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North American M&A Amid Fluctuating Trade Policy

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Overview

Dynamic shifts in global trade policies triggered by U.S. tariffs are raising multifaceted questions for North American M&A. Trade-related issues can vary widely and impact different targets and transactions in various ways. The task for buyers, sellers and their counsel is whether and how to adjust their negotiation, deal structure and risk allocation strategies amid these relatively novel circumstances.

Deal points and strategic issues for consideration can include: (1) valuation and due diligence; (2) supply chain contracts and trade-related contractual terms; (3) potentially impacted representations and warranties; (4) ordinary course of business clauses; (5) material adverse effect clauses; (6) closing conditions; and (7) earnouts. We touch on each of these at a high level only. By no means is this list of potential considerations exhaustive. As M&A lawyers know well, every deal is different.

Valuation and Due Diligence

Trade-related issues and potential risk will vary by deal. Due diligence should be tailored to trade-exposure and may require consultation with financial advisors. Tariff-related costs, for example, may not appear in historical financials, complicating valuation.

Trade concerns are of greatest weight for businesses with cross-border supply chains – such as in manufacturing, pharmaceuticals, or agriculture – where expo-

sure to tariffs can be direct. Due diligence should assess supply chain contracts, import/export compliance, and protocols for adapting to evolving trade environments. In-depth reviews may include supplier/customer relationships, country-of-origin classifications, inventory levels, and potential exposure to retaliatory tariffs.

While some targets may not face significant direct exposure to tariffs in their business, they may still face material indirect exposure, e.g., the potential for decreased demand because of unusual market conditions resulting from increased tariffs or trade uncertainty generally. Further, tariffs may lead to higher overall costs for the target. A detailed review of customer contracts to address the degree to which these costs can be passed on to customers may be important. Tools like trade risk matrices and valuation simulations can help assess potential impacts under various trade scenarios.

Supply Chain Contracts

Key terms for due diligence in supply chain contracts include: (A) financial terms; (B) termination clauses; and (C) force majeure provisions.

Regarding financial terms, supply chain contracts often expressly address responsibility for import taxes, duties or fees, including direct reference to tariffs. These contracts can also provide for automatic price adjust-

ments tied to specified events. Change in law provisions with financial implications can also be triggered by tariffs. The focus will be on determining which party is obligated to absorb tariff-related costs (and to what degree).

Regarding termination, common clauses in supply chain contracts include termination (A) for convenience, (B) for cause, and (C) upon the occurrence of specified events. Termination for convenience may be subject to an express minimum notice period. Termination for cause or a specified event may require careful consideration of whether tariffs, changing market conditions, and/or the counterparty's response to such developments meet the applicable hurdle.

Regarding force majeure provisions, the party seeking to avoid performance will generally have to establish both that the particular force majeure clause is triggered by the circumstances and that performance has been significantly impeded.

Representations & Warranties

In negotiating representations and warranties for trade-related matters, the parties can include (A) additional, trade-specific representations, and/or (B) additional language to customary representations (e.g., tax) to address trade-related issues.

A likely area of focus will be those representations that assure the robustness of the target's financials. Other areas of focus may likely include the target's compliance with laws (e.g., import and export regulations), the absence of legal proceedings or notices of dispute (e.g., regarding supply chain contracts), and material contracts (e.g., the absence of termination or renegotiation rights in supplier and customer contracts triggered by any newly imposed tariffs).

Should the transaction involve an interim period, consideration should be had to a potentially heightened possibility that updates to disclosure schedules could be appropriate. This may raise questions as to whether and on what terms any such updates are permissible under the purchase agreement.

Ordinary Course of Business Clauses

Trade uncertainty merits paying closer consideration to interim period covenants in two-step M&A transactions. In particular, potential fluidity in the trade landscape interacts with "ordinary course of business" clauses on multiple fronts.

First, the longer the interim period, the greater the possibility the target's ability to operate within the ordinary course could be tested by an evolving trade landscape. Second, ordinary course covenants are inherently flexible. The clause can therefore be customized for foreseeable trade-related concerns (e.g., bespoke negative and affirmative covenants). Third, these bespoke covenants can be tailored to address matters identified during the buyer's due diligence (e.g., terminating or amending material contracts, adjusting procurement practice, and/or modifying manufacturing location). Fourth, it is common for acquisition agreements to (A) allow the target to operate outside the ordinary course with the prior consent of the buyer, and (B) for the buyer to be precluded from unreasonably withholding such consent. However, determining whether it is reasonable for the buyer to withhold its consent amid unusual economic circumstances such as an unpredictable trade landscape may present challenges.

Material Adverse Effect Clauses

As with ordinary course covenants, multiple points regarding the interaction of material adverse effect ("MAE") clauses with trade-related risk warrant highlighting.

First, an express exclusion for tariffs may not be necessary. The typical MAE clause, with its core definition of a material adverse effect followed by a series of exclusions or "carve-outs", generally allocates internal, target-specific risks to the seller and external, systemic risks to the buyer. Changes in tariff policy arguably fall into the latter category.

A related consideration is whether the MAE definition will include a "disproportionate impact" qualifier. This would shift the risk of an external/systemic development from the buyer back to the seller where the de-

velopment has a disproportionate adverse impact on the target relative to a comparator group. If included, a key question is how the comparator group is defined, i.e., more broadly or more narrowly, and case law confirms that applying a contractually-defined comparator group to real-world circumstances can be complicated. M&A parties should tackle any disproportionate impact comparator group with tariff-related risks in mind.

Closing Conditions

Closing conditions, and closing risks, often receive close attention in M&A. Trade-related issues can only sharpen this focus. Additional bespoke closing conditions can also be explored.

Closing conditions can be customized for trade-related issues in different ways. A less complicated example would be the absence of tariffs regarding a particular product, industry, and/or import or export jurisdiction. Alternatively, the parties could apply a cap (e.g., 5%) on tariffs on a particular product, industry, and/or import or export jurisdiction. More complicated would be the use of thresholds regarding the adverse impact of tariffs on the target's business (e.g., using a financial metric such as revenue or net income).

Another approach could be a right in favour of either the buyer or seller to extend the closing date in the event a specified type or threshold amount of tariff has either been threatened or imposed (e.g., to give the buyer additional time to weigh whether it believes the closing conditions have been met). For example, should the buyer wish to seek confirmation of a key customer or supplier arrangement following the threat or announcement of a new tariff.

Earnouts

Additional contractual mechanisms available to allocate trade-related risks include earnouts, holdbacks and escrows. These could apply should (A) trade-related matters be significant enough to be the source of (or contribute to) a meaningful valuation gap, (B) the potential adverse impact on the target of a tariff threatened or imposed prior to signing be indeterminable, or (C) a new tariff be threatened or imposed during the interim period.

A carefully constructed earnout can be a win for both the buyer and seller. For example, as earnouts are often structured around EBITDA, they can be repurposed to hedge against any negative impacts on the target's EBITDA post-closing. But an informed and purposeful approach is critical. Careful analysis is required as to how various components of EBITDA and related definitions may be impacted by tariffs and other trade-related issues. Other considerations should include ensuring alignment among the parties regarding applicable accounting standards and metrics (e.g., whether tariff-related costs are classified as ordinary or extraordinary expenses).

Concluding Comments

Overall, informed and tactical negotiation, drafting and strategy will mitigate trade-related risks and allow opportunities to be seized. Careful and creative consideration of these and other factors by deal makers and their advisors is key for successful M&A transactions in this new environment. The market and dealmaking always adjusts to new developments. Uncommon trade policy uncertainty has disrupted some transactions, but business has gone on and deals are getting done.

Got News & Trends?

Are you following any new deal trends or have other news relevant to our committee? If so, I want to share your content. Simply contact me via email at Luciana.Griebel@MorganLewis.com.



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