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## Interview: Mark Reutter

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# The Delphi Case and the Misuse of Bankruptcy Law

*Mark Reutter is the author of the book Making Steel: Sparrows Point, and the Rise and Ruin of American Industrial Might; and other studies and articles on the dramatic use of bankruptcy and consolidation in the global steel industry over the past decade. He was interviewed on Oct. 31 by Paul Gallagher.*

**EIR:** You wrote in the *Washington Post* on Oct. 23, and republished elsewhere, that the U.S. bankruptcy courts have become, in effect, instruments of bank creditors and of managements which declare bankruptcy. What did you mean by that? What change is going on?

**Reutter:** Due to some changes in the law, and to changes on Wall Street, what was once shunned as the “court of last resort”—taking a corporation voluntarily into bankruptcy through what’s called Chapter 11 of the bankruptcy code—has become, in the last few years, a tool for the biggest money, and the sharpest “manager-specialists,” if you will—to shed their pension and welfare benefits, and force a unionized workforce to accept new terms. This began in 2001 in the steel industry, and resulted in major changes in that industry, and then has spread to the airline industry—where today, four of the seven major U.S. carriers are in Chapter 11—and is now spreading, in recent weeks, to the auto-parts industry. And the people who are involved in the voluntary bankruptcy of auto-parts maker Delphi Corp., are the very same people who profitted enormously from the Chapter 11 bankruptcies of the steel industry three years ago.

**EIR:** Does Chapter 11 itself come from the New Deal?

**Reutter:** Chapter 11 preceded that, but during the New Deal, when we had an unprecedented number of bankruptcies, they began changing Chapter 11, so that companies in “technical default”—which was the term then used—could, usually for a matter of months, be protected from creditors, do some fairly small reorganization, and come out with their company intact.<sup>1</sup>

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1. There were two periods of bankruptcy law reform in the 1930s—the first, which put provisions for corporate reorganizations into the bankruptcy law (previously, bankruptcy was just insolvency); and second, the 1938 Chandler Act, which reduced the power of Wall Street and creditors in re-organizations. See “A Short History of ‘Chapter 11,’ Model for a Bankrupt Economy,” by Ed Spannaus, *EIR*, Jan. 25, 2002.

Until around ten years ago, Chapter 11 bankruptcy was considered tremendously disreputable. No “white-shoe” law firm wanted to represent a bankrupt company. Public attitudes have changed, in general, about bankruptcy. The “liberalization” of the law in 1978 gave management—the same management, in many cases, that had brought the company to ruin—exclusive rights to keep creditors at bay and set up their own, exclusive, reorganization plan. This change in bankruptcy law, perversely, became an incentive for Wall Street, and for law firms, to set up “bankruptcy restructuring” departments. And they began, more and more, to see that there was lots of money to be made in these reorganizations.

**EIR:** So, are you saying that, with the 1978 reorganization by Congress, that essentially, a management could then formulate a desired—

**Reutter:** A desired end.

**EIR:** And then go and use bankruptcy to achieve that end? They could start from the end of, say, cutting their labor costs by “x” amount.

**Reutter:** Right. And increasingly, this has become less a tool against creditors—traditionally, the losers in these bankruptcies would be creditors—than a tool against union contracts. Because under the law, a union contract—after a short period in which management is asked to bargain in good faith—management can then use the bankruptcy judge to abrogate a labor agreement. And that’s what began, in force, in 2001, and has become this tremendous hammer held over the head of organized labor.

So these companies get in trouble. They also, however, have big pension and health-benefit plans, which—due to another set of problems, and loopholes in government rules—pensions in private industry, *which employees pay; often, \$5-6/hour of their hourly wage goes to their pensions*—and while the company is supposed to take care of that and be the fiduciary, keeping it in trust, there are huge, gaping loopholes by which a company can get way behind in pension payments. They started getting behind in the 1980s. U.S. Steel, in 1985, was \$500 million behind.

**EIR:** How long is that “short period” requiring bargaining in good faith, in the Delphi case, for example?

**Reutter:** About two months.

**EIR:** So essentially, the management, if it wishes to, can ignore that period?

**Reutter:** It can easily drag something out for two months.

Another very important factor came in with this “liberalization” of the law. . . . Traditionally, the bankers would support creditors, who would want to get their money *out* of a Chapter 11 company. And so there would be fighting going on, of creditors, bankers, against management.

Well, bankers came up with the idea that they were going

to ally themselves with managers, through “debtor-in-possession financing.” As they just did it in the Delphi case, the courts now will allow a bankrupt company to put together credit lines, and revolving credits from banks, to last however long the bankruptcy might occur.

Delphi—which we are told, we read in the press, is hopelessly inefficient, its labor costs too high, it can’t possibly compete—got \$2 billion in credit on excellent terms, two days before it went bankrupt [on Oct. 8].

**EIR:** What was Delphi’s financial condition or status, then, before it went bankrupt?

**Reutter:** Delphi has reported \$700 million in losses for this year. However, it has \$1.6 billion in cash ready at hand. So it’s not a company that was on the verge of not having any money to pay suppliers, to pay labor.

**EIR:** That cash is not the result of the \$2 billion credit line you spoke of?

**Reutter:** No, it’s in addition to that. So, it’s sitting on roughly \$4 billion, by its own account.

Delphi’s had an accounting scandal earlier this year, so we’re not quite sure where they stand, or how that may have affected their losses of this year. But most of those losses are because raw material prices have skyrocketed, and their major purchaser, General Motors, that once owned them, has refused to increase any of the prices they [GM] pay. So, Delphi’s financial problems are heavily due to its relationship to General Motors; almost everyone agrees that GM spun off Delphi, formerly known as Delco, as a way to get its auto parts as cheaply as possible. And as the auto-part costs have risen, due to the high costs of raw materials—including the rise in steel prices in the recent 18 months—GM has helped create these losses that Delphi is using as the rationale, in turn, to attack labor costs.

But the labor costs haven’t changed.

**EIR:** In addition, it seems to me, from what you just described, that even with those losses, this doesn’t sound like an actually bankrupt company.

**Reutter:** No! People think a bankruptcy is, literally, that you don’t have a dollar; you can’t make the payroll for this coming Friday. But this is a company that had \$1.6 billion before going into bankruptcy.

Here’s the other contributing factor: A new breed of corporate manager. And that new breed is personified by the new head of Delphi. Delphi got a new executive in July, three months before it declared bankruptcy—Robert “Steve” Miller. Miller makes his living by taking large companies in and out of bankruptcy. His previous, very short stint as CEO was in putting Bethlehem Steel in and out of bankruptcy. He is on the board of United Airlines, and was instrumental in putting United Airlines into bankruptcy. He’s a lawyer and MBA who specializes in this.

Although Miller claims that he didn’t want to put Delphi into bankruptcy, he did put it into bankruptcy. And that’s out of the same playbook as the case of Bethlehem Steel in 2001. When he took over as CEO, his first announcement was, “I was not hired to put Bethlehem Steel in bankruptcy”; and within 16 days, Bethlehem Steel was in bankruptcy.

Just before it went into Chapter 11, Bethlehem got \$400 million in debtor-in-possession credit from General Electric.

Miller is repeating his same *modus operandi* at Delphi. Another irony—is it an irony, or just a certain gang of people, a deliberate set-up?—is that on the receiving end of the bankruptcy process are “vulture capitalists.” One vulture who has been involved for his entire career in bankruptcy law and finance, first for Rothschild, and now on his own—is Wilbur Louis Ross. He is a billionaire, who made well in excess of \$500 million buying Bethlehem Steel from Steve Miller, and then selling it, several months ago, to the Mittal Steel Corp. in the Netherlands.

Wilbur Ross announced about a month ago, that he was amassing a \$4 billion private equity fund to—lo, and behold—start buying auto parts companies once they go through the cleansing process of Chapter 11.

Delphi has hundreds of millions of dollars of cash flow coming through its system every day. These vulture capitalists want to get that flow directed to them.

**EIR:** Earlier, we were talking about the management formulating a plan, or an end, and using bankruptcy to obtain that end, rather than to protect the company. Now, it sounds as though we’re also talking about banks and/or funds like the one you described in Ross’s case, formulating a plan, and then using a certain management, which in turn uses bankruptcy. The plan may originate not even with the management, as we traditionally understand that, but rather with financial funds outside the company.

**Reutter:** That’s right.

**EIR:** How is it that employee pensions, in the course of bankruptcy proceedings, are so often, or now nearly universally, discarded? Are these not *future* benefits, as opposed to past debts from which a company could be protected?

**Reutter:** That is an excellent point. These companies, through mismanagement and through government inaction of scandalous proportions—forget about Enron—you’re looking [with pension plans] at much more serious fiduciary irresponsibility in many Fortune 500 companies. While there are many responsible companies, the irresponsible ones will boost their bottom lines and increase their quarterly earnings, by not making payments into their pension plans. And believe it or not, there are no laws preventing them from doing that.

Once you get into bankruptcy court, the legal obligations that you have for pension and health-care benefits under a union contract, are voided.

The judges are confronted with legions of lawyers who

present often novel legal theories—theories that influence these judges, of various degrees of competence, to make these rulings. And that has been increasingly shifting, so that as long as management comes before a judge and says, “Look, we don’t have any money”—even though, as I’ve described, they actually do have money—“We can’t afford to pay these costs and successfully reorganize.” In almost every case now, the judge says, “Okay, that’s fine.” The case of Bethlehem Steel is, again, the template of how the airline industry is moving, and is probably what will happen with Delphi, if it’s not stopped. Steve Miller found Wilbur Ross, and Wilbur Ross gave him a low offer intentionally. It was hinged on the fact that Wilbur Ross, who had incorporated a new company called International Steel Group (ISG)—that ISG would not buy Bethlehem Steel until Bethlehem Steel went to the judge and said that they didn’t have the money to pay employee health-care benefits.

**EIR:** So, again, in what you just described at Bethlehem, we’re confronting a situation where it appears that the originator of the debtor-in-possession financing exercised predominant clout over the whole process of how it went through bankruptcy, very much like what we used to call “leveraged buyouts,” in which you had external funds which had a plan, and imposed their plan on a big company through the markets.

But in these cases, you’re saying now they’re imposing this plan from the outside through the bankruptcy court.

Was debtor-in-possession financing, with this degree of clout, was that an innovation of the 1978 “reform”?

**Reutter:** It opened up the possibility. But a lot of it has to do less with the law itself, than with how it has been interpreted and expanded by judges; and how Wall Street and Wilbur Ross types seized upon this opportunity to profit. Here’s what they thought: “We have the steel, auto-parts, airline industries, that are ‘troubled,’ but have a huge cash flow. And here’s a way for us, through the bankruptcy courts, to shed all these employee costs [they’re really not costs, of course, they’re IOUs]. In the case of the steel industry alone, about 150,000 retirees have lost their promised benefits since 2002.

**EIR:** We have discussed the case, in Ottawa, of the big Canadian steel company Stelco, in which the bankruptcy judge—who I think is the chief bankruptcy judge of the province of Ontario—has said to that company in bankruptcy, and to its creditors, “You will not shed these pension costs. You will pay these pension costs, or I won’t let you out of bankruptcy.” Do you know of any major cases in the United States, in which a bankruptcy court has acted that way?

**Reutter:** No. Once an employer goes into bankruptcy, in the United States, they can tear up their contracts with employees.

## Canada Bankruptcy Court Preserves Pensions

A bankruptcy court decision in Ottawa Oct. 6, on the plan of the privatized national steel company, Stelco, to emerge from 20 months’ bankruptcy, occurred in the midst of a bitter fight between Wall St./hedge fund demands, and Canada’s and Ontario’s legislative intent to protect production and labor costs. The court’s decision, still being bitterly opposed by a big Stelco bondholders’ group, is in contrast to the American bankruptcy courts’ increasingly prompt and cheerful “OK” to companies wanting to eliminate their employees’ union contracts and retiree benefits overnight. The American practice is becoming what Lyndon LaRouche on Oct. 5 called a potentially criminal conspiracy to use the bankruptcy law to ruin workers’ living standards, while lining the pockets of executive-shareholders.

On Oct. 6, Ontario bankruptcy court judge James Farley ordered Stelco—in order to be protected for two more months, and then emerge from bankruptcy—to accept \$100 million in aid from Ontario province, and a \$450

million financing deal with Tricap Management (part of Brascan Corp.). Together, the package funds—and the judge enforces—an immediate \$400 million pension-plan contribution by Stelco.

The company, using a loophole in Ontario law, had not made any contributions to its pension funds since 1995, creating a \$1.3 billion pension deficit, and thus causing its own bankruptcy. The Ontario provincial government closed the anti-pension loophole this year, specifically with an eye to Stelco’s case. Judge Farley ruled accordingly.

The bondholders—evidently preferring an activist judge to “legislate from the bench”—are bitterly fighting Farley’s ruling and “vigorously contest the validity and enforceability of any steps taken pursuant to those agreements.” The bondholders are led by Citicorp and a group of hedge funds, including Wexford Credit Opportunities Fund, and Cerberus Capital Management. Shareholders, who are to receive 66 cents on the dollar of their shares, may vote to approve the package on Nov. 15.

Tricap Management, on the other hand, was brought to the deal which Judge Farley has approved and ordered, by the United Steelworkers Union’s five locals which represent Stelco’s 12,000 workers.

—Paul Gallagher

The employees are suddenly unsecured creditors. The banks are totally secured [on their debtor-in-possession financing].

**EIR:** In very recent days, there's been a proposal from one of the co-chairs of the Manufacturing Caucus in the Congress, Senator [Hillary] Clinton, to hold an "auto summit" involving Congress and the White House, and industry and labor, on saving the auto industry, "the unique infrastructure" this industry has, as she put it. Before that, proposals were circulated for months by Lyndon LaRouche, throughout the Congress, for interventions by the Senate to protect and regulate and reverse the industrial collapse going on.

What are your ideas on how the Congress can address this problem we've been discussing, if it were making an intervention to try to save these industries.

**Reutter:** Certainly Congress should start holding hearings, because most Americans are unaware of what is going on here. I fault the press for being very unattentive to these problem. But both parties have also ducked for cover. In Maryland, the two liberal Democratic Senators, both with long ties to the steel industry, have avoided this issue, as has the Republican governor.

Any move to start looking at the issue of infrastructure is important. That is certainly what LaRouche and others have done. They have been working toward this. There is an odd mindset that infrastructure doesn't matter, we don't really need to care that we're losing the industrial base that made this country the economic powerhouse.

But there's a very specific reform that's needed for Chapter 11. A company should not be able to go into bankruptcy unless it is a last resort. And having billions of dollars on hand, isn't.

Employees who have worked for decades for a company, who have been promised that they have benefits waiting for them, should have those benefits. They should not have those stripped out through Chapter 11, while bankers and financial vultures walk away—as in the case of Bethlehem Steel, with around \$500 million in profits. In effect, through bankruptcy, the cash flow of the targeted company is going from the workers to the investment class.

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## Bush's Pandemic Plan Doesn't Add Up

by Christine Craig and Laurence Hecht

President Bush released his long-awaited National Strategy for Pandemic Influenza on Nov. 1, calling on Congress for \$7.1 billion to fight the spread of a deadly strain of avian flu. Senate Minority leader Harry Reid said that he was "pleased to see that the President has finally followed our lead, and released his avian flu plan today," but pointed out that the amount was nearly \$1 billion less than the \$8-billion proposal which passed the Senate by a vote of 94 to 3 the previous week.

In truth, the amounts in both proposals are vastly out of touch with the reality of a threatened global pandemic, and the deteriorated hospital and public health infrastructure in the United States. The H5N1 influenza virus has stricken millions of poultry, and proved over 50% fatal in the 122 humans so far infected. A mutation or reassortment of the virus to a form easily transmissible from human to human could happen at any time, creating a global pandemic that could kill hundreds of millions of people in a matter of months.

Bush's plan cuts \$1.2 billion from the Senate proposal of \$3 billion for stockpiling and development of new antivirals, putting 75% of the burden for antiviral purchase on the states, and cuts \$500 million from the Senate's proposed \$600 million to aid state and local public health systems. It adds somewhat to the funding for vaccine development.

At the heart of the Administration pandemic plan is the development of the capacity to produce 300 million courses (two doses per person) of pandemic flu vaccine within six months of pandemic onset. To accomplish this, \$4.7 billion of \$6.7 billion of new funding requested for HHS in 2006 will be used for creating and increasing vaccine production capacity and stockpiles sufficient to achieve that goal. However, according to Secretary of Health and Human Services (HHS) Michael Leavitt, this capability will only begin to be phased in between 2008 and 2013. This leaves us very vulnerable for the next decade.

The first stage of vaccine production increase will focus on ramping up egg-based vaccine production, to give 20 million courses by 2009. This vaccine would be slated for first responders, medical personnel, and other workers critical to pandemic response. Eventually, 60 million courses of vaccine could be produced in six months by this technology.

The rest of our vaccine production is envisioned to come from the relatively new technology of cell culture-based production. This technology, which involves growing flu virus in mammalian cells rather than eggs, has been used for other