Mandating Dealership Agreements for Automakers Receiving Federal Funds: Constitutional Analysis

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Summary

Auto dealers, which act as intermediaries between automakers and final consumers, are independent businesses with contracts with the automakers. As General Motors Corporation (Old GM) and Chrysler LLC (Old Chrysler) have moved through bankruptcy restructuring, the presence of these dealer contracts has been an important issue. In order to allow the automakers to downsize and seek a more competitive business model, the bankruptcy courts allowed both Old Chrysler and Old GM to cut their dealership networks. This allowed the new entities that bought the assets of the bankrupt companies, Chrysler Group LLC (New Chrysler) and General Motors Company (New GM), to operate without the contractual and statutory obligations associated with those dealership agreements.

Dealers objected to the cuts, first in the bankruptcy proceedings, and later in the media and to the Congress. Several congressional hearings have been held that addressed the reduction of the automakers' dealership networks. Additionally, several bills have been introduced that appear to be intended to restore the dealership agreements with the automakers in bankruptcy or assign those agreements to the newly created automakers that purchased assets from those automakers that are currently in bankruptcy proceedings.

This report discusses the constitutionality of legislation to require that auto manufacturers receiving federal aid be subject to the contractual and statutory obligations owed to such dealers before bankruptcy. The report will address two forms of these proposals, one that addresses GM and Chrysler dealers specifically (H.R. 2743 and S. 1304), and one that addresses the issue of dealership assignment more generally (H.R. 2796 and H.R. 3170 § 744(b)). The report will address three questions: (1) whether these proposals violate the uniformity requirement of Article I, Section 8, clause 4 of the Constitution (the Bankruptcy Clause); (2) whether mandatory assignment of the dealers' contracts to the New GM and the New Chrysler would violate either substantive due process or the Fifth Amendment's Takings Clause; and (3) whether such mandatory assignments could make the United States liable for damages under a theory of breach of implied contract.

The report concludes that, of the proposals at issue, those that arguably are not limited to the GM and Chrysler bankruptcies may be less likely to be found to violate the uniformity requirement of the Bankruptcy Clause. The report also concludes that, while it is difficult to establish the long-term economic impact of these legislative proposals, the application of these bills to the New GM and the New Chrysler are not likely to be found to violate substantive due process, or to constitute a taking in violation of the Fifth Amendment of the Constitution if analyzed under current case law. However, these proposals are beyond anything the U.S. Supreme Court has previously addressed in its substantive due process decisions, which makes it impossible to dismiss the possibility that the Court might find that substantive due process was offended by forcing the new automakers to be parties to dealership contracts formed between the dealers and the bankrupt automakers. Additionally, the report concludes that it is not clear to what extent the United States might be liable under a breach of implied contract theory for the application of these bills to those two new corporate entities.

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Introduction

Recently, several bills have been introduced in the 111th Congress that would require an automobile manufacturer, if formed as a result of bankruptcy and with financial assistance from the U.S. government, to assume the statutory and contractual obligations associated with agreements that existed between auto dealers and the debtor automakers from whom assets had been purchased. While some of these bills may have prospective application, some of them may also apply to existing automobile manufacturers.

Presently, two automakers have been formed as a result of bankruptcy and with financial assistance from the federal government: Chrysler Group LLC and General Motors Company. These new corporate entities (hereinafter "New Chrysler" and "New GM") purchased assets from the two automobile manufacturers that entered bankruptcy bearing similar names: Chrysler LLC and General Motors Corporation (hereinafter "Old Chrysler" and "Old GM"). Old Chrysler and Old GM retained some assets and most liabilities. Although media reports have referred to each as having "exited" or "emerged" from bankruptcy, each is still in bankruptcy, but is now referred to in legal proceedings by a new name.[1]

As part of their bankruptcy proceedings, both Old Chrysler and Old GM, pursuant to 11 U.S.C. § 365, rejected contracts they had with some dealers in their dealership network.[2] Additionally, prior to filing for bankruptcy, Old GM had advised approximately one third of its dealers that it would not be renewing their contracts in 2010. It offered these dealers wind-down agreements that, if signed, would assure the dealers that their contracts would not be rejected under section 363 if the company were to file for bankruptcy protection.[3]

Under the terms of the federal loans both Old Chrysler and Old GM received in December 2008,[4] each auto manufacturer was required to file viability plans in February 2009. In March 2009, each of the plans was rejected by the Auto Task Force, which cited steps that needed to be accelerated. One of these steps was closure of dealerships, although the details of such closures were left to the auto manufacturers.

GM and Chrysler dealers objected to the rejection of their contracts, but each bankruptcy court approved the rejections. The courts also approved the terms of the sales of the auto manufacturers' assets as going concerns. Under those terms, the purchasing entities—New

[1] The former Chrysler LLC is now referred to in court filings as "Old Carco LLC (f/k/a Chrysler LLC)." The former General Motors Corporation is now named "Motors Liquidation Company."

[2] Automobile manufacturers rely on their dealership network for sales and service of their vehicles. These dealers are independent businesses that enter into contracts with the manufacturers. Every state has enacted laws specifically addressing the relationship between dealers and their respective manufacturers. These auto dealer franchise laws generally address termination of contracts as well as nonrenewal of those contracts. For more detailed background information about automobile dealers, please see CRS Report R40712, *U.S. Motor Vehicle Industry Restructuring and Dealership Terminations*, by (name redacted) and (name redacted).

[3] The assurance that they would not be rejected in bankruptcy meant that those dealers who signed a wind-down agreement would be able to continue operations into 2010 rather than ceasing operations in 2009.

[4] For more information on the terms of these loans and the events leading to the auto manufacturers' bankruptcy filings, please see CRS Report R40003, *U.S. Motor Vehicle Industry: Federal Financial Assistance and Restructuring*, coordinated by (name redacted).

Chrysler and New GM—did not assume the contracts of the rejected dealers. New GM did assume the wind-down agreements.

Reducing the number of dealerships has been cited by the old and new auto manufacturers as a necessary step for the viability of the new manufacturers. However, many dealers question whether this reduction of the dealership networks is really necessary to the success of New Chrysler and New GM. Additionally, some rejected Chrysler dealers have objected to the short time they were given to wind-down their operations (26 days). Some GM dealers have raised objections to the terms of their recent contractual agreements; these include some dealers that entered into the wind-down agreements[5] as well as continuing dealers, who entered into performance agreements. Dealers have brought their concerns to Congress, and Congress has responded with both hearings and legislative proposals.

Two companion bills, H.R. 2743 and S. 1304, appear intended to renew statutory and contractual obligations that were owed from Old Chrysler and Old GM to their respective dealers before bankruptcy. The new auto manufacturers, New Chrysler and New GM, would be assigned those contracts.

Another bill, H.R. 2796, has similar requirements without naming the auto manufacturers to which it applies. It defines the covered auto manufacturers as being any in which the federal government has either a financial or ownership interest. However, it is arguable that, as worded, the bill's provisions might not apply to either New Chrysler or New GM.[6]

Related language is also found in an amendment offered by Representative LaTourette to H.R. 3170, the House Financial Services and General Government Appropriations Act, 2010, approved by the House Committee on Appropriations on July 7, 2009, and approved by the House on July 16, 2009. As with H.R. 2796, it is possible that the provisions in this related language would not apply to either New Chrysler or New GM.

This report will address various constitutional concerns raised by these bills. The three areas of concern are (1) whether the bills violate the uniformity requirement of the Bankruptcy Clause of the U.S. Constitution; (2) whether mandatory assignment of the contractual and statutory obligations associated with the dealer contracts in question to the New GM and the New Chrysler would violate either substantive due process or the Fifth Amendment's Takings Clause; and (3) whether such mandatory assignment would make the United States liable for damages under a theory of breach of implied contract.

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[5] However, in oral testimony before the House Committee on the Judiciary's Subcommittee on Commercial and Administrative Law on July 22, 2009, New GM's representative, Michael J. Robinson, said that some of New GM's continuing dealers had asked if they could choose to enter into wind-down agreements and voluntarily terminate their dealership contracts.

[6] The bill provides that a covered manufacturer that enters bankruptcy must "assume (or assign to a successor)" dealer agreements. However, neither New Chrysler nor New GM has entered into bankruptcy. Another provision requires a covered manufacturer to "require any new entity created in such case" to "enter into a new dealer agreement." The effect of this provision is uncertain because Old Chrysler and Old GM do not appear to have legal authority to direct the activities of New Chrysler and New GM, and the provision was not part of the terms of the asset sale.

Constitutional Analysis

The Uniformity Requirement of the Bankruptcy Clause[7]

Congress's power to enact bankruptcy laws is one of its enumerated powers under the U.S. Constitution. Article I, § 8, clause 4 gives Congress the power "[t]o establish … uniform laws on the subject of Bankruptcies throughout the United States." In 1902, the U.S. Supreme Court established that the uniformity required was geographical rather than personal, holding that federal law may allow state law to determine a debtor's exemptions.[8]

Only once in its history, in *Railway Labor Executives' Association v. Gibbons*,[9] has the Supreme Court found that a law violated the uniformity requirement of the Bankruptcy Clause. That case involved a legislative response to a pending bankruptcy case. In analyzing whether the provisions currently before Congress violate the uniformity requirement of the Bankruptcy Clause, it may be helpful to look at the facts and analysis of that case.

Railway Labor Executives' Association v. Gibbons

When the Rock Island and Pacific Railroad Company, already under the protection of a Chapter 11 bankruptcy filing, ceased operations and prepared to liquidate, the bankruptcy court determined that a statutory requirement for "a fair arrangement" to protect the interest of employees when there was a court-approved abandonment of rail service[10] was not necessary when there was a "total, systemwide abandonment of a railroad."[11] Three days before the court's order that no such arrangement be paid out of the assets of the debtor's estate, Congress enacted the Rock Island Railroad Transition and Employee Assistance Act (RITA).[12] RITA required the Rock Island trustee to provide up to $75 million as economic benefits to employees of Rock Island who were not hired by other carriers. The benefits were to be paid out of the estate's assets and treated as an administrative expense and, thus, have priority over other unsecured claims.[13] After a court injunction and subsequent federal legislation,[14] the issue was considered by the U.S. Supreme Court, which found that the labor provisions of RITA, as amended by the Staggers Act of 1980 (Staggers),[15] violated the U.S. Constitution's Bankruptcy Clause.

The Court first analyzed whether the labor provisions were an exercise of Congress's bankruptcy power. Citing earlier cases, the Court provided guidance on the subject of bankruptcies:

> [W]e have previously defined "bankruptcy" as the "subject of the relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his and their

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[7] This section was prepared by (name redacted), Legislative Attorney.

[8] Hanover National Bank v. Moyses, 186 U.S. 181.

[9] 455 U.S. 457 (1982).

[10] The Milwaukee Railroad Restructuring Act, P.L. 96-101, 93 Stat. 744.

[11] *Gibbons*, 455 U.S. at 460-61.

[12] P.L. 96-254, 94 Stat. 399.

[13] *Gibbons* , 455 U.S. at 462-63

[14] The Staggers Rail Act of 1980, P.L. 96-448, 94 Stat. 1959

[15] *Id.*

> relief." Congress' power under the Bankruptcy Clause "contemplates[s] an adjustment of a failing debtor's obligations." This power "extends to all cases where the law causes to be distributed, the property of the debtor among his creditors." It "includes the power to discharge the debtor from his contracts and legal liabilities, as well as to distribute his property. The grant to Congress involves the power to impair the obligation of contracts, and this the States were forbidden to do."[16]

The Court concluded that the labor provisions of RITA, as amended by Staggers, were an exercise of Congress's bankruptcy power and, therefore, must be uniform to be constitutional.

The Court noted that the uniformity requirement "is not a straightjacket that forbids Congress to distinguish among classes of debtors"[17] and that it "permits Congress to treat 'railroad bankruptcies as a distinctive and special problem'"[18] or "'to take into account differences that exist between different parts of the country, and to fashion legislation to resolve geographically isolated problems.'"[19] However, the Court then explained that RITA did not apply to a class of debtors but only to one specific debtor. Further, though other railroads were in reorganization proceedings at the time, only one was affected by RITA's employee protection provisions; therefore, RITA was "a response to the problems caused by the bankruptcy of *one* railroad"[20] rather than a response to either "the particular problems of major railroad bankruptcies or to any geographically isolated problem."[21] The Court also noted that the relationship of various claimants was altered by RITA's requirement that the employees' claims be treated as administrative expenses with priority over the claims of other unsecured creditors.[22] Based on these factors, the Court's conclusion was that RITA was "nothing more than a private bill"[23] and enacting it was not within the power of Congress.[24]

Justice Marshall concurred in the judgment but disagreed with some of the Court's rationale. He questioned whether uniformity requires the law to affect more than one debtor or that it requires the law to "avoid specifying the debtors to which it applies."[25] He concluded that the Bankruptcy Clause allows Congress to enact laws that are specific to the needs of a particular debtor or creditor if it "finds that the application of the law to a single debtor (or limited class of debtors) serves a national interest apart from the economic interests of that debtor or class, and if the identified national interest justifies Congress' failure to apply the law to other debtors."[26]

In *Gibbons*, Justice Marshall further concluded that Congress had not put forward any national interest or policy that justified enacting provisions applicable to only one named debtor. Instead,

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[16] *Gibbons*, 455 U.S. at 466 (alterations within quotation marks in original)(citations omitted).

[17] *Id.* at 469.

[18] *Id.* (citations omitted).

[19] *Id.* (citations omitted).

[20] *Id.* at 470.

[21] *Id.*

[22] *Id.* at 467.

[23] *Id.* at 471.

[24] In making this determination, the Court referenced the language of the Bankruptcy Clause, the debate at the Constitutional Convention regarding the Bankruptcy Clause, and the practice of passing private laws to provide relief to individual debtors, which existed in some states at the time of the convention.

[25] *Gibbons*, 455 U.S. at 474.

26 *Id.* at 474 (Marshall, J., concurring).

he noted, the legislative history revealed that the law was designed to protect one group of claimants (the employees) from the negative effects of bankruptcy, despite generalized assertions of purpose.[27]

Current Legislative Proposals

The current legislative proposals appear to be Congress's response to the current bankruptcy proceedings involving Old Chrysler and Old GM and their network of former and soon-to-be-former dealers. These dealers are understandably concerned about losing their own livelihoods as well as losing the forum in which they have been providing jobs in their communities. That these losses come from unilateral actions of Old Chrysler and Old GM may make the losses more difficult, particularly since many felt that they were protected from such actions by the motor vehicle dealer franchise laws in their respective states.

However, these same state laws would be of particular concern if Congress were to mandate that New GM and New Chrysler accept the old dealer agreements. Most of these state laws require that an automaker have good cause before terminating a dealership agreement, and that dealers must be afforded an opportunity for a hearing on the matter. The reason that these dealerships were easily terminated by Old GM and Old Chrysler was that bankruptcy law has no such restrictions. Under § 365 of the Bankruptcy Code, executory contracts, such as franchise agreements, can be rejected,[28] thus preempting the restrictions state franchise laws may have imposed on terminations of such agreements. Rejection of executory contracts in bankruptcy requires the bankruptcy court's approval, but the standard required for rejection is business judgment. This generally is a low burden to meet, particularly when compared to the usual standard for termination under state franchise laws: good cause.[29]

It may be argued that, since the new corporate entities were never in bankruptcy and were not creditors or claimants to a bankruptcy, the power to regulate these entities will arise under a different constitutional authority, such as the power of Congress to regulate interstate commerce.[30] If this were the case, then it would appear that the uniformity requirements of the Bankruptcy Clause would not apply.

If, as in *Gibbons*, a court were to find that the proposed legislation governs the relationship between debtors and creditors and contemplates "an adjustment of a failing debtor's obligations," then Bankruptcy Clause analysis might apply. If these proposals are analyzed under the Congress's authority under the Bankruptcy Clause, then the requirements of uniformity might bring this legislation into question. Factors a court might consider as suggesting that the proposals, if passed, are bankruptcy laws include (1) the termination of the dealers' agreements

27 *Id.* at 476.

28 Exceptions to this general rule are collective bargaining agreements and certain retiree health benefits. Rejection of these contracts must comply with the requirements of 11 U.S.C. §§ 1113 & 1114, respectively.

29 11 U.S.C. § 365(g). When executory contracts are rejected in bankruptcy, the non-debtor party to the contract is entitled to a claim against the bankruptcy estate for the breach of contract. State law generally determines the damages that can be claimed; however, bankruptcy law determines that these claims are considered pre-petition claims and are treated as unsecured nonpriority claims.

30 U.S. Const., art. I, § 8, cl. 3. Car manufacturing and dealership agreements are likely to be amenable to Congress's power over interstate commerce. See NLRB v. Jones & Laughlin Steel Corporation, 301 U.S. 1 (1937) (rejecting previous distinctions between the economic activities—such as manufacturing—that lead up to interstate economic transactions, and the interstate transactions themselves).

was done during bankruptcies; (2) the dealers were unsecured creditors in the bankruptcies; (3) the assets were sold to the new entities as part of bankruptcy proceeding; and (4) the New Chrysler and New GM were formed as a result of bankruptcies. This legislation could be viewed as being intended to benefit specific named creditors in a bankruptcy case.

It is difficult to evaluate how a court might resolve this issue, as there is little case law that would be relevant to determining if the uniformity requirement should apply. It does not appear that the Court has considered such a dramatic intervention into events in such close proximity to a bankruptcy; nor, besides *Gibbons*, does the Court appear to have considered legislation that was so clearly intended to change the results of specific bankruptcy proceedings. If a court found that the Congress was acting under its bankruptcy power, there appear to be uniformity concerns.

Some of the proposed legislation appears to require that the Old GM and the Old Chrysler, still in bankruptcy, assume dealer obligations that have been rejected or modified. For instance, H.R. 2743 and S. 1304 provide that "[a]n automobile manufacturer in which the Federal Government has an ownership interest, or which receives loans from the Federal Government, may not deprive an automobile dealer of its economic rights and shall honor those rights as they existed [before commencement of bankruptcy for Old Chrysler and Old GM]." Since Old Chrysler and Old GM did receive federal assistance, they would appear to be subject to these requirements. It is less clear whether these automakers would be subject to the proposals in H.R. 2796 and H.R. 3170 § 744(b) because both automakers have already completed the sale of most of their assets and, therefore, may no longer be in a position to impose requirements on the new entities that purchased those assets.

H.R. 2743 and S. 1304

These companion bills (the bills) [31] purport to restore undefined "economic rights"[32] to automobile dealerships whose contracts have been rejected by either Old Chrysler or Old GM in their respective bankruptcies.[33] The rights are to be restored and honored as they existed prior to the filing of the respective bankruptcy cases; therefore, it appears that the bills are also intended to restore rights to the Old GM dealerships which entered into "wind-down" agreements with Old GM if those agreements were signed after June 1, 2009, when Old GM filed its voluntary bankruptcy petition.[34] Wind-down agreements were offered to those dealerships that were advised by Old GM that their dealership agreements would not be renewed in 2010. Under those wind-down agreements, dealers agreed to waive most, if not all, rights that they might have under their respective state's motor vehicle dealer franchise laws.

The bills appear to be intended to reverse both the legal and economic effects of the court-approved rejections of the dealership agreements in bankruptcy. The bills require an affected automobile dealer in bankruptcy to restore the dealership agreements to which it was a party

[31] These companion bills employ different numbering of their sections and subsections but have identical legislative language. For the sake of clarity and convenience, all citations to specific provisions reference only their location in H.R. 2743.

[32] Although the bills do not explicitly define "economic rights," they note that the rights include the right "to recourse under State law." H.R. 2743 § 3(a).

[33] The bills also appear to anticipate restoration of "economic rights" to the Old GM dealerships.

[34] H.R. 2743 § 3(a). Whether the bill would have the effect of annulling the signed wind-down agreements would be a matter for courts to decide and is not part of this constitutional analysis.

immediately before the filing of its bankruptcy petition.[35] In so doing, the bills could affect the distribution of assets from the debtors in bankruptcy to their other creditors.

The bills address only those dealers that had a franchise agreement with Old Chrysler or Old GM, and they require action by those two automakers in their pending bankruptcies. They could, therefore, affect the distribution of assets from those debtors to their other claimants or creditors. For these reasons, the bills may be subject to scrutiny to determine whether they meet the uniformity requirements of the Bankruptcy Clause.

H.R. 2796 and § 744(b) of H.R. 3170

The provisions of § 744(b) of H.R. 3170 and § 3 of H.R. 2796 are substantially similar and were each introduced by Congressman LaTourette. These are the sections where adherence to the uniformity requirement of the Bankruptcy Clause may be questioned. Each section applies to automobile manufacturers in which the federal government has an ownership interest. Section 744(b) also applies to those manufacturers in which the federal government has either a financial interest or the right to acquire an ownership interest. Neither of the sections names any specific auto manufacturer. While the absence of a named debtor may make the provisions less suspect regarding uniformity, it is not a clear guarantee that an argument cannot or would not be made that the provisions violate the uniformity requirement.

As noted above, it is not clear that the language of these proposals would affect the New GM or the New Chrysler. Further, although media reports regarding these provisions have indicated that they would apply to Old Chrysler and Old GM, this is not certain. The language of the provisions is prospective: a covered manufacturer "shall … require any new entity created in such case to enter into a new dealer agreement with the dealer whose agreement was not so assumed or assigned, and on the same terms as existed immediately before such date." Since the language is prospective and the major asset sales have already taken place in both bankruptcies, it is possible that this provision will not apply to either Old Chrysler or Old GM. In that case, it would have no current applicability.

There are, however, other automakers that, as a result of loans made under the Energy Independence and Security Act of 2007 (EISA), would be automakers in which the federal government has a financial interest. If any of them were to enter bankruptcy, it appears that this provision could apply; however, at this time, Old GM and Old Chrysler are the only automakers that are in bankruptcy.

If the provisions of these legislative proposals were to apply to Old GM and Old Chrysler, application of these sections could apply to benefit one class of claimants in a specific class of debtors by allowing them to extend their franchise agreements to a new entity that purchased the assets of the debtor. By so doing, it could affect the price that a buyer would be willing to pay for the assets, thus affecting the money available to the claimants whose only source for relief is in distribution from the bankruptcy estate. This could be construed to have affected the relationship between claimants by effectively removing one class of claimants, but potentially leaving less value to benefit the remaining claimants.

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[35] H.R. 2743 § 3(b). However, the automobile manufacturer is only required to restore the agreement at the request of the affected dealer.

If, despite court-approved rejections of some dealership agreements and wind-down agreements with others, Old Chrysler and Old GM were required to restore the dealership agreements that were in place before they entered bankruptcy, they could be put in a position where they were unable to honor the terms of the agreements, thus breaching those agreements post-petition[36] and, thereby, allowing the dealerships to assert post-petition rather than pre-petition claims for the breach. These post-petition claims might be accorded priority as administrative expenses. Even if the claims were not deemed to be administrative expenses, they could alter the relationship among the claimants.

Application of the Uniformity Clause

As in *Gibbons*, each of the four bills in question appears to be a congressional response to a bankruptcy; however, these bills are responding to two specific bankruptcies rather than only one. *Gibbons* teaches us that Congress may not, in essence, pass private bankruptcy laws. Whether a court would find that naming more than one debtor is sufficient to remove this bill from the onus of being a "private bankruptcy bill" and allow it to meet the uniformity requirement is something that cannot be predicted with any degree of certainty.

Unlike the facts in *Gibbons*, where railroads other than the Rock Island Railroad were also in bankruptcy, the two debtors named in these bills are currently the only automakers in bankruptcy. The *Gibbons* Court noted that the Railroad Reorganization Act of 1973 had operated uniformly even though it focused only on railroad reorganizations in the Northeast because, at the time, there were no pending railroad reorganizations outside the Northeast.[37]Therefore, a court could determine that the provisions of this bill meet the uniformity requirement because there are no other pending bankruptcies of automakers.[38]

Although it is impossible to say whether a court would find that these bills meet the uniformity requirement of the Bankruptcy Clause, comparison to *Gibbons* makes it seem plausible that the bill, if enacted, might face legal challenges in the courts. If one were to employ the analysis offered by Justice Marshall in his *Gibbons* concurrence, one could find that the uniformity requirement was met if the bill "serves a national interest apart from the economic interests of that debtor or class and if the identified national interest justifies Congress' failure to apply the law to other debtors."[39] The question then would be what is the national interest and why does it apply only to these debtors?

The purported national interest is "to protect assets of the Federal Government and better assure the viability of automobile manufacturers in which the Federal Government has an ownership interest or to which it is a lender."[40] If Congress determines that this bill will serve that interest, it is possible that the bill could be found to meet the uniformity requirement as it was understood by Justice Marshall. However, Justice Marshall's opinion was not the majority opinion and,

[36] Old Chrysler and Old GM do not appear to be in a position to fulfill their continuing obligations to dealers under the dealer agreements. Further, even if the assignment provisions of the bill (§ 3(b)) could be enforced against the New Chrysler and New GM, those entities would be unable to fulfill the pre-existing agreements since some of the brands are not being produced by the new entities.

[37] *Gibbons*, 455 U.S. at 469-70.

[38] This could, of course, change in the future and could affect a court's analysis.

[39] *Gibbons*, 455 U.S at 474.

[40] H.R. 2743 § 3(a).

therefore, is not precedential. Neither *Gibbons* nor any other case has yet determined whether national interest can evidence uniformity in a bankruptcy law that did not otherwise meet the uniformity requirement.

Takings and Due Process[41]

The Takings Clause of the Fifth Amendment demands that when property is "taken" by the United States, just compensation be paid. The question here is whether bills requiring automakers such as New Chrysler or New GM, created to purchase assets in bankruptcy proceedings, to accept assignment of or initiate dealer agreements that were in effect with the previous owners before bankruptcy, cause a "taking" of any interest recognized as "property." Note, however—no takings issue arises in connection with voluntary actions by any firms—as, for example, if a firm accepts a requirement that dealership agreements be reinstated as a condition for receiving federal financial assistance in the future.[42]

On the facts as CRS understands them, at least three types of interests may be involved that are recognized as property for Takings Clause purposes and could be the basis for takings claims: (1) any money paid out as a result of costs visited upon the post-bankruptcy firms by having to retain or take on dealerships; (2) assets of such firms; and (3) equity and creditor interests in such firms.

First, any costs to the post-bankruptcy manufacturers from being forced to keep or take on unwanted dealership contracts may involve the outlay of money, a property interest.[43] It is unlikely, however, that the forced divestment of such money would be deemed a taking. A majority of Supreme Court justices opined that a government requirement that a private entity pay money, where the source of funds is not specified, cannot effect a taking.[44] The U.S. Court of Appeals for the Federal Circuit—the appeals court whose jurisprudence will govern any takings challenge against the United States based on the legislation here[45]—has adopted the same rule.[46] Moreover, any costs to the new manufacturing companies that result in less than direct fashion from the forced contracts would be deemed mere "consequential damages." Government liability under the Takings Clause does not extend to consequential damages. Thus, any outlays of money by post-bankruptcy manufacturers as a result of forced dealer agreements would not, in and of themselves, be deemed a taking.

Second, if the claim is that the reformed company could not function profitably under the burden of the unwanted dealer agreements, "regulatory taking" claims could be based on the diminished value of the reformed company's tangible and intangible assets (the mere ability to conduct a profitable business, as something separate from business assets, is not property,[47] nor is goodwill

[41] This section was prepared by (name redacted), Legislative Attorney.

[42] *See* South Dakota v. Dole, 483 U.S. 203 (1987).

[43] Phillips v. Washington Legal Found., 524 U.S. 156 (1998).

[44] Eastern Enterprises v. Apfel, 524 U.S. 498 (1998) (concurring opinion by Justice Kennedy and four-justice dissent both endorse the view that "generalized monetary liability" cannot constitute a taking).

[45] Read together, the Tucker Act, 28 U.S.C. § 1491(a), and "Little Tucker Act," 28 U.S.C. § 1346(a), require as a general matter that takings claims against the United States seeking more than $10,000 be filed in the U.S. Court of Federal Claims, with appeals to the U.S. Court of Appeals for the Federal Circuit.

[46] Commonwealth Edison Co. v. United States, 271 F.3d 1327, 1338-40 (Fed. Cir. 2001) (en banc).

[47] College Savings Bank v. Florida Prepaid, 527 U.S. 666, 675 (1999). *College Savings Bank* is actually a substantive due process, not a takings case. However, the overwhelming majority of cases to address the question hold that (continued...)

or going concern value[48]). However, the classic "*Penn Central* analysis" that would almost certainly be used to assess such claims[49] typically requires that the economic impact on the plaintiff's property of the challenged government action be substantial, if not severe. This is a high economic-impact threshold to satisfy.

Third, and similar to the second claim, is the argument that any nonprofitability arising from the unwanted dealer agreements will erode over time the value of corporate stock or creditor rights, which are property rights. Such takings claims would be brought by individual stockholders or creditors. A similar case arose decades ago.[50] To address a rail transportation crisis brought about by eight major railroads entering bankruptcy reorganization, Congress reorganized the railroads, stripped of excess facilities, into a single system operated by a for-profit corporation. Several creditors and the sole stockholder of Penn Central, the largest railroad in reorganization, sued, claiming what they called an "erosion taking." By this, they meant an "erosion of the Penn Central estate beyond constitutional limits" owing to the "severe inhibitions" imposed by the congressional legislation upon the abandonment of unprofitable rail lines.[51] The analogy to the unprofitable auto dealership agreements here is clear. Though the Supreme Court found it unnecessary to reach this erosion-taking claim, it appeared to recognize its viability. However, given that *Penn Central* is the reigning test today for regulatory takings claims, an erosion-taking-like claim brought by owners or creditors of the reformed auto manufacturers would have to meet the high economic-impact threshold discussed above.

It is also possible that a court would find the affirmative nature of the obligation here (entering into a contract) more objectionable than the negative restrictions that are the typical fodder of regulatory takings cases and, as a result, hold that another *Penn Central* factor, the "character of the government action," weighs in favor of a taking. The very thin case law on this issue points the other way, attributing no categorical significance to the affirmative-negative distinction,[52] but the fact-intensive, case-by-case nature of the *Penn Central* analysis makes it risky to generalize from a few cases. Furthermore, a takings challenge based solely on the terms of the bills separate from the circumstances of the plaintiff—that is, a "facial" takings claim—is an "uphill battle" for the plaintiff.[53]

(...continued)

"property" as used in the Fifth Amendment Due Process Clause is broader than the same term as used in the Takings Clause. Thus, an interest that is not "property" for purposes of the former is unlikely to be judicially viewed as property for purposes of the latter.

[48] United States v. Petty Motor Co., 327 U.S. 372, 377-78 (1946).

[49] Probably the most famous judicial pronouncements in all takings case law is the Supreme Court's statement in *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124 (1978), of the basic analytical framework for determining which regulatory actions of government constitute takings of property, and which do not. The Court said that three factors are particularly persuasive: (1) the economic impact of the government action on the property, (2) the degree to which the government action interferes with "distinct" (in most later Supreme Court decisions, "reasonable") investment-backed expectations of the property owner, and (3) the "character" of the government action. In its most recent pronouncement on takings jurisprudence, *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528 (2005), the Court suggested that the first two of these factors generally carry more weight than the third.

[50] Regional Rail Reorganization Act Cases, 419 U.S. 102 (1974).

[51] *Id.* at 118. Further on, the Court explained that compelled continued rail operations at a loss "may accelerate erosion of the interests of plaintiffs … through accrual of post-bankruptcy claims having priority over their claims." *Id.* at 124.

[52] *See, e.g.*, McClung v. City of Sumner, 548 F.3d 1219, 1227 (9th Cir. 2008) (that ordinance required plaintiffs to take the affirmative step of installing a new pipe, as opposed to prohibiting development generally, does not change *Penn Central* analysis).

[53] Suitum v. Tahoe Regional Planning Agency, 520 U.S. 725, 736 n.10 (1997).

A recent Federal Circuit opinion, in an unrelated factual context, asserted in passing that "[w]here Congress' actions have the effect of keep[ing] the contract alive for the use of the government rather than bring[ing] the contract to an end, a court should conclude that there *has* been a taking."[54] If a court can be convinced that the forced reinstatement of the dealer agreements is "for the use of the government"—as, for example, by arguing that employed persons at unclosed dealerships make fewer demands on government services—the chance of a successful taking claim may be enhanced. Again, however, the ad hoc, fact-based nature of *Penn Central* analysis makes generalization difficult.

Turning to substantive due process (and subject to the voluntary-action exclusion at the start of the takings discussion), the picture remains cloudy. As background, the doctrine of substantive due process holds that even when *procedural* due process is afforded, there are certain government measures that so offend traditions "fundamental to a civilized society" they will not be upheld.[55] This broad constitutional concern has been translated by the Supreme Court into widely varying standards of judicial review, depending on the context. Where, as with the bills here, the government action is purely economic, the standard of review is a very low one – requiring only that the legislature has not acted in an arbitrary and irrational way.[56] As sometimes put, there need only be some rational basis for viewing the legislation as furthering a legitimate governmental purpose. Indeed, research fails to reveal any Supreme Court decision in the past half-century finding economic legislation to violate substantive due process.[57] Since the demise of the "*Lochner* era"[58]in the 1930s, the Court has retreated from use of substantive due process to assess economic legislation.[59] Moreover, the deference accorded economic legislation is no less when the legislation applies retroactively, as the bills might. "Provided that the retroactive application of a statute is supported by a legitimate legislative purpose furthered by rational means, judgments about the wisdom of such legislation remain within the exclusive province of the legislative and executive branches …."[60]

Notwithstanding, it must be noted that coercing the New Chrysler and New GM into contracts they do not want, with specified persons and under specified terms, is an unprecedented fact pattern that the Supreme Court has not confronted in its previous substantive due process decisions on economic legislation. In the typical contract, by contrast, the parties mutually assent to entering into the contract and to its terms, or the existence of a contract is inferred from typically voluntary conduct of the parties. Nor can the required contracts here be passed off as mere conditions for doing business—partly because the terms and parties are rigidly fixed, and

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[54] Cienega Gardens v. United States, 331 F.3d 1319, 1335 (Fed. Cir. 2003) (emphasis in original; quotation marks omitted).

[55] Solesbee v. Balkcom, 339 U.S. 9, 16 (1950) (Frankfurter, J., dissenting).

[56] Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976).

[57] *See, e.g., Usery*, 428 U.S. 1; Pension Benefit Guaranty Corp. v. R. A. Gray & Co., 467 U.S. 717 (1984); Concrete Pipe & Products, Inc. v. Construction Laborers Pension Trust, 508 U.S. 602 (1993); Eastern Enterprises v. Apfel, 524 U.S. 498 (1998)(concurring justice and four dissenters find severely retroactive economic legislation more properly analyzed under substantive due process, rather than taking, theory, but only one of the five justices finds due process violated on facts presented).

[58] Lochner v. New York, 198 U.S. 45 (1905).

[59] *See, e.g.,* Ferguson v. Skrupa, 372 U.S. 726 (1963) ("the doctrine that prevailed in Lochner [and similar decisions of the Supreme Court]—that due process authorizes courts to hold laws unconstitutional when they believe the legislature has acted unwisely – has long since been discarded. We have returned to the original constitutional proposition that courts do not substitute their social and economic beliefs for the judgment of legislative bodies ….").

[60] *Pension Benefit Guaranty Corp.*, 467 U.S. at 729.

partly because the post-bankruptcy manufacturers are already in the car manufacturing business with vast capital assets that cannot easily be transformed to other use. As noted in the Restatement (Second) of Contracts: "Contract law has traditionally relied in large part on the premise that the parties should be able to make … agreements on their own terms, freely arrived at by the process of bargaining."[61] For the foregoing reasons, the possibility cannot be dismissed that the forced contracts (with specified terms and parties) might be judicially determined to offend substantive due process.

Breach of Contract[62]

The facts at issue in the case *United States v. Winstar*[63] may be somewhat analogous to the application of the instant legislation to the New GM and the New Chrysler. In *Winstar*, the Supreme Court addressed the issue of whether the federal government, by facilitating the acquisition of a failing company by another company, can become liable for damages if subsequent legislative actions undermine the economic viability of the acquisition. In 1983, the Federal Savings and Loan Insurance Corporation (FSLIC) sought buyers for failing savings and loan institutions.[64]A group of private investors formed Winstar Corporation for the purpose of acquiring the Windom Federal Savings and Loan Association, and presented the FSLIC with a merger plan. This plan called for capital contributions from Winstar and the FSLIC, and it called for the recognition of supervisory goodwill toward capital requirements.[65] The FSLIC recommended the merger and the Federal Home Loan Bank Board (Bank Board) approved it.[66]

However, as the savings and loan crisis deepened in the late 1980s, Congress responded by passing the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which, among other things, restricted thrifts' use of supervisory goodwill to satisfy capital requirements.[67] Because it could not meet the new minimum capital standards, Winstar brought an action claiming that Congress's exclusion of some of the thrift's supervisory goodwill under FIRREA constituted a breach of contract. The United States Claims Court found that FIRREA constituted a breach of the agreement between Winstar, the Bank Board and the FSLIC. The Court further rejected the government's invocation of the sovereign acts doctrine, which provides that the government cannot generally be held liable for its sovereign acts.[68] The Court held that this defense was not available "where the sole purpose of the government action is to reverse an earlier policy decision later deemed unwise."[69]

The Supreme Court, by a 7-2 vote, also found that the federal government was responsible for damages based on breach of contract, but could not agree on the reasoning behind the decision. Writing for a four-Justice plurality, Justice Souter first concluded that the government had

[61] RESTATEMENT (SECOND) OF CONTRACTS ch. 7 introductory note.

[62] This section was prepared by (name redacted), Legislative Attorney.

[63] 518 U.S. 839 (1996).

[64] *Id.* at 846-856 (Souter, J., plurality opinion).

[65] *Id.* at 864-865 (Souter, J., plurality opinion). The value of the supervisory good will was allowed to be amortized over a period of 35 years.

[66] Case Note, *Winstar v. United States*, Harv. L. Rev. 1162, 1163 (1996).

[67] *Id.* at 857-858 (Souter, J., plurality opinion).

[68] Horowitz v. United States, 267 U.S. 458, 460 (1925).

[69] *See* Winstar Corp. v. United States, 25 Cl. Ct. 541, 552 (1992).

expressly contracted to permit the thrifts to count supervisory goodwill toward satisfaction of minimum capital requirements.[70] The plurality next held that the unmistakability doctrine, which requires that the government's contractual surrender of a sovereign power be accomplished in "unmistakable terms," did not apply to the contracts at issue.[71]

Next, in a section of his opinion joined only by Justices Stevens and Breyer, Justice Souter rejected the government's argument that the sovereign acts doctrine was applicable. According to Justice Souter, the sovereign acts doctrine applies when a sovereign act "incidentally" impairs the government's performance of a contract. However, Justice Souter held that "where a substantial part of the impact of the Government's action rendering performance impossible falls on its own contractual obligations, the [act is not deemed general and the sovereign acts] defense will be unavailable."[72] Justice Souter regarded "Congress's expectation that the Government's own obligations would be heavily affected" by FIRREA as sufficient evidence that FIRREA had such a substantial impact.[73]

Concurring in the judgment, Justice Scalia, joined by Justices Kennedy and Thomas, disagreed that the unmistakability doctrine did not apply. However, Justice Scalia argued that the unmistakability doctrine is merely a presumption that government contracts do not include a promise not to legislate in a way that interferes with the contract's performance. This presumption is overcome, however, when the government makes such a promise not to legislate, and that promise is the "the very subject matter of [the contract], an essential part of the quid pro quo."[74] Further, Justice Scalia wrote, the government in *Winstar* had no sovereign acts defense because "Congress specifically set out to abrogate the essential bargain of the contracts."[75]

The application of *Winstar* to the application of the instant legislation to the New GM and the New Chrysler is unclear,[76] as there may not have been a specific contractual understanding that the federal government would refrain from imposing requirements regarding the terminated dealer contracts. The plurality in *Winstar* noted that the Bank Board had accepted the Winstar proposal and made an Assistance Agreement that incorporated both the Board's resolution approving the merger and a forbearance letter issued on the date of the agreement. The

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[70] Winstar, 518 U.S. at 860-868 (Souter, J., plurality opinion)

[71] *Id.* at 871 (Souter, J., plurality opinion). Justice Souter held that "the application of the doctrine ... turns on whether enforcement of the contractual obligation alleged would block the exercise of a sovereign power of the Government." *Id.* at 880 (Souter, J., plurality opinion). Justice Souter found that nothing in the Winstar contracts "purported to bar the Government from changing the way in which it regulated the thrift industry," and that the contracts were merely "risk-shifting agreements" under which the government assumed the risk of compensating the thrifts for "any losses arising from future regulatory change." *Id.* at 868-69, 881 (Souter, J., plurality opinion). Because the government did not purport to surrender any sovereign power to regulate, but agreed only to pay damages if it exercised that power, the government could not assert the unmistakability doctrine as a defense. *See* Leading Cases, 110 Harv. L. Rev. 345, 347 (1996).

[72] *Id.* at 898 (Souter, J., plurality opinion).

[73] *Id.* at 903, n. 50 (Souter, J., plurality opinion). The plurality also held that even if FIRREA qualified as a "public and general" sovereign act, the government would still be liable because the change was "foreseeable and likely" when the parties contracted. *Id.* at 906.

[74] *Id.* at 921 (Scalia, J., concurring in judgment).

[75] *Id.* at 924 (Scalia, J., concurring in judgment).

[76] The application of this legislation to companies which have not yet received federal funds would appear unlikely to raise the same concerns as were at issue in Winstar. Similarly to the above discussion regarding takings and due process, no breach of contract issue would appear to arise based on a firm voluntarily accepting dealership agreements as a condition for receiving federal financial assistance.

forbearance letter provided that "for purposes of reporting to the Board, the value of any intangible assets resulting from accounting for the merger in accordance with the purchase method may be amortized by [Winstar] over a period not to exceed years by the straight-line method."[77] Further, the Assistance Agreement itself contained language addressing the primacy of the Agreement.[78]

In the instant case, the federal government was instrumental in encouraging the Old GM and Old Chrysler, as a condition of receiving further federal assistance, to create a viable recovery plan that would include a reduction in the number of dealers for those entities. It would appear that the federal government actively encouraged the reduction of dealerships during the bankruptcy process as well. Additionally, it appears that the approval of the sale of assets by the bankruptcy court included both a plan for an infusion of federal money into the New Chrysler and New GM, and an expectation that New Chrysler and New GM would be able to avoid the statutory and contractual obligations of many of the dealership agreements.

On the other hand, it is not clear that there is a document equivalent to the Assistance Agreement in *Winstar* that explicitly conditions the purchase of assets by the new GM or Chrysler on the forbearance of the United States from reinstituting dealer agreements. Further, it is not clear if a contract between the United States and the new corporate entities was established where the rejection of dealer contracts was effectuated by a bankruptcy court, not as promises by the Executive Branch or the Congress. Absent explicit language establishing contractual relations, a challenge to the instant proposals might need to rely on the theory that there was an implied contract between the United States and the new corporate entities.[79] This could prove a more challenging factual burden than if explicit promises were made.

Thus, whether the instant proposal would rise to the level of a contract breach would appear to hinge on a court's evaluation of the specific facts at hand. The first question which would arise is whether the treatment of the new GM and new Chrysler under the terms of the bankruptcy agreement, in other documentation, or in the understanding of the parties constituted a contract or implied contract with the federal government. Next, as per Justice Souter's opinion, the question would arise as to which parties to the agreement bore the burden of losses caused by a change in the regulatory scheme under which the new entities would operate. Then, under Justice Scalia's analysis, the question would arise as to whether allowing New GM and New Chrysler to operate without the obligations of the terminated dealership agreements was "the very subject matter of the contract," such that the instant legislative proposals would "abrogate the essential bargain of the contracts."[80] If a court found these various conditions to be met, then the federal government could be found liable for damages resulting from the New GM and New Chrysler having to honor the dealer agreements which existed before bankruptcy.

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[77] *Id.* at 864-865 (Souter, J, plurality opinion).

[78] "Except as otherwise provided, any computations made for the purposes of this Agreement shall be governed by generally accepted accounting principles ... , except that where such principles conflict with the terms of this Agreement, applicable regulations of the Bank Board or the [FSLIC], or any resolution or action of the Bank Board approving or adopted concurrently with this Agreement, then this Agreement, such regulations, or such resolution or action shall govern." *Id.* at 865.

[79] *See* Winstar Corp. v. United States, 21 Cl. Ct. 112 (1990) ("Winstar I")(Court of Federal Claims found an implied-in-fact contract to exist between the plaintiffs and the United States).

[80] *Id.* at 924. (Scalia, J., concurring in judgment).

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