CLIENT ALERT

Don't Wait for the Federal Rescue Program or Bailout---Auto Suppliers and Servicers Should Take Steps Now to Shore Up Credit Risks and Bankruptcy Exposure

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Over the last few weeks, the halls of Congress have been flooded with representatives of GM, Chrysler, Ford, auto dealers, auto industry suppliers, and mayors from the nation's largest cities, all seeking part of the billions of dollars that Congress is likely to spend on the rescue package for the auto industry. Although Congress appears poised to enact a short-term, condition-laden bailout for the auto industry, companies doing business with the auto industry should not breathe a sigh of relief. Instead, industry participants should view any bailout as a window of opportunity in which to implement changes to help further mitigate credit and bankruptcy risks.

The auto industry is notoriously complex. However, below are a few steps (among others) for industry participants and servicers to consider in these challenging times:

- ***Analyze accounts receivable aging***. Understanding and monitoring current (and usually building) receivables aging is important for beginning to understand and take steps to reduce one's exposure in the event of a bankruptcy filing. There may also be time to manage receivables and to react quickly to avert slippage if receivables are growing. Having receivables aging reports and histories on hand also can be useful when negotiating for preferred vendor or critical/essential supplier treatment.
- ***Analyze and amend current business terms***. When dealing with a stressed or distressed company, it becomes increasing important to reduce credit exposure, ensure timely payment, and protect against writing off receivables or, worse, being directed to return funds already received. Payment terms, shipping commitments, collateral or other security, and a variety of other situation-specific terms can be amended (or enforced if they already exist) to mitigate exposure.
- ***Consider whether an expiring contract should be renewed or allowed to lapse***. When contracts are up for renewal, a company should consider whether or not to operate without a contract in place (so as not to be locked into a long-term contract) if operating on an invoice-only, month-to-month basis is a viable business option. In bankruptcy, the arrearages due on contracts are treated as unsecured claims. Generally, pre-bankruptcy receivables are only paid in full if and when a contract is assumed by a debtor (usually late in the case in connection with confirmation of a plan of reorganization). Thus, counterparties can be required to perform under contracts while being forced to carry unpaid receivables. If the contract is rejected (i.e., breached) in the bankruptcy, then the pre-bankruptcy receivables and any breach damages will be paid in bankruptcy dollars (usually pennies on the dollar). If a contract expires according to its terms (either prior to or during the bankruptcy), then there are no performance obligations and there may be an opportunity to negotiate more favorable terms with the debtor.
- ***Protect against preference exposure***. In bankruptcy, creditors can often be made to return funds received (generally within 90 days) before a bankruptcy filing. An analysis of receivables aging, payment history and business terms is necessary to determine whether and how a company can reduce this risk and what defenses may be available.

- ***Analyze and improve available rights and remedies***. Depending upon the nature of the goods or services being provided and the specifics of the contractual relationship, a variety of rights and remedies may exist or be available. For example, there may be statutory lien rights, rights and remedies under the Uniform Commercial Code, common law rights, and contract-based rights and remedies, such as cross default provisions, available if the parties modify or amend their agreements.

Now is the time for companies in or serving the auto industry to have wide-ranging conversations with creditors' rights and bankruptcy counsel. Our attorneys pride themselves on bringing a practical and innovative approach to complex scenarios. We would welcome an opportunity to help your company navigate the challenges of these times.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Monique D. Almy
Partner – Washington, D.C.
Phone: +1 202.624.2935
Email: malmy@crowell.com