



The impact of Coronavirus Covid 19 on M&A transactions

By Dolores Gallo – Richards, Cardinal, Tützer, Zabala & Zaefferer

The covid-19 pandemic has undoubtedly impacted almost every area of law. M&A transactions are not the exception.

Within the new framework, to initiate and successfully complete future deals, advisors and managers should see beyond the traditional approach to deal making and specifically address the challenges brought by the pandemic.

New issues and insights should be considered during all stages of the process, starting from the negotiation of a letter of intent to the final closing.

1. Letter of Intent

The corona crisis has been causing a direct negative impact on the economics of target companies. Therefore, it is likely that buyers will require longer periods of exclusivity to perform the due diligence and assess the extent of Covid-19's impact on the target's business, solvency, and operations.

While letters of intent commonly provide for exclusivity periods of 30/40 days, sellers may expect buyers to request terms of up to 60 days or even more. In turn, sellers may pretend to broaden the scope of the provisions allowing them to terminate exclusivity.

2. Due Diligence

Traditional Due Diligence requests should be adapted to analyze the impact of the coronavirus in the target's business and operations.

Among others, it will be important to know:

- The target's future liquidity and solvency, its impact on covenants, if any, under any credit facilities of the target.

- Existence of agreements which can be unilaterally terminated by counterparts of the target based on the pandemic.
- Ability of the target to perform or terminate obligations under its major agreements, based on the existence of material adverse effect and force majeure clauses.
- Labor risks associated with remote work and contingencies associated with possible contagion of coworkers.
- Risk of suspension of supply chains.
- Existence of funding assistance by the government and its implications (the Argentine government has imposed foreign exchange restrictions to companies using these subsidies).
- Compliance with the pandemic regulations and restrictions imposed by the government.

Upon completion of the due diligence, if buyer desires to go ahead with the deal, the parties should address the impact of the identified risks in the transaction and regulate how to proceed should the identified contingencies arise (reduction of the purchase price, guarantees or escrow requirements, among others).

3. Terms of the deal

Certain industries severally affected by the Covid-19 may be expected to have a quick recovery as the government restrictions are lifted, such as the food industry. On the opposite side, sectors such as us tourism and entertainment are likely to continue struggling during a much longer term. Together with this, certain industries such as information technology, health and pharmaceutical are expected to grow in response to effects of the pandemic.

In addition, there is still uncertainty as to when the pandemic will come to an end, and therefore, it is likely that buyers and sellers might have different informed opinions as to the valuation of the target.

Sellers will surely seek provisions protecting them from buyer withdrawing from closing the deal, arguing not only that the pandemic was already existing at the time of the deal, but also that it was the driving factor that brought both parties together. Buyers, in turn, will insist that the pandemic is still ongoing and continues to bring uncertainty to the companies' businesses and profitability.

Below are some clauses may come handy for both parties.

Pre-closing covenants

M&A transactions usually entail the obtention of regulatory approvals or third-party consents which take some time to obtain. This results in a gap between signing and closing during which buyer seeks to obtain such approvals. During such period, seller is normally required to conduct its operations in the *ordinary course of business*. Such a covenant is intended to

ensure that buyer receives the business in substantially the same condition it was at the time of execution of the acquisition agreement.

In new transactions, seller will seek that any actions performed in response to the Covid-19 pandemic (adaptation of the business to the Covid-19 restrictions imposed by government, measures intended to protect the safety and health of employees, reduction of cost and maintenance of cash flow), shall not be considered a breach of the ordinary course of business covenant. On the other hand, buyer will be reluctant to acquire the business if the same has been significantly affected by closing. To avoid disagreements on this matter, buyers and sellers should specifically define in advance which actions associated with the pandemic seller may be entitled to perform between signing and closing.

Material Adverse Change Provisions

Clauses known as material adverse change (MAC) or material adverse effect (MAE) allow buyers to withdraw from a deal or request a change in the terms of the transaction upon a substantial economic change in the target company between the signing and the closing.

The drafting of this clause will surely constitute a controversial topic.

As it has been almost a year since the outbreak of the coronavirus, buyer could not certainly argue it ignored the effects of the pandemic in valuation of the target business. Naturally, a reasonable or expected deterioration of the business due to the pandemic shall not constitute a MEC allowing buyer to drop the deal. However, parties may agree that the pandemic may constitute a MAE provided it adversely affects the target business beyond certain threshold values previously and specifically defined by the parties.

Consideration

Due to the complexity of valuating a business affected by the pandemic, buyer and seller may have considerable disagreements on the purchase price, specially taking into account the uncertainty as to when the pandemic will come to an end and businesses may be back to normal. In this scenario, it will be almost unfeasible to agree on a fixed price.

Purchase price adjustment clauses based on future results of the target may be more suitable to address the economic changes produced between signing and closing or even after closing.

Parties may agree on the preparation of post-closing accounts, which may allow buyer to obtain a compensation in the event the target's working capital is reduced below an agreed level due to coronavirus effects (such as suspension of credit facilities, termination of supply agreements.).

Another option are the earn-out clauses, which allow buyers to defer part of the price subject to the obtention of certain financial milestones by target, usually measured as a percentage of gross sales or earnings.

4. Digitalization

The lockdown imposed by the government has made digital work the new modality among office workers.

In the case of M&A, digitalization was already common in the conduction of the due diligence process. However, most negotiations and closings were made at in person meetings having a notary public certify the signature and capacity of the parties in the execution documents.

Digitalization has now been extended to all stages of the transaction, including negotiation, and closing, taking advantage of the use of digital collaboration tools and electronic signatures.

In Argentina, the use of electronic signature has grown to such an extent that nowadays it is the most used form for executing agreements.

From a legal standpoint, the electronic signature is riskier than the holograph signature certified by a notary public because it does not presume the authorship of the signor. The author has the burden of the proof in case third parties challenge the authenticity. However, aligned with the worldwide trends in the digitalization of law, our courts have broadly admitted the validity of electronic documents when they seem credible and consistent with the evidence provided by the signor claiming the authorship.

On a separate issue, the digitalization process requires that data privacy be given a special protection. Involved collaborators should be carefully instructed on the use of sensitive data to ensure compliance with applicable laws and regulations.

5. Conclusion

The Covid-19 pandemic is already causing a considerable impact in M&A transactions. Company managers and advisor shall adjust common deal making practices that have perfectly worked in the past to face this new reality that encompasses us all, particularly target companies.

To achieve successful transactions during the crisis, lawyers and commercial parties shall be flexible and creative to propose alternatives that work for both parties.

For more information, contact:

Dolores Gallo y Yamila Lombardo

Buenos Aires, 1979

+54 11 5031 2734

gallo@rctzz.com.ar