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M&A Transactions During the COVID-19 Crisis

by **Jennifer McGuire**

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As the number of confirmed coronavirus cases escalates globally, parties involved in M&A transactions grapple with increased uncertainty, risk, and practical difficulties.

In this article, we identify the challenges for M&A transactions in this environment. We also offer some practical suggestions for both buyers and sellers to mitigate disruption and protect against risk.

Due Diligence

Most legal and financial due diligence exercises are now carried out in virtual data rooms. This can continue while there are personnel available on the seller side to gather and upload documents, and on the buyer side to review documents. This process may be able to proceed relatively unaffected.

COVID-19 affects arrangements for site visits, inspections, and management meetings, which need to be managed as appropriate in the circumstances. In the light of COVID-19 buyers will conduct more thorough diligence on the ability of employees to work remotely, any related agile working plans, the scope of insurance cover, and the target's ability to perform under its contracts with customers and suppliers.

Software Solutions: Artificial Intelligence (AI)

One way to address the burden of the increasing scope of due diligence with fewer people available to assist, is to make use of an AI software solution. This rapidly developing software can already be used to perform full-scale analysis on contracts, identifying, for example, force majeure and material adverse change clauses. This can assist in quickly establishing the risk profile of a target, so that advice can be provided at an earlier stage in the transaction. Many law firms have already used such software and are therefore not experiencing disruption in this regard.

Material Adverse Change (MAC) Clauses

Many clients may be concerned as to whether the effects of COVID-19 would constitute a MAC.

In M&A transactions, MAC clauses are typically used to permit a buyer to withdraw from an agreement, where there are material adverse changes in the target business between the date of signing an agreement and completion, pursuant to that agreement.

MAC clauses are normally quite bespoke, and a determination of whether COVID-19 constitutes a MAC would depend on the definition of MAC in each agreement, and the facts giving rise to the alleged MAC.

For parties currently in the process of negotiating an M&A transaction and considering a MAC clause, they may wish to provide for either the express inclusion or exclusion, of the potential impact of COVID-19 in the definition of MAC. Alternatively, there could be an exclusion from the definition of MAC of changes that do not disproportionately affect the target compared to competitors in its industry.

Warranties and Indemnities

Parties in the process of negotiating an M&A transaction will need to consider their positions as to what protections are required by the buyer, and what the seller is willing to provide.

For sellers, they should now consider whether any of the warranties being sought could be rendered untrue due to the effects of COVID-19, such as the target's ability to pay debts as they fall due, IT systems functioning properly, details of any recent updates to sick leave policies, etc. The seller should carefully prepare disclosure in its disclosure letter with the aim of shifting the risk to the buyer.

Buyers should seek specific COVID-19 related warranties particularly in relation to business continuity plans and matters that might have a financial impact on the business. If a seller has taken actions seen to be inappropriate or has been inactive in its response to COVID-19, a buyer might seek an indemnity in respect of employee claims relating to issues arising in relation to COVID-19.

Warranty and Indemnity (W&I) insurers may seek detailed analysis of how the parties are addressing the impact that COVID-19 has had on the target business.

Valuations and Price Negotiation

Price negotiations may be kept under review as the financial impact of COVID-19 on the target business is measured. It is unlikely that historical financial information would accurately reflect future performance of the target if it has, for instance, a disrupted supply chain. Sellers may accept lower valuations than originally discussed if the target has been badly affected. Buyers who have the available funds could take advantage of low prices at this uncertain time.

In addition to the impact on earnings, valuations based on EBITDA multiples for a particular industry may be adjusted if the multiple for that industry is deemed to have changed.

This may not always be negative, as certain industries may see increased demand due to COVID-19. Parties to an M&A transaction may wish to progress other matters first and leave any price renegotiation to a later stage where the impact on the target has become more apparent, or the number of new cases of COVID-19 is declining.

Financing

Buyers may find it difficult to secure financing due to market volatility. Budgets and projected financials may be called into question by lenders in light of COVID-19, and there may be a perceived risk that borrowers may fail to meet financial covenants after drawdown, particularly where cash flow issues might arise.

Even buyers who have already entered into finance agreements are at risk that lenders will withdraw the facility before drawdown, if the finance agreement contains a MAC clause.

It is generally not recommended to sign an agreement for an M&A transaction where a condition to completion is the procurement of bank financing by the buyer, as this is essentially one-sided, leaving the seller contractually bound and in limbo without any control on the process. Sellers might seek alternative buyers with access to funding, and buyers might present COVID-19 updated projections to banks, requesting pragmatic solutions, such as temporary relief from certain financial covenants, provision of overdraft facilities, or periods of waiver for defaults.

Timing

Closures of governmental agencies or regulators may result in delays in obtaining required approvals. In Ireland, the Competition and Consumer Protection Commission (CCPC) has asked that merging parties delay merger notices until further notice, but has not yet indicated that there are any delays to the statutory timing of their ongoing reviews.

Specifics of arrangements for completion and contingency plans should be considered well in advance of completion. For example, parties may wish to put in place appropriate powers of attorney for execution of documents should any of the relevant signatories be unavailable. Parties should agree in advance that the exchange of electronic copies of signed documents will suffice, with originals (where required) to follow at an appropriate time.

Thoughts

It is difficult to predict the lasting impact which the COVID-19 outbreak will have on the global economy. We expect M&A activity will remain steady as parties find opportunities for investment and divestment within the current market and adapt to the current circumstances.

If you would like to discuss the potential impact that COVID-19 may have on your transaction, please contact a member of our Corporate team.

For further information please contact [Jennifer McGuire](#), [James Byrne](#), or Ciara Doris. To view our cross-disciplinary coverage of business continuity during the COVID-19 outbreak, please visit our dedicated [special insights page](#) and sign up to our mailing list by [clicking here](#).

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