Keep it simple

VdA's Paulo Trindade Costa on the impact of the Covid-19 pandemic on current and future transactions and how parties should approach risk

Many of us were caught in the making of transactions when the Covid-19 outbreak started or, at least, hit Europe causing a complete shutdown in many countries or started them while confined at home experiencing the sudden and unexpected demise of the economy.

While assessing the business impacts of the pandemic in ongoing transactions and those initiated while navigating new unchartered waters, lawyers, vendors and purchasers started pondering the legal impacts of this 'new normal' on transactions agreements and how risk-sharing provisions would operate in this context and its aftermath. Following the 2008 financial crisis, lawyers submerged on discussions on how provisions in their legal systems would operate, namely on supervening change of circumstances affecting contracts, and if the lessons then learned, carved in jurisprudence and scholars' extensive essays, would apply to transactions generated prior or in the midst of the pandemic. The same amount of time and consideration was dedicated to the discussion on how effective (more or less) standardised risk-sharing provisions would operate in transactions preceding this Covid-19 crisis but not yet completed and how such provisions should play out in acquisitions signed and concluded while we still are besieged by the virus. Provisions on representations and warranties, interim management periods, material adverse change, force majeure, hardship and others were (are) again revisited.

The purpose is not to discuss how the relevant provisions of the law should be construed and enforced in the current context of abnormality or consolidated M&A risk-sharing provisions in transaction agreements should be reshaped or tailored to accommodate the specific features of this pandemic. No one should dare to say that given the succession and seriousness of the global crisis that the economy and businesses have faced this century, such abnormalities should be, henceforward, legally perceived as foreseeable events by parties who are properly advised with an array of advisers covering different areas and, increasingly, using W&I protections. To ensure the sacrosanct contractual balance in M&A transactions, the law and contracts should continue to have mechanisms to restore the equilibrium that allowed parties to agree and, ultimately, provide for the termination or reduction of such contracts.

What it is important to emphasise is that, in abnormal situations such as this pandemic, the agreement of the parties on how to share the risk of transactions and solve disputes arising therefrom is (and was never so) important. The focus should not be to create and populate contracts with more complicated and complex risk-sharing provisions, which, ultimately, ignite conflicts, increase negotiation costs, create difficulties of enforcement and may lead to unclear allocation of risks unpleasing for the interests of the parties. In a way, the deviation from consolidated standards may prove to be a 'remedy' far worse than the 'illness' by giving investors a false expectation of security and a time bomb waiting to explode when enforcement is required. The goal should be to agree in 'clean cut' provisions allocating and distributing the risks between the parties or providing unequivocal termination rights whenever closing is no longer possible or the burden to close has become excessive for one of the parties. In ongoing transactions, the risks of this pandemic should be factored as part of the output of the transaction, distributed evenly between the seller and purchaser (positing that such risks impact them in equal terms giving the exogenous nature of a pandemic) and accrued in the consideration (or its upwards or downwards adjustments) in line with the advice of their legal, financial and technical consultants.

In sum, avoid panicking by using (well-intended) intricate and, yet, misguided provisions intending to cover all possible scenarios that may surge from the current outbreak or, conversely, by just leaving the solution to ancillary applicable provisions of the law always subject to interpretations that may not fully capture the intent of the parties when contracting in a scenario of uncertainty.

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For more information, please contact:

Paulo Trindade Costa, M&A partner

ptc@vda.pt

VdA
T: (+351) 213 113 400
Rua Dom Luís I, 28
1200 151 - Lisboa

lisboa@vda.pt

www.vda.pt