

## BACK TO BUSINESS IOWA PODCAST

A partnership of Iowa State University Extension and Outreach and America's SBDC Iowa

### SEASON 1 | EPISODE 29: Business Exit Strategies

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**Description:** *Attorney Nick Roby with the Drake Law Clinic's Entrepreneurial and Transactional Law division discusses considerations for businesses who do not think they can survive in this business climate and need to wind down operations.*

[music]

**Steve Adams, host** 00:10

Hello, and welcome to the Back to Business Iowa podcast from Iowa State University Extension and Outreach. This podcast is a collaboration between Iowa State University Extension and Outreach and the programs including Community and Economic Development, Farm, Food and Enterprise Development, and the Iowa Small Business Development Centers. These podcasts cover relevant topics for businesses and individuals related to education, research and technical assistance during and post COVID-19.

**Steve Adams, host** 00:54

I'm Steve Adams, field specialist three at Iowa State University Extension and Outreach, part of the Community and Economic Development unit and your host for today's podcast. In this podcast, we're going to be discussing a very difficult topic. What does a business owner do when it's time to get out of business? We've hesitated to bring this up try to keep things on an upbeat path. But I think it's probably time we had this discussion, and with us, our special guest today is Nick Roby, director of the entrepreneurial and transactional division of the Drake Law Clinic. Nick, thank you for joining us today.

**Nick Roby** 01:32

Steve, very good to be here. Thank you.

**Steve Adams, host** 01:35

Well, Nick, can you tell us a little bit about the entrepreneurial and transactional clinic at Drake law school?

**Nick Roby** 01:41

Absolutely, I'd love to. The entrepreneurial and transactional clinic has been part of the Drake law school's legal clinic for the past seven years. We are, as with most small business and transactional legal clinics at law schools, kind of the new kid on the block. Law schools have had criminal defense legal clinics and family or other civil law clinics for a long time. But only in the last decade or so have law schools started to recognize that with respect to their students who are not necessarily interested in the courtroom aspects of law practice, they need to also provide a hands-on kind of real-life experience while in law schools.

**Nick Roby** 02:28

So many law schools, including Drake, have created these small business and transactional law clinics for the benefit of their students and for the broader community. And that's what we have at Drake here with this clinic. In our clinic, we have second and third year law students, and they're sworn in as special practicing attorneys to provide legal services in the clinical setting under the supervision of



faculty and staff who are fully licensed attorneys, and all of our legal services are provided free of charge.

**Nick Roby** 03:02

And we generally limit our clients to those who can't, who it's just not practical for them to engage private practicing attorneys, either for financial reasons, or in the case of some of our community nonprofit clients, that's going to take needed funds that they could use for their charitable purpose, then we provide those organizational legal services free of charge to assist those organizations, as well as small businesses who are in similar situations.

**Steve Adams, host** 03:33

Sounds like a terrific amount of services and the free of charge thing, at least price is right.

**Nick Roby** 03:39

That's right [laughter].

**Steve Adams, host** 03:42

Have you seen your clientele kind of change with the advent of the COVID-19 pandemic?

**Nick Roby** 03:48

Yes, we definitely have. You know, we traditionally have spent most of our time at the front end of the lifespan of a business. That is the formation, organizational issues, management and governance decisions at the front end, perhaps analyzing tax issues in order to advise the client which type of business entity to utilize in forming their business entity. That has traditionally comprised most of the work that we deal with on a day to day basis historically within the clinic.

**Nick Roby** 04:29

More recently, however, specifically in the past three or four months, we've been spending more time with mature businesses that are seeking advice on kind of mid-life or end-of-life issues, I guess you could say. And these issues include advice on new government programs that are intended to help those businesses get through this economic crisis caused by the pandemic, including the much publicized Paycheck Protection Program, and the SBA's Economic Injury Disaster Loan program. Those are examples of, you know, programs that small businesses are looking at, and taking advantage of, hopefully, in many cases, you know, to survive these difficult times.

**Nick Roby** 05:18

And then, you know, we're looking at issues surrounding employee situations, layoffs and terminations and the legal consequences affecting those decisions, and the new unemployment benefit programs and how those might affect not only the employees, but also the business owner and the employer as a result of those new laws.

**Steve Adams, host** 05:44

So that brings up a question for me personally. On a couple of discussions we've had with small businesses who have commented that the unemployment benefit program that extra \$600 is actually turned into a disincentive to get some of their employees back to work. And even some business owners have asked, Well, is there anything I can do to force those employees to come back to work? Would you have an answer to that or a response to that?

**Nick Roby** 06:14

Well, the first response is that, you know, that \$600 federally subsidized supplement to unemployment insurance is no longer exists, at least in Iowa, based on the timing, and across the country, as of

tomorrow, the last day of July, that particular program, and those specific benefits expire. So, and certainly, there's been a lot of discussion at the national level about that perceived problem, perhaps real problem that folks, because of the flat \$600 additional amount, in some situations are making more money receiving their unemployment benefits than they received working full time at their previous job.

**Nick Roby 07:06**

So, certainly the Republican response in the most recent round of pandemic economic stimulus bills and legislation has been to trim that back. And in the current proposal, by the Republicans in the Senate, you know, has been to reduce that flat rate to \$200 for just a temporary period, and then eventually roll that out so that the benefits being received by an unemployed individual will be 70% of of their pay while they were a full time employee. So that certainly has been an issue has been discussed there. Both sides have indicated, have argued about how big of a problem that is.

**Nick Roby 08:03**

I mean, sort of the benefit of the flat \$600 was it was simple, it could be administered easily by state unemployment offices, and money could get out quickly to those folks who needed it and who would then recirculate it back in our economy. And the argument was the reason why we, you know, on a broad basis, the economy has not suffered as much as it might have given the situation, was because of that money being paid out and recirculating in the economy.

**Steve Adams, host 08:36**

Well, it's interesting because we had an economist on this past week that said, a lot of people are have been sitting on that money and that they haven't really been spending it to get it back out into the economy. And yes, that program did kind of officially come to an end in Iowa as of last Saturday. So that lag time is certainly in between now and whenever the ...I think the next incentive package is known as the HEROES act, and we all, none of us know, of course when that may or may not be coming down the pike. So I just had a real quick question here as well. I assume it depends on the reasons that businesses are looking to exit, but could you, in any of those, could you give us a scenario and what kinds of discussions are going on in and around that possible succession planning or exit planning for a business?

**Nick Roby 09:31**

Right, well, you know, the most important analyses that ought to be going on with respect to a business that is suffering during these times and facing a decision about whether to continue or not, is the prospects of future business and how soon and how strong business is expected to return to the volumes needed in order to make the business profitable. So business owners are forced to sort of be as objective as they can, in looking forward and making that analysis and prediction of when the bounce back will be at a level which can sustain the business itself.

**Nick Roby 10:24**

You know, that's one very, very important factor in addition to determining, you know, how big the losses will be until they get to that point. So, what steps can be taken, what things can be taken advantage of during the interim in order to minimize the losses during this period before the revenues return, you know, obviously is an important, a key factor that needs to be taken into account.

**Steve Adams, host 10:55**

So if I'm that business owner, let's say, and you mentioned being able to forecast out maybe what your your cash or your rebound potential might be with the business. But if I am looking at closing a business, what would you say are the most important things I should explore if I'm planning on exiting, other than my cash situation?

**Nick Roby 11:23**

Well, you know, certainly you need to look at the agreements and arrangements that the business has in place, and determine whether all of or only some of those obligations will go away if the business is discontinued and shut down. So, you know, if the business is owned personally, there's not a separate legal entity that's been created to carry on the activity and enter into the agreements and obligations, but instead it's owned as a sole proprietorship or a partnership. Then presumably, in most cases, the owners aren't going to be personally liable for those obligations that still continue on. So if there's long term lease obligations, or loan obligations, even shutting down the business is not going to discontinue the legal obligation to continue to make the payments under those agreements.

**Nick Roby 12:28**

You know, even if a separate entity has been created to carry on the business, lots of times in the case of small organizations, the owners are required to personally guarantee significant financial obligations, like bank loans and commercial lease agreements. So that's an important consideration that needs to be taken into account by the business owner to determine what position he or she will be in if there is a full closure of the business activity, and what continuing obligations and liabilities he or she will have going forward.

**Steve Adams, host 13:12**

So carried liability situation then on those businesses, you know, if you're closing the business, but you still have those debt and lease obligations, those are probably things you need to consider on whether it's worth it or not. I gotta wonder, though, is there a tipping point, you think, for some businesses?

**Nick Roby 13:31**

Absolutely. I mean, again, it's difficult for most businesses that have been started up by one or two individuals and perhaps carried on for a significant period of time, you know, it's very difficult for those folks to be objective in analyzing whether going forward makes sense or shutting down makes sense. But that's really what needs to be done, and at some point, if you have a business which has a lot of variable expenses as opposed to fixed expenses in which you can shut down and cut off those expenses and those losses by discontinuing the business in part or in full. And you know, you're somewhat pessimistic as to how fast and how strong the rebound is going to occur with respect to your particular operation, you know, then the wise decision in those cases is often to say, I need to shut this down and move on to something else.

**Nick Roby 14:42**

And, you know, economists will tell you that you generally are not to take into account you know, sunk costs, the fact that you've invested a lot of time, energy and money in the past. I mean, in many cases it's not really relevant to the decision as to what you should do going forward. Certainly, it may have an impact in that those investments have created, you know, some value and goodwill in the name and reputation of the business, which will result in a faster and stronger rebound of your business. Once things return closer to normal in our economy, then that's important to take into account. But the mere fact that you've been at this for a long time, you spent a lot of money, that generally is not a relevant factor in deciding, you know, where you should go from this point forward.

**Steve Adams, host 15:43**

Well, certainly as a small business consultant, I've seen where a lot of folks have put their heart and soul and even their life savings into a business and, you know, worked hard and diligently and it must be a difficult decision at that point to say I can't keep this boat afloat anymore. They just have to move on. Is there a common mistake, though, that you're seeing that business owners make before they seek

your professional advice on winding up their business, or maybe the structure of the ownership so to speak?

**Nick Roby** 16:15

Yes. Sometimes they take action that they believe is necessary to keep the business running during this interim, or hopefully short interim period, which, you know, maybe if they had some advice from a more impartial objective advisor, they would reconsider. For example, you can see a situation, we've had situations where you have a commercial lease in which the business has struggled to make rent payments during a period of time, and perhaps has entered into some renegotiations with the landlord. And maybe the landlord will forgive or defer those payments if the individual business owner personally guarantees the lease obligation going forwards.

**Nick Roby** 17:13

Hypothetically, let's say that the lease was entered into by a limited liability company or business corporation that was operating the business, but there was no personal guarantee on that. You know, that needs to be a very careful consideration by the business owner as to whether personal guarantees ought to be offered at that point and provided in order to keep the business going, or if those ought to be declined in that situation. That would be one scenario that we've seen, where folks have gone ahead and done that and then come in and sought advice and maybe would have advised to the contrary.

**Nick Roby** 17:58

Another one is, you know, there are certain receipts that a business receives that they kind of hold in trust for others, namely, employee withholding taxes and sales tax receipts. And those monies are sometimes sitting there before deposits are made with the respective governmental agencies, and become very enticing for the business owner to use, thinking it'll only be temporarily, to pay for some other business operating expenses, and then intending to make those up down the road. That's a very dangerous situation to get yourself in.

**Nick Roby** 18:49

The individual business owner is personally liable for those kind of taxes, even if a separate limited liability entity has been created for the business. And so we see that time and time again where that occurs. And unfortunately, then those business owners are going to be asked to pay personally, reimburse the government for those lost tax receipts that should have been turned over but instead were used for other business expenses.

**Nick Roby** 19:22

So there's a couple of examples where what you think is being done prudently in order to buy some more time for the business in order to give it an opportunity to survive, you know, may not have been a good decision and if he would have sought, and in many cases, it's done without fully understanding the legal ramifications of it so that again, seeking advice on those sorts of decisions would have been a good thing before action was taken.

**Steve Adams, host** 19:51

So as kind of a follow-up to that Nick, you know, what types of arrangements you think on a lease, especially with a limited liability corporation—obviously people form LLC to protect themselves personally. So when you talk about personal guarantees, are there other pitfalls there? I mean, does a tenant have to pay the rent if they can't afford it? I'm just a little unclear on that.

**Nick Roby** 20:17

Right. Sure, Steve. So, right usually, when we're advising and other lawyers are advising their new business clients, consideration is almost always given to forming a new limited liability entity. That

could be a business corporation or more recently often it's a limited liability company. And that then insulates the individual owners from most of the obligations and debts of the business that's operated in that entity. So limited liability is one of the very important reasons why we go to the bother of, you know, forming these limited liability companies and business corporations, so that the individual owners won't have that personal liability if things go poorly and the entity itself, the activity itself, is unable to pay its debts.

**Nick Roby 21:14**

So, in the situation I was talking about where that limited liability entity has entered into a lease or commercial space, let's say, and is struggling and may have been unable and may continue to be unable to meet its obligations under that lease, in the usual situation, that landlord has a cause of action, perhaps a lawsuit, a collection action, against the entity itself that signed the lease and is the tenant under the lease. And absent some other agreement, that's the extent of the landlord's rights and he can't pierce through the entity and seek to collect from the individual business owner, himself or herself.

**Nick Roby 22:00**

However, in some cases, personal guarantees are used in small businesses where the creditor or their landlord in this situation says, you know, I'm not really comfortable with the credit-worthiness of this separate legal entity, I want the individual owner to personally guarantee the obligations of the entity that he or she owns. And that occurs sometimes on the front end of a lease agreement or a loan agreement with the bank.

**Nick Roby 22:31**

Other times, again, as I indicated in my earlier example, it may occur along the way, where the business has now struggled a bit, been unable to meet its obligations timely to, in this case, a landlord, and the landlord then says, in order to continue to go forward, to give you some relief from these obligations you failed to meet, I will forgive those or postpone those, but in return for that I want a personal guarantee from the owner of the business. That way if the entity itself is unable to fulfill its obligations, I can look to the individual and seek payment.

**Nick Roby 23:15**

So though that's the situation we're talking about, where you need the business owner needs to be careful, needs to analyze up front what personal guarantees or obligations he or she may have, as well as those that could be requested during a difficult time. That may be necessary, it certainly may be necessary at the front end and may be necessary in order to keep the business afloat during a difficult time. But it needs to be made very carefully and with careful analysis and with hopefully some input from an experienced advisor as to the pros and cons of giving that personal guarantee with respect to an obligation which otherwise would just be an obligation of the entity itself and not the personal owner.

**Steve Adams, host 24:12**

Well, of course, there's always the other option there too, Nick, isn't it, if you were to go to your landlord and say, Hey, I can't make a full monthly payment on my lease, but would you cut my lease payment, perhaps in half? Because really, in the best interest of the landlord, a little bit of something is obviously better than nothing at all, correct?

**Nick Roby 24:33**

Oh, absolutely. And that certainly would be a course of action to take by that business, and certainly those are happening every day in our economy, in which landlords recognize that there's a lot of costs associated with early termination of a lease, especially in these times, right? And so to the extent that

landlord is comfortable that its best course of action is to work with the tenant, then that might happen. But an astute landlord may say, in addition to accepting this half payment for the last couple of months that you're offering me, again, I know that you are a limited liability organization, so I'd also like your owner or owners to personally guarantee it. So that's what may be asked for and what needs to be looked at carefully and considered carefully by those owners.

**Steve Adams, host** 25:37

Of course, your sole proprietor doesn't have that luxury. So they're really caught between a rock and a hard place, right, Nick? I mean, they don't have the protection of a limited liability company.

**Nick Roby** 25:50

Right, absolutely. That's why we talk about with our clients who are forming a business, the benefits of creating a separate entity to carry on the activity, and most of the time, there may be exceptions, but most of the time, the wise decision is to carry on that business activity in a separate legal entity. Many times it's not done though, because advice was not sought, special circumstances exist or otherwise, and the business is simply owned as a sole proprietorship. And one of the disadvantages of that is that the individual owner, the proprietor, is personally liable for all those debts and obligations of the business. And there's no protection from those debts that is likely to exist if you'd created that separate entity.

**Steve Adams, host** 26:44

Well, and certainly, you know, being able to work with your landlord or even other creditors to try to, as you put it, to keep that boat afloat is probably essential. But is there other advice you would give to our listeners who may be business owners that are struggling in these very difficult times?

**Nick Roby** 27:04

Well, certainly, you know, there are programs out there, very new, recently enacted programs that need to be considered and taken advantage of, if possible—you know, again, the most publicized one being the PPP. There's other local and state programs that those businesses need to make sure they've looked at and considered and, if possible, taken advantage of. Otherwise, you know, consideration with respect to, you know, downsizing, which many businesses have done during this period, to minimize the losses until the volume of business rebounds, and knowing what obligations are out there with respect to perhaps employee layoffs, temporary furloughs and the like, is important in considering those things. If the goal is, and it is often the case, of kind of minimizing the losses during this period and to be able to survive so that you can realize a return to profitability once our economy returns to something resembling normalcy.

**Steve Adams, host** 28:28

I think we're all waiting for those days, Nick. Anyway, thank you, Nick, if I'm a small business and I'd like to contact you about something that you said today, what's the best way to reach you?

**Nick Roby** 28:42

Well, the best way to reach me is to email me. I'm at Nick.Roby@drake.edu. So that's my law school email address and again, that will come to the legal clinic. And, you know, I'd be happy to discuss issues with small business folks who are experiencing these issues. And we are in the process of creating our portfolio of engagements and clients for the fall semester, as our students will return middle of August and we like to have projects for those students, both to benefit them in their law school curriculum as well as to help the community in general. But you know, sometimes when we're off season or between sessions like we are right now, it's just common for me to help provide advice directly to those clients. So sometimes, you know, we can avoid the delay that might otherwise occur in us having to deal with the law school schedule.

**Steve Adams, host** 30:13

So that address again, folks, if that didn't get written down the first time, is NickRoby@drake.edu. Our special guest today has been Nick Roby, director of the Drake University Law clinics entrepreneurial and transactional division. Nick, thanks so much for being with us today.

**Nick Roby** 30:36

Steve, I've enjoyed it very much, thank you.

**Steve Adams, host** 30:38

If you have any questions about this Back to Business Iowa podcast, please feel free to contact me, Steve Adams, at stadams@state.edu. And as always, thanks for listening. This podcast once again is a collaboration between Iowa State Extension and Outreach and the small Business Development Centers of Iowa. We're always serving Iowans, hashtag strong Iowa. Let's get back to business, Iowa. Our justice statement is as follows: this institution is an equal opportunity provider. For the full non-discrimination statement or accommodation inquiries, please go to [www.extension.iastate.edu/diversity/ext](http://www.extension.iastate.edu/diversity/ext). Thanks again and we'll see you all next time.

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