



# DEAL-MAKING IN THE COVID-19 TIMES

## INTRODUCTION

The ongoing global healthcare pandemic around COVID-19 has created a clear business continuity risk at all levels and across all sectors. In a globally connected business environment, businesses often tend to be connected at their edges like a house of cards, and a domino effect of a supply chain disruption cannot be discarded. Given that contagion containment requires work shutdown in affected areas (most notable thus far being China, Italy, Washington state in the US) – there are some clear challenges around deal-making. India thus far has been less aggressively affected, but with the number of cases increasing, one needs to evaluate all possible scenarios. In this update, we will provide a view on the Indian deal making scenario and things to think about. Experiences may of course vary slightly for India from other jurisdictions.

## HOW TO DILIGENCE NEW TARGETS?

Some of the following items are relevant and may be considered:

### **Scope and focus**

On the whole, it might not be a bad idea to focus on COVID-19 linked disruptions as a diligence issue cutting across workstreams – finance, legal, commercial, business. More importantly, it is critical to not lose sight of everything else which is otherwise not affected by COVID-19. As a result, one wonders whether a separate workstream leader needs to look at the cumulative impact of COVID-19 asking for specific inputs from other diligence teams.

### **Site-visits and in-person management presentations**

Site visits may become challenging – to the extent required depending on the nature of the target. One reason could be the ever-evolving nature of the outbreak leading to domestic travel becoming an issue in the future and therefore advisors and local teams not being able to travel. Another reason could be travel bans; the Indian Government has introduced travel bans ([view here](#)) for foreigners from 13 March 2020 up to 15 April 2020 to insulate the country from external carriers of the disease. Site visits and management presentations are highly recommended in Indian transactions – to not only establish a working relationship – but to also get a first-hand feel on the business of the target.

### **Data privacy**

A lot of data around travel and health may end up being collected from employees and other stakeholders (potentially, contractors, suppliers, etc.) – hopefully that is being properly stored, archived and protected. While a data protection bill is still in Parliament in India, existing laws already cover “sensitive personal information” which would include medical information. Detailed requirements are prescribed by these laws. Certain Indian organizations may also have a global footprint through subsidiaries and other forms of corporate presence – and hence global data privacy regulations would also be relevant.

## Human resources

This is a critical element for any business, especially an Indian business. Whether it is the innovation or the knowledge element, or the service delivery element – people often tend to be the core aspect of an Indian target. It is relevant from a diligence perspective to see how the crisis was handled and how were employees looked after. Our colleagues from our Employment, Labour and Benefits practice have set out an alert on “*Coronavirus And Workplace Management: Plan, Manage, But Do Not Fret*” which can be accessed [here](#). It sets out some very practical and workable plans to implement to tide over the current crisis.

## Financial position and revenues

Undoubtedly, business disruption will lead to some adverse impact on the target’s financial position. However, it would be helpful to check whether these are indeed interim issues or more systemic long-term issues that require sustained focus and redressal. Really, the exercise has to be more to separate the husk from the grain.

## Customer agreements and dealing with business continuity impact

It is critical to get a good handle from the management on customer commitments that the target anticipates not being able to meet – based on the current levels of business disruption, and projected escalated levels of business disruption. With each level of business disruption, it is relevant to consider the reputational and financial impact of the disruption and breach on the target. Where customer contracts provide for forecasts, it might be a deft touch to assess whether the customers also stick to their forecasts or do they prefer to revisit them as well.

## Customer communications

Have proactive and pre-emptive communications been sent to customers? Recently, a renowned virtual data room services provider sent around releases for their mailers covering all aspects from whether the dataroom services would be continuously running or not. Another large hospitality company assured and addressed people with safety and other measures they took for their guests in their hotels. Such pre-emptive communication helps in reinforcing customer belief and commencing a dialogue with customers on a positive note. Additionally, a good audit trail would be relevant for discussions and concessions made during this time. Some of this correspondence may be used to interpret contracts as well. While this might not be as relevant from an Indian law perspective, several contracts with cross border counterparties may be governed by laws of other countries.

## Supply chain disruption

It is advisable to divide major and minor suppliers in groups of high risk and otherwise. Also, it is advisable to review what sort of communication has been established with these suppliers and whether they are still running the business. Where forecasts are to be provided, please do temper and measure what kind of forecasts are to be provided for the future.

## Force majeure

While this is not a diligence issue usually, and we will work on a separate and more detailed update on the Indian legal position on *force majeure*, we have provided a short overview here. Under Indian contract law, *force majeure* is typically a matter of contract. Under Indian laws, we do have the concept of impossibility of performance, but that would bear a very high standard such as Governmental action or so on making the performance of the contract impossible. Commercial difficulty may not necessarily amount to impossibility of performance. Unlike certain civil law countries, that do subscribe to the concept of “change in circumstances” or “*rebus sic stantibus*” – India does not allow parties to avoid performance of contract basis an unforeseen change in circumstances. It is interesting to note that The Government of India has clarified that corona virus would be treated as a force majeure event ([view notification here](#)) to the extent relevant to certain kinds of public procurement by the Government. It is however important to consider whether the target business has invoked force majeure under a contract. If so, has this been done thoughtfully bearing in mind consequences for the future (termination, suspension of payments, etc.). It is also advisable to take a nuanced and dispassionate view on force majeure; no note that should a situation lead to a dispute, the dispute is likely to be litigated upon well after the sympathy and empathy of the matter has concluded.

## Production / business capacity

If there is a drop in production or capacity – it is relevant to assess whether this will lead to any reporting to regulators. For instance, for the pharmaceutical sector, periodic reporting is required under the Drugs (Price Control) Order, 2013 on pricing as well as production capacity. Similarly, it is possible that certain government schemes and concessions may impose certain exports, production, and other similar obligations. For instance, reporting under minimum supply legislation or concessions or trade benefits or

Government obligations could be impacted. For India, it might obviously be early days – but it might be helpful to start the conversation early.

### **Bank guarantees and letters of credit**

In cross border trade, it is common to make payments using these instruments. Typically, such instruments are as good as cash, depending on the jurisdiction where they have been issued. In a scenario where either the target or its counterparty proposes to invoke force majeure to postpone performance or avoid a breach, the presence of such a payment instrument could be a significant leverage.

### **Insurance**

It is important to evaluate the responsiveness and coverage under the target's insurance policies, and whether it would receive coverage for the risks posed by the pandemic. There is unlikely to be a direct policy around loss of property, etc. However, one could evaluate for instance keyman insurance policies on Key Managerial Personnel, healthcare cover for employees, etc.

## **HOW TO APPROACH NEW TRANSACTIONS?**

### **Price**

While an opportunist may perceive that this would be the right time to see how valuations function – but in the real world – and has been seen in the past – when valuations drop, deals may not be available in the same sense. For ongoing conversations, a thoughtful and well-advised seller would have prepared appropriate narratives to negate such points. Based on how Indian targets may, more often than not, be family business owned – it may be seen by a seller as more respectful and less offensive if a buyer did not try to use the current crisis to get a better deal or reduce price. Now, more than ever, might be a good time to build faith and trust and try to complete the deal at “fair” value.

### **Impact of MAE or MAC clauses**

Either of these clauses are unlikely to protect much. Any thoughtful seller is likely to insist on a carve-out for the current pandemic; unless, there is a specific identified risk that the buyer is keen (and able) to negotiate as a specific walk-away right. Even before the crisis, thoughtful and well-advised sellers would negotiate general carveouts for events that impact the market or the economy or the industry generally. Buyers would be known to push back for further fine-tuning events, which impact the target disproportionately compared to the market or the economy or the industry generally.

### **Impact on conditions precedent**

If there is a significant risk that the buyer spots in the diligence (an exposed bank guarantee or a take or pay obligation with a supplier or a delay penalty with a customer) and wants that mitigated through a waiver or otherwise; it would be reasonable for them to expect that this be cleared as a condition precedent. Whether a seller can resist such a condition will largely be a function of bargaining power. However, it is relevant to ensure that the language both on description and fulfillment is clearly drafted to be objective, and not subjective to the buyer's opinion.

### **Post-closing mitigation plans**

Less relevant for 100% acquisitions, and more pertinent to financial investments or joint ventures would be post-closing plans and conditions. Without this being specifically in the contract, an investor would obviously be exposed to the equity risk of any lingering effects of business disruption caused by COVID-19. There may also be certain other actions which in more normal times would be treated and dealt with as conditions precedent to closure – but require being pushed out to post closing items to give the sellers some deal certainty.

### **Deal process**

From a deal process perspective, India tends to be a jurisdiction where deal-making inevitably involves face-to-face meetings. Given travel bans (mentioned above – [view here](#)) and other consequent lack of availability of advisors or other deal factors, people should prepare realistic deal targets in terms of signing and closing.

### **Warranties, disclosures and indemnities**

Under Indian contract law, information that could have been found through ordinary diligence by a buyer cannot be treated as the base of termination for misrepresentation by the seller. Whether such information could be the subject matter of a claim for damages arising from misrepresentation is a matter which is not completely tested through case law – unlike other western jurisdictions like UK. As a result, it is typically

recommended that any known risks that are quantifiable in damages should be made the subject matter of specific indemnities. Resultantly, any risks which the buyer believes could lead to a loss should be covered through specific indemnities. For items which cannot be the subject of diligence, specific warranties may be considered. However, it would be advisable for a seller to consider as to which warranties should be repeated on closing – depending on the time envisaged between signing and closing, and also looking at the potential disruption exposure of the business of the target to the pandemic.

### Buyer delinquency risk

Unlike western jurisdictions, Indian transactions do not typically carry concepts such as pre-closing escrow. Even otherwise, more Indian transactions are done basis buyer covenants and assurances (whether by way of covenants, equity commitment letters, letters of comfort, etc.) than there are through “hard cash” in the form of escrows or bank guarantees. Therefore, as a matter of course, one would not typically seek “hard cash” comfort. Such items (escrow, bank guarantees, etc.) are more typical in hostile transactions, competitive deal processes or are usually linked to irreversible steps in the transaction. Nevertheless, it is a question that sellers should consider evaluating.

## REVISIT YOUR EXISTING INVESTMENTS

Similar to new deals, it would be advisable for investors and company owners to also evaluate their current investments and also the preparedness and planning that their existing portfolio companies have implemented. Specifically for financial and other investors with further upcoming deal activities – for instance, tranching investments, earn-outs, call or put options, performance based conversions, etc. – it is relevant to assess the short-term and long-term impact of the pandemic over the time that it plays out. Such transactions are seldom covered from a *force majeure* perspective and as explained earlier in the update, Indian law does not have a *force majeure* concept engrained in the statute. Even otherwise, a *force majeure* on the target is unlikely to provide relief to dealings between shareholders.

## CONCLUSION

This pandemic is unprecedented in almost all parameters – in size, magnitude, speed, scale, coverage and global impact. Therefore, it is only natural that this will affect deal making dynamics in a way nothing has before this. However, it is worthwhile to note that all actors involved are taking necessary measures to ensure that this is a temporary setback to the global economy. For the time being, however, it does require a certain re-calibration to deal making strategy.



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Khaitan & Co have also established an internal working group of lawyers to advise clients on COVID-19 issues, and also aid the firm in assessing our preparedness to deal with contingencies and eventualities to ensure business continuity. For any queries, please contact this working group on [COVID19@khaitanco.com](mailto:COVID19@khaitanco.com).

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