



LAW ALERT

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Restructuring and Bankruptcy Options to Save your Company from the Brink

On February 12, 2020, the Dow Jones industrial average crested at 29,551. The economy was considered strong notwithstanding the growing deficit, and unemployment hovered at approximately 3.5%. Fast forward less than three weeks to March 16, 2020, and business owners and consumers are facing the most significant global economic crisis since 2008.

The COVID-19 pandemic has forced governments, business owners and consumers to radically adjust the way that they govern, engage in commerce, and live their daily lives. Federal, state and local authorities have issued unprecedented directives closing schools, shuttering businesses, and directing people to remain in or near their homes in very small groups. The stock market has given back all of its Trump era gains, and new unemployment applications have surged as businesses are forced to furlough and lay-off employees.

The short and long term economic impact of COVID-19 may not fully manifest itself for months or years. In the meantime, business owners must take short and long term measures to protect, or salvage, their operations.

Current State of Affairs

The five days from March 16, 2020 to March 20, 2020 saw a succession of New York State executive orders directing “non-essential” businesses to operate first at half capacity, then 25% capacity and finally to close. Essential businesses include :

- health care operations including, research and laboratory services, hospitals, walk-in-care health facilities, elder care and nursing homes;
- infrastructure including, utilities, telecommunications and data centers, airports/airlines; transportation; and hotels;
- manufacturing including food processing, medical supplies and equipment and items used in essential industries;
- retail including supermarkets, pharmacies, restaurants and bars (take out or delivery only), hardware and building;
- services including trash, mail, auto repair, child care, funeral homes;
- news media;
- financial institutions including banks, payroll, accounting and the markets;
- homeless shelters, food banks and human services providers;
- police, fire safety, security and enforcement;
- essential government services.

[1] For a complete list, see Guidance on Executive Order 202.6 <https://esd.ny.gov/guidance-executive-order-2026>



In addition, any business may submit a request to be included as an essential business, or for providing essential services to an essential entity providing essential services or functions to the Empire State Development Corporation at <https://esd.ny.gov/content/request-designation-essential-business-purposes-executive-order-2026>.

As a direct result of Executive Order 202.6, brick and mortar retailers, already reeling from several years of slowing sales, reduced mall and store traffic, and internet competition are closed. Bars and restaurants must try to subsist solely upon take-out and delivery sales. Salons, barbers, gyms and small retailers are closed.

Potential Relief

Federal, state and local governments are scrambling to prevent the economy from falling any farther, and looking to provide relief to beleaguered businesses and consumers. President Trump signed the Families First Coronavirus Response Act to increase protections for employees adversely affected by the pandemic. New York State followed suit with similar legislation - the New York Emergency Paid Sick Leave Act - designed to supplement, and not offset or replace, the federal legislation. It is noteworthy that while these programs may provide assistance to employees, it comes at a cost to their employers which may be offset in the form of tax credits.

Congress currently is working on a broader economic package, designed to help businesses and individuals. As of this writing, the final details of that legislation remain uncertain. In the meantime, the United States Small Business Administration ("SBA") has made Economic Injury Disaster Loans ("EID") available to qualifying businesses that have suffered a defined economic loss as a result of COVID-19. In the event that a business does not qualify for an EID loan, the SBA has alternatives available such as the 7(a) Loan Guarantee Program and the SBAexpress Loan. These programs may be beneficial to some but will only provide relief to small businesses, leaving mid-sized and larger companies little relief.

In addition to economic protection and stimulus, federal and state agencies have implemented measures to blunt the impact of COVID-19. For example, federal regulators have eased rules allowing banks and financial institutions more leeway in addressing debt. Loans that were not in default prior to the pandemic may be modified to extend terms, defer or forgive payments, reduce or forgive interest reduction or forgiveness without being re-characterized as "troubled debt restructurings." Federal tax filing deadlines have been extended to July 15, 2020. New York state has issued a moratorium on residential and commercial foreclosures.



Strategies to Protect your Business

Every business owner, operator and investor must confront the economic impact of COVID-19 on their business and investments. An out of court restructuring starts with a top to bottom review of business operations and is best effected with the assistance of one or more qualified restructuring professionals. In addition to his or her expertise and ability to analyze the business operations, a restructuring professional enhances credibility with lenders, regulators, trade creditors and employees. The professional should review financials, contracts, operations, staffing, leases, collective bargaining agreements and related materials and work with management to identify a going forward strategy. Most of all, the professional will prepare a reasonable cash flow projection through the immediate crisis.

Depending upon the analysis, the business owner may elect an out of court restructuring, sale of some or all the company's assets or divisions, or if the company is under immediate duress, a bankruptcy. If the company is addressing serious economic impact, but is able to operate and pay some or all of its obligations, an out of court restructuring should suffice. This strategy may include renegotiation of its existing lending facilities, restructure of the business operations, or negotiations with its vendors or suppliers.

The company may consider entering into a forbearance agreement with its secured lender to restructure its obligations. As set for the above, regulators may allow more leeway for lenders to restructure debt without requiring the lender to report the obligation as troubled debt restructuring. This may require providing additional collateral or security. Alternatively, the business may be eligible for an EID or other SBA program, some additional economic stimulus that may be forthcoming. It is likely that some or all of the anticipated legislation will make relief programs available, and additional liquidity available to struggling businesses.

If the business is unable to pay its obligations as they become due, or there is a pending catastrophic event that will significantly disrupt or shut down the business, such as a loan default resulting in a lack of access to working capital, a judgment being entered or executed upon, a default under an existing credit facility, or default under an existing contract or lease, then the business owner must consider a more aggressive remedy such as a bankruptcy filing or assignment for the benefit of creditors ("ABC").

An ABC is a creature of state statute. It permits the business owner to transfer some or all of its assets to an assignee who then liquidates assets for value, and makes a distribution to creditors. The assignment and sale requires state court approval. However, unlike a bankruptcy filing, the assets are not sold free and clear of liens, and the assignor does not receive a discharge of its obligations. If conducted properly, the state court will enter an order that the sale was commercially reasonable, which may preclude creditor claims that the sale of the assets was a fraudulent transfer.



The bankruptcy process can be utilized to effectuate a myriad of restructuring strategies. One of the most significant features of a bankruptcy filing is the automatic stay under the Bankruptcy Code. The automatic stay prohibits collection or enforcement of pre-filing rights. Substantially all collection efforts, litigations and enforcement proceedings are stayed. Contract partners may be prevented from terminating licenses and agreements, including real property leases. This protection extends to enforcement by governmental units (except for criminal proceedings or enforcement of police powers). Any action taken in violation of the automatic stay is void.

Existing management remains in place, and management may retain one or more restructuring professionals including attorneys, financial advisors and brokers to assist in implementing its strategy. The automatic stay provides the company with the breathing room necessary to restructure its operations. Liquidity may be obtained in the form of an equity investment or new credit facility. The company can use the bankruptcy process to: (i) jettison unprofitable or burdensome contracts or above market real property leases; (ii) re-structure its obligations with both secured and unsecured creditors; (iii) re-negotiate (or reject) collective bargaining agreements; (iv) sell some or all of its assets; and (v) close or sell off locations, affiliates or subsidiaries. Ultimately, the goal is to formulate and obtain court approval of a plan of reorganization.

If restructuring is not feasible, the company can engage in an orderly liquidation in a bankruptcy proceeding. The company may sell some or all of its assets under § 363 of the Bankruptcy Code. The sale is conducted under the supervision of the Bankruptcy Court, and is subject to higher and better offers. Ultimately, the Bankruptcy Court will enter an order approving the transfer free of all existing liens, claims and encumbrances.

One of the most significant impediments to bankruptcy is the potential costs. To alleviate this problem, Congress recently enacted the Small Business Reorganization Act of 2019. The purpose of the Small Business Act was to decrease the economic and procedural burdens of Chapter 11. The Act applies to those companies with secured and unsecured debt under \$2,725,625.

Conclusion

The ultimate impact of COVID-19 will be measured in years and decades. Most business owners are facing zero or substantially reduced revenues, continued business obligations in the form of debt and rent payments and potentially increased labor and compliance costs. It is imperative that these owners implement immediate and aggressive strategies to combat the impact of the pandemic.

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