

SPA CONSIDERATIONS – IN THE NEW NORMAL

Like many other things, the pandemic has changed the way parties to a private M&A deal approach a sale and purchase agreement (“SPA”). This commentary seeks to identify some issues that are likely to be re-looked and reconsidered, in what may be a new normal for SPAs that are negotiated in the Covid-19 era.

Purchase Price

For so long as there is no vaccine to the coronavirus, and normalcy cannot be restored to economies and markets, it will be challenging for buyers to accurately value a target’s business or to predict its future performance.

Buyers are thus more likely to insist on structuring a larger portion of the purchase price payment in the form of earn-outs. Such earn-outs may also spread over a longer period, with the objective of outlasting the pandemic. Structures involving retention sums or deferred payment in escrow may also be preferred. A seller may however resist these structures depending on the extent of control that it retains on the conduct of business post-closing.

Price Adjustment

As historical financial data becomes skewed due to the impact of the coronavirus over the last 3 to 6 months, the use of traditional mechanisms such as locked-box and post-closing adjustment based on “normalised” working capital may become more limited – since it is quite impossible to ascertain what is considered “normal”.

Material Adverse Change

The recent attempt by Carlyle and GIC to pull their acquisition of AmEx on the back of a material adverse change clause (“MAC”) has placed the spotlight on the use of such clauses. However, it is unlikely a buyer can simply rely on the Covid-19 pandemic as a general “out” to exit a deal. Buyers will be deemed to have knowledge of this health crisis as a pre-existing global condition and taken to have bought into the risk.

Buyers will need to be more specific about the MAC triggers, for instance linking to a specific drop in loss of contracts, or a specified loss in profits, based on agreed thresholds, rather than tying the formulation to the consequences of Covid-19 generally.

Sellers should therefore resist any broad MAC formulations based on general economic and market conditions, especially if these are tied to generic descriptions of the on-going pandemic.

Long-Stop Date

Parties should be prepared to accept a lengthier long-stop date for the satisfaction of condition precedents, in view that third party consents (whether from government authorities or other third parties) are likely to take longer to be obtained while many business sectors remain disrupted and key economies remain in (or re-enter) a “lock-down”.

Completion

With lock-downs and circuit breakers in place, the physical completion meetings we are traditionally accustomed to will need to be replaced with virtual inspections of completion deliverables using “share-screen” functions. Document exchange / retention mechanisms will also have to be agreed in advance between legal counsels, against undertakings to release certain hard copy originals only after lock-downs are lifted, to the extent that they are not absolutely required for legal completion.

Warranties

Apart from the usual business warranties, a buyer will want warranties to cover specific due diligence issues borne out by the pandemic such as compliance with government-promulgated laws and regulations (e.g. the Safe Management Measures imposed by the Ministry of Health in Singapore), as well as business continuity plans (“BCPs”) and risk management arrangements.

A buyer may also want to use the disclosure regime to flush out the existence of *force majeure*, MAC and other clauses that enable the target or the target’s counterparties to terminate key customer or supplier contracts.

The warranties should also complement due diligence efforts in verifying if any contracts fall within the protective ambit of new laws providing relief against contractual claims (eg. the Covid-19 (Temporary Measures) Act in

Singapore), the status of such contracts and whether claims are likely to be made by or against the target after expiry of the relief period. Solvency risks and adequacy of insurance coverage are also areas to be looked into.

Disclosure

Sellers should be mindful of representations and warranties that are repeated on closing, especially when a lengthier long-stop date has been negotiated. Given the unpredictability and uncertainty of this environment, there should be more sympathy for sellers to update their disclosure letters on closing. General disclosure regimes could also be relooked to allow for deemed disclosure of matters reasonably expected to be impacted by the coronavirus.

W&I Insurance

The uncertainties brought on by the pandemic may give parties more reason to consider using warranty and indemnity insurance as a means of apportioning risks. However, W&I insurers are expected to introduce specific exclusions for risks or losses arising from Covid-19. In a way not too dissimilar to a MAC clause, any W&I coverage on Covid-related issues will need to be specifically worked through with the insurers, perhaps with appropriate adjustments to the W&I premium and language.

Pre-Closing Covenants

While a buyer may expect the target to undertake additional pre-closing actions to address immediate Covid-19 risks, a seller may demand more flexibility to react and adjust his business strategies and policies in order to respond quickly to government imposed measures as well as changing socio-economic trends.

This could be wide-ranging and extend to matters such as restructuring of staff, sale of non-core assets, taking on relief debt packages, incurring capex in technology based solutions to increase e-commerce presence, shutting physical stores in certain locations etc. Carve-outs that allow the seller to do things in the "ordinary and usual course of business" without buyer's consent may need to be refined to cater to such developments.

Limitations on Liability

While it remains to be seen if the coronavirus will affect customarily accepted thresholds for *de minimis* and *de maximis*, those target companies with heightened exposure to coronavirus could see a reallocation of threshold levels for certain categories of warranties to adjust for a corresponding shift in risks (e.g. a buyer may ask for a lower cliff and a higher cap for breach of BCP/risk management warranties). Buyers may also push for a longer contractual time-bar to allow for the full impact of the pandemic to be more accurately assessed. This may go beyond the usual minimum expectation of one audit cycle.

Given the fluidity and unpredictability of the Covid-19 pandemic, parties will have to constantly re-examine their approach to every SPA and M&A transaction, and be prepared to deviate from tried and tested market practices in order to find their own "new normal". This will of course vary from case-to-case taking into account the nuances of each specific sector and industry.

Please do not hesitate to contact us if you wish to enquire about the above commentary, or to discuss how we can support you in your transactional needs.



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