Buchalter

COVID-19 Alert

March 2020

Introduction

As of March 16th, 2020 — The growing public, political and economic turmoil arising out of the COVID-19, or "corona virus," infectious disease strain is creating a broad range of concerns for businesses and governments around the world. The long-range implications are impossible to predict, but recent market volatility attributable at least in part to the developments seem disproportionate to the events we've seen to date.

Our clients, like many others, are increasingly concerned about not only the operational risks, but also to risks arising out of the public's response. Our attorneys are currently advising clients as to the wide-ranging implications and we have decided to publish a bulletin to help our clients and others anticipate and address some of the risks that seem to flow from these circumstances.

Employment Law

COVID-19 creates a myriad of issues for employers. The primary types of questions our attorneys get from employers relate to what the employer can, may, or must do relating to their employees. Some answers are obvious while others are more nuanced and require review of statutes or regulations. The questions employers are asking are, in many ways, similar to those asked by employers during the early days of the SARS and ZIKA scares. For example :

- Can we, may we, or must we send an employee home?
- What happens if an employee refuses to go home or refuses to work with or near another employee?
- What are our obligations to other employees if one employee is infected or suspected to be infected?
- What are our obligations to customers, clients and third parties?
- Must we supply masks or protective items to employees?

Some answers can be found in OSHA's "Guidance on Preparing Workplaces for an Influenza Pandemic" at https://www.osha.gov/Publications/influenza_pandemic.html.

Other questions are similar to the types of questions our attorneys receive regularly relating to employee safety, mandatory or voluntary leave with or without pay, wage and hour issues (particularly with offsite or remote working arrangements), OSHA and CalOSHA standards, and best practices for employee safety, required accommodations (particularly for employees who are more vulnerable), discrimination and termination issues and employee privacy issues. Unionized employers may have some unique questions that arise, particularly issues relating to required bargaining over actions the employer may want to take to protect its work place.

Corporate and Transactional

In the corporate and transactional arena, there are at least three primary areas of concern. First, businesses that have operational risks that arise with employees, customers, and vendors whose performance might be affected by the outbreak or related management concerns. This has proven particularly true with companies that depend on China for manufacturing, supply chains, and customer relationships. As with the overall market tendency to react strongly to perceived threats before those threats materialize, there has been a particularly volatile reaction for electronics manufacturers based on the presumed risks COVID-19 poses to assembly and component manufacturers. Likewise, U.S. companies whose operations have significant export concentration, particularly to China, have seen increasing volatility. Relating to these risks is the potential for securities litigation arising out of allegedly defective disclosures. Anticipating this exposure calls for working closely with counsel and with internal financial staff to develop thorough risk analyses and to assure the timely, accurate communication of known material events and risk factors. These companies also should adjust their investor relations and communications plans to help mitigate the potential for market overreactions, balancing the need for disclosure of operational and financial risks against investors' expectations that management is anticipating and planning for the potential impacts, if, for example, the severity or pervasiveness of COVID-19 were to cause more serious disruptions.

The second category of corona virus-related concerns is the effect of a volatile securities market on M&A and capital markets transactions – including, but not limited to, those involving public companies. We have seen instances with a number of clients questioning whether COVID-19-related risks or the apparently related market volatility might trigger "material adverse change" or "MAC" clauses in pending agreements. Of course, as noted above, the actual impact of corona virus, especially outside China, thus far seems attenuated in relation to the markets' reaction. However, this development, especially if protracted or exacerbated, may affect a buyer's perception of company value, could affect lenders' willingness to extend credit, and may affect capital markets transactions, tender offers, stock buybacks, and dividend programs as issuers and underwriters consider their working capital needs and address the potential for longer-lasting effects on revenues and strategic planning. Our attorneys are advising clients that are currently negotiating such transactions to consider these factors and are recommending thorough and careful review of closing conditions and operating covenants – with particular attention to MAC-related provisions – during the drafting process.

Corporate and Transactional (continued)

A third concern is specific to publicly traded companies. On Feb. 19, 2020, the Securities and Exchange Commission and the Public Company Accounting Oversight Board issued a joint statement addressing, among other items, the effects of the coronavirus on financial reporting, including the issuer's disclosures and the audit firm's audit quality (for example, audit firm access to information and company personnel). The joint statement acknowledges that the coronavirus is dynamic and the effects to any particular industry or issuer might not be known. However, users might need disclosure of how issuers plan for and respond to coronavirus events. The joint statement reminds public companies to 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 in meeting the applicable requirements." In this regard, public companies should carefully consider whether the following items in filings should discuss the impact or potential future impact of the coronavirus:

- Risk Factors
- Management's Discussion and Analysis (including the requirements of Item 303 of Regulation S-K to discuss known trends and uncertainties on liquidity, capital resources, and results of operations)
- Description of Business
- Quantitative and Qualitative Disclosures about Market Risk
- Board risk oversight disclosures pursuant to Item 407(h) of Regulation S-K and Item 7 of Schedule 14A

The additional considerations for public companies come with an offsetting consideration: the SEC has announced conditional regulatory relief that affords public companies affected by the coronavirus an additional 45 days to file certain disclosure reports due between March 1 and April 30, 2020. Companies relying on this relief must file a Form 8-K explaining why the relief is needed in their specific circumstances, among other conditions. We also encourage public companies to consider filing a Form 8-K if the effects of the disease are likely to materially affect results of operation, financial condition, or the accuracy or reliability of financial statements.

Whether the corona virus ultimately proves closer to the "Y2K" concerns leading up to the end of the 20th-Century, or grows more serious and has more far-reaching effects, remains to be seen. However, by anticipating the operational and transactional risks and by monitoring and updating company policies and procedures to address these matters seems to us to be both indispensable and "cheap insurance" against a risk that has not yet fully materialized.

Real Estate

The real estate sector is seeing COVID-19 related impacts on building owners, developers, landlords, and tenants. For tenants, the principal action item is to discuss heightened janitorial and "day porter" services with your landlord. Most landlords have engaged professional janitorial service providers and many are increasing the frequency of cleaning/sanitizing elevators, escalators, front entrances and lobby amenities.

For building owners (or single tenant occupants of buildings under triple net leases), especially those in retail and mixed use environments, where there is a consistent public presence at the project, contingency access control plans need to be developed. In addition, owners should have discussions with their property management services and other key vendors to discuss employee practices governing communications with employees to promptly report illnesses and to avoid the building if they are ill. Based on current medical information, the virus is transmitted through moisture based "droplets" that are absorbed through a person's mucus membranes, and is not by "air borne" transmission. As such, the likelihood that building HVAC systems will be a source of exposure seems relatively low. However, building owners should consider increasing the frequency of common area "day porter" services.

Both landlords and tenants should review their leases to confirm whether a closure of the building, or significantly restricted access, would trigger a rent abatement. Buildings, especially larger retail centers and trophy properties with significant common areas, are likely to incur increased operating expenses, and tenants should discuss these projected costs – and the tenants' responsibility for such costs -- with their landlords. Developers with projects in stages of entitlement review, including building permit review, should anticipate delays in processing of their applications as local jurisdictions close offices, redirect manpower, or otherwise postpone public hearings.

Commercial Finance & Lending

While there is still much uncertainty about COVID-19 and its long-term effects, there is no doubt that the virus has had a real impact on the commercial finance market. Many borrowers dependent on working capital lines and leveraged loans are showing signs of financial strain amid the spread of the virus. This is especially true for borrowers whose cash flow and supply chains are dependent, either directly or indirectly, on customers and manufacturers under quarantine overseas.

As this sort of disruption continues to unfold with the spread of COVID-19, lenders should start to assess their rights and remedies under their existing commercial loan documents. And borrowers in the process of negotiating new commercial loans should carefully consider the risk and consequences of further business deterioration resulting from the virus. Below is a summary of issues and provisions that should be taken into consideration.

Defaults, Forbearances & Workouts

COVID-19 and its potential future effects on many businesses and industries will likely trigger a surge in defaults, forbearances and workouts. Thus, lenders should promptly undertake a review of their commercial loan documents, with counsel, for any deficiencies or so-called "soft-spots." This is especially the case if the loan was documented several years ago utilizing agreements that have since been updated with regulatory or legal changes, was heavily negotiated at closing, or has undergone a series of material amendments after closing.

Lenders and their counsel should pay particular attention to the grant and perfection of liens, the negative covenants, the MAC clause, how the financial covenants are calculated (especially EBITDA addbacks), and the lender's rights and remedies upon default. If the loan is syndicated, then agents and participant banks will also need to pay attention to voting rights, the amendment provision, and the so-called "yank-the-bank" provision.

Commercial Finance & Lending (continued)

The MAC Clause

In most commercial loan agreements, the lender may exercise remedies, refuse to lend, or terminate its commitment if a material adverse change (MAC) in the borrower's business, operations, prospects or financial condition has occurred. However, determining whether a MAC has occurred involves a detailed factual inquiry with an uncertain outcome. If wrong, the lender may be exposed to possible significant liability. For this reason, the MAC clause is notoriously difficult to invoke.

It may be tougher to call a MAC for COVID-19 since the actual economic impact of the virus outside China thus far seems less severe than the financial markets' reaction. At the very least, the lender will need to show a sustained decline in the borrower's business or financial condition due to the outbreak or an unavoidable loss of material business that is reasonably expected to result from the spread of the virus. Lenders considering a MAC for any COVID-19 related issues should consult with in-house or outside counsel.

Health Care

Health Care providers have all of the employment law concerns of any other business, but also have heightened workplace safety issues, because the public seeks care and treatment from them.

In addition, health care payors and providers are facing, and will continue to face, regulatory requirements related to their "front line" status. For example, the California Department of Managed Healthcare issued a directive on March 5, 2020 that provides as follows with respect to health care service plans:

- A directive to health plans to waive all cost-sharing and copays for COVID-19 related treatment (applies to delegated medical providers as well as plans)

- Coverage of all COVID-19 related treatment without need for prior authorization

- No surprise or balance billing for related services and treatment

- Ensuring plans have 24-hour access to a person with the authority to authorize services and ensuring the DMHC has contact information for that person, as required by Health and Safety Code section 1371.4 and California Code of Regulations, sections 1300.67.2.2 and 1300.68.01

- Waiver of prior authorization for prescription of other drugs for treatment

It is likely that the California Department of Insurance will issue similar guidance. Further, as reported cases increase, particularly in densely populated urban centers, providers and facilities are likely to experience substantial increases in demand and, owing to the resulting staffing costs, an uptick in expenses.

Energy & Natural Resources

COVID-19 is already impacting the energy markets for a variety of reasons, including manufacturing and transportation delays and labor stoppages. The slowdown or cessation of manufacturing in China and potential slowdowns at ports of entry may result in a delay in delivery of key supply chain components, such as solar energy panels. The inability to obtain parts needed for construction of projects, or obtain key replacement parts as part of regular maintenance or repair, will impact energy generation and related contractual requirements. Parties should closely review contractual commitments, such as power purchase agreements, to identify material obligations tied to product delay or cancellation. Such delays may impact the ability to meet performance requirements, key contractual milestones, and guaranteed energy production requirements.

The potential impacts of COVID-19 also extend to energy regulatory compliance matters, including Resource Adequacy and Renewable Portfolio Standards compliance, as well as the ability to take advantage of the Investment Tax Credit. Developers and load-serving entities expecting new generation to count towards these obligations, especially in the near-term, should evaluate if manufacturing interruptions may push back the commercial operation dates and whether mitigation measures such as substitution may be necessary. In some circumstances, despite delays, the Investment Tax Credit may still be available, but parties should ensure that they receive adequate documentation supporting delays and explore alternative solutions.

Among issues affecting the petroleum industry is sustaining the complex and integrated supply chain of critical transportation fuels and fuel for electric generation seamlessly and operationally. The teams of personnel necessary for this effort will, in many instances, call for physical proximity for support, operation and maintenance efforts at production fields, refineries, distribution pipelines and distribution facilities. These efforts are necessary for sustaining airport operations, all manners of transportation, and electric generation essential to our daily lives. The implications of a health constraint to isolate individuals in this supply chain is at the very least a challenge and will in all instances create restrictions that must be addressed for the retention of critical infrastructure and emergency services.

Land Development & Regulatory Compliance

While regulators and the regulated community grapple with the long-term implications of COVID-19 on the design, construction, and operation of buildings, and integration with public spaces that may need to be incorporated into new developments at the entitlement stage, the virus is starting to have an immediate impact on the ability of project sponsors to timely complete their projects at the local, state, and federal approval levels.

At the federal level, recent direction from the Federal Office of Personnel Management encourages federal agencies to release preliminary guidance as to how their respective agencies will respond to an outbreak and a resulting reduction in workforce availability. Based on prior guidance, however, some agencies already had limited the ability for federal agency employees to telecommute on a regular basis. With guidance from the CDC regarding triggers for self-quarantine, federal agencies will need to rethink how they make accommodations for reduced staff availability while at the same time responding to other Executive Orders imposing streamlined and expedited permit review. This inherent conflict threatens to leave some projects in limbo indefinitely, much like the prior Federal government shut-downs and emergency incidents (e.g., fires and floods) in which staff were reassigned and/or unavailable to timely complete projects or respond to compliance issues.

Various state agencies, county, municipal governments and special districts are also feeling the pressure to develop emergency response plans and address the uncertainty created by COVID-19. As the entitlement process depends on public interactions, meetings, and hearings, the real estate development industry is particularly vulnerable just as it was during the massive wildfires in California over the past several years. During those tragic incidents, court and agency closures and hearing cancellations hindered timely project delivery. This conflict between meeting regulatory deadlines on the one hand and minimizing potential exposure to COVID-19 is already starting to create challenges for developers and builders trying to expedite the delivery of projects before the next economic downturn.

Land Development & Regulatory Compliance (continued)

From a practical perspective, the real estate industry needs to prepare for and anticipate the potential for indefinite delays due to this latest public health crisis. Developers, landowners, and investors may want to use this as an opportunity to strengthen transactional documents, as well as entitlement approvals and development agreements with municipalities to accommodate the uncertainty. For example, purchase and sale agreements, development agreements, and other instruments may need to provide for even longer feasibility periods and later outside dates. Similarly, force majeure provisions should clearly account for governmental agency delays as a basis for extending performance obligations, and indemnification provisions in project approvals may need to carve out potential liabilities due to exposure to public health hazards. Developers should also work with the respective land use authorities to extend permit expiration dates to account for any permitting and construction delays. In short, to minimize risk and financial loss related to COVID-19, the real estate development industry needs to be more proactive than ever.

Environmental Health & Safety

Employers have a duty to provide their employees with a safe workplace free of occupational hazards. For certain workplaces that are more likely to expose employees to infectious diseases, the occupational hazards include potential exposure to COVID-19. These workplaces include hospitals, clinics, nursing facilities, and other places where infected persons are likely to be found or to go for treatment. Although these workplaces already have measures to protect employees from infectious diseases, employers should review those protective measures against the information from the Center for Disease Control ("CDC") and other authorities to ensure they are ready for COVID-19.

Employers who are not in one of the higher-hazard health care sectors still have a responsibility to provide a safe workplace. Cal/OSHA has provided Interim Guidelines for General Industry on COVID-19, see: https://www.dir.ca.gov/dosh/coronavirus/General-Industry.html. This guidance recommends that employers follow the guidelines of the CDC, such as encouraging sick employees to stay home, providing hand sanitizer, and sending employees with respiratory illness home immediately. Federal OSHA notes that there are no OSHA standards applicable to COVID-19 but that the General Duty Clause requires employers to furnish workers with employment free from recognized hazards likely to cause death or serious harm. Federal OSHA also points to the Cal/OSHA guidance as useful. Interestingly, the Federal OSHA website states that COVID-19 is a recordable illness when a worker is infected on the job, despite the fact that the common cold and flu are explicitly exempted from recordkeeping requirements. As it will be difficult to ascertain where a worker is infected, this essentially makes any COVID-19 case a recordable illness.

Finally, as some businesses may be contemplating operating with reduced staffs, it is important to remember that compliance with environmental permits and regulations is not "optional." Environmental, health and safety requirements should be reviewed to determine which ones must still be carried out in the operating and staffing mode being contemplated.

Conclusion

As can be seen from the above, the impacts to clients globally are complex and far-reaching. As we write, the developments are ongoing: courts and businesses are suspending in-person contact, employees of companies small and large are being asked to work from home, and many others are considering both practical and legal measures to protect their employees while also managing their business and legal concerns. We are available to assist clients with issues related to COVID-19 in all areas of the law.

Please contact your Buchalter attorney with any questions.

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