INSIDE THE MINDS

Chapter 11 Bankruptcy and Restructuring Strategies

Leading Lawyers on Navigating Recent Chapter 11 Cases and Understanding Current Challenges Facing Debtors and Creditors

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Leveraging Critical Vendor Status and Assumption of Contracts to Obtain More Favorable Commercial Trade Terms in Supply Contracts

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Factors Contributing to Chrysler and GM's Bankruptcy Filings

Perhaps no industry was as hard hit during the economic crisis of 2009 than the automotive industry. Chrysler LLC filed for Chapter 11 protection in April 2009, and General Motors Corporation filed for Chapter 11 protection approximately one month later. *See Old Carco LLC (f/k/a Chrysler LLC)*, United States Bankruptcy Court for the Southern District of New York, Case No. 09-50002, Honorable Arthur J. Gonzalez; and *Motors Liquidation Company (f/k/a General Motors Corporation)*, United States Bankruptcy Court for the Southern District of New York, Case No. 09-50026, Honorable Robert E. Gerber.

Production volumes in the automotive industry decreased dramatically in late 2008 and 2009, and particularly in the six months that preceded the Chrysler and GM Chapter 11 filings (in April and May of 2009, respectively). The automotive supply industry typically suspends operations for a period of two weeks in the summer months, as well as during the December holiday seasons (known as the "shutdown"). In 2008, however, the annual December shutdown (which typically lasts two weeks) was extended by Chrysler and GM for at least two additional weeks at almost all facilities, and many manufacturing and assembly plants were idled for even longer periods. Suppliers whose profit margins had already been squeezed in recent years by the automotive manufacturers (known within the industry as original equipment suppliers, or OEMs) were thus hit with extended shutdowns during which production either stopped or dramatically fell off. Examining of the Domestic Auto Industry, Part I: Hearing Before S. Comm. on Banking, Housing and Urban Affairs, 110th Cong. 88 (2008) (statement of Alan R. Mulally, CEO, Ford Motor Co.)

Thus, as the credit crisis unfolded in 2009, automotive suppliers were among those hit the hardest. Two things are unique about the automotive industry. First, the automotive industry supplies parts for assembly based on what is known as the "just-in-time" delivery process. This means that parts are manufactured and shipped to plants for assembly on a daily basis, so that an assembly plant does not stock an inventory (known as a "bank") of parts for future assembly. Second, automotive suppliers are organized by tiers, meaning that a tier one supplier supplies directly to an OEM (such as a seat assembly); a tier two supplier supplies a portion of the part or

materials to the tier one supplier (such as the frame for the seat assembly); and a tier three supplier supplies a portion of the part or materials to the tier two supplier (such as steel used in the manufacture of the frame). Second, most automotive suppliers supply parts to more than one supplier or OEM. The combination of these two factors means that if a single automotive supplier becomes insolvent and therefore stops shipping parts, the entire manufacturing system is at risk, because that supplier's insolvency would cause an interruption in supply for more than one automotive supplier or manufacturer. Id. at 114.

The accounts receivable suppliers held during the months that preceded Chrysler and GM's Chapter 11 filings were in many cases substantial, since suppliers are generally paid net forty-five or net sixty days after shipment of goods to the automotive manufacturer. Additionally, since many suppliers finance their business by borrowing against their accounts receivable, a reduction in accounts receivable means less money in the borrowing base available to finance the supplier's business. Prior to Chrysler and GM's bankruptcy filings, the Treasury Department's Supplier Support Program (SSP) provided some short-term relief to some suppliers by advancing payments on some accounts receivable. Press Release, U.S. Dept. of The Treasury, Treasury Announces Auto Supplier Support Program (Mar. 19, 2009) (available at http://www.ustreas.gov/press/releases/tg64.htm). However, even the SSP came at a cost, with fees of up to 3 percent of the face value of each receivable submitted to the program. David Shepardson & Gordon Trowbridge, *Aid To Suppliers Signals Support Of Auto Industry,* DETROIT NEWS, Mar. 20, 2009. The fees and the terms required for participation made it cost-prohibitive for some suppliers. Robert Sherefkin, *U.S. Treasury To End Auto-Supplier Loan Program,* CRAIN'S DETROIT BUSINESS, Feb. 15, 2010. There were also significant bureaucratic hurdles which caused suppliers to abandon their enrollment in the program. Id. As production and therefore receivables dwindled, it became critical for suppliers to collect the accounts receivable they were owed by the automotive manufacturers.

As it became clear that Chrysler and GM would file for bankruptcy, their suppliers (who numbered in the tens of thousands) became increasingly concerned regarding payment of their outstanding accounts receivable. Examining of the Domestic Auto Industry, Part I: Hearing Before S. Comm. on Banking, Housing and Urban Affairs, Statement of Alan R.

Mulally, *supra,* at 114. One of the greatest risks any supplier faces when its customer files a petition for Chapter 11 is that the supplier's pre-petition accounts receivable will go unpaid, and thus be relegated to the status of a pre-petition general unsecured claim. *See* 11 U.S.C. §362(a) (prohibiting any action to collect on a pre-petition debt once a debtor files bankruptcy); Region 17 United States Trustee Guidelines, Section 6.5 (forbidding payment of pre-petition debts without court approval). This is because the Bankruptcy Code generally prohibits the payment of pre-petition accounts receivables outside of a Chapter 11 plan of reorganization (except for the payment of claims for goods shipped to the debtor within the twenty days preceding the bankruptcy filing). Suppliers to Chrysler and GM generally had two goals in these bankruptcy cases: (1) payment of their outstanding accounts receivable; and (2) assumption of their supply contracts so that they could continue to stay in business. The Chrysler and GM debtors effectively leveraged both the critical vendor doctrine and their ability to assume and assign, or to reject, executory contracts in bankruptcy, in order to extract from their suppliers more favorable commercial trade terms. Because a Chapter 11 debtor has the choice whether to treat a vendor as critical, and whether to assume an executory contract, these debtors made clear that they would generally not do either unless the automotive supplier agreed to more favorable commercial trade terms. Since at least 2004, this strategy had been employed by Chapter 11 debtors in the automotive industry. *See* Motion by Debtor Intermet Corp To Reject Executory Customer Supply Contracts, *In re Intermet Corp.*, Case No. 04-67597 (Bankr. E.D. Mich Nov. 11, 2004). Chrysler and GM extended this strategy to a new scope and level, making it the new norm for treatment of automotive supply contracts in a Chapter 11 bankruptcy. *See*, e.g., Final Order Authorizing, But Not Directing, Payments of Prepetition Claims of Certain Critical Vendors and Administrative Claimholders and Granting Related Relief, ¶11, *In re Lear Corp.*, Case No. 09-14326, Dkt. No. 245 (Bankr. S.D.N.Y. Jul. 31, 2009) (requiring any vendor who sought to be named as a critical vendor to agree to more favorable trade terms which are substantially similar to the GM and Chrysler terms).

New Commercial Trade Terms

Chrysler and GM thus generally agreed to treat suppliers as critical vendors, and to assume and assign their supply agreements to their successor entities,

only if the supplier agreed to execute the new trade agreement which contained commercial terms more favorable to the debtor on a going-forward basis. *See*, Final Order, Pursuant to Sections 105(a), 363(b), and 503 (b)(9) of the Bankruptcy Code, Authorizing the Debtors to Pay Pre-Petition Claims of Certain Essential Suppliers and Administrative Claim Holders, Continuing the Debtors' Troubled Supplier Program and Granting Certain Related Relief, *In re ChryslerLLC*, Case No. 09-50002, Dkt. No. 1318 (Bankr. S.D.N.Y. May 20, 2009) (Attachment A) ("Chrysler Critical Vendors Order"); Final Order Pursuant to 11 U.S.C. §§ 105, 363, and 364 Authorizing Debtors to (I) Pay Prepetition Claims of Certain Essential Suppliers, Vendors, and Service Providers, (II) Continue Troubled Supplier Assistance Program, and (III) Continue Participation in the United States Treasury Auto Supplier Support Program, *In re General Motors Corp.*, Case No. 09-50026, Dkt. No. 2533 (Bankr. S.D.N.Y. Jun. 25, 2009) (Attachment B) (the "GM Critical Vendors Order"); Order, Pursuant To Sections 105, 363 and 365 of the Bankruptcy Code and Bankruptcy Rules 2002, 6004, and 6006, (A) Approving Bidding Procedures for the Sale of Substantially All of the Debtors' Assets, (B) Authorizing the Debtor to Provide Certain Bid Protections, (C) Scheduling a Final Hearing Approving the Sale of Substantially All of the Debtors' Assets and (D) Approving the Form and Manner of Notice Thereof, ¶19, *In re Chrysler LLC*, Case No. 09-50002, Dkt. No. 492 (Bankr. S.D.N.Y. May 20, 2009) (Attachment C) (the "Chrysler Assumption and Assignment Procedures"); Order Pursuant to 11 U.S.C. §§ 105, 363, and 305 and Fed. R. Bankr. P. 2002, 6004 And 6006 (I) Approving Procedures for Sale of Debtors' Assets Pursuant to Master Sale and Purchase Agreement with Vehicle Acquisition Holdings LLC, A U.S. Treasury-Sponsored Purchaser; (II) Scheduling Bid Deadline and Sale Hearing Date; (III) Establishing Assumption and Assignment Procedures and Approving Form of Notice, ¶10, *In re General Motors Corp.,* Case No. 09-50026, Dkt. No. 274 (Bankr. S.D.N.Y. Jun. 2, 2009) (Attachment D) (the "GM Assumption and Assignment Procedures"). The result was generally that the trade agreement would thus constitute an amendment to the supplier's contract with its customer—both during the bankruptcy and for future business with new Chrysler and new GM. For example, among the commercial terms demanded by GM for treatment as an essential supplier were provisions concerning lien rights and possession of tooling that would make it easier for the customer to "resource" a supplier, in effect pulling business from one supplier and awarding it to another. In addition,

suppliers were asked to commit to continue to supply not only GM (as is sometimes required under the Bankruptcy Code), but also its domestic and foreign non-debtor affiliates, which could deprive the supplier of possible future leverage in dealing with those entities. Finally, and in some cases most importantly, the trade agreements as proposed would strip away any contract terms agreed to between the debtor and the supplier within a certain period of time preceding the bankruptcy case that were more favorable to the supplier, including credit limits and payment terms. Motion of Debtors for an Order Pursuant to 11 U.S.C. §§ 105, 363, and 364 Authorizing Debtors to (I) Pay Prepetition Claims of Certain Essential Suppliers, Vendors, and Service Providers, (II) Continue Troubled Supplier Assistance Program, and (III) Continue Participation in the United States Treasury Auto Supplier Support Program, Exhibit A, *In re General Motors Corp.*, Case No. 09-50026, Dkt. No. 76 (Bankr. S.D.N.Y. Jun. 01, 2009) (Attachment E) (the "GM Critical Vendors Motion"). GM also required confidentiality agreements with each supplier, in order to keep the terms of the negotiations private. Agreed Protective Order Establishing Procedures For the Protection of Confidential Information, *In re General Motors Corp.*, Case No. 09-50026, Dkt. No. 3399 (Bankr. S.D.N.Y. Jul. 27, 2009) (Attachment F) (the "GM Confidentiality Agreement").

Critical Vendor Doctrine

In cases where a supplier still has substantial accounts receivable that are unpaid at the time the bankruptcy petition is filed, its best chance for payment of the full amount of pre-petition accounts receivable may hinge on treatment as a "critical" or "essential" vendor of the debtor. The Bankruptcy Code itself does not contain a section specifically authorizing payments to critical vendors. Instead, the doctrine arises under the broad exercise of the bankruptcy court's equitable jurisdiction and has been developed by case law. *See*, e.g., *In re Tropical Sportswear Int'l Corp.*, 320 B.R. 15, 20 (Bankr. M.D. Fla. 2005). Indeed, the critical vendor doctrine receives more favorable treatment in certain jurisdictions, including the Southern District of New York where both Chrysler and GM filed. In many Chapter 11 cases, debtors rely on "critical vendor" motions, often filed the first day of the case, for authority to pay some or all of the pre-petition claims of certain suppliers whose ongoing support is deemed critical to the policy of successful reorganization contemplated by the Bankruptcy Code. *See*, e.g.

GM Critical Vendors Motion, *supra* (filed with the First Day Motions on June 1, 2009).

The first day motions in both the Chrysler and GM bankruptcies included an essential vendor motion with extraordinarily and uniquely broad coverage. *See*, e.g. GM Critical Vendors Motion, *supra*; Motion to Authorize /Motion of Debtors and Debtors in Possession, Pursuant to Sections 105(a), 363(b), and 503(b)(9) of the Bankruptcy Code, for Interim and Final Orders Authorizing Them to Pay the Prepetition Claims of Certain Essential Suppliers and Administrative Claimholders, Continuing the Debtors Troubled Supplier Program and Granting Certain Related Relief, *In re Chrysler, LLC*, Case No. 09-50002 (Bankr. S.D.N.Y. April 30, 2009) (Attachment G) (the "Chrysler Critical Vendors Motion"). Both Chrysler and GM announced their intentions to pay essentially all of their suppliers' prepetition accounts receivable pursuant to essential vendor orders in each case. The supply base breathed a collective sigh of relief. However, in the Chrysler and GM cases, there was no established "list" of critical vendors per se. Rather, Chrysler and GM advised essentially all of their suppliers that, in order to receive essential vendor treatment, the supplier would have to consent to new terms embodied in a new trade agreement. In practice, this forced any supplier that hoped to receive some portion of their prepetition receivables to enter into a new agreement with much more favorable terms for the purchaser, and which would bind them going forward.

Assumption and Assignment of Executory Contracts in Bankruptcy

In addition to leveraging the critical vendor doctrine in order to receive more favorable trade terms from their supplier's supplier, the Chrysler and GM debtors also leveraged their ability to assume and assign executory contracts under § 365 of the Bankruptcy Code. Section 365(a) of the Bankruptcy Code provides as follows:

> Except as provided in sections 765 and 766 of this title and in subsections (b), (c) and (d) of this section, the trustee, subject to the court's approval, may assume or reject any *executory contract* or unexpired lease of the debtor.

11 U.S.C. § 365(a) (emphasis added).

The classic definition of an executory contract is that of Professor Vern Countryman:

> A contract under which the obligations of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.

Chattanooga Memorial Park v. Still (In re Jolly), 574 F.2d 349, 350-351 (6th Cir. 1978) (quoting Countryman, *Executory Contracts in Bankruptcy*: Part I, 57 Minn. L. Rev. 439, 460 (1973)).

The Court of Appeals for the Sixth Circuit approves of the Countryman definition, but also employs a "functional approach" to this issue:

> The key in deciphering the meaning of the executory contract rejection provisions is to work backward, proceeding from an examination of the purposes rejection is expected to accomplish. If those objectives have already been accomplished, or if they can't be accomplished through rejection, then the contract is not executory within the meaning of the Bankruptcy Act.

In re Jolly, 574 F.2d at 351. This "functional approach" gives a trustee with an executory contract a choice of rejection or assumption, whichever would be of the greatest benefit to the estate. Id. "The functional approach is a result-oriented process, which looks first to the relative benefits and burdens to the estate of assumption or rejection, and then reasons backward to a determination of the executory nature of the contract in question." *Huntington National Bank Co. v. Alix (In re Cardinal Industries Inc.)*, 146 B.R. 720, 728 (Bankr. S.D. Ohio 1992). "[I]n determining whether or not an agreement is executory, bankruptcy courts, at least in this circuit must consider the applicability of both the functional approach and the Countryman definition." *In re Cardinal Industries Inc.*, 146 B.R. at 729 n.7 (internal quotations and citations omitted). See also, *In re DMR Financial Services.*, 274 B.R. 465 (Bankr. E.D. Mich. 2002)(applying both the Countryman and functional tests.).

When application of the Countryman and functional tests leave the court in doubt, executory contracts may also be identified by reference to the goals of 11 U.S.C. § 365: (1) taking advantage of contracts which will benefit the estate; (2) relieving the estate of burdensome contracts; (3) promoting the debtor's fresh start; (4) permitting the allowance and determination of claims; and (5) preventing parties from remaining "in doubt concerning their status vis-à-vis the estate." *In re Cardinal Industries Inc.*, 146 B.R. at 726, citing *In re Monument Record Corp.,* 61 B.R. 866, 868 (Bankr. M.D. Tenn. 1986); *In re Jolly*, 574 F.2d at 351.

Automotive supply contracts, typically reflected in either supply agreements or purchase orders or some combination thereof, are oftentimes now viewed as executory contracts, under either the functional approach or the Countryman definition, and as such, are subject to assumption or rejection in bankruptcy. Significant performance obligations typically remain under such supply contracts at the time of a bankruptcy filing, such that failure to perform by either would constitute a material breach, satisfying the Countryman definition. The supplier is typically obligated to manufacture and supply certain parts according to the terms and conditions of the supply contract, and the customer (here, Chrysler and GM) is typically obligated to purchase those parts from the supplier. Clearly, a failure to perform by either party would be a material breach of the supply contract.

The purpose in permitting assumption or rejection of executory contracts is to permit the debtor to use valuable estate property and to "renounce title to and abandon burdensome property." *Orion Pictures Corporation v. Showtime Networks Inc.*, 4 F.3d 1095, 1098 (2d Cir. 1993). Debtors are permitted to reject executory contracts that are burdensome to the estate. *JRT Inc. v. TCBY Systems Inc. (Matter of JRT Inc.)*, 121 B.R. 314, 320 (Bankr. W.D. Mich. 1990). In determining whether an executory contract is burdensome, the courts overwhelmingly defer to the sound business judgment of the debtor. *Lubrizol Enterprises Inc. v. Richmond Metal Finishers Inc. (In re Richmond Metal Finishers Inc.)*, 756 F.2d 1043, 1046 (4th Cir. 1985); JRT Inc., 121 B.R. at 321; *McLouth Steel Corp.*, 20 B.R. at 692; *Phar-Mor Inc.*, 204 B.R. at 954. A court may only override the debtor's business judgment if it determines that the debtor's judgment "is so manifestly unreasonable that it could not be based on sound business judgment, but only bad faith, or whim or caprice." *Lubrizol*, 756 F.2d at 1047; *Phar-Mor Inc.*, 204 B.R. at 954-55; *In re Hardie,* 100 B.R. 284, 287 (Bankr. E.D.N.C. 1989). A

debtor's decision to reject an executory contract should be approved unless it is the product of bad faith or a gross abuse of discretion. *Computer Sales International Inc. v. Federal Mogul, et al. (In re Federal Mogul Global Inc.)*, 293 B.R. 124, 126 (D. Del. 2003); *In re TransWorld Airlines Inc.*, 261 B.R. 103, 121 (D. Del. 2001). "A debtor or a trustee may reject an unfavorable contract under section 365(a) on no other grounds than that to do so is 'a reasonable exercise of its business judgment.'" *Cadillac Vending Co. v. Haynes (Matter of Haynes)*, 19 B.R. 849, (Bankr. E.D. Mich. 1982), citing *In re High Fliers, Ltd.*, 7 B.C.D. 747, 747 (S.D. Cal. B.J. 1981).

In sum, the business judgment test ends the inquiry. The debtor "need not show that continued performance would result in actual loss of value from the estate." *In re Farmland Industries Inc.*, 294 B.R. 903 (Bankr. W.D. Mo. 2003). *See also Federal Mogul*, 293 B.R. at 127 (court rejected argument that rejection requires severe financial hardship); *Control Data Corp. v. Zelman (In re Minges)*, 602 F.2d 38, 43 (2d Cir. 1979) ("It is enough, if, as a matter of business judgment, rejection of the burdensome contract may benefit the estate."); *Carey v. Mobil Oil Corp. (Matter of Tilco)*, 558 F.2d 1369, 1372 (10th Cir. 1977) (court applied business judgment test to Chapter 10 filing and ruled that production of substantial revenue from contract in the past is not determinative).

Chrysler and GM's contract strategy proved very effective for the debtors in these two cases, unless unique circumstances were present which favored the automotive supplier. Chrysler and GM's suppliers were faced with the choice of executing new trade agreements and thus modifying their existing contracts in favor of Chrysler or GM in order to be quickly paid their prepetition accounts receivable and to continue doing business with the newly formed entities that emerged from the Chapter 11s, versus holding out for more favorable terms. Well-counseled suppliers who had established some degree of contract leverage over Chrysler or GM, and who could afford to withstand a delay in payment of their prepetition accounts receivable, had available to them the option of rejecting the proposed trade terms and perhaps negotiating a better deal for themselves. Most of these strategies are based on the effective exercise of rights and remedies under the existing contracts and the Uniform Commercial Code to shore up contracts prior to a filing—for example, by shortening payment terms or requiring cash in advance for prepetition shipments.

Supplier's Use of UCC 2-609 Demands for Adequate Assurance

Section 2-609 of Michigan's Uniform Commercial Code provides as follows:

440.2609. Contract for sale; performance; insecurity, demand, assurance of due performance.

> **(1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired.** *When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.*
> **(2)** *Between merchants, the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.*
> **(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.**
> **(4)** *After receipt of a justified demand, failure to provide within a reasonable time not exceeding 30 days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.*

M.C.L.A. § 440.2609 (emphasis added). The official comment to the statute provides helpful insight as to the scope of Section 2-609 and its purpose and intended function:

> The section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit and that a continuing sense of reliance and security that the promised performance will be forthcoming when due is an important feature of the bargain. ***If either the***

willingness or the ability of a party to perform declines materially between the time of contracting and the time for performance the other party is threatened with the loss of a substantial part of what he has bargained for. A seller needs protection not merely against having to deliver on credit to a shaky buyer, but also against having to procure and manufacture the goods, perhaps turning down other customers. Once he has been given reason to believe that the buyer's performance has become uncertain, it is an undue hardship to force him to continue his own performance.

Three measures have been adopted to meet the needs of commercial men in such situations.

First, the aggrieved party is permitted to suspend his own performance and any preparation therefore, with excuse for any resulting necessary delay, until the situation has been clarified. "Suspend performance" under this section means to hold up performance pending the outcome of the demand, and includes also the holding up of any preparatory action . . .

Second, the aggrieved party is given the right to require adequate assurance that the other party's performance will be duly forthcoming. ***This principle is reflected in the familiar clauses permitting the seller to curtail deliveries if the buyer's credit becomes impaired, which when held within the limits of reasonableness and good faith actually express no more than the fair business meaning of any commercial contract.***

Third, and finally, this section provides the means by which the aggrieved party may treat the contract as broken if his reasonable grounds for insecurity are not cleared up within a reasonable time. This is the principle underlying the law of

> anticipatory breach, whether by way of defective part performance or by repudiation. . .

Courts decide whether a party has "reasonable grounds for insecurity" on a case-by-case basis. There is no bright-line rule to make this determination. *See* John R. Trentacosta and Steven R. Fox, "*Demand for Adequate Assurance of Performance Under the UCC*," 23 MICH. BUS. L.J. 10 (2003). Because the reasonableness of a party's insecurity is determined by commercial standards, ***there must be an objective factual basis for the insecurity with respect to the party's performance of the contract***, rather than a purely subjective fear that the party will not perform (e.g., *Top of Iowa Cooperative*, 608 N.W.2d 454, 466 (Iowa 2000)). Whether a party has reasonable grounds for insecurity concerning a party's performance of a contract depends on the facts of the case, including the party's exact words or actions, the course of dealing or performance between the particular parties, and the nature of the industry. *Id.* What constitutes insecurity in one case might not in another. *Id.*

Prior to Chrysler and GM's bankruptcy filing, some automotive suppliers effectively utilized demands for adequate assurance of due performance under 2-609 in order to improve their contract leverage with these customers. For example, in the months leading up to the Chapter 11 filings, some suppliers demanded that Chrysler or GM provide adequate assurance of their ability to pay for goods shipped. *See* Sample 2-609 Demand For Adequate Assurance Letter (Attachment H). Since many payment terms were net forty-five or sixty days after shipment, this could force Chrysler or GM to take a position regarding its ability to make payments to suppliers after a potential bankruptcy filing. If Chrysler or GM did not provide adequate assurance of due performance, or were otherwise in material breach of their contract with a supplier, then the supplier could declare a material breach and exercise their remedies under the UCC. *See*, e.g., M.C.L.A. § 440.2609; M.C.L.A. § 440.2702. These remedies included suspension of performance—meaning the supplier would not ship to the customer. For an OEM who relies on just in time inventory in order to manufacture automobiles, this action could have a devastating impact on production. Exercise of these remedies could also improve the supplier's contract position post-petition, since it might not be obligated to ship to the debtor post-petition (assuming it had declared a breach and terminated the contract pre-petition). For suppliers who effectively

exercised these remedies, Chrysler and GM needed the supplier, as it turned out, seemingly more than the supplier needed them. Thus, these suppliers were not necessarily at the mercy of Chrysler and GM when it came time for treatment as a critical vendor or assumption of their supply agreements, in large part because the supplier could take the position that no supply agreement existed and thus both sides were free to renegotiate commercial terms.

Conclusion

In sum, while it is true that Chrysler and GM each proposed to essentially make all of their suppliers whole in terms of amounts owed, and in many cases this was the result, some of these payments came at great cost to the suppliers by forcing amendment of the commercial terms of their contracts with Chrysler and GM. The Chrysler and GM bankruptcy cases may have established a new norm for application of critical vendor status and for assumption of executory contracts—including the use of both in order to extract more favorable commercial contract terms. But well-counseled automotive suppliers, who took action pre-petition to improve their contract position with the debtors, still had some counter-leverage to exert against the debtors.

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Dedication*: This chapter is dedicated to the members of Foley & Lardner LLP's Automotive Crisis Response Team and to the many automotive suppliers we are proud to call our clients. The authors acknowledge and appreciate the contributions of associate Tamar Dolcourt and senior counsel Derek Wright, who are both members of Foley & Lardner LLP's Bankruptcy & Business Reorganizations Practice, in support of this article.*

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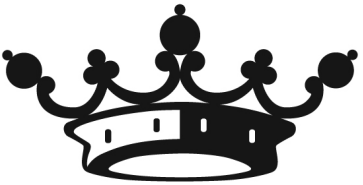

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