Legal Issues: Business Contract Considerations, Workouts & Bankruptcy

The presentation will begin at 12 p.m.
Legal Issues: Business Contract Considerations, Workouts & Bankruptcy

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• Schulze School of Entrepreneurship
• Small Business Development Center
• Family Business Center
• https://link.stthomas.edu/businesssupportseries
Contractual Obligations in the COVID-19 Crisis

Presented by
Marty Rosenbaum & Shane Solinger
Maslon LLP
May 13, 2020
Topics

• Contractual Obligations in the COVID-19 Crisis
  • General principles - not specifically covering loans or leases
• Role of Contracts and Business Lawyers
• Force Majeure Clause
• Other Defenses to Performance
• Personal Guarantees
• Consequences of Breach of Contract
Role of Contracts

- Contracts define the legal aspects of relationships – promises (obligations) of the parties
- The world has changed – have the parties’ obligations changed with it?
  - Would a court (or arbitrator) enforce the promise?
  - Threat of bankruptcy
  - Workouts – short of bankruptcy, can the parties agree to amend?
- Contract considerations are a starting point for negotiations
Role of Business Lawyers

- At the beginning – drafting/negotiation of contract
- Change in the relationship/Conflict situation
  - Strategy for enforcement of contract, or defense of nonperformance
  - Advice on how a court would enforce
  - Renegotiation or termination
  - Negotiations – help the client set the stage
Setting the Stage for Negotiations

- Gather all relevant documents
- Review contract and all addenda
  - What is the governing law? Venue?
- Other communications (may or may not be used to interpret)
- Anything else relevant to understanding the relationship
  - May be relevant to how an amendment can be a “win-win”
Excusing Performance – Force Majeure

- Often contracts contain a clause either delaying or excusing performance upon the happening of certain events
  - “Force Majeure events”
  - Whether performance is excused or delayed depends upon the contractual language
- Force Majeure clauses are generally raised in defense to a claim that the delay or failure to perform constituted a breach
Example – Magic Words

• A party **shall not be held liable for failure of or delay in performing its obligations** under this Agreement **if such failure or delay is the result of an [act of God/event outside of the party’s control], [such as/including but not limited to]** earthquake, hurricane, tornado, flooding, or other natural disaster, or in the case of war, action of foreign enemies, terrorist activities, labor dispute or strike, government sanction, blockage, embargo, or failure of electrical service. The non-performing party must make every reasonable attempt to minimize delay of performance. In the event force majeure continues longer than 120 days, either party may terminate the Agreement, repaying the full amount of the deposit within 10 days of termination notice.
Legal Test for Force Majeure Clause

• Generally, a four-step analysis applies
• **Event** – does it meet the definition in the contract?
  • Was the event contemplated? (Not as simple as it may seem.)
  • Non-exhaustive lists: “such as” or “including, but not limited to”
    – Some states – broad interpretation
    – Others (NY, TX) – unlisted event must be similar to listed events
    – Minnesota – unclear
Legal Test for Force Majeure Clause, cont.

- **Event** analysis – application to Covid-19
  - Important to check contractual language
    - Look for “pandemic” or “epidemic” or “virus” or “disease”
  - If not listed, important to consider whether it is similar to anything listed
  - Factual analysis

- **Causation/Beyond Reasonable Control**
  - Causation
    - Who/what caused the event to occur
    - Party is unlikely to be excused from performance if it caused the event
  - Beyond reasonable control – factual issue
Legal Test for Force Majeure Clause, cont.

- **Effect of the event**
  - Must in fact have caused delay or failure
  - Typically, mere economic effect is insufficient

- **Procedural requirements**
  - Must give notice in accordance with contractual language
  - Generally set forth in the contract
  - Critical component
Excusing Performance – Common Law

- Court-created doctrines can also excuse performance
  - Legal Impossibility
  - Commercial Impracticability
  - Frustration of Purpose
Legal Impossibility

- Performance under contract is no longer possible
- Often requires performance of both parties to be impossible
- Contract to sell priceless artifact, but artifact destroyed by arsonist
Commercial Impracticability

- Performance may be physically possible, but would impose excessive hardship or loss to the promisor
- Less stringent than legal impossibility, but still high bar
- UCC has notice requirements for sales context
Frustration of Purpose

- Event occurs that frustrates the purpose of entering the contract
  - The non-occurrence of the event must be a “basic assumption” the parties had when entering the contract
- Must be basic assumption of both parties
  - *Coker* – looms example
Common Law Doctrines – Conclusion

- High bar for all three
  - Likely require professional legal assistance
- Useful in negotiations
Personal Guarantees

- Often required in context of commercial leases and loans to small businesses
- Excusing performance – many of the same considerations as for the underlying contracts
- Negotiations are tied to bankruptcy considerations – entity vs. personal bankruptcy
Breach of Contract - Consequences

• Typically, damages against a company for breach of contract will be the remaining value of the contract
  • “Expectation damages” – As if the promise were kept
• Possible Remedies – Reliance or Restitution
  • E.g., if you have conferred some benefit on other party (through delivery) and the other party fails to perform, you are entitled to receive the value of the benefit conferred
  • In some cases, may get reimbursed for money spent in preparation to contract even where no benefit has been conferred, but very factually dependent
    – E.g., generally not allowed in the frustration of purpose context
Marty Rosenbaum

Marty has more than 35 years' experience advising public and privately held companies on securities and corporate matters. His practice is concentrated in securities and corporate finance, including public offerings, private placements, venture capital financings, and mergers and acquisitions involving public and private companies. Marty regularly advises public companies of all sizes regarding preparation of public reports and proxy statements, public disclosures, insider trading, securities regulatory compliance, corporate governance matters, executive compensation, and stock plan issues. He provides business legal services to privately held corporations, partnerships, and limited liability companies in all stages, from organization through their initial public offering or sale. He is also an active volunteer business attorney with LegalCORPS, providing pro bono business law advice, is a past president of the board of LegalCORPS and was named Volunteer of the Year in 2019.
Shane Solinger

Shane counsels clients on corporate matters, including mergers and assets acquisitions, contract issues, and corporate governance. With experience spanning a broad range of industries, he has particular depth advising closely held corporations to help them meet their goals throughout all stages of the business cycle—from corporate formation to the sale of the business. Shane is highly skilled at simplifying the complex for his clients—always with the goal of creating a clear actionable path to a meaningful solution.
COVID-19 CRISIS

Bankruptcy and Workout Issues

Presented by:
Karl J. Johnson
• **Non-bankruptcy workouts**

• Banks Don’t Want to Foreclose/Repossess.
• Transparent Financial Disclosures
• Restructure Obligations
  – Defer Payments
  – Extend Amortization
  – Temporary Interest Only Payments
• Bank’s Authority or Flexibility May be Limited
Bankruptcy Objectives

• Address Personal Guarantees

• Reorganize or Sell Business
Personal Chapter 7

- Personal liability for guarantee of business debt is usually dischargeable
- In chapter 7 bankruptcy, debtor keeps exempt assets
- Trustee liquidates nonexempt assets (fancy vehicles, boats, stocks, bonds)
- Qualify for chapter 7 bankruptcy if income is below median or if you primarily have business debt
Chapter 11 to Sell Business

• Some buyers prefer to buy a business out of bankruptcy

• A section 363 sale is free and clear of liens and interests

• Can “cleanse” assets of unknown claims
Chapter 11 Reorganization

• Reduce debt by selling unnecessary inventory and equipment
• Reject burdensome contracts
• Cram down secured claims to current market value
• Re-amortize loan terms and reduce interest rates
• Must still be able to cash flow and service restructured debts
Chapter 11 Can Be Expensive

- US Trustee Quarterly Fees

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Chapter 11 Can Be Expensive

- US Trustee can appoint a Committee of Unsecured Creditors
- Chapter 11 Debtor pays the professional fees for the committee
- Chapter 11 is complicated, involves multiple difficult issues, and attorney fees add up quickly
Chapter 11 Subchapter V

- The Small Business Reorganization Act of 2019 created a streamlined and less expensive form of reorganization
  - Small Business has less than $2,725,625 of debt
  - The Coronavirus Aid, Relief, and Economic Security Act increased the debt cap to $7,500,000
- No US Trustee Fees and No Committees
- Can cram down a HELOC if proceeds were used to fund business
- Pay all disposable income to unsecured creditors for 3-5 years
Ineligibility for PPP Loan

- CARES Act created the Paycheck Protection Program
- SBA loans—forgivable under certain conditions
- SBA policies disqualify bankruptcy debtors
Karl J. Johnson

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