Managing the effects of the novel coronavirus outbreak

February 2020

The outbreak of the novel coronavirus (Covid-19), which has yet to peak, has already caused loss of human lives and disruptions to society. Its impact, both at a macroeconomic and individual corporation level, is expected to be more severe and far reaching than the SARS outbreak of 2003. In order to mitigate possible economic losses and avoid regulatory pitfalls, businesses including but not limited to those in hard hit sectors such as travel and tourism, shipping, logistics, and labour intensive manufacturing, should consider the following issues which are illustrated in this briefing:

- **Contractual**: Have your contractual rights and obligations been affected?
- **Regulatory**: Are you expecting any delay in fulfilling your obligations as a listed corporation/licensed entity? What should you do in the circumstances?
- **Operational**: How should you manage your employees (including their personal data)?

Managing commercial contracts

The draconian and unprecedented measures implemented by the mainland and worldwide governments in response to the coronavirus outbreak, such as effective city lockdowns, closure of transport hubs and operations, and international travel restrictions, are causing significant disruption to a wide range of businesses, industries and individuals. If you find yourself unable to perform existing contractual obligations by virtue of the outbreak, the below legal apparatus may offer some options in order to mitigate the effects of the disruption caused by Covid-19:

Force majeure **(FM)**

FM clauses come in many shapes and sizes, but typically they excuse one or more parties from performance of a contract in whole or in part following the occurrence of events which are unforeseen and outside of a party's control. Since the start of the Covid-19 outbreak, there have already been several reported cases of companies attempting to invoke a FM clause to seek to avoid performance of existing contractual obligations.

If you are contemplating invoking a FM clause, you should at a minimum consider the following:

(i) **Ascertain the precise ambit of the FM clause**: FM clauses operate by express inclusion in a contract rather than by operation of the law. In order to ascertain whether the FM clause in your contract has been triggered, you should consider the exact language of the FM clause. Your starting position would be strong if "epidemic" is specifically listed as a FM event in the contract. If "epidemic" is not stated specifically as a FM event, you may nevertheless seek to rely on the FM clause where the clause contains a sweeping catch all provision such as one which defines an FM event as "any event or circumstance not within the reasonable control nor could reasonably be foreseen by the party claiming the event or circumstances".

However, even if there is a catch all provision, it does not mean the simple fact of the outbreak would entitle you to claim a FM event. This is because often a FM clause will additionally provide that a FM event is one

which "prevents" or "hinders" the affected party from performing its obligations under the contract. Such a formulation would require you to demonstrate how exactly the FM event affected your performance of your contractual obligations. Accordingly, you must prove in what ways the outbreak has prevented or will prevent you from fulfilling your contractual obligations (whether as a result of labour shortages, closure of cities or ports, or other specific administrative measures). Specifically, if a FM clause provides that the FM event must "prevent" performance, you will have to prove that the relevant event has rendered performance legally or physically impossible. On the other hand, if the words "hinder" or "delay" are used in the FM clause instead, an event would qualify as a FM event if it makes performance substantially more onerous.

It is worth noting that economic downturn may be expressly excluded from the definition of FM in commercial contracts. Therefore, in relation to the current outbreak, if you wish to rely on a FM clause, you would have to prove that non-performance was not due merely to a slow-down of economic activities which itself is a knock-on effect of the epidemic.

Further, one should take into account the principles of contractual construction of the governing law of the overall contract when determining the ambit of the FM clause. Courts may tend to interpret such clauses narrowly.

(ii) **Burden of proof**: if you are seeking to rely on a FM clause, the burden will be on you to prove that the event relied on falls within the FM clause and that it was the cause of the non-performance.

(iii) **Timely notification**: often a FM clause will contain notification requirements. For example, if you wish to rely on an FM clause, you may be required to notify the other party (or parties) to the contract of the FM event within a certain number of days after becoming aware of the FM event. You may also be required to provide regular updates or more detailed reports. These notification requirements should be complied with to the fullest extent possible. While a delay in making a notification may not be a complete bar to claiming an FM event (particularly in circumstances where a commercially negotiated contract does not specify that the notification requirement is a condition precedent to a party's reliance on the FM clause), you will run the risk of severe prejudice if you do not comply with the FM notification requirements.

(iv) **Continued performance to the extent possible**: some FM clauses provide that the claiming party must continue to perform obligations unaffected by the FM event. Others require the claiming party to use reasonable endeavours to mitigate the effects of the FM event. Therefore, where such provisions exist in the contract, it is important to remember that the FM clause will not have the effect of relieving you completely from your contractual obligations. Instead, the contract must still be performed to the extent not affected by the FM event.

If you are served with a FM notification by a party who claims to be unable to perform its obligations under the contract, you should:

(i) scrutinise the exact language of the FM clause to be satisfied that the claimed event indeed qualifies as an FM event;

(ii) examine the causal link between the claimed FM event and the non-performance;

(iii) require evidence and regular updates from the party claiming the FM event; and

(iv) consider negotiating with the claiming party in order to amend the contract to reflect a commercially sensible resolution. However, this approach may prove challenging given

the likely need for all parties to agree to any amendments as well as issues such as whether or not it is even practically possible to amend the contract without materially changing its substance.

Frustration

While extremely difficult to establish, a contract may be discharged on the ground of frustration when an event or circumstance arises after the formation of a contract and render its performance physically or commercially impossible (or transforms the obligation into a drastically different obligation). Frustration and FM claims are mutually exclusive: FM events do not constitute grounds to frustrate a contract, as the contract has already provided for how such an FM event should be dealt with. If your contract does not contain a FM clause, you may consider the frustration principle (although note its extremely high threshold).

Material adverse change (**MAC**) and material adverse effect (**MAE**)

Some agreements, particularly in a financing context (e.g. an APLMA-style facility agreement), may include an Event of Default (**EoD**) for the occurrence of a MAC, the scope of which will often be a focus of commercial negotiation.

Such agreements will also often include a concept of MAE (irrespective of whether this is linked to a MAC EoD), which is typically used relatively widely in facility agreements, for example, to limit the scope of representations, undertakings and other EoDs. This may be defined as a material adverse effect on: (i) the business, operations, property, condition (financial or otherwise) or prospects of an obligor's group taken as a whole; (ii) an obligor's ability to perform its obligations under the relevant agreements; or (iii) the validity or enforceability of, or the rights or remedies of any lender under, the relevant agreements.

The extent to which a MAC EoD clause in a facility agreement is triggered, or a MAE threshold for breach of a representation or undertaking or other EoD is met, as a result of the Covid-19 outbreak will need to be assessed on a case-by-case basis, depending on the precise wording used in the agreement and the specific impact on the borrower/obligor in question.

Regulatory implications for listed corporations

Listed corporations should also be aware of the following regulatory implications.

In respect of results announcements, on 4 February 2020 the Securities and Futures Commission (**SFC**) and The Stock Exchange of Hong Kong Limited (**Exchange**) issued a joint statement earlier this month to provide guidance as to how to address disruptions in results announcement caused by travel restrictions arising from the coronavirus outbreak[1]. This would allow listed companies some flexibility in dealing with any disruption to their reporting or audit processes.

Listed corporations are, at the same time, reminded of their obligations, under the Securities and Futures Ordinance, to disclose any inside information as soon as reasonably practicable after the information has come to its

[1] https://www.hkex.com.hk/News/News-Release/2020/200204news?sc_lang=en

knowledge. If you are a listed corporation, you should actively assess the impact of the epidemic on your business operations and any need to make an announcement in respect of any inside information coming to your knowledge, including for example, deterioration of financial performance, commencement of any material litigation by or against you due to contractual non-performance, and prolonged closure of premises and factories due to governmental measures.

Whilst appreciating that some licensed corporations and applicants as well as market participants may experience operational difficulties due to the Covid-19 outbreak, the SFC generally expects them to make all reasonable efforts to maintain "business as usual" in relation to their regulatory obligations and all regulatory filing, reporting and other deadlines[2]. Therefore, if you as licensed corporations foresee or encounter specific difficulties, you should communicate promptly with your usual contact points at the SFC.

We expect other regulators to adopt a similarly pragmatic approach to compliance with regulatory obligations. However, it is important to maintain a dialogue with your usual contact points at the relevant regulators so that they are well informed of the difficult situations you are in which hinder you from complying with any of your regulatory obligations as a result of the Covid-19 outbreak.

IPOs

If you are involved in an IPO process, you will also need to consider the ramifications of the Covid-19 outbreak on your proposed IPO. In particular for sponsors, the current travel restrictions imposed by both local and foreign governments may severely restrict the due diligence process, by making it significantly more difficult for sponsors and others involved in the due diligence process to pay physical visits in order to verify key assets of a listing applicant and its customers and/or suppliers. Accordingly, sponsor principals should actively assess current due diligence plans and consider ways in which the stringent requirements of the regulators in respect of the IPO process are met despite the current outbreak. Any such decisions should also be well documented and closely followed in order to avoid committing a regulatory breach.

Employment implications

You should also be mindful of your obligations as an employer. For example, under the Occupational Safety and Health Ordinance employers are required, as far as reasonably practicable, to ensure the safety and health at work of all employees (in addition to under the common law duty of care). While the steps you should take will depend on the work environment of your employees, some common issues encountered by employers include whether employees should be directed to work from home, as well as steps they need to take to maintain a safe and hygienic work environment (which, depending on the context, could for example include monitoring the body temperatures of employees and visitors as well as recent travel history) and sufficient supplies of protective equipment and disinfectants.

Further, you should note that the Hong Kong government has, since 8 February 2020, been issuing quarantine orders to all persons entering Hong Kong from Mainland China, except for persons falling under exempted categories (such

[2] https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/corporate-news/doc?refNo=20PR10

as cross-border vehicle drivers). Persons subject to quarantine orders are required to stay at their accommodation for a 14-day compulsory quarantine. Please therefore bear in mind the consequences if you require employees to travel to Mainland China for work.

Persons ordered to be put under quarantine are issued medical certificates. This means that if any of your employees becomes subject to a quarantine order, subject to any work from home arrangements for the employee, you would still be obliged to pay that employee's sickness allowance stipulated under the Employment Ordinance. A corollary is that while an employee is under quarantine, you may not terminate the contract of employment during the quarantine period.

Data privacy implications

Naturally, employers will be keen to understand whether or not any of their employees are infected with – or at risk of being infected with – Covid-19. Such enquiries will raise legal issues related to data privacy. While employers can request medical information from their employees, it is important to note that such information will constitute personal data. As a result, employers must specify the purpose of collection of such data, how it will be used, how long it will be retained and whether it will be disclosed to a third party. Such data will also have to be held securely.

The precise scope of an employer's data privacy obligations (including whether any consents are required and which jurisdiction's privacy laws apply) will vary on a case-by-case basis and it is important that they are considered as such.

Conclusion

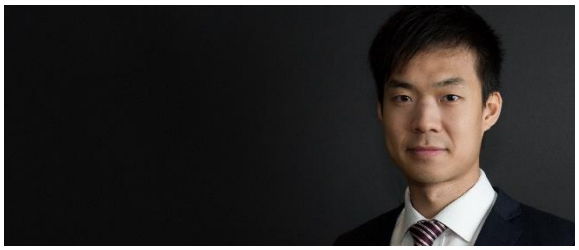
The situation related to the Covid-19 outbreak is rapidly evolving and will likely continue to do so for some time yet. As such, the issues potentially affected organisations will need to consider will develop in parallel. The issues discussed in this briefing represent what we consider to be those which should be at top of the agenda for organisations at present. However, it is not an exclusive list and we will share our thoughts on further issues in due course.

Wynne Mok
Partner
T +852 2901 7201
E wynne.mok@slaughterandmay.com

Ruby Chik
Associate
T +852 2901 7292
E ruby.chik@slaughterandmay.com

Kevin Warburton
Counsel
T +852 2901 7331
E kevin.warburton@slaughterandmay.com

Jonathan Kao
Associate
T +852 2901 7227
E jonathan.kao@slaughterandmay.com



Jason Cheng
Associate
T +852 2901 7211
E jason.cheng@slaughterandmay.com

Dated February 2020