

COVID-19 - Issues to Consider in M&A Transactions



Due diligence

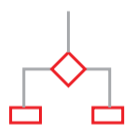
One of the most immediate impacts of COVID-19 will be on the potential increased scope of the due diligence process. The following are likely to be important considerations for buyers and sellers:

- the extent to which the target is affected by restrictions on commerce;
- contractual termination provisions and ongoing negotiations between the target and counterparties;
- exposures, safeguards, mitigation and contingency plans relating to COVID-19;
- solvency risk and impact on revenues;
- potential changes to the legal and regulatory landscape;
- extent of coverage under the target's insurance policies; and
- restrictions on the target's ability to access and provide due diligence information, permit on-site inspections and facilitate operational due diligence.



Representations, Warranties and Indemnities

Buyers and sellers should carefully consider the wording of each indemnity, representation and/or warranty in light of COVID-19. For acquisition agreements that have been signed and are awaiting completion, representations and/or warranties that are to be repeated on completion may be untrue and require supplemental disclosure (where provided for in the acquisition agreement) due to the impact of COVID-19. For acquisition agreements currently under negotiation, additional representation and/or warranty protection relating to COVID-19 (particularly relating to risk assessments prepared by the seller and information gathering provisions) is likely to be considered by buyers. Sellers should adopt an increased focus on disclosure around the potential impact of COVID-19 and consider seeking general liability exclusions for COVID-19 related risks, ring-fencing COVID-19 claims to specific representations and/or warranties, and limiting recovery on the basis of the buyer's knowledge and changes in law. Specific indemnities may be appropriate, particularly where high impact COVID-19 related risks have been identified by the buyer during the due diligence process.



Interim Operating Covenants

Buyers and sellers should consider whether interim operating covenants which require the target business to operate in the ordinary course between signing and completion and to refrain from taking certain actions without the buyer's approval may conflict with the target's response to COVID-19, including how voluntary (yet prudent) actions to limit the potential exposure to COVID-19 should be construed. There should be particular focus on covenants relating to specified activities, such as incurring additional debt and employee related matters, as well as general carve outs for matters required by law or regulation. Compliance with interim operating covenants should be closely monitored by buyers and sellers between signing and completion.



Material Adverse Change ("MAC") Clauses

Typically MAC clauses are designed to address the unexpected, rather than known risks and will often carve out general economic or market conditions or events affecting an industry generally, except to the extent a target business is affected disproportionately to its industry peers. For acquisition agreements currently under negotiation, consider including specific language to address the COVID-19 risk allocation in the context of a MAC clause, or in a bespoke closing condition tailored to specific risks, or triggered by a financial impact, attributable to COVID-19. The extent to which a MAC clause can be triggered in acquisition agreements that have been signed and are awaiting completion is highly fact specific and will depend on the specific language used in the acquisition agreement.



Long-Stop Dates

Buyers and sellers should consider whether requirements to obtain third party approvals/consents, or satisfaction of regulatory or other closing conditions, are feasible or may take longer than might otherwise have been anticipated. It would be prudent to consider which party should bear the risk of a delay to completion, including the circumstances in which a long stop date may be extended or adapted. For acquisition agreements that have been signed and are awaiting completion, where a long-stop date is in place and closing is unlikely to occur by that date as a result of COVID-19, consider whether there is an option to terminate the agreement or extend the long-stop date (whether under the contractual terms of the acquisition agreement or by mutual agreement).



Valuation, Pricing and Acquisition Financing

Valuations may become more challenging as parties seek to measure the short and long-term impact of COVID-19 on the target's business. There is likely to be an increased focus on the allocation of pricing risk between signing and closing, which may increase the use of earn-outs, retention provisions, deferred consideration or other forms of contingent consideration in place of fixed pricing mechanisms.

In relation to transactions where acquisition financing is being used, buyers should look to include a financing condition where there is a split signing and completion to avoid a situation where the buyer is unable to complete the contract as a result of the lender withdrawing finance as a consequence of the rapidly changing economic environment. Buyers should in any case be having regular discussions with their lenders to the extent there is greater flexibility required to the target's financial covenants to reflect the impact of short term adjustments to cash flow.

For more information, please contact [Madeline McDonnell](#) or [Michelle Hughes](#) or your usual Matheson contact.