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Guide

Navigating the challenges of a struggling automotive industry – a supplier's view

A struggling automotive industry

The automotive industry is undergoing a period of profound transformation. Automobile manufacturers (OEM) are focusing on the development and production of electric vehicles (EVs), which are gradually replacing classic drive technologies. At the same time, they are transforming themselves into software-native enterprises – and the vehicle into a software-defined vehicle (SDV). Digital and data-driven services are the drivers of this development and an additional building block in the value chain.

In doing so, they are coming under enormous economic pressure.

Highly specialized providers of autonomous driving technologies and other AI-based services from Asia and the US are entering the automotive market. Competition is leading the way in many forward-looking technologies and has a distinct advantage over domestic manufacturers who have been late to the game in developing alternative drive systems (including EV), connected technologies and autonomous driving. They now feel compelled to source these from suppliers in other parts of the world – particularly China – in order to develop competitive products.

This change is transforming the supply chains in the automotive and supplier industry. Many of the technologies in demand are provided by suppliers from Asia and the US. European suppliers are no longer the "technology leader" in all areas. Competition from countries such as China is increasing commercial pressure through short development cycles, rapid time-to-market and cost-efficient manufacturing methods. They also benefit from a legal environment that is often less regulated, making it easier to test new technologies such as autonomous driving than in the highly regulated EU.

At the same time, German OEMs are facing a decline in demand for their vehicles in traditionally important sales markets such as China, where local brands are conquering the domestic market. This reduces demand from domestic suppliers and further increases competitive pressure.

Furthermore, the increasing polarization of the world – in addition to trade interventions, also accelerated by diverging national environmental regulations and requirements – is leading to new challenges in a global market, from import bans to punitive tariffs, which the new US administration has recently used to try to protect the domestic automotive market. All of this makes it more difficult to plan ahead, especially for automotive suppliers.

These developments are forcing the traditional supply industry to realign its strategy, which is associated with particular challenges:

1. Technological change and investment requirements: Converting the range of products and services to technologies from the field of EVs, connectivity and (partially) autonomous driving requires significant investments in research and development, as well as the adaptation of production capacities, methods and facilities. The conversion of the range of products and services to technologies in the areas of e-mobility, connectivity and (partially) autonomous driving requires significant investments in research and development as well as the adaptation of production capacities, methods and facilities. The automation and application of AI technologies, as well as the corresponding stricter legal requirements for technology, environmental protection and sustainability, require long-term and strategic planning of suitable measures that involve considerable costs.

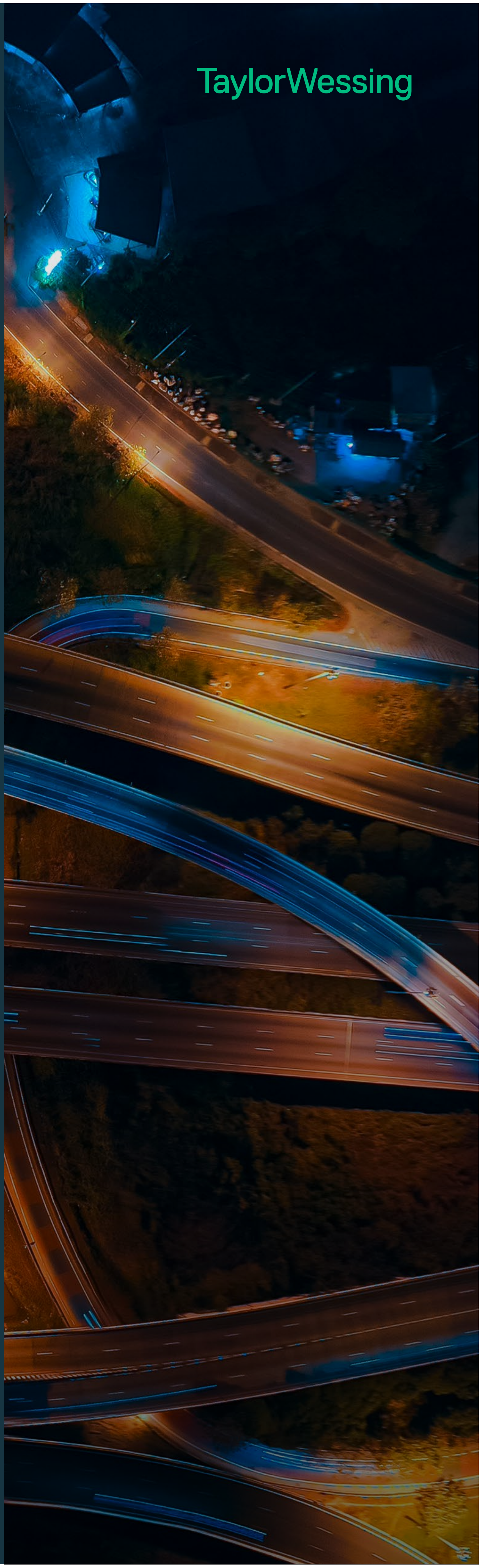
2. Cost competition: Cost pressure from competitors, including those from China, is forcing suppliers to continuously optimize their cost structures.

3. Dependencies: Many suppliers are heavily dependent on a few large customers, which hits them particularly hard when production declines and call-offs are delayed. The competitive disadvantage of being dependent on other countries for energy and raw material procurement must also be counteracted.

If economic conditions deteriorate, comprehensive crisis management strategies are needed that include both short-term measures to control costs and secure liquidity, as well as medium- to long-term adjustments to the business model to reflect the changing conditions of the global market.

Our guide "Navigating challenges of a struggling automotive industry – A supplier's view" by the Taylor Wessing Industry Group Automotive & Mobility shows which aspects and steps are of particular importance in the context of "crisis management" when an automotive supplier is in difficulty, and which measures enable legally secure and economically successful navigation through the crisis situation.

These guidelines offer valuable information and suggestions not only for suppliers in the automotive industry, but also for market participants in other sectors who are affected by similar developments in their respective market environment.



A supplier`s view

An automotive supplier that develops components for classic drive technologies is facing major challenges: the shift towards electric drive technologies and the move away from the combustion engine is leading to a drop in demand and a significant decline in orders from the supplier's main customers (predominantly Tier 1 suppliers to the automotive industry).

The customers (Tier 1 suppliers) reduce the call-off quantities at short notice within the framework of existing orders or longer-term framework contracts. The decline can be explained, among other things, by the reduction in production capacities on the part of the OEM due to the precarious sales and earnings situation.

The supplier tries to cancel orders that have already been placed with its suppliers at short notice, which leads to considerable disputes in the supply chain.

The situation is analyzed together with the consultants. Liquidity decreases because existing obligations to suppliers must be met despite a lack of profitability. Together with the external consultants, strategies must be developed quickly that enable the company to secure its liquidity in the short term and its continued existence in the long term.

The Challenges

Essentially, companies face three (3) main challenges in such scenarios:

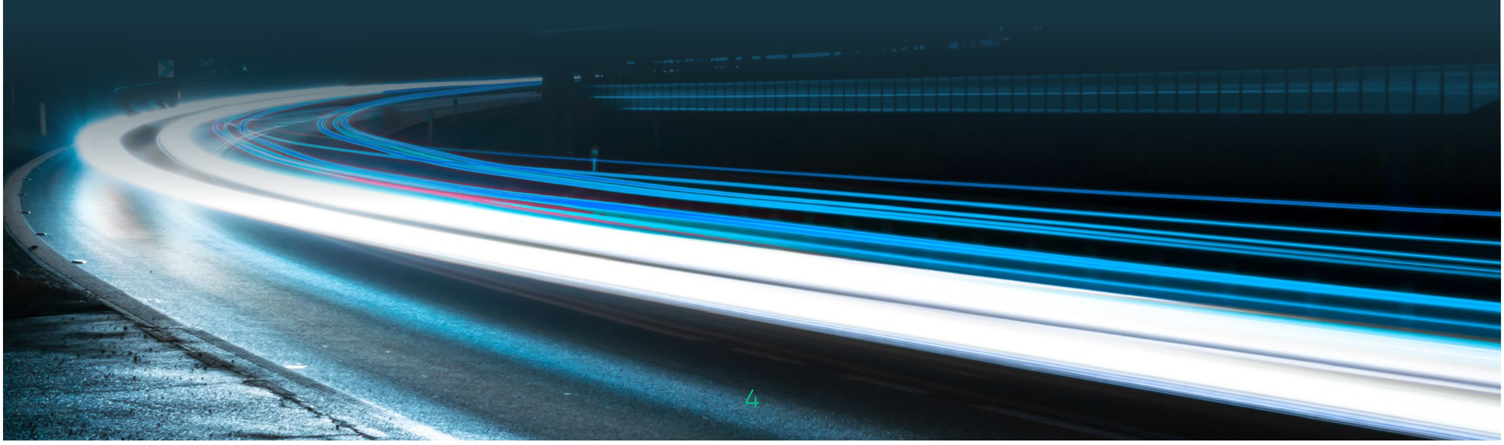
Resizing: Adjusting existing capacities and the range of goods and services to current market conditions and demand

Securing financing: Securing sufficient financial resources to guide the company through the crisis

Restructuring and insolvency: If the measures described above do not provide the desired relief, the options and obligations for management to act quickly must be explored.

These (commercial) challenges are accompanied by a number of "legal challenges", including

- individual and collective labor law (e.g. with regard to co-determination in measures)
- financing law (including legal issues relating to financing agreements)
- corporate law (including in the area of restructuring measures)
- insolvency law (including in the context of liquidation)
- competition and antitrust law (including in the context of cooperation with industry partners)
- IP law (including in the context of technology licensing)
- technology law (including in the context of new product development)



Navigating the Challenges – **Resizing**

1. **Reducing labor costs:** Reducing labor costs is of central importance for resizing the company and the associated reorganization. Short-term labor law measures are often necessary for this, but due to the many special regulations in the collective agreements of the automotive industry, they cannot be implemented without careful examination and without amicable solutions with the employee representatives.

   Legal Challenges: Professional and forward-looking labor law advice is a key success factor in ensuring that the actual goal (cost reduction) can be implemented quickly and consistently. Particular attention is paid to developing and designing socially acceptable solutions for employees, as well as to targeted negotiations with works councils and trade unions, which have considerable (design) power due to the strong co-determination culture in Germany and other European countries..

   - **Introduction of short-time work:** Temporary reduction of working hours and labor costs while maintaining workforce continuity and subsequent recovery. These measures require close coordination with employee representatives and compliance with complicated social legislation in order to develop workable solutions.

Recommended action: Review existing employment contracts, company agreements and collective agreements to identify and, if necessary, eliminate obstacles to restructuring and short-time work at an early stage; involve co-determination bodies at an early stage; conduct a detailed analysis of the various options for reducing personnel costs, including further state government support for short-time work and retraining.

   - **Personnel adjustments:** As a last resort, personnel adjustments in the form of layoffs may be necessary to reduce personnel costs in the long term. Protection against dismissal is particularly strong in Germany and other EU countries. Layoffs can only be announced under certain conditions. This applies in particular to cases in which a larger number of employees are to be dismissed (cases of so-called "mass layoffs"). Here, too, employee representatives have a strong position and a say.

Recommended action: Careful planning and implementation, taking into account socially acceptable measures such as voluntary severance programs, severance payments or support in finding a new job. "Due diligence" of employment contracts, company agreements and collective agreements to identify the scope for personnel adjustments. Early workforce management to continuously adjust headcount in response to fluctuating order volumes, making use of flexible elements.

Practical tip: Careful planning and implementation, taking into account socially acceptable measures such as voluntary severance programs, severance payments or support in finding a new job. "Due diligence" of employment contracts, company agreements and collective agreements to identify the scope for personnel adjustments. Early workforce management to continuously adjust headcount in response to fluctuating order volumes, making use of flexible elements.

2. **Purchasing costs:** Optimizing purchasing costs offers enormous savings potential, but it is not always easy to achieve in the short term.

   Legal Challenges: Pacta sunt servanda – contracts are to be fulfilled. Unless contracts include provisions for termination, service or price adjustments, it is often difficult to make unilateral adjustments despite the crisis. A strategic approach is essential to achieve short and medium-term relief by adjusting existing contracts. In addition, an unauthorized approach (e.g. unilaterally terminating and ending a supply relationship) can lead to claims for damages, which can further exacerbate the company's difficulties

   - **Analysis of status quo / leverage for price savings:** Initial consideration and review of options for adjusting purchase prices or terminating contractual relationships.

     Recommended action: Analysis of the actual and legal possibilities and possible levers for negotiations on price adjustments with suppliers, based on the analysis of current contracts for exclusive purchase obligations, purchase obligations and terms / contract termination. Determining the risk of compensation claims due to unjustified premature termination or non-acceptance / payment of agreed remuneration.

   - **Renegotiate with suppliers:** Targeted renegotiation of existing supply contracts and implementation of additional protective and cost control measures to ensure more favorable conditions and lower costs in the medium and long term.

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Jan-Patrick Vogel
Partner

"The automotive sector is under pressure on the cost side due to the special collective bargaining conditions that have emerged over the years. It must and can remain competitive in the area of labor costs by consistently using the existing flexibility instruments and seeking dialogue with employee representatives from the outset.

> **Recommended action:** Conduct a market analysis to identify lower-cost suppliers (benchmarking) and solicit alternative offers; implement a strict cost control system (monitoring and reporting) and investigate potential bundling effects through cooperation with other companies, taking into account antitrust restrictions.

3. **Revenue Management:** Active dialog with OEMs is crucial to obtain future demand forecasts and secure potential orders.

   Legal Challenges: Where possible, appropriate precautions for a crisis situation should be agreed with customers in advance. If this is not the case, the same applies as for supplier relationships: contracts must be fulfilled. Disputes with major customers are unpopular. However, subsequent agreements to secure a (possibly reduced) delivery quantity can be advantageous for both suppliers and manufacturers, for example in the form of long-term material reservations and purchases, as well as adjustments to production costs. Such options should be explored at an early stage – even in a crisis.

   > **Recommended action:** Negotiations on long-term contracts with fixed purchase quantities, including the preparation of detailed demand forecasts in close cooperation with the OEMs, can help to better manage fluctuations. Existing contracts that can no longer be processed in a cost-effective manner should be renegotiated at an early stage to avoid losses or claims for damages.

4. **Diversification of the product portfolio:** Diversification of the product portfolio offers new sales and revenue opportunities but can often only be realized in the medium to long term. However, if it is an attractive option, it must be initiated promptly in order to start the corresponding developments immediately and in parallel with the crisis management, among other things to send positive signals to investors.

Dr. Benedikt Rohrßen
Partner

"To remain competitive, you need to use contracts strategically, manage costs flexibly, and drive innovation in a legally compliant way – and to achieve this, you need to think about product compliance right from the outset.

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Legal Challenges: Resizing the product range is a complex process in which the legal requirements for new products and services also play an important role. Even in a crisis, products developed under time pressure must be designed in a legally compliant manner in order to be successful in the long term and to ensure the company's survival. This applies in particular to the highly regulated automotive industry and the over-regulated European market in general. When working with other market participants, antitrust regulations in particular can become a stumbling block.

- **Reshaping existing products:** When new products are developed out of the crisis, it often has to be done quickly. Despite the economic pressure and the need for a short time-to-market span, all applicable regulatory requirements must be kept in mind. There are many of these in the highly regulated automotive sector (e.g. EU Regulation 2018/858 on the type approval of vehicles and components, environmental regulations such as the EU Taxonomy Regulation, and in the future possibly also the "right to repair"), which must be taken into account at an early stage in order to develop marketable products that can contribute to the long-term success of the company.

Recommended action: The development process should be supported by internal and external experts from the outset in order to identify and circumvent regulatory hurdles at an early stage. Legal advice must be provided in interdisciplinary teams consisting of representatives from different fields and areas; examination of funding opportunities (e.g. innovation funding at EU level).

- **Synergies through partnerships:** The development of new products, the combination of complementary products, the pooling of manufacturing capacities and mutual support in the development of existing and new markets can be achieved through partnerships. Of course, the search for synergies in partnerships requires a careful analysis of the market, partners and interests, including a careful definition of objectives and determination of the legal

Michael-Florian Ranft
Partner

The automotive industry is global. Whether you are an SME or a multinational corporation, partnerships are often the key to success, whether in terms of capacity, technology, product range or market penetration. But here, too, the rule applies: be careful when choosing a partner and a cooperation model.

framework for a potential cooperation (e.g. joint ventures, purchasing, manufacturing or sales cooperatives, etc.), which must meet certain legal requirements.

Recommended action: The design of the collaboration with partners and the drafting of contracts should be considered at an early stage. In addition to corporate and IP law issues, antitrust and competition law risks in particular must be considered and a clear delineation of responsibilities must be ensured.

- **Development of new revenue sources:** Data and data-driven add-on products and services are an asset that can be used to generate business and revenue.

Recommended action: Evaluate the data available from connected products, among other things, and examine possible extensions to the product portfolio (including through supplementary data-based IT services in the area of product maintenance); early examination of the implementation of legal requirements such as the EU Data Act, data protection and license rights, as well as IoT-specific special regulations such as the Machinery Directive or the new Machinery Regulation, the IT security requirements of the Cyber Resilience Act and the NIS-2 Directive, and the new product liability directive.

5. **Digitization / efficiency assurance / process optimization:** The digitization of operational processes contributes significantly to increasing efficiency and can help to reduce costs and make products more attractive. The use of automated and, where appropriate, AI-controlled production and marketing processes optimizes workflows and reduces costs.

   Legal Challenges: Digitization projects involve a multitude of legal challenges that need to be circumvented. The involvement of external development partners can raise not only intellectual property issues, but also labor, social security, and tax issues. Depending on the origin of the development partner, there may be antitrust and

competition law restrictions. The international transfer of personal data is subject to restrictions under the GDPR. The use of new technologies such as AI and the use of data from networked devices is now also comprehensively regulated by law in the EU. The legal requirements for the use of such technologies are constantly increasing and also raise questions about individual and collective rights, for example, if the technologies used lead to job cuts or (theoretically) enable the monitoring of employee behavior and performance.

Recommended action: Comprehensive evaluation of current IT systems and their modernization potential; strategic planning and investment in modern ERP and production systems as well as AI, taking into account applicable legal requirements such as copyright, AI law, data protection and co-determination (especially when using AI). The use of AI in production (automation, flexibilization of production and supply chains, predictive maintenance) often requires the support of the tool/machine manufacturers supplying the products; clear contractual arrangements for joint development projects and the rights to the corresponding development results; examination of competition and antitrust barriers when working with partners; examination of tax and social security requirements, e.g. in agile project structures.

Navigating the Challenges – **Securing financing**

Securing financing is a central aspect of stabilizing short-term liquidity and ensuring the financing of the long-term stabilization and growth strategy. But it is also important to do your own homework when dealing with existing creditors.

The following measures should be considered:

1. **Analysis of financial requirements:** Determining short-, medium- and long-term financing requirements, taking into account all current and planned projects.

   Legal Challenges: The duties of managing directors can become a sharp sword, especially in a crisis. First and foremost, this concerns the duties of early crisis detection, crisis management, but of course also – in the worst case scenario – filing for insolvency. It follows from these duties that the management must be informed at all times about the economic situation of the company, the causes of the crisis and the options for action.

   Recommended action: Develop a comprehensive reporting system for continuous monitoring of the financial key figures and analyses of the market and the competition; continuously create a 13-week liquidity forecast (ideally on a daily basis) and a 24-month business plan (at least on a monthly basis).

2. **Shareholders as "key players":** family shareholders or professional investors – the trust of the shareholders and management in the shareholders is of paramount importance. In times of crisis, external financing partners always look first to the shareholders and their ability and willingness to provide financing.

   Legal Challenges: Existing notification and reporting obligations of the management may arise from general corporate law, but also from the articles of association or the rules of procedure, and require an active information policy towards the shareholders. However, legal issues are only one aspect. Even more important is that management needs the support of the owner when it comes to challenges and difficult decisions, especially in times of crisis.

   Recommended action: Involve shareholders at an early stage, keep them informed and determine their willingness to provide financing and commitment early in the process and review it regularly; take steps to build trust (e.g. by hiring a Chief Restructuring Officer and setting up a project management office or a steering committee with the financiers).

3. **Secure external sources of financing / measures to increase liquidity:** 'Cash 'Cash is king': Especially in a crisis, liquidity is the key factor in surviving the acute challenges and remaining capable of acting. In this respect, it is essential not only to monitor existing liquidity, but also to secure it and to develop further sources of liquidity.

   Legal Challenges: The provisions of insolvency law alone make it clear that the lights will literally go out if a company can no longer meet its payment obligations. Securing liquidity and corporate financing are therefore essential from a legal perspective as well. Liquidity and securing the company's financing are therefore also essential from a legal point of view.

   - **Suppliers and other contractual partnersr:** Identify overdue liabilities.

     Recommended action: Negotiate with suppliers on extended payment terms; timely agree with medium to large creditors on deferral or suspension agreements.

   - **Existing financing partners:** Analysis of the existing financing structure: Which creditors are there, what adjustments need to be made to the existing credit documents, what legal and procedural options do the existing creditors have, what concessions are conceivable, etc.?

     Recommended action: Create a financing matrix, including the actual need for adjustment, the legal and economic levers of the existing creditors and proposals for adjusting the financing; develop a specific financing proposal for the existing creditors (including adjustment of repayment plans, interest rate increases, increase in existing lines, flexibility in financial key figures, etc.). Prepare a well-founded argumentation; involve the principal banks and other key partners – important: building trust is essential!

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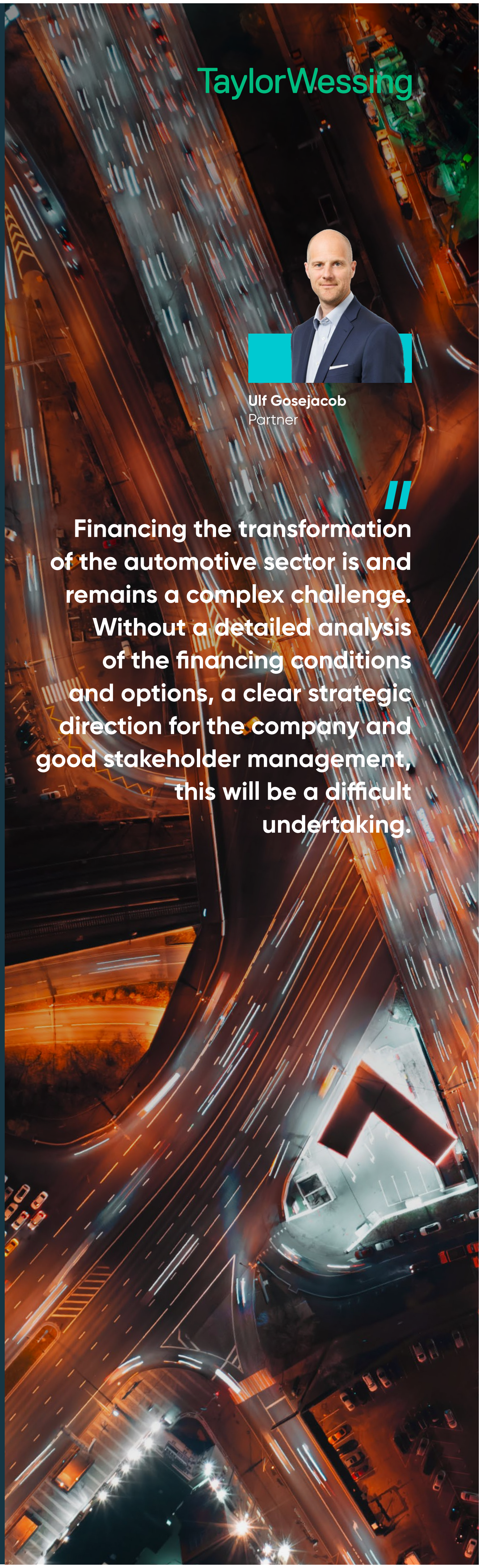

Ulf Gosejacob
Partner

"Financing the transformation of the automotive sector is and remains a complex challenge. Without a detailed analysis of the financing conditions and options, a clear strategic direction for the company and good stakeholder management, this will be a difficult undertaking.

- **Subsidies:** Use state subsidy programs to provide support in times of crisis or for innovation projects.

  Recommended action: Research available subsidy programs at the regional, national and EU level; submit eligible project proposals.

- **Liquidity through asset-based financing:** In times of crisis, alternatives to traditional bank financing should be evaluated. Factoring, sale-and-lease-backs and other asset and sales financing can provide additional liquidity.

  Recommended action: Evaluate the asset portfolio; identify suitable asset financing alternatives; examine sale-and-lease-back options for real estate and/or tangible assets; professional approach process.

- **Shareholdings of investors:** Attracting new investors by selling shareholdings or increasing capital.

  Recommended action: Create a convincing information memorandum; identify potential investors from relevant sectors; conduct investor meetings and presentations.

Clemens Niedner
Partner

"Financial restructuring in the automotive sector requires legal precision, market understanding and the ability to translate complex stakeholder interests into viable financing solutions. Caught between OEM dependency, cost pressure and shareholder positions, only customized structures lead to success. Our strength lies in developing bank approved restructuring concepts that take into account all interests.

Navigating the Challenges –
Restructuring and insolvency

1. **Restructuring proceedings under StaRUG:** The restructuring proceedings allow for early restructuring without formally filing for insolvency. It offers the opportunity to restructure preventively in the event of impending insolvency while maintaining the legal entity, without giving up the management's full capacity to act..

   Legal Challenge: The restructuring process should be initiated at an early stage, as it is no longer possible to restructure a company that is already insolvent and/or over-indebted. This requires forward-looking planning as well as careful legal preparation and documentation of the restructuring plan. Challenges in this phase include dealing with creditors, particularly when creditors have different interests and creditor groups have to be formed. Timely communication with creditors is essential, as they must agree to the restructuring plan.

   Recommended approach: Proactively identify potential conflicts between creditor groups and strategically plan the necessary negotiations and coordination at an early stage.

2. **Insolvency proceedings:** If the restructuring measures do not achieve the desired result, the process ends with the opening of insolvency proceedings, either in self-administration or as classic insolvency proceedings.

Legal Challenge: In the event of insolvency and/or over-indebtedness, management has a duty to file for insolvency in order to avoid criminal and liability risks. Depending on how the insolvency proceedings are conducted, various challenges arise. If the insolvency proceedings are carried out under self-administration, the management remains authorized to act. However, there are increased legal requirements for access to self-administration proceedings, which must be observed. In addition, there is the option of ending the insolvency proceedings by means of an insolvency plan: here, among other things, creditor groups must be formed and the insolvency plan must be carefully prepared.

Recommended action: Closely monitor the financial situation in order to identify compelling reasons for insolvency in good time; seek legal advice in good time in order to be able to take advantage of the best opportunities for maintaining the company despite insolvency; if business operations continue during insolvency, implement an investor process at an early stage to enable the sale via an asset deal.

Conclusion: Suppliers are facing significant economic challenges due to the significant decline in orders from their main customers. It has become clear that a wide range of measures are needed to successfully stabilize the company and get it back on track. A targeted combination of these measures and interdisciplinary project design can help overcome current challenges and create a stable basis for future growth. This holistic approach enables timely and interdisciplinary legal advice that not only helps the client to secure its existence but also to emerge from the crisis stronger than before.

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