MEMORANDUM FROM BERNARD L. SCHWARTZ
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A PLAN TO SAVE THE U.S. AUTO INDUSTRY: THE CASE FOR A GOVERNMENT-SPONSORED, PRE-PACKAGED BANKRUPTCY

The collapse of the U.S. auto industry would deliver a potentially devastating blow to an already badly damaged American economy. It would further destabilize the financial system, result in the loss of thousands of jobs, and destroy a significant part of America's engineering and design capabilities. The question, therefore, is not whether we should save the American auto industry but how.

One solution is for the government to sponsor a pre-packaged Chapter 11 bankruptcy plan that would provide government debtor-in-possession (DIP) financing to the industry. Such a plan would preserve manufacturing continuity, safeguard jobs, and maintain supplier and distributor networks. DIP financing would guarantee suppliers that their current accounts receivable are solid and that they will continue to do business with an important customer. Dealers would be assured that the auto industry will continue to be a going concern. Most important, this financing would guarantee potential auto buyers that the value of their purchase will be maintained and warranties will be honored.

To be successful and avoid the catastrophic collapse of the auto industry, pre-packaged bankruptcy should include the following elements:

DIP financing: The government should pledge, at the time of the bankruptcy filing, low-cost DIP financing sufficient to provide for uninterrupted operations. (The current administration has already offered $25 billion for this purpose.) In return for DIP financing, the government would receive a combination of debt, preferred shares and/or warrants to buy common shares.

Special Administrator: The Debtor-in-possession will appoint a single, impartial administrator who will have the authority to represent the industry, with one voice, in restructuring discussions with all parties, including labor unions, management, creditors, dealerships, etc.

Industry Consolidation: If desirable and feasible consideration should be given to consolidating the three major auto makers in order to achieve economies of scale and eliminate redundancies in costs, products and investments.

Warranties: The DIP financing would guarantee the viability of warranty responsibilities during bankruptcy. (This may not be a costly undertaking because purchasers pay for extended warranties – so this could be at least a break-even proposition.)

Government-led Research and Development: The bankruptcy administrator would eliminate industry research and development (R&D) initiatives across the three automakers, particularly those efforts pursuing alternate fuel sources, by having the government direct and be accountable for the energy R&D initiatives. This step would eliminate wasteful redundancies and ensure that this country's commitment to develop alternative fuel sources would be taken seriously and would eliminate the fractured industry effort. In return, green technology developed by the government would be freely shared by U.S. manufacturers.

Government Vehicle Purchases: The government would undertake a program to purchase American-manufactured automobiles and trucks for its fleet (U.S. Postal Service, Department of Defense, Homeland Security, etc.) that are economical and meet strict fuel-efficiency standards.

Consumer Initiatives: Congress should provide financial incentives to car and truck buyers to purchase vehicles that meet fuel-efficiency standards. This program would jump-start the transformation of America's drivers from purchasers of gas guzzlers to promoters of "green" solutions to our energy consumption needs.

Interim Relief if Necessary: Realizing that any auto industry remedy may not be legislated until after January 20, 2009, TARP (Treasury Asset Relief Program) loans could be advanced weekly as necessary to meet the companies' cash requirements and, subsequently, to be folded into the DIP financing.

Together, these pre-arranged conditions would help guarantee that any reorganization of the U.S. auto industry under Chapter 11 is successful. In the meantime, it would ensure that the three companies can continue to operate as the restructuring is carried out, thereby avoiding serious damage to the economy.

Bernard L. Schwartz
Chairman and CEO, BLS Investments, LLC