In the rapidly developing climate created by Coronavirus (COVID-19), there is evolving uncertainty on how the pandemic would be interpreted under M&A, finance and commercial agreements, and parties’ abilities to enforce or terminate their obligations or performance thereunder. This article briefly summarizes and analyzes provisions that are becoming relevant to assess in the context of COVID-19.

The effects of COVID-19, and specifically its effects on corporate transactions, will continue to develop and therefore, the legal analyses relating to the provisions discussed below remain fluid. As such, it is important to engage legal counsel to assess your agreements and specific questions as the analysis may change based on specific language and on the COVID-19 situation as it continues to evolve.

Mergers and Acquisitions

(a) Material Adverse Effect/Change Qualifiers

In the context of a typical merger or acquisition transaction, a material adverse effect or material adverse change (MAE) qualifier applies to certain of the transaction agreement’s representations and warranties, covenants and closing conditions. Under these agreements, if a MAE occurs as it relates to one of these provisions, the buyer may no longer be obligated to close the transaction. The relevant consideration currently is whether COVID-19 has the potential to trigger a
MAE in a seller/target entity's business. Presently, this appears unlikely, but this may change as the COVID-19 situation and its effects develop.

There is no common law definition of a MAE; however, there are two parts to a typical MAE provision: (1) a MAE is any event, development or condition occurring that has had, or would be reasonably expected to have, a material adverse effect on the business, financial condition or results of operations or, in certain cases, the business prospects of the seller/target entity which was unforeseeable at the time the contract was drafted, but (2) the impact of certain events outside the control of the seller are excluded from the MAE definition, including acts of God, natural disasters, general economic downturns, terrorism and acts of war. However, such exclusions are not excluded to the extent they have a disproportionate adverse effect on the target company as compared to other businesses in the same industry (i.e., even if an industry is affected disproportionately as compared to other industries, it would still need to be established that the individual business in question is disproportionately affected within that industry as compared to its peer companies).

Analysis of the specific MAE provision in question and its named exclusions is necessary to be able to understand whether effects caused by COVID-19 qualify as a MAE. It is important to remember that the typical MAE clause allocates industry/general market risks to the buyer and company-specific risks to the seller/target entity, meaning courts will generally look to an effect that changes the seller business, not merely an effect that changes the business of the entire seller industry or the market in general to constitute a MAE.

To that end, courts have interpreted MAEs narrowly. In both New York and Delaware, there is a high bar to a finding of a MAE, with a heavy burden on the moving party to establish that a MAE has occurred. The courts have typically required that the change was both material and had durational significance (meaning a change measured in years, not months). Currently, a claim that there has been a MAE due to COVID-19 would more than likely not be successful because of uncertain duration, but this generalization is dependent on the specific language and the specific target company. If the MAE provision includes “prospects” of the business or other forward-looking language or does not contain the exclusion softeners described above, a MAE may be triggered.

(b) Representations and Warranties; Covenants; Closing Conditions

Outside of the MAE analysis, both the buyer and seller should review representations and warranties for compliance. A typical closing condition is that the representations are true and correct in all material respects as of the date made and as of the closing date, and it is important to track any possible changes in the veracity of the representations resulting from the effects of COVID-19.

It is also important to consider pre-closing operational covenants, which often limit a target company’s ability to operate outside of the ordinary course of business without the buyer’s consent, including specific restrictions against workforce reductions, material changes in personnel policies and changes in compensation. A seller pivoting its business practices and/or polices due to COVID-19 may bump up
against these operating covenants. There can be exceptions for actions taken in compliance with applicable laws that may otherwise contravene these operating covenants, but sellers should still be wary of the potential need to acquire buyer consent before taking actions in response to public health guidance or other effects of COVID-19.

(c) Post-Closing Covenants

Further, it is important to review and consider the effects of COVID-19 in the context of purchase price adjustments (including working capital clawbacks), and any post-closing operating covenants made in connection with the retention or compensation of employees, any earn outs or post-closing bonus arrangements.

Commercial Finance

In the world of commercial loan financings, lenders and borrowers will need to consider the impact of COVID-19 on representations, warranties and covenants under loan documents. Non-compliance with those items could lead to events of default and could trigger a lender's right not to advance additional loans. Here are some specific considerations:

(a) Financial and Other Covenants

Decline in business as a result of COVID-19 could affect upcoming financial performance tests, such as leverage ratios, fixed charge coverage ratios and interest coverage ratios that are tested monthly or quarterly. Those ratios are primarily based on a company's EBITDA, which is defined differently in each deal. Borrowers and lenders should carefully review the definition of EBITDA in their loan documents, including any add-backs and deductions imbedded in that definition.

While financial covenants are the most likely culprits when considering the impact of COVID-19 on loan documents, a borrower may also be subject to covenants or events of default tied to operational continuation or business interruption. For example, a credit agreement may state that if a borrower were to suspend operations for a specified period of time, then an event of default would arise. These types of covenants and events of default can vary from deal to deal.

Borrowers should also be mindful of any additional reporting requirements that may spring into effect as a result of COVID-19, such as notices required to be delivered to lenders. Borrowers and lenders will be communicating with each other often in the aftermath of COVID-19.

(b) MAE

Like acquisition agreements, loan documents also include MAE provisions. Typically, a borrower represents that no MAE has occurred since the date of its last audit. Representations are usually made at closing and re-made in all material respects on the date of each borrowing under a credit facility. Sometimes, the occurrence of a MAE constitutes an automatic event of default. If an event of default
happens, a lender likely is no longer obligated to lend, and a lender could take various enforcement actions to seek recovery on its loan.

In considering the effects of COVID-19 on MAE provisions in debt financings, the analysis would be similar to acquisition transactions. However, the definition of MAE in a debt financing is typically broader than in an acquisition agreement. For example, risks outside of a borrower’s control (e.g., acts of God, natural disasters, general economic downturns, terrorism and acts of war) generally are not excluded. Also, while courts may consider long-term effects in the context of acquisitions (requiring the effect to span years, not months), it is possible that they may take into account shorter-term factors for debt financings. While the risk of triggering a MAE may be elevated for borrowers under a typical credit agreement when compared to target companies under a typical acquisition agreement, lenders historically have been more comfortable relying on other triggers (such as financial covenants) when assessing events of default. Ultimately, MAE is fact specific and will need to be analyzed on a loan-by-loan basis.

**General Corporate Contracts**

**(a) Force Majeure**

In commercial contracts, a *force majeure* provision may be relevant to assess the parties’ continuing performance obligations in the context of COVID-19. Like MAE, *force majeure* is not defined under common law. A typical *force majeure* provision excuses a party’s nonperformance when “acts of God” or other extraordinary events outside of a party’s control prevent such party from fulfilling its contractual obligations.

Similar to MAEs, courts tend to interpret *force majeure* narrowly. The circumstances that render the party’s performance impossible must be (i) unforeseeable, (ii) outside of the reasonable control of the party invoking the provision and (iii) enumerated in the provision. The analysis under the current COVID-19 situation will depend heavily on the specific language of the provision and whether effects related to COVID-19 have been defined publicly and are currently in effect (i.e., a pandemic/epidemic, governmental regulation, transportation curtailment). Parties should be cautious (i.e., seek legal advice) when relying on a *force majeure* provision to excuse performance.

**(b) Impossibility/Impracticality**

Note that where there is not an express *force majeure* provision, or it is not applicable, the doctrine of impossibility/impracticality may apply in the COVID-19 context. Under the impossibility doctrine, contract performance may be excused when at the creation of the contract, or thereafter, performance became impracticable due to some extreme or unreasonable difficulty, expense, injury or loss involved.

Applicability of this doctrine varies across the states. For example, New York limits the doctrine of impossibility to cases where performance is objectively impossible due to the destruction of the means of performance by an act of God, *force*
majeure event or the subsequent passage of law rendering performance illegal, or there has been a change in circumstances so fundamental that it would be unjust or contrary to public policy to hold the parties to their original agreement. Similar to seeking a force majeure out, parties should be cautious (i.e., seek legal advice) in seeking to rely on an impossibility right as an excuse for performance.

(c) Contract Breach

Unless force majeure, impossibility or a similar provision applies, in the event of contract breach it is likely the non-breaching party will be able to pursue remedies for breach of contract that stem from the general effects of COVID-19.

Conclusion/Recommendation

It is important to note that in all contexts discussed above, analysis of the specific provision in question and law of the particular applicable jurisdiction is necessary to determine its applicability as it relates to the effects of COVID-19. Currently, instances where COVID-19 qualifies as a MAE or force majeure are narrow. It is possible that as the situation further develops, the analysis on these questions will also change, and it is important to seek legal advice to conduct this analysis based on the situation as it currently stands.

Proactive measures to account for the effects of COVID-19 are highly recommended moving forward. Contract parties should attempt to negotiate provisions that account for COVID-19 and also take steps to mitigate potential losses, which will help to reinforce demonstrating to courts that performance was truly impossible or that the material adverse effect resulting from the effects of COVID-19 was truly unavoidable.

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