Managing the Commercial Impact of the Coronavirus: Impacts on the Corporate & Securities Landscape, Including M&A and Public Company Reporting Considerations

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The coronavirus (also known as COVID-19) has now been documented in more than 100 countries and territories. Over 135,000 cases have now been documented across the globe, resulting in more than 5,000 deaths, with cases outside of China tripling in just the past week. In the United States, there have been more than 1,000 reported cases across at least 45 states. The coronavirus has significantly impacted domestic and foreign travel. The Department of State issued a Global Health Advisory – Level 3 (the second highest advisory), requesting United States citizens reconsider any international travel due to the global impact of COVID-19. In addition, many businesses have imposed restrictions on domestic and foreign employee travel. Twitter, Amazon, Salesforce and Nike, in addition to scores of
manufacturers and professional service firms, are among the companies banning certain employee travel due to the coronavirus. Many colleges and universities across the globe, including now K-12 schools in the United States, have suspended in-person classes and certain events through various dates into April, urging those on campus to practice appropriate “social distancing” in order to stop or slow down the spread of the coronavirus.

At the epicenter of the coronavirus is the important worldwide manufacturing hub of Wuhan, China. The recent spread to other major manufacturing hubs further impacts the global economy and supply chains in ways not seen since the SARS outbreak in 2003. Investors reacting to the coronavirus have caused extraordinary fluctuations in the stock market, reflected in the Dow’s end-of-February plunge and its March 2nd gains, both record-breaking. The Federal Reserve made an unscheduled half point interest rate cut, in an effort to calm investors and help protect against the economic impact of the coronavirus. And, the Saudi Arabia-Russia price war has now exacerbated market stresses, causing the greatest drop in crude oil prices since 1991.

At the center of the financial impact is the growing disruption to worldwide supply chains across many industries, including manufacturing, technology, solar, hospitality and travel, healthcare, food, fashion and apparel, to name just a few. China is the world’s second largest economy, and so the effect of the coronavirus extends – much like the coronavirus itself – far beyond its borders. In fact, according to Fortune.com, by the end of February, 94% of Fortune 1000 manufacturers had been hit with disruptions as a result of the coronavirus.¹

Particularly now that the World Health Organization has classified COVID-19 as a pandemic, we urge any and all individuals and businesses affected or prospectively affected by COVID-19, including, for instance, those seeking to pursue or who are pursuing an M&A transaction and public reporting companies (“Affected Parties”), to take time to determine current and future responses to the impacts of COVID-19 on their transactional and/or operational planning and management.

Earlier in the emergence of COVID-19 as a global threat, much of the attention was focused on impacts in East Asia, including China in particular, as discussed above. Many companies were affected at the corporate / securities level due to supply chain impacts from China.

Increasingly, however, COVID-19’s reach extends globally, affecting companies often in both direct and indirect ways. From quarantine or illness of key employees, members of management, or parties to a transaction, to disruptions of audits and other activities necessary for companies to produce Securities and Exchange Commission (“SEC”) reports or conduct due diligence, to the tightening of capital markets / access to debt financing, COVID-19’s current and prospective impacts are far-reaching.

Affected Parties should consider the following “Top 5” impacts of COVID-19, as applicable, which span various corporate and securities factors, many of which are inextricably intertwined (and which are listed in no particular order):

1. Relief from Strict SEC Periodic Reporting Deadlines for Public Companies.
The SEC has enacted an order granting conditional regulatory relief and assistance to public companies affected by COVID-19. Under the order, companies are given 45 additional days to file quarterly reports on Form 10-Q and annual reports on Form 10-K that otherwise would have been due between March 1, 2020 and April 30, 2020. The primary condition for obtaining this relief is that the company must first file a current report on Form 8-K (or, for a foreign private issuer, on Form 6-K) to disclose the conditions caused by COVID-19 that prevent timely reporting. This report is due by the later of March 16th or the original reporting deadline that cannot be met. Companies using Form S-3 or Form S-8 (or both) will remain eligible to use those forms in reliance on the relief order if they were current and timely in their public reports as of the first day of the relief period and if they actually file the subject reports within the 45-day relief period. When the SEC enacted its relief order, Chairman Clayton reminded all public companies to update their published risk factors and the “known trends or uncertainties” disclosures in their Management’s Discussion and Analysis of financial data to account for the actual and expected impacts of the coronavirus on their businesses. This exhortation applies to companies that choose to avail themselves of the reporting deadline relief and also to companies that choose to file their reports on the original deadlines. Reporting companies will want to avail themselves of the existing safe harbor from liability for forward-looking statements in making these novel disclosures. In our view, the need to pause and think critically about risk factors and MD&A is, in itself, a reason to file a Form 8-K so as to obtain the SEC’s timing relief. In a future publication of this series of coronavirus advisories, we will provide guidance to companies relative to appropriate risk factor and MD&A disclosure pertaining to coronavirus events and circumstances.

2. **M&A & Private Equity - Due Diligence Considerations.** In some of the earliest stages of pursuing an acquisition or an investment, due diligence stands out as a core endeavor. Given the still inchoate impact of COVID-19, the otherwise fairly straightforward and conceptually simple process of due diligence now creates a cause for pause. Even where COVID-19’s impact on a target or an investment is less than clear, Affected Parties will want to ensure that the documents, procedures, and teams they are using or consulting with to conduct due diligence are updated, comprehensive, and capable of contemplating a wide range of COVID-19’s potential impacts (aimed at ascertaining what a target company is doing about COVID-19 and how it and its suppliers, customers, and other business partners have been affected by COVID-19, and whether its insurance policies will cover losses caused by COVID-19). Affected Parties engaged in due diligence activities should also keep in mind that COVID-19 outbreaks could lead to the implementation of containment protocols that directly affect targets or parties to a transaction, such that responses to due diligence inquiries may slow down or halt for some period of time. Definitive documents should include appropriate flexibility in timelines, subject to the Affected Parties’ goals and requirements.

3. **M&A and Corporate Governance - Negotiating Intended Deals and Expecting More Unsolicited Bids.** Leading up to definitive documents in M&A transactions, there are generally several rounds of edits to the deal documents, with the aim of allocating or shifting various risks and liabilities between the parties. As in many other ways, COVID-19 complicates this process. For example, the negotiation of core provisions, like Material Adverse Change /
Effect ("MAC" or "MAE") provisions, now – for most parties – will involve discussion and debate regarding whether to carve-out or preserve COVID-19 as a MAC/MAE. Whether COVID-19 (or its impact) features as a MAC/MAE in an acquisition agreement will likely represent a major determining factor, with respect to whether a buyer could walk away (if it is a MAC/MAE), or whether a seller could force a buyer to close (if it is not a MAC/MAE). If COVID-19 proves to develop into an even more serious global issue, M&A activity may see considerable slowdown as a result, in large part due to parties not being willing to compromise and assume unpredictable and potentially materially impactful risks. Certainly, M&A transactions with public equity as consideration in whole or in part will be greatly impacted, if not shelved, for a later time. With that said, activist investor activity typically increases in slow / down markets, as do unsolicited bids for companies with declining stock prices. Keeping in mind the prospect of potentially undesirable, unsolicited bids, companies can plan ahead by reviewing thoroughly (and, possibly, revamping) their activist readiness, including a review of organizational and committee documents (e.g., bylaws and charters), including considering classified boards, advance notice of shareholder proposals, selection of optimal venues and times for annual shareholder meetings, rotation of board committee members, refreshment of the board, proactive engagement with key shareholders, and other changes that might help deter unsolicited bids or other unwanted shareholder activist activities that could disrupt operations and management.

4. **M&A - Pending Deals and Timelines for Deals Under Contract; Travel and In-Person Meeting Restrictions.** A multitude of unexpected events or diversions caused by COVID-19 might create delays, including to the satisfaction of certain conditions to closing or other obligations of the parties. Particularly as regards target companies: (i) quarantine or illness may inhibit the availability of key employees or members of management; (ii) crucial customer and supplier relationships may be under stress; (iii) minimum sales / performance metrics may fail to be met; (iv) regulatory approvals (e.g., HSR and other antitrust regulatory requirements) may experience delays; and (v) other such issues may arise. From a practical and basic perspective, COVID-19’s impact on deal closings or transitions after deals close may include the impeding of crucial in-person meetings, site visits, audits, and travel (generally and related to the foregoing pursuits), which can create further delays and disruptions. Further, issues may arise with regard to MAC/MAE provisions referred to above. For instance, a buyer might have agreed to a certain level of risk with respect to COVID-19 (presumably, the level of risk generally understood publicly at the time of signing), but not a substantially greater level of risk that develops post-signing. Similarly, a buyer might have agreed to assume risks for only a defined period of time, but not if the COVID-19 threat persists for longer than that; or a buyer might have agreed to assume COVID-19’s risk with respect to a target company, but not if the impact on the company becomes substantially greater than on the target company’s industry, more broadly. Our guidance in this regard is to review the wording of MAC/MAE conditions in process and attempt to negotiate modifications that will improve your position with reference to these factors. If you cannot obtain modifications that suit your circumstances, then consider adjourning the possible transaction until the macroeconomic and microeconomic impacts of COVID-19 are clearer.

5. **Financing Considerations in M&A and Generally.** Currently, capital market
conditions are extraordinarily volatile. Both the equity markets and the debt markets have sold off significantly since mid-February. The Dow Jones Industrial Average entered a bear market on March 11, 2020, for the first time since the Great Financial Crisis of 2008. The yield spread between high-yield debt and Treasury securities is at an eight-year high, indicating that the cost of borrowing for below-investment-grade companies – which is the overwhelming majority of American businesses – has risen sharply. As we publish this update, the federal government is considering measures intended to assure the availability of affordable credit for businesses large and small, but no definitive actions have been taken yet. In these highly unusual circumstances, companies seeking debt financing should be prepared for more strenuous, less flexible negotiations. In the context of acquisition financing, both buyers and sellers should attempt to ensure that problems caused by COVID-19 do not thwart transactions. For instance, if regulatory requirements (e.g., HSR) experience delays, buyer and seller parties will want to seek to add to their commitment letters from financing sources sufficient time to close, including allowances for extensions to mitigate the impact of delays. Moreover, both buyers and sellers should be prepared to address any due diligence requests in connection with COVID-19 that financing sources may make.

At this time, Affected Parties should consider taking additional steps now in order to mitigate their risk of suffering negative impacts from the coronavirus. For additional web-based resources available to assist you in monitoring the spread of the coronavirus on a global basis, you may wish to visit the CDC and the World Health Organization.

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