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The Government Robbed Chrysler Creditors

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In January 2009, Chrysler stood on the brink of insolvency. Purporting to act under the Emergency Economic Stabilization Act, the Treasury extended Chrysler a $4 billion loan using funds from the Troubled Asset Relief Program (TARP). Still in a bad financial situation, Chrysler initially proposed an out-of-court reorganization plan that would fully repay all of Chrysler's secured debt. The Treasury rejected this proposal and instead insisted on a plan that would completely eradicate Chrysler's secured debt, hinging billions of dollars in additional TARP funding on Chrysler's acquiescence.

When Chrysler's first lien lenders refused to waive their secured rights without full payment, the Treasury devised a scheme by which Chrysler, instead of reorganizing under a chapter 11 plan, would sell its assets free of all secured interests to a shell company, the New Chrysler. Chrysler was thus able to avoid the "absolute priority rule," which provides that a court should not approve a bankruptcy plan unless it is "fair and equitable" to all classes of creditors
.

Cato Institute joined the Washington Legal Foundation, Allied Educational Foundation, and George Mason law professor Todd Zywickion in a brief supporting the creditors' petition asking the Supreme Court to review the transaction's validity. They argue that the forced reorganization amounted to the Treasury redistributing value from senior, secured creditors to debtors and junior, unsecured creditors.

"The government should not be allowed, through its own self-dealing, to hand-pick certain creditors for favorable treatment at the expense of others who would otherwise enjoy first lien priority. Further, a lack of predictability and consistency with regard to creditors' expectations in bankruptcy will result in a destabilization of existing and future credit markets."

The Court will be deciding whether to hear the case later this fall.

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