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# OVERHAUL

AN INSIDER'S ACCOUNT OF THE
OBAMA ADMINISTRATION'S
EMERGENCY RESCUE
OF THE AUTO INDUSTRY

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HOUGHTON MIFFLIN HARCOURT
BOSTON NEW YORK
2010

'credible'?" Harry asked. Above all, GM needed an attitude transplant. Its people were so used to losing, to watching market share erode and seeing their vehicles outclassed and outsold, that mediocrity became a self-fulfilling prophecy. Harry was fond of a Vince Lombardi quote: "Winning is a habit. Unfortunately, so is losing." Changing GM's psychology became a key goal for the team.

Typical of the cultural challenge was a lack of focus on shareholder value. In all our time interacting with GM executives, we never heard any of them utter that all-important term. Chatting after one lengthy session on the thirty-seventh floor, Troy Clarke told Harry that earlier that day, Ray Young had given the senior leadership a quick tutorial on equity value and "total enterprise value." Troy said he'd been fascinated to learn that if they cut annual operating expenses by $8 billion, they would add approximately $36 billion to GM's worth! He was so pleased by this discovery that he did not notice that Harry was aghast. How could the head of GM North America not understand how value is created for shareholders? The sad truth was that no one at GM thought like an owner.

Reminders of GM's lack of financial discipline were always crossing my desk. The Bush loan agreements required the company to ask for the Treasury Department's approval of any nonroutine expenditure of more than $100 million. Requests from GM's treasury usually arrived in the form of a PowerPoint deck, a handful of pages with no backup analysis or other justification. It was GM's arrogance and sense of entitlement at their worst. The company expected us to take its word for each submission and rubber-stamp the funding, which would of course have to come out of taxpayers' pockets. Close advisers to GM had noted a similar fecklessness for years. At board meetings, $1 billion often seemed the smallest significant amount. Proposals to spend, say, $500 million on this project or $300 million on that would show up on slides as $0.5 or $0.3. Presented that way, a half-billion-dollar expenditure could seem hardly worthy of discussion.

The most frequent beneficiary of GM's lax spending was Delphi, the troubled $18-billion-a-year parts maker that GM had spun off ten years before. Delphi had been languishing in bankruptcy since October 2005, but remained GM's sole supplier of such critical components as steering assemblies. By exploiting that dependency, Delphi had succeeded in extracting huge concessions from GM—a total of $12.5 billion since the spinoff.

In early March, we faced our first Delphi request. GM wanted to pay the parts maker $150 million for operating funds to tide it over for a single month! That ask was coupled with another involving a complicated proposed transaction to buy back the steering business from Delphi, also explained in a single page of PowerPoint. All told, GM would be providing more than $350 million, money it would probably never get back. Yet so certain were GM and Delphi of our acquiescence that Delphi had already issued a press release announcing the agreement.

When Harry asked the GM team how the $350 million would serve Delphi, he was told that it would cover Delphi's operating losses for a period of time, probably two months.

"Then what?" Harry asked. He was told that Delphi would likely be back at that point, its bankruptcy unresolved and asking for more money. "How long has this been going on?" he asked.

"A long time."

Harry wanted to meet with Delphi's management to try to reach a resolution that would bring the company out of bankruptcy, end the threat to GM's supply and production, and minimize the use of taxpayer cash. At a hastily called meeting with GM and Delphi representatives, he looked across the table at a senior Delphi executive who was demanding a massive cash infusion from GM and asked, "Why is this a good deal for GM? Why would we ever want to do this?"

"Because if you don't, we'll shut you down," the Delphi official replied.

Harry had been through enough negotiations to know that you can't give in to threats. "We're not going to do it," he said.

When Harry reported on the meeting, I immediately agreed. A phrase from history flashed into my mind, America's repudiation in 1799 of extortion demands by the Barbary pirates: "Millions for defense, but not one cent for tribute!" This had led to a two-year undeclared war.

As Team Auto delved into Delphi, we discovered one of the most convoluted financial messes any of us had ever seen. The prolonged bankruptcy had produced a capital structure with layer upon layer of debt. Effective control of the business rested with a group of hedge funds, some of which had bought in when Delphi looked like a bargain. They were frustrated with management for not making any fundamental changes to Delphi during its long bankruptcy and were anxious to recover their capital in any way they could. Delphi was also mired in long-running discussions with the Pension Benefit Guaranty Corporation, the independent federal agency that insures private pensions, about its grievously underfunded pension plan.

Privately we told GM that we were going to hit the pause button on Delphi until we figured it out. Though Delphi was important to GM, the sheer volume of outstanding work dictated that we had to prioritize. Ray Young and his associates were not happy; they didn't like being second-guessed and were more scared of Delphi's threats than we were. In their "spare time," Matt and Harry began to sort through the rat's nest. They soon learned that Delphi was exaggerating its need for cash. It was sitting on sufficient rainy-day capital in a sequestered account that the hedge funds refused to release. GM and the hedge funds tried to bridge their differences, but negotiations broke down.

While engaged in this maneuvering, we also undertook contingency planning in the event of an actual Delphi shutdown.

"How long could you keep the factories running if they cut you off?" Harry asked Troy Clarke, GM's North America chief.

"We couldn't," Clarke said.

Incredibly, GM had never tried to stockpile critical components in the event of a Delphi shutdown, nor had it done any meaningful work to create alternative sources of supply. Harry was stymied until later that day, when he and Clarke began a discussion of GM's upcoming production plans, which included a summer shutdown that is routine for automakers. The normal shutdown was four weeks, but this year GM wanted to make it longer to reduce the bloated supply of cars on dealers' lots.

"Wait!" said Harry. "If you shut down, doesn't that eliminate the impact of Delphi's threat? Suppose we make the shutdown even longer?"

By mid-April, we presented Larry and Tim with a plan that we believed would turn the tables and force Delphi into a reasonable negotiation. Would Delphi or any of its investors really want to be perceived as holding GM hostage at such a precarious economic moment? After our confrontation with the Chrysler banks, Larry was at first hesitant to pick another public fight, but Tim backed our strategy, and Larry came around.

On April 23, GM announced it would shut down thirteen North American plants for an extended period. While the closure was partly aimed at reducing the bloated supply of cars on dealers' lots, the accompanying news release—drafted in large part by us—was blunt. Unless Delphi came to terms with GM, it said, "Delphi or its lenders could force GM into an uncontrolled shutdown, with severe negative consequences for the U.S. automotive industry."

Shortly thereafter, the creditors released cash to provide liquidity to Delphi. We had won round one. The negotiations with Delphi continued, but with Matt and Harry forcing GM to bargain hard and strike a deal that satisfied GM's operating needs at the lowest cost to the taxpayer. They began laying the groundwork for GM to take back control of the steering-assembly business as well as of four "keep sites"—Delphi factories that made other key components.

GM's far-flung international empire was its other great cash sponge. We regularly received requests to fund subsidiaries abroad, and just as regularly rejected them. While we were legally permitted to approve these requests—and some may have represented good business decisions—I knew that part of my job was to be sensitive to the politics, particularly where taxpayer dollars were concerned. I developed what I thought of as "the *Washington Post* test": How would the public react to a headline that said the Obama administration was in effect allocating hundreds of millions of dollars of public money to shore up GM Australia, or GM Korea? We managed never to violate this principle, but GM Europe tested it most sorely.

GM Europe, with its flagship business in Opel, was a major automaker in itself. It had $34 billion in annual sales, making it about 70 percent the size of all of Chrysler. It sold about two million vehicles a year, employed 55,000 people across the continent, and was GM's biggest international headache. Not surprisingly, it and other European automakers were suffering many of the same woes as their U.S. counto those names, he had columns for next steps, deliverables, and due dates. In deference to GM, Harry started the meeting by framing bankruptcy as the fallback plan—GM officially still held out hope that it would find enough takers for its bond exchange offer to avoid Chapter 11. But no one else in the room saw that as a serious possibility, and by this point, privately, neither did Fritz nor most other top GMers. Then Harry dove in and began working through the list, item by item, to be sure everyone knew what would be expected.

Next to him was Matt Feldman, our stalwart bankruptcy sage. Minutes after the Chrysler petition was filed the previous day, Harry had gone to him and said, "Feldman, now you're mine." Though exhausted, Matt had dragged himself to New York for this all-day meeting.

The bankruptcy plan Matt envisioned for GM was an outsize version of the one he'd designed for Chrysler. With the help of many billions of taxpayer dollars, GM would separate its assets into two companies. "Old GM" would retain the factories, equipment, brands, and real estate that the business no longer needed. Its sole purpose would be to dispose of these assets, using the proceeds to repay the creditors that the other company, Shiny New GM, had left behind. The new company would own all the assets GM *did* want to keep. Free of crippling costs and debts, this new business would go forth as a streamlined, revitalized competitor on the world automotive scene. We meant it to be not only viable but also highly profitable.

The meeting ended at 6 P.M., having stretched nine hours. Even though it was Friday night, Harry didn't stop; he had booked a session with Carl Icahn, the legendary corporate raider and multibillionaire, who had lately expressed interest in acquiring a stake in Delphi. Icahn's offices were a couple of elevator rides away, on the forty-seventh floor. Matt dutifully accompanied Harry on the short journey, but was soon called back to Connecticut over a family matter. He was not sorry.

Harry, who liked to have an aide-de-camp by his side, summoned Sadiq Malik to Icahn's office as soon as Matt left. The meeting, while not producing any meaningful progress, lasted until after midnight, nearly killing the young analyst, who was too scared of Harry to take a bathroom break.

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He next pushed the Department of Transportation to develop the necessary implementation policies and procedures. What, for example, would be the steps for making sure the clunkers were truly junked? Using the Team Auto approach of daily early-morning conference calls, in just over three weeks — a nanosecond by bureaucratic standards — Cash for Clunkers was up and running. It was an extraordinary success, far beyond anything we had imagined. The first $1 billion was exhausted in less than a week, and the White House scrambled to persuade Congress to appropriate more. Cash for Clunkers became an all too rare example of what can happen when a smart and energetic staffer develops a good idea and runs with it.

In the midst of pushing through the historic GM bankruptcy, Matt and Harry remained attentive to Delphi — including midnight phone updates during which Harry would occasionally fall asleep — and managed to put the parts company onto a glide path toward successful resolution. On the same day that GM filed for bankruptcy, Delphi announced an agreement with GM under which the automaker would buy four key factories from Delphi, along with Delphi's global steering business. This would give GM access to the critical parts that had allowed Delphi essentially to extort billions of dollars of financing from GM over the years. The rest of Delphi would be bought by a private equity firm, Platinum Equity, that had made a specialty of troubled investments.

Under bankruptcy rules, the agreement among GM, Platinum, and Delphi was subject to higher bids from others, including the existing debtor-in-possession lenders, who had been negotiating toward a separate, but ultimately unsuccessful, agreement in May. In late July, the existing lenders decided to trump the agreement by credit bidding — basically, turning in their claims for the equity in Delphi. While the DIP

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Still, there was no way for Deese, or anybody else, to contain the politicians' anger over dealer closings. It simmered all summer, erupting periodically like a geyser fed by a vast underground reservoir of superheated water. Hapless members of Team Auto would be summoned to Capitol Hill at such times to get browbeaten by legislators or their staffs. In early July, it was House Majority Leader Steny Hoyer's moment to vent. A tall, jowly, gravel-voiced Democrat who represented an area of Maryland just south of D.C., Hoyer had been among the most persistent critics of the dealer-reduction plans. Among his constituents were two particularly visible and unhappy dealers who each operated both GM and Chrysler stores, Tammy Darvish and Jack Fitzgerald. When we asked GM and Chrysler to fill us in, we learned that the franchises more than deserved to be closed. Fitzgerald, for example, had sold only around three new Chryslers in 2008.

I was mystified that the House majority leader chose to devote so much time to this. The nation was plagued by economic and financial crises; why would the second most important member of the House after Speaker Pelosi think that two car dealerships merited his personal attention?

Deese and other colleagues worked patiently with Hoyer's staff to explain the need for reductions and the logic behind these particular ones. Brian came away from those conversations believing that he had convinced Hoyer's staff that the automakers were acting appropriately. Nonetheless, Hoyer was not satisfied and called me to say so. Then he ordered a summit meeting of several senior congressmen and representatives of the car companies and Team Auto. We wanted the leaders of NADA to join us but, true to form, the trade association found an excuse would cost a lot more if they were being made in America instead of in China—as would the clothes, shoes, and other basic goods that make up a typical family's budget.

And yet those invisible benefits of globalization are often overshadowed by its ugly and painful costs—high unemployment and stagnant real wages for too many Americans. Based on Census Bureau data, the wages of middle-class Americans have declined by 0.2 percent a year for the past decade, after adjustment for inflation.

The challenges of manufacturing in America hit home for me on a March afternoon early in my tenure on the auto task force. We were in a routine meeting with the parts producer Delphi. Delphi looked and smelled like a quintessential American company, with its Troy, Michigan, headquarters and its management team of mostly plainspoken midwesterners. The executives had come in that day to plead their case for a supplier rescue program.

As they went through their pitch, a question suddenly popped into my head: "How many people do you employ?" I asked.

They told me they had 146,600 workers.

"How many of them are in the U.S.?" I asked, suspecting that the number was low.

The quick answer—18,900—exceeded my pessimistic expectations. Most of Delphi's labor force, it turned out, was in Mexico, Brazil, and China.

"There's nothing we can do for you," I announced. Delphi flunked my *Washington Post* test: How could we use taxpayer money to help a company 87 percent of whose employees were outside the United States?

The bigger question posed by Delphi hasn't gone away. Here was a red-blooded American company with roots going back a hundred years that had, for all practical purposes, become no more American than all the manufacturers that had sprung up throughout Asia in recent decades.

While I have always been an ardent supporter of NAFTA, a casual conversation one day with Fritz Henderson after he became GM's CEO gave me pause. The company had three assembly plants in Mexico, at which it paid its workers a little over $7 per hour.

"How is the productivity in Mexico?" I asked Fritz.