WHITE & CASE

COVID-19: Legal Issues and Considerations

The profound impact of the measures being taken to contain the spread of the novel coronavirus ("COVID-19") is creating a host of issues for businesses and their employees. Legal concerns relate to corporate governance, disclosure, contracts, financing, strategic transactions, employment and others. The following provides a brief discussion of a number of legal issues to consider in the current environment.

Corporate Governance Considerations

Annual Meetings

Given social distancing efforts, many public companies are considering changing the format of their annual meeting from an in-person meeting to a virtual-only meeting.

Ability to Hold a Virtual Meeting. Meetings by means of remote communication are expressly allowed under the corporate law of many states, including Delaware. Companies wishing to make such a change will need to consider the requirements of the jurisdiction of their incorporation and their organizational documents (certificate of incorporation, bylaws or equivalent) to ensure that they do not prohibit, limit or condition shareholder meetings by remote communication.

Optics of a Virtual-Only Meeting. There has traditionally been investor resistance to virtual-only meetings. This resistance is rooted in concerns regarding the inability of shareholders to participate meaningfully in virtual-only meetings. For example, while ISS does not have a formal policy on virtual shareholder meetings, Glass Lewis will generally recommend against governance committee members if the company does not provide detailed disclosure to confirm that shareholders will be afforded the same rights and opportunities to participate as at an in-person meeting. In addition, while both Nasdaq and the NYSE require that listed issuers hold annual shareholder meetings, the NYSE does not impose specific conditions and Nasdaq permits virtual meetings while noting the importance of shareholders having the opportunity to ask questions of management.

A company that elects to hold a virtual-only meeting should coordinate with its platform provider to assess capabilities for live participation (including the ability to ask questions) and finalize appropriate logistics. Furthermore, the company should clearly disclose its rationale for holding a virtual-only meeting along with a description of the manner in which shareholders can participate. In any event, proper communication with your shareholders and specific disclosure regarding the rationale for holding a virtual-only meeting this year may avert criticisms that we have seen in the past.

Notice to Shareholders after the Proxy Statement has been Mailed. If a company decides to change the format of its meeting from an in-person meeting to a virtual-only meeting, or to change the date or location of its meeting after its proxy statement has been mailed, the company would generally give notice to shareholders by filing supplemental proxy materials under DEFA14A on a Schedule 14A (by checking the "Definitive Additional Materials" box on the cover page of the Schedule 14A). The notice would announce the change in meeting format or location. In most cases, filing such supplemental materials with the SEC should suffice and no remailing of proxy materials should be necessary absent other changes, but companies should check whether changing the location or the format of the meeting may trigger a new notice obligation under applicable state law.

Notice to Shareholders before the Proxy Statement has been Mailed. Companies that have not yet filed their proxy statements and intend to hold an in-person meeting should consider adding to their annual meeting notice information indicating that it could change the meeting location or format as circumstances require, including changing to a virtual-only forum. The company should note that any subsequent decisions on this matter would be announced in public filings or through a designated website and indicating where the record date shareholder list would be made available. The following is sample language:

> *We currently intend to hold our annual meeting in person. However, we are actively monitoring the coronavirus (COVID-19); we are sensitive to the public health and travel concerns our shareholders may have and the protocols that federal, state, and local governments may impose. In the event it is not possible or advisable to hold our annual meeting in person, we will announce alternative arrangements for the meeting as promptly as practicable, which may include holding the meeting solely by means of remote communication. Please monitor our annual meeting website at* ***[COMPANY WEBSITE LINK]*** *for updated information. If you are planning to attend our meeting, please check the website one week prior to the meeting date. As always, we encourage you to vote your shares prior to the annual meeting.*

While this should suffice for Delaware companies, other jurisdictions may impose additional requirements for the content of notices of virtual shareholder meetings.

Changing the Meeting Date

We expect most companies will try to keep the scheduled date for their shareholder meetings to the extent possible. A change in the meeting date may trigger a new notice obligation under applicable state law and would require the company's proxy statement to be updated with appropriate disclosure to shareholders. In all cases, companies should assess appropriate adjournment and postponement procedures in order to be ready for contingencies on the annual meeting date.

Changes in Compensation

As the impact of the COVID-19 outbreak continues to escalate, several public companies recently announced decisions to decrease or even completely forego CEO salaries. Public companies implementing broader changes to their executive compensation structures as a result of the COVID-19 outbreak will need to consider whether the nature of the change would trigger a Form 8-K filing obligation under Item 5.02(e). This ultimately turns on the materiality of the change. Even if a filing is not required based on materiality to the CEO's compensation package, the change may be material if it is part of a company-wide decision to decrease compensation. Furthermore, companies may choose to announce the change in light of investor relations considerations.

Corporate Governance Considerations

(continued)

Bonus Plan Targets

Compensation committees may need to assess whether the corporate performance metrics under existing incentive plans continue to appropriately incentivize senior executives, promote desired behaviors and closely align with long-term shareholder interests. This will involve difficult judgments that may be premature until the impact of the COVID-19 is clearer since companies that are considering an adjustment to performance metrics will generally want to avoid having to make further adjustments in light of subsequent developments.

Following the repeal of the performance-based compensation exemption to the compensation deduction limit under Section 162(m) of the U.S. Tax Code (described in our previous memorandum), changes to performance goals should not impact the deductibility of compensation for the issuer. Material amendments to certain performance equity-based awards may constitute new grants, triggering filing obligations under Section 16.

Keeping Board and Management Informed

In discharging their responsibilities, boards must be reasonably informed and are responsible for overseeing enterprise risk management:

- Companies should ensure that their boards are sufficiently informed and engaged with respect to the risks that the company faces in light of COVID-19, as well as how these risks are identified, evaluated and addressed by management. Disclosure of the board's role in risk oversight is required in a company's proxy statement pursuant to Item 407 of Regulation S-K.
- Companies should consider implementing a periodic communications plan with the full board, or the board may designate one or more directors responsible for coordinating with management in connection with COVID-19 related matters.
- Specific actions may require involvement and/or input of particular board committees, such as the audit committee if the company is considering whether an update to its earnings guidance is necessary.

Management should ensure that appropriate disclosure controls and procedures are in place such that accurate information is made available to the CEO and CFO in a timely manner.

Public Disclosure

SEC Guidance

On March 4, 2020, the SEC sent out an order (the "SEC Order") granting conditional relief from certain '34 Act reporting requirements to public companies affected by COVID-19.[1] Specifically, a public company required to file certain Exchange Act reports between March 1 and April 30 would be given an additional 45 days to make its filings if COVID-19 related challenges prevent the company from meeting the original deadline. A company that seeks to use this accommodation must file an 8-K explaining the delay and the reasons causing it, along with other appropriate disclosure.

The SEC Order also provided relief from requirements to furnish proxy statements, annual reports and other soliciting materials to security holders residing in areas where common carriers have suspended delivery, assuming other good faith efforts are made.

In the SEC Order, as well as the release accompanying it (the "COVID-19 Release")[2], the Commission also discussed certain disclosure issues related to COVID-19. These include:

- the need for public companies to provide to investors "their assessment of, and plans for addressing, material risks to their business and operations resulting from ("COVID-19") to the fullest extent practicable" and
- that companies should "work with their audit committees and auditors to ensure that their financial reporting, auditing and review processes are as robust as practicable in light of the circumstances."

Please see the full discussion of the SEC's guidance and relief regarding COVID-19 in our prior publication.

Disclosures in Public Filings

COVID-19 disclosure in public filings, including annual reports on Forms 10-K and 20-F, initially focused largely on the effects on businesses operating in or dependent upon China. More recent filings have discussed actual or potential disruptions domestically and elsewhere.

Given the rapidly changing circumstances, when drafting disclosure companies will need to carefully consider not only how current factors are impacting their business, but also the effect of possible future developments. Proper attention to all relevant factors and discussion of potential impacts can help limit the need to update or change disclosure in the future.

Risk Factors: Companies should clearly outline actual and potential risks to their businesses from the COVID-19 outbreak. Examples of relevant risks include: supply chain disruptions; disruptions from closures of facilities, stores or offices; loss of employee hours from quarantines or other factors; productivity declines due to employees working from home; disruptions from travel restrictions; the effects of the economic slowdown; a decrease in demand due to quarantine, travel restrictions, social distancing or other factors; cybersecurity risks, including from employees working remotely; and a lack of access to financial markets.

Companies should carefully evaluate their own situation relative to COVID-19 risks and not rely solely on precedents when crafting risk disclosure. Each issuer faces distinct risks, and should consider disclosure of material risks that have not yet materialized. When a risk has materialized, that event and its impact should be clearly described.

1 The Order is available here.

2 The SEC Release is available here.

Public Disclosure (continued)

MD&A: COVID-19 did not emerge until after year end, and accordingly the outbreak generally had no impact on the financial performance of public companies in 2019. Nevertheless, appropriate MD&A disclosure includes meaningful discussion of important trends affecting a business and its financial performance and that may require a discussion of the potential effects of COVID-19.

Areas of focus that companies have or could discuss in MD&A include impacts, trends and uncertainties involving the virus' effects on: sales; supply of materials, including price and quantity; costs, including wages and salaries; liquidity; productivity and others. The discussion should include the potential impact of COVID-19 on key performance indicators as well as possible steps the company may take to mitigate the impact of the outbreak.

Earnings Guidance

A company is generally not obligated to update previously issued guidance to reflect new developments, although this may be desirable for investor relations purposes. Companies should carefully assess any guidance they have provided and consider the appropriate approach at this time in light of the current environment. Companies that provide earnings guidance to investors have varied widely in their reaction to the COVID-19 outbreak. Approaches include declining to provide the usual guidance or withdrawing guidance that had been previously issued, updating only first quarter guidance while leaving the full year unchanged or publicly declining to update previously issued guidance.

Drawing Down on a Revolver

Many companies have recently sought to safeguard short-term liquidity by preemptively drawing on their revolving credit facilities. These borrowings can represent a material direct financial obligation under the existing facility or a short-term material debt obligation arising outside the ordinary course of business. As such, the borrowing would be a reportable event under Item 2.03 of Form 8-K.

We have seen several companies disclose such a revolver draw on Form 8-K. These filings typically disclose the amount of the borrowing, the interest rate, and the total cash available to the company after giving effect to the borrowing. Companies also include a short reason for the borrowing that may include, depending on the circumstances, that it is a precautionary measure to increase cash and preserve flexibility in light of uncertainties surrounding COVID-19 and the global economy. Finally, companies provide a short summary of the terms of the relevant credit facility and a reference to the initial filing in which it was disclosed and attached as an exhibit.

Avoiding Selective Disclosure

Investors and analysts have been asking public companies on earnings calls about the impact of the outbreak and the company's plans for mitigating the effects. As a company becomes aware of new information regarding COVID-19 and how the outbreak is affecting the company, it must take care to avoid selective disclosure of material information in discussions with investors and analysts following the earnings call. The SEC referenced this specifically in its COVID-19 Release.

Conflict Minerals/Supply Chain

Exchange Act Rule 13p-1 and Item 1.01 of Form SD (collectively, the "Conflict Minerals Rules") require annual disclosure about public company's use of specific "conflict minerals" originating in the "Covered Countries." A company subject to the Conflict Minerals Rules must make its public filings using Form SD on or before May 31 of each calendar year immediately following the first calendar year for which the disclosure is required.

In order to comply with the Conflict Minerals Rules, a subject company is required to conduct, in good faith, a "reasonable country of origin inquiry" designed to determine if the conflict minerals originated in any of the Covered Countries or are from recycled or scrap sources. This inquiry is typically accomplished through supplier engagement. If, based on this inquiry, a company knows or has reason to believe that any of the conflict minerals originated in the Covered Countries and are not from recycled or scrap sources, then the company is required to exercise due diligence with respect to the source and chain of custody of the conflict minerals, file a Conflict Minerals Report as an exhibit to its Form SD and post a copy of the Conflict Minerals Report on its website.

A company that sources materials from suppliers in affected areas may need to assess the extent to which disruptions caused by COVID-19 might impede its ability to effectively engage with its suppliers to make inquiries about the source of the conflict minerals, as well as the smelters or refiners used to process the conflict minerals. That company may need to make adjustments to its diligence processes, including accelerating timelines in order to meet its filing obligations. The ability to engage in due diligence or to finalize diligence efforts in preparation for filing the required Conflict Minerals Report by May 31, 2020 may be disrupted by impacts to the supply chain as well as to the company's own operations, including the availability of relevant personnel in charge of the required diligence efforts.

As such, it is important to avoid delaying any of the ongoing Conflict Minerals Rules compliance efforts to ensure that there is sufficient time to finalize the conclusions and meet the May 31 filing deadline. Finally, companies should consider carefully what types of disclosures would be required in their Conflict Minerals Reports to address the extent to which their diligence efforts have been impacted by COVID-19. A company that intends to specifically designate any of its products as "conflict free" will be required to conduct an independent private sector audit. For such a company, coordinating with the auditors regarding any impact of COVID-19 on the company's supply diligence efforts may be especially important.

Securities Trading

Trading by Companies and Insiders

The quickly evolving nature of the COVID-19 outbreak is leading companies to evaluate whether to close their trading windows for insiders. In this context, it is important to distinguish between (1) a higher degree of uncertainty about quarterly performance and (2) actually having material information regarding quarterly performance. As a general matter, the former would not result in closing a trading window while the latter would. A decision to close the trading window early would usually only be made with respect to persons who are aware of the material information. That said, determinations of materiality can be questioned after the fact, and it is important to assess whether disclosure of a trade by a senior executive is prudent at a particular time.

The impact of COVID-19 on share performance has made share buybacks appealing to some companies. In this context, a company must consider its knowledge of the outbreak's effects when evaluating whether to repurchase its stock. An issuer should not purchase its securities, or establish a plan to do so, while in possession of material, nonpublic information about its business that has not been disclosed to investors.

Securities Offerings

Companies engaging in securities offerings during this time should take particular care that their disclosure accurately and completely discloses the impact of the COVID-19 outbreak. This is because an issuer is subject to liability if its offering materials include material misstatements and omissions – and this is true whether the offering materials are included in an offering document or incorporated by reference to the issuer's public filings.

Similarly, underwriters of securities offerings will need to establish their due diligence defense, which will include comprehensive diligence on the issuer's exposure to and strategy for addressing the risks from COVID-19. Even the most frequent and sophisticated issuers should expect and be prepared for this scrutiny.

Effects on M&A Transactions

The impact of the COVID-19 outbreak will likely be felt in relation to both existing and future M&A transactions. Transactions that have already signed, but have not yet closed, primarily face four risks: (i) shareholder approval, (ii) financing, (iii) regulatory and (iv) business. Transactions that have not yet signed are likely to be affected through both diligence and contract drafting.

Shareholder Approval

The risk that a transaction does not receive approval of the target's shareholders is likely to decrease between signing and closing for transactions payable in cash as the purchase price was fixed, usually at a premium to the unaffected market price prior to the effects of COVID-19. Transactions payable with equity of a buyer are a bit more complicated. Broad based changes in market values of securities might not make approval of the target's shareholders less likely if the relative prices go up and down together maintaining the transaction premium. If, however, a buyer's stock is negatively affected in a disproportionate manner, shareholders of the target may sour on the transaction as they see both the absolute value and premium slip away. If the deal requires the approval of the buyer's shareholders, such approval could be more challenging if the target's stock price is disproportionately impacted by the price volatility.

Financing

Buyers in the vast majority of transactions mitigate their financing risk by either (1) having sufficient cash on hand or access to a revolving credit facility to fund the purchase price or (2) obtaining commitment letters from debt and equity financing sources. Even during the 2008 financial crisis very few financing commitments were not honored. The volatility currently being experienced in the credit markets, however, could make it more difficult in the short term to obtain and price acquisition financing or could make such financing more expensive, through market "flex" provisions or otherwise. Buyers and sellers will have to consider the remedies available to the parties, and the limitations on those remedies, if such financing is not available.

Regulatory

Regulatory approvals, whether they be antitrust, FERC, FCC, CFIUS, state PUCs or others, often are the primary gating item for transactions that do not simultaneously sign and close. During the 2008 crisis, we saw regulators often work more quickly than normal in approving transactions as deal volumes went down and the government sought to encourage all forms of business. This crisis might not be so smooth. With government workers among those who may be self-quarantined or otherwise subject to a lock down in the near future, the ability for already short-staffed agencies to promptly approve transactions may flag. The current crisis has further heightened political concern that too many key industries have been exported, leading to fears of (or actual) shortages in certain products. Coupled with the existing protectionist trends, the instinct from the regulators may be to carefully scrutinize transactions that present such risks.

Effects on M&A Transactions (continued)

Business

Business risk is generally allocated between signing and closing with a closing condition tied to whether or not the target has suffered a Material Adverse Effect ("MAE"). Transaction agreements usually specify that certain events do not constitute, and cannot be considered when assessing, an MAE (such as changes in general economic conditions or financial markets or the occurrence of natural disasters). Until very recently, most transaction agreements did not directly address the impact of "pandemics", "epidemics" and "COVID-19" on MAE definitions. The limited case law that has addressed MAE has made it clear that it is very difficult for buyers to establish an MAE, but case law has not specifically addressed the impact of pandemics such as COVID-19. In the absence of a specific carve out from the MAE definition for a pandemic, buyers may be able to argue that the pandemic risk was allocated to seller. There is likely to be uncertainty which will depend on the facts of the particular case and whether or not the effects of the COVID-19 outbreak are otherwise captured in the litany of carveouts for which the buyer has contractually agreed to take the risk – such as "general economic conditions", "natural disasters", "national emergencies" and the like. In recent weeks, many transaction documents have been specifically allocating the pandemic or COVID-19 risk in the MAE definition, and we can expect that to continue in the future.

Diligence

As long as the COVID-19 outbreak continues to impact the economy, it will be important that buyers diligence the varying impacts of the outbreak on acquisition targets and consider these impacts in pricing and contract drafting. Beyond the financial impact, might there be liabilities associated with the outbreak? Will it be necessary to reset employee incentive or retention benefits in light of significant shifts in anticipated performance and should that be addressed in the acquisition agreement? Will reductions in force be necessary? Are there impacts on existing commercial or financial contracts (such as covenant compliance issues)?

Employment

The U.S. Occupational Safety and Health Administration ("OSHA") requires employers to maintain a safe workplace, which would include taking steps to reduce the risks associated with the COVID-19 outbreak. The steps that an employer should take will vary depending on the type of business; however, recent guidelines provided by the CDC (which can be found here) should be followed by all employers and include the following elements.

Restrictions on Travel

It is permissible (and recommended in light of OSHA requirements) for employers to implement policies that restrict business travel to high risk destinations and require employees returning from such destinations to self-quarantine for the maximum period it takes for symptoms to appear (currently known to be 14 days). While employers cannot generally restrict personal travel, it is permissible to implement a policy requiring that an employee provide advance notice of any personal travel (in particular to high risk destinations) and requiring that employees self-quarantine upon their return from destinations where there are known cases of COVID-19. Employers should take care to apply the policy impartially and consistently to help avoid claims of discrimination based on the protected class of impacted employees. Proper documentation of decisions made and consistent application will be key to protecting against such claims.

Remote Working

Since employees may be required to work remotely to comply with new policies aimed at OSHA compliance, employers should take steps to prepare for employees to work from home where possible (for example, ensuring IT systems support remote working and that internal policies are in place regarding remote working). New policies may be required for in-person meetings versus telephonic meetings (for example policies limiting the number of people gathered together), and continued attendance at industry conferences (as noted below, injury during work-related travel may impact workers' compensation claims).

The U.S. Department of Labor has confirmed in recent (March 9) guidance (which can be found here) that employers may either encourage or require employees to telework as an infection-control or prevention strategy. This includes imposing such arrangements based on current information from the CDC, state or local public health authorities.

Where working from home is not possible, and employees are absent due to sickness, quarantine, or childcare needs, employers will need to determine whether and for how long absent individuals will continue to be paid.

- **Considerations with respect to Employees who are Exempt under the US Fair Labor Standards Act (the "FLSA")**: The FLSA requires that employers pay at least minimum wage for up to 40 hours in a workweek and overtime pay for any additional time, unless the employee is exempt. Exempt employees are not entitled to overtime pay under the FLSA, however, they generally have to be paid their full salary for any work week in which they perform any work. Employers may require exempt employees to use vacation or paid time off in the case of a workplace closure due to COVID-19, so long as the exempt employee receives his or her full guaranteed weekly salary. If an exempt employee does not have sufficient vacation time or paid time off available, the employee generally must still receive their salary for any week in which he or she performs any work. Exempt employees do not have to be paid for any

Employment (continued)

week in which no work is performed. Employers should also take care to track the type of work performed by exempt employees to ensure that the nature of the tasks being performed remotely are largely exempt-qualifying. While a change in status from exempt to non-exempt should not be an issue for a short-term remote working situation, if remote working is implemented for exempt employees for a longer period of time, the question of exempt status may need to be considered based on the nature of the remote working role under the FLSA and applicable local laws.

- **Considerations with respect to Employees who are Non-Exempt Under the FLSA**: Under the FLSA, non-exempt employees are only required to be compensated for hours worked. An employer is not required to pay hourly employees for time spent in quarantine; however, if work is undertaken while in self-quarantine then employees will need to be compensated for that work and hours worked may be difficult to track as described below. In certain states, payment for time spent in self-quarantine may be required where the employer has required that employees self-quarantine and not perform work. Difficulties in monitoring hours worked for non-exempt employees who are working from home can increase the risk of off-the-clock and overtime claims. In order to help mitigate these risks, employers should implement and communicate a policy that makes clear that employees should work only their regularly scheduled hours and to record all hours worked / breaks taken. A policy prohibiting unauthorized overtime will also be helpful as well as the use of special time-keeping software to help track hours worked.

Employees who become Sick or who have Sick Family Members

In light of OSHA and guidance from the CDC, employers should require employees with symptoms of a contagious disease to stay at home and should not require a health care provider's note to validate their illness or return to work.

- **Unpaid Leave Requirements**: For employees that are off work and who are not being paid, employers should consider the impact of the Family and Medical Leave Act, as well as applicable state and local laws which may permit periods of paid or unpaid time-off to care for sick family members. Currently, there is no requirement under federal law that an employer provide employees leave to care for children who have been dismissed from school. However, in their recent (March 9) guidance, the DOL encourages employers to review leave policies to provide such flexibility.

- **Workers Compensation Insurance**: Employees who contract the virus as a result of business travel may be entitled to benefits under workers' compensation insurance (employees generally would not be entitled to claim under workers' compensation policies as a result of contracting an infectious disease from a colleague in the office).

- **Communication and Confidentiality**: Employers should determine how best to communicate the message that an employee has tested positive for COVID-19. Employers do have a general duty to inform the workforce if an employee tests positive or is a probable COVID-19 case. However, the confidentiality and privacy requirements of the Americans with Disabilities Act, and the Health Insurance Portability and Accountability Act, and other applicable local laws, mean that steps should be taken to preserve the privacy of the impacted employee and not share their identity with the workforce.

Leveraged Finance

M&A Transactions and Committed Funding

Many leveraged finance deals are undertaken to fund the purchase price of M&A transactions. From a committed funding perspective, M&A transactions can effectively be split into two types of transactions: (i) certain funds or (ii) non-certain funds.

A certain funds transaction is either required for regulatory reasons (usually due to mandatory takeover laws) or because the selling party wants increased certainty on the buyer's ability to close the transaction, and thus will not allow a financing condition in its sale and purchase agreement.

In a certain funds transaction, only extremely limited conditions or factors would allow financing parties to withdraw their committed funding from the deal. Thus, COVID-19 should not have an impact on already committed funding and the buyer's ability to draw debt to close should not be impacted. While good for the M&A, where the acquisition financing is on a bridge-to-bond basis, under the cloud of COVID-19, the "take-out" bond may be difficult to market (or simply impractical as investor meetings are postponed or cancelled), and so the take-out transaction will be delayed. This will affect the buyer, as the bridge pricing is likely to step up every three months in the first year of the bridge period.

All of the above may of course have an additional impact of delaying M&A due to either banks' concerns over their ability to syndicate while the COVID-19 situation develops, and thus reluctance to commit financing, and/or buyers' unwillingness to risk being caught in hung bridge debt.

The alternative is to have a financing "out" in the M&A agreement, which would allow the buyer to pull out if it cannot secure financing. This would allow the debt commitment papers to include a material adverse change (MAC) provision which would terminate debt commitments when a MAC occurs.

MAC and MAE – Business, Payment and Market

There are generally three types of MAC, business MAC, payment MAC and market MAC. It is relatively rare to include MAC clauses in an acquisition financing as a drawstop, but they can be included under certain circumstances, and are more common in other leveraged financing transactions such as a refinancing or dividend recapitalization. However, such MAC clauses do exist, and are closely linked to material adverse effect (MAE) clauses, which are discussed together at this stage.

MAC clauses are also the obvious way that financial institutions could try to protect themselves from market deterioration when signing debt commitments, although their incompatibility with acquisition finance transactions that lack a corresponding financing "out" is likely to continue to limit underwriters' ability to include this provision in many situations. When relying on a MAC or MAE, the drafting of the relevant provision and what it covers is key.

Business MAC: If there is a business MAC, it typically relates to an adverse effect on some or all of the business, condition, operations, performance, assets or prospects of the borrower. However, while this may seem broad, common law courts have traditionally set a very high materiality threshold on matters of MAC and there would need to be compelling evidence based on existing circumstances, that the buyer's business was in fact materially adversely changed. Particularly given the relatively early days of the outbreak and the developing situation, it may be difficult to say what the impact will actually be and how, or when, it will affect any particular business. However, to the extent the current circumstances subsist for a significant time, particularly as businesses report Q1 2020 financial results (likely from May onwards), we expect parties to financings will further consider these points.

3 We previously published this section as a standalone alert on March 10, 2020.

Leveraged Finance (continued)

Payment MAC: A payment MAC relates to the borrower's ability to pay its obligations under a finance document. Payment obligations are fairly straightforward to determine and, traditionally, focus on a one-year time frame. Accordingly, to trigger this limb, the relevant creditors would most probably need to establish that the issuer/borrower would be unable to make its payment obligations falling due in the following 12-month period. This can be a difficult threshold for lenders to prove.

Market MAC: A market MAC refers to a MAC in either the debt, equity or capital markets (either international or domestic) or a derivative of those terms, and/or may relate to stock exchanges and/or currencies. Again, while the specifics will be key, the wider markets have generally reacted negatively to COVID-19-related news and these losses are both more public and in most cases more immediate than the impact on any one particular business. The market MAC may also extend to issues with syndication. This may leave more room for discretion on the banks to call a market MAC condition, given they will have more information than the borrower on syndication conditions.

A market MAC is often also included as a closing condition in a high yield bond purchase agreement. Given the closing period on a high yield bond tends to be only three to ten days, this is a more limited period, and in addition, the change must happen during that period and so the underwriters of the bond cannot change their minds based on a mere continuation of bad news, there would need to be additional market developments, for that to be triggered.

In either case, it is important to consider the state of affairs when one entered or enters into an agreement containing a MAC clause. Parties entering into new transactions as COVID-19 spreads must consider this carefully, as whether there has been a material adverse change to any particular circumstances must reference the circumstances at the time of contract. Thus it may be more difficult for more recent contracting parties to call a MAC based on COVID-19, though of course it cannot be predicted how circumstances will ultimately end up and what further adverse effects on business may occur.

The above discussion mainly relates to shorter term financing commitment documents that may currently be in place or may be put in place for a new transaction. In terms of existing financings already in place, the MAE is related to the MAC. The Loan Market Association (LMA) leveraged loan agreement contains an Event of Default where "Any event or circumstance occurs which the Majority Lenders reasonably believe has or is reasonably likely to have a Material Adverse Effect (MAE)", while the LMA Investment Grade version raises this as optional drafting (though with no specific proposal). MAE is similar to MAC, except that a MAE clause typically would only cover the business MAC and payment MAC as discussed above. This means the issuer/borrower is less at the mercy of wider market sentiment, with a sharper focus on their business. To the extent that financial institutions are worried about market sentiment, Events of Default will therefore generally provide no assistance.

The MAE event of default is often resisted by issuers/borrowers in the US and Europe in any event, but the definition is included to qualify undertakings and representations under the loan agreement. That will mean that specified events (such as breach of laws, authorizations, taxation) must both be breached under the loan agreement and potentially cause an MAE. In most instances, the evidential burden on lenders to try and prove such an MAE, being focused on just the business and payment condition, will be challenging. It is more likely that where an MAE is occurring and the business is actually impacted, the issue will be so fundamental that another more obvious event of default will occur, such as non-payment or insolvency. Ultimately the analysis of these provisions must be undertaken under the applicable legal system for the relevant legal contracts. It may be that common law and civil law jurisdictions would not reach the exact same result.

Maintaining Performance – Issues with Maintenance Covenants

While a large proportion of US and European leveraged finance is now covenant light (cov-lite) with no traditional maintenance covenant, a variety of transactions still include maintenance covenants, including older loans, loans in Asia-Pacific, those for lower quality credits, mid-market loans (particularly those held by banks) or private debt deals, as well as more bespoke instruments such as Nordic-bonds. In addition, as discussed below, there is often a springing maintenance covenant in a revolving credit facility which may be included in a financing package.

A maintenance covenant requires an issuer/borrower to maintain a specific financial ratio or metric. Take for example a net leverage covenant, which tests net debt to EBITDA (earnings before interest, tax, depreciation and amortization, which is then typically further adjusted for negotiated items). Negative impacts on a net leverage covenant would either be caused by (i) reduced earnings (impacting EBITDA) or (ii) the use of cash to mitigate such impact, to assist staff or otherwise address a business-need related to COVID-19, which would (i) reduce net income due to higher costs and (ii) increase net debt due to there being less cash to net.

The triggering of a maintenance covenant due to any of the above would be problematic for an issuer/borrower, however there are important mitigating points to consider:

- The definition of EBITDA needs to be reviewed to consider if any add-backs are permitted that may impact the calculation. There may be an add-back for non-recurring (or extraordinary or unusual) losses, charges or expenses. While the exact terminology will differ, it may be arguable (on a case-by-case basis) that costs related to COVID-19 that are extraordinary in nature can be added back to adjust EBITDA. However, these all relate to amounts spent rather than lost revenues. In fewer deals, there is also an add-back for reductions that are covered by insurance and are actually reimbursed or that are likely to be reimbursed. This will require both a careful analysis of the exact add-back permitted, but also of any applicable insurance policy to ensure a good grounding for the determination that the applicable add-back conditions have been met. Discussions on these points may also involve auditors and reference to auditing standards and how these will classify the applicable line items. These add-backs may be one of the more topical points in the near term, given the year-long impact of even one quarter of disruption due to COVID-19.
- If the maintenance covenant is a “springing covenant”, then it may only be tested when an applicable drawing threshold is met. This means that if the company can manage its cashflows, it may be able to draw the cash after the covenant testing date and then not be tested for a full quarter. While this is somewhat risky in the event the COVID-19 situation worsens, it does provide what could be important additional liquidity at a time when the company may have a more immediate requirement.
- In relation to equity cures (a sponsor’s ability to inject equity into a group to avoid/cure a breach of maintenance covenant), the ability to overcure will also be closely examined given the ongoing uncertainty of the impact of COVID-19, with sponsors’ potentially wanting to provide a cushion for the upcoming year rather than having to repeatedly provide emergency funding. Whether that is permissible will vary on a case-by-case basis.

Leveraged Finance (continued)

- Lender sentiment will be interesting to assess and will depend on a number of matters. Generally, a maintenance covenant is meant to act as an early warning sign for lenders, rather than necessarily leading to a route to enforcement. The early warning sign in the COVID-19 context is perhaps more obvious than in other deals where the underperformance is due to less clear reasons. Lenders will have to assess how to react to any covenant breaches which are connected to potentially shorter term impacts of COVID-19, in particular at a time when they may prefer management to spend time working on mitigants to the business effects of the virus rather than additional time with lenders. In addition, the lenders' position in the capital structure (either as super senior on collateral, or closer to the assets), may mean they are able to exercise patience through the more difficult period for the company, compared to junior creditors without a maintenance covenant who may ultimately bear the brunt of impairments to the capital structure.

Remember LTM: It is important to note that the covenant impact will also occur on an ongoing basis. Maintenance covenants are based on a rolling last twelve months (LTM) of EBITDA. This means that the impact seen in Q1 2020 will still affect companies deep into the year, as their look-back period takes into account their operations during the initial growth phase of the outbreak. This also impacts incurrence covenants, as discussed below.

COVID-19 is not an Excuse: It is worth noting that finance documents seldom (if ever) contain a force majeure provision, i.e. one that excuses performance of the contract on the basis of a defined set of circumstances. This is relevant in the context of maintenance covenants, as the issuer/borrower will be unable to merely rely on such a provision and wait for COVID-19 to pass. If a maintenance covenant is breached, the issuer/borrower will ultimately still have to resolve this with the lenders in due course. While beyond the scope of this commentary, in certain legal systems, there are additional considerations such as doctrine of frustration, but this tends to be an even higher threshold than a force majeure clause would have been held to (if included).

Taking Action – Issues with Incurrence Covenants

Many leveraged loan deals in the market are in fact now "incurrence" covenant based, which is the high yield bond covenant position, tested only when certain fundamental corporate actions are taken such as incurring debt, distributing cash to shareholders and/or selling assets.

These cannot be triggered unless such actions are taken: incurrence covenants effectively cannot be breached unless (i) you do not pay interest or (ii) you do not provide relevant financial information (see below).

However, going forward there are impacts on these incurrence covenants worth noting:

- While there are no financial maintenance ratios, there may be incurrence based ratios, such as a net leverage or fixed charge coverage ratio debt incurrence covenant, and the ability to use each of these may be impacted as with a maintenance covenant. While the result is less severe than a default, the inability to use such ratios may impact the business (preventing, for example, the incurrence of additional debt or the payment of dividends or cash distributions to shareholders). the ratios, as well as certain additional tests such as "grower" baskets for various covenant restrictions, may be based on EBITDA. Thus, the discussion above related to EBITDA may be important. Alternatively, there may be a non-fundamental default outstanding that the issuer/borrower is able to remedy in the near term, but they must be mindful that certain corporate actions or covenant baskets may be unavailable while a default is outstanding.

- As also discussed above, the rolling 12-month basis of EBITDA means that notwithstanding a near term COVID-19 resolution, the virus' effects will be felt for the 12-month period under EBITDA. This may particularly affect any businesses that rely on a busy first quarter (due for instance to seasonality), as they may have lost out on a boost they typically get from that quarter in their LTM test, which will impact them for the next year.

Reports, Audits and Information

Frequent reporting is an important investor information right under finance documentation. This typically requires audited annual and unaudited quarterly information to be delivered under a high yield bond, as well as monthly information under certain loan agreements, in each case, within a certain specified time period. Businesses interrupted by COVID-19 may face certain reporting issues, such as an inability to obtain accounting information due to facilities closures. As discussed above regarding force majeure, there is typically no provision for additional time for filing such information due to external issues (which contrasts with, for instance, the position taken by the US SEC, which has announced certain conditional relief for delayed earnings report filings for companies impacted by COVID-19). This means that an issuer/borrower may find itself in default if it cannot provide the relevant information, for instance because it cannot get an audit due to the lack of some supporting information. One solution may be to finalize a qualified audit for the period. However, under the LMA loan agreement, an audit qualification is an event of default, and for future capital markets transactions, a qualified audit can be undesirable.

Contracts

While fact-specific to any particular contract, the outbreak of COVID-19 is likely to have a profound impact on commercial agreements. Companies or their counterparties may find they are unable to perform under an existing commercial agreement.

Parties to existing contracts that are or may be disrupted by the outbreak should promptly assess their legal rights and obligations, including: (i) assessing contractual provisions that have been or may be affected, (ii) identifying and abiding by any relevant notice requirements; (iii) analyzing the risks and consequences of a default or breach under the agreement, and (iv) determining or negotiating alternative means of performance under the contract, where possible.

Parties currently negotiating contractual agreements should proactively consider the impact of COVID-19 and appropriately allocate potential risk in the agreement.

Force Majeure

Companies may be considering whether the COVID-19 outbreak constitutes a *force majeure* event such that a party is excused from its contractual obligations. Contract parties may consider issuing *force majeure* notices or may receive such notices to excuse a party's nonperformance. Any declaration of *force majeure* must be evaluated under the terms of the agreement and analyzed under the law governing the terms of the contract.

Parties should not cease their performance on the basis of a *force majeure* event without consulting counsel because a mistaken assertion of *force majeure* or frustration could have serious consequences. Specifically, an incorrect assertion of *force majeure* or frustration may amount to a breach (or anticipatory breach) of the contract. Business should also be aware that *force majeure* will generally not excuse nonpayment.

Generally (and under New York law), courts construe force majeure clauses narrowly and the application and consequences of the *force majeure* clause will depend upon the precise terms of the contract in question. Accordingly, parties should determine whether the specific event that prevents a party's performance is listed in the *force majeure* clause.

Parties should also consider the consequences flowing from declaring *force majeure*, including:

- Whether the parties' agreement includes notice obligations before declaring force majeure;
- Whether the force majeure event actually made the party's performance impossible, or just more burdensome
- Whether the impacted party is required to mitigate by using diligent efforts to end the failure or delay and ensure the effects of the force majeure event are minimized;
- Whether immediate relief is available for the impacted party;
- Whether *force majeure*-related disputes must be arbitrated; and
- Whether *force majeure* events are covered by the parties' insurance policies (including general liability, business interruption, contingent business interruption, or other insurance policies), and if so, what conditions must the party meet for its claim to be satisfied.

The last two points are key, as it is common that the occurrence of *force majeure* is disputed and, accordingly, parties should consider the potential costs of litigation and/or dispute resolution in evaluating whether to declare *force majeure*.

Parties seeking or faced with the declaration of *force majeure* should also consider the impact to other agreements and obligations.

Frustration or Impossibility

If a contract is silent on *force majeure*, it may still be possible to argue that the COVID-19 outbreak has frustrated the contract or that performance of the contract becomes objectively impossible.

The doctrine of frustration may excuse the performance of a contract in situations where the performance of a contract is possible, but no longer provides a party with the benefits that induced them to make the bargain because of intervening unforeseeable events.

A court's decision regarding whether to excuse a party's non-performance based on the doctrine of frustration will turn on the foreseeability of the event in question and the purpose of the agreement.[4] Generally, invoking the common law doctrine of frustration of purpose is limited to instances where the event is wholly unforeseeable and renders the contract valueless to a party. Frustration of purpose will not apply when a contract simply becomes less profitable, or even when performance causes one party to sustain a loss.[5]

The doctrine of impossibility excuses a party's non-performance when performance becomes objectively impossible because of the destruction of the subject matter of the contract or the means of performance. It is important to note that the test for impossibility is a strict one and courts have only applied this defense in extreme circumstances, where the events in question were truly unforeseeable.

In addition to the common law defenses discussed above, parties can look to relevant statutory law to evaluate whether non-performance would be excused. For example, under the UCC, a seller may be excused from timely delivery or non-delivery of goods due to (i) unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting; or (ii) compliance in good faith with an applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.[6]

Material Adverse Change or Material Adverse Effect

Some commercial agreements contemplate and allocate risk among the parties in the event of a material adverse change ("MAC") or material adverse effect ("MAE") to the business. If triggered, a MAC or MAE may allow a party to terminate the agreement or otherwise avoid performance. Companies should consider and abide by any notice requirements associated with a MAC and MAE.

Insurance

Companies should consider whether insurance may cover losses sustained from COVID-19-related disruptions. This coverage may apply to commercial properties that sustain disruptions to their operations, trade disruption for losses related to quarantines or other travel restrictions and closures, or general liability insurance.

Businesses should not only assess the insurance policies that may apply, but consider providing notice under such policies at this time.

4 A court's analysis of whether the doctrine excuses non-performance is highly fact specific, and could ultimately require a trial on the merits. For example, in Rembrandt Enters. v Dahmes Stainless, Inc., the court considered the doctrine of frustration in the context of the Highly Pathogenic Avian Influenza (Avian Flu). The Plaintiff in that case sought to rely on the doctrine of frustration to excuse its cessation of progress payments to the contract counter-party. No. C15-4248-LTS, 2017 US Dist LEXIS 144636 (ND Iowa Sep. 7, 2017). The court was unable to resolve the frustration argument on summary judgment, finding that there was no way to resolve the frustration issues without making detailed factual findings. See id at *25 "Nothing about this case is as clear cut. Rembrandt fails to point to the specific moment that the contract's purpose was frustrated. Was it when the outbreak of Avian Flu occurred? Was it later, when Rembrandt's board decided not to go forward with the Thompson plant? Was it when Kellogg decided to reduce its dependence on egg products? Was it when Rembrandt's financing collapsed? The cases Rembrandt relies on involved situations in which the alleged frustration was clearly defined and easily attributable to outside forces. Here, by contrast, there is no way to resolve the "frustration" issues without making detailed factual findings."

5 Frustration was the primary grounds for discharge in the English coronation cases, where the purpose of hiring a room or apartment for a day was frustrated when the coronation proceedings were postponed. The doctrine was also argued in as a ground for excuse in cases arising from war-time legislative restrictions, prohibitions of exports and imports, and restrictions on land use, cases that might be analyzed under the impossibility or impracticability doctrines in the United States. 14 Corbin on Contracts § 77.1 (2019).

6 NY UCC § 2-615(a).

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