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In the past several weeks, the Canadian economy has felt the unprecedented impact of business interruption, employee layoffs, travel restrictions, and a reduction in consumer spending. With the rising uncertainty as to the duration of the COVID-19 outbreak and its corresponding economic disruption, questions have arisen regarding its potential impact on corporate mergers and acquisitions. This blog post explores the following potential impacts of COVID-19 on pending and prospective corporate transaction:

- Should COVID-19 alter the letter of intent (LOI) in a corporate transaction?
- What are the possible effects of COVID-19 on the terms of an ongoing corporate transaction?
- Takeaways from COVID-19 to consider in future corporate transactions.

Letters of Intent

LOI's are typically non-binding agreements used in corporate merger & acquisition transactions, which set out the parties' intentions to enter into a binding agreement at a future date. A LOI will also often clarify the intentions of the parties and specify the essential terms of the future agreement, such as the scope and timing of the transaction, the purchase price, financing terms, and due diligence requirements.

Parties who have not yet executed a LOI should carefully consider the following due diligence implications as a result of COVID-19:

- *Revisiting Due Diligence* – Buyers should re-examine their existing due diligence undertaken on a target business. Any prior due diligence (financial, operational, current, prospective, etc.) may no longer be sufficient in light of COVID-19. In most cases, the original LOI should have secured broad due diligence rights in favour of the buyer; these should permit the buyer to conduct more extensive diligence on the target business. Critically however, where the due diligence period has been limited to a particular period of time, that time period may require an extension in light of current commercial realities. There may be new difficulties in obtaining information from the target, as well as obtaining information from third parties (particularly governments of all levels as they are all experiencing large delays in service timelines).
- *New Due Diligence* – Buyers may need to request additional information that they would not have requested in a pre-COVID-19 transaction. This could include (i) any public health or essential services orders which would impact upon the continuing operation of the target business, (ii) any revisions to financial forecasts controlling for negatively impacted sales, (iii) any discussions with third party creditors for debt deferral (e.g. landlords, financial institutions, government tax authorities), (iv) any recourse by the target business to new government programs in light of COVID-19 (e.g. those programs [listed here](#)), (v) any decisions respecting employee temporary or permanent layoffs, and (vi) any contracts currently being revisited in light of COVID-19 (see discussion below respecting "Force Majeure").



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- *Medium of Due Diligence* – The feasibility of any in-person due diligence will be largely impacted by COVID-19. The buyer should, therefore, give consideration to questions such as (i) should a more robust online solution, such as a virtual data room, be used to aggregate information, (ii) are there any inspections that absolutely require an in-person review? If so, can the review be accomplished in a way to limit the number of on-site personnel and provide that personnel with appropriate personal protection equipment, and (iii) are the buyer and target remaining in regular contact through videoconference.
- *Termination* – If appropriate, the parties should also consider modifications to termination clauses in light of COVID-19. For example, it may be appropriate to include a clause that terminates the transaction if a governmental authority, prior to closing, passes a law or regulation which effectively suspends the operations of that business.

Impact on Terms of Ongoing Corporate Transaction

For those agreements which were entered into prior to the COVID-19 pandemic, parties may now be unable or unwilling to proceed with the transaction. In order to assess this risk, both parties will need to look to the relevant provisions in the underlying documentation.

A. Force Majeure

As outlined in the recent McKercher blog post, “[COVID-19 and Force Majeure Clauses](#)”, force majeure clauses generally operate to discharge a contracting party from its obligations when a supervening event beyond the control of either party occurs, making the performance of such obligations impossible. A party seeking to rely on a force majeure clause for relief from contractual obligations must demonstrate that the event was beyond reasonable human foresight and that no reasonable alternatives exist to allow the performance of its contractual obligation. It is relevant to note that force majeure does not exist at common law, and thus a clause would need to be specifically included in the agreement for either party to rely on it.

Whether the present circumstances, which continue to unfold on a daily basis, make it impossible for a party to satisfy their contractual obligations, must be assessed on a case-by-case basis. For further information on whether a force majeure clause may be triggered by the ongoing COVID-19 outbreak, we refer you to the aforementioned blog post, which provides a more in-depth analysis of such clauses and when they may be triggered.

B. Material Adverse Change (MAC) or Material Adverse Effect (MAE)

MAC/MAE clauses are typically found in most merger and acquisition agreements and generally operate to terminate the agreement in the event a material adverse change or effect occurs with respect to the target business. Such clauses are often negotiated at length between the parties and may include several exclusions.

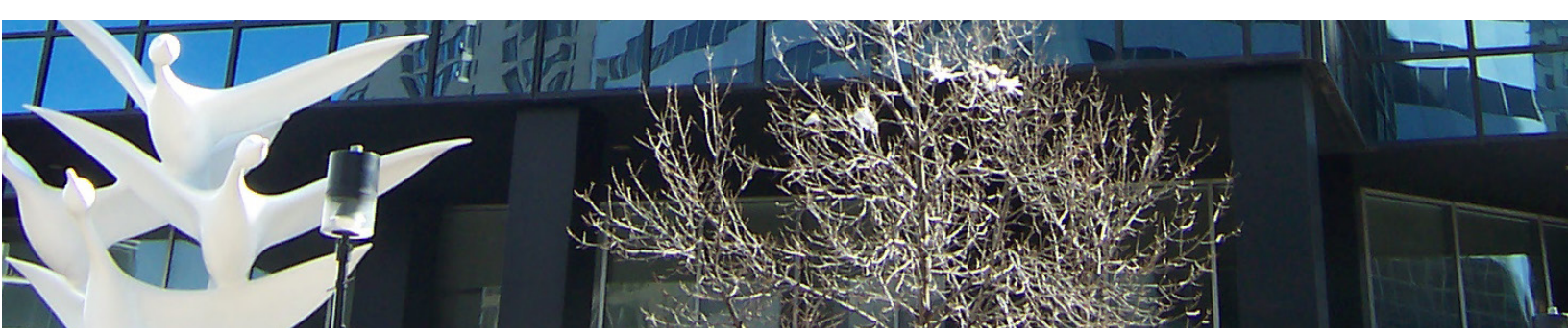
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Canadian courts have considered MAC/MAE clauses in the context of mergers and acquisitions and determined that they are generally considered to mean that, on or before a particular date, a change has occurred which is material to the target business' financial condition. A party attempting to trigger this clause often must satisfy an extremely high threshold and demonstrate that the circumstances are "material" in that a reasonable person would expect them to significantly influence the purchaser's willingness to enter into the transaction.

It is too early to accurately assess the impact of COVID-19 and whether its effects may be considered as materially adverse changes. This is because such changes would likely need to impact the long-term financial vitality of the target business. One should also be wary of invoking such a clause without clear intentions between the parties that such circumstances constitute a MAC/MAE. If a party disputes the invoking of such a clause, it could result in extremely time-consuming and costly litigation, with neither party having certainty as to the outcome.

C. Conditions Precedent

Conditions precedent are another provision typically found in most merger and acquisition agreements. This provision often sets out requirements that must be satisfied by the parties before the agreement will come into force and effect. Key conditions precedent which parties should take note of include:

- *Regulatory Requirements* – Currently, in Saskatchewan, essential services businesses remain open, and most government offices remain operational, albeit with limited capacity. However, in the event of additional closures of government offices, parties should be prepared that they may be unable to obtain a requisite regulatory approval on or before a closing date. Parties would be well-advised to check in with relevant governmental authorities (e.g. Canada Revenue Agency, Competition Bureau, provincial securities regulators, land transfer offices) to assess the impact of processing timelines on transaction approvals.
- *Financing* – In the current economic climate, there is a real possibility that many lenders may alter the terms upon which the financing is provided or may refuse to fund the transaction altogether. Parties should be in contact with their financiers to assess any impacts on their transactions.

In the event a condition precedent is unable to be satisfied, parties may be forced to delay the agreement's closing or may nullify the agreement altogether. The specific impact of a party's inability to satisfy its conditions precedent will depend on the drafting of the agreement. Parties facing similar concerns should discuss these potential issues with one another and consider whether any amendments to the agreement may alleviate the concerns.

D. Representations and Warranties

The last provision discussed, which is nearly always present in a corporate merger and acquisition transaction, is that of representations and warranties. A representation and warranty provision is two-fold, in that: (i) the party makes a representation that a certain fact is true on the date of the agreement's closing; and (ii) the party making the representation warrants that if the fact is found to be false, then they will indemnify the other party for any damages suffered as a result. It is common for a party's warranties to survive beyond the closing of the agreement for an agreed-upon length of time (in many cases, different representations and warranties have different survival periods).

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Notwithstanding that numerous fact-specific representations and warranties will be included in a corporate transaction agreement, the most common representation is that the subject-business will continue to operate “in the ordinary course” between the signing date and the closing date. The target business may technically be in violation of this representation where it: (i) requires all employees to work from home, (ii) refrains from entering into essential contracts with business partners, (iii) lays off a substantial portion of employees, (iv) suspend operations, or (v) halts operations altogether (assuming these are not in its ordinary course – i.e. a seasonal business which ordinarily lays off a substantial portion of employees). Many of these events are very likely to occur, if they have not already, as a result of the COVID-19 outbreak.

Therefore, where the purchaser is willing to do so, parties who have already executed a corporate transaction agreement may wish to mutually agree to amend the agreement in order to allow the target business to operate outside the ordinary course for the duration of this outbreak.

Takeaways

The principal takeaway from this article is that parties to a merger or acquisition strategy should carefully revisit all their initial assumptions heading into the transaction. With the rapidly changing economic impacts of COVID-19, coupled with new government announcements daily, it is incumbent on parties’ (and their counsel) to continually challenge the reasons they entered into the transaction in the first place. Assuming parties still wish to proceed with a transaction, they may need to entertain changes to transactional documents (e.g. letter of intent, share purchase agreement, asset purchase agreement) to make the transaction feasible.

If you are a purchaser or vendor who is presently in the process of negotiating and drafting an agreement, specific and purposeful drafting may help define the present economic landscape and limit, or avoid altogether, the risk that either party will be unable to satisfy their obligations under the agreement.

The lawyers at McKercher LLP have a depth of expertise in negotiating, drafting, and closing all manner of merger and acquisition transactions. We take a collaborative approach to these transactions, leveraging lawyers with expertise in corporate, tax, environmental, land, and other industry-specific laws. If you are contemplating a merger or acquisition transaction, please contact one of our lawyers, and we would be pleased to help you assess the ever-changing landscape.

About the Authors:

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About McKercher LLP:

McKercher LLP is one of Saskatchewan’s largest, most established law firms, with offices in Saskatoon and Regina. Our deep roots and client-first philosophy have helped our firm to rank in the top 5 in Saskatchewan by Canadian Lawyer magazine (2019/20). Integrity, experience, and capacity provide innovative solutions for our clients’ diverse legal issues and complex business transactions.



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