Obama to Detroit: Restructure or else

Administration gives GM and Chrysler a short-term lifeline, but the threat of bankruptcy still looms for the battered automakers.

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NEW YORK (CNNMoney.com) -- The Obama administration offered General Motors and Chrysler LLC a huge carrot Monday - the possibility of billions of dollars more in loans if they can win additional concessions from creditors and unions.

It also gave GM and Chrysler a break by not recalling the $13.4 billion already loaned to GM (GM, Fortune 500) and the $4 billion already loaned to Chrysler.

But it also unveiled a large stick - the threat of putting the two companies into bankruptcy, and possibly even forcing Chrysler out of business, if they do not reach deals that the government insists are needed to make the two companies viable for the long-term.

So where do GM and Chrysler go from here?

Jessica Caldwell, an industry analyst at Edmunds.com, said the fact the government didn't pull the previous loan suggests just how much the administration is committed to keeping at least GM, if not both companies, out of bankruptcy.

"This is definitely a lifeline. The government is not going to let them walk down the bankruptcy road," she said.

But the administration insisted Monday that it may force a bankruptcy to bring about the restructuring it thinks is necessary, including the shedding of debt and further closings of plants and dealerships.

Even some who think GM and Chrysler should get more government help said the threat of bankruptcy may well be what is needed to convince bondholders and the United Auto Workers union to make more concessions.

"The threat of bankruptcy is the leverage the automakers need," said David Cole, chairman of the Center for Automotive Research. "They have to keep the pressure on, and that's what Obama was really doing."

Investors own $27 billion in unsecured bonds at GM. And there are more than $6 billion in loans to Chrysler backed by that company's assets.

So far, creditors have been unwilling to accept the proposed swap of equity in GM and Chrysler for their debt, even though the bonds are trading at only pennies on the dollar.

A committee of major holders of GM bonds issued a statement late Monday afternoon saying they are willing to make a deal with the company, but not unless GM makes other changes to prove it can be viable.

"We were encouraged to hear that the Obama administration shares the committee's long-standing concern that GM's current restructuring plan is not viable," said the group in its statement.

"Bondholders have been and remain willing to reduce GM's future debt burden by exchanging a substantial part of their debt for equity, but that exchange must occur in support of a business plan that has a chance to succeed," the creditors added.

University of Maryland professor Peter Morici, a vocal critic of the auto industry, maintained that the bondholders should not agree to a debt-for-equity swap, even if the alternative is a trip to bankruptcy court.

Morici said he thinks the Obama administration is focused too much on getting concessions from bondholders and not enough on getting further changes in labor contracts.

"I don't know if Obama is leaning on the union in the background, but I doubt that he is," said Morici. "I wouldn't be surprised if they end up in bankruptcy court, but I also wouldn't be surprised if they just continue to give them money."

The United Auto Workers union was not immediately available for comment about Monday's announcement by the Obama administration. But Cole said he thinks the current labor deal is already close to competitive and that a bankruptcy filing would only set back turnaround efforts.

Still, as grim as the picture is for the automakers today, there is general agreement that the outlook is not hopeless.

Both Morici and Cole said they think GM and Chrysler are more efficient at making cars than widely believed. And both said there is bound to be some improvement in sales in the future, even it it's not as great or as soon as the pickup predicted by the automakers themselves.

Administration officials insisted that if there is a bankruptcy it would be a "quick rinse" of the company's obligations and that they could be in and out of bankruptcy in as few as 30 days.

"What I am talking about is using our existing legal structure as a tool that, with the backing of the U.S. government, can make it easier for General Motors and Chrysler to quickly clear away old debts that are weighing them down so they can get back on their feet and onto a path to success," said President Obama Monday. "What I am not talking about is a process where a company is broken up, sold off, and no longer exists."

Some bankruptcy experts scoffed at that idea though, given the size, complexity and contentiousness of the problems in the industry.

Heidi Sorvino, head of the bankruptcy practice in the New York office of law firm Smith, Gambrell & Russell, said the only way a quick trip through bankruptcy would work is if the automakers, creditors and union all agreed on the restructuring changes before the bankruptcy filing.

She doesn't see that happening unless the government comes up with tens of billions of dollars to make all the different parties happy.

"Money solves all problems. If the government is willing to pay to satisfy all the creditors, you could do it," she said. "If not, no way can it happen in 30 days or even six months."

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