The COVID-19 pandemic has created financial and operational distress for certain automotive suppliers, who will struggle to return to stability following what for many was a nearly 3-month shutdown. As automotive suppliers know all too well, one weak link can shut down assembly lines and wreak havoc on the global supply chain. It is now more important than ever for automotive suppliers to review their own supply base to determine whether financial or operational distress threatens the continued supply of goods. Supply chain stress tests – not unlike the financial stress tests which banks have been subjected to since the Great Recession – are a good place to start, as certain automotive suppliers struggle to deliver now that the industry is once again running.

The following are the top considerations to keep in mind for dealing with financially distressed suppliers.

**Identifying a Distressed Supplier**

A “distressed supplier” (or troubled supplier) is a supplier that is financially and/or operationally unsound and one that, without assistance, may not meet production requirements or pay its sub-tiers for materials. There are a number of warning signs to look out for in identifying a distressed supplier:
1. Missed, late, frequent expedites, or short shipments
2. Low quality shipments
3. Unprofitable operations (delay of new program launches)
4. Failure to pay sub-tiers/stretched payables
5. Requests to change payment terms
6. Litigation involving claims against the supplier, including for non-payment of sub-tiers
7. Defaults under credit agreements
8. Extraordinary capital expenditures which appear to be behind schedule

It is important to discuss the current situation and assess management’s understanding of each of these warning signs.

**What to do in the Case of a Distressed Supplier**

If your supply chain includes a distressed supplier on whom you depend for materials or component parts in order to supply to your end-customer, delay is your enemy, so quickly assembling a team to address the situation is critically important. This team should include members of your purchasing, engineering, operations, finance and legal groups. Depending on the severity of the situation, you may also need to consult with outside financial or legal specialists who work regularly with distressed suppliers in the automotive supply chain. The key is to assess the impact of the distressed supplier on your production, as well as your exit or resourcing options, considering the following:

- Other suppliers’ capabilities
- Quality, timing, and costs associated with resourcing
- Legal options/terminate contract for breach or convenience
- Potential requirements for approving tooling/PPAP

In some cases, it makes sense to work with the troubled supplier and even provide some support for the continued flow of goods, while you take other steps to protect your long-term supply of goods. In other cases, it may be best to utilize your contract remedies for breach and move on to another supplier.

**Considerations if Forced to Stay - Accommodation Agreement**

If you are unable to exit your current contract, you may need to reach an “Accommodation Agreement,” which is an agreement between the troubled supplier, one or more of its customers, and its lender (where applicable), where each provides certain considerations to prop up the supplier in order for it to continue production. Accommodation agreements typically include the following provisions:
How to Guard against Distress and Protect Your Supply

Sometimes the best offense is a good defense. Establishing financial and other criteria for new suppliers can help to build a strong supply chain for future supply. Consider the following:

Financial position

- Review financial statements, credit applications, etc.
- Determine financial resources (i.e., lines of credit)
- Lender, customer, and supplier diligence
- Check UCC filings, tax liens, and judgment search

Managerial

- Due diligence regarding past experiences

Establishing these processes can help guard you against distress and protect your position going forward.

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