ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 19, 2010

Neil M. Barofsky
Special Inspector General
Office of the Special Inspector General for the Troubled Asset Relief Program
1500 Pennsylvania Ave., NW, Suite 1064
Washington, D.C. 20220

RE: Follow-up on your report entitled "*Factors Affecting the Decisions of General Motors and Chrysler to Reduce their Dealership Networks*"

Dear Mr. Barofsky:

The Department of the Treasury (Treasury) appreciates receiving a copy of the Special Inspector General for the Troubled Asset Relief Program's (SIGTARP) report entitled "*Factors Affecting the Decisions of General Motors and Chrysler to Reduce their Dealership Networks*" (the Report). This letter supplements our initial response letter dated July 16, 2010 regarding your official draft report.

As we noted previously, Treasury strongly disagrees with many of your statements, as well as the "conclusions and lessons learned" that are presented. Although we communicated previously some of our concerns about the draft report to your audit staff, these were not reflected in the final Report. While SIGTARP did not provide specific recommendations in this report, we would like to provide responses to certain statements in the report which we believe are materially inaccurate or incomplete. These are listed in Appendix A.

We look forward to continuing to work with you and your team as we continue our efforts to stabilize our financial system.

Sincerely,

Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability

Appendix A

Statements with which Treasury Disagrees from SIGTARP's July 19, 2010 Report

Listed below are areas in which Treasury disagrees with specific statements made in the Report. After each section Treasury's reasons for disagreement and responses are listed.

1. Job Losses – SIGTARP criticizes the Auto Team by contending that job losses at terminated dealerships were not sufficiently considered.

SIGTARP's Report contains the following statements, among others, that overstate one factor of the restructurings and demonstrate a misunderstanding of Treasury's decision-making process:

- Executive Summary and page 29 of the Report: "[J]ob losses at terminated dealerships were apparently not a substantial factor in the Auto Team's consideration of the dealership termination issue. Although there is some controversy over how many jobs will be lost per terminated dealership… it is clear that tens of thousands of dealership jobs were immediately put in jeopardy as a result of the terminations by GM and Chrysler."

- Page 13 of the Report: "The impact of job losses was not a significant factor in the Auto Team's findings that GM's proposed pace would be an obstacle to its viability. Indeed, it was only after the decision was made that the Auto Team considered the impact its decision would have on job losses."

- Page 31 of the Report: "[A]t a time when the country was experiencing the worst economic downturn in generations and the Government was asking its taxpayers to support a $787 billion stimulus package designed primarily to save jobs, Treasury made a series of decisions that may have substantially contributed to the accelerated shuttering of thousands of small businesses and thereby potentially adding tens of thousands of workers to the already lengthy unemployment rolls – all based on a theory and without sufficient consideration of the decisions' broader economic impact."

Treasury's Response

SIGTARP fails to mention that without taking steps to obtain viability, both GM and Chrysler faced almost certain liquidations, which would have resulted in the loss of hundreds of thousands of jobs across multiple industries – including all dealers. Prior to the restructuring, both GM and Chrysler were fundamentally too big to remain viable without shrinking many aspects of their businesses. The GM and Chrysler revised viability plans aggressively restructured multiple aspects of each company in order to become viable. This process required deep and painful sacrifices from all stakeholders – including workers, retirees, suppliers, dealers, creditors, and local communities. However, it avoided a liquidation of each company and saved hundreds of thousands of jobs and helped maintain a vibrant American auto industry.

In the year prior to the bankruptcies, the auto industry as a whole shed 334,000 jobs.[1] It was not Treasury's mandate to study how to best preserve jobs for one group of stakeholders given the enormity of the risk to the industry and the limited time in which a plan had to be implemented. Moreover, SIGTARP has not provided any data to suggest that overall job losses could have been reduced. Assuming that it was Treasury's role to conduct such a review, to perform the types of studies SIGTARP suggests for each group of stakeholders would have required the Administration to continue to fund the companies with billions of taxpayer dollars in the absence of approved viability plans. Given the duties of Treasury to protect taxpayer dollars, the option to fund in the absence of restructuring was not feasible.

Further, SIGTARP fails to note that over the past year since GM and Chrysler emerged from bankruptcy, employment at auto dealers has actually *increased*. Auto dealers have actually added jobs, not lost them. According to the Bureau of Labor Statistics, the last time employment at auto dealers increased year-over-year was in late 2005. Further, since June 2007, employment at auto dealers is down only 18% compared to a 30% decline in auto manufacturing employment, emphasizing that auto dealers actually fared better than the rest of the auto industry with regards to job losses.

2. <u>Treasury Role in Decisions – SIGTARP argues that the decisions of GM and Chrysler to accelerate dealership closures were based entirely on Treasury's written viability plan determination</u>.

The following portions of SIGTARP's report appear to fault Treasury for recommending that GM and Chrysler increase the pace of its dealership closures:

- Executive Summary and Page 28 of the Report: "In response to the Auto Team's rejection of their restructuring plans and in light of their intervening bankruptcies, GM and Chrysler significantly accelerated their dealership termination timetables."

- Page 7 of the Report. "In response to the Auto Team's determination that GM's proposed pace for closing dealerships was too slow and an obstacle to its viability, GM accelerated its dealership closures; Chrysler also accelerated, and at a faster pace."

<u>Treasury's Response</u>

Treasury did not direct the companies to terminate specific dealers, or accelerate dealer closings in particular. Treasury determined that each company's initial viability plans failed to aggressively effectuate the *entire* restructuring across several different criteria. In the case of GM, these were market share, pricing, brands/dealers, product mix, and legacy liabilities. In the case of Chrysler, they were research & development, quality, product mix, manufacturing, and geographic concentration. As you mention in your Report, Treasury did not specify dealer rationalizations as one of the stated specific criteria for Chrysler's revised viability plans. In order for the companies to receive further government support, they both needed to effectuate a complete restructuring (including restructuring debt, labor, brands, nameplates, plants, factories, management, suppliers, and dealers).

[1] In the year since, auto industry employment has increased by 55,000 jobs (Source: BLS).

The companies determined that the only way to restructure their debt obligations was through a bankruptcy proceeding. The bankruptcy process provided an opportunity for an extensive restructuring of other liabilities, including those concerning facilities, suppliers, environmental liabilities, and the dealer network. The restructuring of all liabilities minimized the amount of taxpayer money that had to be injected into each company.

3. <u>Arguments in Favor of Dealership Closings –SIGTARP criticizes the companies and the Auto Team for having "not-universally-accepted" theories on the benefits of dealer terminations and not performing explicit cost savings analyses before recommending acceleration of dealership closings</u>.

The following statements in the SIGTARP Report fail to acknowledge the benefits of early implementation of planned dealer closures:

- Executive Summary and Page 28 of the Report: "The Auto Team's view about the need for GM and Chrysler to reduce their dealership networks and do so rapidly was based on a theory that, with fewer dealerships…the remaining dealerships would be more profitable and thus would permit the dealerships to invest more in their facilities and staff…perhaps only time will tell whether and to what extent the Auto Team's theory proves valid;"

- Page 31 of the Report: "The anticipated benefits to the companies of accelerated terminations were based almost entirely on the not-universally-accepted theory that an immediate decrease in dealerships…would improve the companies' profitability."

- Page 29 of the Report: "It is worth noting that GM's top rival among US automakers, Ford Motor Company, which is also carrying out plans to "aggressively restructure to operate profitably," is closing dealerships at a rate similar to that in GM's original restructuring plan which was rejected by Treasury."

- Page 29 of the Report: "[T]he acceleration of dealership closings was not done with any explicit cost savings to the manufacturers in mind."

- Page 30 of the Report: "The disparity in the companies' cost savings estimates are telling. Chrysler estimated a savings of only $45,500 per dealership. GM, however, estimated cost savings of $1.1 million per terminated dealership. The difference in these estimates alone casts doubt on their credibility."

<u>Treasury's Response</u>

Treasury is disappointed that after a review lasting more than 12 months, SIGTARP chose to downplay the almost unanimous consensus amongst industry experts – nearly a dozen of whom we consulted with and to whom we provided you access – that GM and Chrysler should reduce their dealership networks, while emphasizing the views of one or two experts who disagreed, in part, with that consensus.

Further, as stated in the report, GM and Chrysler had planned dealership closures irrespective of any guidance that Treasury provided about the viability plans. The companies independently believed that closing dealers would contribute to better brand equity, increased throughput and a healthier overall network. However, each company's initial viability plan, which was not predicated on a chapter 11 filing, indicated that significant costs would be incurred to close dealers over a protracted time frame.

After the companies elected to file for bankruptcy to restructure their debt liabilities, it would have been irresponsible of them to not consider restructuring other contractual commitments, and instead to implement dealership closures over a costly and protracted time frame. GM estimated that the benefit to shutting down dealers in the course of its bankruptcy proceeding rather than over a long period of time was worth in excess of $1 billion to GM. This is one cost savings that the manufacturers did have in mind.

SIGTARP implies in the Report that acceleration was not necessary because Ford is also currently closing dealerships but at a rate similar to that in GM's original restructuring plan. The fact is Ford did not pursue dealer closures at the same pace as GM and Chrysler. Ford did not file for bankruptcy, so it was not able to pursue the option that bankruptcy affords to shed excess liabilities at less cost and greater speed.

As to why GM's and Chrysler's cost savings analyses were different, on pages 25-27 of the Report, SIGTARP provides the specific rationale and detailed evidence: they were conducted using different methodologies. Specifically, on page 25 SIGTARP states that "GM's estimate was significantly higher than Chrysler's because it included anticipated savings from reduced incentive payments to dealerships, which Chrysler did not include its estimate." Further, on page 26-27 of the Report, SIGTARP notes after a lengthy and detailed analysis of the cost breakdown that "GM's savings estimate is significantly higher because it includes $2.1 billion in anticipated incentive payment reductions that it currently pays to dealerships….Chrysler did not include incentive savings in its estimate."

4. <u>Arbitration Outcome -- SIGTARP argues that because GM and Chrysler reinstated dealers after mandatory legislation was passed by Congress, the dealer terminations were not critical to either companies' viability</u>.

The following statements in the Report represent a misunderstanding of the situation the companies faced after the mandatory arbitration law was passed:

- Page 29 of the Report: "The fact that, after mandatory arbitration legislation was passed, GM offered to reinstate 666 dealerships and Chrysler offered to reinstate 50 dealerships…suggests, at the very least, that the number and speed of the terminations was not necessarily critical to the manufacturers' viability."

- Page 31 of the Report: "That the automakers have offered reinstatement to hundreds of terminated dealerships in response to Congressional action without any apparent sacrifice to their ongoing viability further demonstrates the possibility that such dramatic and accelerated dealership closings may not have been necessary and underscores the need for Treasury to tread very carefully when considering such decisions in the future."

<u>Treasury's Response</u>

SIGTARP's conclusions about events occurring after a law mandating arbitrations was enacted are perplexing. Congress passed a bill that the President of the United States signed into law in December 2009 that required GM and Chrysler to engage in arbitration proceeding with former dealers that were terminated as part of the bankruptcy process. Of the dealers terminated at both GM and Chrysler, 56% filed for arbitration. Despite the use of criteria far more favorable to dealers than what was used in the bankruptcy, nearly 70% – the overwhelming majority – of the arbitrations ruled in favor of the manufacturers and found that reinstatement was not appropriate.[2]

5. <u>Monitoring -- SIGTARP concludes that Treasury should have done more to monitor the implementation of the dealership closure plans</u>.

The following statements represent a misunderstanding of Treasury's role in monitoring TARP investments:

- Page 32 of the Report: "[Treasury]'s decision not to monitor the process that [the automakers'] employed [regarding closing dealerships] is far more questionable. In the future, to the extent that Treasury takes action with respect to a TARP recipient that has the potential to affect so many jobs in different communities, Treasury should monitor the recipients' actions to ensure that they are carried out in a fair and transparent manner."

- Page 31 of the Report: "…several of the lessons from the process should be considered in the event Treasury once again is compelled to make decisions that directly affect the businesses in which it has invested."

<u>Treasury's Response</u>

The President gave Treasury the clear directive to take a broad commercial approach to these restructurings and refrain from intervening in the day-to-day decisions of the companies. He did this because the long-term viability of these companies and their ability to repay the government's investment would be seriously undermined if the government became involved in individual business decisions. This is consistent with the policy that Treasury has followed in all TARP investments, which is to not participate in day-to-day management of the firms. In these cases, the government's role was to facilitate restructurings of these companies because that was deemed critical to financial stability. The government's role was not to run the companies.

[2] Summary of Automobile Industry Special Binding Arbitration Program (July 15, 2010), American Arbitration Association.