

The Global Impact of COVID-19 on Corporate Transactions

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COVID-19, also known as the novel coronavirus, has spread rapidly throughout the globe since it first emerged in China at the end of 2019. As governments, businesses and individuals all take measures to protect against the potential public health issues that the coronavirus poses, its outbreak has already led to significant economic disruption around the world. This article explores the potential impact that this economic disruption has on global corporate transactions and suggests some potential considerations in connection with negotiating transactions in this environment.

Impact on Transactions

We have seen the coronavirus cited as a key driver for postponing or cancelling proposed cross-border transactions that were in the diligence/bidding stages. While earlier this year such considerations were linked to businesses that had direct or indirect links to China, it is clear that the problem has since become substantially more international, particularly given the recent downturn in global trading markets. As such, we are seeing potential initial public offerings (IPOs), mergers and acquisitions (M&A) deals and private equity transactions with no particular nexus to China being impacted by considerations related to the coronavirus.

Joint venture and distribution arrangements that involve supply chain arrangements are facing challenges around delivery and stock maintenance undertakings. Further, we also anticipate an increase in insolvencies that cite the coronavirus as a factor, as businesses suffer from a decrease in revenue or an inability to meet debt covenants as a result of the outbreak. These issues could present opportunities for distressed purchasers.

As the economic effect of the coronavirus begins to bite, governments around the world have acted to take economic stimulus measures. While these measures may go some way to mitigating the potential economic impact of the coronavirus, they will not entirely de-risk the impact the outbreak may have on businesses and corporate transactions.

The impact of the coronavirus will be felt more strongly in some industries as opposed to others. However, there are certain considerations that all dealmakers should be

Contact Information

Should you have questions regarding this article, please feel free to contact us

Vance Chapman

Partner

vance.chapman@akingump.com

London

+44 20.7661.5333

Zachary N. Wittenberg

Partner

zwittenberg@akingump.com

New York

+1 212.872.1081

Tyler A. Conte

Associate

tconte@akingump.com

Houston

+1 713.250.2101

Ryan Donnelly

Title (Sidebar text, Arial 9pt)

ryan.donnelly@akingump.com

London

+44 20.7012.9620

Kelvin Mahal

Associate

kelvin.mahal@akingump.com

London

+44 20.7012.9676

mindful of in order to help mitigate the risk that the coronavirus poses to corporate transactions.

Relevant Clauses

For those agreements that were signed before the coronavirus outbreak, there may be some provisions in the underlying documentation that could be triggered or affected by the outbreak and its impacts. Separately, for those agreements that have not yet been signed, specific drafting may help to limit, or clearly define the risk allocation between the parties with respect to, the risks that the outbreak poses. As a guide, we have set out below some of the key contractual provisions that may be relevant.

Force Majeure

A force majeure provision excuses a party's failure to perform some or all of its obligations under an agreement to the extent that such failure to perform is due to a set of specified circumstances outside of that party's control (such as a natural disaster or an act of terrorism or war). Force majeure does not operate automatically under English or United States law generally and, as such, a specific force majeure provision would need to be included in an agreement to allow a party to rely on it. As with a material adverse change or material adverse effect clause (discussed below), much will depend on the specific drafting of the provision. In the absence of a force majeure clause, a party may find relief in the English common law doctrine of frustration. However, this is a particularly difficult test to satisfy.

In agreements that include force majeure provisions, a "laundry list" of events or circumstances is often included in the force majeure provision which is intended to be a non-exhaustive, illustrative list of the types of events that could trigger a force majeure, and such lists may include epidemics or government-imposed quarantines. While the coronavirus and governments' responses to it could fall within the examples included in this "laundry list," in most United States agreements, the event or circumstance must also not have been foreseeable, not have been within the control of the party claiming relief and/or not have been the type of event that could have been prevented or overcome with the exercise of reasonable diligence. Force majeure under English law operates in a similar fashion, although there is no requirement that the event or circumstances being relied upon to invoke the force majeure clause were unforeseeable at the time the contract was executed. Instead, the burden is placed on the invoking party to establish that the event or circumstances were beyond its reasonable control and to show that it used its reasonable endeavors to prevent, or at least mitigate, the effects of the alleged force majeure.

Therefore, even though "epidemics and quarantine" may be listed in the examples of events that could constitute force majeure, the other elements of the clause must still be met in order for a party to invoke a force majeure provision.

Material Adverse Change

A typical material adverse change (MAC) clause would allow a party to terminate a definitive agreement for an M&A transaction in the event that there is a material adverse change with respect to the target business after the signing date. What constitutes a material adverse change is negotiated between the parties and is often subject to a number of exclusions, which may themselves be subject to exclusions (e.g., to the extent an applicable condition or circumstance has a disproportionate

effect on the target business as compared to other companies in the same industry). As a result, each MAC clause is highly fact-specific.

A party should think carefully about either invoking a MAC clause, if such a provision is in place, or including a coronavirus-specific MAC clause in any agreement, as much will depend on the specific drafting. It is also important to note that under the United Kingdom Takeover Code (which regulates United Kingdom public M&A), there is a higher threshold for calling a material adverse change in the context of public M&A. In order to effectively invoke such a provision, the material adverse change must be so substantial that it “strikes at the heart of the purpose of the transaction in question”.¹ This has historically been a difficult standard to satisfy, but the outbreak of the coronavirus could lead to the principle being tested in ways not seen since the shocks arising from 9/11 and the 2008 global financial crisis.

In order for a MAC clause to be enforceable, the intentions of the parties should be clear and the trigger for invoking the MAC clause should ideally be objective. If this is not the case, and a counterparty disputes the calling of a material adverse change under a MAC clause, it could potentially lead to costly litigation with a very uncertain outcome.

Representations, Warranties and Indemnities

A party can use representations and warranties to elicit material information from a counterparty. Under United States law, the terms “representation” and “warranty” are for the most part used interchangeably; however, under English law, they have slightly different meanings. Under English law, a warranty is a statement of fact made on the date the agreement is signed which, if false, gives rise to a claim for damages on the basis of breach of contract. If that false statement is also drafted as a representation, it may also give rise to a claim for damages as a misrepresentation under tortious law. The measure for a claim for damages under misrepresentation is different from the measure for a claim under breach of contract, and could result in the claimant receiving more (or less) than they otherwise would have been able to had the statement been purely a warranty. An indemnity is an undertaking by one party to reimburse another party directly for certain costs and expenses upon the occurrence of certain agreed events or circumstances. Indemnities are helpful to mitigate risk, as they are primary obligations that do not depend on having to prove a breach of contract, though they are not as widely used in United Kingdom purchase agreements as in the United States.

A party should carefully consider the wording of each indemnity, representation and/or warranty in light of the coronavirus outbreak. The outbreak may have now rendered some negotiated representations and/or warranties untrue (for example, representations and warranties around the company’s financial statements or ratios, the operational viability of a certain supply chain or project, or the security of company or customer data or information), and under certain transaction structures, some representations and/or warranties may need to be repeated under the relevant transaction documents. Moreover, buyers in M&A transactions would be prudent to consider inserting coronavirus-specific representations and warranties into their acquisition agreements to learn more about the exposures and safeguards the seller has related to the coronavirus and any associated operational and financial impacts on its business. A party who agrees to provide an indemnity, representation and/or warranty should pay close attention to the drafting of such indemnities, representations

and warranties, in order to fully understand the impact the coronavirus may have on their business.

In M&A transactions in the United States, representation and warranty insurance (RWI) is a common method for buyers to offset some of the risk associated with the seller's representations and warranties being untrue. As the coronavirus outbreak has developed, we have learned that RWI insurers are specifically excluding losses related to any business interruption or downturn due to the coronavirus. If RWI insurers are unwilling to provide coverage for these types of risks, the allocation of such risk between the buyer and seller via the representations/warranties and related indemnities becomes even more critical. It remains to be seen whether other markets will follow the United States' lead.

Condition Precedent

A condition precedent (CP) can be used to provide that a contract, or certain parts of it, will only come into force if and when a certain specified condition has been satisfied.

When drafting a CP, parties to an agreement should consider whether the terms of the CP can be satisfied in light of the coronavirus. For example, the widespread institution of work from home policies due to the coronavirus could have an impact on the security and/or privacy of certain sensitive company or customer information. In this case, a party may be more likely to have failed to satisfy a CP that requires compliance between signing and closing with all applicable laws and internal policies related to data security and information technology due to the higher incidence of its employees working from home for extended periods of time.

Regulatory Approvals

Following the outbreak of the coronavirus in China, transactions were impacted as a result of the closure of various governmental offices who were required to provide approvals for closings. If this pattern of behavior is repeated in other jurisdictions, it will increase the possibilities that transactions fail because of an inability to satisfy the relevant regulatory conditions in the required timeframe.

Long-stop Dates

A typical long-stop date provision gives a party the right to terminate an agreement if the closing has not occurred by a particular date. If a long-stop date is in place and the closing is now unlikely to occur as a result of the coronavirus, a party should consider: (i) whether the counterparty has an option to terminate the agreement, in whole or in part, under such a provision, as well as any conditions that may need to be met in order for this option to be exercised; and (ii) if the respective long-stop date should be extended through mutual agreement of the parties.

Conversely, for those who are contemplating inserting a long-stop date in any agreement, it would be prudent to consider whether inserting a long-stop date is feasible in light of the coronavirus, or if the relevant date should be specified as being further in the future than it otherwise might have been, in order for the arrangements to be monitored and/or adapted as necessary in light of the rapidly evolving situation.

Furthermore, in a debt-financed acquisition, the buyer should pay close attention that the long-stop date in the acquisition agreement is not pushed to a later date than the long-stop date in the debt commitment papers. In this case, depending on the drafting

of the acquisition agreement, a buyer could be committed to make an acquisition but not have necessary funding to do so.

Operating Covenants During Execution Period

In an M&A transaction with a bifurcated signing and closing, the target company typically agrees to certain covenants regarding the operation of its business during the period between signing and closing (known as the “executory period” or “interim period”). A common covenant of this type requires the target to continue operating “in the ordinary course of business,” which in general means that the target’s business must continue to operate as it has on a day-to-day basis in the past. For example, a clothing retailer that decides to open its first automobile factory would breach this covenant unless exceptions apply.

Additionally, a target company subject to an ordinary course of business covenant could be considered to be in breach of this covenant if it is forced to suspend a meaningful portion of its business due to the impact of the coronavirus. Clearly, such a business would not be operating in a normal, day-to-day fashion as it has in the past. Sellers that could be particularly impacted by the coronavirus and are negotiating M&A transactions should consider providing for the right to operate outside the ordinary course of business without the buyer’s consent in order to deal with the impact of the outbreak, including taking actions necessary for the protection of public health (such as implementing remote working policies).

Termination Rights

Whether or not a termination right will be available to a party will depend heavily on the drafting of the relevant agreement. A party seeking to enforce a termination right in light of the coronavirus should carefully consider whether the relevant requirements under the agreement to terminate have been met and should also look to ensure full compliance with any other procedural requirements.

It may also be worth considering inserting a termination right that is specific to the coronavirus. For example, if relevant to the parties’ commercial arrangements, it may be possible to agree a termination right upon a specific number of employees becoming infected with the coronavirus or a certain number of locations or manufacturing facilities being temporarily closed due to the virus.

Risk Factors

In relation to public reporting obligations and securities offerings which have not been postponed or cancelled as a result of the outbreak, we are starting to see issuers consider the inclusion of certain risk factors covering issues arising in their business as a result of the impact of the coronavirus. For a more complete discussion of disclosure regarding the coronavirus by public companies filed with the United States Securities and Exchange Commission, please see the article entitled [“2020 Filing Season Survey: Coronavirus \(COVID-19\) Disclosures so Far”](#).

Conclusion

The outbreak of the coronavirus has been rapid and its future remains unpredictable. Removing risk from corporate transactions in relation to the outbreak is impossible, but a party seeking to mitigate its risk to the largest extent possible should think about the issues raised in this article..

¹ 2001/15 decision of the Takeover Panel in respect of the offer by WPP Group Plc for Tempus Group Plc.

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