

IMPACT OF COVID-19 ON M&A TRANSACTIONS

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Authors: [Tan Min-Li](#) and Jennifer Lo

As the COVID-19 virus continues to wreak havoc around the world, most countries have imposed restrictions of some kind on their residents and businesses, in some cases, imposing lockdowns that have brought much economic activity to a standstill. Against this backdrop, sellers and buyers engaging in corporate acquisitions and disposals are faced with increasing uncertainty. While transactions are still being closed, it is of paramount importance to build in deal protection mechanisms in sale and purchase agreements (“**SPAs**”) to deal with and ensure maximum protection for parties.

In this article, we will discuss the considerations that should be borne in mind when negotiating SPAs in light of the COVID-19 situation, as well as ways to mitigate risks in merger and acquisition (“**M&A**”) transactions.

Effect of COVID-19 on contractual provisions in Sale and Purchase Agreements

Due diligence

Buyers in M&A transactions will typically conduct due diligence on a target company (“**Target**”) to identify

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legal, operational, financial, and other risks before signing or closing a transaction. The extent and focus of due diligence to be conducted will vary from deal to deal and depends on a range of factors. Travel restrictions and lockdowns in many countries have made conducting of physical meetings and inspection of factory premises in many cases, virtually impossible, forcing many to shift these online wherever possible. In view of the COVID-19 situation, buyers will naturally be concerned about the impact of COVID-19 on the Target's financials and business operations. Flowing from this, it will be important to buyers to assess business vulnerabilities of the Target, and greater emphasis should, therefore, be placed on the following areas when conducting due diligence, such as:

1. Material contracts to assess parties' rights and obligations, including provisions in relation to termination and force majeure;
2. Financing arrangements of the Target including any requirements to maintain financial ratios;
3. Potential changes to law and regulations due to the COVID-19 situation, which would have an impact on the Target's ongoing business operations;
4. Review of the Target's operations and policies for compliance with applicable laws and regulations, in particular, new regulations imposed in view of COVID-19, such as the circuit-breaker measures prohibiting workers in non-essential services from going to work;
5. From an operational perspective, customer and supply chain arrangements, which may be disrupted due to lockdowns in countries around the world

Some additional issues to consider would be whether the Target has put in place any business continuity plans and the adequacy of such plans, as well as whether losses arising from COVID-19 are covered by insurance policies taken out by the Target. Extra time may also be required for conducting due diligence, due to restrictions on movement and getting hold of physical documents.

When considering the ability of parties to fulfil their contractual obligations, buyers should bear in mind the temporary relief afforded by the COVID-19 (Temporary Measures) Act 2020 ("**COVID-19 Act**") to certain contracting parties who are unable to meet their contractual obligations amidst the severe business disruption caused by the pandemic. For more details on the temporary relief measures under the Act, please refer to our article here:

<https://www.cnplaw.com/how-to-use-the-covid-19-temporary-measures-act-to-protect-you-and-your-business-from-an-economic-downturn-cnupdate-may2020>

Representations and warranties

Buyers and sellers should examine carefully the representations and warranties to be disclosed in SPAs, and prepare detailed disclosures that will address and capture the implications of the COVID-19 crisis. For example, it will be important for sellers to address work-from-home arrangements for its employees and inability to fulfill contractual obligations arising from supply chain disruptions.

If representations and warranties have already been given, sellers should check to ensure that they have not inadvertently breached any of them or that such representations and warranties can still be repeated at

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closing, if applicable, without any additional disclosures being made. Buyers, on the other hand, will need to consider if COVID-19 specific warranties are required to protect themselves from the risks and potential impact arising from COVID-19.

Given the fluid situation, sellers should exercise care when disclosing inability to fulfill contractual obligations due to disruptions in supply chain, and these should be considered in light of the constantly evolving legal landscape, such as the enactment of the COVID-19 Act and its subsidiary legislation. You may find out more information about the COVID-19 Act and its subsidiary legislation and how they may have an impact on you or your business here:

<https://www.cnplaw.com/how-to-use-the-covid-19-temporary-measures-act-to-protect-you-and-your-business-from-an-economic-downturn-cnupdate-may2020>

Material adverse change

Material adverse change (“**MAC**”) clauses in SPAs generally allow a buyer to walk away from a transaction before closing, upon the occurrence of certain events that are detrimental to the business of the Target between signing of the SPA to closing of the transaction. MAC clauses are often heavily negotiated to address and allocate risks between the buyer and the seller in the event of adverse changes in the Target’s business between signing and closing.

In light of COVID-19, parties should reconsider the allocation of risks. Sellers may want to negotiate for more specific carve-outs in MAC clauses to prevent matters arising from COVID-19 or pandemics or epidemics to be constituted as MAC events. Buyers, on the other hand, may want to insist on a clear right to walk away from the deal if the business is materially adversely affected due to COVID-19 and similar events.

Force majeure

“Force majeure” refers to contractual terms that contracting parties have agreed upon to deal with situations that might arise, over which the parties have little or no control, that might impede or obstruct the performance of the contract. Whether the COVID-19 pandemic and/or the resulting government restrictions are covered will be determined by the wording of the specific contract term and applicable law. Parties will need to consider the wording of such clauses carefully to see whether they may be able to rely on such clauses or want to challenge them. When negotiating the drafting of SPAs, parties should consider specific carve-outs for the COVID-19 and similar situations.

Long-stop date

With many countries around the world currently under lockdown, it may become impossible for parties to adhere to the original long-stop dates envisaged in the SPA.

Parties should, therefore, negotiate to extend the long-stop date. Some relevant considerations for

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determining the extension period will be the length of the state of emergency or lockdown, or the length of time that the banks will be closed, or if approval is required as a condition precedent, the expected delay in obtaining such approval.

Other practical considerations

Employment issues

The purchaser may consider adopting cost-cutting measures such as salary cuts and trimming of the workforce to deal with the fallout from COVID-19. This could be negotiated between the parties as a post-completion obligation, and if so, the consideration for the Target should be adjusted accordingly. It should be noted that employers who implement cost-saving measures during the circuit-breaker period (ie. From 7 April to 4 May 2020) are required to inform the Ministry of Manpower (“**MOM**”) if the cost-saving measures result in more than 25% reduction in the salaries of their employees and the employer has at least 10 employees, within one week of the implementation of such cost-saving measures.

Obtaining shareholders’ approval at a general meeting

If the approval of shareholders is to be sought for the transaction, it is important to consider how the holding of general meetings will be impacted by safe-distancing and circuit breaker measures imposed by the Singapore government.

In this regard, please refer to our article for the latest updates on the alternative arrangements for holding of general meetings in the current climate here:

<https://www.cnplaw.com/covid-19-update-alternative-arrangements-for-meetings-for-companies-cnplaw-date-may2020>

Obtaining the relevant regulatory approvals

Where regulatory approval needs to be sought for a particular M&A transaction, parties should take into account the time that may be required for obtaining such approval. Whilst government bodies in Singapore are continuing to operate “business as usual” via telecommuting insofar as possible, the same may not be true of those in other parts of the world. Therefore, there remains a possibility that timelines may be delayed, particularly in transactions that involve the obtaining of foreign regulatory approvals, and parties should take this into consideration when agreeing on an appropriate long stop date for satisfaction of the relevant condition.

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Funding

With the impact of the COVID-19 crisis hitting all sectors of the economy, the global economic outlook is bleak and as a result, potential sources of funding for acquisitions may pull out. For buyers, it may be difficult to gauge how committed the funds are to at an early stage of a transaction and at signing, and buyers may suddenly find themselves struggling to obtain financing for their acquisitions.

Valuation and pricing mechanism

Due to factors such as poor general economic sentiments, disruptions in supply chain, distorted accounts receivables and payables, the bottom line of many companies will be adversely affected. Buyers and sellers may therefore need to reassess financial projections and valuations of target companies. Pricing mechanisms may also need to be adjusted to properly allocate the risk between buyers and sellers. Given the impact of COVID-19 on the Target's business and the economic uncertainties, buyers should consider whether to adopt a fixed pricing mechanism or a locked-box pricing mechanism. Buyers should also consider whether an earn-out consideration or other forms of contingent consideration are appropriate, taking into account the financial projections of the Target.

Completion

With the circuit breaker measures in place in Singapore and other measures restricting movement and physical gatherings in many countries, parties may find it challenging to obtain signatories from the relevant persons for completion documents, and to hold physical meetings for the exchange of documents at completion.

As a result, greater coordination will be required, and as mentioned above, parties should exercise flexibility and consider shifting the long-stop date of the transaction to a later date, and accepting soft copies of documents insofar as possible.

Concluding remarks

The COVID-19 pandemic has brought about a great deal of uncertainty to the deal-making process. It is therefore imperative for parties to carefully consider the impact of COVID-19 on the different aspects of the transaction, and on the business of the Target and to mitigate their risks with careful planning and drafting of contractual provisions.

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