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Coronavirus FAQ: Key corporate and commercial considerations

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The global outbreak of the novel coronavirus COVID-19 is having profound implications for businesses all over the world. A Hogan Lovells team of corporate and commercial lawyers from the United Kingdom, United States, and Asia outline the key issues companies should be thinking about – no matter where in the world they are doing business.

1. COMMERCIAL CONTRACTS

What happens if you are unable to perform a contract as a result of COVID-19? And what are your rights if your counterparty fails to perform?

- **Can I claim force majeure?**
  The answer will depend on the governing law of the contract – in many civil law jurisdictions force majeure is an implied term whereas in common law jurisdictions the contract will need to contain an express clause. Where a contract includes a force majeure clause, the definition of force majeure will need to be considered carefully to assess whether the COVID-19 outbreak is covered. The consequence of force majeure also varies between contracts – it may allow a party to terminate the contract or merely to be excused from performance for a temporary period.

- **Can I claim frustration?**
  Parties to common law contracts may be able to claim frustration where force majeure is not available but the threshold is generally very high.

- **Am I required to mitigate?**
  If you are claiming force majeure or frustration, you may still be required to take steps to mitigate your loss as a matter of law or under the contract.

- **What if there is a change in law?**
  Governments' responses to the virus could make performance of a contract illegal. For instance, on 10 February 2020, Chinese legislators explained that the varieties of Coronavirus epidemic prevention and control measures taken by the local governmental departments that make a party unable to perform its contractual obligations constitute a force majeure event under the PRC Contract Law.

- **What are the notification/procedural requirements?**
  Carefully check the procedure for serving notice on the counterparty. Following the relevant notice provisions is important, particularly in certain industries such as construction where it can impact a claim.

- **Can the parties renegotiate?**
  It is always open for parties to renegotiate their agreement – careful consideration needs to be given as to the wider effects this may have and how any modifications to the existing contractual terms are documented.

2. OEM SUPPLY CHAIN MANAGEMENT

The supply chain from an OEM perspective: an Original Equipment Manufacturer purchases parts from other manufacturers and assembles them into finished products, for example, auto and aircraft manufacturers. If an OEM's supplier cannot deliver, this will have consequential effects further down the supply chain. Consider:

- **What is the length of the supply chain?**
  The longer the supply chain, the more vulnerable the end user will be to delays, disruptions etc.

- **Which jurisdictions does the supply chain cross through?**
  Each jurisdiction will have its own laws and court processes. In some cases they may conflict with each other.

- **Can a replacement supplier be found?**
  Highly specialist industries will have fewer suppliers of component parts, and may require pre-qualification of suppliers, which can be a lengthy process.

- **Can stressed or failing suppliers cooperate with OEMs to serve common clients?**
  Antitrust rules may prevent cooperation between the supplier and the OEM.

- **Can costs be passed on to the ultimate customer?**
  Depending on the terms of the contract, customers may be exposed to pass through of increased cost; however in cases where the customer price is set, the suppliers down the chain will bear risk of performance in the face of increased cost. Customers may seek to renegotiate pricing terms or seek to defer deliveries or acceptance of services.

- **What will the impact be on financing arrangements?**
  Disruptions in the supply chain may put pressure on cash flows, trip financial and other covenants in the financing agreements, enable lenders to refuse further drawdowns of loans

and/or trigger payment and other defaults that could lead to creditors commencing insolvency proceedings or seeking a refinancing. Where cash flows are significantly impacted, directors will also have to consider whether the company is approaching the insolvency twilight zone and the potential impact both on their duties and their own potential liabilities.

3. M&A AND JV TRANSACTIONS

The COVID-19 outbreak has potentially wide-ranging implications for M&A and JV transactions. Key issues to consider include:

- **Can I invoke a MAC clause?**
  This will ultimately come down to how "material adverse change" is defined in the sale and purchase agreement. To some extent it will also be jurisdiction-specific – for instance, in the United States the buyer's burden of proof is typically very high. In a JV scenario, the joint venture contract may also provide for a termination right on the occurrence of a "material adverse change," which could entitle a party to exercise an equity/asset buyout right or trigger the liquidation/dissolution of the JV.

- **Can I claim for breach of representation/warranty?**
  The COVID-19 outbreak may lead to certain representations and warranties given by a seller and/or target company at signing no longer being true when repeated at closing – this may give rise to a termination right and/or claim for contractual damages. The implications under any R&W/W&I policy will also need to be carefully considered.

- **Should I build in COVID-19 specific protections?**
  For deals that have not yet signed, sellers may take the opportunity to negotiate additional carve outs and make additional disclosures whereas buyers may want to conduct enhanced due diligence and look to negotiate specific protections such as termination rights, purchase price adjustments and indemnities.

- **Will this lead to more distressed M&A?**
  Opportunistic investors may target strategic companies experiencing short to medium-term disruption. However, external financing, where required, may be expensive as banks may need to sell debt on account of own capital constraints. We may also see an increase in alternative sources of financing such as from private equity and other institutional investors with capital to deploy.

4. COMPANY LAW/DISCLOSURE REQUIREMENTS

Governments' responses to COVID-19 are evolving on a daily basis and this will have a knock-on effect on companies' ability to comply with company law requirements and past practice as well as implications for listed companies which are subject to disclosure rules. For example:

- **Can my company still hold its annual shareholder/other general meetings?**
  COVID-19 poses a challenge given that governments are increasingly advising people to avoid large gatherings and imposing quarantines. Companies are already exploring holding virtual general meetings or postponing their meeting. A company may need to postpone its annual meeting or move to a virtual meeting as permitted by its organizational documents and applicable law. Government agencies have and may continue to issue guidance on the procedures around these changes. For example, on 13 March 2020, the United States Securities Exchange Commission issued guidance for conducting annual meetings in light of COVID-19 concerns. U.S. issuers that have already mailed and filed their definitive proxy materials can notify shareholders of a change in the date, time, or location of their annual meeting without mailing additional soliciting materials or amending their proxy materials provided that the issuers follow the U.S. SEC's guidance on required disclosures.

- **Is my listed company required to make additional regulatory disclosures?**
  Some listed companies have begun making disclosures relating to the risks and possible impacts of COVID-19. Businesses will need to closely monitor the potential effects of the outbreak on an ongoing basis and consider the timing and extent of any appropriate additional disclosures. Companies should consider whether they are eligible for conditional regulatory relief from filing certain disclosure reports.

- **Should my listed company consider additional trading restrictions for employees?**
  Companies will need to be cautious about the potential for insider trading by employees who may have access to material, non-public information related to the impact of COVID-19. Company leadership should review the scope and distribution of securities trading policies and consider whether further restrictions are necessary such as additional black-out periods or pre-clearance requirements.

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