



A Robinson+Cole Legal Update

Coronavirus (COVID-19)

April 15, 2020

How Will COVID-19 Impact M&A?

Authored by [Frank W. Eucalitto](#), [Eric M. Kogan](#), and [Leslie J. Levinson](#)

It is readily apparent that the COVID-19 pandemic has had an impact on transactional activity—at least in the short term—for both buyers and sellers across a range of industries. Whether parties are still moving forward with their transactions, placing them on hold until markets stabilize, or initiating them during the continuing COVID-19 crisis, both buyers and sellers may want to carefully review deal terms and consider what might need to be updated to properly account both for this pandemic and for similar events in the future. There are many provisions commonly found in M&A transactions that stand out as requiring careful consideration going forward, in light of market conditions. Below is a short summary of some key areas that buyers and sellers may want to consider addressing.

Deal Terms: Moving Off of a Seller's Market

Immediately prior to the COVID-19 pandemic, we were in the midst of a 10+-year bull run and one of the hottest and most seller-friendly markets in recent memory. Deal terms considered to be “market” increasingly became more seller-friendly, as sellers had numerous exit opportunities at attractive valuations financed by an abundance of debt and equity capital. In a matter of weeks, however, the COVID-19 pandemic has flipped the global economy on its head and, at least in the near term, has tipped the scales of leverage in favor of buyers and investors who have dry powder ready to be deployed. To that end, sellers should not only expect valuations to ease off their all-time highs, but also for buyers to start pushing back on seller-friendly legal terms. For example, buyers may be reconsidering the scope of their diligence activities, contingent purchase price payouts and mechanics, representations and warranties coverage, closing conditions, and interim operating covenants.

Reduced Purchase Prices and Earnouts

Buyers are likely to ask for (or at least consider) a reduction in the purchase price for pending deals, and even more likely to adjust their offers in future deals if there is COVID-19 risk attributable to, or perceived attributable to, the seller's business. In addition, given the current environment, buyers might consider the use of earnouts as part of the purchase price in order to allocate purchase-price risk to sellers. Parties may also consider delaying or extending the time limitations where earnouts are employed to account for the current market conditions and their impact on the business' short-term performance.

Deal Timing and Time Required to Reach a Closing

Both buyers and sellers should anticipate a lengthening of the time required to close a transaction. Most of the workforce is now working from home, and while technology enables people to continue moving business forward, working from home poses challenges that may slow down work flow between all parties. Additionally, with many private and public offices closed, as well as reduced workforces due to layoffs, parties should expect that it will take longer to obtain certain items that are required to close a transaction. For example, a seller might be required to obtain written consents to the transaction from several third

parties, and those third parties might take longer than usual to respond to the seller's request. Similarly, lien and litigation searches, surveys, title searches, and other similar conditions to closing might take much longer than is typical to complete. For that reason, the parties may want to carefully consider any time limitations in the transaction documents to complete such conditions, as the time required might be materially longer than that to which we have all become accustomed.

Operating “in the Ordinary Course of Business” between Signing and Closing

Depending on the structure of a transaction, the parties might not execute the transaction documents and close the transaction simultaneously. Rather, many transactions are held in two parts, a signing followed by a specified period of time prior to the closing. In this scenario, it is common for the agreement to require that the seller operate “in the ordinary course of business” during the period between signing and closing in order to preserve the business that the buyer is acquiring in the condition it was at the contract signing. In light of the unforeseen circumstances caused by COVID-19, sellers will likely seek an exception to the “ordinary course of business” requirement in the event of a pandemic or other similar events, which would permit the seller to take actions in order to appropriately respond to such an event without breaching the agreement. Buyers may want to carefully consider any such language proposed by a seller, as it could create situations in which a seller is permitted to take actions outside of the ordinary course of business, but that ultimately impact the business in a manner that could adversely impact the buyer (potentially without giving the buyer any recourse or ability to back out of the transaction).

Closing Conditions

Relying on traditional interim-operating covenants—such as the “ordinary course of business” requirements discussed above—may not ultimately provide sufficient protection for a buyer for transactions moving forward during this pandemic. To further mitigate risk, buyers might consider adding specific closing conditions related to: (i) defaults or force majeure notices under certain material contracts, including those with both customers and suppliers; (ii) potential government orders or other actions that could have a material impact on the business; and (iii) the availability of key employees and a sufficient workforce to maintain operations.

“Material Adverse Change” or “Material Adverse Effect” Definition

One of the many terms likely to be reconsidered during and after the COVID-19 crisis is the definition of a “Material Adverse Change” or “Material Adverse Effect.” Often the parties will negotiate certain exceptions to the definition that, even though they could have a material impact on the business, will in any event not fall within the definition. The term is typically found in certain representations and warranties made by the target company, pre-closing covenants and closing conditions in transactions that do not simultaneously sign and close. For example, a target company might be required to covenant that it will not incur any changes to the working capital of the business or incur any debt that would have a Material Adverse Effect. A closing condition could include that the target company has not suffered a Material Adverse Change and that the representations and warranties of the target company are true and correct, except as may have a Material Adverse Effect. In light of the COVID-19 crisis and ensuing government shutdown of non-essential businesses as well as the shelter-in-place requirements rolled out across the United States and abroad, sellers are likely to seek to include a carve-out to the Material Adverse Effect definition to exclude pandemics or other government-related shutdown of businesses. Buyers may want to consider limiting the scope of such a request by clarifying that any such event impacts the U.S. or global economy as a whole but does not have a disproportionate adverse effect on the seller.

Force Majeure Clauses

Much like the definition of Material Adverse Change, force majeure clauses may also be impacted by the COVID-19 crisis—although these clauses are less common in M&A transactions because of the use of the Material Adverse Change provisions. A force majeure clause provides that a party may be excused from performing its obligations under a contract upon the occurrence of certain events that are considered beyond the control of that party. Historically, such events typically include, acts of God, acts of war or terrorism, and natural disasters, among other things. While certain general language used in some clauses might be (at least arguably) broad enough to encompass a pandemic such as the one we are currently experiencing, many force majeure clauses do not address pandemics specifically and might not be triggered by such an event. While the scope of such clauses will have to be negotiated on a case-by-case basis, parties may want to consider whether it is appropriate to add a pandemic to the list of events

constituting a force majeure event. Alternatively, buyers may consider adding a “force majeure event” to certain representations, warranties and covenants. For example, buyers may seek to revise the typical representation made by sellers that no “Major Supplier” or “Major Customer” has given notice of termination of its agreement with seller to include that such parties did not give notice of a force majeure event either. Additionally, as discussed below, buyers may begin adding force majeure-related diligence items to their request lists.

Due Diligence

Buyers may want to request expanded due diligence focusing on the impact (or potential impact) of the COVID-19 pandemic on the seller’s business. This is likely to include financial, operational and legal requests. For example, buyers may look more deeply at the strength of accounts receivable, the availability of employees to continue operations, outstanding debt and free cash flow to weather a continued drop-off in revenue, the susceptibility of key employees to the virus and any corresponding succession plans, and any correspondence between the seller and its customers, vendors and suppliers since the start of the pandemic. With respect to legal diligence, buyers may request and review all contracts containing a force majeure clause and inquire as to whether any force majeure notices have been issued by the seller or received from third parties.

Representation and Warranties Insurance

Representation and Warranties insurance has become increasingly prevalent in middle market transactions over the past few years, particularly those that involve competitive bidding processes. We are beginning to see and expect that underwriters will require that COVID-19 claims be specifically excluded from coverage in most transactions. In such event, the buyer and seller will need to consider the risks of this exclusion and plan for allocation of the risk in the event it impacts the business and the parties.

The COVID-19 pandemic has impacted M&A activity from both an economic and a legal perspective. In time, we will learn the full scope of the impact, but for now it is prudent for all parties involved to carefully consider all deal terms in light of this crisis. However, we remain cautiously optimistic that deal flow will resume and in time reach or surpass prior levels, given that the fundamentals of many industries remain strong, interest rates are at historic lows (and many believe will remain that way for some time), and many acquirers are sitting on substantial stockpiles of capital. We continue to work with both buyers and sellers in navigating the current market, assisting them in reviewing deal terms and crafting appropriate diligence requests.

Read more legal updates, blog posts, and speaking engagements related to this area on [Robinson+Cole's Coronavirus Response Team](#) page and feel free to contact any member of our team with questions.

[Bruce B. Barth \(Chair\)](#) | [Kenneth C. Baldwin](#) | [Michael H. Bernstein](#) | [J. Tyler Butts](#) | [Dennis C. Cavanaugh](#)
[Britt-Marie K. Cole-Johnson](#) | [Candace M. Cunningham](#) | [Andrew A. DePeau](#) | [Kathleen E. Dion](#)
[Conor O. Duffy](#) | [William J. Egan](#) | [Steven L. Elbaum](#) | [Gilbert L. Lee](#) | [Virginia E. McGarrity](#)
[Matthew T. Miklave](#) | [Endicott Peabody](#) | [Kathleen M. Porter](#) | [Taylor A. Shea](#) | [Lauren M. Sigg](#)
[Brian R. Smith](#) | [Alisha N. Sullivan](#) | [Anna Jinhua Wang](#) | [Abby M. Warren](#) | [Jeffrey J. White](#)

For insights on legal issues affecting various industries, please visit our [Thought Leadership](#) page and subscribe to any of our newsletters or blogs.

Boston | Hartford | New York | Providence | Miami | Stamford | Los Angeles | Wilmington | Philadelphia | Albany | New London



© 2020 Robinson & Cole LLP. All rights reserved. No part of this document may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior written permission. This document should not be considered legal advice and does not create an attorney-client relationship between Robinson+Cole and you. Consult your attorney before acting on anything contained herein. The views expressed herein are those of the authors and not necessarily those of Robinson+Cole or any other individual attorney of Robinson+Cole. The contents of this communication may contain ATTORNEY ADVERTISING under the laws of various states. Prior results do not guarantee a similar outcome.

Robinson & Cole LLP | 280 Trumbull Street, Hartford, CT 06103 | www.rc.com