
CRAVATH, SWAINE & MOORE LLP

COVID-19: Impact on M&A Agreements

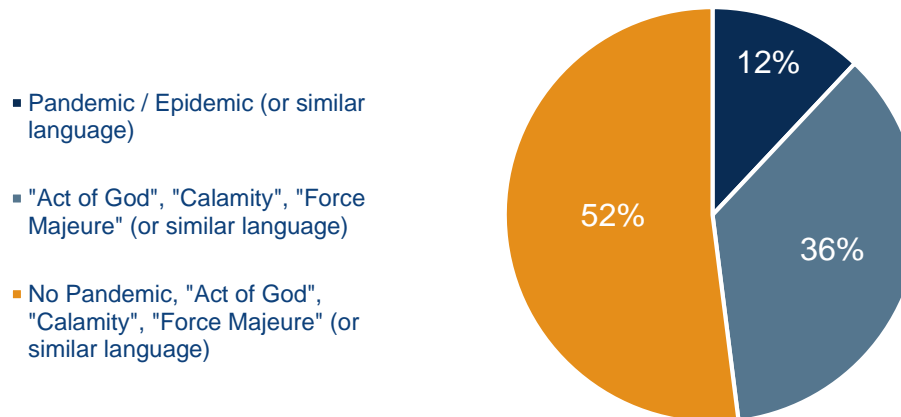
SEPTEMBER 2020

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World Before COVID-19

- **Material Adverse Effect (“MAE”) definitions routinely contained a carve-out for general economic, market or industry conditions, subject to a “disproportionate impact” exception to the carve-out**
- **MAE definitions sometimes contained a carve-out for *force majeure* events, natural disasters or acts of gods, which (if included) were routinely subject to a “disproportionate impact” exception**
 - More specific carve-outs for pandemics or epidemics were less common

MAE Definition Carve-Outs
(Jan. 2003 – Mar. 2020)



- **Affirmative interim operating covenants (“IOCs”) requiring the target to operate in the ordinary course:**
 - sometimes went on further to say “in a manner consistent with past practice”;
 - were often qualified by a commercially reasonable efforts (or other efforts) standard; and
 - often contained an exception for actions required by applicable law
 - Inclusion of these provisions was deal-specific, but was generally not a topic of intense focus or negotiation
- **Access covenants routinely required that the target provide the buyer with “reasonable” access to its properties, personnel and books and records, and were not qualified by an efforts standard**

When COVID-19 Struck

- **The onset of COVID-19 gave rise to a wave of litigation starting in April 2020 relating to buyers' attempts to delay or terminate pending M&A deals which were signed before the crisis**
- **Despite COVID-19 having a clearly demonstrable negative impact on many targets' businesses, pure business MAE claims were not the primary grounds for challenging deals. This is in light of:**
 - the fact that most standard MAE definitions contain carve-outs for general economic, market or industry conditions
 - Practitioners and legal scholars have coalesced around the view that COVID-19 would be captured by these general carve-outs in most cases, even if there is not a specific carve-out for pandemics or epidemics, unless the facts and negotiation history of the specific case indicate otherwise
 - the difficulty of establishing disproportionate adverse impact on the relevant target business given the sweeping effects of COVID-19 on entire industries and market segments
- **As a result, buyers have pursued other contractual claims, and sometimes extra-contractual common law claims, or have coupled their business MAE claims with other more central claims**

When COVID-19 Struck (cont'd)

- **The most commonly cited grounds for refusing to close have been breaches of interim operating covenants**
 - Buyers have claimed both breaches of the affirmative covenant to operate in the ordinary course / consistent with past practice, as well as the negative covenants not to take specified actions without the buyer's consent
 - Some buyers have asserted that various cost-cutting measures implemented by the sellers (e.g., furloughing employees, reducing compensation or capital expenditures) violated the ordinary course covenant
 - Others have argued the exact opposite – that the failure to take cost-cutting measures was not consistent with acting in the ordinary course when faced with a crisis
- **Buyers have sought to delay deals due to alleged breaches of access provisions, both as they relate to access to information and physical access to properties and employees**
- **Buyers have also exploited dual-prong MAE definitions to bring claims asserting that the inability of the target to perform its obligations under the transaction agreement constitutes an MAE and excuses the buyer from closing**
 - Claims have been possible where the MAE definition contains two prongs – prong one, capturing material adverse effect on the business and prong two, capturing material adverse effect on the ability of the target to consummate the transaction / perform its obligations under the agreement
 - This second prong, which is not included in all transactions, is usually not subject to the carve-outs that have rendered a traditional business MAE case difficult to make in the current environment
 - Again, failure to perform obligations under the interim operating covenant has been at the heart of cases challenging pending deals on these grounds

COVID-19 M&A Cases

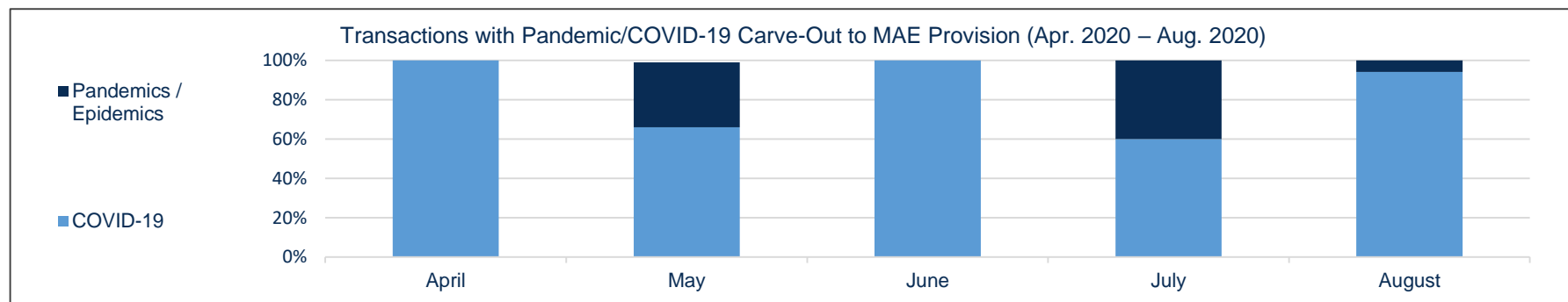
Parties (Buyer / Seller)	Initial Filing Date	Court	COVID-19 Litigation Themes*	Status
1-800-Flowers / Bed Bath & Beyond	April 1, 2020	Delaware Court of Chancery	Buyer Unilaterally Delaying Closing	Settled with purchase price reduction; transaction closed August 2020
Cinemex / Khan	April 2, 2020	U.S. District Court for the Southern District of Texas	Access to Properties and Employees	Stayed; further action involving dispute before bankruptcy court
CorePower Yoga / Level 4 Yoga	April 2, 2020	Delaware Court of Chancery	Contract Repudiation	Pending; CorePower's motion to dismiss denied August 2020
Cast & Crew / Oberman	April 6, 2020	Delaware Court of Chancery	Access to Information	Settled; terms not disclosed; transaction closed April 2020
KCAKE / Snow Phipps	April 14, 2020	Delaware Court of Chancery	Unavailable Debt Financing	Pending; oral arguments on KCAKE's motion to dismiss held August 2020
Sycamore Partners / L Brands	April 24, 2020	Delaware Court of Chancery	Failure to Operate in the Ordinary Course / Seller MAE	Settled; transaction agreement mutually terminated
Mirae / AB Stable	April 27, 2020	Delaware Court of Chancery	Failure to Operate in the Ordinary Course / MAE	Pending; trial held August 2020
SIRVA / Realogy	April 27, 2020	Delaware Court of Chancery	MAE	Court dismissed seller suit seeking specific performance; settled; terms not disclosed
Carlyle and GIC / Juweel	May 6, 2020	Delaware Court of Chancery	MAE / Failure to Operate in the Ordinary Course / Financing	Pending; trial set for November 2021
Simon Property / Taubman	June 10, 2020	Circuit Court for the 6th Judicial Circuit of Michigan	Failure to Operate in the Ordinary Course / MAE	Pending; trial set for November 2020
LVMH / Tiffany	September 9, 2020	Delaware Court of Chancery	MAE / Compliance with Operating Covenants	Pending; trial set for January 2021

*Illustrative cases are categorized by the main COVID-19-related themes underlying the buyer's position for refusing to close a pending transaction. Buyers routinely advanced several arguments in support of their position that they were not required to close. Therefore, these illustrative cases are not exclusively limited to the indicated theme(s) and in many cases cover more than one topic.

How Did M&A Agreements Change in the Aftermath of COVID-19?

■ MAE definitions

- Since April 1, 2020, 100% of public target M&A deals over \$100 million* included an explicit carve-out for pandemics, epidemics or similar health emergencies
- Before April 1, 2020, COVID-19 was mentioned by name in only two MAE carve-outs. Since then, the vast majority of agreements have included an explicit reference to COVID-19 in the MAE carve-outs (26 of 32)
 - Many agreements define COVID-19 to also include any evolutions or mutations of the COVID-19 virus/disease and any subsequent or second waves
- In addition to a carve-out for COVID-19 itself, a number of merger agreements signed since April 1, 2020 also included carve-outs for COVID-19 related measures
 - Example: “COVID-19 Measures” shall mean any quarantine, “shelter in place,” “stay at home,” workforce reduction, social distancing, shut down, closure, sequester, safety or similar Law, directive or guidelines promulgated by any Governmental Authority, including the CDC and the WHO, in each case, in connection with or in response to COVID-19, including the CARES Act and the Families First Coronavirus Response Act (Momenta Pharmaceuticals / Johnson & Johnson (Aug 19))
- Four merger agreements contained blanket carve-outs for COVID-19 and/or COVID-19 Measures (i.e., carve-out not subject to a disproportionate impact exception):
 - Vivint Solar / Sunrun (Jul 6 – all stock); Innerworkings / HH Global Group (Jul 16 – all cash); Varian Medical Systems / Siemens Healthineers (Aug 2 – all cash); BMC Stock Holdings / Builders FirstSource (Aug 27 – all stock)



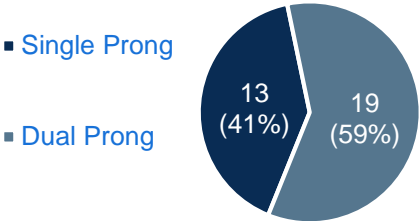
Source: DealPoint Data (data includes 32 transactions from April 1, 2020 through August 31, 2020 with equity value greater than \$100M where the target was a public company and the transaction agreement was publicly available).

How Did M&A Agreements Change in the Aftermath of COVID-19?

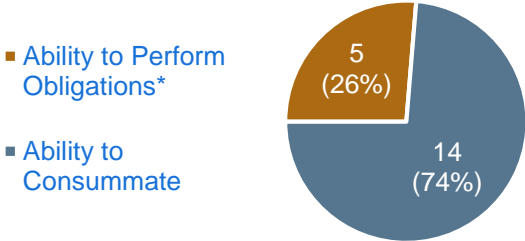
- **MAE: “Prong One” / “Prong Two” Structure**

- “Prong two” was encountered in approximately 60% of MAE definitions
- In almost 75% of the MAE definitions which included “prong two”, it was limited to the ability of the company to consummate the transaction and it did not cover performance of the company’s obligations under the transaction agreement
- In several instances, the carve-outs to “prong one” (i.e., business MAE) also applied to “prong two”, especially if “prong two” contained the broader formulation that captured performance of obligations

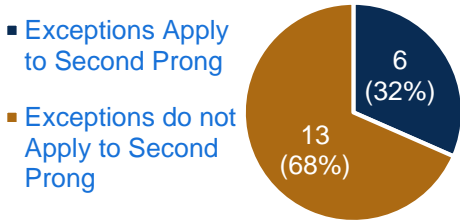
Single-Prong vs. Dual-Prong (Apr – Aug 2020)



Scope of Dual-Prong Language (Apr – Aug 2020)



Application of MAE Carve-Outs (Apr – Aug 2020)

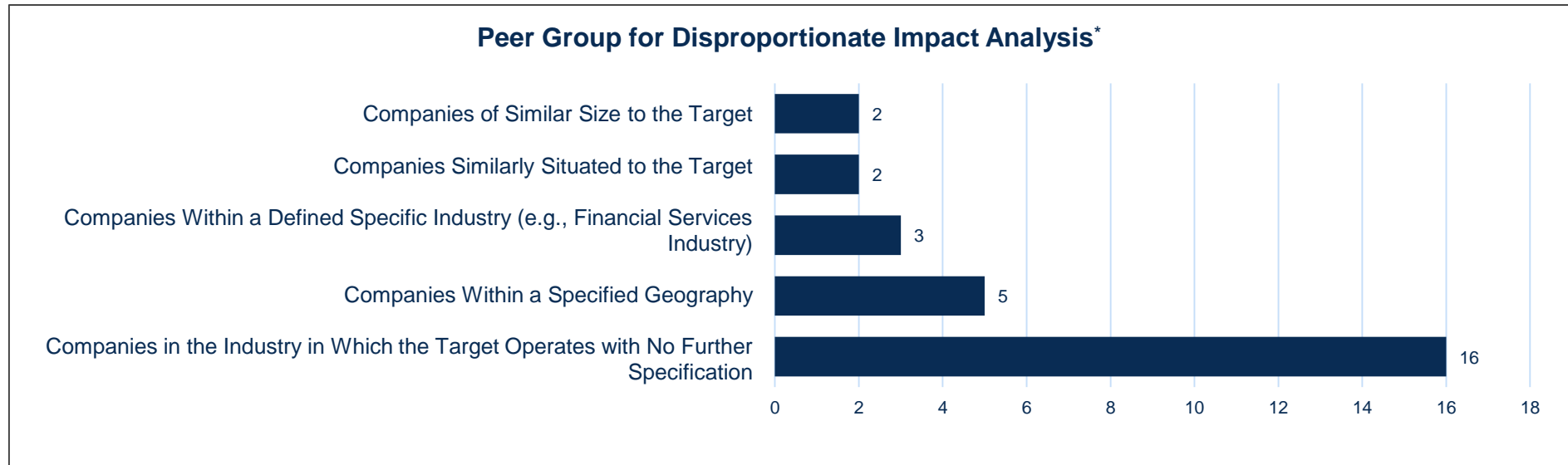


Source: DealPoint Data (data includes 32 transactions from April 1, 2020 through August 31, 2020 with equity value greater than \$100M where the target was a public company and the transaction agreement was publicly available). *Includes deals with language that addressed ability to perform obligations and consummate transactions.

How Did M&A Agreements Change in the Aftermath of COVID-19?

▪ Disproportionate Impact Exception

- While there has been an uptick in parties specifically addressing pandemics or COVID-19-related carve-outs in recent MAE definitions, most deals still refer to the target's industry in a general way to assess "disproportionate impact"
 - As a result, we may see disputes as to the appropriate industry and comparable companies (if not explicitly defined)



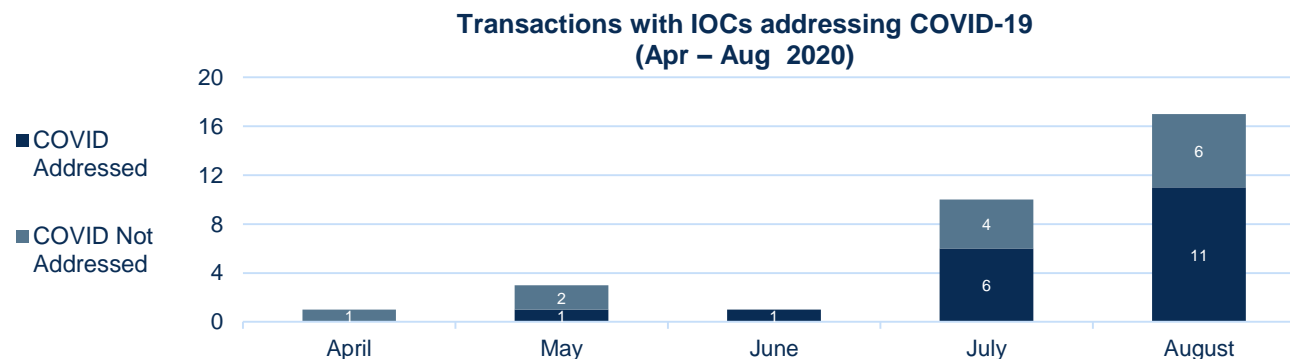
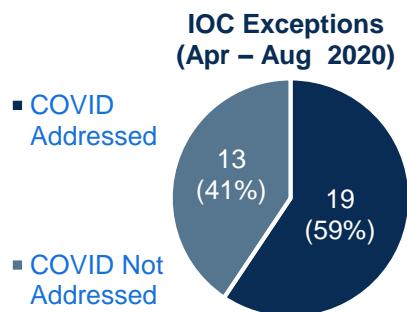
*Chart does not reflect deals that had a flat carve-out for COVID-19.

Source: DealPoint Data (data includes 32 transactions from April 1, 2020 through August 31, 2020 with equity value greater than \$100M where the target was a public company and the transaction agreement was publicly available).

How Did M&A Agreements Change in the Aftermath of COVID-19?

▪ Interim Operating Covenants

- IOCs now frequently feature COVID-19 exceptions, but the exceptions are not uniform. Exceptions may include:
 - actions necessary to protect the health and safety of employees or others having business dealings with the company
 - actions to respond to third-party supply or service distributions caused by COVID-19
 - social distancing measures, office closures or safety measures adopted in response to COVID-19
 - actions taken in response to COVID-19 or certain authorized COVID-19 Measures
- Some merger agreements impose incremental obligations on the target in order to avail itself of the exception:
 - requirement to consult with buyer / consider in good faith the views of buyer regarding the proposed action
 - requirement that the action must be commercially reasonable
- Deals that were signed later in the summer, after the COVID-19 pandemic had been going on for several months, also often specify that ordinary course of business / consistency with past practice include recent past practice in light of COVID-19 and/or actions taken in good faith in response to the actual or anticipated effects of COVID-19
- Since disclosure letters are frequently not publicly filed there may be further variance with respect to the treatment of IOCs that is not reflected in IOC language contained in the definitive agreements

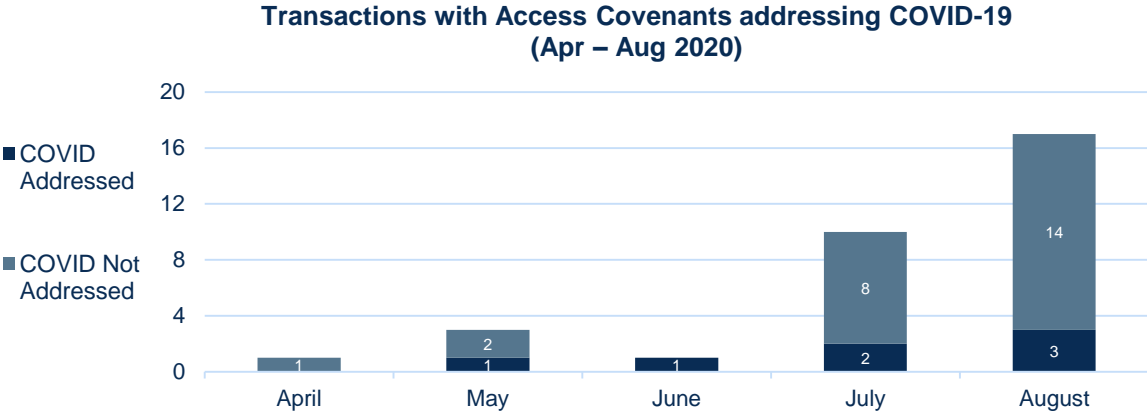
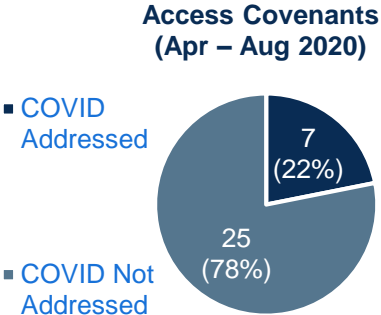


Source: DealPoint Data (data includes 32 transactions from April 1, 2020 through August 31, 2020 with equity value greater than \$100M where the target was a public company and the transaction agreement was publicly available).

How Did M&A Agreements Change in the Aftermath of COVID-19?

Access Covenants

- COVID-related exceptions to the access covenant have been fewer
- Exception usually provides that physical access may be limited to the extent the company determines in good faith that it would jeopardize the health and safety of its employees



Source: DealPoint Data (data includes 32 transactions from April 1, 2020 through August 31, 2020 with equity value greater than \$100M where the target was a public company and the transaction agreement was publicly available).

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