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General Motors bankruptcy 2.0: lessons learned

By Christine Spagnoli

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General Motors CEO Mary Barra prepares to testify on Capitol Hill in Washington, April 2, before the Senate Commerce, Science and Transportation subcommittee.

The recent headlines surrounding General Motors' recall of millions of cars for an ignition switch defect have prompted head-scratching by consumers, the media and many lawyers about the impact of the automaker's 2009 bankruptcy on consumers' remedies for injuries and deaths associated with the bad parts. Revisiting the basic events sheds some light on the answers, but also reveals the harsh realities of a bankruptcy gone bad, which closed the courthouse doors and left thousands of consumers and grieving families with nowhere to turn.

Early 2009 saw the impending collapse of the heart of the U.S. automotive industry. Rumors of potential bankruptcies of the big three manufacturers led the news and caused fear from Wall Street to Main Street. Such a collapse would ripple through not just the factories turning out Cobalts and Sebrings, but threatened to extend to dealers and component parts suppliers, as well as retirees counting on pension benefits and health plans. The magnitude of such potential failures led the president to appoint an auto task force to attempt a rescue of the industry. As the deal came together, and a bankruptcy "sale" of GM and Chrysler to new "buyers" got fast tracked through the bankruptcy courts, consumer advocates had little chance to alert the public to the dirty secrets that were getting swept under the rug.

The initial bankruptcy "sale" agreement negotiated by the auto task force called for the Old GM to be liquidated, and a New GM, partially owned by the U.S. government, to take its place by a purchase of Old GM's assets. The plan was to leave the liabilities behind, in what remained of the Old GM, now named Motors Liquidated Corporation. Those liabilities included leaving behind in Old GM all responsibility for every car manufactured and sold before the bankruptcy.

New GM was going to be able to start fresh — which meant that it could avoid responsibility for warranties that came with cars sold before July 2009. It also meant that New GM would be immune from any injuries or deaths that occurred because of design or manufacturing flaws in cars sold before the bankruptcy. The New GM, and the New Chrysler, were going to be allowed to walk away from their contractual and legal obligations to car owners and the public by being relieved of any ongoing responsibility for the cars sold by the old companies.

A small but determined band of consumer advocates forced a change in the initial sale agreements — first by shaming the new companies into "voluntarily" agreeing to honor warranties for the pre-bankruptcy cars. Once the new companies agreed to protect the parts, it became clear that they also had to accept responsibility for protecting the people too, or face a consumer relations nightmare.

But there were limits to this goodwill and liability was accepted only to a point. If a defective car sold before the bankruptcy caused a death or injury after 2009, then the New GM and New Chrysler agreed to allow lawsuits to proceed. But those consumers who were injured in a defective car before the July 2009 bankruptcy were left behind to share in the distribution of the remnants of the old companies for pennies on the dollar.

It is this harsh reality that has just now dawned on most people. The revelations that GM knew about and failed to fix a dangerous defect for years, which had killed people, and then took its government handout and shirked its legal responsibilities has finally been exposed to a wider audience. When the new CEO of the New GM, Mary Barra, told Congress that GM had a "moral" responsibility to those who had died in defective Cobalts, that is what she was talking about. It was her sheepish acknowledgement that the New GM had no "legal" responsibility to those people, who are left only with a "promise" by Barra to look into whether or not GM will now voluntarily accept responsibility and compensate the injured.

The courthouse doors have been shut as a consequence of the bankruptcy shield granted New GM. Perhaps as a result of this look behind the curtain of the GM debacle, future bankruptcy judges will tread more carefully before allowing companies to sell themselves to themselves and emerge with a cloak of immunity that shields them from the legal responsibility of being held accountable for lives lost.

Christine Spagnoli *is a partner at Greene, Broillet & Wheeler LLP.*

CHRISTINE SPAGNOLI
Greene, Broillet & Wheeler