APPROVAL OF SALE IN CHRYSLER BANKRUPTCY

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To Our Clients and Friends:

Late Sunday evening, Judge Gonzalez approved the sale, under section 363 of the Bankruptcy Code, of substantially all of Chrysler's assets, denying the objections of a group of first-lien lenders. The objecting creditors have filed a notice of appeal with respect to the approval order. This update focuses on four determinations that led the bankruptcy court to a speedy approval of the sale.

APPROVAL OF THE SALE PURSUANT TO SECTION 363

Dissenting creditors contended that the sale dictated the recoveries of various creditor groups and could only be accomplished through a plan of reorganization. Judge Gonzalez rejected this contention and held that the proposed sale met familiar standards for expeditious approval. Second Circuit standards for approval of a section 363 sale seek to balance a debtor's ability to sell assets with the creditors' right to a meaningful vote on a plan. Judge Gonzalez applied these standards conventionally, emphasizing the traditionally predominant factor: whether the asset is increasing or decreasing in value. The court concluded that the Chrysler business was rapidly deteriorating in value and that the sale was the only alternative to a liquidation.

Following precedent of the Bankruptcy Court for the Southern District of New York, Judge Gonzalez held that the Chrysler sale could be made free and clear of all liens because the $2 billion sale price exceeded the *economic value* of the liens, even though it was less than the face amount of the secured debt. As we have previously mentioned, decisions in other jurisdictions have held that a sale may not be made free and clear of liens unless the sale price exceeds the *amount* of the liens.

The dissenting creditors challenged some aspects of the valuation submitted by Chrysler, which concluded that the company had a liquidation value between zero and $1.2 billion. However, they did not offer a competing valuation. Judge Gonzalez added that the sale itself was the "real test" of value, and since the secured lenders received the entire sale proceeds, more than the liquidation value, the asset could be sold free and clear of all liens.

PAYMENTS BY NEW CHRYSLER TO JUNIOR CREDITORS OF OLD CHRYSLER WERE NOT BARRED

The objecting first-lien creditors took particular exception to the greater *overall* recovery by junior creditors – notably the unions, vendors and dealers – under the Fiat Transaction. Judge Gonzalez found that the section 363 sale did not violate the absolute priority rule, since no junior creditor recovered anything from the debtor. All of the $2 billion paid in the sale went to the senior, first-lien lenders. Judge Gonzalez held that any additional amounts paid by the post-sale, non-debtor Chrysler to cure defaults, or to provide adequate assurance of future performance, under executory contracts were not relevant to the priority rules, even if the contract payments benefited counterparties that were also junior creditors.

FIRST-LIEN CREDITORS WERE BOUND BY CONSENTS GIVEN BY THE AGENT

Judge Gonzalez agreed that dissenting first-lien creditors had standing to appear as parties-in-interest to the Chrysler bankruptcy, but held that the dissenting creditors remained bound by the terms of the agreements by which they obtained their liens. By these agreements, the court held, the first-lien creditors had irrevocably designated the agent to act on their behalf in any bankruptcy in accordance with a controlling majority of the lenders. The agent acting on instruction of 92.5% (by amount) of the first-lien creditors, had properly consented to the Fiat Transaction. Judge Gonzalez concluded that the dissenting creditors had flatly "contracted away their right to act inconsistently" with such consent.

THE GOVERNMENT'S MOTIVES WERE IRRELEVANT

The Chrysler bankruptcy was enabled by the U.S. Treasury's unprecedented extension of debtor-in-possession (DIP) financing. The dissenting creditors urged the bankruptcy court to subject the budget, timetable, and motivation of the DIP loan to special scrutiny on that basis. Judge Gonzalez, in a holding sure to bear relevance to the General Motors bankruptcy filed today, refused that invitation and instead held that the fact that the U.S. and Canadian governments were the DIP lenders "does not alter the analysis under bankruptcy law," even if their participation was motivated by non-economic considerations. The governments' DIP loan would be held to the same bankruptcy standards as a loan by any private lender. Indeed, Judge Gonzalez insisted, governmental DIP lenders may enjoy the same considerable leverage and influence over a proceeding as conventionally exercised by private DIP lenders.

APPEAL OF THE SALE ORDER

In response to the filing of a notice of appeal by the objecting first-lien creditors, Chrysler has filed a motion seeking immediate appeal to the United States Court of Appeals for the Second

Circuit. Each of Fiat, the UAW and the official committee of unsecured creditors appointed in Chrysler's bankruptcy have joined this motion, which seeks to eliminate intermediate stages of appeal and reach finality as expeditiously as possible.

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