

DELPHI CORPORATION Harvard Case Solution & Analysis



Chapter 11 - Reorganization

If management decides that it is in a position to reorganize, it will file for Chapter 11.

- The bank management, not a trustee, remains in control of the firm and because the debt is reorganized.
- Control is retained for the first 120 days of the bankruptcy proceeding, after which it is turned over to the trustee.
- Management has the exclusive right to the property of the corporation until the court orders otherwise.
- Provides protection of selling, making new contracts, hiring, firing, and so on.
- "Stay of execution" applies to creditors from repossessing property and the company cannot be sued from any creditor.

Chapter 7 - Liquidation

Management determines that the firm should be liquidated. It files for Chapter 7 bankruptcy.

- U.S. bankruptcy trustee is appointed to supervise the liquidation of the company's assets.
- Assets are liquidated and proceeds are distributed to creditors.

 1. Secured Claims
 2. Administrative Expenses
 3. Priority Claims
 4. Unsecured Claims
 5. Preferred Stock
 6. Common Stock

- Cash that remains after payment in full (and interest) of secured claims (plus fees and expenses) is used to pay unsecured claim holders and equity holders in the order of an asset.

Company Background

- Delphi was born a combination of 2 prior auto OEMs.
- Common Ownership - Top 10 of GM, they were not for structural reorganization.
- Internal financing issues. They reorganized too while business deal with suppliers were not very profitable.
- Chief Executive Officer - They were not profitable during 1998 for 2 years of operations. After that they reported losses to more all paid by. It was able to begin their operations after 2000 with the new financial condition credit products lines.

Why didn't Delphi management negotiate reorganization with the various claimants instead of choosing to go into bankruptcy?

- Delphi's reputation was at stake in financial turmoil. Along the time, they did not have providing the last financial things.
- They could not come to a point that investors to creditors were successful offers for the company to create.
- Filing for Chapter 11 would protect the company against any other claim, make it more attractive to new creditors than by a closing cost flow, and would allow 180 days to negotiate and reduce their cost to create the company reorganization again.

Why did it choose Chapter 11 instead of Chapter 7?

- On October 9th 2005, Delphi filed for the largest Chapter 11 reorganization filing in auto management history to receive the judge that the firm was reorganized as a going concern.
- Chapter 7 is liquidation and the firm would not be able to continue its operations.
- Chapter 11 reorganization allows the firm to continue its operations and to restructure its debt.
- Chapter 7 liquidation would result in the liquidation of the company's assets and the proceeds would be distributed to creditors.
- Chapter 11 reorganization allows the firm to continue its operations and to restructure its debt.

Explanation of DIP financing.

- Order of Priority in DIP Financing
- High cost financing, which is riskier and makes it attractive to lenders.
- This helps the company by ensuring new cash flow.
- Regular effective new money credit because they claim to be new assets to the new lenders.
- The brought on value of a 5 billion cash flow to Delphi while restructuring from new lenders.

Would you vote for the POR as an equity holder, a secured bondholder?

- For the equity holder they would vote yes because they would get more value settling for less than their full value of the claim through the POR, so new POR would require more time in bankruptcy which is expensive and will have a negative effect on the company's value. Therefore, they will get more by voting yes than through liquidation or a new POR.
- The secured bond holder will be paid in full with first priority if the company goes through liquidation, unless the lower priority claim holders get nothing. Then their payment will be reduced from full payment. There will be more value and less risk in voting yes to the POR than no and getting a liquidation for this reason.

Would you vote for the POR as an unsecured creditor or GM? Explain your reasons.

- An unsecured creditor is lowest on the priority payments through liquidation. Therefore, they will reduce their risk of not being paid and increase the value of their claim by voting yes to POR rather than voting no for liquidation or a new POR.
- A GM would vote yes because it will keep the company intact unlike liquidation. They will not want to create a new POR because keeping the company in bankruptcy would increase expenses and decrease the value of the firm.

How important is the valuation of Delphi to your vote as an equity holder, a secured bondholder, an unsecured creditor, GM?

- The valuation of Delphi is important to the vote of all types of claim holders.
- The secured bondholder will have the least risk of the credit holders to not be paid and therefore would be the least worried about the valuation of the firm. They will have some risk, as previously stated, if the lower priority claim holders are paid nothing, this will decrease their payment from full.
- The valuation of the firm would be most important to the GM whom during bankruptcy, shifts his concern to the firm's value over the value for shareholders.
- An unsecured creditor and an equity holder will want the highest valuation because this increases their likelihood of being paid rather than liquidation.
- Equity holders have the lowest priority through liquidation, with preferred stock holders over common stock holders. They will want the POR and high valuation.

Technical Note "A Managerial Primer on the U.S. Bankruptcy Code"

- Bankruptcy Reorganization of 1978 Bankruptcy Code
- Chapter 1: Business Operations, Sale of Assets
- Chapter 2: Case Administration
- Chapter 3: Creditors, Claims and the Trustee
- Chapter 4: Liquidation
- Chapter 5: Reorganization of Debtor's Assets
- Chapter 6: Reorganization
- Chapter 7: United States Trustee

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Chapter 11 - Reorganization

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- The best management, not a takeover, means control of the firm and because the debt is reorganized
- Control is retained for the first 120 days of the bankruptcy proceeding, after that is sold
- Management at the exclusive right to the portion of corporation that is sold during the time after reorganization and the plan must be Court's approval and majority
- Provides protection of selling making new creditors have the highest priority
- "Who of the case" implies that creditors from reorganization get priority over company assets, steps remain from reorganization

Chapter 7 - Liquidation

- Management decisions that are made be liquidated, if that is Chapter 7 bankruptcy
- U.S. bankruptcy code is applied to corporate reorganization
- Assets of the liquidated firm are sold in "liquidation"

 1. Secured Claims
 2. Unsecured Claims
 3. Preferred Stock
 4. Common Stock

- Cash from the liquidation process is split and distributed to each party (they have done before reorganization) "The higher claim holders will receive less than full amount"

Company Background

- Delphi was born a combination of 2 prior auto OEMs
- General Motors - Top of OEM hierarchy but declining sales and profit
- Ford Motor Company - They reorganized too while business deal with high labor costs were high and profitless
- Other major automakers - They were not as profitable during 1990s but a lot of operations that they had expected began to move off shore. This was due to begin change from GM, Ford, and Chrysler into three common credit products lines

Why didn't Delphi management negotiate... (Chapter 11)

- On October 19th 2005, Delphi filed for the largest Chapter 11 reorganization filing in auto management history to convert the judge that led the reorganization of reorganized
- Chapter 11 reorganization is a liquidation and a reorganization of the firm over the time Chapter 7 liquidation
- Delphi emerged from reorganization with the support of its assets
- Delphi emerged from reorganization that was a Chapter 11
- Delphi emerged from reorganization that was a Chapter 7 liquidation, which is being supported by the claim holders that are liquidated. This is because secured creditors were not high cost in reorganization

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Technical Note "A Managerial Primer on the U.S. Bankruptcy Code"

- Bankruptcy Reorganization of 1978 Bankruptcy Code
- Chapter 1: Business Operations, Sale of Assets
- Chapter 2: Case Administration
- Chapter 3: Creditors, Claims and the Estate
- Chapter 7: Liquidation
- Chapter 9: Reorganization of Municipalities
- Chapter 11: Reorganization
- Chapter 12: Small Business Reorganization

Technical Note
*"A Managerial Primer on
the U.S. Bankruptcy
Code"*

- **Bankruptcy Reform Act of 1978** (Bankruptcy Code)
- **Chapter 1** - Provisions, Definitions, Rules of Construction
- **Chapter 2** - Case Administration
- **Chapter 5** - Creditors, Debtors and The Estate
- **Chapter 7** - Liquidation
- **Chapter 9** - Adjustment of the Debt of Municipality
- **Chapter 11** - Reorganization
- **Chapter 15** - United States Trustees

Chapter 11 - Reorganization

If management decides firm value is maximized as a going concern, rather than liquidation it will file for Chapter 11

- Incumbent management, not a trustee, retains control of the firm and becomes the debtor in possession (DIP).
- Control is retained for the first 120 days of the bankruptcy proceeding, or the exclusivity period.
- Management has the exclusive right to file a plan of reorganization (POR) during this time. After expiration any interested party may file. Courts usually extend exclusivity.
- Provides sources of relief by making new creditors have the highest claim priority
- "Stay of Execution" legally bars creditors from repossessing or acquiring any company assets
- Stops interest from accruing

Chapter 7 - Liquidation

If management determines the firm should be liquidated, it files for Chapter 7 bankruptcy.

- A U.S. bankruptcy trustee is appointed to supervise the liquidation of the company's assets
- Value is distributed to creditors according to "absolute priority."
 1. Secured Claims
 2. Administrative Claims
 3. Involuntary Gap Claims
 4. Unsecured Claims
 5. Preferred Stock
 6. Common Stock
- Claims of Higher priority are paid in full first and then claims of lower priority. Unless lower claim holders receive nothing. Then higher claim holders will receive less than the full amount.

Company Background

- Delphi has been in bankruptcy for 2 years (since 2007).
- Company Description - Spin off of GM. They manufacture electronic automotive parts
- Internal Outsourcing Issues - They maintained too many locations abroad with high labor prices and were not profitable
- What brought on Bankruptcy - They were only profitable during their first 2 yrs of operations. After that their expenses began to erode all profits. This was due to legacy claims from GM, high labor costs, and too broad and non profitable product lines.

Why didn't Delphi management negotiate reorganization with the various claimants instead of choosing to go into bankruptcy?

- Delphi Corporation was in stuck in financial turmoil during the financially difficult times preceding the bankruptcy filings.
- Their debt had risen to a point that payments to creditors were increasingly difficult for the company to make.
- Filing for Chapter 11 would protect the company against accruing debt interest, make it more attractive to new creditors there by increasing cash flow, and would allow it time to reorganize and reduce their debt to make the company profitable again

Why did it choose Chapter 11 instead of Chapter 7?

- On October 8th 2005, Delphi filed for the largest Chapter 11 Bankruptcy filing to date.
- Management was able to convince the judge that the firm had more value as a going concern.
- Chapter 11 is preferable to credit holders and share holders because it offers more value than Chapter 7 liquidation.
- Delphi emerged from bankruptcy in 2009 with the selling of all of its assets.
- Delphi had only 4 of the 44 plants it had when it filed for Chapter 11.
- Delphi staying in Chapter 11 instead of Chapter 7 bankruptcy, ended up being worse for the claim holders than if it had liquidated. This is because bankruptcy expenses were so high and it was in bankruptcy for 4 years.