

message from partner in charge

In this issue, we spotlight for clients and friends some issues resulting from this persistently rocky economy.

First, Mr. Cohen and Mr. Hoogerhyde caution suppliers to be vigilant about assumption and assignment of executory contracts when dealing with companies declaring bankruptcy. We also report that merger and acquisition activity should increase this year as a result of the high level of distressed debt, according to a study commissioned by Pepper and Carl Marks Advisory Group LLC (for details about Pepper's webinar on this topic, see page 4).

A Peppercast sheds light on bankruptcy 'safe harbors' for commodity forward contracts, and a Pepper webinar discusses the proposed Consumer Financial Protection Agency Act, part of a package of regulatory reforms for the financial services industry.

In other news, Mr. McDevitt reports on Delaware's new ban on discrimination based on sexual orientation.

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Assumption and Assignment of Executory Contracts: Lessons from Chrysler and GM

The recent bankruptcies of Chrysler, LLC (Chrysler) and GM Corporation (GM) have raised many novel legal questions and issues, including unusual procedures for the assumption and assignment of executory contracts. The Chrysler and GM bankruptcies also are a reminder of the pitfalls facing contract counterparties. The Bankruptcy Code, 11 U.S.C. §365, permits a debtor to reject or assume, and, after assumption, assign executory contracts and unexpired leases. The Bankruptcy Code also provides protections for contract counterparties that require the debtor to: (1) cure all outstanding defaults at the time of assumption, (2) compensate the counterparty for actual pecuniary loss resulting from the default or provide adequate assurance of such compensation and (3) provide adequate assurance of future performance. The Bankruptcy Code does not set forth the procedures that a debtor must follow to assume and assign contracts. However, debtors routinely establish procedures, approved by court order, for the assumption and assignment of executory contracts when selling all or substantially all of their assets in bankruptcy.

Chrysler and GM both proposed procedures for the assumption and assignment of executory contracts, and these procedures were approved by the court. The breakneck speed at which both cases are moving through the court also has significantly affected contract counterparties. Chrysler filed for bankruptcy on April 30, 2009, and on May 3, 2009 Chrysler filed its motion to approve bidding procedures, including procedures for assumption and assignment of executory contracts. Similarly, GM filed for bankruptcy on June 1, 2009 and filed its bidding procedures motion, including assumption and assignment procedures, that same day. Bidding procedures and assumption and assignment procedures are not traditionally sought in "first-day motions."

Unlike assumption and assignment procedures encountered in most bankruptcy cases, Chrysler's procedures

provided for two notices. The first notice advised the counterparty of the expected assumption and assignment of the contract and included Chrysler's version of the cure amount. Two noteworthy issues regarding the first notice warrant further discussion. First, the cure amounts were calculated as of April 30, 2009, the petition date. Calculating the cure amounts as of the petition date is not in compliance with the Bankruptcy Code, which requires that all existing defaults be cured as of the date of the *assumption* of the contract. This problem was exacerbated by a provision in the notice that payment of the designated cure amount would be in full satisfaction of all obligations arising before the assumption and assignment. Second, the notices were sent to the highest corporate parent level entity instead of to the actual parties to the contract.

As a result of the inaccurate calculation of cure amounts, numerous contract counterparties, who did not otherwise oppose the assumption and assignment of their contracts to the purchaser, were required to file objections. The pace of these cases and the provision of notice only to the parent, combined with the requirement that objections to cure amounts be filed within ten days of service, further complicated the assumption and assignment of contracts that were otherwise uncontested. In fact, many suppliers were required to scramble and file a last-minute objection to the cure amount to preserve their rights.

Suppliers must be vigilant and watch for important notices from bankrupt companies. In these difficult economic times, suppliers must be cautious with regard to assumption and assignment of their contracts with debtors.

Unlike traditional assumption and assignment procedures, the Chrysler contracts were not assumed at the expiration of the ten-day period even when no objections were filed. Instead, contracts were assumed when the supplier received a second notice, which informed the supplier that the contract had been assumed and assigned. Until receipt of the second notice, but before a deadline established by Chrysler, up to 90 days after the closing of the Fiat sale, Fiat could exclude contracts for which the counterparty received the first notice. Also unusual was the provision permitting the *purchaser* to exclude a contract for which the counterparty received the first notice but had not yet received the second notice. If the contract counterparty did not receive the second notice, or the purchaser deemed the contract not assumed, Chrysler was permitted to assume or reject the contract at a later date.



Peppercast: New Light Shed by Fourth Circuit on Bankruptcy 'Safe Harbors' for Commodity Forward Contracts

Gregg Miller, a partner in Pepper Hamilton's Corporate Restructuring and Bankruptcy Practice Group, recently authored an article titled "New Light Shed by Fourth Circuit on Bankruptcy 'Safe Harbors' for Commodity Forward Contracts."

In this podcast, Mr. Miller discusses the new light that has been shed and why this information is important to the energy industry.

Listen today by visiting the Corporate Restructuring and Bankruptcy section of Pepper's podcenter at www.pepperpodcasts.com.

GM's bidding procedures motion included assumption and assignment procedures similar to those in Chrysler's bankruptcy case, in addition to some other unusual procedures. GM's procedures, like Chrysler's, require that counterparties file objections, if any, within ten days of the date of the notice. A notable difference between GM's and Chrysler's procedures is that GM uses a secure Web site that enables the counterparty to view information for only their individual contract. In Chrysler's case, the expected assumed contracts were made public by filing schedules with the court. GM also established a call center for the attempted resolution of cure amount objections. As only some contract counterparties have received notice of their password for the Web site, and contract counterparties have not yet received notice that their contract has been assumed, we are still waiting to see if the assumption and assignment procedures in GM's bankruptcy case will work better than those used in Chrysler's.

Chrysler's and GM's assumption and assignment procedures are an important reminder for suppliers to these and other debtors. Suppliers must be vigilant and watch for important notices from bankrupt companies. These notices

should be forwarded to counsel as soon as possible to avoid missing the short deadlines provided for in the procedures and outlined in the notices. Further, suppliers should avoid being lulled into a sense of security by assuming the debtor will treat them fairly regarding the assumption and assignment of their executory contract, especially when the supplier supports the assumption of their contract. Instead, suppliers must confirm that the cure amount has been calculated correctly and conforms to the requirements of the Bankruptcy Code. In these difficult economic times, suppliers must be cautious with regard to assumption and assignment of their contracts with debtors.

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Market Conditions to Produce Significant Distressed M&A Opportunities in Second Half of 2009

The current economic downturn will offer greater discounts on distressed assets than previous downturns have offered, drawing both financial and strategic buyers to the market in the coming months, according to 92 percent of respondents to a new **Distressed M&A Outlook** survey conducted by mergermarket, Carl Marks Advisory Group LLP and Pepper Hamilton LLP.

In the second quarter of 2009, Carl Marks Advisory Group LLP and Pepper Hamilton LLP commissioned mergermarket to survey 75 investment bankers, private equity practitioners, hedge fund investors and lawyers regarding their outlook for distressed M&A activity in the upcoming year. Respondents provided invaluable insight into current market conditions, as well as a forecast for the year ahead.

"With a variety of factors contributing to an increased volume of distressed opportunities, both buyers and sellers are expected to eagerly pursue deals, as each side stands to gain unique benefits," said Jim Rosener, managing partner of the New York office and head of the International Practice Group at Pepper Hamilton LLP.

Aside from attractive discounts, debt-related issues will likely be the most prominent drivers of distressed M&A activity in the upcoming year, according to respondents. An increase in covenant defaults is identified as a major catalyst to distressed deal flow, as is companies' inability to meet debt obligations or refinance upcoming maturities.

Distressed investors are likely to find the greatest opportunity in the following two sectors:

- Real Estate, where 63 percent of respondents expect to see the highest volume of distressed deals in the year ahead.
- Financial Services, which 38 percent of respondents believe will experience the highest volume of distressed M&A this year.

Sixty-three percent of respondents expect most distressed deals to be handled outside of court; however, Chapter 11 reorganizations may be an exception as these are expected to be extremely common over the next 12 months.

The predominance of out-of-court deals is likely related to time constraints, as many respondents cite time as a major drawback to handling deals in court. Fifty-nine percent of respondents say the distressed M&A process can exceed four months when handled in court. Meanwhile, on cases handled outside of court, only 25 percent of respondents say the process can take this long. “If implementable, out-of-court solutions are generally less expensive and disruptive. However, it is not clear whether companies with complex capital structures will ultimately be able to obtain all of the consents necessary to use these solutions,” explains Duff Meyercord, partner at Carl Marks.

Time constraints also are expected to put pressure on management teams within distressed companies, which in turn may influence the dynamics of distressed transactions going forward. According to Jim Rosener, “Not only is the market characterized by people having to do something and forced to do it on a tight timetable, but there also is an increased opportunity as management loses focus and interest over these orphaned businesses.”

Additional findings:

Exit outlook: 65 percent of respondents plan to delay their exits from distressed investments in the upcoming year.

Valuations: 54 percent of respondents say asset-based valuations tend to be the primary determinant of price.

Distressed M&A Outlook Webinar

August 11, 2009
12:00 – 1:00 P.M. EASTERN

To gain perspective on the current distressed M&A market, Carl Marks Advisory Group LLC and Pepper Hamilton LLP commissioned mergermarket, a research and publishing company, to survey a diverse group of corporate executives, private equity practitioners, hedge fund investors and lawyers regarding the foremost issues facing distressed investors today.

Join us for a complimentary, one-hour online seminar, that will discuss the report findings and implications for the combination of eager sellers and opportunistic buyers who will undoubtedly provide fuel for distressed activities in the second half of 2009.

Register online at https://www.regonline.com/Distressed_MA_Opportunities.

Please contact Brian Dolan at dolanb@pepperlaw.com with questions about the event or to request a copy of the study.

Alternative strategies: 79 percent of respondents expect debt buy-backs to increase in the year ahead.

If you would like a copy of this report, please contact Brian Dolan at 215.981.4568 or dolanb@pepperlaw.com.

Delaware Gov. Signs Sexual Orientation Ban into Law

On July 2, 2009, Delaware Gov. Jack Markell signed into law Senate Bill No. 121, which bans discrimination on the basis of sexual orientation in employment, housing, public accommodations and insurance law. “Sexual orientation” is defined as heterosexuality, homosexuality or bisexuality. Transgendered employees and gender identity issues are not covered by the changes in the law. The Delaware House and Senate passed this legislation by large margins. Delaware joins twenty other states and the District of Columbia in prohibiting discrimination based on sexual orientation.

SB No. 121 adds the term “sexual orientation” to an existing list of prohibited practices of discrimination. SB 121 forbids discrimination against a person on the basis of sexual orientation in housing, employment, public works contracting, public accommodations and insurance. It also establishes that the Superior Court, in the first instance, would hear and adjudicate alleged criminal violations concerning equal accommodation, fair housing and employment discrimination.

The law includes “carve outs” concerning sexual orientation. The law specifies that the term “employer” does not include religious corporations, associations or societies whether supported, in whole or in part, by government appropriations, except where the duties of the employment or employment opportunity pertains solely to activities of the organization that generate unrelated business taxable income subject to federal income tax. That means that religious entities may consider sexual orientation in their decision-making consistent with the tenets of the faith, except where the religious organization earns unrelated taxable income and, in those activities, may not discriminate on the basis of sexual orientation.

The act also provides that employers are not required to offer health, welfare, pension or other benefits on the basis of sexual orientation on the same terms as benefits afforded to the spouses of married employees. Consequently, employers are not obligated to extend benefits received by married employees to same-sex couples.

Delaware employers should review their employee handbooks and add sexual orientation to their lists of protected characteristics.

Delaware employers should review their employee handbooks and add sexual orientation to their lists of protected characteristics. Delaware employers also should train their supervisors concerning this change to the law.

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Webinar: The Consumer Financial Protection Agency Act: What Does It Mean to You?

On July 9, U.S. Rep. Barney Frank (D-Mass.), the chairman of the House Financial Services Committee, introduced H.R. 3126, the Consumer Financial Protection Agency Act, which is a significant part of the Obama Administration's package of regulatory reforms for the financial services industry. The legislation would create a new Consumer Financial Protection Agency charged with overseeing virtually all facets of consumer finance, from credit cards and mortgages to payday lenders.

This legislation is on the fast track for consideration by the House. Although certain details may change, it is clear that this legislation would profoundly change regulation of the financial services industry.

Visit http://www.pepperlaw.com/webinars_update.asp?ArticleKey=1544 to view the webinar and download a copy of the slides.

Issues covered include:

- the legislative process and timing for passage of the law, and the politics behind its likely passage and any changes
- coverage and general powers of the new CFPA
- changes in preemption and enforcement powers
- likely litigation trouble spots and related issues.

Speakers

- *Richard P. Eckman*, Partner, Pepper Hamilton LLP
- *Stephen G. Harvey*, Partner, Pepper Hamilton LLP
- *Frank A. Mayer, III*, Partner, Pepper Hamilton LLP
- *Timothy R. McTaggart*, Partner, Pepper Hamilton LLP
- *Daniel G. Murray*, Partner, Pepper Hamilton LLP
- *Audrey D. Wisotsky*, Partner, Pepper Hamilton LLP
- *Travis P. Nelson*, Associate, Pepper Hamilton LLP

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