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#### Preparing for a Chrysler LLC Bankruptcy Filing: Issues for Your Consideration

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Yesterday, Chrysler LLC (together with its affiliates, “Chrysler”) announced a tentative deal with the United Auto Workers’ union (the “UAW”). The deal, which was reportedly negotiated among the UAW, Chrysler, the U.S. Department of the Treasury (“Treasury”), and Chrysler’s potential suitor, Fiat SpA (“Fiat”), is a step toward meeting the April 30, 2009 deadline imposed by the Obama administration, by which time Chrysler is required to reach agreements on cost-cutting deals with its unions, secured creditors, and other stakeholders as a precondition for receiving further Treasury assistance. The tentative deal with the UAW — the specific terms of which are undisclosed and depend on a union member vote — reportedly meets the terms imposed by Treasury in the \$4 billion U.S. Government loan package received by Chrysler in December 2008.

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The UAW deal not only places additional pressure on Chrysler’s secured lenders, who have indicated that they would not consider accepting equity in satisfaction of their approximate \$6.9 billion claim without union concessions, but also furthers Chrysler’s potential acquisition by Fiat, whose representatives also stated that union concessions were a precondition to any agreement. The Obama administration has stated that Chrysler is unsustainable on a stand-alone basis, and over the past month, has placed increasing pressure on Chrysler to strike a deal with Fiat. According to recent reports, Treasury is pressing Chrysler to prepare to file for bankruptcy in the next several days, regardless of whether it meets the Obama administration’s deadline of reaching deals with its major creditor groups.

This briefing highlights some of the major issues we expect a significant number of our clients — including creditors and potential investors — will confront in a Chrysler bankruptcy filing. Although many of the complex issues in any Chrysler filing would be similar to those we highlighted last week in our briefing regarding a potential General Motors Corp. (together with its affiliates, “GM”) bankruptcy filing, there are several differences that warrant your consideration — namely, the possibility of a U.S. Government-backed alliance with Fiat, a possible U.S. and Canadian debtor-in-possession (“DIP”) financing facility, and the possibility that Chrysler could liquidate. President Obama described some of these differences when comparing the two automakers on March 30, 2009:

The situation at Chrysler is more challenging. It's with deep reluctance but also a clear-eyed recognition of the facts that we've determined, after careful review, that Chrysler needs a partner to remain viable. Recently, Chrysler reached out and found what could be a potential partner -- . . . Fiat, where the current management team has executed an impressive turnaround. Fiat is prepared to transfer its cutting-edge technology to Chrysler and, after working closely with my team, has committed to build -- building new fuel-efficient cars and engines right here in the United States. We've also secured an agreement that will ensure that Chrysler repays taxpayers for any new investments that are made before Fiat is allowed to take a majority ownership stake in Chrysler.<sup>[1]</sup>

If Chrysler and Fiat succeed in reaching an agreement in the next several days, Treasury will provide Chrysler with what it deems "adequate capital to continue operations," including possibly lending up to \$6 billion to finance the Fiat acquisition.<sup>[2]</sup> Under this scenario — and assuming the reported agreements with both the UAW and Canadian Auto Workers' union (the "CAW") are approved — Fiat may wish to complete its alliance with Chrysler as part of a Chrysler bankruptcy filing. But even if Chrysler fails to reach an out-of-court agreement with its major creditor constituents by April 30th, the Obama administration has made clear that in the absence of any other viable partnership, the U.S. Government "will not be able to justify investing additional tax dollars to keep Chrysler in business."<sup>[3]</sup> If no viable restructuring plan emerges, Chrysler will likely be forced to liquidate its assets piecemeal as part of a bankruptcy filing.

That the U.S. Government has taken an active role in steering Chrysler's survival is an understatement. As with any GM filing, we expect that any Chrysler filing will involve a significant number of complex issues, a broad range of parties, and a host of legal issues never before faced by U.S. bankruptcy courts. Regardless of the specific posture of any Chrysler bankruptcy filing (i.e., restructuring with a strategic partner vs. liquidation), its proposed features will likely present significant opportunities for clients, especially for those who identify and grasp key issues early on.

The few publicly available details surrounding Chrysler's reorganization plan remain in flux. This briefing 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 briefing does not constitute legal advice and is not intended to provide a comprehensive summary of all issues that may arise in any Chrysler bankruptcy, or all issues relevant to each of the firm's clients.

## 1. Debtor-in-Possession ("DIP") Financing Issues

***U.S./Canadian DIP Sponsorship.*** One unique feature of any Chrysler filing will involve the extent of the role of Treasury and the Canadian government either as DIP lenders (possibly in conjunction with agent/conduit lenders who are experienced in structuring DIP loans) or as providers of credit support. A DIP loan could total \$20 billion according to Bloomberg reports. As DIP lenders, the Canadian and U.S. Governments (together, the "Governments") would play a significant role in directing the management of Chrysler's bankruptcy case and would presumably be entitled to a "super priority" claim, required to be paid before all other administrative claims and secured claims.<sup>[4]</sup> Indeed, there appears to be no question about Chrysler's need for DIP financing. As of December 6, 2008, Chrysler stated that without the DIP funding, it would need to liquidate, closing 29 factories, firing 53,000 workers, and cutting off \$7 billion in payments to suppliers.<sup>[5]</sup>

In addition to "super priority" status, the Governments (and any conduit lender) would be able to charge fees and dictate many of the terms of borrowings (including related performance milestones and covenants). The Governments may require the grant of a security interest in Chrysler's unencumbered assets, wherever located, including leasehold interests. There may be DIP agreement provisions that allow the Governments to have unfettered control over any unencumbered property. The terms of the DIP will be determined very shortly after a bankruptcy filing. Therefore, it will be critical for parties to understand how the proposed DIP structure works, what assets it seeks to encumber (in the U.S. and abroad), and whether the proposed liens will "prime" existing liens and claims.

***Loan Trading Issues Involving Chrysler Debt.*** Financial institutions currently trading Chrysler debt (or potentially trading a DIP loan backed by the Governments) will also need to have a comprehensive understanding of any Chrysler DIP facility, especially because its terms may impact a lender's ability to continue trading Chrysler debt. Assuming the Chrysler DIP facility looks to recent multi-billion dollar

bankruptcy court-approved DIP facilities as a guide, it may allow existing 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 Chrysler DIP facility seeks the participation of existing lenders (or potentially new investors), parties in the secondary loan market should understand not only how their rights as a prepetition lender may be affected, but also whether they will be able to clear the hurdles necessary to participate.

Existing lenders should also understand how a Chrysler DIP facility will treat existing senior secured debt. The unprecedented nature of a Chrysler 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 the Governments will fund and/or guarantee most of any Chrysler DIP facility, to what extent will the Governments exert pressure on existing Chrysler lenders (some of whom are recipients of U.S. Government bailout monies) as a means of steering a Chrysler 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.

## 2. Liquidation Issues and Acquisition Opportunities

***Fiat Acquisition/Reorganization vs. Liquidation.*** If Chrysler and Fiat reach an agreement this week, Fiat may purchase its stake in Chrysler through a “Section 363” bankruptcy sale (described in further detail below) as part of Chrysler’s Chapter 11 filing. There is a track record for approving such large Section 363 acquisitions within a relatively brief time period, especially due to the constraints of emergency funding. As recently as last September, for example, Barclays plc received bankruptcy court approval within three days of the Lehman Brothers Holdings Inc. (“Lehman”) bankruptcy filing to purchase, among other things, Lehman’s banking and trading units for \$250 million. Less accelerated, but still swift: UBS’s multi-billion dollar acquisition of Enron Corp.’s trading business, and American Airlines’ multibillion-dollar acquisition of TWA.

Generally, Chapter 11 permits businesses an opportunity to reorganize and continue functioning while coming up with a reorganization strategy or “plan.” The plan requires agreement by various creditor constituencies, under specifically prescribed thresholds, before it can be approved by a bankruptcy court. Even if Chrysler were unable to garner sufficient support from its creditors for a proposed plan, it may be possible for Chrysler to get its plan approved over the objection of creditors. In either scenario, the DIP lending agreement in place would, at a minimum, be designed to allow Chrysler to consummate its alliance with Fiat and provide bridge funding until such time as Chrysler can obtain bankruptcy court approval of its plan of reorganization.

If, however, no viable restructuring plan or alternative partner emerges before April 30th and Chrysler is unable to reach a deal with lenders who are collectively owed approximately \$6.9 billion, Chrysler is likely to face liquidation either through a Chapter 7 filing, or a liquidating Chapter 11 case. If Chrysler files for Chapter 7 liquidation, it will be forced to sell any non-exempt assets to pay its creditors. A Chapter 7 trustee would be appointed by the court, and the trustee would ensure that any proceeds from the sale of secured assets are paid to secured creditors. To the extent any assets and/or residual cash remains after secured creditors are paid, those assets and cash will be pooled together to pay off any unsecured creditors, including trade creditors and equity holders — i.e., Cerberus Capital Management, a private equity fund that owns an 80% stake in Chrysler as a result of Cerberus’s 2007 takeover of Chrysler from Daimler-Benz.

Alternatively, Chrysler may file a Chapter 11 liquidation case if it can demonstrate that the sale of its assets will result in a higher recovery for creditors than a Chapter 7 liquidation. Should Chrysler file a liquidating plan as part of its Chapter 11 case, such plan would likely allow Chrysler to liquidate its business under more economically advantageous circumstances than a Chapter 7 liquidation. It might also permit creditors to take a more active role in fashioning the liquidation of the assets and the distribution of the proceeds than a Chapter 7 case.

Regardless of the form of any Chrysler bankruptcy liquidation, there will be significant opportunities for investors to bid on Chrysler assets and brands in bankruptcy sales. If Chrysler is able to forge a deal with Fiat, Fiat will buy only the assets and operations its wants — reportedly, the JEEP brand — potentially leaving less desirable assets, including unwanted brands, affiliates, factories, plants, and health care obligations, in the “old Chrysler,” which would be liquidated over months or years. If these plans take hold, old Chrysler will be under significant pressure to sell assets promptly pursuant to a series of “Section 363” bankruptcy sales, giving potential investors another opportunity to buy Chrysler assets at significant cost savings and obtain various other potential benefits.

**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 can be distinct advantages to being a stalking horse bidder.

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 Chrysler bankruptcy in a cost-efficient and relatively quick manner.

### 3. Pension Plan Issues

Similar to GM, Chrysler reportedly faces a significant shortfall on its pension plan. Stakeholders are gearing up for what could be a significant battle in bankruptcy court. On April 16, 2009, reports indicated that the Pension Benefit Guaranty Corporation (the “PBGC”), a quasi-governmental corporation created by Congress in 1974 to protect pension programs of bankrupt companies, had retained a law firm to advise it on Chrysler’s unfunded pension liability.

As of November 30, 2008, Chrysler had a reported \$9.3 billion unfunded pension plan liability, as calculated by the PBGC on a termination basis. If Chrysler were to terminate its pension plans, the PBGC would cover approximately \$2.2 billion of the shortfall, leaving \$7.3 billion in lost benefits. GM’s pension plan alone, if terminated, could potentially sink the PBGC. A Chrysler pension plan termination could likely have the same effect, meaning that bailout of the PBGC might be required before either a Chrysler or a GM case could be resolved. So far, it appears that Chrysler has reached a preliminary agreement with the UAW in the U.S. We assume, based on published reports, that the deal would give the UAW Chrysler equity in exchange for part of the \$10.1 billion Chrysler is required to pay into a union-run trust designed to take over retiree health care costs in 2010. Depending on the terms of the deal, the UAW could become reorganized Chrysler’s biggest shareholder.

According to recent reports, it also appears that the CAW reached a preliminary cost-cutting deal with Chrysler, which is expected to save Chrysler about \$198 million annually. Besides a reduction in health-care benefits (among other features), the CAW agreement is reported to involve the creation of a trust

fund that will recover retiree health care costs.

Even if the UAW and CAW workers ultimately ratify these agreements, there is still a possibility that Chrysler will file for bankruptcy, especially if Chrysler's secured lenders believe they will obtain greater in recovery in a bankruptcy case than they would if they voluntarily waived a portion of their \$6.9 billion claim outside bankruptcy. Should a bankruptcy filing occur, Chrysler, like GM, may look to prior bankruptcy precedent, such as the landmark LTV Corporation steel company bankruptcy, for specific guidance on the treatment of pension plans in and after bankruptcy. If so, there is a possibility that after any bankruptcy filing, Chrysler/Fiat will take back responsibility for its pension plans, negotiate new terms with the UAW and the CAW, and agree to make up a large portion of lost benefits.<sup>[6]</sup> For creditors-at-large, this means that if Chrysler decides to unwind its pension plan, the significant costs associated with such termination might not be dischargeable in a Chrysler bankruptcy, and Chrysler might require additional funding from the U.S. Government and/or any DIP lenders to cover these costs.

#### 4. Vendor Issues

**Critical Vendor Status.** Chrysler trade creditors and vendors are likely to wonder whether a Chrysler 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, Chrysler 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 Chrysler 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 on which the vendor can assert a lien to satisfy its prepetition invoice; and (iii) the vendor is in a foreign jurisdiction and if it is not paid may not be able to be compelled to continue to supply.

**Reclamation.** In addition to the possible critical vendor protections, Chrysler 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, in preparation for a Chrysler bankruptcy filing, trade creditors should be able to identify their Chrysler 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 Chrysler reclamation procedures that Chrysler 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 Chrysler.

**Treatment of Executory Contracts.** Under the Bankruptcy Code, Chrysler 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 Chrysler and the counterparty to the contract. Examples include employment contracts, maintenance agreements, service contracts, supply contracts, typical lease agreements, and franchise agreements.<sup>[7]</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 kinds of executory contracts that 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 Chrysler vendors across the U.S. and the world are also in a precarious financial situation. A Chrysler filing and a rejection of their supply contracts could potentially put these vendors into bankruptcy.<sup>[8]</sup> Although Chrysler 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, Chrysler will have to make sure that its decision to reject supply contracts does not have the "domino" effect of driving suppliers out of business and thereby jeopardizing production.

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

**Auto Supplier Support Programs.** As a means of reassuring Chrysler suppliers, Treasury released a statement on April 8, 2009, regarding the launch by Chrysler 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 Chrysler and GM reliable access to the parts they need. Please contact us if you would like notice of any developments on the ASSP.

## 5. Impact of a Chrysler LLC Bankruptcy Filing on Chrysler Affiliates

A bankruptcy filing by Chrysler will not necessarily include a filing of all of Chrysler'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 Chrysler bankruptcy case. As noted above, Chrysler 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 Chrysler 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 Chrysler bankruptcy filing. As events progress, we will be updating our clients and friends on key developments. Please feel free to contact the attorneys listed below about any issues you deem to be relevant.

## East Coast:

Karen Ostad	<a href="mailto:kostad@mofo.com">kostad@mofo.com</a>	(212) 468-8041
Gary Lee	<a href="mailto:glee@mofo.com">glee@mofo.com</a>	(212) 468-8042
Larren Nashelsky	<a href="mailto:lnashelsky@mofo.com">lnashelsky@mofo.com</a>	(212) 506-7365
Geoffrey Peck	<a href="mailto:gpeck@mofo.com">gpeck@mofo.com</a>	(212) 336-4183
Charles Cole	<a href="mailto:ccole@mofo.com">ccole@mofo.com</a>	(202) 887-1502
Alexandra Steinberg Barrage	<a href="mailto:abarrage@mofo.com">abarrage@mofo.com</a>	(202) 887-1552

**West Coast:**

G. Larry Engel	<a href="mailto:lengel@mofo.com">lengel@mofo.com</a>	(415) 268-6927
Adam Lewis	<a href="mailto:alewis@mofo.com">alewis@mofo.com</a>	(415) 268-7232

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**Footnotes**

[1] See <http://www.whitehouse.gov/blog/09/03/30/GM-and-Chrysler/>.

[2] See *id.*

[3] See *id.*

[4] An open question remains regarding the relative priority of the Chrysler bailout funds totaling \$4 billion to date.

[5] See <http://www.bloomberg.com/apps/news?pid=20601087&refer=home&sid=aQvW8upjmf dg>.

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

[7] 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.

[8] In addition to supply contracts, Chrysler would have the ability to renegotiate or reject burdensome dealership and franchise agreements, thereby streamlining its dealership network. To the extent Chrysler 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 Chrysler prepackaged plan.