

Insights

CORONAVIRUS (COVID-19): MATERIAL ADVERSE EFFECT AND M&A TRANSACTIONS

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Acquisition agreements customarily address risk associated with significant downward changes to the target's business prior to closing through a variety of provisions, including through the use of the "material adverse effect" or "material adverse change" ("**MAE**") representations, qualifiers and conditions. Broadly speaking, MAE provisions are intended to serve as a backstop that protects a buyer from unknown events that could substantially threaten the long-term earning potential of the target and, if triggered, may allow a buyer to terminate the agreement prior to closing. This "escape valve" is frequently achieved through both or either of a buyer closing condition to the effect that no MAE has occurred and the "bring-down" of the seller's representation and warranties (or certain of the seller's representations and warranties) to an MAE standard – that is a remaking of the representations and warranties as of the closing, albeit to an accuracy standard that is qualified by MAE, such that the representations and warranties must be true and correct, except as may give rise to an MAE. Certain of the sellers' representations themselves may also be qualified by MAE. As such, the definition of what constitutes an MAE for the purposes of a particular acquisition agreement is important in allocating risk between buyers and sellers, both during the interim pre-closing period and thereafter.

The outbreak and unprecedented spread of the novel coronavirus (COVID-19) has had a dramatic effect on global markets and industries, and as COVID-19's impacts continue to evolve, transaction participants should evaluate the ways in which MAE provisions may be applied and interpreted in transactions currently under negotiation, in the executory phase and following closing.

For parties evaluating their respective risk positions in transactions pending closing, as a threshold matter, the specific language used in the MAE definition must be examined carefully. A seller-favorable MAE definition may specifically exclude any occurrence of any "pandemic" or "outbreak." In recent weeks, a number of publicly-filed acquisition agreements have expressly excluded these items, sometimes specifically referencing COVID-19. If such language is included in the MAE definition, then the buyer may not be permitted to terminate or exercise other rights under the agreement based on an MAE either as a result of COVID-19 itself or as a result of actions taken in response to COVID-19, though the inquiry will ultimately be heavily dependent on the specific contractual language and underlying state law. There may be other applicable exclusions in the

MAE definition that could restrict the buyer's ability to refuse to close as well, such as exclusions for changes to the general economic conditions as a whole or changes in general economic conditions that affect the industries in which the target conducts its business. The MAE definition should also be reviewed carefully for exclusionary language that may be applicable to such carve-outs for events that have a "disproportionate" effect on the target or the target's industry and references to "reasonably expected" events or circumstances (as compared to those that have actually occurred). Historically, courts have been reluctant to find the existence of an MAE in the M&A context. It remains to be seen and is difficult to predict how courts would respond to the invocation of an MAE provision based on COVID-19 in the current context, given the widespread impacts of COVID-19 across geographies and industries.

In agreements currently under negotiation, transaction participants should focus on specifically allocating risks around COVID-19 and its follow-on effects, through specific references and carve-outs in the MAE definition or otherwise. Including a reference to COVID-19 as an express exclusion in the MAE definition, for example, is a starting point for a seller seeking to shift COVID-19 risk to the buyer, but other representations and covenants should also be carefully reviewed and considered in light of the current environment and parties' respective risk appetites.

Finally, for acquisition agreement representations and warranties that include MAE qualifiers, the MAE definition will be critical in determining whether or not a breach of any of these representations has occurred, for both closing condition and, potentially, post-closing indemnity purposes. We understand that, while the market continues to evolve daily, many representation and warranty insurance providers are underwriting very carefully around or expressly excluding COVID-19, which potentially implicates a number of potential issues relative to risk allocation and may further raise the stakes around MAE clauses and the respective rights of the parties under the acquisition agreement.

For more information on how the attorneys of Bryan Cave Leighton Paisner LLP can help guide you through any current and future transaction impacted by the COVID-19 outbreak, please contact our COVID-19 M&A Task Force at COVID-19M&A@bclplaw.com or your BCLP contact.

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