CHRYSLER'S TWO OPTIONS: WHAT JP MORGAN'S INSISTENCE ON BANKRUPTCY WILL MEAN

Yesterday, I pointed to a WSJ report that JP Morgan wants to force Chrysler into bankruptcy rather than make the concessions necessary for a Fiat merger.

There was some uncertainty about what those two different scenarios really mean—and therefore what the impact of JP Morgan's intransigence might be. So this is an attempt to lay out what those scenarios are. Details on these two scenarios come from the viability plan Chrysler submitted on February 17, though some of its assumptions are optimistic and both the VEBA numbers and the secured debt numbers are out-of-date.

The bottom line, though, is this: If Chrysler goes into bankruptcy, it will likely mean 210,000 extra lost jobs and the loss of healthcare for up to 700,000 UAW retirees.

Fiat-Chrysler

Before it will provide $6 billion additional funding to support the Fiat-Chrysler merger, the Obama Administration has demanded:

- Cerberus and Daimler to write off their stake in Chrysler
- Fiat to take a 20% stake in the company
- UAW to accept half of the VEBA payment Chrysler owes—$4.4 billion dollars—to come in the form of equity

in the new Fiat-Chrysler (along with some additional concessions)
- Chrysler's secured creditors (JP Morgan, Citibank, Morgan Stanley, Goldman Sachs, and others) to accept equity in exchange for over $5 billion in debt
- Additional $6 billion in government funding

Now, Chrysler doesn't describe in detail what would happen If the Fiat deal were to go through, so the following is a guesstimate on my part.

The quickest change would be that Chrysler dealers throughout North America would have Fiats to sell—primarily the small A and B platform cars with which it is competitive in Europe (including its 500, which just won car of the year in Europe). It would take at least a year and a half to do this, though, and Fiat will face some trouble assembling them cheaply in the US (in Europe 500s are assembled in Poland). Still, if it were able to pull almost inhumanly quick adjustments to the North American market in the next 2.5 years, Fiat (and with it, Chrysler), might be instantly competitive in the A and B segments and with that, dealers might be much more viable. But it remains to be seen whether that would be profitable.

The single biggest problem with the Fiat deal, IMO, is that gas prices are going to be volatile for the foreseeable future, which means being competitive in the A and B segments could either be a godsend (if gas goes up to $5/gallon again) or a blip on the radar (if gas remains cheap).

In the longer term (4 years), Chrysler would have vehicles of its own developed with Fiat technology, maybe something to revitalize the PT

Cruiser or something, manufactured on the same line as the partner Fiat car. This would give Fiat and Chrysler a global platform that would allow them to minimize development costs. And if, at that point, Chrysler and Fiat had the money to do a real product intro, it might start producing viable products again.

The problem, as you can see, is the benefits of a Fiat-Chrysler deal are a ways away. So while Chrysler claims that this deal would allow it to use idled capacity (and Fiat claims it would save US jobs), that's not going to happen for a year at least. And Chrysler has said that 22% of its suppliers and 27% of its dealers are in trouble, which means a number of Chrysler stakeholders probably couldn't hold out that long.

So I'm going to make a wildarsed guess that the following would happen:

- Chrysler sheds another 10,000 blue collar jobs and 2,000 white collar workers
- 990 dealers would close and 45,000 jobs are lost
- 35,000 supplier jobs are lost

Still, this is much better than what might happen in a bankruptcy.

Chrysler Bankruptcy

Chrysler has said Chapter 11 would be the beginning of an ordered wind-down of its business. But it expects it would need $24 billion in Debtor-in-Possession funds to proceed through Chapter 11, and the Administration has said, "If the Chrysler/Fiat partnership has not been successfully concluded within 30 days, and in the absence of another viable partnership, the government will not invest any additional money in the company," which suggests the government is not willing to provide DIP for Chrysler.

Chrysler expects its creditors would get the following (this is based off an assumption of getting $2.3 to $3.8 billion for its assets, which I think ridiculously optimistic):

- Cerberus and Daimler: nothing
- UAW: nothing
- Chrysler's secured debtors: 25% return on their debt ($1.7 billion, of which JP Morgan would get $629 million)
- US government: 5% ($200 million)

There are two other factors, though, that no one is really talking about. First, Chrysler's creditors may go after pension funds. Rayne found this paragraph in a WSJ article on a Chrysler pension fund that has been in trouble.

> Chrysler's precarious financial situation exacerbated investors' problems with the stable-value fund. The Chrysler Salaried Employees' Income Deferral Plan, which offered the fund, isn't subject to Erisa, the law governing many pension and benefit plans. One key distinction: The fund's assets must be made available to creditors in the event of Chrysler's bankruptcy.

Now, from what I could see with Chrysler's plan, it doesn't seem to account for that, and a Chrysler retiree told me all the regular 401(k) funds are protected under ERISA, but it may be that in addition to budging in line ahead of Chrysler's UAW employees to get money, JP Morgan may try to pick the pockets of Chrysler's white collar retirees.

And then there's the issue of the hedges. Chrysler's creditors—and likely a great many other players—are likely to have hedged their exposure to Chrysler. So those companies may well make money if Chrysler fails. And who knows who will be taking money from whom at that point. (Masaccio wrote about this in the context of GM.)

In any case, according to its statement, Chrysler anticipates that if it unwound in orderly fashion over the course of 24 to 30 months, the following will happen:

- 29 manufacturing facilities and 22 parts depots closed immediately
- 40,000 Chrysler employees lose their job
- 3,300 dealers with 150,000 employees go out of business
- $7 billion in outstanding supplier invoices go unpaid
- 31 million vehicle owners lose ongoing support (though the Obama Administration has promised to honor warranties)
- 300,000 jobs total lost (presumably 40,000 Chrysler jobs, 150,000 dealer jobs, and 110,000 supplier jobs)

Now, I think this estimate leaves out the possibility that someone would buy pieces parts of Chrysler and keep them running in the short term. For example, if Dongfeng were to buy just Jeep, it might keep some of the white collar engineers and factory workers on for a period, and try to transition engineering and assembly to China over a decade (though China would have no reason to honor UAW contracts). Chrysler has a few factories that are fairly modern and I could see Nissan picking up one as a way to bring more production to the US to shield it from currency exchange woes. VW might want to pick up a Chrysler minivan factory to retain the capacity Chrysler had been providing it.

But the thing is, almost no one has the money to invest right now, so even though some of these moves might make sense from a long-term capacity perspective, they are unlikely to happen in this climate. At least not quickly and not with the factory workers included in the deal.

A Chrysler bankruptcy might also doom the VEBA fund that was supposed to provide for 700,000 UAW retirees and their dependents' health care.

> If any of the Detroit Three automakers that owe payments to the VEBA — an amount totaling nearly $60 billion — declare or are otherwise forced into bankruptcy, the trust that was established to fund health-care costs for UAW retirees could be shattered, says one bankruptcy expert.
>
> In particular, some had speculated that if General Motors Corp. or Chrysler LLC, the two Detroit automakers that have accepted billions in "bridge" loans from the U.S. Department of Treasury, were to declare bankruptcy, the VEBA obligation might legally be shifted to the Pension Benefit Guaranty Corp., the federal corporation that assumes payments for legally terminated corporate pension plans.
>
> But the PBGC is not specifically or legally bound to take over the UAW's VEBA if any of the Detroit Three declare bankruptcy, said Doug Bernstein, practice group leader for banking, bankruptcy and creditors' rights at legal firm Plunkett Clooney.
>
> Pension plans are the province of the government's PBGC — and the UAW's VEBA technically is not a pension plan, Bernstein told *AutoObserver*.

The VEBA funds of the three companies have not yet been combined (that happens next year), so this may or may not affect all 700,000 VEBA beneficiaries. But it will basically mean the benefits workers were promised some thirty years ago would be lost and many of those people might well do without healthcare.

So 210,000 jobs and 700,000 retirees' healthcare, promised thirty years ago. And JP Morgan, the recipient of tens of billions (if not more than a hundred billion) in benefits through various recovery schemes, will push that outcome rather than give up its debt.