Getting Back on Track with a Fresh Pair of Eyes

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No doubt that this health crisis has impacted M&A deals: deals that have been signed tend to proceed to completion, but the interim period is likely to be extended in many cases, and deals that are in an advanced stage of negotiation tend to be renegotiated or aborted, whereas new deals tend to be put on hold because parties have become uncertain about the chances or ability to secure financing, the valuation of the business, and the ability to implement forecasts. In addition, parties are focused on their own ability to guarantee the survival of their business. The impact varies from one sector to another, with the automotive, airlines, hospitality, entertainment and interim recruitment sectors being hit the hardest, whereas software, telecom, healthcare, and food being less—or even positively— impacted. Despite this, we should not overlook that private equity has dry powder available at this time, and it can put itself forward as an alternative source of financing.

Deal making will gain back its momentum, but this pandemic has forced all of us to look at the aspects of M&A deal making differently. In this edition, we want to share with you some specific elements in M&A deal making that have evolved because of COVID-19. These are Due Diligence, R&W and indemnification, and signing.

Broadening Due Diligence

Before the pandemic, the buyer usually carries out a standard due diligence on the target and its business. Now, although the pandemic is not yet over, we see that one of the preoccupations of the buyer is the target's business as a whole and the target's capacity to react to uncommon and highly disruptive events. For example, the buyer will examine how quickly the business can scale downwards and upwards, the supply chain integrity, the ability to adjust and change suppliers, and the robustness and integrity of IT systems. This also means that the buyer's due diligence checklist will have to be updated, hence broadened, to leave no stone unturned. The seller will have to be more prepared than ever before to give appropriate answers or justifications to the buyer. Hence, parties and their lawyers must go out of their autopilot mode and adapt to the changed perspectives and expectations prompted by the health crisis.

Rethinking R&W and Indemnification

In line with the broadened due diligence, the pandemic has also caused parties to rethink the R&W and indemnification. They begin to scrutinize every single R&W, the types and anticipated effects of seller's disclosures, the notion and the impact of knowledge on the buyer's right to indemnification, and the repetition of R&W at completion (bring-down condition). This process of risk-allocation requires more strategic planning and advice.

We've already come across some examples of this in the deals we handled: the buyer would try to demand specific R&W that are triggered by COVID-19, such as the R&W regarding the existence of and compliance with emergency plans, health and safety and remote working policies for employees. It would also seek a R&W confirming that the seller has disclosed all COVID-19-related disruptions. Furthermore, the buyer would try to go even further and attempt to obtain an extended R&W that the seller has disclosed all facts that can impact the target and even the buyer's decision to buy the shares. The seller would in turn want to make disclosures against the R&W as much as possible as regards all COVID-19-affected actions to try to exclude or limit its liability.

The key role of the notion of knowledge in R&W is also being made more explicit and tested by the COVID-19 context. Indeed and in general, the notion of knowledge on the buyer's part is often overlooked, although it can have a tremendous impact on its chances of success in seeking indemnification from the seller in the event of alleged breach of the R&W. The SPA can stipulate that the buyer's right to seek indemnification cannot be impacted by any knowledge that would include any COVID-related effects that the buyer is aware of or has acquired (or ought to have been have acquired) before the completion date (pro-sandbagging clause). In the opposite anti-sandbagging scenario, the SPA will state that the seller cannot be held liable for breach of the R&W if the buyer knew or should have known about the breach of the R&W. If parties fail to have the SPA mention what the impact of the buyer's knowledge is on its right to claim under the R&W, then it will be determined according to the general principles of civil law. The outcome will be uncertain, as it depends on the specific details of the case. COVID-19 has indeed added another layer of complexity on top of the notion of knowledge, its scope and the consequences of having such knowledge, which we must examine and ascertain even more carefully from now on.

Finally, COVID-19 has also triggered rethinking the often "ill-considered" repetition of the R&W at completion (See our Strelia M&A Series of March 2020).

E-Signing

We humans are social animals. We are accustomed to holding physical meetings for signing and completion because we like the human interaction, the handshake and emotional exchange, and because it is simply customary. But in midst of signing a deal during COVID-19, we were forced to do things differently: use electronic signing tools because physical meetings and gatherings were impossible. We already highlighted in our October 2019 edition of the Strelia M&A Series that the use of electronic signatures would require a real change in culture and practice that could only be achieved gradually. It seems that COVID-19 has spurred this change, even if parties still prefer ordinary signatures over advanced or qualified signatures. Using e-signing tools was proof of tremendous efficiency. Everyone saved time—and trees. For a more elaborate explanation on electronic signing, see our Strelia M&A Series of October 2019.