

**AMERICAN BANKRUPTCY INSTITUTE  
MEDIA TELECONFERENCE TO EXAMINE THE FUTURE OF  
AUTOMOTIVE SECTOR DISTRESS**

INTRODUCTION

JACK F. WILLIAMS<sup>\*</sup>

The coming demise of the Detroit Three has captured the attention of the country and has catapulted bankruptcy practitioners to "rock star status." Well, maybe not rock star status, but ordinary folks have developed a keener appreciation of what we do. And so has Congress. In the Winter of 2008, Congress held hearings on whether to fund an interim bailout to help the Detroit Three to avoid a bankruptcy filing. Concerns were launched that such filings would result in the liquidation of these large companies, leaving thousands unemployed, dealerships abandoned, auto-parts suppliers in distress, and factories fallow. Many talking heads appeared on television suggesting that the bankruptcy system could not handle behemoths like General Motors and Chrysler.

However, those of us who make a living at business restructuring knew that chapter 11 is not always doom and gloom. The chapter 11 process permits the debtor in possession to revisit its business relationships with its banks, bondholders, suppliers, employees and their union, customers, and shareholders in an effort to develop a plan with a reasonable likelihood of success in restructuring its debt (usually through deleveraging the balance sheet in an equity for debt swap, among other techniques) and turning around operations (usually by streamlining operations, replacing old management, and selling off assets no longer necessary for core operations). After several days of hearings, however, Congress allocated multi-billions in aid to the Detroit Three in an effort to avoid bankruptcy. As we go to press, that plan that would see the Detroit Three out of bankruptcy appears to have failed.

Below, we at the ABI introduce you to an excellent panel of experts on financial distress in the auto sector. The panelists are knowledgeable, informative, and even entertaining. They will provide key insights on the pressing problems in and challenging future of the auto sector. Sit back and enjoy the ride.<sup>1</sup>

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<sup>\*</sup> ABI Resident Scholar and Professor, Georgia State University

<sup>1</sup> The comments made in this roundtable discussion are those of the panelists and moderator, and do not necessarily reflect the views of their employers, organizations, the American Bankruptcy Institute, or St. John's University School of Law. This discussion took place on October 29, 2008.

## TRANSCRIPT

**John Hartgen (ABI):** Welcome everyone to today's discussion examining future distress in the automotive sector.

The prospects of consumers cutting back on spending and credit markets tightening intensify the financial distress for the automotive sector. Despite adjustments to their recovery plans and a \$25 billion loan package from the government, automakers and parts manufacturers continue to face a grim future.

Joining us today is a panel of experts specializing in automotive company restructurings. They will be discussing the problems currently being experienced in the marketplace, as well as what future trends might lie ahead for the automotive sector. Our speakers include **Deborah L. Thorne**, a partner at Barnes & Thornburg in Chicago. Also joining us is **Ronald J. Silverman**, a partner with Bingham McCutchen in New York. Finally, **Ben Pickering** is a senior managing director at Mesirow Financial Consulting in New York as well.

Our moderator for the program will be **Professor Jack Williams**, ABI's resident scholar. I'll now turn it over to our moderator, Jack Williams.

**Williams:** Thank you very much John, and thank you folks again for joining us today. We've got a lot of issues we'd like to discuss. But before we hit the particular issues, I'd like to ask Ben Pickering to kind of frame the environment in which the issues that we are going to address swim. Ben, would you like to go ahead and do that?

**Pickering:** Sure Jack, thanks very much. Good afternoon everyone, it's Ben Pickering here from Mesirow Financial. And as Jack mentioned, and as all of you have been following I'm sure, plenty of change in the automotive industry. And in particular, one of the focuses that we have is looking at what happens to the automotive part suppliers, as that really has been—that's kind of the culmination of issues prior to what we're seeing now in the press with respect to the potentials for merger between GM and Chrysler.

But let me back up a little bit and just talk a little bit of what happens with the automotive parts supplier industry, because that really has been the stress point in the supply chain so far.

Certainly the big three OEMs, GM, Ford, and Chrysler have struggled to trim their costs and their production as demand has decreased. We've certainly seen a number of chapter 11 filings of their tier one suppliers, Dana, Delphi, Citation, Oxford, Collins & Aikman, Meridian, Cadence, you name it—there's been a wide variety across a wide range of suppliers.<sup>2</sup>

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<sup>2</sup> See Philip Nussel, *Supplier CEOs use bankruptcy as a tool*, AUTOMOTIVE NEWS, Aug. 8, 2006, at 11, available at 2006 WLNR 13836937 (explaining as of August 2006 thirty-three U.S. automotive suppliers

There has certainly been a trickle down from the tier ones to the tier twos in that chain of events, and really what you are seeing is, in part, it's due to the reduction in volume.<sup>3</sup> Prior to the most recent significant reduction in volumes you saw a lot of migration of production to the extent that it would be migrated out of the U.S. into Mexico or even from overseas. And so that's also had some stress on the supplier industry here in the U.S.

As well what you've seen is the, what we call the imports, the sort of non-domestics like Honda, Nissan, etc., who have brought with them into the U.S. their own suppliers. And of course they're coming into the U.S. to open up their own production facilities. They've asked their tier one and tier two suppliers to follow them into the North American market and construct from new as well.

That, of course, leads to a very different competitive nature. They have much reduced legacy costs. And therefore they have a competitive advantage. So what you're seeing as well is there's been an attempt to migrate from a lot of these suppliers' perspectives, the domestic ones, trying to latch on to the imports to take advantage of new players in the market. But they're finding that difficult given their legacy cost issues.

Other factors for driving the depression of the auto parts industry would be modulization, that really is, the OEMs increasingly expecting their suppliers to provide their pre-assembled combinations of components and complete automotive interiors rather than just individual components. Again, increased outsourcing has happened at the OEMs and they're asking for just-in-time sequencing, which really adds additional manufacturing time and complexities to the tier one.

Growing technological content is a factor as well. You're seeing a lot of technology expanding and that really provides the competitive edge for the OEMs and so they're asking for the tier ones to provide that technological content. And so the savvy suppliers are the ones who have technological advances. The ones that are more commodity based really are the ones that are having even more difficulty.

Globalization is a factor as well. Significant cost savings are being seen by the OEMs by globalizing some of their supply chain.<sup>4</sup> Raw material costs, of course, which we'll talk a lot more about shortly, is certainly impacting what's happening with raw materials. Just in general is, of course, the suppliers to the tier ones and tier twos are asking for price increases. The tier ones and tier twos don't have as strong of a means to fight that, so they absorb the cost and then they try to pass it on

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filed for chapter 11 bankruptcy because of "lower Big 3 production volumes, higher raw material costs and less production of higher-margin truck parts").

<sup>3</sup> See Steve Lannen, *Automotive Notes: Suppliers are also feeling the squeeze Raw Material*, LEXINGTON HERALD-LEADER, Apr. 17, 2006, at C1, available at 2006 WLNR 6391092 (noting smaller tier two suppliers that are less able to "absorb higher costs" are hurting as result of automakers cutting costs while raw material prices have risen).

<sup>4</sup> See Justin Hyde, *Foreign? American? Auto Parts Go Global: Vehicles Are Becoming the World's Melting Pots*, GRAND FORKS HERALD, May 20, 2006, available at 2006 WLNR 8648986 (showing U.S. automakers are increasingly looking to foreign suppliers to acquire parts with lower costs).

to the OEMs who basically either through contract or through just their own strength know it. And so you do end up with a squeeze at the tier one level.

As well, a lot of the regulatory changes recently, particularly for example, the EPA-compliant engines and things like that—in the commercial sector—has led to, again, more technological advances, more costs at the tier one level that the OEMs are less willing to absorb.

Just moving into, again, things like raw materials. Just to give you some examples, I think you're all aware of where oil traded at in mid-July of this year, at \$147 a barrel—that was a record high.<sup>5</sup> That has obviously impacted costs of any polymer-based product—resins for example, when they do any plastic injection molding for vehicles—that can be very costly.

And I mentioned the similar in a presentation two weeks ago when oil was at \$80 a barrel; I noticed today it's at \$68 a barrel, so that price is fluctuating a great deal.<sup>6</sup> You might think that would provide a benefit to the tier one suppliers in the sense that they can now see a cost reduction. Unfortunately, what's happened, and this was confirmed yesterday at the meeting that I was at with actually a tier one supplier who is in the injection molding business, is that their suppliers are unfortunately saying—we don't believe that it's going to stay at that level, and therefore we have two issues. One is we've got inventory that was bought at the \$147 a barrel level, or something in that vicinity, and it still has to work its way through our system, and therefore we're not reducing our price. Or two, we're not going to sell at a lower price only to find that our replacement raw material for our end is going to be at a higher level. And so they're hesitant to reduce their prices.

Steel is another one that broke a thousand dollars a ton recently, and there is obviously lots of steel in an automobile. Just compare that for a second when LTV failed back in 1991, I believe it was, '92—hot rolled steel was at \$295 a ton.<sup>7</sup> Today, it is close to \$1,000 a ton. I think it's \$850 or somewhere in that vicinity right now for hot roll, but it did crack a thousand bucks a ton not that long ago.

So again, those are the kinds of constraints that are being pushed back on to the tier one suppliers; this is why you're seeing a lot of difficulties in that area. And I think, again, legacy costs and I'll turn it over to my other speakers here to talk about

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<sup>5</sup> See Kevin G. Hall, *The Read: Oil Prices Plunging, So Why Not Gas?*, CHARLESTON GAZETTE, Sept. 5, 2008, at 2A, available at 2008 WLNR 16859495 (reporting oil prices hit "record high of \$147.27 a barrel" on July 11, 2008).

<sup>6</sup> See Bloomberg News, *Analysts: Continued Crude Drop Possible*, NEWSDAY, Oct. 18, 2008, at A25, available at 2008 WLNR 19835248 (remarking futures crude oil dropped to \$68.57 in mid October 2008, which was drop of 51 percent from record high reached in July 2008).

<sup>7</sup> See Thomas C. Hayes, *LTV's Creditors Support Bankruptcy Exit*, N.Y. TIMES, Feb. 15, 1992, at 137, available at 1992 WLNR 3311307 (acknowledging LTV entered into bankruptcy in 1986 and filed for reorganization for first time on February 14, 1992); see also Peter Scolieri, *Pricing no shoo-in for steel; in '91, it was off to the races to place bets on hikes*, AM. METAL MARKET, Dec. 30, 1991, at 1, available at 1991 WLNR 3366384 (stating hot-rolled steel in mid December 1991 cost between \$295 and \$315 per ton).

that as well, I think legacy costs such as pension OPEB, salaries, all have created a competitive disadvantage in that area.<sup>8</sup>

**Silverman:** Sure, thanks Ben. This is Ron Silverman from Bingham McCutchen. I think that legacy costs are a singularly huge problem for the automotive industry, particularly of course the OEMs, but also the large tier one and maybe even some tier two manufacturers. And I think that there's some—if we look back there's some precedent to how some industries have dealt with legacy costs, like pension costs, like retiree benefits—like health benefits, disability benefits, things like that, and may give us a little bit of a foreshadowing of how the automotive industry might deal with some of those legacy costs in order to reduce and manage them, to try and right side themselves going forward.

If we look back, we see first with the steel industries, and then following that over a period of years with the airlines, as those industries and companies in those industries entered, where they had to—chapter 11 cases—they were able to crystallize the pension liabilities and our bankruptcy laws give companies the ability to also crystallize,<sup>9</sup> and even—and modify and reduce—collective bargaining costs—things like healthcare and disability benefits that are otherwise very hard to modify outside of bankruptcy.

So that you could quantify them, you could crystallize them, and you could treat them with a payment plan, or some sort of compensation, so those companies can get those behind them and move on without that cost overhang that many of newer companies, who are their competitors, don't have.<sup>10</sup>

So if the steel companies and the airline companies have been able to do that. What is likely to happen is beginning to happen now in the automotive sector, as Ben was saying, we see competitors to the American automotive companies coming in at a later stage, the foreign competition, they don't have the same type of legacy costs, union contracts, and collective bargaining agreements that the Big Three have, and some of the large tier ones have.<sup>11</sup> So obviously there's a competitive cost disadvantage to the U.S. companies, and it's quite likely, we think, that we've seen with the large tier ones and maybe even with some OEMs, that they'll be using chapter 11 to try and address those pension liabilities and reduce those, then get more in a cost competitive situation.

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<sup>8</sup> See Lannen, *supra* note 3 (suggesting an additional factor that hurts tier suppliers is "labor costs, such as health insurance").

<sup>9</sup> See Finance and Commerce Staff Report, *Federal Agency Wants in on Delta-Northwest Merger Talks*, FIN. & COM. DAILY NEWSPAPER, Mar. 7, 2008, available on Westlaw at 2008 WLNR 4729484 (reporting judges have allowed certain corporations reorganizing under chapter 11 bankruptcy, and particularly those in airline and steel industries, to turn over their pension obligations to Pension Benefit Guaranty Corporation).

<sup>10</sup> See *Revival Efforts Across Bric Economies*, FIN. EXPRESS, Dec. 31, 2008, available at 2008 WLNR 24960921 (examining affect increase in overhang would have in financial markets around world).

<sup>11</sup> See Mark Trumbull, *Best U.S. Factory Jobs in Rising Jeopardy*, CHRISTIAN SCI. MONITOR, Feb. 15, 2008, available at 2008 WLNR 2886892 (discussing fierce foreign competition in automotive industry due to high cost of American labor).

And a little bit later in the presentation we'll discuss in more detail, of how actually there will be some particular techniques that may be used more frequently in the future to reduce the size and the scope of pension liabilities.

**Thorne:** This is Deborah Thorne from Barnes & Thornburg, I was just going to add that even if we were able to look at a crystal ball, but looking back on the airlines and the steel, not every airline went in, but because the other airlines were able to go in and strip some of these costs off—move them off their balance sheet—the other airlines were able to deal more effectively with their unions and become more competitive. So it may be that as we move forward, if one goes in, or even I suppose to a certain extent, if they're really good at negotiating they may be able to explain to their unions what this would mean the ability to get a little more leverage in terms of dealing with them head on outside of bankruptcy, but more likely in.

**Pickering:** As well I think one of the other important factors here that has now obviously come to the forefront for the OEMs is simply their reduction in volume. That's really created a lot of over-capacity now—production is down, I think if you look at some of the recent announcements, I think Ford was going to close 14 plants by 2012.<sup>12</sup> I think GM announced that they were going to do nine. They announced at the beginning of the year they were going to do nine plant closures, and I think they added more closures after that, including, of course, SUVs and pick-ups and things like that.

I think all across the U.S sales are estimated to decline somewhere like 13% this year from where they were last year.<sup>13</sup> And that really equates to around two million fewer vehicles being produced in the U.S. this year. Clearly that's an issue that, as Deborah and Ron mentioned as far as the union issues, the legacy cost issue, I think everyone recognizes that a volume decline impacts everybody extremely adversely. You know, while the OEMs and the parts manufacturers are doing their best to try and consolidate production into fewer facilities, and doing their own kind of restructuring that way—operationally—and getting a little bit more savvy as to how they do that. But again, I think the OEMs are looking for how do they get their cost reduced by looking at alternatives for parts production as well.

That kind of sounds like a little bit of gloom and doom for the automotive parts industry in the U.S., and I think it's important to point out that manufacturing in the U.S. is not going to go away from the automotive perspective. You certainly are going to have the need for production in the U.S. I think it would be cumbersome and costly to try and import fully produced vehicles from other places, which is why you have the non-domestics, the imports coming into the country and building

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<sup>12</sup> See *World Components: The Wheels Come Off*, AUTOMOTIVE FORECAST, Nov. 3, 2008, available at 2008 WLNR 20905321 (explaining result of production slashes in automotive industry).

<sup>13</sup> See *Chrysler's Future in Doubt: Analysts Do Not Expect the Automaker to Survive 2009, Even With Government Loans*, RICHMOND TIMES DISPATCH, Jan. 8, 2009, available at 2009 WLNR 702066 (discussing drastic decline in U.S. auto industry in 2008 and its expected losses in 2009).

facilities here—they recognize that they can make a better dollar by having their production here.<sup>14</sup>

As a result then does that mean that parts supply is going to go away from the U.S.? The answer to that is no as well. A lot of the just-in-time production, a lot of the quality control needs to be done—and that's why it needs to be done in the U.S.—right near by the OEM facility. And so that's why you see that the positioning of a lot of the tier one manufacturing is placed very close to the OEMs that they supply. And as a result, again, I don't think the automotive industry is going to go away in the U.S., but I certainly think we're at the front end of a significant change as to what you're seeing.

A lot of talk goes around the domestic OEMs feeling the impact of this, and it was interesting—I spoke recently with some folks who do operational restructuring for the automotive industry and I asked them if they were starting to see any of the imports, and the import suppliers, having issues as well. And the answer to that was—for the first time, yes, there are some as well. So the volume decline is not just hitting the Big Three, but it's hitting the imports as well now. And again, I think that's just a general decline across the board. We're just seeing it at a larger scale because of the Big Three and where they're coming from a cost perspective, particularly on the legacy issue side.

**Williams:** I think as well, Ron and Deborah, we had a discussion before regarding the volume of inventory at the actual dealerships. And I don't know if you guys want to comment further on that.

**Thorne:** I figure Ben probably knows the pressure on the dealers is coming from a lot of different places. Clearly people are buying fewer cars. It's much more difficult to finance the purchase of individual cars. GMAC is struggling to borrow to have money to lend. In fact, I saw recently—or I think this weekend in the *Automotive News* a report talking about the credit unions in Virginia picking up some of the slack.<sup>15</sup> They are actually able to lend money more advantageously, are coming in and trying to work directly with the dealers to pick up this so that if in the event somebody actually wants to buy a car these days, there's somebody there to buy the paper.

And there are other credit unions [that] have been doing this around the country. Some of our clients have been doing this for a long period of time, but are stepping up when there are actual sales. But meanwhile the dealers are having a huge amount of pressure on the individual dealers in terms of their floor plan

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<sup>14</sup> See Daniel Gross, *Southern Comfort*, NEWSWEEK, Dec. 22, 2008, available at 2008 WLNR 24022099 (analyzing numerous benefits of gradual increase in presence of foreign automakers establishing production in United States).

<sup>15</sup> See David Sedgwick, *GMAC Steps Back From The Brink*, AUTOMOTIVE NEWS, Feb. 9, 2009, available at 2009 WLNR 2881232 (discussing possibility of credit unions taking over as "primary providers of car loans").

financing themselves, and so they're really getting caught in the crunch. And I think we're going to see, and we are seeing now, a lot of consolidation among dealers, dealers that have existed for you know, 50 years, going out of business and just really not able to make it as they are finding that their floor plans are being really ratcheted back.

So that's just another, I guess, trickle down, not only from the OEM pressure, but also from just the general instability in the general economy.

**Williams:** And consumers are getting strapped for cash, as we know. If you think of consumer debt as the kind of stool with three legs to it, a lot of attention has been paid to the home mortgage leg. Then there's the credit card leg, and then the third major leg of consumer debt is auto financing. And we've seen, as Deborah was pointing out, a constriction in lending and restriction in access to funds. And attempts to become more creative to promote and enhance consumer buys in this industry.

But we're probably looking at an increase in bankruptcy filings as just one indicator of financial distress—from about 800,000 last year to over 1.1 million for calendar year 2008.<sup>16</sup>

So, on the revenue side it doesn't look like things are going to get any better soon, assuming that there's nothing that happens that's drastic or dramatic that happens in the short term. Would you agree with that?

**Silverman:** Yes Jack. I do agree with that. And I think with respect to the financing angle, I think there's a little bit of a double whammy that's going on right now because of—there's sort of a global credit crunch—it's coming at the auto manufacturing sector of the automotive retailing sector two ways.

First, as the economy contracts and businesses in general contract—consumers, like you were saying, feel less confident. They have less disposable income to purchase automobiles, and that drives down demand. But the other angle is the global credit crunch is also affecting directly the automotive companies and their financing arms, as Deborah was saying, directly. To the financing companies, and supposedly consumers, it's making it more difficult for the automotive companies to provide financing to the consumers so that consumers are able to borrow less and therefore buy less of a car.<sup>17</sup>

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<sup>16</sup> See *Bankruptcy Filings by Consumers Soar*, L.A. TIMES, Jan. 6, 2009, available at 2009 WLNR 238746 (remarking on incredible increase in consumer bankruptcy filings in 2008 and its expected continuance into 2009).

<sup>17</sup> See Greg Bensinger & Alex Ortolani, *GMAC's Lending Limits May Add to GM's U.S. Sales Woes*, BLOOMBERG.COM, Mar. 2, 2009, available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=am.hB81anEHU#> (reporting as of October 2008, GMAC was "granting financing only to buyers with" credit scores of 700 or above, which represented only about 58% of U.S. consumers).



And what we might be seeing now, sort of the first time in 20 years is, 20 years ago before the leasing industry in the automotive sector got prevalent, you know when you wanted to buy a car you put down 20% and you financed the rest. So to get your first car, you saved up money, you got 20%, you got a loan, you bought your car. And five, six years later, when the loan was paid down, you still had, hopefully, something that was worth some money—you had equity in your car, hopefully—and that was your 20% for your next purchase.

With the leasing industry there is no equity built up in the car. You use all your money to get a car, but at the end of the three years, you give the car back. And as long as you can get another nice low interest rate—a favorable interest rate on your lease to get a new car, that works well. But when someone stops offering that product, you're not able to do that—you're not able to buy, if you will, as much of a car next time around. And I think that's what we're beginning to see in this cycle. And that's a double whammy that's hitting the automotive sector both from the consumer and the financing end.

**Pickering:** I'll jump in here with another comment on how the liquidity in the marketplace is impacting the auto industry. And that's simply on the restructuring side of things, both in and out of bankruptcy, what we had seen before—and I've got a long list here in front of me of M&A activity in the industry where part suppliers were being gobbled up by other suppliers, or by private equity funds, hedge funds, were getting into that industry as well.

With the liquidity crunch, what we see now is that the M&A activity is significantly declining, if it hasn't already almost dried up.<sup>18</sup> There has been, I think there's still activity from the strategic buying perspective, in other words, other suppliers looking to buy added volume strategically within their business. But we're seeing the segment that used to do the private equity and the hedge fund type buys aren't as prevalent now.<sup>19</sup> It's not that they've dried up, but I think they're being a lot more selective in what they're looking for.

So as a result, when you've got a company that's struggling, whether it be in or outside of a chapter 11, that M&A solution is not necessarily there anymore. As well, they used to finance themselves out of some of their difficulties, that has also dried up as well. So that certainly creates an issue with respect to the ability and the time that the suppliers can weather the storm. And as you've got volumes declining for a variety of reasons, as you've just heard, that again creates difficulties in the solution that you get at the other end.

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<sup>18</sup> See Katherine Yung, *Fewer Firms Being Gobbled Up; Market Meltdown, Tight Credit Sink '08 Deals in Michigan*, DETROIT FREE PRESS, Jan. 30, 2009, available at <http://www.freep.com/article/20090130/BUSINESS06/901300332> (reporting mergers and acquisitions decreased 63% in 2007 and this trend would likely continue, especially in auto industry).

<sup>19</sup> See Craig Mullet, *Downturn Upsides for Strategic Buyers*, SOURCEMEDIA INC., Jan. 1, 2009 (outlining changing strategies of strategic buyers in economic recession).

I think a lot of it as well is with—you get soft retail demand, high inventory—the mix is changing, consumers are now looking towards hybrids. It's become the flavor away from the SUVs—that creates a lot of retooling, for lack of a better term, at the OEM level, which means now they're angling towards not building the SUV, but now building more of a smaller vehicle with a hybrid solution to it.<sup>20</sup> That, again, trickles down the chain to the tier ones and tier twos. You also have to take that focus.

In order to do all that retooling, of course, you need capital to invest. And that is difficult for a lot of folks to obtain at the moment. So again, the liquidity crunch has had that kind of an impact as well.<sup>21</sup>

**Thorne:** I would add though that I do see activity coming from, in particular, from Japanese manufacturers. And interest in Japan, where there is some money still out there to invest, in coming in and making some strategic buys into, I guess what they would call a distressed market—as long as it's away from Detroit. I think there is still a significant amount of interest in purchasing parts manufacturers that may be closer to Indiana, Wisconsin, western Michigan, maybe where there are no union issues, but where they have Japanese OEMs, or maybe Korean, located nearby. So I do see that.

And the other thing I would add in terms of the Japanese manufacturers is that a lot of the Japanese tier ones—more tier twos and tier threes—are selling also to the domestic OEMs.<sup>22</sup>

And so that brings the problem into the Japanese OEMs in particular, because their parts manufacturers on down the line have been hurt by the problems within our—the crunch and the squeeze that comes from the domestic OEMs.

But I do believe that there is interest in coming in and doing some, maybe, picking off some good companies because there is money to invest, and there is interest. And now because Japan has been here for so long, they have, I think, a more sophisticated view of using bankruptcy as a tool to do this—where maybe ten years ago they were very reluctant to have anything to do [with] bankruptcy in the

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<sup>20</sup> See Jere Downs, *Small Cars May Be the Theme at Detroit Auto Show*, COURIER-JOURNAL.COM, Jan. 11, 2009, available at <http://www.courier-journal.com/article/20090111/BUSINESS/901110389/1003/ARCHIVES> (reporting statement of official with Center for Automotive Research: "Automakers that pump up the profitability and choices of their small-car offerings have the best prospects of surviving the recession . . .").

<sup>21</sup> See *Day to Day: Michigan Governor Reflects On Changing Economy* (National Public Radio broadcast Dec. 3, 2008) (transcript on file with ABI Law Review) (noting automakers have been unable to secure credit to retool their factories in order to produce fuel-efficient vehicles).

<sup>22</sup> See Ted Evanoff, *Japan's Automakers Have Stake in Deal*, INDIANAPOLIS STAR, Dec. 3, 2008, at 1 (reporting American and Japanese automakers buy their auto parts from same manufacturers).

United States.<sup>23</sup> Now they sort of have a much better understanding and are interested in using it as a tool to help them purchase companies.

**Silverman:** I would echo that. I think that Ben is absolutely right, that the amount of—at the current stage—the amount of financing that's being done to leverage acquisitions is reduced. But that being said, both on the strategic side and we do a lot of work with the hedge fund industry, particularly the part that's focused on perhaps distressed industries, is looking at the automotive businesses right now. And there are funds with cash put aside—they are biding their time—they are looking to try and make smart purchases and get good value. But there is the interest there to purchase, particularly suppliers where they think there are good opportunities. So we do think there will be continued M&A activity, and that will increase as well once the credit markets reopen.

**Pickering:** I couldn't agree more, Ron, I think when the credit markets open up I think you'll see a pick up again in that M&A activity. And Deborah, to your point, I think what I'm seeing in the rate of the actual file cases is that, yes, there is more interest from foreign than there is from domestic.

It hasn't completely dried up, don't get me wrong. I just think that the level of activity that we saw a year or two years ago when there was a lot of people vying for these assets; certainly I've seen a significant reduction in that activity—or that interest level.

**Williams:** Do you folks then see the strategic use of bankruptcy and Bankruptcy Code 363 sales as being the vehicle by which many of these acquisitions will take place? And then I should say the follow-up question to that would be—are we going to see any old-fashioned supplier rehabilitations in chapter 11?

**Thorne:** I think, at least in terms of people making strategic buys, and I'm particularly talking about Japanese companies coming in and making strategic buys, that they are thinking if they can do this that they would like to do it through maybe even a pre-package so that they don't go—they're a little wary, interestingly enough, of 363 as a vehicle. They'd like to do the whole thing and be done—they don't want it to stretch out. But they are very interested in using bankruptcy as a way to cleanse the assets.

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<sup>23</sup> See, e.g., MASAHIKO AOKI ET AL., *CORPORATE GOVERNANCE IN JAPAN* 179 (Oxford University Press ed. 2007) (positing that before 1990, financially troubled Japanese firms generally turned to private restructuring rather than formal bankruptcy proceedings).

**Williams:** So the profile of a case would be a very quick—a lot of flurry on the front end and in and out, at least from the major part, or substantially all the asset side, in three months or less?

**Thorne:** That would be the hope.

**Silverman:** I also see that with respect to somewhat larger purchases. The flip side where we could see what we call 363 sales, referring to a section of our bankruptcy law, is where you had a larger company that's trying to reorganize, it's in a chapter 11 proceeding and it's got some good operations, it's got maybe some balance sheet and some financial problems that it needs to restructure, but there's a business there. But it may have some non-core operations that it's looking to hive off, so it can right size it down to more of a core operation.

You'll see the 363, the sort of one-time sales, in chapter 11s, and I think you'll continue to see those, particularly with respect to both strategies and the financial buyers who may look to do those for two reasons. First, they think they can pick up similarly situated operations and consolidate and form new types of tier one and two tiered suppliers by picking up the operations at good prices. And number two, the view that we've been hearing is that when you have an operation that does actually make something, as supposed to just being purely a service company, people are thinking they can still—they will still be able to finance those. There will be hard assets; they will actually make something, as long as you can right size the cost they will be worth something even if they ultimately have to grant liens on it to get financing. There are assets there to finance that's different than a service business. So we do see financial buyers with their minds open towards individual smaller—relatively smaller acquisitions as well.

**Pickering:** The other issue in there Ron is—or another factor, I guess I should say—is a lot of the folks are going back now, be they the incumbent or a potential purchaser, going back to the OEMs and asking for pricing concessions. I mean, you can only do that so much, but particularly in a time of distress it's your best opportunity to go back to an OEM and ask for a price increase of some kind and bit it justified either through—it's better if you've got means to do that, such as raw material price increases that you had been unable to pass along has made it untellable for you. Or just simply that the metrics don't work based on volume or whatnot, but being able to go back to the OEMs, I think they are getting peppered with those requests, certainly over the last number of years, from their suppliers they're being peppered with those requests.

I think if you've got a unique product as well, I think that really helps to the extent that you produce something that maybe no one else does. Or you've got technology that the OEM really likes and it's a good seller. I think that gives you a competitive advantage when you're asking for those concessions.

**Williams:** I have a bigger question. We often get questions about the 2005 amendments to the Bankruptcy Code. And from where you stand on the issues that we've discussed—and particularly this market—do you think the changes in the 2005 Code, in particular things like the 20-day section 503(b) administrative claim and the like, the period of exclusivity of proposing a plan leased as an executor contracts all being shortened and arguably the removal of the discretion of the bankruptcy judge on a number of these issues that's going to help, hurt, or is indifferent to reorganizations in this particular sector.

**Thorne:** I think the 20-day administrative claim is enormous and it's becoming more enormous. It's just in case the people on the call don't know, when the Code was amended in 2005, any deliveries of goods which were made to a debtor 20 days before the filing of the case are given an administrative priority over other general unsecured claims.<sup>24</sup> And those have to be paid 100% of those 20-day delivery invoices at the time of confirmation. Or if the sender agrees to something less, I guess they could do that. But [] generally it's going to be 100%.

And just an example, in the Plastech case,<sup>25</sup> which is pending in Detroit, at least \$26-million in 20-day claims were filed as these administrative claims, and I believe Plastech thinks they're going to be able to reduce those to about 17-million. But that's a huge dollar amount that has to be paid upon confirmation. And this is a liquidating plan, but you could only imagine if it was an actual reorganization, the amount of additional cash that the debtor has to know it's going to be able to get to get through the process.

In the old days those would just be unsecured claims and would be paid on a pro rata basis, so I think that tension between a debtor contemplating going it—it's lender on one part and the vendors delivering goods, is enormous. And I think it's made confirmation of a reorganization extremely difficult. And I think it's one of the reasons why, besides exclusive trade being shortened some other things, I think that's one of the real reasons why we just aren't seeing reorganization. It's very expensive to get through the process.<sup>26</sup>

**Pickering:** And the other angle on that is some of the changes that Jack referenced do shorten the, effectively put pressure on or shorten the time frame of chapter 11 cases.<sup>27</sup> It's now—the companies don't have the same amount of time

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<sup>24</sup> See, e.g., Deborah L. Thorne, *New Law Gives Trade Creditors Help*, 24 AM. BANKR. INST. J. 1, 1, 62 (May 2005) (explaining new section 546(c)(2) "elevate[s] the reclaiming creditors' rights above other unsecured creditors" by "giv[ing] a reclaiming creditor an administrative claim for the goods delivered within 20 days before the commencement of the case, so long as the goods were sold in the ordinary course of the debtor's business").

<sup>25</sup> See *In re Plastech Engineered Prods., Inc.*, 397 B.R. 828 (Bankr. E.D. Mich. 2008).

<sup>26</sup> See, e.g., 7 NORTON BANKR. L. & PRAC. 3D, § 139:1, at 139-3 (2008) (describing chapter 11 reorganizations as more expensive than alternatives).

<sup>27</sup> See, e.g., Symposium, *New Realities for Financial Advisors Under the New Law and Other Emerging Problems, Chapter 11 Changes Under the New Bankruptcy Act*, AM. BANKR. INST. (2005), available on

before they have to make some decisions, and as a result of that, one of two things will happen. They'll probably plan better for their reorganization and make some decisions earlier. And if they don't it opens the door towards other parties other than the company—whether they're creditors or other investors—being able to put their own proposals on the table for the company.

So those things together should probably shorten, not lengthen, the time frame for reorganization—chapter 11 proceedings going forward.

**Williams:** Well folks, we're just about out of time. I was wondering if we could wrap it up with an exit question for all of you and if I could use the discretion of the moderator, I'd ask each of you to address this question.

What do you see as the future of the automotive sector, both short and long term? Ben, how about if we kick it off with you?

**Pickering:** Sure, yes. I think I partially addressed that in what I mentioned before. I don't think we're going to see the automotive sector in the U.S. go away, but I think in the near term we're going to see continued struggles mainly because of liquidity and volume. That is certainly going to trickle down to the tier ones and below, depending on how they can absorb those costs. Again, there has been a lot of requests for pricing concessions for the OEMs and, obviously, given their current status and situation I'm not sure that they can afford to do that to any great extent now as well. So that is creating quite a pinch in the industry. I think for the first time we're seeing that pinch floating its way up to the OEM level now and that's why you're seeing the news that GM, Chrysler talks—that kind of issue.

So I think short term we will certainly see some more bankruptcy filings, particularly at the supplier level. And in the longer term, I don't think the industry is going away, I think it's just going to be readjusted, right-sized, per se.

**Williams:** Thank you Ben. How about you, Deborah?

**Thorne:** Well I certainly agree that there are going to be—I think there will be many fewer part suppliers. They're obviously going to be in different geographic areas—you have Janesfield, who is closing down the GM plant there. There will be fewer part's suppliers right in that immediate area, so I think we're going to see a lot of little towns that had a number of them kind of disappear. And I think the suppliers will disappear as well, but they certainly will be there.

I also think that it's going to be a push for more innovation—you know, long term those are the companies that are going to survive. If you look at what's going on with Toyota in terms of how popular the Prius is. They were just ahead of us on that. I assume that there is going to be more innovation. And a lot of it also

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Westlaw at 120105 ABI-CLE 124, at Exhibit A (pointing out BAPCPA, *inter alia*, shortens timeframe of chapter 11 proceedings).

depends on what happens after the election. There may be rewards out there for innovation that we don't even see now.

**Williams:** Thank you. Ron, we'll give you the last word on that question.

**Silverman:** OK thanks. I agree, we will continue to see consolidation. It's an industry that's having financial difficulty. The weak will shake out, the stronger will survive. But in that shakeout, inevitably companies will resort to the use of the chapter 11 form. And I think what we will see is increased litigation in that form. There will be smaller pots to divvy up. When that happens people fight over the amount in the pot to a greater degree. And there are significant wins and losses to be had in that chapter 11 forum of how the company will restructure and how the investors will come out of it.<sup>28</sup> And there is the ability, through litigation, for people to come out better or come out worse and I think that we'll be seeing that.

**Williams:** All right, thank you Ben, Deborah, and Ron—thank you so much for sharing your thoughts with us today. At this time we're ready to take any questions our audience may have.

**Question:** I was wondering, as a result of that tight situation—that credit markets there's a substantial lack of DIP financing and so do more of these cases that might start out as potential reorganizations end up being liquidations or 363 sales? And does that result in just larger suppliers as these things get bought up? Or does that just result in fewer suppliers all together?

**Pickering:** I'll take the first crack at that one. I think the answer is in part that it depends. It really depends on what that supplier—if they're having trouble financing that puts them into a certain realm of, you know, what do they supply? And I think if there [are] competitive suppliers, alternative suppliers out there for the OEMs to turn to, then perhaps we're going to see that that supplier will go away.

But again, I think if there's something unique that they're supplying, or if they are the only supplier of that product that has the capacity of supply, you know, it has to survive in some way. And again, you're seeing it in certain size cases; you're seeing the OEMs stepping up to provide some of that financing to keep those companies in place while they transition.

So I think the answer is it really depends on the type of product that they've got, the ability of the OEM to re-source, and how important they are to the company.

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<sup>28</sup> See, e.g., *Companies in Chapter 11 Pose Risk for Investors*, OLYMPIAN, Aug. 17, 2007, available at 2007 WLNR 15986694 (cautioning putative investors in companies that have filed for chapter 11 protection of attendant risks).

**Question:** During some of your comments you said that part of the disadvantage American auto manufacturers is due to legacy costs. I wanted to know if you'd comment on what you think of the management of these automakers. I think you could have looked five years ago and known that demand for oil was going to go up in the long term. That family wages were stagnant. Yet it doesn't seem that—well, it seems that American auto manufacturers were beaten to market with the kinds of cars that are in demand today. So do you lay any of this at the doorstep of the management of the auto manufacturers—the American auto manufacturers?

**Silverman:** I was just going to say my experience has been that from what we have seen in the restructuring of—with a variety of companies that we've worked on—is that I think you'll see a mixture between good management and bad management. I think bad management—we could understand what the issue is and why it failed. Good management always begs the question—why does a good management team and a smart operator run into trouble?

And again, part of it comes back to the product that they supply. Part of it comes back to the ability to pass along raw material price increases to the OEM, as well as the paying pricing concessions for any other factors that you've got.

So I would certainly say that at times you could place it on the backs of management. But I think most of the management that I've experienced has been very good and just they're caught at a difficult situation. You got to remember that this is a very linear supply chain, when you go through PPAP, which is a production part approval process, it really makes it difficult for both the supplier and the OEMs, quite frankly, to look for alternatives. It's a long process to get to an approval with an OEM to produce a part for them and which is a terrific win, but it also means that for you to get lead time on business elsewhere it's a long time.

Conversely, for the OEMs, they say—well, it's not easy for us to resource because it does take us time as well. So it really creates a joint relationship depending on which party has the stronger position will really depend on whether you can get the pricing concessions you need or pass on the raw material costs, etc., or fight against that.

So a long-winded way of saying I think—my experience has been that most management has been good. They could see the problem coming; they just were kind of hamstrung at what they could do.

**Williams:** Again, I want to thank the panel members, Ben Pickering, Deborah, Thorne, and Ron Silverman for some wonderful comments and sharing your experience and expertise with us today.