In many cases where a supplier in the automotive industry is in financial distress, its customer(s) will provide support to the supplier through financial and other accommodations, in order to maintain a continued flow of goods to the customer. In these cases, an “accommodation agreement” between a customer (either an OEM or a Tier 1 supplier) and its supplier is based on a promise by the supplier to maintain the production and supply of parts to the customer without interruption, and a corresponding promise by the customer to provide certain financial and other accommodations to help support the supplier. Accommodation agreements provide additional liquidity to distressed suppliers when senior secured lenders lose the appetite to fund, reduce disruption to business, maintain supply to key customers, and increase likelihood of payout to senior secured lenders. This requires negotiating with the distressed supplier’s customer base and lender group. Self-preservation will typically bring these groups together, but not always, and it is important to understand each party’s leverage in order to protect your position as a customer or supplier. Increasingly, accommodation agreements are being used to facilitate out-of-court sales and/or wind downs of operations. These agreements are popular among lenders and customers, as they reduce time and expense associated with a bankruptcy filing, and maintain some control with lenders and customers.
The following are typical key terms that are negotiated with respect to accommodation agreements between automotive customers and their suppliers. Often, the supplier’s lender is also a party to or beneficiary of the accommodation agreement.

1. Forbearance from Resourcing Existing Business

Customer agrees **not to resource** business currently with supplier to another supplier for a defined period (or to extend the term of business), provided that supplier complies with the following conditions:

- No material default on any purchase order
- No “Event of Default” as defined in the accommodation agreement
- No material default on financing arrangements
- Creation of parts inventory bank

2. Limitation of Setoffs or Recoupment

Customer agrees to retain its rights and claims against supplier, **but not to exercise its right of setoff or recoupment against accounts payable to supplier** for damages arising from supplier’s failure to perform its obligations, except for:

- Short shipments
- Defective or non-conforming products
- Improper invoicing
- Warranty claims
- Direct payment to vendors for raw materials

3. Change of Payment Terms

Customer agrees to change (**i.e., accelerate**) payment terms on shipments made during fixed period.

4. Purchase of Inventory

In a case where a lender is involved, and there is a default under either the applicable loan documents or accommodation agreement, the customer agrees to purchase all raw materials, work in process and finished goods inventory which are merchantable, usable and related to parts provided to the customer by supplier. Prices are fixed at certain percentages of the supplier’s actual cost or purchase order price and the customer will make payments directly to the lender.
5. Customer Financing

Typically, only customers that agree to provide a specific amount of financing to the distressed supplier to cover the supplier’s cash shortfalls will receive production from the supplier. Customers may provide financing through:

- Subordinated participation in the lender’s line of credit to supplier; or
- Price relief for customer’s production.

6. Inventory Bank Financing

The customer agrees that it is solely responsible for financing its inventory bank requirements. Where a lender is involved, any financing arrangement it enters into is subject to the lender’s approval, and no part of the lender’s line of credit may be used to finance the inventory bank.

7. Acceleration of Payables

The customer agrees to pay all existing payables within __ (e.g., three) business days of execution of the accommodation agreement.

8. Payment of Operations Costs

The customer agrees to reimburse supplier, on a daily basis, its pro rata share of the total costs incurred in the production of its parts.

Individual accommodations will be negotiated with each customer. The above terms will vary based on the customer’s dependency on the distressed supplier, and the lender’s security position (e.g., whether it is over- or under-secured). The more dependent, the better the terms for the supplier and the longer the wind-down process will take, and the less dependent, the less support a customer will provide for the distressed supplier. So, it is essential that customers and suppliers identify their points of power and leverage in working through a distressed supplier issue, and negotiate support according to that leverage.

© 2020 Foley & Lardner LLP

Source URL: https://www.natlawreview.com/article/top-considerations-accommodation-agreements-distressed-suppliers