

# Neighborhood Entrepreneur Law Project

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CITY BAR JUSTICE CENTER



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PROJECT

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- ❖ Legal services for low- to moderate-income micro-entrepreneurs to help start their businesses on sound legal footing
- ❖ Legal advice regarding incorporation and tax issues, contracts and agreements, commercial lease negotiations, copyrights, trademarks, and patents
- ❖ Presentations and legal clinics at community-based organizations on issues of concern to micro-entrepreneurs

# Small Business Contract Issues Arising Under COVID-19

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*In partnership with the Neighborhood Entrepreneur Law Project (NELP)*  
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# Introduction

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# This Presentation

The COVID-19 pandemic has raised never-before-seen challenges, and the response has placed an extreme strain on the economy.

We are seeing that many small businesses are running into major problems with their contracts because:

- Either they or the other side can no longer do what the contract requires; or
- Even if doing what the contract requires is technically possible, doing so is extremely difficult.

This presentation is designed as a high-level training for small business owners potentially affected by COVID-19.

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# Limits of this Presentation

This presentation is focused on contracts that are **governed by New York law**.

- In the U.S., each state has its own set of laws. We are going to talk specifically about New York law.
- Be sure to check whether your contract says that New York or another state's law governs. If another state's law governs, the rules may be a little different.

You should also know that certain kinds of contracts have special rules, including:

- Employment contracts;
- Residential and commercial leases, or other real estate contracts;
- Insurance contracts, *etc.*

If you have detailed questions about these kinds of contracts, you should think about seeing a specialized lawyer.

This presentation does not address other issues that may be relevant to small businesses, such as:

- Questions about lawsuits by employees or customers who claim they have gotten sick or been harmed because of your business (personal injury and similar issues);
- Regulatory requirements;
- Applications for federal / state relief programs such as Small Business Administration loans or unemployment;
- Employment issues, *etc.*

# Think In Practical Terms

We're going to explain some key legal concepts for contracts. However, this is only part of the story. There are a number of important practical considerations.

## LAWSUITS ARE TIME-CONSUMING

- Lawsuits often take several years.
- Some contracts provide for special procedures that may be quicker than a regular lawsuit (like arbitration or mediation), but those processes can still take many months.
- Small businesses may not have the cash on hand to survive during the months or years that a lawsuit can last.

## LAWSUITS ARE EXPENSIVE

- Lawyers can charge hundreds of dollars an hour.
- Even if you don't use a lawyer, or you have a special deal with a lawyer, there may be other costs involved with gathering the materials for a lawsuit.

## YOU CAN'T SQUEEZE BLOOD FROM A STONE

- If performance is simply impossible, a judgment from a court will not fix this.
- Additionally, the other side may not have any money to pay even if a court says they have to (*e.g.* if they are bankrupt).

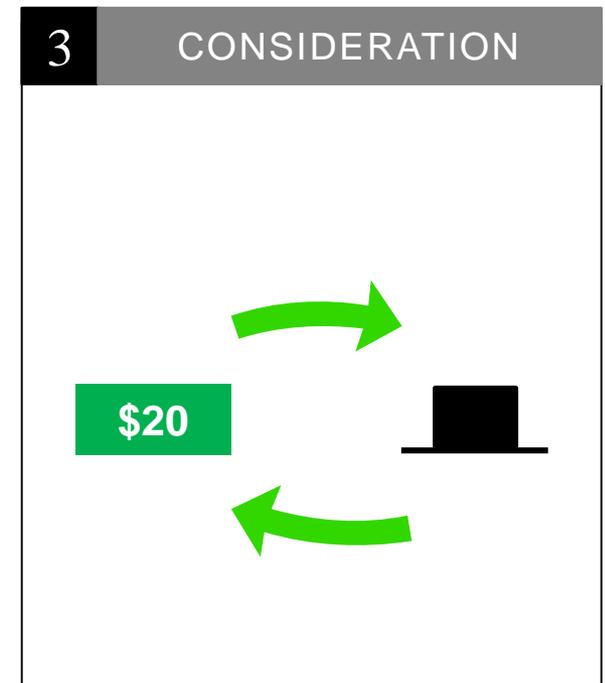
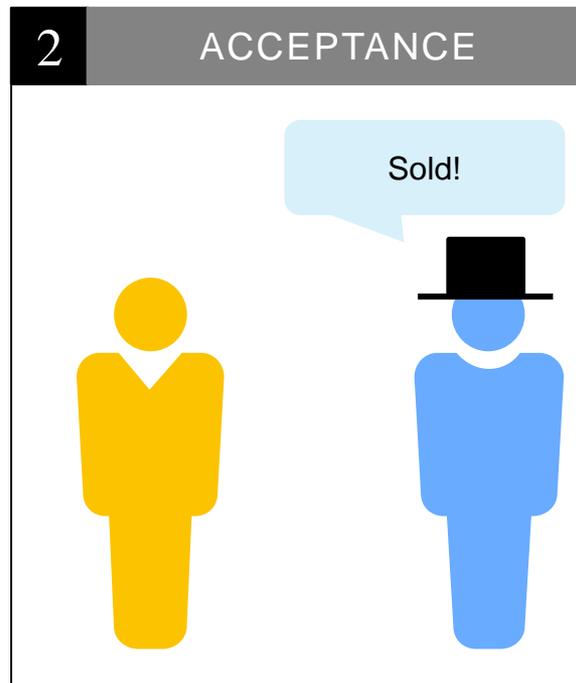
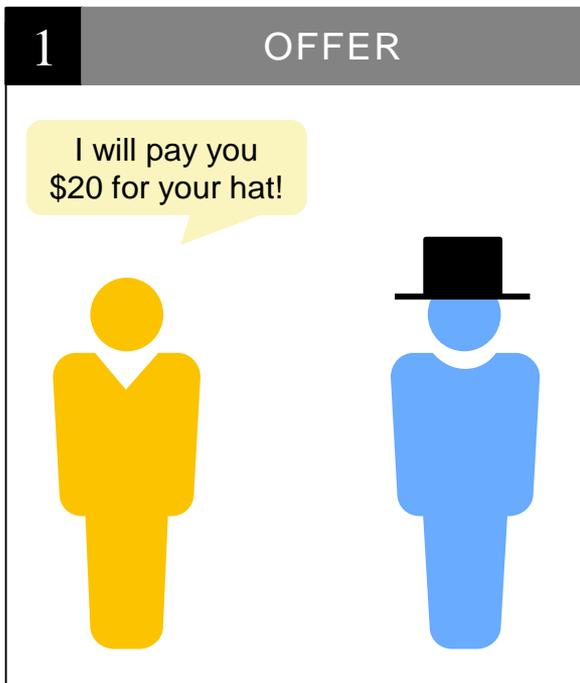
**For these reasons, we encourage you to think creatively about practical solutions, such as delaying obligations or otherwise changing the terms of the contract.**

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# Contract Basics

# What is a Contract?

A contract is an agreement between two or more people or entities that creates obligations that are enforceable in court. For there to be a valid a contract, there must be an “offer” by one party that is “accepted” by the other party in exchange for “consideration.”



# Statute of Frauds

Certain types of contracts must be **in writing** to be enforceable in order to prevent one party from inventing a fraudulent contract.

## EXAMPLES OF CONTRACTS THAT MUST BE IN WRITING

1 Contracts for the sale of real estate interests

2 Contracts to guarantee debt for another person

3 Contracts for the sale of goods over \$500

4 Contracts in consideration of marriage (prenups)

5 Contracts that can't be completed in less than one year

6 Lease agreements longer than one year

7 Assignments of insurance policies

8 A new promise to pay a debt discharged in bankruptcy

9 Certain negotiation services relating to loans, real property and business opportunities



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# What is a “Breach”?

A “breach” is failing to do something required by the contract. Normally, a breach occurs when the breaching party must do something and it does not.

Sally agrees to deliver 50 toy cars to Bob on May 1. On May 1, Sally delivers 25 toy cars. Sally breached the agreement on May 1 because she delivered fewer cars on the agreed date.

However, if a party tells another party that they will not perform on the contract *in advance of* when performance is due, that is called “anticipatory repudiation.”

Charlie agrees to make and deliver custom pink chairs to Barbie on May 1, with payment due on May 7. However, on March 15, Barbie emails Charlie to tell him that she will not be able to pay Charlie for any of the chairs. Charlie does not need to wait until May 7 to say Barbie has breached. However Charlie should try to limit his injury, including by stopping work on the custom chairs.

In addition, if A has good reason to think B will not be able to perform, they may ask B to confirm that B will perform. If B doesn’t give this assurance, A may treat B as though B had repudiated the contract.

Barbie hired Danielle to design and print menus. Danielle issued Barbie an invoice for her design work, which Barbie has not paid. Danielle has agreed to print and deliver the menus to Barbie by May 1, with payment due on June 1. Danielle hears from Charlie that Barbie is having money troubles. Danielle tells Barbie she is concerned about Barbie’s ability to pay for her design work and the menus. On March 20, she asks Barbie to pay her past-due invoice and to pay for the menus up front. Barbie does not agree to either request. Danielle can treat Barbie’s failure to provide assurance as a repudiation.

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# After the Breach

## OPTIONS FOR THE NON-BREACHING PARTY

- May stop any performance owed to the breaching party
- May wait for performance or renegotiate terms – if the due date has not yet occurred and the contract is not impossible
- Resort to any remedies available for breach of contract
- However, typically the breaching party must be given a chance to correct the breach

## DEFENSES FOR ALLEGEDLY BREACHING PARTY

- There was no breach:
  - Performance is not yet due
  - Contract has been performed
- Performance is excused:
  - Because there is a contractual provision saying performance is excused (such as *force majeure*)
  - Impossibility
  - Frustration of purpose

# Main Types of Remedies for Breach

## MONEY DAMAGES

- Money damages are usually meant to compensate the non-breaching party for the economic harm caused by the breach
- Not a penalty
- These include direct damages resulting from the breach as well as indirect damages that are sufficiently connected to the breach

## SPECIFIC PERFORMANCE

- Party will be required to do what it said it would do
- Usually difficult to obtain

## SALE OF GOODS

- If there is a breach by the seller, the buyer can cancel the contract, recover the goods or seek specific performance
- If there is a breach by the buyer, the seller can withhold goods if they have not yet been delivered, recover goods if they have been delivered, or, in some situations, force the buyer to accept the goods

# Types of Damages

**Example:** In September, homeowner hires contractor to build a new house for \$100,000. The contractor expects to profit \$20,000. Contractor buys \$10,000 worth of materials and puts in a foundation. Homeowner refuses to pay the contractor. Contractor sues homeowner for damages.

If there is a lawsuit and a court rules in favor of contractor, what amount of damages will the contractor receive from the homeowners?

## EXPECTATION

- Meant to put the other party in the position they would have been in had the breach not occurred

*Homeowner owes contractor  
\$20,000*

## RELIANCE

- Intended to put injured party in position they would have been in had the contract never been made

*Homeowner owes contractor  
\$10,000*

## RESTITUTION

- Intended to ensure that *the breaching party is not unjustly benefited* by the breach

*Homeowner owes contractor  
foundation's value*

However, these types of damages have to be proved in court before they can be recovered. It can be difficult to recover damages when they are uncertain.

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# Contractual Provisions May Limit Damages

Parties can limit damages by excluding certain kinds of damages or imposing additional requirements in their contract for parties to minimize – or “mitigate” – their damages.

Parties may also include “**liquidated damages provisions**” in their contracts:

- This is a provision where the parties have agreed that damages for breach will be calculated in a specific way or set at a specific amount so that a court does not have to determine the amount of damages to award.
- If challenged in a lawsuit, liquidated damages provisions will generally be upheld if the specified amount is proportional to the likely loss and the amount of actual loss is impossible or difficult to calculate.
- Courts will not enforce liquidated damages provisions if the amount fixed is clearly disproportionate to the probable loss and looks like it is meant to punish the breaching party.

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# COVID-19-Related Contract Non-Performance

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# Is there a *force majeure* clause?

Some contracts include something called a “*force majeure*” clause.

These clauses say that if certain events that are outside the control of the parties occur, then certain obligations under the contract may be postponed or excused.

In the past, people often included these clauses without thinking too much about them, but people have been paying a lot more attention to them since COVID-19.

## KEY QUESTIONS WHEN LOOKING AT A FORCE MAJEURE CLAUSE

- How is the term “force majeure” defined? Does it include anything relevant?
- If a force majeure event occurs, what does the contract say happens to the party’s contractual obligations? Are there any obligations that will not be excused, even if there is a force majeure? Is only one party able to use the provision?
- Does the contract specify what the effect of the force majeure event must be before an obligation is suspended? Must the event make performance impossible, or only more difficult or inadvisable?
- Do you have to do anything in order to invoke force majeure? Is there a requirement to provide written notice by a certain date?

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# Sample *Force Majeure* Clause

**Force Majeure.** No party shall be liable or responsible to the other party, nor be deemed to have defaulted under or breached this Agreement, for any failure or delay in fulfilling or performing any term of this Agreement (except for any obligations to make payments to the other party hereunder), when and to the extent such failure or delay is caused by or results from acts beyond the impacted party's (“**Impacted Party**”) reasonable control, including, without limitation, the following **force majeure** events (“**Force Majeure Event(s)**”): (a) acts of God; (b) flood, fire, earthquake, epidemic or explosion; (c) war, invasion, hostilities (whether war is declared or not), terrorist threats or acts, riot or other civil unrest; (d) government order or law; (e) actions, embargoes or blockades in effect on or after the date of this Agreement; (f) action by any governmental authority; and (g) national or regional emergency; (h) strikes, labor stoppages or slowdowns or other industrial disturbances; (i) shortage of adequate power or transportation facilities; and (j) other similar events beyond the reasonable control of the Impacted Party.

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# Examples of Relevant Language for COVID-19

Depending on the specific language of the relevant *force majeure* clause, a company could seek to invoke *force majeure* as a result of:

- Quarantine
- Epidemic
- Pandemic
- National or regional emergency
- Labor stoppages (if the it does not specifically refer to only strikes or lockouts)
- Government action, law or regulation
- Breakdown of the logistics chain
- Potential other circumstances

Each of these events can also be something specifically excluded as a *force majeure* event.

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# New York Law Basics on *Force Majeure*

Under New York law, *force majeure* clauses tend to be interpreted narrowly and courts generally excuse non-performance based on a *force majeure* clause “only if the clause specifically includes the event that actually prevents a party’s performance.”

If there is a generic catchall provision (such as “among others”, “etc.”), courts will generally limit it to include only events of the same kind as the listed examples. For example, a list of “poodles, golden retrievers, Chihuahuas, etc.” would likely encompass “Dalmatians,” but not “cats.”

Also, New York courts will usually require that an event have been unforeseeable so exact timing may matter (January vs. April).

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# Impossibility and Frustration

Even if there is no *force majeure* clause, or if it doesn't apply, you may be able to rely on two general rules:

## IMPOSSIBILITY

- If performance of the contract has been rendered truly and objectively impossible, it may be excused (which means you don't have to do it, and you don't have to pay damages).
- In order to excuse performance, the impossibility must be a result of an unanticipated event that could not have been foreseen or guarded against in the contract.
- Simply being more expensive does not make something impossible.
- A court could find that a government stay-at-home order made performance impossible.

## FRUSTRATION

- “Frustration of purpose” happens when performance is possible but the contract has become completely pointless for one of the parties.
- The reason must be unforeseeable, must make the contract wholly valueless to the affected party, and must have been understood by the parties to be the sole reason for entering into the agreement.
- If a bride hired a caterer to cater a 500 person wedding but the wedding was canceled due to a state imposed limitation on gatherings, the bride could claim “frustration of purpose”.

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# Other Options

## AMENDMENTS

- With an amendment, you can add, delete or correct part of the contract without completely replacing the contract. This can be helpful if you want to postpone or reschedule an event due to the outbreak of COVID-19 instead of cancelling it.
- Look for an “amendments” provision in the contract to find out who has the right to amend, what is required to amend and whether there are any notice requirements.

## TERMINATION

- Depending on your circumstances, you may want to cancel the contract. This will depend on whether you want to “undo” the contract altogether and are comfortable giving up its benefits and potentially paying a cancellation penalty.
- Look for a “cancellation” or “termination” clause, which will tell you whether cancellation is an option and explain the process you will need to follow to cancel and any notice requirements.
- Some contracts do not provide an option to cancel.

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# Dispute Resolution

Dispute resolution provisions set out the mechanism for resolving disagreements between the parties.

To check if your contract has dispute resolution provisions and what they might require, check the following:

- Is there a provision in your contract that requires that you negotiate with the other party before you sue?
- Are there any specific notice or timing requirements? Are you required to formally notify the other party and are there specific requirements for how to do so? Do you have to wait a certain amount of time between any steps?
- Does your contract mention “arbitration” or “mediation”? Does it say you are required to mediate or arbitrate, or is it an option alongside a lawsuit in court?
- Does your contract name a specific court or place where a lawsuit must be brought?

If you are considering taking legal action instead of other options, it is important to review these dispute resolution provisions and ensure you are following them. Otherwise, a court may decide it cannot address your case.

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# Practical Considerations

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# Protect Your Rights

## INITIAL STEPS TO PRESERVE YOUR RIGHTS:

**1** *Gather* contracts and assess obligations.

- Determine if you will be able to meet your contractual obligations and/or if you are concerned about whether your counterparty will be able to meet their obligations.

**2** *Notify* customers/ counterparties if you know or think you cannot meet your obligations.

- You should *not* assume that because everyone knows about COVID-19 formal notice is not required.
- Avoid delaying notice.

**3** *Document* all calls/emails/ communications with counterparties (even if you usually communicate by phone).

- At a minimum, you should keep detailed notes of all telephone calls (date, time, what you discussed, etc.).
- Modifications to contracts should be in writing.
- Make clear whether a document is part of settlement negotiations.
- Assume documents can end up in front of a judge or jury.

# What Documents Should I Review?

When reviewing your contract, be sure to collect and review the full set of documents that make up the contract.

These documents might include:

- original contract or lease (signed and dated versions)
- amendments and renewals (common in leases and in government contracts)
- riders (common in leases)
- other agreements or documents referenced in the main contract, such as requests for proposals and proposals in government contracts or master leases / over leases
- subcontracts or subleases
- schedules, annexes and exhibits

You should make sure that you read the *whole* contract, including any of the above documents. Pay special attention to “defined terms” and how different parts of the contract interact with one another, as different sections of the contract can reference each other.

## POTENTIALLY RELEVANT CONTRACTUAL CLAUSES

- Termination Rights
- Cancellation Rights
- Changes / Amendments / Modifications
- Material Adverse Change
- No Oral Agreement / No Oral Modification
- *Force Majeure* / Act of God / Excused Non-Performance
- Insurance Requirements
- Notices
- Limitation on Damages
- Indemnity
- Repudiation

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# Focus on the Possible and the Practical

Regardless of what your legal rights are, enforcing those rights through a lawsuit is likely not practical.

Instead, we recommend that you think practically and creatively. We encourage you to try and work through any disputes with your counterparties.

If renegotiating/modifying/amending the contract is not possible, you should try to determine and discuss ways of either mitigating potential damages or the impact of the disruption.

## KEY QUESTIONS TO PREPARE FOR NEGOTIATIONS

- What is my goal?
- What are potential roadblocks to performance? Can they be overcome?
- What is essential? What is helpful, but not essential? What can I give up?
- What does the other side need? What do they want?
- What is my leverage?
  - Even if litigation is not on the table, strong legal arguments will be helpful leverage.
  - Possible bankruptcy, loss of business relationship may also be used as leverage.
- What is the other side's leverage?
- Are there possible compromises or creative solutions that are beneficial to both parties?
  - For example, postponing payments.

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# Relationship Considerations

How important is the business relationship?

- Do I want to maintain goodwill or simply walk away?
- What does the other side want?

Is the other side likely to be fair and reasonable if I am?

This is a very stressful time—try to avoid taking it personally; don't make it personal.

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# Plan Negotiation Strategy



Review the contract, any prior communications about the contract, and what each party agreed to.



Figure out your and your counterparty's respective leverage in the negotiation.  
How much does the language of the contract help or hurt each party's position?  
How much has each party been impacted by COVID-19?



Decide what your opening negotiation position will be and what you are looking to get in an ideal world. Also figure out what you are willing to accept in order to compromise.



Consider your possible responses to the counterparty's anticipated claims and demands.



Prepare for the possibility that the negotiation may happen in parts, and think through how you would communicate to the counterparty that you would like to pause the negotiations and resume them at a later time.

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# Other Things to Consider

## INSURANCE

- Do you have insurance that may cover some of the events that have happened as a result of COVID-19?
- Collect and review your existing insurance policies and contact your insurance broker or agent to (i) assess whether you have applicable coverage and (ii) file any claims within the required time period.

## NEW CONTRACTS

- If you are considering entering into a new contract, consider whether any of the topics we discussed would be helpful to protect you in the future.
- Consider including detailed terms and conditions for cancelling or postponing a contract within a specified period of time or negotiate a more flexible cancellation policy.

## NEWS AND UPDATES

- Regulations and policies are constantly changing as a result of COVID-19 and new regulations are issued on a regular basis.
- Follow the news and government websites for recent updates and think about how these may affect the types of contracts you have.

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# Additional Resources

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# Additional Resources: Small Business Resources

- Cleary Gottlieb – Chart on Federal Financial Relief for Small Businesses Under the CARES Act (COVID-19) – Chart
- U.S. Small Business Administration - Coronavirus (COVID-19): Small Business Guidance & Loan Resources
- U.S. Chamber of Commerce - Coronavirus Small Business Survival Guide
- NYC Small Business Services - Assistance & Guidance for Businesses Impacted Due to Novel Coronavirus
- New York State Department of Labor – Unemployment Assistance

# COVID-19 Remote Small Business Legal Clinic

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- ❖ NELP has expanded its services in the wake of the COVID-19 pandemic to adapt to the emerging needs of small business owners, working with Lawyers for Good Government and several NYC law firms to provide free, remote legal consultations to small business owners.
- ❖ The purpose of the clinic is to help small business owners understand and act upon options available under the federal government's COVID-19 stimulus package and other opportunities available through federal, state and local programs as well as navigate any additional remedies available to small businesses related to COVID-19.
- ❖ Fill out our [brief intake form](#) to request an appointment.

# Partners

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# Questions & Answers



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