

# M&A AGREEMENTS IN THE COVID-19 CLIMATE

April 10, 2020

**In the midst of the business closures, travel restrictions and social distancing measures caused by the COVID-19 outbreak, many companies are grappling with the question of how to approach and structure M&A transactions in an atmosphere of extreme uncertainty and ever-evolving challenges. Although many are now hitting the brakes on M&A activity, COVID-19 does not have to be an impediment to closing deals. In fact, due to COVID-19 pressures, sellers may be more likely to look for exits, and buyers searching for good, long-term acquisitions may be able to find them at a lower cost. Parties looking to complete transactions during this time, however, may want to build in additional terms and conditions to protect against COVID-19 uncertainty.**

Below is a brief summary of issues that buyers and sellers should consider when evaluating potential M&A transactions and negotiating acquisition agreements during this unprecedented time.

## DUE DILIGENCE

---

Throughout the COVID-19 crisis, potential buyers should invest extra effort into the diligence process, and take the time to review the target company's records with a careful eye. When reviewing historical financials, buyers should interpret the figures with a grain of salt, understanding that, given the current affairs, past financials may not be reliable indicators of the future financial health of the target company. Buyers should make sure to review recent 2020 financials to investigate how the target has responded financially to COVID-19 thus far. In addition, buyers may want to consider requesting documents and information relating to the target's COVID-19 response, to determine whether the target is equipped to

weather the ongoing storm. *Has the target established a task force? Has it terminated employees? Does it have remote-working capabilities? Is its business substantially dependent on employees' physical presence in the office? What measures has it put in place to respond to the crisis? Are the target's customers and suppliers likely to make it through these difficult times and maintain their relationships with the target?* And although sellers don't typically engage in the same level of diligence as buyers, sellers receiving equity, notes or earn-out payments as part of the purchase consideration will want to ask similar questions.

## REPRESENTATIONS AND WARRANTIES

---

Prudent buyers should seek extra assurances by requesting the inclusion of coronavirus-specific representations and warranties that ensure that the target company has processes in place to appropriately deal with business interruptions, key employee sickness, and other coronavirus-related crises.

Sellers, on the other hand, will want to avoid such additional representations; but, if buyers demand them, sellers should attempt to limit the representations by incorporating materiality and knowledge qualifiers, and by making every representation subject to applicable law. To the extent that the target has been, or expects to be, impacted by COVID-19, sellers should disclose these impacts in the disclosure schedules to protect against future claims by buyers. Sellers should also request a provision allowing sellers to update the disclosure schedules between signing and closing.

Parties seeking to use representation and warranty insurance should note that some insurers have listed COVID-19 as a policy exclusion. The parties should seek to strike this exclusion.

## TERMINATION RIGHTS

---

Given the risk and uncertainty buyers take on between signing and closing, buyers should seriously consider structuring any transaction as a simultaneous signing and closing. In the event this is not feasible, buyers should seek provisions that mitigate their risks, including termination rights and interim covenants (which will be discussed in the next section). Both parties should seek termination rights that reflect their respective risk tolerance, keeping in mind that COVID-19 may result in difficulty and delays in obtaining financing, government approvals and third party consents. Even in times of market stability, these deliverables are often insisted upon as closing prerequisites, and buyers would be wise to demand the same during the current crisis. Buyers with concerns about the target's financial viability should also consider seeking termination rights that are triggered if the target's financial condition deteriorates beyond a certain metric (e.g., if the target's available cash falls below a predetermined threshold).

**Drop-Dead Dates:** "Drop-dead dates" or "outside dates" give parties the right to terminate an agreement if a deal is not consummated by a certain date. Parties should take into account the possibility of delays

when setting drop-dead dates and should consider incorporating automatic extensions of drop-dead dates under certain circumstances. Note that any automatic extensions should be conditioned on the other party using best efforts to satisfy closing conditions.

**Material Adverse Conditions:** Most purchase agreements allow parties to back out of a deal in the case of a “material adverse condition” prior to closing. Buyers should consider including certain COVID-19 impacts on the business in the definition of material adverse condition. Sellers, on the other hand, should push back on any such demands, given that COVID-19 has left virtually no business untouched. Some buyers and sellers have begun to qualify the inclusion of COVID-19 in the definition of material adverse condition by, for example, requiring that any such COVID-19 condition negatively impact the target to a greater extent than its impact on other similarly situated companies.

## COVENANTS

---

**Access to Books and Records / Interim Financials:** Buyers should request access to the target's books and records during the interim period between signing and closing. Because social distancing measures and business closures may render this access meaningless, buyers should request periodic reports of the target's financial condition so that they can monitor the target's status during the interim period.

**Operating in the Ordinary Course of Business:** Ideally, target companies will continue to operate in the ordinary course of business between signing and closing. COVID-19, however, may make this impossible for many companies. Sellers should carefully review interim covenants that impose restrictions on how they can operate the company, and make sure that all such restrictions are subject to applicable law, and lax enough to allow sellers to appropriately respond to COVID-19 emergencies. Buyers should work with sellers to arrive at conditions that give sellers the agency to conduct crisis management, while still safeguarding the financial condition of the target. Buyers should consider options such as: (1) working with sellers to draft an interim-period COVID-19 policy acceptable to buyer; and (2) seeking approval rights before seller takes any emergency actions outside of the ordinary course of business.

## POST-CLOSING PAYMENTS

---

**Post-Closing Adjustments:** Customarily, post-closing adjustments are based on working capital projections. COVID-19 will likely make these estimates increasingly difficult to predict, even in the short-term. To mitigate the risk of having to pay post-closing payments to buyers, sellers should make sure that any projections of normalized working capital are not merely extrapolations of historical financials, but are also realistic against the backdrop of COVID-19.

**Earn-outs:** Sellers should be wary of accepting part of the purchase price in earn-outs. Earn-outs are typically periodic payments based on the company's future revenue in both the short and long term. As

stated above, the current climate makes it nearly impossible to accurately predict revenue for most businesses, which calls into question the likeliness of future earn-outs.

## Related Practices

---

Corporate and Securities

Mergers and Acquisitions