

Client Alert

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Private Equity: Restriction of Movement Order and the Implications on Deals and Portfolio Companies

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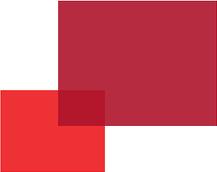
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1. Announcement

Following the global coronavirus (COVID-19) outbreak and the recent spike in COVID-19 cases in Malaysia, the Malaysian Prime Minister announced a Restriction of Movement Order ("**the Order**") on 16 March 2020 as a measure to curb the outbreak. This Order will last for two weeks, starting from 18 March 2020 to 31 March 2020 and is effective nationwide.

Restrictions under the Order	
No mass gatherings	Closure of premises
General prohibition on mass movements and gatherings across the country including religious, sports, social and cultural activities.	Closure of houses of worship, business premises as well as all government and private premises.
Closure of education sector	Travel ban
Closure of all kindergartens, government and private schools including daily schools, boarding schools, international schools, tahfiz centers and other primary, secondary and pre-university institutions, and public and private higher education institutions (IPTs) and skills training institutes.	All Malaysian citizens are prohibited from travelling out of Malaysia and those returning from overseas travel must undergo a health check and to undergo quarantine or self-quarantine for 14 days. All tourists and foreign visitors are prohibited from entering Malaysia.

Exceptions to the closure of premises	
Essential Stores	Essential Services
Supermarkets, public markets, convenience stores (including convenience stores selling everyday necessities).	Water, electricity, energy, telecommunication, postal, transportation, irrigation, oil, gas, fuel, lubricants, broadcasting, finance, banking, health, pharmacy, fire, prison, port, airport, safety, defence, cleaning, retail and food supply.



2. Implications on private equity deal activity

(a) Regulatory uncertainty

Private equity ("PE") deals that are executed pending the resolution of the Order will require a degree of flexibility. With the shutdown of all but the Essential Services, securing necessary regulatory approvals and third party approvals will be delayed. Provisions should also be made in transaction documents to give target companies the flexibility to make adjustments to their ordinary business practices given consequential restrictions in the supply chain, workforce and other constraints.

(b) Material adverse change clauses

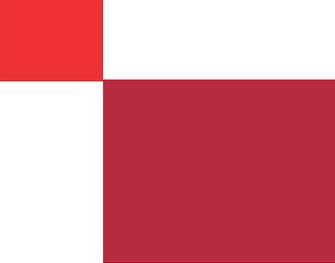
We anticipate increasing ask for material adverse change ("MAC") clauses and for the effects of pandemics or epidemics to be included as a MAC provision. We also expect other related concepts to find their way into transaction documents (e.g., references to lockdowns, travel restrictions, quarantines, workforce disruption etc.). It will be hard to allocate the risks arising from the COVID-19 outbreak between buyers and sellers. Consequently, we also see high transaction uncertainty for deals in particularly hard hit sectors such as hospitality, retail, aviation and tourism.

Warranty and indemnity (W&I) insurance is unlikely to help mitigate risk as insurers are already proposing exclusions related to COVID-19 that can vary in scope.

(c) A buyer's market

Sellers will have to demonstrate that they are serious and credible. We anticipate an increasing application of stringent vendor due diligence and earnest prepping of a target company for a serious go-to-market sale strategy. It is also likely that buyers will negotiate for the application of earn-outs, retention amounts and deferred payments.

By the same token, buyers may also opportunistically push to reduce their risk and advocate for a simultaneous signing and closing, although in a heavily regulated environment such as Malaysia, this may not always be possible. There will likely be an increased demand for indemnities and warranties and longer limitation periods.



3. Implications on portfolio companies

(a) Force majeure

A force majeure ("FM") clause is a provision that often appears in commercial contracts and excuses a party's failure to perform as a result of unanticipated events outside of the party's control. An FM clause may relieve a party from liability arising from their inability to fulfil their contractual obligations due to circumstances beyond their reasonable control. Performance is usually suspended for a short period or the duration of the FM event. If the FM event is prolonged or permanent then



the clause may allow either party to terminate the contract. Interpretation of the specific FM clause is necessary to ascertain if the FM clause can be invoked and whether COVID-19 constitutes an FM event depends on the FM clause itself.

It will be crucial for portfolio companies to identify quickly if they need to revisit any key contracts (tenancies and leases, supply, manufacturing, service etc.) to determine if it is possible to invoke the FM clause to suspend or relieve itself from its obligations (such as rental payments). For new contracts, provisions covering similar eventualities should also be strategically reviewed and drafted.

In addition to commercial contracts, portfolio companies should also look carefully at its financing agreements, insurance policies, investment agreements and any other contracts that may be affected by the current situation for similar FM clauses.

(b) Frustration

The doctrine of "frustration" may also apply to similar circumstances that would trigger an FM clause. There must be a supervening event (frustrating event) that is not the fault of either party, significantly changes the nature of the contractual rights and/or obligations and makes it unjust to hold the parties to the contract. It is not sufficient if the event makes it more expensive or onerous or impracticable to perform the contract, nor if an alternative method of performance is available. Frustration results in the termination of the contract, and the terms of the contract cease to operate. The Court then has a wide discretion to allocate the parties' rights and liabilities, including restitution of monies paid or payable, claim for expenses incurred and compensation for benefits rendered to the other party prior to the frustration of the contract.

Similar to the FM clause, portfolio companies should identify quickly if there are any contracts that would qualify as being 'frustrated' and determine if it wishes to terminate these contracts on that basis.

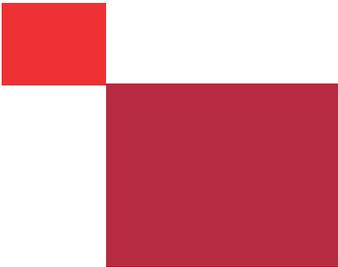
(c) Insurance

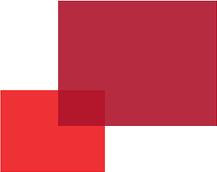
Portfolio companies may wish to consider the availability of business interruption policies where applicable and commence engagement with insurers.

(d) Workforce management

Portfolio companies will face concerns of decreased revenue and the ability to maintain overhead and operational costs including payment of wages. Some business have also indicated the possibility of implementing retrenchment exercises in light of COVID-19.

The following is general guidance to commonly asked questions.





(i) Closure of business premises

Unless a portfolio company can be operated remotely/virtually (i.e., employees can work from home), or it falls within the Essential Services sector or is one of the Essential Stores, the business will have to be closed. In such instance, portfolio companies will have to consider alternative work arrangements, such as:

- to the extent practicable, implement work-from-home arrangements; and
- arrange for meetings to be conducted virtually (by video or audio conference).

(ii) Travel restrictions

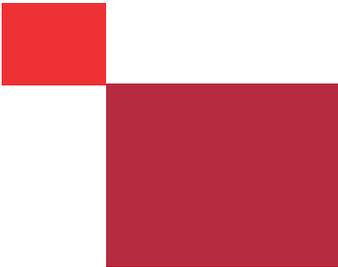
The travel ban and requirements will affect physical business meetings. Pending further clarification from the Malaysian Government, although the Minister's announcement only referred to Malaysian citizens, it should similarly apply to non-Malaysian citizens who have been issued with a pass (other than a social visit pass) to remain in Malaysia.

(iii) Are portfolio companies required to pay employees during the implementation of the Order?

Yes. The Malaysian Government has not made any announcement which exempts employers from making salary payments. There are guidelines stating that employers should continue making salary payments to its employees during any quarantine period, whether the employee is working or not. Whilst not law *per se*, the guidelines will most likely be considered by the Industrial Court when determining the issue of constructive dismissal.

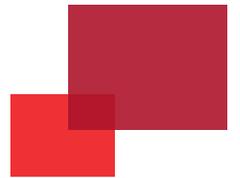
(iv) Can employees work from home or are they required to be given paid time-off?

Employers can request employees to work from home, where it is practical. The employer should provide the employees with the necessary facilities to work from home, otherwise an employer may be exposed to potential liability arising from lack of appropriate facilities to properly conduct his/her work. If the nature of the operations do not allow for work-from-home arrangements, then employees must be placed on paid-leave. Employees will need to be paid throughout the restriction period and the employees cannot be required to utilise their annual leave.



(v) Can portfolio companies force employees to take unpaid leave/pay-cut?

Forcing employees to take unpaid leave or a pay-cut is a unilateral variation of their employment terms and employers run the risk of facing a constructive dismissal claim. Employers should obtain prior



consent of its employees where it is seeking to require its employees to take unpaid leave or a salary reduction. These requests are typically made before the employer decides on more drastic cost-cutting measures, such as workforce reduction or business closure. Employers must be careful to ensure that the minimum statutory annual leave entitlements afforded to employees protected under the Malaysian Employment Act, and to all employees under the Minimum Wage Order, are followed.

(vi) Can portfolio companies implement a retrenchment exercise?

Businesses must demonstrate that it had taken steps to avert retrenchment if faced with an unfair dismissal claim. Specifically businesses must ensure that:

- it has a legitimate business case to implement a retrenchment exercise, and such business case is supported by substantive evidence; and
- it has implemented the retrenchment exercise in a fair manner in line with Malaysian industrial practice standards, such as, among others, complying with termination notice obligations and providing severance payments.

Special considerations also apply to employees protected under the Malaysian Employment Act.

4. Conclusion

There is a possibility of the Order being extended and or amplified, so we would also advise watching developments closely.

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