

## Corporate

# Mergers and Acquisitions in the COVID-19 Environment



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The widespread impact of COVID-19 on our local, national and global economies, our societal norms and day-to-day lives has caused us to adapt to a “new normal” way of life. As M&A professionals, we recognize the risks and uncertainty posed by COVID-19 in M&A transactions. This client alert focuses on certain of those risks and offers guidance to better prepare for evaluating, negotiating and structuring M&A transactions in the COVID-19 environment. We have compiled an outline of practical due diligence tips and drafting techniques for our clients to consider with respect to COVID-19 and its potential impact in the context of M&A. The COVID-19 crisis has initially slowed M&A activity, but as the impact of the pandemic on companies becomes clearer over time, there are likely to be new M&A opportunities, particularly in the area of distressed investing. Moreover, as companies gradually recover from the challenges they are facing, we expect M&A to re-emerge as an important component of operational and strategic growth.

## I. Due Diligence

COVID-19 has impacted ongoing M&A transactions in the area of due diligence reviews. Importantly, “stay-at-home” and “shelter-in-place” orders and the virtual work environment necessitated by COVID-19 create new obstacles for previously established due diligence practices. These obstacles, including travel restrictions, cancelled site visits, challenges performing physical diligence inspections and the inability for deal teams to meet in person, have a direct impact on the timing of negotiations. In addition, given the required coordination among multiple parties involved in the due diligence process, parties are experiencing significant delays as counterparties work virtually to collect information, assemble the appropriate internal constituents and resolve other logistical issues regarding delivery of information.

Parties should expect an expanded scope of due diligence that will address specific COVID-19 issues. From a buyer’s perspective, due diligence teams will increase their focus on operational and related issues that take on enhanced importance given the uncertainty of the COVID-19 pandemic. From a seller’s perspective, sellers must ensure that all relevant information is disclosed in relation to these issues and should expect to continuously update their contingency planning to account for the evolving COVID-19 environment.

The below list highlights an expanded scope of due diligence focus areas and additional considerations in light of COVID-19:

- **Operational.** Is the company’s industry disproportionately impacted by COVID-19, including supply chains and key facilities? Is the company overly dependent on suppliers in certain geographic regions hard hit by COVID-19 (e.g., Italy, China, etc.) and, if so, what impact will that have on the ability of the business to meet its contractual obligations? How are travel restrictions impacting the business? How does the company anticipate COVID-19 impacting its business in both the near- and long-terms? What are the implications of *force majeure* and other provisions contained in the company’s contracts and office, warehouse or other leases related to its

operations, and how might such provisions impact the rights and obligations of the company in this environment? For more information on *force majeure*, please see [“Evaluating Force Majeure Clauses in Connection with COVID-19 Outbreak.”](#)

- **Financial.** How and to what extent will COVID-19 impact the financial projections of the business? Is this reflected in its most-recent projections or financial guidance? Are revised financial projections reasonable in light of the uncertain duration and impact of COVID-19? What is the company’s cash and liquidity position? Does the company have sufficient working capital to satisfy its near-term obligations? Are there new risks on collectability of accounts receivable? What is the company’s ability to control or reduce operating expenses? Has the company defaulted on or significantly delayed any of its outstanding obligations? Is the company able to service its debt and comply with covenants under existing debt documents if current conditions do not improve or worsen? Is the company seeking any debt or equity financing in connection with financial issues related to or caused by COVID-19? Is the company seeking any forbearance agreements or loan modifications related to COVID-19?
- **Internal Policies.** Does the company have current crisis management and/or emergency preparedness plans, disaster recovery procedures or business continuity plans? Are the company’s internal policies, procedures and/or protocols compliant with all applicable employment and other laws, including those recently enacted in response to COVID-19? How has the company adapted its internal policies, procedures and/or protocols to the virtual work-from-home environment? What, if any, preventative measures have been put in place to prevent employees from violating company policies outside of the workplace?
- **Customers and Suppliers.** How does COVID-19 impact the company’s key customers and suppliers? Are they timely performing under their respective contracts with the company? Are there any anticipated supply chain issues that would impact a customer or supplier’s ability to perform under their respective contract with the company? Has the company received notice or any other indication that a key customer or supplier will no longer perform under its contract due to COVID-19 related issues, including with reference to *force majeure*? If so, how is nonperformance or termination handled under those contracts, and how has the company responded?
- **Employees.** How has the company’s workforce been impacted by COVID-19? Has the company established appropriate health and safety protocols for its employees? What expenses has the company incurred as a result of providing equipment to employees working from home? Have any employees been furloughed? Has the company complied with all applicable laws in connection with furlough and layoffs (including the WARN Act, if applicable)? How is the company complying with OSHA regulatory requirements? For more information on OSHA, please see [“OSHA Promises Relaxed Enforcement during Pandemic if Employers Make “Good Faith Effort” to Comply with Non-Achievable Recurring Requirements.”](#) Who are the company’s key employees? Are these key employees located in high risk areas or are they geographically separated? Does the company have a current succession plan in place? How dependent is the business on those key employees?
- **Information Technology / Cybersecurity / Privacy.** What IT, cybersecurity or data breach issues has the company recently encountered? Has the company been able to integrate video conferencing tools? Has the company implemented sufficient policies for resolving cybersecurity threats or other data breach issues? What is the effect of working from home for employees (e.g., data privacy and privacy breaches)? How has the company adapted its current data privacy policies, including with respect to health data of employees, to comply with the Consumer Data Protection Act of 2020 in light of the working from home environment? For more information on data privacy issues, please see [“COVID-19 Consumer Data Protection Act 2020”](#) and [“COVID-19 Consumer Data Protection Act 2020 Update.”](#)

- **Intellectual Property.** How is the company protecting its intellectual property and confidential information in the current work from home environment? Has the company instituted any training programs for its employees to address these issues? How is the company controlling and monitoring the discussion or dissemination of confidential information? For more information on how best to protect intellectual property and confidential information, please see [“Safeguarding Company Trade Secrets in a “Work from Home” Environment.”](#) Parties should also be aware that many patent, trademark and copyright-related filing deadlines have been extended by relevant governmental agencies in light of COVID-19.
- **Environmental.** How have the company’s operations been impacted by COVID-19? Have any facilities been idled or closed? If so, what steps were taken to minimize environmental risks prior to their closure (e.g., securing above-ground storage tanks or hazardous materials used during operation, etc.)? Are any company facilities currently undergoing remediation? How will ongoing remediation efforts be impacted by COVID-19? Is a Phase I assessment required? Does applicable state law exempt remediation services and/or Phase I assessments from its shelter-in-place order? What timing delays are anticipated in re-opening any facilities and how does this impact the timeline for the transaction as a whole? For more information on other environmental issues, please see [“EPA Issues Guidance on COVID-19 Impacts for Ongoing Cleanups”](#) and [“EPA’s Temporary Enforcement Discretion Policy for COVID-19 Pandemic.”](#)
- **Real Property.** How are the property taxes for owned and leased property impacted by COVID-19? If the company owns some or all of its real property, are there any third-party tenants impacted by COVID-19? If the company has leased sites, are the sites operating in the normal course of business? If not, are there viable defenses to the payment of rent? Has the company discussed forbearance arrangements with its landlord(s)? Are there lease modification discussions pending related to the impacts of COVID-19 on the company’s physical operations?
- **Insurance.** Has the company suffered any losses that may be covered by existing insurance as a result of COVID-19? Have claims been made to the insurers? Have claims been made by employees under the company’s workers compensation policy for COVID-19-related injuries? Does the company have D&O insurance and, if so, does such D&O insurance cover defense costs and/or claims for potential liability arising from shareholder complaints for misleading public disclosure or lost stock value? For more information on D&O insurance, please see [“D&O Insurance Tips for Coronavirus-Related Claims.”](#)
- **CARES Act and Other Government Relief.** Has the company applied for CARES Act or other federal, state or local relief? If so, what are the obligations of the company associated with such relief? For more information on the CARES Act, please see [“Legislative Update: An Analysis of the Historic \\$2 Trillion CARES Act.”](#)

While the above list is not intended to be exhaustive, it reflects several of the issues we are encountering in our current transactions as a result of COVID-19. Moving forward, parties will need to continue to monitor developments to ensure their due diligence identifies and addresses these issues.

## II. Contractual Provisions

In addition to allowing parties to address valuation issues, the information uncovered during the due diligence process is key to the structure, negotiation and drafting of M&A transaction documents.

Parties define and allocate risk based upon such information and through the scope of representations and warranties, the inclusion of closing conditions and the parameters of operating covenants in M&A transaction documents. In addition, parties use representation and warranty insurance to allocate risk, which is an area beyond the scope of this alert, but which has also been impacted by COVID-19.

- **Representations and Warranties.** Representations and warranties serve as one of the primary risk allocation mechanisms in an M&A transaction. Buyers have been ensuring that the scope of representations and warranties specifically address the COVID-19 impact on the seller's business, relying on their due diligence investigation, and are now seeking specific COVID-19 representations and warranties, particularly in the areas highlighted above. Sellers have been working closely with their management teams to identify the impact of COVID-19 on their businesses as reflected in representations and are relying on reduced lookback periods, date limitations, knowledge qualifiers and materiality qualifiers to limit the scope of coverage. Sellers can seek to limit certain representations as being made as of, or prior to signing in order to limit exposure for breaches unknown and outside their control during the post-signing, pre-closing period, as well as changes in regulatory guidelines enacted to combat the evolving COVID-19 environment, thereby shifting the risk to the buyer for matters outside the scope of a more narrowly tailored representation and warranty.
- **Conditions to Closing.** As with representations and warranties, conditions to closing are negotiated between buyers and sellers and are traditionally qualified by reference to "material adverse effect" or "MAE." The definition of MAE, particularly the exceptions, address specific facts, known risks, and circumstances associated with the seller's business. Unfortunately, the dynamics of COVID-19 are constantly evolving and thus the true extent of its negative economic impact on any particular business may as yet remain unknown. For example, industries such as travel and retail have been particularly hit hard by the COVID-19 pandemic, and recently some buyers have sought to cancel previously negotiated deals by claiming, in addition to allegations of breaches of operating covenants and the failure of closing conditions, that an MAE has occurred as a result of COVID-19. And while historically Delaware courts have been reluctant to find that an MAE has occurred, as the COVID-19 pandemic continues, it is likely that we will see sellers negotiating to include more specific references to COVID-19 as exceptions to the definition of MAE in an effort to reduce uncertainty surrounding closing or any potential claim by a buyer alleging MAE. For a further discussion on "material adverse effect," please see "[Considerations of the Effects of COVID-19 on M&A Transactions](#)." Depending on the nature of the business being acquired, the parties may consider drafting specific COVID-19 closing conditions in order to reduce the uncertainty of closing to the extent possible. In addition, in those transactions where third-party consents or regulatory approvals are required, parties should anticipate delays in obtaining those approvals or consents, and should be aware that in the event extended regulatory review periods are necessary or result in litigation, further delays may occur.
- **Operating Covenants.** Interim operating covenants, which set forth the activities a seller is permitted to undertake with respect to the business during the time period between signing and closing, have also been impacted by COVID-19. Traditionally these interim operating covenants generally required a seller to operate in the "ordinary course of business," with exceptions and limitations included to address known or likely future actions (such as limits on hiring or firing key employees, borrowing under a revolving credit facility, etc.). The uncertainty posed by COVID-19 will require accommodation by both parties to allow for appropriate flexibility in a constantly evolving environment. Buyers are interested in protecting the value of the seller's business as a going concern. At the same time, sellers will need to ensure adequate flexibility to respond to the COVID-19 pandemic and operate their business during the interim period in compliance with applicable law without the risk of failing a closing condition. One approach is to implement a mutually acceptable degree of efforts provision (e.g., commercially reasonable efforts) to adjust interim operating covenants to include exceptions addressing the specific challenges of the current operating environment faced by the seller in light of COVID-19, such as enabling a seller to comply with requirements under applicable law and to protect the health and safety of its employees.

### III. Conclusion

Although the extent of COVID-19 and its impact on M&A transactions are still developing, and we are all

learning about the new challenges we face in the COVID-19 environment, parties to existing or potential M&A transactions must take into account COVID-19 and its impact. Jenner & Block lawyers have significant experience working with clients on the most complicated and sophisticated matters and are available to assist in these uncertain times.

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*Conscious of the human, operational and financial strain that coronavirus is placing on businesses and organizations worldwide, Jenner & Block has assembled a multi-disciplinary Task Force to support clients as they navigate the legal and strategic challenges of the COVID-19 / Coronavirus situation.*

*For additional information and materials, please visit our COVID-19 / Coronavirus Resource Center.*

[Click here to visit our COVID-19 / Coronavirus Resource Center](#)

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