It dropped about a half-million units in 2006 to 16.5 million, another half-million to just more than 16 million in 2007, then plunged to just 13.2 million in 2008.[117] Car and light truck unit sales by the Detroit 3 fell to just 6.4 million, compared to 11.5

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[115] *Automotive News*, "Transplant Expansions: Onward Ho!" December 1, 2008, p. 3.

[116] Ray Windecker, former research and analysis manager for Ford Motor Co., has pointed out that in past cycles, sales declines at the trough were 30% or higher, and between 1978 and 1982 the net decline in annual vehicle sales was 4.5 million units; "A Rough Ride Is Nothing New for Autos," *Automotive News*, November 10, 2008, p. 14. By comparison, the fall in total light motor vehicle sales from a peak of about 17.0 million units in 2005 to 13.2 million units in 2008, represents a decline of 3.8 million units or 22% (data from *Ward's Motor Vehicle Facts & Figures, 2008*, and unpublished data provided by Ward's). However, the fall in monthly sales in late 2008 to an annual rate of about 10.0 million units indicates that we may not yet have seen the trough of this cycle.

[117] For the third quarter, the annual rate of sales was even lower, and, owing to lower-than-average income and credit ratings among their customers, Detroit 3 companies only commanded 42% of the domestic retail market; *Detroit Free Press*, "Credit Crunch Hits Buyers of Detroit 3" (October 26, 2008).

million in 2000, and almost 10 million as late as 2005. More detailed data show that each of the Detroit 3 saw sales decline by nearly one million vehicles or more just since 2005, and each suffered significant market share losses.

Automotive data is usually figured in "units," which means, for example, that an expensive Cadillac Escalade counts the same as an inexpensive Kia Rio. But for the entire industry, average new vehicle transaction prices, after rising from 2004 through 2007, fell steadily in 2008, meaning less "top line" revenue per unit sold.[118] Moreover, **Table 1** illustrates that part of the Detroit 3's problems relate to the continued reliance on truck sales, when light trucks are declining as an overall share of the market. Having become more specialized in larger vehicles, the Detroit 3 have been especially adversely affected by the sharper decline in the sales of such vehicles.

In 2001, "light truck" sales, which include smaller SUVs known as "crossover" utility vehicles (CUVs), were higher than U.S. passenger car sales for the first time. Trucks' lead over cars continued to expand through 2005—9.3 million units to 7.7 million units in that year, for a net margin of 1.6 million. But 2004-2005 saw Hurricanes Ivan, Katrina, and Rita, which temporarily disrupted oil and gas production in the Gulf of Mexico and exacerbated a period of rising fuel prices and volatility that continued through 2008.[119] In 2008 U.S. car and truck sales both fell: car sales by 800,000 versus a two million unit decline in light truck sales. Truck sales were also more than three million units less than the all-time 2005 annual peak. While most foreign-owned manufacturers had also expanded their truck offerings (including SUVs and minivans) in the U.S. market, they have not been as reliant as the Detroit 3 on truck products. By 2008, each of the Detroit 3 still counted on light trucks for a majority of sales (55% for GM, higher levels for Ford and Chrysler), while no foreign-owned competitor did so. Only about a third of foreign-brand companies' sales overall were classified as light trucks.

[118] *Detroit Free Press*, "Vehicle Transaction Prices Continue Falling" (October 28, 2008).

[119] On recent trends, see CRS Report RL34625, *Gasoline and Oil Prices*, by Robert Pirog.

Table 1. Market Shares of U.S. Car and Truck Sales

Manufacturers	2001 Sales (millions of units)				2005 Sales (millions of units)				2008 Sales (millions of units)			
	Cars	Light Trucks	Total	Market Share (%)	Cars	Light Trucks	Total	Market Share (%)	Cars	Light Trucks	Total	Market Share (%)
GM	2.3	2.6	4.9	28.3	1.8	2.7	4.5	26.3	1.4	1.6	3.0	22.3
Ford	1.5	2.4	3.9	22.9	1.0	2.1	3.1	18.3	0.7	1.3	2.0	15.1
Chrysler	0.6	1.7	2.3	13.3	0.5	1.8	2.3	13.6	0.5	1.0	1.5	11.0
Detroit 3 (total)	**4.4**	**6.7**	**11.0**	**64.5**	**3.3**	**6.6**	**9. 9**	**58.2**	**2.5**	**3.9**	**6.4**	**48.4**
Asian Brands	**3.3**	**1.9**	**5.2**	**30.4**	**3.6**	**2.6**	**6.2**	**36.6**	**3.8**	**2.1**	**5.9**	**44.6**
German Brands	**0.8**	**0.1**	**0.9**	**5.0**	**0.7**	**0.1**	**0.8**	**5.0**	**0.7**	**0.2**	**0.9**	**6.5**
Total U.S. Sales[a]	**8.4**	**8.7**	**17.1**	**100.0**	**7.7**	**9.3**	**16.9**	**100.0**	**7.2**	**6.3**	**13.5**	**100.0**

Source: Automotive News Market Data Center (2008 data); *Ward's Automotive Yearbook* (2001-2008).

a. U.S. total includes other specialty manufacturers.

During the present decade, both market forces and federal regulation have begun to push fuel economy levels upward, leading to a move away from larger, less fuel-efficient vehicles, a market that the Detroit 3 have generally dominated. While the CAFE standard set by the Department of Transportation's National Highway Transportation Safety Administration (NHTSA) for cars has held steady at 27.5 mpg throughout the decade, the actual average of model-year vehicles sold, as measured on a different basis by the Environmental Protection Agency (EPA), has increased from 22.9 mpg to 24.1 mpg, with most of the gain coming in model year (MY) 2007-2008.[120] While the light truck standard held steady at 20.7 mpg through 2004, actual average truck mpg, as measured by EPA, remained less than 17.0 mpg. Both the federal standard and the actual average declined in 2005 for light trucks. The actual average mpg was 18.1 by MY2008.[121]

Falling Demand Affects All Automakers in the United States and Abroad

While the first half of 2008 was characterized by a market shift to more fuel-efficient vehicles in the U.S. market under the influence of high fuel prices, the latter half of the year saw all almost OEMs suffer from declining sales, in the United States and globally. IHS Global Insight estimated that global vehicle production fell by 16% in the fourth quarter of 2008. CSM, an automotive consulting group, estimated that there is now enough worldwide capacity to build 90 million cars a year, but only 66 million will be produced in 2009.[122]

Not just the Detroit 3 are affected by this slump. Toyota announced that it would probably record its first annual operating loss in more than 70 years in the fiscal year to March 31, 2009.[123] On March 3, 2009, the Associated Press reported that Toyota's financial subsidiary, Toyota Financial Services, had requested a $2 billion loan from the Japan Bank for International Cooperation, a government-backed bank.[124] Nissan CEO Carlos Ghosn in February 2009 revised earlier predictions of an annual profit to a projected $2.9 billion loss. He announced plans to reduce production by 20% and to eliminate 20,000 jobs.[125]

Honda similarly projected negative results for the second half of its fiscal year. Both Honda and Toyota cited strengthening of the yen against the U.S. dollar to the highest level in 13 years as a major factor in worsening their results. According to the *Financial Times*:

> "I would like the government and the Bank of Japan to move a bit more swiftly in ensuring the stability of the exchange rate," [said Honda CEO Takeo Fukui], code for intervening in the market to weaken the currency.[126]

[120] EPA's numbers, which are used on the window stickers of new cars and trucks, are downgraded from the CAFE test to better reflect in-use fuel economy. For example, the CAFE test is limited to 55 miles per hour, and does not include the use of air conditioning or other accessories.

[121] For more details, see CRS Report RL34743, *Federal Loans to the Auto Industry Under the Energy Independence and Security Act,* by Stephen Cooney and Brent D. Yacobucci.

[122] Sources quoted in *New York Times*, "Car Slump Jolts Toyota, Halting 70 Years of Gain," December 23, 2008, p. 1.

[123] Associated Press, "Toyota Projects First Loss in 70 Years," December 22, 2008.

[124] Reported by *Detroit News*, "Toyota Talking on Japan Government Loan" (March 3, 2009).

[125] *Automotive News*, "Nissan Expects $2.9 Billion Loss; Will Cut Jobs, Output" (February 16, 2009).

[126] Quoted by Jonathan Soble, "Honda Cuts Expenses Amid Further Downturn," *Financial Times*, December 18,2008; see also *Wall St. Journal*, "Corporate News: Honda Slashes Outlook for Full-Year Sales, Profit," December 18, 2008, (continued...)

Reaction among Japanese companies in their U.S. plants included temporary production cutbacks, and Toyota's announced delay in completing its new plant in Mississippi to build the Prius hybrid model. Toyota also consolidated production of its full-size Tundra pickup at the San Antonio plant, and temporarily closed one line there. Production cutback and temporary production shutdown announcements were widespread among Asian OEMs in the United States.[127] Nissan has converted its truck and SUV line in Mississippi to produce a commercial type of vehicle.[128] Among German-owned manufacturers, Mercedes Benz has offered buyouts to all 4,000 of its production workers in Alabama.[129]

Assistance to the auto industry by encouraging owners to trade in older, more polluting, vehicles in favor of new or late-models is one option that has gained favor in Europe. Part of the German government's recently enacted $106 billion stimulus package is an allocation of about $2 billion to subsidize those who scrap vehicles at least nine years old by giving them up to $4,000 to purchase a new car that meets the newest and strictest European emission standard. Volkswagen, Opel, and Fiat have seen significant sales increases in Germany since the measure was introduced. With a budget to cover about 600,000 car purchases, official sources say they are receiving 6,000 subsidy applications per day.[130] A similar program in France provides more than $1,000 for those who trade in older vehicles for newer models, though the emission requirements are not as strict as in Germany.[131] Canada also has a national Vehicle Scrappage Program, but instead of directly encouraging new car purchases, it offers incentives to use other forms of transportation or $300 in cash.[132] Similar to these efforts abroad, Senator Dianne Feinstein on January 14, 2009, introduced S. 247, a bill to pay up to $4,500 to those in the United States who trade in an older, less fuel-efficient model for a new, high fuel economy vehicle.

More direct subsidies are also being considered by other governments. A French government plan to loan about $7.6 billion to Renault and Peugeot ran into opposition from the European Commission and other European Union member states, because it apparently would have required these OEMs not to close any plants in France and to source from French-based suppliers. After discussions with the European Commission, French authorities agreed "not to implement measures that would breach the principles of the single market."[133] The European Union, through the European Investment Bank (EIB), has also indicated that it would assist the industry, although one commentator has said, "The European Union has talked about making a huge wedge of money available for the industry – up to ... $50 billion – but this has remained hot air so far."[134]

(...continued)

p. B3; While Japanese domestic auto sales fell to the lowest levels in 20 years in 2007-08, a cheap yen level of about 120 to the dollar and strong exports allowed Japanese production to reach an all-time high in early 2008. But the dollar's fall to less then 90 yen and a global growth slowdown has led to falling auto company profits, production and exports; *Business Week*, "How the Strong Yen Has Weakened Japan," January 19, 2009, pp. 50-51.

[127] *Automotive News*, "Honda, Toyota, Others Whack N.A. Output," December 15, 2008, p. 8.

[128] *Automotive News*, "Nissan to Sell Small Commercial Vehicles in U.S.," December 15, 2008, p. 24.

[129] *Tuscaloosa News*, "Mercedes Offers Buyouts to Vance Plant Employees," October 31, 2008.

[130] The best English-language description of the program is in Canadian Press, "Germany Pays Consumers to Junk Old Cars" (February 5, 2009); also, Deutsche Welle, "Berlin Rejects Expansion of Car Subsidy Scheme" (February 12, 2009); *Financial Times*, "Scrapping Old Cars Boosts German Sales" (March 3, 2009).

[131] Government of France. Decree no. 2009-66 (January 19, 2009). See comments also by Neil Winton in *Detroit News*, "Survival of the Fittest Trumps Everything at Geneva This Year" (February 27, 2009).

[132] CBC News, "Clunker Removal Program Bound to Fail, Says Analyst" (February 2, 2009).

[133] *Financial Times*, "Brussels and France Resolve Auto Dispute" (March 2, 2009).

[134] Winton, "Survival of the Fittest." The EIB has limited the total loan amounts available to the European auto industry (continued...)

The British government has announced an Automotive Assistance Program, which will offer loan and loan guarantees up to a total of ₤1.3 billion. Following a collapse in new vehicle sales there, the Bank of England has also indicated that it would assist OEMs and dealers in consumer lending.[135]

Labor Negotiations in 2007 to Address Competitive Issues

Many analysts have commented that, in competing with foreign-owned auto manufacturers, the Detroit 3 are hampered by outdated labor contracts, negotiated with the UAW through decades of collective bargaining.[136] In 2007, each of the Detroit 3 negotiated new collective bargaining agreements with their principal union, the UAW.[137] These agreements provided for transfer of retiree health care in 2010 from the companies to a separate trust, with some board members appointed by the UAW. The trusts are to be established with financial support initially from each of the Detroit 3. The agreements also provided the companies with other flexibility in managing and reducing labor costs, so that they could compete on a footing perceived to be more equal to foreign-owned companies, which are generally non-union in the United States. This included union acceptance of a second, and lower, tier of wages and benefits for new hires by the Detroit 3, under specified circumstances.[138]

But with the auto market declining, there has been little new hiring at the lower wage rate.[139] Even so, wage rate gaps between the Detroit 3 and the international companies may be exaggerated. CAR data quoted in a *Wall Street Journal* article compare standard UAW hourly assembly line worker pay of $26 per hour with $26 per hour at Toyota, $24 at Honda, and $21 at Hyundai. Honda and Kia are starting production line workers at their new plants in Indiana and Georgia, respectively, at a wage of just less than $15 per hour, but this compares with a similar starting "Tier 2" wage for new UAW hires at Ford and GM.[140]

The principal gap remains in the legacy cost burden that the 2007 Detroit 3 contract agreements with the UAW attempted to address. CAR is quoted as calculating that Toyota's hourly total labor cost, including all benefits, is $44 per hour versus $73 at GM.[141] In its December 2008 restructuring plan presented to Congress, Ford attached a table showing that wages and wage-

(...continued)

to 7 billion (less than $10 billion), "with most of the funds to develop clean cars." See *Financial Times*, "Carmakers Warned Nearing Loan Limits" (March 9, 2009), and "EU Lender's Rebuff on Auto Loans Likely to Inflame Ailing Carmakers" (March 10, 2009).

[135] *Detroit Free Press*, "British Bank Nears Aid for Carmakers' Finance Units" (February 25, 2009); *Detroit News*, "General Motors Yet To Approach UK for Aid" (March 5, 2009).

[136] This issue was reviewed in CRS Report RL32883, *U.S. Automotive Industry: Recent History and Issues*, by Stephen Cooney and Brent D. Yacobucci, pp. 37-43; and, CRS Report RL33169, *Comparing Automotive and Steel Industry Legacy Cost Issues*, by Stephen Cooney.

[137] This included Chrysler, which had become newly independent from German parent Daimler after Cerberus, a hedge fund, bought an 80% share of the company.

[138] These agreements are described in CRS Report RL34297, *Motor Vehicle Manufacturing Employment: National and State Trends and Issues*, by Stephen Cooney, pp. 25-32.

[139] *Washington Post*, "Bankruptcy Could Offer GM More Flexibility" (November 29, 2008), p. D1.

[140] *Wall St. Journal*, "America's Other Auto Industry," December 1, 2008, p. A22; *Automotive News*, "Transplant Wages Are a Moving Target," December 15, 2008, p. 3.

[141] *Wall St. Journal*, "America's Other Auto Industry."

related costs in 2008 were $43 per hour, versus an average of $35 per hour at foreign-owned U.S. auto manufacturers. But Ford's total hourly labor cost was $71, against $49 for the foreign-owned companies. The principal difference was a "legacy cost" – principally projected health care costs for retirees – of $16 per hour, versus comparable foreign companies' costs of $3 per hour. The new UAW contract, by transferring this cost off Ford's books to the VEBA in 2010, would bring the hourly cost burden down to $58 per hour. And, if Ford could replace 20% of its projected workforce with new, entry-level employees, as allowed by contract, Ford asserts it would bring the hourly cost level down to $53.[142]

Another issue addressed in the 2007 contracts and in congressional hearings was pay for laid-off autoworkers and the "jobs bank." Laid-off Detroit 3 production workers receive unemployment compensation from state governments, plus supplementary compensation from company funds that brings their pay close to the base level for one year.[143] After that, if they are still unemployed, they may be eligible to enter the jobs bank, where they may continue to receive almost their full base salary, even if no jobs are available. The terms are now more restrictive under the new contract, and two years is the maximum stay. The jobs bank was declared suspended by the UAW as of December 2008, in an effort to assist the Detroit 3. Elimination of the jobs bank was made an explicit target of the federal loans term sheets signed by GM and Chrysler in December 2008. In January 2009, on the occasion of announcing its annual 2008 financial results, with a large corporate loss, Ford indicated that it and the UAW had agreed to end the jobs bank program at Ford.[144]

The Energy Independence and Security Act of 2007 (EISA)

The new collective bargaining agreements were negotiated and ratified by the time Congress approved, and President Bush signed, a substantial increase in mandated fuel economy in EISA (P.L. 110-140) in December 2007. Although the Detroit 3 were losing money, the new labor agreements, combined with an EISA direct loan program for manufacturing advanced technology vehicles and components, appeared to provide new resources for a transition that would aid the Detroit 3 in achieving improved fuel economy.[145]

By the time Congress considered funding this program in September 2008, the economic climate for the auto sector as a whole, and for the Detroit 3 in particular, had worsened markedly. The downturn in the broader domestic economy reduced sales for virtually all manufacturers in the middle of the year, as consumer confidence declined and credit became harder to obtain. While neither Ford nor GM has been profitable since 2006, the operating losses turned much worse in 2008. After total GM losses of $18.7 billion for the first two quarters, the company reported an adjusted third-quarter loss of $4.2 billion. Ford reported a small net profit in early 2008, but that was offset by an $8.7 billion loss in the second quarter. It had only a small reported net overall loss in the third quarter, but its after-tax operating loss was $3 billion. "Cash burn" (net operating cash loss) for the two companies accelerated to about $7 billion each for the quarter.[146] In

[142] *Ford Business Plan*, Appendix 2.

[143] Communication to CRS from UAW, December 17, 2008.

[144] Ford Motor Co. news release, January 29, 2009.

[145] Details of the direct loan program are discussed in CRS Report RL34743, *Federal Loans to the Auto Industry Under the Energy Independence and Security Act*, by Stephen Cooney and Brent D. Yacobucci, pp. 14-24.

[146] *Automotive News*, "Cash Burn Rates Threaten GM, Ford" (November 10, 2008).

testimony before the Senate Banking Committee on November 18, 2008, CEO Robert Nardelli of privately held Chrysler acknowledged that, after losing money in the first half of the year, his company's "cash burn" increased to $3 billion in the latest quarter. At the same hearing, UAW president Ron Gettelfinger testified that of the three companies, GM was in most immediate danger of failure, and Chrysler was next; Ford, having arranged credit during a more favorable period two years earlier, was in less immediate danger.[147]

Representatives of the Detroit 3 reportedly attempted to increase the scale of loans available during legislative consideration of appropriations to fund the EISA direct loan program, as well as to reduce restriction of the EISA loans to production of advanced technology vehicles. But these efforts were unavailing, as Congress maintained the same program rules, when it approved the appropriations in September 2008.[148]

Legislative Efforts to Assist Automakers Prior to December 2008

Following the November 2008 elections, the Bush Administration was asked to consider making funds available to the auto industry from the $700 billion appropriated for relief of the financial sector in the Emergency Economic Stabilization Act (EESA, P.L. 110-343).[149] Secretary of the Treasury Henry Paulson and Senate Minority Leader Mitch McConnell instead urged Congress to assist the automakers by diverting funds from the EISA loan program.[150]

On November 17, 2008, Senate Majority Leader Harry Reid introduced S. 3688, which, in Title II, included a provision allowing $25 billion from the EESA funding to be used as loans to automakers in the United States under certain conditions. On November 18-19, hearings were held before the Senate Banking Committee and the House Financial Services Committee, in which the chief executive officers of the Detroit 3, as well as UAW President Gettelfinger, made the case for immediate assistance to the industry. They were supported by some Members of Congress. Critics of such assistance were also heard.

The industry CEOs stated that they were asking for "bridge loans" to tide them over, during a market decline of unanticipated severity, which had affected all automakers, and an equally unanticipated unavailability of credit from financial markets. The bridge loans would provide time for cost-saving measures, including the transfer of retiree health care responsibilities, to work. That, plus a hoped-for recovery of the domestic auto market by 2010, could allow the Detroit 3 to return to financial stability. As GM CEO G. Richard Wagoner testified:

> [We, in cooperation with the UAW] have taken actions designed to improve GM's liquidity by $20 billion by the end of 2009, and they obviously affect every employee, retiree, dealer, supplier, and investor involved in our company ... I do not agree with those who say we are not doing enough to position GM for success. What exposes us to failure now is not our

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[147] See hearing citation below.

[148] See CRS Report RL34743, *Federal Loans to the Auto Industry Under the Energy Independence and Security Act*, by Stephen Cooney and Brent D. Yacobucci, pp. 10-11, 17.

[149] Speaker of the House Nancy Pelosi and Senate Majority Leader Harry Reid, Letter to Secretary of the Treasury Henry M. Paulson (November 8, 2008).

[150] *Financial Times* (*FT.com*), "Paulson Rejects TARP Aid for US Carmakers" (November 12, 2008); *Bloomberg.com*, "Paulson Urges Congress to Approve Automaker Funding" (November 13, 2008); and "Democrats, Bush Deadlocked over Expanding Aid to U.S. Carmakers" (November 19, 2008).

> product lineup, is not our business plan, is not our employees and their willingness to work hard, it is not our long-term strategy. What exposes us to failure now is the global financial crisis, which has severely restricted credit availability and reduced industry sales to the lowest per capita level since World War II.
>
> Our industry, which represents America's real economy, Main Street, needs a bridge to span the financial chasm that has opened before us. We'll use this bridge and we'll use it effectively to pay for essential operations, new vehicles and power trains, parts from our suppliers, wages and benefits for our workers and suppliers, and taxes for state and local governments that help deliver essential services to millions of Americans.[151]

In the hearings, the CEOs revealed how the $25 billion in loans would be divided among their three companies. CEO Wagoner of GM stated that his company would need $10-12 billion to bridge the present period of financial insecurity, while Robert Nardelli of Chrysler said that his company would require $7 billion. CEO Alan Mulally of Ford stated that Ford currently did not have an operating capital shortfall, but would request that $7 billion to $8 billion be reserved in case of eventual cash needs.[152]

Congressional critics of the industry's requests included Senator Richard Shelby, Ranking Member of the Banking Committee, and Representative Spencer Bachus, Ranking Member of the House Financial Services Committee. They argued that to a large extent, the problems of the Detroit 3 were due to the long-term consequences of poor management and labor decisions, which would not be fixed with short-term financial assistance, and that the industry would soon be requesting additional federal support. Moreover, assistance to the auto industry, it was stated, would encourage other industries to also importune the federal government for aid during the present economic downturn.[153]

No action was taken in the Senate on S. 3688 in November 2008. Further developments were deferred until December 2008, after full reports had been presented by the Detroit 3 on their financial condition and restructuring plans.

Assistance to Auto Industry in the 2009 Stimulus Package

After the Bush Administration provided loans to the auto industry in December 2008, Congress also considered assistance as part of the 2009 stimulus package approved as H.R. 1 (P.L. 111-5, signed into law by President Obama on February 17, 2009). Senator Barbara Mikulski had introduced a bill, S. 333, which would have allowed purchasers of light motor vehicles to deduct interest payments and state and local excise taxes on their 2009 federal income tax return. The measure was subject to a cap on the amount paid for the vehicle, and the benefit was reduced for higher income earners. A companion bill, H.R. 159, was introduced in the House by Representative William Pascrell. The chief provisions of S. 333 were included as §§1008-1009 in the version of H.R. 1 approved on a 61-37 vote by the Senate on February 10, 2009.

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[151] U.S. Senate. Committee on Banking, Housing, and Urban Affairs. Hearing. *Examining the State of the Domestic Auto Industry* (November 18, 2008), Testimony of G. Richard Wagoner.

[152] Senate Banking Committee hearing, November 18. The total level of requests was raised to $34 billion in subsequent business plans formally submitted by the three companies to Congress on December 2, 2008 (as summarized in *Washington Post*, "Auto Giants Ratchet Up Pleas for Aid" (December 3, 2008), p. A1.

[153] See their respective statements in the Senate Banking Committee hearing (December 4, 2008) and the House Financial Services Committee hearing (December 5, 2008), on the domestic auto industry.

In the conference committee, the deduction for interest charges was deleted. Thus, §1008 in the law as finally approved and signed, the deduction for motor vehicle purchases in the balance of 2009 is restricted to state and local sales or excise taxes on the vehicle. The same income and sales price limitations are in effect, but the provision is expanded to include motorcycles and motor homes.

Analysts generally agreed that the final measure would have a relatively minimal effect in increasing auto sales. An analyst for the automotive data firm R.L. Polk & Co. estimated that the average value to consumers would be $330 per vehicle. The impact on sales was estimated at less than 100,000 vehicles, whereas, if the interest deduction had been maintained, the impact could have been as high as 350,000 vehicle sales. In addition to this direct assistance to individual private consumers, the legislation also contained a number of aid provisions for development of advanced vehicle technologies, and to finance the purchase of such vehicles for the federal vehicle fleet.[154]

Employment in the Automotive Sector

Employment in the automotive sector of the U.S. economy includes both manufacturing and services activities, but the latter actually employ more than in manufacturing. As seen in **Table 2**, at the end of 2008 the Current Employment Survey of the Department of Labor's Bureau of Labor Statistics estimated that there were about 790,000 persons employed altogether in motor vehicle manufacturing (including heavy trucks, trailers and other vehicles), compared to more than 3.5 million in various service activities.

Since the era of Henry Ford, automotive employment has been a mainstay of U.S. manufacturing employment. But its relative significance has declined in recent years, despite the opening or expansion of foreign-owned assembly and parts facilities. **Table 2** examines levels of and changes in automotive employment by both manufacturing and services categories.[155] It presents data, from December 2008, compared to December 2000. Motor vehicle manufacturing employment in 2008 was down about 127,000 jobs, a drop of 43%. However, as pointed out by Thomas Klier and James Rubenstein, as well as in earlier CRS analyses, by far more people are employed in parts manufacturing than in motor vehicle assembly.[156] In December 2008, total employment in all categories of automotive manufacturing, as defined by the Labor Department, was half a million jobs less than at the end of 2000, a decline of nearly 40%.

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[154] See analyses in *Washington Post*, "Analysts Rate Stimulus Bill as Lean on Automaker Aid" (February 19, 2009); and *Detroit Free Press*, "Stimulus Light on Aiding Car Sales" (February 22, 2009).

[155] The table uses the Bureau of Labor Statistics *Current Employment Survey*, in order to estimate the most recent data available.

[156] Thomas Klier and James Rubenstein, *Who Really Made Your Car?* (Kalamazoo, MI: W.E. Upjohn Institute, 2008). A detailed CRS analysis of U.S. automotive manufacturing employment trends, nationally and by state, is in CRS Report RL34297, *Motor Vehicle Manufacturing Employment: National and State Trends and Issues*, by Stephen Cooney, pp. 1-20.

Table 2. U.S. Automotive Employment

	NAICS Code	All Employees ('000s) Dec. 2000	Dec. 2008	Change
Manufacturing:				
Motor Vehicle Mfg.	3361	294.7	167.8	-126.9
Motor Vehicle Bodies and Trailers	3362	172.7	122.6	-50.1
Motor Vehicle Parts	3363	819.1	499.4	-319.7
Total Motor Vehicle Mfg.		**1,286.5**	**789.8**	**-496.5**
Services:				
Wholesale Distribution	4231	351.2	326.8	-24.4
Auto Dealers	4411	1,222.0	1098.3	-123.7
Auto Pts., Accessories & Tires	4413	500.1	489.8	-10.3
Gasoline Stations	4470	929.8	834.4	-95.4
Auto Repair & Maintenance	8111	894.8	830.4	-64.4
Total Services		**3,897.9**	**3,579.7**	**-318.2**
Total Automotive Employment		**5,184.4**	**4,369.6**	**-814.8**

Source: Dept. of Labor. Bureau of Labor Statistics. *Current Employment Survey* (February 23-24 and unpublished data).

Note: All data seasonally adjusted. Monthly survey data may differ from annual figures cited earlier. "Services" total does not necessarily include all NAICS auto-related categories.

Service activities employment directly related to the automotive industry has also declined, but not nearly as significantly as manufacturing employment in the sector. Wholesale distribution of vehicles and parts fell by about 24,000 jobs since the end of 2000. Employment at dealers—the largest single North American Industry Classification System category in the sector, with more than one million jobs—fell by 124,000 jobs, or 10%. Employment in retail outlets for automotive parts, accessories, and tires was close to steady, holding near 500,000 jobs. The decline in gasoline station jobs was also 10%, and the decline in auto repair and maintenance was estimated at about 7%. Altogether, 61% of the decline of more than 800,000 jobs in the automotive sector since 2000 is accounted for by the decline in manufacturing jobs.

Both Ford and GM are consolidating their dealer networks, so that their unit sales per dealer will better approximate the levels recorded, for example, by Toyota and Honda. Each of the latter companies has roughly 1,000 U.S. dealers, compared to 3,790 dealers for Ford as of 2008, and 6,450 for GM. Yet in terms of market share, GM in 2008 was just over 22%, Toyota just under 17%, Ford about 15%, and Honda nearly even with Chrysler at around 11%. The Detroit 3, then, sell far fewer vehicles per dealer than Toyota or Honda. GM and Ford have already begun to consolidate dealers and reduce their numbers. GM has eliminated more than 1,000 dealers since 2005, and their restructuring plan calls for eliminating 1,800 more, down to a total level of 4,700 by 2012. Ford has eliminated 600 dealers since 2005, but did not indicate a target number for the future.[157]

[157] *GM Restructuring Plan*(December 2008) pp. 18-19; *Ford Business Plan,* p. 11. Chrysler reported that it had 3,300 dealers in *Chrysler Viability Plan* (February 2009), p. U162.

Paul Taylor, chief economist of the National Automobile Dealers Association, has forecast that, because of economic conditions, there will be a total net loss of about 1,600 dealers in 2008-09. About two-thirds of those closing have been Detroit 3 dealers, he estimated. If this forecast holds, there will be fewer than 20,000 new car dealers in the United States at the end of 2009, compared to 28,000 in 1980.[158] Even if the Detroit 3 succeed in consolidating franchises into larger operations, the implication is that the total number of dealership employees will decline, perhaps dramatically.

Automotive manufacturing employment has also fallen as a share of total employment in manufacturing. While total manufacturing employment has fallen by more than three million jobs since September 2001, employment in motor vehicle manufacturing dropped at an even faster rate, with its share of total manufacturing employment falling from 7.4% to 6.4%. During this period, total automotive sector employment, including services, as shown in **Table 2**, fell from 5.2 million to 4.4 million, while total U.S. employment grew by six million. As a result, automotive employment, including both manufacturing and services, as a share of total U.S. employment, fell from 3.9% to 3.3%.

Financial Issues in the Auto Industry

Credit Conditions[159]

Credit is the lifeblood of the U.S. auto industry. Credit conditions govern the industry's ability to invest, the ability of its dealers to finance their inventory ("floorplan"), and the ability of dealers, in turn, to sell to individual consumers. The systemic crisis in the U.S. and global financial markets in 2008 has had a severely negative impact on all these aspects of automotive credit.

An auto dealer's floorplan is the financing dealers must have to finance their inventory. A new vehicle dealer will generally buy cars from the OEM, most often in the past on credit provided by the OEM's "captive" financial organization. The dealer will then sell vehicles to customers at a negotiated transaction price. The dealer will be paid, alternatively:

- in cash by the customer;
- through a financial transaction by the OEM captive credit organization; or
- through a third party loan to a customer from a bank, credit union, or finance company.

Each of the Detroit 3 has traditionally operated with a captive credit organization for both floorplan financing and consumer credit: General Motors Acceptance Corporation (GMAC), Ford Motor Credit and Chrysler Financial, respectively. Floorplan financing has generally been provided for dealers by these credit organizations at favorable (better than prime) interest rates.[160] Dealers have also been financially encouraged to refer customers to the captive finance

[158] *Automotive News*, "Economy Decimates Dealerships," December 15, 2008, p. 1.

[159] This subsection was written by Stephen Cooney, Specialist in Industrial Organization and Business.

[160] For example, "As recently as September 30, [2008,] GMAC provided dealer inventory financing for 80% of GM vehicles worldwide." *Automotive News* , "A GMAC Failure Could Doom Dealers," December 15, 2008, p. 31.

organizations. For much of the period since 2000, a very large share of each of these OEM's corporate profits has been accounted for by its captive financial organization.

But the financial performance of the three credit organizations has progressively deteriorated. According to *Automotive News*:

> Standard & Poor's has assigned subinvestment-grade ratings to all three finance arms. Ford Credit and GMAC are rated B- with a credit watch of negative. Chrysler Financial has an S&P rating of CCC+ with a negative outlook ...[161]

This means that the financial arms have found it much more difficult to raise capital to lend to dealers or customers. GMAC, in particular, had virtually ceased lending except to customers with the highest credit scores, and stopped supporting domestic leasing altogether. All three companies have had to raise interest rates on floorplan financing, in many cases forcing dealers or customers to use third-party lending.[162]

Two of the three captive credit organizations are now controlled by the private equity hedge fund Cerberus Capital Management. Cerberus acquired Chrysler's credit arm with its acquisition of a controlling share (80.1%) of the auto manufacturing operation in 2007. Earlier, it had bought a 51% stake in GMAC. GMAC has been particularly affected by the global credit squeeze and subprime lending, as it had become a major player in mortgage lending through its Residential Capital (ResCap) division. The latter has been primarily responsible for GMAC's multibillion-dollar losses in 2008.[163] However, unlike the situation in subprime home mortgages, Detroit 3 CEOs at the November 18, 2008, Senate Banking Committee hearing on the domestic auto industry said that there had not been a major rise in delinquencies among their automotive credit borrowers.[164]

Ford Motor Credit remains 100% owned by Ford Motor Company. It has sought to offset negative reports on credit availability by widely advertising that Ford consumer credit is still available. It has raised floorplan financing rates by 0.5% in view of higher borrowing costs, but has also waived the increase for dealers that meet overall sales targets.[165] CEO Alan Mulally testified before the House Financial Services Committee on December 5, 2008, that Ford Motor Credit still supported "77% of all wholesale financing.[166]"

The Japanese OEMs are also affected by the financial crisis. Traditionally weaker than the U.S. companies' financial arms and more reliant on third-party consumer lending by banks, they have become much more competitive in recent years. Notably, Toyota has inaugurated an aggressive "Saved by Zero" consumer lending campaign that features 0% loans for qualified buyers on most

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[161] *Automotive News*, "Advantage, Ford: Mulally Likes Owning Ford Credit" (November 3, 2008) p. 8.

[162] *Automotive News*, "The Scramble for Credit" (Oct 27, 2008); CRS interview with Patrick Calpin, National Automobile Dealers Association (November 10, 2008).

[163] *Financial Times*, "GMAC Losses Add to GM Woes;" *Detroit News*, "GMAC Posts $2.52 Billion Quarterly Loss" (both stories November 5, 2008).

[164] Comments at the hearing from G. Richard Wagoner (GM) and Robert Nardelli (Chrysler).

[165] *Automotive News*, "Advantage, Ford".

[166] U.S. House. Committee on Financial Services. Hearing, *Auto Industry Stabilization Plans* (December 5, 2008), discussion between Alan Mulally and Rep. Paul Hodes.

models. Nissan has followed suit.[167] Even so, the Japan-based car companies saw monthly sales declines in late 2008 of about 30% or more, compared to sales one year earlier.

Customers and dealers have alternatively sought to finance deals through banks, but the banks have also reduced their consumer lending.[168] Dealers have sought alternative inventory funding sources from community banks, which generally have funds to loan, and which have not been as severely affected by the subprime mortgage crisis as the money center banks. The local banks may offer more attractive financing rates than the OEMs, but for many dealers, they do not have the scale to cover a dealer's floorplan.[169] On the other hand, GM and Ford have told Congress that they have explicitly planned to consolidate and reduce their numbers of dealers.

Credit has thus been more difficult for the Detroit 3, their dealers, and their customers. Former U.S. Senator from Michigan and Bush Administration cabinet member Spencer Abraham has written that an estimated $700 billion to $800 billion in auto loan exposure "is currently thrashing around our financial system." He has further stated that securities tied to auto loans account for more than 25% of all asset-backed securities, with large holdings by insurance companies, mutual funds, and pension funds, as well as banks.[170]

GMAC on November 20, 2008, applied to become a bank holding company, in order to make itself eligible to obtain new capital from the EESA financial relief package described in a section above.[171] With some difficulty, GMAC achieved this transition on December 24, 2008.[172] On December 29, 2008, the Treasury Department announced that it was making a $5 billion investment in GMAC, through a purchase of "senior preferred equity." These funds also came from the TARP program. In addition, the agency also loaned $1 billion to GM itself, with the funds to be used to increase its investment in GMAC. These funds increased GMAC's liquidity, allowing it to continue to support dealer floorplans and to liberalize significantly its credit requirements for consumers.[173] On January 16, 2009, the Treasury announced that it had agreed to make a $1.5 billion loan to Chrysler Financial.[174]

Meanwhile, earlier in December 2008, the Federal Reserve Board announced that auto dealers could participate in a new $200 billion "term asset-backed securities loan facility" (TALF) to finance inventory.[175] However, that plan has been slow to get started. Its purpose, with respect to

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[167] *Automotive News*, "To Match Toyota, Nissan Offers 0% Loans" (November 3, 2008), p. 43.

[168] *Detroit News*, "Big Banks Back Off Consumer Car Loans" (November 10, 2008).

[169] "Scramble for Credit;" NADA interview.

[170] Spencer Abraham, "A Cure for the Coming Crisis in Auto Finance," *Financial Times* (November 3, 2008).

[171] *Detroit News*, "GMAC Files with Fed for Bank Holding Status" (November 20, 2008).

[172] Associated Press (*Durham* [NC] *Herald-Sun*), "Fed: GMAC OK to Seek Bailout Money," December 25, 2008, p. 1.

[173] U.S. Department of the Treasury. Press release, "Treasury Announces TARP Investment in GMAC," December 29, 2008. See also attached term sheet and GM commitment letter. The easing of GMAC's credit requirements for consumers is discussed in *Detroit Free Press*, "GMAC To Offer More Loans in Wake of Aid," December 30, 2008; and *Washington Post*, "GM Aims To Drive Sales with Incentives," December 31, 2008. According to press analysis, because investors' bonded indebtedness has been converted to equity, GM and Cerberus may lose financial control of GMAC; see *Detroit News*, "Feds Invest $6B in GMAC;" *Detroit Free Press*, "$6B for GMAC; Aid Planned for Other Auto Finance Companies;" and, *Washington Post*, "GMAC To Get $6 Billion Lifeline," all December 30, 2008.

[174] U.S. Department of the Treasury. Press release, "Treasury Announces TARP Investments in Chrysler Financial," January 16, 2009.

[175] National Automobile Dealers Association. Press release, "Federal Reserve Approves NADA-Backed Initiative Aimed at Increasing Inventory Financing," December 22, 2008.

auto dealers, is to encourage traditional floorplan lenders to stay in the market, as dealers require refinancing. A key issue has been a requirement that securitized loans and floorplans must be rated AAA, the highest rating, a criterion that dealers have generally not been able to meet. Dealer representatives have been in discussions with the Federal Reserve bank and the Treasury to modify this requirement.[176]

Aside from consumer and dealer credit, another issue has been the unavailability of capital for major Detroit 3 investment projects. Delphi is GM's former parts-making subsidiary, now an independent company, but still linked to GM by a supplier relationship and labor contracts through the UAW and other unions. It has been operating in bankruptcy since 2005, and was unable to exit as planned in 2008 because a private investor group backed out of a deal to buy its securities for $2.5 billion.[177] GM's plan to acquire Chrysler and merge the two companies, which was widely reported in October 2008, was similarly withdrawn when the companies could not find sufficient funds, including proposed federal financial support, for the deal.[178]

Bush Administration's Financial Plan to Assist Automakers[179]

On December 19, 2009, President George W. Bush announced his plan to provide credit assistance to U.S. automobile manufacturers. He stated that "In the midst of a financial crisis and a recession, allowing the U.S. auto industry to collapse is not a responsible course of action."[180] His plan would provide General Motors and Chrysler with loans for a three month window allowing them to develop plans to restructure into viable companies.[181] "This restructuring will require meaningful concessions from all involved in the auto industry – management, labor unions, creditors, bondholders, dealers, and suppliers."[182]

GM received up to $13.40 billion in subsidized loans: $4.0 billion on December 29, 2008, $5.4 billion on January 16, 2009, and $4.0 billion on February 17, 2009 (contingent of congressional action).[183] Chrysler received $4 billion on December 29, 2008.[184] The loans were issued by Treasury through authority provided for the TARP under EESA.

By February 17, 2009, top executives at General Motors and Chrysler were required to submit restructuring plans to achieve and sustain their long-term viability, international competitiveness

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176 CRS interview with David Regan, National Automobile Dealers Association (February 25, 2009). *Wall St. Journal*, "Auto Industry Faces Squeeze from Fed Lending Program" (February 25, 2009). For more information on the TALF, see CRS Report RL34427, *Financial Turmoil: Federal Reserve Policy Responses*, by Marc Labonte.

177 *Detroit Free Press*, "Delphi's Fate Still Tied to GM's" (November 14, 2008).

178 *Detroit Free Press*, "GM's Efforts to Merge with Chrysler Put on Hold for Now" (November 8, 2008).

179 This subsection was written by James Bickley of the Government and Finance Division. More detail on pensions, health care, executive and labor compensation, and some other issues is provided in subsequent sections of the report.

180 "President Bush Discusses Administration's Plan to Assist Automakers," White House Press Release, Dec. 19, 2008, p. 1. Available at [http://www.whitehouse.gov/news/release/2008/12/20081219.html], visited Dec. 19, 2008.

181 Ibid.

182 Ibid.

183 U.S. Treasury, "Indicative Summary of Terms for Secured Term Loan Facility" [for General Motors], Dec. 19, 2008, p. 14 [Appendix A]. Available at [http://www.ustreas.gov/press/releases/hp1333.htm], visited Dec. 19, 2008.

184 U.S. Treasury, "Indicative Summary of Terms for Secured Term Loan Facility" [for Chrysler], Dec. 19, 2008, p. 14 [Appendix A]. Available at [http://www.ustreas.gov/press/releases/hp1333.htm], visited Dec. 19, 2008.

and energy efficiency of the companies and their subsidiaries.[185] On or before March 31, 2009, each company must submit a report detailing the progress it has made in implementing its restructuring plan.[186]

Stakeholders' Concessions

Each major stakeholder would be required to make concessions in order for General Motors and Chrysler to receive financial assistance.[187]

The Union

The Bush plan was similar to the plan in H.R. 7321, the *Auto Industry Financing and Restructuring Act*, which was passed by the House.[188] The primary difference is the requirement that U.S. employees of General Motors and Chrysler accept reductions in their compensation to an equivalent level of employees in foreign transplants in the United States. The president of the UAW opposes these additional union concessions.

Union Concessions

- "Compensation Reductions": The corporations' restructuring plans will include a reduction in compensation of their U.S. employees to an equivalent level paid by foreign transplants in the United States by no later than December 31, 2009.
- "Severance Rationalization": Payment to idled U.S. employees of the corporations or their subsidies, other than customary severance pay, would be eliminated.
- "Work Rule Modifications": Work rules would be changed in a manner that is competitive with foreign transplants in the United States.
- "VEBA Modifications": Not less than one-half of companies contributions to a new union-administrated healthcare fund will be paid in shares of the respective corporation. VEBA is an abbreviation for "voluntary employees beneficiary association."

Investors

- "Bond Exchange": Outstanding unsecured public indebtedness (other than pension and employee benefits obligations) must be reduced by not less than two-thirds through a debt-for-equity exchange.
- No dividends permitted while government loans remain unpaid.

[185] Ibid., p. 5.

[186] Ibid., p. 6.

[187] This section on concessions is based on "Indicative Summary of Terms for Secured Term Loan Facility" [for General Motors and Chrysler]; and Daniel Dombey and Bernard Simon, "Bush Bails Out Detroit with $17 Billion Package," *Financial Times*, December 19, 2008, pp. 1-2.

[188] "President Bush Discusses Administration's Plan to Assist Automakers," p. 2.

Management

- Benefits plans must be modified or terminated (including golden parachute agreements).
- Limits are imposed on the annual executive compensation of the CEO and the four highest compensated officers (other than the CEO), which are deductible as a business expense. These limits are one-half of the amount (or $500,000 per year) stated in Section 162(m)(5) of the IRS Code.
- The 25 most highly compensated employees (the "Senior Employees") cannot receive or accrue any bonus or executive compensation except as approved by the President's Designee.
- Management of Chrysler and General Motors must report "material transactions" (any asset sale, investment, contract, or commitment) of more than $100 million to the President's Designee for review and approval.
- Private passenger aircraft will be divested.
- Chrysler and General Motors shall maintain and implement a comprehensive written policy on corporate expenses ("Expense Policy"). Any material deviations for the expense policy shall promptly be reported to the President's Designee.

Dealers/Suppliers

- New agreements to lower costs.
- New agreements to reduce capacity.

Treasury Stock Warrants

In return for providing loans to General Motors and Chrysler, the U.S. Treasury receives warrants to purchase common shares of each company. The exercise price per share is the 15 day trailing average price determined as of December 2, 2008. The total number of warrants equals to 20% of the maximum loan amount divided by the exercise price per share. A "warrant limit" is set, however, at 20% of the issued and outstanding common shares. The warrants have a perpetual term and are immediately exercisable, in whole or in part, at 100% of their issue price plus all accrued and unpaid dividends.[189]

Financial Solutions: Bridge Loans and Restructuring[190]

In late 2008, when the Detroit 3 executives requested federal financial assistance, they dismissed the possibility of filing for reorganization under the Bankruptcy Code. They asserted that such a

[189] U.S. Treasury, "Indicative Summary of Terms for Secured Term Loan Facility," pp. 11-13.

[190] This section was written by Carol A. Pettit of the American Law Division.

filing would inevitably lead to liquidation rather than reorganization because consumers would not purchase a car from a company in bankruptcy. A survey by CNW Marketing Research reportedly indicated that 80% of consumers said that concerns about warranty coverage and replacement parts would make them unlikely to buy a car from a company operating in bankruptcy reorganization. However, two later surveys—including another by CNW—indicated that this reluctance could be reduced or neutralized if the government were backing the reorganization.[191] Currently, none of the Detroit 3 has filed a bankruptcy petition, but both GM and Chrysler each recently received some immediate financial assistance from the federal government. GM received additional federal assistance in January and February 2009. Repayment of the loans is due December 29, 2011, but would be accelerated if certain conditions are not met within the first four months of 2009.[192] If one of the loans is accelerated, the affected automaker might have no option other than filing for bankruptcy. This section will look at the terms for the loans as they involve protection of the loan amounts, the restructuring plan, and the restructuring targets. It will also outline basic options available under the Bankruptcy Code if the companies are not able to successfully restructure outside of Chapter 11 reorganization.

Federal Bridge Loans

On January 21, 2009, the House passed H.R. 384. Title III of that bill proposed adding a new title (as Title IV) to EESA. Some of the bill's provisions could allow additional financial assistance to the automakers currently or potentially receiving federal loans. The terms and protections provided in this assistance differ in some ways from those discussed below. As this bill will have no legal effect , unless it is taken up by the Senate, analysis of the changes are beyond the scope of this report.

Collateral and Other Protections

On December 29, 2008, GM and Chrysler each received a loan of $4 billion. Under the terms of the loans, the federal government receives collateral for the loans in the form of first-priority liens on all unencumbered assets and junior liens on all encumbered assets. This provision appears to provide greater protection for the taxpayer dollars that were loaned to the automakers than would otherwise exist in the event of a bankruptcy filing. Additional protections include: (1) Mandatory prepayments of the net cash proceeds from certain transactions, such as sales of any collateral outside the normal course of business;[193] (2) Warrants to purchase common shares of the automaker;[194] (3) Additional guarantors and pledges of collateral from subsidiaries, etc.;[195] and (4) Conversion of the loan to debtor-in-possession (DIP) financing if the automaker is in

[191] John D. Stoll, "Chapter 11 May Not Deter Some Car Buyers," *Wall Street Journal*, December 17, 2008, p. B3. He reports that a Merrill Lynch study indicated 90% of car buyers might buy a car from an automaker in bankruptcy, while a CNW Marketing Research survey indicated 48% would consider it.

[192] The companies' Restructuring Plan Reports must be reviewed by the President's Designee and certified no later than April 30, 2009 to avoid automatic acceleration of the loans' maturity. GM and Chrysler term sheets, p. 7.

[193] *See* Term Sheets, pp. 2-3.

[194] *See* Term Sheets, pp. 11-12.

[195] *See* Chrysler Term Sheet, App. A (requiring consent by majority of holders of Chrysler LLC first lien and second lien indebtedness to pledge MOPAR Parts Inventory and some real estate collateral to the government as Lender); GM Term Sheet, App. A (requiring consent by the common holders of Class A and Class C Membership Interests of GMAC LLC to pledge Class B Membership Interests as well as Preferred Membership Interests to the government as Lender).

bankruptcy. In addition to restrictions on executive compensation discussed later in this report, the terms of the loans also restrict expenses and "material transactions."[196]

Although the terms of the loans are intended to provide protection for taxpayer funds, the protection provided by these terms may not be sufficient to ensure repayment of the loan amount. A lien provides protection only to the extent that the property that is subject to that lien has sufficient value to cover the lien. Likewise, the mandatory prepayment requirement will result in early repayments only when the collateral sold outside the ordinary course of business has sufficient value to equal or exceed all liens against it. Warrants to purchase stock provide protection only to the extent that there is either a market for the warrant or value to the stock that exceeds the warrant price; however, if the automakers are able to successfully restructure, the warrants may allow the government, and thus the taxpayers, to benefit financially from the loan agreements.

The terms of the loan impose first-priority liens only against otherwise unencumbered assets. For other assets, the terms grant the United States only a junior lien. A junior lien provides protection only to the extent that the asset has sufficient value to cover the junior lien *and* all liens that are senior to it. The extent to which either GM or Chrysler has any significant assets that are not encumbered has been questioned.[197] There is also some question about the value of any of the collateral, encumbered or unencumbered, to anyone other than the automaker who currently owns it or to a party who wanted to buy the entire operation as a going concern. Thus, the liens may not fully secure the money that has been loaned to GM and Chrysler.

The warrants to buy common stock may be exercised at a relatively low cost. The number of warrants is determined by dividing 20% of the maximum loan value by the exercise price of the warrants. However, the warrants exercised cannot be higher than 20% of the issued and outstanding common equity interests before the warrants are exercised. The ability to either buy common stock or sell warrants (as with Chrysler warrants in 1983) has value only if the automakers remain in business and their stock value increases above the warrant price.

Each of the loans requires guarantors. For the Chrysler loan, CarCo Intermediate HoldCo I and all direct and indirect domestic subsidiaries are guarantors of the loan on a joint and several basis, meaning that any one of them may be responsible for the entire loan. Additionally, half of the Chrysler loan amount must be guaranteed by FinCo Intermediate HoldCo LC and DaimlerChysler Financial Services Americas LLC. GM's domestic subsidiaries are guarantors of the GM loans, again on a joint and several basis. Additionally, the terms specify that any successor entity of GM would also be a guarantor of the loan, thus preventing sale of GM free and clear of the debt obligation.

The loans also have conditions precedent that are specific to each automaker and involve pledges of inventory, real estate, or membership interests to the U.S. government to provide another layer of protection for the loans.[198]

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[196]*See* Term Sheets, pp. 4-5.

[197] *See* Adam Levitin, "More on the Auto Bailouts," *Credit Slips*, December 20, 2008, at http://www.creditslips.org/creditslips/2008/12/more-on-the-auto-bailouts.html; Adam Levitin, "Auto Bailout," *Credit Slips*, December 19, 2008, at http://www.creditslips.org/creditslips/2008/12/auto-bailout.html.

[198] Term Sheets, App. A.

One protective provision of the loans anticipates the possibility of an automaker's bankruptcy. If a bankruptcy petition is filed, the terms of the loan allow the government to convert the existing loans to "DIP" financing. "DIP" financing provides the debtor-in-possession (or the trustee in a Chapter 7 case) with sufficient funds to meet continuing expenses while the business is either reorganized or liquidated. Generally, DIP financing is a post-petition obligation that enjoys a high priority for being repaid from the bankruptcy estate or under the reorganization plan. In contrast, the government loans are being made while the companies are still operating outside of bankruptcy protection, and the loans are pre-petition debts.[199] One of the purposes of bankruptcy protection is to provide debtors relief from pre-petition debts. This provision in the terms of the loans seems to go against that purpose as well as the purpose for DIP financing. It may also make it more difficult to arrange true DIP financing to use during reorganization.

Accelerated Repayment Provisions

Although the expiration date for the loans is December, 29, 2011, the loans made to GM and Chrysler could become due early in the second quarter of 2009 or possibly even earlier. Under the terms of the loans, the entire outstanding amount of the loans could become due upon an "event of default," as defined in the term sheets.[200] Additionally, if the restructuring plan report submitted by the automakers fails to meet the required standards and is not approved by the President's Designee, the loan would automatically be accelerated and amounts not "invested in or loaned to the Borrower's principal financial subsidiaries"[201] would become due within 30 days.

Restructuring Outside of Bankruptcy

As a condition of the financial assistance, GM and Chrysler must each submit a restructuring plan designed to achieve certain goals. Additionally, they must "use their best efforts to achieve ... [restructuring] targets."[202] The goals involve financial viability and vehicle production. The targets involve a "Bond Exchange,"[203] "Labor Modifications,"[204] and "VEBA Modifications."[205] For these restructuring targets, each company must submit to the President's Designee agreements that have been signed by company representatives and applicable representatives of the affected groups.[206]

One of the advantages of reorganizing under the Bankruptcy Code is the ability to modify creditors' claims without the agreement of all of the affected creditors. Outside of bankruptcy, the automakers will not have this advantage as they attempt to design a restructuring plan and achieve sufficient cooperation from creditors to allow the plan to succeed. An additional advantage to reorganization in Chapter 11 is the ability to reject most executory contracts and

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[199] Whether a court would honor the pre-petition contract provision to convert the government loans to DIP financing following a bankruptcy filing is beyond the scope of this report. If a court were to honor the provision, the debtor might encounter more difficulty arranging additional DIP financing to carry it through its reorganization.

[200] Term Sheets, p. 10.

[201] Term Sheets, p. 7.

[202] Term Sheets, p. 5.

[203] Term Sheets p. 5.

[204] Term Sheets, p. 6.

[205] Term Sheets, p. 6.

[206] Term Sheets p. 6.

leases. Without §365 of the Bankruptcy Code, automakers may be unable to terminate franchise arrangements with their dealerships without a significantly greater cost than they would incur if reorganizing in Chapter 11.

Among the restructuring targets are several modifications to existing collective bargaining agreements (CBAs) that govern wages, work rules, and benefits, including retiree health benefits. The targets may or may not involve terms that union members will be willing to accept. Chapter 11 of the Bankruptcy Code includes two code sections that allow the Bankruptcy Court to approve a debtor's request to reject or modify CBAs when the debtor and union have been unable to reach a negotiated agreement and the Court finds that the debtor's proposals have been rejected without good cause.[207] This provision does not exist outside of bankruptcy. Presumably, the union workers are concerned with the continued survival of the automakers and will be willing to negotiate with the automakers if they believe that the CBA must be changed to ensure the company's survival. However, in the non-bankruptcy environment there is no judge to evaluate the balance of equities to determine whether the union members are being asked to make disproportionate sacrifices to aid the company's survival. Further, there appears to be no provision for transparency that would allow all creditors to evaluate the restructuring plan as a whole and their place in it.

Bankruptcy Procedures in Case Restructuring Fails

Most domestic corporations have two choices when filing bankruptcy: Chapter 7[208] or Chapter 11.[209] Chapter 7 involves liquidation, effectively ending the corporation's existence. Chapter 11 involves reorganization, generally allowing the company to modify contract obligations and debts so it can be financially viable and continue its operations long-term. However, some cases filed under Chapter 11 result in liquidation.

Under the Bankruptcy Clause of the U.S. Constitution,[210] Congress may create sections of the Bankruptcy Code (shortened in this part of the report to simply "the Code") to address issues of a particular type of industry or entity so long as the laws are uniform rather than for a specific, named debtor. In the past, during times of financial turmoil, Congress has modified the existing bankruptcy law. Examples include Chapter 9: municipalities (11 U.S.C. § 901 *et seq*); Subchapter IV of Chapter 11: railroads (11 U.S.C. §§ 1161-1174), and Chapter 12: farmers and fishermen (11 U.S.C. § 1201 *et seq*). Congress has the power to modify the Code to customize reorganization for the automotive industry.[211] Therefore, the following discussion of Chapters 7 and 11 generally describes the characteristics of these two chapters of the existing Code, but should not be interpreted as constraining Congress's ability to enact laws that would modify the provisions of these chapters as they apply to the automotive industry or to create an additional chapter of the Code that is applicable to the automotive industry.

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[207] *See* 11 U.S.C. §§ 1113, 1114.

[208] 11 U.S.C. § 701 *et seq*.

[209] 11 U.S.C. § 1101 *et seq*.

[210] Art. I, sec. 8, cl.4.

[211] Since the Bankruptcy Clause empowers Congress to enact "*uniform* laws," modifications could be industry-specific, but not company-specific.

Chapter 7

In Chapter 7 of the Bankruptcy Code,[212] a trustee is chosen to represent and administer the bankruptcy estate.[213] The trustee takes over the company's assets, sells them, and distributes the proceeds to the creditors who have presented valid claims. There is a hierarchy to the distribution of the proceeds.[214] Secured creditors generally will receive payment up to the amount of their secured interest. Unsecured creditors include those with priority claims and those with non-priority claims. Priority claims are paid in the order of priority so long as there are funds available.[215] When the funds are depleted, no more claims are paid even if they are priority claims. After all priority claims are paid, remaining funds are distributed on a pro rata basis to the remaining unsecured creditors.

Chapter 11

Chapter 11 of the Bankruptcy Code provides companies with a way to continue in business while at the same time receiving protection from creditors. It also provides them with opportunities to modify debts and contracts[216] in a way that enhances the company's possibilities of recovering from financial troubles. It is generally believed that a business is worth more as a going concern than as an assortment of assets that are sold separately. Survival of the company benefits creditors, employees, and the community in which the business is located. In most cases, the company retains its management. Generally, a trustee is appointed only when management is removed "for cause."[217] However, even when a trustee is not appointed, the company may decide to turn operation of the business over to a "turnaround specialist" who has experience in guiding companies through Chapter 11 and into solvency.[218]

The reorganization plan is the key to a Chapter 11 bankruptcy. The plan is a proposal, generally by the debtor-in-possession (DIP), as to how the valid claims of each class of creditors are going to be resolved.[219] To be confirmed, the plan must be agreed to by at least one impaired class of claims. Additionally, each holder of a claim in an impaired class must accept the plan unless the amount received under the plan is no less than the amount that would have been received under Chapter 7.[220] In a standard Chapter 11 bankruptcy, the plan proposal and negotiation with the creditors takes place after the company has filed for bankruptcy. In a prepackaged Chapter 11, the

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[212] The Bankruptcy Code is 11 U.S.C. § 101 *et seq.*

[213] The "trustee" of the bankruptcy estate is different from the U.S. Trustee, who is a member of the U.S. Trustee Program and appointed by the U.S. Attorney General. A private trustee, who represents a bankruptcy estate, is either appointed by the U.S. Trustee or elected by the creditors. 11 U.S.C. §§ 701-703.

[214] *See* 11 U.S.C. § 726.

[215] *See* 11 U.S.C. § 507.

[216] Most executory contracts can be accepted or rejected, with the court's approval, under 11 U.S.C. § 365. Modification of collective bargaining agreements (CBAs) is subject to greater limitation under 11 U.S.C. § 1113. Similarly limited is modification of retiree health benefits under 11 U.S.C. § 1114.

[217] "Cause" generally involves fraud, dishonesty, incompetence, or mismanagement. *See* 11 U.S.C. § 1104. Note, however, that under the Railroad Reorganization Act, a trustee *must* be appointed. 11 U.S.C. § 1163.

[218] An example of such a specialist in the automotive industry is Robert S. Miller, who has been leading parts-maker Delphi through its bankruptcy since 2005. He earlier led Bethlehem Steel through its Chapter 11 bankruptcy and its sale to the International Steel Group (eventually, the company was acquired by ArcelorMittal Steel).

[219] *See* 11 U.S.C. § 1123 (Contents of Plan).

[220] *See* 11 U.S.C. § 1129 (Confirmation of Plan).

company does not file for bankruptcy until negotiations with creditors have resulted in a confirmable plan that is presented when filing the bankruptcy case. This may have the effect of reducing uncertainty about the company's future. Negotiating a prepackaged Chapter 11 does take some time, so it is unclear to what extent a "prepack" would benefit the automakers. In their requests for government financial assistance the automakers said they were rapidly running out of operating capital. The assistance they received was less than requested. It is possible that conditioning receipt of additional government assistance on a prepackaged agreement among the creditors might encourage creditors to quickly reach negotiated modifications with debtor companies. An additional benefit to a prepack is the elimination, in some cases, of the need for arranging "DIP financing."

DIP financing involves agreements to provide funds to a debtor-in-possession to allow it to meet expenses incurred during reorganization. If suppliers have refused to continue shipments without prepayment, DIP financing can provide the means of making the prepayment. In some cases, simply having the loan agreements is sufficient to restore supplier's confidence and willingness to ship without prepayment. If one or more of the Detroit 3 filed under Chapter 11, it is possible that government loans could provide the DIP financing. The DIP financing lender can enjoy the highest protection available in a Chapter 11 bankruptcy. When used for current operating expenses, the financing is an administrative expense under 11 U.S.C. § 503(b)(1) and would be a priority claim under 11 U.S.C. § 507(a)(2).[221]

Section 507 priorities are important in a Chapter 11 bankruptcy and must be addressed in the reorganization plan, but Chapter 11 provides greater flexibility in the payment of these claims than does Chapter 7. The holders may agree either to modify their claims or to accept alternative payment arrangements rather than receiving full payment before other unsecured claims are paid. If there is no such agreement, the Code prescribes treatment for each priority claim that must be met for the plan to be confirmed. However, some of the statutory treatments allow deferred payments or installment payments of amounts due.[222] This added flexibility for resolving priority claims may increase the amounts available to pay other unsecured claims. It may also make it possible for the company to meet its operations expenses both short-term and long-term.

Automaker Response to Bankruptcy as an Alternative[223]

Both GM and Chrysler addressed the option of some type of Chapter 11 reorganization in bankruptcy, as part of their February 2009 viability plans. Both companies have said that they have studied the bankruptcy option. They have concluded that it would be more costly than the "out-of-court" plans that they have proposed. If continued operation after reorganization is a desired outcome, bankruptcy might also be more costly in terms of federal support, they calculate.

GM presents a comprehensive analysis of its bankruptcy options. In summary, it states that bankruptcy is unlikely to be quick or easy, noting that, in one-third of all cases involving reorganization of companies with more than $1 billion in assets since 1995, bankruptcy proceedings took two years or longer, while only in 3% of cases did companies exit the

[221] Greater protection may be available to DIP lenders if credit cannot be obtained without such protection. *See* 11 U.S.C. § 364(c), (d).

[222] *See* 11 U.S.C. § 1129(a)(9).

[223] This subsection was written by Stephen Cooney, Specialist in Industrial Organization and Business.

proceedings in 90 days or less. And, as stressed frequently in testimony by CEO Wagoner, market research has indicated that 80% of potential car buyers would not purchase a vehicle from a company that had filed for bankruptcy. Hence, not only would the process be more expensive, GM fears, but there is a strong possibility that the company would not exit the process as a going concern.[224]

GM discusses bankruptcy costs and considerations in more detail in a special appendix to its viability plan. It lists three possible Chapter 11 options:

- "Pre-solicited or Pre-packaged Chapter 11." This approach would require bondholders to agree 100% to debt restructuring plan prior to filing, including resolution of the VEBA liabilities. The assumption is that such a process could be completed in about 60 days. However, there would be "a quite severe negative revenue impact during the ... proceeding," and continuing serious negative impact even after exit from Chapter 11. GM calculates that this option would cost $36 billion in government financial support, especially because of increased support required for suppliers. This compares to a total of $27 billion for the process GM proposes (roughly $23 billion for GM, under the baseline market conditions, and $4 billion for suppliers). GM also estimates that its net present value would be less than under its proposed non-bankruptcy plan.
- "Pre-negotiated Cram-Down Plan." This option would take a minimum of 90 days, GM believes. It involves a more aggressive reduction of debt, including greater or possibly complete "equitization" of its VEBA liability. However, GM also believes that such a maneuver would be "vigorously contested" by the UAW, possibly resulting in protracted negotiations and ending in a traditional bankruptcy. GM calculates that the "cram-down" process would cost $46-55 billion in government support – including higher levels for GM and suppliers – and would not leave the company with any positive NPV.
- "Traditional Chapter 11 Case." This is the worst of the possible options in the GM view. An 18-24 month process would require DIP financing from the Treasury so that GM could continue to operate. Including increased financial support of suppliers, the total Treasury cost could be as high as $86 billion, with a total financial cost possibly in excess of $100 billion – and no assurance that the company could successfully exit from the process.[225]

By comparison with the GM report, Chrysler offers a cursory "orderly wind down" scenario. Failure to gain its incremental funding request from the U.S. government and concessions from other stakeholders would lead to a Chapter 11 bankruptcy, the company states. This would require an estimated $24 billion in DIP financing. If such financing cannot be secured, the result would be liquidation over a 24-30 month period. That would mean a closure of 51 Chrysler manufacturing and parts facilities and the loss of 40,000 jobs for people directly employed by Chrysler. Chrysler also says that 3,300 dealers employing 140,000 people would also go out of business, and it further calculates the other social and business costs in the U.S. economy.[226]

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[224] "Bankruptcy considerations" are summarized in *GM 2009-14 Restructuring Plan* (February 2009), pp. 36-37.

[225] The three bankruptcy scenarios are presented in *GM 2009-14 Restructuring Plan* (February 2009), Appendix L (pp. 103-108).

[226] *Chrysler Viability Plan* (February 2009), pp. U162-163.

The companies emphasize the negative consequences and the high costs of bankruptcy filings, as opposed to their preferred viability plans, which would involve continued federal support for them and their suppliers. As both GM and Chrysler have repeatedly emphasized that a formal bankruptcy filing could have a damaging effect on sales, it is clearly a course of action both companies want to avoid. But some commentators have urged that a formal proceeding under Chapter 11 should be considered as an option, because such a course does provide a framework in which all participants may be forced to accept concessions to provide firms with a reasonable chance to restructure and continue as a going enterprise. Douglas Foley, an experienced practitioner of bankruptcy law in private practice has said, in describing these companies' cost estimates, "The restructuring plans appear to overstate the costs and understate the benefits of the Chapter 11 reorganization process."[227]

Pension and Health Care Issues

Pensions and Pension Insurance[228]

The Pension Benefit Guaranty Corporation

Pension benefits provided under qualified defined benefit plans are insured up to certain limits by the Pension Benefit Guaranty Corporation (PBGC), a government corporation established by the Employee Retirement Income Security Act of 1974 (ERISA, P.L. 93-406). In 2008, the PBGC insured the pensions of approximately 44 million workers and retirees in more than 29,000 private-sector defined benefit pension plans. The PBGC does not insure pension benefits provided by state and local governments or benefits under defined contribution plans, such as 401(k) plans. The maximum pension benefit guaranteed by the PBGC is set by law and adjusted annually. For plans that terminate in 2009, workers who retire at age 65 can receive up to $4,500 a month ($54,000 a year). The guarantee is lower for those who retire early or when there is a benefit for a survivor. The guarantee is higher for those who retire after age 65.

The PBGC receives no funds from general tax revenues. The PBGC collects insurance premiums from employers that sponsor insured pension plans, earns money from investments, and receives funds from pension plans it takes over. When the PBGC takes over a pension plan, it assumes responsibility for future benefit payments to the plan's participants, up to the limits set in law. In general, the PBGC takes over only plans that are underfunded and that the employer is not expected to be able to fully fund because it has filed for bankruptcy or is experiencing serious financial difficulties that put its ability to fund its pension obligations at risk. Consequently, in most cases in which the PBGC takes over a pension plan, it assumes pension liabilities that are greater than the assets held by the pension plan it has taken over. In recent years, the PBGC has taken over several large pension plans that were significantly underfunded. As a result, the PBGC's liabilities exceed its assets.

According to the most recent annual report of the PBGC, its insurance program for single-employer plans had assets of $61.6 billion against liabilities of $72.3 billion on September 30,

[227] Comment to CRS by Douglas M. Foley, Chairman, Restructuring and Insolvency Department, McGuireWoods LLP (March 4, 2009).

[228] This subsection was written by Patrick Purcell of the Domestic Social Policy Division.

2008. If the current economic downturn were to result in the termination of several large defined benefit plans with significant underfunding, the PBGC's deficit could grow rapidly. Although ERISA does not provide for supplementing the PBGC's income with general tax revenues, it is likely that if the PBGC were unable to meet its financial obligations to the participants whose pensions it has taken over, there would be considerable political pressure on Congress to provide the PBGC with the financial resources necessary for it to continue to pay benefits to retirees and their surviving dependents.

In order to qualify for the tax exemptions and deferrals that Congress has authorized for employer-sponsored retirement plans, defined benefit plans must meet certain requirements established under ERISA and the Internal Revenue Code (IRC). One requirement is that the plans must be "fully funded," i.e., the plan's assets must equal or exceed its liabilities. In most cases, the sponsor of a plan that is underfunded is required to make additional contributions to the plan that would amortize the underfunding in seven years or less.[229] In addition to meeting the funding requirements of ERISA and the IRC, companies that sponsor defined benefit plans must report certain information about the plans annually to the Internal Revenue Service. This information is available to the public, but the financial data is often out of date by the time it is released to the public. Publicly traded companies must report information about their pension plans to the Securities and Exchange Commission (SEC). These reports are generally available to the public immediately.

Funded Status of Auto Manufacturers Pension Plans

GM, Ford, and Chrysler each maintain one or more defined benefit pension plans for workers employed in the United States.[230] The companies have separate plans for union members and nonunion workers. According to the information filed by GM and Ford with the SEC in February 2008, both companies' plans for U.S. employees had assets in excess of plan liabilities at year-end 2007. GM reported a pension surplus of $18.8 billion and Ford reported a pension surplus of $1.3 billion (see **Table 3**). GM's pension surplus was equal to about 22% of its pension plan liabilities, while Ford's surplus was much smaller, amounting to 2.8% of its pension liabilities. As a privately-held company, Chrysler is not subject to the same SEC reporting requirements as are GM and Ford. Current information about Chrysler's pension plans was not available at the time this CRS report was written.[231]

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[229] For a more detailed description of the funding requirements for defined benefit plans, see CRS Report RL34443, *Summary of the Employee Retirement Income Security Act (ERISA)*, by Patrick Purcell and Jennifer Staman.

[230] ERISA governs only pensions provided to workers employed in the United States.

[231] According to information filed by Chrysler on the IRS Form 5500 for 2005, its pension liabilities at that time totaled approximately $15.8 billion and its assets were valued at about $15.0 billion.

Table 3. Funded Status of General Motors and Ford Pension Plans for U.S. Employees, Year-end 2007

(amounts in millions of dollars)

	General Motors	Ford Motor Co.
Benefit obligation (plan liabilities)	$85,277	$44,493
Fair value of plan assets	104,070	45,759
Surplus or (Deficit)	18,793	1,266
Surplus (Deficit) as a percentage of liabilities	*22.0%*	*2.8%*
Estimated allocation of plan assets		
Equity securities	26%	51%
Debt securities	52%	46%
Real estate, private equity, and other assets	22%	3%

Source: Company filings of Form 10-K with the Securities and Exchange Commission, Feb. 2008.

Several factors have affected the funding status of the automakers' pension plans going forward. Among the most important of these factors are:

- Stock prices fell sharply in 2008, depressing the value of pension fund assets. This would tend to reduce pension surpluses and increase pension deficits.
- Long-term interest rates rose during 2008, reducing pension plan liabilities. This would tend to increase pension surpluses and reduce pension deficits.
- Plan participants have accrued an additional year of pension benefits.
- Plan sponsors have, in some cases, made contributions to their pension plans.
- Certain one-time events may have occurred including plan amendments to raise or lower future benefit accruals, the sale or acquisition of businesses with pension liabilities, and the expiration or initiation of collective bargaining agreements.

GM Pension Fund

In its most recent quarterly filing with the SEC, GM noted several factors that reduced its pension surplus, including

- investment losses of $6.3 billion in its pension plan asset portfolio;
- recording a $2.7 billion liability related to a settlement agreement with the United Auto Workers (UAW) related to retiree medical care;
- recording a $2.7 billion liability due to the increase in the monthly pension benefit paid to salaried employees as compensation for the elimination of post-65 healthcare benefits;
- the transfer of $2.1 billion of Delphi Corporation pension liabilities to GM; and
- recording a $2.0 billion cost due to special workforce attrition programs for union members.

GM reported in November 2008 that its plan for hourly workers was underfunded by $500 million as of September 30 and that its plan for salaried employees was overfunded as of June 30. The plans were overfunded on a combined basis. GM stated that it did not expect to have to make any contributions to its defined benefit plans for 2008.[232]

Ford Pension Fund

The two most significant factors affecting the funding status of Ford's pension plans since year-end 2007 are the decline in the stock market and in the increase in long-term interest rates. Based on the estimated percentage of Ford's pension plan assets invested in stocks, if its pension fund assets performed as the major market indices did in 2008, Ford's pension assets invested in equities would have lost $8.2 billion to $9.4 billion in value through the first eleven months of 2008. This would represent 18% to 20% of the value of assets held by Ford's U.S. pension plans at year-end 2007. The effect of the decline in asset prices was offset to some extent by the rise in long-term interest rates in 2008.[233] Rising interest rates reduce the present value of pension liabilities. In its most recent 10-K filing with the SEC, Ford estimated that an increase of 0.25% in interest rates would reduce its pension liabilities by 2.3%. Ford estimated that with an increase in the discount rate of 1.0% in 2008, its pension liabilities would have fallen by $4.1 billion. This would represent a 9.2% decline in Ford's year-end 2007 pension liabilities.

In its SEC filing for the third quarter of 2008, Ford stated that during the first nine months of 2008, it "contributed $1.9 billion to our worldwide pension plans," and that the company expected to contribute an additional $300 million in 2008. Although the statement did not specify how much of this contribution was made to its U.S. plans, less than 10% of Ford's pension contributions in 2007 and less than 15% of its contributions in 2006 were made to its U.S. defined benefit plans.

PBGC Actions in Late 2008 and Early 2009

In a November 2008 interview with *The Wall Street Journal*, PBGC Director Charles Millard reportedly characterized the funding of the automakers' plans as "OK," but said that the agency was concerned that the cost of funding early retirement incentives could cause financial difficulties for their pension plans in future years.[234] During the week of November 24, the PBGC sent letters to General Motors, Ford, and Chrysler stating the agency's concern that early retirement incentives offered to employees could adversely affect the funding of their pension plans, and asking the companies to inform the PBGC of the costs of their buyout and early retirement programs.[235] The PBGC is concerned that buyout and early retirement programs were

[232] "General Motors Corp. does not expect to have to make any pension contributions to meet minimum funding requirements in the next three to four years, even though its funded status declined in the first nine months of 2008 because of negative investment returns and recent employee-related cutbacks, according to its third-quarter financial report Friday, November 7." "GM Doesn't Foresee Required Pension Contributions," *Workforce Management*, November 11, 2008.

[233] Watson Wyatt reported that as of September 30, discount rates had increased by about 1 percentage point since year-end 2007, and that yields on AA rated corporate bonds had risen by almost 80 basis points from the end of September to mid-November.

[234] Early retirement programs could result in pensions being paid earlier than was originally forecast, creating an unfunded liability for the plans.

[235] *Detroit Free Press*, "Agency Concerned about Detroit 3 Buyout Costs" (November 29, 2008).

not fully accounted for when the automakers estimated their pension liabilities, and that these programs could "undermine the state of the plans."[236]

PBGC Director Millard added, in a separate November 2008 statement, that if an automaker were to initiate a termination of a pension plan while in bankruptcy, the agency would oppose the termination.[237] According to Mr. Millard's public statements, the PBGC would argue in federal court that the companies should maintain their defined benefit pension plans.[238]

In January 2009, the PBGC clarified and somewhat altered the tenor of its earlier comments on the pension plans of GM, Ford, and Chrysler. While they are "well funded" according to the accounting procedures of the Securities and Exchange Commission, their pensions were collectively underfunded by as much as $41 billion according to the accounting rules followed by the PBGC when a plan terminates.[239] The PBGC estimates that if all three automakers were to declare bankruptcy and terminate their pension plans, the agency would pay out $13 billion of the $41 billion shortfall to plan participants and beneficiaries. The remainder represents benefits that PBGC could not pay because of legal limits on the benefits that are insured by the PBGC.

The PBGC has estimated that GM's plans are underfunded by $20 billion (20%) on a termination basis. Chrysler's plans would be $9.3 billion (34%) underfunded if they were terminated. Ford's plans are estimated to have an $11.7 billion (27%) deficit under the termination accounting rules. Outgoing PBGC Director Millard noted that if the companies were financially healthy and were able to meet all of their future funding obligations, the current underfunded status of their pension plans would not necessarily pose a risk to the PBGC. However, said Millard, the possibility that one or more of the companies will file for bankruptcy protection and terminate their pension plans poses a financial risk for the PBGC. Millard stated that as of January 2009, the risk to the PBGC "is significantly greater than it was six or seven months ago."[240]

In effect, GM's February 2009 report confirmed this PBGC concern. The company determined that the pension fund value had declined by $20 billion in the latter half of 2008, leaving it undervalued by 13%, and possibly requiring future net cash contributions.[241] An analysis by the *Detroit Free Press* indicated that only $11.3 billion of the loss in 2008 was owing to asset devaluation. The remaining $8.7 billion had been taken out of the pension fund, which at the time had been considered overfunded, to pay for employee buyouts and to make contributions to the VEBA. Olivia Mitchell, a pension law expert at the University of Pennsylvania's Wharton School was quoted in the article as questioning whether the GM move, while legal, was consistent with the "promise" of pension obligations.[242]

[236] *Wall St. Journal*, "Pension Agency Sounds Alarm on Big Three," (November 28, 2008).

[237] "Federal Pension Agency Asks Automakers for Details on Buyouts," *Bloomberg News*, November 28, 2008.

[238] *New York Times*, "GM's Pension Fund Stays Afloat, Against the Odds" (November 25, 2008).

[239] This is known as the "termination liability," for which the PBGC may ultimately become responsible. "Agency Raises Concerns About Car Makers' Pensions," *Wall St. Journal*, January 9, 2009.

[240] *Detroit News*, "Big 3 Pension Gap Grows" (January 10, 2009).

[241] *GM 2009-14 Restructuring Plan* (February 2009), p. 31 and Table 13.

[242] *Detroit Free Press*, "Questions Arise from GM's Use of Pension for Buyouts, VEBA Trust" (March 1, 2009).

Health Care Issues[243]

If an automaker files for bankruptcy, health care coverage for both active and retired workers and their families could be at risk. The risk differs depending on whether the bankruptcy is a liquidation under Chapter 7 or a bankruptcy reorganization under Chapter 11, whether individuals are still working or retired, and whether they are covered by a collective bargaining agreement. Individuals' options for obtaining alternative coverage, either private or public, also differ; factors such as age or Medicare eligibility, income, and family circumstances could be important. The 111th Congress might consider broad health care reforms that could provide further options at some point in the future.

The future funding status for retiree health insurance for workers covered by the UAW's collective bargaining agreement may be uncertain. During the 2007 contract negotiations, each of the three firms reached separate agreements with the UAW to contribute a percentage of their projected retiree health liabilities to a Voluntary Employees' Beneficiary Association. Following their initial VEBA contributions in 2007, the firms agreed to make additional contributions to the VEBA trust beginning in 2008. In total, the Detroit 3 contributions are projected to fund 64% of their future retiree health obligations.[244] Before January 1, 2010, the automakers remain responsible for funding retiree health. By 2010, the VEBA will be managed by an independent board of trustees appointed by the UAW and the court.[245] The automakers will have no funding responsibilities after this point.[246]

However, the size of the actual 2008 to 2010 contribution to the VEBA could depend on the financial conditions of the Detroit 3. For example, under Chapter 11, the Detroit 3 and the UAW may renegotiate health insurance benefits during the reorganization process. In addition, increasing the share of funding of the VEBA from stock could affect the value of its funds.

Bankruptcy filing could also threaten health plans for union workers and nonunion workers and retirees.[247] Under a liquidation, there would presumably be no health plans remaining for any former workers or retirees. In the event of a bankruptcy reorganization under Chapter 11, if a firm continues to provide health benefits to its workers, certain individuals would be entitled to purchase health benefits through COBRA (Title X of the Consolidated Omnibus Budget Reconciliation Act of 1985, P.L. 99-272).

Under COBRA, employers who offer health insurance must offer the option of continued health insurance coverage at group rates to qualified employees and their families who are faced with loss of coverage due termination of employment, a reduction in hours, or certain other events.

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[243] This subsection was written by Carol Rapaport, Janemarie Mulvey, and Hinda Chaikind of the Domestic Social Policy Division.

[244] GM and Ford Investor Presentations, *UAW. Chrysler Report*, 2007.

[245] There is pending litigation including possible appeals or court challenges that could potentially affect the VEBA terms and conditions.

[246] For more information see CRS Report R40420, *Health Insurance Premium Assistance for the Unemployed: The American Recovery and Reinvestment Act of 2009*, coordinated by Janemarie Mulvey.

[247] One option for subsidizing the purchase of health insurance, that could be available although is unlikely at this time for the Detroit 3 workers, is the Health Coverage Tax Credit (HCTC) for certain categories of affected workers. The HCTC covers 65% of the premium for qualified health insurance purchased by an eligible taxpayer. For further information on the HCTC see CRS Report RL32620, *Health Coverage Tax Credit Authorized by the Trade Act of 2002*, by Bernadette Fernandez.

Employers are permitted to charge the covered beneficiary 100% of the premium (both the portion paid by the employee and the portion paid by the employer, if any), plus an additional 2% administrative fee. The continued coverage for the employee and the employee's spouse and dependent children must continue for 18 months.

P.L. 111-5 includes COBRA premium subsidies of 65% to help the unemployed afford health insurance coverage from their former employer. The subsidy is available for up to 9 months to those individuals who meet the income test and who are involuntarily terminated on or after September 1, 2008, and before January 1, 2010. There will also be a special extended enrollment period for two groups of unemployed who were involuntarily terminated from their employment on or after September 1, 2008: (1) individuals who did not elect COBRA coverage at the time, and (2) individuals who had chosen COBRA coverage after September 1, 2008, but dropped their coverage because they could not afford the premiums. Persons in these two groups are to be notified by their former employer within 60 days of enactment, and will have an additional 60 days after being notified to elect COBRA and receive the subsidy.

A retiree may have access to COBRA coverage in the event that a former employer terminates the retiree health plan as a result of a bankruptcy reorganization under Chapter 11.[248] This option would only be available to those retirees who are receiving retiree health insurance. In this case, the COBRA coverage can continue until the death of the retiree. The retiree's spouse and dependent children may purchase COBRA coverage from the former employer for 36 months after the retiree's death. However, beginning on January 1, 2009, GM followed the lead of Ford and Chrysler, and stopped providing non-union retirees with health benefits once they become eligible for Medicare at age 65. Instead, retirees will receive additional funds which they may choose to use to purchase Medicare supplemental policies. Similarly, beginning January 1, 2010, GM will no longer provide health benefits for 2 groups of non-union retirees under 65: (1) those eligible for Medicare, and (2) those hired since 1993. Individuals who are not receiving health insurance could not qualify for COBRA.

The 111th Congress may consider broad health care reforms that could help some autoworkers, either active or retired, and their family members to obtain and pay for health care coverage. While it is unclear when specific broad health care reform proposals will be developed, let alone whether they will be adopted, the possibility of reforms might be taken into account as policy makers consider the financial future of the auto industry and its workers.

Stipulations and Conditions on TARP Loans to the Auto Industry

Most supporters and advocates of assistance to the Detroit 3 through a program of federal direct loans have acknowledged that such assistance may be accompanied by conditions placed by Congress on the Detroit 3 and their management. In the 110th Congress, S. 3688 and H.R. 7321 both would have addressed this issue, and in similar ways. In the 111th Congress, the House

248 If the retiree coverage is eliminated and it differs from coverage offered to active employees, "presumably the obligation can be satisfied if the affected retirees are offered coverage similar to that provided to active employees," according to the American Bar association, Joint Committee of Employee Benefits (Employee Benefits in Bankruptcy: COBRA Health Continuation Coverage Rules. Teleconference/Live Audio Webcast, May 12, 2004).

addressed these conditions in H.R. 384: in §409 specifically for the auto industry, and in §102 for all recipients of TARP funds more generally. None of these measures has been enacted into law.

The present report has already included an outline of the Bush Administration's conditions and stipulations placed on the loans planned for GM and Chrysler, especially relating to loan repayment and financial oversight. The following section concludes the report by reviewing in more detail:

- Restrictions on executive privileges and compensation;
- Requirements in company restructuring plans;
- Restructuring targets required of the companies, including competitive pay and benefits for the hourly workforce.

Executive Privileges and Compensation[249]

Until the facility is repaid in full and the U.S. Treasury no longer owns any of their equity securities, the following restrictions on executive privileges and compensation will apply to GM and Chrysler. Such standards generally apply to the treatment of the chief executive officer, chief financial officer, and the next three most highly compensated executive officers. A number of the requirements derive from Section 111(b) of the EESA and subsequent Treasury Department interpretive guidelines, while others do not.[250]

Required Compliance with the Overall Executive Compensation Requirements in Section 111(b) of the EESA. Both companies are subject to the overarching executive compensation and corporate governance requirements established in Section 111(b) of the EESA and the Treasury Department guidelines for companies involved in the TARP's Systematically Significant Failing Institutions' (SSFI) program.[251] Briefly, the section in the EESA requires participating institutions to ensure that their five most senior executive officers, including the CEO: (1) do not take unnecessary and excessive risks that threaten the value of the company; (2) are subject to provisions that allow for the company's recovery or the clawback of any bonus or incentive compensation paid to them that is based on financial statements of such things such as earnings

[249] This subsection was written by Gary Shorter, Government and Finance Division.

[250] P.L. 111-5 further limits executive compensation for financial institutions receiving assistance under §111 of EESA by amending the section. The rules appear to be intended to be applied to all recipients of TARP funds, including automotive companies and must be adopted by Treasury to be implemented. Among other things, for applicable companies, it will: (1) require the adoption of standards that prohibit paying certain executives any bonus, retention or incentive compensation other than certain long-term restricted stock that has a value not greater than one-third of the total annual compensation of the employee receiving the stock. (The determination of how many executives will be subject to these limitations depends on the amount of funds received by the TARP recipient.); (2) require the adoption of standards that requiring the recovery of any bonus, retention award or incentive compensation paid to senior executive officers and the next 20 most highly compensated employees based on earnings, revenues, gains or other criteria that are later found to be materially inaccurate; (3) require the adoption of standards that prohibit any compensation plan that would encourage manipulation of the reported earnings of the firm to enhance the compensation of any of its employees; (4) require the adoption of standards that prohibit the provision of "golden parachute" payment to an SEO and the next five most highly compensated employees for departure from a company for any reason, except for payments for services performed or benefits accrued; (5) require the adoption of standards that prohibit any compensation plan that would encourage manipulation of the reported earnings of the firm to enhance the compensation of any of its employees; and (6) require each firm to allow its shareholders the opportunity to participate annually in a non-binding vote on senior executive compensation.

[251] U.S. Department of the Treasury Notice 2008-PSSFI.

that are later proven to be materially inaccurate; and (3) are not allowed to receive golden parachute payment from the company during the time in which the Secretary of the Treasury holds an equity stake in the company.

Strictures on the Provision of Golden Parachutes. Both companies are required to modify or change the benefit plans, arrangements and agreements, including golden parachute agreements for all senior officials to the extent necessary to be in compliance with the aforementioned Section 111(b) of the EESA and applicable guidelines.

Golden parachutes are defined in the relevant Treasury Department interpretation as payments of more than three times an executive's average base compensation from a firm over the five most recent years in the event of the official's involuntary termination, or bankruptcy or receivership of a financial institution. It is the definition of a golden parachute that the department has used for tax purposes for many years, and it is the applicable definition for the financial firms that are participating in the EESA's TARP Capital Purchase Program.[252] Explaining the rationale for the proscription in the EESA, a Treasury Department official observed that " ... our key focus is that we do not want to reward poor performance ... "[253]

However, there are some concerns that the provision sets too high a level of reward to have much impact. Some executive compensation consultants stress that it is uncommon for executive severance payments to reach the size that would trigger the provision's parameters. They note that such relatively large payments do not normally occur unless an executive is released without cause immediately after a "change in control" situation, usually involving a corporate takeover.[254] Echoing that view, in a letter of October 29, 2008, to Treasury Secretary Henry Paulson, Senate Majority Leader Harry Reid and House Speaker Nancy Pelosi said "... [G]iven the level of public outrage over these compensation schemes.... We would urge you, in particular, to consider the possibility of further restrictions on the use of 'golden parachutes' at such [participating] institutions ... "[255]

Under the compensation strictures outlined in Treasury guidelines for participants in the EESA's SSFI program, GM and Chrysler are subject to more restrictive criteria on golden parachute payments: any compensation that is paid by reason of an involuntary termination from employment or in connection with bankruptcy, insolvency, or receivership is subject to golden parachute treatment even if the total amount of such compensation is less than three times an executive's average taxable compensation during the five most recent years.

Required Compliance with Executive Compensation Corporate Limits on Tax Deduction. Both companies must comply with the limits on annual executive compensation tax deductions imposed by Section 162(m)(5) of the Internal Revenue Code of 1986.

In 1993, in response to outrage at executive pay levels, P.L. 103-66 added section 162(m), titled "Certain Excessive Employee Remuneration," to the Internal Revenue Code. It imposes a $1

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[252] This definition is much broader than the popular definition of a golden parachute, which is severance payment to an executive in the event that a company undergoes a change in control.

[253] Chris Isidore, "Golden Parachutes Here to Stay," *CNNMoney.com*, (September 29, 2008).

[254] Theo Francis, "Bank Rescue: Making Wall Street Pay?," *Business Week*, October 15, 2008.

[255] Letter from Senate Majority Leader Harry Reid and House Speaker Nancy Pelosi to Treasury Secretary Henry Paulson (October 29, 2008). Released on website, Democrats.senate.gov, (October 29, 2008), under "Reid, Pelosi Call On Paulson To Strengthen Golden Parachute Restrictions on Financial Institutions Receiving Taxpayer Funds."

million cap on the corporate tax deductibility of compensation that applies to the CEO and the four next highest-paid officers of publicly-traded firms. (Pay itself is not capped, only the deduction of pay from corporate income.) Key compensation categories excluded by the law from the $1 million deduction limit include: (1) commission-based remuneration; (2) performance-based compensation that meet outside director and majority shareholder approval; (3) payments to tax-qualified retirement plans (including salary reduction contributions); and (4) amounts excludable from the employee's gross income.

The EESA amended Section 162(m) to provide for Section 162(m)(5), which generally requires firms participating in the EESA's Capital Purchase Program (CPP) to agree to senior executive pay deduction limitations of $500,000, a halving of Section 162(m)'s $1 million deduction limit. Unlike Section 162(m), it also applies to firms that are not publicly traded. Under the terms of the loan agreements, GM and Chrysler would also be subject to such terms.

Limitations on the Executive Pay Arrangements that Would Encourage the Taking of Unnecessary and Excessive Risks. This provision elaborates on the overarching proscription on both companies making compensation arrangements for their senior executives that would encourage them "to take unnecessary and excessive risks" found in Section 111 (b) of the EESA. To comply, the principal executive officer of GM and Chrysler are required to certify in writing, under penalty of perjury, to the Treasury Department's Chief Compliance Officer that their compensation committees have consulted with their senior risk officials and determined that such senior executive pay schemes would not encourage the taking of unnecessary and excessive risks that would pose a threat to their companies' values.

An argument could be made that the provision's operative phrase, "... take unnecessary and excessive risks.... " is quite vague, potentially resulting in considerable interpretative leeway. There is a widely held view that one of the contributing causes of the financial crisis that led to the enactment of the EESA was the managerial compensation structure at Wall Street firms: many think that Wall Street pay packages overly emphasized short-term incentives such as bonuses, helping to encourage often reckless and harmful behavior driven by the pursuit of short term corporate profits.[256] Concerns over the relationship between managerial incentive compensation and exceptional risk taking appears, however, to be largely confined to specific parts of the financial sector such as the investment banking sector and hedge funds. In addition, a number of compensation consultants have observed that while the use of uncapped annual incentive pay has been a significant feature of many financial service firms, the practice is said to be generally atypical outside of the sector.[257]

To the extent that legitimate concerns over excessive risk taking do exist, there is a vigorous debate over the extent to which members of corporate boards are able to act independently of senior management's influence.[258] Similar concerns could be raised about the ability of senior risk managers to maintain their detachment from top management as they also help to arbitrate on top executive pay arrangements under the terms of the agreements. Such concerns might be especially germane to Chrysler, which is owned by a private equity firm. Some research on the

[256] For example, see Robert Samuelson, "Wall Street Ignored Risk to Gain Short-Term Riches, *Washington Post*, September 18, 2008.

[257] "Bank Rescue: Making Wall Street Pay?," *Business Week*, October 16, 2008.

[258] *USA Today*, "GM Pushes the Pedal on Hydrogen Fuel-Cell Power" (November 5, 2007).

quality of corporate board governance at private equity firms found that such boards tend to be heavily influenced by and at times controlled by the principal investors of the equity firm.[259]

Within the motor vehicle industry, the provision also raises a fundamental policy question: to what extent would the discouragement of risk-taking behavior also result in the discouragement of potentially beneficial, innovative, and entrepreneurial behavior? For example, in late 2007, General Motors announced that it hoped to start selling cars powered by hydrogen fuel-cells by 2011.[260] If an automaker began embarking on the development of such technology, under the "excessive risk" provision should such undertakings be seen as excessive risk taking or potentially beneficial and innovative entrepreneurship?

A Ban on the Provision of Incentive Compensation to the 25 Highest Paid Officials. Neither company can provide bonuses or incentive compensation packages to the 25 most highly compensated employees (including the senior executive officers) except as authorized by the President's Designee.

Studies on corporate compensation describe executive bonuses as a popular type of variable incentive pay normally given as a once-a-year payment tied to some short-term performance goals. These can range from judgments on executive performance by a corporate board, to levels of company profits or company sectoral market share. After the EESA's enactment, there was concern expressed both in and out of Congress over reports that executives at financial firms participating in the EESA were receiving what many perceived to be excessively large bonuses, an issue not specifically addressed in the law's restrictions on executive pay. A central concern was that participating companies were using EESA funding to pay for bonuses, a charge that firm executives denied. Among those in Congress expressing concerns was Representative Henry Waxman, then Chairman of the House Oversight and Government Reform Committee, who indicated the funds "might be used for extravagant pensions or bonuses or dividends or any other purpose, inconsistent with what the Congress intended."[261]

Some executives in recent years have received substantial bonuses in the automobile industry. In 2007, Ford reported that CEO Allan Mulally received $2 million in base salary, and $4 million in bonuses (he had also received $18.5 million in bonuses in 2006). Ford also reported that the next four highest paid officials received between $1 million and $780,000 in base salary and between $708,000 and $439,000 in bonuses. However, in response to the industry crisis at the end of 2008, Ford eliminated merit increases and bonuses for all salaried workers in 2009. Its senior executives are to receive no salary increases at all. The company has suspended its 401(k) match program, and eliminated or restricted other benefits for salaried employees.[262]

General Motors reported that the 2007 base salary paid to its top five officials ranged from CEO G. Richard Wagoner's $1.56 million down to $825,000, but none of the GM officials received bonuses in 2007. According to the data presented in its restructuring plan, CEO Wagoner and president and chief operating officer (COO) F.A. Henderson each received total compensation of just less than $2 million in 2007, as stock options for the company have been "under water" (less

[259] John England, Vickie Williams, "Private Equity: Redrawing the Rules of Executive Compensation," *Towers Perrin online*, (July 7, 2008).

[260] *USA Today*, "GM Pushes the Pedal on Hydrogen Fuel-Cell Power."

[261] "Frank Warns Banks Against Misuse of Bailout Funds," *NPR's All Things Considered* (October 31, 2008).

[262] *Ford Business Plan*, pp. 12 and 27, and Appendix 1.

than the target price) since 1999. Top-level salaries were reduced as much as 50% in 2007. GM's 401(k) matching contribution was eliminated in 2008 for all salaried employees, and there was a reduction or elimination of other benefits.[263] As of January 1, 2009, the salary of GM's CEO was reduced to a nominal $1 per year, as was the annual retainer for all board members. The company president's salary was reduced by 30%, and the other three top officers, including executive vice-chairman Robert Lutz, took 20% salary cuts.[264]

There are news reports that Chrysler, which as a privately owned company is not required to disclose data on executive compensation, has contractual agreements to pay what originally totaled $30 million in retention bonuses (reportedly reduced because some of the officials left) to about 50 executives, to be paid out in August 2009. The retention bonuses were crafted by Chrysler's former parent, DaimlerChrysler, as it was preparing to sell Chrysler to Cerberus Capital Management, its current owner. Three of Chrysler's top paid executives, CEO Robert Nardelli, president James Press, and vice-chairman Tom LaSorda, are reportedly not participating in the plan. However, according to Daimler filings, in 2007, Mr. LaSorda received a $15.7 million bonus for his help in Chrysler's sale to Cerberus.[265]

A Chrysler official justified the bonuses because of the need to ensure potential buyers that key company executives would remain in place after the sale, while acknowledging that they had become a source of controversy.[266] Nonetheless, the official also emphasized that it was important to keep in mind that the bonuses had been crafted by DaimlerChrysler, the company's former owner, and that they appear to have been effective in keeping its executive talent in place.[267] Subsequently, as stated in testimony before Congress , CEO Nardelli has agreed to a salary of $1 for both 2008 and 2009.[268]

An argument could be made that the provision's proscription on incentive pay could significantly narrow the types of compensation arrangements that would generally be available for the top five executives. It could thus potentially remove significant parts of executive pay package features from compensation committee consideration as they carry out the earlier provision requiring them to ensure that the pay packages do not encourage excessive and unnecessary risk taking.

A Ban on Compensation Plans that Would Encourage Earnings Manipulation. Neither company can adopt or maintain compensation plans that would encourage manipulation of their reported earnings to enhance the compensation of any of their employees.

This provision is not part of Section 111 (b) of the EESA. Earnings manipulation, often referred to as earnings management, is an umbrella term that is used to encompass everything from earnings "smoothing" to outright accounting fraud. Investors, analysts, and auditors disapprove of such actions, because it makes reported corporate earnings less reliable as a measure of firm performance. A perceived epidemic of earnings management was a significant impetus behind the

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[263] *GM Restructuring Plan*, (December 2008) p. 31.

[264] Senate Banking Committee hearing, December 4, 2008, testimony of G. Richard Wagoner, and additional information provided to CRS by GM on January 22, 2009.

[265] Tom Walsh and Tim Higgins, "Chrysler Leaders Get Millions," *Detroit Free Press*, November 13, 2008.

[266] Ibid.

[267] See the debate discussed in Gene J. Puskar, "Chrysler Leaders Get Millions," *USA Today* (November 14, 2008).

[268] Confirmed to CRS in communication from Chrysler LLC, January 23, 2009.

enactment of the Sarbanes-Oxley Act of 2002 (SOX, P.L. 107-204), which contained a broad range of corporate governance and accounting reforms.

Publicly traded companies have a long history of using stock options as a major component of executive compensation; the strategy's central objective is aligning an executives' personal interests with those of shareholders. In 2007, Ford reported that its stock option awards to its top five senior executives ranged between $2.49 million and $7.51 million. General Motors reported that its option awards to its top five executives ranged from $534,000 to $3.77 million.

There is a growing body of research that has found that executive stock options can have negative consequences with respect to encouraging a greater tendency toward earnings manipulation. For example, one empirical study found statistical evidence that earnings manipulation is more likely where stock options play a larger role in CEO compensation.[269] Another study concluded that CEOs were more apt to manipulate firm earnings when they had more out-of-the-money stock options[270] and lower holdings of conventional company stock.[271] Jack Dolmat-Connell, president of Dolmat-Connell & Partners, an executive-compensation consulting firm, reportedly observed, "While I think that options are an extremely good driver of performance, there's no downside to them from the executive's standpoint... [Y]ou have to have someone with unethical standards who gets lots of stock options for misrepresentation and fraud to occur. If you give someone with strong ethical standards lots of options, nothing is likely to happen."[272]

Thus, it could be argued that to faithfully implement the provision's "prohibition on any compensation plan that could encourage manipulation of the reported earnings" of a recipient firm, companies would have to ensure that executive stock option packages were tailored properly to balance their positive incentive attributes with their potential for encouraging inappropriate behavior. This may assume that the process is conducted with a minimum of executive influence and bias, which, as noted earlier, could be questioned.

A Prohibition on Altering Previously Imposed Restrictions on Executive Benefit Plans. Both companies must not alter the suspensions and the restrictions on company contributions to senior executive benefit plans that were either in place by, or that had been initiated by, the closing date of the agreement.

Clawbacks of Executive Bonuses, Etc. The Treasury Department reserves the right at any time during the period of the loans to require either company to clawback any bonuses or other compensation, including golden parachutes, paid to any of their senior executives that are in violation of any of the aforementioned requirements.

The provision appears to be an expansion of the executive clawback provision in Section 111(b) of the EESA. That provision approaches the recoupment of executive bonuses and incentives in a

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[269] Gary K. Meek, Ramesh P. Rao, and Christopher J. Skousen, "Evidence on Factors Affecting the Relationship Between CEO Stock Option Compensation and Earnings Management," *Review of Accounting & Finance*, Vol. 6, Issue 3, 2007, p. 304.

[270] This is a stock option that would be worthless if it expired today due to the fallen current market price of the underlying stock.

[271] Xiaomeng Zhang, Kathryn M. Bartol, Ken G. Smith, Michael D, Pfarrer, and Dmitry M. Khanin, "CEOS on the Edge: Earnings Manipulation and Stock-Based Incentive Misalignment," *Academy of Management Journal*, April 2008, p. 241.

[272] David Shadovitz, "The Risks of Stock Options," *Human Resource Executive Online* (July 25, 2007).

somewhat different fashion than does an earlier provision in SOX. SOX and its clawback provision were collective responses to the widespread corporate misstatements of corporate earnings that were widely observed in the preceding years. SOX's clawback provision only applies to the CEO and the chief financial officer (CFO) of publicly traded companies. The clawback provision in the GM and Chrysler agreements would also apply to privately held firms (like Chrysler) and the top five senior officers, including the CEO and the CFO. And unlike the provision in SOX, it would not limit the recovery period and covers not only material inaccuracies related to financial reporting, but also material inaccuracies related to other performance metrics used to award bonuses and incentive compensation. Reports indicate that the Securities and Exchange Commission has rarely prosecuted violations of Sarbanes-Oxley's clawback provision. Possibly, this is because executives often settle financial misstatement cases without admitting wrongdoing, thus avoiding the triggering the provision, and because of how the pivotal concept of "misconduct" is interpreted.[273]

The expanded clawback provisions in the GM and Chrysler agreements also appear to provide for the broad-based punitive threat of Department of Treasury-initiated clawbacks of top executive bonuses or other forms of compensation in the event that there are violations of any of the agreements' aforementioned requirements on executive pay.

Other Restructuring Plan Conditions[274]

Restructuring Plan Requirements

The term sheets for GM and Chrysler required them to submit by February 17, 2009, a plan to "achieve and sustain ... long-term viability, international competitiveness and energy efficiency ..." This must include "specific actions to ensure:

- Federal loan repayment under applicable terms and conditions;
- Ability of the company both to meet all applicable federal fuel economy and emission requirements, and to begin manufacturing advanced technology vehicles, as specified in the EISA direct loan program;[275]
- Achievement by the companies of a positive net value;
- Rationalization of "costs, capitalization, and capacity" with respect to workforce, suppliers, and dealer networks; and
- Competitive "product mix and cost structure."

The companies will be required to produce monthly and annual statements on meeting these restructuring requirements. In addition, the term sheets required the companies to use their best efforts to achieve the following three "targets":

[273] Peter Galuszka, "What Are Compensation 'Clawbacks'?," *Bnet Briefing*, 2008.

[274] This subsection was written by Stephen Cooney, Specialist in Industrial Organization and Business.

[275] Requirements for eligibility under this program are described in CRS Report RL34743, *Federal Loans to the Auto Industry Under the Energy Independence and Security Act*, by Stephen Cooney and Brent D. Yacobucci.

Restructuring Plan Targets

"Bond Exchange"

Reduction of unsecured debt by two-thirds (excluding pension and employee benefit obligations) by conversion of debt into equity or by other means.

"Labor Modifications"

- "Compensation Reduction." Reduce total compensation, including wages and benefits, by the end of 2009 to an average equivalent to those of Toyota, Honda, and Nissan in the United States, as certified by the Secretary of Labor.
- "Severance Rationalization." Eliminate payment of any compensation or benefits to fired, furloughed, laid off, or idled employees, beyond "customary" severance pay;
- "Work Rule Modification." By the end of 2009 apply work rules "in a manner competitive" with the three Japanese-owned companies in the United States named above.

With respect to labor contract modifications and other provisions under collective bargaining agreements covering the hourly workforce, "if any labor union or collective bargaining unit shall engage in a strike or other work stoppage," it has been defined as an "event of default" in the "loan and security agreements" signed by the recipient companies as a condition of receiving the loans from the Treasury Department.[276]

"VEBA Modification"

Convert one-half of the value of each future corporate contribution to the planned VEBA for retiree health care, due by January 1, 2010, to company stock holdings.

Each company was required by February 17, 2009, to submit term sheets signed by representatives of the company and, respectively, bondholders, unions, and VEBA representatives. That is to be followed up by full approval of the terms by the respective groups, and certification by the President's designee, with such variation as may be allowed. Failing completion of this process, the designee could require full loan repayment in 30 days.[277]

Modifications in UAW Contract with Ford

While Ford did not participate in the program of federal assistance, it is affected by the same competitive issues in the UAW contract with U.S. hourly workers as the other Detroit 3 OEMs. In

[276] U.S. Securities and Exchange Commission. Form 8-K filed by General Motors Corporation, December 31, 2008, p. 60. A similar provision is reportedly in the loan agreement signed by Chrysler LLC, a privately held company. This provision was first noted by the press: *Wall St. Journal*, "Bailout Pact of GM, U.S. Would Block a UAW Strike;" *Detroit News*, "Strikes Would Imperil Bailout Funding;" *Detroit Free Press*, "UAW Strike Would Kill Auto Loans," all January 9, 2009. Commentators quoted in the stories noted that strikes were in any case highly unlikely in view of the financial conditions of the automakers.

[277] These conditions are summarized from Treasury, GM and Chrysler *Term Sheets*, pp. 5-7.

February 2009 Ford and the UAW announced agreement on modification of operating provisions in Ford's national labor agreement and to how Ford will pay its contributions to the VEBA retiree health care trust. While Ford is not tapping into the TARP for government loans, under the principle of "pattern bargaining," it can be expected that the Ford labor agreement modifications provide the basis for the UAW position in negotiations under the loan agreements with GM and Chrysler.[278]

The Ford deal with the UAW modified the previous agreements of 2007 in two general ways:

- Reduction in labor costs. The UAW agreed to the elimination of Christmas and performance bonuses for 2009-10. These bonuses had totaled about $1,100 per employee per year. The union also agreed to surrender its cost-of-living escalator that had been negotiated through 2011, and gave up one paid holiday, Easter Monday. The Jobs Bank program was replaced with a more financially limited plan of supplementary unemployment benefits and "transition assistance" for laid-off workers. The modified agreement also included a new one-time buyout offer of $20,000-$50,000, depending on seniority, plus a voucher for a new Ford vehicle, that could be converted into $20,000 in cash.
- VEBA contributions with Ford Equity. The UAW agreed to accept Ford stock in part payment for the company's VEBA contributions. In each scheduled contribution period, the company can now contribute up to half the value of the amount owed in company stock, instead of cash. The VEBA is allowed to convert the equity contributions immediately into cash on the open market. The amount of stock contributed must be equal in value to half of the cash contribution owed, except that the first three contributions, at the end of 2009, and in mid-2010 and mid-2011, respectively, were agreed to be valued at $2.00 per share. This means that the VEBA would assume the risk that Ford stock would be less than that value, which it was as of early March 2009.[279]

The agreement between Ford and the UAW Ford Department was unanimously approved by the UAW Board and was ratified by the active UAW membership on March 9, 2009.[280]

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[278] Ford Motor Co., "UAW and Ford Reach Tentative Agreement on Future Funding of the Health Care Trust;" and, UAW, "UAW and Ford Reach Tentative Understanding on Modifications to VEBA, Contract" (both news releases on February 23, 2009). On significance for GM and Chrysler, see, *Wall St. Journal*, "Ford Gets UAW Concessions Ahead of Rivals;" *Detroit News*, "Ford's Health Deal May Set Trend", and Daniel Howes, "Commentary: UAW Deal with Ford Pressures Rivals;" *Washington Post*, "UAW, Ford Cut Deal on Health Benefits" (all February 24, 2009).

[279] The agreement is spelled out in full detail by UAW Ford, *Modifications to 2007 Agreement and Addendum to VEBA Agreement* (February 2009).

[280] *Detroit Free Press* "Ford UAW Workers OK Cuts in Benefits;" Associated Press, "Ford Workers Approve UAW Contract Changes" (both March 9, 2009).

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Key CRS Policy Staff and Areas of Expertise

This report was originally coordinated by Stephen Cooney, who retired from CRS in March 2009. General inquiries may be directed to Bill Canis, Specialist in Industrial Organization and Business. The table below provides a quick reference for congressional staff seeking to identify experts to contact regarding specific issues or aspects of the U.S. motor vehicle industry.

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