



# The Chrysler Effect: The Impact of the Chrysler Bailout on Borrowing Costs

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Absolute priority rule: Secured creditors before unsecured creditors

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<u>Claim (bil)</u>	<u>Claimant</u>
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\$2	Cerberus & Daimler
\$4	US Treasury & Canada (Bridge)
\$5	US Treasury & Canada (DIP)
<i>UNSECURED</i>	
\$10	UAW Trust

## Absolute priority rule: Secured creditors before unsecured creditors

<u>Claim (bil)</u>	<u>Claimant</u>	<u>Received (bil)</u>
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\$4	US Treasury & Canada (Bridge)	
\$5	US Treasury & Canada (DIP)	
<i>UNSECURED</i>		
\$10	UAW Trust	\$1.5 cash \$4.6 debt 55% equity



Bankruptcy laws arbitrarily overthrown

Dangerous precedent

Significant increase in cost of debt



No priority violation

- Purchaser is not restricted by Code

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\$10	UAW Trust	<u>From Buyer</u>
		\$1.5 cash
		\$4.6 debt
		55% equity



No priority violation

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Priority violation

- But common in bankruptcy

No significant impact on the cost of debt

Question: Did the Chrysler bailout increase borrowing costs?

Approach: Investigate effect of bailout on borrowing costs of highly unionized companies

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Answer: No evidence of a negative reaction to bailout by bondholders of unionized firms

- Bonds of unionized firms had lower yields than bonds of non-unionized firms
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- Positive abnormal returns for unionized bonds on key event date

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## Academic Literature

- Empirical Studies: creditor–shareholder conflict

Franks and Torous 1989, 1994; Eberhart et al. 1990; Weiss 1990, Betker 1995, Bharath et al. 2007

- Law Scholarship: creditor conflict

Baird and Rasmussen 2010, 2003; Ayotte and Morrison 2009; Baird 2009; Levitin 2009; Baird and Bernstein 2006; Miller and Waisman 2004

Bond Information

TRACE

FISD

Firm Information

Compustat & CRSP

Exclude

Non-plain vanilla bonds

Maturity within 1 year

Issued within 1 year

Insufficient trading

Financial Firms

Chrysler, Ford, General Motors



Bonds: 508

Firms: 269

Value-weight at firm level

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Unionization

SEC Filings (firm)

Unionstats (industry)

“Unionized” firm

30%

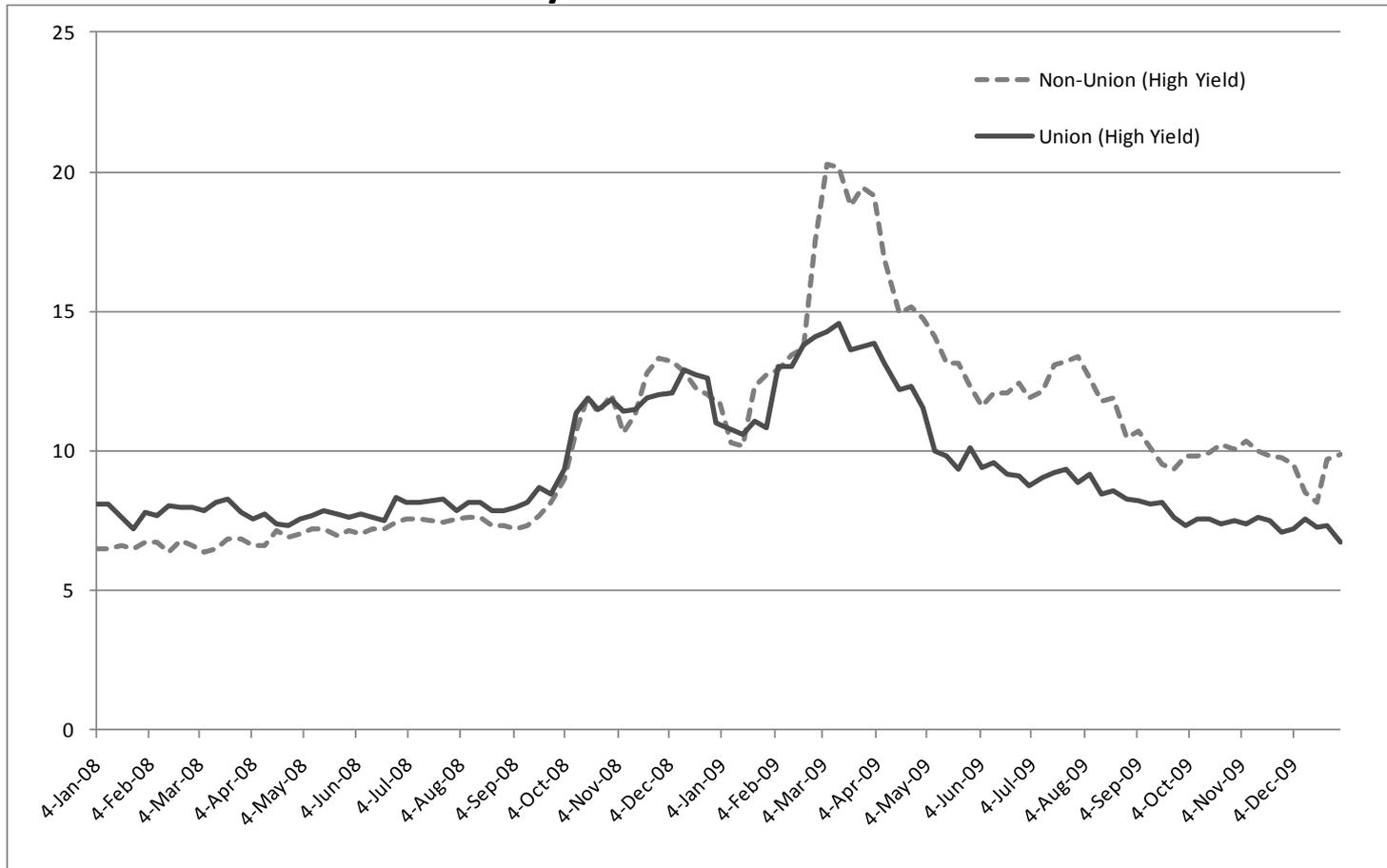
Firms: 163

Unionized: 69

Non-Unionized: 94

Variable	UNION – NON-UNION	
	Mean	t-stat
O-Score	0.109	-0.84
Merton Distance to Default	-0.739	1.06
Campbell Default Probability	0.000	1.39
Aggregate Volatility	-0.003	1.15
Idiosyncratic Volatility	0.000	0.11
Maturity	2.141	1.91**
Rating	0.886	-1.65
Book to Market	0.058	-0.33
Market Capitalization (log)	0.463	-1.79*
Profitability	-0.005	-4.34***
Leverage	0.056	-1.74*

# January 2008 – December 2009

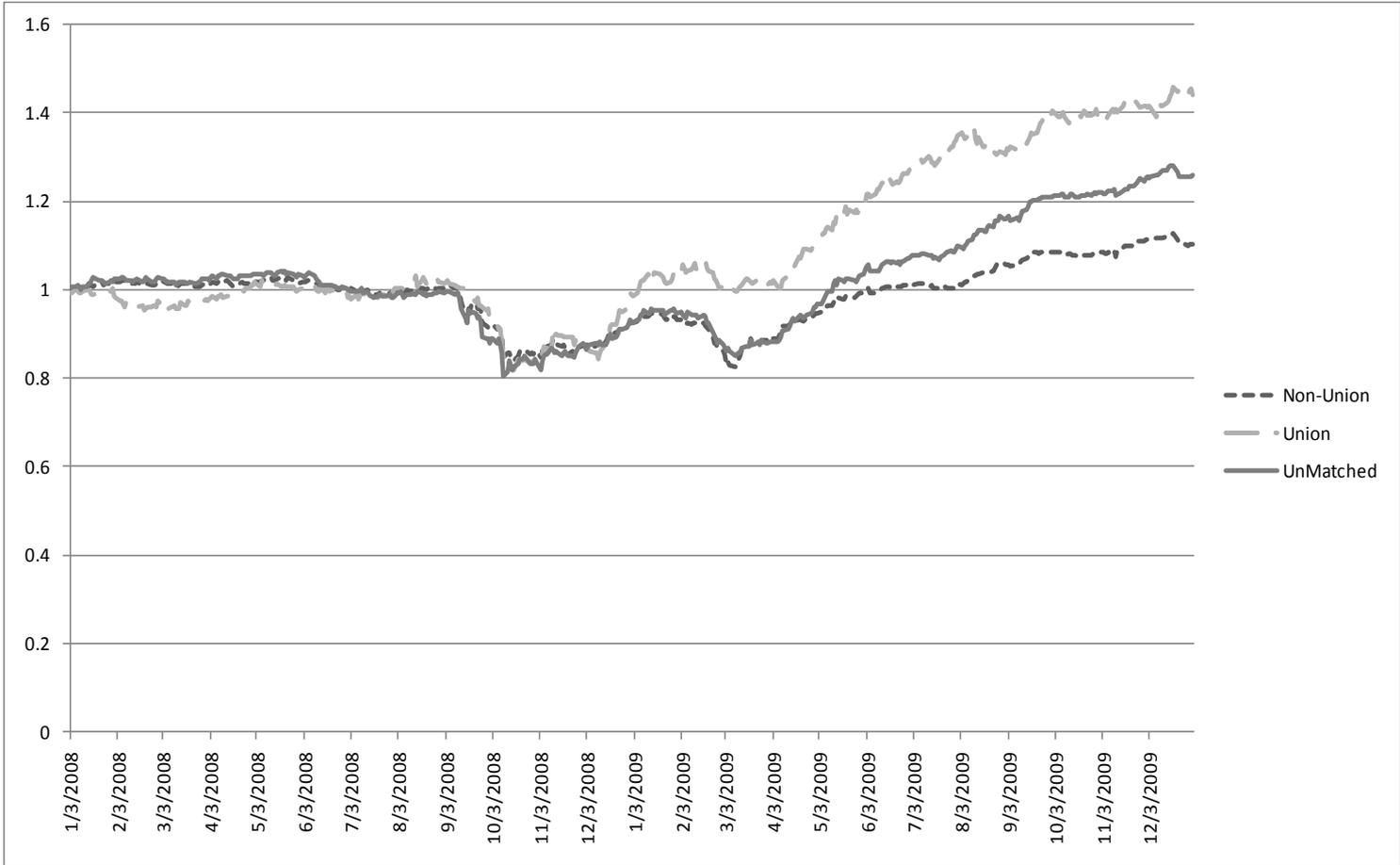


Lehman

Bridge Loans

Bailout Terms

Ch. 11 Filing

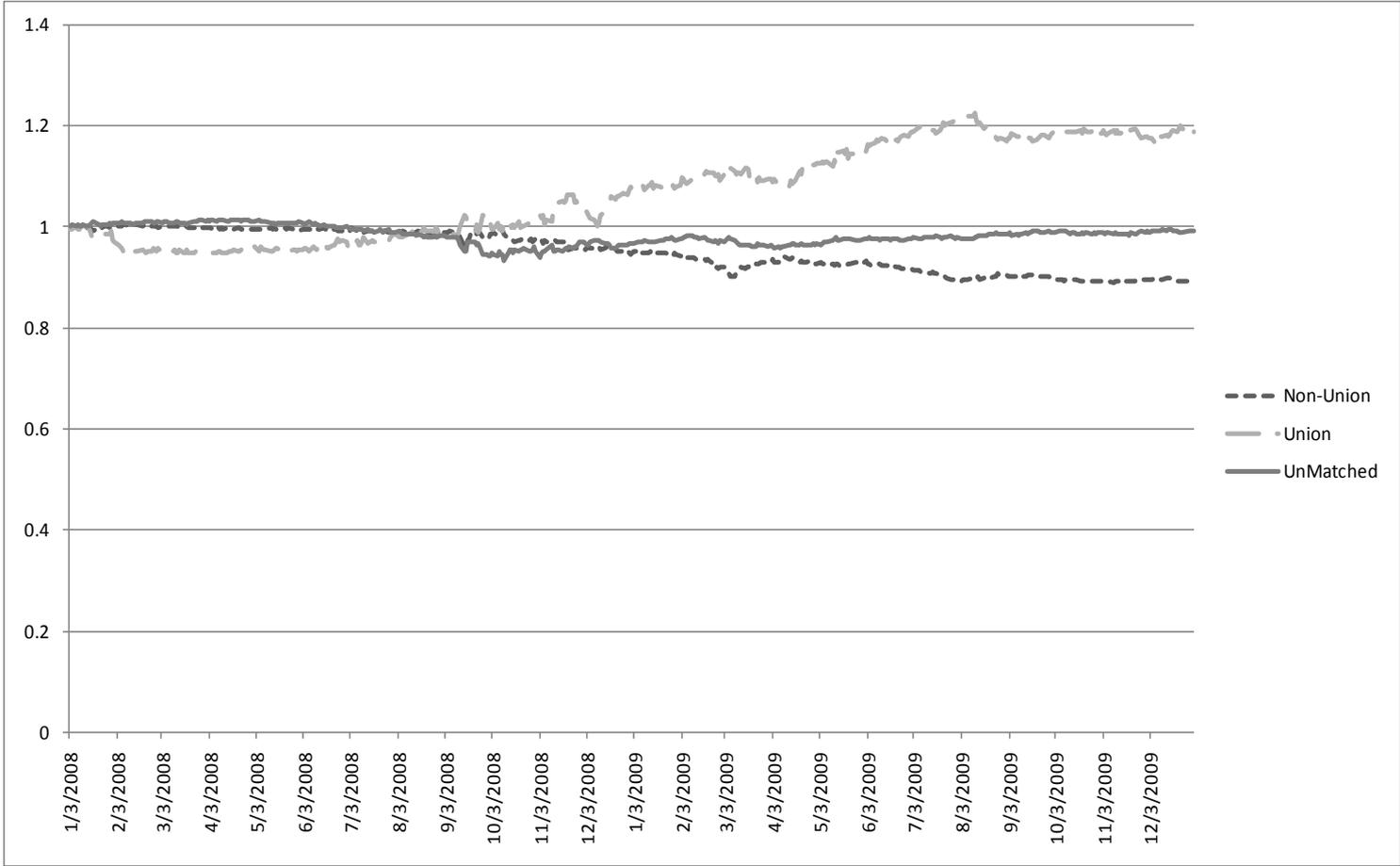


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Date	Event	Abnormal Bond Returns		
		Unionized	Non-Unionized	Difference
12/12/08	Bush Administration suggests TARP might be used for the auto companies, reversing its earlier position.	0.0077 (1.50)	0.0054 (1.27)	0.0023 (0.37)
12/19/08	Bush Administration announces decision to make bridge loans to the auto companies.	0.0119 (3.35) <sup>***</sup>	0.0000 (-0.01)	0.0127 (2.94) <sup>***</sup>
1/15/09	Congress approves release of second half of TARP funds.	0.0016 (0.31)	0.0065 (1.53)	-0.0049 (-0.79)
3/29/09	Treasury announces summary findings of its review of Chrysler's viability plan.	0.0011 (0.18)	-0.0053 (-1.03)	0.0064 (0.85)
3/30/09	President Obama and Treasury announce further details, set forth requirements for Chrysler's viability plan, and give Chrysler 30 days to submit a revised plan.	0.0011 (0.18)	-0.0053 (-1.03)	0.0064 (0.85)
4/30/09	Chrysler files for bankruptcy protection under Chapter 11 of the Bankruptcy Code.	-0.0012 (-0.23)	0.0023 (0.53)	-0.0034 (-0.55)

Date	Event	Abnormal Bond Returns		
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6/1/09	Bankruptcy Court authorizes sale of Chrysler's assets under §363 of the Code.	0.0009 (0.18)	0.0000 (-0.01)	0.0010 (0.16)
6/2/09	Second Circuit issues a motion for a stay.	0.0021 (0.41)	-0.0023 (-0.54)	0.0045 (0.71)
6/5/09	Second Circuit affirms the Bankruptcy Court.	0.0005 (0.09)	-0.0005 (-0.11)	0.0009 (0.15)
6/8/09	Supreme Court issues stay.	0.0052 (1.02)	-0.0010 (-0.23)	0.0062 (1.00)
6/9/09	Supreme Court vacates stay.	0.0058 (1.14)	-0.0032 (-0.75)	0.0090 (1.46)
6/10/09	Chrysler's assets are sold under §363 of the Code.	0.0009 (0.17)	-0.0004 (-0.09)	0.0013 (0.20)
8/5/09	Second Circuit issues its opinion explaining its June 5 <i>Chrysler</i> decision.	0.0015 (0.29)	0.0040 (0.94)	-0.0025 (-0.40)

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In fact, reaction was positive

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