Present Tense: Allocating the Evolving Risk of COVID-19 in M&A Transactions

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The enormous impact the COVID-19 outbreak has had on individual companies, industry sectors, and the economy overall, coupled with the continuing uncertainty about the duration and magnitude of its effects, presents a difficult challenge for parties negotiating M&A agreements in this environment. Sellers naturally want the buyer to bear all risk associated with COVID-19 since the risk (if not its full impact) is known, and because the seller of a company today, probably accepting a lower price than might have been obtained just a few weeks ago, does not want to give the buyer open-ended conditionality. At the same time, no buyer can really know the full extent of the risk that COVID-19 represents, and the buyer might reasonably want to be able to back out if things get a lot worse or affect a particular business in a way that might not be reasonably anticipated at the time of signing the deal.

The most seller-favorable way to allocate this risk would be make clear in the acquisition agreement that the buyer is bearing it, i.e., COVID-19 as well as responses to the pandemic by the target (and its customers and suppliers), the government and the markets generally, could be expressly excluded from the material adverse effect (MAE) definition and from the obligation to operate the target business in the ordinary course between signing and closing. Events arising from or in response to COVID-19 could also expressly be deemed not to result in a breach of representations and warranties. This could be the case with respect to all COVID-19 effects or only those that do not have a disproportionate effect on the target business compared to others in its industry.

A middle ground might be to exclude COVID-19 and like events from the MAE definition and ordinary course covenant (and perhaps the representations and warranties), but to define those events such that the exclusion does not cover a material worsening of the effects of the event (or possibly a material worsening that has a disproportionate impact on the target). Such a formulation might allow a buyer and a

seller to sign a definitive agreement despite the current uncertainty, but if the buyer later tries to back out of the agreement as a result of COVID-19 events, there is likely to be a dispute about whether those events represented a material worsening or were instead a likely or at least foreseeable effect of the crisis as it existed when the agreement was signed. This potential for dispute may not be fatal; indeed, it is an existing feature of the MAE clause, which almost never defines materiality with specificity.

Another possible approach would be to combine one of the constructs outlined above with a reverse termination fee payable by the buyer if it fails to close for COVID-19-related reasons. This would at least partially compensate the seller if the impact of COVID-19 on the business proves too great for the buyer, while also motivating the buyer not to walk away from the deal unless the situation really has taken a serious turn for the worse.

Various combinations of these approaches, and variations on them, are also possible. It is always difficult to reach agreement on M&A transactions during times of upheaval. The unprecedented nature of the COVID-19 outbreak may require new tools to allocate risks in a way that both parties can accept. It may also mean that some deals simply will not be reached until the impact on the target business becomes clearer.

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For more information regarding the coronavirus, please visit our Coronavirus Resource Center.

Please do not hesitate to contact us with any questions.

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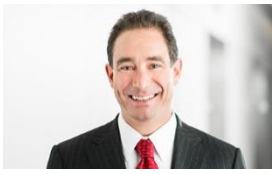

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