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COVID-19:
IMPACT ON ENTERING INTO AND/OR COMPLETING OF MERGERS & ACQUISITIONS (M&A) TRANSACTIONS

The world is reeling from the on-going effects of the COVID-19 pandemic with the consequential effects of lockdowns and restricted movements choking businesses and economic activities. All of these are likely to have a major impact on target companies and their businesses with more counterparties to the target companies looking to suspend, terminate or even cancel contractual commitments, orders and funding arrangements which pose major challenges to Sellers and Buyers looking to sell, acquire or complete M&A transactions.

Parties engaging in or completing M&A transactions need to consider the following legal points:

Time Period

In this period of lockdowns or in the case of Malaysia, a Restricted Movement order ("**RMO**"), parties negotiating M&A transactions should give special attention to the following crucial milestones as listed below and to allocate adequate time, taking into account the prolonged lockdown or RMO, to complete the obligations stipulated under the contract as time is of the essence in M&A contracts:

(a) exclusivity period for negotiation;

(b) adequate timing to complete due diligence and verifications;

(c) longstop dates to fulfill condition precedents in particular to apply and obtain consent from governmental authorities and counterparties to contracts of target companies; and

(d) time period for completion.

There are also other practical issues to consider, for example, the ability to conduct relevant vital searches for verification, stamping and filing of relevant documents with the companies registry to give effect to appointments and resignations of directors or company secretaries etc.

Whilst to a certain extent reliance maybe put on force majeure clauses (which will be discussed below), it would be prudent and more effective for parties to address these issues thoroughly in the relevant parts of the definitive contract to avoid disputes and opportunities for the relevant transaction counterparty to terminate the transaction.

Due Diligence and Warranties

Sellers should, for their protection, make full disclosure as a part of the information to be disclosed during the due diligence process or provide written disclosures of the impacts of the COVID-19 pandemic, lockdowns or RMO, as the case may be, on its business to qualify the warranties given to Buyers. Sellers, where possible, should avoid giving warranties on forward looking statements and on projections from such events.

Buyers should give special attention to areas of the target companies which would likely to be affected by such events and should insist on a full and adequate disclosure in writing from the Sellers before they proceed to enter or to complete the acquisition.

Typical warranties that would require attention or consideration for disclosure arising from the impact of the COVID-19 pandemic, lockdowns or RMO ("**Events**") are:

(a) Changes in financial and trading position of the target company since the last accounting date which would include status of trading or manufacturing activities and any material supply chain effects on the target company since the last accounting date;

(b) New claims and litigations arising from the Events;

(c) Defaults or impacts on material contracts including financing documents and details of any delay or extension of time to perform obligations of the company or its counterparty;

(d) Changes or effects on material borrowings and financial commitments and breach of covenants in financing documents;

(e) Defaults in payment obligations to financial institutions or withdrawal by financial institutions of loans and funding commitments;

(f) Adequacy of capital or solvency requirements of which companies in financial industry may be regulated under its operating licence or relevant applicable laws;

(g) Impact of the Events on employees, for example, whether there are arrears in payment of salaries and relevant statutory payments and any infections amongst employees, in particular key employees; and

(h) Impact of the Events on its overseas subsidiaries or associates.

Buyers should consider requiring for specific clauses/warranties from Sellers on the effects of the Events and the right not to proceed to execute or complete the contract if the information disclosed qualifying the original warranties given on or prior to the execution of the contract are not acceptable to the Buyer. Further, Sellers are typically required to make repetition of the warranties being true and correct as at the completion. In this regard, Buyers may wish to provide for indemnity or adjustment to the purchase price as alternatives to termination in such events.

Material Adverse Change

It is a common practice for Buyers or Buyers' solicitors to insist on "no material and adverse change to business and economic condition of the target company" as a condition precedent to completion of the transaction in the contract. This has the effect that Buyers have the right not to complete the transaction in the event the Events have a material impact on the target company.

However, where parties are about to enter into an M&A contract, as the outbreak of COVID-19 has already occurred and lockdown or RMO have already been implemented in many jurisdictions, parties may not be able to invoke the material adverse change provision in the contract based on the Events as the adverse change has already taken place on the execution of the M&A contract.

Further, for those who are entering into M&A transactions now, Sellers should consider rejecting a wide "material adverse change" clause in the contract whereas Buyers should bear in mind that they may have difficulty relying on such clause later to terminate the contract in view that all these Events have occurred on execution and do not constitute a material adverse change. As the full extent of the effect of Covid-19 pandemic is still unknown at this moment, it is prudent for parties in negotiation for M&A transactions to state expressly that where there are impact of the Events, parties may allow for adjustment to the purchase price or allow the Buyer to terminate where the consequences are beyond the parameters expressly provided for in the contract.

For those transactions pending completions, Buyers can certainly rely on "material adverse change" clauses to terminate and to not proceed with completion if indeed there was material adverse change to the business of the target company.

For a detailed article by our firm on "Material Adverse Change" clauses please refer to "**Material Adverse Change (MAC) Clauses in Mergers and Acquisitions Transactions**" at: https://www.linkedin.com/posts/azmi-%26-associates_material-adverse-change-mac-clauses-in-activity-6650450190312570882-2TD3. Also published in our firm's @Azmilaw Newsletter Issue #59 (April – June 2019).

Force Majeure

It is common for parties to provide for a force majeure clause in commercial contracts. However, in normal circumstances, it is not often that force majeure clauses are provided for in an M&A contract. This is because from the view point of the parties, the obligations of the Seller or Buyer in an M&A transaction for completion are short term obligations (and easily mitigated if the Events do occur) where parties should be able to perform their obligations easily, whereby the Seller will deliver to the Buyer the completion documents in exchange for the payment of the purchase price by the Buyer.

In order for a party to rely on force majeure, parties must have included the force majeure clause in the M&A contract and the language of the said clause must have expressly provided for force majeure in the event of an outbreak of disease, lockdown and/or RMO. On a practical note, even if there is a force majeure clause, it is likely that a party may invoke the force majeure clause to seek extension of time to complete the M&A agreement until the effects of the force majeure event is over. Depending on the language of the force majeure clause, it is unlikely that a party will be able to rely on the said clause for termination unless there is a prolonged period of breakdown of the banking system of the Buyer's jurisdiction whereby the Buyer is unable to effect payment to the Seller or the Seller is unable to deliver the completion documents required under the M&A contract.

The effects of the force majeure event on the target company or its business as opposed to the force majeure effects on the parties will be dealt with by other provisions as described above such as the material adverse change clause or the warranty provisions remaining true or acceptable disclosure by Seller clause.

Further, for M&A transactions to be entered into the near future, one has to bear in mind that in current times, the Events have taken place in most jurisdictions, so it may not be regarded as an "unforeseeable event or events which was not contemplated by the parties and render it impossible for a party to perform its obligations under the contract". Therefore, parties are advised to expressly address the impact of the Events on the ability of parties to complete the M&A agreement and the alternative arrangements to mitigate such issues, for example, requiring documents and purchase price to be deposited with stakeholder upfront upon execution.

For a detailed article on force majeure prepared by the firm, please refer to "**COVID-19: A Force to Invoke Force Majeure**" at https://www.linkedin.com/posts/azmi-%26-associates_covid-19-a-force-to-invoke-force-majeure-activity-6646326277617827840-VAK_.

Frustration of Contract

Parties may rely on the common law doctrine of frustration to terminate a transaction and not proceed to completion if an Event constitute a frustrating event whereby one of the parties is not able to perform its obligations under the contract. However, as highlighted above, the completion obligations for M&A transactions is typically the delivery of completion documents in exchange for the purchase price. To rely on the doctrine of frustration, there has to be a very drastic effect from such events which affects the completion obligations of the relevant party.

In some jurisdictions like Malaysia there are frustration rights provided in its statutes. Frustration has the effect of terminating the contracts due to the impossibility of performance rather than a suspension of performance. Therefore, parties cannot rely on frustration to suspend and/or extend time for completion.

For new transactions, given the Events have already taken place and the orders have been put into effect in various jurisdictions, it may no longer be regarded as a frustrating event allowing parties to terminate the M&A agreement. Therefore, similar to the discussion above on force majeure, parties are advised to expressly address the consequences of the Events on the ability of parties to complete the M&A transaction and the alternative arrangements to mitigate such issues.

For a detailed article by our firm on the doctrine of frustration, please refer to "**COVID-19: Frustration of Contract?**" at https://www.linkedin.com/posts/azmi-%26-associates_covid-19-frustration-of-contract-revised-activity-6650032803234873344-bgju.

Important Information

Azmi & Associates has set up Azmilaw Covid Task Force to look into all issues arising from COVID-19 and MCO. Clients are welcomed to contact their usual Partner who will bring their issues to Azmilaw Covid Task Force for our further action.

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We hope the above discussion is of assistance to you and your company. If your company's operations or contractual obligations are affected by the COVID-19 outbreak, we are ready to assist you on any queries you have.

Corporate Communication
Azmi & Associates
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