

COVID-19: A PRACTICAL HANDBOOK FOR CLIENTS

# COVID-19: A Practical Handbook for Clients

March 31, 2020

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## Introduction

- This handbook is intended to provide clients with a list of material business, operational and legal issues to be aware of and consider while navigating the COVID-19 pandemic.<sup>1</sup>
- In the course of advising various sponsors, portfolio companies and other businesses in connection with their responses to the crisis, we have identified various common areas of concern, which include:
  - (i) [Liquidity & Debt Considerations](#)
  - (ii) [Small Business Loans](#)
  - (iii) [Labor, Compensation & Benefits](#)
  - (iv) [Tax](#)
  - (v) [Real Estate](#)
  - (vi) [Operations](#)
  - (vii) [Data Privacy & Cyber Security](#)

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<sup>1</sup> This document does not constitute legal advice on any matter that may arise as a consequence of the pandemic or otherwise; you should consult legal counsel if there are any questions or issues that you would like to address after reading this handbook. The COVID-19 situation is constantly evolving and so are responses by federal, state and local governments. As such, this handbook only reflects information that is current as of March 31, 2020.

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(viii) [General Corporate Matters](#)

(ix) [Fund-Level Considerations](#)

(x) [Restructuring](#)

- Within each of these key areas, this handbook provides a brief description of the material issues and action items to consider and, in certain cases, implement, in responding to the COVID-19 pandemic.
- Many of the issues highlighted in this handbook are addressed in greater detail in client alerts that we have made available on the [Willkie COVID-19 Resource Center](#).
- If you have any questions or would like to discuss any of these issues in depth, please do not hesitate to contact any member of the Willkie COVID-19 Task Force or the Willkie attorney with whom you regularly work. Task Force contact information is listed at the end of this handbook.

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### Liquidity and Debt Considerations

- **Liquidity Assessment** – Assess current and future liquidity needs and borrowing availability (under revolvers or otherwise). Consider (i) revising capital expenditure budgets and (ii) identifying unencumbered assets that may be utilized in obtaining or expanding financing.
- **Covenant Compliance** – Assess potential impact of any government-ordered shutdown of operations and any cash conservation strategies (e.g., deferred rent or vendor payments) on general credit agreement covenant compliance.
- **Financial Covenants** – Assess the impact of Q1 results (or more likely Q2 results) on financial covenants and determine the availability of addbacks to financial definitions.
- **Debt Buybacks** – If considering a debt buyback, assess whether this is permitted under applicable credit agreements and other debt documents (e.g., any limitations or mandated procedures), as well as related securities laws issues, corporate governance considerations, bankruptcy issues, investment fund mandates and related matters. Associated tax considerations are addressed on page 7.

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### Small Business Loans

- **Loan Forgiveness** – The Coronavirus Aid, Relief and Economic Security Response Act (the “CARES Act”) provides forgivable loans up to 2.5 times the average monthly “payroll costs” (including salaries up to \$100,000 and group insurance, but excluding payments and benefits to overseas employees) for the one-year period ending on the date the loan was made, up to \$10MM.
  - The loan is eligible for forgiveness in an amount equal to specified costs incurred and payments made during the 8-week period after the loan has been granted.
  - The loans do not require the borrower to post any collateral or guarantees; payment is deferred for at least 6 months after issuance.
  - Any portion of the loan that is forgiven will be deemed to be cancelled indebtedness by the lender and will not be deemed income to the borrower.
  - The amount of loan forgiveness will be reduced: (1) proportionally by the reduction in headcount in the 8-week period from the date the loan is made compared to February 15 to June 30, 2019 or, if the borrower prefers, January 1 to February 29, 2020; or (2) on a dollar-for-dollar basis for any reduction of more than 25% of any employee’s compensation other than a portion of salary above \$100,000.
- **Eligibility** – Consider eligibility for a loan under the CARES Act. Subject to aggregation rules, an applicant is eligible if it has no more than 500 employees (full time, part time or otherwise), or is a “small business concern,” based on three primary factors:
  - the number of employees (depending on industry, capped at 1,500);
  - the annual receipts for a business concern (depending on industry, capped at \$41.5MM); and
  - the alternative size standard (the maximum tangible net worth of the applicant is not more than \$15MM and the average net income after Federal income taxes is not more than \$5MM).
- **Aggregation**
  - When determining the total annual receipts, number of employees, tangible net worth and average net income, such amounts must be aggregated across the applicant’s business and all its “controlling” companies and sister companies (i.e., all funds and portfolio companies managed by the same sponsor will be aggregated for this purpose).

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- “Control” may exist in minority investments with significant governance rights or common management, determined by a case-by-case factual analysis.
- Businesses operating under NAICS 72 codes and specified franchises are eligible for waivers to the affiliation rules.
- For more information, please see our alert on [small business loans](#).

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### **Labor, Compensation & Benefits**

- ***Furloughs & RIFs*** – If permanent or temporary layoffs are being contemplated:
  - Focus on the implementation process, maintaining compliance with wage and hour laws. Document the process.
  - Base decision on objective and reasonable criteria; avoid any disparate impact on protected categories (age, race, etc.).
  - Determine WARN Act implications depending on the separation measure and the timeframe.
  - Keep morale/goodwill considerations in mind; carefully craft message for temporary layoffs to avoid litigation.
  - Consider compensation program changes in lieu of, or in addition to, workforce reductions.
  - Consider implications of compensation reductions under applicable employment agreements or offer letters.
  - Consider implications of workforce reductions and cost-cutting measures in connection with any contemplated request for a small business loan under the CARES Act.
- ***Paid Leave & CARES Act*** – Evaluate impact of new sick leave and paid family leave rules (both federal and state), including the CARES Act, on the business. For more information, see our alerts on [the paid leave](#) and [the CARES Act requirements](#).
- ***Benefit Plans***
  - Consider the impact of workforce reductions on benefit plans, continuity of coverage and COBRA obligations.
  - Review plan documentation and discuss any issues or proposed plan changes with counsel, plan providers and insurers.
  - The CARES Act provides certain eligible employees with enhanced opportunities to access their 401(k) plan account balances without penalty, as well as increased flexibility with respect to required minimum distributions and repayment timing for outstanding plan loans, and also offers relief to defined benefit plan sponsors.
- ***Unions*** – Evaluate any changes in work force and compensation package in light of applicable CBAs. Consider need for potential renegotiation of CBAs.

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### Tax

- **Tax Credits** – Consider eligibility for tax credits (and potential refunds) for payroll taxes. Eligibility is based on whether (i) the business is required to (a) discontinue operations by a governmental authority, or (b) provide paid leave benefits to employees affected by the COVID-19 pandemic, or (ii) is otherwise suffering significant reduction in revenues.
- **Tax Filings** – Note all federal (and certain state) tax filing deadline dates have been automatically extended to July 15, 2020.
- **Payroll Taxes** – Employers can defer paying 2020 payroll taxes (50% can be deferred until December 31, 2021, with the remaining 50% due December 31, 2022).
- **NOLs** – NOLs arising in a taxable year beginning in 2018, 2019 or 2020 can now be carried back five years. NOLs generated in taxable years beginning on or after January 1, 2018 can now offset 100% of taxable income for 2019 and 2020 (rather than only up to 80% of taxable income).
- **Business Interest Expense** – Deductibility of business interest expense (previously limited to no more than 30% of the sum of the taxpayer's adjusted taxable income and business interest income) is increased to 50% in any taxable year beginning in 2019 or 2020.
- **Debt Buybacks** – If debt buybacks are being considered, assess tax implications – i.e., potential Cancellation of Indebtedness Income (COD) for the portfolio company and Original Issue Discount (OID) income for the sponsor (if purchaser).
- **State and Local Taxes** – Many states and local taxing authorities have implemented various extensions, suspensions, deferrals and waivers of taxes. Accounting firms should be consulted as to these activities in each applicable jurisdiction.

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### **Real Estate**

- **Leases** – Review specific lease clauses to understand tenant and landlord obligations and remedies. Note the following:
  - Most leases provide that force majeure does not excuse failure to pay rent. Many leases provide for rent abatements if the landlord is not providing services, but typically carve out force majeure.
  - Equitable remedies to avoid payment of rent will likely be difficult to claim and are very fact- and document-specific.
  - Tenants in the midst of transitioning to new space or in the midst of build-outs should carefully review lease provisions relating to timing of delivery, penalties and force majeure, as well as related holdover provisions in their existing space.
  - Closures of courts and governmental restrictions on eviction may provide temporary relief but, in the long term, landlords will likely be able to exercise remedies for non-payment.
- **Real Estate Financing**
  - Get in front of lenders quickly; keep initial modification requests simple, particularly for CMBS financings.
  - For construction loans and other loans with future funding for capital work, document any delays caused by COVID-19 issues.
- **Governmental Restrictions**
  - Recent NY DFS regulations on mortgage forbearance do not apply to commercial mortgages.
  - Federal regulators have issued guidance encouraging lenders to modify loans for financial hardship, and borrowers should press this point with lenders.

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### Operations

- ***Vendors and Customers***
  - Analyze force majeure provisions in commercial contracts, but note that negotiated solutions will most likely be needed if the contract does not specify pandemics as a force majeure or the defense is not otherwise available. Equitable defenses may also be available as an alternative.
  - Monitor and document steps taken to mitigate any non-performance.
  - Consider any upstream supply chain disruption and source alternative suppliers if needed.
- ***Government Required Shutdowns***
  - Determine whether operations qualify as “essential” (including as a provider of service to another “essential” business) and whether to apply for designation as an “essential business.”
  - If in-person operations continue, prepare materials for facility managers and employees to show law enforcement that the operations and the employees commuting to work are essential.
  - Ensure all social distancing and sanitization methods are followed and documented as long as in-person operations continue.
- ***Business Continuity***
  - Develop, implement and communicate business continuity plan to employees, customers and vendors.
  - Assess adequacy of mitigation measures (including WFH policy, social distancing and enhanced cleaning schedules).<sup>2</sup>
  - Check EPA and CDC websites regularly for information on products effective against COVID-19<sup>3</sup> and follow CDC and OSHA environmental and cleaning recommendations.<sup>4, 5</sup>

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<sup>2</sup> [CDC Interim COVID-19 Guidance](#)

<sup>3</sup> [EPA List of COVID-19 Disinfectants](#)

<sup>4</sup> [CDC Cleaning Guidelines for Businesses](#)

<sup>5</sup> [OSHA Cleaning Guidelines](#)

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- If an employee tests positive for COVID-19, such employee and any other employees who have interacted with the first employee must be sent home for 14 days. Names of such employees must be kept confidential. Common work areas in which such employees performed their duties should be shut down for 24 hours and thoroughly cleaned and disinfected.
- ***Environmental***
  - Facilities must continue to comply with environmental laws under EPA-issued policies in response to COVID-19, as well as existing consent orders.
  - Document any decisions made to prevent or mitigate noncompliance and how noncompliance was related to COVID-19.
  - Businesses must return to compliance as quickly as possible and any non-compliance during the outbreak should be reported through existing procedures.
- ***Insurance Coverage***
  - Request coverage analysis from insurance brokers under all business, key man and cyber insurance policies.
  - Business interruption policies are unlikely to provide coverage as most have excluded pandemics and outbreaks following SARS.
  - Currently no federal regulations require insurers to provide coverage as a result of the COVID-19 pandemic.
- ***Audit Timing***
  - Timing will likely be delayed due to auditors suffering business disruption or being unable to access company facilities or employees.
  - Any delays in timing of audit with respect to SEC filings, debt reporting and tax filing obligations need to be managed.
- ***Intellectual Property***
  - Review agreements to ensure ongoing operations are protected. Consider what functions and service levels are protected, and what potential remedies apply.

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- Ensure that services arrangements with new and existing service providers are sufficient to ensure business continuity.
- Consider both U.S. and EU laws and regulations. Be careful not to collect information that is not relevant to the risks in the overall workplace.

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### **Data Privacy & Cybersecurity**

- ***Remote Working & Cybersecurity***

- Consider and address cybersecurity issues in light of the massive shift to “remote” working (e.g., new attack vectors for threat actors, such as unsecured home devices and networks, and the use of personal cloud storage accounts to save confidential information).
- Communicate with employees about increased cyber risks related to COVID-19 scams and phishing emails and the importance of maintaining vigilance as they shift to remote work.
- Review IT hardware and software, including security tools, to identify and remediate default settings (e.g., default passwords) that could be exploited by bad actors.
- To the extent possible, implement and enforce key remote work security tools, such as multifactor authentication.
- Undertake device inventory and apply patch management policies to all connected devices, servers, and other IT infrastructure.
- Identify and assess key IT infrastructure, incident response, and business continuity plans, and contact any key vendors to ensure continued capabilities and security. Update as needed in light of remote work capabilities and constraints.

- ***Data Collection***

- Update internal privacy policies to align with any changes in the type, manner, or disclosure of information collected, and communicate such changes to employees and third parties whose information is being collected.
- Develop a written list of questions that you can (and cannot) ask employees about their health in connection with managing the health and safety of your workplace and workforce during the pandemic.

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### General Corporate Considerations

- **Dividends** – Consider whether to proceed with a regularly scheduled dividend. Alternatively cancel or delay such dividend.
- **Virtual Annual Shareholder Meetings** – Review state law and charter/bylaw provisions if considering holding a virtual or hybrid annual shareholder meeting.
- **SEC Disclosure** – Assess the COVID-19 pandemic’s impact on SEC disclosure obligations. The SEC has indicated that disclosure should be tailored and should provide material information about the pandemic’s impact on businesses.<sup>6</sup>
- **SEC Filing Deadlines** – Under certain circumstances, SEC filing deadlines (including 10-Ks) may be extended. For more information, see [Release No. 34-88465 / March 25, 2020](#).
- **MNPI** – Sponsors or other insiders holding public company stock should keep in mind MNPI issues when considering securities transactions.
- **Stock Buybacks** – Prior to effectuating a stock buyback, boards need to determine whether the company has adequate liquidity and assess fiduciary duties (as well as MNPI considerations).
- **Pending Acquisitions** – If a transaction is being reassessed, MAE provisions should be analyzed to determine if the COVID-19 pandemic resulted in a “durationally significant” material adverse effect and disproportionately affected the target company.
- **Regulatory Review** – Anticipate and account for any delays in merger, antitrust or other regulatory reviews and approvals as a result of COVID-19.

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<sup>6</sup> [SEC COVID-19 Disclosure Guidance](#)

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### Fund-Level Considerations

- **Disclosures** – Update disclosures and risk factors in PPMs for the COVID-19 pandemic's impact on strategy and performance.
- **Valuation** – Evaluate valuation methods in light of market disruption. Determine whether fund manager is permitted to change such valuation methods and document justification for doing so. Consider the impact of valuation determinations on fund economics.
- **LP Relations** – Be prepared for uptick in LP defaults, redemption requests, requests to not call capital, and sale of fund interests. For private equity managers, review LPA default remedies. For hedge fund managers, review gate/suspension provisions and consider whether a pricing disruption has occurred. Prepare communications plans in response to anticipated LP questions, but bear in mind securities law issues in discussing performance.
- **Liquidity** – Review and consider various options (where permitted by LPAs): (i) drawing on subscription lines, (ii) increasing borrowing capacity with sub line lenders, (iii) using recycling/reinvestment provisions, (iv) calling capital or using cash flow to establish reserves.
- **Registered Funds** – Registered fund managers should consider the following: (i) necessity of additional backup liquidity, (ii) LRM programs and valuation procedures, (iii) leverage covenants and events of default, (iv) sufficiency of cushion under other fund agreements, and (v) frequent communications to fund boards.

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### Restructuring

- ***Preparation for a Restructuring*** – If a restructuring or liquidation is necessary, prepare in advance by:
  - Adhering strictly to corporate formalities;
  - Considering and advising the board of any shifts in fiduciary duties (e.g., requirement to be cognizant of creditors' rights);
  - Retaining separate legal counsel for the company and equity sponsors to avoid conflicts of interest issues;
  - Properly structuring and documenting additional capital infusions as loans to minimize risk of recharacterization in the future;
  - Opening discussions with lenders and creditor constituencies early on to maximize the likelihood of a consensual reorganization/liquidation structure; and
  - Evaluating funding options during a potential bankruptcy proceeding, including the availability of cash collateral, any restrictions on its use and the need for DIP and/or exit financing.

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