COVID-19
RESOURCE CENTER

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What to Do if Your Supplier or Customer is Financially Distressed?

Updated as of March 31, 2020:

The COVID-19 pandemic is creating financial distress across almost every industry and is affecting suppliers and customers alike. The first step is to recognize when your contract counterparty is in financial distress. When a company's financial conditions are strained, there are usually early warning signs.

What are the early warning signs?

- Distressed Supplier: If you are the customer and your supplier is in financial distress:
  - Product delivery schedules may become unpredictable; products may be late or cancelled.
  - Supplier may request price increases or alter or accelerate payment requests.
  - Supplier may request/notify customer of delay in, or cancellations of, deliveries.
- Distressed Customer: If you are a supplier and your customer's business is experiencing financial distress:
  - There may be increased delays in payment.
  - Checks may bounce.
  - When you call to follow up regarding payment, it may be hard to reach your company contact.
  - If the customer created a payment hierarchy, what "tranche" do you fall into?

Other Warning Signs of Distress

- Credit Agreement Default: payment default, financial covenant default, borrowing base deficiency, debt maturity default
- Federal or state tax liens are filed
- Management turnover
- Employee furloughs or layoffs
- Key clients or vendors have been lost or financing terms have been altered
- Frozen bank accounts
- Going concern auditor opinions
- Revolver draw-downs

What to Do if your Supplier is Financially Distressed

If you suspect your supplier is under financial stress, consider:

- Reviewing purchase orders and contracts
- Freezing accounts payable
- Extending financial accommodations to help the supplier get through these difficult times (i.e., temporary waiver of setoffs, accelerated payments, funding purchase of raw materials).

Other options:

If the supplier does not deliver the goods:

- The customer's remedy is usually a damage claim against the supplier.
- The customer may also "cover" and purchase the goods from an alternative source and recover the price difference between the cover cost and the contract price at a later time (but the damage claim may be limited if the supplier becomes bankrupt).
- Under limited circumstances, the customer may be able to recover the goods, if the supplier becomes insolvent within ten days following receipt of the first installment of the contract price, and the customer should be prepared to pay the balance (although the rights to reclaim the goods are subject to rights of secured creditors).

What to Do if your Customer is Financially Distressed

If the supplier suspects the customer is financially distressed, the supplier should consider the following:

- Request cash on delivery or cash in advance
- Withhold shipment until previous invoices are paid in full
- Request collateral for unpaid invoices, or other means of amortizing old invoices to get new products
- File liens (mechanics' or warehouseman's) on delivered goods
- Purchase insurance on the buyer's credit and request reimbursement of such cost.

If the goods are already in transit, you may consider stopping the delivery if the customer is insolvent. The supplier has the right to stop the goods if the customer is insolvent and has not taken physical possession, so the carrier is obligated to return them. But to do so, you must inform the carrier to return the goods by a prescribed method and pay for any additional expenses. If the customer has pledged the goods to a creditor, then the supplier's rights to the goods may be subordinate to the secured creditor's interest in the goods. If the goods have been delivered but remain unpaid, you may sue to recover the contract price.

During this crisis, many suppliers and customers likely will be looking for financial accommodations in the coming months. Best strategies will include reaching agreements with your counter-parties, seeking temporary price relief (increase/decrease), payment deferments or debt moratoriums, production relief (timing, amount, sharing of cost), adjustment of payment terms, and other accommodations to provide temporary liquidity relief.