

# **Crisis Management in the Automotive Industry due to the Corona Pandemic**

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**Ensuring safe framework conditions**

**Berlin, 22 April 2020**

# I. Problem: COVID-19 Pandemic in the Industry

- Existence of numerous suppliers in the automotive industry at risk because of financial losses due to the COVID-19 pandemic.
- State aid measures are the essential building block for financing companies. The aids are very good in volume and intent. However, in their current form, they are not enough to prevent the “dying“ of many companies in distressed situations.
- It is expected that due to the exceptional crisis situation many companies, possibly with a time delay, get into an economic imbalance.
  - No company will be able to solve the crisis triggered by the Covid19 pandemic on its own: There is a complex network of international supply chains. These supply chains must be maintained cross national borders.
  - International supply chains are affected by different government measures, but also by different closing times and individual measures of suppliers and manufacturers.
  - The manufacturers and suppliers (competitors) are often dependent on the same sub-suppliers.
  - The failure of individual sub-suppliers can prevent restarting production at other suppliers and manufacturers and thus further increase economic damage for the entire supply chain and lead to higher rates of unemployment.



- ▶ Making use of the offer given by the German Federal Cartel Office to discuss flexible solutions because of the remaining legal uncertainty in the antitrust assessment with regard to measures that need to be taken to cope with the crisis
- ▶ Also current state aid measures guarantee the necessary speed in the operational stabilization of supply chains.
- ▶ The more sub-suppliers stay in the market, the better for a well functioning competition after the crisis.

## II. Proposed solution: A “basic cooperation” and a regulation to enable “cooperation for individual case solutions”

### Two levels of cooperation necessary to strengthen supply chains:

- ▶ A basic cooperation in which a holistic coordination takes place on overarching topics.
- ▶ A case-by-case cooperation to support sub-suppliers in crisis through coordinated single measures.

### Cooperation

#### Basic Cooperation:

- Organization of the restart (e.g. regulation regarding capacity shortages and closing times)
- Common position on state aid
- General exchange between stakeholder groups how to deal with crises

#### Case-by-case Cooperation:

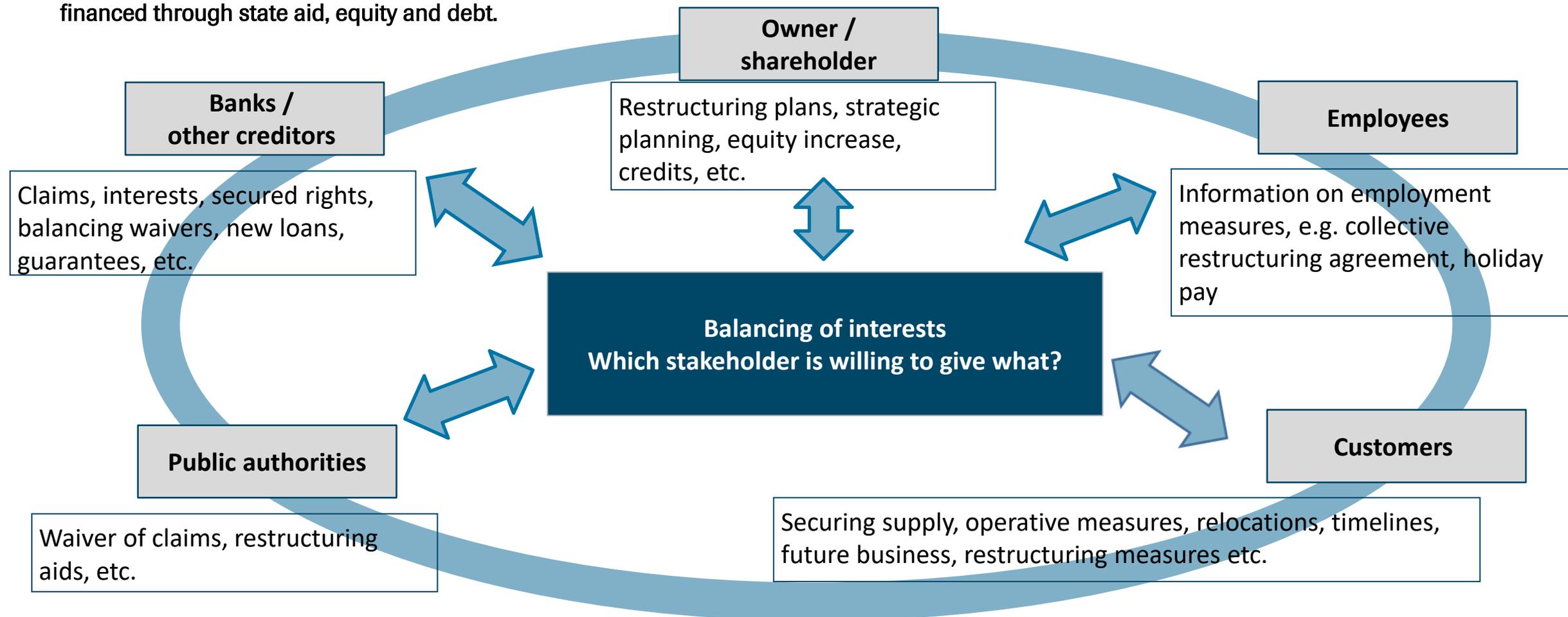
- Formation of customer groups (common practice in US restructuring cases)
- Coordination of the measures to be taken and their distribution within the customer group
- Coordination with the other stakeholder groups
- Joint appointment of consultants

# III. COVID-19 Basic Cooperation in detail

- **Organization of the restart** of production (e.g. regulation regarding capacity shortages and closing times)
  - It is necessary to coordinate the **closing times** for a secure restart of production (possibly via ACEA and others) in order to keep production downtime and the impact on sub-suppliers as low as possible. Otherwise it extends the risk of failure due to the effects of different closing times on the sub-suppliers.
  - In the event of a **shortage of capacity**, manufacturers and suppliers should be able to work together on a case-independent basis. Develop a distribution model with regard to resources, for example based on the sales ratio before Covid19.
  - Publication of a list of all closing times of manufacturers and suppliers at plant level, if possible worldwide, by the VDA, ACEA in cooperation with other international organizations for better planning security in the supply chain.
  - Exchange and coordination of the bundling of existing transport capacities during transport shortages caused by the crisis
- Common position on **state aid measures**
  - Joint discussions, also with involved countries, by the manufacturers and suppliers about the effectiveness of the government aid programs.
- Exchange between and within the various stakeholder groups on the **general, case independent handling of sub-suppliers in crisis**.
  - Examples are the case-independent coordination between the stakeholders about when and who should be involved, how to deal with sales trusts, how the contributions of the different stakeholder groups are to be compared, cost reduction common consultants determines etc.
  - According to current experience, these discussions can be long-lasting in individual cases. A clarification on a basic level would become a clear one and accelerate the ability to act.

## IV. Case-by-Case Cooperation in detail – chart of stakeholder groups

- The support of sub-suppliers in single cases requires a strong balancing of interests of various stakeholder groups and within these groups among the individual members.
- Fast and efficient operational measures by manufacturers and suppliers are an essential contribution in current times. Sub-suppliers must be financed through state aid, equity and debt.



# IV. Case-by-Case Cooperation in detail

It is believed that there will be a significant increase in the number of distressed sub-suppliers due to COVID-19

- The **number of sub-suppliers who find themselves in crisis situations will rise rapidly** in a short time (also because many aid programs are not fully applicable).
  - This presupposes that the various stakeholder groups, regardless of the case, agree on the fundamental questions of their own potential contributions, reducing consultant costs, simplifying procedures to reduce the settlement times.
  
- The **speed at which sub-suppliers will no longer be able to produce and deliver products is far higher than in normal crisis situations**
  - One customer alone cannot support the respective sub-supplier and especially in the pandemic all sub-suppliers in crisis.
  - It is not possible to negotiate the individual contributions of everyone on an individual basis. By the time the negotiations are completed, the company is already closed down or in bankruptcy. Because different customers will offer different solutions, so that the sub-supplier has to go from customer to customer again and again to discuss the new proposals. The same proceeding happens with every stakeholder. Many pre-insolvency restructurings are already failing because of this reason.
  - The only **solution is the formation of stakeholder groups** (model e.g. USA). Each group discusses and negotiates possible contributions within their group. Then the groups negotiate with each other. See for the process in detail the above slides with regard to **Part A** and the **case study** in the appendix.

# IV. Case-by-Case Cooperation in detail

**INFORMATION EXCHANGE A:** Theoretically and case-independent information regarding the situation of the company in crisis that needs to be exchanged in most restructuring scenarios among and between sub-suppliers, customers and other stakeholders

- **Purpose:** accelerating the process of finding a solution by simultaneously informing all stakeholder groups
- **Content:** minimum scope referring to the expert opinion of the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany, Incorporated Association] (hereinafter IDW) definitions (IDWS6 or S11). For this, e.g. the following information needs to be discussed:
  - Structure of the group / owners, including a strategy for potential investors. Involvement of stakeholders in the investor process.
  - How has turnover developed in recent years and how will planned business in the next 3-4 years look like? How much of it is booked business and how much is expected business?
  - The development of liquidity in the short, medium and long term.
  - Discussion on the income statement and on the asset and liability side of the balance sheet in detail.
  - Aid requested (primary source of financing for the company in crisis).
  - What kind of loans, claims and liabilities does the company have? Are they all recognized?
  - What contributions does the company expect from each individual (no detailed discussion of individual prices)?
  - What operational problems does the company have, how do they affect business and what kind of solutions can be found?
  - How does the situation in the individual plants look like? What is the reason for any losses or liquidity shortages that may arise?
  - Discussion of an operational restructuring concept, the schedule for its implementation and respective individual measures.
  - Basic information about contracts and relationships with banks, customers, commercial credit insurers, employees and other stakeholders (in particular everything that influences or concerns the contributions of the members).

# IV. Case-by-Case Cooperation in detail

## INFORMATION EXCHANGE B (1): Necessary exchange of information within the customer group

- Customers can freely decide if they want to be part of the customer group or not. If they do, they get access to the group. The group designates a **negotiator** (team or individual).
- Group may mandate joint **consultants** which might act as clearing house and a monitor. The consultant will accelerate the information given to the customers and assess the financial and operational situation of the sub-supplier - mostly also through on site visits. If appropriate, group also mandates a joint **legal advisor**;
- The minimum scope of information exchange in many cases includes the possible components of the expert opinion in accordance with restructuring standards necessary to be fulfilled to be able to get new credit lines. In Germany, this would be the IDW standards (IDWS6 or S11). Theoretical, non-conclusive indispensable contributions might be (each be understood as part of a comprehensive solution, including financial contributions through state aid, equity providers, lenders):
  - Personal support of the sub-supplier by the customers, e.g. to help solve operational problems, or replace staff missing due to the corona crisis. Compensate employees through agency workers;
  - Support for relocation of production within the company concerned and alternative sub-suppliers to be determined autonomously by the individual customer;
  - Support in building local manufacturing capacities.
  - Coordination of acceptance and delivery quotas in the event of capacity bottlenecks (i.e. proportional allocation to customers in coordination with the sub-supplier)
  - Agreement that the customers do not terminate supply contracts for a certain period of time, despite any existing termination rights. No common decision to terminate the contractual relationship. Discussion of the willingness of customers to already firmly assign future business, to grant calls and under what conditions this happens.
  - Discussion of how to deal with (possibly reciprocal) claims that burden the supplier. Conversion to instant payment in order to provide companies with liquidity more quickly, agreeing on a prepayment for delivery and service, coordinating the provision of materials by the customers and the associated relief of the sub-supplier from material. Agreement on billing model regarding the provision of materials.
  - Exchange about whether customers are willing to guarantee minimum purchase quantities. Discussion of increasing call-offs and other possible monetary contributions of the customer as a total and their distribution to the customers (e.g. distribution model determination / whether the basis for the contribution calculation is the entire company or individual locations. Whether monetary contributions should be made as part of a part price increase or in total amounts independent of delivery (but without exchange at concrete reference prices).
  - To the extent that monetary contributions have to be made by customers (e.g. part price increases or loss compensation), it may be necessary to make repayments (type and amount); possibly also about participation in a future company purchase price that is achieved for the sub-supplier.

# IV. Case-by-Case Cooperation in detail

## INFORMATION EXCHANGE B (2): Necessary exchange of information within the customer group

### Future of the supplier

- The customer group must provide the company's information and the results of its own investigations and investigations by commissioned consultants and discuss a position on a common pre-insolvency restructuring concept, develop its content and schedule and discuss and agree with the company. If the company had only its own requirements, the company would always have to implement other measures that would not fit together. All stakeholders have to agree on a restructuring concept together with the company.
- Customers have to develop a joint milestone plan with the company on when which measures should be implemented at the sub-supplier. This is the only way for the sub-supplier not to suffer from different restructuring plans of different customers.
- The restructuring plan and milestone plan ultimately ensure that the long-term preservation of a competitor in the market and prove whether the sub-supplier becomes competitive again.

### M&A process

- Customers need to find a common position on whether the sub-supplier should be sold or not. In particular, a position must be found on the sales trust that the banks often request.
- In addition, a position will have to be worked out on how the customers are to be involved in an M&A process that may take place.
- In particular, the content of the information and the question of a veto right and the conditions under which it exists must be discussed.

## IV. Case-by-Case Cooperation in detail

### INFORMATION EXCHANGE C (1): Necessary exchange of information between the main stakeholder groups (1/2)

- Supply chains and individual sub-suppliers can only be supported if they are supported not only by the customers and banks, but also by politicians and other key stakeholders such as trade credit insurers, suppliers, employee representatives and others.
  - Both the development of basic measures and the rescue of individual sub-suppliers require the involvement not only of customers and creditors but also of other key stakeholders.
  - No restructuring solution without the involvement of all key stakeholders.
  - Cooperation between the sub-supplier and its customers, creditors, trade credit insurers, suppliers, employees and shareholders is pivotal for the success of a successful restructuring process.
  - Here too, a quick restructuring can only be achieved if all stakeholder groups have the permission to cooperate within their group and comprehensive cooperation between the stakeholder groups is also permitted.
  - Essentially, such a timely agreement enabling a restructuring of the sub-supplier is only possible through the contributions of the various stakeholder groups, whereby their respective contributions must be weighed against each other in the case at hand.

# IV. Case-by-Case Cooperation in detail

## INFORMATION EXCHANGE C (2): Necessary exchange of information between the main stakeholder groups (1/2)

- If necessary **hiring joint consultants to all stakeholders** (economic and legal); may also be used as a clearing house.
- About the distribution of the contributions (see case study):
  - Type of contributions
  - Amount / scope of the contributions of the individual stakeholder groups
  - Weighting of the individual contributions from the groups to each other
  - If necessary rankings for repayment of contributions
  - Discussion of the components of the expert opinions according to the IDW definitions (IDWS6 or 11)
- **Future of the sub-supplier**
  - Coordination of the restructuring concept
  - Development of a milestone plan recognized by all stakeholder groups to secure the restructuring
- **M&A process**
  - Involvement of the individual stakeholder groups in the M&A process and the respective influence of the individual stakeholder groups in the process

# V. Legal assessment (1/2)

- The proposed cooperations (the basic cooperation as well as the case-by-case cooperation) do not constitute a violation of the prohibition of agreements restricting competition (Art. 101 para. 1 TFEU or § 1 GWB).
  - The existence of many sub-suppliers is at acute risk
  - The coordination of programs and the development of basic measures as well as support measures in individual cases by the manufacturers and sub-suppliers will result in a considerable stabilization and possible a liquidity gain for the sub-suppliers.
  - No manufacturer or supplier is able to solve the corona crisis in the automotive industry alone.
  - Only by working together and balancing different interests through stakeholder groups can the burdens and risks of the failure of individual suppliers that are threatened in their existence can be shouldered (ad hoc working group necessary).



- The planned cooperation is temporary, appropriate and objectively necessary;
- Participation is equally open to all stakeholders;
- No other anti-competitive objectives - e.g. hard-core price fixing, customer allocations or territorial restrictions – are pursued;
- Milder, equally effective measures are not evident.

# V. Legal assessment (2/2)

In any case, the proposed cooperations are exempted under Article 101 (3) TFEU or § 2 GWB:

- The coordination achieves macroeconomic efficiencies of major importance.
- Consumers are allowed a faire share of the resulting benefit due to the efficiency enhancement, because the continuation of the ability to deliver to a cost-effective onward delivery that results in a significant cost saving in comparison to the development of an alternative source of supply with a complex testing and qualification process that prevents the passing on of price increases to end consumers in relation to cars. About that it also prevents shortages and delays of vehicle deliveries due to new approval procedures.
- Cooperation in the Corona crisis ensures that market exits because of restructuring cases can be avoided as far as possible and consequently sufficient competition remains after the crisis.
- Measures do not go beyond what is absolutely necessary until the stabilization of the situation has been achieved.
- Competition is not eliminated because the cooperation between manufacturers and suppliers is strictly limited and, in addition, companies continue to compete normally, particularly with regard to the sales market.
- Competitive advantages of the proposed cooperations outweigh possible disadvantages.

# VI. Result: Offer of antitrust law clarification

## Legal assessment

- The proposed cooperation between manufacturers and suppliers in favor of distressed sub-suppliers does not constitute a violation of Art. 101 Para. 1 TFEU or § 1 GWB.
- Supplying suppliers themselves is positive under antitrust law even in times of non-crisis.
- Individual customers cannot handle the rescue of the supply chain and the rescue of the sub-suppliers alone.

## Suggestion

- The VDA therefore asks the BKartA - in coordination with the European Commission and the ECN - for the following:
  - Clearance for the proposed cooperations by comfort letter
  - Enactment of a clarifying regulation that stipulates that the proposed cooperations regarding sub-suppliers in crisis do not violate antitrust law ("safe harbor ")