



COVID-19: Due Diligence Considerations for M&A Transactions

Posted by Thomas W. Christopher and Alexander B. Johnson, Latham & Watkins LLP, on Saturday, May 30, 2020

Editor's note: Thomas W. Christopher and Alexander B. Johnson are partners at Latham & Watkins LLP. This post is based on a Latham memorandum by Mr. Christopher, Mr. Johnson, David S. Allinson, Joshua M. Dubofsky, Austin Ozawa, and Nineveh Alkhas. Related research from the Program on Corporate Governance includes [Allocating Risk Through Contract: Evidence from M&A and Policy Implications](#) by John C. Coates, IV (discussed on the Forum [here](#)).

Buyers in M&A transactions should consider a number of due diligence items in response to COVID-19 and the governmental response thereto.

As parties pursue mergers and acquisitions transactions during, and in the wake of, the COVID-19 pandemic, both buyers and targets should consider a number of factors from a due diligence perspective, including the impact of COVID-19 and related developments on the target from a legal, compliance, human resources, business, insurance, financial, and operational perspective. This post identifies some of the issues buyers should consider when undertaking legal due diligence in connection with an M&A transaction, and highlights for targets some of the types of due diligence questions they may need to address.

Due Diligence Considerations

As with any due diligence investigation, due diligence related to the COVID-19 pandemic should be tailored to the particular target company. Accordingly, the applicability of each of the topics discussed below will likely vary based on the particular target company, its industry and geography, and a number of other factors.

1. ***Compliance with laws relating to COVID-19:*** As has been widely reported, a number of federal, state, and local laws, orders, and guidelines have been implemented in response to COVID-19, many of which are subject to change. Consequently, buyers should ensure they understand the legal and regulatory landscape that applies to the target and its business, debt instruments, employees, contracts, and other items. This landscape may include federal, state, and local laws, orders, and guidelines regarding business closures and re-openings, stay-at-home requirements, employee testing and screening, social distancing and safety requirements, and the handling of positive COVID-19 cases, as well as federal and state aid and relief programs, some of which are discussed below. Buyers should monitor these regulations as well as assess the target's compliance with them and the anticipated costs and implications of such compliance. Moreover, buyers should ensure the target is complying with all applicable confidentiality obligations and

privacy laws (particularly those applicable to personal and/or health-related information), both in assessing and addressing COVID-19-related issues and in sharing information with buyers with respect thereto.

2. **Government programs:** Buyers should determine whether the target has applied for or obtained any financial aid or other assistance or relief under the array of federal, state, and local programs adopted in response to COVID-19, such as the CARES Act and similar non-US. If the target has done so, buyers should ensure that the target has complied with the requirements of the applicable program and implemented controls and procedures to maintain ongoing compliance. As with health, safety, and other laws, orders, and guidelines enacted or issued in response to COVID-19, buyers should continue to monitor developments under these programs and understand the target's obligations and other implications arising from any relief it may have obtained, as well as any opportunities for the target to obtain additional relief, either before or after the closing of the transaction. Buyers should also consult with their tax advisors in light of the complexity and evolving nature of certain tax law changes implemented in response to COVID-19 and their potential impact on the target.
3. **Employee impact:** Clearly the most direct impact of COVID-19 has been on the health and well-being of people around the globe, including employees in almost every industry and jurisdiction. The impact of COVID-19 on a target's employees continues to evolve at a rapid pace, and investigating and understanding this impact can present challenges, particularly in light of applicable safety and well-being, confidentiality, and privacy-related restrictions. (See Latham's *Client Alert US Employment Considerations During the COVID-19 Pandemic*.) Below are some potential questions for buyers to consider:
 - Have any directors, officers, or employees, or any of their relatives, been diagnosed with COVID-19 or been quarantined with possible symptoms, and how is the company handling those instances?
 - What is the current status of the company's workforce? For example, what portion of employees has been physically present and what portion has been working remotely? What portion of employees, if any, has been furloughed or terminated?
 - Has the target (from a business, operational, and technological standpoint) been able to support remote working environments for some or all of its employees? If so, what has been the business, operational, and personnel impact of doing so (including the impact on interaction with customers and suppliers, internal and external collaboration, and other factors)?
 - If the target's business depends on a physically present workforce (such as in a manufacturing facility or personal service business), are employees permitted to go to work under federal, state, and local laws, orders, and guidelines? Even if the target's employees are permitted to be physically present, are they willing to go to work in light of personal health concerns? How is the target handling those employees who decline to go to work?
 - Is the target complying with applicable federal, state, and local laws, orders, and guidelines adopted or issued in response to COVID-19, including providing required employee relief, time off, and benefits as well as complying with applicable federal and state occupational, safety, and health laws such as OSHA? Has the target provided employees with paid leave or made any commitments to employees regarding paid leave?
 - What measures has the target taken to ensure a safe and hazard-free work environment for its employees in light of COVID-19?

- To the extent the target has engaged in any employee screening (such as taking employees' temperature), has it done so in compliance with applicable privacy, disability, and other laws and guidance?
 - Have modifications to the terms and conditions of employment triggered the right of any executive or group of employees to resign for "good reason" and become entitled to severance?
 - Has the target taken advantage of any government programs or benefits adopted or granted in response to COVID-19 (such as obtaining a loan under the Paycheck Protection Program or the Main Street Lending Program, or taking employee retention credits under the CARES Act's Employee Retention Credit program)? If so, is the target complying with the terms of those programs or benefits? How is the target documenting such compliance?
 - Has COVID-19 resulted in (or will it result in) workforce reductions or disruptions, such as employee terminations, furloughs, or suspensions; reductions in compensation; or other material changes to the terms or conditions of employment for any employees?
 - To the extent the target has taken (or plans to take) any of the above actions, has it complied with (or how does it intend to comply with) the following?
 - Its existing plans and policies, such as severance, equity compensation, and health and welfare plans
 - Collective bargaining obligations, which may require union or works council notifications, consultations, or approvals, or effects bargaining
 - Applicable employment laws, such as the WARN Act or similar state or local laws that may require advance notice of a mass layoff; wage and hour laws that require exempt employees to be paid a minimum base salary to maintain an exemption; and any state or local laws that may require notice prior to a wage reduction or certain benefits upon termination or furlough
 - Any COVID-19-specific federal, state, or local laws, orders, guidelines, or programs
4. **Pension plan liability:** Buyers should assess the potential impact of COVID-19 on employee benefit plans—particularly any plans, such as pension plans, that have funding and/or liability implications. Specifically, buyers should understand: (i) the funding position for any defined benefit pension plan of the target (or any multi-employer plan to which it contributes), (ii) the likelihood of increases in funding obligations or increased risk of incurring withdrawal liability, and (iii) the likelihood that the Pension Benefit Guaranty Corporation or other governmental authority may take an interest in the proposed transaction.
5. **Supply chain management:** As has been widely reported, a number of businesses (and consumers) have already been impacted by supply chain disruptions. However, the degree of disruption can vary considerably. Accordingly, buyers should understand the target's level of dependence on particular suppliers, the availability of alternatives, existing and projected inventory levels and forecasts, and other target-specific lines of inquiry.
6. **Contract performance; force majeure:** Not surprisingly, a number of companies have faced challenges performing under existing contracts, which prompts a number of areas of inquiry. For example:
- Have any covenants, obligations, or other contract terms been, or are they likely to be, breached by the target or its counterparties? For example, are any

applicable volume or delivery requirements of the target and its contract counterparties able to be satisfied?

- What are the consequences of (and potential defenses to, and cure rights with respect to) any contract breaches? For example, are there any material adverse effect, force majeure, impossibility of performance, frustration, or similar contractual provisions that could potentially be invoked by the target or one of its counterparties to relieve the invoking party of some or all of its contractual obligations based on COVID-19? If the target is seeking to assert one of these provisions or theories as a basis for avoiding contractual performance, has it taken the proper steps to maximize the likelihood of success of such a claim?
- Have any of the target's suppliers (or other contract parties) taken any actions that indicate they might cease or alter performance or potentially assert a basis for non-performance?
- Are there any notice requirements that the target (or its contract counterparties) are required to comply with in light of the foregoing considerations or otherwise?
- Has any relevant jurisdiction enacted or issued any law or order that relieves the target or a counterparty of any of its contractual obligations due to COVID-19 even though the relevant contract may not contain any material adverse effect, force majeure, or similar provisions?
- Is there material credit risk relating to a particular customer or other counterparty?
- Has the target considered how risks relating to COVID-19 (and pandemics generally) should be addressed in future contracts and pending and future contract negotiations?

7. **Real property considerations:** In light of remote working, stay-at-home requirements, and other COVID-19-related factors, the use of real property raises a number of considerations and areas of inquiry for buyers in M&A transactions. For example, buyers should consider whether workplace attendance and similar restrictions present opportunities or issues under real property lease or similar commitments, including understanding whether the target has any "give back," termination, or similar rights under its leases that it should consider exploring. Buyers should consider the use of particular spaces and whether such use raises any new liability issues that should be considered in light of COVID-19 and whether appropriate policies have been adopted to address such issues. Moreover, buyers should be mindful of whether any restrictions (such as in a sale-lease back arrangement) limit the ability of the target to shut down or restrict activities at a particular facility or limit the taking of any other actions. Finally, buyers should analyze whether the target has been paying rent under its leases and/or whether the target's tenants have been paying rent under its leases currently or whether any deferrals or other modifications have been made or are under discussion.
8. **Insurance:** Parties are not surprisingly assessing whether insurance can cover any COVID-19-related consequences, and buyers should evaluate and consult with their insurance brokers and other advisors on these matters. Buyers should understand the terms and conditions of any insurance the target maintains that may be relevant to COVID-19, including the costs, levels of coverage, and renewability of that insurance, as well as the general response of the relevant insurers (and the insurance industry generally) with respect to similar claims under any comparable policies. Buyers should also consider whether the target self-insures any health or disability benefits, and if so, whether it has assessed the amount of any potential liability to provide such benefits upon the spread of COVID-19 within its employee base. In addition, to the extent the

- target has made (or intends to make) any insurance claims, a buyer should consider if such insurance is actually available and whether the target has properly complied with the notice and other requirements under applicable insurance policies.
9. **Debt obligations:** Buyers should determine if there have been any defaults, events of defaults, waivers, amendments, concessions, cross-default, or similar consequences under the target's debt facilities and instruments arising out of the impact of COVID-19 or the target's actions in response thereto. Additionally, buyers should ask whether there have been any communications from holders of the target's debt alleging any such issues under their debt agreements. Buyers should consider whether the target has been (and will be able to continue) servicing its existing debt and complying with its representations, warranties, and covenants, and whether the target will have adequate liquidity until closing (and, to the extent any facilities are to remain in place following closing, on a going-forward basis). If the target's indebtedness is to remain outstanding, buyers should closely diligence the recent covenant calculations under the target's agreements, in particular any adjustments taken as a result of the impact of COVID-19, as buyers will inherit these calculations and positions taken by the target. In addition, buyers should determine whether the target has taken advantage of any government finance programs such as the CARES Act, and if so, whether it is in compliance with both the terms of the program and the target's existing debt and capital structure. Separately, buyers may wish to consider whether there are any potential opportunities based on the trading price of, or other matters relating to, the target's debt, including exchange offers or other tender offers. Lastly, if committed financing is involved, buyers should be prepared for any financing sources to conduct additional diligence related to the impact of COVID-19 and consider such diligence in the overall timeline of when to engage financing sources.
 10. **Securities laws compliance:** In response to COVID-19, the Securities and Exchange Commission (SEC), stock exchanges, and non-US and other securities regulatory bodies have provided relief and guidance to public companies in a number of areas, including with respect to the timing and content of filings and disclosure guidance. Nonetheless, buyers considering the acquisition of a publicly traded company should continue to focus on whether the target has complied with applicable securities laws and stock exchange rules and regulations, including confirming that, to the extent the target has availed itself of COVID-19-related relief, it has properly done so. Moreover, regulatory bodies have emphasized their continued monitoring for fraud and misconduct, including insider trading, and thus buyers should understand the compliance policies and procedures that target companies have put in place, particularly in light of the increased risks of confidentiality breaches in a remote working environment.
 11. **Regulatory communications:** A number of federal, state, local, and other authorities (including health and safety authorities, regulatory bodies, and others) in a variety of industries and geographies have enacted or issued laws, orders, and guidelines requiring notice and reporting of certain COVID-19-related developments, such as actual or potential cases of the virus and other developments. Buyers should attempt to understand these notice and reporting requirements applicable to a target company, the target company's compliance therewith, and the costs of such Buyers should also seek to ensure that in complying with such requirements, the target company is adhering to its applicable confidentiality obligations and relevant privacy laws.
 12. **Representations and warranties insurance:** Buyers considering representation and warranty insurance (RWI) policies should be mindful that insurers will likely consider a number of areas of inquiry described herein as part of their underwriting process. Accordingly, buyers should solicit sufficient information to perform appropriate due

diligence, which in turn should assist buyers in securing RWI coverage. Like any RWI policy, however, insurers will exclude known liabilities and breaches of representations and warranties, including those stemming from known COVID-19-related issues uncovered in due diligence, and thus RWI should not be viewed as a substitute for otherwise addressing potential known COVID-19 issues.

13. ***Virtual and in-person activities:*** While due diligence is largely conducted through online data rooms and conference calls, a limited number of in-person management meetings and physical site visits (including for environmental due diligence) have typically been a part of the due diligence process. Buyers should consider whether the due diligence activities that have historically involved meetings or site visits can be conducted remotely. When in-person attendance is required, parties should take appropriate steps to protect the safety and health of all participants, and be mindful of any federal, state, and local laws, orders, and guidelines that could be applicable to such activities. Moreover, even at the due diligence stage, buyers should consider how integration will be implemented if COVID-19 restrictions on travel remain in place and how to ensure that employees stay in place through closing and beyond.

Conclusion

In conducting due diligence on a target, buyers should consider the impact of COVID-19 on the target's business, operations, financial condition, prospects, and personnel. Some of the consequences of COVID-19 for a target may be relatively obvious, including the health and safety consequences for the target's employees and the implications of stay-at-home and social-distancing orders. However, some of the implications of COVID-19 for a target and its business may be less obvious, including issues that may impact the target's customers or suppliers rather than the target itself. In addition, COVID-19 has led to the passage or issuance of numerous laws, orders, and guidelines, the exact scope and applicability of which are still being determined and interpreted, and additional COVID-19-related laws, orders, and guidelines are likely to be enacted and issued as the pandemic, and the response thereto, evolves. Buyers should understand the laws and regulations applicable to a target and the target's compliance therewith. Finally, parties should be mindful that the issues raised in this post are subject to change and that additional implications and considerations will need to be considered as matters develop.