LEGAL FOUNDATIONS

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Rising Interest Rates and Business Tips for 2015

By: Chad J. Cochran

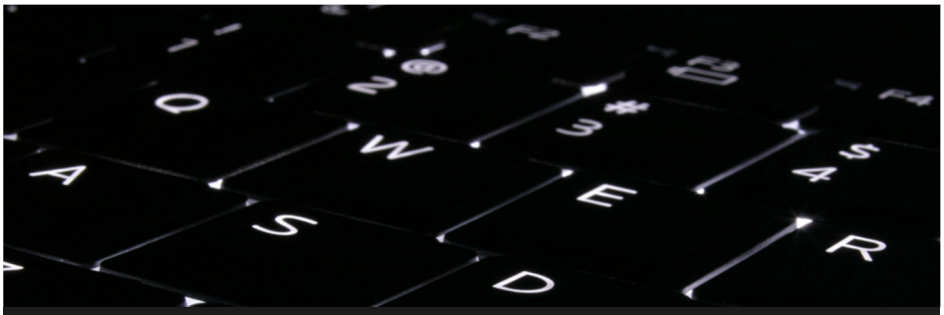
The Federal Reserve administers a key economic indicator, the federal-funds rate. Banks use the federal-funds rate to conduct overnight transactions which trade account balances maintained at the Federal Reserve. When the Fed raises this key rate, personal and business loan rates follow closely behind. In September 2014, the Fed signaled that its six year practice of maintaining a near zero federal-funds rate would likely come to an end at some point in 2015. Policymakers specifically signaled a 1.25% federal-funds rate by the end of 2015 with additional increases on the horizon for 2016. In light of these likely interest rate increases, we hope you will consider three business tips for 2015:

1. **Lock-In Financing Sooner Rather Than Later.** Cash is king. If you are able, it is always better to grow your money via higher interest rates rather than dilute it by paying interest to the bank. With that said mortgages, equipment loans, lines of credit, etc. are reality for many of our clients. Adjustable rates will likely rise over the next couple of years, so it makes sense to lock-in long term financing sooner rather than later. If your business model involves short and/or long term debt, it would be wise to re-visit your interest rate structure in the near future.

2. **Beware Line of Credit Balances.** Lines of credit rates are usually tied to the prime rate (which runs approximately 3% above the federal-funds rate). Businesses which maintain balances on their lines of credit will likely see increased carry costs in the near future. Obviously, customers with added carry costs enjoy less cash on hand to conduct the transactions they have over the past six years of near-zero Fed interest.

3. **Closely Examine Assets and Security.** Interest increases naturally cause businesses to look into refinancing assets. Lenders often utilize multiple sources of collateral, complicating refinancing efforts. New loans often seek new collateral. Cross-collateralization typically requires an existing lender's consent to a new secured loan, so be careful.

In This Issue



Bankruptcy Law

The Long and Winding Road of Bankruptcy

By: Nan E. Hannah

As the economy appears to be settling into what we can only presume is the new normal, once again contractors and subcontractors are, from time to time, filing petitions in the bankruptcy court. A few years ago, everyone was filing Chapter 7 and had no assets. Now, we are again in a time where even a Chapter 7 debtor may have assets, so the process of bankruptcy comes into play. With that in mind, this article seeks to remind the reader of the purpose and procedures of bankruptcy.

The concept of bankruptcy arose long ago as society recognized that debtors' prisons did not serve the intended purpose of modifying behavior, nor did it pay anyone back. At the outset, the idea was to provide folks who encountered life events which put them in such a deep financial hole from which they would be hard-pressed to recover a chance to clear their slate and start over again. Even today, if you think about individuals and families who lose a job, face a life-altering medical crisis or some other life event which is economically crushing, bankruptcy serves its original purpose. The same applies to a corporate entity faced with mounting debt as a result of a busted project, changes in the economy, or a similar event which overwhelms the firm's financial structure. It is unfortunately true that there are also individuals and businesses who find themselves in need of bankruptcy protection because of poor financial management and decisions. Then, there are the "frequent flyers" – those individuals who use debt as a means of getting ahead and the bankruptcy court as a way to mask their bad behavior (or they are just really slow learners who continuously make the same mistakes).

Understanding the general purpose of bankruptcy may help in developing some patience in what can be a rather annoying process. The purpose of the process is to either hold creditors at bay while the debtor gets back on its financial feet (Chapters 11 and 13) or to insure the fair distribution of whatever assets remain to be liquidated (Chapter 7). In any of these chapters, if a creditor protects itself by securing its debt with collateral which has value then the creditor may anticipate receiving payment in full either through the plan, outside the plan, or in the liquidation. If the collateral is otherwise encumbered, then there is no such assurance. If you hold a second deed of trust, a second position in terms of equipment, inventory and the like, then you stand to recover as much as the collateral will cover after the first position creditor has recovered. If your collateral is accounts receivable, then your opportunity for recovery is as good as the debtor's actual chance of being paid – and there are many obstacles which may reduce that opportunity; think liens and back charges.

Chapter 11 cases are often the most frustrating. The debtor is trying to reorganize. They are supposed to pay for everything that they use post-petition (ongoing rental agreements, monthly utility bills, loan payments). There are emergency or first-day motions and orders (usually heard within a week of the filing) seeking to work with the primary lenders to get post-petition financing and permission to use the current assets of the business to maintain day-to-day operations while they get a handle on the business' finances. Some Chapter 11's fail at this stage, but this "stage" may take several months to play out. If you have rental or financed equipment, you must move for relief from stay or for adequate protection which is not an inexpensive process. Therefore, you are usually going to try to work through the cash collateral order to get paid and only if that fails or appears likely to fail, do you file the motion. There then is a 20-day period for the debtor to respond. Assuming they do not simply return the equipment, you have to wait for the next hearing in the case in order to have your motion heard. If the debtor can demonstrate to the court that the equipment is necessary to successfully reorganize and that they can make "adequate protection" payments on the equipment, they will get to keep it. If not, you will get it back.

The moral of this story? Think of bankruptcy as the Titanic. You may know that the ship is headed for trouble, but it is virtually impossible to turn the ship in any direction quickly. You are just along for the ride and whether it hits the iceberg or slides by will ultimately determine your fate.

Nan Hannah's Famous Tiger Butter Recipe

1 lb. white chocolate
1/2 c. semi-sweet chocolate chips
1/2 c. peanut butter (creamy or crunchy)

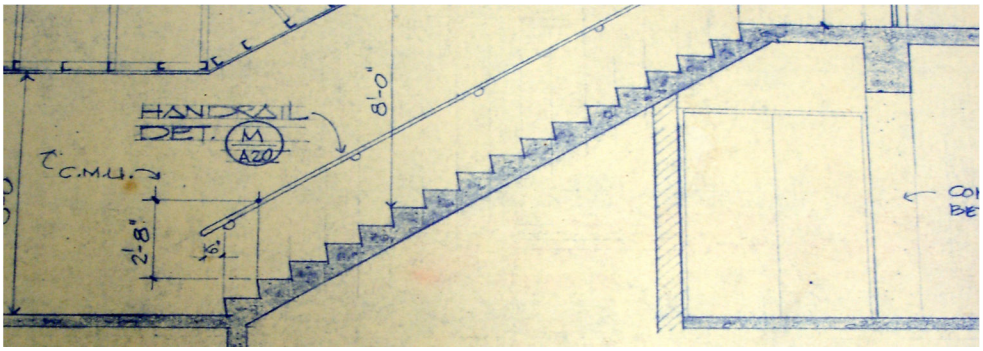
Melt white chocolate and peanut butter over low heat, stirring constantly until smooth. Spread mixture on cookie sheet which has been lined with wax paper. Melt chocolate chips and drizzle over peanut butter mixture. Swirl together with knife. Refrigerate until firm then break into bite-size pieces.

Nan Hannah in the News

If you know Nan E. Hannah, you know that she is 100% committed to the legal profession and the Triangle community. Her many efforts have previously resulted in extensive recognition from multiple organizations in our community. Nan recently received three new accolades:

1. Martindale-Hubbell granted Nan its highest rating as a result of evaluations from Nan's attorney peers.
2. On Sunday, October 19, 2014, Nan was ordained and installed as an Elder at White Memorial Presbyterian Church, in Raleigh.
3. On November 19, 2014, the North Carolina Bar Association presented Nan with a Recognition Award for appreciation of her guidance and leadership. This award relates to, among other efforts, her service as Chair of Lawyers in the Schools and the Law Related Education Advisory Committee.

Congratulations and thank you, Nan.



Construction Law

Public-Private Partnerships Come to North Carolina

By: Cody R. Loughridge

"The health of a democratic society may be measured by the quality of functions performed by private citizens" – Alexis de Tocqueville, *Democracy in America*, 1835.

In August of 2013, Governor McCrory signed into law House Bill 857 (codified as G.S. 143-128.1C) which authorized governmental agencies to utilize Public-Private Partnerships (often referred to as "P3s") as a delivery method for construction projects. Generally speaking, P3s are contractual relationships between a governmental agency and a private sector business, in which the private sector business becomes heavily involved in the financing and delivery of a public construction project (such as a school, public building or public roadway). Occasionally, the private sector's involvement can even extend beyond delivery of the construction project and into the operations and maintenance of the public facility. Benefits of the P3 delivery system are thought to include: accelerated project delivery, increased return-on-investment for the governmental agency, reduction in cost to the governmental agency, and the transfer and reallocation of risk to the private sector business in exchange for revenue generated from the public project.

Prior to House Bill 857 becoming North Carolina law, North Carolina had required that non-traditional delivery methods, such as a P3, be approved by the State Building Commission. However, with the passage of House Bill 857, local governments and state agencies are now at liberty to utilize the P3 delivery system if it is determined that there is "a critical need for a capital improvement project". The administration of P3s are now monitored by the Secretary of Administration, to whom the governmental or state agencies are required to report and justify the preference of the P3 system, over a more traditional procurement/delivery process.

Once the state or governmental agency establishes their need for a P3, the public unit must publish to interested private developers, via "a newspaper having general circulation", the contract terms and request that interested private businesses submit their qualifications (which include considerations such as financial stability, experience, projected project timeline, etc.). Following 30 days' publication of the contract terms, the governmental agency must then award the contract at an open meeting. Upon award of the P3, the private contractor must undertake a good faith effort to include HUBs (historically underutilized businesses) on the project.

Although the broad application of P3s are in their infancy in North Carolina, there are instances where P3s have been previously utilized in North Carolina, and beyond. North Carolina witnessed North Carolina State University's Centennial Campus and the University of North Carolina at Chapel Hill's Horace Williams Campus succeed as a result of P3s. Beyond North Carolina, large scale P3 projects such as the $2.2 billion Hudson-Bergen light rail project in New Jersey and the $1.9 billon JFK Air Train rail system in New York City have thrived, in part, as a result of successful partnerships between private industry and governmental agencies.

Public construction, and its interplay with the private sector, continues to be an ever-evolving landscape in North Carolina. If you have additional questions regarding public construction or public-private partnerships, please contact our office.

Termination for Convenience Clauses

By: Paul A. Sheridan

Contract Law

As part of the continuing series of articles identifying important construction contract clauses, perhaps the most impactful clause in a contract can be the standard termination for convenience clause. Imagine this scenario: your firm expended time and material in bidding a project, you have obtained an award and entered a contract. You may enter into other contracts with subcontractors or suppliers. Everyone feels good and the project is moving forward. You've dedicated a certain percentage of your fixed overhead costs towards this project, and your cash flow is dependent on moving forward, successfully and timely completing the project on budget. You may have hired additional personnel and dedicated your firm's resources to the project, perhaps even turning away from other projects due to limited resources. You're doing a great job on the project, hitting your marks, and the project is moving forward as planned. Then, you receive a notice of termination for convenience. Perhaps the owner has decided to move in a different direction due to economic or marketplace indicators, or perhaps financing fell through.

The termination for convenience clause is one of the most unique provisions of any contract clause in the world of contracts, arising only in construction contracts. It allows the owner or general contractor to unilaterally terminate the contract, even if it is the owner that may be heading towards a default, without incurring a breach of contract. This arrangement defies the legal principle of mutuality of contract and the contractual necessity of consideration. If it is the written contract, the courts will enforce it, absent a showing of bad faith. If you see this type of clause, negotiate with thoughts that it can and will be invoked. While the act of excluding the clause may not be negotiable, make sure that there is a clear distinction drawn between the conditions of termination for default verses termination for convenience. Note that the damages between termination for convenience and termination for cause should be different. Make sure that your firm is entitled to full reimbursement for actual costs incurred plus a measure of profit and overhead, perhaps going so far as delineating a specific profit number that you are entitled. To protect yourself, it is advisable to have a similar flow down provision in contracts with subcontractors and suppliers, in the event materials are special ordered. Consideration of expedited payment terms upon the owner invoking this clause may be a consideration.

As with any complex contract, to reduce risk, it is best to recognize different type of contract clauses and take the time at the front end to contemplate potential outcomes. Obtain the advice of a qualified attorney if you have questions.

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