

# US Small Business and Emerging Growth Company Resource Guide

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## Question and Answer Summary

The COVID-19 pandemic has resulted in unprecedented disruption to worldwide markets and personal livelihoods, affecting global companies, small companies and main street businesses alike. As business owners struggle to understand the short-term and long-term implications of the COVID-19 pandemic on their business, customers and employees, we have prepared the following Q&A resource addressing issues business owners need to know as the fallout from the COVID-19 pandemic progresses.

This resource guide is intended to provide a general overview of issues you may encounter in managing your business. It is not intended to provide legal advice. You should consult a lawyer prior to taking actions regarding your business so that you can properly evaluate your specific circumstances, applicable laws and other considerations.

## Continuing Operations Under Shelter-In-Place Rules

### **Can I continue to operate my business under the “Shelter-in-Place” and similar executive orders that have been issued by many state and local governments?**

You should review carefully these orders as they differ among jurisdictions, although many of them make reference to a common set of criteria published by the federal government to determine whether a business qualifies as an “essential service.” These criteria are referred to as the CISA, and can be located at [www.CISA.gov](http://www.CISA.gov). Violation of the orders can result in fines, penalties, loss of business licenses, and in some cases, criminal charges. Accordingly, you should consult with your legal counsel if you are unclear about whether your business qualifies as an essential service under the orders that are applicable to you.

## Vendor, Customer and Landlord Relationships

### **I am concerned about my supply chain. What should I be doing?**

First, you should identify any potential supply chain disruptions and which suppliers are essential to performing your obligations to your customers. If your company relies on “just-in-time” shipments, early identification of supply chain disruptions will be crucial to allowing you to fulfill your own obligations to your own customers. After identifying likely supply chain disruptions, preemptively reach out to your key suppliers to ascertain whether they anticipate any disruptions rather than waiting to receive notice of such from suppliers, which may or may not be provided in a timely manner. Be sure to ask your suppliers where they anticipate any disruptions in their own supply chain, which will impact the ability of the supplier to fulfill your orders.

As you gather this initial information, you should be identifying alternative suppliers to address both short-term and long-term supply disruptions. If you are a small business that relies on third party large manufacturers, the COVID-19 outbreak has forced such manufacturers to close factories for long periods of time, resulting in massive backorders. Even when factories are able to reopen, a large portion of manufacturers are likely to prioritize fulfilling backorders from larger customers at the expense of smaller customers. This means that your supply chain disruption is more than likely a long-term problem and not a momentary issue.

### **My supplier informed me that it cannot satisfy its obligations under our supplier contract. What are my options?**

We recommend opening communication channels with your suppliers to see if there are arrangements that can be utilized to allow the supplier to meet some or all of its obligations to you, while also addressing needs of its other customers. In many instances, suppliers may choose to prioritize businesses that are deemed

“essential” under federal and state “Shelter-in-Place” rules over non-essential businesses, or may choose to fill orders for large accounts. Engaging in a proactive discussion with your suppliers may allow for partial delivery of your needs, alleviate friction between you and a supplier, and avoid situations where a supplier may simply refuse to supply you under “Force Majeure” or other legal theories – an outcome that has negative consequences for all involved. See below for a more detailed discussion of contractual rights. For example, if the supply chain breakdown involves transportation of supplies, identify whether there are transportation companies in industries negatively impacted by the COVID-19 shelter-in-place orders, such as restaurant food service delivery companies, that can pivot and provide delivery services.

If a mutually satisfactory solution cannot be obtained with your suppliers, you can evaluate whether to pursue legal remedies, including trying to enforce your contractual rights, which may include, among others: monetary damages, specific performance, rescission, and/or a right to terminate the contract. However, you should carefully consider whether seeking to enforce your legal rights under the contract (e.g., initiating legal proceedings for specific performance) would be practical from a time and cost perspective. See [“What contract provisions should I be aware of, in both my customer contracts and my supplier contracts?”](#) for a more detailed discussion of contractual rights.

#### **I may not be able to deliver on my commitments to customers. What should I be telling them?**

Promptly upon learning you may not be able to deliver on customer commitments, you should:

- I. First, review (with counsel as needed) your obligations to the customer to identify potential exposure and understand whether there are provisions that allow for excuse, delay of performance or termination of the obligations (e.g., force majeure); and
- II. Second, initiate open communication with your customers to manage expectations and discuss workable solutions to mitigate the effect of disruptions.

You should proactively identify whether there are alternative means to perform your contractual obligations, whether in full or in part, or other actions that can be taken to mitigate any anticipated future effects of the COVID-19 pandemic.

#### **What contract provisions should I be aware of, in both my customer contracts and my supplier contracts?**

In addition to a thorough working knowledge of the specific business terms of the contract (e.g., deliverables, delivery dates, payment terms), you should be aware of the following terms that may be included in contracts:

- I. Force Majeure Clauses. A force majeure event is an event that occurs outside of the reasonable control of a party and that prevents a party from performing its obligations under a contract. Force majeure events typically include war, natural disasters or lockouts. If a force majeure event has occurred, a party may be relieved from performing its obligations under a contract. A pandemic or epidemic, such as the COVID-19 epidemic, or the various “shelter in place” orders prohibiting non-essential workers to leave their homes, may be deemed a force majeure depending on the language of the particular contract’s force majeure clause. Further, “Shelter-in-Place” orders and similar executive orders may form the foundation for a company to claim that it cannot perform under the contract under an “illegality,” “impossibility of performance,” “frustration of purpose” or similar legal theories. For additional information, please see [“COVID-19: Force Majeure Event?”](#)
- II. Material Adverse Effect or Material Adverse Change. A “material adverse effect” clause, or MAE clause, often used interchangeably with the term “material adverse change,” may provide a way for a party to postpone or suspend performance under the contract or terminate the contract entirely. An MAE is an event that would reasonably be expected to materially and adversely affect (a) the business or financial condition of a party, or (b) the ability of a party to fully and timely perform their obligations under the contract. For example, if a “Shelter- In- Place” or similar executive order has resulted in the suspension of a material part of a company’s business, such event may constitute an MAE. For certain industries, changes in day-to-day life may result in a marked reduction in the use of their products or services, which could arguably result in an MAE (e.g., medical device companies manufacturing medical devices for suspended elective surgeries). If a party is not able to perform under a customer contract, an MAE clause may provide relief.

- III. Indemnification. Many agreements will include an indemnification provision. You should understand your liability to a counterparty (and vice versa) in the event of breach of the agreement. You should also understand what types of losses would require indemnification, any limits on indemnification and any notices required to invoke an indemnification provision.
- IV. Termination Provisions. You should carefully read the termination provisions in any agreements, both from the perspective of the ability of the business to terminate the agreement and the ability of a customer or vendor to terminate the agreement. In some cases, you should consider whether a pragmatic solution to potential non-performance is to terminate the agreement, rather than risk non-performance. You should also carefully scrutinize rights others may have to terminate agreements with the business, and the impact such terminations may have on the business's revenue or supply chain. Termination of an agreement usually requires written notice within a certain time frame. In conjunction with termination, you should review what provisions may survive termination. Typical provisions that survive are confidentiality, IP assignments and non-competes.
- V. Remedies and Damages Provisions; Termination Fees. If you breach a contract, or if a supplier breaches a contract, you or the supplier may be liable for damages or subject to remedies. For example:
  - a. Liquidated Damages and Termination Fees. A liquidated damages clause requires the breaching party to pay a pre-determined fixed amount or an amount based on a pre-determined formula to the non-breaching party, and can include formulations such as termination fees, late fees, or service credits. The types of damages that may be recovered may also be specified, including actual damages, direct or general damages or incidental damages and consequential (e.g., damages related to third-party claims, interest, loss of anticipated profits, attorneys' fees, loss of goodwill). Oftentimes, the agreement will specify a limitation on the damages that may be awarded in the event of a breach of the agreement as well.
  - b. Specific Performance. You may be able to have a court compel performance under a contract in the event of a breach or termination, which is most likely to make the other party whole. However, if performance is impossible or impractical, courts generally will not award specific performance as a remedy.
- VI. Source Code Escrow Provisions. For technology companies, some license agreements may include a "source code escrow" provision, which provides for the deposit of source code with a third party in the event that a company can no longer support the software. If a license agreement includes a source code escrow provision, non-performance or termination of the agreement may result in the release of a company's intellectual property to the licensee. Often, there will be a separate escrow agreement with the third-party escrow agent that will include important terms related to the source code escrow.
- VII. Notice Provisions. If you want to invoke your rights under an MAE, force majeure, termination provision or any other provision under an agreement, you should scrupulously comply with the notice provisions of the agreement. Notice provisions may require written notice, notice within certain time periods or certain types of delivery methods (e.g., "read receipts," deemed delivery times, no email notice, etc.).

Companies should (i) carefully analyze their agreements in light of potential non-compliance, either by themselves or the counterparty, and understand their rights and obligations; (ii) consider preemptively opening lines of communication with the counterparty to craft practical solutions to potential non-compliance, rather than relying strictly on legal remedies, which can be costly and time-consuming with uncertain outcomes; and (iii) be sure to document any waivers or amendments to the agreement in compliance with the terms of the agreement.

**I'm not sure I will be able to comply with my lease. Is there anything in my lease that I can rely on to avoid payment or eviction?**

You should open communications with your landlord immediately. Your landlord may be willing to grant a payment plan, rent abatement or reduced rent. If you are still able to meet your financial obligations, but are in breach of non-financial requirements under your leases, landlords may be willing to waive such breaches. However, your landlord is under no obligation to provide any relief, so you should clearly understand your rights under your lease in the event you are not able to make rent payments. In particular, please note the following provisions:

- I. Events of Default: Events of Default typically include the failure to pay rent, filing bankruptcy or abandonment of the premises. Upon the occurrence of an Event of Default, the landlord may have a number of remedies, including termination of the lease and lock-out from the premises or financial penalties.

- II. Continuous Operations and Cessation of Business: Most commercial leases contain a provision that requires the tenant to be open for business for a minimum number of days during the week for a certain period of time each day and/or to continuously operate with adequate staff and sufficient stock of merchandise, and failure to do so may constitute a breach under the lease agreement. The various “Shelter-In-Place” or similar executive orders could prevent a tenant from complying with such provisions, which a landlord may assert is a technical event of default. You should determine whether exceptions to the continuous operations provisions are provided for events such as conforming to new local, state or federal government requirements or force majeure events. Landlords may be willing to waive compliance with this provision.
- III. Damages: If an Event of Default has been triggered, the landlord may be able to: (i) assess daily penalty payments; (ii) retain the security deposit (in part or in full); (iii) obtain specific performance from a court of law; or (iv) terminate the lease and repossess the leased premises. In addition the landlord may sue the tenant for any unpaid rent and damages for the lost benefit of the remainder of the lease term.
- IV. Temporary Suspension of Evictions. Several jurisdictions have imposed temporary suspensions of eviction proceedings. If you are in a jurisdiction that has imposed such a limitation and are relying on the landlord’s inability to bring an eviction action, you should consult your legal counsel as to the consequences of failing to perform under your lease.

You should also consider whether any personal guarantees were entered into in connection with the lease, and whether the lease default by the company results in any personal liability.

**I have heard that the federal government and some cities and states are freezing evictions and foreclosures. How does this affect me?**

The federal, state and city governments are implementing various relief efforts to help tenants who cannot pay rent on a home or business due to the financial hardships caused by COVID-19 and its economic impact. On March 18, the Federal Housing Administration (FHA) implemented an immediate 60-day foreclosure eviction moratorium for single-family homeowners with FHA-insured mortgages. Government-sponsored enterprises Fannie Mae and Freddie Mac will also suspend foreclosure and evictions for at least 60 days, which will impact homeowners with single-family mortgages backed by either of the mortgage lenders.

Local governments across the country have put in place temporary bans on commercial evictions through executive measures or court orders. For example:

- I. San Francisco, CA: Starting March 17, 2020, San Francisco instituted a 30-day moratorium on commercial evictions for small and medium-sized businesses (defined as those having less than \$25 million in annual gross receipts).
- II. State of New York: New York courts have issued a state-wide temporary ban on all eviction proceedings and eviction orders, which went into effect on March 16 and will be enforced indefinitely.
- III. State of Texas: On March 19, 2020, the Supreme Court of Texas issued a state-wide emergency order blocking most eviction hearings and trials for one month.

If you are in a jurisdiction that has imposed such a limitation and are relying on the landlord’s inability to bring an eviction action, you should consult your legal counsel as to the consequences of failing to perform under your lease.

## Loan Agreements and Credit Facilities

**I’m concerned I won’t be able to make payments on my outstanding loans or that I am in breach of covenants in my loan agreement. What should I do?**

Your loan agreement likely requires you to inform your lender that you are in breach or that you anticipate being in breach of the loan agreement. You should evaluate carefully whether you may have such an obligation, and consider the pros and cons of engaging in a discussion with your lender about a default or potential default under the loan agreement. There may be serious consequences to this decision, and we recommend you consult your counsel to make a fully informed decision.

**What constitutes an event of default under my loan agreement? What happens if I default?**

Loan agreements generally make a distinction between an “event of default” and a “default.” An event of default is an event or condition that immediately gives the lender the right to pursue remedies under the loan agreement. In contrast, a “default” is an event or condition that would become an event of default upon the passage of time or the giving of notice. Such remedies may include acceleration of the principal and interest, termination of the lender’s obligation to fund any unfunded tranches, foreclosure on the company’s assets or financial penalties.

Loan agreements differ, but common events of default include the following:

- I. Failure to Pay Principal and Interest. Your failure to timely pay principal and interest is an event of default. Although it is unlikely that there are grace periods for failure to pay principal, there may be grace periods for failure to pay interest. Failure to pay principal is often an immediate event of default, meaning the lender can immediately exercise its remedies under the loan agreement. In contrast, an event of default with respect to non-payment of grace periods will occur after the expiration of the grace period.
- II. Breach of Affirmative Covenants. Loan agreements often include affirmative covenants, which require a borrower to perform a particular act. Examples of affirmative covenants include covenants to provide certain information, like financial statements, or covenants related to the company’s business, like maintaining a license or approval. Affirmative covenants often include a grace period, so a breach of an affirmative covenant will not constitute an event of default until the expiration of the grace period. One common affirmative covenant that might be impacted by the COVID-19 pandemic is the obligation to discharge material payments. If you are unable to pay your material obligations because of the economic slowdown related to the COVID-19 pandemic, you may be in breach of this affirmative covenant. Other potential examples of potential breaches of affirmative covenants arising out of the COVID-19 pandemic include temporary cessation of business due to the “Shelter in Place” orders, layoffs that materially affect the ability of the business to be a going concern, failing to enforce important customer contracts or failing to give any notices under the loan agreement.
- III. Breach of Negative Covenants. Negative covenants require a borrower to refrain from performing a particular act. Examples of negative covenants include selling the company or issuing dividends without the consent of the lender. Sometimes loan agreements prohibit changes in lines of business. If your business has had to significantly pivot to address the COVID-19 pandemic, you may be in breach of this negative covenant.
- IV. Financial Covenants. Loan agreements often require that a borrower maintain certain financial metrics, and there are often no grace periods for breaches of financial covenants and are usually not curable. For example, the loan agreement may require a borrower to maintain a certain level of net worth or a minimum of EBITDA.
- V. Cross-Defaults. If you have more than one credit facility, a default under any other loan agreement may constitute a default under the other loan agreement.
- VI. Bankruptcy or Insolvency. The initiation of bankruptcy proceedings by or against a company will constitute an event of default. If a borrower cannot pay its debts or is otherwise insolvent, such condition would also be considered an event of default.
- VII. Material Adverse Change. Loan agreements will sometimes include material adverse changes as an event of default. Since the language is often very subjective, it is important to carefully review the language (with counsel, if needed) to determine whether the impact of the COVID-19 pandemic would constitute a material adverse change event of default.

There may be serious consequences to the manner in which you manage your relationship with your lender, and we recommend you consult your legal counsel to make a fully informed decision. For additional insights, please see [“Coronavirus Implications in Loan Documents.”](#)

**I have an existing revolver that says I cannot draw if there is an MAE. Should I draw on it?**

Generally, borrowers may be able to draw fully, depending on the value of the collateralized assets. For receivables-based facilities, the ability to draw and the amount that can be drawn will be based on qualifying accounts receivables. However, under typical U.S. loan agreements, lenders are only required to fund their commitment under a revolver when no default exists or would result from the borrowing and the representations and warranties provided in the loan agreements are true and correct in all material respects



on the date of the request. For example, the COVID-19 pandemic has resulted in a Material Adverse Change, and thus an event of default under the loan agreement, you cannot draw on your revolver. As such, regardless of the type of loan, your ability to draw may be limited by an occurrence of an event of default or any other breach of your obligations or covenants under the loan agreement. It is important to contact your counsel to discuss your rights and obligations under any revolver or other credit facility.

## Taxes

### What types of tax relief efforts are underway?

Congress passed the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”). The CARES Act contains tax provisions that are intended to increase cash flow for both individuals and companies. The CARES Act aims to achieve this generally by allowing taxpayers to (i) to fully offset taxable income for certain years with post-2017 net operating losses (“NOLs”); (ii) to carryback certain NOLs up to five years; (iii) to immediately claim tax credits for taxes paid under the alternative minimum tax (“AMT”) in pre-2018 years; (iv) to deduct additional interest expense; (v) to claim bonus depreciation for improvements to nonresidential buildings; (vi) to claim a refundable payroll tax credit for qualified wages paid by COVID-19 impacted taxpayers; and (vii) to delay tax payments for the employer portion of certain payroll taxes. Some of these provisions only apply to corporations. In addition, the CARES Act allows individual taxpayers to take certain penalty-free withdrawals from their retirement plans and expands the ability to deduct charitable contributions. For additional insights, please see [“Tax Relief Provisions in the CARES Act Stimulus Package.”](#)

### I’m concerned I won’t be able to remit my taxes. What are the consequences?

The IRS announced the extension of the due date for the filing and the payment of federal income taxes (both individual and corporate) due April 15, 2020 until July 15, 2020, with no interest, penalties or additions to tax accruing until July 16, 2020. As a result, taxpayers generally do not need to take any action with respect to their federal income taxes until the July 15, 2020 deadline. Taxpayers should confirm whether applicable states have also extended their filing and payment dates. For additional insights, please see [“IRS Extends Tax Filing and Payment Deadline to July 15, 2020.”](#)

The CARES Act provides that employers and self-employed individuals can defer the payment of the social security portion of employer payroll taxes for the period between the date of enactment and December 31, 2020. This provision requires that the deferred employment tax be paid over the two subsequent years. An applicable employer or self-employed individual would owe 50% of such deferred taxes on December 31, 2021, and the remaining 50% of such deferred taxes on December 31, 2022.

Failure to remit sales tax may result not only in penalties and accrued interest, but also in a personal liability for business owners in many states. In New York and Texas, for example, penalties and interest are due on late sales tax remittances. On the state level, for business entities in California such as corporations, S-Corps, LLCs, and partnerships, the tax return and payment deadline was extended from March 15, 2020 to June 15, 2020. Some localities, such as San Francisco, are allowing small businesses to defer payments of some business taxes and licensing fees.

## Employee Matters

### What if I can’t make payroll? If I need to lay off employees, when do I need to pay them?

Many states have wage statutes that provide employee payroll protections. For example, the Texas Payday Act governs all companies operating in Texas, regardless of size, except for public employers like the federal



or state governments. Under the Texas Payday Act, covered employers must deliver wages to employees located in Texas. In particular, if a covered employee is laid off, discharged or fired, you, as the employer, must deliver wages to the employee within six calendar days of the discharge. An employee who has not been paid all wages in accordance with the Texas Payday Act may submit a claim with the Texas Workforce Commission, which may commence an administrative action against the employer.

Companies operating in California that fail to comply with California Labor Code Section 204 may be assessed financial penalties. Under Labor Code Section 204, wages must be paid twice a month, and an employee located in California that is discharged must be paid all of his or her wages, including accrued vacation, immediately at the time of termination. Under Section 193 of New York's Labor Law, manual workers must be paid weekly and clerical and other workers may not be paid less than semi-monthly, on regular pay days designated in advance by the employer. Upon termination, the former employee must be paid his or her wages not later than the regular pay day for the pay period during which the termination occurred.

Prior to terminating employees or withholding payroll, you should consider consulting with legal counsel to understand your obligations.

**What is the impact of the COVID-19 disruption on my company's incentive compensation plans?**

Companies should carefully consider the impact of market disruptions on the fair market value of the securities underlying upcoming equity grants. Although delaying grants may de-motivate employees, staying the course may create the impression that equity grant recipients received a substantial windfall because the share price at grant was artificially low. Further, as the valuation of companies decline, more shares may need to be issued in order to incentivize employees, resulting in dilution to existing stockholders and depleted authorized share pools. Additionally, 2020 incentive targets may need to be revisited in light of rapidly changing circumstances. For additional insights, please see our publication "[The Impact of COVID-19 on Incentive Compensation.](#)"

**I need to terminate the employment of several employees. What issues should I be concerned with?**

At the federal level, the Worker Adjustment and Retraining Act of 1988 ("WARN"), as amended, requires employers with 100 or more employees to provide 60 days' advance written notice to employees whose employment terminates as a result of a "plan closing" or "mass layoff." Applicable state notice requirement statutes should also be considered. Further, employers that sponsor group health plans must notify terminated employees of their right to elect continuing health coverage under the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA") and state law will govern the timing of the payment of wages earned through the date of termination. Other factors to consider include releases, the return of property, restrictive covenants, and best practices when terminating the employment of an individual working remotely. For additional insights, please see our publication "[Key Considerations in Employee Terminations.](#)"

Prior to terminating employees or withholding payroll, you should consider consulting with legal counsel to understand your obligations.

**I need to furlough some of my employees. What should I be thinking about?**

Rather than engaging in layoffs, a number of employers have announced that they are furloughing employees until the COVID-19 pandemic subsides. These employers must keep in mind that the notice requirements of WARN may be triggered if employees are furloughed for a period that lasts six months or longer. In addition, a reduction in hours causing an employee to lose coverage under the employer's group health plan will trigger the right of the employee to elect benefit continuation coverage under COBRA. For

additional insights, please see [“Key Considerations in Employee Terminations.”](#) We note that a number of employers have announced salary cuts as a means of preserving cash without having to furlough or terminate employees. We will be addressing considerations for companies choosing this option in an upcoming publication.

Prior to terminating employees or withholding payroll, you should consider consulting with legal counsel to understand your obligations.

**I need to reduce salaries. What should I be thinking about?**

Reducing salaries is an approach some companies are now taking. If you are considering reducing salaries, there are a number of things to be thinking about that may complicate the decision. One question is whether the salary reduction is really a reduction or, instead, an intention to defer the salary payment. If you are considering deferring the payment, compliance with Section 409A of the Internal Revenue Code must be kept in mind. A violation of Section 409A can result in significant tax penalties and interest on the employees (including a 20% federal penalty tax and a 5% penalty tax for employees subject to taxation in California). It is also important to consider whether the salary reduction is going to include any replacement compensation (like an equity award or bonus). This type of replacement compensation can also implicate Section 409A and requires considering the terms of your equity and incentive plans. Particular caution should be taken in any situation in which you are considering elective reductions (i.e., the employee chooses to reduce his or her salary) or reductions for employees that have employment agreements that set a contractual rate of pay. Companies should also review their severance plans and arrangements when making salary reductions to consider whether the salary reduction could trigger a severance payment (for example, related to a constructive or “good reason” termination) or reduce the ultimate payout on a termination in unanticipated ways. Other considerations include the impact on retirement plan contribution levels and other benefits that involve payroll deductions. When making any type of salary reduction, also keep in mind federal and state wage laws.

**Are there any federally-mandated changes to sick leave policies?**

The Families First Coronavirus Response Act (the “FFC Act”), which became law on March 18, 2020, as is effective as of April 1, 2020, provides employees impacted by the COVID-19 pandemic with paid sick leave if they work for covered employers. Under the FFC Act, full-time employees of businesses with fewer than 500 employees have the right to 80 hours of paid sick leave, and part time employees have the right to a number of hours equal to the average number of hours the employee worked over a two-week period. In general, employees on leave because they are quarantined are entitled to a maximum of \$511 per day (\$5,110 in the aggregate) and employees that are on leave to care for others impacted by the COVID-19 pandemic, or because of the closing of a school or other care facility, are entitled to a maximum of \$200 per day (\$2,000 in the aggregate). Further, the Act provides for an additional 10 weeks of paid leave (up to a maximum of \$200 per day) for employees who are at home in order to care for a child whose school is closed due to COVID-19 reasons. The FFC Act provides employers with tax credits against the employer’s payroll taxes for amounts paid in respect of mandated paid sick leave.

**Insurance**

**Will business interruption insurance cover any losses related to COVID-19?**

The applicability and scope of insurance coverage for losses related to COVID-19 will vary by insurance policy and will depend on the specific circumstances and policy language. Under standard business interruption insurance policies, COVID-19-related losses caused by economic shutdowns (such as “stay at

home” and “essential businesses only” orders) are not likely to be covered. Business interruption insurance is typically offered as an extension to commercial property insurance policy and provides extra coverage against losses resulting from physical loss, damage or destruction to tangible property caused by disasters such as fires, windstorm and other specified perils. For covered losses, the policy will reimburse the policyholder for certain lost income and expenses incurred as a result of disruptions to their operations until the holder can resume normal operations. However, pandemic-related losses do not directly harm the insured property and thus are not likely to trigger payouts. In addition, most policies contain coverage exclusions for losses due to communicable diseases, particularly those concerning viruses or bacteria, which were put in place in the aftermath of the 2003 SARS outbreak.

Contact your insurance broker after determining, among other things: whether the policy requires physical loss; if there are arguments that you have suffered physical loss; and if there are any exclusions. Certain policies may cover “profits” only, so determining what “profits” means is essential. In addition, maintain complete and accurate records as evidence in case of any claims.

You should carefully examine the specific language of your business policies to determine whether any income losses from shutdowns related to the COVID-19 pandemic may qualify for coverage. In addition, policyholders should stay apprised of developments in the interpretation and treatment of business interruption insurance by the courts or state legislation. For example, a restaurant in the heart of New Orleans filed a lawsuit in Louisiana asking a state judge for a declaratory judgment that its business-interruption policy will cover its damages if it is ordered to close by civil authorities in response to the coronavirus. New Jersey’s State Assembly has proposed legislation to retroactively expand business interruption insurance to cover COVID-19-related claims, as further described in [“Are there any efforts to provide coverage for COVID-19 losses?”](#) below.

### **Are there any efforts to provide coverage for COVID-19 losses?**

New Jersey’s State Assembly has proposed legislation to retroactively expand business interruption insurance to cover COVID-19-related claims. The proposed bill, New Jersey Bill A-3844, would apply to small businesses (defined as those businesses with less than 100 eligible employees) that had a business interruption insurance policy in place as of March 9, 2020. Bill A-3844, if passed, would effectively restructure insurance contracts parties have previously agreed upon, and in many cases, override specific virus exclusions contained in many policies. The bill is thus facing questions of legality, practicality and constitutionality from various interested groups.

On March 18, 2020, a bipartisan group of 18 members of Congress sent a letter to four leading insurance industry trade groups urging them to retroactively recognize financial losses relating to COVID-19 under existing commercial property policies. The lawmakers argued that the COVID-19 pandemic constitutes a “direct physical loss” to a property and interruptions in businesses due to the outbreak should be covered. The trade groups disagree and believe standard commercial insurance policies are not designed to protect against diseases such as COVID-19, and their member companies were taking other voluntary approaches, such as assisting local charitable relief efforts or working out flexible arrangements with policyholders. The groups stated that the pandemic crisis will require “federal assistance that provides funding directly to those American individuals and businesses most in need.”

It remains to be seen when, in what form and from whom relief will come, if at all, as Congress, state governments, private industry groups and other groups continue to work together to provide relief to affected policyholders.

## Fundraising and Investor Relations

### **I need additional funds pending a new financing round that I was in the process of launching. What are my alternatives?**

Although there is no one-size-fits-all approach, you should consider approaching existing investors as soon as possible with simple and efficient options, such as a discounted convertible note or Simple Agreement for Future Equity (SAFE) instruments. Convertible Note and SAFE financings can be closed quickly and inexpensively, often requiring limited documentation (i.e., board and stockholder consent, a preemptive rights waiver, and form of note or SAFE). In addition, convertible instruments can delay setting a valuation to a time when markets are less volatile, which may provide investors comfort and allow companies to negotiate for a better valuation than current markets would support. Alternatively, you may consider a simple extension to your existing, or most recent, equity round, which could be effected with the same consents and waivers, a simple new purchase agreement and disclosure schedule, and charter amendment to increase authorized shares.

If you plan to raise a new round of financing during this time of market volatility, you should consider the potential dilutive impact on the financing. You should keep in mind that while no company has failed because of dilution, running out of cash is fatal 100% of the time.

You should also be prepared to see a return to investor-friendly deal structures. In the past few years, investors have moved toward “founder-friendly” deals in order to win deals. As money dries up, expect that investors will be more focused on protecting themselves, either through valuation or other control terms, and will be less willing to negotiate.

No matter what funding strategy you choose, be prepared to share your cash reduction and conversation plans with investors. Your budget will need to be revised to reflect the new operating reality during and after the COVID-19 pandemic.

### **I am currently in the middle of a fundraising. What should I be doing?**

Close your deal as soon as possible. You should focus on the important issues in your deal and stop negotiating more minor issues. You also need to impress a sense of urgency on your existing stockholders and ask them to be willing to sign documents as quickly as possible. The longer you wait to close a deal, the more likely it is that your investors will start to re-trade deal terms (not to your advantage) or will delay closing, which can be fatal.

You should also critically evaluate your investor syndicate. If your syndicate is comprised of strategic investors, particularly banks, their ability or appetite to invest may be reduced. Traditional venture capital funds may still be willing to invest, but they will also be more mindful of terms.

### **What should I be telling my investors?**

You should be proactively communicating with your investors, particularly if you are trying to close a financing. Your written communications should be frequent and concise, and you should also consider periodic update calls. In companies with a number of passive investors, such as small funds, family offices and angel investors, proactive communication will ultimately be more efficient for you and will likely take the place of needing to respond to frequent inquiries from a large number of stockholders. Specifically communicate, with an appropriate level of detail, to your investors the steps you are taking to address the COVID-19 pandemic, risks and opportunities particular to your business and how your business plan is changing in light of the constantly-changing COVID-19 landscape.

Consider the following questions you investors may have:

- I. What steps are you taking to review your business, marketing and product plans to address challenges posed by this crisis or new realities that may emerge when it subsides? Have you made and/or adopted any contingency plans or continuity plans?
- II. What are the potential challenges your business will face and how are you preparing for them? Consider any potential decline in sales, disruption in supplies and short-term liquidity issues, among others.
- III. What steps are you taking to conserve cash and improve financial strength of the company? Are you engaging in any new fundraising activity? Do you expect to meet your near-term financial obligations?

We believe that frequent and proactive communication will smooth the way, should you need to reach out for interim financing from your current investors.

## Small Business Administration Loans

### What types of relief efforts are underway from the Small Business Administration (“SBA”)?

The CARES Act creates the Paycheck Protection Program under Section 7(a) of the Small Business Act (a “PPP Loan”) and expands eligibility for Economic Injury Disaster Loans (“EIDLs”). A PPP Loan is a loan from a participating lender under Section 7(a) of the Small Business Act which may be used by small businesses for payroll costs generally (including salary, wages, cash tips, payments for vacation, parent, family, medical or sick leave, among other things), as well as for utilities, rent and mortgage interest incurred from February 15, 2020 to June 30, 2020. EIDLs are federal disaster loans for working capital to small businesses suffering substantial economic injury as a result of a declared disaster. Currently, a disaster related to COVID-19 has been declared in all U.S. states. For more information on the CARES Act, see our publication “[Congress Passes Largest Ever Economic Stimulus Package: Key Provisions of CARES Act.](#)”

### Am I eligible to apply for a PPP Loan?

You are eligible to apply for a PPP Loan (i) if you have fewer than 500 employees (or otherwise meet the [SBA’s size standards](#)); (ii) if you are a business, nonprofit organization, veterans organization or Tribal business concern that meets the SBA’s sized standards; (iii) if you are a sole proprietor, independent contractor or are self-employed; or (iv) generally speaking, if your business is in the accommodation or food service industry, provided that companies with multiple physical locations employ no more than 500 employees per location. In addition, you must have been in operation as of February 15, 2020 to be eligible to apply for a PPP Loan. Furthermore, unless your business is in the accommodation or food service industry, you must also qualify as a small business under the SBA’s affiliation rules, which may be an issue for venture- or private equity-backed companies.

### What are the affiliation rules for PPP Loans?

Under the affiliation rules, portfolio companies of private equity and venture capital firms may be required to aggregate the employees of all such private equity or venture capital firm’s portfolio companies when determining whether the company exceeds the 500 employee limit. It is possible that additional waivers of the affiliation rules may be adopted in the SBA’s regulations implementing the CARES Act provisions. For more information, see “[Affiliation Guide for Size Standards.](#)”

### When is the deadline for a PPP Loan?

PPP Loans must be made prior to June 30, 2020.

**How much can I get through a PPP Loan? When do I need to pay it back and at what interest rate?**

You may be eligible to receive the lesser of (x) \$10,000,000 or (y) 2.5 times the average total monthly payments for covered payroll costs (excluding the prorated portion of any annual compensation above \$100,000 for any person) for the year preceding the date of the loan (with exceptions for businesses that are seasonal or businesses that were not open during the period beginning on February 15, 2019 and ending on June 30, 2019). Payments under PPP Loans will be deferred for 6–12 months, and there are no personal guarantee or collateral requirements. The maximum maturity date is 10 years from the date of the loan and the maximum interest rate 4%.

**What can I use a PPP Loan for?**

You can use a PPP loan to fund salaries, wages, vacation, parental, family, medical or sick leave, severance, retirement benefits, health care benefit costs like insurance premiums, employee commissions and tips, interest on mortgage obligations, rent, utilities or interest on other debt incurred prior to obtaining the PPP Loan. However, PPP loan funds cannot be used to pay salaries over \$100,000. For additional insights, please see our publication "[Compensation and Governance Restrictions on CARES Act Stimulus Recipients.](#)"

**Are there any loan forgiveness programs in effect for PPP Loans?**

Yes, forgiveness programs are available. The principal amounts on PPP Loans used for payroll costs, interest payments, rent and utilities incurred during the 8-week period following the origination of the loan may be forgiven. However, the amount eligible for forgiveness will be reduced as follows:

- I. proportionately by any reduction in employee headcount as compared with the period between February 15, 2019 and June 30, 2019 or January 1, 2020 through February 29, 2020, as selected by the borrower; and
- II. to the extent that compensation for any employee that made less than \$100,000 on an annualized basis during any pay period in 2019 is reduced by 25% or more.

There is a savings provision to the extent employees are rehired or given wages or salary increases by June 30, 2020.

**Which lenders offer PPP Loans?**

While it is not yet certain which lenders will offer PPP Loans specifically, loans under Section 7(a) are offered by many lenders. The SBA provides an [online referral tool](#) to match small businesses with participating SBA-approved lenders.

**If I get a PPP Loan, does this affect my ability to get other types of relief?**

Under the current form of the CARES Act, you may not receive an EIDL and a loan under Section 7(a) (including PPP Loans) for the same purpose. Accordingly, you should carefully evaluate which form of relief is appropriate for a specific purpose. Furthermore, if you receive a PPP Loan, you are not eligible for the payroll tax credit under the CARES Act. In addition, if you receive a PPP Loan and the loan is forgiven, you are not eligible for the delayed payment of payroll taxes under the CARES Act.

**Am I eligible to apply for and receive an EIDL?**

EIDLs are available to businesses with less than 500 employees or that otherwise meet the [SBA's size standards](#). You must also qualify as a small business under the SBA's affiliation rules, which may be an issue for venture- or private equity-backed companies.

### **How much can I get through an EIDL?**

EIDLs can be obtained for up to \$2 million, with interest rates of up to 3.75% for small businesses and 2.75% for nonprofits, and may be used for working capital purposes (e.g., to pay fixed debts, payroll, accounts payable, and other bills that can't be paid to due to the impact of a disaster).

### **How do I apply for an EIDL?**

You can [download the forms or apply online for an EIDL](#) (or after filling out such forms, mail them in).

## **Regulatory Issues for Fintech Companies**

### **Is there any US government action to ensure our partner banks keep originating loans?**

The Federal Reserve, in conjunction with the U.S. Department of the Treasury, has created a group of loan liquidity facilities to encourage asset purchases and to facilitate liquidity in the marketplace. In conjunction, the bank regulators have been encouraging banks to work with borrowers impacted by the COVID-19 pandemic to continue issuing loans to support businesses and consumers. The bank regulators have also loosened certain bank capital and liquidity requirements in order to free up capital and support such lending activity. These productive steps should lay the groundwork for continued lending in the consumer market by FinTech partner banks. For additional insights, please see "[The Fed Repurposes the Financial Crisis Playbook for Pandemic Response.](#)"

### **What should we do if our BSA / AML compliance function is short-staffed?**

The Financial Crimes Enforcement Network ("FinCEN") issued a press release on March 16, 2020 encouraging financial institutions affected by the COVID-19 pandemic to contact FinCEN and their functional regulators as soon as practicable if there were concerns about any potential delays in their ability to file required BSA reports. FinCEN's Regulatory Support Section will continue to be available to support financial institutions for the duration of the COVID-19 pandemic.

### **How has the COVID-19 pandemic affected my digital banking platform?**

FinTech digital banking platforms are primed to serve as a fast, convenient way for consumers who are at home to manage their finances, pay bills and make and receive other payments, as necessary. The strongest and most adept digital banking platforms will develop new products and services that meet the new and unique needs that have arisen as a result of the COVID-19 pandemic. Such consumer-friendly products and services would likely be met with positive feedback and support.

## **Conclusion**

The COVID-19 pandemic has wide-ranging implications for small businesses across markets and industries. As governmental, public health and private industry responses to the COVID-19 pandemic continue to develop, the Shearman & Sterling team will be updating this resource guide according to the latest information available. As always, we strive to offer the highest level of service to our clients during these uncertain and unprecedented times. Please direct any additional questions you may have to a member of the [Emerging Growth Practice](#) or to the [Shearman & Sterling COVID-19 Task Force](#).

For further questions or concerns, please see our [COVID-19 Resource Center](#).



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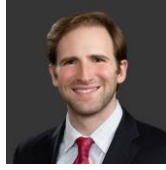
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