

## **AUTOMOTIVE INDUSTRY IN CRISIS: WHAT YOU NEED TO KNOW ABOUT A CHAPTER 11 CASE**

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## **Foley's Automotive Industry and Restructuring Capabilities**

2

- More than 1,000 attorneys in U.S. and foreign offices (Brussels, Shanghai and Tokyo). Foley's Automotive Industry Team represents companies throughout the automotive supply chain, primarily representing Tier 1 and 2 suppliers
- More than 50 attorneys practice in Foley's Bankruptcy & Business Reorganizations Group, including in New York, Delaware, Detroit and other jurisdictions

## Foley's Automotive Industry and Restructuring Capabilities

3

- Foley is the only national law firm with a Detroit office and dedicated Automotive Industry Team, with deep knowledge of supply chain contracts and how to deal with troubled customers/suppliers
- Foley is positioned to be adverse to all of the Detroit 3 and focuses its automotive practice on automotive suppliers

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## Government Emergency Loan Update

4

- \$13.4B Emergency Loans from TARP
  - \$9.4B to GM and \$4B to Chrysler
  - \$4B additional loans for GM in 2/09 if TARP drawn down
- Restructuring Plan
  - Initial plan due 2/17/09 and finalized by 3/31/09
  - Must use these funds to become financially viable

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## Government Emergency Loan Update

5

- Viable only if positive net present value, taking into account all current and future costs, and can fully repay the government loan
- Loans callable – liquidity and insolvency risk until plans confirmed

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## Government Emergency Loan Update

6

- Presidential Designee Appointed for Oversight
  - Approve Restructuring Plans and \$100M+ transactions
  - Review financial records including subs and affiliates
  - Negotiate with (pressure) constituencies for concessions

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## Government Emergency Loan Update

7

- Target Goals
  - Convert 2/3 Debt to Equity
  - Wage and Work Rule Competitiveness by 12/31/09
  - Partial conversion of VEBA to equity
- Executive Compensation Limits, Dividend Restriction and 20% Warrants

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## Supplier Proposals to Treasury

8

- Quick Pay – reduce to 10 day payment terms to provide liquidity
- Government Guaranty of Supplier Receivables – provide a guaranty of OEM receivables to support bank loans
- Direct Funding for Suppliers – provide bridge loans and lines of credit to suppliers.
- DIP Financing – provide a backstop for lenders in supply chain restructuring transactions

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## Constituents in Chapter 11 Case

- DIP Lender
- United States Trustee
- Senior Secured Lenders (Pre-Bankruptcy)
- Other Secured Creditors
- Official Committee of Unsecured Creditors
- Official Committee of Equity Holders

## Constituents in Chapter 11 Case

- Customers
- Suppliers
- Landlords
- Professionals

## Timing and Triggers for a Chapter 11 Filing

11

- “Run on the trade” -- liquidity, liquidity, liquidity
- New lenders insist on lending in Chapter 11
- Lawsuits/automatic stay
- Implementation of a strategic objective
  - Sale through Chapter 11
  - Confirmation of a pre-negotiated plan (e.g. conversion of debt to equity or the like)

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## Objectives of a Chapter 11 Filing and How to Emerge from Bankruptcy

12

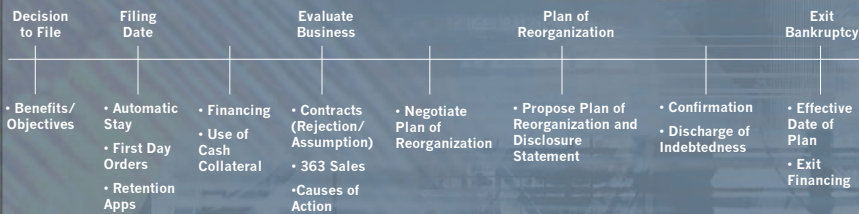
- Stays burdensome and expensive litigation
- Enables company to obtain new financing with priority over other required debt
- Enables company to reject burdensome contracts /re-negotiate critical contract terms
- Enables company to pursue asset sales free and clear of liens
- Enables company to restructure balance sheet – convert debt to equity, discharge/eliminate debt

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# Overview of Chapter 11 Bankruptcy Case

13

## Chapter 11 Bankruptcy Case



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# Key Facets of a Chapter 11 Proceeding

14

## Debtor-in-possession (DIP) Financing

- Post-bankruptcy loan to debtor to fund Chapter 11 expenses and operations during the bankruptcy case
- Often “primes” pre-bankruptcy secured lenders; highest priority claim
- Pre-petition lender likely candidate but competitive process leads to better terms

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## Key Facets of a Chapter 11 Proceeding

15

### Use of Cash Collateral

- No new loan but operate with cash-flow from business
- Must obtain consent of pre-bankruptcy lender or offer adequate protection
- Adequate protection: (i) periodic cash payments; (ii) replacement lien; or (iii) other relief which constitutes “indubitable equivalent” of lender’s interest

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## Key Facets of a Chapter 11 Proceeding

16

### Assumption and Rejection of Executory Contracts

- Executory contract determined by mutual material unperformed obligations
- Debtor must assume or reject “executory contracts” for the sale of goods no later than confirmation of plan of reorganization
- Non-debtor party to executory contract must perform under the contract during the period between the filing and assumption or rejection

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## Key Facets of a Chapter 11 Proceeding

17

- Debtor can be compelled to assume or reject an executory contract sooner, for “cause”
- Non-debtor party’s only remedy for breach of executory contract post-petition is to compel assumption or rejection
- To assume executory contract, all monetary defaults must be promptly “cured” and adequate assurance of future performance given

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## Key Facets of a Chapter 11 Proceeding

18

- Claims under assumed contract are entitled to priority as administrative claims
- Administrative claims paid in full upon confirmation of POR
- Negotiation or court imposition of early assumption or rejection deadline by the debtor depends on contract leverage and “cause”

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## Key Facets of a Chapter 11 Proceeding

19

- Rejection of executory contract results in unsecured pre-petition claim for damages
- Rejection provides ability to shed burdensome contracts
- Ability to reject collective bargaining agreements, after negotiation in accordance with Sections 1113 and 1114 of Bankruptcy Code (make proposal to union, provide information in support of proposal, meet and confer with union in good faith, court finds balance of equities weighs in favor of rejection)

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## Key Facets of a Chapter 11 Proceeding

20

### Sale of Assets Free and Clear

- “Section 363” sale permits sale of assets free and clear of liens and interests after notice and hearing with bankruptcy court
- Generally subject to competitive bidding through auction process, although can have private sales
- Can obtain “stalking horse” bidder who can be awarded break-up fee and reimbursement of expenses, in lieu of exclusivity
- Debtor subject to business judgment standard if arms-length sale (heightened scrutiny when sale to insider)
- Can be substantially all or a portion of the assets

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## Key Facets of a Chapter 11 Proceeding

21

### Negotiations with Key Constituents, including Labor, Bondholders, and Other Creditors

- Ability to reject contracts and to discharge claims presents opportunity for negotiation
- Negotiation depends upon where value line cuts
- Observance of absolute priority rule
  - Secured creditors - collateral
  - Unsecured creditors
  - Equity

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## Key Facets of a Chapter 11 Proceeding

22

- Discharges debtor from liability for all claims arising pre-confirmation except for treatment provided in plan and imposes injunction on future claims
- Creditors' claims divided into classes
- Plan negotiated with creditor constituencies
- Plan must be filed with the bankruptcy court
- Plan sets forth treatment and distribution method for creditors' claims
- Assumes or rejects all executory contracts and unexpired leases
- Identifies officers and directors of reorganized entity

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## Key Facets of a Chapter 11 Proceeding

23

- Disclosure Statement filed in tandem with plan
- Disclosure statement must provide adequate information to enable informed vote on plan
- Bankruptcy court approves (confirmation)
- Debtor exits bankruptcy and executes plan

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## Key Facets of a Chapter 11 Proceeding

24

- A class accepts the plan if the plan is accepted by creditors holding at least two-thirds in amount and a majority in number of the claims of the class that vote on the plan
- Bankruptcy court will confirm a plan if several requirements are met, including, but not limited to:
  - Plan complies with Bankruptcy Code
  - Plan proponent complies with Bankruptcy Code

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## Key Facets of a Chapter 11 Proceeding

25

- Plan proposed in good faith
- Payments under plan for services or costs incurred in connection with bankruptcy case must be approved by bankruptcy court as reasonable
- Plan discloses identity of officers and directors who will serve reorganized entity
- For each “impaired class of claims” (creditors whose pre-bankruptcy claims are altered), creditors receive at least what they would in Chapter 7 liquidation (known as “Best Interests Test”)

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## Key Facets of a Chapter 11 Proceeding

26

- Each class must accept the plan or be unimpaired
- Administrative and priority claims must be paid in full unless the creditor agrees otherwise
- At least one impaired class must accept the plan
- The plan is feasible --- not likely to be followed by liquidation or further financial reorganization

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## Key Facets of a Chapter 11 Proceeding

27

- All U.S. Trustee fees must be paid
- Plan must provide for continued payment of retiree benefits at either (i) level originally provided by debtor without modification, or (ii) at modified level established pursuant to Section 1114 of Bankruptcy Code

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## Key Facets of a Chapter 11 Proceeding

28

### **Pre-packaged bankruptcy (prepacks)**

- Debtor prepares reorganization plan that is negotiated and voted on by creditors and stockholders before bankruptcy filing (true prepack)
- “Pre-negotiated” plan of reorganization results from pre-bankruptcy negotiation of critical terms of plan but no voting
- Prepack shortens and simplifies bankruptcy process --- plan of reorganization filed on first day of case
- Can save debtor significant expenses
- If prepackaged plan involves an offer to sell securities, may need to comply with SEC rules for disclosure
  - If securities are distributed through a plan in satisfaction of debt, the Bankruptcy Code provides exemption from compliance with SEC rules, under most circumstances.

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## Differences Between Financial and Operational Restructurings

29

- Financial restructuring focuses on cleaning up balance sheet through elimination/discharge of indebtedness and recapitalization of debtor
- Operational restructuring modifies terms of customer contracts, supply arrangements, CBAs, lease agreements, etc., to achieve profitable performance

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## KEY TAKEAWAYS

30

- Out-of-Court restructuring *always* preferred where possible
- Chapter 11 bankruptcy process very expensive (more restructuring out of court is better)
- Must have identifiable *reason* to seek protections and powers afforded by Bankruptcy Code
- Operational restructuring opportunities exist
- Know exit strategy before filing bankruptcy

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## Questions and Answers

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