

Transactions in trouble: M&A in times of the Coronavirus

Within a few weeks and months, the outbreak of the Coronavirus (SARS-CoV-2) or the disease Covid-19 has posed major challenges to people worldwide. The private life of the individual is upside down, health care systems and governments of every country have to prove themselves in the crisis and companies worldwide are being put to a hard test. The German government announces financial support, the obligation to file for insolvency is to be suspended in individual cases, tax relief such as forbearance and waiver of enforcement measures are being considered. Nevertheless, companies have to revoke their forecasts and many companies are facing existential problems. In the midst of escalating reports about the spread of the virus and measures to contain the pandemic, companies must try to keep a cool head and make difficult decisions to survive the crisis.

Setting the course in crisis mode

Companies are faced with a mammoth task: not only must they master the acute challenges of the crisis; they must also keep an eye on how things can and should continue after the pandemic has subsided. Often, however, such a forecast is hardly possible. In fact, to ensure the survival of a company, drastic immediate measures are necessary and it is almost impossible to predict how things will continue. In many cases, it may be necessary to put planned transactions on hold, either because the company's own business situation requires it or because the target has fallen into crisis and an acquisition or sale jeopardizes its own survival.

Withdrawal before a transaction

In the run-up to a transaction, a withdrawal is often still possible without any problems. The termination of contract negotiations may even accommodate the contractual partner at times, so that the parties can decide by mutual consent to suspend negotiations. However, this can also be different in individual cases. In this case, before breaking off the transaction, it is important to check whether this is possible without consequences. If a preliminary agreement has been concluded, its provisions are decisive. In many cases, however, the parties do not agree on a preliminary contract, but only on a so-called Letter of Intent (LoI). The LoI represents a "non-binding declaration of intent". However, the non-binding nature of a Letter of Intent usually refers only to the conclusion of the transaction. With regard to the exchange of information during the contract negotiations and the termination of the talks, LoI includes frequently also binding regulations. For example, LoI may contain provisions on so-called break-up fees, which are intended to allow for the reimbursement of expenses or damages if, for example, one party unilaterally withdraws from the contractual negotiations for no reason, or is responsible for their termination. In the event of changes due to the coronavirus pandemic, fault on the part of one of the parties should generally be ruled out, but the agreements reached should nevertheless be carefully examined. Without a preliminary contract, LoI or other agreement, the reimbursement of expenses or damages of the parties will only be considered in a narrowly exceptional case.

Material Adverse Changes

If the contract was concluded before the global spread of the Coronavirus and it is now established that the business situation of the target will deteriorate significantly in the course of the pandemic, the contract should be reviewed for possible MAC clauses. Such "Material Adverse Change" clauses, or MAC clauses for short, grant the buyer a right of rescission in individual cases if events occur between signing of the contract and its execution, which lead to a serious change in the financial situation of the purchase object. This is often referred to certain key figures of the company, such as sales, EBITDA or EBIT, or the occurrence of imminent insolvency or overindebtedness. In the absence of express provisions, material adverse changes will be considered in particular military conflicts, natural disasters or other events that severely affect the entire industry. Whether the current situation may fall within the scope of a MAC clause must be examined on a case-to-case basis. It is certainly possible to take into account assessments made by other parties in the current situation. For example, the Baden-Wuerttemberg state parliament is said to have decided to regard the Coronavirus pandemic as a natural disaster in order to enable special measures to be taken. However, in order to grant a right of withdrawal, the pandemic must also have a respective effect on the target. It could be difficult to do so because the effects on financial figures will sometimes only become apparent in the further course of the event. As usual, the individual case is therefore decisive.

Recommended procedures

If a transaction has not yet been bindingly agreed, but is still in the review and negotiation stage, a risk analysis should be carried out with regard to the economic risks of the target because of the pandemic. Especially within a due diligence, possible risks resulting from the spread of the pandemic should be included in the audit and the crisis management as well as any existing contingency plans of the company, including those relating to supply chains, should be examined. In addition, appropriate rights of withdrawal should be agreed upon in purchase contract negotiations, whereby care should be taken to ensure that their conditions are clearly formulated and, if necessary, that they explicitly reflect the case of an epidemic as well as indirect disruptions in the company's environment. Possible uncertainties may also affect the purchase price or possible purchase price adjustments. Here too, however, care must be taken to clearly formulate appropriate regulations. If no further precautions are taken, it will be very difficult to adjust the contract in the event of later reference to impairments due to the Coronavirus pandemic, which were already foreseeable at the time the contract was concluded.