Financial and Economic Crisis – Law Firms

A Bankruptcy Saga For The History Books

The Editor interviews ***Matthew Feldman****, who recently returned to Willkie Farr & Gallagher LLP after serving as Chief Legal Advisor to the Obama administration's Presidential Task Force on the Auto Industry. He is currently a Partner and Co-chair of the firm's Business Reorganization and Restructuring Department.*

Editor: Please provide our readers with information about your background before being appointed chief legal advisor to the Auto Team working on the presidential auto task force responsible for restructuring GM, Chrysler, GMAC and Delphi.

Feldman: I graduated from NYU law school in 1988 and joined Willkie Farr & Gallagher in 1991. I have been practicing in the reorganization/restructuring area continuously since 1991 and have been a partner at Willkie since 1998. I am currently co-head of the Business Reorganization and Restructuring group.

Editor: Please describe the team on the presidential task force, the multitudinous hours spent in negotiations and preparation, and your strategy for dealing with creditors.

Feldman: It was a very small team comprised of 11 professionals. We were tasked with assisting and representing the government in the restructurings of General Motors, Chrysler, GMAC and Delphi. The White House mandated a very tight time frame to accomplish our mission when it inherited approximately $17.4 billion of TARP loans previously made to Chrysler and General Motors by the Bush administration. President Obama clearly supported the idea of making loans available to these companies, but he was not prepared to use taxpayer money to fund the companies without their completing a comprehensive restructuring. As a result, President Obama set very aggressive deadlines: April 30 for Chrysler and May 31 for General Motors for them to meet various restructuring conditions.

With respect to the approximately $17.4 billion of loans made by the Bush administration, those loans were made without condition but required each of Chrysler and General Motors to come back to the government with: a redone labor agreement, a renegotiated agreement with their creditors and an updated business plan. When each presented their list of accomplishments to the Obama administration and to the Auto Team on February 17, 2009, it was clear to the Auto Team that they were not able to fully meet any of the conditions. The Obama administration and the Auto Team believed, however, that the conditions set by the Bush administration were not substantial enough if these companies were really going to be turned around. Essentially, we worked on average between 18 and 22 hours a day for approximately four months, beginning in March and continuing through the end of June, to restructure these companies both in and outside of Chapter 11. By the end of June Chrysler and GMAC were done, General Motors was largely completed, and Delphi was at least on a path towards a successful conclusion. It was the most intense and difficult work experience I have ever been through.

Editor: Were other options besides the Bankruptcy Code's Section 363 provision for resolving the problem considered?

Feldman: Yes. As has been pretty widely reported, it was a very close call within the Obama administration as to whether to save Chrysler or whether the country would have been better served to let Chrysler liquidate. There was a view that a better allocation of resources would have been to let Chrysler liquidate and redirect those resources towards saving GM. Alternatively, once the decision was made not to let Chrysler liquidate, if we had been able to obtain the consent of all the creditors, there would not have been any need for Chapter 11 and Chrysler could have consensually reorganized. Ultimately, more than 90 percent of the senior secured lenders consented to exchange their liens for $2 billion in cash. Had the handful of remaining lenders agreed, Chrysler would have restructured without the need to resort to Chapter 11. Absent a consensual restructuring, the next best way to implement the transaction was through a 363 process. Section 363 is a provision of the Bankruptcy Code that allows companies in bankruptcy with court approval to enter into transactions outside of the ordinary course, including under the right circumstances a sale of substantially all of their assets.

Matthew Feldman

With GM, the facts were different. It was clear early on to the Auto Team that GM needed to file for bankruptcy. Unlike Chrysler, which has senior secured bank debt, GM had about $11 billion in outstanding bonds with millions of holders. To restructure this debt without filing for Chapter 11, GM would have needed 100 percent of the bondholders to consent, which was logistically impossible. While there were other liabilities GM sought to shed, the need to restructure the bonds was the driver that made it almost inevitable that GM would have to file. We debated at length whether it would make sense to try to confirm a prepackaged Chapter 11 plan or whether a 363 process was the better route. Our ultimate conclusion, shared by Auto Team and GM, was that 363 provided a surer, quicker avenue to complete the transaction rather than a prepackaged bankruptcy.

I think what was particularly gratifying in the case of Chrysler was that the 363 structure was appealed by certain creditors all the way to the Second Circuit, which handed down a cogent opinion completely vindicating the structure that we had helped put in place. That decision was appealed to the Supreme Court, and while the appeal remains extant, Justice Ruth Bader Ginsburg issued an opinion in which the Supreme Court refused to stay the closing of the 363 sale. I don't think the Supreme Court ultimately will hear the appeal on the merits, but if they do, I'm confident that they would rule consistently with the Second Circuit.

Editor: I guess Section 363 was also used in the Lehman bankruptcy, wasn't it?

Feldman: Section 363 was used in Lehman to sell its main assets to Barclay's.

Editor: What advantages does Section 363 offer over a plan of reorganization from both a buyer's and seller's point of view?

Feldman: I think there are really three advantages and one major disadvantage. One advantage is speed – the Bankruptcy Rules provide that a 363 sale can be done upon notice to creditors of approximately 20 days, so most 363 sales can get done within a 20- to 120-day time frame depending upon how complicated the transaction is, how much marketing has to be done, etc. Another advantage for a buyer is that the assets are sold free and clear of liens. Purchasers are buying relatively pristine assets. The third advantage is that there are fewer statutory conditions to approve a 363 sale as compared to a plan of reorganization. The disadvantage to selling under section 363 as compared to a plan is that under a plan the old debts are discharged, the estate is wrapped up and the bankruptcy is completed. From the perspective of the seller, the court and even the buyer, the entire situation is completed at one time – there is no residual overhang. As an example, both the Chrysler and GM Chapter 11 cases remain open and may continue for years.

Editor: Is there ongoing litigation by any of the stakeholders in the four companies as a result of the upsetting of the customary bankruptcy hierarchy for paying out creditors?

Feldman: First, I would disagree that the customary hierarchy was upset or breached in any way. As I mentioned, in the case of Chrysler the Second Circuit issued an opinion which held that all laws were followed. While there is an ongoing appeal to the Supreme Court, the Court has not granted certiorari and in my opinion is unlikely to grant certiorari to the appellants. Among other reasons, the issue is now moot since the transaction closed in June.

Editor: One of the matters of confusion was the seeming setting aside of the customary bankruptcy hierarchy for paying out creditors with the senior lenders getting the first cut of assets.

Feldman: I think the secondary market creditors who bought senior secured bank debt in Chrysler did a very good job at confusing the public in terms of what really happened. In fact, the priorities in bankruptcy in the Chrysler case were completely respected. The banks, as the senior secured creditors, received 100 percent of the proceeds of the $2 billion cash purchase price. (Had the senior secured creditors believed that their liens were worth more than $2 billion, they could have foreclosed or credit bid.) What people have complained about is that Fiat, as purchaser of Chrysler, agreed to give a portion of the equity of its new company to the VEBA, a trust set up by the UAW to fund healthcare costs of its retirees. Fiat agreed to that structure since they needed and wanted auto workers to show up at their plants every day and build cars. From Fiat's perspective, it was obviously important to share its equity with the VEBA. The senior secured creditors were not happy with this decision by Fiat, but they had no entitlement to this equity. In fact, over the past 20 years, many manufacturers have restructured using a similar structure. In my opinion, what was unusual was the amount of stock that Fiat elected to give to the VEBA, which was about 55 percent of the company. Fiat's reasoning was that the value of new Chrysler stock was speculative and relatively low at this time, and even at this level the VEBA was taking a huge haircut on what it was owed.

Editor: As I remember, Fiat actually put no money into Chrysler.

Feldman: Fiat did not contribute cash. Fiat contributed intellectual property and technology to new Chrysler that new Chrysler will be able to use regardless of whether Fiat continues to own the company.

Editor: How often is Section 363 invoked today in bankruptcy scenarios? Does there have to be a viable asset pool available to a purchaser before this option is considered?

Feldman: It has always been common in bankruptcies to sell a portion of a business or an entire business where there is no external source of funding and the lenders have decided they are not prepared to fund the business over the long term. Today we are seeing more and more leveraged capital structures in the form of first, second and third lien debt, which makes it difficult to fund a debtor during a lengthy Chapter 11 case, and therefore, many more companies have resorted to 363 sales over the last five years. The secured lenders simply do not want to see a company spend 12 months or more in a bankruptcy restructuring, and they are not prepared to provide funding over that time. They will typically put the company on a short leash, try to find a buyer, and if no buyer emerges, then buy it themselves by credit bidding the amount of their secured debt.

Editor: Do you visualize that future lenders will reconsider what part of a corporate structure will assure them the greatest protection in a bankruptcy and either prefer a senior secured creditor status or seek to cobble together other forms of credit guaranties such as insurance or other means to protect their investment?

Feldman: Bankruptcy techniques tend to swing like a pendulum. The pendulum has swung towards 363 sales. Undoubtedly, it will swing back and lenders will be forced to look at other options because courts and judges will decide that 363 sales cannot be a solution for all cases. Section 363 is a tool that is appropriate in certain cases, but like many tools creative lawyers will push it too far and the pendulum will swing back.

Editor: What lessons were learned from the Chrysler and GM bankruptcies?

Feldman: I think we're still learning the lessons, which go beyond the bankruptcy. One lesson is that there is a role, albeit a limited role, that government can play in the capital markets of this country when the capital markets are as displaced as they were back in the early part of 2009. The prospect that GM could have been liquidated because there was no source of private capital is unthinkable. Thus, in my opinion there are certain times when the government as the last source of capital should play a role in saving critical companies and/or industries. I think those times are few and far between, but we are clearly in the midst of one of those moments in history.

Editor: What does your recent experience add to your already substantial restructuring experience in terms of assisting your clients?

Feldman: It was a fantastic experience. I'm sure in hindsight I will look back on it as one of the highlights of my professional career, but I think ultimately what it taught me was that when people really want to come together – including the company, the union, the purchaser, the bond holders, the banks and all of their lawyers and other professionals – and work very hard to see a good, positive outcome, it can happen and it can happen over a pretty accelerated time frame. The other lesson it taught me was that in tough situations, it always helps to have the President on your side.

Please email the interviewee at mfeldman@willkie.com with questions about this interview.