

WEBINAR

# *Contract Issues in Light of the COVID-19 Pandemic*

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WEBINAR

*Speakers*



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## *Agenda*

- **We Will Cover the Following Areas:**
  - Force Majeure and Common Law Doctrines to Excuse Performance
  - Material Adverse Change and Material Adverse Effect Clauses
  - Earn-Outs and Milestone Payment Obligations
- **For Each of the Topic Areas We Will Address:**
  - Issues under Current Contracts
  - Changes to Consider for Contract Terms Going Forward



*Force Majeure and Common  
Law Doctrines*



## *Force Majeure Clauses*

- A force majeure clause may excuse a party from a contractual obligation in light of an unexpected event beyond its control in specified circumstances
  - The language varies considerably from contract to contract
  - The governing law has a significant impact on interpretation and therefore scope and operation
- Force majeure clauses typically have several common elements

## *Force Majeure Clauses – Definition of Covered Event*

- Definitions often refer to specified requirements that must be established, which may include:
  - Not within the reasonable control of the parties
  - Not reasonably foreseeable
  - Effects cannot be avoided through reasonable efforts or due diligence
- Definitions often include a list of covered events
  - Exhaustive or non-exhaustive
  - Often includes certain *natural* events, such as “acts of God,” floods, fires, earthquakes, hurricanes, etc.
  - May include certain *political and human* events, such as acts of war, civil strife, invasion, riots, labor strikes or other government measures
  - And some clauses also expressly exclude certain events





## *Force Majeure Clauses – Standard for Degree of Impact*

- Some clauses excuse an obligation only when a covered event “*prevents*” performance
- Often clauses extend coverage to excuse an obligation when a covered event “*prevents,*” “*hinders,*” or “*delays*” performance
  - Other clauses might instead use different language that requires that a covered event renders performance “*impossible*” or in some contracts “*impracticable*”
  - The language used greatly affects the scope of coverage of the clause



## *Force Majeure Clauses – Additional Requirements*

- Many force majeure clauses set forth additional requirements that the party invoking force majeure must establish, such as:
  - A duty to mitigate damages arising from the event
  - An obligation to provide notice within a defined period
  - A duty to undertake reasonable endeavors to resume performance as soon as practicable



## *Force Majeure Clauses – Consequences of Force Majeure*

- If a party has established that a covered event has caused the required degree of impact on performance and has satisfied all additional requirements, clauses generally excuse the party's performance of the specific obligation
- Some clauses refer to a specified duration for any excused non-performance
- Some clauses entitle a party to terminate the contract
  - Termination may be subject to specified conditions



## *Implied Rights and Common Law Doctrines*

- In contracts without a force majeure clause or where the clause is not applicable, the parties may have rights and obligations in the face of unexpected events that are implied under the governing law
- In civil law jurisdictions, a right of force majeure may be implied into contracts that are silent
  - Changes in circumstances, hardship or modification provisions may also apply
- In common law jurisdictions, doctrines such as impossibility, impracticability or frustration of purpose may apply
  - The availability of these doctrines depends in part on the language of the contract and the extent to which risks have been allocated



## *Common Law Doctrines to Excuse Performance*

### 1. The Doctrine of Impossibility

- Generally excuses performance when a supervening event that the parties assumed would not occur destroys the subject matter of the contract or the means of performance, effectively making performance objectively impossible

### 2. The Doctrine of Impracticability

- Generally excuses performance when a supervening event that the parties assumed would not occur renders performance impracticable

### 3. The Doctrine of Frustration of Purpose

- Generally excuses performance when a supervening event that the parties assumed would not occur substantially frustrates a party's principal purpose under the contract



## *Recurring Issues as to Force Majeure and Common Law Doctrines to Excuse Performance*

- The applicability of force majeure clauses and the three common law doctrines excusing performance often raise similar issues, regarding:
  - Unforeseeability of the supervening event
  - Causation (by an external event beyond the party's control)
  - Avoidability (without fault and exercising due diligence or reasonable efforts)
  - Allocation of the risk by the parties
  - Notice



## *Force Majeure Clauses Going Forward*

- Consider the Parties' Obligations under the Contract
  - Which party is more likely to invoke the clause to seek relief from performance?
  - Is your company the customer under the contract?
  - Many contracts have mutual obligations of the Parties
- Defining the Force Majeure Event
  - Consider whether to include a reference to pandemics or infectious diseases
  - Should the clause cover governmental actions taken in response?
  - Consider including language relating to the foreseeability of defined events



## *Force Majeure Clauses Going Forward*

- Exclusions for Events that are not Force Majeure Events
  - What happens if the carve-outs are affected by the Force Majeure Event?
  - Should the performing party be excused?
- Standard for Relief from Performance Going Forward
  - Force Majeure Event “prevents” performance
  - Or “hinders, delays or adversely affects”





## *Force Majeure Clauses Going Forward*

- Consider Obligations on Affected Party upon Occurrence
  - **Notice requirements regarding occurrence, effect and duration**
  - Can effect and duration of any pandemic be determined with certainty?
  - Consider qualifying notice requirements as good faith estimates only
- Obligation to Mitigate Effect and Resume Performance
  - **Standards vary:** “best efforts” or “commercially reasonable efforts”
  - What level of effort is appropriate going forward?



## *Force Majeure Clauses Going Forward*

- Termination Rights
  - Consider termination rights for prolonged force majeure events, or when product has limited shelf life, or service must be performed before a certain date.
- Consider Specific Obligations that Could Apply
  - Should your contract specify alternate performance obligations upon the occurrence of a Force Majeure Event?
  - Disaster recovery time frames in IT agreements
  - Limited supply allocation provisions in supply agreements
  - Alternative performance sites
  - Preferential treatment of customer

An overhead view of a meeting room with five people seated around a white table. The room has a light-colored tiled floor. A large, semi-transparent red rectangle is centered over the table, containing the title text. The people are dressed in business casual attire. Two people at the top of the frame have their heads bowed, while the others are looking towards the center of the table.

# *MAC and MAE Clauses*

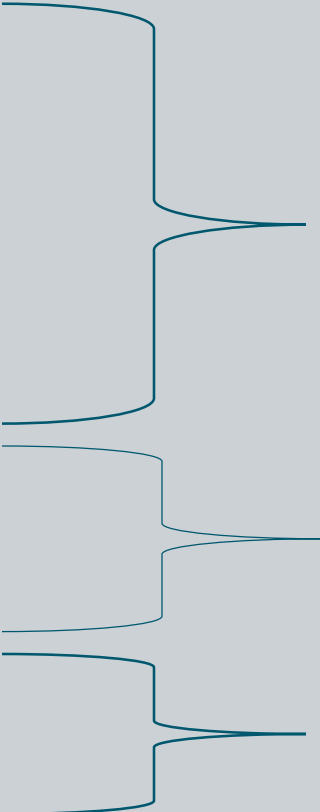


## *Typical MAE Closing Conditions*

- Stand-Alone Condition: Since the date of this Agreement, there shall not have occurred a Material Adverse Effect.
- Representation and Warranty Bring-Down Condition: The target's representations and warranties shall be true and correct as of the date of this Agreement and as of the Closing except for such failures to be true and correct that have not had a Material Adverse Effect.



# Elements of Material Adverse Effect

<p><b>Element 1:</b></p> <p><b>What is an MAE?</b></p>	<p>An event that has had [or [would/could] reasonably be expected to have] a material adverse effect on:</p> <ul style="list-style-type: none"> <li>• Business-related items:             <ul style="list-style-type: none"> <li>• Business</li> <li>• Financial condition</li> <li>• Results of operations</li> <li>• Others?</li> </ul> </li> <li>• Ability of target to perform its obligations</li> </ul>
<p><b>Element 2:</b></p> <p><b>Exclusions</b></p>	<ul style="list-style-type: none"> <li>• Changes in economy</li> <li>• Changes in industry</li> <li>• Acts of war or terrorism</li> <li>• Natural disasters</li> <li>• Changes in law</li> <li>• Changes in GAAP</li> <li>• Failure to meet projections</li> <li>• Credit rating downgrade</li> <li>• Declines in stock price</li> <li>• Pendency of transaction</li> <li>• Actions taken at request of buyer</li> </ul> <div style="display: flex; align-items: center; margin-left: 20px;">  <div style="margin-left: 20px;"> <p><b>Systematic risks</b></p> <p><b>Indicator risks</b></p> <p><b>Agreement risks</b></p> </div> </div>



## *How do Courts Interpret Material Adverse Effect?*

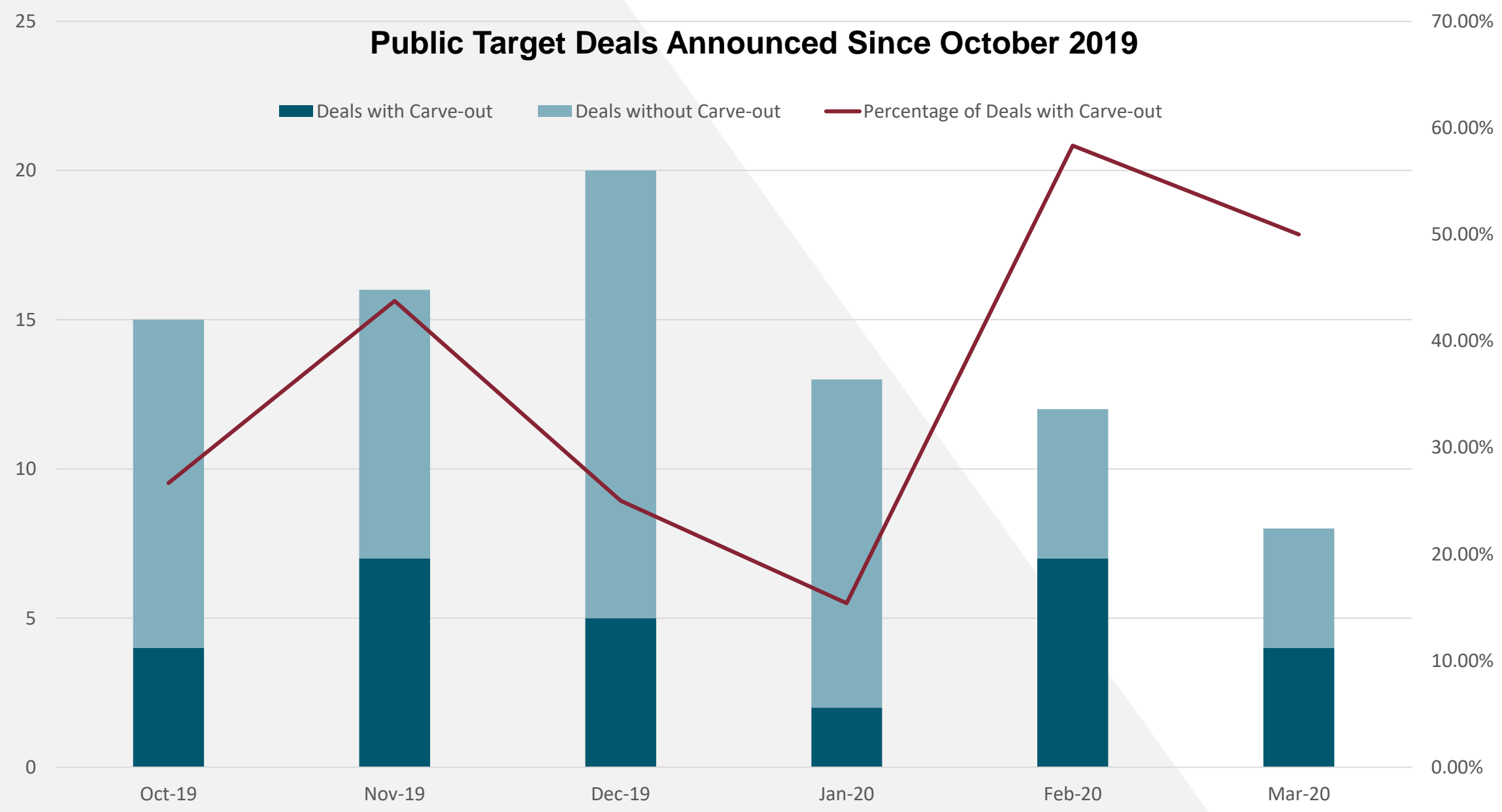
A very high bar:

- Substantial threat to overall earnings potential
- Durational significance

*A first in Delaware: Akorn, Inc. v. Fresenius Kabi AG*



# Impact of COVID-19 on Pending Deals



Is our deal going to close?



## *Allocating COVID-19 Risk Going Forward*

MAE Provisions:	<ul style="list-style-type: none"><li>• Not a great mechanism for allocating specific COVID-related risks</li></ul>
Other Possibilities:	<ul style="list-style-type: none"><li>• Earnout provisions</li><li>• Closing conditions</li><li>• Representations and warranties</li><li>• Financing provisions / reverse termination fees</li></ul>





*Earn-Outs/Milestone  
Obligations*



## *What Is an Earnout?*

- Contingent consideration
- Way to increase transaction consideration based on success after closing
- Examples:
  - Revenues
  - Net Income
  - Introduction of New Products
  - Hitting Product Milestones
  - Contingent Value Rights (Public Company alternative)



## *Connection to Other Provisions of the Agreement*

- Diligence Obligations
  - Defined or undefined
  - Subjective or objective--why does it matter?
- Material Breach/Termination
- Reversion Rights
- Governance/Decision-Making Rights



## *Defined Diligence Expectations (Example)*

“**Commercially Reasonable Efforts**” means (a) with respect to the efforts to be expended by a Party with respect to an agreed objective, except as otherwise provided in clause (b), such reasonable, diligent and good faith efforts as such Party would normally use to accomplish a similar objective under similar circumstances, and (b) with respect to Licensee’s obligations relating to the Development or Commercialization of Licensed Product(s), mean the efforts and resources normally used by a company in the biopharmaceutical industry of similar size and resources as Licensee for a product that is of similar market potential at a similar stage in its Development or product life, taking into account all relevant factors, including without limitation the potential profitability of the product, the costs and risks of Developing, Manufacturing and Commercializing the product, scientific, safety and regulatory concerns, product profile, the competitiveness of the marketplace and the proprietary position of the product.



## *What is Commercially Reasonable/Diligent in the Current Environment?*

- Reduced staff
- Reallocating resources
- Delayed clinical trials
- Modification of Clinical Trial Protocols
- Businesses temporarily closed
- Consumers tightening purse strings
- Decreased need for products/services
- Supply chain disruptions

Consider:

- FDA Guidance
- Business Continuity Plans
- Subjective vs Objective Diligence Standards: must you consider how a similarly situated company would react?
- Governance and Consent Rights: who has the authority to decide if/when to make changes?



## *Considerations Outside of the Contract*

- Some COVID-19 related issues cannot be resolved by reference to the contract
- Timelines that seemed reasonable before might not be reasonable now
- Reliance on contract language (Commercially Reasonable Efforts, Force Majeure) might not be helpful
- What is the best outcome?
- Consider getting out ahead of the problem through negotiation



## *Questions*

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