Strategies to Address Financially Distressed Suppliers Resulting from the COVID-19 Pandemic

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- Former Circuit Judge for Midland County – presided over more than 150 jury and non-jury trials
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- Chair of Warner's Restructuring and Insolvency Practice Group
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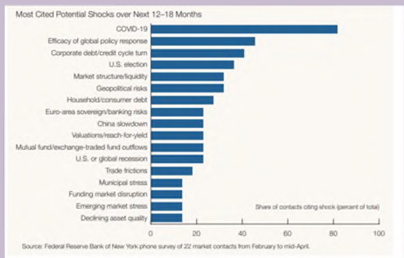
Distressed Suppliers



– Some financial distress may be masked by PPP program and other governmental assistance

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Distressed Suppliers

Does supply chain distress present significant business risk?

- Normally "yes" because:
  - It may take weeks or months to transition to another vendor
  - There may be contractual restrictions against re-sourcing (for example, exclusivity or minimum purchase requirements)
    - Note: in this presentation, the "contract" may be an actual written agreement or a PO (blanket or spot buy)
  - Existing vendor may have critical technology

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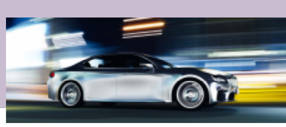
- Certain industries (e.g., auto) have requirements that have to be met in order to re-source (PPAP)
- Costs can be significant since the customer may have no viable alternative



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Pre-bankruptcy Strategies

1. Review supply base to detect signs of trouble
   - Consider implementing supplier review program
     - Determine key suppliers
     - Take steps to review suppliers:
       - Require financials from key suppliers (the more often the better, not just annual financials)
       - Credit reports can provide some information, but information is often limited and dated
       - Are there late shipments, quality/warranty problems?
       - Changes in executive management (e.g., CFO resigns)?
       - Any new UCC filings which may suggest financial issues?
       - Upon an inspection, facilities not being maintained
       - Publicly available information, including news alerts

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- Obtaining financial information from privately-owned suppliers may be difficult. Possible strategies:
  - Look at contract terms and conditions to require financials to be provided
  - Possible middle ground resolutions (third party certification)

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Pre-bankruptcy Strategies

2. If you have concerns about a supplier's financial condition, then review the key terms of the contractual terms and conditions to understand your rights:
   - Sole source/exclusive contract ("requirements contract") or any minimum purchase requirement?
   - Ability to transition supply and how long will it take (including obtaining necessary approvals from end customer)?
   - What is the duration of the contract?
   - What are the termination or exit rights?
   - Are there any IP issues if you transition to a new supplier?
   - Who owns the tooling, and is there a bailment agreement in place?
   - In addition to tooling, is any specialized equipment needed by the new supplier?

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Pre-bankruptcy Strategies

3. If serious concerns about a critical supplier, consider making a demand for adequate assurance of performance under UCC 2-609
   - This could include a demand for financials
   - May have limited value if you cannot re-source easily
   - Sometimes suppliers will make a reciprocal demand for adequate assurance of performance by the customer (so be careful)

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Pre-bankruptcy Strategies

4. Consider engaging in negotiations to modify contractual terms with key suppliers
   - Do this NOW – if you wait, it may be too late
   - May need to use leverage to amend terms because supplier may push back

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Pre-bankruptcy Strategies

5. Other strategies include the following:
   - Building parts bank (if supplier has capacity)
   - Begin review of other sources of supply NOW re-sourcing
   - Begin preparation for re-sourcing, including possibly building another set of tools
   - Move away from single source supply to multiple suppliers, or perhaps re-source 100% of business

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Pre-bankruptcy Strategies

6. If no other viable alternatives, provide financial support for continuity of supply, but in return require an access and accommodation arrangement. Terms could include:
   - Reduced payment terms
   - Pay for finished goods and raw materials on hand (confirm title by filing UCC financing statement)
   - Limitations on setoff, or perhaps no setoff
   - Price increase
   - Limitations on re-sourcing
   - Loans, including possible participation with existing bank lenders
     - Loans should be secured if possible

Negotiation point: It is critical to understand other customers' needs for supply so that fair and equitable terms can be reached.

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Post-bankruptcy Strategies

1. The automatic stay may limit or prohibit the customer from exercising its normal contract remedies. For example, the automatic stay:
   - Usually prohibits early termination of contracts
   - Could restrict re-sourcing, depending upon terms of contract
   - Limits setoff (but not recoupment)

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Post-bankruptcy Strategies

2. Close monitoring of the supplier's bankruptcy is required:
   - DIP (debtor in possession) financing could affect contractual rights
     - The fact that the supplier obtains DIP financing doesn't mean that funds will always be available. There could be an event of default allowing the DIP lender to "pull the plug"
   - Promptly review monthly operating reports showing financial results
   - Identify signs that the supplier may sell assets as a going-concern (Section 363 sale) or wind-down operations

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Post-bankruptcy Strategies

3. Supplier has the right to "assume" or "reject" contracts
   - If a supplier "assumes" a contract, that means the supplier will continue the contract.
     - In order for the supplier to assume the contract, all defaults need to be cured. For example, if the supplier has warranty liability, that will have to be cured.
   - Supplier could reject "unprofitable" contracts – if rejected, will need to negotiate pricing or other terms to continue supply
   - Must be careful to review all possible notices of supplier's desire to assume or reject contract. Prompt attention (often 10 days) is required

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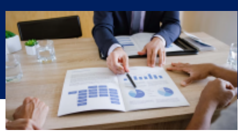
Post-bankruptcy Strategies

4. Consider taking actions that do not violate the automatic stay, including:
   - Building parts bank
   - Exploring alternative vendors (although re-sourcing may be prohibited or limited, depending upon terms of contract)



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Post-bankruptcy Strategies

5. Bankruptcy court assistance may be limited. Often courts tend to favor bankrupt company, especially at outset of bankruptcy

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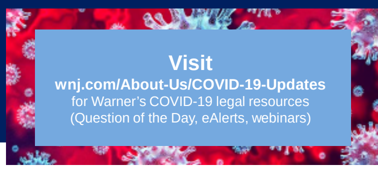
- **June 15** – Bankruptcy Update



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Questions?

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Conclusion

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