

## Legal Updates & News

### Legal Updates

---

#### Preparing for a General Motors Corp. Bankruptcy Filing: Issues for Your Consideration

April 2009

In light of recent reports indicating that the U.S. Department of the Treasury (“Treasury”) and General Motors Corp. (together with its affiliates, “GM”) are working on a plan for a “surgical” prepackaged Chapter 11 filing by June 1, 2009, this memorandum highlights some of the major issues we expect a significant number of our clients — including existing creditors and potential investors — will confront in the event of a GM bankruptcy filing. We expect that any GM filing, whether it is “prepackaged” or not, will be one of the largest and most complex cases ever filed, involving a broad swath of parties and a novel set of legal issues never before faced by U.S. bankruptcy courts.

Notwithstanding the various challenges a GM bankruptcy will inevitably bring, its proposed features will present significant opportunities for clients, especially for those who identify and grasp key issues early on.

As the details surrounding GM’s reorganization plan are currently being negotiated, this memorandum is a preliminary overview based on our collective knowledge of a variety of automobile industry-related issues and our expertise in the secondary loan trading market, as well as our broad-based expertise in “mega”-sized bankruptcy cases across various jurisdictions (U.S. and foreign). This memorandum does not constitute legal advice and is not intended to provide a comprehensive summary of all issues that may arise in any GM bankruptcy, or all issues relevant to each of the firm’s clients.

#### Debtor-in-Possession (“DIP”) Financing Issues

**Government-Sponsored DIP.** Perhaps the most unique feature of any GM filing will involve the extent of Treasury’s role either as a DIP lender (possibly in conjunction with conduit lenders who are experienced in structuring DIP loans) or as a provider of credit support for a DIP loan, which loan could total \$70 billion. As a DIP lender, the U.S. Government would play a significant role in directing the management of GM’s bankruptcy case and be entitled to a “super priority” claim, which would be required to be paid before all other administrative claims and secured claims pursuant to a GM plan of reorganization.<sup>[1]</sup>

Besides “super priority” status, Treasury (and any conduit) would be able to charge fees and dictate many of the terms of borrowings (including related milestones and covenants). Treasury may require the

#### Related Practices:

• [Bankruptcy & Restructuring](#)

grant of a security interest in GM's unencumbered assets, wherever located, including leasehold interests. There may be DIP agreement provisions that allow DIP lenders to have unfettered control over any unencumbered property. Therefore, it will be critical for parties to understand how the proposed DIP structure works, and whether it seeks to encumber property (located in the U.S. and abroad) otherwise subject to a grant or pledge, existing third-party agreement, or applicable law.

**Loan Trading Issues Involving GM Debt.** Financial institutions currently trading GM debt (or potentially trading a U.S. Government-backed DIP loan) will also need to have a comprehensive understanding of any GM DIP facility, especially as it may impact a lender's ability to continue trading GM debt. Assuming the GM DIP facility looks to recent multi-billion dollar bankruptcy court-approved DIP facilities as a guide, the GM DIP facility may allow existing GM lenders to participate in the funding of the DIP loan. Should this occur, the DIP facility may contain both a new money loan component and a roll-up loan component, allowing existing and eligible lenders to put up additional cash and reap certain DIP lender benefits, including lucrative new terms.

Based on our experience counseling lenders, agents, and secondary market participants on DIP facilities (including the recent Lyondell and Aleris DIP facilities), participation in DIP facilities can be problematic for certain entities, including CDO/CLO funds. If a GM DIP facility seeks the participation of existing lenders (or potentially new investors), parties in the secondary loan market should not only understand how their rights as a prepetition lender may be affected, but also whether they will be able to clear the necessary hurdles in order to participate.

Lenders should also understand how a GM DIP facility will treat existing senior secured debt. The unprecedented nature of a GM bankruptcy filing will raise a host of novel questions for both existing and potential DIP lenders. For example, will existing lenders be treated as a separate and superior tranche in a DIP facility? Will they be entitled to full voting rights on most issues concerning the DIP facility? Given the likelihood that Treasury will fund and/or guarantee most of any GM DIP facility, to what extent will Treasury exert pressure on existing GM lenders (many of whom the U.S. Government has large equity stakes in) as a means of steering a GM bankruptcy case? One thing is clear: Whatever priority structure is proposed in the DIP facility will be announced in the first days of a bankruptcy filing, and vigilance is needed for existing lenders to protect their rights.

### **Liquidation Issues and Acquisition Opportunities**

**Splitting GM In Two.** According to recent reports, Treasury officials are examining one potential outcome in which the "good GM" enters and exits bankruptcy protection in as little as two weeks, using \$5 billion to \$7 billion in federal financing. Less desirable assets, including unwanted brands, affiliates, factories, plants, and health care obligations, would be left in the "old GM," which would be liquidated over several years. Putting aside the question of whether GM assets can successfully be divided (given GM's overlapping platforms, technology, and production), asset sales in any GM bankruptcy are likely to be very expensive. According to recent reports, GM may require more than \$70 billion from the U.S. Government, depending on the costs to unwind GM's pension plan. Assuming these plans take hold, old GM will be under significant pressure to sell assets promptly pursuant to a series of "section 363" bankruptcy sales.

**Sale Process.** Section 363 bankruptcy sales could present a golden opportunity for investors, including non-U.S. investors, focused on purchasing hard assets, equity, technology, brands, and other intellectual property, and/or other intangible assets. In a typical section 363 sale, assets generally are transferred on an "as-is" basis without warranties, but free of liens, adverse interests, and claims. The buyer would purchase only those assets and related contracts it actually wants, and leave behind unwanted assets. For example, assets can be sold free and clear of a lender's security interest and most other creditor claims, although the lender's security interest likely will attach to the seller's proceeds from the sale. In addition, most bankruptcy sales also allow the buyer to cut off claims for "successor liability," which could otherwise arise in sales outside of bankruptcy. Not all liabilities are cut off, however. Certain types of environmental claims, for example, may be brought against transferees of the relevant asset.

In a typical section 363 sale, an interested buyer enters into an asset purchase agreement with the debtor(s). The debtor then files a motion with the bankruptcy court to approve the agreement, subject to higher and better offers that may be received in an auction-like process before a hearing to approve the agreement. The interested buyer is known as a "stalking horse." The stalking horse buyer normally

negotiates various deal protections for itself, including a break-up fee designed to compensate the buyer if it is outbid. In addition, a stalking horse buyer will negotiate auction procedures specifying how competing bids will be made, including limitations on due diligence for competing bids. For these reasons, there are distinct advantages to being a stalking horse bidder in appropriate circumstances.

Many section 363 sales are accomplished within an average of 30-45 days, although some sales may take up to 90 days. In either situation, the winning bidder often is the buyer with the best ability to quickly evaluate the desired assets and react quickly to competing bids from other parties, usually on the same day. Indeed, the key to reaping the benefits of a section 363 sale involves knowing how to identify strategically sound opportunities and using the bankruptcy process as a powerful tool to help manage the sale process. Advance preparation is critical. With the appropriate protections and procedures in place, investors will be able to obtain desirable assets in a GM bankruptcy in a cost-efficient and relatively quick manner.

### **Pension Plan Issues**

Recent reports indicate that GM faces a \$13.5 billion shortfall on its pension plan, with \$98 billion in liabilities and \$84.5 billion in assets as of the close of 2008. GM's pension plan, if terminated, could potentially sink the Pension Benefit Guaranty Corporation (the "PBGC"), a quasi-government corporation created by Congress in 1974 to protect pension programs of bankrupt companies. A bailout of the PBGC might be required before a GM case could be resolved.

Measured by participants, GM's pension plan would be the largest taken over by the PBGC. So far, GM has declined to disclose pension benefits or discuss what might happen to its pension plan as part of a bankruptcy filing. If GM looks to prior bankruptcy precedent, such as the landmark LTV Corporation steel company bankruptcy, there is a possibility that after any bankruptcy filing, GM will take back responsibility for its pension plans, negotiate new terms with the United Auto Workers union, and agree to make up a large portion of lost benefits. [2] For creditors-at-large, this means that if GM decides to unwind its pension plan, the significant costs associated with such termination might not be dischargeable in a GM bankruptcy, and GM might require additional funding from the U.S. Government and/or any DIP lender to cover these costs.

### **Vendor Issues**

**Critical Vendor Status.** GM trade creditors and vendors are likely to wonder whether a GM filing will result in a significant delay in payment on a prepetition invoice. Under the critical vendor doctrine, however, during the first days of its bankruptcy case, GM may request that the bankruptcy court authorize it to make immediate payment of certain vendors' prepetition claims (both domestic and foreign), in exchange for a commitment by vendors to continue to sell to GM on a post-petition basis under the same or better terms.

A request to make payments to critical vendors will be carefully scrutinized. Approval of such a request would have the effect of elevating the priority of an otherwise non-priority prepetition claim, ensuring payment in full. A request to pay the prepetition claims of critical vendors will be subject to the approval of the bankruptcy court upon notice to creditors, including the DIP lender(s), the unsecured creditors' committee, and other parties in interest. In making its determination, the court will analyze, among other things, whether: (i) the vendor's contract was terminated before the bankruptcy filing or whether the automatic stay of the bankruptcy filing requires the vendor to continue its supply to the debtor despite nonpayment of the prepetition invoice; (ii) the vendor is holding critical finished goods or supplies that the vendor can assert a lien on to satisfy its prepetition invoice; and (iii) the vendor is in a foreign jurisdiction and may not be able to be compelled to continue to supply if it is not paid.

**Reclamation.** In addition to the possible critical vendor protections, GM suppliers may also be able to take advantage of Bankruptcy Code provisions enacted in 2005 that give priority to reclamation claims. These claims arise under state law and are governed by section 546(c) of the Bankruptcy Code.

Reclamation generally refers to a trade creditor's right to reclaim goods shipped on credit to an insolvent customer shortly before the customer files for bankruptcy. For example, where a debtor receives goods while insolvent within 45 days before the petition date, a seller has 45 days after receipt of the goods to

demand reclamation. If this period expires before the commencement of a debtor's case, a seller has 20 days after the petition date to assert the reclamation claim. If a seller of goods fails to provide notice of the reclamation claim, the seller may assert an administrative expense claim — *i.e.*, a claim that is paid in full after bankruptcy court approval — for the value of any goods received by the debtor within 20 days before the petition date. Accordingly, reclamation treatment may result in a creditor obtaining a more favorable recovery on its prepetition unsecured claim than the creditor would have received as a general unsecured creditor.

At a minimum, trade creditors should be able to identify their GM counterparties, including any guarantors, under their respective agreements. In order to reap any reclamation claim benefits, trade creditors will need to act quickly, understand any specific GM reclamation procedures that GM may seek to have the court approve in its bankruptcy case (such as requiring the filing of a reclamation proof of claim), and keep accurate records detailing the shipment to and receipt of any goods by GM.

**Treatment of Executory Contracts.** Under the Bankruptcy Code, GM will be obligated to preserve and maximize the value of its estate by rejecting burdensome executory contracts and assuming (and in some cases also assigning) beneficial ones. Essentially, executory contracts are contracts on which performance remains due, to some extent, by GM and the counterparty to the contract. Examples include employment contracts, maintenance agreements, service contracts, supply contracts, typical lease agreements, and franchise agreements.<sup>[3]</sup>

Assumption of an executory contract (or unexpired lease) occurs when a debtor elects to remain obligated under the terms and provisions of the agreement and, in exchange, is entitled to enjoy the benefits of the agreement. Assumption of a contract elevates a creditor's current and future damage claims to administrative expense priority status (meaning they get paid in full). Except in certain situations dealing with personal service contracts and intellectual property licenses, if an executory contract or unexpired lease is assumed, it may also be assigned to a third party, provided that the prepetition payment defaults are cured and adequate assurance of the purchaser's future performance is given. Rejection of an executory contract occurs when the debtor elects to terminate the agreement and thereby forfeit the benefits of the agreement. Apart from certain executory contracts which the Bankruptcy Code requires to be assumed or rejected within a specific time period (such as a lease for nonresidential real property), most debtors do not assume or reject an executory contract until either a plan of reorganization is confirmed or the executory contract is sold pursuant to a section 363 sale.

**Rejection of Supply Contracts.** Many GM vendors across the U.S. and the world are also in a precarious financial situation. A GM filing and a rejection of their supply contracts could potentially put these vendors into bankruptcy.<sup>[4]</sup> Although GM could decide to renegotiate or reject certain supply contracts in order to lower its own cost-of-goods, given the financial stress that the supply chain is already experiencing, GM will have to make sure that its decision to reject supply contracts does not have the effect of driving suppliers out of business and thereby jeopardizing production.

If GM decides to reject a supply contract, it has the practical effect of terminating the contract, giving rise to a prepetition rejection damages claim. GM must reject the contract in its entirety, and unless the contract or lease is subject to a special rule (*i.e.*, involving a non-residential real estate lease), GM may assume or reject a supply contract at any time before confirmation of its plan.

**Auto Supplier Support Programs.** As a means of reassuring GM suppliers, Treasury released a statement on April 8, 2009 regarding the launch by Chrysler LLC and GM of their respective Auto Supplier Support Programs (the "ASSP"). Although the specific details of these programs are presently unknown, it appears the ASSP apply to any receivable created with respect to goods shipped after March 19, 2009 made on qualifying commercial terms. Backed by Treasury, the ASSP are designed to help stabilize the auto supply base and restore credit flows in the automotive sector. According to Treasury, the ASSP will provide supply companies with access to liquidity and protect American jobs while giving GM and Chrysler reliable access to the parts they need. Please contact us if you would like notice of any developments on the ASSP.

### **Impact of a General Motors Corp. Bankruptcy Filing on GM Affiliates**

A bankruptcy filing by GM will not necessarily include a filing of all of GM's domestic or foreign

subsidiaries or other affiliates. Non-debtor affiliates will be empowered to continue doing business in the ordinary course. Even creditors of entities not seeking bankruptcy protection should evaluate their contracts and pay attention to the requests for relief made in a GM bankruptcy case. As noted above, GM may seek court approval to sell its stock in and/or the assets of its domestic and foreign affiliates. In addition, a DIP financing request may be conditioned on a pledge of assets and/or a guaranty of a GM affiliate that is not a debtor in the bankruptcy case.

## Conclusion

The issues described above are just a few of the many complex issues that could arise from a GM bankruptcy filing. As events progress, we will be updating our clients and friends on key developments.

---

[1] An open question remains regarding the relative priority of the GM bailout funds totaling \$13.4 billion to date.

[2] LTV eventually sought bankruptcy protection again and liquidated in 2002, at which point the PBGC assumed the company's pension liabilities.

[3] Although collective bargaining agreements are no longer considered executory contracts, sections 1113(b) and (c) of the Bankruptcy Code set forth the statutory requirements for judicial approval or rejection of a collective bargaining agreement.

[4] In addition to supply contracts, GM would have the ability to renegotiate or reject burdensome dealership and franchise agreements, thereby streamlining its dealership network. To the extent GM intends to sell off some of its brands in a section 363 sale, dealers whose agreements are rejected would have unsecured claims that would likely be dealt with as part of any GM prepackaged plan.