December 8, 2008

**TO:** Interested Parties

**FROM:** Bernard L. Schwartz, Chairman and CEO of BLS Investments and Chairman of Third Way's Board of Trustees

**RE:** A Plan to Save the U.S. Auto Industry: The Case for a Government-Sponsored, Pre-Packaged Restructuring Agreement

The collapse of the U.S. auto industry would deliver a potentially devastating blow to an already badly damaged American economy. It would further destabilize the financial system, result in the loss of tens of thousands of jobs, and destroy a significant part of America's engineering and design capabilities. The question, therefore, is not whether we should save the American auto industry but how.

Much of the debate thus far has centered around two choices: One choice suggests that the auto industry be allowed to fail, undergo Chapter 11 bankruptcy, and through bankruptcy eventually emerge a stronger, more profitable, streamlined set of companies. The pain would be significant up front, but the reward—proponents argue—would be a lean and successful auto industry sometime in the future. The second choice is to provide the industry with guaranteed loans in exchange for a series of high-profile cost-cutting measures. The loans—proponents argue—will allow the industry to weather the economic storm and return to profitability in several years.

Both of these choices leave too much to chance in this high stakes crisis. This memo offers an alternative approach between bankruptcy and loans that is modeled on a pre-packaged Chapter 11 bankruptcy with two significant exceptions: there would be no bankruptcy filing and the government, not a private entity, would step in to provide bridge financing during the restructuring process. This can be called a "pre-packaged restructuring" and would provide auto manufacturers with the billions of dollars in loans they need in exchange for a comprehensive contractual restructuring agreement for the industry.

This pre-packaged restructuring plan would preserve manufacturing continuity, safeguard jobs, and maintain supplier and distributor networks. The bridge financing would guarantee suppliers that bills will be paid, contracts will be honored, and that they will continue to do business with an important customer. Dealers would be assured that the auto industry will continue to be a going concern. This financing would guarantee potential auto buyers that the value of their purchase will be maintained and warranties will be honored. And such a plan would minimize taxpayer risk and maximize the probability that the U.S. automobile industry will emerge as a financially successful world leader.

The following are the elements that together or separately could be included in a pre-packaged restructuring plan:

**Bridge financing:** The government should pledge—at the time a contractual agreement is reached—low-cost bridge financing sufficient to provide for uninterrupted operations. In return for this financing, the government would receive a combination of debt, preferred shares and/or warrants to buy common shares. It is essential that the government be the lender, because only the government has both the resources to meet the industry need and the national economic incentive to preserve the auto industry.

**Special Administrator:** The auto industry will appoint a single, impartial administrator who will have the authority to represent the industry, with one voice, in restructuring discussions with all parties, including labor unions, management, creditors, dealerships, and other relevant parties.

**Industry Consolidation:** If desirable and feasible, consideration should be given to consolidating the three major auto makers in order to achieve economies of scale and eliminate redundancies in costs, products and investments.

**Warranties:** The bridge financing would guarantee the viability of vehicle warranty responsibilities during restructuring. (This may not be a costly undertaking because purchasers pay for extended warranties—so this could be at least a break-even proposition.)

**Government-led Research and Development:** The special administrator would eliminate industry research and development (R&D) initiatives across the three automakers, particularly those efforts pursuing alternate fuel sources, by having the government direct and be accountable for the energy R&D initiatives. This step would eliminate wasteful redundancies and ensure that this country's commitment to develop alternative fuel sources would be taken seriously and would eliminate the fractured industry effort. In return, green technology developed by the government would be freely shared by U.S. manufacturers.

**Government Vehicle Purchases:** The government would undertake a program to update its fleet and purchase American-manufactured automobiles and trucks (U.S. Postal Service, Park Service, Department of Defense, Homeland Security, etc.) that are economical and meet strict fuel-efficiency standards.

**Consumer Initiatives:** Congress should provide additional financial incentives to car and truck buyers to purchase vehicles that meet fuel-efficiency standards. This program would jump-start the transformation of America's drivers from purchasers of gas guzzlers to promoters of "green" solutions to our energy consumption needs.

**Interim Relief if Necessary:** Realizing that any auto industry remedy may not be legislated until after January 20, 2009, TARP (Treasury Asset Relief Program) loans could be advanced weekly as necessary to meet the companies' cash requirements and, subsequently, to be folded into the bridge financing.

**Conclusion of Agreement:** The automobile industry would return to fully private status once it has fully repaid its debt to the federal government.

Together, these pre-arranged conditions would help guarantee that the restructuring of the U.S. auto industry is successful. In the long term, the industry will emerge as a world leader with fewer redundancies and less expensive structure. In the meantime, it would ensure that the three companies can continue to operate as the restructuring is carried out, thereby avoiding serious damage to the economy.