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ADVOGADOS

COVID-19
Impacts on M&A transactions

The novel coronavirus is generating tremendous impacts on businesses and contracts, including M&A transactions. This material aims at summarizing the key points related to the pandemic that must be considered by potential buyers (“**Buyer**”) and sellers (“**Seller**”) in M&A transactions in different stages, both in connection to the parties themselves and the target company (the “**Target**”).

BEFORE SIGNING

DUE DILIGENCE

SELLER’S KEY POINTS

- ? Will the Buyer be able to complete the transaction despite the effects of the pandemic? If it is a leveraged acquisition, will the Buyer continue to have access to the credit facility until closing?
- ? Have any projections or scenarios previously shared with the Buyer been reviewed to account for the estimated impacts of the pandemic on the business? An open discussion about this matter will anticipate Buyer’s reassessment of the acquisition and may facilitate future discussions about the impacts of the pandemic on the share purchase agreement (“SPA”).

BUYER’S KEY POINTS

- ? Which of Target’s material contracts are more likely to be violated, suspended, terminated or reviewed due to the pandemic? Has Target sent or received any notices with respect to its material contracts?
- ? What are the impacts of the pandemic on Target’s revenues and operations? The following are examples of potential impacts: (a) plants or stores operating with limited capacity or simply shutting down, (b) operational difficulties affecting supply chains and/or sales channels, (c) loss of perishable inventory, (d) quality of accounts receivable and (e) expropriation or other governmental action directly aimed towards Target.
- → Assess whether Target has postponed payment of either tax or other liabilities, and whether such decision has an impact on Target’s indebtedness.
- ? How easily can Target replace any suppliers who are affected by the pandemic?
- ? Has Target rearranged its work force (home office, different work shifts etc)? Has this generated (a) additional labor risks, (b) information security risks, (c) productivity losses and/or (d) investments not contemplated in the M&A model?
- ? What are the impacts of either a prolonged lockdown or travel restrictions on Target?

NEGOTIATING THE SPA

PRICE

- → The effects of the pandemic may significantly affect working capital and net debt, resulting on a significant price adjustment at closing. The parties may assess the possibility of normalizing extraordinary variations.
- → Deferred payment mechanisms (e.g. earn-out) must consider the likely negative impact on Target’s short-term results.

REPRESENTATIONS AND WARRANTIES (“R&Ws”)

- → Special attention to those R&Ws regarding (a) ordinary course of business, (b) material contracts, (c) clients and suppliers and (d) accounts receivable.
- → Buyers will likely push to include R&Ws about risks and adverse impacts of the pandemic on Target.
- → Sellers will likely push to exclude the impacts of Covid-19 from the scope of the R&Ws to ensure deal certainty; or limit its impacts via knowledge and materiality qualifiers.

CONDITIONS PRECEDENT

- → If applicable, consider including the mitigation or remediation of certain effects of the pandemic (e.g. loss of a material supplier or client) as a condition precedent.
- → If applicable, set forth the conditions under which a potential increment of the pandemic's effects on Target will allow Buyer to exit the transaction without any liability.
- → Set deadlines for fulfillment which are in line with the new reality of public agencies and any relevant third parties (e.g. antitrust authorities, real estate registrars and boards of trade).
- → Consider creating a mechanism to either postpone (if the pandemic and its effects persist or resurface) or anticipate (if the pandemic and its effects are shortened) the deadline for fulfillment of the conditions precedent.
- → Make it clear that none of the parties may excuse itself from fulfilling those conditions precedent under its responsibility due to the pandemic.

MATERIAL ADVERSE CHANGE

- → Review the Material Adverse Change ("MAC") definition to consider the impacts of the pandemic, either excluding the pandemic from such definition or clearly setting the limits within which its impacts will be considered acceptable.
- → Draft a clause indicating that the pandemic does not constitute a force majeure and does not fall within the concepts of the doctrine of excessive burden (*onerosidade excessiva*) and unconscionability (*lesão*) under Brazilian law.

OTHER PROVISIONS

- → **Conduct of the business between signing and closing**. The parties must consider the impacts of Covid-19 in the provision dealing with the conduct of the business and its operations between signing and closing.
- → **Indemnification**. The parties should consider liability exclusions or limitations due to events deriving from the pandemic, even if such events materialize only after closing.
- → **Termination**. The SPA may need to be terminated if the pandemic and the state of public calamity continue for a given period.

PRE-CLOSING

The pandemic may also create incentives for a party not to close the transaction as originally agreed to. The arguments for those who may want to close and for those who may not want to close the transaction will likely be focused on the following issues and questions:

MAC CLAUSE

- ? It will be necessary to analyze the text of the clause itself: is the language clear and objective enough to include the pandemic?
- → Usually, MAC clauses are designed to exclude those events that have an overall impact on businesses or on Target's business sector.
- ? Has the pandemic caused a direct impact on the business?
  - → Is it possible to prove the impact?
  - → Has Target been disproportionately impacted when compared to its competitors?

FORCE MAJEURE

- → Does the SPA have a definition of force majeure? Usually, SPAs do not deal with this issue extensively.
- → If the pandemic and the orders from governmental authorities are characterized as force majeure under the SPA or the law, the liability for the nonperformance of an obligation (e.g. a pre-closing covenant) whose fulfillment was made unattainable by the pandemic will be excluded.
- → Exclusion of such liability does not necessarily mean that (a) the affected party will no longer have the duty to complete the transaction (the other party may wait until the force majeure is no longer in place) or that (b) the closing deadline will be postponed.
- ? Should the nonperformance of a condition precedent that is dependent on actions of a third party (not performed due to the pandemic) be considered a force majeure event?

DOCTRINE OF EXCESSIVE BURDEN (*ONEROSIDADE EXCESSIVA*)

? Is the pandemic an extraordinary and unpredictable event within the context of the SPA?

? Has the pandemic made any consideration or covenant excessively onerous or given a material advantage to the other party?

→ Even if the tests above are met, abandoning a transaction due to the doctrine of excessive burden (*onerosidade excessiva*) will probably be very difficult because the impacts of the pandemic will most likely be limited in time and the M&A transactions are usually based on long-term horizons.

POST-CLOSING

→ **Deferred payment**. It is possible that buyers may try to either avoid or defer the payment of certain installments of the purchase price after closing of the transaction based on theories such as force majeure and the doctrine of excessive burden (*onerosidade excessiva*). In this case, Sellers will likely argue that the pandemic originated after closing and therefore is a risk to be borne solely by Buyer.

→ **Payments based on financial goals**. Due to the new economic circumstances deriving from the pandemic, there may be discussions about their impacts on payment obligations linked to Target's financial results post-closing and on the subsequent need to review the applicable clauses (e.g. earn-out provisions).

DISCLAIMER

This material is for information only and aims at introducing ideas and generating debate on issues that will certainly materialize as a result of the Covid-19 pandemic. Our comments are not exhaustive and there probably are important caveats which are not expressly mentioned herein. Each transaction must be considered individually, pursuant to its own circumstances. The content of this infographic does not constitute the opinion of Veirano Advogados about the issues discussed herein but is rather a description of certain trends that we identified in M&A transactions within the context of the Covid-19 pandemic. This material must not be considered as legal advice nor as a substitute to legal counseling by a duly qualified lawyer.

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Veirano has set a multidisciplinary team focused on COVID-19. Contact us!

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