

Covid-19's impact on global corporate transactions

Akin Gump lawyers from around the world explain what companies actively engaging in deals should be – and are – doing about the coronavirus

An increasing number of companies are experiencing a range of issues with respect to existing corporate transactions as a result of the Covid-19 outbreak. The situation is rapidly evolving and remains highly unpredictable across a variety of industries, but common themes appear to be emerging.

This article offers an overview of the common issues businesses are facing, the key considerations in tackling these issues, and the potential investment strategies that may arise for cash buyers, distressed market participants, and regional players who are less affected by the negative effects of the outbreak.

Uncertainty

A material number of parties have already postponed or cancelled proposed transactions as a result of the outbreak, with the downturn and volatility in global financial markets further compounded by the collapse in oil prices. A number of initial public offerings (IPOs) have been cancelled entirely or postponed with the hope of restarting the listing process once market conditions stabilise. Similar patterns are emerging in M&A and private equity transactions – high-value deals in particular are being either postponed or cancelled, with the uncertainty and volatility caused by the outbreak being cited as the driver behind these decisions.

Actions taken in order to mitigate the effects of the outbreak have also added further uncertainty. For example, China has issued over 5,600 *force majeure* certificates as of March 11 2020 – for contracts worth approximately \$72.5 billion – in response to the outbreak. While these are likely to be of assistance to claimants within the domestic Chinese market, there are doubts as to whether they will assist in a cross-border context.

Chinese firms have entered into many agreements with international parties that are governed by US state law or English law – which is of course different to those under Chinese law – and

1 MINUTE READ

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therefore it is not clear what impact these certificates will have in the event of a legal dispute. In fact, Total and Royal Dutch Shell have already publicly rejected *force majeure* notices from the Chinese National Offshore Oil Corporation.

Companies in industries particularly affected by the outbreak have already begun to reduce their workforce, initiate hiring freezes and limit overtime for existing employees. In addition to adopting some of these measures, Boeing – in the face of the dramatic impact of the coronavirus on the aviation industry – has drawn down the full amount of its \$13 billion delayed loan much earlier than expected to provide liquidity in the face of growing uncertainty for its near-term cash flow.

Supply and demand

The disruption to supply chains caused by the coronavirus has been well-documented. Many market participants are either facing substantial delays in deliveries of necessary supplies or are turning to other providers less affected by the outbreak, with the latter often resulting in significant increased costs. There is also no guarantee that these new, less-affected providers will not face their own supply difficulties in the future as government and industry measures to combat the outbreak continue to expand. Although *force majeure* provisions may be able to provide some relief to suppliers, invoking such a provision could prove difficult and uncertain, as discussed above.

Certain industries, such as hospitality, transportation and tourism, are seeing a substantial drop in demand, which will inevitably put a strain on cash flows going forward.

At both a company and asset sale level, there is a decrease in the number of potential M&A purchasers, which is causing many sellers to reconsider, or press pause on any sales processes for the time being.

Travel and logistics

Travel and logistical issues are also increasingly impacting corporate transactions, as areas in heavily affected jurisdictions have been placed into lockdown and public gatherings have been cancelled. These actions can present a range of issues for potential transactions – the bidding and diligence stages being an obvious one – as parties are now unable to conduct face-to-face negotiations or onsite diligence. Many businesses are also experiencing difficulties in maintaining an onsite workforce due to travel restrictions, quarantines and self-isolation measures.

Technology may provide a partial solution, with videoconferencing and remote working more prevalent than ever due to advances in technology. However, while this will mitigate the impact for some businesses, others, such as manufacturing, will not be able to take advantage of these alternatives.

Governments around the world have begun to enact more significant restrictions on travel. On March 11 2020, US President Donald Trump announced that the US would be suspending all travel by foreign nationals who had visited the Schengen Area (a group of 26 countries within the EU) 14 days prior to their arrival in the US. These restrictions, which could significantly impact trade between the US and the EU, were later expanded further to include the UK and Ireland.

It is difficult at this time to predict future travel restrictions among nations affected by the coronavirus, though these should be expected. At the time of writing, travel to, from and within Italy has been severely restricted, and various European countries have closed schools and colleges.

Deals catering explicitly for the outbreak

Some market participants are prepared to

press ahead with transactions through the outbreak, and are trying to mitigate risk via coronavirus-specific drafting in their agreements.

Parties are attempting to explicitly carve out any negative effects that the coronavirus may have on a particular party's ability to perform its obligations. Such provisions may be effective in ensuring a counterparty's compliance with its obligations where an asset or entity is located in a jurisdiction particularly affected by the outbreak. However, it may also conflict with emergency governmental measures designed to contain the outbreak (such as the regional and nationwide lockdowns that have been implemented in China and Italy). It may be worth considering whether carveouts should be added to such provisions to allow the parties to comply with all applicable laws and public health and safety measures.

Separately, in the US, there have already been a number of specific exclusions by representation and warranty insurers of losses related to any business interruption or downturn due to the coronavirus. If insurers are unwilling to provide coverage for these types of risks in connection with an M&A transaction, the allocation of such risk between the buyer and seller via the representations/warranties and related indemnities will become even more critical.

Comparisons with the 2001 and the 2007-2008 global financial crises

Global markets have not seen such volatility since the events surrounding the 2001 downturn and the 2007-2008 global financial crisis. During those periods, material adverse change (MAC) clauses were brought to the fore as parties used, or considered using, these provisions to renegotiate or withdraw from transactions.

In 2001, advertising group WPP Group attempted to abandon its £434 million (approximately \$531 million) takeover bid for Tempus on the grounds that prevailing dislocations to the market caused by the terrorist attacks in New York had resulted in a MAC to the target business. In its decision rejecting this argument, the UK Takeover Panel noted that in order to effectively invoke a MAC clause, the change must be so substantial that it strikes at the heart of the business. In Hong Kong SAR, a key Asian market, the Hong Kong Takeover Panel has taken a similarly

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stringent approach to the use of MAC clauses to lapse takeover offers – and that basic position is reflected in most other major Asian capital markets jurisdictions.

Similarly, as market conditions began to deteriorate at the start of the global financial crisis in 2007, the Royal Bank of Scotland (RBS) was in the process of making its ill-fated acquisition of ABN Amro. There was commentary around this time suggesting that RBS was reviewing the possibility of invoking a MAC clause to either reduce the purchase price, or walk away from the deal entirely, given the substantial decline in value of ABN Amro. However, RBS did not choose to invoke the provision, and this decision may well have been, at least in part, due to the UK Takeover Panel's history of ruling against such clauses (as noted in relation to the WPP Group case above).

There may well be similar situations to those outlined above as a result of the current downturn and volatility being experienced by global financial markets. MAC provisions could therefore come to the fore again, as parties attempt to address the impact of the outbreak on their business.

In line with English law, US courts have generally held that buyers have a high bar to clear in demonstrating that a MAC has occurred. While a Delaware court recently found a MAC to have occurred for the first time in a litigated Delaware case, a buyer has the burden of proof to demonstrate that the decline in the target company's business is consequential to the earning power of the business over a commercially reasonable period of time, measured in a period of years rather than months. Additionally, MAC clauses in US M&A agreements typically include an expansive list of exclusions to the provision; i.e., events or circumstances that will not be taken into account in determining whether a MAC has occurred. When drafting or reviewing a MAC clause, it is important to review these exclusions carefully in the context of the coronavirus outbreak.

Market changes

As businesses across regions and industries face challenges with issues such as those discussed above, it is possible that a number of coronavirus-specific special situations may arise, such as breaches of financial or operating covenants, as well as restructurings and insolvencies. These circumstances may present opportunities for cash buyers, distressed market participants and regional players who are less affected by the outbreak to acquire such distressed entities and/or assets.

Market sentiment may also lead to liquidity crunches; however, the same degree of disruption seen following the 2007/2008 global financial crisis is not expected as the market is dealing with an external shock as opposed to a systemic failure. The actions of central banks and governments will be critical in determining the final outcome. Undoubtedly, however, opportunities will arise for cash buyers and distressed players.

The impact of the coronavirus on professional working practices may also accelerate the adoption of technological changes that impact traditional sectors of the market. For example, the more organisations become accustomed to remote working, the less need for large prime office premises, and the greater the demand for appropriate hardware and software products.

It is likely that different markets will emerge from the outbreak at different times, although they will undoubtedly be entering into a different environment to the one that existed before the outbreak.

Hong Kong SAR, China and other Asian capital market jurisdictions have been tackling the outbreak since the end of 2019, and with an apparent slowdown in new cases, these jurisdictions seem to be emerging from the initial phase of uncertainty, while the rest of the world enters the lockdown phase. Whilst certain Asian jurisdictions may begin to see increased market activity at an earlier stage than UK and US markets, the

effects of globalisation mean that businesses and corporate transactions in these markets will inevitably continue to feel the impacts of the now global outbreak.

Given the rapid and unpredictable development of the outbreak, it is likely that businesses and transactions will continue to face disruption on multiple fronts in the near-term as governments around the world attempt to contain the outbreak. Awareness of the types of issues arising in corporate transactions as a result of the outbreak can help market participants understand and navigate such risks. The situation remains extremely fluid, with many moving parts – which could quickly develop from the time of writing.

This article is intended as a general overview and discussion on the subject matters it addresses. It is not intended to be, and should not be used as, a substitute for taking legal advice in any particular situation.



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