M&A IN THE COVID-19 WORLD AND BEYOND – VIEWS FROM FRANCE, GERMANY AND THE UNITED KINGDOM

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INTRODUCTION

After a decade of relatively stable deal activity across Europe and globally, companies now find themselves operating in a new and evolving M&A environment. Transactional risk and disruption are the current norm, but against that backdrop of uncertainty, there are also opportunities. Distressed M&A has come back to the fore and we are starting to see interesting developments in deal strategy and negotiation tactics. We believe some of these developments are here to stay.

It is clear that just as governments seek to grapple with COVID-19 and the economic fallout, so too must dealmakers. M&A transactions will need to adapt to the current deal climate and the measures implemented in response to the pandemic; dealmakers will need to account for the impact on the general transaction framework and timeline, as well as the business being acquired or sold.

We have highlighted the following deal points as requiring particular thought and attention during this crisis. Some of these are likely to continue to have an impact on and influence deals beyond COVID-19.

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VALUATION AND PRICE STRUCTURING

Where there is a possibility that the value of a target business could change over the course of a transaction (e.g., where there is a period of time between signing and completion), parties typically address and allocate the risk of such change by agreeing a mechanism for price adjustments. Broadly speaking, the two principal mechanisms are: (i) completion accounts, where the final purchase price is determined by reference to a set of accounts made up to the closing date; and (ii) locked-box accounts, where the purchase price is determined on the basis of accounts as at a specific date, with any adjustments to be made based on agreed parameters and any extractions of value that have occurred between the date of those accounts and closing.

We expect to see parties giving greater thought and attention to these valuation and adjustment mechanisms. In the short-term, the uncertainty and disruption caused by the pandemic is likely to move buyers away from locked-box mechanisms. Sellers will come under pressure to agree price adjustments based on completion accounts, and it is possible that the timeframe for agreeing those accounts will increase to take into account potential lockdowns and restrictions on access to information and personnel. We are also seeing buyers request greater use of deferred remuneration mechanisms like earn-outs to mitigate the risk of gaps in due diligence. If agreeing to deferred remuneration, sellers will have to be careful not to assume undue counterparty risk, especially where there are concerns around the buyer's credit or liquidity.

France

Subject to tax considerations, an alternative to share deals could be to structure a transaction as an asset deal, in particular in jurisdictions where a legal instrument exists that allows the transfer of a business unit or going concern (with all assets and rights, including clientele) in a single transaction and under a special tax regime, such as a cession de fonds de commerce under French law.

DUE DILIGENCE

Scope, extent and access

We are seeing a greater emphasis on due diligence as buyers assess the impact of the COVID-19 pandemic, as well as the respective responses of governments, regulators, financiers and counterparties. The rapidly evolving situation in different countries means that sellers, especially those with global operations, can find it difficult to provide real-time or up-to-date assessments of the impact of COVID-19 on their businesses.

Similarly, buyers may struggle to meaningfully access information and material, especially where lockdowns mean that site visits or physical inspections are restricted. Lack of access and restrictions on valuations during the lockdown have led to some interesting bid approaches in M&A, particularly in the commercial real estate and manufacturing sectors. Buyers are using the opportunity to make quasi-bids which they can then pursue, chip or drop when the market reopens and values can be established. Sellers, in the meantime, are adopting a wait-and-see approach.

United Kingdom

Sellers that have produced vendor due diligence reports are finding that buyers are requesting extensive top-up due diligence, in addition to conducting their own confirmatory due diligence. Before commissioning vendor due diligence, sellers should consider whether this will adequately address a buyer's COVID-19 concerns and, in an auction with several buyers or with cross-border implications, may want to revisit the cost-benefit analysis in producing these reports.

Areas on which to focus due diligence

Information that buyers are likely to require, and which sellers should consider preparing and disclosing, include papers or board discussions about the financial and operational impact on the target company or business and any guarantor and any planned measures to address such impact, any immediate impact on revenue and liquidity and concerns around solvency, any material changes to the existing business plan and strategy, and business continuity, interruption and contingency plans and IT infrastructure and sufficiency assessments.

Other specific issues that may arise, and which are likely to continue being relevant beyond COVID-19, include:

→ **corporate governance** – arrangements for holding shareholder and board meetings in accordance with statutory/ constitutional requirements;

→ **financing** – compliance with financial covenants, changes to credit rating, discussions with auditors regarding signing-off the accounts on a going concern basis,

→ **contracts** – *force majeure* and termination provisions, including whether any has been invoked, as well as ascertaining any ongoing or likely default under those contracts;

France

Legislation has been introduced so that deadlines expiring during the current crisis will be suspended until June 23, 2020. In addition, the same law provides that contracts which would have terminated during the same period continue until after the protected period.

In addition, specific regulation for public procurement contracts has been enacted which, on a case by case basis, would allow to consider Covid-19 as a force majeure event. Thus, depending on the situation and subject to the terms of the relevant contract, if default occurs as a result of Covid-19 or its consequences, such default could fall under the force majeure exception.

→ **insurance** – coverage for business disruption and epidemics, as well as for key personnel within the business;

→ **operations** – impact on supplies/ supply chain, trading, stock levels;

→ **employment** – suspected or confirmed cases of COVID-19 and steps taken to protect other employees, furlough, shortened working weeks, deferral of pay or bonuses, redundancies, remote working and the implications for compliance with health and safety requirements, confidentiality and data protection and cyber-security;

United Kingdom

Recent UK government guidance clarifies that employees who transfer to a buyer as part of an asset sale can be furloughed, provided that the business succession rules apply to that sale. This is a positive step for asset deals.

→ **real estate** – any premises that are required to be closed (or that fall within any exemption) and steps taken to protect against damage or unauthorised entry, impact on planning applications or ongoing construction, any rent reduction, suspension or early determination, and where tenants have adjusted their operations (e.g., set up takeaway or delivery services), whether the appropriate waivers have been granted;

→ **regulators** – compliance with permissions and authorisations, filing deadlines, as well as liquidity, capital and prudential requirements, including, in each case, any exemptions; and

→ **government support schemes** – eligibility, any applications already made, repayment timelines and review of any debt incurred under them to confirm accuracy of application materials and proper use of proceeds, especially where support was conditional on certain undertakings or restrictions.

France, Germany and the United Kingdom

Regulators, government agencies, tax authorities and competition authorities have taken measures to suspend certain administrative deadlines and requirements, as well as providing various schemes to support companies and workers. While buyers are expected to price in the economic fallout from COVID-19, this is also an opportunity to identify, through the due diligence exercise, the financial support and exemptions that are available. The expected discount in price, together with the potential upsides in doing a deal now, mean that buyers could be generating significant value in the long-term.

REPRESENTATIONS AND WARRANTIES

COVID-19 inclusions and exclusions

Unsurprisingly, COVID-19 is dominating the negotiations that invariably surround representations and warranties in sale documentation. We are seeing a growing tension between buyers that expect warranties to include comprehensive COVID-19 protection around

compliance, performance of material contracts, and claims and litigation and sellers that are determined to exclude COVID-19 on the basis that it is an external event, the development and direction of which are manifestly outside the control of either party.

There are also specific implications for warranties that would normally be given as a matter of course, as well as warranties that are not normally given as a matter of market practice. For example, warranties that refer to the business being operated in the ordinary course of business for a given past period will need to accommodate the impact of the pandemic. Sellers are also coming under pressure to warrant the completeness and accuracy of the data room or, at the very least, to warrant that information provided in the data room as regards COVID-19 is materially accurate. Paragraph 0 addresses the potential impact on the availability of warranty and indemnity insurance.

Warranties are, as usual, a matter of risk allocation amongst parties with different bargaining positions, but the pandemic has highlighted the stark contrast between those who are under pressure to do the deal and those who have the luxury of waiting.

Disclosures

The necessary corollary of a comprehensive suite of warranties is a similarly comprehensive set of disclosures. We are seeing sellers seeking to make general disclosures around COVID-19 and all related and publicly available information, on the bases that: (i) it is not possible to identify with any accuracy the precise effect of the pandemic and government measures on all aspects of the business; and (ii) the rapidly evolving situation means that a specific disclosure prepared two days before signing could be out of date at the time of signing. We think there is a balance to be struck here – buyers should consider whether having a shorter set of specific warranties for which specific disclosures could be drafted outweighs having a longer set of warranties against which sellers seek to make wide-ranging disclosures.

United Kingdom

The legal concept of fair disclosure is being tested by buyers keen to understand the full impact of COVID-19 on the target business and by sellers who are, understandably, unable to fully gauge the effect of a constantly evolving situation. While the definition of fair disclosure is normally a matter to be agreed between the parties, sellers should be careful to ensure that there is sufficient detail in any disclosure to enable buyers to identify the issue and to evaluate the effect of such disclosure.

Repetition of warranties

Where warranties are being repeated (e.g., on completion), parties will need to consider the possibility that those warranties will be out-of-date or inaccurate at the time they are repeated. The same applies to bring-down confirmations and other compliance certificates. If the parties agree that supplemental disclosures are permitted, then it will be important to set parameters around those disclosures, the key being whether unintended and unforeseen COVID-19 consequences can be disclosed when the warranties are repeated.

"Fundamental" or "standard" warranties

Certain warranties that are considered fundamental or standard will require a thorough review to assess the impact of government measures and, in particular, any forbearance granted by any court or public authority.

France, Germany and the United Kingdom

Legislation has been introduced in France, Germany and the United Kingdom in respect of insolvency.

In France, there is now a grace period (currently expiring on 10 October 2020) for businesses to file insolvency declarations. This allows businesses that are not in a state of insolvency as at 12 March 2020 to continue to operate, or to apply for preventive measures, during this protected period. The usual 45-day period for filing for insolvency will only start to run after 23 August 2020. That means that any insolvency warranties will require review and, if appropriate, adaptation.

Similar legislation has been introduced in Germany, granting a grace period that expires on 30 September 2020 where the relevant company was not in a state of insolvency as at 31 December 2019.

In the UK, the Corporate Insolvency and Governance Bill introduces significant reforms to the UK's corporate restructuring and insolvency framework, with the aim of providing businesses with the flexibility and breathing space they need to continue trading during the current pandemic. The reforms to the restructuring and insolvency framework have been under consideration for a number of years, but the reforms have been expedited to form part of the UK government's response to the economic impact of the pandemic.

Impact on warranty and indemnity insurance

We expect W&I insurers to assume a greater role in M&A transactions and to become additional parties with which to negotiate, as they seek to mitigate underwriting risk.

We are starting to see some insurers drafting exclusions into their policies, covering losses arising out of or increased by the presence, transmission, or threat of COVID-19 or any evolution of it, as well as restrictions and measures issued by public authorities in connection with it. Parties should be prepared to query these exclusions and to work with insurers to remove or narrow them by conducting specific due diligence on identified risks and implementing mitigating measures. Sellers may also find that they will have to assume some degree of liability to cover any policy gaps. It is clear that insurers will continue to demand robust due diligence, in particular regarding the impact of COVID-19, both presently and going forward.

We are also seeing insurers seeking to provide greater input into the drafting and negotiation of warranties. The risk of not engaging with insurers at an early stage is that certain representations and warranties may be deemed excluded from policy coverage. This is more likely to occur where the warranty overreaches or where it seeks to address COVID-19 risks that are presently known and subsisting.

Apart from representations and warranties, we expect insurers to pay particular attention to valuation and provisions that seek to define "material adverse change" or "material adverse effect", as well as provisions requiring a businesses to be conducted in the ordinary course.

In distressed transactions, there is also a renewed focus on the relationship between the deal timetable and the insurability of the transaction. As a general observation, targets that have entered into a formal insolvency process may be less attractive to insurers as it becomes more difficult to conduct thorough due diligence on the business. This means that, before sellers initiate formal insolvency proceedings, they should consider the impact that this may have on the availability of W&I insurance and, therefore, the attractiveness of the target to a potential buyer.

INTERIM COVENANTS

Conducting business in the ordinary course

Where there is an interim period between signing and closing, it is common for sellers to give undertakings as to the operation of the target business. This will usually include an undertaking

to procure that the business is operated in the ordinary course, consistent with past practice. Thought will need to be given as to appropriate carve-outs from the undertaking, including the right for the target or the seller to take action where required to limit the impact of COVID-19 on the business, or to do things in relation to the business which are consistent with actions taken by the seller's parent company or other group members in relation to their respective businesses. Parties should also consider including a detailed description of business operations that accounts for measures already taken or that could foreseeably be taken to address COVID-19.

Where sale agreements have already been exchanged, parties will need to have a sensible discussion about what, if any, measures taken by the business (e.g., remote working) can be properly considered ordinary course.

Access to information

To increase visibility into the business during the interim period, buyers may seek to impose regular reporting and notification obligations on the seller, as well as reinforce any auditing rights or other rights of access it may already have under the transaction documents.

Decision-making

We expect that buyers may request the ability to veto any material business decision not contemplated in the existing business plan. Sellers will want to ensure that they can continue to comply with any legal, governmental or regulatory guidance, and that the business is sufficiently nimble to react to developments without being paralysed by the need to seek prior consent from the buyer. Care will need to be taken not to trigger any gun-jumping rules under competition law.

CONDITIONS PRECEDENT

Deal certainty and completion risk

Buyers are increasingly seeking to allocate deal risk to sellers by requesting additional conditions precedent to closing. In certain cases, CPs that are normally a matter of commercial negotiation (e.g., no MAC, no material breach of warranties) are tacked onto CPs that are necessary for completion (e.g., competition clearance, regulatory approval, the obtaining of certain licences). Sellers should be aware that, with clearances and approvals taking longer to obtain and the difficulty in convening shareholders' and other meetings, deal timetables have inevitably become longer. This in turn lengthens any interim period between signing and closing and, by implication, gives buyers a greater opportunity to withdraw from transactions for breaches of covenants or warranties or for material adverse changes. Sellers will need to consider whether it is preferable to exchange on a deal that is contingent on multiple conditions or to wait for a more opportune time to do a deal.

Regulatory approvals and merger clearance

Some delay in obtaining regulatory approvals is expected, especially if the relevant authorities are not operating at full capacity. Broadly speaking, however, our experience is that most regulators are operating remotely and more or less on their usual timescales. It is also clear that many public authorities are demonstrating a willingness to engage pragmatically with transaction-specific challenges presented by the pandemic.

In terms of competition clearance, a number of authorities have taken action to loosen regulations, extend timelines, or apply new interpretations to existing practices. The EU Commission, for example, temporarily loosened relevant antitrust regulations to allow pharmaceutical companies to reach agreements on the production and distribution of drugs to avoid bottlenecks and ensure optimal resource allocation. There are early signs that competition authorities may look more favourably at transactions in which struggling targets are acquired and the business preserved. However, parties should proceed with caution and continue to respect prohibitions on coordination and gun-jumping.

Germany

German authorities have yet to make any formal changes to existing merger controls, though it published a recent press statement asking parties to notify the authorities only if there was an appropriate reason to do so. Under German law, transactions which are necessary to achieve cost reductions or an improvement in supply may be exempt from antitrust regulations. It is arguable that COVID-19 may require competitors to exchange information to avoid short-term supply bottlenecks in certain areas, but these will need to be reviewed on an individual basis. Systematic coordination (e.g., price agreements, territorial and customer allocations) will remain prohibited.

France

Legislation introduced at the end of March suspended the legal deadlines applicable to merger-control filings during the current crisis. This suspension will now end on June 23, 2020 and normal procedures and deadlines will resume. The Autorité de la Concurrence has nevertheless maintained a close to normal review process during the last weeks and approved more than 20 transactions since mid-March.

Foreign investment controls

In general, foreign investment control is subject to national foreign investment regulations which vary broadly. However, the European Commission recently issued guidance to member states, advising them to be mindful of the potential loss of critical assets, industries and technology that may have a role to play in the COVID-19 crisis. Therefore, EU member states are expected to closely scrutinise investments in certain areas, particularly in the pharmaceutical, biotechnology and supply science sectors. We expect regulators to pay special attention to transactions in the healthcare sector, especially where the target is involved in vaccine research and development. The German government just published a draft bill introducing a stricter auditing standard for foreign investments and an expansion of the critical industries under scrutiny.

TERMINATION AND OTHER WALKAWAY RIGHTS

Material Adverse Change/ Material Adverse Effect

The pandemic is starting to have a significant impact on the way in which parties approach termination rights in transaction documents and, in particular, clauses that permit buyers to terminate the acquisition and avoid closing where a material adverse change has occurred between signing and closing, whether in relation to the target business or otherwise.

Where MAC clauses are included in the transaction documents, the parties will need to determine whether events caused by COVID-19 and its consequences could constitute a material adverse change or whether such events should be excluded entirely. This is a matter of risk allocation and is normally a matter for negotiation. In jurisdictions where MAC clauses are more commonly accepted, we are seeing sellers seeking to exclude COVID-19 and pandemics and outbreaks of disease generally from what could constitute a material adverse change. This is, broadly speaking, consistent with the evolution of MAC clauses, where generic changes caused by the external macro-economic environment and general market conditions are typically excluded. Sellers should be aware that, even if the MAC clause does not refer expressly to COVID-19, termination rights may be triggered if the pandemic causes specific events in the MAC clause (e.g., the loss of key personnel, termination of material contracts, or breach of financing covenants) to occur.

Force Majeure

Force majeure clauses, which excuse a party from performing its obligations under a contract in specified circumstances, have been in the spotlight during the pandemic as parties seek ways to avoid liability for contractual non-performance. These clauses have gained particular

significance in M&A, particularly when conducting due diligence on material contracts. If a contract contains a force majeure provision, the buyer will need to consider the wording of the specific provision to determine if COVID-19 and the resulting measures and government restrictions are covered and whether the clause would create termination or other rights.

The threshold at which force majeure is triggered will vary from contract to contract. Certain clauses refer to events that occur outside the control of a party and set out an indicative list of possible events, while other contracts excuse contractual performance when this has become "inadvisable" or "impossible". We expect buyers to focus on these thresholds in determining counterparty risk and, in the case of material contracts, pricing.

United Kingdom

Unlike other jurisdictions, force majeure is not implied into a contract under English law and does not operate automatically. As such, specific drafting would be required to allow a party to rely on it.

France

The French concept of legal hardship is generally not applicable to acquisitions of shares/ equity instruments. If legal hardship is applicable, parties are required to renegotiate their agreement failing which they can agree to terminate the agreement or, absent such agreement, request that the court terminate the agreement.

COVID-19 AND BEYOND

It is clear that the current crisis has had an adverse effect on market sentiment and traditional M&A, with deals being postponed or withdrawn entirely as companies reassess their acquisition and divestment strategies and as financiers seek to shore up capital and preserve liquidity. However, the long-term effects on the deal landscape are far from obvious. A number of points discussed in this article and, in particular, those dealing with business interruption and events with unintended, widespread consequences, are likely to have real longevity and long-term implications for deal documentation. At the same time, M&A fundamentals and their drivers, manifested in bargaining positions and risk allocation decisions, are unlikely to change.

Private equity investors have raised high amounts of capital and despite COVID-19 are looking for ways to invest going forward. Even though the investments declined since the beginning of the crisis, it is expected that private equity will return faster than after other crises due to the available liquidity and the tremendous state aids and other subsidies by the governments.

Early signs are that dealmakers are now operating in a buyer's market, but this is by no means a foregone conclusion. As with previous economic downturns, there will be winners and losers in any crisis. For companies with strong balance sheets, M&A represents a great opportunity to generate value and to emerge from this pandemic stronger and better.

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BCLP's M&A and Corporate Finance team

With more than 250 lawyers across Europe, Asia, the Middle East and the U.S., our M&A and Corporate Finance team has the international presence to support our clients' business needs internationally.

Our team is best known for advising on cross-border and domestic mergers and acquisitions, and disposals, as well as equity capital markets transactions, joint ventures, private equity backed acquisitions, spin-offs, split-offs, carve-outs and other strategic alternatives and corporate reorganizations. We also advise clients on corporate governance and approaches relating to tender offers, proxy contests and antitakeover planning.

We are recognised for our market-leading position in mid-market transactions by legal directories Legal 500, Chambers, JUVE and by deal count (Refinitiv)

Getting in touch

When you need a practical legal solution for your next business opportunity or challenge, please get in touch.

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