

COVID-19 Coronavirus Business Impact Broadcast Series

COVID-19 Coronavirus Business Impact Broadcast Series: Deal Disputes in the Time of COVID-19

MAY 1, 2020



On May 1, 2020, Dechert LLP's Private Equity and Litigation groups presented "Deal Disputes in the Time of COVID-19," an episode of the firm's COVID-19 Coronavirus Business Impact Broadcast Series. The episode was hosted by Melanie MacKay (moderator), a Litigation associate in the firm's Chicago office; Mark Thierfelder, an M&A partner in the firm's New York office and chair of the firm's Corporate and Securities practice; and Neil Steiner, a Litigation partner in the firm's New York office.

The presenters discussed the wave of disputes that has arisen from deals signed prior to the onset of the COVID-19 crisis, with particular emphasis on the basis of these disputes, their merits and key takeaways for private equity deal-making going forward.

HIGHLIGHTS FROM THE EPISODE

Basis of the Disputes: Shift to Interim Operating Covenants

While buyers in several disputed deals are claiming a Material Adverse Effect ("MAE") due to the negative effects of the COVID-19 pandemic on target businesses, we are seeing more claims centering around an argument that the seller has breached its interim operating covenant as a result of actions it has taken to navigate the current crisis. Buyers are claiming that these breaches cause a failure of the closing condition that the seller satisfy its covenants.

Merits of the Disputes

Although each claim is subject to the particular contract terms and deal-specific facts and circumstances, buyers are aware of the high burden for establishing an MAE under Delaware law. As a result, buyers are focusing on whether certain drastic actions taken by sellers (e.g., furloughing employees and closing stores, among other things) comply with the covenant in most agreements to operate in the "ordinary course of business consistent with past practice" – i.e., whether such extreme measures are a departure from the ordinary course of business or whether they are in fact consistent with past practice for navigating a global crisis. Informing the buyer's tactics are both its exposure to damages under the acquisition agreement for failing to close and its ultimate goal in the dispute, be it to renegotiate price, pay a fee to exit the deal, or simply to buy time.

Drafting Advice

Parties should be clear about the treatment of COVID-related actions and effects when drafting the MAE definition and the interim operating covenant, with attention paid to risk allocation. In addition, if debt financing becomes more difficult to obtain and there is an increase in full equity backstops for middle-market deals, we wonder whether there will be an increase in reverse termination fees – a reversal of the downward trend we have observed over the past 15 months.