



CRISIS PRACTICE

# Coronavirus

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## Impact of COVID-19 on M&A and Private Equity Transactions and Other Considerations

COVID-19 has spread rapidly across the world since it first emerged in late 2019 and has impacted everything from the way we work, to certain aspects of M&A and Private Equity transactions and the way in which they are carried out. Dealmakers will need to consider a number of commercial and legal points when negotiating and concluding regional M&A and private equity transactions.

We expect that these impacts will continue for at least the medium-term and, depending on the depth of the economic impact of COVID-19 (and the recent drop in oil prices), could lead to additional issues and concerns. Below we consider the key areas in regional M&A and private equity transactions which may be impacted by the outbreak and our observations in relation to these matters. We also set out some observations and forecasts on opportunities that may arise as a result of the economic impacts.

### SALE AND PURCHASE AGREEMENT (SPA) CONSIDERATIONS

#### 1. Purchase Price Considerations

Particular focus should be given to the pricing mechanism, including whether a locked box or completion accounts mechanism is more appropriate. Furthermore, the parties should consider whether some form of post-completion price adjustment, or deferred consideration (e.g. an earnout linked to post-COVID-19 financial performance) should be included in the SPA. In particular, if a transaction must proceed and stay-at-home orders and/or the recent drop in oil prices have had a material impact on a target's financial position, buyers should consider bridging any valuation gap with an earnout linked to post-COVID-19 financial performance.

#### **Locked Box**

Given the uncertainty imposed by the outbreak and its impact on most business sectors, buyers should consider whether a locked-box



mechanism is appropriate for the transaction, particularly if they predict that the business has deteriorated/underperformed from the locked box date as a result of COVID-19, or if the industry sector or geographic location is adversely affected by the current pandemic. If the parties agree to a locked box mechanism, the parties should carefully tailor what would constitute “*permitted leakage*”. For example, it would be reasonable to include specific expenses (which customarily may not be ordinary course) which the target will likely incur to mitigate the impact of COVID-19 on its business.

### **Completion Accounts and Post-Completion Price adjustments**

Most SPA’s contain provisions regarding post-completion purchase price adjustments and, in particular, net working capital adjustments. Careful attention should be paid to the following issues in connection with any net working capital adjustment:

- **Determination of normalized/target working capital:** given the impact of COVID-19 on the working capital of many businesses which have been subject to government mandated stay-at-home orders, for many (if not most) industries, taking an average of the last twelve months may not be the best measure. We expect that in the weeks since regional stay-at-home orders have been issued that the working capital position of many businesses will have deteriorated significantly. In addition, with some analysts forecasting rolling stay-at-home orders, and/or social distancing measures for up to twelve months (if not longer), parties should consider the appropriate level of working capital based on when the business is likely to reopen.
- **Completion date:** the impact of completion timing on net working capital will need to be considered.
- **Post-completion adjustments:** taking into consideration the above points, consider whether the timetable to prepare and provide the completion accounts, to agree any adjustments to those completion accounts and any expert determination process is adequate.

Sellers may need to take measures to maintain acceptable liquidity at the target level and may want to seek floors or collars in the purchase price adjustments to avoid being unduly penalized during the crisis. Conversely, buyers will remain focused on ensuring they will be acquiring a business with adequate levels of working capital and liquidity (which fall within defined parameters).

### **Earnouts**

An earnout in an acquisition can serve to balance the risk of the future performance of a business between a buyer and a seller. Given the outbreak and the uncertainty on target performance in an environment where some analysts have anticipated rolling stay-at-home orders and social distancing measures for up to twelve months (and potentially longer), the parties will need to consider how to best balance the risk of the future performance of the business. Attention should be paid to the impact of COVID-19 in connection with the structuring of the earnout, including, whether or not milestones are met, how milestones are set, how the business will be run after completion (i.e. general carve-outs for ordinary course activities, or activities consistent with past practice will need to be tailored) and the specific activities that the business can engage in after completion.

## **2. Conditions to Completion and MAC/MAE Provisions**

### **Conditions**

COVID-19 may impact the conditions to completion set out in an SPA either: (i) directly, by the inclusion of specific COVID-19 focused conditions (particularly relating to a low likelihood but high impact event); or (ii) indirectly, through a material adverse change (**MAC**)/material adverse effect (**MAE**) clause, or due to the seller refusing to repeat certain representations and warranties at completion.



The consummation of certain transactions may also trigger the requirement to obtain regulatory approval. The time frames for regulatory approvals should be taken into account and the parties should consider and factor into the deal timetable any delays that may be caused by COVID-19 (e.g. due to staff at relevant authorities working remotely and meetings to respond to queries needing to be held remotely).

### **MAC/MAE**

If a MAC/MAE condition/termination right will be accepted by a Seller, careful thought should be given to the scope of the MAC/MAE definition and whether to include a specific reference to COVID-19 or a carve out, or more general carve-outs for disease outbreaks, pandemics, international calamities and/or public health events. Attention should also be given to any disproportionate impact the outbreak has on the target as compared to others in comparable industries, or given the nature of the outbreak, in the same geography.

Based on when the SPA was signed, and the customary approach to drafting MAC/MAE clauses, the impact of the virus may not trigger a generic MAC/MAE provision if news of the virus was widely reported at the time the SPA was signed (i.e. if at that point a material adverse change/effect resulting from the virus was potentially foreseeable). Furthermore, in many cases the outbreak may not have a long-term impact on overall earnings potential and may further be caught by any carve-out for changes in general market conditions (i.e. the outbreak does not have a disproportionate effect on the target as compared to other industry participants).

Sellers are also unlikely to concede a MAC/MAE that is specifically related to the impact of COVID-19 unless, it is linked to a specific risk (i.e. loss of revenue/profits between a certain period above a certain threshold, loss of customers/orders over a specific threshold, termination of material agreements etc.), or triggered by an actual (as opposed to anticipated future) financial impact in the period between signing and completion. The evidential certainty of a specific MAC/MAE will also be beneficial for the parties.

It is worthwhile noting that, at least in the United States and the United Kingdom, following the 2008 global financial crisis, the approach to drafting MAC/MAE provisions shifted so that parties specifically defined the relevant triggers. This resulted after parties had difficulty triggering and then enforcing generic MAC/MAE conditions/termination rights. We expect that a similar rebalancing may take place if market sentiment shifts to a buyer-friendly market and large numbers of private equity firms and other buyers seek to push the risk of COVID-19 impacts on to sellers.

### **3. Representations and Warranties**

In light of the outbreak, careful attention should be paid to the wording of each representation and warranty. For transactions that are currently being negotiated, the outbreak may have rendered certain representations and warranties untrue or inaccurate. For example, representations and warranties regarding a company's financial statements, the operational viability of certain supply chains or projects, employment matters, or the security of company or customer data or information may no longer be accurate. In those cases, consideration should be given as to what amendments need to be made to customary representations and warranties (including appropriate knowledge and materiality qualifiers and avoiding forward looking statements) and/or what disclosures need to be made against representations and warranties.

For transactions that are under negotiation, buyers may want to consider inserting COVID-19 specific representations and warranties into their SPA's to learn more about the exposure the business has to COVID-19 related issues and any associated operational and financial impacts on the business. Particular focus should be paid to representations and warranties concerning financial statements, inventory, supply chain, data privacy, undisclosed liabilities, employment matters, material contracts, risk assessments, business continuity and contingency plans and insurance.



#### **4. Pre-Completion Undertakings**

##### ***Pre-Completion Undertakings***

Careful attention should be paid to each pre-completion undertaking as COVID-19 may impact a target's ability to comply with those undertakings. For example, a target may need to act quickly to close certain locations or terminate the employment of certain employees, or may need to take actions necessary for the protection of public health (i.e. a remote working policy). Sellers will need to consider if any of these matters may not comply with pre-completion undertakings in the SPA. Parties should also consider whether there should be express obligations on the parties to work together to limit the impact on COVID-19 on certain aspects of the target's operations. This will be particularly relevant where a locked box mechanism is being used and the target is effectively being run for the benefit of the buyer. Gun-jumping will however need to be considered based on the regulatory regime that is applicable.

#### **5. Termination Rights and Longstop Date**

##### ***Termination Rights***

Parties should pay attention to customary termination provisions, given the requirements for third-party consents and/or government approvals and the satisfaction of other conditions may be substantially more difficult to achieve, or take longer to obtain under current market conditions. In particular, who bears the risk of delay and for what period. Furthermore, with continued volatility in the financing markets, transactions that depend on third-party debt financing can present particular challenges.

##### ***Longstop Date***

Given the impact of the outbreak on the markets, consideration should be given as to the appropriate "longstop date" for any transaction. A transaction that might have taken three months pre-COVID-19 may now take much longer to complete given the impact on the parties, the target, regulators and third-party authorities. Parties may wish to consider inserting automatic extension provisions to the "longstop date" as a result of the outbreak, or an obligation to act reasonably in extending the "longstop date".

#### **6. Indemnities and Limitations**

##### ***Indemnities***

Consideration should be given as to whether or not a specific indemnity for an issue should be added as a result of the outbreak. For example, potential liabilities arising from workforce accommodation costs, supply chain disruptions or contract terminations could be covered by a specific indemnity.

##### ***Limitations***

Sellers may wish to consider compartmentalizing warranties so that COVID-19 related claims can only be made under certain warranties (as opposed to all warranties, particularly accounts related warranties). Carve-outs for buyer's knowledge, changes in law and other limitations will also need to be considered.

#### **7. Warranty and Indemnity (W&I) Insurance**

COVID-19 is likely to have an impact on W&I insurance premiums, carve-outs that will be sought by insurers and the level of due diligence comfort that will be required by the insurer. It is likely that insurers will propose exclusions from policies relating to COVID-19, including: (i) business interruption or other losses arising out of or resulting from the outbreak; (ii) disruption to the target's operations as a result of the spread of the virus; (iii) supply-chain disruptions arising out of or resulting from the outbreak; and (iv) losses arising from or relating to any business interruption or other



business downturn to the extent such interruption or downturn arises out of the outbreak or any government of other regulatory sanctioned response thereto.

## 8. Due Diligence

### *Timeline and Process*

We expect that during the outbreak and for the medium-term following the outbreak, timelines for due diligence processes will lengthen as buyers seek to better understand: (i) the impact that the pandemic has had on the target's operations; and (ii) the preparedness of the target for similar black-swan events. This will certainly have knock-on impacts on overall transaction timelines.

### *Areas of Focus*

Given the uncertainty raised by the outbreak, buyers are raising specific COVID-19 related queries and investigating the target's approach in relation to a range of factors, which include: (i) impact on a target's workforce and the ability of personnel to function remotely and continue operations; (ii) impact on supply chain, go-to-market strategy and capital expenditures; (iii) overall financial condition of the business, including its ability to control operating costs, service debt and other fixed obligations; (iv) strength and financial condition of customers and the likely impact this will have on revenue in the short to medium term; (v) location and condition of facilities and the ability to store reserves of products (if viable based on the business); (vi) terms of key contracts (including termination and MAC/MAE provisions); (vii) regulatory/compliance exposure and other company/sector focused risk factors.

Particular areas of focus can include:

- the impact that COVID-19, or the reaction to it, has had on operations and the likely impact over the next 6 to 12 months;
- impact experienced or anticipated on end market demand, including any material revenue exposure to countries or regional areas under lockdown or containment;
- impacts on supply chain and alternatives available for the sourcing of raw materials and/or manufacturing, if applicable;
- exposure to any material counterparties (i.e. customers, suppliers, distributors, creditors, business partners and other parties) that have been significantly impacted by the outbreak;
- disruption caused by the virus on the company's human resources (i.e. outbreaks within the target's workforce, target-imposed work limitations and other impacts on productivity);
- the target's contingency plans for workforce and/or facilities that become subject to a COVID-19 outbreak; and
- material changes in the company's liquidity resulting from the impacts of the outbreak.

## OTHER PRACTICAL CONSIDERATIONS AND OBSERVATIONS

### 1. Electronic Signatures

Parties will have to take into consideration a number of other matters when undertaking M&A and private equity transactions during the applicability of stay-at-home orders. For example, signature of transaction documents that would have otherwise taken place with wet ink signatures may now have to be undertaken electronically. Additional information on the use of electronic signatures in the UAE and Saudi Arabia can be found [here](#).



## **2. Board and Shareholder Meetings**

The constitutional documents or, where one exists, shareholders' agreement for many companies will have provisions relating to the holding of in person board or shareholder meetings (e.g. a requirement that all parties are able to hear and be heard simultaneously). In addition, if parties are unable to meet electronically and elect to pass resolutions by circulation, they will have to consider whether any special thresholds apply to the passing of circular resolutions (e.g. unanimity) which do not apply to in-person meetings.

## **3. Foreign Investment Controls**

While many regional economies have moved to further open their economies to foreign investment, there have been moves in many large global economies (e.g. the UK, EU and the United States) to restrict foreign investment in certain critical industries impacted by the COVID-19 pandemic.

Considering the trends in recent years, it is unlikely that a similar approach will be taken in the UAE or Saudi Arabia. We would expect that regional sovereign wealth funds may be tasked to support critical industries which are adversely impacted. However, other regional economies which were already straining under difficult economic conditions, may be forced to adopt a similar protectionary approach as has been taken by the UK, EU and United States. We expect further developments on this.

## **4. Insolvencies and Bankruptcies**

A number of regional jurisdictions, including the UAE and Saudi Arabia, have issued new or relatively new laws and regulations providing a clearer bankruptcy procedure. We are aware of a number of institutions that have started assessing or are currently assessing the process and likely outcomes of a bankruptcy filing in the UAE and/or Saudi Arabia for some of their entities and expect that, if the severe economic impact continues, additional institutions may also consider whether a bankruptcy filing is the best out of a number of difficult options. We expect that well capitalized parties operating in sectors significantly impacted by the pandemic (e.g. 'bricks and mortar' retail and hospitality) will find opportunities to acquire undercapitalized competitors or significant pieces of their businesses.

## **Conclusion**

We expect that any advice given now will need to be updated as the economic and social landscape continues to evolve. Accordingly, we expect to issue additional alerts setting out our observations and expectations in relation to regional M&A and private equity. That being said, as was the case during previous crises (both regionally and globally) we expect that some parties will find opportunities among the uncertainty and will be able to use the many tools available to proceed with their key transactions.



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