Material adverse changes in light of COVID-19

Mergers and Acquisitions Alert

18 May 2020
By: Steve Reil

The M&A activity worldwide thus far in 2020 has experienced a severe decline compared to last year, largely as a result of the coronavirus disease 2019 (COVID-19) pandemic. During the first quarter of 2020, the value of M&A activity worldwide experienced a 25 percent year-over-year decrease, while the volume of announced US M&A deals declined by 51 percent to its lowest levels since 2014.[1] Many deals in progress have been put on hold, while other deals that have been signed but not closed are currently in dispute. An examination of one of these disputes sheds light on other deals that may be taking a similar trajectory as well as instructs parties currently negotiating and drafting definitive M&A agreements during this pandemic.

L. Brands Inc. and Sycamore Partners

As noted in the New York Times,[2] a PE buyer is looking to get out of a signed deal citing COVID-19, but that same deal contemplated the pandemic in its transaction documents. On February 20, 2020, Sycamore Partners III, L.P. and Sycamore Partners III-A, L.P. (collectively, "Sycamore Partners") agreed to purchase a 55 percent interest in Victoria's Secret from L. Brands, Inc. ("L Brands") for US$525 million pursuant to a transaction agreement, dated as of February 20, 2020. Sycamore Partners sent L Brands a letter on April 22, 2020 to terminate the transaction agreement. Sycamore Partners indicated that a "Material Adverse Effect has occurred" as a result of the COVID-19 pandemic.

L Brands brought a complaint on April 23, 2020, seeking specific performance of the equity commitment from Sycamore partners, and seeking a declaratory judgment that Sycamore Partners' purported termination of the transaction agreement was invalid. As alleged by L Brands, Sycamore Partners conceded that termination was caused by the COVID-19 pandemic, and L Brands argued that Sycamore Partners agreed to bear the risk of such pandemic, which was known at the time the transaction agreement was executed and the parties even carved such pandemic out of the definition of a material adverse change ("MAC"). The definition of a MAC in the transaction agreement has an explicit exception for "the existence, occurrence or continuation of any pandemics."

L Brands alleged that Sycamore Partners indicated that it still wanted to consummate the transaction, but at a lower purchase price because of the COVID-19 pandemic. After a number of exchanges between counsel and principals, Sycamore Partners sent notice of termination arguing that L Brands had breached the agreement by, among other actions, temporarily closing bricks-and-mortar stores, failing to maintain inventory, and failing to pay rent at store locations. L Brands argued in its complaint that its actions were reasonable given the pandemic, Sycamore Partners agreed to bear the risk of the pandemic, and the parties had agreed the specific performance was an appropriate remedy, as set forth in the transaction agreement.

On May 4, 2020, Sycamore Partners issued a press release stating that "Sycamore Partners and L Brands agreed to settle all pending litigation and mutually release all claims" and that "[n]either party will be required to pay the other a termination fee or other consideration as a result of the mutual decision to terminate the agreement and settle the pending litigation." L Brands issued its own press release that stated that it was in the best interest of the Company to address the current challenges of this environment "rather than engaging in costly and distracting litigation."

Definitive agreements negotiated during the COVID-19 pandemic

This is obviously a difficult time for many companies, including those involved in ongoing M&A activity. DLA Piper has previously provided valuable guidance for M&A transactions that have signed buy have not yet closed.[3] This guidance remains valuable advice in these turbulent times. For deals that have not yet signed, parties in such deals can take steps to protect themselves.

First, the parties may consider requiring that the definitive M&A agreements clearly and concisely allocate risk in the event of a MAC related to the COVID-19 pandemic. Parties engaged in M&A activity likely want to be explicit as to the risk of a pandemic and who bears such risk.

Second, to the extent possible, the parties may consider requiring that the definitive M&A agreements set forth actions that are reasonable to be taken by each party during the COVID-19 pandemic to avoid confusion. Everyone is aware of the current pandemic and under the current environment it is unwise to rely on general principles in the definitive M&A agreement rather than explicit language.

While it still remains too early to understand or evaluate the full impact that the COVID-19 pandemic will have on the M&A market, it is obvious that the pandemic is having an significant impact and cited above is only one of examples of transactions affected by the current pandemic. As such, participants in the M&A market should take actions to protect their interests as they negotiate definitive M&A agreements during this pandemic and clearly delineate risks that match the intent of the parties.

If you have any questions regarding these new requirements and their implications, please contact a member of DLA Piper's M&A group or your DLA Piper relationship attorney.

Please also visit our Coronavirus Resource Center and subscribe to our mailing list to receive alerts, webinar invitations and other publications to help you navigate this challenging time.

This information does not, and is not intended to, constitute legal advice. All information, content, and materials are for general informational purposes only. No reader should act, or refrain from acting, with respect to any particular legal matter on the basis of this information without first seeking legal advice from counsel in the relevant jurisdiction.

---

1 *Global M&A Review (First Quarter 2020)*. Refinitiv.

2 https://www.nytimes.com/2020/04/29/business/victorias-secret-sycamore-coronavirus.html?auth=login-facebook&referringSource=articleShare

3 https://www.dlapiper.com/en/us/insights/publications/2020/03/covid-19s-likely-impact-on-the-us-ma-market/

AUTHORS

Steve Reil
Partner
Los Angeles (Downtown) | T: +1 213 330 7700
stephen.reil@dlapiper.com