FRIED FRANK

To Our Clients and Friends

Memorandum

March 13, 2020

Update on Legal Issues and Developments Relating to the COVID-19 Pandemic

The Coronavirus pandemic, while primarily a public health issue, is creating numerous legal concerns. We have identified some of the key issues and developments below. In addition, we have formed a task force comprised of partners and senior lawyers from across all practice groups and offices to track developments and provide timely guidance to clients on Coronavirus-related issues. Should you have any questions relating to Coronavirus or any other matter, please reach out to your usual Fried Frank contact.

M&A

- ***Level of activity.*** Business and market disruption and uncertainty may lead to a slowdown in M&A activity. At the same time, depressed stock prices and general dislocation may lead to an increase in unsolicited bids for companies; and supply chain disruptions may increase restructuring activity.
- ***Due diligence.*** Due diligence protocols are being updated to seek to assess the potential impact of the Coronavirus on target companies. At the moment, most deals under consideration appear to be moving forward.
- ***Banker valuations.*** Banker valuations and fairness committee processes are being updated to take into account the potential impact of the Coronavirus. One issue of note is that, with declining interest rates resulting in a lower discount rate input to a discounted cash flow (DCF) analysis, the DCF result is higher than it would be if the interest rate were higher--even though the company's value has declined. Bankers need to take into account and explain this anomalous result.
- ***Definition of a MAC.*** In the negotiation of merger agreements, parties have focused on whether the definition of "material adverse change" should expressly include the potential impact of the Coronavirus, or whether the impact should expressly be specified as an exception from what otherwise would constitute a MAC. With respect to pending deals, parties are considering whether the Coronavirus pandemic (or the government's response to it) is potentially covered by the definition of a MAC; how to value the potential impact; and whether the durational significance of the impact would or would not trigger a MAC-based condition or right to terminate. Some key concerns have centered on vulnerability in the target's supply chain and inability to travel internationally. One area of focus has been the standard exclusion from most MAC clauses of changes that do not disproportionately affect the company from others in its industry.
- ***Other merger agreement issues.*** Other merger agreement issues include the potential impact of the Coronavirus pandemic (and the governmental responses to it) on (i) the bring-down at closing of representations and warranties --relating to, for example, financial condition, adequacy of reserves, status of material contracts and business relationships with customers and suppliers, and sufficiency

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of internal operating controls; (ii) operation of the business pending closing; (iii) the availability (and cost) of acquisition financing (and remedies for a failure to obtain financing if related to the Coronavirus); (iv) protection of key executives and continuation of employee-related policies and benefits adopted in light of the Coronavirus; (v) impact on the timing of the "end date" for closing; and (vi) in the private company context, inclusions or carve-outs from post-closing indemnification. Companies will have to consider when and how to communicate Coronavirus-related developments at the company to their merger agreement counterparty.

- ***Logistics.*** Logistics will be a challenge that requires significant planning and adaptation, including with respect to conducting due diligence, negotiations, board meetings, etc. Health safety concerns, widespread and extended school and daycare closing, government-imposed or -recommended travel or other restrictions, and the counterparty's views all will have to be taken into account. Backup plans should be in place in the event key persons involved become unavailable.

Asset Management/Private Equity

- ***Ongoing and new fundraising.*** Most major sponsors are continuing closings in ongoing offerings and, to the extent possible, accelerating timing to close where they have final investor documents in hand, rather than holding documents to aggregate them for a larger close. For sponsors ramping up to launch new funds, generally activity has not slowed. However, given the anxiety in the markets and around the overall impacts of Coronavirus, many are revising their anticipated timing for first closings to the summer or early in the fall. In limited circumstances, sponsors are considering launching new mandates or seeking to accelerate new fundraising for current mandates for which there is a view that there may be buying opportunities in this period of uncertainty or as we emerge from it. In other cases, where their mandates are particularly challenged by the current environment, we have seen sponsors take a pause on current fundraising or delay plans to launch new products.

- ***Force majeure clauses.*** We have been reviewing investor-facing documents to access the applicability of *force majeure* or similar contract avoidance clauses in the context of Coronavirus and pandemics more generally. As expected, these provisions are not broadly incorporated into fund agreements. We have also not seen investors seeking to incorporate such triggers into documents being negotiated now. That said, where such provisions do appear, an examination of their relevance is fact specific and depends on the application of the relevant governing law.

- ***Financial contracts***. Market participants need to evaluate how events stemming from Coronavirus are dealt with under trading agreements governing derivatives and other financial instruments. In addition to force majeure clauses, market disruption provisions and fallbacks in those contracts may be triggered. Scheduled valuation dates or dates for making payments and deliveries may be postponed due to business interruption and unscheduled holidays. Large and sudden fluctuations in financial markets may trigger demands for collateral; parties to OTC derivatives and other similar transactions need to monitor and manage their liquidity to ensure they are prepared to meet such collateral posting requirements.

Operations and General Board Oversight

- ***Oversight responsibility*.** A board must exercise appropriate oversight with respect to material risks facing the company. The Coronavirus may well constitute such a risk for many companies given its global scale, novelty, and potential direct impact on numerous business areas (personnel, supply chain, customers, financing, and so on). We note that the SEC recently has emphasized the need for

disclosure of material risks and the extent of the board-level oversight. A board should ensure that it receives relevant and timely updates from management to understand how the company is being affected, as well as the most recent guidance from health organizations.

- ***Policies.*** Management should consider implementing specific policies relating to travel, sick days, working-from-home, large meetings and gatherings, increased sanitation measures, etc. In advising the board, management should consider whether input from internal or external health experts should be included.
- ***Incidents.*** The company should consider whether any incidents of personnel being diagnosed with the Coronavirus may require notification to government agencies or internal notifications, or may trigger other regulatory requirements. Any incident also may trigger a need to revise internal policies or cancel planned events.
- ***Task force.*** Many companies are forming task forces comprised of senior management to coordinate Coronavirus-related issues.
- ***Communications plan.*** A company should develop a comprehensive communications plan to provide consistent messaging to all corporate constituents, including shareholders, lenders and employees.
- ***Meetings.*** Companies are considering whether to make changes to hold virtual-only or virtual-and-in-person meetings (including annual shareholder meetings) and events. Not holding large meetings or events can help prevent the spread of Coronavirus. Also, companies are beginning to suffer public relations problems based on a person attending a large gathering sponsored by the company and then testing positive for the Coronavirus. At least one large public company has announced that its annual meeting this year will be virtual. Before changing to a virtual annual meeting, companies should consider the company's corporate governance documents, state corporate law, stock exchange requirements, proxy advisory firm policies, and proxy statement disclosure. Companies also should take into account the investor relations impact and should consider engaging with major shareholders about making the change.

Shareholder Activism

- ***Increased activity.*** There may be new activism-focused funds formed to take advantage of the business and market dislocations. Activists may take advantage of depressed prices to accumulate shares and offer plans for recovery. Companies should continue to focus on changes in their shareholder base (including through options-buying) so that they are alerted as early as possible to the potential of activist challenges.
- ***Need for continued preparation.*** Companies should redouble their efforts to be prepared for possible activist challenges (i.e., through up-to-date governance provisions and "thinking like an activist" to facilitate the development of effective communications and business strategies in response to a potential attack).

Commercial Contracts; Insurance

- ***Existing contracts.*** Companies should assess the existing and potential impact of the Coronavirus pandemic on their existing commercial agreements--including whether the pandemic would trigger: a material adverse change or *force majeure* provision or another provision relating to a right to delay

performance; a right to revise the terms or terminate the agreement; or a notice requirement. In addition, the potential of an inability to perform by the company or the counter-party should be considered, the potential impact assessed, and next steps considered. When entering into new contracts or business arrangements, the company should evaluate whatever pandemic-related risks are foreseen at that time and consider whether and how those (and unknown) risks should be addressed. The types of contracts that could be involved will depend on the circumstances at the time but would likely include, among others, merger, joint venture, employment, supply, and service agreements.

- ***Insurance coverage.*** Companies should consider whether their insurance policies cover the effects of the pandemic, including any business interruption. Business interruption due to the pandemic may not be covered under a company's classic business interruption policy (which often covers only damages that result from physical damage to the insured's property). Business interruption losses may, however, be covered as an add-on to the company's property or umbrella insurance (although typically there is a force majeure exception to the coverage). It is important to be aware of the specific conditions or exclusions, and the usually strict notice requirements, under these policies. Many current business interruption policies exclude bacterial and/or viral events from coverage. Companies should consider whether to expand their business interruption insurance going forward to cover losses resulting from epidemics or public health emergencies.

Financings

- ***Liquidity concerns.*** In light of the tremendous turmoil in global markets during the last month resulting from the Coronavirus and the plunge in oil prices, many companies are focused on ensuring that they have sufficient liquidity to support their operations during a potentially prolonged economic downturn. Major corporate borrowers have been upsizing revolvers and some companies have considered drawing down under existing revolving or term credit facilities and "banking" the funds to ensure that cash remains available to them. Each borrower will need to make a business judgment and weigh the additional costs of borrowing prophylactically against macroeconomic market risks and risks that may affect the particular borrower differently from the overall market because of its industry or particular situation.

- ***Reps bring-down; MAC; force majeure.*** When considering additional borrowing, it should be kept in mind that borrowers are generally required to bring down credit agreement representations and warranties (in all material respects) in connection with a revolving credit facility borrowing. Borrowers should focus in particular on the language of their "no material adverse change" and solvency representations, including whether the MAC rep covers a material adverse change in the Borrower's business "prospects," and whether the solvency representation is limited to historical solvency (at the time of an LBO, for example) or pro forma for the borrowing being made. Borrowers should review their credit agreements for "*force majeure*" or similar provisions that might excuse a revolving lender's obligation to lend in bad economic environments. (Generally in our experience, committed facilities do not include such provisions.)

- ***Counterparty credit risk.*** Borrowers should remember that notwithstanding the language of their respective contracts, they remain subject to counterparty credit risk. For the time being, the risk is even greater for lenders in China, Italy, and other countries with severe travel and work restrictions.

- ***Covenants.*** Many sponsor-backed borrowers have financial covenants applicable only to their revolving credit facility that are triggered when the revolving credit facility is drawn in excess of certain

thresholds (generally between 30-40%). Often, certain items (*e.g.*, undrawn letters of credit) are excluded subject to a cap. Borrowers should refamiliarize themselves with these covenants (what the levels are, when the covenant is tested, updated compliance projections, etc.).

- ***SEC disclosure.*** Borrowers that are SEC registrants should consider whether a material borrowing under their revolving credit facility triggers a Form 8-K disclosure obligation under Item 2.03 (Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant).

Restructuring and Insolvency

- ***Expectations.*** The pandemic, and the government and public reaction to it, has already resulted and will continue to result in stress and strain on the economy as a whole as well as various business segments. We can reasonably expect continued disruption and deterioration of cash flow (and, as applicable, supply chain) related to, among others, the airline, travel, hotel and leisure, restaurant, bricks and mortar retail, energy (particularly oil and gas owing to extant geopolitical disputes among Saudi Arabia and Russia), motion picture exhibition and real estate sectors. Particularly hard hit will be small and mid-size businesses with limited resources. A need for great liquidity and resources will be driven by higher costs, greater risk profile and a reduction in consumer headcount and spending; and near-term layoffs and long-term workforce head count reduction, along with other impairment of compensation arrangements for current employees, will further the negative impact on consumer spending. Those businesses that fail to secure requisite and incremental liquidity and resources will be constrained to restructure or may need to seek formal relief under applicable insolvency laws.

- ***Government action.*** Many businesses will do all they can to await government resources and bailout packages. Those that cannot wait will be constrained to implement restructurings in and out of court (note that Bankruptcy Courts are beginning to implement certain restrictions related to COVID-19 which may result in delayed hearings, digital motion practice, trials, other proceedings and more). In addition, with respect to the current cohort of pre-COVID-19 restructurings, those restructurings may be on pause or significantly delayed given that, for the moment, access to financing and capital markets may be curtailed and perceptions of value are at sea. As it was with the Great Recession, there is reason and basis to anticipate a short-term spike in restructuring activity followed by a more measured period.

- ***Interest rates.*** The recent low interest rate environment and readily available capital has allowed a significant number of companies that would have otherwise needed restructuring relief to limp along and kick the can down the road. It is reasonable to anticipate that in the weeks and months ahead, such ease and largesse will no longer be available. By reason of instability in the markets, precipitous reduction in equity values and challenges that financial institutions are currently facing, many may find it more difficult to obtain new financing and there may be much more restrictive credit criteria imposed.

- ***Covenant compliance.*** In addition to liquidity concerns it is reasonable to anticipate that we stand on the threshold of a new paradigm as related to covenant compliance. Creditors will be quick to scrutinize and seek accounting and enforcement. There will not be safe margin for error. Likewise, business Darwinism where the strongest survive and the weak fail will be a norm.

- ***Activism.*** We expect renewed activism by distressed investors and there should be a broader base of distressed investment product. In advance of markets starting to stabilize and when they start to stabilize, there should be a deployment of capital driven by loan to own strategies and the like.

SEC Public Company Disclosure

- ***Specifically tailored disclosure.*** The SEC has long encouraged issuers to customize their disclosure to address material risks and trends, and in light of the Coronavirus outbreak, the SEC has recently reminded companies "to provide investors with insight regarding their assessment of, and plans for addressing, material risks to their business and operations resulting from the coronavirus to the fullest extent practicable to keep investors and markets informed of material developments." Disclosure issues will vary based on the particular facts and circumstances of each company--for example, whether the company's business is heavily reliant on travel, leisure or entertainment, vulnerable to supply chain disruptions, dependent on certain jurisdictions that have been significantly impacted by the virus or just particularly sensitive to general economic uncertainty.

- ***Risk factors and MD&A.*** Since the outbreak, numerous companies have updated their risk factors to address the potential impact to their business. As the virus continues to spread, including throughout the US, companies are encouraged to customize their disclosure to flag the particular risks they are facing, whether relating to disruptions to operations (from personnel illness and quarantines), supply chain problems, travel restrictions, reduced consumer spending and traffic, and other factors. Some companies have also addressed the Coronavirus outbreak within the overview portion of MD&A to highlight any impact suffered to date, as well as ongoing and expected trends and uncertainties in their business, including liquidity. In addition, it is important for companies to consider with their auditors whether any subsequent events disclosure is warranted prior to the issuance of financial statements. Companies should also review their forward-looking statements disclaimers and update cautionary language as appropriate to reflect expectations regarding the Coronavirus outbreak.

- ***Proxy statement board oversight section.*** Disclosure of board-level oversight of the material risks the company faces is required in the board risk oversight section of proxy statements.

- ***Earnings Guidance.*** Some companies have updated or withdrawn previously issued earnings guidance due to the uncertainty created by the outbreak, while others have decided to suspend providing guidance during the current environment. Assessing the potential impact from the virus may be challenging when it comes to full-year guidance. Management should be prepared to receive many questions during earnings calls and communications with investors and analysts and should work with counsel and investor relations in advance on how to address this difficult topic. In light of Regulation FD, it is important to be careful to navigate selective disclosure concerns and, in particular, because of the rapidly developing nature of this situation, reaffirming guidance could constitute new material information.

- ***Securities trading windows.*** Given the rapidly developing situation relating to the outbreak, companies should consider whether to suspend their usual practice of opening their trading windows following their earnings release and keep the window closed. Companies that choose to open the trading window should monitor developments and revisit the window decision as appropriate. On March 4, 2020, the SEC released a statement that observed that when companies "become aware of a risk related to the coronavirus that would be material to its investors, it should refrain from engaging in securities transactions with the public and to take steps to prevent directors and officers (and other

corporate insiders who are aware of these matters) from initiating such transactions until investors have been appropriately informed about the risk."

- ***SEC filing relief.*** On March 4, 2020, the SEC issued an order granting relief for certain filing obligations of public companies. The order provides an additional 45 days to file certain disclosure reports (including Form 10-K, Form 10-Q and Form 8-K) that would otherwise have been due between March 1, 2020, and April 30, 2020, subject to certain conditions. To qualify for relief, among other conditions, companies must file a current report on Form 8-K (or, if eligible, a Form 6-K) by the report's deadline with a statement that the company is relying on the SEC's order, a brief description of why the company could not file its required material on a timely basis, an estimate of when the late material will be filed and, if appropriate, a risk factor explaining the impact of the Coronavirus on the company's business, among other requirements. The SEC has said that companies relying on this order will be considered current and timely in their filing requirements for purposes of Form S-3 and Form S-8 eligibility.

- ***Potential securities litigation.*** The uncertainties and stock declines associated with the Coronavirus outbreak may lead to the filing of securities litigation relating to companies' disclosures or operational response to the outbreak. Careful disclosure--such as updating risk factors and including clear cautionary language--can help to reduce potential liability in any such litigation that may be brought.

- ***Securities Offerings***. The current market environment has made it extremely challenging to launch pending securities offerings. In the meantime, underwriters and counsel have been engaging in expanded due diligence to understand how the outbreak has impacted (and could in the future impact) the issuer's business and have been focused on updating disclosure as appropriate to address the outbreak, as discussed above. For offerings subject to SEC review, companies should be prepared to respond to additional comments from the staff relating to the pandemic.

Employee Matters

- ***Governmental guidance.*** The U.S. Occupational Safety and Health Administration (OSHA) requires employers to maintain a workplace that is "free from recognized hazards that are causing or are likely to cause death or serious physical harm." OSHA has issued guidance on Preparing Workplaces for the Coronavirus, setting forth general guidance for all employers and specific requirements for certain workers and employers with high or medium Coronavirus exposure risk (e.g., healthcare workers, certain high-volume retail workers). In addition, the U.S. Centers for Disease Control and Prevention (CDC) has developed interim guidance for businesses and employers to plan for and respond to the Coronavirus. Coronavirus-related updates from OSHA (and state OSHA counterparts), the World Health Organization, the CDC, and state and local departments of health should be monitored and changes to the company's policies and practices considered as appropriate.

- ***Existing obligations.*** If an employee falls ill, companies may have Coronavirus-related obligations under state or federal Family Medical Leave Acts, the Americans With Disabilities Act (or similar state laws for disabled employees), state or local sick leave laws, or the company's own policies. Employees may be entitled to Workers Compensation benefits. Many companies are considering whether changes to their existing leave policies would be appropriate, at least temporarily.

- ***Privacy.*** If an employee becomes infected, when determining how to notify employees or others (including building owners who request such information), the company must keep in mind the need to keep confidential the employee's health information. As noted above, employers may have

reporting obligations to local health authorities if they learn that an employee is infected with Coronavirus.

- ***Information.*** Employees should be kept updated on the company's policies and practices that relate to the Coronavirus outbreak.

- ***Furloughed employees.*** If an employee decides to self-quarantine, or if otherwise healthy employees are kept at home by quarantine, employers will need to review company policies and make their own determinations about paying salaries and benefits for furloughed workers, although disability insurance is likely unavailing.

Real Estate

- ***Notice to tenants of confirmed infection.*** Under New York law and general tort principles, landlords have a duty to disclose known hazards to tenants. That duty may apply in the context of contagious diseases such as Coronavirus, and to both residential and commercial properties. Therefore, landlords should take appropriate steps to notify tenants if they learn that an occupant of or visitor to the building has been infected with Coronavirus. Landlords in New York City have been notifying tenants of these incidents and the affirmative steps that they are taking to mitigate risk. Notice of these incidents should include: (i) the fact that one or more of the occupants of or visitors to the building have been infected with Coronavirus; (ii) the date that the occupant or visitor was last on the premises; and (iii) the steps that the landlord and any occupants who were being visited have taken (and will continue to take) to disinfect common areas and other relevant spaces.

- ***Privacy.*** Landlords should not disclose the names of any infected individuals or their employers or specify where in the building they worked in order to protect individual privacy interest as much as possible. The objective is to provide notice but minimize the personal information that is disseminated.

- ***Disinfection practices.*** Landlords generally have a duty to maintain safe premises, which under the circumstances should include enhanced cleaning protocols. On March 5, 2020, the NYC Department of Health issued guidance to commercial and residential landlords concerning disinfection practices. In other jurisdictions, landlords should check with their local and state boards of health to determine if such guidance is provided.

- ***Construction projects.*** If a landlord is engaged in a base building, tenant improvement or other construction project that has contractual deadlines for completion and which may be delayed by reason of the Coronavirus outbreak, whether due to disruptions in the supply chain, inability of lenders to pass on draw requests or otherwise, it is important to determine whether the governing documents provide for *force majeure* delay, whether the delay due to the Coronavirus outbreak will constitute such *force majeure* delay (which is not automatically the case), and whether any notices are required to be given. In addition, construction loan documents may permit the lender to withhold funding if a Material Adverse Change occurs.

  Rent Abatements and Rent Insurance. Owners should review their leases and their insurance coverage to determine whether, in the event of a full closure of a building, or a government-imposed lockdown, tenants will have the right to claim a rent abatement and whether or not the owner's rent insurance will cover such a claim. Since SARS in 2003, most policies have excluded coverage related to bacterial/viral events and, in addition, many policies require that there be direct physical

damage to the building in order for coverage to be available. Many tenants, particularly in the retail sector, have begun to approach landlords for rent relief; thus, an overall strategy must be considered, bearing in mind that any such agreement may require the consent of lenders, ground lessors and/or partners.

- ***Pending real estate financings.*** Because most commercial real estate financings today are based on non-binding term sheets rather than commitment letters, there is an increased risk, so long as the financial markets remain unstable, that a lender may walk away prior to closing. Even where a binding commitment letter has been signed, it must be reviewed to determine whether the lender can elect not to close in the event of a MAC, and how a MAC is defined.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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