NOW + NEXT

LITIGATION ALERT | NIXON PEABODY LLP

APRIL 27, 2020

Five steps businesses can take now to minimize risk in coronavirus-related disputes

By Kathleen Ceglarski Burns, Christopher Mason, Richard McGuirk, Carolyn Nussbaum

The health and economic crisis caused by COVID-19 has resulted in unprecedented disruption to businesses worldwide. While some businesses may wait until the storm blows over to deal with the damage, those who prepare now will be in a stronger position to succeed in the long term. In fact, we are already seeing new cases being filed arising from the COVID-19 crisis. Nixon Peabody's Litigation team has identified five key issues you should analyze now to help your business avoid—or win—litigation in the wake of the COVID-19 pandemic.

1. Consider your contractual obligations

Typically, a party does not have a legally valid breach of contract claim until after a breach occurs. But that does not mean you have to sit idly by when you can see the writing on the wall.

As has been discussed at length over the course of the past several months, many businesses have been reviewing their contracts to determine whether they contain force majeure clauses, how those clauses are structured and what their impact may be, and whether there are other provisions that may allow parties to excuse or suspend performance as the result of current circumstances. Businesses should also make sure to review contract language regarding material adverse events or changes, threshold amounts or service levels, differences between defaults and events of default, and triggers for termination rights. And if your business buys goods, consider sending a request for adequate assurance of due performance (and a reminder of the obligation to allocate) when you have "reasonable grounds for insecurity" as to whether a seller in your supply chain will continue to perform its contractual obligations to sell to you. Likewise, consider how to respond if a counterparty makes such a demand on you.

Many counterparties are making concessions during the crisis, and negotiations with business partners will often be the most effective way to solve problems. However, in the midst of these discussions, do not forget to reserve your contractual and common law rights, and to document the specific facts that are affecting you and support a change in performance. For example, what are the shortages in your supply chain caused by—is it a government-mandated shutdown, a failure of another counterparty to live up to its obligations, or an increase in pricing? The details can be important in avoiding further disputes that may arise after the dust has settled. In addition,

consider that now that the COVID-19 crisis has occurred, it may be very difficult to argue for further changes or accommodations, as the pandemic is no longer an unforeseeable event.

2. Review your financing documents for cross defaults

Borrowers and lenders should review all credit and debt agreements, not just those that appear at first glance to be at risk of default. Cross-defaults provisions triggered by a breach of contract or payment obligation can exponentially increase borrowers' exposure. For example, lenders under the Paycheck Protection Program are often providing for cross-defaults in their notes against any other debt provided to the borrower—which could include mere credit cards. For companies with complex capital structures, the cross-default issues can be especially worrisome. Identifying issues as early as possible and taking steps to mitigate or remedy defaults is critical to avoiding serious consequences.

3. Explore all options for relief

Obtaining a court judgment from a contract dispute arising out of the current pandemic could take months, or more likely, years. Thus, as always, first consider whether a negotiated resolution can provide finality and preserve customers and counterparty relationships for the future. In addition, assess all other avenues for relief. Consider what funding programs your business may qualify for, including the Paycheck Protection Program, Employee Retention Credit, Main Street Lending Program, or other state or federal economic relief funds. Understanding the details of these programs is important because some of the options are mutually exclusive. In an effort to help our clients understand the pros and cons of these options, and obtain the most value for their businesses, Nixon Peabody has created a model that can calculate the approximate expected benefits of several of the programs. Applying for relief is not only important because you may qualify for useful benefits; it may also be important to demonstrate efforts to mitigate damages caused by a counterparty's breach of an obligation.

Similarly, assess all of your insurance policies, and ask your lawyer, not just your broker, to review your insurance coverage. There are significant details hidden in the "fine print" of insurance policies, and many new theories are being advanced regarding available coverage under the current circumstances. For example, experts disagree about whether the presence of coronavirus at a site is property damage, and the courts have not yet addressed it directly. Some policies may, for example, include disease as a peril covered by a policy, and the *presence* of the virus might then be damage to the property from that peril. It all depends on the specific language, and may not be clear at first glance.

4. Carefully manage federal funds

Federal stimulus funds can provide a lifeline to businesses, but they come with strings attached. The CARES Act provides for Congressional oversight, and the Department of Justice and Securities and Exchange Commission will rely on a host of existing federal statutes to police the use of that lifeline. For example, Section 951 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, 12 U.S.C. § 1833, provides for million-dollar penalties for misstatements, even if no one suffers any loss because of them. Additionally, both the DOJ and private whistleblowers will likely scrutinize payments from CARES Act programs. This can lead to actions under the False Claims Act, 31 U.S.C. §§ 3729-33, which provides for triple damages for falsely certifying compliance with the conditions of payment for federal funds. Liability is not limited to outright fraud, and even administrative mistakes can put a business at risk of a lengthy, costly investigation.

For example, the legal risks businesses face when they apply for Paycheck Protection Program ("PPP") loans are not always readily apparent, and the guidance is evolving in real time. Question 11 of the Small Business Administration's Frequently Asked Questions about the PPP highlights one nuance, noting that while "lenders [may] accept signatures from a single individual who is authorized to sign on behalf of the borrower," any such signature "is a representation to the lender *and to the U.S. government* that the signer is authorized to make the certifications, including with respect to the applicant *and each owner of 20% or more of the applicant's equity*, contained in the Borrower Application Form."[1] Some signers may not fully appreciate how this could put them at risk if, in fact, they do not have such authority or do not understand relevant facts about a minority owner. In another example of the constantly changing nature of the current landscape, after the first round of funding was exhausted, the SBA issued updated FAQs with additional guidance on the "necessity" certification, indicating for the first time that a business's access to alternate sources of capital was a factor in determining whether the PPP loan was necessary.[2] There are numerous other nuances associated with the PPP loan application and unanswered questions about the forgiveness process, and further guidance is expected. Checking with outside counsel can and should be an important part of monitoring the use of proceeds from any federal funding process.

5. Analyze dispute resolution clauses

A dispute resolution clause is frequently an afterthought, relegated to the "miscellaneous" portions of the last few pages of a contract. But such clauses can have major implications when it comes time to enforce contractual rights and obligations. We are already seeing an increase in litigation caused by COVID-19 business disruption, from commercial business disputes to consumer class actions, to insurance and shareholder litigation. How these disputes play out will depend in large part on the existence (or not) of arbitration, mediation, choice of law, and choice of venue clauses, in addition to limitation of liability language in contracts (both inbound and outbound). Understanding now whether your contracts have dispute escalation clauses or notice requirements, and what the process and location may be for making a claim against a counterparty, are important steps toward a successful claim or defense.

While these five steps should be relevant to virtually any business facing the current pandemic, there are a host of issues to consider in navigating the additional complexity of the economic and regulatory environment being created by COVID-19. Reach out to your Nixon Peabody attorney to discuss the particular issues your business is facing.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

- Kathleen Ceglarski Burns at **kburns@nixonpeabody.com** or 617-345-1109
- Christopher Mason at **cmason@nixonpeabody.com** or 212-940-3017
- Richard McGuirk at **rmcguirk@nixonpeabody.com** or 585-263-1644
- Carolyn Nussbaum at **cnussbaum@nixonpeabody.com** or 585-263-1558

---

[1] *See* Paycheck Protection Program Loans Frequently Asked Questions, April 8, 2010.

[2] *See* "New guidance from Small Business Administration emphasizes 'need' in Paycheck Protection Loans," which contains a link to the FAQ, April 24, 2020.