

Reflecting and Keeping Your Cool in M&A Dealmaking

The COVID-19 pandemic has obviously put a lot of things on hold, from daily life routines to M&A deals: parties who haven't signed the deal yet will still try to renegotiate deal terms or change their minds and abort the deal. In this edition of our Strelia M&A Series, we share with you what topics are trending and what parties should keep in mind when trying to reach deals in midst of COVID-19.

Volatile Valuations

With the value of the target being uncertain during these times, the purchaser will use the COVID-19 pandemic to justify its desire to renegotiate the purchase price (including the adjustment mechanisms by, for example, going from a locked-box to a completion-accounts mechanism). Particular attention should be paid to the potential impact of the COVID-19 pandemic on the definition of adjustment mechanisms, such as working capital. As seen in previous crises, the use of earn-out and deferred payment clauses will increase.

Material Adverse Changes

MAC (material adverse change) clauses allow a party (usually the purchaser) to withdraw from the deal if certain events occur after signing that have a material adverse effect on the target (or on the purchaser). When defining the MAC clause, the seller would likely assert that pandemics, including COVID-19, should be excluded, whereas the purchaser would be adamant about wanting to include a disproportionate impact exception to such exclusion (i.e., the pandemic has a disproportionate impact on the target compared to other participants in the industry in which the target operates). Regarding the disproportionate impact notion, parties would have to carefully set out the appropriate criteria for determining the disproportion. Belgian law stipulates that deviating clauses such as a MAC clause are to be interpreted strictly, and in the event of doubt, interpreted against the party whom the clause is to benefit (i.e., the purchaser). Therefore, given the heavy burden to successfully invoke a MAC (clause) should a dispute be brought before a court, it would be in the purchaser's interest if it had carefully described the objectives being pursued with the transaction and had listed the MAC events carefully (if possible, exhaustively), including their consequences, by referring to, for example, the EBITDA.

Interim Operations

Traditionally, the transaction documentation will state that between signing and completion, the seller will conduct the target's business as usual in the ordinary course and consistently with past practices. Here, the seller would have to figure out how it can commit to conducting the business in times of uncertainty due to a public health crisis. The seller could assert that the obligation to conduct business as usual should be limited to using commercially reasonable efforts along with specific exceptions that allow the seller/the target to cope with or even overcome the health crisis. The transaction documentation could also state that parties must cooperate between signing and completion to confront and cope with the health crisis together. The importance of interim operations to a purchaser can even be more explicit in a locked-box mechanism whereby the risks and benefits of the target are transferred to the purchaser as from a historical date-specific financial situation of the target, which is very often before the signing date.

The purchaser might want to include a condition precedent requiring that the seller has committed no material breach of the interim covenants, provided that the term material breach is clearly defined. On the other hand, the seller should be on a look-out—from a liability perspective—for breaches of the covenants during the interim period. If, after completion, the purchaser alleges that the seller has breached the interim covenants, should the seller have to indemnify the purchaser? In other words, the questions that should be answered here are: What are the time limits for the purchaser to claim indemnity from the seller? And is the seller's liability capped?

Long-stop Dates

Satisfying conditions precedent, such as regulatory requirements, could take more time as institutions have their staff work remotely and meetings are being postponed. Parties should therefore carefully consider the long-stop dates and the consequences for the failure to meet the long-stop date, for example, by asking: Will there be a break fee payment? And under what circumstances can the long-stop date be extended?

Representations and Warranties – R&W Insurance

As usual, but even more so because of the COVID-19 pandemic, a purchaser will want R&Ws to state that the target has no supply chain issues. The purchaser will also want to look at other aspects of the business that could be impacted by the COVID-19 pandemic and would like R&W's on employment, accounts receivable and stock. The seller, on the other hand, would be cautious and foresee exclusions in the R&Ws that would cover any issue arising directly or indirectly from the health crisis. When all or some R&W are made on signing and are considered made again on completion, the seller should determine what the potential impact of the COVID-19 pandemic is on the relevant R&W, especially if there is a long lapse between the signing and completion. Mechanisms for additional disclosures by the seller after signing and their consequences should be set out in detail in the transaction documentation.

From an R&W insurers' perspective, we see that insurance companies are excluding any COVID-19-related risk from coverage, subjecting COVID-19 risks to scrutiny during due diligence as well as monitoring process deals tightly during the interim period to assess any COVID-19 impact.



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