After the Pandemic—What Happens Next?
Distribution, Franchise, and Supply Chain Issues

June 23, 2020
Introduction

Michael J. Lockerby
Partner,
Washington, D.C. | Bio
202.945.6079
mlockerby@foley.com
Coronavirus Resource Center

Offers insights from across Foley's many practice disciplines to provide timely perspective on what companies can do now and how they can prepare for the future.

FOR MORE INFORMATION, PLEASE VISIT: bit.ly/Foley-Coronavirus-Resource-Center
What Happens Next?

- The Supply Chain: Lessons Learned
- *Force Majeure* Clauses
- COVID-19 Related Insurance Issues
- Real Estate & Finance
- Bankruptcy: Offense & Defense
The Supply Chain: Lessons Learned

PRESENTER:

Vanessa Miller
Partner, Detroit
313.234.7130
vmiller@foley.com
The Supply Chain

- Renewed focus on the supply chain
- COVID-19 was the stress test for weaknesses and areas for improvement
- Weaknesses inherent in the Just In Time (JIT) production model
- Required an interdisciplinary crisis response team
Lessons Learned

- Supply chain “mapping”
- Consider entire supply chain
  - And its supply chain of raw materials, distributors, and sub-suppliers
  - Location, location, location!
  - Labor and workforce issues
  - Other common disruptions
  - Understanding suppliers’ inventories and warehousing process
- Understanding 3PL, flow of parts and raw materials
Lessons Learned

- Cost is not the only consideration
  - Companies typically source from the lowest-cost supplier
  - Future global supply chain strategy may change
  - Companies may be willing to pay more to diversify and establish a more resilient and flexible process
  - Costs still will be a factor, but so will location, diversification and flexibility:
    - Dual-sourcing
    - Expedited qualification of alternate suppliers
    - Ability to perform certain functions in-house
Lessons Learned

- Risk allocation by contract
  - *Force Majeure* – creature of contract
  - Already seeing issues as a result of tariffs
  - Other charges that were incurred:
    - Warehousing costs
    - Return costs
    - Freight expedites
    - Overtime and other ramp-up costs

- Supply chain contracts can proactively anticipate and allocate these risks
Lessons Learned

- Expect to see a quicker adoption of new technologies
  - End-to-end connectivity/data exchange
  - Digital freight tracking platforms to track shipments and raw materials in real time
  - AI and robotics were already on the rise
Force Majeure Clauses

PRESENTER:

Leslie Smith
Partner, Miami
305.482.8406
mlsmith@foley.com
Force Majeure Clauses

- An overview
- Types of performance affected by COVID-19 pandemic
- Lease agreements
- The supply chain
- Franchise & dealer agreements
What is a *force majeure* clause?

- *Force majeure* clauses excuse the performance by one party or another (or both) to a contract for defined contingencies beyond the control of the contracting parties.

- *Force majeure* clauses are a creature of contract, not common law.

- While terms can vary, the specific language used is important because courts generally strictly construe them.
An overview

- What do force majeure clauses cover?
  - Typically cover unanticipated events such as adverse or extreme weather, casualty, condemnation, war, strike, acts of God, and government regulation
  - Less common terms included in such clauses, but more apropos of recent events, are those such as “disease,” “epidemic,” “pandemic,” “public health emergency,” “quarantine” and “curfew”
An overview

- Factors that courts consider:
  - Is the obligation that has been interrupted covered by the *force majeure* clause?
  - Does the event that is causing the interruption fall within those described in the *force majeure* clause?
  - Did the event causing the interruption actually prevent performance of the party’s obligation?
An overview

- Other remedies:
  - If the contract does not contain a *force majeure* clause, or if it does not apply, a party may have other common law or statutory defenses
  
  - Common Law
    - Frustration of purpose
    - Impossibility or impracticability of performance
  
  - UCC
    - Doctrine of commercial impracticability
    - Codified at § 2-615 for sales of goods
Lease agreements

- Types of performance affected by COVID-19:
  - Landlord’s obligation to complete build-out or renovations within a specific time period
  - Landlord’s obligation to provide tenant with “quiet enjoyment”
  - Tenant’s obligation to take possession of the premises
  - Tenant’s obligation to pay base rent and expenses
  - Tenant’s obligation of continuous operation
Lease agreements

- **Other obstacles for tenants:**
  - Assuming a party can meet the clause’s criteria, be aware that other lease provisions may still prevent the clause’s application.
  - Carve-outs from the force *majeure* clause for the obligation to pay rent are very common, *e.g.*, a tenant’s agreement to pay rent “without abatement, set-off or deduction.”
The supply chain

- Severe disruptions in the supply chain are likely to continue for the foreseeable future, especially since a “second wave” of COVID-19 cases appears likely.
- To prepare, businesses need to assess their risk, consider targeted solutions, and act promptly to mitigate any damages.
Assess *force majeure* clauses

- Review supply chain contracts to determine whether they contain *force majeure* clauses and, if so, evaluate scope.

- If operative effect of *force majeure* event is suspension of the supplier’s performance:
  - Does clause suspend performance until event giving rise to *force majeure* is over?
  - Or does clause suspend performance for a defined period of time?
  - Does clause allow parties to terminate supply chain contract if performance has not resumed by end of specified time period?
  - Does *force majeure* clause contain a notice requirement that obligates supplier to provide customer with prompt notice of event giving rise to *force majeure*?
The supply chain

- Be a realist
  
  - Which of your business relationships do you need or want to continue after the disruption passes?
  
  - Consider negotiated resolutions such as price or timing adjustments modified to account for the disruption and any changed circumstances
  
  - Alternatively, consider diversifying procurement sources across regions and suppliers
    
    ▪ Even if more costly, it can ensure continuity
The supply chain

- **Plan ahead**
  - Look to define rights and obligations with greater specificity going forward
  - Identify and agree on dates for resumption of supplies and services and whether resumption will be immediate or gradual
  - Determine whether contract amendments are needed to address the risks of future pandemics through provisions targeted to price adjustments, additional insurance, or other mechanisms
Franchise and dealer agreements

- Use of *force majeure* by franchisees & dealers
  - Avoid royalty payments (especially minimum)
  - Avoid unit opening deadlines
  - Avoid development obligations
  - Avoid operating restrictions
  - Avoid exclusivity and territorial limits
Franchise and dealer agreements

- **Response by franchisors & manufacturers**
  - Determine which obligations can be avoided—and which cannot
  - Provide a prompt response that addresses the difference between the two and reminds the franchisee or dealer which obligations are not excused
  - Look for areas of compromise
Franchise and dealer agreements

- What if a supplier to the franchisor or manufacturer invokes *force majeure*?
  - Agree and accept the consequences
  - Dispute that the contract language applies
  - Negotiate a compromise
    - Temporarily reroute orders through other countries or suppliers
    - Negotiate to receive first orders when supply becomes available.
    - Cover cost through supplier’s insurance
Franchise and dealer agreements

- What if the franchisor or manufacturer invokes the *force majeure* clause?
  - Cancel current orders and source the goods elsewhere
  - Extract concessions on credit and delayed payments for existing orders
  - Explore potential claims under insurance policies of the franchisor or manufacturer
COVID-19 Related Insurance Issues

PRESENTERS:

Max Chester
Partner, Milwaukee
414.297.5573
mchester@foley.com

Andy Meerkins
Associate, Milwaukee
414.319.7033
ameerkins@foley.com
Insurance Issues

- Business-interruption insurance
- Losses occasioned by orders of civil authority to close
- Commercial general liability (CGL) claims and coverage
- Immunity under the federal Public Readiness and Emergency Preparedness Act (PREP Act)
Insurance Coverage for Loss of Business Income and Civil Authority Orders to Close
Business-interruption insurance

- Many policies contain coverage reimbursing lost business income caused by “direct physical damage or loss to property” or similar wording
- Key question: does the presence or potential presence of COVID-19 constitute the requisite physical damage or loss?
- Specifics of policy language will be of central importance
Business-interruption insurance

- Insurance industry position: a virus pandemic was never intended to be insured
  - No premium ever collected
  - Significant imbalance between losses and surplus

- Apparently, The All England Club (Wimbledon) has been paying for pandemic insurance since 2002 (following SARS)
  - Manuscripted coverage

- Specific ISO “virus exclusion” available since 2006
  - Present in many policies
Business-interruption insurance

- Hundreds of cases filed seeking coverage for business-interruption losses related to COVID-19
  - Motions to dismiss filed in several cases already
  - Briefing underway to establish MDL in E.D. Pa. or N.D. Ill.
  - PA Supreme Court declined extraordinary jurisdiction
  - SDNY denied TRO, stating during oral argument there was no proof of physical damage to property and it was accessible, citing key NY case (Roundabout Theater)
  - W.D. Pa. judge remanded to state court sua sponte, finding novel issues to be decided under state law.
Business-interruption insurance

- No prior case law specifically deciding business-interruption coverage for virus pandemic losses
- Courts have decided analogous cases both ways:
  - Courts have found coverage in cases involving presence of smoke in open theater, gasoline and vapors contamination, friable asbestos, and ammonia gas—all of which left insured properties inaccessible
  - Courts have found no coverage in cases involving foul odor and bacterial contamination in ductwork, asbestos fibers, construction dust and debris, yarn exposed but not affected by covered peril, loss of electronic data, loss of contract because ingredient (beef) was stuck in Canada due to mad cow disease outbreak

bit.ly/Foley-Coronavirus-Resource-Center
Civil authority coverage

- Policies may cover “business income” lost because of “action of civil authority that prohibits access to your premises due to direct physical loss of or damage to property, other than at the covered premises”

- Physical loss is typically the pivotal issue for this coverage as well

- In many cases concerning the pandemic, this coverage could be squarely at issue, if it exists
Civil authority coverage

- As with business-interruption coverage, courts have made decisions that seemingly conflict, though in many cases, policy wording differed.
- Courts have found coverage where local authorities order closure for hurricanes, riots and civil unrest, and the like.
- Other courts found no coverage in cases involving damage to neighboring buildings, airport closure orders following 9/11, etc.
Commercial General Liability Claims and Coverage
CGL Coverage

- Businesses can expect suits alleging negligence in protecting against COVID-19 infection
- Many CGL policies deal with “pollutants”
  - Some exclude pollution or ”pollution hazards”
  - Some specifically cover “pollution conditions”
- The way these provisions are written and the way “pollution” is defined are key
- Courts have decided cases concerning viruses, bacteria, and mold—with varying results
CGL Coverage

- Determining “number of occurrences”
  - CGL policies typically contain “per occurrence” limits
  - Many states use a “cause” approach to determining the number of occurrences, which looks to the underlying cause or causes of the injury
  - A minority of states use an “effect” approach, which focuses on the number of individuals harmed

- Even under majority “cause” approach, courts have differed regarding “number of occurrences” in analogous cases involving E coli, salmonella, and botulism outbreaks

bit.ly/Foley-Coronavirus-Resource-Center
Public Readiness and Emergency Preparedness Act (PREP Act)
PREP Act immunity

- Public Readiness and Emergency Preparedness Act (PREP Act) authorizes Secretary of DHHS to limit legal liability for losses relating to administration of medical countermeasures

- February 4, 2020 declaration by Secretary of DHHS invoked the PREP Act, declared COVID-19 to be a public health emergency warranting liability protections to “covered persons” involved in deployment of “covered countermeasures”
  - In effect through October 1, 2024, with additional one-year period to dispose of items as needed
PREP Act immunity

- “Covered person”
  - Manufacturer, distributor, program planner, or qualified person as defined in the PREP Act
  - Any person as authorized by authority with jurisdiction to prescribe, administer, deliver, distribute, or dispense “covered countermeasure”
  - Any person authorized to perform an activity under an Emergency Use Authorization
  - April 17, 2020 Advisory Opinion by GC of DHHS: even if entity does not fit definition of “covered person,” immunity available if “reasonably could have believed it was a covered person”
PREP Act immunity

“Covered countermeasures”
- Any antiviral, drug, biologic, diagnostic, other device, or any vaccine, used to treat, diagnose, cure, prevent, or mitigate COVID-19
- Any device used in the administration of any of the foregoing, and all components and constituent materials of any such product
- Respiratory protective devices, if NIOSH approved and determined by Secretary of DHHS to be a priority for use
- Same “reasonable belief” protection

Activities must relate to federal government contracts or activities prescribed by authority having jurisdiction to deploy countermeasures
Exception to immunity

- Sole exception to PREP Act immunity is for death or serious physical injury caused by “willful misconduct”
  - Requires proof by clear and convincing evidence that covered person acted (i) intentionally to achieve a wrongful purpose; (ii) knowingly without legal or factual justification; and (iii) in disregard of a known or obvious risk that is so great as to make it highly probable that the harm will outweigh the benefit
  - Must first seek compensation through Countermeasures Injury Compensation Program, cannot sue if elect such compensation
Suits for “willful misconduct”

- Injured persons may sue only in the U.S. District Court for the District of Columbia
- Heightened standards for pleading and discovery
- Recovery for non-economic damages such as pain and suffering is limited
Real Estate & Finance

PRESENDER:

Toni Prestigiacomo
Partner, Madison, WI
608.258.4765
aprestigiacomo@foley.com
Rent relief considerations for commercial landlords and tenants after the pandemic
- Lease review checklist
- Best practices for tenants and landlords

Post-pandemic commercial loan issues
- Amendments to loan agreements
- Securing liquidity
- Main Street Lending Program
Rent Relief Considerations for Commercial Landlords & Tenants After the Pandemic
Rent relief

- It’s not “business as usual” yet
- COVID-19 continues to impact businesses across all sectors of the economy
- Tenants: even if you received a rent deferral or abatement from your landlord during the past 3 months, most landlords recognize their tenants may still be dealing with liquidity and other issues
  - Landlords want their tenants to stay in business especially since COVID-19 has reduced their potential pool of new tenants. As a result, landlords are more likely to forego profit now to keep their tenants afloat. Now may be the perfect time to renegotiate your lease.

bit.ly/Foley-Coronavirus-Resource-Center
Rent relief

- Lease negotiations could result in
  - better terms and rates
  - additional payment deferrals
  - subletting agreements
  - potential subdividing
  - late payment fee waivers

- Landlords: consider the type of additional relief you might offer a tenant
  - It may take the form of a rent deferral, a rent reduction or rent abatement. Consider the impact of any of these options on your cash flow.
Lease review checklist

- **Rent**
  - What is rent amount, what is included as rent, how often are increases scheduled?
  - Is the tenant responsible for payment of its proportionate share of real estate taxes, common area maintenance expenses, insurance costs?

- **Lease expiration**
  - When does it end?
  - Options to renew?

- **Default**
  - What constitutes default?
  - What are the remedies for default (late charges, interest, eviction)?

- **Security deposit**
  - Is there one?
  - How much was it?
Lease review checklist

- Operating covenants
  - Does lease require remaining open a certain number of hours on specific days?
- Insurance
  - What insurance coverage do you have?
  - Does coverage include COVID-19 related circumstances?
- Force majeure
  - Does any lease provision excuse performance by either party due to outside circumstances?
  - See In re Hints Restaurant Group, 20-05012 (Bankr. N.D. Ill. June 3, 2020)
Tenant best practices

- **Know your numbers**
  - Protect your cash flow for multiple scenarios

- **Approach your landlord *now***
  - Don’t wait until you can’t pay rent

- **Prepare your evidence of hardship**
  - Landlords may request documentation of continuing COVID-19 financial stress

- **Leverage a positive longstanding relationship**
  - Remind landlord how long you have been a reliable tenant

- **Get your agreement with landlord in writing, consider retaining professional help**
Landlord best practices

- Assess type of relief requested and financial impact on landlord’s cash flow
- Analyze each tenant situation
- Consider whether tenant has applied for other forms of financial relief
- Review tenant lease obligations
  - Consider whether tenant is in compliance with lease obligations, both monetary and non-monetary
- Review lender issues, loan documents
- Request confidentiality
Post-Pandemic Commercial Loan Issues
Commercial loan issues

- The post-pandemic business environment will remain recessionary even after businesses begin to resume operations.
- Borrowers will likely continue to experience liquidity issues, supply chain disruption, scaled back or continued cessation of business operations resulting in material adverse effect, insolvency, and going concern triggers under debt/loan agreements.
- Anticipate and proactively address liquidity needs and actual or potential defaults.
Amending loan agreements

- Review loan agreements and consider financial and other covenants impacted by COVID-19

- Financial covenants waivers
  - Request lenders to waive financial covenant compliance from and including 1st quarter of 2020 up to and including 4th quarter of 2020

- Calculation of EBITDA
  - Request lenders to modify the calculation of EBITDA so as to exclude the effect of COVID-19 impacted fiscal quarters.
  - This is important because the calculation of EBITDA is directly related to financial covenant compliance
Securing liquidity

- Make draws under existing resolving credit facilities
- Adopt operational measures to conserve cash (perhaps including renegotiation of lease terms related to payment of rent)
- Modify material adverse effect clause in loan agreements to include a carve-out for impact of COVID-19 on borrower’s business
- For revolving credit facilities, request amendment that impact of COVID-19 will be disregarded in ascertaining the accuracy of bring-down representations
Securing liquidity

- Modify negative covenants in loan agreements by temporarily lifting restrictions on certain EBITDA and financial covenant based restrictions on restricted payments, distributions, additional debt and loans

- What to expect from lenders:
  - In exchange for financial covenant waivers, lenders may demand new covenants requiring borrowers to comply with minimum liquidity levels during waiver period, provide cash flow projections on a weekly or monthly basis
  - Lenders may increase pricing, charge amendment fees
Main Street Lending Program

- Authorized under CARES Act and Federal Reserve Act to provide financial assistance to small and medium sized businesses
  - Loans are not forgivable but are at low interest rates
  - Offered through the Federal Reserve rather than SBA
  - Intended as an additional source of liquidity and borrowing

- Three different loan facilities:
  - Main Street New Loan Facility
  - Main Street Priority Loan Facility
  - Main Street Expanded Loan Facility
Main Street Priority Loan Facility

- Federal Reserve will purchase 95% participation in Eligible Loan originated on or after April 24, 2020 if it has following features:
  - Minimum loan amount of $250,000
  - Maximum loan amount that is lesser of $50 million and an amount, that—when added to Eligible Borrower’s existing outstanding and undrawn available debt—does not exceed six times 2019 adjusted EBITDA of Eligible Borrower (including affiliates applying for or receiving loan)
  - At time of origination and during its term, must be senior to or pari passu with, in terms of priority and security, other loan or debt instruments of Eligible Borrower except mortgage debt (includes debt secured by real estate and limited recourse secured equipment)
Main Street Priority Loan Facility

- If secured, loan cannot at time of origination or during its term, be subordinated in terms of priority to Eligible Borrower’s other loans and debt instruments (other than mortgage debt)

- If secured, loan must at time of origination have a Collateral Coverage Ratio of at least 200% or not less than the aggregate Collateral Coverage Ratio for all of Borrower’s other secured loans or debt instruments (other than mortgage debt)

  - “Collateral Coverage Ratio” means aggregate value of relevant collateral security, including pro rata value of shared collateral, divided by outstanding aggregate principal amount of relevant debt
Eligible Lenders

- U.S. federally-insured depository institutions
  - Banks, savings associations, credit unions
  - U.S. branches or agencies of foreign banks, U.S. bank holding companies, U.S. savings and loan holding companies, U.S. intermediate holding companies of foreign banking organization, subsidiaries of foregoing

- Non-bank lenders are not currently eligible

- Federal Reserve considering expanding list of Eligible Lenders

- Eligible Lenders must make certain certifications and agree to certain covenants for in connection with each Eligible Loan
Eligible Borrowers

- Entity organized for profit as a partnership, LLC, corporation, association, trust, cooperative, joint venture with no more than 49% participation by foreign business entities, or tribal business concern
  - Federal Reserve has discretion to include other forms of organization
- Established prior to March 13, 2020
- Created or organized in U.S. or under laws of U.S., has significant operations in U.S., majority of employees based in U.S.
- 15,000 employees or fewer or 2019 annual revenues of $5 billion or less
  - Including employees and revenues of “affiliates” determined under SBA affiliation rules, 13 CFR 121.301(f)
  - Number of employees calculated same way as for PPP loans (include all full-time, part-time, seasonal, or otherwise employed persons, exclude volunteers and independent contractors)
- No “Covered Individual”* owns, controls, or holds 20% or more (by vote or value) of any class of equity ownership interest

*“Covered Individuals” include the U.S. president, vice president, heads of executive departments, members of Congress, and certain immediate family members of foregoing
Ineligible Borrowers

- Financial businesses primarily engaged in lending (e.g., banks)
- Passive businesses owned by developers and landlords
- Life insurance companies
- Businesses located outside the U.S.
- Pyramid sale distribution plans
- Businesses that derive more than 1/3 of revenue from legal gambling
- Businesses involved in illegal activity
- Private clubs and businesses that limit the number of memberships for reasons other than capacity
- Government-owned entities (except businesses owned or controlled by a Native American tribe)
- Businesses that derive more than 1/3 of revenue from packaging SBA loans
- Businesses with an associate who is incarcerated, on probation or parole, or has been indicted for a felony or crime of moral turpitude
- Businesses in which lender or an associate owns an equity interest
- Businesses of a prurient or sexual nature
- Businesses that have previously defaulted on a federal loan or federally assisted financing resulting in loss to federal government
- Businesses primarily engaged in political or lobbying activities
- Speculative businesses (including private equity funds and hedge funds)
Other eligibility requirements

- Any other loans outstanding with the lender as of December 31, 2019 must have had an internal risk rating equivalent to a “pass” in the Federal Financial Institutions Examination Council’s supervisory rating system on that date.

- Borrowers can participate in only one facility under the Main Street Lending Program, cannot also participate in the Primary Market Corporate Credit Facility or receive other specific support from the Federal Reserve under the CARES Act.
  - Receipt of an Economic Injury Disaster Loan (EIDL), a COVID-19 emergency EIDL advance, or a Paycheck Protection Program loan will not preclude participation.

- Borrower must certify inability to secure “adequate credit accommodations” from other banking institutions.
  - Does not necessarily mean that no other credit is available for Borrower’s purposes.
  - Rather, Borrower can certify that it is unable to secure “adequate credit accommodations” because amount, price, or terms of credit available from other sources are inadequate for Borrower’s needs during current circumstances.
Main Street Lending Program

- **Documentation**
  - Required to use documentation substantially similar to that used in ordinary course of business for similarly situated borrowers
  - Appendix A of Main Street Program FAQ guidance provides checklist of terms that must be addressed in loan documentation (including cross-acceleration and mandatory prepayment provisions and financial reporting covenants)
  - Does not address all of terms and conditions to be included in definitive loan documentation

- **Loan terms**
  - Five-year maturity
  - Interest deferred for one year (unpaid interest capitalized).
  - Principal deferred for two years, followed by principal payments of 15%, 15%, and 70% at end of years three, four, and five, respectively
  - No prepayment penalty
  - Adjustable rate of LIBOR (1 or 3 month) + 3.0%
  - No prescribed fall back index
Main Street Lending Program

- **Transaction Fee**
  - Eligible Lender pays Federal Reserve SPV 1% (New and Priority) or 0.75% (Expanded) of principal amount of Eligible Loan at time of origination
  - Eligible Lender may require Eligible Borrower to pay this fee

- **Origination Fee**
  - Eligible Borrower pays Eligible Lender an origination fee of up to 1% (New and Priority) or 0.75% (Expanded) of principal amount
  - Lender has discretion whether and when to charge fee to Borrower

- **Servicing Fee**
  - Federal Reserve SPV pays Eligible Lender a servicing fee of 0.25% of principal amount of its participation in the Eligible Loan per annum for loan servicing

- Eligible Lender cannot charge any other fees *except*:
  - *De minimis* fees that are customary and necessary in underwriting commercial and industrial loans to similar borrowers—such as appraisal and legal fees, and customary consent fees in context of upsizing a loan under the Main Street Expanded Loan Facility
Restrictions on compensation

- Until 12 months after loan has been repaid, officers and employees whose total compensation exceeded $425,000 in calendar year (CY) 2019 may not:
  - Receive total compensation during any consecutive 12-month period in excess of total compensation received in CY2019
  - Receive severance pay or other benefits upon termination of employment in excess of 2 times their total compensation in CY2019

- Officers and employees whose total compensation exceeded $3 million in CY2019 may not receive total compensation during any consecutive 12-month period greater than $3 million plus 50% of excess over $3 million of total compensation received in CY2019

- “Total compensation” includes salary, bonuses, awards of stock, and other financial benefits
Other Borrower restrictions

- **Restricted payments**
  - Until 12 months after loan has been repaid, Borrower may not repurchase listed equity securities (including securities issued by the borrower’s parent), except to the extent required under a contractual obligation in existence as of March 27, 2020
  - Borrower may not pay dividends or make other capital distributions with respect to the common stock of the business (other than tax distributions by S corporations and other pass-through entities)

- **Retaining employees**
  - Borrower must make commercially reasonable efforts to retain employees during term of loan
  - Main Street Program FAQ guidance states that Borrower “should undertake good-faith efforts to maintain payroll and retain employees, in light of its capacities, the economic environment, its available resources, and the business need for labor”
  - Borrowers that have already laid off or furloughed workers as a result of COVID-19 are eligible under the Main Street Lending Program
Restrictions on debt repayment

- Cannot make payments on other debt (other than payments mandatory and due) until loan repaid, except that Borrower may refinance other debt at time of origination of loan under Priority Loan Facility.

- Payments on other debt “mandatory and due”
  - on future dates scheduled to be paid as of date of origination of Main Street Lending Program loan or
  - upon a mandatory prepayment event under a contract for indebtedness executed before date of origination of Main Street Lending Program loan, except that prepayments triggered by the incurrence of new debt can be paid only if de minimis or under Priority Loan Facility loan at the time of origination.

- Cannot cancel or reduce any committed lines of credit.
Practical considerations

- As of today, funding is still available under both the PPP and Main Street Lending Program
  - If a borrower qualifies for both, PPP loans are forgivable

- Borrowers need to determine eligibility for and decide whether to participate in one of three Main Street Loan Facilities, taking into account affiliation rules, which affect eligibility and selection
  - Affiliated borrowers can choose only one Main Street Loan facility
  - Maximum loan size varies

- Borrowers should review existing agreements and commitments for limitations on additional borrowing, liens, and other provisions that loan could trigger and determine whether consents, amendments, or waivers required

- Borrowers should determine whether assets sufficient to meet Collateral Coverage Ratio under Main Street Priority Loan Facility

- Borrowers interested in Main Street Loan Facilities should contact their lender now to ensure funds are disbursed soon after the Facilities are operational
Bankruptcy & Restructuring

PRESENTED:

Tom Scannell
Senior Counsel, Dallas
214.999.4289
tscannell@foley.com
Bankrupt Franchising: A Unique Intersection
Executory contracts

- Agreements critical to the distribution or franchising relationship—including the dealer/distributor/franchise agreement, trademark license, equipment leases, and real property leases—will be deemed “executory contracts” in a bankruptcy case.
- Definition: any agreement where, as of petition date, there are material unperformed obligations by both parties.
- Executory contracts are governed by Section 365 of the Bankruptcy Code, which provides debtors with powerful options that are not available under contract law outside of bankruptcy.

bit.ly/Foley-Coronavirus-Resource-Center
Executory contracts

- Implications for non-debtor counterparties to dealer/distributor/franchise agreement?
  - Notwithstanding bankruptcy filing, obligated to continue performing under dealer/distributor/franchise agreement
  - Debtor also must continue performing obligations under dealer/distributor/franchise agreement
  - It would be inequitable to require non-debtor to continue performing while excusing debtor from performing
Why not just terminate?

- The Automatic Stay – 11 U.S.C. 362(a)!!!!!
Automatic stay

- Section 362(a) prevents **ANY** (there are few exceptions) action to enforce pre-bankruptcy contractual rights and remedies without seeking **PRIOR** relief from the bankruptcy court.
- Even if the bankruptcy filing is a breach of the dealer/distributor/franchise agreement and is grounds for termination, the stay prevents counterparties from enforcing default remedies.
- Like it or not, the automatic stay requires continuing to do business with the bankrupt party.
What can you do?

- Terminate dealer/distributor/franchise agreement in writing **before** bankruptcy filing in compliance with all terms of contract and applicable state law

- Seek relief from automatic stay for “cause” pursuant to 11 U.S.C. 362(d)(1)
  - Grounds: debtor is not performing under terms of the dealer/distributor/franchise agreement

- Compel debtor’s rejection of executory dealer/distributor/franchise agreement
  - Force debtor to make a decision!!!
Executory contracts

- Debtor’s options:
  - Assumption
  - Assumption and assignment
  - Rejection

- Timing
  - In a Chapter 11 bankruptcy, other than a lease of non-residential real property, the debtor has until confirmation of its plan to make this choice.
  - Upon request of a party in interest, the timetable for this decision can be expedited
Assumption

- If debtor deems contract to be valuable to going concern, debtor can elect to “assume” the contract pursuant to 11 U.S.C. § 365
  - Subject to “business judgment” standard
  - Before contract can be “assumed,” debtor must:
    - Cure any defaults, both monetary and non-monetary, and both pre-bankruptcy defaults and post-bankruptcy defaults (at time of assumption, debtor cannot be in default under any contractual provisions—cannot “cherry pick” provisions it wants to keep or modify contract without non-debtor’s consent)
    - Provide “adequate assurance” of future performance (i.e., present evidence of financial wherewithal and other means to continue performing all terms going forward and that it will not default)

bit.ly/Foley-Coronavirus-Resource-Center
Assumption and assignment

- If debtor is selling assets and prospective purchaser deems contract valuable to its going concern interests, debtor can sell the contract by “assigning” it pursuant to 11 U.S.C. 365, again subject to the business judgment standard
  - Over its objection, non-debtor can be forced to do business with a new party
  - General rule in bankruptcy law is that contractual anti-assignment provisions are not enforceable
  - Exceptions for intellectual property licenses and personal service contracts: many dealer/distributor/franchise agreements will have one or both elements
Assumption and assignment

Before a contract can be “assigned,” debtor and prospective assignee must:

- Cure any defaults, both monetary and non-monetary, and both pre-bankruptcy defaults and post-bankruptcy defaults (at time of assignment, non-debtor can require compliance with all terms of contract; prospective assignee cannot “cherry pick” provisions it wants to keep or modify contract without non-debtor’s consent)

- Prospective assignee must provide “adequate assurance” of future performance (i.e., present evidence of financial wherewithal and other means to continue performing all terms going forward and that it will not default under contract terms)
Rejection

- If debtor decides (in its business judgment) that contract is not valuable to its going concern interests, debtor can be excused from future performance by “rejecting” contract pursuant to 11 U.S.C. § 365
  - Rejection does not mean termination; it simply means that debtor is no longer obligated to perform terms of dealer/distributor/franchise agreement
  - Rejection will provide “cause” under 11 U.S.C. § 362(d)(1) for grounds to lift automatic stay so that non-debtor can terminate the contract, be excused from future performance, take possession of premises (if applicable), and proceed with efforts to mitigate

bit.ly/Foley-Coronavirus-Resource-Center
Rejection

- Treated as “deemed breach” of contract
- Breach deemed to have occurred as of date of filing for bankruptcy
- Non-debtor party will have a claim in the amount for which it would ordinarily be entitled for breach
  - Such a “rejection damage claim” is treated as a general unsecured claim under the Bankruptcy Code
  - Fact that rejection damage claims are unsecured claims can be significant, because in many Chapter 11 cases such claims are paid at pennies on the dollar, or not at all.
Rejection

- Covenants not to compete are common in dealer/distributor/franchise agreements
  - Most U.S. bankruptcy courts have permitted post-petition enforcement of covenants not to compete in rejected contracts
  - Some courts, however, have held that rejection makes the covenant unenforceable, so that the supplier’s sole remedy is filing a claim
    - As a result, manufacturers and franchisors are rarely satisfied with merely receiving a monetary unsecured claim in bankruptcy following rejection
    - These considerations often provide leverage in negotiations to assume the dealer/distributor/franchise agreement for less than 100% cure and/or assignment to a less-than AAA creditworthy assignee.
    - Sometimes, when considering all the various business interests in play, something is better than nothing!
Live Q&A

Questions selected from submissions during the webinar
Thank You

For More Information:

Michael J. Lockerby
202.945.6079
mlockerby@foley.com
Our Core Values

CLIENTS FIRST
Our clients are our first priority. When we provide quality work, value and superior service to our clients, our own success inevitably follows.

DIVERSITY
We embrace diversity and are committed to the inclusion of our diverse attorneys and staff and to the success of all our people.

INTEGRITY
We will adhere to high standards of ethics, professionalism and integrity and safeguard the reputation of the firm at all times.

TRUST AND RESPECT
The success of our partnership stands on a foundation of trust, mutual respect, collegiality, communication and teamwork.

STEWARDSHIP AND ACCOUNTABILITY
As stewards of the firm, we are accountable to one another and will commit our time, talent and energy to the firm’s success, growth and long-term prosperity.

CITIZENSHIP
We embrace our responsibilities to our communities and profession and will lead by example through civic, pro bono, professional and charitable service.

PROFESSIONAL SATISFACTION
Our work should be professionally satisfying and provide competitive financial rewards while affording the opportunity to achieve a reasonable balance between professional demands and personal commitments.

OUR PEOPLE
Our people are our most valuable asset and their quality, creativity and dedication are indispensable to our success.