

COVID-19: Impact on Your M&A Deals Under English Law

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Having begun as a fairly localized issue in the centre of China, the COVID-19 outbreak has spread rapidly across borders, significantly impacting the global economy and causing havoc in financial markets. The impact has been across all sectors, from transport and tourism to manufacturing, technology, energy, retail and beyond.

Amidst the market volatility and worsening newsflow, buyers that have entered into purchase transactions at pre-crisis valuations may be seeking to terminate transactions or renegotiate purchase prices prior to closing. This is particularly so where the target has trading links with those parts of the world that are most severely affected, but as the virus spreads the temptation to renegotiate or to walk away from contractual commitments is likely to become more intense.

Please note that the analysis below is specific to acquisition agreements governed by English law.

Existing deals

Where a buyer has exchanged contracts on a transaction but is looking to walk away from the transaction prior to closing – where, for example, the target has been materially impacted by the COVID-19 outbreak or even where the buyer itself is no longer in a position to proceed to completion – there are a number of contractual provisions that may be relevant and which need to be closely analysed.

Termination rights and conditions precedent

For a buyer looking to walk away from a transaction, any express termination rights, as well as the conditions precedent to completion, will be relevant.

Is there a MAC (material adverse change) or MAE (material adverse event) condition that would allow the buyer to refuse to complete? Whether COVID-19 falls within a MAC/MAE clause will depend on the precise wording, including any applicable exclusions (broad changes in general market conditions are often excluded). It may be more difficult to rely on a MAC/MAE walk-away right in circumstances where the event or circumstance in question was known to the parties at the time the contract was signed but again this will depend on the precise wording and circumstances.

The sale and purchase agreement may also include a termination right for the buyer in the event of a material breach of warranty or other covenant occurring between signing and completion. Again these clauses need to be carefully reviewed and navigated. In particular, COVID-19 may trigger a breach of a warranty that would not otherwise have been breached in normal circumstances. This may be particularly relevant to warranties around financials, trading, pipeline and customer contracts where the position has materially changed as a result of the impact of COVID-19.

A buyer that develops cold feet about proceeding with a deal might also seek to use the other conditions precedent and associated deadlines to cause a transaction to fail. In particular, conditions that require some form of action or cooperation on behalf of a buyer (such as information sharing in the context of required competition or regulatory approvals) will need to be reviewed in

order to ensure that the buyer's obligations are sufficiently definite and clear. If such obligations are framed in terms of 'reasonable obligations' or similar standards, they are likely to be at risk of gaming by a reluctant buyer.

Acquisition agreements should also be analysed for various other potential walk-away rights, whether based on rescission or frustration. However, we would typically expect such rights to be specifically excluded.

Pre-completion covenants

Acquisition agreements typically include pre-completion covenants on the part of the seller, including that they will operate the target company in the ordinary course and obtain the buyer's approval before carrying out certain activities or operations. Operating in the ordinary course may be difficult in the extraordinary circumstances in which many businesses currently find themselves. However, sellers should review pre-completion covenants with a view to managing their obligations and ensure that a breach of these covenants does not give a buyer an excuse to terminate the deal or renegotiate its terms.

Repetition/bring-down of warranties

Where an acquisition agreement requires a seller to repeat or 'bring down' all or some of its warranties at completion by references to the circumstances at that time, this may give a buyer an opportunity to terminate the transaction or claim damages, where circumstances beyond a seller's control have rendered the warranties untrue at completion.

Timetable

Deals that have been signed are likely to take longer than anticipated to reach completion. In particular, transactions that require regulatory approvals or other governmental clearances or third party consents will be subject to processes that may well be seriously disrupted by the lockdowns imposed in many cities around the world.

Sale and purchase agreements will routinely include long stop dates by which closing must occur and typically include automatic termination rights if closing fails to occur by that date. The long stop date will often be a specific date but capable of being amended by mutual agreement.

Long stop dates should be reviewed and if there is a risk that completion may not occur on the relevant long stop date due to delays caused by COVID-19, an early extension should be sought. If one party is not willing to agree to an early extension that may serve as an early warning sign of their intention not to close or to keep their options open.

Parties should therefore review long stop dates and other timings set out in their acquisition agreements and strategize accordingly.

Future deals

For M&A transactions currently under negotiation, parties may need to reassess transaction timetables. In particular, do travel and other restrictions impact the ability to carry out physical due diligence or prevent physical meetings from taking place?

More importantly, valuation is likely to be a key point of contention, with bargaining power likely to have shifted decisively towards buyers over the last few weeks.

Due diligence is going to be focused on the target's ability to continue its operations in the new business environment. Areas of concern will include:

- Impact on revenues and potential solvency concerns
- Risks of counterparties terminating or suspending material contracts for frustration, force majeure or on some other basis
- The target company's and its counterparties' ability to comply with their material contracts
- Relationships with key suppliers, customers and other counterparties
- Potential supply chain disruptions and the target's ability to find alternative suppliers
- Impact of travel restrictions, social distancing measures and forced closures and shutdowns
- Potential insurance claims for business interruption and other losses

Buyers will obviously be keen to see warranties around all these issues. Knowledge and materiality qualifiers will be key mitigation measures for sellers, who should also be wary of giving forward-looking warranties and repeating warranties at completion.

Buyers may also want to impose conditions precedent around potential COVID-19 related eventualities and there will be a greater focus on material adverse change clauses and termination rights to specifically take account of COVID-19.

Sellers will also need to consider whether specific COVID-19 related disclosures are appropriate, including in relation to the impact on material contracts and the supply chain. Details of any contingency plan and other mitigation measures should also be disclosed. Sellers should also consider whether a general COVID-19 related exclusion of liability should be sought and whether virus-related claims can be ringfenced or boxed in other ways. Ultimately, however, with bargaining power likely to be more with buyers than sellers, many of these negotiating positions are likely to fall on deaf ears.

The Landscape

Buyers and sellers who have entered into sale and purchase agreements where closing takes place at a later date should review the agreements and take advice.

Buyers and sellers who are in the process of negotiating agreements where closing is conditional upon regulatory approvals, competition clearance, tax clearances, third party consents or another condition, should factor in the impact of COVID 19 so that all parties enter into the transaction with their eyes open and the transaction is successful.