

Galvanising your business against Supply Chain and Customer Insolvency Risk

Protecting your business from exposure to supplier and customer insolvency

As we move through Q1 of 2023, significant shifts are occurring in the Global financial and economic landscape which are of significant consequence for business. The marked upward shift in the cost (and reduced availability) of finance, largely unseen for over a decade, combined with high energy and natural resource/raw material costs and challenges and currency fluctuations has the potential to sharply to expose financial distress in businesses in many countries and global supply chains.

The increasing risk of unforeseen counterparty, customer, or supplier financial distress and failure means that urgent action should be taken to re-appraise and identify potential exposure to third party failure. This will also help to implement preemptive legal and operational protections against the risk of heavy financial loss or business disruption from customer/supplier failure.

Now is the time for businesses to assess critically their potential exposures, review whether legal protections in supply contracts may be ineffective and to enhance legal and operational protection. Specific legal and operational planning and on-going monitoring processes, tailored to the jurisdictions in which the operations/exposure may

arise, will significantly mitigate the risk and effect of customer or key supplier insolvency, increase optionality from an early stage and thereby enable resulting business costs to be minimised.

The key takeaway is that **early action is vital** – businesses that fail to take early action to enhance resilience to key-counterparty distress may be significantly exposed to wider consequences from unforeseen counterparty failure.

There remain significant scope for well positioned businesses to enhance value by implementing effective protections against disruption from supply chain shock and seizing strategic opportunities to enhance offerings and implement operational efficiency by being alert to competitors and supply chain businesses facing insolvency in the coming months. Outlined here are some key warning signs and a number of solutions within the legal and operational toolkit available to ensure businesses can take **pro-active steps** to re-assess their exposure, **enhance resilience** to customer and key supplier financial distress and, where possible, take advantage of market conditions which may arise.



WARNING SIGNS

- Delayed payment/stretching of supplier credit.
- Re-negotiated payment terms sought/requests for deposits and upfront payments.
- Deteriorating service levels.
- Spurious/unjustifiable claims.
- CCJs, late filing of accounts, withdrawal of credit insurance, pending winding up proceedings.
- Auditor's report subject to qualifications.
- New/additional security being granted to an alternative funding provider.
- Market rumour/industry specific challenge/external shock.
- Over-leveraged business.
- Significant changes in management.

Options to protect your goods/exposure



CUSTOMER RISK

- Review supply terms and revise if current provisions will be ineffective upon the customer's insolvency under UK legislation.
- Retain title to goods supplied until all payments due from the customer are made (key legal provisions properly incorporated in supply contracts can be very valuable).
- Periodic on-going monitoring:
 - are customer accounts filed on time?
 - any CCJs/winding up proceedings commenced?
 - audit of stock segregation conditions at customer premises if holding goods supplied which are not yet paid.
 - is credit insurance available?
- Review of financial position and payment terms.
- Monitor and review level of credit exposure.
- Are you an essential supplier (of utilities/certain IT services) which may be compelled to continue supply after the consumer enters an insolvency process?



SUPPLIER RISK

- Is the supplier key to your supply/production operations?
- If the supplier ceased trading, what alternatives would be available and within what time frame?
- Monitor potential knock on impact on your ability to deliver an onward supply contract.
- In the event of supplier distress, would that provide an opportunity to acquire assets/bring part of production required for your business in-house?
- Be alert to key payment dates and risk of non-performance following a staged payment.
- Implement legal vesting of title on staged production basis – protected and monitored by strong on site monitoring.



Early action to recover assets/obtain payment

- Where concern is identified with regard to a customer or supplier, early action is key to avoiding potentially large exposure as an unsecured creditor upon an insolvency.
- At an early stage, key steps can be taken, including:
 - enhancement of protective provisions in your terms and conditions of trade (for example retention of title clauses and early insolvency triggers);
 - diversification of the supply of key goods and services;
 - audit and inventory of stock held by customer where title has been retained;
 - recovery action in respect of stock/suspension of credit terms absent payment of debts being made up;
 - written reminders of directors' duties/potential personal liability for directors acting in breach of duties to creditors and/or threat of early enforcement action/commencement of insolvency proceedings to apply immediate pressure for payment;
 - procuring payment on account/guarantee from third party for continued supply;
 - the taking of security and guarantees to elevate and enhance creditor rights;
 - securing provision of pertinent financial information;
 - if potential "essential supplier" obligations, early action and termination of arrangements may enable a supplier to extract itself from being subsequently compelled to supply if customer enters insolvency;
 - early engagement with a key supplier in financial distress will enable optionality to be identified to secure continuing supply (with/without financial support to the current supplier or by procuring continued supply from an alternative).

Key Contacts



Peter Manley
Partner
London
+44 207 796 6056
peter.manley@dlapiper.com



Jonathan Richards
Partner
London
+44 207 796 6164
jonathan.richards@dlapiper.com