



Bankruptcy & Reorganization Law Alert

A Corporate Department Publication

May 2009

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Protecting Yourself During Automotive Industry Reorganization Efforts

The Chapter 11 bankruptcy filing by Chrysler, LLC and 24 of its affiliates, as well as General Motors' continued struggle to reach an out-of-court reorganization with its creditors, is likely to create a ripple effect of defaults and lawsuits through all tiers of the automotive supply chain and will impact businesses connected to that supply chain. Although all signs suggest that Chrysler will attempt to emerge from Chapter 11 proceedings very rapidly, the underlying bankruptcy case may proceed for months, if not years. The ripple effect could cause primary or lower tier suppliers to stretch payables or seek their own bankruptcy protection. Taking steps now may help protect you against the effects of insolvent customers or suppliers and prepare your company for a possible waive of bankruptcy avoidance and preference actions.

The keys are simple: pay attention to Chrysler notices, GM news, and your customers and suppliers; use common sense business judgment when dealing with your customers and suppliers; preserve relevant records; identify knowledgeable personnel and conduct a preference analysis.

1. Pay Attention

In the Chrysler Chapter 11 cases, it is likely that certain suppliers will be designated "critical vendors" and continue to be paid as if the bankruptcy case had not been filed. Although it is not clear which suppliers will receive that designation, it is important to pay attention to those proceedings if your business is closely linked to the automotive supply chain. To begin, stay on top of all notices from the Chrysler Bankruptcy Court. Similarly, pay close attention to the steps General Motors is taking to deal with its suppliers and vendors. Finally, use common sense and closely scrutinize current relationships with your suppliers and customers. If you sell to Tier One suppliers, you may wish to consider exercising rights under the Uniform Commercial Code to obtain additional assurances of future performance from them. Such assurances will verify that the Tier One supplier will have the ability to pay for the product you deliver. Additionally, if your customers are insolvent, you have a right to stop goods in transit, return items yet to be delivered, and reclaim goods already delivered. Additionally, if your customer has become a "slow pay," consider additional credit limitations, review margins, and adjust payment methods to C.O.D. or cash in advance.

If your supplier appears to be insolvent or is likely to end up in a bankruptcy proceeding, develop alternative sources of supply and, as appropriate, consider termination of existing supply arrangements with the vendor before the bankruptcy proceeding.

2. Protect Yourself From Bankruptcy Preference Actions

Although it is not clear whether the Chrysler bankruptcy estate will pursue avoidance actions against Chrysler's suppliers and other creditors, it is always helpful to prepare in advance for possible recovery actions when you have received payments from an entity that is now in a bankruptcy proceeding.

Under the bankruptcy code, a debtor generally has two years to file suit to avoid and recover payments made to creditors during the 90-day preference period¹ before it sought bankruptcy protection. In general, a debtor may avoid payments made during the preference period if they were not made in the ordinary course of its business relationship with the creditor or otherwise were not made on terms customary within the industry and result in the creditor receiving more than it would have received had the debtor filed a Chapter 7 liquidation.

Because a debtor can initiate a preference action months or years after the underlying transaction, taking the following steps now will help you maximize your potential defenses and minimize your exposure to a preference claim if it is filed:

- A complete set of business records can be the best defense to a preference action, so as soon as you learn that one of your customers is now a debtor in bankruptcy, organize and store your records, electronically or manually, of any transactions that resulted in a payment from the debtor within 90 days before the bankruptcy filing. Retain those records for at least 36 months or until advised otherwise by legal counsel. If the debtor files a preference action against you, you will save time and money by having the records on hand and available to your legal counsel.
- Identify personnel, including staff in the sales and accounts receivable areas, with knowledge of the transactions and record their information. If key personnel leave the debtor, obtain up-to-date contact information. Their assistance and testimony may be important in successfully defending a preference action. In addition, identify what is ordinary course in your business or industry. Determine if value was given by extending credit after each payment was made during the 90 days.
- After gathering your business records, conduct a preference analysis to determine the company's potential exposure to a preference action. Legal counsel can help with this analysis. If the preference exposure is significant, budget for the potential repayment and for legal fees.

3. Be Prepared to File Suit

In addition to facing bankruptcy avoidance actions, you may determine that you need to file suit against a customer for unpaid invoices or against a supplier to recover tooling or other property. The documentation for a collection action is usually limited to an account statement, unpaid invoices, and a related contract, if any. A replevin action, which is used to recover assets held by a third party, requires more extensive documentation. Conduct an internal audit to verify that you have the following information and documentation, which your legal counsel will need to prepare a replevin lawsuit:

Contracts and Agreements

- Contracts, such as a supply contract, tooling agreement, or access agreement
- Purchase orders and material releases
- Copies of letters and e-mails with your supplier that vary any written contract terms
- UCC-1 financing statement

(Footnotes)

¹ The preference period is one year for insiders, which, for a corporate debtor includes directors, officers or persons in control of the debtor. 11 U.S.C §101(30).

- Insurance certificates issued by supplier's insurer

Asset Information and Documentation

- Inventory of assets to be recovered, including work-in-progress, raw materials, manuals and intellectual property
- Asset tags or other identifying information
- Asset location(s) by address, including county
- Asset value supported by historical value and replacement value information
- Accounting records with respect to amortization of assets, if applicable
- Information regarding contractual penalties you may face for not timely supplying your customer

Supplier Information

- Supplier's location and state of incorporation or organization
- Alternative supply sources
- Supplier's secured creditors who might claim a lien on your assets

Assembling the information and documents described above will enable you to react quickly to protect yourself and your business from bankruptcy preference claims and to assert your rights in the event of a customer's payment default or a supplier's failure. A modest amount of advance planning will save you time and money in the long run.

4. Conclusion

The crisis in the automotive industry may have a far-ranging, and perhaps long-term, impact on businesses in the United States and around the world. You can protect yourself in these uncertain times by paying close attention to developments, timely exercising your legal and contractual rights in dealings with insolvent customers and suppliers, preserving relevant records, and analyzing your risks of preference or other claims that may exist if you are or have been dealing with a bankrupt debtor or an obligor close to insolvency. If you have any questions, please contact any of the attorneys listed on this alert.



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