

More on the Auto Bailouts

posted by Adam Levitin

The term sheets are up [here](#) and [here](#). Two initial observations:

(1) These are supposed to be secured loans, but they are almost assuredly junior liens--Chrysler already has a second lien facility, so that would make Treasury third. These liens might be underwater from the start, and a lot of the collateral probably isn't very valuable to anyone but GM or Chrysler. These companies are a lot like railroads in that a lot of their value is as going-concerns. Piecemeal, there isn't much there. This means that the primary value of being a secured creditor is having hostage value--the liquidation value isn't going to be very much. But if either GM or Chrysler can't meet the restructuring terms, they will be going into the Chapter to liquidate (whether they say so or not). And if that's the case, then it doesn't do the government much good to be secured.

(2) The government has tried to protect itself by providing that if there's a bankruptcy, the loan will rollover into a DIP facility at the government's exclusive option. I don't think that works. First, this is likely an executory contract, so it is automatically rejected under 11 USC 365(c)(2). Second, even if it isn't an executory contract, there will still have to be a 364 hearing. I can't see the government getting into a priming fight (or winning--there's no ability to offer the senior lienholders adequate protection). And because everything is encumbered, the government will have to settle for junior liens, which puts it right back where it was--an underwater junior. Moreover, if the government wants to do this as a rollup refi of the prepetition loan or a cross-collateralization, I'd wager that it will find itself in some pretty sharp litigation. There's no circuit level ruling (as far as I'm aware) that signs off on a rollup refinancing, and cross-collateralization is viewed very skeptically. There's huge hostage value to any creditor that can make a credible threat of pursuing such litigation. In any case, if GM or Chrysler goes into the Chapter as a freefall, the government would probably do well to wash its hands of the matter.

December 20, 2008 at 9:37 AM in [Corporate Bankruptcy](#)

Comments

you can't have your cake and eat it too, I don't think a bankruptcy court would enforce that DIP provision. You get superpriority for post-petition financing and this isn't post-petition financing. How is this different from just granting the government an illegal superpriority lien outside of bankruptcy?

Posted by: Phineus Q. Sixpack | [December 22, 2008 at 11:39 AM](#)

This was just money down the rat-hole, unless a miracle occurs. The government could have had senior status in Ch. 11 providing DIP financing, instead they opted for junior status here. Sigh. I would hardly call this "having their cake" ... but legally I'm sure you are right.

If there's not much to recover in a liquidation, what is the value of the going concern in an environment where the human capital has nowhere to run? They liquidate, a PE fund or Chinese company buys up the assets, offers to revive deals with suppliers, offers work to former employees, and they're more or less back in business fairly fast.

Disclaimer: I'm an economist not a lawyer.

Posted by: artichoke | [December 24, 2008 at 12:23 PM](#)

FYI, the Bankruptcy Court in Delaware currently allows roll-up refinancing, so the question is whether it is permitted in E.D.Mich, the only other plausible place they'd file.

Posted by: Jared | [December 24, 2008 at 09:05 PM](#)

Bankr. D. Del. might allow it, but will the 3d Circuit? Also Del. might not be the best place to file because of IP license issues--I think 3d Circuit has a Catapult-like precedent. I have no idea what the 6th Cir. law is, but surely GM or Chrysler have some SDNY-based affiliate on which they could piggyback.

Posted by: [Adam Levitin](#) | [December 24, 2008 at 09:08 PM](#)

I feel our situation is really difficult. Maybe because our habit who spend money just for shopping before? Just never give up, God never leaving us alone. Merry Christmas.

Posted by: [Edwin](#) | [December 25, 2008 at 05:02 AM](#)

Its one thing to allow a rollup refinancing by a fully secured first lien lender but are you saying that a Delaware bk court would permit an undersecured second or third lien lender to jump first and second liens through a rollup?

Posted by: Phineus Q. Sixpack | [December 26, 2008 at 08:49 AM](#)

Do you know anything about the reputation of the Bankruptcy judges in Detroit? Would a prudent lawyer risk filing there to get some home cooking? What's the last large debtor case to roll through?

Gertreg filed there, which is a sizable case.

Posted by: Jared | [December 27, 2008 at 12:40 PM](#)

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