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The GM Saga So Far

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The current financial crisis is arguably the largest corporate debacle and multi-market crash since the Great Depression. Its costs for corporations are substantial and many high profile companies have filed for bankruptcy protection under Chapter 11 (U.S. Code, Title 11, Chapter 11) or the *Companies' Creditors Arrangement Act* (R.S., 1985, c. C-36) ("*CCAA*"). In the United States and elsewhere, this has even affected financial institutions, institutions previously viewed as "too big to fail", namely AIG, Citigroup, Bear Stearns, IndyMac Bank, F.S.B. (the second largest bank failure in U.S. history), Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), Lehman Brothers, and Wells Fargo. To date, many Canadian corporations have filed for *CCAA* protection.

Two of the corporations that have been getting much press are the automotive giants, Chrysler LLC ("Chrysler") and General Motors Corp. ("GM"), companies that fell victim to the financial crisis and are currently in Chapter 11 protection in the U.S. Chrysler filed under Chapter 11 on April 30, 2009 and GM on June 1, 2009. GM's bankruptcy filing alone is the largest industrial company bankruptcy filing in U.S. history. This move will have significant impact on the Canadian automotive sector, since the Canadian subsidiaries are currently considering their parent corporations' Chapter 11 filings and whether they, the subsidiaries, will have to file under the *CCAA*. That said, as of now, GM will not file under the *CCAA*. Rather it plans to take a similar course to Chrysler, which only filed for Chapter 11 protection in the U.S. and hopes to emerge.

GM has been a successful and viable corporation for decades. As one of the world's largest automakers, GM was founded in 1908 and in 2008, sold 8.35 million cars and trucks globally under thirteen brand names. However, when GM ran into financial problems in 2008 (reporting a $6 billion loss in the first-quarter of 2009 and a loss of $52.8 billion since the same period in 2008 - see P. Holm, "Chart Shows Earnings for GM", Washington Post, May 10, 2009), the financial crisis was not perceived as being entirely to blame. Rather, many maintained that GM would have nonetheless eventually ventured into insolvent territory, that "[t]he current crisis is simply the proverbial straw that breaks the camel's back" (see Joshua Rauh & Luigi Zingales, "A Bankruptcy to Save GM", VOX Research-based policy analysis and commentary from leading economists, November 19, 2008). The issues being experienced by the auto industry should not be surprising. After all, the domestic auto industry has been in trouble for years, with GM alone reporting record losses for the last five years. GM reported a $10.6 billion loss in 2005 and $38.7

billion in 2007 (See Heidi N. Moore, “General Motors: The Biggest Credit Risk of All Time?” Wall Street Journal, February 23, 2009). Now, the current corporate failures and the consequent bailouts are raising many questions.

Corporate reorganization (also referred to as “restructuring”) is an alternative to bankruptcy and occurs when a debtor corporation in financial trouble negotiates an arrangement with its creditors under the supervision and protection of a court. The procedure allows the debtor corporation to remain in business (but will sometimes result in the sale of a going concern to a third party). The Canadian government is determined to help the auto industry emerge as a viable entity through reorganization, even if it means the automotive companies continue to receive long-term government aid. Stephen Harper, himself an economist and proponent of the free market system, has indicated, “[A] free-market solution was not on the table in this case” (Barry Brown, “Chrysler Canada put on life support”, The Washington Times, May 3, 2009). With regard to Chrysler, both governments are to provide U.S. $10.5 billion in financing to assist with Chrysler’s court-supervised restructuring and the Ontario and Canadian governments are also extending a working-capital loan and a medium-term restructuring loan to Chrysler Canada Inc. in support of further restructuring. And when (if) Chrysler emerges, the union retiree trust will own 55 percent, Fiat will hold 20 percent of shares, which could eventually grow to 35 percent, and the U.S. and Canadian governments will own minority stakes. (See Judge Gonzalez’s May 31, 2009 ruling *In re Chrysler LLC*, 2009 WL 1507547 (Bkrtcy. S.D.N.Y.), approving the sale of substantially all the debtors’ (Chrysler LLC and 24 of its domestic and indirect subsidiaries) assets to an entity owned jointly by Fiat, the UAW and the U.S. and Canadian governments). The restructuring at GM will have the U.S. and Canadian governments providing GM with $30 billion and $9.5 billion, respectively, and becoming equity holders in the new GM, with the U.S. government holding 60 percent controlling shares and the Canadian and Ontario governments, 12.5 percent. The figures quoted do not include the $20 billion that GM has already received, in the form of low-interest loans (”Highlights of the GM Plan”, Globe & Mail, June 1, 2009).

The restructuring of the two automotive giants has raised many issues, a few of which are posed for your consideration. First, what should be the extent of the government’s involvement in corporate structure, if any, and what are the implications for various stakeholders when the government becomes a substantial equity holder? In a backlash to these restructuring plans, House Republican Leader John Boehner of Ohio has maintained, “The only thing it makes clear is that the government is firmly in the business of running companies using taxpayer dollars… Does anyone really believe that politicians and bureaucrats in Washington can successfully steer a multinational corporation to economic viability? It’s time for the administration to fully explain what the exit strategy is to get the U.S. government out of the board room once and for all” (Patrice Hill, “Experts Expect Long Road to Profitability for GM”, Washington Times, June 2, 2009). And although both the U.S. and Canadian governments have maintained that they are not interested in running GM, and President Obama has called them “reluctant shareholders”, he did nonetheless say that they would not be staying out of the “fundamental decision-making”. What does that mean for the company, shareholders, and creditors?

And on a larger scale, some argue that the government is taking control of the economy by taking an equity stake in GM. The government is driving the economy to become more energy efficient, and create and preserve manufacturing jobs. Is this a proper way for the government to go about carrying out an agenda or is it an improper intervention into the free market economy?

Other questions arise with regard to whether the bailouts have implications for other industries that may be affected by the financial crisis, such as Alberta's oil and gas industry. On a political level, how will the bailouts affect feelings of regional inequality if only certain sectors, that happen to be region-specific, are receiving government funds? Saskatchewan Premier Brad Wall has already noted that workers in the Western oil sands are also struggling and members of the Communications, Energy and Paper workers Union of Canada marched through downtown Ottawa, demanding government backing for commercial loans for struggling paper companies (Bill Curry, "Forestry Workers Ask Ottawa For Aid", Globe & Mail, June 3, 2009). This issue is inevitable and should have been anticipated by the government when it agreed to bail out the auto industry in a time when most other industries are also suffering.

And finally, are the bailouts simply delaying the inevitable? Canadian auto analyst Dennis DesRosiers has maintained that the bailout will not be assisting Chrysler in the long run, that "Chrysler needs an orderly wrap-up. This just buys them two to three years' time" (see Barry Brown, "Chrysler Canada put on life support", The Washington Times, May 3, 2009). Some bondholders have even bought credit default swaps, insurance policies that will pay out if GM defaults on its debts (see Greg Wood, "Ugly Choice for GM Creditors", BBC News, June 1, 2009). The fact is that there are never guarantees that a company will emerge as a viable entity once there's been a restructuring. But are there different considerations here?

The restructuring of GM and Chrysler raises numerous issues. The restructuring plans are complex and the world is waiting to see whether government bailouts can be successful. This post is a short commentary on the situation so far.