



DEAL LAWYERS

7600 N. Capital of Texas Highway, Bldg B STE 120, Austin, TX 78731

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A Dealmaker's Guide to Post-COVID-19 Purchase and Sale Agreements

By Matthew T. Simpson, Partner, and Bethany Hickey, Associate, of Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.

As the global COVID-19 pandemic continues, M&A activity has slowed considerably, with buyers and sellers taking a “wait and see” approach to the markets. When dealmaking eventually resumes, and for those few deals that nevertheless continue during the pandemic, dealmakers should update their purchase and sale agreements to account for the impact of COVID-19 on target companies and the new dealmaking environment.

To assist dealmakers in this task, we convened a firm-wide interdisciplinary team to propose a drafting guide for purchase and sale agreements in the post-COVID-19 era.

With an eye toward making this material as

accessible and user-friendly as possible, our format tracks that of a typical stock purchase agreement, marching through key considerations in the order in which they typically appear. We take an industry-agnostic approach as we expect much of our analysis will apply across industries, and while we have endeavored to be comprehensive, these considerations are by no means exhaustive, and are subject to change as the pandemic progresses and the dealmaking environment changes in response.

Deal Economics

Consideration. Except for those few targets that come out of the pandemic on top, expect buyers to reduce purchase prices and shift a portion of the consideration to post-closing (e.g., earn-outs) or to incorporate forms of non-cash consideration (e.g., stock consideration, seller notes).

Working Capital Targets. Buyers and sellers will need to work with their financial advisors to confirm the appropriate time periods for the calculation of working capital targets and any COVID-19-related adjustments.

True Up Procedures. Given expected adjustments and the fluidity in targets' financial operations, consider requiring sellers to deliver the estimated numbers more than just a few days prior to closing to allow buyers more time to review the estimates. Buyers should push for a seller obligation to make available to the buyer all information necessary to review the estimates, and a right for the buyer to approve such estimates, subject to a reasonableness standard, or, alternately, a right to propose changes to the estimates that the seller(s) must consider in good faith. Additionally, consider extending the post-closing true up period to allow the buyer more time to review the estimated

6 See *Larkin v. Shah*, 2016 WL 4485447, at *1 (Del. Ch. Aug. 25, 2016) (“In the absence of a controlling stockholder that extracted personal benefits, the effect of disinterested stockholder approval of the merger is review under the irrebuttable business judgment rule, even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors.”).

working capital numbers.

Escrows. Buyers should consider pushing for increased working capital escrow amounts to account for the variability in the financial operations of the target and the potential that true ups will be more significant.

Accounting Principles

Financial terms (working capital target, EBITDA, etc.) should be drafted taking into account any short- or long-term changes that were made to the target's standard accounting practices in response to the pandemic (for example, treatment of government funds received in connection with the COVID-19 response (grants, bailouts, etc.)). Expect buyers to push for adjustments to EBITDA to exclude COVID-19-related unusual revenue and gains, and sellers to seek to adjust EBITDA to exclude temporary and non-recurring costs.

Representations and Warranties

COVID-19 Disclosures. To avoid parsing out the impact of the pandemic on each representation, expect sellers to argue for broad COVID-19-related disclosures, with buyers resisting any such broad disclosures.

Capitalization/Ownership of Equity. Confirm ownership rights and whether any defaults/foreclosures have occurred during the pandemic that might affect ownership or transferability of equity.

No Violation. Given the increased risk of financial stress and proactivity of contract counterparties to adjust contracts that are now considered off-market, confirm all required consents and notices are appropriately scheduled, including those relating to any CARES Act loans or other contracts signed during the pandemic. For transactions that are priced lower than pre-COVID-19 pricing, also consider whether the target validly authorized the transaction and any risk relating to breaches of fiduciary duties (Revlon, etc.).

Financial Statements. Confirm with financial advisors that any extraordinary measures taken during the pandemic were properly accounted for in compliance with GAAP (or other applicable standards). Expect buyers to require sellers to schedule any material deviations from GAAP and/or the target's standard accounting principles.

Accounts Receivable/Payable. Expect additional scrutiny to the target's accounts receivable and payable, in particular any AR and AP deferrals and write-offs. Sellers should also be prepared to schedule and defend bad debt reserves.

Absence of Certain Changes. Sellers will have multiple new disclosures related to this representation, including, for example, those related to:

- Changes in lines of business (for example, a distillery that pivoted to manufacturing hand sanitizer during the pandemic);
- Supplier/customer changes;
- Reductions in force ("RIFs") or temporary shutdowns;
- Write-offs and AP forgiveness;
- Draw-downs on revolvers;
- Changes in accounting methodology or cash management practices;
- Insolvency proceedings;
- Government orders; and
- Tax extensions.

Environmental Matters. Phase I and other environmental inspections require onsite visits. Work with environmental consultants early in the process to identify their operating limitations and expected timelines.

Real Estate. Work with title companies early in the process to identify operating limitations and expected timelines. Additionally, confirm that any improvements to facilities (e.g., reconfiguring manufacturing facilities for COVID-19-related manufacturing) were done in compliance with all regulatory and contractual obligations.

Employment, Labor and Benefits. COVID-19 is impacting nearly every element of employment, labor and benefits representations and warranties. When drafting a purchase agreement, consider the target company's compliance with, among other things:

- Governmental telework, shutdown and sick leave orders;
- Disability laws (for example, in the event an employee is particularly susceptible to COVID-19 and requires alternative work arrangements in the absence of a governmental order to do so);
- Family leave laws (for example, in the event an employee's family member is particularly susceptible to or has already contracted COVID-19);
- Occupational safety requirements to keep employees safe from contracting COVID-19;
- For those industries that went into "overdrive" (such as online marketplace websites (e.g., Amazon) and medical facilities), overtime laws;
- Discrimination and privacy laws (for example, an employer cannot ask employees about their health conditions or whether they have had contact with individuals of certain ethnicities);
- Where plan asset values of multi-employer defined benefit pension plans have declined in line with market changes, whether contributions have been made in response to the foregoing in accordance with pension plan rules and credit agreements;
- If the target issued any equity-based compensation during the pandemic, consider whether FMV determinations made prior to the pandemic are still valid (i.e., whether a new 409A valuation is required);
- If RIFs were undertaken in response to the pandemic, whether they were done in accordance with law, whether severance obligations have

been discharged and whether any WARN Act concerns exist; and

- During the pendency of the pandemic, many collective bargaining agreements were renegotiated; expect representations and warranties to the effect that such renegotiations complied with applicable labor laws.

Taxes. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) passed by Congress includes several changes to tax laws.

Pursuant to the CARES Act, employers are permitted to defer the employer portion of social security (6.2% on employee wages) for the remainder of 2020, which deferred portion is required to be paid over the following two years.

Some companies are also eligible for social security tax credits under the CARES Act. Buyers should require the target to represent what credits the target has used. The buyer should also be indemnified for improperly used or miscalculated credits by the target.

Insurance. Confirm whether insurance coverage was available for any COVID-19-related losses (political risk insurance, civil authority coverage, D&O, EPLI, etc.) and related waiting periods (many policies have waiting periods of several months). Additionally, identify whether insurance proceeds for COVID-19-related losses are properly owned by the seller(s), or, alternately, belong to the buyer, and draft appropriate mechanisms to allocate ownership of the proceeds accordingly.

Material Contracts. The pandemic will place considerable stress on the target's material contracts. Confirm that all such contracts are in full force and effect, that there is no breach thereunder by any party thereto and that no counterparty has threatened to cancel the contract or implement a material reduction related thereto. Also, be sure to include any new contracts entered into during the pandemic/

outside of the ordinary course of business, including any government loans or other assistance.

With an eye towards post-closing integration and operation, buyers should review force majeure provisions in material contracts to confirm the target's rights and obligations. If counterparty performance is at risk, buyers should thoroughly analyze the impact of such excuse on the target's business and downstream performance.

Inventory. Inventory with a short shelf life may be outdated or stale if demand was reduced during the pandemic. Expect increased scrutiny on inventory representations and related disclosures.

Information Technology. The target's IT system's ability to handle spikes in telework should be reviewed, including compliance with licenses, sufficiency of infrastructure, data security and compliance with internal policies.

Data Privacy. Expanded remote working makes targets more vulnerable to cyberattacks. Buyers should thoroughly diligence security procedures and practices, as well as test vulnerabilities.

Compliance with Laws/Government Orders. Businesses in otherwise lightly- or non-regulated industries are increasingly subject to emergency orders covering operational shutdowns, telework requirements, manufacturing priorities, etc. Sellers should include these pandemic-related orders in their disclosures, and buyers should diligence the target's compliance with the same.

Supply Chain. Given the supply disruptions resulting from the pandemic, consider whether new representations addressing the target's supply chain and related resiliency matters should be added. Such a representation may cover mapping of the supply chain and statements relating to resiliency. It may also make sense to take a deeper-than-normal dive into supply-chain diligence, for example, to uncover geographic concentration risk.

Buyer Representations and Warranties

In a time of unprecedented market volatility, the risk of buyer insolvency is increased. As such, sellers may want to push more aggressively for a solvency representation. Buyers may be willing to live with a solvency representation to the extent it is qualified by the veracity of the seller representations and warranties, without regard to any materiality or similar qualifiers.

Sellers should also consider more thorough-than-normal seller diligence of the buyer's authority and compliance with laws representations to confirm the pandemic didn't impact the buyer's ability to execute on the transaction.

Interim Period Covenants

Debt Payoff. With closing certainty at higher risk, prepayment notices are more likely to be withdrawn. Existing credit agreements should be reviewed early in the process to ensure that prepayment notices can be sent contingent on the closing.

In a market where lenders are eager to refinance, they may be less likely to permit a payoff letter to be withdrawn unless the credit agreement permits as much. Parties should also consider reaching out to lenders earlier in the process to confirm any changes to their prepayment processes or timelines.

Operating Covenants. Obligations to operate the business "in the ordinary course of business" will need to be reviewed and better defined. Sellers will look for a broad exception that would allow them to respond to the impact of the pandemic on the target's business. Buyers will likely respond asking for oversight/notice of any such decisions.

Specific activities to consider in light of the pandemic include: (i) changing telework arrangements; (ii) expansion of sick leave policies; (iii) extensions of, or requests for, trade credit in amounts or durations not typical for that business; (iv) delays or cancellations of orders

(from either the supplier side, the customer side, or both); (v) operational shutdowns; (vi) increasing capital expenditures related to enabling remote working; and (vii) amending material contracts.

Information Sharing. U.S. antitrust agencies have identified legitimate reasons for companies to exchange information during a crisis (diligence of compliance programs, integration of COVID-19 response, etc.). Nevertheless, companies should identify legitimate goals for information exchange that are pro-competitive or competitively neutral and ensure that all communications with competitors are limited to what is reasonably necessary to achieve those goals. Further, any such exchange should be voluntary for each company to adopt at its own discretion.

HSR Approvals. Preparing filings may take longer than usual, as management teams are stretched thin responding to the pandemic and required data may not be as readily available. In addition, if there ends up being a backlog of deals to approve, approval processes may take longer, so parties should be prepared to “pull and refile” with more frequency.

Consider extending deadlines for preparing and submitting filings. Also, note that the FTC and DOJ have suspended early termination and require all HSR filings to be made through a temporary e-filing system.

Closing Conditions and Termination Rights

Financing. Given the challenging credit markets, buyers will likely push more aggressively for financing outs. We may see a rise in reverse break fees as a result.

Third-Party Consents. Many businesses are evaluating existing contracts to identify those that are no longer “market” in the post-COVID-19 era. Where a contract is favorable to a counterparty (e.g., many real estate leases), we expect the counterparty to consent to transactions in the

hope of maintaining such favorable terms. Where a counterparty believes a contract is off-market against their interest (e.g., certain long-term supply contracts), however, we expect those counterparties to couple any consents with a rebalancing of the terms.

Dealmakers should also be mindful of the fact that contract counterparties may be short-staffed and struggling to work remotely, causing a delay in response times. If the counterparty is in financial distress, lenders may also be involved in ordinary course decision-making, and approvals may take longer.

Outside Date. Given the potential additional time needed to obtain antitrust and other third-party consents, longer “outside” or “drop-dead” dates may be appropriate and consideration should be given to automatic extensions of any such outside or drop-dead date if the delay is related to COVID-19.

Indemnification

Fraud. When markets are down, management teams and sellers often feel increased pressure to deliver value to shareholders. Increased attention should be paid to fraud diligence and recourse.

Limitations of Liability. When dealmaking resumes, we would expect a shift towards more buyer-friendly indemnification terms, in particular for distressed targets. Expect to see buyers resist the pre-pandemic trend towards no-recourse deals and push for more seller “skin in the game.”

R&W Insurance

R&W Insurance Underwriting Process. Expect underwriters to focus on COVID-19-related issues and the operation of the target during the pendency of the pandemic. Buyers will need to demonstrate thorough diligence of these topics, and should be prepared to support any judgment calls. Buyers that are repeat customers (i.e., private equity firms and serial acquirers) with

existing relationships with leading brokers and underwriters may fare better than other buyers who are new to the product or whose diligence process is less tested and trusted.

Exclusions. R&W insurers have begun to push for COVID-19-related exclusions, ranging from blanket exclusions for all related losses, to more targeted exclusions focusing on employment and supply chain issues. Buyers should work closely with their R&W insurance broker and legal team to narrow these exclusions as best as possible.

R&W Insurance Policy Pricing/Terms. It is too early to tell what impact COVID-19 will have on R&W insurance pricing. In the short term, given the light deal flow, we may see underwriters compete more aggressively for market share, which could result in decreased premiums. That said, as underwriter balance sheets become threatened and claims eventually increase, we may see premiums drift upward.

Claims Activity. Following the adage that indemnification claims spike when markets drop, we would expect increased claims activity.

Disclosure Schedule Updates. Sellers may push for the right to update disclosure schedules during the interim period in response to pandemic-related changes and events. Note that any such updates will be excluded from the R&W insurance policy and therefore buyers are likely to reject this concept or insist upon any or a combination of purchase price adjustments, walk rights or bullet indemnities for any material disclosures.

Post-Closing Covenants

Employee Benefits. Obligations that the buyer maintain certain employment levels/terms will need to be tailored to reflect ordinary course levels/terms, and not necessarily those levels/terms that were implemented during the pandemic (which may be higher or lower, depending on the industry).

D&O Indemnification. While markets are down, shareholders may seek to recapture value by suing management teams for improperly reacting to the pandemic. Buyers should carefully diligence all target shareholder communications, as well as the target's management response, to see if any such suits are threatened. To minimize exposure, sellers should push for robust post-closing D&O indemnification rights, including D&O tail policies.

Further Assurances/Cooperation. Generally, the open-ended nature of these provisions should be sufficient to cover any post-closing cooperation needs. However, buyers will struggle with the task of integrating a business that has seen considerable disruption as a result of COVID-19, particularly if many or most of the relevant employees are teleworking for the first time. Accordingly, consider whether specific post-closing support terms are appropriate (for example, in a TSA).

Defined Terms

Cash. Consider whether "Restricted Cash" includes government funds received in connection with the COVID-19 response (grants, bailouts, etc.) and whether any other adjustments to the definition of "Cash" are required to account for the pandemic's impact on the balance sheet of the target.

Governmental Authority/Law. Continue to review these definitions to ensure they capture any new laws/regulations and regulatory bodies/committees created in response to the pandemic that might be applicable to, or have jurisdiction over, the target.

Material Adverse Effect. Sellers should consider adding "pandemic," "epidemic" or "COVID-19" to their definitions of Material Adverse Effect. In response, buyers are likely to require that the pandemic not disproportionately impact the target (as compared to the target's industry at large) for the carve-out to apply. Note this is particularly

important in delayed sign-and-close transactions, where the MAE definition is critical for termination rights.

Miscellaneous

Force Majeure. Consider whether a force majeure provision permitting delay of performance of obligations during the pendency of such force majeure is appropriate. If such a provision is included, sellers should try to limit the buyer's ability to delay the closing during the pendency of a force majeure if all other conditions to closing are otherwise met.

Dispute Resolution. Consider the merits of ADR as a more flexible form of dispute resolution over litigation, especially as courts scramble to catch up with months-long closures. For any internal disputes (working capital adjustment disputes, indemnification disputes, etc.), consider expressly permitting video/virtual meetings to allow the continuation of any such proceedings during periods of restricted mobility.

E-Signatures. During the pendency of the pandemic, executive officers may not have regular access to printers/scanners. Accordingly, parties should be flexible and accommodating in permitting use of DocuSign and electronic delivery of documents. Lenders will still likely require wet-ink signatures, but are more likely to close on PDFs and require delivery of originals post-closing.

FOUNDING PUBLISHER - Jesse M. Brill, J.D. Yale Law School

Formerly an attorney with the Securities and Exchange Commission and a leading authority on executive compensation practices, Mr. Brill is also the Founding Publisher of **The Corporate Counsel** and **The Corporate Executive**, and Chair of the National Association of Stock Plan Professionals.

EDITOR - John Jenkins, Senior Editor of DealLawyers.com and Partner of Calfee, Halter & Griswold LLP

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