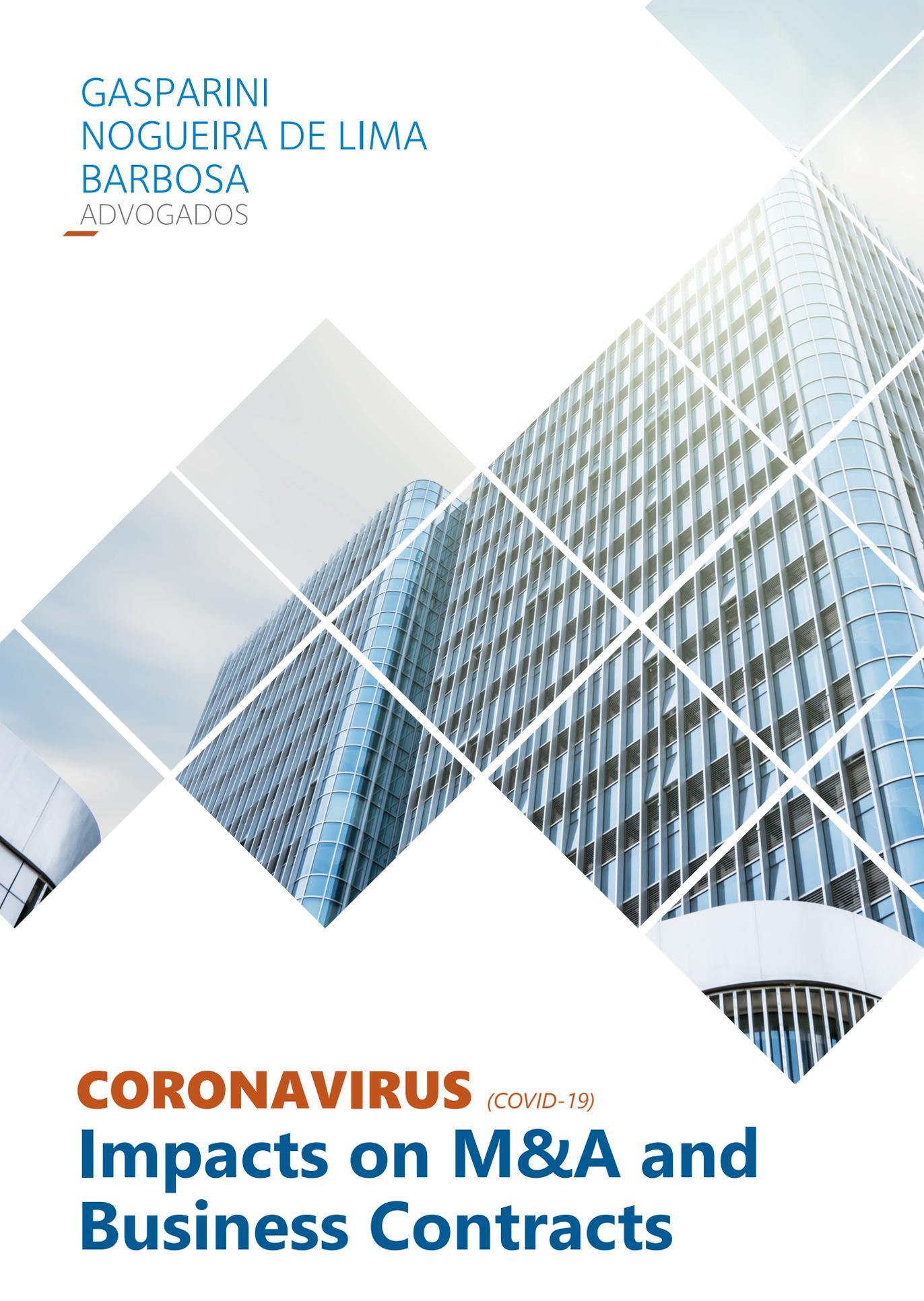


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CORONAVIRUS *(COVID-19)*
**Impacts on M&A and
Business Contracts**

PANORAMA

2020 started with great expectations of investments and mergers and acquisitions (M&A), which, in theory, would positively impact the national economy in the most diverse sectors.

However, on March 11, the World Health Organization (WHO) raised the status of the Coronavirus contamination to the category of "pandemic", which drastically changed the initially envisaged scenario.

The situation faced by the world, which currently affects several countries and the largest global economies, is already having different effects on investments and contracts entered between companies.

Due to the high contagion capacity of the Coronavirus (COVID-19), in addition to health complications of the infected population, there has been a need to implement severe actions by governments to contain the transmission and, eventually, avoid overloading the health systems, where isolation (separation of sick or contaminated people) was one of the first measures taken by government officials.

Currently, several countries already face strict quarantine conditions (lockdown, restriction of activities and social isolation) and consequences of such measures on the market during and after the pandemic are still being discussed.

Due to the urgency of taking measures to contain the effects of the pandemic, the Brazilian Government has been publishing new rules, ordinances, regulations, provisional measures and laws dealing with the matter almost daily.

In the current scenario, it is not possible to imagine business sectors that have not been affected, whether to a lesser or to a greater extent. Within such context, we present herein the legal impacts, under a Brazilian law point of view, initially envisaged on M&A and business contracts as a whole.



SUMMARY

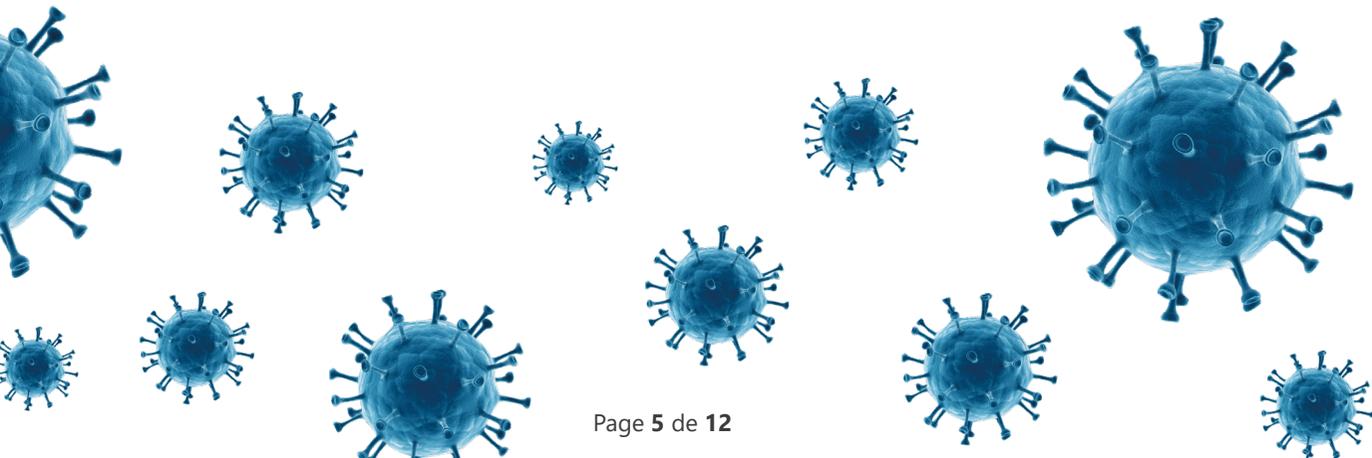
Impacts on M&A	page 05
Material Adverse Effect (MAE) and Material Adverse Change (MAC)_____	page 06
Auditing_____	page 07
Pricing _____	page 08
Representations and Warranties_____	page 09
Impacts on Business Contracts.....	page 10

IMPACTS ON M&A

In general, M&A contracts are complex because they involve a series of obligations, rights and duties between the parties, such as, but not limited to: conditions precedent for closing; suspensive or resolutive condition; loss mitigation and price adjustment clauses; parties' representations and warranties; indemnification, termination and post-closing obligations.

In addition, until there is an effective closing of the transaction described in the contract, several steps must be considered by the parties, such as: carrying out a due diligence exercise, negotiation of the transaction documents, technical assessments, compliance with conditions precedent, execution of ancillary agreements, compliance with other requirements, discussion of price adjustments and impacts of contingencies on the price.

As a result, the Coronavirus pandemic (COVID-19) may affect M&A transactions in different ways and at different times.



❖ **Material Adverse Effect (MAE) and Material Adverse Change (MAC)**

For ongoing M&A transactions, the main clauses that should be assessed under the effect of the pandemic are the “Material Adverse Effect (MAE)” and “Material Adverse Change (MAC)”.

As stated above, M&A contracts generally provide for certain security measures - for both the seller and the buyer - in the event of drastic changes in a context that may affect the transaction, especially between the time of “signing” the documents - when the parties enter into binding contracts subject to compliance with conditions precedent - until the effective “closing” of the deal - when the conditions precedent are met and the purchase price is effectively paid by the buyer to the seller.

Such changes can substantially affect the target’s operational capacity, eventually decreasing its enterprise value, which, above all, is used as an assumption:

- (i) for the buyer’s decision to acquire the target; and
- (ii) subsequently, to calculate the target’s purchase price.

Since they are clauses imported from Anglo-Saxon law, they do not find corresponding provisions in Brazilian laws - the hypothesis of extinction of contracts due to excessive burden is the one that comes the closest. Therefore, it is recommended that the parties carefully assessed the

events that were mutually agreed upon as triggers for MAC and MAE, in compliance with the principle of objective good faith and the business bases used for the execution of M&A agreements.

It is very likely that the MAC and MAE clauses generate divergence of interpretation at this point in relation to the effects of the pandemic and should therefore be analyzed on a case-by-case basis.

It is important to point out henceforth that it will not be enough to claim the mere existence of the pandemic as a basis for changing the clauses, conditions and price of executed M&A agreements or that are about to be executed. In each case, the real effects of declaring the pandemic for a given business sector, for each company, and specifically for each operation, should be considered.

❖ **Auditing**

For starting transactions, it is common for the parties to hire independent audits for due diligence, risk assessment and purchase price determination, among other purposes.

Considering the current pandemic scenario, it is recommended that the audit includes specific analyses on this situation, as the outcome may have consequences in the following years.

In addition, the auditor should observe whether, during the pandemic, the company has complied with its obligations and existing contracts, or if there has been reasonable justification for non-compliance.

❖ Pricing

As anticipated, it is common for the results of the audit to reflect on the purchase price offered by the buyer to the seller for the acquisition of the target company.

Any risks found in the audit end up being reflected in the final purchase price and the contingency amount, which is withheld by the buyer for later payment to the seller. It is important to consider, at this moment, the effects of the pandemic on the results of the target company (both present and future).

Such effects directly impact contingent payments resulting from the performance of the target company, the so-called earn-outs, which are very common on M&A transactions.

Other aspects related to the financial balance of the transaction, the ability to pay the price by the buyer and the excessive exchange rate variation must also be considered by the parties.



❖ **Representations and Warranties**

The representations and warranties are designed to provide information arising from the parties' objective good faith. It is in the representations and warranties that several points sensitive to the negotiation are inserted.

Therefore, in the event that any information conflicts with the statement provided for in the contract, as a rule, the aggrieved party will be free from damages and the party that made the untrusted statement will have the duty to indemnify the aggrieved party. Accordingly, the clauses on representations and warranties also present an indemnity bias.

Considering the faced pandemic scenario, we recommend the inclusion of representations regarding the following topics: compliance with workplace hygiene protocols; compliance with the guidelines of the local Health Department; compliance with published Decrees with determination to isolate the site; no exposure of any worker to the risk of contamination; removal of all employees considered to be a "risk group" from on-site work activities; among others.

As mentioned, any verification contrary to the representation will imply the duty to indemnify the other party.

IMPACTS ON BUSINESS CONTRACTS

The contracts signed by the companies in Brazil are expected to be strongly impacted by the pandemic, what may require renegotiation by the parties.

Some contracts may provide for certain procedures to settle differences between the parties (such as negotiation, conciliation and mediation), before taking the case to the Courts or the Arbitral Chambers. It is important that the parties take the contractually agreed procedures seriously, aiming to settle the disagreement in the least costly way for both parties. The impossibility of amicable settlement may result in a judicial or arbitration demand, with different costs and less speed.

Much is being discussed about the allegation of act of God, force majeure or excessive burden to impose the renegotiation of business contracts or even justify the breach of obligations. The scenario is still uncertain, and we do not know what the interpretation of the Courts will be regarding the matter.

Furthermore, we emphasize that the party invoking the act of God, force majeure or excessive burden as a justification for noncompliance with the contract will always need to prove its effective characterization (such as unpredictability and unavoidability of the fact, supervenience thereof, lack of control over the situation, absence of

fault, among other related criteria).

The mere allegation of a pandemic will not serve to rule out the compliance of contractual obligations, since it is the duty of the party in the contract to act to mitigate the loss and come as close as possible to complying with the obligation.

In this scenario, as good practice for the companies that find it difficult to comply with any obligation, we suggest that they formally communicate to the other party, by submitting the grounds of the difficulty faced and the proposals for solving the problem, before any obligation is breached or any divergence is instituted.

At last, companies should pay special attention to their financial contracts, by reviewing the guarantees and carefully analyzing the events of early maturity, cross-default terms, obligations to do and not to do, the duty to inform, the possibilities of extraordinary amortization and the formalities for notifications.

This document is for information purposes only and provides basic aspects on M&A and business contracts in the meandering environment created by the Coronavirus pandemic.

Our team is available to provide clarification on the above topics.

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