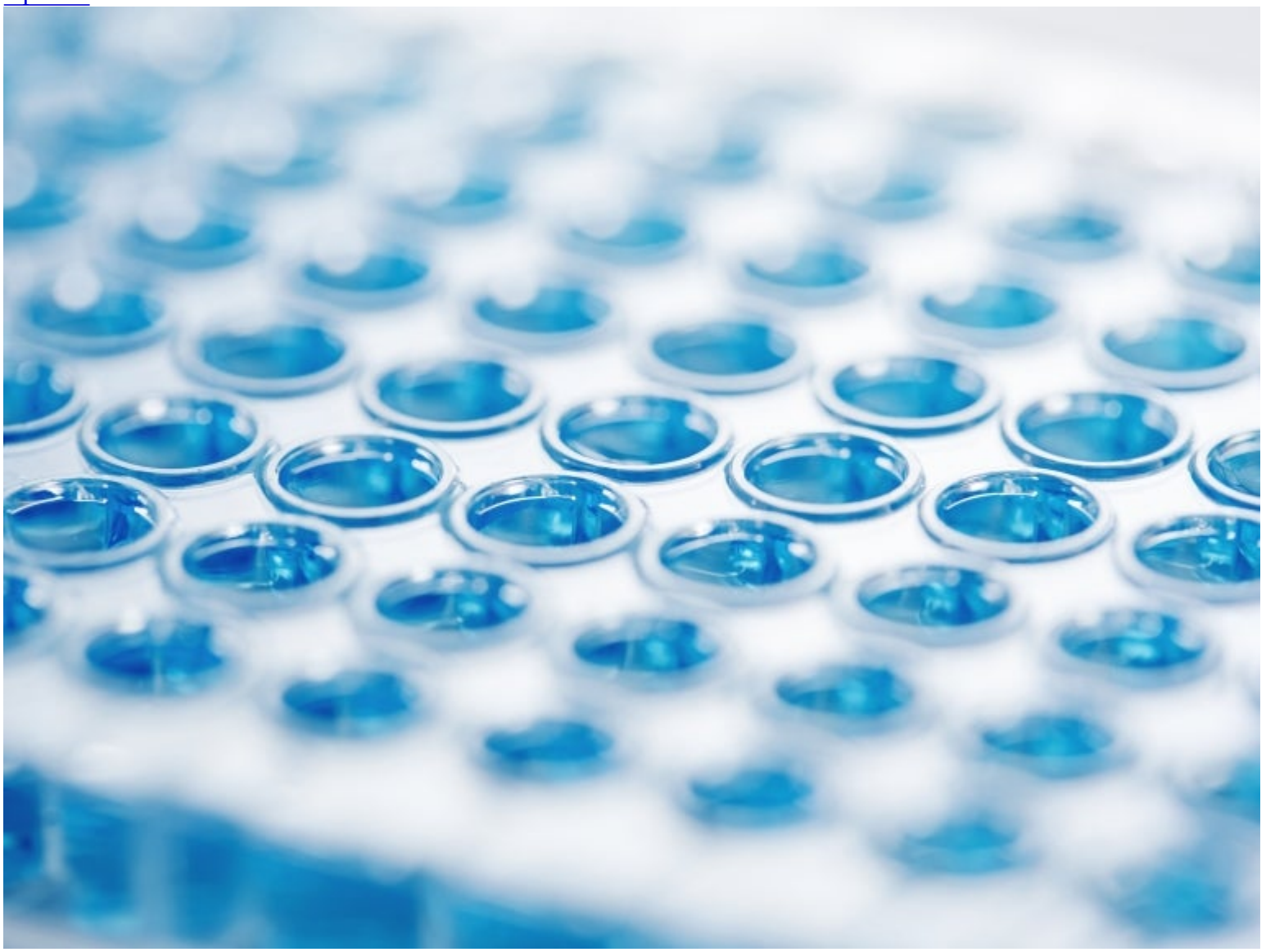
Updates



Several COVID-19-related mergers and acquisitions (M&A) complaints have been filed with the Delaware Court of Chancery since the start of this month, with spurned sellers alleging that buyers experienced a change of heart due to COVID-19's economic impact and asking the court to compel their suitors to close the deals. First, retailer Bed Bath & Beyond sued floral retailer 1-800-Flowers to complete the $252 million acquisition of Personalizationmall.com. One day later, Level 4 Yoga, a franchisee yoga studio of CorePower Yoga, asked the court to force CorePower Yoga to complete the staggered acquisitions of 34 yoga studios it had agreed to purchase from Level 4 Yoga. And most recently, Oberman, Tivoli & Pickert, the majority holder of Media Services, sued Cast & Crew, a competitor payroll services company, and its parent guarantor, to complete the acquisition of Media Services. Although Oberman withdrew its complaint four days after the filing, we included it here since it offers some interesting lessons. We share with you below a few observations from these cases:[1]

The Broken Deals Follow Similar Fact Patterns and Timelines

The parties entered into their respective definitive agreements right before or at the early stage of the pandemic in the United States, with closings expected late March or early April, when many states initiated "shelter-in-place" or "stay-at-home" orders. As the pandemic escalated, each of the buyers asked to delay the closing or asked that their obligations be excused, citing unsatisfied closing conditions. In the Bed Bath & Beyond case, a few days before the anticipated closing, 1-800-Flowers requested that the closing be delayed for one month due to uncertainty surrounding COVID-19, apparently without citing any contractual basis for the delay.[2] In the Oberman case, in the days leading up to the closing, Cast & Crew requested recent financial information from Media Services focusing "almost exclusively on the purported future impact of the COVID-19 pandemic on several aspects of the Business."[3] Cast & Crew later communicated to the seller that it was not satisfied with the information request and that as a result it was not required to close.[4] In the Level 4 Yoga case, CorePower Yoga notified seller Level 4 Yoga several days before the scheduled initial closing that CorePower Yoga did not need to close since the latter failed to operate the studios in the ordinary course of business in violation of interim operating covenants.[5]

Takeaways: Unfortunately, we anticipate that the number of broken or delayed deals is likely to continue to rise amidst economic uncertainty. In some cases, buyers may attempt to walk from signed agreements without a contractual basis, especially if the duration and magnitude of the consequences from COVID-19 exceed dealmakers' expectations. We expect to see that some sellers will continue taking buyers to court to enforce acquisition closings, but many sellers and buyers will probably find common ground outside of court, given the high uncertainties and costs of litigation. Parties entering into new definitive agreements with interim periods between signing and closing need to consider how to allocate the risks during the interim period, as the financial conditions or outlook of a target may deteriorate rapidly under the shadow of COVID-19 without fault of either party.

Buyers Had Not Explicitly Invoked MAE (Yet)

No buyer explicitly invoked material adverse effect (or MAE) as a reason to delay or terminate a transaction, although the buyer in the Bed Bath & Beyond case indicated that it needed more time to "assess" whether an MAE had taken place.[6] Each seller argued that no MAE occurred. The Level 4 Yoga complaint did not supply an MAE definition, but Level 4 Yoga argued that its MAE definition was "standard" and was "intended to allocate short-term or market and industry-wide risk to [CorePower Yoga]."[7]

The MAE definitions in the Bed Bath & Beyond and Oberman cases followed a fairly typical construct, where any change in general business, financial, or economic conditions or natural disasters would not result in an MAE, absent a disproportionate effect on the target compared to other similarly situated companies in their respective industries. None of the MAE definitions specifically carved out (or otherwise expressly dealt with) pandemics or COVID-19. As many are aware, an MAE determination is highly fact-intensive and the bar of finding one is high. The Delaware courts never allowed a buyer to walk away due to an MAE until the 2018 landmark decision in *Akorn, Inc. v. Fresenius Kabi AG*, which presented a set of particularly unique and challenging facts, including an 86% decline in Akorn's EBITDA one year after the signing and a loss of 21% in value due to Akorn's breaches of regulatory and compliance representations. It is not immediately clear how the court will view MAE in light of COVID-19, but the court will likely rely heavily on the specific wording of an MAE definition in light of the particular circumstances.

Takeaways:

- Due to Delaware courts' historical reluctance to find an MAE, a buyer dealing with buyer's remorse may, instead of relying on MAE, look to potential breaches of interim covenants, a failure to bring-down representations and warranties not qualified by MAE, or any other technical breaches of the definitive agreement to avoid its obligations. We believe that in this environment, sellers should be extra vigilant to comply with all obligations within their control.
- Parties negotiating a deal may consider setting materiality thresholds using quantifiable financial metrics in the definition of MAE. This could provide both parties with greater certainty, for example by identifying the level of performance deterioration which may (or may not) give the buyer the ability to walk, but may significantly increase negotiation costs.
- Finally, sellers should, where possible, seek to specifically exclude pandemics and epidemics, including COVID-19 and the potential resulting financial losses, from the MAE definition to clearly indicate to court the parties' intent.

Buyers Alleged Breaches of Interim Covenants

In both the Oberman and Level 4 Yoga cases, buyers cited sellers' alleged breaches of interim covenants as reasons to not close. Cast & Crew relied on the access to information covenant and the further assurances covenant,[8] to request "an extensive list of information regarding the existing and forecasted financial condition of Media Services" according to Oberman,[9] which claimed that Cast & Crew's "wide-ranging and apparently insatiable request for information … is a transparent attempt to find information to avoid consummation of the transaction based on the theory that the COVID-19 pandemic has led to a Material Adverse Effect."[10] CorePower Yoga focused on breaches of interim operating covenants, which required Level 4 Yoga to operate in the "ordinary course of business" and not to have "terminated or closed any facility, business or operation."[11] Based on the complaint, Level 4 Yoga did not appear to have sought written consent from CorePower Yoga before it temporarily closed its studios in response to government orders, although it's unclear what Level 4 Yoga could have done if CorePower Yoga withheld consent since the failure to close its studios would have violated law and thus also breached the agreement.[12]

Takeaways: A seller currently in the process of negotiating a deal with an interim period between signing and closing needs to more thoroughly evaluate its obligations in the interim period and avoid committing to obligations that it may not be able to satisfy or ones that cannot be clearly and objectively tested. For example, with respect to the access to information covenant, a seller may consider clearly defining the scope of information it is obligated to provide to buyer in the interim period, especially in regard to updated financial projections not in existence at signing. With respect to interim operating covenants, in light of COVID-19, a seller should consider tailoring the scope of interim operating covenants to allow itself flexibility to access liquidity, manage its working capital, and comply with government orders or changes in law generally (which may include shut-down orders or other measures), without breaching any covenant or having to seek buyer's consent first.

ENDNOTES

[1] You can find the filed complaints at: *Bed Bath & Beyond, Inc. v. 1-800-Flowers.com and 800-Flowers, Inc., No. 2020-0245 (Del. Ch. Apr. 1, 2020)* (https://www.bloomberglaw.com/public/desktop/document/BedBathBeyondIncv1800FlowerscomIncDocketNo2020024); *Level 4 Yoga, LLC v. CorePower Yoga, LLC and CorePower Yoga Franchising LLC, No. 2020-0249 (Del. Ch. Apr. 2, 2020)* (https://www.bloomberglaw.com/public/desktop/document/Level4YogaLLCvCorePowerYogaLLCetalDocketNo202002); and *Oberman, Tivoli & Pickert, Inc. v. Cast & Crew Indie Services, LLC and Camera Holdings, LP, No. 2020-0257-PAF (Del. Ch. Apr. 9, 2020)* (

https://www.bloomberglaw.com/public/desktop/document/ObermanTivoliPickertIncvCastCrewIndieServicesLLCandCa
). All recitations of factual events or claims, either in quotations or not, are allegations of facts or claims from the respective complaint, and this article does not necessarily represent the view of Perkins Coie LLP or any of its clients.

[2] *Bed Bath & Beyond, No. 2020-0245 (Del. Ch. Apr. 1, 2020) at 6, 22.*

[3] *Oberman, No. 2020-0257-PAF (Del. Ch. Apr. 9, 2020) at 32.*

[4] *Id. at 34.*

[5] *Level 4 Yoga, No. 2020-0249 (Del. Ch. Apr. 2, 2020) at 12.*

[6] *Bed Bath & Beyond, No. 2020-0245 (Del. Ch. Apr. 1, 2020) at 8-9.*

[7] *Id. at 16.*

[8] *Oberman, No. 2020-0257-PAF (Del. Ch. Apr. 9, 2020) at 26.*

[9] *Id. at 5.*

[10] *Id. at 7-8.*

[11] *Level 4 Yoga, No. 2020-0249 (Del. Ch. Apr. 2, 2020) at 12.*

[12] *Id. at 15.*

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