KING & SPALDING

CRISIS PRACTICE

Coronavirus

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COVID-19's Impact on Acquisition Agreements and M&A Deal Processes

When approaching a potential new M&A transaction in the face of the volatility and unpredictability created by COVID-19, dealmakers should consider a range of topics in order to determine how to best protect their interests while still making the deal happen. We have set forth below the key points to serve as a dealmaker's checklist in this context.

ACQUISITION AGREEMENTS

Representations and Warranties

In an acquisition agreement, the target party typically provides certain "representations and warranties", which are the target's statements/confirmations that certain facts about it are true. Many times these representations and warranties must be true at the time of signing and again at the time of closing. However, COVID-19 has had a tremendous impact on the normal operations of many, if not most, businesses, making certain typical representations and warranties untrue.

Check the wording: As a result of COVID-19, it is important to pay careful attention to the wording of each representation and warranty to ensure that it is accurate or that accurate exceptions are disclosed. Examples of representations and warranties potentially impacted by COVID-19 include those related to the:

- company's financial statements;
- operational viability of certain supply chains or projects; or
- security of company or customer data or information.

COVID-19 Specific Reps and Warranties: In order to learn more about a target's exposure to COVID-19-related issues, buyers should consider inserting into the acquisition agreement COVID-19-specific representations and warranties (i.e., representations and warranties that specifically reference COVID-19's impact (or lack thereof) on certain parts of the target company and its business). Examples include

representations and warranties concerning a target's financial statements, inventory, supply chain, absence of certain changes since a specific date (including "no Material Adverse Effect" on the business), data privacy, undisclosed liabilities, hedging programs, employment and labor, material contracts, business continuity and contingency plans and insurance.

Pre-Closing Covenants

Operating Covenants

In acquisition agreements, it is not unusual for the target company to agree for the period of time between signing and closing to "operate in the ordinary course of business consistent with past practice" and to not take certain actions. Careful attention should be paid to each operating covenant as COVID-19 may impact a target's ability to comply with such covenants. For example, a target may need to close certain locations, furlough or terminate the employment of certain of its employees, change compensation or benefits, or take actions necessary for the protection of public health (i.e., implementing a remote workplace policy), each of which would likely not be in the ordinary course of business and therefore not comply with typical operating covenants in an acquisition agreement.

Interim Agreements

Parties are also inserting interim covenants in transaction agreements to address the impact of COVID-19 on the transaction and the parties. For example, the parties may agree to cooperate and work together between signing and closing to seek to mitigate the potential implications of the pandemic and government measures on the transaction.

Financing

As COVID-19 continues to disrupt the economy, including the financing markets, we expect to see some buyers (particularly financial sponsors) begin to request limitations on their obligations to obtain debt financing and on the remedies available to sellers if there is a financing failure. The range of contractual techniques advanced by buyers will likely vary depending on the state of the debt markets, but could include (i) outright financing contingencies, (ii) limited efforts covenants to obtain financing, and (iii) below market reverse termination fees.

Regulatory

When negotiating the time frames for regulatory actions/approvals (such as antitrust approval) in acquisition agreements, parties may want to take into account delays for governmental approvals caused by COVID-19, which could be significant as governmental agencies may continue to face temporary shutdowns and/or limited operations with governmental employees at certain agencies working remotely.

Conditions to Closing

COVID-19's impact on a target's business may impact the conditions to closing (i.e., the conditions that must be met before the parties are required to close the transaction) set forth in an acquisition agreement. This has taken shape in two ways:

i. directly, by the addition of COVID-19-directed conditions, and

ii. indirectly, through the Material Adverse Effect ("MAE") closing condition being triggered or because the seller is unable to bring down (i.e., reaffirm) its representations and warranties at closing.

Given the importance of the MAE closing condition (and the use of MAE as a qualifier in the representations and warranties), when negotiating the definition of MAE, careful thought should be given as to:

- whether or not to include as exclusions from the definition of MAE disease outbreaks, pandemics (including COVID-19) and/or public health events (note that buyers will push back on such additions to the exclusions, as such exclusions would make it harder for buyers to get out of an acquisition agreement if the target performs poorly between signing and closing due to COVID-19); and
- if there is likely to be any disproportionate impact COVID-19 will have on a target as compared to others in comparable industries or, given the nature of the COVID-19 outbreak, in the same geography.

Termination

Given the impact of the COVID-19 outbreak on the markets, parties should consider the appropriate "drop dead date" for any transaction, which is the date by which a transaction must close before the parties have a right to walk away from the deal. While delays to acquisitions have not be significant so far, transactions may take longer than normal to complete given the impact of COVID-19 on regulatory approval timing and impacts on obtaining financing. Options to address this issue include: (i) initial "drop dead dates" that are farther from signing, (ii) tolling provisions or automatic extension provisions to extend the "drop dead date" as a result of the outbreak or (iii) obligations to act reasonably in extending the "drop dead date." Termination rights specifically related to COVID-19 may also be appropriate.

Indemnification

The COVID-19 pandemic could warrant inclusion of a specific indemnity (i.e., a hold harmless provision) for issues related to the pandemic. For example, potential liabilities arising from supply chain disruptions, workforce accommodation costs or contract terminations could be covered by a specific indemnity pursuant to which the seller would compensate the buyer if such events were to occur. Sellers should attempt to compartmentalize COVID-19 indemnification so that claims arising as a result of COVID-19 can be made only under certain representations and warranties (as opposed to all warranties). Consideration should be given to indemnification carve-outs for buyer's knowledge of COVID-19 impacts as well as COVID-19-related changes in law.

> *For a summary of how COVID-19 is impacting the **purchase price** in acquisition agreements, please be on the lookout for our upcoming Client Alert titled, "M&A Purchase Price Considerations in the Context of COVID-19."*

DUE DILIGENCE REQUESTS

While it is unclear exactly how long the outbreak will last, it is clear that the outbreak is making performing due diligence (i.e., a buyer's detailed review of a potential target before entering into an agreement to acquire such target) more difficult. In-person meetings with management and visits to manufacturing facilities are harder to achieve while social distancing, and buyers are asking even more questions in order to understanding the impact of COVID-19 on targets. Particular areas of focus in due diligence include a target's contingency plans and the impact of COVID-19 on a target's: (i) **operations**, including labor needs, the workforce's ability to function remotely, the supply chain and the location and condition of facilities, (ii) **customer and other contractual relations**, including the target's go-to-market strategy, the strength and financial condition of customers and the terms of key contracts (including the termination provisions), (iii) **financial condition**, including capital expenditures, financial condition, the ability to service debt and other fixed obligations and the ability to control operating costs, and (iv) **regulatory/compliance exposure**.

Additionally, as a result of the Black Lives Matter protests over the past couple of months and general unrest over social and racial injustices, we expect to see an increased focus in due diligence on a target company's anti-discrimination practices and policies. Buyers will be interested in any historic, current or threatened discrimination claims against the target and how such claims could negatively impact the target's image and business going forward. Buyers may require expanded anti-discrimination representations in acquisition agreements, much like the #MeToo clause (regarding a

target company's knowledge of sexual harassment allegations against any senior employees of the company) that emerged in early 2018.

CARES ACT CONSIDERATIONS

Congress passed the CARES Act in March 2020 to address the economic fallout of the COVID-19 outbreak in the United States. Given the significant potential consequences of non-forgiveness of Paycheck Protection Program ("PPP") loans or a retroactive ineligibility determination, the parties should be sure to address CARES Act funding issues in the context of any M&A transaction. In particular, the following five areas merit close attention:

- *Purchase Price.* If the target obtained a PPP loan, the parties should have a clear understanding of the impact of the PPP loan (including if the PPP loan is forgiven) on the purchase price, any post-closing adjustment and any earnout.
- *Due Diligence*. Due diligence should focus on the amount of the CARES Act funding received by the target and any potential compliance issues, including with respect to CARES Act funding that has been repaid or forgiven prior to the transaction (as such repayment or forgiveness will not generally cure compliance issues).
- *Structuring*. If due diligence results in red flags, the parties should consider if the deal can be structured to isolate the exposure going forward or, ideally, leave the exposure behind. The transaction should also be structured in a way, both at the time of closing and after closing (for example, in connection with a post-closing internal restructuring), that does not violate any CARES Act obligations that survive loan repayment or any restrictions on executive compensation and dividends.
- *Representations and Warranties*. Unless due diligence warrants more specific and expanded representations and warranties, consider adding a simple representation that the borrower has complied at all times with all applicable obligations (contractual and legal) in connection with the CARES Act funding, including during the application/granting process as well as following receipt of the funds.
- *Conditions and Covenants*. It may be appropriate to include, for example, (i) a closing condition that no funding has been applied for or obtained under the specific provisions of the CARES Act that entail obligations that survive repayment or (ii) a covenant not to take any action which would violate the applicable CARES Act funding program.

CONCLUSION

COVID-19 has impacted how dealmakers are getting deals done, from how they perform diligence to the length of time it may take to consummate a deal to the provisions in the acquisition agreement. If the parties take into account the items set forth above, they will be able to best protect their interests while still making the deal happen.

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