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COURT URGED TO PROTECT SECURED CREDITORS' RIGHTS IN BANKRUPTCY

(Indiana State Police Pension Trust v. Chrysler LLC)

The Washington Legal Foundation (WLF) yesterday urged the Supreme Court to review (and ultimately overturn) a decision of the U.S. Court of Appeals for the Second Circuit that threatens to drastically undermine important Chapter 11 protections that secured creditors have come to rely on in bankruptcy proceedings.

In a brief filed in *Indiana State Police Pension Trust v. Chrysler LLC*, WLF argued that, by affirming the decision of the bankruptcy court, the appeals court in effect condoned the U.S. Treasury's redistribution of value in the Chrysler bankruptcy from senior, secured creditors with priority liens to junior, unsecured creditors. WLF agreed with the petitioners that, by undermining the property rights of secured creditors, the Second Circuit's decision will result in a destabilization of existing and future credit markets.

WLF filed the brief on its own behalf and on behalf of its clients, the Allied Educational Foundation, the Cato Institute, and Professor Todd J. Zywicki.

The case arose in connection with the high-profile bankruptcy of Chrysler, in which the U.S. Treasury orchestrated a sale under Section 363 of the Bankruptcy Code to avoid the debtors' having to fully compensate a group of first lien priority creditors, which included two funds invested on behalf of roughly 100,000 retired teachers and police officers from Indiana. Before Chrysler filed for bankruptcy, the Treasury extended Chrysler a \$4 billion loan in TARP funds and then strongly urged Chrysler to proceed with the sale in bankruptcy. Although the Indiana pensioners objected that the Section 363 sale would deprive them of their priority preference as secured creditors (a preference they had bargained for in deciding initially to invest in Chrysler), the bankruptcy court nevertheless approved the sale as being in Chrysler's best interest.

"The Chrysler bankruptcy sets a dangerous precedent," said WLF Senior Litigator Cory Andrews after filing WLF's brief. "By allowing debtors to use the expedient of a Section 363 sale to circumvent the important protections normally afforded secured creditors under Chapter 11, the decision below creates a powerful disincentive for investors to lend vital capital to troubled companies that might be in danger of insolvency."

In the wake of the Chrysler bankruptcy, noted economists, legal scholars, and other commentators have warned repeatedly that the precedent established by the bankruptcy court below, and subsequently affirmed by the appeals court, could destabilize the nation's vital investment markets. Historically, banks and other creditors lend money to businesses with the expectation that bankruptcy rules will protect their investments in the event of financial crisis. Many have expressed fear that a lack of transparency and consistency in applying the rules in bankruptcy could result in a lack of confidence among investors and lenders.

In its brief urging the Supreme Court to grant discretionary review, WLF argued that it was fundamentally unfair for the government to exploit its unique powers by saddling private parties (in this case, the Indiana pensioners) with the losses attributable to the federal government's own plan to "rescue" Chrysler from insolvency. WLF emphasized that, as a junior creditor effectively in control of the debtors, the Treasury owed a fiduciary duty to all of Chrysler's creditors, not just a select few.

WLF also argued that the Emergency Economic Stabilization Act (EESA) does not authorize the federal government to use TARP monies to "bail out" the automobile industry. The Treasury had relied on EESA as its authority to help rescue the failing automobile manufacturer, despite the fact that the statute authorizes the Treasury to make such payments only to "financial institutions." Notably, the Treasury's use of TARP in the Chrysler case also was in conflict with the Treasury's own prior public pronouncements about its authority.

WLF is a public interest law and policy center with supporters in all 50 States. WLF devotes a substantial portion of its resources to defending free enterprise, individual rights, and a limited and accountable government. Among other things, WLF works to ensure that the property expectations of investors and creditors in bankruptcy are protected by the courts.

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For further information, contact WLF Senior Litigator Cory Andrews, (202) 588-0302. A copy of WLF's brief is posted on its web site.