



SENATE REPUBLICAN

POLICY COMMITTEE

Legislative Notice

No. 79

December 10, 2008

S. 7005 – Shell for the Auto Financing Bill

Calendar No. 1128

S. 7005 was read twice and placed on the Calendar on December 9, 2008.

Noteworthy

- Senator Reid filed cloture on the motion to proceed to S. 7005 on the evening of December 10, 2008. It is expected that S. 7005 will serve as a shell for the Auto Industry Financing and Restructuring Act (AIFRA), which is legislation that will provide a taxpayer financed bridge loan to the three domestic automakers, namely Ford, Chrysler and General Motors (Detroit 3).
- The House passed similar legislation, H.R. 7321, on December 10, 2008 by a vote of 237 to 170 with one Member voting present.
- On October 3, 2008, the President signed into law the Emergency Economic Stabilization Act of 2008 (EESA), which created a \$700 billion Troubled Asset Relief Program (TARP) to allow the Department of Treasury to purchase troubled assets.
- Shortly after the EESA was signed into law, Secretary Paulson announced that TARP funds would not be used to buy troubled assets but would instead be used for capital infusions. Around that time, corporations outside of the financial services industry, including the Detroit 3, requested TARP funding from Treasury but such requests have been denied on the basis that TARP is limited to the financial services sector.
- This legislation would provide the Detroit 3 with an upfront \$14 billion in a taxpayer financed loan to enable these companies to return to viability and to retool their product lines to begin to produce more fuel efficient vehicles.
- The legislation also requires that the President appoint a “designee” to oversee the restructuring and, as a condition for receiving the loan, that the Detroit 3 each submit a plan on how they intend to significantly restructure their operations and reduce many of their structural costs.
- If the designee does not approve a long-term restructuring plan by March 31, 2009 (or 30 days thereafter), then the designee shall require repayment of the loan within 30 days. In addition, the designee may require accelerated repayment of loans if the designee determines that the participating automaker has not made adequate progress toward a long-term restructuring plan or if the automaker does not make adequate progress in implementing an approved restructuring plan.

Background

The United States economy has experienced significant turmoil over the past two years. In response, Congress, the Department of Treasury, the Federal Reserve (Fed) and the Federal Deposit Insurance Corporation (FDIC) have taken significant steps to try to manage the turmoil. These expenditures include:

- Passage of the Economic Stimulus Act of 2008 (H.R. 5140), which passed the Senate on February 7, 2008 and became law on February 13, 2008. The Act provided stimulus checks to individual tax filers who filed returns in tax years 2007 and 2008, with a direct spending cost of \$152 billion.
- On March 14, 2008, JP Morgan Chase, in conjunction with the Federal Reserve System guarantee, provided a 28-day emergency loan to Bear Stearns in order to prevent Bear Stearns from becoming insolvent. Two days later, Bear Stearns merged with JP Morgan Chase.
- On July 26, 2008, the Housing and Economic Recovery Act of 2008 (H.R. 3221) passed the Senate and later became law on July 30, 2008. According to the Congressional Budget Office (CBO), the legislation included a new mortgage guarantee program and other provisions which cost a total of \$41.7 billion in direct spending. The legislation also included an increase in the public debt limit of \$800 billion (to \$10.615 trillion).
- The Housing and Economic Recovery Act of 2008 gave authority to the Secretary of the Treasury to exercise expanded regulatory authority over Fannie Mae and Freddie Mac (Government Sponsored Enterprises “GSEs”) through the newly established Federal Housing Finance Agency. In an exercise of that authority, on September 7, 2008, the Administration placed the GSEs under a conservatorship after concluding that the companies did not have enough capital to continue their operations and made arrangements to invest up to \$200 billion in the GSEs.
- On September 14, 2008, the New York Federal Reserve intervened when Lehman Brothers announced it would file for Chapter 11 bankruptcy protection. According to reports, a group of Wall Street firms agreed to provide financial assistance for Lehman’s orderly liquidation and the Federal Reserve agreed to swap lower-quality assets in exchange for loans and other assistance from the government.
- On September 16, 2008, the American International Group, Inc. (AIG) suffered a liquidity crisis following the downgrade of its credit rating. The Federal Reserve extended \$85 billion in credit to AIG for a term of 24 months with AIG pledging assets as collateral and a warrant for 79.9 percent of AIG shares which were issued to the Federal Reserve. On November 10, the government changed the terms associated with this loan by reducing its size to \$60 billion, cutting the interest rate from “14 percent to as low as 5 percent” and extending the term of the

loan from two to five years.¹ The government has since expanded the size of the AIG bailout twice, most recently to \$152 billion.

- On September 19, 2008, the Secretary of the Treasury, Henry Paulson, announced the need for additional legislation allowing the federal government to purchase \$700 billion in distressed assets from institutional investors and submitted language to Congress to accomplish this purpose. At the same time, the Department of Treasury announced the establishment of a temporary guaranty program for the U.S. money market mutual fund industry for up to \$50 billion in guarantees.
- On October 1, 2008, the Senate responded by passing the Emergency Economic Stabilization Act of 2008 (EESA) by a vote of 74 to 25. This legislation created a \$700 billion Troubled Asset Relief Program (TARP) which allows the Treasury Department to purchase distressed assets. The House of Representatives, by a vote of 263 to 171, passed the EESA on October 3rd and the bill was signed into law by the President later that same day.
- The EESA divided the available TARP funds into three separate tranches and required Treasury to obtain congressional approval before tapping into the final \$350 billion of the TARP funds. To date, it is estimated that Treasury has already allocated \$335 billion in TARP funds which would require congressional authorization before Treasury can access the final tranche of TARP funds.
- Following enactment of the EESA, Secretary Paulson announced that instead of using the TARP funds to buy troubled assets Treasury would instead inject capital into several large banks among which was Citigroup. In October, Treasury invested \$25 billion of TARP funds in Citigroup. On November 24, 2008, Treasury, the Fed and the FDIC announced it was taking further action to shore up Citigroup by investing another \$20 billion and agreeing to guarantee Citigroup from over \$300 billion in potential losses arising from its troubled assets. In exchange, the government would receive \$7 billion in preferred shares in Citigroup.

Following Treasury's shift in strategy for use of TARP funds, companies other than those in the financial services sector began to request access to TARP funds for bridge loans and other assistance. This includes requests for capital from Ford, General Motors and Chrysler (Detroit 3). To date, despite support from some on Capitol Hill, Secretary Paulson has declined to use the TARP funds other than for financial service companies. In response, Senate Majority Leader Harry Reid introduced legislation on November 17, 2008 to provide up to \$25 billion in direct loans to the Detroit 3 from the TARP funds (S. 3688).

In response, the Administration instead proposed using funds set aside in the advanced technology vehicle production program set up under Section 136 of the Energy Independence and Security Act (EISA, P.L. 110-140) as a source of funds for a bridge loan for the Detroit 3. Others have suggested that the Detroit 3 should pursue bankruptcy as an alternative to a taxpayer bailout in order to restructure their debts and an obligation including reducing the significant legacy costs that burden these companies.

¹ *Washington Post*, "Government Again Expands AIG Rescue Plan," November 11, 2008. http://www.washingtonpost.com/wp-dyn/content/article/2008/11/10/AR2008111000502.html?wprss=rss_business%2Feconomy

Following a lack of agreement between the President and the Democratic Majority in the House and Senate on how best to proceed, and after several polls showing a lack of support by the American people for an auto industry bailout, the Democratic leadership in Congress postponed consideration of a bailout for the Detroit 3 until the week of December 8th and requested that the Detroit 3 put forward detailed recovery plans on how they intend to restructure their operations to return to viability. The details of the Detroit 3's plans were released on December 2, 2008, and the automakers collectively requested a bailout of \$34 billion from the American taxpayers.

Bill Provisions

Section 1. Short Title. Table of Contents.

Section 2. Findings and Purposes.

The purposes of this Act are: (1) to immediately provide authority and facilities to restore liquidity and stability to the domestic auto industry in the United States; and (2) to ensure that such authority is used to stimulate manufacturing and sales of U.S. automobile manufacturers, to enhance the ability of the U.S. automobile manufacturers to produce energy efficient advanced technology vehicles, and to protect jobs and benefits while promoting a viable U.S. automobile industry in the future.

Section 3. Presidential Designation.

The President shall designate one or more officers, hereinafter referred to as "designee," from the Executive Branch having appropriate expertise in such areas as economic stabilization, financial aid to commerce and industry, financial restructuring, energy efficiency, and environmental protection. The colloquial name given to the designee is "car czar."

The President or his designee may also employ additional people who the President believes possess the requisite expertise.

Other federal agencies may detail staff as requested by the car czar.

Section 4. Bridge Financing.

The designee shall authorize, allocate and direct the disbursement of bridge loans or commitments for lines of credit to each automobile manufacturer that submitted a plan to Congress on December 2, 2008. The Detroit 3 were the only companies to submit plans. The designee shall authorize an amount necessary to facilitate continued operations of the Detroit 3.

Section 5. Restructuring Progress Assessment.

No later than January 1, 2009, the designee must determine appropriate measures to assess the progress of each of the Detroit 3 in turning the plan submitted to Congress on December 2, 2008, into a long-term restructuring plan. The evaluation of the long-term restructuring plans must be completed within 45 days from the date that the designee outlines such measures.

Section 6. Submission of Plans.

The President's Designee shall work to finalize the restructuring plans for the eligible automobile manufacturers taking into consideration their long-term viability, competitiveness and energy efficiency and to reach help the automakers reach agreement on such plan with their "interested parties" (defined as employees, retirees, unions, creditors, suppliers, dealers and shareholders). Such designee may convene meetings to facilitate agreement without the need to comply with the Federal Advisory Committee Act.

Not later than March 31, 2009, the eligible automobile manufacturers shall submit a restructuring plan to the President's designee and the designee shall approve the plan if the designee determines that the plan will result in: (1) all government provided financing being paid back; (2) the Detroit 3 demonstrating that they can meet all applicable Federal fuel efficiency standards, can produce advanced technology vehicles, and meet the requirements of Section 13 of this Act; (3) the ability to achieve a positive net present value; (4) efforts to rationalize costs and capacity with respect to their workforce, suppliers and dealers; (5) a restructuring of corporate debt; and (6) development of a product line that is competitive in the U.S. marketplace.

The President's designee may extend for 30 additional days the deadline requirements for the plan upon providing notice of such extension to the Congress.

Section 7. Financing for restructuring.

If the designee approves the restructuring plan of an eligible automobile manufacturer outlined in Section 6 above, then such designee may provide financial assistance so as to implement said restructuring plan.

Section 8. Disapproval and Call of Loan.

If the designee has not approved the restructuring plan by the end of the time period outlined above in section 6, then the designee shall call the loan or cancel the commitment within 30 days, unless a restructuring plan is approved within that period.

Section 9. Allocation.

The designee must prioritize allocation of funds to the auto manufacturers.

For bridge loans, the priority is as follows: (1) necessity of the financial assistance; (2) potential impact of the failure of the auto manufacturers on the U.S. economy; and (3) ability to utilize the financial assistance optimally.

For long-term financial assistance, the priority is as follows: (1) ability to utilize the financial assistance optimally; (2) potential impact of the failure of the auto manufacturers on the U.S. economy; and (3) necessity of the financial assistance.

Section 10. Funding.

For the purposes of providing financial assistance for this Act, such sums shall be appropriated as are necessary to fund up to \$14 billion in loans. The \$14 billion is taken from the Energy Independence and Security Act of 2007 Section 136. Section 136 provides loans to automobile and automobile part manufacturers for the cost of re-equipping, expanding, or establishing manufacturing facilities in the United States to produce advanced technology vehicles or qualified components, and for associated engineering integration costs. Funding for the \$25 billion direct loan program was already made available in section 129 of the Consolidated Security Disaster Assistance and Continuing Appropriations Act, when \$7.5 billion was appropriated to cover the subsidy costs of the program. Of that \$7.5 billion, \$7.01 billion shall be made available to cover the subsidy costs of this \$14 billion financial assistance, and the additional appropriation authority may only be necessary if CBO estimates a subsidy rate that requires additional funding. The remaining \$500 million is specifically reserved for the original \$25 billion loan program.

Section 10 authorizes the future appropriation of funds to replenish the direct loan program of all funds made available for financial assistance by the President's designee.

Section 11. Terms and Conditions.

The duration of all loans made shall be seven years, or longer if the President's designee determines necessary. The loans will have a five percent interest rate for the first five years of disbursement, and a nine percent interest rate for any period after the first five years. Payments of interest on loans shall be made semiannually.

As a condition for any financial assistance, the manufacturers must agree to allow the designee to examine all relevant company records and data and must provide any information requested by the designee.

During the loan period, the manufacturer must inform the designee of any asset sale larger than \$100 million or any other material change in the financial condition of the manufacturer.

The designee has the authority to review any asset sale, contract, or commitment and prohibit the manufacturer from consummating any such proposed sale, investment, contract or commitment. If the manufacturer fails to make adequate progress towards meeting the restructuring progress measures, fails to comply with any conditions or requirements applicable under this bill or applicable federal fuel efficiency and emissions requirements, fails to submit a restructuring plan by March 31, 2009, or fails to make adequate progress in the implementation of the plan, then the loan repayment may be accelerated as the designee sees fit, or the financial assistance may be cancelled.

Section 12. Taxpayer Protection.

The President's designee may not provide financing unless the manufacturer provides to the designee or such department or agency, as is designated by the President, an equity warrant equal to 20 percent of the amount of the financing provided. The warrants enable the Government to purchase nonvoting stock and preferred stock. The warrant described above shall have a value equal to 20 percent of the amount of the financing provided to the eligible automobile manufacturer, or such greater value as may be determined by the President's designee.

The exercise price of the warrants shall be the 15-day average of the market price of the common stock as determined by the designee prior to December 2, 2008. The antidilution protection provisions contained in the TARP legislation will also apply to any warrant issued.

Any manufacturer receiving assistance will be subject to section 162(m)(5) for the Internal Revenue Code and "appropriate standards" for executive compensation and for corporate governance. These standards shall include limits on senior executive compensation, a provision for the recovery of inappropriate bonuses, a prohibition on golden parachutes, a prohibition on bonuses or incentive compensation to the 25 most highly-paid employees, and a prohibition on any compensation plan that would encourage manipulation of reported earnings.

During the loan period, the manufacturer may not own or lease any private passenger aircraft and must take all reasonable steps to divest such current aircrafts or interests.

Except with respect to obligations pursuant to law to, or existing contracts with, non-affiliated parties, as of December 2, 2008, no dividends or distributions of any kind may be paid while financial assistance is outstanding.

Any other obligations of a manufacturer shall be subordinate to the loan, and such loan shall be senior and prior to all other obligations and liabilities. In addition, any possible future proceeding under Chapter 11 Bankruptcy will not discharge the eligible auto manufacturer, or any successor in interest, from the debt associated with receiving financial assistance under this bill. Further, any financial assistance provided to an eligible manufacturer shall be exempt from the automatic stay established by section 362, title 11 U.S. Code. The automatic stay prohibits a creditor from collecting from a debtor when bankruptcy is filed; however, such a rule would not apply to the Government in this circumstance.

Section 13. Oversight and audits.

The Comptroller General shall conduct appropriate oversight over the President's designee and the Government Accountability Office (GAO) shall provide the appropriate space and facilities for that oversight. The Comptroller shall submit reports to Congress every 60 days. A special inspector general shall conduct audits and investigations of the designee.

Section 14. Automobile Manufacturers' Study on Potential Manufacturing of Transit Vehicles.

Each auto manufacturer that receives financial assistance shall conduct an analysis of potential uses of any excess production capacity to make vehicles for sale to public transit agencies, including buses and rail cars. The Comptroller shall review the analyses conducted and shall provide reports to Congress and the designee.

Section 15. Reporting and Monitoring.

The designee shall submit a report to Congress on each bridge loan made, not later than five days after the date of consummation of the loan. The designee shall also submit reports to Congress on the restructuring progress assessment measures established for each manufacturer, the detailed findings and conclusions of the designee in connection with the evaluation of an eligible manufacturer under section 5(b), and on the exercise of a right under section 9(f) to accelerate indebtedness or cancel any financial assistance.

The designee shall monitor the use of the loan funds by the manufacturer and shall report to Congress once every 90 days on the ability of the recipient to continue operations and proceed with restructuring.

Section 16. Report to Congress on Lack of Progress Toward Achieving an Acceptable Negotiated Plan.

At any time the designee determines, to avoid disruption to the economy or achieve a negotiated plan, the designee shall submit to Congress a report on any additional powers and authorities necessary to facilitate the completion of a negotiated plan.

If the designee determines that adequate progress is not being made toward achieving a negotiated plan by March 31, 2009, the designee shall submit a report detailing the impediments to achievement of a plan.

Section 17. Submission of Plan to Congress by the President's Designee.

The designee shall submit to Congress a plan that represents the steps necessary to achieve long-term viability, international competitiveness, and energy efficiency, consistent with the factors set forth in section 6 above, including a discussion of achieving long-term viability via Chapter 11 Bankruptcy reorganization, a negotiated plan, or further legislation.

Section 18. Guarantee of Leases of Qualified Transportation Property

Section 18 would require the President's designee to function as a guarantor for lease transactions approved by the Federal Transit Administration (FTA) prior to January 1, 2006. The designee would serve as a guarantor if a lessee of qualified property (property leased subject to a FTA approval before the date above) requests a guarantee, and is required to establish the terms and conditions of the guarantee within 14 days of the date of enactment. The language provides that if the designee pays claims that exceed collateral amounts, the excess shall be paid from the General Fund of the Treasury. The designee is directed to recover these amounts within three years through a fee assessed to the lessee or guarantor for whom the claim was paid.

The transit agencies requested that Treasury guarantee certain financial instruments with respect to lease in/lease out and sale in/sale out (LILO/SILO) transactions under the TARP; however, Treasury denied such a request. Even though Treasury has denied the request, this section appears to be an attempt to resurrect it and to permit the federal government, through the designee, to function as the insurer of certain transit transactions. Under so-called “sale lease-back transactions,” a transit agency would typically sell capital items to a bank or other private entity, leasing-back the property for the agency’s use. The guarantor of the transaction, typically an insurance company holding collateral provided by the agency, must be rated “AAA” or better. The downgrading of such an insurer can trigger the contractual demand for certain payments or other surety, depending on the contract. Opponents of SILO assert that it is a tax avoidance transaction in which Congress has already legislated, as there was prohibitive language contained in the American Jobs Creation Act of 2004 and the Tax Increase Prevention Act of 2005. They further argue that it is inappropriate to support or guarantee tax shelter transactions that previous Congresses have deemed to be illegitimate.

Scoring for this provision may be difficult to calculate. While as many as 120 projects could qualify for a guarantee request, the nature of the guaranteed transaction, the fiscal health of the transit authority, and the terms and conditions provided by the designee may vary significantly.

Section 19. Coordinating with Other Laws.

No provision of this Act should be construed as altering, affecting or superseding: (1) the funding for the Section 136 direct loan program; or (2) any existing authority to provide financial assistance to liquidity for purposes of the day-to-day operations in the ordinary course of business or research and development. No federal financing may be used for the purpose of assisting an eligible manufacturer to achieve financial viability or otherwise to avoid bankruptcy except to provide bridge financing or to implement a plan for long-term viability.

The legislation also provides generally that antitrust laws will not apply to discussions between an eligible automobile manufacturer and its interested parties, for a period of three years, when done in accordance with section (6)(a)(2). This exemption requires that the Attorney General and the Federal Trade Commission receive notice of meetings between the automobile manufacturers and interested parties. The exemption does not extend to cases involving price-fixing, monopolies, market allocations or boycotts. Furthermore, this section would not preclude enforcement actions for any action prohibited by antitrust law.

This section also temporarily suspends the prohibition on the annual cost of living salary adjustment (COLA) for judges and justices of the United States. The COLA is permitted for fiscal year 2009.

Section 20. Treatment of Restructuring for Purposes of Applying Limitations on Net Operating Loss Carryforwards and Certain Built-In Losses.

Section 382 of the Internal Revenue Code shall not apply in the case of an ownership change or pursuant to a restructuring plan. In general, the rules of section 382 apply to limit a corporation's ability to utilize existing net operating loss (NOL) carryovers once the corporation experiences an ownership change.

Section 21. Emergency Designation

Amounts provided by the Act are designated as emergency for purposes of S. Con. Res. 21, the concurrent resolution on the budget. This section precludes the application of PAYGO.

Administration Position

At press time, there was no Statement of Administration Policy (SAP).

Cost

At press time, no CBO cost estimate was available.