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THE EFFECTS OF COVID-19 ON NEGOTIATED M&A TRANSACTIONS

As a result of the COVID-19 pandemic, many companies have suffered declines in operational and financial performance, which has disrupted numerous pending M&A transactions, leading to terminations, renegotiations, and litigation. In this article, the authors begin with a survey of COVID-19's effect on pending M&A transactions. They then discuss the one case to date that directly addresses the interpretation of key transaction terms with respect to COVID-19-related claims. Next, they consider COVID-19's effect on new M&A deal-making. They close with an appraisal of the continuing legacy of COVID-19 in M&A transactions going forward.

By Kathryn King Sudol and Michael Chao *

As COVID-19 began to spread across the globe in the first quarter of 2020, mergers and acquisitions ("M&A") activity declined significantly, with the values of global and U.S. M&A transactions announced in the first quarter of 2020 declining 21% and 50%, respectively, compared to the values announced in the first quarter of 2019.[1] By the second quarter of 2020, the value and number of global M&A transactions announced declined to lows not seen since 2009 and 2004.[2] While M&A activity rebounded strongly in the third quarter of 2020 (and continued with an enormous surge of activity in the fourth quarter of 2020), the total value of global and U.S. M&A transactions announced in the first nine months of 2020 was still down 17% and 40%, respectively, compared to the values announced in the first nine months of 2019.[3]

On top of the dip in new M&A activity in 2020, many companies have seen their operational and financial performance decline, sometimes precipitously, as a result of COVID-19 and related market volatility. These conditions have disrupted numerous pending negotiated M&A transactions and have led to notable changes in deal terms in transaction agreements entered into following the start of the global spread of COVID-19.

[1] Refinitiv M&A League Tables.

[2] Refinitiv M&A League Tables; Joshua Franklin & Pamela Barbaglia, *Coronavirus Strikes Down Global M&A as Companies Keep Their Distance*, Reuters, https://www.reuters.com/article/us-global-m-a/coronavirus-strikes-down-global-ma-as-companies-keep-their-distance-idUSKBN241190 (Jun. 30, 2020, 5:29 AM).

[3] Refinitiv M&A League Tables.

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In the first section of this article, we review the impact of COVID-19 on certain pending negotiated M&A transactions, including various delays, disputes and terminations, and analyze a recent Delaware case addressing certain COVID-19-related claims raised in the context of a deal termination. In the second section of this article, we provide an overview of certain new deal terms that have been added to negotiated purchase agreements and merger agreements to directly address the existing and potential future impact of COVID-19.

COVID-19'S EFFECT ON PENDING M&A TRANSACTIONS

While some transactions announced prior to the global spread of COVID-19[4] have been terminated, the number of M&A transactions actually terminated through the first half of 2020 has been limited and largely consistent with previous years.[5] The pending acquisition or merger transactions in which termination (or attempted termination) arose as a result of COVID-19 can be split into two categories: (1) transactions terminated by mutual agreement and (2) transactions terminated (or sought to be terminated) unilaterally.

The transactions terminated by mutual agreement have typically been strategic transactions. Even though COVID-19 may not have eliminated the underlying strategic rationale for these proposed transactions, it appears that the parties to these transactions believed it was in their best interests to abandon them in order to focus on steering their individual businesses through the turbulence of COVID-19 without adding the complexities of merger integration. For example, in connection with the termination of each of the mergers of Woodward, Inc. and Hexcel Corporation, Texas Capital Bancshares, Inc. and Independent Bank Group, Inc., and Ally Financial Inc. and Cardholder Management Services, Inc., the parties issued press releases announcing their mutual agreement to terminate in light of the significant impact of COVID-19.[6]

The transactions terminated (or sought to be terminated) unilaterally have included both strategic and private equity buyers, although the transactions involving strategic buyers have tended to be transactions where the buyer was paying all cash consideration. Unsurprisingly, many of the transactions where a party has sought to terminate without the consent of the other party have led to significant disputes and litigation.

[4] For purposes of this article, we define transactions announced prior to the global spread of COVID-19 as transactions entered into prior to March 9, 2020.

[5] Gaurang Dholakia & Lindsey White, *More than $100B of M&A Deals Terminated amid 'New World Order' of COVID-19*, S&P Global Market Intelligence, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/more-than-100b-of-m-a-deals-terminated-amid-new-world-order-of-covid-19-59143275 (Jun. 25, 2020).

[6] Press Release, Woodward, Inc. & Hexcel Corporation, Woodward and Hexcel Announce Mutual Termination of Merger Agreement, https://www.businesswire.com/news/home/20200406005143/en/Woodward-and-Hexcel-Announce-Mutual-Termination-of-Merger-Agreement (Apr. 6, 2020, 7:30AM) ("The pandemic has resulted in a need for each company to focus on its respective businesses and has impacted the companies' ability to realize the benefits of the merger during these unprecedented times."); Press Release, Texas Capital Bancshares, Inc., Texas Capital Bancshares, Inc. Announces Mutual Agreement to Terminate Proposed Merger With Independent Bank Group, Inc., https://www.globenewswire.com/news-release/2020/05/26/2038497/0/en/Texas-Capital-Bancshares-Inc-Announces-Mutual-Agreement-to-Terminate-Proposed-Merger-With-Independent-Bank-Group-Inc.html (May 26, 2020, 7:00 AM) ("The termination was approved by both companies' boards of directors after careful consideration and given the significant impact of the COVID-19 pandemic on global markets and on the companies' ability to fully realize the benefits they expected to achieve through the merger."); Press Release, Ally Financial Inc. & Cardholder Management Services, Inc., Ally Financial Inc. Announces Mutual Agreement To Terminate Proposed Merger With CardWorks, https://www.prnewswire.com/news-releases/ally-financial-inc-announces-mutual-agreement-to-terminate-proposed-merger-with-cardworks-301083203.html (Jun. 24, 2020, 4:30 PM) ("The board of directors for each company approved the termination after carefully considering the meaningful impacts of COVID-19 on global markets and the economy.").

Certain of these disputes have been settled by the parties mutually agreeing to proceed on the basis of amended transaction terms, while other disputes have resulted in the termination of the transaction or remain pending in litigation.

Attempted Terminations Resulting in Amended Transaction Agreements

Some of the attempted terminations have been resolved by settlements in which the parties agreed to reduce the purchase price and close the pending transaction. For example, LVMH Moët Hennessy-Louis Vuitton disputed the right of Tiffany & Co. to extend the "outside date" in their November 2019 merger agreement. LVMH alleged that Tiffany had suffered a "material adverse effect" and materially breached its interim operating covenants, and asserted that LVMH was subject to a legal restraint from a governmental authority prohibiting it from closing the transaction prior to January 7, 2021, which was after the outside date in the merger agreement.[7] Tiffany disputed each of LVMH's allegations and sought specific performance against LVMH to obtain required regulatory approvals and consummate the merger.[8] Prior to the commencement of oral arguments for trial, the parties settled their litigation. The parties agreed, among other matters, to reduce the merger consideration from $135.00 per share to $131.50 per share, stipulate that the closing would not occur prior to January 7, 2021, and eliminate the closing conditions related to the bringdown of Tiffany's non-fundamental representations and warranties, and the absence of a "material adverse effect" with respect to Tiffany.[9]

Similarly, Simon Property Group attempted to terminate its February 2020 merger agreement with Taubman Centers Inc. in June 2020, alleging that Taubman had suffered a "material adverse effect" and materially breached its covenants to operate in the ordinary course of business. Prior to the scheduled trial, the parties agreed to reduce the consideration to be paid to Taubman shareholders from $52.50 per share to $43.00 per share.[10] In another strategic transaction involving solely cash consideration, 1-800-Flowers.com, Inc. attempted to unilaterally postpone the closing of its pending acquisition of PersonalizationMall.com LLC from Bed Bath & Beyond Inc. based on "commercial impracticability" due to COVID-19 and 1-800-Flowers' alleged inability to determine whether the target business had suffered a "material adverse effect" or violated interim operating covenants. Bed Bath & Beyond filed suit seeking specific performance of 1-800-Flowers' obligation to close the transaction. Following various filings by the parties, the parties entered into a settlement agreement that reduced the purchase price from $252 million to $245 million on the condition that the closing would occur by August 3, 2020.[11]

In another transaction (in this case, a stock-for-stock transaction), BorgWarner Inc. asserted its right to terminate a January 2020 transaction agreement to acquire Delphi Technologies PLC following a full drawdown of a $500 million revolving credit facility by Delphi Technologies on March 30, 2020. BorgWarner asserted that the drawdown by Delphi Technologies was a material breach of an interim operating covenant that restricted Delphi Technologies from incurring indebtedness for borrowed money in excess of $5 million without BorgWarner's prior written consent and that such material breach, if uncured, gave BorgWarner the right to terminate the transaction agreement. Delphi Technologies disputed BorgWarner's right to terminate the transaction agreement on the basis that BorgWarner unreasonably withheld its consent to the drawdown by Delphi Technologies which, according to Delphi

[7] LVMH's Verified Counterclaim and Answer to Verified Complaint, *Tiffany & Co. v. LVMH Moët Hennessy-Louis Vuitton SE et al.*, C.A. No. 2020-0768-JRS (Del. Ch.). In connection with this allegation, LVMH cited a letter from the French Minister of Foreign Affairs dated August 31, 2020 which requested LVMH to delay the acquisition until January 2021 in light of the U.S. government's imposition of additional customs duties on the import of certain French goods, including goods in the luxury sector, and the need to "take part in [France's] efforts to defend its national interests."

[8] Tiffany & Co.'s Answer to Verified Counterclaim, *Tiffany & Co. v. LVMH Moët* Hennessy-*Louis Vuitton SE et al.*, C.A. No. 2020-0768-JRS (Del. Ch.).

[9] Tiffany & Co., Current Report (Form 8-K) (Oct. 28, 2020).

[10] The parties expect to close the merger in late 2020 or early 2021, pending receipt of Taubman shareholder approval and required regulatory approvals. Press Release, Simon Property Group, Inc. & Taubman Centers, Inc., Simon and Taubman Modify Merger Price to $43.00 per Share in Cash, https://www.prnewswire.com/news-releases/simon-and-taubman-modify-merger-price-to-43-00-per-share-in-cash-301173266.html (Nov. 15, 2020, 5:51 PM).

[11] The transaction closed on August 3, 2020. Press Release, Bed Bath & Beyond Inc., Bed Bath & Beyond Inc. Completes Sale of PersonalizationMall.com, https://www.prnewswire.com/news-releases/bed-bath--beyond-inc-completes-sale-of-personalizationmallcom-301104961.html (Aug. 3, 2020, 4:15 PM).

Technologies, was prudent and in the best interests of its shareholders to weather market conditions and was consistent with actions taken by other companies across all industries in light of the COVID-19 pandemic.[12] The dispute between the parties did not result in litigation, and the parties subsequently agreed to an amendment to their transaction agreement which provided for a 5% reduction in the transaction consideration and added a variety of new closing conditions with respect to Delphi Technologies' outstanding revolver borrowings and net debt-to-adjusted EBITDA level at closing.[13]

Private equity buyers have also grappled with the COVID-19 fall-out. For example, Advent International, a private equity buyer, sought to terminate its February 2020 merger agreement to acquire Forescout Technologies, Inc. In May 2020, Advent informed Forescout that the deal was on hold because of uncertainty resulting from COVID-19.[14] Forescout subsequently filed a lawsuit disputing that it had suffered a "material adverse effect" and seeking specific performance of the merger agreement against Advent.[15] Following various filings by the parties, on July 15, 2020, Forescout and Advent entered into a settlement agreement and an amended merger agreement that reduced the purchase price from $33 per share to $29 per share.[16]

Terminated Transactions and Pending Disputes

By contrast, various other M&A transactions announced prior to the global spread of COVID-19 have been terminated following a disputed unilateral termination by one party or remain subject to pending litigation. Terminated transactions include the proposed acquisition by an affiliate of Sycamore Partners of a 55% interest in the Victoria's Secret business owned by L Brands, Inc. (announced in February 2020) that was ultimately terminated following an initial termination by Sycamore Partners in April 2020 and litigation in the Delaware Court of Chancery. In another example, the proposed acquisition by SIRVA Worldwide, Inc., a portfolio company of Madison Dearborn Partners, of Cartus Corporation from Realogy Holdings Corp. (announced in November 2019) was terminated following an initial termination by SIRVA in April 2020 and litigation in the Delaware Court of Chancery. Although both of these transactions involved allegations of breach or "material adverse effect" as a result of COVID-19, both transactions were terminated for reasons that were not directly related to COVID-19. It appears that the Sycamore Partners/L Brands transaction was terminated with no payment of a termination fee by Sycamore Partners on the basis that certain actions by L Brands seeking monetary damages against Sycamore Partners resulted in the termination of Sycamore Partners' equity commitment letter.[17] Similarly, it appears that the SIRVA/Realogy transaction was terminated after certain direct claims by Realogy against Madison Dearborn Partners resulted in the termination of Madison Dearborn Partners' equity commitment letter, which caused the SIRVA debt commitments to expire during the pendency of litigation with respect to the transaction.[18]

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[12] Press Release, Delphi Technologies PLC, Statement from Delphi Technologies, https://www.prnewswire.com/news-releases/statement-from-delphi-technologies-301032457.html (Mar. 31, 2020, 8:00 AM).

[13] The transaction closed in October 2020. Press Release, BorgWarner Inc., BorgWarner Completes Acquisition of Delphi Technologies, https://www.prnewswire.com/news-releases/borgwarner-completes-acquisition-of-delphi-technologies-301144611.html (Oct. 2, 2020, 6:30 AM).

[14] Press Release, Forescout Technologies, Inc., Forescout Commences Litigation Against Advent International, https://www.globenewswire.com/news-release/2020/05/20/2036337/0/en/Forescout-Commences-Litigation-Against-Advent-International.html (May 20, 2020, 8:00 AM).

[15] Verified Complaint, *Forescout Technologies, Inc. v. Ferrari Group Holdings, L.P. and Ferrari Merger Sub, Inc.*, C.A. No. 2020-0385-SG (Del. Ch.). In addition, Forescout's stockholders filed a class action securities litigation against Forescout, its chief executive officer and its chief financial officer alleging that Forecast misrepresented or omitted to disclose material information regarding the impact of COVID-19 on its business and financial results, and the COVID-19-related risks with respect to the pending merger. Complaint, *Sayce v. Forescout Technologies, Inc. et al.*, 3:20-cv-00076-SI (N.D. Cal.).

[16] The transaction closed on August 17, 2020. Forescout Technologies, Inc., Current Report (Form 8-K) (Aug. 14, 2020).

[17] Verified Complaint, *Sycamore Partners III, L.P. and Sycamore Partners III-A, L.P. v. L Brands, Inc.*, C.A. No. 2020-0297-JTL (Del. Ch.).

[18] On July 17, 2020, the Delaware Court of Chancery granted SIRVA's motion to dismiss on the basis that specific performance was not an available remedy. Order Granting Motion to Dismiss, *Realogy Holdings Corp. v. SIRVA Worldwide, Inc. et al.*, C.A. No. 2020-0311-MTZ (Del. Ch.). On August 8, 2020, the parties settled their dispute in a

Several other transactions announced prior to the global spread of COVID-19 remain mired in pending litigation regarding purported terminations.[19] As much has already been written about the disputes in these various transactions in other articles, we do not discuss those pending cases in detail here, but do observe that the recent M&A litigation can be most simply be described as "everything old is new again." Absent fraud or a material breach of "fundamental" representations and warranties,[20] a buyer seeking to avoid the consummation of a signed transaction agreement is typically limited to making at least one of two claims: (1) the occurrence of a "material adverse effect" or (2) the material breach of a covenant. The unprecedented nature of COVID-19 has not changed this reality, as made clear in recent litigation.

In a number of the cases filed (including some which have settled),[21] the buyer asserted claims that the target company suffered a "material adverse effect" which would relieve the buyer from its obligation to close the proposed transaction. However, a claim of "material adverse effect" is not new — this is a go-to claim for any buyer seeking to renegotiate or abandon a proposed transaction where economic or other circumstances have changed and the proposed transaction loses its luster. For example, in 2008, Hexion Specialty Chemicals, Inc. unsuccessfully sought to terminate its transaction by claiming, in part, that Huntsman Corp. had suffered a "material adverse effect" arising out of the global financial crisis.[22] In that case, the Delaware Court of Chancery set a high bar for buyers, explaining that "[a] buyer faces a heavy burden when it attempts to invoke a "material adverse effect" clause in order to avoid its obligation to close" and that a buyer must demonstrate "a change in the target's business that is consequential to the company's long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months."[23] To date, the Delaware courts have found, in the context of an M&A transaction, that a "material adverse effect" has occurred in only one case, *Akorn, Inc. v. Fresenius Kabi AG, et al.*, in 2018,[24] which involved extreme facts, including the target company's submission of falsified data to its primary regulator and substantial declines in revenues and operating income over four quarters following the signing of the merger agreement.

In most cases in which a buyer asserted that the target business suffered a "material adverse effect" arising out of COVID-19, the key issues were (1) whether any exceptions in the "material adverse effect" definition applied, (2) whether the target business suffered a "disproportionate" or "materially disproportionate" adverse effect compared to other industry participants, and (3) whether a "material adverse effect" occurred with respect to the target company's or seller's ability to perform its obligations under the transaction agreement. As to the first issue, most practitioners agree that even in the absence of an express COVID-19, pandemic, or similar express exception in the "material adverse effect" definition in a transaction agreement, the effects of COVID-19 on a target company's business, operations, and financial condition would likely fall within nearly universal exceptions in "material adverse effect" definitions for general changes in economic and market conditions, general changes in the relevant industry, changes in applicable law, and/or other *force*

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confidential settlement. Realogy Holdings Corp. & Realogy Group LLC, Current Report (Form 8-K) (Aug. 11, 2020).

[19] For example, (1) Cast & Crew Indie Services, LLC's proposed acquisition of assets from Oberman, Tivoli & Pickert, Inc.; (2) Cinemex's proposed acquisition of Star Cinema Grill from Mr. Omar Khan; (3) CorePower Yoga LLC's proposed acquisition of assets from Level 4 Yoga LLC; and (4) the proposed acquisition of a minority interest in GBT JerseyCo Limited by a consortium of investors including affiliates of The Carlyle Group and GIC (Ventures) Pte. Ltd from Juweel Investors Limited and certain other sellers (termination but pending damages claim).

[20] "Fundamental" representations and warranties are typically limited to those related to organization, authority, capitalization, and brokers' fees. As non-fundamental representations and warranties are typically "brought down" to a "material adverse effect" standard, breaches of non-fundamental representations and warranties are unlikely to give rise to a termination right unless the target has also suffered a "material adverse effect," in which case there would often be an independent right of termination beyond the breach of a non-fundamental representation or warranty.

[21] *See, e.g.*, *Simon Property Group, Inc. v. Taubman Centers, Inc.*, No. 2020-181675-CB (Mich. Cir.); *Tiffany & Co. v. LVMH Moët Hennessy-Louis Vuitton SE et al.*, C.A. No. 2020-0768-JRS (Del. Ch.); *Realogy Holdings Corp. v. SIRVA Worldwide, Inc. et al.*, C.A. No. 2020-0311-MTZ (Del. Ch.); *Juweel Investors, Ltd. v. Carlyle Roundtrip, LP et al.*, C.A. No. 2020-0338-JRS (Del. Ch.).

[22] *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, C.A. No. 3841 (VCL) (Del. Ch. Sept. 29, 2008).

[23] *Id.*

[24] *Akorn, Inc. v. Fresenius Kabi AG, et al.*, C.A. No. 2018–0300–JTL (Del. Ch. Oct. 1, 2018).

majeure events. As to the second issue, it will likely be challenging for buyers to prove any claims based on disproportionate adverse effect given the widespread adverse impact of COVID-19 on most industries and most companies in any industry.

As to the third issue, in many "material adverse effect" definitions there is a separate prong related to an effect that would prevent, materially delay, or materially impede the target company's or seller's performance of its obligations under the transaction agreement. Typically, this "performance" prong is not qualified by the long list of exceptions in a "material adverse effect" definition. Many buyers pointing to this prong of the definition have done so in conjunction with claims of covenant breaches which have already allegedly occurred and/or expected breaches of post-closing covenants based on damage to the target company due to COVID-19.[25] Again, these are not novel legal arguments and have been addressed in prior M&A litigation, including the *Cooper Tire & Rubber Company* case in which Vice Chancellor Glasscock of the Delaware Court of Chancery noted that the absence of carve-outs in this separate prong of the "material adverse effect" definition precluded the ability of a target company to rely on such carve-outs to avoid a finding that a "material adverse effect" had occurred due to material breaches of interim operating covenants and other obligations of a seller.[26]

The second claim raised by buyers in a number of the recent cases is that the target company breached one or more covenants.[27] Again, claims of a covenant breach are another go-to claim by buyers seeking to escape a proposed transaction. In the *Akorn* case, Fresenius coupled its "material adverse effect" claims with claims that Akorn had breached a number of its covenants, and as noted above, the buyer in the *Cooper Tire & Rubber Company* case alleged various covenant breaches as part of its arguments that a "material adverse effect" had occurred.[28] Most cases involving allegations of covenant breaches have centered around claims that the target company breached its obligation to operate "in the ordinary course of business" and "consistent with past practice," and typically include allegations of specific covenant breaches based on actions taken by a target company in response to COVID-19 (*e.g.*, debt drawdowns, facility closures, employee layoffs or furloughs).

The key issues regarding COVID-19-related covenant breach claims have centered around (1) the meaning of "ordinary course" during the COVID-19 pandemic, (2) whether a target company acted in a "commercially reasonable" manner (including by failing to take "commercially reasonable" actions to mitigate against damages resulting from the effects of COVID-19), and (3) whether a buyer acted "unreasonably" in withholding, delaying, or conditioning its consent to certain actions proposed to be taken by a target company in response to COVID-19. Additional issues include whether a target company could be held to be in breach of its covenants if it has taken actions in order to comply with applicable legal requirements (*e.g.*, state or local orders mandating store closures) adopted in response to COVID-19 (whether or not an express "as required by applicable law" exception is included in the transaction agreement) and whether a target company has breached its "access" covenants by failing to provide a buyer with sufficient access to information, properties, and personnel (including access to information regarding the impact of COVID-19 on the target business).

AB Stable VIII Case and Its Impact

There has been only one court decision to date that directly addresses the interpretation of key transaction agreement terms with respect to COVID-19-related claims: *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC, et al*.[29] In this recent decision, issued on

[25] *See, e.g.*, *Sycamore Partners III, L.P. and Sycamore Partners III-A, L.P. v. L Brands, Inc.*, C.A. No. 2020-0297-JTL (Del. Ch.); *Tiffany & Co. v. LVMH Moët Hennessy-Louis Vuitton SE et al.*, C.A. No. 2020-0768-JRS (Del. Ch.); *Realogy Holdings Corp. v. SIRVA Worldwide, Inc. et al.*, C.A. No. 2020-0311-MTZ (Del. Ch.).

[26] *Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd.*, C.A. No. 8980-VCG (Del. Ch. Oct. 31, 2014) ("In other words, the logical operation of the definition of Material Adverse Effect shifts the risk of any carved-out event onto Apollo, unless that event prevents Cooper from complying with its obligations under the Merger Agreement; the parties agreed not to excuse Cooper for any such breach.").

[27] *See, e.g.*, *Omar Khan, SCGC, Inc. et al. v. Cinemex USA Real Estate Holdings, Inc. et al.*, No. 20-1178 (S.D. Tex.); *AB Stable VIII, LLC v. MAPS Hotel and Resorts One, LLC, et al.*, C.A. No. 2020-0310-JTL (Del. Ch.); *Snow Phipps Group, LLC v. KCAKE Acquisition, Inc. et al.*, No. 2020-0282-KSJM (Del. Ch.); *Juweel Investors, Ltd. v. Carlyle Roundtrip, LP et al.*, C.A. No. 2020-0338-JRS (Del. Ch.).

[28] *Akorn, Inc. v. Fresenius Kabi AG, et al.*, C.A. No. 2018–0300–JTL (Del. Ch. Oct. 1, 2018); *Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd.*, C.A. No. 8980-VCG (Del. Ch. Oct. 31, 2014).

[29] *AB Stable VIII LLC v. Maps Hotels and Resorts One LLC, et al.*, C.A. No. 2020–0310–JTL (Del. Ch. Nov. 30, 2020).

November 30, 2020, the Delaware Court of Chancery validated the right of an affiliate of Mirae Asset Global Investments Co. to terminate a purchase agreement for its pending acquisition of 15 U.S. luxury hotels owned by affiliates of Anbang Insurance Group Co (announced in September 2019). Mirae alleged, among other things, that the target business suffered a "material adverse effect" and that Anbang materially breached its obligation to operate in the ordinary course of business.[30] Although the court found that Mirae failed to establish a "material adverse effect" on the target hotel business due to an exception for "calamities" in the "material adverse effect" definition, the court held that Mirae successfully proved Anbang materially breached its "ordinary course" covenant based on Anbang's actions taken in response to COVID-19, which resulted in the failure of a condition to Mirae's obligations to consummate the transaction.[31]

In reaching the conclusion that no "material adverse effect" had occurred, Vice Chancellor Laster of the Delaware Court of Chancery determined that, despite the absence of an express "pandemic" exception, the effects of COVID-19 qualified as a "calamity," and thus fell within the exception for "natural disasters and calamities" in the "material adverse effect" definition.[32] The court based this finding on an analysis of the meaning of the word "calamity," expert testimony regarding precedent transactions, and policy reasons.[33] Vice Chancellor Laster noted that the following exceptions in the "material adverse effect" definition shifted "systematic risk" (including the risk of COVID-19) to the buyer, although his conclusion regarding "material adverse effect" did not rely on these exceptions: (1) general changes in any of the industries in which the target company or its subsidiaries operated, (2) changes in general economic, business, regulatory, political or market conditions, or in financial markets, and (3) changes in applicable law.[34]

The decision in *AB Stable VIII* indicates a willingness by the Delaware Court of Chancery to find that the effects of COVID-19 on a target business are covered by a variety of customary exceptions in a "material adverse effect" definition. Nevertheless, as the court in *AB Stable VIII* did not have the opportunity to address the impact of a "disproportionate effect" qualifier (no such qualifier was included in the transaction agreement) or the performance prong in the "material adverse effect" definition (this claim was not raised by the buyer),[35] these issues will likely be the subject of future litigation when a buyer claims a target company has suffered a "material adverse effect."

In reaching his conclusion regarding Anbang's material breach of its "ordinary course" covenant, Vice Chancellor Laster reviewed Mirae's factual allegations and Anbang's various defenses to the alleged covenant breach. Mirae alleged that Anbang had breached its obligation to operate in the ordinary course of business through its actions taken in response to COVID-19, including closing various hotels, operating other hotels at reduced levels with reduced staffing, laying off or furloughing over 5,200 employees, closing restaurants, and discontinuing marketing and other non-essential capital expenditures.[36] Anbang did not dispute these factual allegations, but argued that management must have the flexibility to address changing circumstances and unforeseen events, including by engaging in "ordinary responses to extraordinary events" in light of COVID-19.[37] Based on precedent and the plain language of the covenant, the Delaware Court of Chancery found that the "ordinary course of business" covenant required a seller to act in the "customary and normal routine of managing a business in the expected manner," and thus held that Anbang had violated its

[30] *Id.* Mirae also alleged a breach of the implied covenant of good faith and fair dealing by Anbang and that Anbang had engaged in fraud which resulted in the failure of a specific condition to closing related to title insurance. This article does not address the findings by the Delaware Court of Chancery related to these other allegations or the failure of the title insurance closing condition, although the facts underlying these issues certainly contributed to the court's overall findings that Anbang was a "bad actor."

[31] *Id.*

[32] *Id.* (holding that, even if the effects of COVID-19 had been material and adverse, they would have been excluded by virtue of an exception to the "material adverse effect" definition for "calamities").

[33] *Id.* (finding, among other things, that the "plain language of the term 'calamities' controls" and that this term "encompasses the COVID-19 pandemic and its effects").

[34] *Id.* (noting that "the risk from a global pandemic is a systematic risk").

[35] *Id.* (noting that a "disproportionate effect" qualifier was included in "an overwhelming majority of contemporary deals" and that the absence of a "disproportionate effect" qualifier indicated a "seller-friendly MAE clause").

[36] *Id.*

[37] *Id.* (claiming that "management operated in the ordinary course of business based on what is ordinary during a pandemic").

obligation to operate in the "ordinary course of business."[38]

Vice Chancellor Laster determined that the language of the covenant requiring that Anbang operate "only" in the ordinary course of business and "consistent with past practice" (and without any sort of "commercially reasonable" or other "efforts" qualifier) meant that *Anbang could only look at its past actions and could not obtain relief based on comparable companies' responses to COVID-19*.[39] In connection with this finding, Vice Chancellor Laster rejected the argument that a breach of the ordinary course covenant would need to rise to the level of "material adverse effect" (noting these are separate and distinct conditions which guard against different risks).[40] The court did not address certain of Anbang's other claims, including (1) whether it was contractually obligated to deviate from ordinary course operations (noting this argument was only briefly mentioned and not developed by Anbang), (2) whether it was required to act outside of the ordinary course in order to comply with law (noting Anbang did not meet its burden of proof in showing that it was legally obligated to deviate from the ordinary course), and (3) whether Mirae "unreasonably" withheld its consent to Anbang's actions outside of the ordinary course (noting that Anbang never requested consent from Mirae).[41]

Going forward, it seems likely that courts will require target companies to be held to the plain language of a contract exempting a buyer from its obligation to close a transaction in the event of a material breach of specific interim operating covenants by the target company, so practitioners will need to continue to pay close attention to the specific formulation (including any exceptions) of the interim operating covenants. Nevertheless, even in the absence of an exception for "compliance with law," it remains to be seen whether courts might take a different view with respect to a buyer's claim for breach of the general "ordinary course" covenant if, for example, a seller took limited actions solely to comply with specific laws (*e.g.*, store closure or "shelter-in-place" orders). In *AB Stable VIII*, where the transaction agreement did not include a "compliance with law" exception to the "ordinary course" covenant, Vice Chancellor Laster described competing policy considerations regarding a "compliance with law" defense to an alleged violation of an ordinary course covenant and noted that it was unclear whether this defense would prevail compared to a buyer's position that the relevant closing condition requiring material compliance with covenants turned on *whether* the business failed to operate in the ordinary course and not *why* it failed to do so.[42]

Similarly, it remains to be seen how a court may view a seller's arguments that a buyer "unreasonably" withheld, delayed, or conditioned its consent to a seller's request to take certain actions that would violate an "ordinary course" covenant or other specific interim operating restrictions. In the *AB Stable VIII* case, the court noted the importance of notice and consent requirements because these requirements permit the buyer to engage in discussions with the seller, seek information, and protect its interests by negotiating reasonable conditions to its consent.[43] Any future court cases resolving claims regarding the reasonableness of a buyer's refusal to grant its consent to non-ordinary course actions by a seller will likely be very fact-specific and may turn on whether the requested action breached a specific, detailed interim operating covenant restriction rather than only the general "ordinary course" covenant.

Given that the majority of claims raised in M&A litigation arising from COVID-19 appear to be merely applications of existing principles and/or a recycling of old legal arguments, these cases should serve as a reminder to practitioners that transaction agreements need to protect against more than just general risks — today's "corner case" may be next year's key development, particularly as the COVID-19 pandemic is continuing. As *AB Stable VIII* is the only case to date which has resulted in holdings that directly address "material adverse effect" and covenant breach claims

[38] *Id.* (citing Black's Law Dictionary, *Ivize of Milwaukee, LLC vs. Compex Litig. Support, LLC* 2009 WL 1111179 at *8 (Del. Ch. Apr. 27, 2009), *Anschutz Corp. v. Brown Robin Cap., LLC*, 2020 WL 3096744, at *12 (Del. Ch. June 11, 2020), *rearg. granted on other grounds*, 2020 WL 4249874 (Del. Ch. July 24, 2020), *Akorn, Inc. v. Fresenius Kabi AG, et al.*, C.A. No. 2018–0300–JTL (Del. Ch. Oct. 1, 2018), *ChyronHego Corp. v. Wight*, 2018 WL 3642132, at *8 (Del. Ch. July 31, 2018) and *Osram Sylvania Inc. v. Townsend Ventures, LLC*, 2013 WL 6199554, at *7–8 (Del. Ch. Nov. 19, 2013)).

[39] *Id.* (noting that, despite evidence from Anbang's industry expert regarding similar actions taken by owners of comparable hotels, "[t]hat is not the test").

[40] *Id.* (suggesting that the parties could have built "MAE language" into the ordinary course covenant if they intended these provisions to be linked).

[41] *Id.*

[42] *Id.* (noting that there would be "credible and contestable contractual, conceptual, and policy-based arguments for both positions").

[43] *Id.*

arising out of the COVID-19 pandemic, practitioners will need to continue to monitor developments in pending cases, including with respect to the issues that were not addressed in the *AB Stable VIII* case.

COVID-19'S EFFECT ON NEW M&A DEAL-MAKING

The impact of COVID-19 has led to certain changes in deal terms contained in M&A transaction agreements entered into since the start of the global spread of COVID-19. We reviewed publicly filed acquisition agreements and merger agreements for 60 transactions with a reported transaction value of $500 million or greater that were entered into on or after March 9, 2020, and have summarized below certain of the notable deal term changes reflected in these agreements.[44]

COVID-19 Exception to "Material Adverse Effect"

While some transaction agreements entered into prior to the global spread of COVID-19 included "pandemic" as an exception to the definition of "material adverse effect," this was not common practice. Since March 9, 2020, however, with the exception of three transaction agreements (one of which was signed on March 13, 2020 and another of which involved a buyout of a target company by its controlling stockholder), all of the transaction agreements reviewed contained an express "COVID-19," "pandemic," or a similar formulation as an exception to the definition of "material adverse effect." While some transaction agreements continued to simply exclude "pandemic," unsurprisingly, the "material adverse effect" definition in a vast majority of transaction agreements expressly excluded COVID-19 and also contemplated the possibility of similar events (*e.g.*, epidemics, public health crises, shelter-in-place orders, and guidelines from governmental authorities and other advisory bodies). Just as exceptions for "acts of terrorism" became standard after September 11, 2001, we would expect that, even after the dissipation of the COVID-19 crisis, express exceptions for COVID-19, pandemics, and similar events will become standard, mostly non-negotiated exceptions in "material adverse effect" definitions going forward.

Of the 57 transaction agreements reviewed which did exclude COVID-19 from constituting a "material adverse effect," the vast majority of these agreements also permitted COVID-19 to be taken into account in determining whether a "material adverse effect" had occurred if COVID-19 had a disproportionate impact on a company compared to others in the industry in which it operates. Eight of these transaction agreements did not include this type of "disproportionate effects" qualifier (of which two were transactions between public companies and the other six were transactions between a public company and a private company). We would expect that buyers will continue to negotiate for a "disproportionate effects" qualifier to apply to COVID-19, pandemic, or similar exceptions in "material adverse effect" definitions on the basis that these exceptions are similar to general economic or industry changes (which are typically subject to a "disproportionate effects" qualifier), and that sellers will continue to argue that COVID-19, pandemic, and similar exceptions should not be subject to a "disproportionate effects" qualifier similar to the treatment of exceptions for other *force majeure* events, such as acts of terrorism, earthquakes, floods, and similar catastrophes (which are often not subject to such qualifier).

Treatment of COVID-19 in Interim Operating Covenants

As companies started to identify and address the effects of COVID-19, sellers and target companies began to negotiate for both broad flexibility and specific exceptions under interim operating covenants in transaction agreements. Two types of interim operating covenants are generally included in M&A transaction agreements: (1) "affirmative" covenants that require a company to continue to operate its business in the "ordinary course" (and, often, "consistent with past practice") and (2) "negative" covenants that restrict a company from taking certain specified actions. Together, these covenants give the buyer (or both parties in a merger of equals or other transaction where the consideration includes stock of the buyer) the assurance that the counterparty's business at closing will be substantially the same and will have been operated in the same manner as it was at signing.

Two-thirds of the transaction agreements we reviewed provided for the express ability of a company to take actions in response to COVID-19, with 38 agreements containing express COVID-19-related exceptions to the "affirmative" interim operating covenants and 19 agreements containing express COVID-19-related exceptions to some or all of the "negative" interim operating covenants. It is possible that this number actually underestimates the inclusion of COVID-19-related exceptions to interim operating covenants because the parties without these exceptions

[44] We did not include recent agreements for transactions involving "special purpose acquisition companies" ("SPACs") because, in our experience, these transactions are not representative, as the transaction dynamics and negotiation posture frequently favor the target company.

in the text of the transaction agreement itself may have instead chosen to provide flexibility in the disclosure schedules in order to avoid public disclosure of such details.

Although it appears to have become commonplace to see an express exception for actions taken in response to COVID-19 in both the "affirmative" and "negative" interim operating covenants, the scope of such exceptions varies significantly from agreement to agreement. The narrowest form of this exception is one that permits only those actions required to comply with applicable law enacted in response to COVID-19, including exceptions for quarantine, "shelter-in-place," "stay at home," workforce reduction, social distancing, shutdown, closure, sequester, safety or similar laws, directives, guidelines, or recommendations promulgated by a governmental authority (which, in many transaction agreements, expressly includes the Centers for Disease Control and Prevention and the World Health Organization). As most transaction agreements historically have already included exceptions to the interim operating covenants for actions required by law, we believe that such a narrow exception provides little additional benefit to a seller. The broadest forms of this exception in the transaction agreements we reviewed are ones that, in addition to permitting actions to comply with applicable law, permit actions taken in response to COVID-19 generally and/or to protect the health and safety of employees, in response to service, supply or other third-party disruptions, or in response to directives, guidelines and recommendations issued in response to COVID-19 (regardless of whether they are issued by a governmental authority or an industry group).

Of the transaction agreements that included an express exception for actions taken in response to COVID-19 in either the "affirmative" and "negative" interim operating covenants, 33 of these agreements contained additional requirements that the responsive action be "reasonable" or taken in "good faith," and 16 of these agreements required that the seller or target company consult with or otherwise provide written notice to the buyer in advance of, or promptly following, the taking of such responsive actions. "Reasonableness" and "good faith" qualifications could be litigated in certain cases, but it may be an uphill battle for buyers to establish that an action was unreasonable or not in good faith given the ongoing uncertainty and heightened risks posed by the protracted and unpredictable nature of the COVID-19 pandemic. It seems prudent for a buyer to require notice and consultation regarding a target company's specific action taken in response to COVID-19, although buyers and sellers will likely continue to negotiate the extent to which "prior" notice and consultation is practicable in all circumstances.

In addition, with respect to the "affirmative" interim operating covenants, some parties have expressly clarified that a target company's obligation to operate in the ordinary course of business must be evaluated in the context of the actions the company has already taken in response to COVID-19. This clarification would allow a target company to take similar actions in the event that COVID-19 or some other unexpected contingency were to occur during the pendency of a transaction, but would not permit the company to take new steps in response to changes or developments arising out of the continuing COVID-19 pandemic. While this clarification has appeared only in six of the transaction agreements we reviewed, it is one that seems reasonable since the "affirmative" interim operating covenant is not intended to freeze a business at signing but rather to ensure a company does not act differently than it would have absent the pending transaction.

Furthermore, in three of the transaction agreements reviewed, the parties agreed to specific exceptions in certain of the "negative" interim operating covenants, which have related to the treatment of employees (including furlough, reductions-in-force, work-from-home and similar arrangements, and modifications to compensation and benefits) as well as payroll or other tax deferrals or credits. We believe that this number substantially underestimates the actual number of transaction agreements providing specific exceptions to "negative" interim operating covenants based on our assumption that most specific COVID-19-related exceptions are set forth in disclosure schedules, which are not publicly filed. In our experience, we have observed that many parties are negotiating detailed COVID-19-related exceptions to "negative" interim operating covenants that relate to the treatment of employees, payroll or other tax deferrals, or credits, rent deferrals and abatements, incurrence of debt, and breaches of material contracts. We would expect these negotiations to continue in M&A transactions entered into during the pendency of the COVID-19 pandemic, as companies further develop ongoing policies and practices in response to COVID-19 and parties to M&A transactions seek to tailor COVID-19-related exceptions in interim operating covenants to the specific nature and needs of a target business.

Representations Related to COVID-19 and Related Laws

Following the enactment of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"),

some transaction agreements have included new representations and warranties related to CARES Act programs, such as the Payroll Protection Program and payroll tax deferrals. The inclusion of these specific representations and warranties is not surprising, given that any benefits that a target company may have obtained under these policies and programs may, among other effects, impact the purchase price payable and additional liabilities assumed by a buyer. Buyers have also sought to receive assurances that companies have complied with their obligations under other laws that have been enacted in response to COVID-19 (*e.g.*, mandatory facility closure orders or laws related to protective equipment to be worn by employees) and that companies have not otherwise been materially affected by COVID-19. As with the COVID-19-related exceptions to interim operating covenants, these additional types of representations and warranties have primarily related to, among other matters, layoffs or furloughs, employee compensation, and the fulfillment of contractual arrangements (whether as a customer or as a supplier).

These new COVID-19-related representations and warranties have appeared in only 20 of the 60 transaction agreements reviewed. However, we would expect that the inclusion of any COVID-19-related representation or warranty is likely driven, at least in part, by whether any related concerns have been identified in due diligence. We have observed that, since the start of the global spread of COVID-19, parties to M&A transactions are regularly conducting due diligence regarding the impact of COVID-19 on a target business, including with respect to supply chain disruptions, adverse changes in key customer relationships, compliance with COVID-19-related laws, impact on employees, operational changes, rent deferrals, additional debt drawdowns, insurance coverage, and adequate public disclosures related to the impact of COVID-19. As has been noted in many other articles related to the impact of COVID-19 on M&A deal-making, practitioners and transaction participants should ensure that specific COVID-19-related matters are fully covered in due diligence in any M&A transactions until some period of time after the abatement of the current pandemic.

Other Provisions Related to COVID-19

A minority of transaction agreements reviewed included other provisions related to COVID-19. Nineteen transaction agreements included limitations on the customary "access" covenant that allows buyers access to a company's properties, personnel, and books and records in the event that COVID-19 measures (*e.g.*, "shelter-in-place" orders) would otherwise restrict such access. Six transaction agreements modified the customary "benefits continuation covenant," which obligates a buyer to continue the compensation and benefits of an acquired company for a limited period, and provided that post-closing salary reductions are permitted under certain circumstances and subject to certain limitations (*e.g.*, a company-wide reduction that also applies to similarly-situated buyer employees of up to 20%). In addition, one transaction agreement included an automatic extension of the "outside date" by which the transaction was required to be consummated if a law were to be passed extending a regulatory waiting period in light of COVID-19. Based on our experience and anecdotal evidence, although there may be no express reference to COVID-19 in the text of the transaction agreement, we believe that a variety of negotiated M&A transactions have provided for longer-than-normal "outside dates" in light of various shutdowns of governmental offices, and other regulatory delays and backlog due to COVID-19.

Furthermore, we note that the COVID-19 pandemic has also impacted the manner in which parties to an M&A transaction negotiate purchase price adjustments and earn-out provisions. Although these deal terms are not covered by our analysis because purchase price adjustments and earn-out provisions are not typical terms in acquisitions of a public company target, we have seen increased challenges for both buyers and sellers in negotiating the key elements of purchase price adjustments in private company M&A transactions as well as a slight increase in the use of earn-outs. For example, the impact of COVID-19 has increased complexity in determining what constitutes a "normalized" and appropriate level of working capital that can be expected by a buyer at closing. In some transactions, parties have agreed to an adjusted net working capital target that takes into account specific changes arising out of the impact of COVID-19 identified in due diligence, and in other transactions, parties have formulated a net working capital target based on historical net working capital levels over an 18- to 24-month or longer period. Similarly, for purchase price adjustments based on target company EBITDA, buyers and sellers have been required to negotiate EBITDA thresholds and definitions that go beyond the typical exclusions of non-recurring and extraordinary items in order to address the impact of COVID-19. Based on our experience and anecdotal evidence, we believe that there has been a slight increase in the use (or at least consideration) of earn-out provisions in private company M&A transactions, but the challenges with respect to setting appropriate thresholds, time periods, and operational restrictions in connection with an earn-

out provision remain very deal-specific and are exacerbated by ambiguity arising out of the uncertain impact and duration of the COVID-19 pandemic.

CONTINUING LEGACY OF COVID-19 IN NEGOTIATED M&A TRANSACTIONS

While the possibility of an effective COVID-19 vaccine may lead to a return to relative normalcy in 2021, we expect that the uncertainty and market changes brought about by the COVID-19 pandemic will continue to affect deal-making in negotiated M&A transactions for some time to come. For M&A practitioners, we will need to continue to monitor ongoing developments in pending litigation with respect to M&A transactions that have been disrupted by COVID-19, including whether any of these cases will result in substantive changes in law regarding what may constitute a "material adverse effect" in the context of an M&A transaction. In addition, for so long as the COVID-19 pandemic is ongoing, we expect that parties will continue to demand flexibility and specific coverage in the interim operating covenants, representations, warranties, and other provisions in transaction agreements to address the impact of COVID-19. Lastly, even when COVID-19 is finally well-controlled, we expect that most of the new provisions, which have been developed during the current pandemic, will continue to be included in transaction agreements either indefinitely (*e.g.*, express exceptions in "material adverse effect" definitions for pandemics and COVID-19) or at least as long as a responsive law, such as the CARES Act, continues to have some import. ■