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RESEARCH NOTE
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Legal Implications of Proposed GM/UAW VEBA

This research note provides an initial assessment of certain legal implications of the proposal to finance a new $30 billion Voluntary Employee Beneficiary Association ("VEBA") with a $4.3725 billion convertible note to be sold by General Motors Corporation (the "Convertible Note" or "Note") to the VEBA. Please note that this assessment is based on currently available public information and is thus limited in its scope by the content of that information.

Summary

The argument by top United Auto Workers officials and General Motors ("GM") that the permanent transfer of GM's longstanding and carefully negotiated health care obligations from GM to the VEBA will create a financially secure and independent union-controlled entity is inaccurate and misleading. Despite appearances, the plight of GM's unionized workforce – including current, retired and future employees - remains tightly linked to the fortunes of GM itself. Neither GM nor top United Auto Workers ("UAW") officials have made clear this basic fact about the VEBA and the Convertible Note. I also conclude that the ratification vote/investment decision to be made this week by UAW member/investors is part of the distribution and sale of a security potentially in violation of federal and state securities laws by both GM and top UAW officials.

I. Top UAW Officials inaccurately claim VEBA is secure and protects UAW members

As currently understood, the UAW and GM have tentatively agreed – pending the vote by the union member/investors – to establish the VEBA to take over the health care liabilities of GM. The VEBA will be established by the UAW and will take the form of a legally independent trust. The UAW will appoint the trustees who will manage the day-to-day operations of the VEBA. Initially, GM will provide cash, certain other assets and the Convertible Note to fund the VEBA in consideration of the willingness of the UAW to assume GM's health care obligations on a going forward basis. The VEBA, in turn, will be obligated to manage those financial assets in such a manner that it has sufficient funds to meet the health care obligations it assumes. GM will no longer have those obligations, or liabilities, on its books and thus will, in theory, gain a lower cost of capital enabling it to make profitable investments to benefit employees and shareholders.

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The success of this transfer of the health care obligations to the VEBA depends on the safety of the funding provided to the trust. In a press release on its website dated September 28, 2007, top UAW officials stated that, under the VEBA, health care for retirees "was secure in the near and long-term future." UAW International President Ron Gettelfinger is quoted in the release as saying: "Our retirees will be protected under this VEBA." Similarly, in its "Message to UAW GM Retirees" (the "Message") which has been widely distributed in the media and to the current UAW membership, top UAW officials stated that they and GM have "establish[ed] a funding mechanism that will protect your retiree medical benefits through the establishment" of the VEBA (emphasis in original). The Message further states, "even if GM were to someday file for bankruptcy, the money in the VEBA would be secure."

However, such broad conclusions are unwarranted based on my analysis of the actual funding provided to the VEBA. That funding is based heavily on the sale to the VEBA of the Convertible Note. The face value of the Convertible Note will be $4.4 billion representing approximately 15% of the assets to be placed in the VEBA. There are three major areas of concern that should be explained to the UAW member/investors in advance of their decision – via the ratification vote – to approve the sale to the VEBA of the Convertible Note. These concerns are equivalent to risk factors that the securities laws require be disclosed to all potential purchasers of a security by anyone who helps the process by which such securities are sold to investors. Neither GM nor top UAW officials have disclosed these risks publicly during the campaign to secure approval for the transaction by the UAW member/investors.

1) Value of Convertible Note tied to value of GM stock

First, like any derivative instrument, the Convertible Note "derives" its fundamental value from the so-called "underlying," the common stock into which it can be converted. But notice that this creates a set of perverse incentives: the UAW appointed trustees managing the VEBA will be inclined to support potentially risky policies aimed at increasing the stock price of GM in order to maximize the value of the bond. Just as the recipients of stock options in the "dot-com" and Enron era were willing to take wild chances with company resources, the trustees could back shortsighted gambles by GM management to increase the value of the Note or any shares of GM stock they have purchased by converting a portion of the Note. These could include aggressive cost cutting measures or the sale of the entire company to a private equity fund that leads to widespread layoffs or other radical restructuring measures. These are precisely the steps likely to be opposed by the UAW membership.

2) Convertible Note is illiquid and faces other severe restrictions

Second, the ability to value the Note is limited by its illiquidity and the Note is subject to other severe restrictions. Thus, although the UAW member/investors have been told the Convertible Note is "worth" $4.3725 billion and thus given the impression that the VEBA will be financially secure, this may

be an unwarranted conclusion. There is no readily available secondary market for a security of such magnitude and so no easy means of tracking its value. Even if the Note is converted into common stock it cannot easily be resold. A Memorandum of Understanding on Post-Retirement Medical Care dated September 26, 2007 between the UAW and GM (the "MOU") is being widely circulated by top UAW officials and GM describing the changes in health care obligations. Appended to the MOU is a summary term sheet for the Convertible Note (the "Term Sheet"). According to the Term Sheet, GM places a two-year "lock-up" on the ability of the VEBA to sell the Convertible Note or any stock into which the Note is converted prior to January 1, 2010.

Even then, finding a buyer for such a large block of stock could be difficult. Although GM promises to provide the registration statement that such a resale would require under federal securities laws, GM has placed severe limits on the volume and timing of sales of stock by the VEBA. GM retains the option to delay any such sales unilaterally by up to six months. And even if the VEBA converts the Convertible Note into shares of GM stock it will not be allowed to join with other investors to impact a shareholder vote through a proxy contest. Thus the VEBA will become a truly passive investor, giving up important rights that other GM shareholders retain.

3) Convertible Note and VEBA subject to fall in value in case of GM bankruptcy

Finally, the UAW leadership's promise that the VEBA will be secure in case GM declares bankruptcy ignores the impact of bankruptcy on the Note itself, which will make up approximately 15% of value of the VEBA's assets. The Convertible Note's value would decline significantly in case of bankruptcy just as the value of GM stock declines. In addition, it would have a low priority relative to other creditors and thus would be in danger of not being repaid at all. The Term Sheet states that the Convertible Note "will rank equally with all [of GM's] other unsecured and unsubordinated debt." According to the May 24, 2007 prospectus for other equally ranked unsecured debt to be issued by GM, "in the event of [GM's] insolvency, bankruptcy, liquidation, reorganization, dissolution or winding up, [GM] may not have sufficient assets to pay amounts due on any or all [such debt] then outstanding." Since the Convertible Note has identical ranking to this other debt, it is very likely that GM and top UAW officials would issue a similar warning to the UAW member/investors – if they had provided the disclosure required by the federal securities laws.

In addition, if GM does declare bankruptcy it would likely secure additional so-called "debtor in possession" financing from major banks. During the Delphi bankruptcy process, for example, major Wall Street investment banks such as JP Morgan lent Delphi – allegedly "bankrupt" – billions of dollars. Although other investors in Delphi stock and bonds had invested longer and earlier with the company, the JP Morgan investment stood ahead in line of those investors because of their willingness to lend to the company during the

bankruptcy process. This is a very common tactic in today's financial environment. Convertible bonds usually rank low in priority behind other debt instruments of a company and if new money were to be lent by Wall Street that new money could easily stand ahead of the Convertible Note held by the VEBA.

In conclusion, the argument that the VEBA is financially secure is unwarranted by an assessment of the financial assets that are to be used to establish the VEBA.

II. GM and Top UAW Officials May be Violating Securities Laws

As noted at the outset, my conclusion is that General Motors ("GM") and the top officials of the United Auto Workers (the "UAW") may be currently violating federal and state securities laws. These laws mandate civil and criminal penalties where such violations occur. Some parties may thus consider it appropriate to take legal action to enjoin the current ratification vote until these potential securities violations are investigated fully and, if necessary, remedied. Such an injunction, if pursued, may be particularly significant in light of the link between the ratification vote and the decision to issue the Convertible Note as set forth below.

These potential securities law violations include the following:

1) Top UAW officials and GM have not provided UAW members adequate information to assess the risks associated with the VEBA and, in particular, the risks that the union may incur because of the financial structure of the VEBA.

Federal securities laws mandate that potential purchasers of a security – such as the Convertible Note - be provided adequate disclosure about the risks of that security in advance of the decision to purchase the security. The membership vote that begins on Wednesday will be an attempt to ratify the decision by GM and top UAW officials to sell to the VEBA the Convertible Note. According to the MOU, ratification by the union membership is a "condition precedent" to the establishment of the VEBA and sale of the Convertible Bond to the VEBA. Thus, the failure to provide adequate disclosure about the implications of this purchase to the UAW member/investors now, in advance of the ratification vote, could be a violation of federal securities laws by both GM and top UAW officials.

2) The absence of full disclosure about the risks associated with the Convertible Note means the MOU is potentially misleading to the UAW member/investors.

The UAW and GM have circulated widely to the union member/investors the MOU that sets forth the details of the proposal to shift health care obligations from GM to the UAW if ratified by the membership. Neither the MOU nor the Term Sheet includes any of the risk factors associated with this securities offering. However, Federal and state securities laws deem the circulation of such misleading written material illegal "gun-jumping." Anti-gun-jumping laws are aimed at protecting investors – such as the membership of the UAW who are

being asked to decide whether the VEBA should buy the Convertible Note from GM – from making such a significant investment decision without adequate disclosure about the risks associated with the investment. The Term Sheet is based on a similar term sheet for other GM securities for which a prospectus dated May 24, 2007, *has been made available* to possible investors. That May 24, 2007 prospectus contains six pages of single spaced text setting forth sixteen separate risks associated with the securities to be issued under that prospectus. No such disclosure has been provided to the UAW member/investors who are about to decide whether the VEBA should purchase the Convertible Note.

3) Top UAW Officials may be deemed sellers or underwriters of securities under federal law

It should be noted that under federal securities laws, the issuer of a security – in this case, GM - is not the only person obligated to provide investors with full and adequate disclosure about a financial instrument offered for sale. Anyone who is deemed to be a "seller" of that security is also so obligated. The federal courts and the SEC interpret the term "seller" broadly. In a leading case in 1988 the U.S. Supreme Court stated, "liability…extends [to a] person who successfully solicits the purchase [of a security], motivated at least in part by a desire to serve his own financial interests or those of the securities owner." (Pinter v. Dahl, 486 U.S. 622)

In addition, the obligation to provide disclosure can fall on anyone found to be an "underwriter" of the sale of securities. The SEC and the federal courts also interpret this term broadly. Thus, it can include a wide range of persons associated with the effort to secure the distribution of the security from the actual issuer to investors. In a case that is still followed today, the federal courts decided in 1941 that individuals who engage in steps necessary to the distribution of a security are obligated to provide adequate disclosure. (SEC v. Chinese Consolidated Benevolent Association, 120 F. 2d 738 (1941), cert. denied, 314 U. S. 618)

In conclusion, top UAW officials are campaigning to secure ratification of the decision to establish the VEBA including the sale to the VEBA of the Convertible Note. Such efforts could be viewed as a sale and/or distribution of a security. Because the current information made available to the UAW member/investors by the union's top officials is not adequate, if the SEC or a federal court deemed top UAW officials to be engaged in the sale and/or distribution of a security, I believe they would be doing so in violation of federal securities laws. This may call into question the validity of the financing of the VEBA itself.

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