As the effects of the Coronavirus (COVID-19) crisis ripple through the global economy, buyers contemplating—or in the process of negotiating—an acquisition can and should take measures to contain and handle deal risk prior to signing.

IN DEPTH

The outbreak and rapid spread of Coronavirus (COVID-19) has affected businesses across a plethora of industries and threatened the global economy. As health organizations and governments around the world are working to contain COVID-19 and cure the infected, what measures can buyers take to contain and treat deal risk prior to signing?

Given current uncertainty regarding both the short-term and long-term effects of COVID-19, below is a checklist of key considerations for buyers with respect to COVID-19 era transactions.

Extensive Diligence: Take the Target’s Temperature

1. Analyze key contracts with respect to termination and force majeure clauses in order to understand the circumstances under which the target (or counterparty)
may suspend or terminate performance as a result of COVID-19’s impact.

2. Perform a detailed review of supply chains (for example, raw material suppliers, distributors, wholesalers, retailers and end consumers) to understand their geographic scope and to assess exposure to potential disruption.

3. Review the target’s existing insurance policies for business interruption terms.

4. Evaluate compliance with existing and new regulations relating to the epidemic, including with respect to employment matters. Seek to understand potential relevant changes in law.

___Attempt to Cure Purchase Price Uncertainty

1. The potential short-term and long-term impact of COVID-19 creates an extra challenge when valuing a target.

2. To help mitigate uncertainty, consider purchase price mechanisms such as earnouts, milestone payments, coronavirus-related holdbacks, adjustments to net working capital and rollover equity.

___Provide Protection through Representations and Warranties

1. Require disclosure of all material impacts to the business relating to the virus.

2. Examples of such impacts may include the status of material contracts, customers, suppliers and other business relationships, the accuracy of financial statements (including the adequacy of reserves), data privacy controls (notably, with respect to an increase in remote working), employee layoffs, regulatory compliance, pending litigation, inventory, and any current precautions or business continuity plan as a response to the pandemic.

___“Social Distance” from Representation and Warranty Insurance Policy Exclusions

1. Expect that insurers will exclude losses arising from COVID-19. Attempt to narrowly tailor the language of any proposed exclusions, including by limiting them to specific concerns and jurisdictions.

2. Should a policy exclude such losses, consider excluding coronavirus-related representations and warranties from indemnification deductibles and caps or adding a special escrow.

___MAC Carve-outs: Stop the Spread

1. A well-drafted material adverse condition (MAC) clause should provide the buyer with a broad walk-away right from the transaction if the target’s business suffers materially due to the impact of the virus.

2. Leave no ambiguity and explicitly reference COVID-19 as a MAC, or include terms such as “pandemic,” “epidemic,” “outbreak of disease” or “public health event.” Push back if the seller includes any of the above terms as a carve-out to the MAC clause.

3. Potential compromises may include accepting a coronavirus carve-out except to the extent it has a disproportionate effect on the target as compared to other participants in the target’s industry, deciding how long or the extent to which the negative impact of the virus on the target’s business must continue in order to constitute a MAC, or the buyer accepting the level of harm caused by the virus.
pandemic at the time the deal is signed, but not a material worsening of such harm after signing.

### Diagnose Risk in Interim Operating Covenants

1. Expect that sellers will negotiate heavily any interim operating covenants to take into account any steps taken in response to or in anticipation of the outbreak or worsening of the virus.
2. Resist any major changes to ensure that the target is operating consistently with past practices and normal, day-to-day operations, or otherwise that such carve-outs are minimal in scope.

### Prescribe Appropriate Closing Conditions

1. In addition to including the nonoccurrence of a MAC as an express closing condition, consider other relevant closing conditions that will protect you if the business of the target deteriorates before closing.
2. Examples may include no termination of or receipt of notice to terminate under the target’s most significant contracts, no government interference in the business of the target (for example, through the invocation of the Defense Production Act), no closure of key facilities of the target or of key members of the target’s supply chain, or no adoption of any law imposing restrictions on the operations of the target or a target’s major customer or supplier related to COVID-19.

### Treat Deal Timelines with Flexibility

1. Expect that, more likely than not, your deal timeline will be delayed and be prepared for such a delay. Possible sources of delay include travel restrictions and delays in obtaining financing or regulatory approvals.
2. Limit or eliminate in-person meetings in favor of conference calls or video conferences. Evaluate the necessity of site visits and the possibility of virtual site visits. Request an “outside date” that is further out or provide for its extension.

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