

April 2009

AUTO INDUSTRY

Summary of Government Efforts and Automakers' Restructuring to Date





Highlights of [GAO-09-553](#), a report to congressional committees

Why GAO Did This Study

The turmoil in financial markets and the economic downturn has brought significant financial stress to the auto manufacturing industry. The economic reach of the auto industry in the United States is broad, affecting autoworkers, auto suppliers, stock and bondholders, dealers, and certain states. To help stabilize the U.S. auto industry and avoid disruptions that could pose systemic risk to the nation's economy, in December 2008 the Department of the Treasury established the Automotive Industry Financing Program (AIFP) under the Troubled Asset Relief Program (TARP). From December 2008 through March 2009, Treasury has allocated about \$36 billion to this program, including loans to Chrysler Holding LLC (Chrysler) and General Motors (GM).

GAO has previously identified three principles to guide federal assistance to large firms: define the problem, determine the national interests and set goals and objectives, and protect the government's interests. As part of GAO's statutorily mandated responsibilities to provide timely oversight of TARP activities, this report discusses the (1) nature and purpose of assistance to the auto industry, (2) how the assistance addresses the three principles, and (3) important factors for Chrysler and GM to address in achieving long-term viability and the challenges that they face to become viable.

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View [GAO-09-553](#) or key components. For more information, contact Katherine A. Siggerud or Susan Fleming at (202) 512-2834.

AUTO INDUSTRY

Summary of Government Efforts and Automakers' Restructuring to Date

What GAO Found

From December 2008 through March 2009, the Treasury Department established a series of programs to help bring relief to the U.S. auto industry and prevent the economic disruptions that a sudden collapse of Chrysler and GM could create. In December 2008, Treasury provided bridge loans of \$4 billion to Chrysler and \$13.4 billion to GM and required both automakers to submit restructuring plans in February 2009. In March, Treasury determined that the automakers' restructuring plans were not sufficient to achieve long-term viability and required that they take more aggressive action as a condition of receiving additional federal assistance. At the same time, Treasury also established programs to ensure payments to suppliers of parts and components needed to manufacture cars and to guarantee warranties of cars Chrysler and GM sell during the restructuring period. In addition to these programs, the President announced a new White House initiative to help communities and workers affected by the downturn in the industry. In the coming weeks, Treasury will determine whether the additional steps Chrysler and GM have taken or plan to take are sufficient to warrant further assistance. If the companies are successful in implementing the additional steps toward restructuring, then Treasury may provide additional assistance.

Components and Funding Levels under Treasury's AIFP

Component	Funding level (in billions)
Loans to automakers	\$22.9
Assistance related to auto finance companies	7.4
Supplier Support Program	5.0
Warranty Commitment Program	1.1
Total	\$36.4

Source: GAO analysis of Treasury information.

In providing assistance to the auto industry, Treasury identified goals and objectives and took steps to protect the government's interest. Provisions to protect the government's interest include requiring automakers to submit periodic financial reports and to gain concessions from stakeholders such as the UAW, creditors, and bondholders. To date, however, Chrysler and GM have not reached agreements with these stakeholders. In addition, Treasury included provisions to secure collateral from the automakers. However, because many of Chrysler's and GM's assets were already encumbered by other creditors, the amount of assets on which Treasury could secure senior liens was limited. An additional area of risk is the financial health of the automakers' pension plans. In the event that Chrysler or GM cannot continue to maintain its pension plans—such as in the case of liquidation—the Pension Benefit Guaranty Corporation, a government corporation, may be required to take responsibility for paying the benefits for the plans, which are not fully funded.

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To address these objectives, GAO reviewed Chrysler's and GM's restructuring plans and financial statements, as well as Treasury documents related to AIFP. GAO also reviewed the terms and conditions of the federal loans to identify risks to the government and compared these loan provisions to GAO's principles for providing federal financial assistance to large firms. In addition, GAO interviewed representatives of Chrysler, GM, Ford Motor Company (Ford) and the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), and officials from the Departments of the Treasury, Transportation, and Energy. GAO also conducted semistructured interviews with a panel of individuals identified by the National Academy of Sciences for their expertise in the fields of auto industry trends and data, labor relations, vehicle manufacturing, and corporate restructuring.

GAO provided a draft of this report to the Departments of the Treasury, Transportation, and Energy for their review and comment. These agencies provided technical clarifications, which GAO incorporated as appropriate. GAO also made a draft of this report available to Chrysler and GM officials for their review and comment. Chrysler and GM officials provided technical corrections and clarifications, which GAO incorporated as appropriate.

GAO is not making recommendations in this report.

GAO's panel of individuals with auto industry expertise identified a number of factors for achieving viability, including reducing the number of brands, reassessing the scope and size of dealership networks, reducing production capacity and costs, and obtaining labor concessions. However, Chrysler's and GM's restructuring plans submitted in February do not fully address these factors, according to GAO's panelists. In its assessment of the plans, Treasury identified concerns similar to those identified by the panelists, and concluded that Chrysler and GM need to establish a new strategy for long-term viability in order to justify a substantial additional investment of federal funds. Achieving viability is made more difficult because of many additional challenges facing the automakers, some of which are outside their control—such as the weak economy and the limited availability of credit. The condition of the U.S. economy will likely continue to affect the financial health of Chrysler and GM, as historically automobile sales almost always decrease during periods of economic recession. Given these challenges, Treasury, Chrysler, and GM are considering a range of options available for the automakers to achieve viability, including restructuring under the bankruptcy code.

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United States Government Accountability Office
Washington, DC 20548

April 23, 2009

Congressional Committees:

The United States is experiencing stress in financial markets and a severe economic downturn, affecting many sectors of the economy, including the automotive industry. The economy has been in a recession since December 2007, and several economic indicators, including economic growth and the employment rate, worsened at the end of 2008. Economic growth is expected to continue to decline in 2009. Automakers selling cars in the United States, including the three major domestic automakers—Chrysler LLC, Ford Motor Company, and General Motors Corporation (the Detroit 3)—as well as Japanese automakers with production facilities in the United States—Honda, Nissan, and Toyota (transplant automakers) and others, have seen dramatic decreases in sales and idling of factories. Sales have been trending downward since 2006, but the decrease has become markedly sharper in the past year. Although most automakers experienced declining sales in 2008 and early 2009, recent economic conditions have particularly hurt sales of the Detroit 3, resulting in significant financial losses and necessitating the use of billions of dollars of borrowed money or cash reserves to keep operating. The drop in sales has a cascading economic effect as autoworkers are laid off, the revenues of dealerships and automotive parts suppliers decline, and shareholders in the companies lose the value of their investment.

To help stabilize the U.S. automotive industry and avoid disruptions that would pose systemic risk to the nation's economy, in December 2008 the Treasury Department established the Automotive Industry Financing Program (AIFP) under the Troubled Asset Relief Program (TARP).¹ Through AIFP, Treasury in December extended loans of \$4 billion and \$13.4 billion, respectively, to Chrysler Holding LLC (Chrysler)—for use by its automotive manufacturing subsidiary, Chrysler LLC—and General Motors Corporation (GM) and may provide substantially more financial

¹The Emergency Economic Stabilization Act of 2008 (EESA) authorized the Troubled Asset Relief Program (TARP), Pub. L. No. 110-343, 122 Stat. 3765 (2008), 12 U.S.C. § 5201. Under TARP, Treasury has the authority to purchase or guarantee up to \$700 billion in troubled assets through its Office of Financial Stability. As of March 27, 2009, Treasury had publicly announced funding programs under TARP totaling \$667.4 billion, most of which was used to purchase or guarantee troubled assets from financial institutions, and about \$422.4 billion had been apportioned.

assistance.² As required by the loan agreements, Chrysler and GM submitted restructuring plans to Treasury on February 17, 2009. These plans were to identify how the companies plan to repay government assistance, meet fuel economy standards, become competitive, and achieve and sustain long-term financial viability. On March 30, 2009, the President announced that the restructuring plans Chrysler and GM submitted did not establish a credible path to viability and do not justify substantial new investment of taxpayer dollars. The President outlined a series of actions that each company must undertake within a specified time frame—30 days for Chrysler and 60 days for GM—and Treasury agreed to provide working capital to fund the companies' operations during this time. After these time periods expire and depending on the adequacy of the actions taken by Chrysler and GM, additional federal assistance may be provided.

As part of our statutorily mandated responsibilities for providing timely oversight of TARP, we have been monitoring Treasury's assistance to automakers, including reporting on conditions under which assistance should be provided.³ In December 2008, for instance, we testified on the principles that guided previous federal assistance to large firms and municipalities and their applicability to assistance to automakers.⁴ These principles include identifying and defining the problem, determining the national interests and setting clear goals and objectives that address the problem, and protecting the government's interests. In this report, we describe the (1) nature and purpose of federal assistance to the auto industry, (2) how the federal assistance to the auto industry addresses these three principles, and (3) important factors for Chrysler and GM to

²Specifically, Treasury purchased debt obligations of GM and of Chrysler LLC's parent company, Chrysler Holding LLC. Debt obligations constitute TARP "troubled assets" under section 3(9) of the Act, 12 U.S.C. § 5202(9). Under the terms of the Treasury-Chrysler Holding LLC Loan and Security Agreement, Chrysler Holding then provided the loan proceeds to Chrysler LLC, and Chrysler LLC has carried out the requirements of the loan agreement.

³EESA requires GAO to report at least every 60 days on findings resulting from, among other things, oversight of TARP's performance in meeting the purposes of the act; the financial condition and internal controls of TARP; the characteristics of both asset purchases and the disposition of assets acquired; TARP's efficiency in using the funds appropriated for the program's operation; and TARP's compliance with applicable laws and regulations.

⁴GAO, *Auto Industry: A Framework for Considering Federal Financial Assistance*, [GAO-09-242T](#) (Washington, D.C.: Dec. 4, 2008) and *Auto Industry: A Framework for Considering Federal Financial Assistance*, [GAO-09-247T](#) (Washington, D.C.: Dec. 5, 2008).

address in achieving long-term viability and the challenges that they face to become viable.

Scope and Methodology

To describe the nature and purpose of the federal assistance provided to the auto industry, we reviewed Department of the Treasury documents related to AIFP—including white papers on the Supplier Support Program and the Warranty Commitment Program, terms and conditions of the loans provided to Chrysler and GM, and disbursement reports on the amount of funding allocated and disbursed under the AIFP. We also interviewed Treasury officials to obtain further information and clarification on these programs.

To identify how the federal assistance to the auto industry addresses our three principles for government assistance, we obtained and reviewed program information and loan documentation from Treasury to identify the goals and objectives of the assistance and the problems the assistance was intended to address. We reviewed the terms and conditions of the loan agreements to determine mechanisms in place to protect taxpayers from excessive or unnecessary risks and compared these mechanisms to the principles we have previously identified for providing financial assistance to large firms. We also obtained and reviewed financial information of the automakers to ascertain the automakers' financial position. We reviewed the reports that GM and Chrysler periodically submitted to Treasury, as required by the loan terms, and interviewed Treasury officials about their reviews of these reports. We conducted interviews with Treasury about the loan program and agreements to identify the procedures established to oversee, monitor, and enforce the terms and conditions of the loan agreements. We also conducted interviews with officials from the Departments of Energy and Transportation to obtain information on their coordination with Treasury in providing and overseeing assistance to automakers; representatives from Chrysler, GM, Chrysler Financial Services Americas LLC (Chrysler Financial) and GMAC LLC (GMAC) to obtain information on how they determined the level of funding needed and their plans for using the funding; and representatives from Ford Motor Company and Ford Motor Credit Company to determine why they have not sought federal assistance.⁵

⁵Ford Motor Credit Company, GMAC, and Chrysler Financial are companies that provide financing for consumer automotive and dealer purchases.

To identify important factors for Chrysler and GM to address to achieve long-term viability and the challenges they face to become viable, we contracted with the National Academy of Sciences (NAS) to identify a diverse group of individuals with expertise about the past and current financial condition and operations of the domestic automakers, the restructuring of distressed companies, labor relations issues, financial management and analysis of distressed or restructuring companies, factors influencing competitiveness in the auto industry, and engine and vehicle technologies that may affect the auto manufacturing industry today as well as in the near future. We selected a panel of 17 individuals from among those NAS identified based on achieving a variety of expertise and avoiding any potential conflicts of interest. We conducted individual semi-structured interviews with the panelists to identify factors influencing the current condition of the auto industry; factors affecting future viability; obstacles to achieving long-term viability; and elements that, according to members of our panel, if contained in the plans, would positively or negatively influence the potential for successful restructuring and future viability. (Appendix I lists the panel of individuals whom we interviewed.) We used a content analysis to systematically analyze transcripts of these interviews to identify principal themes that emerged from the interviews. We also reviewed comments on the content of the restructuring plans that panelists provided to us once the plans had been submitted. We compared the content of the automakers' restructuring plans to the criteria identified by our panel and the requirements in the loan agreements. To further identify challenges to achieving long-term viability, we reviewed Treasury's assessment of the restructuring plans Chrysler and GM submitted in February.

The views expressed by the members of our panel should be interpreted in the context of the following qualifications. Although we were able to secure the participation of a balanced, highly qualified group of individuals, other individuals with expertise in relevant fields could not be included because of the need to limit the number of interviews conducted. Although many points of view were represented, the panel was not representative of all potential views. Nevertheless, the members of our panel provided rich information on the current state and future of the auto industry and insightful comments.

To provide additional information and context on all issues examined in this report, we conducted interviews with other stakeholders, including a representative of the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW), representatives of the Association of International Automobile Manufacturers, and other

knowledgeable individuals including financial analysts specializing in the auto sector, a lawyer knowledgeable about state franchise laws, and an economist specializing in labor issues.

To ensure the accuracy and completeness of the information contained in the report, we asked representatives of Chrysler, Ford, GM, the UAW, and the Pension Benefit Guaranty Corporation (PBGC), and two members of our panel to review portions of a draft of this report. We also provided Chrysler and GM with the opportunity to review the complete draft and discuss their comments with us. They offered some technical corrections and clarifications, which we incorporated as appropriate.

We conducted this performance audit from January 2009 to April 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings, based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings based on our audit objectives.

Background

GM, a publicly traded company, was incorporated in 1916 and employs about 240,000 people worldwide. It has manufacturing facilities in 34 countries and sells more than a dozen brands of vehicles in about 140 countries.⁶ Chrysler is a privately held company that was established 9 years later, in 1925, and employs about 54,000 people worldwide, including at manufacturing facilities in 4 countries and vehicles assembled under contract in 4 others.⁷ Chrysler and GM reported losses in 2008 totaling \$8 billion⁸ and \$31 billion,⁹ respectively, and there are significant concerns about the future of both companies. For instance, in GM's 2008 audit report, its independent registered public accountant raised "substantial doubt" about GM's ability to continue as a going concern due to "recurring

⁶GM's core U.S. brands are Buick, Cadillac, Chevrolet, and GMC; other brands include Daewoo, Holden, HUMMER, Opel, Pontiac, Saab, Saturn, Vauxhall and Wuling.

⁷Chrysler's brands include Dodge, Chrysler, and Jeep.

⁸Chrysler noted that its losses are preliminary and include non-recurring impairment and restructuring charges totaling \$4.2 billion. Because Chrysler is privately owned, data on its financial condition are not currently available to the public. However, Chrysler reported the unaudited \$8 billion loss for 2008 in its restructuring plan submitted to Treasury on February 17, 2009.

⁹GM's loss was reported in its audited financial statements for 2008.

losses from operations, stockholders' deficit, and inability to generate sufficient cash flow to meet its obligations." In addition, Chrysler stated in its restructuring plan that additional federal funds will be needed this spring to prevent the company from having to file for bankruptcy.

The automakers themselves are not alone in suffering the effects of declining automotive sales and revenues. The economic reach of the auto industry in the United States is broad, with many groups affected by its downturn and the financial condition of the automakers. Some key groups include the following.

- **Autoworkers:** At the end of 2007, Chrysler, Ford, and GM employed about 240,000 hourly and salaried workers in the United States. Thousands of workers have been laid off, retired, or taken buyouts in the past months as the automakers seek to cut their costs and excess production capacity. Most hourly workers are represented by the UAW, which is in discussions with Chrysler and GM to modify existing labor agreements to achieve cost reductions.¹⁰
- **Suppliers:** More than 500,000 workers are employed by companies in the United States that manufacture parts and components used by automakers—both domestic automakers and transplants. According to the Motor and Equipment Manufacturers Association, many suppliers are in severe financial distress, with a number having filed for bankruptcy in 2008. Some members of our panel said that because many of these suppliers have relatively high costs and depend on the business of the Detroit 3, some of them may not have enough revenue to survive if one of the automakers were to cease production. This, in turn, could affect the automakers' ability to obtain parts needed to manufacture vehicles. This dynamic has the potential to affect all automakers with production facilities in the United States, regardless of home country.
- **States and localities in auto manufacturing regions:** The automotive manufacturing industry, including the Detroit 3, transplant automakers, and suppliers, is concentrated in certain states in the Midwest and South. For instance, in Michigan, 28 percent of manufacturing jobs are in the automotive sector, as of March 2008. Other states with a high proportion of jobs in this sector include Kentucky (19 percent), Indiana (14 percent), Ohio (13 percent), Alabama (10 percent), and Tennessee (9 percent). A December 2008 Brookings Institution report identified 50 metropolitan

¹⁰In March, the UAW ratified changes to its 2007 labor agreement with Ford.

areas, clustered primarily in the Midwest and South, that rely heavily on Detroit 3-related jobs.¹¹ Although any loss of output due to the difficulties of the auto industry could be felt nationwide, the geographic concentration of the industry means certain regions will be harder hit than others as residents in these regions lose their jobs and the tax base shrinks.

- **Automaker retirees:** About 600,000 individuals currently receive pension payments from Chrysler and GM.¹² Due to the retirement benefits—including pensions and healthcare—provided to autoworkers, established and enhanced through several decades of collective bargaining, the Detroit 3 are facing a significant financial commitment. In an effort to reduce costs and become more competitive with the transplants, the Detroit 3 in 2007 reached an agreement with UAW to transfer responsibility for administering the health plans to the union. Under this agreement, voluntary employee beneficiary associations (VEBAs) were created to manage retiree health plans starting January 1, 2010, and the automakers agreed to make several cash contributions of specific amounts (totaling about \$10.3 billion for Chrysler and up to \$26 billion for GM) on specific dates to fund the VEBAs. Chrysler and GM are currently negotiating with the union to provide a portion of their monetary contribution as equity in the companies rather than cash.
- **Dealerships:** The Detroit 3 have about 14,000 U.S. dealerships, most of which are independently owned and operated. Many are struggling financially due to low sales and lack of credit to purchase inventory from the automakers. In addition, in comparison to transplants, the Detroit 3 automakers generally have more dealers and sell fewer vehicles per dealer. According to Automotive News, more than 900 dealers have closed during the last year, due in part to the current economic conditions. Employment at dealers—with more than 1 million jobs—has also fallen.
- **Bondholders and other creditors:** Individual and institutional investors hold about \$27.2 billion of unsecured GM bonds, and GM is currently engaged in negotiations with its bondholders to reduce this debt by at least two-thirds through an exchange of the bonds into company equity, or other appropriate means. Chrysler, which does not have significant

¹¹Detroit 3-related jobs account for 1 percent or more of the workforce in these 50 metropolitan areas. Howard Wial, “How a Metro Nation Would Feel the Loss of the Detroit Three Automakers,” *Metropolitan Policy Program at Brookings* (Dec.12, 2008).

¹²Data on pension recipients are from March 2009 for Chrysler and December 2008 for GM.

unsecured public debt,¹³ has proposed debt restructuring to three creditor groups, which would convert \$5 billion of debt to equity.

- **Shareholders:** GM, as a publicly traded company, has experienced a significant decline in the price per share of its common stock. In October 2007, GM's equity traded at levels over \$40 per share; in March 2009 the equity traded for a low of \$1.45 per share. Chrysler, which is privately owned, currently has two shareholders.¹⁴ Chrysler reported in its restructuring plan that these shareholders have expressed willingness to relinquish their current equity and to convert their debt to equity. To the extent that restructuring efforts result in additional equity, the interest of GM's and Chrysler's current shareholders' will be diluted, which would affect the voting of shares and any future dividends.

The sharp downturn in the U.S. auto industry has been influenced by a convergence of factors, including both those within and outside the control of the automakers. According to reports on the auto industry and individuals with expertise in the industry, the following factors contributed to this downturn.

- **Economic factors** contributing to the downturn include the weak economy and competition from transplants, which have led to decreased sales and market share. The U.S. economy has been in recession since December 2007, with increasing unemployment and declining personal wealth. During this time period, light vehicle sales in the United States—including domestic and foreign brands—have dropped by about half, with the decrease disproportionately affecting the Detroit 3.¹⁵ For example, Detroit 3 sales in the United States dropped by 49 percent from February 2008 through February 2009, whereas U.S. sales for Honda, Nissan, and Toyota dropped 39 percent during this period. Additionally, the Detroit 3 have been losing U.S. market share to foreign automakers for several years. For instance, GM's U.S. market share for total light vehicle retail sales fell from 27.2 percent in 2004 to 22.1 percent in 2008, while during

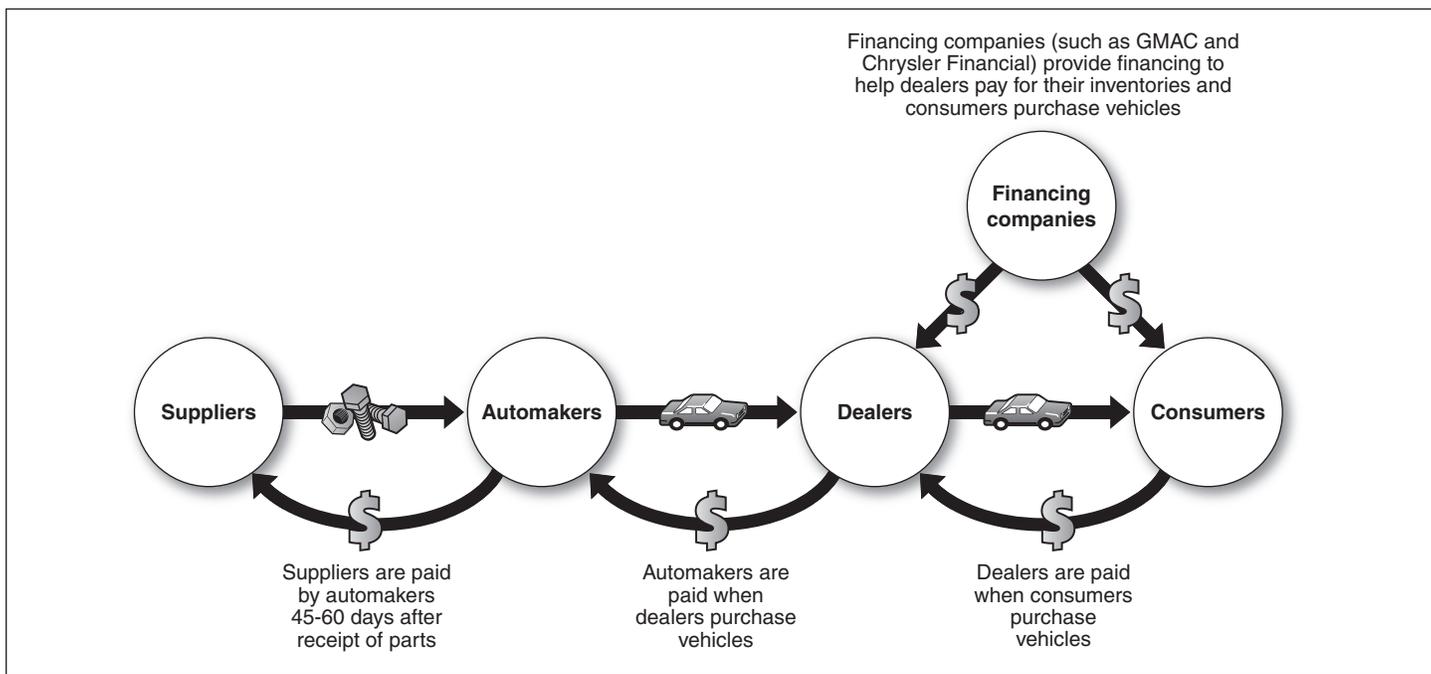
¹³According to Chrysler, \$20 million of unsecured public debt remains outstanding following a tender offer made by Chrysler in 2007 for the purpose of eliminating all such debt.

¹⁴An affiliate of Cerberus Capital Management owns 80.1 percent of Chrysler Holding LLC, and Daimler AG indirectly owns the remaining 19.9 percent. Chrysler Holding LLC, in turn, indirectly owns 100% of Chrysler LLC.

¹⁵Light vehicle refers to passenger cars, multipurpose passenger vehicles, trucks, and buses with a gross vehicle weight rating of up to 10,000 pounds.

the same period, the market share of Japanese auto manufacturers grew from 29.8 percent to 38.9 percent. In addition, the recession has made credit less available, which may have limited the ability of auto manufacturers and suppliers to finance their businesses, consumers to purchase cars, and dealers to obtain loans to sustain their inventories. Figure 1 illustrates the financial relationships among suppliers, automakers, dealers, consumers, and financing companies.

Figure 1: Key Financial Relationships in the Auto Industry



Source: GAO.

- **Management decisions** that, according to members of our panel, have contributed to the automakers' financial condition include labor agreements that resulted in wages and retiree benefit costs higher than those of transplants and a heavy reliance on sales of light trucks and sport utility vehicles (SUV), which are more profitable than cars.¹⁶ Additionally, offering consumer incentives and discounts over the past few years stimulated demand but contributed to an erosion of the value of the

¹⁶A UAW representative, in commenting on this statement, disagreed, saying that the difficulties facing the Detroit 3 are more a result of the sharp drop in vehicle sales.

brands and to average purchase prices that are lower than comparable foreign cars. As a result of the lower purchase prices, Chrysler and GM have to sell more cars in order to cover costs.

In December 2008, the chief executive officers (CEOs) of Chrysler, Ford, and GM testified before Congress to request financial assistance from the federal government.¹⁷ In their testimonies, the CEOs from Chrysler and GM stated that without federal assistance, their companies would likely run out of the cash needed to continue operating. The Chrysler and GM CEOs further testified that they believed it would be difficult or impossible to return to financial solvency while operating under bankruptcy because consumers would be reluctant to make a long-term purchase such as an automobile from a company whose future was in question.

We have previously identified three fundamental principles that can serve as a framework for considering federal government financial assistance to large firms. According to these principles, the federal government should (1) identify and define the problem, (2) determine the national interests and set clear goals and objectives that address the problem, and (3) protect the government's interests.¹⁸ Table 1 provides a description of these principles as they apply to the assistance provided to the auto industry.

Table 1: GAO's Principles for Government Assistance as Applied to the Auto Industry Financing Program

Principle	Applicability to AIFP
Identify and define the problem	Clearly identify and define the problems confronting the industry, separating out those that require an immediate response from structural challenges that will take longer to resolve.
Determine the national interests, and set clear goals and objectives that address the problem	State the objectives and goals of the program to help determine which financial tools are best, provide criteria for program decisions, and serve as a basis for monitoring progress.

¹⁷Ford subsequently determined that it would not request loans from Treasury at this time.

¹⁸[GAO-09-242T](#).

Principle	Applicability to AIFP
Protect the government's interest	<ul style="list-style-type: none"> • Achieve concessions from management, labor, suppliers, dealers, and creditors. • Institute controls over management. The government must have the authority to approve an aid recipient's financial and operating plans and new major contracts. • To the extent feasible, the government should require that the recipient provide adequate collateral and that the government be in a first lien position. • The government should receive compensation through fees or equity participation for risk. • Accountability should be built in so that Congress and the public can have confidence that the assistance is used in a manner consistent with the identified objectives.

Source: GAO.

Treasury Has Established Programs to Help Stabilize the Auto Industry

In an attempt to help stabilize the U.S. automotive industry and avoid disruptions that would pose systemic risk to the nation's economy, in December 2008 Treasury established AIFP and agreed to provide Chrysler and GM with loans of \$4 billion and \$13.4 billion, respectively.¹⁹ These loans were intended to allow the automakers to continue operating through the first quarter of 2009 while working out details of their plans to achieve and sustain long-term viability, recognizing that after that point, additional loans or other steps would be needed. According to Chrysler and GM officials, the companies have been using the loans to cover routine operating costs.

As a condition of the December loan agreements, Chrysler and GM were required to submit restructuring plans to Treasury in February that describe actions the automakers would take to achieve and sustain long-term viability. These plans were required to show how the automakers would repay the loans, comply with federal fuel economy requirements, develop a product mix and cost structure that are competitive in the U.S. marketplace, and become

¹⁹Ford requested a \$9 billion line of credit to protect against further industry downturns, but company officials have said that they do not intend to use this line of credit.

financially viable. Chrysler and GM submitted these plans on February 17, 2009, and requested up to an additional \$5 billion and \$16.6 billion in federal financial assistance, respectively, because of the continued sluggish economy and lower than expected revenues.²⁰

To oversee the federal financial assistance—including evaluating the restructuring plans—and to make decisions about future assistance to the automakers, the loan agreements provided for a presidential designee. Rather than appoint a presidential designee, President Obama on February 20, 2009, announced that he was establishing the Presidential Task Force on the Auto Industry to advise him and the Secretary of the Treasury on issues impacting the financial health of the industry.²¹ Under the terms of the loan agreements, since no presidential designee was appointed, the Secretary of the Treasury will make decisions on all matters involving financial assistance to the automakers, including future decisions about providing additional assistance to Chrysler or GM.

Treasury's Key Findings on the Viability of Chrysler and GM

Treasury determined that Chrysler's and GM's restructuring plans did not establish a credible path to viability.

For Chrysler, Treasury identified the following challenges:

- A limited global presence that leads to greater vulnerability to local economic fluctuations and the inability to leverage economies of scale.
- Quality scores that lag behind those of competitors.
- A product mix that does not cover smaller-car segments.
- Lack of investment in manufacturing practices that are critical to long-term profitability.

For GM, Treasury identified the following challenges:

- Over reliance on trucks and SUVs for a large share of profits.
- Substantial costs associated with retiree benefits, which will continue to grow through the restructuring period.
- Closing underperforming dealers at too slow a rate.

On March 30, 2009, the President announced that the restructuring plans submitted by Chrysler and GM did not establish a credible path to viability and do not justify substantial new investment of taxpayer dollars. The President outlined a series of actions that each company must undertake to receive additional federal assistance. The President's announcement further said that Treasury officials will work closely with Chrysler and GM as the companies take steps to achieve the following.

Chrysler: According to the Task Force, Chrysler is not viable as a stand-alone company and must find a partner to achieve long-term viability. Chrysler and the European automaker Fiat are in discussions about such a partnership, but additional work must be completed to result in a binding agreement and gain

²⁰These amounts are in addition to the loans Chrysler and GM are seeking through the Department of Energy for advanced technology vehicles. These loan applications are discussed later in this report.

²¹The Task Force is a cabinet-level group that includes the secretaries of Transportation, Commerce, Labor, and Energy. It also includes the Chair of the President's Council of Economic Advisers, the Director of the Office of Management and Budget, the Administrator of the Environmental Protection Agency, and the Director of the White House Office of Energy and Climate Change. The President has directed the Secretary of the Treasury and the Director of the National Economic Council to lead the Task Force. Also, Treasury has retained two additional individuals to assist the Task Force—a senior adviser to the Task Force who has experience in labor-management relations and a counselor to the Secretary who will advise on issues related to the auto industry. According to Treasury officials, the Task Force is advisory and has no decision-making authority.

the necessary support of stakeholders. Treasury agreed to provide Chrysler with up to \$500 million in loans under TARP to fund its operations for 30 days while the company takes additional steps toward restructuring. If Chrysler is successful in completing the additional steps, Treasury said it will consider investing up to an additional \$6 billion in Chrysler. If not, Treasury will not provide further federal assistance, which, according to Treasury officials, would likely result in a liquidation bankruptcy.

GM: The Task Force concluded that GM can be a viable company if it develops a more aggressive restructuring plan and implementation strategy. Treasury agreed to provide GM up to \$5 billion in loans under TARP to fund its operations for 60 days while it undertakes the additional work. Treasury also announced this restructuring effort would entail leadership changes at GM and increased involvement by Treasury and its outside advisers. If GM submits a satisfactory restructuring plan and implementation strategy by the end of the 60 days, Treasury will invest an unspecified amount of additional federal funds to help with GM's restructuring efforts. If, however, GM fails to meet these conditions, according to Treasury, it will not invest additional federal funds, creating the possibility that GM will file for a reorganization bankruptcy. GM's CEO stated that the Treasury's determination makes a bankruptcy filing for GM more "probable" than prior to the announcement.

Several new initiatives to help stabilize the auto industry and bring relief to those affected by the industry were announced in March 2009. The first two initiatives will be administered through AIFP and will be funded under TARP. The third initiative will seek to leverage federal funding available through other programs.

- **Supplier Support Program:** Under this program, Chrysler and GM will receive funding for the purpose of ensuring payment to suppliers. The program is designed to ensure that automakers receive the parts and components they need to manufacture vehicles and that suppliers have access to credit from lenders. The automakers will designate certain suppliers who are most critical to their operations to receive guaranteed payment for delivered supplies. After agreeing to participate in the program, the supplier sells eligible receivables to a special purpose entity established by the automaker to fund the program. Prior to the sale of the receivable, the automaker owes the supplier a payment for the receivable at a due date. If the supplier sells a receivable to the program, it receives payment from the special purpose entity, which becomes the owner of the receivable. If the supplier chooses to receive cash up front, a service fee of 3 percent is deducted from the payment; if the supplier chooses to receive payment on the receivable's due date—typically 45 to 60 days after delivery—the service fee is 2 percent. On the due date, the automaker is

responsible for paying the program servicer the amount due for the delivery. Treasury has made up to \$5 billion available through this program.²²

- **Warranty Commitment Program:** This program is intended to mitigate potential consumer reluctance to buy a vehicle from a financially distressed company by providing funding to guarantee the warranties on new vehicles purchased from participating auto manufacturers during the restructuring period.²³ Under this program, participating automakers (currently Chrysler and GM) and Treasury will contribute cash to a separate special purpose company. The total amount of cash to be contributed will equal 125 percent of the expected cost of paying for warranty service on each covered vehicle, with the automakers contributing 15 percent of the projected costs and Treasury providing a loan to contribute 110 percent of the projected cost. Should a participating automaker go out of business, a program administrator will be appointed to identify a qualified service provider to supply warranty services for vehicles sold during the restructuring period in exchange for the assets of the special purpose company. Treasury officials estimate the cost of this program to be about \$1.1 billion. According to several members of our panel, addressing consumers' concerns about warranties is important because, unlike buying a plane ticket from a bankrupt airline, purchasing a vehicle is a significant and long-term investment. Thus, consumers may avoid purchasing vehicles from an automaker facing the possibility of bankruptcy because they are concerned their warranties may not be honored, further depressing vehicle sales.
- **Initiative to Support and Revitalize Auto Industry Workers and Communities:** This initiative is intended to coordinate government efforts in providing assistance to communities and workers affected by the loss of auto manufacturing jobs. The director responsible for the initiative is tasked with working with all parties to ensure that communities and workers take advantage of all available government resources and to work with government and elected officials in helping retool and revitalize the economies of affected communities. In carrying out his duties, the director is charged with exploring all possible strategies, including seeking to maximize the use of funds from the American Recovery and Reinvestment Act of 2009

²²If Chrysler or GM file for bankruptcy, Treasury has the right to cease accepting receivables into the program.

²³In April, the government of Canada announced a similar program to guarantee warranties on Chrysler and GM vehicles sold in Canada. The program is valued at about \$150 million.

(Recovery Act), deploying rapid response units to communities facing plant closings, attracting new industries to the region, and working with stakeholders on legislative efforts to direct emergency support to the affected communities.²⁴

The programs that Treasury has announced for the auto industry—including the automakers, auto financing companies, and other stakeholders—as of April 2009, are summarized in table 2.

Table 2: Components and Funding Levels under the Automotive Industry Financing Program

Component	Description	Funding level
Automaker loans	Loans to Chrysler and GM to fund their operations while they take steps to restructure their companies	\$22.9 billion ^a
Assistance related to auto finance companies	Funding to assist Chrysler Financial and GMAC	\$7.4 billion ^b
Supplier Support Program	The program will provide funding to guarantee suppliers are paid for the products they ship to participating automakers.	\$5.0 billion ^c
Warranty Commitment Program	The program will set aside funds to guarantee warranties for vehicles Chrysler and GM sell during restructuring.	\$1.1 billion ^c
Total		\$36.4 billion

Source: GAO analysis of Treasury information.

^aThis includes the \$17.4 billion in loans agreed to in December 2008, which have been fully disbursed, and the up to \$500 million and up to \$5 billion that Treasury is providing to Chrysler and GM during their additional 30- and 60-day restructuring periods. Treasury may provide more assistance based on the outcome of the restructuring efforts.

^bThis amount includes an \$884 million loan to GM to allow the company to participate in GMAC's new rights offering related to its reorganization as a bank holding company; a \$5 billion purchase of preferred stock investment plus warrants from GMAC; and a loan of \$1.5 billion to a special purpose entity created by Chrysler Financial to finance the extension of new consumer automotive loans. A separate subsidiary of the Chrysler Holdings, Chrysler Financial Company provides financing to automotive dealers and consumers. Chrysler and Chrysler Financial operate independently from each other under separate managements. In April 2009, Treasury offered additional financial assistance to Chrysler Financial, but the company declined the assistance.

^cThese amounts are Treasury's estimated costs of the programs.

²⁴Pub. L. No. 111-5, 123 Stat. 115 (2009).

In Providing Assistance to the Auto Industry, Treasury Identified Goals and Objectives for the Assistance and Took Steps to Protect the Government's Interest

Treasury identified as a problem of national interest the financial condition of the U.S. automakers and its potential to affect financial market stability and the economy at large. In determining what actions to take to address this problem, Treasury concluded that Chrysler and GM's lack of liquidity needed immediate attention and, in order to prevent a significant disruption of the automotive industry, provided short-term bridge loans to the automakers. To address the industry's structural challenges, which will take more time to resolve, Treasury required Chrysler and GM to prepare restructuring plans that describe the changes the automakers intend to make in order to achieve long-term financial viability.

Treasury established goals and objectives for the federal financial assistance in the loan agreements and other program documentation. For example, the loan agreements state that funding should be used to enable the automakers to develop a viable and competitive business and develop the capacity to produce energy-efficient advanced technology vehicles, among other things. Although Treasury identified goals for the assistance, it will need to determine how to assess goals that rely on concepts that are not clearly defined and to evaluate the relevant trade-offs associated with the goals that appear to conflict. For example, the goals stated in the loan agreements include concepts that were not defined, such as rationalized manufacturing capacity and competitive product mix.

If additional assistance is provided to the automakers, it will be important for Treasury to clearly articulate what it intends to achieve with this assistance. We have previously reported that it is important for policymakers to identify objectives and goals for federal assistance that are clear, concise, and consistent. Such objectives and goals can help program administrators and Congress determine which financial tools are needed and most appropriate for the industry and for company-specific circumstances; provide criteria for program decisions; and serve as a basis for monitoring progress. In addition to lacking clear definitions, some of Treasury's goals may work at cross purposes, at least in the short-term, and thus will require an assessment of the relevant trade-offs among the goals. For example, according to members of our panel, producing advanced technology vehicles has the potential to conflict with the goal of developing a viable business in the near term because the costs of designing, developing, and producing these types of vehicles are greater than the revenue generated in the initial years of sales. We have previously

reported that it is important that policymakers choose clearly among potentially conflicting goals of providing federal financial assistance.²⁵ Without knowing the primary goal, it is difficult to decide what steps are appropriate and to judge whether a program has succeeded.

In developing the terms and conditions of the loans to Chrysler and GM, Treasury included provisions to manage risk and protect the government's interest. Table 3 describes these provisions. Treasury also established an internal working group—referred to as the auto team—to oversee the AIFP and provide analysis in support of the Task Force and the Secretary.

Table 3: Loan Terms and Conditions Designed to Manage Risk and Protect the Government's Interest

Concessions from stakeholders

- Executive compensation limitations: Restrictions on compensation for senior executive officers include recovery of any bonus or incentive payments based upon materially inaccurate statements of earnings, limiting tax deductions on executive compensation over \$500,000 per executive, and prohibiting golden parachute payments.^a
 - Agreements with debt holders: The automakers must use their “best efforts” to convert at least two-thirds of their unsecured public debt through a bond exchange or other appropriate means.
 - Labor concessions: The automakers must use their “best efforts” to reduce the compensation of their workers to be comparable to workers at transplant facilities, align their work rules^b more closely with those of transplants, and close the Jobs Bank programs.^c
 - Retiree concessions: The automakers must use their “best efforts” to reach agreement with the union to provide at least one-half of the automakers' future payments or contributions for retiree health plans (VEBAs) in the form of company stock.
-

²⁵GAO, *Guidelines for Rescuing Large Failing Firms and Municipalities*, GAO/GGD-84-34 (Washington, D.C.: Mar. 29, 1984).

Controls over management

- Approval of material transactions: Treasury must approve any fundamental changes to the automakers' companies and certain transactions for more than \$100 million in value and outside the ordinary course of business.
- Restrictions on expenses: The automakers must maintain and implement an expense policy with limitations on, among other things, sponsoring conferences and events, travel costs, office renovations, and entertainment. In addition, the automakers must provide for oversight and mechanisms to ensure compliance with the expense policy.
- Restructuring plans: The automakers are required to prepare restructuring plans outlining the actions they will take to meet the requirements set forth in the loan agreements, including concessions from various stakeholders. Treasury must approve these plans and the actions the automakers have taken toward implementing the plans before additional assistance is provided.^d
- Periodic reporting requirements: The automakers must submit periodic financial reports including weekly rolling cash forecasts^e and biweekly liquidity status reports,^f as well as monthly certifications of expense policy conformance and quarterly certification of compliance with executive compensation provisions.

Collateral

- Liens: In negotiations prior to signing the loan agreements, Treasury attempted to obtain senior liens on all unencumbered assets at both GM and Chrysler.^g

Compensation for risk

- Compensation: The automakers agreed to provide Treasury with compensation in the form of warrants and notes in the case of GM and additional notes in lieu of warrants in the case of Chrysler. Both automakers are required to repay the loans with interest.

Source: GAO analysis of Treasury information.

^aA golden parachute is defined as any payment in the nature of compensation to a senior executive officer made on account of involuntary termination or in connection with any bankruptcy filing, receivership, or insolvency of the institution to the extent that the present value of the payment equals or exceeds three times the executive's average annual compensation over the preceding 5 years.

^bWork rules generally refer to those sections of a contract that define issues such as hours to be worked and what work is done by what employees.

^cUnder their Jobs Bank programs, the Detroit 3 continue to provide wages and benefits to workers that have been laid off.

^dAs discussed above, Chrysler and GM submitted these plans on February 17, and Treasury announced on March 30 that additional steps must be taken before further assistance is provided.

^eThis forecast outlines for each of the thirteen weeks both operating and non-operating cash receipts and disbursements which result in a net cash flow for the week that increases or decreases the previous week's ending cash balance and results in the current cash balance.

^fThis report details the company's current liquidity profile; expected liquidity needs; any material changes in the company's business since the date of the last status report; any transfer, sale, pledge or other disposition of any material asset since the date of the last status report; and any changes to the company's capital structure.

^gA lien is a legal right that a creditor has in another's assets, usually lasting until a debt is repaid. Senior liens have priority over other liens on the same asset.

While the loan agreements include a number of terms and conditions to help protect the government's interests, some potential risks, as described below, remain.

Concessions from stakeholders. The loan agreements called for stakeholder concessions, including agreements from creditors to reduce overall debt, from labor for more competitive wage structures, and from retirees for modifications to VEBA contributions, as well as limits on executive compensation.

Agreements with debtholders: According to Chrysler officials, the company does not have substantial public debt, but it said in its restructuring plan that it would work with three groups of creditors, including Treasury, senior lien bank lenders, and the UAW VEBA, to reduce debt by \$5 billion. GM stated in its restructuring plan that it was negotiating a potential debt-for-equity exchange with an unofficial committee of GM bondholders.²⁶ As of April 22, although the automakers have begun negotiations with their bondholders (in the case of GM) and creditors (in the case of Chrysler) agreement has not been reached.

Labor and retiree concessions: Chrysler's and GM's negotiations with the UAW continue, and tentative agreements have been reached on modifications to labor costs and work rules. For instance, General Motors and the UAW reached a tentative agreement modifying wages, benefits and work rules to become more cost competitive with transplants. The net effect of these changes is a reduction in the company's annual hourly-related cost by approximately \$1.0 billion to \$1.1 billion, and potentially more, according to GM. As of April 22, agreements on restructuring Chrysler and GM's monetary contributions to fund retirees' health care plans have not been reached.

Executive compensation: According to Treasury officials, they are waiting for the Office of Management and Budget to approve additional regulations that Treasury has drafted on executive compensation as required by the Recovery Act before establishing a process to monitor compliance with the executive compensation requirements. Establishing procedures to oversee compliance with such requirements is important to

²⁶ According to a GM official, as of March 2009, GM had identified about 182,000 bondholders. However, they are certain that not all bondholders have been identified. Therefore, the total number of bondholders is expected to be higher.

help ensure that the automakers adhere to conditions set forth in the loan agreements.

Collateral. Treasury's goal in its negotiations with Chrysler and GM prior to signing the loan agreements was to obtain senior liens whenever possible and, for assets already encumbered, to obtain junior liens. For Chrysler, because most assets were already encumbered with senior liens, Treasury was only able to obtain a senior lien on a portion of the company's parts inventory, known as Mopar.²⁷ For GM, Treasury obtained a senior lien on cash, inventory, real property, equity in domestic and foreign subsidiaries, and intellectual property. Treasury also received junior liens on additional assets from both companies. According to Treasury officials, Treasury cannot put an estimated dollar value on either company's pledged collateral because the value of certain items, such as cash and inventory, is constantly changing. Treasury officials said that the limited amount of assets on which the government has senior liens could become an issue if the companies enter bankruptcy or otherwise liquidate their assets, although the situation differs somewhat for the two companies.²⁸ According to Treasury, in the case of Chrysler, the sale of the assets would result in cash equal to only a small percentage of the value of the loans. Moreover, because Treasury placed liens on all unencumbered assets to secure the December loans, it will be difficult or impossible for the government to obtain additional collateral for any new loans that may be provided. In its restructuring plan, GM proposed that additional federal assistance could be in the form of a preferred equity investment in the company, a revolving facility,²⁹ and a loan secured by the collateral already used to support the current \$13.4 billion loan. Chrysler did not propose collateral options for any additional federal assistance in its restructuring plan.

In considering whether the federal government should provide additional assistance to Chrysler and GM, it is important to assess the government's

²⁷Chrysler reported in its restructuring plan that the Mopar inventory has a recovery value between \$149 million and \$261 million.

²⁸In commenting on a draft of this report, a GM official stated that in a normally functioning credit market, the assets GM provided as collateral would likely have supported similar loans from commercial lenders, although GM did not have formal valuation data to support this statement.

²⁹A revolving facility is a type of loan allowing a borrower to draw down and repay amounts (up to a limit) for short periods throughout the life of the loan. Amounts repaid can be re-borrowed, thereby providing some flexibility to the borrower.

overall financial exposure should one or both of the automakers fail to achieve long-term viability. A potential area of significant financial exposure is the government's liability for terminated pension plans. Specifically, the Pension Benefit Guaranty Corporation (PBGC)—a self-funded government corporation—insures private-sector defined benefit plans.³⁰ When PBGC takes over a terminated pension plan, it assumes responsibility for future benefit payments to the plan's participants, up to the limits set in law.³¹ An underfunded pension plan that is insured by PBGC may be terminated only if certain statutory criteria are met. In general, an employer is permitted to terminate an underfunded plan only if it can demonstrate that it is in serious financial distress and cannot continue in business or reorganize (if in bankruptcy) unless the pension plan is terminated.

The pension plans of Chrysler and GM pose considerable financial uncertainty to PBGC. In the event that Chrysler or GM cannot continue to maintain their pension plans—such as in the case of liquidation or an asset sale—PBGC may be required to take responsibility for paying the benefits for the plans, which are currently underfunded by a total of about \$29 billion.³² Although it is impossible to know what the exact claims to PBGC would be if it took over Chrysler's and GM's pension plans, doing so would likely strain PBGC's resources, because the automakers plans' represent a

³⁰PBGC was established by the Employee Retirement Income Security Act of 1974. Pub. L. No. 93-406, 88 Stat. 829 (29 U.S.C. §§ 1001- 1461).

³¹PBGC's single-employer insurance program guarantees participant benefits up to \$4,500 per month for age-65 retirees of plans terminating in 2009, with lower guarantees for those who retire before age 65. Additionally, benefit increases arising from plan amendments in the 5 years immediately preceding plan termination are not fully guaranteed, although PBGC will pay a portion of these increases. A similar 5-year phase-in limit applies to benefits payable upon the permanent closing of a plant or similar event. PBGC is also restricted from paying certain supplemental benefits, such as temporary benefits payable from early retirement to the date a retiree becomes eligible for Social Security benefits. These temporary supplemental benefits are generally not guaranteed.

³²Estimates of pension funding levels vary based on the methods and assumptions used. According to PBGC, GM's plans were underfunded by \$20 billion and Chrysler's by \$9.3 billion on a termination basis as of November 30, 2008, for GM and January 1, 2009, for Chrysler. Termination liability reflects the cost to a company of paying an insurer to meet its pension obligations should the plan terminate. This is calculated by using actuarial assumptions PBGC makes including interest and mortality. Termination liability is often higher than liability calculated for other purposes. According to GM's financial statements, its U.S. pension plans were underfunded by \$13.6 billion as of December 31, 2008; according to information provided by Chrysler, its U.S. pension plans were underfunded by \$3.6 billion as of December 31, 2008.

significant portion of the benefits it insures. Further, from an administrative standpoint, PBGC would be presented with an unprecedented number of assets to manage as well as benefit liabilities to administer.³³ To the extent these additional claims markedly increase PBGC's accumulated deficit and decrease its long-run liquidity, there could be pressure for the federal government to provide PBGC financial assistance to avoid reductions in guaranteed payments to retirees or unsustainable increases in the premium burden on sponsors of ongoing plans.³⁴

Automakers Have Addressed Some of the Factors Important for Achieving Viability, and Many Challenges Remain

In general, we found that Chrysler's and GM's February restructuring plans contain some of the key factors our panel of individuals with auto industry expertise identified as important for achieving viability, such as reducing the number of models and brands and rationalizing dealerships. However, the plans do not fully address all of the considerations that members of the panel identified, which are discussed below. Treasury identified similar concerns and concluded that Chrysler and GM need to establish a new strategy for long-term viability in order to justify substantial additional investment of federal funds. Achieving viability may be difficult because of a number of challenges facing the automakers, including some outside of their control.

Chrysler's and GM's February Restructuring Plans Do Not Fully Address Factors Needed to Achieve Viability

Reducing the number of brands and models

About half of the members of our panel said that reducing the number of brands and models would be a key factor in achieving financial viability. Some of the cited advantages of eliminating brands and models include reducing intracompany competition for sales of similar models, eliminating associated costs such as factory tooling and product development, and focusing remaining resources on fewer models for

³³For example, we estimate that GM's and Chrysler's plans include roughly 900,000 participants, both those receiving benefits now and those who have earned benefits payable in the future, which would increase the total number of PBGC's current or future beneficiaries by nearly 80 percent. Additionally, PBGC would pay all the plans' benefit promises, up to certain limits set by Congress. These limits mean that some individuals, typically younger retirees, would see reduced benefits.

³⁴PBGC has available a \$100 million line of credit from the U.S. Treasury for liquidity purposes if its self-generated funds are insufficient to meet operating cash needs in any period.

greater improvements in quality, brand image, and performance. One panelist further noted that eliminating brands and models also eliminates dealers, another cost savings, although as discussed below, there are costs associated with closing dealers that can be difficult to estimate.

According to its February plan, Chrysler has reduced its number of vehicle models by seven. However, some members of our panel criticized Chrysler's product mix; for example, one panelist noted that most of Chrysler's product line contains older models and that to be competitive the company needs to introduce more new products in 2009. Another noted that Chrysler has plans for only one midsize model and no luxury models to compete with models from other companies. GM's February plan proposes to reduce its brands to the four core brands that account for more than 90 percent of the company's U.S. aggregate contribution margin (revenue less variable cost) by selling or phasing out three brands.³⁵ One panelist noted that GM's focus on the remaining four brands is a good long-term strategy, although another noted that this may cause difficulties in short-term sales because consumers may be unlikely to buy cars from a brand that is being discontinued. GM's plan also includes a total reduction in the number of models by 25 percent, including the reduction of models from brands that GM is planning to sell or phase out. Within the planned overall reduction in the number of models, GM is planning to introduce five new hybrid and plug-in models by 2012, bringing the total of such models to 14. These new models would include at least one extended range electric vehicle;³⁶ however, members of our panel cautioned that this electric model may not sufficiently improve GM's viability because the car is expected to be priced too high to result in substantial sales.

Treasury identified similar challenges related to both Chrysler's and GM's product mixes. According to Treasury, given that Chrysler and GM rely on profits from trucks and SUVs, which typically have higher profit margins than smaller vehicles, both companies face challenges due to the

³⁵ Additionally, one existing brand would become a niche brand.

³⁶ An extended range electric vehicle has an electric motor that turns the vehicle's wheels and is powered by a battery that is charged from an outlet. It also has a small internal combustion engine that is fueled with gasoline or other alternative fuel, but, in this case, the engine acts as a generator for the electric motor.

vulnerability of demand for these vehicles based on fuel prices.³⁷ Treasury also concluded GM is currently burdened with underperforming brands and models and that GM's plan does not act aggressively enough to curb these problems. Treasury noted that although the decision to sell or phase out three brands is an important step, GM is late in taking this step. Additionally, Treasury determined that GM's current plan retains too many unprofitable models that have negative effects on GM's operations.

Rationalizing dealership networks

Half of the panelists considered decreasing the size of the domestic automakers' dealership networks to be an important factor for future viability, with several noting that the networks are too large to be supported by the sales levels of recent years. Today, Detroit 3 dealerships—many of which are independently owned and operated—are more numerous and, in general, sell half or fewer vehicles per dealership than transplant dealerships. As one panelist noted, higher sales per store allow for a greater return on the dealer's fixed costs of running the business, allowing for more investment in facilities and advertising—which ultimately benefits the automaker by improving the price for which its cars can be sold.

Chrysler's plan for reducing dealerships includes merging its three brands—Chrysler, Jeep, and Dodge—into combined dealerships rather than having separate dealerships for each brand. Although the plan indicates that Chrysler has reduced its number of dealerships by about 700 since 2004, the plan does not indicate how many additional dealerships can be eliminated through combined dealerships. A Chrysler official also noted that because of unfavorable market conditions, many dealers are choosing to close or consolidate with other dealers. GM has already reduced the size of its dealership network and plans to further reduce it from its 2008 level of 6,246 to 4,100 in 2014. GM's plan also indicates specifically which brands and locations (metropolitan or rural markets, for instance) will be targeted for reductions. Several members of our panel told us that eliminating dealerships against their will would be challenging due to state franchise laws that protect dealers, as discussed later in this report, and therefore the companies would need to negotiate with the

³⁷In commenting on a draft of this report, a GM official noted that for all automakers, SUVs and trucks generally have higher profit margins than cars. In addition, the official said that GM's increased emphasis on smaller cars was evident by 2007 and that GM had promoted its ability to deliver fuel efficient cars as early as 2004.

dealers. Chrysler's plan does not discuss such negotiations and associated costs, such as buying back dealer inventory; however, GM's plan acknowledges that each negotiation is unique depending on factors such as the individual state law, the dealer, possible union contracts, and associated finance and warranty business, and that the costs of terminating a dealership can vary greatly.

Treasury concluded that although GM has been successfully pruning dealerships for several years, more aggressive restructuring is needed. According to Treasury, GM's current pace for reducing the number of dealerships will burden the company with too many unprofitable or underperforming dealerships for a long period of time, which hurts brand equity and the prospects of stronger dealerships.

Reducing production costs and capacity

According to our panel, the companies have excess production capacity and their cost structures do not facilitate the companies' profitable operation in a market in which sales volumes are significantly lower than they have been in past years. Panelists told us that the companies' cost structures were established during a time when they dominated the U.S. market, and as foreign competition grew, their market shares decreased. Some of the panelists added that rather than adjust their cost structures, such as by reducing fixed costs, the companies pursued higher sales volumes to try to profitably operate under their existing cost structure. Given the forecast for continued decreased sales volumes, members of our panel said that they expected the restructuring plans to identify significant reductions in fixed costs. Additionally, these individuals said the automakers could benefit from incorporating efficiencies used by some of the foreign automakers into their production processes, such as manufacturing multiple types of vehicles at the same production facility or relying more on common vehicle architectures for the production of vehicles. Common vehicle architectures can allow automakers to plan, design, engineer and source vehicles for all global markets, whereas previously these efforts may have differed based on whether a car was to be sold in the United States or Europe, for example.

According to Chrysler's February plan, the company began restructuring in 2007 to reduce fixed costs, and, by the end of 2009, these costs will have been reduced by \$3.8 billion (27 percent), which includes a reduction of its

salaried workforce by 35,000.³⁸ In addition, Chrysler is requesting a 3 percent reduction in suppliers' prices. However, some members of our panel said that reliance on supplier price cuts is a problematic assumption because the suppliers are struggling financially and cannot afford to reduce their prices. Chrysler's plan does not address specific plans for production flexibilities. According to GM's February plan, the company plans to reduce its North American fixed costs by about \$6 billion from 2008 to 2011 and keep those cost levels constant through 2014. These savings are largely the result of the initiatives outlined in the plan and include the reduction of U.S. employment levels (hourly and salaried) by about 20,000 from 2008 to 2011, acceleration of labor cost parity with transplants, idling of 14 additional manufacturing facility in the United States by 2012, and reduction of 12 models offered in the United States by 2012. However, some members of our panel cautioned that the company may not be able to "cut its way to prosperity" and that GM needs to have a plan for how remaining salaried workers will carry out the restructuring efforts. GM's plan also indicates that the company plans to increase production flexibility by increasing the number of plants that can produce multiple vehicle models and that by 2012, more than half of its U.S. passenger car sales will be derived from common architectures.

Treasury concluded that although both Chrysler and GM have made progress related to manufacturing, Chrysler still faces challenges in this area. Treasury noted that Chrysler's plan identified opportunities for reducing the company's cost structure, including fixed-cost reductions; however, manufacturing is still a key challenge for Chrysler because it has not invested significantly in common architectures and manufacturing flexibility. In contrast, Treasury said that GM has made material progress in creating common architectures and has worked to create greater flexibility in its facilities. According to Treasury, GM's actions in this area allow it to spread its product development and fixed costs over a large range of vehicles; in contrast, Treasury identified Chrysler's scale as a challenge because the company must spread fixed costs over a smaller number of vehicles, which may limit funding for the research and development needed to maintain competitiveness.

³⁸Chrysler provided some examples of fixed-cost reductions including plant closures, improved asset utilization, program deferrals and cancellations, and healthcare actions related to active and retired employees.

Obtaining labor concessions

A number of panelists attributed the domestic automakers' current financial condition in part to the labor agreements with the existing workforce, as well as health-care and pension costs associated with the companies' retirees. Several of them noted that Chrysler's and GM's labor costs are higher than those of transplants primarily because of more generous healthcare benefits for workers. Others noted that work rules contained in the labor agreements can increase costs and limit production flexibility.³⁹ According to the companies' plans, the UAW, and our panelists, previous labor agreements reached between the UAW and the automakers are helping to restructure labor costs to be competitive with transplants, by, for instance, bringing in new hires in nonskilled trades at a substantially lower wage rate than current workers, but some members of our panel said that more needs to be done in this area.⁴⁰

Both Chrysler's and GM's February restructuring plans discuss proposed labor concessions, but no final agreements have been reached to date. According to Chrysler's plan, it has a tentative agreement with the UAW to implement labor terms competitive with those of transplants. The tentative agreement includes adjustments to levels of compensation, work rules, and severance provisions such as elimination of the Jobs Bank program, which provided income and benefit protection in lieu of layoffs. Similarly, GM's plan indicates that the company has reached agreement with the UAW to implement competitive work rules and to reduce labor costs. GM's plan also discusses some labor concessions that are in the process of being implemented, namely reducing costs through buyouts. Neither company has reached an agreement with the UAW to reduce cash contributions to the VEBAs to fund retirees' healthcare plans, also part of Chrysler's and GM's plans to achieve viability. According to the UAW, union members will not vote to ratify the labor modifications (e.g.,

³⁹For instance, some of our panelists told us that transplants have fewer job classifications for hourly workers, which creates flexibility in reassigning workers to new or different tasks. In contrast, UAW contracts establish dozens of job classifications and narrowly define the roles that each classification can perform, limiting flexibility in managing staffing.

⁴⁰As previously discussed, the terms of the automakers' loan agreements require the automakers to try to (1) achieve total compensation packages (wages and benefits) competitive with transplants, (2) apply work rules that are competitive with transplants, and (3) eliminate any compensation or benefits, other than customary severance pay, to employees that have been fired, laid off, furloughed or idled.

compensation and work rules) until a tentative agreement has been reached on the modification to VEBA contributions.⁴¹

Treasury concluded that neither company has satisfied the terms of the loan agreements, in part, because neither reached approval on labor and VEBA modifications. Treasury also identified liabilities associated with pensions and health care for retirees as a challenge for GM, given that the company would need to sell 900,000 additional cars per year to cover its future cash payments for these costs. According to Treasury, these costs leave GM aiming to maximize sale volumes rather than focusing on return on investment.

Relying on realistic estimates for sales volumes, market share, and other assumptions

Members of our panel said that the success of the plans would depend on whether the underlying assumptions for sales, market share, and possible future financial assistance were realistic. They cautioned against basing estimates for viability on assumptions of an immediate increase in sales volumes or in the Detroit 3's market share. Some of the panelists attributed the automakers' financial struggles, in part, to the companies' historical reliance on unrealistic expectations of sales volumes and market share that were not later met. As previously discussed, given their existing cost structure, the companies must have high sales volumes in order to achieve profitability. However, if the companies' forecasts for sales volumes and market share are too optimistic compared to actual consumer demand, the restructuring plans may not result in financial viability without further modifications to the restructuring plans. Therefore, some panelists said that restructuring efforts need to rely on realistic or conservative assumptions about sales volumes and market share.

Regarding sales assumptions, Chrysler's baseline plan relies on 10.1 million unit sales in the United States for cars and light trucks in 2009, and GM's baseline plan relies on 10.5 million unit sales. Both plans include

⁴¹Although Ford has not accepted federal assistance and is not bound by the terms of the loan agreements that Chrysler and GM signed, Ford and the UAW reached agreement in March 2009 on modifications to the 2007 labor contract and to plans for Ford's contributions to the VEBA. This agreement is noteworthy because, according to the UAW, the agreement addresses all of the labor and VEBA modifications that Chrysler and GM must achieve under their loan agreements with Treasury.

2009 downside scenario sales estimates that are 1 million unit sales lower than their 2009 baseline scenario sales estimates (9.1 million, for Chrysler; and 9.5 million, for GM). Some panelists told us that they thought the automakers' baseline sales estimates were realistic. With respect to market share, they said the companies should provide analysis to support their market share assumptions, given that the companies have been losing market share for decades while continuing to project gains in market share. GM's plan includes some key assumptions that drive its market share analysis; however the plan does not indicate to what extent each of these assumptions affects market share estimates. Chrysler's plan does not identify the assumptions that contribute to its market share estimates. One panelist commended GM for acknowledging the potential for dropping from its 2008 U.S. market share of 22 percent to below 20 percent market share, although another cautioned that GM may not be able to maintain more than 16 percent market share. A few of the panelists noted that sales projections may not be realized due to the effect of eliminating or discontinuing brands because buyers interested in those brands may turn to competitors' products, rather than to other brands of GM and Chrysler.

The February plans also assume assistance from other entities, including loans from the Department of Energy (DOE), an alliance with another automaker (in the case of Chrysler), and loans from foreign governments (in the case of GM).⁴² In addition to the AIFP funding the automakers requested in their February restructuring plans, Chrysler's plan assumes \$6 billion in DOE loans and GM's plan assumes \$7.7 billion in DOE loans. However, DOE has not completed its review of either company's application, in part, because DOE's program rules require loan recipients to be financially viable. DOE officials told us that they cannot finish reviewing Chrysler's and GM's applications until Treasury makes a final determination on the companies' viability, and that DOE will coordinate with Treasury in making that determination. Additionally, Chrysler's plan indicates that to be viable on a long-term basis, the company must pursue strategic alliances and includes a scenario based on a proposed alliance between Chrysler and Fiat, a European car company. Chrysler states in its plan that this alliance would provide Fiat with an equity stake in Chrysler and will provide Chrysler access to Fiat's smaller, fuel-efficient platforms

⁴²Chrysler and GM have both applied for loans from DOE's Advanced Technology Vehicle Manufacturing Program, which will provide low-cost loans to auto manufacturers or component parts producers to retool or build plants to make cars or components that will substantially improve vehicle fuel economy.

and technologies, as well as Fiat's international dealer network. However, the alliance does not provide any financial resources, for example, through equity contributions to Chrysler. Chrysler also states in its plan that even with a Fiat alliance, the company would struggle if sales fall below its downside estimate.

In its plan, GM assumes it will receive about \$6 billion in financial assistance from foreign governments to be able to maintain adequate cash balances for its global operations through the beginning of economic recovery. The company's restructuring plan details the progress of ongoing discussions with governments in Australia, Canada, Europe, and Asia in order to achieve viable operations in those regions. GM submitted a separate restructuring plan to the Canadian government on February 20, 2009, which the Canadian government found to be insufficient.

Treasury criticized several of the automakers' assumptions as being too optimistic or too aggressive. Treasury noted that Chrysler assumes it will maintain its market share even though it has lost market share over the last decade and there are few signs it can reverse this trend. Similarly, Treasury determined that GM's market share assumptions are too optimistic. GM has been losing 0.8 percent market share annually over the last 30 years and its plan assumes a slower rate—0.3 percent per year—of market share decline. With regard to pricing assumptions, Treasury stated that it will be challenging for Chrysler to maintain pricing as projected in its plan given what Treasury characterized as the perception of poorer product quality. With respect to GM, Treasury noted that its plan does not assume a decreased contribution margin despite a severely distressed market and the company's plan focuses on passenger cars and crossovers, which traditionally have earned lower contribution margins than trucks and SUVs. Additionally, Treasury concluded that GM's assumption of European assistance represents a risk to the viability of its plan because funds from European governments have not been allocated.

Automakers Face Many Challenges to Successful Restructuring

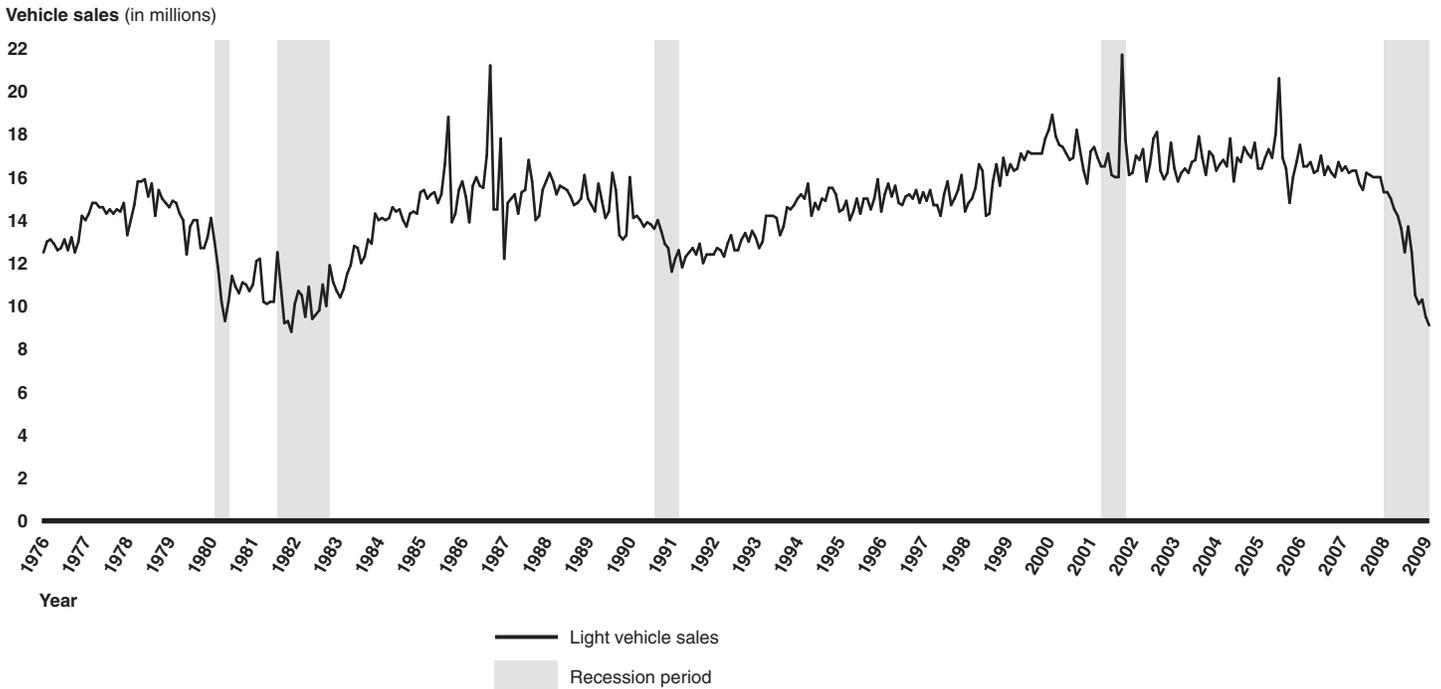
The automakers are confronting a number of challenging conditions in their efforts to restructure in a way that will achieve and sustain long-term viability, according to members of our panel and research we reviewed. Some of the challenges are the same ones that led to the automakers' current condition, such as the weak economy and changing consumer preferences. Although Chrysler and GM acknowledged many of these challenges in their restructuring plans, many are beyond their control.

Weak economic conditions

The poor condition of the U.S. economy will likely continue to affect the financial health of Chrysler and GM. As figure 2 shows, over the past 30 years, automobile sales almost always decreased during periods of economic recession. Chrysler and GM officials, as well as some panelists, noted that the current recession has had a similar effect on consumer confidence in general and automotive purchases in particular. Some panelists attributed this pattern to the discretionary nature of automobile purchases—that is, these purchases are easily postponed during periods of economic downturn. Reflecting the current economic conditions and projected slow recovery, both Chrysler and GM revised their sales projections downward, as noted above. However, if the economy recovers more slowly than the companies anticipate and sales revenues are lower than projected, the companies may not be able to achieve viability according to schedule and under the conditions laid out in their plans. For instance, both Chrysler and GM noted that their downside scenarios, which will occur if sales volumes are lower than expected, would result in the need for more federal funding than their baseline scenarios. However, although GM’s assumption about economic growth (measured by gross domestic product) for 2009 was characterized as more conservative than other estimates, this assumption now looks optimistic compared to Congressional Budget Office and IHS Global Insight estimates.⁴³

⁴³IHS Global Insight is a private sector firm that provides economic and financial forecasts and industry analysis.

Figure 2: Monthly Light Vehicle Sales, 1976 to 2009 (Seasonally Adjusted Annual Rate)



Source: U.S. Department of Commerce, Bureau of Economic Analysis.

Note: According to members of our panel, the spike in sales during 2001, a recession period, is largely attributed to the financing incentives that the automakers offered consumers.

Frozen credit markets

The continuing lack of credit availability—on both a consumer and institutional level—is a major challenge for the automakers. A substantial amount of vehicle financing is obtained through asset-backed securities (ABS) transactions, which provide liquidity to the automotive financing companies, such as GMAC and Chrysler Financial, and enable dealer and consumer financing. However, due to conditions in the capital markets, considerably less of this type of financing is occurring. In turn, this has affected the ability of dealers to offer retail financing to consumers. Because almost all consumers rely on some level of financing to purchase automobiles, this lack of credit has negatively impacted sales. In addition, the lack of credit availability has affected dealers’ ability to finance their inventory (referred to as floorplan financing). Since dealers purchase vehicles from the automakers, the lack of floorplan financing also negatively impacts the automakers’ revenues. Given the role the automotive financing companies play in vehicle sales, Chrysler and GM

indicated in their restructuring plans that the financial health of Chrysler Financial and GMAC is critical to their financial viability. As noted earlier, both GMAC and Chrysler Financial have received federal financial assistance through AIFP.⁴⁴

To increase the availability of credit for consumers, Treasury and the Federal Reserve have announced the Term Asset-Backed Securities Loan Facility (TALF) program, which will provide financing to investors for purchases of ABS and could generate up to \$1 trillion in lending for individuals and businesses.⁴⁵ Eligible ABS includes newly issued AAA-rated tranches of securitizations backed by auto loans. However, officials from the automakers and auto financing companies we interviewed expressed concern about the AAA-rating requirement, noting that under such a requirement certain of the auto financing companies' securities would not be eligible.

Solvency of suppliers

Officials from Ford, GM, and Chrysler, as well as members of our panel, stated that the tenuous financial condition of auto suppliers is a major concern because the solvency of the supply chain is critical to the automakers' viability. As Ford's CEO noted in his December 2008 congressional testimony, the domestic auto manufacturing industry is interdependent, especially in the area of suppliers, with an estimated 80 percent overlap in supplier networks. Thus, according to the automakers and some panelists, the collapse of one or more of the domestic automakers would affect the remaining automakers because, among other things, such a collapse could impact the ability of shared suppliers to continue operations. Ford also noted that a supplier financing safety net—such as guarantees on payment from the federal government—would help prevent this situation. Moreover, large production cuts due to sluggish sales, especially in the first quarter of 2009, have affected the cash flow and liquidity of many automotive suppliers. According to the Motor & Equipment Manufacturers Association (MEMA), more than 40 major

⁴⁴To date, Ford Motor Credit Company (Ford Credit) has not received financial assistance under AIFP; however, it is a participant in the Commercial Paper Funding Facility and the Term Asset-Backed Securities Loan Facility programs. Like Chrysler Financial, Ford Credit has applied to FDIC to establish an industrial loan company. An industrial loan company is a financial institution that lends money and may be owned by nonfinancial institutions. To date, FDIC has not made a decision on Chrysler Financial or Ford Credit's application.

⁴⁵Up to \$100 billion in funding will come from TARP.

suppliers filed for Chapter 11 restructuring in 2008, with industry surveys indicating approximately one-third of all suppliers are in imminent financial distress.⁴⁶ As previously noted, Treasury announced in March it would provide up to \$5 billion in assistance to help suppliers.

Cost of developing advanced technology vehicles

Several panelists noted that not only is developing advanced technology vehicles expensive, but also the return on the investment in those vehicles can be low because the initial demand for new technologies can be slow to develop. For example, the Toyota Prius was on the market for 10 years before reaching 1 million units sold. According to our panel, given the high development costs and low initial demand, especially if gasoline prices remain relatively low, these new vehicles are not likely to generate a profit for several years. Thus, changing the companies' product mix to include more advanced technology vehicles may not be the best way to improve the financial bottom line in the short term. Furthermore, at least one panelist questioned whether the necessary energy infrastructure, such as electrical outlets to charge batteries, will be available to support these new technologies. Without adequate infrastructure, consumers will be reluctant to purchase these new advanced technology vehicles. GM officials acknowledged these challenges but indicated that the company decided to continue investing in advanced technologies even during the current financial crisis because they need this technology in their fleet to help meet federal fuel economy standards in the future. In addition, GM officials said they are planning for higher oil prices than current futures market expectations, in order to make GM's plan more robust against oil price volatility.

Reducing the number of dealerships to align with sales volumes

Many panelists said that it will be difficult for Chrysler and GM to resize their dealership networks. The large number of dealers increases intra-brand competition and thus reduces the pricing power of individual dealers. One GM official noted that the biggest competition for a GM dealer is often the other GM dealer down the street. As previously mentioned, Detroit 3 dealerships sell substantially fewer vehicles per dealership than transplant dealerships sell. Given these and other concerns, Chrysler, Ford, and GM are

⁴⁶MEMA represents motor vehicle parts suppliers. MEMA supports its members through its three affiliate associations: Automotive Aftermarket Suppliers Association, Heavy Duty Manufacturers Association, and Original Equipment Suppliers Association.

working to “right size” their dealer networks to better align with automakers’ current and projected sales volumes and market shares. However, panelists told us state franchise laws make eliminating dealerships difficult because these laws generally provide strong protections for auto dealer franchisees. For example, Michigan’s law on auto dealer franchises states that manufacturers must provide adequate notice, act in good faith, and have good cause in order to terminate an agreement with a dealer.⁴⁷ Any action to consolidate or eliminate a dealer—outside of a bankruptcy court—must be negotiated with the affected dealers. According to members of our panel, under the best-case scenarios, the automakers can expect to incur significant costs and delays in rationalizing their dealership networks. Given the current depressed level of automobile sales, automakers and panelists also told us that some dealers are looking either to go out of business voluntarily or to merge their business with other dealerships.

Uncertainty over future fuel economy standards

The current uncertainty of future fuel economy standards could complicate the auto manufacturers’ ability to plan for future market conditions. The National Highway Traffic Safety Administration (NHTSA), within the Department of Transportation, issues fuel economy standards for vehicles sold in the United States. Currently, fuel economy standards are set through model year 2011. NHTSA officials told us they plan to propose standards for model years 2012 through 2016 this summer and issue final standards by March 31, 2010. Further, according to NHTSA, it must coordinate the rule making with the Environmental Protection Agency (EPA). EPA will be responsible for setting standards regarding the level of greenhouse gases passenger vehicles can emit if it adopts its proposed finding that greenhouse gases in the atmosphere endanger the public health and welfare.⁴⁸ In addition, NHTSA officials said they were monitoring events relating to California’s and other states’ attempts to set and enforce individual greenhouse gas emission standards for passenger vehicles. Chrysler and GM officials told us they would prefer one national standard to individual state standards. If NHTSA raised the fuel economy standards above what the automakers have planned for their near-term product line, or if states are allowed to set individual standards, it could complicate the viability plans of the auto manufacturers by forcing them to make faster, more costly technological investments in their vehicles than they otherwise had planned. NHTSA officials told us that when

⁴⁷Mich. Comp. Laws § 445.1567(1)(a)-(c).

⁴⁸Greenhouse gas emissions in vehicles are directly related to a vehicle’s fuel economy.

setting future fuel economy standards, they would take into account the ability of the auto industry to make the necessary technological investments in its products to increase fuel economy.

Reducing debt

Restructuring the automakers' balance sheets by reducing debt and related leverage are critical elements to any plan for long-term viability.⁴⁹ As of December 31, 2008, GM had total liabilities of \$176.4 billion compared to negative stockholders' equity of \$86.2 billion. GM's liabilities of \$176.4 billion included current liabilities (payable in 2009) of \$73.9 billion and noncurrent liabilities of \$54.1 billion for pensions and postretirement benefits and \$29.6 billion of long-term debt.⁵⁰ The loan agreement calls for GM's "best efforts" to reduce its unsecured public debt by at least two-thirds. As of December 31, 2008, GM had about \$27.2 billion of unsecured public debt (consisting of amounts included in GM's debt payable in 2009 and long-term debt). In its restructuring plan, GM reported that negotiations were under way with its bondholders to convert the unsecured debt to equity. This debt restructuring would reduce interest expense and immediately improve cash flow to GM. Chrysler, which does not have significant unsecured public debt, proposed working with creditors, including Treasury, senior lien bank lenders, and the UAW VEBA, to reduce its debt by \$5 billion.⁵¹

According to members of our panel and financial analysts we interviewed, reaching agreements with bondholders could be difficult because the value of company stock is less than the value of the bonds. Bondholders will be trading a known rate of return that is subject to bankruptcy risk for a completely unknown rate of return that is also subject to bankruptcy risk. As a Treasury official noted, however, by not agreeing to the exchange, the bondholders are subject to the risk that the companies could file for bankruptcy, potentially rendering their bonds worthless. According to financial analysts we spoke with, many bondholders are willing to take their chances waiting for more government assistance. Recognizing these

⁴⁹Leverage represents the amount of debt in relation to equity plus reserves and is a critical measure in determining an entity's financial flexibility and solvency.

⁵⁰The remaining \$18.8 billion of liabilities are comprised of liabilities for financing and insurance operations, other liabilities, and deferred income taxes.

⁵¹We reviewed Chrysler's financial statements but because it is not a public company, information on its liabilities cannot be disclosed in this report.

challenges, officials from both Chrysler and GM told us they will likely need the assistance of the Presidential Task Force or Treasury to reach agreement with their bondholders or creditors.

Given Challenges, Treasury and Automakers Are Considering Options for Restructuring

Given the substantial amount of debt that both Chrysler and GM have, and the uncertainty that revenues from car sales will increase in the near term or that the automakers' stakeholders will reach an agreement needed for successful restructuring, Treasury and the automakers have acknowledged the very real possibility that restructuring might be accomplished through a reorganization under the bankruptcy code. Under that scenario, according to Treasury, the most likely approach would be a court-supervised asset sale, in which the company's good assets would be sold to a new entity,⁵² and substantial amounts of the company's debt would remain in possession of the old part of the entity to be dealt with in bankruptcy court. Treasury said this approach would help accelerate the turnaround of the companies by allowing them to quickly exit bankruptcy. According to Treasury, another possibility for restructuring for GM would be a "prepackaged" bankruptcy, in which the company's creditors approve a reorganization plan before the company files for bankruptcy; however, according to Treasury, it appears unlikely that such an agreement could be reached in the limited amount of time available. Treasury has said it would consider providing bankruptcy financing to Chrysler and GM if the companies meet the conditions Treasury set in its March 30 announcement and if Treasury and the companies determine that a reorganization bankruptcy is the best course of action.⁵³

Agency Comments and Our Evaluation

We provided a draft of this report to the Departments of the Treasury, Transportation, and Energy for review and comment. These agencies provided technical clarifications, which we incorporated as appropriate.

We also made a draft of this report available to Chrysler and GM officials for their review and comment. Chrysler and GM officials provided technical corrections and clarifications, which we incorporated as appropriate.

⁵²The sale would be conducted under 11 U.S.C. § 363, and the shareholders of the new entity would include the federal government and the current stakeholders of Chrysler or GM.

⁵³Section 364 of the bankruptcy code governs debtor-in-possession financing and authorizes various kinds of credit after a bankruptcy petition is filed. If the federal government were to extend credit to the automakers in a Chapter 11 reorganization bankruptcy, the federal government could receive priority regarding the payment of such loans under 11 U.S.C. § 364.

We are sending copies of this report to other interested congressional committees and members, the Departments of the Treasury, Transportation, and Energy, and others. The report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact Katherine Siggerud at (202) 512-2834 or siggerudk@gao.gov or Susan Fleming at (202) 512-2834 or flemings@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix II.

A handwritten signature in black ink that reads "Gene L. Dodaro". The signature is fluid and cursive, with a long horizontal stroke extending to the right from the end of the name.

Gene L. Dodaro
Acting Comptroller General
of the United States

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Committee on Ways and Means
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Appendix I: Members of GAO's Auto Industry Panel

We contracted with the National Academy of Sciences (NAS) to identify a balanced, diverse group of individuals with expertise about the past and current financial condition and operations of the domestic automakers, the restructuring of distressed companies, labor relations issues, financial management and analysis of distressed or restructuring companies, factors influencing competitiveness in the auto industry, and engine and vehicle technologies that may affect the auto manufacturing industry today as well as in the near future. We selected 17 individuals for interviews from among those NAS identified based on achieving a variety of expertise and avoiding any potential conflicts of interest (see table 4).

Table 4: Individuals with Auto Industry Expertise Identified by NAS Who Were Interviewed

Name	Company or Institution
Bruce M. Belzowski	University of Michigan, Transportation Research Institute
Richard N. Block	Michigan State University, School of Labor and Industrial Relations
John Casesa	Casesa Shapiro Group
K.G. Duleep	Energy & Environmental Analysis Inc.
George Eads	CRA International
Susan Helper	Case Western Reserve University
Rod Lache	Deutsche Bank
Tim Lieuwen	Georgia Institute of Technology
John Paul MacDuffie ^a	University of Pennsylvania, Wharton School of Business
Walter S. McManus	University of Michigan, Transportation Research Institute
Glenn Mercer ^a	The International Motor Vehicle Program at the Massachusetts Institute of Technology
Henry S. Miller	Miller Buckfire & Company
Justin Mirro	Moelis & Company, Transportation Investment Banking Group
Nabil Nasr	Rochester Institute of Technology
William A. Niskanen	Cato Institute
Douglas M. Steenland	Formerly of Northwest Airlines Corporation
Marina Whitman	University of Michigan, Ross School of Business

Source: GAO.

^aThese individuals also reviewed a portion of a draft of this report to ensure the accuracy and completeness of the information.

Appendix II: GAO Contacts and Staff Acknowledgments

GAO Contacts

Katherine A. Siggerud, (202) 512-2834 or siggerudk@gao.gov

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Staff Acknowledgments

In addition to the contact names above, the following individuals made important contributions to this report Marcia Carlsen, Nikki Clowers, and Raymond Sendejas, Assistant Directors; Alana Finley; Chuck Ford; Cole Haase; Heather Halliwell; Jennifer Henderson; Joah Iannotta; Matthew LaTour; Susan Michal-Smith; and Susan Sawtelle.

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