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Memorandum

As Coronavirus Continues to Spread, Companies Should Consider a Range of Legal Issues to Meet Their Obligations, Protect Their Positions and Mitigate Risk

March 10, 2020

As the coronavirus disease 2019 ("COVID-19") spreads across the globe, we are beginning to see the first major impacts on businesses, financial markets, and international trade and commerce, with analysts increasingly pessimistic about a near-term solution. In this climate, our clients should expect to confront a range of legal issues related to the outbreak and resulting business disruptions—including, for example, questions about disclosure obligations to investors, the scope of commercial insurance coverage for COVID-19-related losses, obligations to maintain a safe workplace, and obligations to perform under contracts entered into under vastly different market conditions. While the impact of the spread on any individual business requires a fact-specific inquiry, the discussion below summarizes relevant legal issues and outlines some suggested considerations.

Disclosure Obligations and Related Issues

The outbreak of COVID-19 raises a number of issues relating to proper disclosure to investors and trading in company securities. A company's failure to provide adequate disclosure addressing the impact of the outbreak of COVID-19 on the company's current or prospective financial performance could lead to potential lawsuits by investors or regulatory action by the SEC. Companies should develop a comprehensive communications plan for dealings with their investors, lenders and other constituents to ensure consistent messaging, avoid confusion and manage potential liabilities.

PUBLIC COMPANY DISCLOSURE

A public company subject to SEC reporting needs to consider whether disclosure about the impact of COVID-19 on its business is required or otherwise warranted in the company's annual report on Form 10-K or quarterly reports on Form 10-Q. Such disclosures have already been made by many companies during the current reporting cycle, most commonly in the Risk Factor and MD&A sections of their reports. Disclosure was initially most prominent for companies with significant operations in China, but has recently expanded to a much wider group of public companies.

To date, Risk Factor and MD&A disclosures have predominantly focused on the impact that the outbreak has had so far on companies' current operations, including manufacturing facilities, supply chains and employees, as well as the expected effects on ongoing operations and future results should the outbreak continue or worsen. In their disclosures so far, most companies have emphasized the uncertainty around the potential impact to their ongoing results, but it is expected that if the outbreak continues, it will be advisable for companies to further evaluate whether to provide more quantitative and specific information regarding the impact on a company's financial results and management's views on how this will affect results for the remainder of the year. See "Earnings Guidance" section below.

The SEC has provided the following guidance to companies on this topic:

- On January 30, 2020, SEC Chairman Jay Clayton issued a public statement explaining that he had asked the SEC staff "to monitor and, to the extent necessary or appropriate, provide guidance and other assistance to issuers and other market participants regarding disclosures related to the current and potential effects of the coronavirus."[1] While Chairman Clayton recognized that "such effects may be difficult to assess or predict with meaningful precision both generally and as an industry- or issuer-specific basis," he noted that "how issuers plan for that uncertainty and how they choose to respond to events as they unfold can nevertheless be material to an investment decision."[2]
- In a February 19, 2020 statement, Chairman Clayton provided examples of disclosure issues related to the effects of COVID-19. For example, companies listed in the U.S. "may have significant operations in China and other jurisdictions that may be affected by the coronavirus."[3] Furthermore, "companies that do not themselves have operations in China or other potentially affected jurisdictions may depend on companies that do have operations in those jurisdictions, including, for example, as suppliers, distributors and/or customers."[4]
- In light of the evolving impact of COVID-19 on investors and capital markets, on March 4, 2020, the SEC announced that it is providing conditional regulatory relief for certain filing obligations under the federal securities laws.[5] Subject to conditions, publicly traded companies have an additional 45 days to file certain disclosure reports that would otherwise have been due between March 1 and April 30, 2020.[6]

  In the announcement, Chairman Clayton asked that companies (i) "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"; (ii) "work with their audit committees and auditors to ensure that their financial reporting,

[1] Chairman Jay Clayton, Proposed Amendments to Modernize and Enhance Financial Disclosures; Other Ongoing Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure, Jan. 30, 2020, *available at* https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30.

[2] *Id.*

[3] Chairman Jay Clayton, Statement on Continued Dialogue with Audit Firm Representatives on Audit Quality in China and Other Emerging Markets; Coronavirus—Reporting Considerations and Potential Relief, Feb. 19, 2020, *available at* https://www.sec.gov/news/public-statement/statement-audit-quality-china-2020-02-19.

[4] *Id.*

[5] Press Release, SEC Provides Conditional Regulatory Relief and Assistance for Companies Affected by the Coronavirus Disease 2019 (COVID-19) (Mar. 4, 2020), *available at* https://www.sec.gov/news/press-release/2020-53.

[6] *Id.*

auditing and review processes are as robust as practicable in light of the circumstances in meeting the applicable requirements"; and (iii) "avail themselves of the safe harbor in Section 21E of the Exchange Act for forward-looking statements."[7]

A related consideration is maintenance of effective disclosure controls and procedures and quarterly CEO/CFO certifications, as required by Sarbanes-Oxley and rules promulgated under the Exchange Act.

Public companies should also be mindful of their procedures relating to other communications to investors, analysts and the public, including statements made in quarterly earnings releases and related investor conference calls. Company management should anticipate that questions may be asked on earnings calls directly related to COVID-19 and its current and anticipated impact on operations and results, and should prepare accordingly. Members of senior management also need to be mindful of obligations under Regulation FD. As analysts and investors contact companies directly to discuss COVID-19 and how management is addressing its consequences, executives should be careful not to share material information with market participants that has not been broadly shared with the investing community.

EARNINGS GUIDANCE

One of the thorniest disclosure issues with which public companies have been grappling in recent days and weeks relates to earnings guidance. Companies have adjusted their guidance in light of recent events, and certain companies have even decided to discontinue guidance temporarily or withdraw previously issued guidance. Although companies generally do not have an obligation to update guidance to reflect new developments, to the extent that companies provided guidance prior to the rise of COVID-19 concerns, consideration should be given to updating or withdrawing such guidance in order to reset investor expectations.

SECURITIES OFFERINGS

In the context of offerings of securities, whether SEC-registered or pursuant to a private placement exemption, the disclosure issues discussed above are magnified given that issuers and other transaction participants can be subject to liability for material misstatements or omissions in offering materials. Given the potential for liability, underwriters and counsel are engaging in more extensive diligence efforts to understand how a company is addressing COVID-19 matters and to ensure full and accurate disclosure of all material developments has been made in offering documents. In the case of IPO registration, the SEC may request additional information and more robust disclosure on these topics as well.

PRIVATE COMPANY DISCLOSURE

Although not subject to SEC reporting obligations, private companies with outstanding debt and equity securities typically have contractual reporting obligations to their investors. The content of private reports is often guided by similar considerations to those of public companies.

[7] *Id.*

Investors in private companies may make requests for additional information beyond what is strictly required by reporting covenants. In responding to these requests, companies should not only review the reporting covenants in their agreements to determine what is required, but should also consider relationship dynamics with their existing investors and the broader financing market in deciding what information to disclose and how they do so.

Similarly, even though Regulation FD does not apply to private companies, executives should be cognizant of selectively disclosing information to one or a small group of investors without disclosing such information to all of their securityholders.

TRADING IN COMPANY SECURITIES

A related issue to the nature and timing of investor disclosure is managing when company insiders can trade in company securities. Companies and their directors and officers should review their securities trading policies and consider whether trading windows should remain closed unless their public disclosure reflects all material facts about the impact of COVID-19 on the company.

ANNUAL MEETING PLANNING

In light of the COVID-19 outbreak, many companies that have historically held in-person meetings are considering changing the traditional physical location of their annual meeting or perhaps reevaluating the advisability of a virtual-only annual meeting. Companies that are contemplating holding a virtual-only shareholder meeting for the first time should confirm with counsel that both state law and the company's governing documents, *e.g.*, by-laws, permit a virtual-only shareholder meeting. Furthermore, companies that determine to hold a virtual-only shareholder meeting should evaluate their proxy disclosure, including the related notices, to determine whether additional language may be necessary. State law, for example, may dictate that certain statements be included in a notice for a virtual annual shareholder meeting, while Glass Lewis recommends adverse voting recommendations for members of a company's governance committee if the company holds a virtual-only meeting without adequate disclosure regarding shareholder participation rights.

Companies that have already filed their proxy statements and that wish to convert from an in-person to virtual-only meeting or to change the physical location of the meeting should confirm with counsel as to the state law requirements surrounding the dissemination of a revised notice, including timing and physical remailing obligations. Changes to the location of a company's announced annual meeting location would also require further proxy filings with the SEC and perhaps public notice.

Companies should also consult with counsel regarding adjournment and postponement procedures to prepare for contingencies as they get closer in time to their annual meeting.

Employee Issues

Employers have a legal obligation to ensure a safe workplace, which includes taking steps to guard against the risk of infectious diseases.[8] Developing and circulating a plan to employees that outlines the steps the business is taking to reduce the risk of a COVID-19 outbreak at work can protect employees and help employers comply with their legal obligations.

For example, employers are within their rights to restrict business travel and should consider restricting business travel to high risk destinations and requiring employees returning from such destinations to self-quarantine for the maximum period it takes for COVID-19 symptoms to manifest (which is presently 14 days under the latest Centers for Disease Control and Prevention ("CDC") recommendations). Employers also may instruct an employee to remain home or leave work if they have symptoms of a contagious disease. While employers generally may not restrict employees from personal travel, even to high risk areas identified by the CDC, employers may require that an employee provide advance notice of any personal travel and self-quarantine upon their return should they travel to an area designated as high risk or which has had reported cases of the virus. In requiring self-quarantine or other measures, employers should take care that their decisions are not based on the national origin, age, gender, religion, race or other protected category of the employee, which could give rise to claims of discrimination. Employers would be well served to document these decisions to ensure reasonably consistent decision making and treatment of employees.

Many employers have already limited or canceled in-person meetings, conferences and similar events, with an increased preference for telephonic or video conferences. In addition, many interviews are being conducted by telephone or video conference.

Employers should review internal policies and employment contracts to determine whether there are any provisions preventing them from enforcing a work-from-home policy. They also should determine whether an employee who cannot perform their duties from home will be paid, even if circumstances prevent them from coming into the office. When allowing or denying employees the ability to work from home, or deciding whether to pay employees for time away from the office, it is important for an employer to ensure that these requests are not based on a protected classification, such as gender, age, disability or national origin. Employers should not ask employees who express safety concerns to further identify their specific reasons, as doing so could require an employee to describe a disability or need to care for a family member.

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[8] Employees are protected under the Occupational Safety and Health Act, 29 U.S.C. ch. 15 § 651 ("OSH Act"). Section 5(a)(1) of the OSH Act requires employers to provide a workplace "free from recognized hazards…likely to cause death or serious physical harm." The federal Occupational Safety and Health Administration ("OSHA") can cite employers for violating this clause in the event that an employer does not take reasonable steps to prevent or abate a recognized hazard. OSHA has recently issued guidance that its recordkeeping requirements for covered employees mandate an employer to record on its OSHA logs instances of COVID-19 when a worker is infected on the job. *See* *https://www.osha.gov/SLTC/covid-19/standards.html#workers*.

Employers should also familiarize themselves with leave laws, such as the federal Family and Medical Leave Act, as well as similar state and local laws. Many of these laws allow employees to take job-protected unpaid, and, in certain instances paid, time off for the care of family members who may be ill.

With respect to balancing a duty to inform the employee population with the privacy of medical information, employers do have a general duty to inform their workforce if an employee is a laboratory-confirmed COVID-19 case, is a probable COVID-19 case, or may have had close contact with or been exposed at work to a laboratory-confirmed or probable COVID-19 case. However, an employer should not identify the name of the individual employee as they may run afoul of confidentiality or privacy requirements under the Americans with Disabilities Act, the Health Insurance Portability and Accountability Act, as amended, and other federal laws or state and local laws, such as those that limit uses or disclosures of medical records, family medical history, and health information.

If an employee contracts COVID-19 and can establish a direct causal connection to the workplace, the employee generally would not be entitled to workers' compensation unless the disease was contracted during the course of their employment. While health care and lab workers may fall into this category, employees that incidentally contract the disease from a co-worker typically do not. However, there remains the possibility that employees, including those on business travel who can establish that they were infected as a result of work-related activities, may be able to receive workers' compensation benefits as a result of any exposure.

Finally, employers should take care not to make employment, compensation, performance, disciplinary and similar decisions based on coronavirus-related absences, quarantines and/or an inability to travel. Doing so could implicate any number of laws regarding employee rights.

Contractual and Related Commercial Considerations

The impact of COVID-19 already is being felt commercially, with particular impact on distressed companies. Companies in the midst of refinancing or recapitalization transactions may find themselves unable to transact in the current environment at normalized valuations. Waiver and/or amendment fees and/or forbearance arrangements may be required to bridge to a normalized financing environment. Businesses that are unable to avail themselves of the needed headroom may be forced to take aggressive positions with counterparties, transact at uneconomic pricing or even consider filing for bankruptcy protection.

CONTRACT ISSUES

Many companies will find themselves unable to perform commercial contracts, or with counterparties who are unable to deliver. In these circumstances, it is critical to examine termination and exclusivity rights. Some lesser known legal doctrines may become important.

Force Majeure

Some companies are considering whether the COVID-19 outbreak constitutes a force majeure event that relieves them of their obligations under commercial contracts. A force majeure clause is a contractual provision that concerns events beyond the control of the parties which prevents performance under a contract and may excuse non-performance. The specific language of the force majeure clause will dictate whether the occurrence of an event confers an immediate entitlement to terminate the obligation to perform, or only suspends the obligation to perform for a period of time.

Force majeure clauses may excuse performance under a contract based broadly on circumstances outside the party's control, or may enumerate specific events that trigger the force majeure clause. Such events typically include "acts of God," extreme weather events, riot, war or invasion, or government action including strikes, terrorism, or the imposition of an embargo. It is less common for force majeure clauses to specifically enumerate a global health crisis as a force majeure event.

A party seeking to suspend its obligations under the force majeure clause of a contract has the burden of demonstrating the existence of a triggering event. Contracts typically require that any party seeking to avoid performance on the basis of a force majeure event first provide notice to its counterparty. Many courts also require that then nonperforming party demonstrate that it attempted to fulfill its contractual obligations despite the alleged force majeure event, but was unable to do so. Some courts have further held that the force majeure event must be unforeseeable.

Contracting parties should not cease performance of their obligations on the basis of a force majeure event without first consulting counsel. Incorrectly declaring a force majeure event may constitute an anticipatory breach of the contract, entitling the other party to significant damages.

Frustration

In the absence of a force majeure clause, a party may seek to excuse nonperformance by invoking the common law doctrine of frustration of purpose. Frustration is generally limited to instances where a virtually cataclysmic, wholly unforeseeable event renders the contract valueless to one party.

Before invoking frustration of purpose as a defense for nonperformance, a party should consider the following:

- The purpose that is frustrated must have been the invoking party's principal purpose in making the contract. In other words, "[t]he object must be so completely the basis of the contract that, as both parties understand, without it the transaction would make little sense."[9]
- The frustration must be substantial. Courts may hold that it is not enough that the transaction has become less profitable for the affected party or even that he will sustain a loss. A change in market conditions or an increase in the cost of performance are often insufficient grounds to assert frustration of purpose. The frustration must generally be so severe that it is not fairly to be regarded as within the risks that the affected party assumed under the contract.

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[9] Restatement (Second) of Contracts § 265 (1981), Comment *a*.

- The non-occurrence of the frustrating event must have been a basic assumption on which the contract was made.

Impossibility

A party also may invoke on the doctrine of impossibility to excuse nonperformance. Before invoking impossibility of performance as a defense for nonperformance, a party should consider the following:

- The destruction of the subject matter of the contract or the means of performance must make performance objectively impossible. However, financial difficulty or economic hardship of the promisor, even to the extent of insolvency or bankruptcy, does not generally establish impossibility sufficient to excuse performance of a contractual obligation.
- The impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract.

Similar to the doctrine of frustration, the defense of impossibility is generally applied narrowly.

INSURANCE COVERAGE

Businesses should consider whether there is insurance coverage available for COVID-19-related business disruption to mitigate losses, and whether notice should be provided under these policies at this time. While the scope of coverage will depend upon the specific terms of the policy, certain common policy provisions may provide coverage for losses associated with COVID-19.

For example, commercial property insurance policies often provide business interruption coverage, which protects businesses against losses incurred as a result of disruptions to their operations. These policies typically require direct physical loss of, or damage to, insured property to trigger coverage, but may contain coverage for losses associated with diseases occurring within the vicinity of the insured property or governmental orders that result in the interruption of business.

For businesses that rely on complex global supply chains, trade disruption insurance (“TDI”) may provide coverage for losses incurred as a result of embargoes, quarantines, port closures, and other disruptions to trade.

Businesses also may face claims that they failed to exercise reasonable care in protecting against, or warning of, the risk that customers or patrons could contract COVID-19 at their establishment. Businesses in the hospitality industry are particularly vulnerable to claims of this nature. Commercial general liability insurance policies may cover these types of claims.

Conclusion

The circumstances presented by COVID-19 are of course still evolving and the full impact on the financial and commercial markets remains uncertain. Thinking about the direct and collateral consequences of the continuing spread of the illness and developing a comprehensive, thoughtful strategy will help companies mitigate risk while preserving their commercial strength through the current uncertainty.

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