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COVID-19 and MAC Clauses: The Next Shoe Drops

Client Advisories

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This client advisory follows up on our client advisory MAC Clauses in M&A and Debt Transactions During COVID 19 of March 26, 2020, and focuses on one of the first reported cases in a Delaware court involving a buyer not closing an acquisition based on the effects of COVID-19.

On April 1, 2020, Bed Bath & Beyond Inc. ("Bed Bath") filed a complaint in the Court of Chancery of the State of Delaware (the "Court") asking the Court to order the defendants, 1-800-Flowers.com, Inc. and 800-Flowers, Inc. (collectively "1-800-Flowers"), to close on the approximately $252 million purchase of Personalizationmall.com, LLC (the "Company") from Bed Bath.

In the complaint, Bed Bath claims that under the parties' Equity Purchase Agreement dated February 14, 2020 (the "Agreement"), 1-800-Flowers was in breach of its obligation to close the transaction on March 30 (the date that the parties were required to close the transaction if all the conditions to closing were satisfied at least three business days prior to such date).

The complaint attaches back-and-forth correspondence between the parties during the days leading up to its filing. According to that correspondence, 1-800-Flowers unilaterally postponed closing until April 30. Further, 1-800-Flowers stated that:

- "...none of the parties is in a position to close on March 30...";
- "...the impact, both known and unknown, of the novel coronavirus (COVID-19) pandemic on both of our businesses makes the closing of the transaction on March 30, 2020 commercially impracticable";
- closing "prior to April 30, 2020 would be extremely and unreasonably difficult for both businesses, and would severely strain the ability of both businesses to focus on the needs of their respective employees and customers"; and
- "as the long- and short-term consequences of this pandemic continue to rapidly evolve, we do not think that either party is in a position to determine if the conditions to closing the transaction have been or will be satisfied, including assessing whether PersonalizationMall.com has been, or would reasonably be expected to

be, materially adversely effected by the COVID-19 pandemic and the necessary government reaction which have created significant disruption of business, prevented business from operating consistent with past practice (including closing facilities and ceasing operations) and adversely affected employees, customers and suppliers."

While 1-800-Flowers was not asserting that events constituting a material adverse change (or material adverse effect) (a "MAC") had occurred (or that events had occurred that would reasonably be expected to have a MAC), it was (1) asserting that it was impossible to determine at this point whether the foregoing was the case and (2) setting forth commercial and operational arguments, which appear to be reasonable on their face, justifying delaying closing.

Under the Agreement, the absence of a MAC is a closing condition for the buyer's benefit. Thus, the occurrence of a MAC would allow the buyer to walk away from, or exercise leverage to renegotiate more favorable terms of, the deal. However, in this case, as is typical for M&A agreements, a MAC excludes certain events:

- "...any change resulting from conditions affecting any of the industries or markets in which the Company operates"; and
- "...any change resulting from changes in general business, financial, political, capital market or economic conditions (including any change resulting from any calamity, natural or man-made disaster or acts of God, hostilities, war or military or terrorist attack (including cyber-terrorist attack))".

However, to the extent that such changes had a disproportionate effect on the Company compared to other participants in the industries or markets in which the Company operates, then such changes may be considered for purposes of determining the occurrence of a MAC.

Bed Bath maintains that the Company's situation is no different to that of "millions of businesses worldwide" that are also facing the impacts of the COVID-19, and as such, the current crisis has no bearing on 1-800-Flowers' obligations under the Agreement.

Also, a MAC excludes "any facts or circumstances relating to the Buyer or any of its Affiliates or its future plans for the business of the Company, including the impact on relationships, contractual or otherwise, with or actions taken or threatened to be taken by any customers, vendors, landlords, partners, employees or Governmental Authorities."

In addition, the Agreement was entered on February 14, 2020 at which point COVID-19 was widely known (although its impact on the United States was not felt yet). Delaware courts are loath to allow parties to walk away from their contractual obligations, and, in the M&A arena, thereby condone "buyer's remorse", especially when such parties possessed, or could reasonably have possessed, knowledge that should or could have changed their behavior and avoided the predicament that they are currently facing.

On the other hand, the Agreement's MAC clause does not have a specific exclusion for pandemics generally or COVID-19 specifically (or their worsening) and 1-800-Flowers is implicitly suggesting, and is expected to argue, that the MAC closing condition isn't satisfied because the current situation is so unclear that one would not be reasonably able to determine whether a MAC has occurred. In any event, such a determination would have to focus on the extent to which COVID-19 was more devastating on the business of the Company than on other companies in its industry or markets, which determination would be fact specific and time consuming.

Another M&A transaction, Softbank's tender offer for shares of WeWork, was terminated around April 2, 2020 by Softbank due, *inter alia*, to the effects of COVID-19 on WeWork's business. WeWork has indicated that it may

initiate litigation against SoftBank because of the termination. Publicly available details on this situation are still limited.

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