

Impact of the Coronavirus outbreak on M&A and JV Transactions

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The outbreak of novel coronavirus 2019-nCoV ("**Coronavirus**") is an extraordinary challenge for many transactions involving Chinese companies. In this section, we analyse its impact on certain key aspects of mergers and acquisitions ("**M&A**") and joint venture ("**JV**") transactions, the remedies that may be available under the share purchase agreement ("**SPA**") and joint venture agreement ("**JVC**"), and what the parties could do to manage the relevant risks.

1. Coronavirus outbreak may constitute "material adverse change"

The Coronavirus outbreak and the exceptional measures adopted by the Chinese government to cope with the crisis (which include lockdown of areas, extended holidays, shutdown of factories, travel restrictions and mandatory quarantine) are causing significant risks to companies operating in China. They may be experiencing operational difficulties, financial losses and disruption to supply chains, and be exposed to a breach of their commercial contracts, including a breach by their suppliers. For instance, the government in certain locations ordered local companies to change their production lines to support medical supplies, resulting in increased costs, logistical complications, and potential breaches of pending orders.

These circumstances could trigger a material adverse change ("**MAC**") clause under the SPA or JVC. A MAC clause typically provides that if an event having a material adverse effect on the assets or business of the target company or its group occurs, the buyer in an SPA can terminate the SPA and walk away from the deal (often referred to as a "**MAC out**" clause). Similarly, a JVC may provide a termination right upon the occurrence of such event, which could entitle a party to exercise an equity/asset buyout right or trigger the liquidation and dissolution of the JV.

Similar termination rights could also be available due to a breach of representations and warranties stating that a MAC has not occurred: the supervening occurrence of a MAC after signing may cause a breach of those representations and warranties when repeated (for instance, at closing under the SPA, or at the business license issuance date under the JVC). Conversely, sellers and JV parties who wish to preserve the deal may consult with their counterparties to provide reassurances on the continuity of the company's business and its ability to survive the crisis, and obtain the relevant waivers aiming at avoiding the termination and claims for damages and indemnities.

Buyers and JV parties may consider the opportunity to exercise their MAC-related termination rights under the SPA and JVC. As there is no statutory concept of MAC, the extent to which a

MAC clause can be invoked, the underlying trigger events, and the remedies available thereunder are primarily based on the wording used in the contract. A typical buyer-friendly MAC definition includes a broad spectrum of events (**including change of law or other agreed event not within the control of the parties**) that materially and adversely affects (**or could reasonably be expected to** materially and adversely affect), either individually (**or in the aggregate with all other events**), the business, valuation, operations, licensing, assets, liabilities, condition (whether financial, trading **or otherwise**) or operating results of the target, **or the ability of the target and/or the parties to consummate the transaction**. The added emphasis highlights typical pro-buyer wording that aims to expand the range of events that fall within the scope of the MAC, making it easier for the buyer to invoke a MAC. Under this more inclusive definition, the buyer may try to argue that the Coronavirus outbreak itself and the exceptional measures adopted by the Chinese government and foreign governments to cope with the crisis result in a MAC affecting the target company, and as such exercise the relevant termination rights. A seller-friendly MAC definition instead describes the trigger events in a more limited and objective way, as such making it more difficult for a buyer to invoke a MAC. For example, it commonly carves out a long list of events not within the target/seller's control, such as macro-economic downturn, catastrophe, as well as changes of law/rules by governmental authorities and epidemic.

The governing law of the SPA/JVC should also be taken into account as it may impact the extent to which a MAC clause is enforceable. For instance, under the laws of most U.S. states, the buyer's burden of proof is heavy and largely depends on the specific circumstances of the case. A short-term (e.g., a few weeks or even months) adverse impact, even if severe, may not be sufficient to convince the court that a MAC has occurred. Thus, if the loss suffered by a target company due to the Coronavirus outbreak is only expected to last for a short term, a termination based on MAC grounds may not be supported by a court in the U.S. Needless to say, not all companies are affected by the Coronavirus outbreak in the same way and therefore whether a MAC has or not been triggered in this specific instance must be assessed on a case by case basis, depending on the impact such event has on the company and the factual circumstances that can be adduced in support of the enforcement of the MAC clause. A careful evaluation of all these aspects and factual elements is essential to assess the possibility of relying on a MAC clause, and whether any related representations and warranties have been breached.

2. Coronavirus outbreak may constitute "force majeure"

Whether a particular event could qualify as a force majeure event depends on the specific definition of force majeure event used in the contract and its governing law. A force majeure event usually refers to an event that is beyond the control of the parties, is unforeseeable (at the time of conclusion of the contract), unavoidable or insurmountable, and prevents total or partial performance. Absent a force majeure clause in the contract, the governing law of the contract may also provide a statutory principle of force majeure that may automatically apply or supplement its terms. This is the case under Chinese law, as opposed to, say, Hong Kong or English law.

For example, a JVC is mandatorily governed by PRC law, and typically includes a force majeure clause providing that if a force majeure event prevents a party from performing its obligations under the JVC, such party is excused from performance, and if the event continues in excess of a given period (e.g., 6 months) either party can terminate the JVC and exercise an equity/assets buyout right (purchasing the equity interest of the other party, or some of the assets of the JV) or put the JV into liquidation.

There are good chances that the Coronavirus outbreak together with the exceptional measures adopted by the Chinese government might qualify as force majeure. In this regard, on February

10, 2020, the spokesman of the Commission of Legislative Affairs of the National People's Congress, the national legislature of China, in response to public queries, explained that the varieties of Coronavirus epidemic prevention and control measures taken by the local governmental departments that make a party unable to perform its contractual obligations constitute a force majeure event provided under the PRC Contract Law. This approach is similar to the one taken by the Supreme People's Court after the outbreak of SARS about 17 years ago¹ but notably this time the National People's Congress has expressly stated that the circumstances constitute force majeure under the PRC Contract Law.

It is worth noting that a force majeure event arises under a JVC contract only to the extent the force majeure impacts the performance of the obligations of a party (not the business and operations of the JV itself), and it often must involve "material" obligations, further qualified by the requirement that their breach would cause a material adverse effect on the operations of the JV. As such, the impact of the Coronavirus outbreak on the JV's business and prospects may not by itself constitute a force majeure event under the JVC, allowing a party to terminate the JVC. And there are usually not many material obligations of a party under a JVC that may be affected by a force majeure event of this kind. For example, it is hardly arguable that the Coronavirus outbreak prevents the performance of the JV parties' funding obligations.

However, if a JV party is prevented from performing its obligations under the key ancillary commercial contracts between such party and the JV (often attached in agreed form to the JVC), and the JVC provides the parties' obligation to perform such ancillary contracts, the non-performance of those ancillary contracts could qualify as a breach of a party's material obligation under the JVC. In this case, the affected party might be able to invoke the force majeure, usually if the breach has a material adverse effect on the JV. Other obligations of the affected JV party, such as handling JV registration formalities and/or negotiating and executing ancillary commercial contracts, may also be suspended on a force majeure ground (and give rise to the termination right referred to above subject to the applicable requirements being met).

In the event of a breach of the ancillary commercial contracts by a JV party or by the JV itself due to a force majeure event, the possibility to invoke force majeure thereunder may also be explored to excuse the breach and suspend performance, avoiding a termination of the JVC or the ancillary contracts.

3. Coronavirus outbreak may constitute "change of circumstances"

If it is not possible to invoke a force majeure event or a MAC, Chinese law provides another avenue to seek redress for similar extraordinary challenges: the doctrine of "change of circumstances". This doctrine, provided in the *Interpretation on Certain Issues Concerning the Application of the Contract Law (II)* (Fa Shi [2009] No. 5, 《最高人民法院关于适用〈中华人民共和国合同法〉若干问题的解释（二）》（法释[2009]5号）) issued by the Supreme People's Court, allows the affected party to a contract governed by Chinese law to petition the Chinese court to modify or terminate the contract if there is a material and objective change of circumstances that: (i) was unforeseeable by the concerned parties at the time of conclusion of the contract; (ii) is not caused by force majeure and does not constitute a commercial risk; and (iii) renders the performance of the contract obviously unfair to the party who invokes the change of

¹ See the Notice of the Supreme People's Court on Conducting the Trial and Enforcement of the People's Court in the Period of the Prevention and Control of Infectious Atypical Pneumonia (《最高人民法院关于在防治传染性非典型肺炎期间依法做好人民法院相关审判、执行工作的通知》(Fa [2003] No. 72, expired)). Article 3 of this notice puts it that "... *disputes caused by the government and relevant departments' administrative measures to prevent the SARS epidemic that directly result in the contract being unable to be performed, or due to the impact of the SARS epidemic, the parties to the contract being unable to perform at all, should be dealt properly in accordance with the provisions of Articles 117 and 118 of the PRC Contract Law.*"

circumstances (i.e., different from force majeure, it doesn't require the party to be unable to perform – only that performance becomes obviously unfair) or renders the purpose of the contract no longer achievable. Therefore, a party that is unable to claim a force majeure event or a MAC could try to invoke a "change of circumstances" to modify or terminate the contract.

However, it must be noted that this remedy is rarely given by Chinese courts, and there is a heavy burden of proof on the party who invokes it that makes it very difficult to bring a successful claim thereunder. In addition to the elements listed above, the Chinese courts typically requires, among others, the "change of circumstances" to satisfy the following requirements: (i) it is so great to cause a fundamental change to the objective circumstances relied upon by the parties at the time of the conclusion of the contract; (ii) it occurred after the conclusion of the contract and before the fulfilment of all the underlying obligations; and (iii) it cannot be attributed to either party.

Moreover, a termination of the JVC under this ground may not necessarily lead to the desired effect of allowing the parties to exercise the equity/asset buyout rights or put the JV into liquidation. If the equity/asset buyout and liquidation clauses of the JVC only cross-refer to the specific termination events listed in the termination clause of the JVC, they may not apply if the JVC is terminated on different grounds (e.g., a termination imposed by the court due to a "change of circumstances").

4. Other implications for M&A and JV transactions

We have listed below some of the major additional challenges that the Coronavirus outbreak presents for M&A and JV transactions. The parties should assess their respective rights and remedies which could be available under the SPA or JVC and be prepared to engage in consultations to manage these challenges.

- (a) **Delays to closing.** The challenges posed by the Coronavirus outbreak may cause delays to the closing of M&A and JV transactions. For instance, the satisfaction of certain closing conditions may not be possible at the moment or require longer time, due to disruptions caused to the functioning of government offices and the impact of international and domestic travel restrictions imposed to prevent the spread of the virus. These closing conditions may include obtaining government licenses and approvals, completing JV post-establishment registrations and other formalities, and entering into ancillary commercial contracts. With respect to outbound acquisitions, a Chinese investor may experience delays in obtaining the Chinese outbound investment approvals and registrations required to carry out the acquisition and pay the purchase price.

If closing is delayed past the long-stop date provided by the SPA/JVC, the parties may be entitled to terminate the contract and walk away. The delay may also put a party in breach of its obligations to procure the prompt satisfaction of the relevant closing conditions (particularly if it is required to use "best efforts") unless the party can prove the impossibility to satisfy the condition or invoke force majeure. The parties required to satisfy any closing conditions that may be delayed should consult with their counterparties to manage expectations and negotiate the appropriate waivers, moving certain closing conditions to the post-completion covenants, or extending the long-stop date.

- (b) **Delays to due diligence.** The exceptional measures adopted by the Chinese government to cope with the Coronavirus outbreak (such as mandatory quarantine, lockdown of areas, prolonged holidays, shutdown of businesses, and travel restrictions) may cause delays to due diligence activities, including the impossibility to conduct on-site due diligence, audits and inspections, and exercising the relevant access rights.

Virtual data rooms and other forms of electronic transmission of documents should be the preferred choice to minimize delays in due diligence activities and communications among the parties. Buyers should also be prepared to face a longer response time from a Chinese seller or target. The opportunity to negotiate a later long-stop date, allowing extra time to complete the due diligence, may also be explored.

- (c) **Breach of reps/warranties.** The disruption brought by the Coronavirus outbreak to the business of Chinese companies operating in China may also result in certain representations and warranties given by a seller and target company no longer being true when repeated under the SPA or JVC (for instance, at closing or at the business license issuance date), including the representations and warranties stating that there is no MAC (as analysed above) or that there is no breach of material contracts (e.g., contracts with customers or suppliers of the target group, whose performance may be jeopardized by the crisis).

Whether the SPA or JVC has been signed or not, all parties should conduct a comprehensive assessment of the impact that the Coronavirus outbreak may have on the representations and warranties listed therein. If the SPA has not yet been signed, the seller may take this opportunity to negotiate the appropriate carve outs and submit the relevant disclosures to the buyer to limit the risk of breach, and the buyer may negotiate the appropriate adjustments to the purchase price and obtain the necessary indemnities from the seller. If the SPA has already been signed, the seller should negotiate the appropriate waivers from the buyer, and the buyer should start assessing and preparing its warranty and indemnity claims.

- (d) **Pre-completion conduct.** The seller may need the flexibility to allow the target group to borrow money or dispose of some assets, or lay off some employees, or carry out other type of restructuring, to allow the target group to optimize its operations and survive the crisis. In this regard, it is worth mentioning that measures have been issued at the national level and in Hubei/Wuhan that encourage banks to provide unsecured loans at reduced interest rates to local companies in financial need to help them survive the crisis, and to refinance and restructure outstanding loans. However, the representations and warranties and pre-completion covenants in the SPA may not allow such flexibility. Sellers may need to approach buyers to negotiate the relevant carve outs.
- (e) **Termination events.** The persistence of the Coronavirus outbreak may lead to the occurrence of a range of termination events under the SPA or JVC, including those considered above (e.g., breach of representations and warranties and other obligations, MAC, force majeure, failure to satisfy closing conditions by the long-stop date), and additional termination events such as: (i) issuance of laws and regulations (i.e., the exceptional measures adopted by the Chinese government and foreign governments to cope with the crisis) that prohibit, restrict or delay the entering into or performance of the transactions or the operation of the business of the JV/target group, (ii) failure to meet financial targets, (iii) breach of ancillary contracts by the JV or a JV party, and (iv) a JV shareholder or the JV/target company ceasing to carry on business, or becoming insolvent.

The parties should assess carefully if a termination event has occurred or is likely to occur, due to the present situation and its foreseeable impact. The affected party who wishes to preserve the deal will have an incentive in engaging in consultations with the other party to provide reassurances and obtain the relevant waivers. On the other hand, there could be an opportunity for a party to exit from an unattractive deal, or to increase its equity stake in the JV by serving a termination notice and exercising the equity/asset buyout

right provided by the JVC. If the business of the JV is severely impacted by the crisis, it may reduce its fair market value and allow a party to purchase the other party's equity interest in the JV at an attractive price. The same logic applies to the exercise of any call option that may be available under the JVC, regardless of the existence of a termination event.

- (f) **Inability to attend physical meetings.** The exceptional travel restrictions and safety measures implemented in China and abroad to limit the spread of the Coronavirus create difficulties in traveling and attending business meetings in person, whether in China or abroad. A quarantine period may be imposed to travellers on arrival. The impossibility to meet in person may put at risk the development of the negotiations, as it impacts the ability to conduct management presentations and have the leaders of both parties meet physically, which is typically a prerequisite to signing up to a deal from a Chinese company's perspective.

The parties should be aware of these restrictions, re-arrange their meeting schedules accordingly, and rely primarily on remote communications for the time being, or where possible arrange physical meetings in countries that have not implemented such restrictions (although it must be noted that a mandatory quarantine may be imposed upon re-entry into China). At the same time, it is important to manage the expectations of the other side and maintain and cultivate business relationships through other available means.

5. Conclusion

The parties to M&A and JV transactions affected by the Coronavirus outbreak should carefully examine the terms of their transaction documents (whether they are in the negotiation, post-signing or post-closing phase) and consult with their counterparties as appropriate, to promptly address the challenges brought by the Coronavirus outbreak. Our team of corporate lawyers regularly assists Chinese and foreign clients in structuring and negotiating cross-border M&A and JV transactions and navigate the complexities of the Chinese regulatory and business environment, and is ideally positioned to support you in assessing and mitigating the risk associated with the Coronavirus outbreak, as well as identifying any opportunities that may come with it.

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