

## COVID-19: CONSEQUENCES FOR DEALS AND CONTRACTS

### 1. Introduction

The outbreak of the novel coronavirus (also referred to as Covid-19) has now become a global pandemic.

Companies will inevitably be affected, either directly or indirectly, by the outbreak and by its economic and financial consequences. Government restrictions have had immediate consequences requesting the closure of several public and private businesses, requiring work from home arrangements and a reorganization within the working environment in order to protect the health and safety of those workers who still need to physically go to work. Due to national and international traveling restrictions, other activities have closed and this has caused and will continue to cause very relevant consequences for businesses, whose contingency plans and operational/risk management models are now put to full work and stress.

Letting aside long-term consequences of Covid-19, which cannot be assessed for the time being, this newsletter offers guidance for deals and contracts that have already been executed and need to be performed, those deals and contracts that are currently being negotiated, as well as for corporate information of listed companies, for which - in times of increased prices volatility and heavy scrutiny on management bodies - shareholders trust is an asset to preserve and regulatory oversight becomes more intense (not to mention the possibility of increased shareholders activism).

### 2. Impacts on M&A and private equity transactions

In the context of private equity or M&A transactions, the impact of Covid-19 can be extremely relevant.

#### *Price*

Agreeing on the amount of a purchase price in an extraordinary transaction could be the greatest challenge since the expectations of the buyer and the seller might differ significantly given the uncertainty of the economic consequences in the short and medium term of Covid-19.

Buyers should consider whether locked-box and fixed pricing carry too much risk in this environment. One alternative could be to defer a portion of the purchase price to be paid after Closing as an earn-out amount, in order to be able to assess the actual consequences

of the current crisis on the target's business. Another protection could be to request a price adjustment mechanism based on changes to working capital.

### ***Due diligence phase***

The due diligence activity is certainly subject to delays because of some offices being closed and due to numerous travel restrictions. This can translate in technical difficulties for the seller to collect the documentation for the virtual data room or for the Q&A process, given the physical absence of certain staff in offices.

The analysis of the buyer will need to address the same issues addressed in the past having in mind the possible impact of Covid-19 and new specifically Covid-19 related issues including in particular:

1. The wording of termination and force majeure clauses in contracts of the target that could be triggered (or have been triggered) and that could affect the continuity of the target's business;
2. the existence of claims deriving from delays in the supply of goods/services or late payments that could be justified by the outbreak of Covid-19;
3. the liquidity difficulties and going concern risks for the target, its key suppliers and clients;
4. the health & safety procedures to be adopted by the target (and its subcontractors) aimed at protecting the employees from the virus;
5. existing insurance policies and their coverage, including business interruption policies;
6. exposure of the business (including its counterparties, suppliers and customers) to jurisdictions highly impacted by the coronavirus epidemic;
7. supply chain risk and the availability of, and costs associated with, utilizing alternative sources of supply;
8. the effectiveness and use of business continuity plans and crisis management procedures; and
9. the compliance with all the applicable national and regional laws and regulations on containing the spread of COVID-19.

### ***Sale purchase agreement***

With regard to SPAs, it is easy to predict that certain provisions will be subject to difficult negotiations. In particular:

1. The wording of the MAC (*material adverse condition*) clauses shall be drafted trying to address the needs of each party: a seller should try to push back requests to insert a MAC clause that considers Covid-19's effects based on the argument that this health crisis and its immediate effects are well known by now; buyer will want to capture the possibility that new countries and sectors be heavily affected and that effects in the target's sector exceed parties' expectations or the effects on target are disproportionate compared to the other companies in the same sector or jurisdiction;
2. the reps and warranties specific to this crisis need to be carefully crafted in order to obtain confirmation from the seller that no outbreak has occurred in its premises or in the premises of its key suppliers and sellers; that sellers have not stopped their activities or closed their stores or such closures have not materially affected target's sales; that seller has not experienced delays in payments and have not delayed payments to their counterparties beyond the contractual or legal due dates;

3. condition precedents might be inserted in order to make the deal subject to the seller solving certain Covid-19 related issues, i.e. the overcoming of the disruptions caused by an outbreak that occurred in the target's premises; the reopening of stores or offices of the target or of its key clients; the conclusion of contracts with new suppliers in order to replace suppliers that are based in highly affected jurisdictions; the adoption of all necessary measures to ensure health and safety of the employees in compliance with all the applicable national and regional laws and regulations specific to COVID-19;
4. long stop dates: acquisition agreements, in whatever form, typically provide a term within which closing should occur; be mindful to provide a long period of time before the contract ceases to have effect without closing since the current crisis triggers unavoidable delays for both public authorities and private entities;
5. a long period of time between signing and closing creates the need to protect the buyer with a very detailed interim provision and a MAC that captures unexpected events or unforeseen consequences of the current pandemic; a seller will need to make sure that there are no discretionary way-outs for the buyer and that the interim period restrictions still entitle target to address the current crisis managing the company in ways that can be different from past practice but that are needed to respond to the current challenges.

In addition to the above, the impossibility of physical meetings can be addressed by using software that allows to digitally sign documents having the same validity of a physical signature.

For those contracts that require the intervention of a Public Notary, Notaries might agree to organize a closing in a variety of ways:

1. If the entities involved in the closing are all in Italy but in different cities, one party can grant a proxy through its local Notary to a person in the city where the closing will take place, the first Notary can transmit electronically the proxy in real time to the other Notary for the latter to effect the closing;
2. if the entities involved in the closing are not all in Italy the same system can be used but the proxy will need to be apostilled or legalized and then sent to the Italian Notary;
3. parties can also decide, for certain Notarial deeds, to sign the document that would have been signed as a single document using different Notaries (just like a proposal and acceptance mechanism); this system can also be used by a single Notary to avoid the presence of many parties simultaneously; the price can be paid to the Notary before closing and it would then be transferred by the Notary to the seller(s) upon completion of the process.

### **3. Impacts on financing transactions**

With respect to existing financing arrangements, the following impacts can be envisaged:

1. A new and continued scrutiny of financial covenants by both parties is highly likely, as borrowers may face unexpected working capital and cash needs. Borrowers, including PE funds and sponsors, may consider preemptively liaising with the banks and seeking covenant waivers should a default of their financial maintenance covenants be already anticipated. This proactive approach is likely to be adopted by borrowers that do not need to draw any further amounts from their financing agreements;

2. it is likely that lenders will require from borrower the provision of information under their (often wide) information undertakings with respect to the consequences of the Covid-19 on the borrower's operations and on its ability to correctly perform contracts with customers, as well as the ability of strategic partners and suppliers to perform their obligations vis-à-vis the borrower;
3. if the loan is not fully drawn, the parties will be examining whether the circumstances will result in a draw-stop or require an extension of the availability period of the loan, particularly if force majeure has been triggered under key contracts for the business or project;
4. ongoing analysis will be required to determine whether any event of default has been triggered. For example, credit agreements in construction or capex financings often include events of default for abandonment or suspension of construction works, for failure to achieve construction milestones or to progress the works;
5. an analysis should be carried out also with reference to the insurance policies and the related coverage (e.g. business interruption or advanced loss of profit) to assess whether any mandatory prepayment event has occurred;
6. also, financing arrangements may include a material adverse change clause. Whether or not the impact of the outbreak constitutes a material adverse change for the purposes of a representation and warranty, condition precedent or event of default is mainly a matter of contractual interpretation and applicable law;
7. as syndicated loans trade at significant discounts on the secondary market, PE sponsors can be expected to take potential advantage of their existing debt buyback provisions; accordingly, that is another area of loan documentation that should be subject to increased scrutiny in the months to come.

The coronavirus outbreak will most likely also impact on-going negotiations for new financing arrangements, as lenders will most probably seek strengthened protections around financial reporting and notice requirements as well as tightened terms of incremental debt provisions (including with respect to MFN sunsets and free-and-clear tranches). New representations and warranties covering Covid-19 issues - such as no outbreaks within the borrower's premises or its suppliers', compliance with the safety measures for employees, emergency plans in place in case of outbreaks - are likely to be required. Borrowers, on the other hand, should request longer covenant holidays in order to have more time to recover from the effects of this emergency.

#### **4. Listed companies' corporate information profiles**

In a context like the Covid-19 outbreak, with the ensuing full barrage of operational and legal challenges to business enterprises, it is paramount to have in place solid procedures for the management of corporate information, not only to comply with legal obligations, but also as an essential management tool, since the situational awareness deriving from a steady information flow from the company's operational/financial divisions all the way to top management and board of directors allows:

1. The quick on-field deployment of proper operational measures;

2. the identification of the information to be disclosed so as to comply with legal obligations;
3. the adjustment of contingency plans/risk management models, in the light of new (market or industry-specific) external threats.

The Regulation (EU) No. 596/2014 of the European Parliament and of the Council of April 16, 2014 (“MAR”) mandates that issuers disclose as soon as possible any relevant significant information concerning the impacts of COVID-19 on their fundamentals, prospects or financial situation.

The assessment on what information to disclose must be made in the light of the general criteria set out by MAR, under which must be disclosed to the public the *“information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers or to one or more financial instruments, and which, if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments”*.

In sum, to evaluate what information to disclose, the issuer must consider:

1. The relevance of the underlying facts in the light of the sensitivity of the securities prices to the related information; and
2. the general economic situation (as required by the 2017 CONSOB guidelines on management of inside information).

Several Covid-19 related events are therefore suitable to be encompassed in the information to disclose to the market, such as:

1. Enactment of bans/restrictions on the issuer’s specific activity (or on activities closely related);
2. closure of operational premises (mandated or contingent);
3. supply-chain/other operational disruptions;
4. disruptions in the cash cycle (such as due to delays in payments by the clients/incidence of fixed costs);
5. disruptions in extraordinary transaction processes (such as interruptions of negotiations);
6. activation by the counterparties to material agreements of “MAE”/other walk-away clauses;
7. related material litigation;
8. material commercial presence in markets affected by Covid-19;
9. key-persons incapacitation due to Covid-19 illness;
10. identifiable material impacts on the activity or business performance/prospects of the issuer.

That said, in the assessment on what instances to disclose, the issuer must also consider that information on such events may have a different impact on the securities prices, since, as the case may be, share prices are generally more sensible to information than debt securities prices, with the latter that are essentially impacted by information on circumstances that may jeopardize the issuer possibility to serve the loan.

As Covid-19 related events materialize rapidly - and in the light of the current high volatility on the markets - any decision on the delay of disclosure under MAR needs to be

carefully evaluated, as a delay in such situation is likely to mislead the public (and would be therefore prohibited).

In any case:

1. Disclosure of information must also include the actions that the issuer has taken/planned to take to tackle the relevant issue (such as activation of insurance policies, presence of contractual protections, deployment of contingency plans, etc.);
2. the issuer should also disclose the relevant instances where its activity is not affected by Covid-19 related events/measures, as also good news has an impact on the securities prices;
3. disclosed information must be clear and constantly updated in the light of the evolution of the events/issuer actions (for instance, if a profit guidance has been initially disclosed, any update of the same post-Covid-19 outbreak must be as well communicated to the market).

Finally, in times of higher market/regulatory scrutiny on the issuers, a freeze on managers dealing during the Covid-19 emergency could also be considered, so as to quell any risk of abusive behavior/opportunistic action.

## **5. Impacts on day-by-day management and activity**

The current pandemic is heavily impacting the performance of commercial contracts. Parties are facing significant delays in performing contractual obligations, certain covenants have become impossible to comply with and other contracts have become excessively burdensome for one of the parties. In these cases, certain provisions of law and contractual clauses can be used to avoid any responsibility.

### ***Force Majeure***

The current epidemic and the consequent restrictive measures adopted by the Italian Government can certainly qualify as typical Force Majeure events under Italian law and pursuant to most contractual definitions consistent with standard practice.

We cannot exclude that certain parties could try to take advantage of the current situation to justify contractual breaches: the above Force Majeure events can justify a suspension of the performance of the contract only to the extent these events have actually prevented a party from duly performing its obligations. The party whose performance has been prevented by Force Majeure needs to prove that the event was beyond its control and that such event has actually prevented it to duly comply with its contractual obligations.

Force Majeure may also entitle the termination of the contract, if it exceeds a duration specified in the contract or, given the lapse of time, the other party has no longer interest in the performance of the obligation.

The assessment of whether a Force Majeure event has occurred thus entailing the suspension of parties' performance or altogether the contract's termination needs to be made on a case by case basis. For example, supply agreements for seasonal products are likely to be terminated if delays extend beyond the period in which these products are usually sold to final customers.

Certain unexpected and unwelcome consequences might be triggered should one party justify its breach for Force Majeure since in certain contracts such type of events vest the other party with step-in rights thus excluding the other party from the performance of the service.

Force Majeure is widely applicable in common law jurisdictions and is frequently used in commercial contracts governed by such common law systems because of the limited remedies otherwise available to the parties when the contract becomes impossible, difficult or burdensome to perform due to events outside the affected party's control.

***A contract becomes excessively burdensome for one party or impossible, also temporarily, to comply with***

Under Italian law, a party is entitled to request the termination of the contract if unforeseeable events make the performance of its obligation excessively burdensome. Again, the current pandemic and government restrictive measures certainly qualify as unforeseeable events, the possibility that such events have caused the relevant obligations to become excessively burdensome needs to be proven on a case by case basis. The party that is requesting the termination of the contract will need to prove that the aggravation it is currently experiencing well exceeds the risk that can normally be envisaged. In turn, the counterparty may avoid the termination of the contract by proposing an amendment to the contract terms in order to restore the proper balance. Hence, this legal provision entitles the affected party only to request the termination of a contract which might not be ideal since many deem that the current situation will be only temporary and therefore do not want to lose their contracts. We refer in particular to retail stores that have been forced to close and cannot afford to pay the rent but do not want to lose their lease agreements.

***Focus 1: Lease agreements***

With travel restrictions first and the forced closure of all retail stores with few exceptions, many businesses have incurred in significant losses since revenues have dropped during the pandemic.

In trying to reduce costs, businesses have asked to suspend the payment of leases. We believe this right can be exercised only in case of closure of the business since before such closure, the owner of the premises is still able to offer the lease of the building. In this situation, lessees can request the termination of the contract if the same has become excessively burdensome. The lessor could reply offering to modify the terms of the contract but it is not an obligation of the lessor that can well decide to terminate the contract or challenge the lessee's claim that the lease has become excessively burdensome. The lessees can also decide to withdraw from the agreement since the law grants such right for serious reasons (*gravi motivi*) and we believe that the current crisis could qualify as one. However, in all of the above cases, the lessee cannot force the lessor to renegotiate the terms of the contract. On the contrary, if the business has been forced to close, the owner is not performing its obligation to allow the lessee to use its premises, and the lessee should be entitled to suspend the payment of the rent and if the forced closure lasts for an extended period of time, parties can also terminate the contract.

***Focus 2: Insurance policies***

Covid-19 is causing significant losses for many companies. Those losses may be covered under insurance (typically, business interruption or business income policies). In order for the insurance policy to be triggered, insured entities shall consider the following:

1. A written notice of actual and potential losses must be made, complying with the term set out in the policy;
2. proof of loss must be provided describing the nature and amount of the losses suffered, and how they have been caused by an insured event. In this respect, insured should keep a detailed record of how the coronavirus outbreak and its knock-on effects are impacting the performance of the company, since it might be useful in a later dispute over liability; and
3. insurances only cover losses which are accidental, and therefore may not apply to losses caused by the insured's mishandling of its response to an insured event. Many policies also impose express duties on the insured to mitigate its losses.

## 6. The effects on civil trials

The hearings of civil trials due to take place in any Italian Court between March 9 and March 22, 2020 have been postponed after 22 March 2020. The new date of the relevant hearing will be determined at a later stage. This postponement does not apply to hearings relating to certain family law matters, to human rights and to those declared urgent by the Court. Consistently, the lapse of procedural time limits has been suspended.

From 23 March 2020 up to 31 May 2020 the head of each Italian Court will decide which measures will be adopted to allow proceedings to continue to the extent possible given the current pandemic (including by using videoconference tools).

The postponement of hearings and the suspension of procedural time limits do not prevent the filing of new writs of summons or of provisional reliefs including the filing of a request for a composition with creditors (*domanda di concordato*) or of a request for an injunctive relief (*richiesta di decreti ingiuntivi*).

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