

DOING DEALS DURING A PANDEMIC



While it is too early to predict the long-term impacts of COVID-19, this pandemic is already impacting whether and how buyers and sellers approach M&A transactions. To assist parties involved in current M&A transactions or who are considering new M&A opportunities, we have prepared the following list of key issues and considerations.



◆ Business and Market Disruption:

- ◆ **Deal Volume, Timing and Structuring:** The forced slowdown in the United States and global economies will likely impact M&A activity, with buyers exercising more caution and sellers unwilling to sell at lower valuations. These factors, among others, may cause a slowdown in the speed and overall volume of transactions, but may also increase the number of unsolicited bids for companies whose businesses or stock prices are negatively impacted by this crisis. In addition, companies that are experiencing supply chain disruptions and liquidity issues may need to consider restructuring their operations both in the short- and long-term.
- ◆ **Availability of Financing:** Buyers that do not have revolving credit facilities or other committed sources of capital may be more challenged in obtaining financing. This may result in the need for financing conditions in purchase agreements, increased use of seller notes and buyer equity as consideration, longer outside dates for deal completion, and the use of alternative financing sources.

◆ Purchase Price:

- ◆ **Valuations:** The combination of significant stock market declines, short-term business closures and revenue losses, and potential long-term damage to companies and the overall economy is upending target company valuations. In addition, falling interest rates will impact discounted cash flow analyses. Buyer and sellers may need to be more creative in bridging valuation gaps, including with earnouts or other valuation and risk-shifting mechanisms.
- ◆ **Working Capital Adjustments:** Immediate and dramatic revenue losses, collectability issues for accounts receivable and difficulties in projecting future business operations will make it more difficult to determine appropriate levels of target working capital and required cash on hand. Parties will also likely need to have complicated discussions regarding the need for specific COVID-19-related working capital exclusions, with differences potentially bridged through other mechanisms.

◆ Deal Certainty:

- ◆ **Application of MAE Clauses:** Given Delaware courts' continued reluctance to find that a material adverse effect (MAE) has occurred (at least to date), buyers seeking certainty should not rely on the general terms of the MAE definition but should instead negotiate a specific closing condition regarding COVID-19 and its impact on the target company's business. Sellers, however, may be unwilling to assume deal execution risk relating to COVID-19 and instead may push back or pause the sale process.
- ◆ **Termination Rights and Fees:** Parties should carefully consider the circumstances permitting termination of acquisition agreements due to the current crisis or the escalation thereof and who bears the related costs (e.g., termination fees). Sellers should especially be sensitive to termination rights related to representations and warranties, including scope, materiality qualifiers, interim notice obligations and bringdown standards, as well as interim operating covenants (discussed below).
- ◆ **Bring-down Conditions:** The historical tension between buyers wanting to ensure they are getting what they thought they were paying for and sellers wanting deal certainty will be further tested by an unpredictable and ever changing business environment.

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◆ Due Diligence Issues for Buyers:

- ◆ Scope of representations and warranties, including reviewing standard representations and warranties through a COVID-19 lens;
- ◆ Ability (or inability) to conduct in-person diligence, including access to materials and assessment of (and ability to build rapport with) the target's team;
- ◆ Ability to rely on projections in light of extreme disruption of business operations;
- ◆ Sufficiency of typical indemnification rights, including with respect to indemnification limitations (e.g., caps) and seller creditworthiness;
- ◆ Force majeure provisions in target commercial contracts should be closely considered (similar to MAE clauses, force majeure clauses in the target's commercial contracts will be key in assessing how the outbreak may affect the target business; courts typically do not have the same hesitancy to find that a force majeure prevented contract performance as they have shown in deciding that an MAE has occurred);
- ◆ Target company contingency plans and business continuity practices, programs and policies;
- ◆ Insurance policies, including with respect to business continuity;
- ◆ Data privacy and security practices and policies, including for remote working employees;
- ◆ OSHA compliance;
- ◆ Solvency and debt service capability;
- ◆ Supply chain diligence, including availability/permissibility of alternative suppliers and force majeure provisions that would excuse supplier performance; and
- ◆ Overall economic impact of the outbreak on the target business.

◆ **Representations and Warranties Insurance:** Representations and warranties insurance (RWI) policies generally exclude known risks from coverage, and we expect that carriers will seek to limit or exclude coverage for issues arising out of COVID-19. Buyers will therefore need to evaluate whether RWI still makes sense for specific deals, carefully evaluate COVID-19 related policy exclusions and consider the need for additional recourse against sellers.

◆ **Interim Operating Covenants:** Buyers will likely want additional protections but sellers will likely need additional flexibility. For example, parties should consider how voluntary (yet prudent) actions to limit social interactions or potential exposure to COVID-19 should be construed and whether the buyer's consent would be needed for such actions.

◆ **Timing of Regulatory Approvals:** HSR filings are currently not being accepted in hard copy, and early termination of HSR is not being granted. As a result, parties will need to build in more time for approvals (DOJ has announced that it will need more time to process), including potentially filing off of letters of intent. Parties should also consider whether to extend closing deadlines where delay may be caused by the pandemic and whether to add such provisions as exceptions and automatic extensions.

◆ **Third-Party Consents:** Parties should expect delays in obtaining all types of third-party consents, should consider seeking those consents prior to signing and should consider extending the timing of drop-dead dates as they relate to difficulties in obtaining such consents.

◆ **Shareholder Rights Plans (so-called "Poison Pills"):** Publicly traded companies should consider whether to prepare an "on the shelf" poison pill or formally adopt a poison pill as a defensive measure in light of recent stock price declines.

If you have any questions regarding a current or contemplated transaction or any of the above issues, please do not hesitate to contact a member of our firm's Mergers and Acquisitions group or any Smith Anderson lawyer with whom you work.

Visit: www.SmithLaw.com/COVID-19 to access our Coronavirus Business Resource Center to view timely legal alerts on various areas of law and a listing of federal and state resources to assist businesses during this challenging time.