

Considerations for Internationally Focused Private Equity Funds

APRIL 2, 2020

Given these uncertain times, we've prepared a general summary of high-level matters for our fund clients to consider to help navigate this crisis. Obviously, this is a rapidly changing situation, and the discussion below may become outdated. Accordingly, please use the below for general information purposes only and not legal advice. As always, please reach out with any specific questions or issues you have.

I. LP Matters.

- A. Consider whether any required notice provisions in LPAs or side letters have been triggered.
- B. Review capital call lines to check availability. Typically, these lines would only be drawn in advance of a capital call.
- C. Consider providing guarantees to facilitate portfolio company borrowings, but take into account limitations imposed by LPA fund diversity provisions and leverage restrictions.
- D. Consider providing alternatives to holding in-person LP meetings, including webcasts or other means.
- E. Consider reviewing fund documents to determine whether investment objectives permit alternative investments, such as investing in securities of public companies, distressed investing, etc. For new fund offerings, consider broadening the fund's strategy to include distress investing for control and investing in debt of portfolio companies.
- F. For ongoing fund offerings, consider extending offering periods beyond the customary 12 months or include flexibility for GP or consent of the advisory board to extend the offering period.
- G. Consider (a) sending capital call notices well in advance of the due date to allow LPs more time to fund and (b) increasing the amount of capital calls for a new investment or for partnership expenses beyond the estimated amounts needed to take into account possible delays or failures by all LPs to fund by the due date.
- H. Consider asking LPs in funds that are winding down to reallocate unfunded commitments into non-traditional strategies such as distress.

- I. For ongoing fund offerings, consider including extension of commitment periods with consent of advisory boards.
- J. Consider including the ability of GPs to lend to funds or to portfolio companies if customary financing is not available.
- K. GPs should be consistent in disclosure to LPs or initiate an investor call to provide updates related to the coronavirus impact on working capital, supply chain, valuation, deal pipeline, etc.
- L. GPs should review insurance coverage and determine whether claims can be made under existing coverage.
- M. Consider the impact of COVID-19 on the valuation of your portfolio companies. Closely review the valuation procedures in your fund documents and compliance manual. Extra consideration will need to be taken when setting quarterly valuations. Consider consulting with the advisory board or outside service providers in connection with your valuation process.

II. New Investments.

- A. Consider the extent to which due diligence investigations (both business and legal) will need to be revisited to account for COVID-19-impacted issues (e.g., interruptions in supply chains, the potential inability of customers to make payment, the ability of the target company and its customers and suppliers to perform under material contracts, the impact of force majeure provisions in contracts, the adequacy of the target's insurance policies, impact on the workforce and labor issues, etc.).
- B. Consider the impact on historical financial performance when determining deal value and the adequacy of normal levels of working capital.
- C. Understand that there will likely be limited availability to debt financing.
- D. While rep and warranty insurance is not as prevalent in Latin American transactions as in the U.S., even when utilized it is likely that the policies will treat the impact of COVID-19 as an exclusion.
- E. The parties that support you in your transactions (financing, equity co-invest, rep and warranty insurance, and others) will likely expect a fulsome COVID-19 analysis on both the supply side and the demand side in order to support the transaction.
- F. As we come out of this crisis, COVID-19 may actually "mask" other underlying business issues, so you will need to be more diligent in your legal and financial analysis following this crisis.

III. Negotiating New Acquisition Agreements

- A. Buyers and sellers should consider expressly addressing COVID-19 risk allocation in MAE definition and closing conditions. (As noted below, it's likely that the current situation would not constitute an MAE under the typical formulation, but every deal needs to be reviewed on a case-by-case basis.)
- B. A number of standard representations and warranties may be implicated and should be reviewed carefully by sellers and buyers for both indemnity and closing-condition purposes. These include (i) no undisclosed liabilities, (ii) financial statements (and adequacy of reserves), (iii) adequacy of internal controls, (iv) no MAE since last balance sheet date, (v) collectability of receivables, (vi) status of material contracts, (vii) adequacy and viability of inventory, (viii) non-reliance on information outside the reps and warranties.
- C. Also consider adding representations and warranties not typically included relating to emergency and risk-management protocols, contingency planning, privacy and business continuity processes.
- D. Sellers may try to ringfence specific representations and warranties relating to COVID-19 and try to introduce so-called "anti-sandbagging" clauses to exclude claims relating to COVID-19 as a risk known to buyers.
- E. As noted above, it is likely that rep and warranty insurance policies (when utilized) will treat the impact of COVID-19 as an exclusion. In such cases, parties should consider the need for seller indemnities for claims relating to COVID-19 matters.

- F. Sellers may attempt to negotiate for an “ordinary course” covenant provision that provides target with the right and flexibility to operate the target business outside the ordinary course of business without buyer’s consent in order to deal with the impact of the COVID-19 outbreak, including taking emergency actions necessary to run the business. If buyers agree, they may still require the right to be consulted before the target takes such action.
- G. Consider whether outside termination dates should be longer than under normal circumstances given that approvals (including regulatory approvals) may take longer to obtain.
- H. For PE deals utilizing debt financing, parties will want to review risk-allocation provisions (including reverse-termination fees) given the possibility of more risk-averse lenders not funding.

IV. Deals in Executory Period.

- A. Whether the impact of COVID-19 constitutes an MAE will need to be determined on a case-by-case basis. It is likely that the current situation would not constitute an MAE under the typical formulation. That said, this may change depending on the length and severity of the crisis.
- B. Prepare for the need to pay reverse-termination fees if lenders do not fund when required.
- C. Analyze the extent to which other closing conditions may be affected (including the “bring-down of reps” condition).
- D. Review and be mindful of operating covenants requiring seller to operate the target business in the “ordinary course” between signing and closing unless buyer consents to a departure. Sellers should consider whether consultation with or consent from buyer is required for certain actions taken to deal with the COVID-19 outbreak.
- E. Consider the effect of potential government shut-downs on deals awaiting regulatory approvals for closing.
- F. Consider the availability of signatories for closing documentation (including in cases where documents must be signed in front of a notary in order to be valid), and potential delays.
- G. Consider the availability of termination rights in the purchase agreement.

V. Portfolio Company Matters.

A. Employment Matters.

1. Depending on the portfolio company’s business, consider allowing employees to work remotely.
2. If employees are working remotely, ensure procedures remain in effect to ensure data privacy and security.
3. Consider amending paid-time-off policies to provide for additional PTO for employees who cannot work remotely but are required to stay home from work.
4. Consider the impact of any legislation with respect to employment matters that has been or may be enacted by applicable jurisdictions in response to the COVID-19 outbreak, as well as existing laws with respect to employee privacy, family and medical leave, disability, discrimination and the like.
5. Consider obligations under labor union contracts that may be impacted.

B. Financing.

1. Consider portfolio company liquidity needs, and whether it makes sense to draw down on revolvers now while in covenant compliance in case of difficulties borrowing in the future.
2. Consider financial covenant compliance issues and the extent to which relief from lenders may be necessary.
3. Consider any notice requirements under credit agreements that may be triggered.

C. Operational Matters.

1. Review material contracts for notice requirements and timing.
2. Consider the impact of an inability to perform by the portfolio company or the counterparty.
3. Consider the impact of travel restrictions on sales and daily operations.
4. Consider the impact of decreases in demand.
5. Consider possible increases in liquidity risks that may affect daily operations.
6. Consider disruptions from closures of facilities, offices or stores.
7. Whether the impact of COVID-19 constitutes an MAE or a force majeure will need to be determined on a case-by-case basis.

D. Insurance Matters.

1. Review the portfolio company's insurance policies to determine the extent of available coverage, and take note of notice obligations and timing thereof.
2. Note that under these circumstances, depending on the terms of the policy, business-interruption-insurance policies may not provide adequate coverage for all potential losses.
3. Examine whether coverage under other policies is available.
4. Review the need to add additional policies and coverage. This review should assume that new policies will likely add disease-related exclusions.
5. Review local laws and regulations applicable to insurance matters.

E. Regulatory Matters.

1. Coordinate and communicate with regulatory authorities to the extent changes in operations impact regulatory oversight or authorizations.
2. Expect longer lead times to receive regulatory approvals from governmental entities.
3. Consider impacts of any amendments to tax regulations due to COVID-19.

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