

## Private M&A: A Different Bargain for an Unsettled World

| by Steven SY Tee and Joyce Ong Kar Yee |

The emergence of the COVID-19 pandemic continues to pose challenges for companies all over the world. Numerous countries have imposed lockdown and quarantine measures, resulting in unprecedented reduction in business and income from which they may be unlikely to recover. On the other hand, this may create attractive buying opportunities for cash-rich investors, such as private equity funds, as companies will require capital injection and sellers may be eager to liquidate their assets. Buyers may also want to seize the chance to acquire companies that can thrive in the post-COVID-19 environment, such as those in the healthcare, technology solutions, and pharmaceutical research and development sectors.

What, then, are the matters that should be thought or rethought of in doing a private M&A deal in this uncertain post-COVID-19 world?

### *MAC clauses*

“Material adverse change” (or “material adverse effect”) provisions are usually included in acquisition agreements to provide the buyer with the right to walk away from the deal or claim compensation in the event of significant detrimental changes in the target between signing and closing. These MAC clauses, as they are commonly referred, are intended to cater for unforeseen circumstances having an adverse and durable effect on the target’s value. They are heavily negotiated (but rarely enforced) with the buyer commonly negotiating to have an expansive definition of what constitutes a MAC while the seller will seek a wide list of exceptions to the MAC or restrict the MAC to specific events.

Sellers may want to then carve out events such as “pandemics” or “public health emergencies” or measures adopted in response to them, from the operation of MAC clauses particularly where the sale valuation has taken account of any ongoing similar events. On the other hand, buyers may resist this as the target could be disproportionately affected as compared to its industry peers, due to geography, access to supply or other factors. Further, the impact of the adverse event may not yet be fully known. Parties could alternatively consider specifying a quantitative level of financial or operational impact from any event which, if reached, would give rise to a MAC.

### *Purchase price adjustments*

Heightened uncertainty surrounding the target’s receivables and performance affected or which could be affected by pandemics and the inevitable steps taken to counter them mean pricing risk between signing and closing should be even more carefully considered. Sellers generally prefer the use of the locked box price adjustment mechanism which only allows for purchase price changes to the extent that the target has incurred unpermitted expenditures or “leakages” such as unplanned dividend payments. It is unlikely that buyers will be comfortable with this approach where the locked box accounts were made up to a date prior to an outbreak or otherwise cannot yet take into account its full impact. Further, sellers will likely be required to incur unexpected costs in dealing with the adverse impact of any pandemic. Both buyers and sellers may then want to revert back to the traditional purchase price adjustment based on the price determined from post-completion accounts made up to the date of closing.

### *Additional due diligence and valuation*

Buyers will have to consider performing more extensive due diligence to ascertain the target’s condition. They should review the target’s compliance with existing and new laws and regulations enacted in response to any pandemic or similar event, and the liabilities of the target

to its employees relating to termination or suspension of work. *Force majeure* provisions as well as termination rights of the target or counterparties in the target's key contracts should be examined to see if they are or can be triggered. Further, buyers may want to revisit valuations and internal rates of return that were done prior to an outbreak since they may no longer correctly reflect the target's current status. Sellers should also make available information on the impact of the outbreak on the target's business, including its supply chains, IT systems and insurance coverage, as well as any appropriate mitigation and contingency plans. These will almost inevitably be requested by buyers for review.

#### *Representations and warranties*

The usual representations and warranties may have to be relooked to see how they should be dealt with in light of any pandemic. For example, MAC clauses are found in different forms, including as a representation and warranty, and, as indicated earlier, may need to be revised. The buyer could consider obtaining warranty and indemnity insurance as an alternative to reliance on the seller or guarantor's covenants. Although the effects of a pandemic outbreak are likely to be excluded from coverage, it may be possible to negotiate for a more restricted exclusion.

#### *Gap controls*

In an M&A transaction, sellers usually agree that business will be run in the "ordinary course" during the gap between signing and closing to protect the value of the target. However, these usual operating covenants will generally not permit measures such as redundancy or debt refinancing which may be needed in the face of a pandemic outbreak, even if they are in the best interests of the target. Parties should consider providing the seller and target with greater flexibility to act in that case, coupled with increased oversight for the buyer such as more extensive consultation rights and information reporting requirements.

#### *Timelines*

Transactions will definitely be slowed down due to logistical issues arising from a pandemic or measures taken to address it. Site visits and in-person meetings, especially relevant in a cross-border deal or where the target has multinational operations, may be impermissible. There could be delays in making information on the target available to buyers or, where third party financing is required, their lenders. Buyers may also experience difficulties and delay in obtaining such financing. Parties should consider extending timelines and long stop dates to allow more time to negotiate, sign and close the deal, including fulfilment of closing conditions such as third party consents and regulatory approvals.

Dealmakers will be significantly challenged in pursuing M&A transactions during these uncertain times. Improvisation in how deals are to be done is almost certain. Only its scope and permanence remains to be seen.

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