The Ruggles Report™

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Bankruptcy Looms…

Until the bitter end, Rick Wagoner, deposed CEO of GM, refused to acknowledge bankruptcy as being a viable option for GM. I believe the plan he submitted to the Administration's Auto Industry Task Force was the best he felt he could do without the benefit of bankruptcy court.

Bankruptcy court represents handing over control of the process to a bankruptcy judge. The judge has broad powers. A possible "benefit" GM, Chrysler, and the Car Czars might hope to accomplish through bankruptcy is to have all of their franchise agreements with their Dealers rendered null and void.

In theory, this would negate the auto dealer franchise laws in the 50 states. It seems the Administration's Task Force is determined for GM and Chrysler to shed Dealers. They think there is a cost to an OEM for each Dealer. Nothing could be further from the truth.

But it is probable that GM and Chrysler will be forced to do some things that are ultimately not in their best interest in exchange for "Debtor in Possession" financing required for a Chapter 11 process. The ONLY place DIP financing might be available in the current economic environment is from the government.

Even though I agree the Administration did the right thing when they "broomed" Wagoner, turned down the deeply flawed GM "recovery plan," and gave GM an extension, the Car Czars are complete rookies in the auto business. For example, they offer up a government supported plan for warranty coverage to try to get people to continue to buy vehicles from GM and Chrysler. But if there are no parts being produced, and no Dealers left in business, how will this warranty work be accomplished?

The Ruggles' Report is an ongoing, independently published report with insights, reflections and opinions from noted vehicle expert David Ruggles.

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The principle issue the Car Czars don't understand is how the threat of bankruptcy has caused any GM or Chrysler Dealer with any brains to STOP ordering vehicles! Rick Wagoner recognized this.

In a bankruptcy, the franchise agreement becomes null and void, and along with that goes the OEM's obligation to buy back new vehicle inventory, parts, and special tools from their Dealers. Under the franchise agreements, the OEM is even required to buy back the Dealer's brand signs.

But it is the new vehicle "buy back" provision of the franchise agreement that allows Dealers to gain bank floor plan financing in the first place. The parts and tools "buy back" provision provides some security for lenders to extend capital loans. How many banks will call Dealer "floor plan" loans because there will be no OEM "buy back" provision in place in the case of voided franchise agreements?

Losses from this debacle will kill off many Dealers and will take quite a few local banks along at the same time. What might GM and Chrysler new vehicles be worth without a viable OEM?

In Chapter 11, it is not a given that a company will emerge at some point. Many companies slide from Chapter 11 into liquidation. Without a franchise agreement, the OEM's technically have no Dealers.

Even if they execute some interim contract, if that's possible under bankruptcy, how will Dealers floor plan inventory? For what amount would banks floor plan them? Why would lenders want anything to do with it?

I see no evidence that the Car Czars have considered this critical issue, but the fact that Dealers are ordering very little inventory as they wait for the next "shoe to fall" should open their eyes at some point.

Despite the fact GM and Chrysler will pay Dealers for vehicle orders, what guarantee exists that says they will be able to collect that "purchase incentive" money as an unsecured creditor in the case of an OEM bankruptcy? And how long would it take to collect whatever they are allocated by the bankruptcy court?

GM and Chrysler would like their dealers to continue to order right up to, and through bankruptcy. But why wouldn't their Dealers stand pat and work out of each other's inventory to minimize their exposure? A Dealer would have to be in complete denial to still be ordering vehicles from GM and Chrysler. At the very least, his floor plan lender would have to have missed a few key points!

Fritz Henderson has had to acknowledge the bankruptcy possibility and is using it as a bargaining chip as best he can. He desperately needs to get the unions and bondholders to cooperate to achieve the parameters agreed to with the Bush Administration when they took the original money back in December 2008. A major problem is that some of the bondholders have insurance to cover their loss in the case of bankruptcy. This insurance, or AIG type Collateralized Default Obligation, doesn't pay off if the creditor agrees to a settlement outside of bankruptcy. Why would a bondholder settle for less when they can collect their entire loss in the case of bankruptcy?

GM and Chrysler are already "floating" on their Dealers. Of course, Dealers not ordering cars just hastens the OEMs' journey to bankruptcy court where they will no longer be bound by their franchise agreements, rendering their already strapped Dealers insolvent. What point is there to save GM and Chrysler if there are no Dealers left to sell their products?

The Car Czars need to see how the threat of bankruptcy virtually assures bankruptcy. They need to understand that a so called "surgical pre-packaged" bankruptcy is a disaster waiting to happen. It could cause a ripple effect that could impact South Detroit.

It may already be too late. Resolution on many issues is required before Dealers will feel comfortable ordering inventory and lenders comfortable floor planning them. Since the Dealers are the OEMs' ONLY customer, the Dealers had better get some answers they can live with soon!

A pre-packaged bankruptcy is a joke in the case of either company. In a Chapter 11 all creditors are entitled to be heard. The primary people who benefit are attorneys. The executive retention bonuses and attorney fees granted in a Chapter 11 will raise a "hue and cry" that will ring to the rafters. Without government DIP financing, liquidation is the only option. 5 years is an optimistic projection for a successful Chapter 11 for either GM or Chrysler IF DIP financing is made available. Forget about a 90 or 120 day process.

At some point the Car Czars will see that Dealers have dramatically curtailed their ordering of vehicles because of the floor plan and franchise agreement concerns. Then perhaps it will dawn on them that, in the face of cheap fuel, consumers are unlikely to pay a technology premium to buy the vehicles the government wants GM and Chrysler to design and build.

In the meantime, FIAT isn't going to tolerate any union deals that aren't favorable to their purpose. They have Chrysler by the “short and curlies” with the government deadline hanging over their head. FIAT doesn’t have a lot of cash and would like to get in on the 6 billion the U. S. government has promised Chrysler under certain conditions.

Of course, the Car Czars should scrutinize any deal with FIAT to try to ensure FIAT CEO Marchionne doesn’t try to spirit some U. S. taxpayer money off to Europe! While these tricky negotiations are taking place it’s hard to imagine a Chrysler Dealer ordering anything.

This makes it somewhat difficult to put together a business plan based on a “current sales rate.” Things don’t look good for Chrysler and that bodes poorly for GM. The ripple effect of a Chrysler liquidation puts GM, Ford, and some other OEMs in jeopardy.

The government pension guarantee fund would take a huge hit, UAW retirees will get less money than if they agreed to a deal, and that will just be the beginning.

We are truly living in historic times.

About Dave Ruggles

Dave Ruggles is a widely known, auto industry veteran with more than three decades' worth of experience. His self-titled Ruggles Report is a highly acclaimed industry insider brief detailing the latest hot-button topics in automotive sales, training, recruiting, finance and service.

Ruggles has sold cars, managed, owned and trained dealerships literally across the world. For the last sixteen years, he has spent a month each summer teaching sales desk training to the world's largest privately owned Toyota dealership group in Nagano, Japan.

He lives in Las Vegas, Nevada.

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The company's latest effort is focused on a soon-to-be-released entry into the Consumer Market: BuyerBidsOnline.com. A sister site of the much discussed AutoBidsOnline.com, BuyerBids is set to revolutionize today's new and used car market by providing Dealers with only the most serious new-car buying leads.

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