SHEARMAN & STERLING

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UK 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 solicitor prior to taking actions regarding your business so that you can properly evaluate your specific circumstances, applicable laws and other considerations.

Recommended Considerations

Below, we highlight some of the recommended considerations for business owners to focus their attention on over the next several months:

- Impose any precautionary measures to keep your employees healthy.
- Discuss with your customers any solutions to mitigate disruptions.
- Take mitigation actions to suppress any adverse effects of the pandemic on your business.
- Review your commercial agreements and consider if you can trigger any specific terms related to MAE, force major or termination. Be mindful of any notice requirements. Do take advantage of the remedies that might be available to you.
- Review and, if necessary, revise your business plan.
- Consider if you need to recalculate and extend your runway.
- Re-assess your funding needs and options. Do you need to extend your existing equity round?
- Do not assume the funding process will go quickly even if you had secured financing before the COVID-19 broke out.
- Communicate with your investors on a timely basis.
- Consider your eligibility for, and accessing, the government support package.
- Do not assume that you can secure government support quickly enough.
- Inform your lenders of any anticipated breaches under your existing loan agreements.
- Explore any repayment options with your lenders.
- Consider taking advantage of the new U.K. tax measures.
- Consider applying for the Coronavirus Job Retention Scheme.
- Be mindful not to miss any notice periods.

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 fulfil your own obligations to your own customers. After identifying likely supply chain disruptions, pre-emptively 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 fulfil 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 re-open, a large portion of manufacturers are likely to prioritise 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 utilised 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 prioritise businesses that are deemed "essential" under the lockdown 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 lockdowns, 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, recission 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 your solicitors 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 contractual 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 lockdown 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. For additional information, please see "COVID-19: Force Majeure Event?"

II. Material Adverse Effect or Material Adverse Change Clauses. 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 the lockdown 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 Provisions. 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 scrutinise 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 analyse their agreements in light of potential non-compliance, either by themselves or the counterparty, and understand their rights and obligations; (ii) consider pre-emptively 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 have heard that the U.K. government is freezing evictions and foreclosures. How does this affect me?
The U.K. government will be implementing various relief efforts to protect from eviction commercial tenants who cannot pay rent due to the financial hardships caused by COVID-19 and its economic impact. The measures were introduced under the emergency Coronavirus Act 2020 and will help commercial tenants to avoid evictions if they miss a payment in the next three months in England, Wales and Northern Ireland. Commercial tenants will still be liable for the rent after this period, but the Government will be able to extend the freeze if needed. The freeze on evictions is coming alongside £330 billion of bailout loans.

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?

As Coronavirus Act 2020 is expected to provide tenants with temporary relief to ease cash-flow concerns, you should:

I. open communications with your landlord immediately as the legislation does not suspend the right of the landlord to be paid this rent or other payments, only the landlord's right to forfeit the lease for non-payment until the moratorium ends; and

II. review your loan documents for any obligations which may be breached by virtue of this non-payment of rent or other sums as they fall due. In particular, you should review the provisions for any events of default and any applicable grace periods provided therein.

Your landlord may be willing to grant a revised payment plan, rent abatement or reduced rent after the expiry of the relief provided under the Coronavirus Act 2020. If you are still able to meet your financial obligations, but are in breach of non-financial obligations under your lease, the Coronavirus Act 2020 may limit the ability of your landlord to enforce any covenant that has been breached until 30 June 2020.

After the relief expires on 30 June 2020, your landlord is under no obligation to provide any financial accommodation, so you should clearly understand your rights under your lease in the event you are not able to make rent payments at such time. 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 lockdown 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 U.K. 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.

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

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 legal 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 gives the lender an immediate 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. The types of remedies that the lender may pursue typically include acceleration of the principal and interest, termination of the lender's obligation to fund any unfunded credit facility, foreclosure on the company's assets or the application of default interest.

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

I. Failure to Pay Principal and Interest. Your failure to pay principal and interest on time is an event of default. Although it is unlikely that a loan agreement will provide a grace period for the failure to pay principal, there may be a grace period for failure to pay interest. Failure to pay principal is often an immediate event of default, which means that the lender can exercise its remedies under the loan agreement immediately upon the non-payment of principal. In contrast, an event of default with respect to non-payment of interest is likely to provide a grace period so the event of default (and a lender's ability to exercise remedies) will only be triggered after the expiration of the grace period.

II. Breach of Affirmative Covenants. Loan agreements often include affirmative covenants (sometimes referred to as "undertakings"), which require a borrower to perform a particular action. Examples of affirmative covenants include covenants to provide certain information, such as financial statements, churn/attrition analysis and key changes and progress of software development, covenants to notify the lender if a material contract has been terminated or there is a material breach and covenants relating to the company's business, such as maintaining a license or approval and ensuring the company owns or has the right to use all intellectual property necessary for the conduct of their business. Affirmative covenants often include a grace period, so a breach thereof will not constitute an event of default until the expiration of the grace period. Affirmative covenants that might be impacted by the COVID-19 pandemic is the obligation to discharge material payments and also the obligation to notify the lender of the termination or material breach of a material contract. If you are unable to pay your material obligations because of the economic slowdown related to the COVID-19 pandemic or one of your material contracts is in breach or has been terminated, you should review your loan agreement to check whether this impacts any of your obligations under the affirmative covenants. Other potential examples of potential breaches of affirmative covenants arising out of the COVID-19 pandemic include temporary cessation of business due to the lockdown, 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 action. 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, which are proxy for financial health of the borrower. For example, the loan agreement may require a borrower to maintain a minimum level of liquidity, and also comply with a recurring revenue ratio (or leverage ratio) and possibly a maximum churn rate. Borrowers with financial covenants should be aware that the economic effects of the COVID-19 pandemic are widespread likely to be severe and often there are no grace periods for rectifying a breach of a financial covenant.

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, this will also be considered an event of default.

VII. Material Adverse Change. Loan agreements will sometimes include material adverse change as an event of default. Since the language is often very subjective, it is important to carefully review the language (with your solicitors, if needed) to determine whether the impact of the COVID-19 pandemic could constitute a material adverse change event of default as determined by the lenders.

There may be serious consequences to the manner in which you manage your relationship with your lender, and we recommend you consult your solicitors 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?

Under typical English law loan agreements, borrowers are generally able to fully draw all committed credit lines provided by their lenders; however, for receivables-based facilities, the ability to draw and the amount that can be drawn will be based on qualifying accounts receivables. Typically, however, lenders are only required to fund their commitment under a revolver when (i) no default exists or would result from the borrowing and (ii) the representations and warranties provided in the loan agreements are true and correct in all material respects on the date of the request. It is important to contact your solicitors to discuss your rights and obligations under any revolver or other credit facility as to the extent that your lender reasonably determines that the COVID-19 pandemic has resulted in a Material Adverse Change to your business you may not be able to draw on your revolver.

Taxes

What types of tax relief efforts are underway?

On 20 March 2020, the U.K. government announced a series of tax and other measures aimed at supporting those impacted by COVID-19. The tax measures included an automatic deferral of any VAT liabilities arising for payment between 20 March 2020 and 30 June 2020 until 31 March 2021. There is also a deferral until 31 January 2021 for income tax payments on account for 31 July 2020—broadly speaking, the payments on account system requires certain individuals, typically in the self-employed sector, to make two advance income tax payments for the current tax year, based on the individual's income tax liability for the previous tax year. In accordance with previous announcements, for certain retail, hospitality and leisure businesses, there will be a 12-month business rates holiday. This is in addition to Small Business Rate Relief, which can provide full or partial business rates exemption for small businesses which occupy a single property of rateable value below £15,000.

Notably, however, no deferral or other changes have been made in relation to U.K. corporation tax charged on the profits of U.K. companies.

For additional insights, please see "U.K. Government Includes Tax Deferral in COVID-19 Business Support Package."

I'm concerned I won't be able to pay my taxes on time. What are the consequences?

Failure to pay taxes by their due date can result in interest and penalties becoming due for late payment. Late payment interest is generally calculated on a daily basis from the date the tax is due until the date the tax is paid. The relevant rates were reduced at the end of March 2020 following recent cuts to the Bank of England base rate, and include a drop in the rate applicable to main business taxes on 30 March 2020 from 3.25% to 2.75%. Penalties for late payment differ depending on the tax in question and may be calculated taking into account the wider circumstances around non-payment. Currently, small companies (falling outside the quarterly instalment payment regime) would be charged interest rather than penalties for the late

payment of corporation tax, although penalties can apply to these companies in respect of other taxes, and for other defaults such as the late filing of tax returns.

With respect to the particular tax deferral measures referred to above, the U.K. tax authority (HMRC) has clarified that no interest or penalties for late payment will be charged during the deferral period.

If a business is in financial distress and has outstanding tax liabilities, it may be eligible to receive support with its tax affairs through HMRC's existing "Time to Pay" service. This service allows taxpayers facing financial or administrative challenges in paying HMRC on time to apply for tax to be paid in instalments and, in certain cases, for the suspension of debt proceedings. The arrangements are agreed on a case-by-case basis and would be tailored to the individual circumstances and liabilities of the business. Late payment interest may still run during a "Time to Pay" arrangement, and penalties accrued before the arrangement came into effect may still be charged, unless HMRC specifically agree to cancel these amounts under the terms of the particular arrangement. To assist with the anticipated increase in "Time to Pay" applications due to COVID-19, HMRC have launched a designated Coronavirus helpline, which is expected to be manned by 2,000 call handlers providing assistance and support to affected businesses.

Employee Matters

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

In the U.K., all employees will have individual employment contracts. Apart from certain types of atypical workers (such as zero-hours workers), most regular workers will have a contractual right to work a certain number of hours and receive a certain agreed wage/salary. Failure to pay such wages or salary will be likely to be a material breach of contract by the employer, which would either enable the employee to resign and claim he/she had been constructively dismissed or remain in employment and sue the employer for breach of contract.

Although U.K. law does have a concept of "lay off" (where an employer can effectively require the employee to take unpaid leave because the employer does not have any work to provide to him/her) or short-time working (where an employee works reduced hours or is paid less than half a week's pay), this can only be imposed on an employee where the employment contract contains a right for the employer to do so. In practice, although this was more common in the 1980s, it is highly unusual nowadays to see U.K. employment contracts containing such a right. As such, if an employer wishes to place an employee on lay-off or short-time working, it would generally need to implement this with employee consent, otherwise it would run risks of constructive dismissal/breach of contract claims.

The U.K. government has, however, launched the Coronavirus Job Retention Scheme. Under this Scheme, employers will be able to apply to HMRC for the government to reimburse up to 80% of an employee's wages (up to a maximum of £2,500 per month) where the employee is placed on "furlough" leave (see below for details). It is open to the employer to top up the remaining 20% of the employee's salary if it chooses, but it is not obliged to do so. The government has stated that the Job Retention Scheme will be in place for at least three months, and it may consider extending it. It covers regular full-time and part-time employees as well as employees on agency contracts and employees on flexible and zero-hours contracts. The Scheme also covers employees who have been dismissed by their employer since 28 February 2020, if they are rehired by the employer.

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

Companies should carefully consider the timing of making incentive grants, such as whether the market disruptions will adversely affect the fair market value of the securities underlying the grants. Delaying grants not only may de-motivate employees, but may also result in substantial windfalls for management if the price is artificially low. As the valuations of companies decline, companies may need to issue more options to incentivise employees, potentially resulting in increased dilution to existing stockholders. Additionally, 2020 incentive targets may need to be revisited in light of rapidly changing circumstances. For additional insights, please see "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 present, the U.K. has not introduced any restrictions on implementing redundancies in connection with the COVID-19 crisis. There are, however, certain issues that need to be borne in mind as a matter of established U.K. employment law in implementing redundancies.

The employer will need to establish that there is a genuine redundancy situation as defined under U.K. employment law and will need to follow established procedures to implement the redundancies, which in broad terms involve certain requirements to warn and consult individuals (and implement a fair redundancy selection process) before final decisions are made on who is made redundant. If the employer cannot establish a redundancy reason and/or fails to follow a fair redundancy process, this may give rise to claims for unfair dismissal (but generally only employees with two or more years' service have the right to claim unfair dismissal). As part of the fair redundancy process, the employer may also need to consider whether it is possible to furlough the employee and place them on the Coronavirus Job Retention Scheme instead of making them redundant. The employer will also need to give the required period of notice of termination under individual employment contracts (or pay in lieu of such notice periods). In addition, if the employer is proposing to make 20 or more redundancies at one establishment in a 90-day period or less, it will need to engage in a consultation process with any recognised trade unions (or, if there are none, elected employee representatives) prior to implementing the redundancies. That consultation must last a minimum of 30 days (where the employer proposes between 20 and 99 redundancies in that 90-day period or less) or 45 days (where the employer proposes 100 or more redundancies in that 90-day period or less). Failure to undertake such consultation requirements can result in awards of up to 90 days' pay (pay is uncapped for these purposes).

Statutory redundancy payments are calculated according to a set statutory formula based on the employee's age, length of service and weekly wage (a "week's pay" is capped at £538 per week (from 6 April 2020)). If the employer has an established policy or practice under which it pays enhanced redundancy payments in addition to the statutory minimum, it will need to consider whether that policy or practice is a legal entitlement of employees and, if so, what payments are due under such policy or practice.

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

As set out above, in order to qualify for the U.K. government's Coronavirus Job Retention Scheme, employees must be placed on furlough leave. This effectively means that employees are kept on as employees but must not perform any work whatsoever. If the employee is working (from home or not), but on reduced hours, or for reduced pay, they will not be eligible for the Scheme, and the employer will have to continue paying the employee through payroll and their salary/wages will be subject to the terms of the employment contract agreed with the employee. Government guidance recommends that employers should discuss furloughing with their staff and make any changes to employment contracts by agreement with employees. Employers should then write to their employees confirming that they have been furloughed and keep a record of this communication.

Are there any government-mandated changes to sick leave policies?

Prior to the COVID-19 crisis, U.K. statutory sick pay rules provided that an employee who was off work on sick leave was only entitled to Statutory Sick Pay (SSP) from the 4th day of such absence. The government has announced that it is temporarily changing the SSP rules so that SSP will be payable from day 1 rather than day 4. SSP will also be available to individuals who are not ill but are unable to work because they have been told to self-isolate in line with government guidance. In addition, individuals who are advised to self-isolate for COVID-19 reasons will be able to obtain an alternative to the fit note to cover this by contacting NHS111 rather than visiting a doctor.

Instead of making employees redundant or placing them on furlough, can I reduce the salaries of my employees to save costs?

Reducing the salaries/wages of employees is an option that many employers are considering in response to the COVID-19 crisis. However, most employees will have a contractual right to a certain salary and it would be highly unusual in U.K. employment contracts for the employer to have a right to reduce salaries unilaterally. As such, if the employer is to reduce salaries, it would normally need to obtain the consent of relevant employees to implement the change without risk. If the employer sought to impose such changes without consent, this would incur risks of employees either resigning and bringing claims on the basis that they had been constructively dismissed or the employees remaining in employment, not accepting the change and claiming against the employer for breach of contract or unlawful deductions from wages. Some employers may take the view that, in the circumstances, there may not be enough time to obtain the consent of all employees and may simply impose the change unilaterally and take a view on the relative risks of employees resigning and claiming constructive dismissal. An alternative approach to implementing such changes without employee consent may be to terminate the employment of relevant employees and offer immediate reemployment on the lower salary, but again this may run risks of unfair dismissal claims (but likewise the employer may be willing to take a view on the relative risks of such claims) but may be perceived as being more aggressive in terms of employee relations.

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," "lockdown" and "essential businesses only" orders) are not likely to be covered.

Business interruption insurance provides extra coverage against losses resulting from physical loss, damage or destruction to tangible property caused by disasters such as fires, windstorm floods, losses by theft 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 pay-outs, unless additional cover has been purchased. In addition, policies can contain express coverage exclusions for losses due to communicable diseases, particularly those concerning virus or bacteria, which were put in place in the aftermath of the 2003 SARS outbreak. Notably, on 17 March 2020, the Association of British Insurers stated that "*Standard Business interruption cover—the type the majority of businesses purchase—does not include forced closure by authorities as it is intended to respond to physical damage at the property which results in the business being unable to continue to trade.*"

If the policy does cover closure as a result of disease, consideration should be given to whether the policy specifies particular contagions which are covered. With COVID-19 being a relatively newly discovered virus, any policy which specifies particular pathogens may not include the COVID-19 amongst its list of covered diseases. Finally, some coverage may exist if the business has purchased a "non-damage, denial of access" extension to a business interruption policy. Again, purchase of these extensions tend to be rare.

You should carefully examine the specific language of your business policies to determine whether any income losses from the COVID-19-related shutdowns may qualify for coverage. In addition, policyholders should stay apprised of developments in the interpretation and treatment of business interruption insurance by the courts.

Are there any efforts to provide coverage or support for COVID-19 losses?

Members of the U.K. Parliament's Treasury Committee have written to the Association of British Insurers, requesting data on how members intend to consider claims for losses in connection with COVID-19. Furthermore, the U.K.'s Financial Conduct Authority has published guidance stating that it expects insurance firms to carefully consider the needs of their customers and to show flexibility in their treatment of them.

It remains to be seen when, in what form and from whom further relief will come, if at all, as Parliament, the Financial Conduct Authority and Prudential Regulation Authority, private industry groups and/or other groups continue to work together to provide relief to affected businesses.

Firms are also advised to consider the COVID-19 financing that has been made available. Whilst these forms of support do not amount to insurance (rather, taking the form of a loan, overdraft or commercial paper, etc.) they may assist businesses wanting to access liquidity during a period in which trading has ceased as a result of the current global pandemic.

Fundraising and Investor Relations

What funding is available to impacted business?

In the U.K., additional support for business interruption has been announced in the form of:

a. the Coronavirus Business Interruption Loan Scheme (CBILS);

b. the Coronavirus Large Business Interruption Loan Scheme (CLBILS); and

c. the Bank of England's COVID Corporate Financing Facility (CCFF).

The CBILS is operated by the British Business Bank through accredited lenders. It offers financial assistance in the form of loans, invoice finance, overdrafts and asset finance up to £5 million. In turn, the U.K. government guarantees lenders 80% of the value of each loan made and will also cover the interest payments and lender fees of the loan for the first 12 months, so smaller businesses will benefit from no upfront costs and lower initial repayments. As part of the scheme, the government has prevented lenders from requesting personal guarantees on loans of less than £250,000. For loans of more than £250,000, lenders may only require a personal guarantee of 20% of any amount which remains outstanding after recoveries have been made from business assets. The principal private residence of those extending the personal guarantee should not be pursued, irrespective of the lent amount. However, this facility is limited to those businesses which have an annual turnover of up to £45 million and which meet the other CBILS eligibility criteria.

The CLBILS is an additional scheme, announced on 3 April 2020, aimed at assisting larger businesses. Whilst at the time of publishing this note, full details are yet to be made available, the intention is that the facility

will enable businesses with an annual turnover of between £45 million and £500 million to access government backed loans. The government will guarantee lenders up to 80% of the value of each loan with a maximum loan value of £25 million. Loans backed by a guarantee under CLBILS will be offered at commercial rates of interest and further details of the scheme will be announced later in April.

Alternatively, the CCFF, jointly provided by HM Treasury and the Bank of England, provides assistance to larger firms through the purchasing of commercial paper (limited up to one-year maturity). Note that banks, building societies, insurance companies and other financial sector entities regulated by the Bank of England or the Financial Conduct Authority will not be eligible. Furthermore, commercial paper issued by leveraged investment vehicles or from companies within groups which are predominantly active in businesses subject to financial sector regulation are also not eligible. Companies wanting to access these schemes must do so via a bank and meet the other criteria for the scheme. For firms to meet these criteria, they would usually be U.K. incorporated (including those with foreign-incorporated parents) with a business in the U.K. A firm should also be able to show it had a minimum credit rating of investment grade as at 1 March 2020. However, if a firm does not have a credit rating then they are encouraged to discuss this with their bank prior to contacting the Bank of England. The full criteria for participating in the CCFF can be found at the Bank of England's CCCF information page.

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 instruments. Convertible Note financings can be closed quickly and inexpensively, often requiring limited documentation (*i.e.*, board and stockholder consent, a pre-emptive rights waiver and form of note). 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 authorised 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 your 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.

Regulatory Issues for FinTech Companies

Is there any U.K. government action to ensure our partner banks keep originating loans?

The Bank of England has announced an emergency rate cut to 0.1%. The Bank of England has also expanded its Term Funding Scheme with additional incentives for supporting small businesses, reduced the countercyclical capital buffer rate to 0% and increased the purchase of U.K. government bonds and sterling non-financial investment-grade corporate bonds. The Prudential Regulation Authority has issued a statement welcoming the decision made by large U.K. banks to suspend their dividend and buyback programmes and has published guidance stating they also expect banks to carefully consider payment of bonus pools. As set out above, the Government has also introduced the COVID Corporate Financing Facility and the Coronavirus Business Interruption Loan Scheme. These policy decisions and schemes are designed to free up capital and support lending activity, in particular to small businesses.

What should we do if our compliance function is short-staffed?

The FCA has stated that that they “expect all firms to have contingency plans to deal with major events” and that firms should “take all reasonable steps to meet the regulatory obligations which are in place to protect their consumers and maintain market integrity.”

The FCA is mindful of the exceptional circumstances faced by firms and has published COVID-19 specific guidance, that regulated FinTechs are encouraged to consider. Generally, firms are encouraged to maintain their dialogue with their regulators if they believe they may be unable to meet their regulatory requirements.

Finally, we note that there has been a series of discussions on what constitutes a "key worker" in the U.K. context. On Thursday 20 March 2020, the FCA followed up the U.K. government's announcement on Key Workers by stating:

> "*A key financial worker at a dual-regulated, FCA solo-regulated firm or PSR-regulated firm, or operators of financial market infrastructure, fulfils a role which is necessary for the firm to continue to provide essential daily financial services to consumers, or to ensure the continued functioning of markets*."

As part of this advice, the FCA highlighted that those individuals performing "risk management, compliance, audit and other functions necessary to ensure the firm meets its customers' needs and its obligations under a regulatory system" may be considered as providing essential service and could be treated as key workers by their employers accordingly.

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 ShearmanFinTech@Shearman.com.

For further questions or concerns, please see our COVID-19 Resource Centre.

THIS NEWSLETTER IS INTENDED ONLY AS A GENERAL DISCUSSION OF THESE ISSUES. IT SHOULD NOT BE REGARDED AS LEGAL ADVICE. WE WOULD BE PLEASED TO PROVIDE ADDITIONAL DETAILS OR ADVICE ABOUT SPECIFIC SITUATIONS IF DESIRED. IF YOU WISH TO RECEIVE MORE INFORMATION ON THE TOPICS COVERED IN THIS PUBLICATION, YOU MAY CONTACT YOUR USUAL SHEARMAN & STERLING REPRESENTATIVE OR ANY OF THE FOLLOWING:

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