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Actions that may be taken to address some of the risks arising from the COVID-19 crisis in connection with M&A transactions

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1. Introduction

1.1 On the 24th of March 2020, the President of the Republic of South Africa announced a nationwide lockdown in terms of the Disaster Management Act No 57 of 2002 (the Act) in an attempt to curb the spread of the coronavirus pandemic. The national lockdown is an unprecedented restriction on the movements of persons, and economic activity in South Africa save for the provision of "essential services" as defined in the Act.

1.2 South Africa is now in the fifth week of the national lockdown. Although it is widely accepted that the lockdown has undoubtedly slowed the rate of COVID-19 infections in South Africa, it has become clear that a health strategy to resolve the COVID-19 pandemic that is largely based on an extended lockdown is economically unsustainable. COVID-19 will only be eliminated either when a vaccine is found or sufficient natural immunity in the population is achieved. In view of this realisation, on 23 April 2020, the President of South Africa announced a gradual easing of the lockdown restrictions and the reopening of the economy in a risk adjusted manner with effect from 1 May 2020. The main takeaway from the President's announcement is that there will be significant changes in the way we do business and conduct our lives even after the end of the current lockdown restrictions.

1.3 Apart from the devastating human and social cost of COVID-19, one of the impacts of the COVID-19 pandemic is the economic fallout arising from it. Not to say that the South African economy was shooting the lights out before the COVID-19 pandemic but the wake of COVID-19 and the lockdown restrictions have worsened the economic situation in South Africa. As a result it is expected that there will be a significant rise in the number of financially distressed businesses and the unemployment rate in the short to medium term. In light of this, one of the big talking points at the moment is that we will see an increase in the restructurings and mergers and acquisitions of financially distressed businesses by opportunistic cash strong companies and private equity firms in the medium to long term.

2. Key Considerations

2.1 Against the above background, we set out hereunder some of the critical considerations and actions that may be taken to address some of the risks and challenges posed by the COVID-19 crisis when preparing and negotiating M&A transactions.

2.1.1 **Thorough Due Diligence Investigations**: Current low valuations of businesses might tempt dealmakers to take short cuts when analysing deals but we caution against that. Extensive and thorough financial, commercial and legal due diligence investigations of target companies are more important now in order to assess and understand the risks, opportunities and threats as well as valuations of the target companies. Furthermore, thorough due diligence investigations will also assist with the assessment of the viability of the businesses of the target companies during and post the COVID-19 crisis. Past experience has shown that failure to conduct, or rushing through, due diligence investigations can result in poor investment decisions for the purchasers which could have been avoided had thorough due diligence investigations been conducted.

2.1.2 **Representation and Warranties**: In addition to the usual representations and warranties, acquisition agreements should now include specific representations and warranties relating to the COVID-19 crisis particularly in relation to health and safety issues relating to the COVID-19 crisis. Furthermore the COVID-19 crisis necessitates careful preparation of disclosure schedules to also cover the adverse consequences arising from the COVID-19 crisis including, *inter alia*, workplace and employee matters, labour shortages and reduced productivity, travel restrictions, financial covenant breaches, breaches of contracts and disruptions to supply chains, in order to avoid inadvertent breaches of representations and warranties in acquisition agreements.

2.1.3 **Termination Rights**: It is important to ensure that acquisition agreements include termination rights which would allow the parties to terminate the deal if there are material changes to the operational/financial position of the target company due to the COVID-19 pandemic. This is typically addressed by the inclusion of carefully crafted material adverse change (MAC) provisions in the acquisition agreements. Simply, the MAC provisions give the purchaser a right to terminate the acquisition agreement in the event that there is a material adverse change to the target company's operating, economic and financial conditions.

2.1.4 **Price Adjustment Mechanism**: The uncertainty around the performance of target companies as a result of the COVID-19 crisis may also be contractually addressed by including price adjustment mechanisms in the acquisition agreements. This allows for the adjustment of the purchase price payable for the target company/assets in the event that there are material changes in the financial performance or position of the target company. Although the purchase price adjustment mechanism often results in valuation disputes, it allows for the renegotiation of the purchase price and adjustment of purchase price in the event that the financial position/performance of the target has changed.

2.1.5 **Regulatory Approvals and Timetables**: Given the magnitude of the effects of the COVID-19 crisis, we anticipate that it will take longer than normal to close M&A transactions particularly those that require regulatory approvals/consents. Accordingly deal timetables should be meticulously prepared to allow for the additional time and steps that may be required to secure regulatory approvals.

3. Conclusion

The above mentioned considerations and actions are by no means exhaustive but merely give an idea of some of the measures that may be taken to address some of legal risks arising from the COVID-19 crisis in the context of M&A transactions.



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