

Mergers & Acquisitions

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The Automotive Industry

In the early to mid 1800s, the automotive industry was not much more than a collection of small boutiques producing a handful of cars a year. A common characteristic amongst them was that they would abandon the industry soon after arriving. It wasn't until the dawn of mass production that we would experience the automotive industry at its full power. From there, the industry quickly developed and spread drastically, shaping our current global economy and also affecting billions of people's lives. The industry has gone through a wide range of changes over the last few years in order to adapt to the changing environment of business and strict regulations. After World War I, Ford was the driving company of the industry. With Model T, and taking credit for the creation of Fordism and mass production, the company was the maximum representation of American capitalism. General Motor and Chrysler later in the decade would follow-suit to construe the infamous big-three of the American automotive industry. With a global outreach, soon mass production and assembly lines led to the creation of giants such as Daimler, Benz, Volkswagen, Peugeot, etc.

The industry in the United States was dominated by domestic players until the 1980s, then an increased competition from imported cars - mainly from Japan and Europe - as well as an increasing demand for smaller and more compact vehicles continuously put pressure onto the big three. Fast-forward to current times although still a significant force in the American economy, most of the domestic players failed to rise to the challenge and piled up exorbitant amounts of debt. General Motor and Chrysler both filed for bankruptcy in the last two decades; and Ford's future does not look too promising either. Internationally, Japan, South Korean, and Europe have been rapidly gaining territory.

Today, the most important segment of the auto industry includes commercial vehicles and passenger cars, as the sales of passenger cars are forecasted to cross 74 million units by 2020 globally. Over the years the automotive sector has become extremely competitive with barriers of entry being extremely high, such as

1 - Economies of scale – Companies with huge demand are able to scale down the costs of their production, making companies more profitable

2 - Capital requirements - are the financial resources a company owns such as infrastructure, machinery, R&D and advertising.

3 - Product differentiation – In a somewhat commoditized industry, in which all offers serve the basic need for you to get from point A to B, differentiation became a key factor. In addition to this, customers are very loyal to certain brands and can identify companies who are well-known for their service, forcing new companies to spend heavily on marketing to poach customers from competitors.

The industry is known for squeezed margins with gross profit ranging in between 10% to 20% approximately, this is very reflective of their brand positioning: premium brands enjoy higher profit margins than budget brands. Net margin in the industry is around 3%, competition thus is unforgiving and every effort is valid into trying to squeeze some extra profit.

Consolidation trend & strategic alliances

The financial crisis was a very tough time for the whole world, the automobile sector was hit very hard and lost a lot of money as vehicle production declined by 3.7% in 2008 and 15.8% in 2009 (OICA, 2012). One of the main reasons the automobile sector died was due to less access to consumer credit, which led to financing of a high share

of new vehicles in huge markets like the United states. Even the emerging markets were not spared as countries including China, India and Brazil, saw lower demand for new cars in 2008 compared to other years, but still saw their new vehicle sales continued to grow during the crisis.

From the year 2008 one can see major acquisitions and takeovers in the automobile industry. One of the major acquisitions was Tata motors buying Jaguar and Land Rover for \$2.3 billion. The major reason why Ford agreed to sell Jaguar was because Jaguar stood at a loss of \$715 million, given the high manufacturing costs in the UK. This led to a huge cost burden for Ford, eventually leading to Ford selling Jaguar and Land rover at half the price.

In 2009, Fiat bought out Chrysler closing its looming Chapter 11, and ending Chrysler's ownership by Cerberus Capital Management – which had bought the company from Germany's Daimler years before. Fiat came out of the deal owning 35% of Chrysler. In 2012 Volkswagen paid \$5.6 billion to acquire, Porsche – another major deal in the industry. In 2014, Fiat completed the acquisition of the remaining 41.5% from the United Auto Workers, making the Chrysler Group a wholly owned subsidiary. In the same year, Volkswagen acquired 37% of Scania for \$9 billion.

All-in-all, there has been a consolidating effort from the players in the industry. In a study about impact of financial crisis towards the automobile industry done by Van Biesebroeck and Sturgeon (2010) stated that “financial crisis led to further consolidation of the supplier base as surviving smaller, local suppliers were more vulnerable to closure and bankruptcy than large ‘global’ suppliers”. Through which it can be understood the automotive industry was consolidating as losses were mounting up and companies had to let go off their companies not performing well. Another major

reason, was that companies were not able to get loans in order to get through this tough phases, companies either needed loans or had to let go of their subsidiary companies which were not performing well.

In the following section we will dive into Fiat and Chrysler's merger. A long-lasting and much anticipated transaction that involved bankruptcy filings, extensive media-coverage and a lot of money.

Acquirer (Fiat)

Fabbrica Italiana Automobili Torino (Italian Automobile Company Turin) otherwise known as Fiat was first formed in 1899 by Giovanni Agnelli in Turin. He had a dream of an Italian automobile factory that could offer democratic mobility. In their first year they produced 24 vehicles called the Fiat 3/2HP. The company is the third oldest car manufacturer in the world. In Italy during this time many people were preoccupied by agriculture and as a result of the industrial revolution people's purchasing power and demand for products increased. In 1903, Fiat was listed on the Milan stock exchange and began producing vehicles for goods transportation, trams and commercial vehicles. In 1908, the first Fiat was exported to the US. By 1910, a plant in New York was licensed to produce Fiat cars. There was a large distinction in price for Fiat's cars compared to other automobile companies. A Fiat sold in the USA cost between \$3,600 and \$8,600 compared to the \$825 a Ford model would cost. In 1916 construction of the new plant in Turin began also known as the Lingotto plant. It was the largest factory in Europe with a test track on the roof. The factory became a symbol of the automotive industry in Italy. Fiat's growth was steady however due to World War I Fiat devoted itself to supplying the Allied Forces with weapons, aircrafts and vehicles.

Fiat's aim was to address a potential market of the need for a small and cheap car. This market had been left untouched. Space was an issue in the cities therefore Fiat understood that what people needed was a two seated small car therefore the new 500 Topolino went under production to address that segment. The 500 Topolino was a success due to the affordability of it and practicality. In 1937 the company started to build a new plant in Mirafiori (Turin). To date the plant is the biggest in Italy and the oldest functioning plant in Europe. During World War II Fiat had to convert again its plants to military production and almost abandon car production, focusing mainly on trucks, aircraft-engines and submarines. In 1945, when Misolini was overthrown, the Italian Committee of national Liberation removed the Agnelli family from leadership over Fiat because of their involvement in World war II. The family would have no more involvement in Fiat until 1963 when Giovanni's grandson, Gianni Agnelli, took over as general manager.

After the second world war, Fiat played an important role in the Italian economic boom. The car production increased by 6 times and there was a significant increase in the amount of employees due to the opening of new plants all over the world. In 1963 Gianni Agnelli took control of the company and marked the return of the Agnelli family in the Fiat company. The first thing he did was a massive reorganisation of the company management. From being high centralised, with almost no provision for the delegation of authority and decision making power, to an emphasis on product-line basis, with two main product groups (one for passenger cars, the other for trucks and tractors) and a number of semi independent divisions and subsidiaries. In addition to this, the following years marked an expansion of acquisitions.

In 1973 an oil crisis occurred which had far going effects on the car industry. Fiat was also hit, even though they had a very diverse product line. The effect of this Oil Price Shock was that Fiat put a heavier emphasis on smaller cars due to fuel efficiency. To keep Fiat on the path to automation of production, Robogate, a flexible robotic system for assembling bodywork was introduced to factories in 1978. Fiat was also becoming an economic, as well as industrial powerhouse, as it became a holding company when it spun off its various businesses into autonomous companies. Fiat Group is divided into two companies: Fiat S.P.A and Fiat Industrial. Fiat S.p.A. consists of three business units: automobiles components, production systems, publishing and communications. Fiat industrial consists of three business units as well: agricultural, construction equipment; truck - commercial vehicles and FPT industrial. FPT industrial comprises the industrial and marine activities of Fiat Powertrain technologies.

In 1984 Fiat withdrew from the US market due to the fall in oil prices. Americans began purchasing sport utility vehicles, minivans and pick up trucks in larger numbers. In addition to this, Japanese car manufacturers were starting to take larger shares of the car market in the USA.

In 1986 Fiat acquired Alfa Romeo, a brand globally famous for the quality of its cars. Fiat acquired Alfa Romeo from the State who had owned the company since 1933 through the Institute of Industrial Reconstruction. By 1990 Fiat had set up numerous operations as independent companies. These included Fiat Avio, Fiat Engineering, Comau, Fiat Ferraviaria, Magneti Marelli and Teksid. Magnetti Marelli is still a World-leading manufacturer of components for the Automotive Industry. Fiat's multiple strategy of product innovation, internal reorganisation and expansion into new markets

outside of Europe meant in 1993 Fiat also acquired Maserati. A luxury car manufacturer further expanding their product offerings to the upper sector of the market. In 2000 Fiat and General Motors agreed to a joint venture under which GM acquired 20% of Fiat and kept the right to sell the remaining 80% to GM at a fair market value. This joint venture was due to Fiat being in a crisis and having many loans from banks, they would not be able to face international competition alone. After 4 years both companies were still in a very hard economic situation therefore GM paid Fiat 2 billion dollars in order for Fiat not to use its right to sell the remaining 80% to GM. Fiat was close to bankruptcy and had a low market penetration. In 2004 Sergio Marchionne took over Fiat as CEO. Fiat saw its first profit in more than 4 years. Marchionne reduced Fiat's managerial bureaucracy and emphasized a focus on markets and profits. All brands launched new successful models and Marchionne began to analyse the industry looking for possible partners to create an alliance.

Due to Fiat acquiring other automobile companies it has enabled Fiat to increase globalisation and offer a range of products to suit many consumers all distinguished by their innovative content style and manufacturing solutions. Fiat's brand portfolio includes Lancia, Fiat, Alfa Romeo, Fiat Professional, Abarth, Maserati and Ferrari. For example Fiat is known for creativity, versatility and practicality. Alfa Romeo is characterised by the combination of sportiness technology and elegance in a unique design. Ferrari is known for elite and exclusive lines of models.

In 2009 the current position of Fiat Professional, the light commercial vehicles brand, was well positioned in the European rankings with 12.8% of the market share. Fiat held a position of absolute strength in South America and more specifically Brazil, where

the company was the market leader and its activities were very profitable for a decade, generating the majority of the company's earnings before interest and tax. Fiat was a European leader in terms of technological solutions for CO2 emission reduction. The Fiat Group's margins were solid and very much in line with the average of the automotive industry, even in periods of higher pressure as a result of adverse macroeconomic conditions.

On the other hand Fiat did not hold a big market share in Europe. The profitability appeared to be too heavily dependent on LCVs, and the total volumes of Alfa Romeo and Lancia were not sufficiently powerful to ensure the brand self-sustainability. The main Italian production plants were underutilised. Finally, the sales distribution of Fiat Group by automobile segment was too unbalanced toward mini and small segments which together comprised of 77% of the group's registration in Europe whereas the total European registration showed a clear predominance of small, compact and large segments as well as a characteristic presence of MPVs and sport utility vehicles.

To sum up the situation of Fiat in 2009 could be regarded as a serious standoff: the growth momentum propelled by group turnaround was stifled by the global crisis, which in turn led to contracted revenues and higher levels of caution toward investments, even with respect to new models. Moreover, some sales targets were missed; this fact led to a revival of the Lancia and Alfa Romeo brands and to the acquisition of a stable presence in all emerging markets, particularly China.

Target (Chrysler)

Founded after World War I by Walter Chrysler, Chrysler Corporation became a titan of the US automobile industry. In January 1924, Chrysler launched the Chrysler automobile, a 6-cylinder designed to provide customers with an advanced, cutting-edge engineered car, but that was still affordable. It was a success. Walter Chrysler used the then working General Motors brand diversification model and acquired Fargo Trucks and Dodge Brothers and created the Plymouth and DeSoto brands in 1928. In that way the company started to divide its product offering strategically according to price and quality. In 1957, Chrysler had announced the first production electronic fuel injection (EFI), an untapped technology at the time. The company then expanded into Europe in the 1960s. From 1963 through 1969, Chrysler increasingly acquired stakes in the French Simca, British Rootes and Spanish Barreiros companies, merging them into Chrysler Europe in 1967 (a strategy that soon failed and Chrysler Europe was sold to PSA Peugeot Citroën in the 1970s).

Despite Chrysler's early success the company greatly struggled to adapt to the 1970s changing environment in which consumers started to prefer smaller. After being bailed out by the government in 1979, the company was plagued by excess capacity, ever-increasing prices from suppliers, high fixed plant costs and, most importantly, pressure from newly unionized workers fighting for higher benefits. In addition, foreign automakers became more competitive and strengthened their position in the domestic market by building their own plants and hiring a non-unionized workforce. This effectively eliminated Chrysler's competitive advantage, producing lower quality cars at higher costs.

The bid to salvage the situation through a merger with Daimler, a German auto company, in 1998 proved a failure and Daimler sold its stake in Chrysler to Cerberus Capital Management, a private equity firm, in 2007. As part of the purchase, Cerberus invested \$7.5 billion in the company and lent Daimler \$2 billion, alongside \$10 billion from the bank syndicate in secured debt. The PE firm additionally elected a new CEO to implement a Recovery and Transformation Plan, which would cut costs by getting rid of unprofitable assets and ventures.

The 2008 financial crisis dealt the last blow, sparking an unforeseen drop in car sales, decreasing the ability of consumers to secure loans and causing auto manufacturers to struggle to secure their liquidity positions as credit markets halted and syndications of Asset Backed Securities stalled. As the company's cash conversion cycle got tighter due to payment agreements with material suppliers, Chrysler unsuccessfully attempted to secure deals with other OEMs. Thus, it was forced to turn to its debtholders, owners and the federal government for emergency funding. As part of the Troubled Assets' Relief Program, Chrysler received a \$4 billion loan from the Obama government in exchange for certain concessions.

In exchange for the new financing, Chrysler would have to follow a Loan and Security Agreement which involved, among other measures, creating a viability plan, cutting variable costs and employee benefits to industry standards, and heavily investing in more energy-efficient vehicles to increase the company's long-term competitiveness. Among the three options of the Viability Plan (continue as a standalone company, engage in a partnership with Fiat, or liquidate) the optimal one was to formalize a strategic alliance with Fiat, an Italian automaker. It was clear that Chrysler could not survive as a standalone company due to its inferior quality products, weak international

presence, and structural production deficiencies. On the other hand, liquidation would spell catastrophe for the US auto industry, as analysts predicted Chrysler's default would result in 2-3mm lost US jobs. A strategic partnership with Fiat followed through and after a series of events Chrysler eventually became a wholly-owned subsidiary of the Italian giant.

The deal

To understand the desirability of the deal for both parties, the potential benefits have to be analyzed from each perspective. Beginning with Chrysler, their reasons can be classified into three categories.

To begin with, Chrysler's Viability Plan under its looming bankruptcy in 2009 basically forced the company into a merger. A strategic partner would reposition its company and strengthen the brand. Fiat stood out from other contenders due to its own experience with bankruptcy. In 2003/4 the Italian company would accomplish a 360° turn-around themselves avoiding a bankruptcy. But not only Fiat's proven management capabilities were of interest for Chrysler, but Fiat's strong base of capital, new technology and international standing. Especially, when Barack Obama set new fuel efficiency standards for the U.S. in 2011, Chrysler could profit from Fiat's expertise in producing low emission (high efficiency) cars.

The deal *"(...)would allow Chrysler to use Fiat's technology and vehicle platforms to build more fuel-efficient, small and midsize cars and sell them in North America,"* (New York Times, 2009)¹ saving the U.S. company billions of dollars in R&D.

¹ "Fiat acquires a third of Chrysler", New York Times, 20.01.2009
<https://www.nytimes.com/2009/01/20/business/worldbusiness/20iht-21chrysler.19518776.html?searchResultPosition=4>

Besides the cost and R&D synergies, Fiat would enable Chrysler to increase its geographic market coverage by not only letting them access their European distribution networks but also helping them gain a foothold in emerging markets where Chrysler can piggyback Fiat's existing sales and distribution structures. Now changing perspectives, Chrysler was an attractive target for Fiat for several reasons:

After already having acquired a cheap majority in 2009 through Barack Obama's reorganization plan (53,5%), Fiat bought the remaining 46,5% to settle a lawsuit with VEBA and finally gain complete control over the company.

Apart from these legal reasons, there are strategic motives why Fiat bought a majority stake from Chrysler already in 2009.

With Chrysler being the 3rd largest US vehicle manufacturer with trusted international reputation, it was the perfect opportunity for Fiat to obtain access to Chrysler's U.S. sales and distribution network, returning to the only global market where it did not compete. Fiat had stopped any U.S. sales of cars other than its luxury Ferrari and Maserati models in 1983 and was hoping that especially its Fiat 500, a hit in Europe, would prove successful in the United States. Furthermore, it wanted to introduce American drivers to its other main mass-market offerings, the Punto, Bravo and Panda, and its high-end brand Alfa Romeo.

What is more, the already mentioned product synergies and cost savings remain of course true for Fiat as well and are probably besides increased market coverage, the main reason for the merger.

Due to a similar target customer base - namely people looking for reliable good cars, but not exotic ones - there was a high potential for not only R&D and general cost

savings in areas of production, distribution etc, but also product portfolio consolidation. Sharing parts between models and brands is a key feature of the Fiat-Chrysler makeover so that future models will cut costs by sharing parts that comprise up to two-thirds of an auto's value. In compact cars, more than 20 Fiat-Chrysler models will be based on the same technology.

*"Fiat, together with Chrysler, will create a stronger automobile group, with a full range of products, present in every market around the world,"*² said Fiat Chairman John Elkannet.

Who took the initiative? Valuation, exchanges, friendly versus hostile bids, etc.

The merger between Fiat and Chrysler took more than five years to be fully completed, with many ups and downs the deal has an eventful and convoluted timeline with some notorious protagonists like Sergio Marchionne, Judge Arthur Gonzales and even President Bush with the Troubled Assets' Relief Program it issued in 2008. In the timeline of events there were no hostile bids.

From the start of their relationship in 2009 until the final merge in 2014, Fiat and Chrysler both had their own incentives. Chrysler in 2009 desperately needed a bail-out as it had just filed for bankruptcy. Judge Arthur J. Gonzalez approved the government restructuring plan and sale of Chrysler's assets in January 2009. A strategic alliance with Fiat was proposed,

A strategic alliance with Fiat thus yielded a proposal where all of Chrysler's assets would be sold to a new entity named *"New Chrysler"* for \$2 billion. Fiat would in turn

² "Fiat raises Chrysler stake to 46% in \$1.27bn deal", BBC, 21.04.2011, <https://www.bbc.com/news/business-13154490>

transfer technology and invest \$8-\$10 billion in New Chrysler in exchange for 20% of the new equity. Cerberus and Daimler would walk away from their equity and Second Lien claims, and VEBA would be issued a \$4.6 billion note, payable in 13 years at an interest rate of 9%, in addition to receiving 55% of New Chrysler's equity. Finally, First Lien holders were offered \$2 billion in cash to satisfy their previous \$6.9 billion claim. This was a sticking point for the several lenders in that category who refused to accept any reduction in their original claims. They held out and forced Chrysler to file for Chapter 11. As a last resort, the sale plan to Fiat was then proposed as a §363 type sale under Chapter 11, with an additional \$8.5 billion in funding from the US and Canadian governments.

Section 363(b)(1) of the U.S Bankruptcy Code permits the sale of assets free and clear of all liens, claims and encumbrances, aiming at a speedy transaction to maximize asset value. This out-of-plan sale strategy aims to stream-line the restructuring process as it only requires the court's approval rather than several classes of creditors, and all transactions are final unless marred by bad faith. Although an increasingly popular asset sale strategy for companies in need of fast cash, section 363 sales have faced increased controversy and public scrutiny. A lack of disclosure statements describing the conditions of the plan as well as limited time and information for review makes a §363 sale vulnerable of abuse. The sale can thus constitute a sub rosa reorganization by utilizing section 363 to push through a plan that violates the absolute priority rule of the chapter 11 bankruptcy code.

In Chrysler's case, the secured creditors believed that Chrysler had put together a §363 sale that restructured the company without extending the plan protections afforded to creditors by the Chapter 11 process, essentially ignoring the Absolute

Priority Rule. First-priority secured creditors were getting twenty-nine cents on the dollar and junior claims were being placed on top of them. It was under these circumstances that Judge Gonzales had to decide if the debtor had a good business justification for the §363 sale it was pursuing or if the sale was a sub rosa plan of reorganization. If the sale were to be completed as outlined in the case the winners would be the lower priority claimants, namely VEBA and UAW, and the losers would be the first-lien lenders (*Appendix 1 explains in detail all the implications surrounding a §363 sale*).

For these reasons, this 363 asset sale was a very disputed one and marked the restructuring landscape in the United States. Eventually the sale was allowed and the final equity structure was now 20% Fiat, and 68% UAW from the VEBA notes. When Fiat emerged from the Chrysler bankruptcy, Sergio Marchionne was appointed CEO, replacing existing Robert Nardelli. Sergio Marchionne was a big proponent of the full merger. Under his command, in July 2011, following the purchase of the ownership interests held by Canada and the US Treasury, Fiat's stake in Chrysler increased to 53.5%.

The U.S. business was a profit center for Fiat, but the two companies were still forced to manage their finances separately. Its full merger for Marchionne was an opportunity to achieve great cost synergies and fully integrate the 3rd-largest U.S auto company with an international appeal into Fiat's portfolio. Furthermore, a fully merged company would make it easier to combine the cash pools of the two companies. In early 2013 Sergio Marchionne admitted that his efforts to convince the VEBA Trust to sell its 41.5% Chrysler stake had failed and there were rumors that Chrysler was expected to IPO. The IPO would have been a tragedy for Fiat as it would: a) delay the merger

between Fiat and Chrysler, and b) possibly put at risk the benefits of their industrial cooperation. Eventually though, Marchionne managed to turn-around his plan and in January 2014, Fiat announced that it had completed the full buyout of Chrysler, making the U.S. business a wholly owned subsidiary of the Italian carmaker.

The acquisition of the remaining 41.46 percent stake in Chrysler from a UAW union was financed with a combination of cash and notes payable. The deal was cut at \$4.35 billion dollars from which VEBA (UAW) would receive \$3.65 billion in cash for the stake (\$1.9 billion of which came from Chrysler and \$1.75 billion from Fiat). Furthermore, Chrysler committed to giving the UAW trust another \$700 million in four equal annual installments. This merger structure put Chrysler's equity value at just over \$10 billion. Considering Chrysler 2013A net debt of 2bn and Pension and OPEB liabilities at \$8bn the total Enterprise Value would sum up to \$20bn. Implied multiples, were around 0.2x EV/Sales and 3.0x EV/EBITDA. The deal gave Fiat shares a lift, and it was considered to be an accretive merger. Wall street expected Fiat to pay up to \$5 billion to take full control of Chrysler. Given the price it paid, analysts calculated almost a 15% addition to the implicit value to Fiat's shares.

Finally, the result was the formation of Fiat Chrysler Automobiles N.V., often abbreviated as FCA, an Italian American multinational corporation, and now the world's eighth largest automaker.

Post-acquisition

Over the last 15 years Chrysler has been characterised by three acquisitions/mergers. After Fiat S.p.A.'s \$4.35 billion acquisition of Chrysler Group LLC in 2014, a merger of culture, technology, and dealer networks was surely to come. Although Chrysler had

previously filed for Chapter 11 bankruptcy, Fiat understood there was an opportunity to access new market segments, technologies, and distribution channels (research gate). For Fiat-Chrysler, sales in emerging markets represented a possible way to make up for the losses taken in declining developed markets. The smaller vehicles (mini, small, and compact segments) would be developed by Fiat whereas the others would be developed by Chrysler (research gate). Additionally, Fiat would lengthen and widen the compact platform of the Alfa Romeo Giulietta to be able to compete in US markets, spawning a range of mid-sized vehicles for Chrysler, Dodge, and Jeep to manufacture (Research). Another significant effect of the Fiat-Chrysler alliance is the introduction of Fiat's fuel-saving technology to Chryslers line-up of cars. In return, Chrysler offered a new petrol engine with excellent performance and superior competences in electric and gasoline-hybrid vehicles (research).

In addition to Chrysler owning 55 percent of a union retiree trust, Fiat would own a 20 percent share with the U.S. and Canadian governments holding minority stakes (New York Times). Andrea Giuricin, transport analyst at Bicocca University, mentions his concerns over the deal: "This is an increasingly American company now, because in Europe, and especially in Italy, the business conditions remain difficult" (Bus Insider). Despite these concerns, Fiat had an opportunity to build on Chrysler's culture of innovation and grow a company free of high labor costs and debt levels (New York Times).

In terms of share allotment, the merger issued 1,167,181,255 shares to Fiat shareholders as well as 408,941,767 special voting rights to eligible Fiat shareholders who "elected to participate in FCA's loyalty voting program (FCA) and 35,000 common

shares as treasury (FCA). In terms of realignment of the Board of Directors, the FCA became composed of: John Elkann, Sergio Marchionne, Andrea Agnelli, Tiberto Brandolini d'Adda, Glenn Earle, Valerie A. Mars, Ruth J. Simmons, Ronald L. Thompson, Patience Wheatcroft, Stephen M. Wolf and Ermenegildo Zegna (FCA). Additionally, the Board appointed John Elkann as Chairman and Sergio Marchionne as CEO, with the others leading various committees (FCA). Today the Board of Directors of FCA resolved to appoint John Elkann as Chairman of FCA and Sergio Marchionne as Chief Executive Officer. Of this group, Fiat appointed three directors, the federal government appointed four directors, and the Canadian government and United Automobile Workers' Retiree Medical Benefits Trust appointed one member respectively (FCA).

According to FCA's financial statements, although FCA increased its revenue from \$96,090,000,000 to \$110,595,000,000 from 2014 to 2015, its net profits decreased significantly from 632,000,000 to 377,000,000 (financial statement). A year after the acquisition, FCA lost a lawsuit in which auto safety regulators investigated some 895,000 Jeep and Dodge S.U.V.s that could short-circuit and catch on fire (NYTimes). In February 2016 the FCA stock hit an all-time low of \$6.11 USD yet slowly rose over the years to peak at \$24.81 USD in January 2018 (Macrotrends). However, since then FCA's stock value has decreased significantly. In fact, FCA US and Fiat Chrysler Automobiles agreed to pay \$40 million to settle for a class action lawsuit in which FCA misled investors about the number of vehicles sold each month in the United States (U.S. Securities And Exchange).

In terms of company culture, much credit has been given to former CEO Sergio Marchionne. After acquiring Chrysler, Marchionne wanted to create a culture where “everyone is expected to lead” (HK). Before the merger, Fiat presented ready-made solutions with few consulting and marketing skills. On the other hand, Chrysler was considered to be overconfident and bureaucratic in its outdated product portfolio (HK). Marchionne successfully built relationships under the radar with his employees and inquired about common issues among the organization. Marchionne once said, “Our engagement is mostly very informal. I’m always texting my people or calling them at odd hours to talk about the business or about their careers” (HK). In every merger there must be a decision regarding corporate hierarchy: to change or not to change. In the case of Fiat-Chrysler, Marchionne effectively refined existing routines as well as experimenting and expanding beyond conventional boundaries (HK).

Was Fiat’s acquisition of Chrysler successful? Yes and no. Under the leadership of Marchionne, the market value of Fiat from June 2004 to January 2018 rose from \$5.8 billion to \$71.4 billion. Despite setting lofty expectations for Fiat Chrysler, Marchionne has proved doubters wrong. Fiat-Chrysler has reported steady earnings but lags its rivals in China and is experiencing a slowdown in profit in North America, given that $\frac{3}{4}$ of its profits are from North America (NYT). Marchionne has helped alleviate the transitional challenges associated with acquisition and done an “incredible job revitalizing the company since Chrysler’s bankruptcy in 2009,” said Rebecca Lindland, an analyst at Kelley Blue Book, ‘But there’s more work to be done. There’s still a lot that needs to be addressed” (NTY). Given that consumers are opting for pricier, sport-utility vehicles, Fiat Chrysler will have to grow in China in order to compete with leading car manufacturers in the near future. Additionally, Fiat Chrysler will have to assess

North American demand for its signature Fiats to see if they should still be sold in North America.

Appendix 1

Was Chrysler a good candidate for application of the §363 sale process?

The question of whether Chrysler was a good candidate for application to the section 363 sale is a complicated one. Prevalent standard for court approval of §363 asset sale, as recognized by the Lionel seminal case, requires only a motion, a hearing, and a court's determination that the debtor has a sound business purpose of selling its assets. What constitutes a sound business purpose is subjective and as such may give the impression that the debtor is aiming at a *sub rosa* reorganization plan. A more detailed approach to assessing the justification for a §363 sale comes from the Bankruptcy Court for the Southern District of Texas in *In re Gulf Coast Oil Corp.* in which thirteen factors that should be considered to determine whether or not to approve §363 sales were outlined. These factors help balance between judicial discretion and creditor protection. Factor number one surrounds the need for speed and whether the decline in asset value threatens a company's ability to emerge from bankruptcy successfully. Given that Chrysler was burning \$100 million in cash a day and that the government gave Chrysler a deadline for plan approval, the need for speed is justifiable. The second factor refers to business justification. Even though Chrysler had lost its competitive advantage, gaining access to Fiat's technology, production plants and sales network would generate substantial incremental revenues and cost synergies and Chrysler predicted \$6.9 billion in total synergies between 2009 and 2016, pointing to a solid business justification. The third factor of whether the case is sufficiently mature addresses the time elapsed since the filing and whether adequate notice has been provided to all interested parties in the asset. Although it is unclear, it seems that 10 days could be deemed as an inadequate time notice.

The fourth factor refers to whether the process facilitated competitive bids. As discussed in the case, Fiat seemed to be the only interested party and other competing bidders would not have access to government funding. They would also have to meet several requirements in the Master Transaction Agreement, that made an outside bid highly unlikely due to several stringent requirements, such as having the full bid be paid as a cash deposit by the deadline and that any bid be substantially higher to account for loss of government funding and new break-up fees. As a result, there is a strong case to claim that the bidding process for Old Chrysler's assets was not straightforward and conducive to maximizing the value of the asset. Sequentially, factor five seems to have not been fulfilled, as no other companies submitted any competing bids and Old Chrysler's assets were not aggressively marketed to other interested buyers. The management is not fully disinterested as they are more likely to keep their jobs in a §363 sale than in a liquidation scenario or a buy-side acquisition, so point six is

only partially met. The seventh factor, which questions whether an asset sale will include all of a company's assets or its most valuable asset is fully met as per the description of the plan. The original purpose of §363 was to liquidate assets like equipment to fund a successful reorganization plan. Although the law does not prohibit sales of companies in their entirety or sales of a business's most valuable asset, it should discourage sales that extend beyond the legitimate scope of corporate reorganizations. Factor eight is unclear but given the unfair advantage gained from extra government funding it could be analyzed as not being met. Factor nine, which examines the likelihood of the sale to be accepted in a chapter 11 plan, is an obvious no as first lien holders would be getting only 29 cents on the dollar and it would be hard to get their approval. The tenth factor analyzes which parties will benefit from the sale and relies on the fact that the equal treatment of creditors should not be distorted by permitting one or a few select parties to profit from the purchase of the debtor's assets to the detriment of other parties. In the case of Chrysler the main parties benefited are the unsecured UAW & VEBA claims that, by pushing a §363 sale, transfer value to themselves from senior creditors. Factor eleven is met as adequate benefits seem possible. A lack of absolute priority rule argues against factor twelve.

After considering all the factors, it still remains unclear whether Chrysler was in fact a good candidate for a section 363 sale. Chrysler was rapidly burning cash and the sale of its assets to Fiat seemed like the only viable option, as liquidation would result in a lower valuation and catastrophic consequences for the US auto industry. Additionally, Chrysler could lose skilled workers and further erode consumer confidence by not solving the issue immediately. Lastly, part of the going concern value would be eroded as government financing would expire without a deal. Nevertheless, other sources of financing could be procured and the argument of whether assets were being wasted was not settled.

What potential consequences might this use of section 363 have?

Judge Gonzalez "held in his hands the fate of America's third-largest auto company, and, symbolically that of America's entire auto industry". US law's use of precedent made it clear this decision would have repercussions on future bankruptcy decisions, as well as creditor rights, capital markets and the well-being of the economy.

Section 363 sales as described above already undermine creditor rights as they do not require voting from creditors to approve the sale: they rely on a debtor's *business judgement*. There were clear misgivings on whether the assets were 'wasting', with the only valuation of the assets having been provided by the debtors themselves. If a §363 sale were to be allowed

under conditions which undermine the true value of the asset and thus push through a transaction that would result in higher recovery rates for junior claims at the expense of senior claims, undercutting the APR, this would heavily undermine the statutory protections given to senior creditors in Chapter 11. Moreover, accepting a dubious §363 sale would dilute the meaning of a *sub rosa* reorganization, setting a dangerous precedent for undermining creditor contracts. In turn, this would affect capital markets by lowering the willingness to lend, particularly for more risky companies. This would raise rates, specifically within the auto-industry which already struggled from high levels of debt in a low point of the cycle.

On the other hand the consequences on the auto-industry and the economy of not pushing through the §363 asset sale would be substantial. With no government funding, a negative decision would likely have led to the liquidation of the business, risking the loss of 2 to 3 million jobs in the US in a worst-case scenario resulting from further bankruptcies to smaller suppliers, small auto-part makers, competitors and customers, not to mention the large financial losses to taxpayers and to the retirement plans affecting the 40,000 US Chrysler employees. Although these factors were not legal in nature, the gravity of the potential economic consequences should be accounted for in the judge's decision

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